Automating Securities Class Action Settlements

*Jessica Erickson**

Securities class actions are supposed to vindicate the rights of investors injured by corporate fraud. Yet, despite multimillion- or even multibillion-dollar settlements, many injured investors never receive a dime in compensation. To receive money from a settlement in a securities class action, investors must comply with a cumbersome claims process, documenting their transactions in the defendant corporation's stock and detailing their losses. Faced with this hurdle, many investors never claim their shares of the settlement funds. Courts continue to insist that investors comply with cumbersome claims processes because they do not think they have another way to accurately identify class members. Companies do not know who purchased their shares during the class period, nor has there been a global database that tracks securities purchases down to the level of individual shareholders. As a result, the only way to identify injured investors has been to require them to identify themselves, typically by filing a claim and documenting their transactions.

This Article argues that the time has come to modernize the distribution of settlement funds in securities class actions. There are two possible ways to modernize this process. The first approach relies on market innovation, proposing an automated system that collects the relevant transaction data from individual banks and brokers. Claims administrators could then use this data to calculate every class member's pro rata share of the settlement and send them their money. The second approach relies on regulatory innovation using the SEC's Consolidated Audit Trail, which, once it is up and running, will contain a complete record of nearly all securities transactions in the financial markets. The Consolidated Audit Trail will contain exactly the type of data needed to automate the distribution of settlement funds in securities class actions. Neither

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of these solutions is turnkey, and both would require the cooperation of courts and lawmakers, but they have the potential to revolutionize how investors recover money lost to corporate fraud.

INTRODUCTION

Securities class actions, like nearly all class actions in the United States, are ostensibly opt-out lawsuits.[1] Under the opt-out model, individuals who fall within the class definition are automatically members of the class unless they take affirmative steps to opt out.[2] This model was a deliberate choice by the drafters of modern class action rules back in the 1960s,[3] and it has been vigorously protected ever since.[4] It is thought to breathe life into class actions by ensuring that individuals who do not have the financial incentive to opt into a lawsuit nevertheless get their day in court.[5]

Yet the reality has never been this rosy. True, class members in securities class actions are automatically part of the litigation, but that does not mean that they will get any money as a result. Even if a securities class action ends with a multimillion-dollar settlement, investors do not receive any money from the settlement unless they file a claim as part of the settlement administration process.[6] In this process, they must prove that they purchased the corporation's securities during the class period, usually by presenting the claims administrator with detailed records of their relevant transactions.[7]

Investors often fail to participate in the settlement process. A well-known empirical study published in 2005 by Professors James Cox

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1. *See, e.g.*, Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14, 30 (2007) ("Plaintiffs in securities class actions generally proceed under Rule 23(b)(3) . . . ."); David H. Webber, *The Plight of the Individual Investor in Securities Class Actions*, 106 NW. U. L. REV. 157, 181 (2012) (explaining that "[v]irtually all securities class actions are brought under [Rule 23(b)(3)]").

2. *See* FED. R. CIV. P. 23(c)(2)(B) (stating that, for any federal class action certified under Rule 23(b)(3), notice to the class must state that "the court will exclude from the class any member who requests exclusion").

3. *See* Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356, 397–98 (1967) (explaining how the drafting committee reached the conclusion that it "seem[ed] fair for the silent to be considered as part of the class").

4. *See* Edward H. Cooper, *Federal Class Action Reform in the United States: Past and Future and Where Next?*, 69 DEF. COUNS. J. 432, 439 (2002) (explaining that "[t]he Advisory Committee has studied several versions of an opt-in rule" with "[t]he most aggressive approach . . . to convert all Rule 23(b)(3) actions to opt-in classes").

5. *See* Kaplan, *supra* note 3, at 397–98.

6. *See, e.g.*, Francis E. McGovern, *Distribution of Funds in Class Actions—Claims Administration*, 35 J. CORP. L. 123, 125 (2009) (explaining that "[m]ost class action securities cases are handled by claims administrators who develop claim forms").

7. *See, e.g.*, Corrected Declaration of Jeremy A. Lieberman in Support of (A) Class Representatives' Motion for Final Approval of Class Action Settlement and Plan of Allocation; (B) Class Counsel's Motion for an Award of Attorneys' Fees and Reimbursement of Litigation Expenses; and (C) Class Representatives' Motion for Reimbursement of Costs at Ex. 2, 22–26, *In re* Petrobras Sec. Litig., No. 14-cv-9662 (JSR) (S.D.N.Y. April 23, 2018), ECF 789-2 (presenting a proof of claim form).

and Randall Thomas found that less than one-third of large institutional investors actually filed claims in securities class actions.[8] The percentage is likely even smaller for less sophisticated investors.[9] This study sparked a number of changes in the claims administration process, including a burgeoning industry of third-party claim filers that assist larger institutional investors with filing their claims.[10] As a result, the percentage of submitted claims is likely higher today. Still, however, no one thinks that all or nearly all shareholders receive their share of the settlement funds. Opt-out securities class actions are still opt-in, at least if investors want their money.

No one set out to create an opt-in requirement for securities class actions. The complexities of the claims administration process developed not out of malice, but because courts do not think they have another way to accurately distribute settlement funds. In a securities class action, damages are based on the number of shares that each class member purchased in the defendant corporation during the class period, as well as the price they paid for those shares.[11] There is no global database that tracks securities purchases down to the level of individual customers.[12] The companies themselves do not have this information, nor do any of the securities intermediaries or clearinghouses that are involved in these transactions behind the scenes.[13] As a result, the only way to identify class members has been to require them to identify themselves, typically by filing a claim and documenting their transactions. In short, the opt-in requirement at the settlement stage is a result of a critical gap in the available data.

Yet the data now exists to automate this process. This Article identifies two possible ways to automate the distribution of settlement funds in securities class actions. The first approach relies on market innovation. Right now, only individual banks and brokers have records

8. 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, 413 (2005).

9. The exact percentage of retail investors who file claims is not publicly available, but as discussed below, several claims administrators with whom I spoke estimated that, on average, approximately twenty to twenty-five percent of total eligible shares file claims in a securities class action settlement. *See* discussion *infra* notes 58–60 and accompanying text.

10. *See* Alex Villanova, *Current Claims Filing Trends in Securities Class Action Settlements*, JD SUPRA (May 22, 2018), https://www.jdsupra.com/legalnews/current-claims-filing-trends-in-74704 [https://perma.cc/7ADU-B7UH] (stating that "the days of individuals printing out a claim form, completing the information accurately, and attaching the necessary pages of documentation are long gone" and "the increase in these third party filings has resulted in a huge boost in electronic claims filed").

11. *See* Janet Cooper Alexander, *The Value of Bad News in Securities Class Actions*, 41 UCLA L. REV. 1421, 1428–29 (1994) (explaining how damages are calculated in securities class actions).

12. *See infra* Section I.B.2.

13. *See infra* Section I.B.2.

that identify transactions by particular customers in a company's securities.[14] Each bank and broker has data that identifies its own customers' transactions, but there is no centralized database that collects this data.[15] But claims administrators could create an automated system that collects the relevant information from individual banks and brokers. This system could then calculate every class member's pro rata share of the settlement and send each one the appropriate amount of money. This approach would require the cooperation of multiple players, including courts, banks, brokers, and plaintiffs' attorneys, but it would not be technologically difficult to obtain the customer data and distribute the settlement funds.

The second solution relies on regulatory innovation. Right now, there is not a centralized database that tracks all transactions in a given corporation's securities. Yet the Securities and Exchange Commission ("SEC") is on the verge of creating exactly this database. Spurred by a desire to shed light on the dark web and catch insider trading, the SEC has authorized the creation of the Consolidated Audit Trail, or CAT.[16] Once the CAT is up and running, it will include a complete record of nearly all securities transactions, including approximately *fifty-eight billion records every day* of orders, executions, and quote life cycles for equities and options markets.[17] In other words, the CAT will contain exactly the type of data that is needed to automate the distribution of settlement funds in securities class actions. The SEC currently places strict limitations on the use of this data,[18] so it will almost certainly need some convincing to use the CAT data in this way. Doing so, however, would help fulfill the SEC's mission of investor protection and would complement the agency's own enforcement agenda.

This Article argues that the legal system should explore both market and regulatory approaches to automating the distribution of settlement funds in securities class actions. The current claims administration process was developed at a time when the data needed for automation was not available. Today, however, this data is within reach, both through individual outreach to banks and brokers and through the SEC's promised CAT database. Neither system is turnkey

14. *See infra* Section I.B.2.

15. *See infra* Section I.B.2.

16. 17 C.F.R. § 242.613 (2019).

17. *See CAT NMS Provides Progress Update on the Consolidated Audit Trail*, BUS. WIRE (Oct. 26, 2018, 5:15 PM), https://www.businesswire.com/news/home/20181026005523/en/CAT-NMS-Progress-Update-Consolidated-Audit-Trail [https://perma.cc/2YPZ-QSX3].

18. *See* 17 C.F.R. § 242.613(e)(2) (providing that the SEC shall only have access to the CAT "for the purpose of performing its respective regulatory and oversight responsibilities pursuant to the federal securities laws, rules, and regulations").

right now, but both have the potential to revolutionize the way that investors recover money lost to fraud.

This Article focuses on securities class actions, but it has broader implications. Many other types of class actions face similar problems when it comes to distributing settlement funds.[19] The problems in securities class actions are particularly well documented, which makes these lawsuits an obvious starting point in any effort to reform the distribution of settlement funds. Yet, in a world of increasing data sophistication, it may be possible to use similar measures to automate the distribution of settlement funds in other types of aggregate litigation as well. This Article is therefore intended to spur a broader conversation about modernizing this stage of the litigation process.

This Article will proceed in three parts. Part I will explore the opt-out promise of securities class actions, along with the opt-in reality of the claims administration process. Part II will describe market and regulatory solutions to the problem of distributing settlement funds in these suits, explaining how private companies and the SEC have access to the data needed to automate this process. Part III will explore the possible repercussions of automating this process. Although automation will lead to greater compensation for most investors, it could also present unexpected consequences and risks.

I. THE OPT-IN REQUIREMENT IN SECURITIES CLASS ACTIONS

The opt-out model of class actions is a distinctly American invention.[20] In the United States, it is common for class members to have their rights vindicated in court, even if they do not know they are members of the class or anything else about the litigation. This Part examines the promise of this opt-out model, before turning to the opt-

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19. In most types of class actions and even in SEC Fair Funds distributions, courts use a claims administration process to create a list of class members and to calculate the amount of their individual claims. *See, e.g.*, Francis E. McGovern, *Second-Generation Dispute System Design Issues in Managing Settlements*, 24 OHIO ST. J. ON DISP. RESOL. 53, 54–60 (2008) (describing two large consumer class actions and the complicated means to identify potential claimants); Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. CAL. L. REV. 97, 103 (2014) ("[I]n some class actions, a significant number of absent class members' identities are not known and it is impossible to provide them with individual notice of the opportunity to file a claim."). In other types of class actions, however, it is relatively easy to identify and communicate with the class. In a class action filed on behalf of current and former employees for unpaid wages, for example, the defendant will have records for these employees, including their dates of employment and salary information. Armed with this information, it would not be difficult for the claims administrator to calculate each class member's share of the settlement.

20. *See, e.g.*, John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 293 (2010) (explaining that "outside of the United States," lawmakers "remain reluctant to buy into 'entrepreneurial litigation' and continue to search for intermediate options that stop short of adopting either the contingent fee or the opt-out class action").

in reality of securities class actions. It will then discuss the data challenges that upended the original participatory vision of these lawsuits.

A. The Opt-Out Promise

To understand the opt-in reality of securities class actions, one must first understand their promise. Securities class actions are controlled by Rule 23 of the Federal Rules of Civil Procedure, just like nearly all class actions in the federal courts. Congress has passed legislation, such as the Private Securities Litigation Reform Act of 1995 ("PSLRA"), that overrides Rule 23 in certain limited ways,[21] but procedurally speaking, securities class actions are still largely a creature of Rule 23. Accordingly, this discussion focuses on the history and goals of this rule, interspersed with specific quirks of securities law and practice where relevant.

The modern version of Rule 23 is a child of the 1960s, and it reflects the hope and optimism of the era. The original version of Rule 23 was based on traditional rules of equity and included few of the procedural complexities of the modern version.[22] By the mid-1960s, however, class actions began to grow in popularity, especially in the civil rights area, and lawyers and judges alike began to recognize the need for greater clarity and guidance in this area of law. In 1966, the Civil Rules Advisory Committee of the United States Judicial Conference decided to completely overhaul the rule, ultimately creating the three types of class actions currently laid out in Rule 23(b).[23]

The type of class action most common today—the Rule 23(b)(3) class action—was created as part of this overhaul. This subsection permits a federal court to certify a class if two requirements are met—(1) questions of law or fact common to class members predominate over any questions affecting only individual members and (2) a class action is superior to other available methods for fairly and efficiently adjudicating the controversy.[24] This category of class action is notable because it expressly permits class representatives to bind absent class

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21. *Compare, e.g.*, FED. R. CIV. P. 23(h) (permitting the court to award "reasonable attorney's fees"), *with* 15 U.S.C. § 78u-4(a)(6) (2012) (limiting fees to a "reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class").

22. *See, e.g.*, John G. Harkins, Jr., *Federal Rule 23—The Early Years*, 39 ARIZ. L. REV. 705, 706–07 (1997) (quoting the original version of Rule 23 and explaining the three types of class actions permitted under the rule).

23. FED. R. CIV. P. 23(b).

24. FED. R. CIV. P. 23(b)(3).

members.[25] As a result, someone who falls within the definition of the class is automatically a member of the class—and thus bound by any judgment in the proceeding—unless she affirmatively takes steps to opt out.

In debating the contours of what ultimately became Rule 23(b)(3), the committee considered an opt-in model, but ultimately rejected it. An opt-out model, they believed, would avoid "freezing out the claims of people—especially small claims held by small people—who for one reason or another, ignorance, timidity, unfamiliarity with business or legal matters, will simply not take the affirmative step" to opt into the class action.[26] The committee believed that this approach would help ensure that "the silent [would] be considered as part of the class."[27] This subsection is now the dominant means through which class actions are certified, such that "the world of class actions . . . [is] primarily a world of Rule 23(b)(3) damages class actions."[28]

The decision to adopt an opt-out model of class actions has implications for silent class members, including those who may not even be aware that they are part of the class. On the plus side, they are automatically eligible to receive their pro rata share of any proceeds paid out as part of a judgment or settlement, assuming they do not opt out of the litigation. On the other hand, they are also automatically bound by the judgment and therefore precluded from later filing their own suit if they do not think their interests were well represented in the class action.[29] In this way, Rule 23(b)(3) represents a quid pro quo. Absent class members are entitled to their share of the litigation proceeds, but they also surrender their individual claims against the defendants.

The opt-out model for class actions reflects a goal of full participation, especially for small claimants who do not have the economic incentive to affirmatively opt into litigation. As we shall see, however, the opt-out model does not fulfill its promise. Indeed, when it

25. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 592 (1997) ("Rule 23(b)(3) was the most adventuresome innovation of the 1966 Amendments, permitting judgments for money that would bind all class members save those who opt out.").

26. Kaplan, *supra* note 3, at 398. That said, the opt-out model was not the result of careful reflection by the advisory committee in 1966. Instead, it emerged as a "moment of inspiration," with the committee members having "not the slightest idea what it would become," given the relatively small number of class actions at that time. *See* Cooper, *supra* note 4, at 432.

27. Kaplan, *supra* note 3, at 398.

28. DEBORAH R. HENSLER ET AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 52 (2000); *see also* Maureen Carroll, *Class Action Myopia*, 65 DUKE L.J. 843, 863 (2014) ("Due in large part to the creativity of the plaintiffs' bar with regard to the aggregated-damages subtype, the other subtypes now represent a minority of class actions.").

29. *See* Samuel Issacharoff & Geoffrey P. Miller, *Will Aggregate Litigation Come to Europe?*, 62 VAND. L. REV. 179, 206 (2009).

comes to the final step of paying individual members, securities class actions follow an approach that is functionally equivalent to the opt-in model that the rules drafters long ago rejected.

B. The Opt-In Reality

In practice, securities class actions, like nearly all class actions in the United States, are opt-in lawsuits, at least when it comes to compensating class members. For class members to receive their share of any settlement proceeds, they must typically complete claim forms and submit them online, a process that relatively few class members complete. As a result, many class members never receive any direct monetary benefit from being part of the class. This Section explains the practical hurdles in distributing settlement proceeds in securities class actions, before turning to the data challenges that have created these hurdles.

1. Claims Administration Hurdles

a. The Traditional Claims Administration Process

In securities class actions, settlements follow a fairly predictable pattern. Once the parties get close to finalizing the settlement agreement,[30] plaintiffs' counsel will start working with a claims administrator and an economic expert to draft a proposed plan of allocation, which lays out the methodology that the claims administrator will use to determine each class member's compensable damages.[31] The plan of allocation is typically based on damage analyses developed by the economic expert using an event study to measure the impact of the alleged fraud on the price of the securities at various points during the class period.[32] Once the settlement agreement and

30. The settlement agreement specifies the amount of the settlement, the parties to the settlement, and the class period, among other terms. It typically does not include the plan of allocation, and indeed many settlement agreements specify that the terms of the plan of allocation are not necessary terms of the settlement and alteration of the plan by the court is not grounds for terminating the settlement. *See, e.g.*, Stipulation and Agreement of Settlement at 19, Robb v. Fitbit, Inc., No. 3:16-cv-00151-SI (N.D. Cal. Jan. 8, 2018).

31. *See* Stevie Thurin, *A Guide to Settlement Plans of Allocation in Securities Class Actions*, A.B.A. (Nov. 15, 2018), https://www.americanbar.org/groups/litigation/committees/securities/articles/2018/fall2018-a-guide-to-settlement-plans-of-allocation-securities-class-actions/ [https://perma.cc/H7MT-UMM6]. This proposed plan of allocation is typically included in a separate document intended for distribution to class members, rather than in the settlement agreement itself. *See id.*

32. *See id.*

plan of allocation are finalized, plaintiffs' counsel presents both documents to the court for preliminary approval.[33]

Following preliminary approval of the settlement, the claims administrator's next major task is to notify class members.[34] As discussed below,[35] claims administrators do not have a list of class members, so they must use indirect means to contact them.[36] Typically, firms will send notice of the settlements and the accompanying claim forms to banks and brokers across the country.[37] The banks and brokers are then supposed to pass along these notices to their investor clients, who must complete the claim forms and return them to the claims administrators to receive their share of the settlement proceeds.[38]

The claim forms are complicated for even the most sophisticated investors. Resembling tax forms, they can be ten or more pages, with detailed instructions requiring the claimant to list all of her transactions in the relevant securities during the class period, along with the dates and purchase or sale price.[39] If the claimant purchased both common and preferred stock in the issuer, or purchased stock in both the primary and secondary markets, she may have to list those transactions separately.[40] She must also attach documentation of all listed transactions.[41] Finally, the forms often require a claimant to

33. *See* FED. R. CIV. P. 23(e) ("The claims, issues, or defenses of a certified class . . . may be settled, voluntarily dismissed, or compromised only with the court's approval."); MANUAL FOR COMPLEX LITIGATION (FOURTH) § 21.632 (2004) ("Review of a proposed class action settlement generally involves two hearings. First, counsel submit the proposed terms of settlement and the judge makes a preliminary fairness evaluation." (footnotes omitted)).

34. *See, e.g.*, Declaration of Josephine Bravata Concerning Mailing of Notice of Pendency & Settlement of Class Action & Proof of Claim & Release para. 3–4, Fitzpatrick v. Uni-Pixel, Inc., No. 4:13-cv-01649 (S.D. Tex. Mar. 31, 2015) (outlining the claim administration process for identifying class members, providing them with information about the settlement, and confirming their claims); Affidavit of Michelle M. La Count, Esq., In Support of Lead Plaintiffs' Unopposed Motion to Authorize Distribution of Net Settlement Fund para. 5–8, *In re* Take-Two Interactive Sec. Litig., No. 1:06-cv-00803-RJS (S.D.N.Y. July 6, 2011) (same).

35. *See infra* Section I.B.2.

36. *See* Cox & Thomas, *supra* note 8, at 419 ("Because of the way in which stocks are both owned and traded, the claims administrator faces multiple challenges in assuring that potential claimants in fact receive notice of the settlement.").

37. *See id.*

38. *See id.* at 419–20. Alternatively, banks and brokers can themselves send the claim forms to any of their customers who may be eligible to file a claim. *See* Villanova, *supra* note 10. Additionally, as discussed below, third-party filers often simply send the claims administrators a spreadsheet of their clients' claims. See discussion *infra* note 58 and accompanying text.

39. For a representative claim form, see *Proof of Claim and Release Form*, GTAT SEC. LITIG. (2018), http://www.gtatsecuritieslitigation.com/docs/POC.pdf [https://perma.cc/982F-X77J]. This form is sixteen pages long with seventeen paragraphs of "general instructions," plus additional specific instructions on each subsequent page.

40. *See, e.g.*, *id.* at 6–13 (providing space to list transactions in the issuer's common stock, convertible senior notes, call options, and put options).

41. *See, e.g.*, *id.* at 3:

certify, upon penalty of perjury, that (1) she read and understood the entire contents of the settlement notice and claim form and that (2) she is in fact a member of the settlement class.[42]

Once the claims administrator receives these claims, it must calculate each class member's compensable loss. These calculations are typically done in-house by the claims administrator based on the plan of allocation approved by the court.[43] The claims administrator audits a certain percentage of the claims and then pays those who submitted valid claims their pro rata share of the settlement.[44]

b. Problems with the Claims Administration Process

The claims administration system is far from perfect. In a landmark study published in 2005, Professors James Cox and Randall Thomas detailed the failings of the traditional claims administration process, even with respect to the most sophisticated institutional investors.[45] Using a list of 118 securities class actions, they first identified institutions that traded stock in the target companies during the class period.[46] They then worked with three claims administration firms to identify whether these investors submitted claims as part of the settlement.[47] They found that only twenty-eight percent of the institutions filed claims, despite an average mean loss of nearly $850,000 and an average potential recovery of approximately $280,000.[48] They concluded that "financial institutions with significant

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> You are required to submit genuine and sufficient documentation for all of your transactions in and holdings of the applicable GTAT Securities set forth in the Schedules of Transactions in Part III to VI of this Claim Form. Documentation may consist of copies of brokerage confirmation slips or monthly brokerage account statements, or an authorized statement from your broker containing the transactional and holding information found in a broker confirmation slip or account statement.

42. *See, e.g.*, *id.* at 4:

> By submitting a signed Claim Form, you will be swearing to the truth of the statements contained therein and the genuineness of the documents attached thereto, subject to penalties of perjury under the laws of the United States of America. The making of false statements, or the submission of forged or fraudulent documentation, will result in the rejection of your claim and may subject you to civil liability or criminal prosecution.

43. *See supra* notes 31–32 and accompanying text.

44. *See, e.g.*, *The Role of the Claims Administrator in Securities Class Action Settlements*, BATTEA CLASS ACTION SERVS. (Feb. 17, 2015), https://www.battea.com/role-claims-administrator-securities-class-action-settlements [https://perma.cc/WN6M-LS76] ("During these steps, there are a number of audits and data integrity checks that are performed by the Claims Administrator. If there are any issues on a claim, the administrator can and will reject a claim entirely or partially.").

45. Cox & Thomas, *supra* note 8.

46. *Id.* at 421.

47. *Id.* at 420–21.

48. *Id.* at 421–24 tbl. 1, 424–25.

provable losses fail at an alarming rate (approximately seventy percent) to submit their claims in settled securities class actions."[49]

As surprising as the Cox and Thomas study was, the percentage of total class members who submit claims is likely even smaller. In their study, Professors Cox and Thomas focused on institutional investors who had to disclose their holdings on SEC Form 13F.[50] This form only covers investment managers who exercise investment discretion with respect to accounts having an aggregate fair market value of at least \$100 million.[51] In other words, the Cox and Thomas study only included large investment managers because they are the only investors who have to file Form 13F. There is no data on the percentage of smaller investors who file claims in securities class actions. It is fair to assume, however, that they are even less likely to navigate the complexities of the claims administration process than their larger, more sophisticated counterparts.[52]

Why do sophisticated institutional investors leave settlement money on the table? Professors Cox and Thomas surveyed investors and found that many of them had no idea that they were failing to collect their share of settlement funds. Many assumed that their bank or broker handled this task.[53] Others did not have a designated in-house person responsible for overseeing the claims process, and even if they did, the forms were not always forwarded to this person.[54] And they often did not think the amounts at stake were worth the internal monitoring and oversight costs.[55] These institutions were focused on managing their investment funds, and the bureaucratic task of submitting claims in securities class actions was just not on their radar.

For smaller, retail investors, the problems are likely similar, although there is no research available on this side of the process. Retail investors may view the claim forms they receive in the mail as the legal equivalent of junk mail, and they may be skeptical that they really

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49. *Id.* at 425.

50. *Id.* at 421.

51. 17 C.F.R. § 240.13f-1(a)(1) (2019).

52. *Cf.* Coffee, *supra* note 20, at 304 (stating that "the same apathy that confounds the opt-in class action at the outset also arises at the back end of the opt-out class action when claims must be filed").

53. *See* Cox & Thomas, *supra* note 8, at 432 ("This oversight might also be due to a failure of the institution to clearly specify in its contract with its custodian, advisor, or broker the procedures to be followed with respect to handling possible claims.").

54. *See id.* ("One can imagine that institutions or custodians could assign to one of their staffers responsibility for handling all matters related to the institution's possible securities claims. This obligation is not likely to be either the sole or primary obligation of the employee.").

55. *See id.* at 438 ("[T]hey view securities litigation as simply taking money from one pocket (as owners) and putting it into another pocket (as victims) while paying a percentage of it to the lawyers.").

could receive money by going through a cumbersome claims process. Additionally, they may not be able to track down their trading records from years past, or even if they can, they may not want to go through the effort without any sense of how much money they stand to receive in the settlement.

The Cox and Thomas study sparked a number of changes in the claims administration industry. In the years after the study was published, for example, a robust industry of third-party claims filers emerged, with companies such as Battea, FRT Services, and Securities Class Action Services (which is owned by Institutional Shareholder Services) offering to file claims on behalf of institutional investors.[56] Today, these third parties file many, if not most, of the claims in securities class actions,[57] and claims administrators often let them use a streamlined filing process.[58] In exchange for filing these claims, the third-party filers receive a portion of any recovery that their clients receive from the settlement, perhaps around thirty percent.[59]

It is difficult to know precisely how the rise of third-party filers has impacted the claims rates in securities class actions. There have not been any follow-up studies to the Cox and Thomas study, and even anecdotal evidence is thin. In 2015, for example, a well-known plaintiffs' law firm stated that only an estimated thirty-five percent of eligible institutional investors file claims in U.S. securities class

56. *See The Role of the Claims Administrator in Securities Class Action Settlements*, *supra* note 44 (detailing the firm's securities class action recovery services); *Securities Class Action Services*, INSTITUTIONAL SHAREHOLDER SERVS. INC., https://www.issgovernance.com/securities-class-action-services/ (last visited Nov. 8, 2019) [https://perma.cc/G7JT-792W] (detailing the firm's Securities Class Action Services solution).

57. *See, e.g.*, Alex Villanova, *Current Claims Filing Trends in Securities Class Actions*, EPIQ ANGLE (May 22, 2018), https://www.epiqglobal.com/en-us/thinking/blog/trends-in-securities-class-action-settlements [https://perma.cc/4696-TA68] (highlighting both the surge in the number of class action lawsuits filed in 2017 as well as the decrease in settlement value). There is not official data available on the percentage of claims filed by these third-party filers. During my conversations with claims administrators, however, several of them informally pulled up information on their computers regarding recent settlements that they had handled and went through who had filed the claims. The majority were filed on behalf of an institution by either a company such as Battea or ISS or a plaintiffs' law firm.

58. In my conversations with claims administrators, they stated that these third-party filers typically do not file traditional claims with completed claim forms and supporting documentation for their clients. Instead, they send the claims administration a spreadsheet of transaction data relevant to their clients' claims, and the claims administrator conducts random audits to help ensure the accuracy of this information. The investors that use these services therefore often do not have to go through their old files to track down confirmation of their transactions unless their claims are audited, unlike class members who file claims directly.

59. The exact percentage that these third-party filers charge is not publicly available. In my conversations with claims administrators, they estimated that these companies charge thirty percent of their client's recovery.

actions, but it did not outline the empirical support for this claim.[60] Similarly, in my conversations with claims administrators, several told me that they price their services on the assumption that approximately twenty to twenty-five percent of claim forms will be returned, although they also said that the actual percentage can vary significantly in individual cases. Yet this number does not mean that only twenty to twenty-five percent of eligible shares file claims. There are many reasons why the actual claims rate may be higher than this percentage suggests. Claims administrators may want to maximize the number of filed claims, for example, and therefore may decide to send out duplicate forms to banks and their clients, even though only one claim can ultimately be filed for each class member. Additionally, the class is often defined broadly to include everyone who bought or sold the company's shares during the class period.[61] Yet, many shareholders who meet this definition may not have suffered a recognizable loss and therefore are not entitled to a share of the settlement.[62] These shareholders have no need to return the claim forms. In short, we simply do not know the percentage of class members who receive their share of settlement funds.

Whatever the exact percentage, however, it is clear that the Cox and Thomas study did not solve the problem. Most retail investors still lack the financial incentives to navigate the claims administration process, nor do they have enough money at stake to seek out the help of third-party claims filers.[63] Larger institutional investors have more at stake, but many of the institutional barriers that kept them from filing claims in the Cox and Thomas study still exist. Some institutions have

60. *See 10 Years Removed from Cox & Thomas: A Survey of the Claims Filing Landscape for U.S. and Non-U.S. Securities Litigation Recoveries*, KESSLER TOPAZ MELTZER CHECK LLP (Nov. 5, 2015), https://www.ktmc.com/news/10-years-removed-from-cox-thomas-a-survey [https://perma.cc/9W9L-G6AQ] (providing an overview of current trends in claims administration and the institutional investors' responses).

61. *See, e.g.*, Amended Class Action Complaint for Violation of the Federal Securities Laws para. 1, Kanefsky v. Honeywell Int'l, Inc., No. 2:18-15536 (WJM) (D.N.J. Apr. 10, 2019), 2019 WL 3000264 (defining the class to include "all persons who purchased or otherwise acquired Honeywell securities from February 9, 2018 through October 19, 2018").

62. *See, e.g.*, Notice of Plaintiffs' Motion (1) for Preliminary Approval of Proposed Settlement, (2) for Approval of the Form & Manner of Notice, & (3) to Schedule a Hearing on Final Approval of the Settlement & on Plaintiffs' Counsel's Application for an Award of Attorneys' Fees & Expenses at Ex. A (Proposed Order Preliminarily Approving Settlement, Directing Notice to Class Members, & Settling Hearing for Final Approval of Settlement), *In re* Pfizer Inc. Sec. Litig., No. 04-cv-9866 (LTS)(HBP) (S.D.N.Y. Aug. 26, 2016), ECF No. 698-1 (laying out a proposed plan of allocation for the settlement funds based on each claimants' recognizable losses).

63. There is not specific data available on this point, but the fundamental incentives identified in their study remain unchanged.

addressed these barriers by hiring third-party claims filers,[64] but these companies receive a percentage of the recovery in exchange for filing these claims.[65] As a result, investors lose a significant portion of their recovery by relying on these intermediaries.

This reality complicates the oft-told story about class actions. Recall the advisory committee's hope that the opt-out model in Rule 23(b)(3) would allow "the silent to be considered as part of the class" to avoid "freezing out the claims of people—especially small claims held by small people—who . . . will simply not take the affirmative step" to opt into the class action.[66] It is fair to ask whether this hope has survived the realities of complex claims administration. True, shareholders do not have to affirmatively opt into the class action to be considered a member of the class. They must, however, opt in at the settlement stage to receive any benefit whatsoever from the class action.

Ironically, class members face the drawbacks of the opt-out model regardless of whether they file a claim. The preclusive effect of the class action—that is, the release of liability laid out in the settlement agreement, coupled with claim preclusion from the judgment itself—applies regardless of whether class members file a claim or receive any money.[67] Class members can always opt out of the class,[68] but if they do nothing and thus remain a part of the class, they are bound by the judgment and cannot later file their own lawsuit. In other words, the only part of a class action that is truly opt out is the release that class members give to the defendants. Any benefit for the class members is available only to those who opt in at the settlement phase. To be fair, class members who do not claim their share of the settlement are unlikely to want to file their own lawsuit later. Nonetheless, it is striking that class members give up something simply by being part of the class, but they must jump through administrative hoops to receive any benefit.

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64. *See* Villanova, *supra* note 10 (characterizing 2017 trends in securities class action lawsuits, including the rise in third-party filers).

65. *See* Edward Radetich, *Avoiding Risks with Third-Party Claims Filers*, HEFFLER CLAIMS GRP. (Dec. 19, 2018), https://www.hefflerclaims.com/securities-posts/avoiding-risks-with-third-party-claims-filers/ [https://perma.cc/UTR8-X9K4] ("Once the distribution occurs, third-party filers receive a percentage of their clients' reward.").

66. *See* Kaplan, *supra* note 3, at 398.

67. *See* 18A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4455.5 (3d ed. 2019) [hereinafter WRIGHT & MILLER]; Julia C. Kou, *Closing the Loophole in the Private Securities Litigation Reform Act of 1995*, 73 N.Y.U. L. REV. 253, 286 (1998) ("Even class members who do not file claims but who do not opt out will be barred from pursuing claims after a class claim is concluded.").

68. *See* 18A WRIGHT & MILLER, *supra* note 67 § 4455 (stating that "class members who properly avail themselves of an opportunity to 'opt out' of the class action likewise are not bound").

2. The Data Problem Behind These Hurdles

None of this is motivated by malice. No one set out to deprive class members of their share of settlement funds, nor did anyone purposefully make it harder for class members to claim their money. The hurdles of the claims administration process exist because requiring class members to file a claim is often the only way that that courts can identify class members and determine the amount of their claims. This Section first describes the specific information that claims administrators need to distribute settlement funds in a securities class action, before turning to the information available to various players in the securities markets.

a. Calculating Damages in Securities Class Actions

To accurately distribute settlement funds in a securities class action, claims administrators need certain information about the damages suffered by individual class members. Damages in a securities class action are based on, among other things, the difference between the price that an investor paid for the corporation's stock and the value of this stock had the corporation not lied to the market.[69] To pay class members their share of a settlement fund, claims administrators therefore need three specific pieces of information. First, they need to know the number of shares that class members purchased during the class period. Second, they need to know the date on which these transactions occurred. Third, they need to know the price at which these transactions occurred.[70] The claims administrator can then plug this information into its damages model and determine each class member's individual damages.

In nearly all securities class action settlements, however, the settlement fund is far smaller than the total amount of investor losses.[71] As a result, the claims administrator cannot simply send all class members, or even all claimants, the full amount of their calculated loss. The claims administrator instead needs to calculate the total value of

69. *See* 15 U.S.C. § 78u-4(e)(1) (2012) (limiting recoverable damages to the difference between the sale price of the security and the security's mean price over a ninety-day period following the disclosure of the information).

70. *See id.*

71. *Cf.* Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, NERA ECON. CONSULTING 34–35 (Jan. 29, 2019), https://www.nera.com/content/dam/nera/publications/2019/PUB_Year_End_Trends_012819_Final.pdf [https://perma.cc/B5VR-79LD] (finding that, from 1996 to 2018, "the ratio of settlement to Investor Loss for the median case was 19.4% for cases with Investor Losses of less than $20 million, while it was 0.7% for cases with Investor Losses over $10 billion").

the claims and then determine the pro rata share of the settlement fund that each class member should receive. Only after finishing these calculations can the claims administrator send claimants their share of the settlement fund. To complete this final step, the claims administrator needs to know either the account number where the funds can be electronically deposited or the class member's physical address where a check can be sent.

Putting these steps together, in order to calculate and distribute each class member's share of the settlement fund, the claims administrator needs to know the following pieces of information: (1) the number of shares in the defendant corporation that each class member bought or sold during the class period, (2) the dates of these transactions, (3) the relevant sale or purchase prices, and (4) the class members' contact information. As we shall see, however, this information is not housed in a single, easily accessible place.

b. Information Available to Corporations

Corporations have far less information about their shareholders than one might guess. It is easy to imagine that public corporations have a list of their shareholders tucked in a drawer, and state law indeed requires corporations to have a version of such a list.[72] These lists, however, only include the names of registered shareholders, and typically a trust company called Cede and Company ("CEDE") is listed as the registered owner of nearly all of the corporation's shares.[73] These lists are not helpful to claims administrators who need to identify a corporation's beneficial shareholders because only beneficial shareholders are class members in a securities class action.

Corporations are entitled to obtain additional information about their shareholders, but even this information does not provide all of the details that claims administrators need. To understand these challenges, one must recognize that most investors manage their investments with the assistance of a bank or broker who places trades on the investor's behalf. Banks and brokers place these trades with the assistance of a company called the Depository Trust and Clearing Corporation ("DTCC"). DTCC functions as the clearinghouse to fifty

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72. *See, e.g.*, DEL. CODE ANN. tit. 8, § 220(b)(1) (2019) (noting stockholders' right to "inspect" such a list).

73. *See* Cox & Thomas, *supra* note 8, at 419 ("[B]ecause most investors hold their securities in street names, the list, in most instances, reports that ownership is with CEDE & Co., the depository for most brokers."); *see also* David C. Donald, *Heart of Darkness: The Problem at the Core of the U.S. Proxy System and Its Solution*, 6 VA. L. & BUS. REV. 41, 44 (2011) (stating that "corporation law defines a shareholder as someone who is registered on the stockholders list, not a person who has title to shares" (footnote omitted)).

exchanges and exchange-type platforms in the United States, including the New York Stock Exchange and the NASDAQ.[74] Together, DTCC and its affiliates facilitate nearly every trade for every public company in the United States.[75]

Corporations are only entitled to receive limited information from DTCC about their shareholders. Specifically, corporations can request the so-called CEDE list, which identifies the banks and brokers on whose behalf CEDE holds shares. This list, however, does not provide the names of beneficial owners or their individual transaction data. Companies can also get the names of certain beneficial owners who do not object to their names being shared, but companies are strictly limited in how they can use this information.[76] The so-called NOBO list (that is, a list of non-objecting beneficial owners) also only captures beneficial owners at a particular moment in time.[77] It does not provide a complete record of these owners' purchases and sales of the company's stock, which is the information needed to determine their pro rata share of a settlement fund. In short, corporations have access to some limited information about their shareholders, but it is not the specific information needed to calculate and distribute settlement funds.

c. Information Available to Securities Intermediaries

Claims administrators also cannot access this information directly from DTCC or other securities intermediaries. To understand why this is not possible, it is necessary to delve into the precise role that DTCC plays in clearing securities transactions. DTCC's role as a central

74. DTCC is the holding company for a network of subsidiaries, many of whom play a role in the processes detailed in this Section. *See About DTCC*, DTCC, http://www.dtcc.com/about (last visited Nov. 8, 2019) [https://perma.cc/ZP38-GSW9]. I use the term DTCC to refer to both the holding company and its subsidiaries.

75. *See, e.g.*, Yuliya Guseva, *Destructive Collectivism: Dodd-Frank Coordination and Clearinghouses*, 37 CARDOZO L. REV. 1693, 1736 (2016) (noting that DTCC has a functional monopoly because the "smaller clearing agencies and depositories [have] gradually perished"); *Clearing Services*, DTCC, http://www.dtcc.com/clearing-services (last visited Nov. 8, 2019) [https://perma.cc/7HUW-GS69] ("DTCC clears and settles virtually all broker-to-broker equity, listed corporate and municipal bond and unit investment trust (UIT) transactions in the U.S. equities markets.").

76. *See* 17 C.F.R. § 240.14b-1(b)(3)(i) (2019) (stating that brokers or dealers shall "provide the registrant, upon the registrant's request, with the names, addresses, and security positions . . . of its customers who are beneficial owners of the registrant's securities and who have not objected to disclosure of such information"); *see also* 17 C.F.R. § 240.14a-13(b)(4) (2019) (stating that registrants seeking this information regarding beneficial owners must "use the information . . . exclusively for purposes of corporate communications").

77. *See* 17 C.F.R. § 240.14b-1(b)(3)(i) (noting that the information is "compiled as of a date specified in the registrant's request which is no earlier than five business days after the date the registrant's request is received").

clearinghouse makes it significantly easier for banks and brokers to clear their trades—in other words, to transfer the purchase price and net the various trades with each other. Imagine, for example, that broker A has a client who wants to buy fifty shares of a company's stock, and broker B has a client who wants to sell these same shares. DTCC, through a subsidiary, ensures that the money gets from broker A to broker B.

These records, however, only identify the banks and brokers that authorized the trades.[78] DTCC and its subsidiaries do not know the identity of the individual customers on whose behalf the trades are made.[79] It is up to individual banks and brokers to ensure that the relevant customer accounts are credited or debited the correct amount. DTCC simply allocates shares at the broker level. While data from clearinghouses like DTCC is therefore more specific than the information available on corporations' shareholder lists, it still does not provide the level of detail needed to distribute settlement funds.[80]

Data on individual customer accounts lives in only one place—within the records of the individual banks and brokers who manage these accounts.[81] Banks and brokers have all of the data that claims administrators need, including customers' names, addresses, account numbers, and the date and price of the customers' specific transactions in the relevant securities. The problem is that there are hundreds of banks and brokers across the country and no centralized database that contains all of their customer data.[82] This fact explains why claims administrators typically start the claims administration process by

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78. Joseph A. Grundfest, Morrison*, the Restricted Scope of Securities Act Section 11 Liability, and Prospects for Regulatory Reform*, 41 J. CORP. L. 1, 14–15 (2015) ("The participants in the process only know the name of the broker, bank, or other 'street' entity at which the account is being held.").

79. *See FAQS: How Issuers Work with DTC*, DTCC, http://www.dtcc.com/settlement-and-asset-services/issuer-services/how-issuers-work-with-dtc (last visited Nov. 8, 2019) [https://perma.cc/WE2V-W8KT] ("DTC does NOT have beneficial owner information. Issuers need to coordinate through DTC for communications to DTC participants and these financial institutions are responsible to pass along communications to their customers who may be ultimate beneficial owners.").

80. To understand this point, imagine that one of broker A's customers bought stock in the defendant corporation, while another of broker A's customers sold this same amount. From DTCC's perspective, the transaction is a wash and it does not need to do anything. The broker can simply transfer the shares from one of its clients to the other, and DTCC does not need to be involved. Yet one of these customers has been hurt by the fraud—likely the customer who purchased stock at an inflated price during the class price. Relying just on DTCC's records would not reveal this injury.

81. Grundfest, *supra* note 78, at 15 ("Only the broker, bank, or other street entity knows the name of the beneficial owner who actually owns the shares represented by the street name account.").

82. *See, e.g.*, J. Travis Laster & Marcel T. Rosner, *Distributed Stock Ledgers and Delaware Law*, 73 BUS. LAW. 319, 326 (2018) ("Over 800 custodial banks and brokers are participating members of DTC and maintain accounts with that institution.").

sending information about the settlements, along with copies of the relevant claim forms, to banks and brokers, requesting that the banks and brokers then pass these forms along to their customers.[83] If the banks and brokers do not pass along the information, if they pass along the wrong information, or if customers mistakenly think that the broker is handling the claims process, these customers will never receive their share of the settlement.

In summary, claims administrators do not have direct access to information about securities transactions at the beneficial owner level, which is the level that matters in securities class action settlements. Corporations only have lists of their registered owners and non-objecting beneficial owners, and even this data is only for particular moments in time. DTCC only has data at the broker level. Additionally, the data from specific banks and brokers is dispersed among hundreds of proprietary databases around the country, and banks and brokers are under no obligation to pass this data along to claims administrators. This complicated structure of securities ownership goes a long way toward explaining the low claims rate set out in the prior Section.

C. The Drawbacks of an Opt-In Reality

Before turning to possible ways to fix this system, it is worth asking whether it needs fixing. Does it matter if most shareholders do not receive the settlement money to which they are entitled? In some ways, this may feel like an odd question. Of course, it matters if people do not get money to which they have a legal entitlement. Yet the analysis becomes more complicated when reflecting on the goals of securities class actions.

It is widely recognized that securities class actions have two primary goals: (1) deterring corporate fraud and (2) compensating injured investors.[84] A better method of distributing settlement funds would not significantly impact the goal of deterrence because the defendants pay the same amount regardless of how this amount is distributed. Even with the low claims rate in securities class actions, shareholders still claim more than one hundred percent of the settlement fund, so there is typically no amount left unclaimed.[85] Given

83. *See supra* notes 34–38 and accompanying text.

84. *Cf.* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1536 (2006) (recognizing compensation and deterrence as the traditional justifications for securities class actions, but arguing that "compensation [is] unobtainable and deterrence [is] deeply compromised by a variety of inconsistent legal doctrines that pull the punch of private enforcement").

85. Even if the amount of the claims was less than the settlement amount, the defendant would still not get any portion of the settlement amount back because most settlement agreements

that defendants do not get any money back, they should not care how settlement funds are distributed, nor should the distribution method influence the behavior of corporate managers more generally.

Instead, the way in which settlement funds are distributed primarily impacts the compensatory goal of securities class actions. Under the current system, the settlement fund is shared among a small group of class members, while the rest receive nothing at all. This imbalance could be substantial. Imagine a settlement of $50 million in which the total alleged damages of the class are $500 million. On paper, each class member should recover ten percent of the alleged damages. If, however, class members owning only thirty percent of the relevant shares file claims, this group of shareholders with a total of $150 million in alleged damages will share a settlement fund of $50 million, each receiving thirty-three percent of the alleged damages. In other words, members of the group that files claims will receive far more money than they would if the settlement fund was distributed among all class members. The remaining class members would receive nothing. In this way, the current distribution method significantly overcompensates some shareholders and significantly undercompensates others.

Some scholars have argued that this imbalance does not really matter.[86] Fifty million dollars may sound like a lot of money, but it is actually a drop in the bucket for most institutional investors. Institutional investors typically aggregate the investments of many investors, so $50 million may mean only a few pennies per individual investor in these funds. As a result, even if the legal system comes up with a way to distribute the money more effectively, this reallocation will result in only marginally increased returns for the investors on the receiving end of these funds.[87] In other words, the amounts at stake will

include a nonreversion provision. *See, e.g.*, Amended Stipulation & Agreement of Settlement at Ex. A-1, Zacharia v. Straight Path Commc'ns, Inc., No. 2:15-cv-08051-JMV-MF (D.N.J. Dec. 5, 2017) (noting that "[n]either Defendants nor any other person or entity that paid any portion of the Settlement Account . . . are entitled to get back any portion of the Settlement Fund once the Court's order or judgment approving the Settlement becomes Final"); Stipulation of Settlement at 18–19, *In re* DS Healthcare Grp., Inc. Sec. Litig. No. 16-60661-WPD (S.D. Fla. May 26, 2017) (explaining the disbursement process for any remaining money in the Net Settlement Fund, which does not include any reversion to defendant).

86. Professor Adam Pritchard made this argument in an article *Who Cares?*, which was a response to Professors Cox and Thomas's study of institutional investors' failure to file claims in these cases. Adam C. Pritchard, *Who Cares?*, 80 WASH. U. L.Q. 883, 884 (2002). In his article, Professor Pritchard used rough estimates to calculate that the amount of money institutions were losing by failing to file claims was less than 0.1 percent of their total funds under management, which he stated was "in the range of a rounding error." *Id.* Based on this figure, he hypothesized that "[p]erhaps money managers have more important things to worry about. For example, money managers may spend their time investigating companies so as to avoid investing in fraudulent firms." *Id.*

87. *Id.*

not fund otherwise-empty retirement accounts or make the next economic downturn financially irrelevant. Viewed within the broader context of the U.S. financial markets, these are relatively small amounts of money.[88]

On the other hand, defendants pay out billions of dollars in securities class action settlements each year,[89] and it is odd not to care about how billions of dollars are allocated in our legal system. Indeed, the legal system purports to care when it requires courts to approve settlement plans of allocation. If the compensatory goals of securities class actions were truly irrelevant, the legal system would not have any claims process at all. It would simply take the money from the defendants and give it to the U.S. Treasury or a worthy nonprofit. Or it would set fire to the money. The legal system does not do any of these things because it believes that individual investors have been injured by the defendants' fraud and deserve to be made whole. The money in these settlements belongs to the class members, and it should be returned to them.

The current compensation system also has distributional consequences for investors. Settlement funds are not distributed randomly under the current system. Some investors likely receive a far greater share of settlement funds than others because they have developed processes within their organizations that make it easy for them to regularly file claims or because they have effectively outsourced these processes. Given the complexity of the claims administration process, it is fair to assume that a greater percentage of large institutional investors have figured out how to navigate this process than have less sophisticated retail investors. As a result, although the opt-out model of securities class actions was designed to make these suits benefit all investors equally, the claims administration process means that large institutional investors are the ones who primarily benefit.

The current distribution system also means that most investors do not personally experience the benefits of these suits, impacting the system in two significant ways. First, it contributes to the overall sense

88. It is important not to overstate this point. Yes, settlement amounts are a drop in the bucket compared to the total amount of investment in the United States, but they are not nothing. Between 2009 and 2018, the total amount of money paid by defendants in court-approved settlements was over $50 billion. *See* Boettrich & Starykh, *supra* note 71, at 34. To put this number in context, it is roughly equal to the annual budget of the Commonwealth of Virginia. *See* H.B. 30, 2016 Gen. Assemb., Reg. Sess. (Va. 2016) (establishing Virginia's operating expenses as more than $50 billion).

89. *See* Boettrich & Starykh, *supra* note 71, at 34 (showing that, from 2009 to 2018, defendants paid out an average of about $5 billion per year and no less than $1.8 billion in any of these years).

in society that securities class actions, and perhaps class actions more generally, are frivolous and do not benefit average investors. Second, it reduces investors' interest in the suits, which in turn reduces their commitment to improving these suits. This area of the law is crucial to the functioning of the capital markets, and meaningful reform will not occur if investors have already written off these suits.[90] In short, if the legal system can improve the claims administration process, it would not only put settlement funds in the pockets of a larger group of investors, but it could also impact the public's confidence in these suits more broadly.

II. TWO PATHS TO AUTOMATION

The time has come to overhaul the legal system's current approach to distributing settlement funds in securities class actions. This Part outlines two possible ways for claims administrators to access the necessary data and use it to automate the distribution of settlement funds in these suits. The first approach relies on market innovation. Building on a method used in the proxy context, claims administrators could work with banks and brokers to obtain transaction data of investors who bought or sold the issuer's stock during the class period and then automatically distribute the investors' pro rata shares of the settlement funds to them. The second approach relies on regulatory innovation, using the new Consolidated Audit Trail developed by the SEC to track relevant securities purchases and calculate settlement proceeds. As we will see, both approaches rely on technical improvements to the claims administration system combined with careful consideration of the incentives that motivate the various participants in these settlements.

A. Automating Through Market Innovation

1. An Automated Claims Administrator

As outlined in the prior Part, the current claims administration process is hampered by the fact that only individual banks and brokers have access to the records that identify specific transactions by specific customers in a given company's securities.[91] Each bank and broker has data that identifies its own customers' transactions, but no centralized

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90. *See* Cox & Thomas, *supra* note 8, at 454 ("If the system needs reform, as both we and Professor Pritchard agree it does, the more institutional investors are active participants, the more pressure will be placed on the system to improve.").

91. *See supra* Section I.C.

database collects all of this data. Yet this data gap is not insurmountable. Claims administrators could collect transactions data directly from banks and brokers and then use this data to distribute settlement funds to shareholders, obviating the need for a claims process.

More specifically, this approach envisions that, once the parties reach a settlement, the claims administrator will reach out to the relevant banks and brokers across the country—approximately nine hundred in all—and ask for transaction data for any of their clients who bought or sold the company's stock during the class period.[92] This transaction data would include (1) the date of the relevant transactions, (2) the price at which the stock was bought or sold, (3) the number of shares for each transaction, and (4) identifying information regarding the beneficial owner—all of which is data that banks and brokers already have in their files. The claims administrator would request that banks and brokers produce this data in a standardized way, allowing the claims administrator to aggregate it into a single database.

This proposal looks a lot like the current claims administration system, with one significant change. Under the current system, claims administrators ask banks and brokers for their clients' contact information and then, using this contact information, they send claim forms to these clients in the hopes that they will fill out the forms and return them to the claims administrator. In contrast, under this proposal, the claims administrator would get all the necessary data directly from the banks and brokers. Banks and brokers place the relevant trades on behalf of their clients, so they have the information and documentation that claims administrators need. There is no need for the added step of asking class members to provide this information themselves.

This is especially true when viewing the current system of claims administration through a process improvement lens. This lens requires an examination of each step in the current system to determine where problems and inefficiencies are most likely to occur.[93] Using this

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92. This estimate of the number of banks and brokers came from an interview with an employee at Broadridge Financial Solutions. A partial list also appears on DTCC's website, although this list does not include banks and brokers that clear trades through other larger institutions. *See DTC Participant Report*, DTCC (Aug. 2019), http://www.dtcc.com/~/media/Files/Downloads/client-center/DTC/alpha.pdf [https://perma.cc/6WX5-WJ7N] (providing an alphabetical list of DTC participants).

93. *See* Silvia L. Coulter, *Process Improvement and the Legal Work Product*, PRAC. INNOVATIONS 3 (Mar. 2013), https://info.legalsolutions.thomsonreuters.com/signup/newsletters/practice-innovations/2013-mar/Mar13_PracticeInnovations.pdf [https://perma.cc/U98T-88F8] (arguing that a process improvement methodology, which examines each individual area of a particular legal process, allows law firms to better manage a given project and provide higher quality legal work).

lens, most steps in the current system work relatively well. Claims administrators contact nearly all banks and brokers, banks and brokers pass along contact information for most putative class members, and most class members receive their claim forms. The process breaks down at one specific step—the step at which class members are supposed to fill out and return the claim forms. From a process improvement perspective, therefore, eliminating this step by getting the necessary data directly from banks and brokers would solve the principal problem with the current system.

Once claims administrators receive the relevant data from banks and brokers, they can use it to calculate each class member's pro rata share of the settlement. As part of this process, the claims administrator will have to compare the lists provided by the different banks and brokers to calculate the net number of shares purchased during the class period by each shareholder. This comparison will help ensure that a shareholder who purchased shares from one broker but sold shares through another broker is deemed to have the correct net purchases. This step will allow the claims administrator to calculate each class member's estimated damages and his or her pro rata share of the settlement.

At this point, the claims administrator could just send these funds to each class member using the contact information provided by the banks and brokers. Doing so, however, would not allow class members an adequate opportunity to contest the amount of their claim or to opt out of the class action.[94] As a result, the claims administrator should instead send class members a letter that would (1) inform them of the presumptive value of their claim in the settlement, as well as how this value was calculated,[95] and (2) let them know that they will automatically receive this amount, either by check or electronic deposit, unless they opt out of the class action by a certain date. The class members should then have at least sixty days to review their options.[96] If they do nothing, they will automatically receive their calculated share of the settlement fund.

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94. *See* FED. R. CIV. P. 23(c)(2)(B) (providing that class members must be notified of their opportunity to opt out of the class action).

95. Claims administrators will have to calculate these amounts before knowing how many class members will ultimately opt out of the litigation or challenge the calculation of their share of the settlement. As a result, claims administrators may want to inform class members that their recovery will likely fall within a certain range, rather than specifying an exact amount. If far more class members than expected opt out or challenge the calculations, the claims administrator may have to provide a new round of notice and opportunity to opt out.

96. The claims administrator should then have at least sixty days to review any objections to the calculations and respond accordingly.

This proposal is not wholly different from the current process of distributing settlement funds. Claims administrators would still use customer data to determine each class member's share of the settlement fund. The difference is that the claims administrator would have access to the transaction data for *all* investors who bought or sold the company's stock during the class period, not just for the relatively small number of investors who file claim forms. As a result, nearly all class members would receive their share of the settlement fund.

One likely hurdle is that banks and brokers will be reluctant to release transaction data and other sensitive customer information to claims administrators. Overcoming this reluctance will require action by the courts that oversee these settlements. First, courts should require banks and brokers to participate in this stage of the process. This step may sound radical, but courts *already* require banks and brokers to participate in the claims administration process, just in a slightly different way. In most judicial orders granting preliminary approval to settlements in securities class actions, the court orders banks and brokers to send the claim forms to their clients who transacted in the company's stock during the class period.[97] Alternatively, the banks and brokers give the claims administrator the contact information for these clients so the administrator can send them the claim forms directly.[98] Under either approach, however, the banks and brokers must participate in the claims administration process.

If courts want to automate the settlement distribution process, they will have to amend this portion of their standard preliminary approval orders. In addition to clients' contact information, courts will also have to require banks and brokers to turn over their clients' detailed transaction data in the relevant securities, which is far more sensitive information than they currently provide. As discussed in detail in Part III,[99] courts should not go down this road unless they are confident that claims administrators can secure this data. If the claims administrators can make this showing, however, the court should order the banks and brokers to provide the necessary information.

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97. *See, e.g.*, Preliminary Approval Order para. 14, Robb v. Fitbit Inc., No. 3:16-cv-00151-SI (N.D. Cal. Jan. 19, 2018); Order Granting Lead Plaintiff's Motion for Preliminary Approval of Class Action Settlement para. 16, *In re* Tangoe, Inc., Sec. Litig., No. 3:17-cv-00146-VLB (D. Conn. Nov. 13, 2017).

98. *See, e.g.*, Preliminary Approval Order, *supra* note 97, para. 14; Order Granting Lead Plaintiff's Motion for Preliminary Approval of Class Action Settlement, *supra* note 97, para. 16.

99. *See infra* Section III.A.

2. Spurring Market Innovation

This proposal would overhaul a system that has remained largely the same for decades. Such a significant overhaul would not be easy, and courts, attorneys, and lead plaintiffs do not always have the right incentives to pursue these changes, as described in the next Section. Nonetheless, as we have seen in a number of other industries, innovation is possible even if traditional market participants prefer the status quo. This Section describes three different ways that this proposal could get off the ground, providing a foundation for the discussion in the next Section about the incentives of the existing participants in the settlement process to support these changes.

Before turning to how the private market could spur automation in this area, it is worth noting that companies can make a fair amount of money in the claims administration industry. Although there is not market data on the average amount that claims administrators currently charge, it appears that they often receive between $100,000 and $300,000 in fees for overseeing the distribution process.[100] Given that there are typically between sixty and eighty securities class actions per year,[101] a rough estimate of the total market size is around $15 million. If claims administrators expand automation to other forms of corporate and securities litigation, such as SEC enforcement suits, the total revenue could be far higher. In other words, there is money to be made in this business, and a company that offers an innovative claims administration process could capture a significant part of this market.[102] The question, therefore, is what types of companies are particularly well situated to make this move.

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100. *See, e.g.*, Order Authorizing Payments for Settlement Administration Expenses from Settlement Funds at 2, Robb v. Fitbit Inc., No. 3:16-cv-00151-SI (N.D. Cal. Aug. 9, 2018) (authorizing a payment of approximately $330,000 in connection with the claims administration process); Lead Plaintiffs' Motion for Approval of Distribution Plan & Incorporated Memorandum of Law at 6, *In re* Altisource Portfolio Sols., S.A. Sec. Litig., No. 9:14-CV-81156-WPD (S.D. Fla. Aug. 2, 2018) (requesting a payment of approximately $200,000 for the claims administrator); Letter from James E. Cecchi to Judge Sheridan at 1, *In re* CommVault Sys., Inc. Sec. Litig., No. 14-cv-05628 (PGS)(LHG) (D.N.J. May 18, 2018), ECF 132 (authorizing a payment of up to $225,000 to the claims administrator). In larger cases, the claims administration fees are significantly more. *See, e.g.*, Order & Final Judgment para. 18, *In re* Petrobras Sec. Litig., No. 14-cv-9662 (JSR) (S.D.N.Y. July 2, 2018) (authorizing up to $3.8 million in claims administration fees for the distribution of an approximately $3 billion settlement).

101. *See* Laarni T. Bulan, Ellen M. Ryan & Laura E. Simmons, *Securities Class Action Settlements: 2017 Review and Analysis*, CORNERSTONE RES., 3 (2017), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2017-Review-and-Analysis [https://perma.cc/R8V2-UZ6G] (graphing the amount of settlement dollars awarded in class action suits and providing the number of class actions in each year from 2008 until 2017).

102. If the fees are not enough to compensate a claims administrator for its fees in setting up this new system, a court would be justified in authorizing higher fees to spur this market change.

First, one of the traditional claims administration companies could automate its processes with the goal of stealing market share from its competitors. Right now, these companies all use the same basic system to distribute settlement funds,[103] which makes it difficult for any one company to distinguish itself in this market. These companies can try to compete on price, among other factors, but the plaintiffs' attorneys charged with choosing among claims administration companies do not pay this fee themselves. Instead, they receive a gross percentage of the settlement regardless of the amount of the claim administration fees. As a result, plaintiffs' attorneys are also motivated by the promise that the claims administration firm will distribute the settlement funds competently and without error. In a world of fairly standard prices and processes, claims administration firms do not have much room to distinguish themselves. A company that brings an innovative approach to its relationships with banks and brokers could disrupt this status quo and increase its own profits.

Second, a new entrant could offer these services. Broadridge Financial Solutions, Inc. ("Broadridge") is in a unique position to make this move. Broadridge has already developed a niche as a proxy intermediary,[104] working with banks and brokers to pass along proxy materials directly to their customers.[105] Prior to a corporation's annual meeting, banks and brokers send Broadridge a list of customers who own the corporation's stock.[106] Broadridge then works with the

These increased fees would come at the expense of class members in that particular lawsuit, but given the diversification of most investors, these class members would be compensated for these fees in future suits in which they have a far greater likelihood of receiving their pro rata shares of settlement funds.

103. *See, e.g.*, *The Role of the Claims Administrator in Securities Class Action Settlements*, *supra* note 44 (describing the process used by claims administrators).

104. At least annually, corporations must send proxy materials to their shareholders, providing them with detailed information on the matters up for a vote at the annual shareholder meeting and soliciting their proxy for these votes. 17 C.F.R. § 240.14a-3 (2019). As discussed above, corporations do not have complete lists of their shareholders, so they used to have to reach out to every bank and brokerage house to find out the number of their customers who owned the corporation's securities. The corporation would then pass along that number of proxy statements to the banks and brokers, and the banks and brokers would in turn pass them along to their customers. Broadridge's services have obviated the need for corporations to engage in this time-consuming process on their own.

105. *See, e.g.*, *Proxy Management*, BROADRIDGE FIN. SERVS., https://www.broadridge.com/financial-services/capital-markets/streamline-trade-support-services/proxy-management? (last visited Nov. 8, 2019) [https://perma.cc/TS9B-NWTT]. Broadridge "dominates" proxy distribution, with "98% of the market." Donald, *supra* note 73, at 71.

106. *See* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1244–45 (2008) (explaining the "critical role" held by Broadridge because of its access to information regarding the identities of the corporate shareholders).

corporation to pass along the proxy materials.[107] The process feels seamless for corporations, as well as for banks and brokers, because Broadridge has created an automated system to handle most of the logistics.

Broadridge could expand its services to include claims administration in securities litigation.[108] This expansion would require Broadridge to increase the data that it collects. Under its current practices, Broadridge does not have a record of customers' individual transactions. The data that it receives from banks and brokers only provides the names and addresses of investors who owned stock in a given corporation as of the record date.[109] Broadridge, however, could leverage the relationships it has built in the proxy context to obtain this additional data. Or another company with entrepreneurial aspirations in this area could develop these relationships much the same way that Broadridge did when it first developed its niche in the proxy market.

Finally, courts could take the lead in overhauling this system by appointing a special master paid out of the settlement fund to oversee the distribution of these funds. This approach would mirror one used by the SEC in a few of its own enforcement actions. For example, in 2006, the SEC reached a settlement with two companies called Columbia Management Advisors, Inc. and Columbia Funds Distributor, Inc. (collectively, "Columbia"), which the SEC claimed had engaged in undisclosed market-timing arrangements.[110] As part of the settlement, Columbia agreed to pay $140 million into a fund that would compensate injured investors.[111] When it came to distributing the $140 million to Columbia's investors, the SEC could have used a process similar to the

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107. *See id.* at 1245–46 ("Once the issuer has identified its beneficial owners, it must provide each custodian with sufficient copies of the proxy packet (proxy cards, annual report, and proxy statement). . . . Typically, Broadridge performs all of these tasks as an agent for the custodians.").

108. Broadridge currently has a small division devoted to securities class action settlements. *See Global Securities Class Action Services*, BROADRIDGE FIN. SERVS., https://www.broadridge.com/financial-services/wealth-management/wealth/advance-control-risk-and-support-services/global-securities-class-action-services (last visited Nov. 8, 2019) [perma.cc/9K86-2GPS]. It has mostly focused on helping investors claim their shares of settlements. It has not tried to automate the system as a whole.

109. *See, e.g.*, Pac Rim Cayman LLC v. Republic of El Salvador, ICSID Case No. ARB/09/12, Witness Statement of Charles Pasfield, ¶ 10 (Mar. 2, 2011), https://www.italaw.com/sites/default/files/case-documents/ita0612.pdf [https://perma.cc/G4G6-V9WL] (stating that "[w]hen a corporate issuer needs to communicate with its beneficial owners," Broadridge collects "the name, address, and number of securities held for each beneficial owner" from the banks and brokers).

110. *See* Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Columbia Mgmt. Advisors, Inc., Securities Act Release No. 8534, Exchange Act Release No. 51164, Investment Advisers Act Release No. 2531, Investment Company Act Release No. 26752 (Feb. 9, 2005).

111. *See id.* § IV.E.

one typically used in securities class actions. In other words, the agency could have hired a claims administrator, distributed notice of the settlement, and required Columbia's investors to fill out lengthy claim forms documenting their losses. Indeed, this is the normal process for distributing Fair Funds proceeds in SEC enforcement actions.[112]

Instead, however, the SEC hired an outside expert—Professor Lawrence Hamermesh—as an Independent Distribution Consultant ("IDC") to develop a distribution plan.[113] Professor Hamermesh and his team directly reached out to banks and brokers and asked them which of their clients had invested in the Columbia funds.[114] They also requested specific information about these investments.[115] After receiving this information, the SEC then distributed the appropriate portion of the settlement proceeds to individual investors, billing the cost of this process to the defendants.[116] According to the SEC, this outreach "obviat[ed] any need for a claims process."[117]

This approach was undoubtedly more time-consuming for the SEC, as the IDC and the experts hired by the IDC had to contact individual banks and brokers to obtain the necessary information. Yet this investment of time and resources meant that all Columbia investors injured by the alleged fraud received their pro rata share of the settlement fund. In addition, if there is related litigation filed against the same company, an IDC could use the same process to distribute settlement funds in these other lawsuits, creating economies of scale. If the company paid settlements in both a securities class action and an SEC enforcement action, for example, the IDC could reduce the cost of the claims administration process by using the same data to distribute both settlement funds.

In short, a variety of market players—including traditional claims administrators, Broadridge, and special masters hired by the court—could potentially take the lead in automating the claims

112. *See, e.g.*, Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 343 (2015) (describing the process that the SEC uses to distribute Fair Funds).

113. Proposed Plan of Distribution ¶¶ 1.1, 7.2, Columbia Mgmt. Advisors, Inc., Admin. Proc. File No. 3-11814 (2016), https://www.sec.gov/litigation/admin/2006/34-54175-pdp.pdf [https://perma.cc/S6XD-LL5F].

114. *See id.* ¶ 7.6 (discussing distribution to omnibus and retirement accounts in the case).

115. *See id.*

116. *See* Proposed Plan of Distribution, *supra* note 113, ¶¶ 7.6–7.7 (explaining that omnibus account holders could provide customer information to the IDC or distribute the funds themselves, while retirement holders had to distribute the funds in accordance with their contractual and statutory obligations).

117. Order Approving a Distribution Plan at 2, Columbia Mgmt. Advisors, Inc., Exchange Act Release No. 55598 (Apr. 6, 2007).

administration process, and these players could make money by doing so. As we will see, however, they cannot do it alone.

3. Legal Support of Market Innovation

Even if claims administrators are eager to overhaul their practices, they cannot automate the claims administration process without help. Market innovation will not happen unless courts or other lawmakers provide legal support for these changes. At the very least, claims administrators need courts to order banks and brokers to provide them with the relevant transaction data and contact information for their clients. Ideally, however, they would also help drive reforms in this area, asking the hard questions that could prompt a review of long-standing practices.

The history of reform in the proxy area is illustrative. As discussed above, Broadridge overhauled the proxy system by working with banks and brokers to pass along proxy materials directly to their customers.[118] Yet Broadridge did not rely on charm alone to convince banks and brokers to turn over customer data. Instead, Broadridge was able to get this data from banks and brokers because SEC rules required them to share it with Broadridge.[119] The SEC also required issuers to pay for these banks' and brokers' proxy-related expenses, which further encouraged these institutions to work with Broadridge.[120] When it comes to the claims administration process, it would not be technologically difficult for a private company to work with banks and brokers to obtain the customer data needed to distribute settlement funds. The challenge comes in giving banks and brokers a legal incentive to cooperate with whatever private company leads these efforts.

Lead plaintiffs and their counsel are unlikely to drive any changes in this area because they have a conflict of interest when it comes to the distribution of settlement funds. Right now, settlement funds are divided among the relatively low percentage of shareholders who file a claim, a group that presumably includes the lead plaintiff.[121] If the system is automated, however, these same funds will be divided among all class members who can be identified through bank and broker records. This change would benefit class members who would not file a claim under the current system because they currently get no financial benefit from the settlement. In contrast, shareholders who

118. *See* discussion *supra* notes 104–109 and accompanying text.
119. 17 C.F.R. § 240.14b-1 (2019).
120. 17 C.F.R. § 240.14b-2 (2019).
121. *See supra* Section I.B.

already participate in settlements are financially better off filing claims under the current, more burdensome system and hoping that their fellow class members are not willing to jump through the same administrative hoops.[122]

Their attorneys are also unlikely to push for reform. In theory, lead counsel is supposed to protect the entire class, not just the lead plaintiff and other participating class members.[123] As scholars have long recognized, however, they do not have the right financial incentives to fulfill these fiduciary obligations when it comes to distribution of the settlement fund.[124] Lead counsel receives no financial benefit from improving how settlement funds are distributed. Their contingency fee depends on the total value of the settlement, not on how the settlement is allocated.[125] As a result, they are at best indifferent to this stage of the process. In many cases, however, lead counsel may have a financial incentive to *oppose* automation. Under the PSLRA, institutional investors are law firms' ticket into securities class actions.[126] As discussed above, institutional investors who regularly participate in these suits will not want their attorneys to press for automation because it will reduce their personal recoveries. A law firm that alienated its institutional clients would find it much more difficult

122. To understand this point, return to the example of a securities class action that settles for $50 million. Imagine that the total damages of the class are $1 billion and that the lead plaintiff has damages of $10 million. Under the current system, perhaps twenty percent of claims totaling $200 million would be filed because most class members will not jump through the logistical hoops of tracking down their transaction data and filing a claim. This claims rate means that each class member who files a claim will receive twenty-five percent of damages claimed. The lead plaintiff will therefore receive $2.5 million.

Under an automated claims administration system, however, the lead plaintiff's share of the settlement fund would likely fall dramatically. The lead plaintiff would no longer be sharing the settlement with the twenty percent of class members who filed claims. Instead, they would be sharing the settlement fund with the close to one hundred percent of class members who can be identified through bank and broker records. This increased participation means that each class member would receive approximately five percent of damages claimed. Under the example above, the institutional lead plaintiff will now receive $500,000, or twenty percent of its recovery under the current system.

123. FED. R. CIV. P. 23(g)(1)(B). Courts have recognized that, in carrying out this obligation, the interests of the class may diverge from the interests of the named plaintiff and that in such instances the duties run to the class as a whole, not to the named plaintiff or any other specific class members. *See, e.g.*, Walsh v. Great Atl. & Pac. Tea Co., 726 F.2d 956, 964 (3d Cir. 1983).

124. *See* Charles Silver, *Merging Roles: Mass Tort Lawyers as Agents and Trustees*, 31 PEPP. L. REV. 301, 317 (2003) (noting that "lawyers always incur conflicts when recommending settlement allocations").

125. *See, e.g.*, Bruce L. Hay, *The Theory of Fee Regulation in Class Action Settlements*, 46 AM. U. L. REV. 1429, 1440, 1470 (1997) (explaining that, under a system that caps fees, such as a contingency fee model, "the counsel is largely indifferent to the distribution of the settlement recovery").

126. 15 U.S.C. § 78u-4(a)(3)(B)(v) (2012) (providing that the lead plaintiff "shall, subject to the approval of the court, select and retain counsel to represent the class").

to win lead counsel fights. As a result, law firms that want to hold onto their clients are unlikely to press for changes in how settlement funds are distributed.[127]

Instead, if change is to come to the claims administration process, it will need to be driven by courts or other lawmakers. They will have to be the ones to inquire into automation or create incentives for attorneys to automate. And yet these groups face their own disincentives to overhaul the process. Under the current system, judges have little involvement in how settlement funds are distributed.[128] Lead counsel typically presents the judge with the settlement agreement and a proposed plan of allocation; the judge generally approves it without much inquiry. It is quite rare for judges to question the attorneys about the details of these documents or to require changes to them.[129] This hands-off approach results in part because claims distribution comes at the very end of the case, when everyone involved is ready for the case to be over. As one scholar stated, "[L]itigation warfare is news; peace is an afterthought."[130] If judges are unwilling to ask basic questions about settlement terms, they are likely to be even less willing to take the lead in overhauling how settlement funds are distributed.

Moreover, even if judges wanted to change the procedures involved in claims administration, they face structural impediments in doing so. Automating the claims administration process requires sophisticated financial and technical knowledge. Judges will have to understand the complicated ways in which securities are transferred and held in the financial markets, as well as the technologies involved in obtaining customer data from banks and brokers, calculating settlement claims, and distributing funds directly to class members. A

127. This analysis is not meant to impugn the integrity of these law firms. Some law firms may well support automation despite these potential costs, recognizing that their duty is to the class, not to the lead plaintiffs. Yet it would be hard for any firm to ignore the very real risk that automation could drive away their client base. *See, e.g.*, McGovern, *supra* note 19, at 65 ("It is not uncommon, therefore, to see counsel satisfied with a low claiming rate because the proportionate payments to each claimant will be higher.").

128. There are, however, a few well-known examples of judges who have chosen to be far more involved in the settlement process. *See, e.g.*, Alexandra Lahav, *Fundamental Principles for Class Action Governance*, 37 IND. L. REV. 65, 113 (2003) (discussing Judge Jack Weinstein of the U.S. District Court for the Eastern District of New York as the "most prominent example of the expansive role a judge might play in settling class action litigation, its pitfalls and possibilities").

129. *See, e.g.*, Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377 (2011) (arguing that judges are not "doing their jobs" when it comes to scrutinizing settlements in securities class actions).

130. Kenneth R. Feinberg, *Democratization of Mass Litigation: Empowering the Beneficiaries*, 45 COLUM. J.L. & SOC. PROBS. 481, 481 (2012).

judge presented with a plan for automation that outlines these details may well not feel competent to evaluate them.[131]

Automation is also risky, especially in the beginning when courts and claims distribution companies are figuring out the kinks. Judges will have to contend with data security issues, which they may not understand very well. They will also have to think through the possibility of fraud, which is a real risk given that millions of dollars are on the line.[132] And they will have to ensure that the funds are sent to the right bank accounts and physical addresses. In short, a process that judges can largely ignore right now will suddenly take up a lot of time and create a risk of significant problems.[133]

Where do these challenges leave the automation process? At a minimum, it means that judges are unlikely to lead this effort. Instead, they are more likely to be in a position of reacting to the proposals of other players in the settlement process—namely, private companies hoping to make money by introducing a new claims distribution model. If these companies can convince judges that the risks are relatively small, judges may acquiesce, but the private market will have to do most of the heavy lifting.

Recent amendments to Rule 23(e) of the Federal Rules of Civil Procedure may make it easier for private companies to convince judges that they need to pay more attention to the claims administration process. Rule 23 used to be silent on the distribution of settlement funds in class actions.[134] The new version, however, provides that a court must consider "the effectiveness of any proposed method of distributing relief to the class, including the method of processing class-member claims, if required."[135] New best practices also emphasize that, in requesting approval for class action settlements, "[t]he parties should describe the proposed plan for equitably and reasonably distributing the settlement

131. *See, e.g.*, William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. REV. 1435, 1470 (2006) (stating that "judges are for the most part generalists, handling all forms of cases and encountering class action settlements only occasionally," which makes it difficult for them to develop a nuanced understanding of how the law works in particular settings).

132. *See infra* Section III.B.

133. *Cf.* Howard M. Erichson, *Aggregation as Disempowerment: Red Flags in Class Action Settlements*, 92 NOTRE DAME L. REV. 859, 907–08 (2016) ("U.S. judges, steeped in the adversary system, are ill-equipped for the inquisitorial judging required for careful review of class settlements.").

134. Not only did the text of Rule 23 itself not mention claims administration, but the judicial standards for reviewing settlements also did not mention this issue. *See, e.g.*, Lahav, *supra* note 128, at 86 (discussing the standards that courts used to review settlements under Rule 23(e)).

135. FED. R. CIV. P. 23(e)(2)(C)(ii).

funds to class members."[136] For the first time, therefore, the rules and accompanying guidance to judges stress that they should pay close attention to how class action settlements are distributed. These amendments provide a window of opportunity for private companies seeking to disrupt this market.

Finally, private companies should make it as easy as possible for judges to support automation. For example, rather than asking judges to oversee every detail of a new claims administration process, judges could outsource this oversight to a special master. Alternatively, they could create incentives for class counsel to explore automation on their own. Current rules do not require class counsel to report back to the judge on the claims distribution process, including the percentage of class members who filed claims.[137] Additionally, contingency fees typically do not depend on how many class members file claims. Judges could change these incentives by requiring class counsel to file a detailed report outlining the percentage of class members who filed claims, as well as specific efforts to maximize this figure. They could even go one step further and hold back a portion of the fee until class counsel is able to get a certain percentage (such as fifty percent or more) of class members to file claims.[138]

Alternatively, the SEC could take the lead. The next Section addresses how the SEC could use its own data to automate the claims distribution process, but the SEC could also adopt rules requiring banks and brokers to provide claims administrators with the relevant data, similar to what the SEC has done in the proxy context. Unlike judges applying ad hoc oversight, the SEC could use the rulemaking process to study the claims administration process more systematically and develop rules that guard against data breach and fraud. It could also begin monitoring the impact of these rules to ensure that they are functioning effectively.

The SEC could also play a role in solving a slightly different problem. The process outlined in the prior Section in which banks and

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136. *Guidelines and Best Practices: Implementing 2018 Amendments to Rule 23 Class Action Settlement Provisions*, BOLCH JUD. INST., DUKE LAW SCH. 10 (2018), https://judicialstudies.duke.edu/wp-content/uploads/2018/09/Class-Actions-Best-Practices-Final-Version.pdf [https://perma.cc/D9TC-CTK4].

137. *See, e.g.*, Lahav, *supra* note 128, at 87–88 ("[N]either the Rules nor most courts require the parties to report on the ultimate payout at the end of settlement administration.").

138. Scholars have made this suggestion in the mass tort context, where many of these same issues arise. *See, e.g.*, Elizabeth Chamblee Burch, *Monopolies in Multidistrict Litigation*, 70 VAND. L. REV. 67, 148 (2017) (recommending that judges "should require parties to submit an accounting statement" that describes, among other things, "how the settlement funds were allocated" and "the number of plaintiffs who submitted claims" and then should award attorneys' fees based on "a percentage of plaintiffs' actual recovery, not the fund itself").

brokers provide claims administrators with relevant transaction data would work well for investors who trade directly through a bank or broker. Complications arise, however, when it comes to mutual funds or other types of funds in which investors' money is pooled and these pooled funds are used to purchase securities. For pooled funds, even if claims administrators receive customer data directly from banks and brokers, this data will only show the funds' investments, not the pro rata interests of those invested in the funds.

If fund investors remained the same over time, this structure would not pose a problem in the settlement process. Claims administrators would simply send the settlement money to the funds and the individual investors would indirectly receive their shares of the settlement as a result of their continuing investment in the fund. The challenge, however, is that settlements typically come years after the underlying fraud, and in the intervening years, the individual investors in specific funds often change. As a result, simply depositing settlement money into the funds will provide a windfall to investors who joined the fund after the fraud and leave uncompensated those who left the fund before the settlement.

In discussing these challenges, Professors Cox and Thomas stated that "[i]deally, we would want to have any recovery that the fund makes credited to the accounts of those persons that held interests in the fund at the time of the loss suffered in proportion to their share of those losses."[139] What their survey of large, institutional investors actually found was that the funds either deposited settlement money into the specific portfolio fund that suffered the loss or into the fund's general account. No funds distributed the money to the accounts of specific investors.[140] As Professors Cox and Thomas noted, funds likely take this approach to avoid "complex calculations about who the particular beneficiaries were at that point in time and what percentage of the recovery they were entitled to receive."[141]

The data, however, exists to automate this part of the system as well. Investment funds know which of their clients had money in the impacted funds; this data should be in the funds' electronic files. In a world of increasing data sophistication, it should not be overly difficult for investment funds to provide claims administrators with the names and contact information of those investors who were invested in the funds during the class period. The challenge is that these funds have no obligation to provide claims administrators with this data. Nor do they

139. Cox & Thomas, *supra* note 8, at 437.
140. *Id.* at 438.
141. *Id.* at 437–38.

have any clear obligation to pass along settlement money to those investors who lost money.[142]

The SEC could help with this part of the puzzle as well. The next Section discusses how the SEC can take more sweeping action to overhaul the claims administration process by using its own data, but the SEC could also spur the changes discussed in this Section. Specifically, it could adopt a rule requiring investment funds to pass along settlement money to the beneficial investors who were injured by the fraud, at least if their pro rata amount is more than a nominal amount. Alternatively, it could require these funds to provide claims administrators with transaction data for their beneficial investors, allowing the administrators to distribute the settlement money directly to these investors. Either approach would allow claims administrators to fully accomplish their goal of distributing settlement funds to all investors injured by the underlying fraud.

The SEC may not be eager to take up these issues, however. The agency has its own agenda when it comes to investor protection, and it may not want to put institutional energy and resources toward reforming the claims administration process. Indeed, the SEC tends to be fairly hands-off when it comes to private enforcement of the federal securities laws, with limited exceptions.[143] On the other hand, securities class actions often target the same underlying misconduct as SEC civil enforcement actions, and the SEC has stated that securities class actions provide "valuable and necessary additional deterrence against securities fraud . . . supplementing the [SEC's] own enforcement activities."[144] Given the SEC's stated mission to "protect investors,"[145] it

142. These funds may have a fiduciary duty to distribute settlement funds to beneficial investors injured by the fraud. *See, e.g.*, James D. Cox & Randall S. Thomas, *Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?*, 80 WASH. U. L.Q. 855, 860–67 (2002) (discussing the fiduciary duties of mutual funds and other investment companies). Nonetheless, this duty alone has not changed the funds' underlying practices. *See* Cox & Thomas, *supra* note 8, at 438–39 (finding a "widespread failure to file claims in securities fraud class actions" among institutional investors).

143. *See* 15 U.S.C. § 77n (2012) (invalidating "[a]ny . . . provision binding any person . . . to waive compliance with any provision" of the securities laws); *see also* 15 U.S.C. § 78cc(a) (2012) (invalidating "[a]ny . . . provision binding any person to waive compliance with any provision" of the securities laws or "any rule of a self-regulatory organization").

144. *Concerning the Impact of the Private Securities Litigation Reform Act of 1995*: *Hearing Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 105th Cong. 3 (1997) (statement of Arthur Levitt, Chairman, United States Securities and Exchange Commission); *see also* Dain C. Donelson et al., *The Role of Directors' and Officers' Insurance in Securities Fraud Class Action Settlements*, 58 J.L. & ECON. 747, 775 (2015) (stating that "the United States relies on private enforcement as a complement to public enforcement, particularly for securities regulation").

145. *The Role of the SEC*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/basics/role-sec (last visited Nov. 8, 2019) [https://perma.cc/FX3F-YBR4].

is not a stretch to think that the SEC should offer some regulatory assistance in this area. As we shall see, however, the SEC can do even more by opening its own databases to claims administrators.

B. Automating Through Regulation

The second option for automating the distribution of settlement funds in securities class action relies on the SEC's plan for a new database to track activity in the securities markets. As discussed in Part I, the current hurdles in the claims administration process result from the fact that there is no central database that tracks all purchases and sales in a given company's securities.[146] Yet the SEC is in the process of creating exactly this type of database. The SEC's plan for a Consolidated Audit Trail ("CAT") will contain all of the information needed to automate the claims distribution process in securities class actions. This Section provides an overview of the CAT, explaining how it can be used to distribute settlement funds. It then discusses the institutional challenges involved in using data from the CAT in this way.

1. The SEC's New Data Opportunity

Although not up and running yet, the CAT will soon allow regulators to track all securities activity in the U.S. financial markets. The desire for the CAT arose out of the so-called Flash Crash in 2010, in which $1 trillion of value disappeared from the securities markets in less than 30 minutes because of high frequency trades that went awry.[147] Following the Flash Crash, the SEC decided that it needed greater surveillance and control over the financial markets.[148] In August 2012, it promulgated Rule 613, which required self-regulatory organizations ("SROs") and the Financial Industry Regulatory Authority ("FINRA") to jointly submit a plan to create, implement and

146. *See supra* Section I.B.2.

147. Press Release, Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Statement on Status of the Consolidated Audit Trail (Nov. 14, 2017), https://www.sec.gov/news/public-statement/statement-status-consolidated-audit-trail-chairman-jay-clayton [https://perma.cc/VP9A-47GP] (stating that the SEC adopted Rule 613 "in the wake of the 2010 'Flash Crash' ").

148. *See id.* (stating that the CAT was developed to provide regulators with better oversight of securities markets); *see also* Rachel E. Barkow, *The New Policing of Business Crime*, 37 SEATTLE U. L. REV. 435, 454 (2014) (analogizing the CAT to street crime policing and stating that "the consolidated audit trail will be a way for the SEC to gain access to more streets so that its own cops can directly observe the activity there and analyze the information to make better use of its resources").

maintain the CAT.[149] These players subsequently developed the CAT National Market System ("NMS") Plan,[150] a 267-page document that outlines in great specificity the plans for the CAT.

Once operational, "the CAT will be the world's largest data repository for securities transactions."[151] It will track approximately fifty-eight billion records every day—including orders, executions, and quote life cycles[152]—and this number is projected to increase rapidly over time.[153] For each transaction, the CAT will record the buy/sell price, the number of shares involved, and the date and time (down to the millisecond) that the trade occurred.[154] The CAT will also give all investors a unique customer identifier that will be used consistently across all banks and brokers reporting into the CAT.[155] For individual clients, this identifier will be linked to the customer's name, address, date of birth, and social security number.[156] For institutional clients, the identifier will be linked to their name, address, and employer identification number or legal entity identifier.[157] This linking will give regulators the ability to track the transactions of individual customers across different banks and brokers.[158]

This is exactly the data that claims administrators are currently lacking. The entire claims administration process is designed to

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149. 17 C.F.R. § 242.613 (2019).

150. *See Limited Liability Company Agreement of CAT NMS, LLC*, CONSOLIDATED AUDIT TRAIL, https://www.catnmsplan.com/wp-content/uploads/2018/02/34-79318-exhibit-a.pdf (last visited Nov. 8, 2019) [https://perma.cc/3AQC-P3LM] [hereinafter *CAT NMS Plan*].

151. *SROs Launch Study to Analyze Implementation Cost of the Consolidated Audit Trail*, CONSOLIDATED AUDIT TRAIL 2 (June 23, 2014), https://www.catnmsplan.com/wp-content/uploads/2017/03/p534383.pdf [https://perma.cc/R2ZH-YAWA].

152. *Id.* at 2.

153. *See, e.g.*, Yesha Yadav, *The Failure of Liability in Modern Markets,* 102 VA. L. REV. 1031, 1086 (2016) (stating that the volume of data from the equities, options, futures, and indexes increased fourfold in a single year).

154. 17 C.F.R. § 242.613(c)(7) (listing the information that must be included in the CAT plan); *CAT Reporting Technical Specifications for Industry Members,* THESYS CAT 20–63 (Oct. 30, 2018), https://www.catnmsplan.com/wp-content/uploads/2018/10/Industry-Member-Tech-Specs-Order-Events-v1.0.pdf [https://perma.cc/U9AA-NRMU] (outlining the technical data that must be submitted for various types of orders and trades).

155. *See CAT NMS Plan*, *supra* note 150, app. C at 7–9 ("[T]he CAT NMS Plan must require each CAT Reporter to record and report 'Customer-ID(s) for each customer' when reporting to the CAT order receipt or origination information."). Under Rule 613(j)(3), the term "customer" includes "(i) The account holder(s) of the account at a registered broker-dealer originating the order; and (ii) Any person from whom the broker-dealer is authorized to accept trading instructions for such account, if different from the account holder(s)." 17 C.F.R. § 242.613(j)(3).

156. *CAT NMS Plan, supra* note 150, § 1.1.

157. *Id.*

158. *See* 17 C.F.R. § 242.613(c)(8), (j)(5) (requiring all CAT plan sponsors and members to "use the same Customer-ID and CAT-Reporter-ID for each customer and broker-dealer" and defining Customer-ID as "a code that uniquely and consistently identifies such customer for purposes of providing data to the central repository").

recreate this data by collecting claim forms from those who purchased or sold the relevant company's securities during the class period. Soon, however, this information will be readily available from the CAT. The exact timing of the CAT rollout is unclear. Certain market participants were supposed to start reporting into the CAT in November 2018,[159] but they missed this deadline. The SROs and FINRA proposed a new timeline that would delay the start of this reporting until the fall of 2019,[160] and the SEC tentatively accepted this new timeline.[161] In late January 2019, however, the stock exchanges fired the company hired to build and oversee the CAT,[162] and it is unclear whether this development will further delay the CAT timeline.

Whenever banks and brokers start reporting into the CAT, this data will be more accurate than other forms of transactional data currently available to the SEC and other market regulators. Take the blue sheets, for example. Federal law requires broker-dealers to assist the SEC and other regulatory agencies upon request by providing these agencies with information concerning transactions by their clients who bought or sold a given security during a specified review period.[163] This system, commonly known as the "electronic blue sheet" or "EBS" system, assists the SEC in conducting market timing and insider trading investigations.[164] In practice, however, blue sheet data is often incomplete, inaccurate, or both.[165] As a result, the SEC does not rely on

159. *See Industry Update on the Consolidated Audit Trail,* CAT NMS, LLC OPERATING COMM. 9 (June 28, 2018), https://www.catnmsplan.com/wp-content/uploads/2018/06/CAT-Industry-Webcast-6.28.18.pdf [https://perma.cc/4F9P-QDR7] ("Currently . . . the CAT NMS Plan state[s] that each Participant must require its Industry Members . . . to report . . . by November 15, 2018.").

160. *Id.* at 4.

161. *See* Brett Redfearn, *Statement on the Status of the Consolidated Audit Trail,* U.S. SEC. & EXCHANGE COMMISSION (Aug. 27, 2018), https://www.sec.gov/news/public-statement/tm-status-consolidated-audit-trail [https://perma.cc/D47U-3BZP] (recognizing the impracticability for industry members to report data to the CAT while the CAT has not been sufficiently developed).

162. Dave Michaels, *Stock Exchanges to Fire Company Building Stock-Market Supercomputer*, WALL ST. J. (Jan. 31, 2019), https://www.wsj.com/articles/stock-exchanges-to-fire-company-building-stock-market-supercomputer-11548956486 [https://perma.cc/YZK5-YFJ9].

163. *See* 17 C.F.R. § 240.17a-25 (2019) (requiring all exchange members, brokers, and dealers to, upon request, provide to the SEC information regarding the transaction date; price; number of shares; account number; and customer's name, address, and tax identification number for trades that she effectuates).

164. Electronic Submission of Securities Transaction Information by Exchange Members, Brokers, and Dealers, Exchange Act Release No. 44,494, 66 Fed. Reg. 35,836 (June 29, 2001) (to be codified at 17 C.F.R. pt. 200, 240).

165. *See, e.g.*, Michael Drews, *Capco: Blue Sheet Blues - Regulators Renewed Interest in Total Transparency*, RISKTECH F. (Aug. 1, 2014), http://www.risktech-forum.com/opinion/capco-blue-sheet-blues-regulators-renewed-interest-in-total-transparency [https://perma.cc/HE6P-TVB5] (quoting a securities market insider as stating, "Over and over we are seeing feeds from various source systems and mapping tables not being thoroughly documented, causing data attributes to be inadvertently dropped from regulatory reporting obligations, including Electronic Blue

it in distributing Fair Funds recoveries, although it has on occasion given blue sheet data to claims administrators to use as a starting point in their process.[166] The CAT will be a much-needed upgrade of the blue sheet data, centralizing it in a single database with a uniform system of recordkeeping.

Using this data to automate the distribution of settlement funds in securities class actions would not be difficult. The CAT is essentially a giant spreadsheet with the equivalent of separate rows for various securities and separate columns for various details about individual transactions in these securities. Following a settlement in a securities class action, the SEC could provide data from the relevant rows and columns to the claims administrator, so the claims administrator would know who purchased or sold the securities during the class period and at what price. The claims administrator could then run this data through the damage models in the plan of allocation to calculate each class member's pro rata share of the settlement fund. Once the claims administrator has made these calculations, it can send each class member notice of her share of the fund using the contact information contained in the CAT.[167] Similar to the market automation approach discussed previously,[168] the class members would then have an opportunity to opt out of the class action. If they did nothing, however, they would automatically receive their pro rata shares of the settlement fund.

Sheets, . . . leading to suppression of reportable trades, incomplete reporting and inaccurate values"). This critique was repeated to me in interviews with current and past SEC officials, and SEC and FINRA have brought several actions over the past five years against banks and brokers who have not maintained accurate blue sheet data. *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC: Citigroup Provided Incomplete Blue Sheet Data For 15 Years (July 12, 2016), https://www.sec.gov/news/pressrelease/2016-138.html [https://perma.cc/SX6J-LNVD] (imposing a $7 million penalty on Citigroup and listing fines against other companies that similarly maintained inaccurate blue sheet data).

166. I confirmed this point with a past SEC employee as well as claims administrators. According to the claims administrators, they have occasionally been given blue sheet data when assisting with distribution of Fair Funds settlements, but they do not have access to it in private securities class actions. Even in the Fair Funds cases, however, the SEC instructs the claims administrators only to use this data as a starting point. In other words, the claims administrators can send claim forms to investors identified in the blue sheet data, but upon receipt of these forms, the investors must still fill them out and send the claims administrators documentation of their trades. As a result, the settlements are still opt-in.

167. One concern with such notice is that the bank or broker's contact information may not always be accurate, especially if the settlement occurs several years after the relevant transactions. Investors may have moved; others may have closed or transferred their accounts. Nonetheless, even if this automated process does not work one hundred percent of the time, it will still significantly increase the percentage of class members who receive their share of settlement funds.

168. *See supra* Section II.A.

This approach would require the SEC to address how more complex forms of share ownership should be handled in the claims administration process. The current process of distributing settlement funds assumes that each class member controls her own shares, including the voting and economic rights associated with those shares. Today, however, the bundle of rights associated with share ownership can be split among multiple investors. For example, investors can purchase the voting rights of shares, but not the economic rights.[169] They can also engage in share lending and borrowing, as well as hedging transactions that reduce their financial risk in a given security.[170]

These new forms of share ownership raise difficult questions when it comes to the claims administration process. If an investor has lent stock to someone else, is the lender or the borrower entitled to the pro rata share of the settlement fund associated with this stock? Who decides whether the shares should opt out of the settlement? Similarly, if the investor has entered into hedging transactions that reduced her economic risk during the class period, should these transactions reduce her recovery in the class action? The claims administration industry has generally been able to avoid these questions because investors with such complex forms of investments tend not to file claims in securities class actions. However, in my conversations with claims administrators, one stated that the claims administration industry is just "whistling by the graveyard" with respect to these questions but will have to confront them eventually. If the SEC allows claims administrators to use CAT data, this day could come sooner rather than later.

Ultimately, the technological piece of this proposal would not be difficult. Although the CAT involves vast amounts of data, it would be relatively easy for the SEC to identify the data needed in a particular securities class action settlement and provide this data to the claims administrator. The claims administrators will have to decide how to handle more complex forms of stock ownership, but they will have to confront these issues sooner or later either way. The hard part, as we will see, is convincing the SEC that it should use CAT data in this way.

169. *See, e.g.*, Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811, 816 (2006) (stating that "[t]here are a number of ways to decouple votes from economic ownership"); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 778 (2005) ("Parties instead routinely utilize financial derivatives and structured finance techniques to reallocate various interests in the firm, including both residual claims and voting rights.").

170. Martin & Partnoy, *supra* note 169.

2. Incentives in SEC Regulation

The main impediment to this proposal is not the technology; it is the SEC. Although the SEC has not publicly commented on the use of CAT data in securities class actions, they are unlikely to support this proposal. As discussed above, the original purpose of the CAT is to allow regulators to identify and investigate illegal activities and to improve their analysis of market activities, especially those occurring on the dark web.[171] These goals are ambitious from a regulatory perspective, but they are also narrowly tailored to the SEC's investigative mission. The SEC has not approved use of CAT data for other purposes.

Even with its relatively narrow goals, however, the SEC has faced significant pushback on its plans to develop the CAT. Banks and brokers have protested that the CAT data will not be secure enough to protect their customer data and their proprietary trading platforms.[172] Indeed, these concerns, combined with the technological complexity of the CAT's reporting requirements, have now delayed the CAT launch by more than a year.[173] As a result, the SEC has resisted any effort to use CAT data in additional ways.

Yet the SEC has also indicated that it might be open to additional uses of the CAT in the future. In promulgating the initial rule authorizing creation of the CAT, for example, the SEC "requested comment on whether it should allow the Consolidated Audit Trail data to be made available to third parties, such as for academic research."[174] After evaluating the feedback, however, the SEC determined that "because the creation and implementation of the Consolidated Audit Trail is in the formative stage, and in light of commenters' concerns about the privacy and security of the information, the Commission believes it is premature to require that the NMS plan require the

171. *See* Consolidated Audit Trail, Exchange Act Release No. 67,457, 104 SEC Docket 748 (July 18, 2012).

172. *See, e.g.*, Declan Harty, *Wall Street Still Worries SEC's Massive Trading Database Could Be Hacked*, S&P GLOBAL MKT. INTELLIGENCE (Nov. 14, 2018, 12:17 PM), https://platform.mi.spglobal.com/web/client?auth=inherit#news/article?id=47923578&cdid=A-47923578-10282 [https://perma.cc/YQ53-U5G9] (stating that the CAT is "a holy grail for hackers" and "Wall Street is not yet satisfied with the security of a massive SEC trading database set to begin collecting investor data in the coming days"); *see also* Hal Scott & John Gulliver, *The SEC Plans to Collect Too Much Information*, WALL ST. J. (Oct. 2, 2017), https://www.wsj.com/articles/the-sec-plans-to-collect-too-much-information-1506983751 [https://perma.cc/5HEK-P79X] ("[A] breach could still be catastrophic. Broker-dealers would surely pull back from trading in response to the news that their proprietary trading strategies were no longer secure. The resulting volatility could require an indefinite marketwide shut down. That would deal an irreparable reputational blow to our markets.").

173. *See* Redfearn, *supra* note 161 (describing the delays in the rollout of the CAT).

174. Consolidated Audit Trail, Exchange Act Release No. 67,457, *supra* note 171, at 102.

provision of data to third parties."[175] In my own conversations with SEC staff, they stated that the CAT data might be used for additional purposes in the future, but that they need to get it up and running before they are willing to consider any additional uses.

The relevant rules and guidelines on the books do not prohibit the SEC from using CAT data in this way. Rule 613 provides that the SEC shall only have access to the CAT "for the purpose of performing its *respective regulatory and oversight responsibilities* pursuant to the federal securities laws, rules, and regulations."[176] The SEC's regulatory and oversight responsibilities include protecting investors injured by fraud. The SEC's Division of Enforcement, for example, has stated that one of its core principles includes "impos[ing] remedies that most effectively further enforcement goals," including "returning funds to harmed investors."[177] The SEC has also frequently lauded the importance of securities class actions in promoting these goals.[178] It would be somewhat odd if the SEC uses this new treasure trove of data only to catch investors engaged in illegal activity and not also to help law-abiding investors injured by others' misconduct.

The SEC could take a step in this direction by using CAT data to distribute settlement funds in its own enforcement actions. The SEC frequently imposes financial penalties on defendants in its enforcement proceedings. It also orders defendants to disgorge any ill-gotten gains.[179] The Sarbanes Oxley Act of 2002 allows the SEC to place this money into a Fair Fund for distribution to investors.[180] Since 2002, the SEC has distributed billions of dollars to investors through its Fair

175. *Id.* at 103.

176. 17 C.F.R. § 242.613(e)(2) (2019) (emphasis added). The CAT NMS Plan, which establishes detailed guidelines for the development and use of the CAT, similarly provides that the Commission shall have access to the CAT data "solely for the purpose of performing such Person's regulatory and oversight responsibilities pursuant to the federal securities laws, rules, and regulations or any contractual obligations." *CAT NMS Plan*, *supra* note 150, at § 6.1(u).

177. U.S. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT ANNUAL REPORT 4, 11 (2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf [https://perma.cc/B8WS-45YL].

178. *See, e.g.*, Robert J. Jackson, Jr., Comm'r, U.S. Sec. & Exch. Comm'n, Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration (Feb. 26, 2018), https://www.sec.gov/news/speech/jackson-shareholders-conversation-about-mandatory-arbitration-022618 [https://perma.cc/S5WS-8733] ("My colleagues in the Division of Enforcement do invaluable work every day protecting investors. But there are limits to what they can do . . . . So it comes as no surprise to me that shareholders are now working harder than ever to enforce our securities laws.").

179. *See, e.g.*, U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2017 AGENCY FINANCIAL REPORT 16 (2017), https://www.sec.gov/files/sec-2017-agency-financial-report.pdf [https://perma.cc/4VP2-GCKX] (stating that, in fiscal year 2017 alone, "the SEC obtained judgments and orders for over $3.8 billion in penalties and disgorgement").

180. 15 U.S.C. § 7246(a) (2012); *see also* 17 C.F.R. § 201.1100 (2019) (authorizing the creation of funds from disgorgement payments for the benefit of harmed investors).

Funds program.[181] Annually, the amount of money that the SEC distributes to investors through this program is larger than the agency's entire budget.[182]

Yet the SEC typically uses the same claims process used in securities class actions to distribute this money.[183] The SEC has not released data on the percentage of eligible investors who typically submit claims. It is fair to assume, however, that the same process that has such glaring problems in the securities class action context causes similar problems in Fair Funds cases.

The SEC could streamline this process by using CAT data to identify injured investors who are eligible for compensation from Fair Funds. As discussed above, the CAT includes all of the information necessary to calculate individual investors' losses and send them their shares of the settlement. The SEC could share the precise information needed for the claims distribution process with the claims administrator for the Fair Funds distribution. Alternatively, if the SEC does not want to share this sensitive data with an outside company, it could run the claims distribution process itself. If this process works effectively and an increased number of investors receive their share of the Fair Funds, perhaps the SEC will be motivated to expand the use of the CAT data into private securities class actions.

III. THE COMPLEXITIES OF AUTOMATION

The legal system has long struggled to distribute settlement funds in securities class actions to investors injured by fraud. But this problem has a simple solution—give claims administrators access to the data they need to automate the process. Banks and brokers have data on their own customers' transactions, and the CAT will soon have data on all securities transactions. If claims administrators had access to the relevant data from either of these sources, more shareholders would receive their shares of the settlement funds and no class member would have to go through the cumbersome process of submitting a claim.

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181. *See* Velikonja, *supra* note 112, at 332–33 ("Since 2002, the SEC has deposited $14.46 billion for defrauded investors into 243 distribution funds.").

182. *See id.*

183. See 17 C.F.R. § 201.1101(b)(6) (2019), which provides that a plan for distributing a Fair Fund must include, among other things:

> Procedures for the administration of the fund, including selection, compensation, and, as necessary, indemnification of a fund administrator to oversee the fund, process claims, prepare accountings, file tax returns, and, subject to the approval of the Commission, make distributions from the fund to investors who were harmed by the violation.

However, there are three possible complexities to using this data to automate the claims administration process, which this final Part will outline. First, it describes the likely reaction of lead plaintiffs and other large institutional investors who currently participate in these suits. Second, it lays out the steps that the legal system would need to take to guard against fraud. Finally, it outlines data security concerns that will likely arise if claims administrators receive access to detailed transaction data. Taken together, these complications mean that claims administrators and lawmakers should tread carefully when it comes to automating the claims administration process.

A. Lead Plaintiffs and Opt-Outs

Automating the distribution of settlement funds could have a dramatic impact on some investors' willingness to participate in securities class actions. Section II.A described how automation would likely reduce the money that many institutional investors currently receive from securities class action settlements.[184] To briefly repeat this point, under the current approach, settlement funds are still being distributed, just to a smaller pool of investors—the approximately thirty or forty percent of class members who file a claim.[185] If courts automate the distribution of these settlement funds, the same amount of money will be distributed among nearly one hundred percent of class members. As a result, automation will help those who do not currently receive their share of the fund, but it will hurt those who have traditionally filed claims.[186]

In Part II, this point helped explain why many institutional investors would not push for automation. Yet the impact of these changes on institutional investors could also affect their willingness to participate in these suits more generally. One study found that the primary factor in an institutional investor's decision to serve as lead plaintiff is the size of its loss and the corresponding size of the potential litigation recovery.[187] The study concluded that "[f]unds are concerned with the bottom line in pursuing litigation activism."[188] Institutional investors may lose interest in serving as lead plaintiff if their recovery

184. *See supra* Section II.A.3.

185. *See supra* Section I.B.

186. *See* Cox & Thomas, *supra* note 8, at 450 ("By letting billions slip through their fingers, institutions essentially enhance the amounts recovered by those investors who present their claims. That is, their slumbering actually enhances the compensatory quality of securities class actions for those who do file claims.").

187. Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 340 (2008).

188. *Id.*

shrinks significantly. If institutional investors become less likely to lead these lawsuits, many law firms could again rely on smaller investors to serve as lead plaintiff, which could reduce the institutional monitoring that Congress thought it was getting with the PSLRA.

Automation could also prompt some institutional investors to opt out of securities class actions altogether. As outlined in Part I, securities class actions are opt-out class actions, which means that individuals who fall within the class definition are still free to opt out of the class action and file their own individual lawsuits.[189] A study of opt-out rates by Cornerstone Research found that approximately three percent of securities class actions filed between 1996 and 2014 included at least one investor that excluded itself from the class to pursue a separate lawsuit.[190] An earlier study also found that the most significant "predictor of opt-outs is the dollar amount recovered per class member."[191] In other words, investors are more likely to file their own lawsuit if they think that they will end up with significantly more money from an individual lawsuit than if they stay in the class action. If automation dramatically increases the number of shareholders who share in the settlement fund, large institutional investors could see their recovery from these suits fall significantly, prompting an increased number of opt-outs.

Of course, not all institutional investors would stop participating in securities class actions. The Cox and Thomas study found that even the largest institutional investors are not very good at filing claims in these lawsuits,[192] so many will likely welcome a streamlined process to receive their share of settlement funds. Still, those institutional investors who already participate in class actions and receive their share of settlement funds may decide that they can make more money by filing their own individual lawsuits.

It is difficult to predict the impact of such an exodus. On one hand, it could hurt class actions because institutional investors have

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189. *See supra* Section I.A.

190. *See* AMIR ROZEN ET AL., CORNERSTONE RESEARCH, OPT-OUT CASES IN SECURITIES CLASS ACTION SETTLEMENTS: 2012–2014 UPDATE 2 (2016).

191. *Id.*; *see also* Choi & Fisch, *supra* note 187, at 332 ("Funds appear to believe that they will recover more money and receive payment more quickly when they opt out."); Jeffrey Paul Mahoney, Gen. Counsel, Council of Inst. Inv'rs, Navigating Alternatives to Securities Fraud Class Actions: State Law and Opt-Out Litigation, Remarks Before the Institute for Investor Protection Conference (Oct. 24, 2014), *in* 46 LOY. U. CHI. L.J. 459, 463–64 (2015) ("In general, it appears that the more material the amount of the estimated claim or damage is to the fund's assets under management, the more likely the fund will conclude that overall benefits of opting out exceed the costs to the fund, including the costs for extra time and resources often associated with pursuing an opt-out action.").

192. *See* Cox & Thomas, *supra* note 8, at 421–25 ("[O]n average, roughly 28% of eligible institutional investors file claims in these settlements.").

long been associated with better case outcomes and lower attorneys' fees.[193] If they start filing their own lawsuits, securities class actions could fall back into the hands of smaller, individual investors, which could reduce the quality of the suits.[194] At the same time, however, it is also possible that increased opt-outs could lead to greater overall recovery for shareholders, which could *increase* the deterrent effects of these suits. In short, changing settlement practices will have ripple effects, but it is impossible to predict their exact impact.[195] This does not mean that the legal system should cling to an antiquated system. Instead, judges and lawmakers should be attentive to these ripple effects to ensure that securities class actions function effectively.

B. Risk of Fraud

Claims administrators will also have to be on the lookout to prevent efforts to defraud the settlement process. Securities class action settlements are a multibillion-dollar business, and any changes to a system that involves this much money is likely to spark new efforts to get undeserved windfalls.

This is not a new concern in the claims administration business. Claims administrators have often had to adapt their methods to prevent fraud,[196] and they have spoken publicly about how the use of technology can increase the risk of fraud in this industry. As one example, in 2017, various app distributors agreed to pay $5.3 million to settle claims that

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193. *See* Stephen J. Choi & A.C. Pritchard, *Lead Plaintiffs and Their Lawyers: Mission Accomplished or More to be Done?*, *in* RESEARCH HANDBOOK ON SHAREHOLDER LITIGATION 271 (Sean Griffith et al. eds., 2018) (surveying the empirical evidence regarding the impact of institutional investors on securities class actions).

194. Alternatively, law firms may do even more to entice institutional investors to serve as lead plaintiffs, complicating an already ethically fraught market for institutional investor clients. *See, e.g.*, Stephen J. Choi et al., *Frequent Filers: The Problems of Shareholder Lawsuits and the Path to Reform*, U.S. CHAMBER INST. FOR LEGAL REFORM 10 (2014), https://www.instituteforlegalreform.com/uploads/sites/1/Frequent_Filers_Final_Version.pdf [https://perma.cc/JN3W-4V39] (noting that law firms have made campaign contributions to the directors of public funds in order to be named lead counsel); Coffee, *supra* note 20, at 310–11 (2010) (" '[P]ay-to-play' practices began to develop, because for the first time plaintiffs' law firms saw a reason to make political contributions to officials who controlled or at least influenced public pension funds.").

195. One possible approach is to permit greater incentive awards in securities class actions. Richard A. Nagareda, *Restitution, Rent Extraction, and Class Representatives: Implications of Incentive Awards*, 53 UCLA L. REV. 1483, 1484 (2006) (arguing that the PSLRA's restrictions on compensating lead plaintiffs is "odd" considering the fact that "other features of that legislation proceed upon—indeed, enshrine—the notion of high-quality monitoring by large institutional investors as class representatives").

196. *See, e.g.*, *Securities Class Action Cases*, HEFFLER CLAIMS GROUP https://www.hefflerclaims.com/securities/ (last visited Nov. 8, 2019) [https://perma.cc/23NM-VJBS] ("Heffler uses advanced fraud control processes in the administration of all securities class action settlements to reduce fraudulent claims and fraudulent distribution checks.").

they had improperly accessed data stored on Apple devices.[197] The settlement claims administrator, KCC Class Action Services, agreed to email notice of the settlement and instructions for filing claims to thirteen million potential class members whose contact information it received from the defendants.[198] It also agreed to publish this same information on Twitter.[199] In all, approximately ninety-one thousand claims were filed, including more than forty-six thousand claims that could be traced back to the Twitter announcement.[200] KCC later told the court that Twitter doubled the claims rate for the settlement,[201] reflecting the power of technology in this space.

Yet KCC also found that technology dramatically increased the rate of fraudulent claims. In an affidavit filed with the court, KCC detailed approximately six thousand Twitter-originated claims filed by bots that appeared to be fraudulent.[202] Approximately 5,400 of these suspicious claims were submitted from the same IP address, and nearly one thousand of the claims were from people who purported to live in the same single-family home in Toledo, Ohio.[203] This revelation prompted the judge to refer the suspicious claims to the local U.S. Attorneys' office for investigation.[204] A class action notice expert told Reuters News that he is worried that claims administrators, which are facing significant market pressure, "don't have the resources to keep up with the bots" in cases like these. "We've created a very difficult challenge," he observed. "The risk is great that we're not catching this."[205]

It is difficult to predict exactly how automation would affect the risk of fraud in securities class actions. On one hand, automation would likely eliminate at least some fraudulent practices. Right now, individual investors file claims by sending in documentation of their

197. Plaintiffs' Notice of Motion & Motion for Preliminary Approval of Class Action Settlement; Memorandum of Points & Authorities at 9, Opperman v. Path, Inc., No. 3:13-cv-00453-JST (N.D. Cal. Apr. 3, 2017).

198. *See id.* at 8–9 (requiring Defendants to provide the settlement administrator with a list of settlement class members so that the settlement administrator can provide notice through email).

199. *Id.* at 9.

200. Declaration of Lana Lucchesi in Support of Administrative Motion para. 3, Opperman v. Kong Techs., Inc., No. 3:13-cv-00453-JST (N.D. Cal. Nov. 30, 2017).

201. Alison Frankel, *The Class Action Claim Bots are Coming! (Actually, They're Already Here)*, REUTERS (Jan. 18, 2018, 3:23 PM), https://www.reuters.com/article/us-otc-bots/the-class-action-claim-bots-are-coming-idUSKBN1F7331 [https://perma.cc/XU3B-TDZ9].

202. Declaration of Lana Lucchesi in Support of Administrative Motion, *supra* note 200, para. 3.

203. *Id.* para. 5.

204. Frankel, *supra* note 201.

205. *Id.*

alleged trades during the class period.[206] This documentation can be falsified, and it is difficult for claims administrators to catch such falsification unless they individually verify every claim with banks and brokers, a process that is cost prohibitive. Automating claims administration would address this concern because claims administrators would receive transaction data directly from the banks and brokers, and therefore individual investors would not have an opportunity to submit fraudulent transaction data.

Just as automation would eliminate some fraudulent practices, however, it would likely spark new ones as well. Any market innovation, especially one that involves billions of dollars, brings out those eager to exploit it. On a small scale, it could be hard to identify those who should be excluded from the class, including family members of the defendants or entities affiliated with them.[207] On a larger scale, fraudsters could partner with those working inside the banks and brokers to falsify transaction data. While it may be impossible to predict the exact fraud, the rise of the internet has shown that people are ever creative in finding new ways to exploit one another.

Claims administrators, in conjunction with courts, could take steps to prevent fraudulent claims. To prevent smaller-scale frauds, they could require defendants to provide a list of immediate relatives and other household members, as well as the entities with which they are affiliated.[208] To prevent larger frauds, claims administrators should consider additional steps to verify larger claims. For example, the claims administrator could flag all claims over $250,000. The administrator would pay claims under this amount automatically. For claims over this amount, however, the administrator would send letters to the class member and the brokerage house, informing them of their estimated share of the settlement fund and inviting them to submit supporting documentation to receive this amount. If the class members do not submit this additional documentation, they will not receive their shares of the settlement. Claims administrators could take similar steps with any other claims that raise similar red flags.

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206. *See supra* Section I.B.1.a (describing the traditional claims administration process).

207. *See, e.g.*, Declaration of Jacob A. Goldberg in Support of Lead Plaintiff's Unopposed Motion for Preliminary Approval of Class Action Settlement at Ex. A (Stipulation and Agreement of Settlement), *In re* Tangoe, Inc., No. 3:17-cv-00146-VLB (D. Conn. Oct. 3, 2017) (defining the "Settlement Class" to exclude these individuals and entities); Stipulation of Settlement para. 1.31, Harr v. Ampio Pharm., Inc., No. 2:15-cv-03474-TJH-PJW (C.D. Cal. Feb. 28, 2017) (same).

208. Claims administrators can also be on the lookout for class members with different names or accounts but with the same addresses or other relevant information to ensure that they are accurately calculating net sales during the class period.

C. Concerns About Data Security

One final impediment in automating the claims administration process is concern about data security. Banks and brokers will likely be quite reluctant to hand over proprietary client transaction data to claims administrators. These institutions would worry about what would happen to their clients and their relationships with those clients if the data was hacked or leaked, and these concerns are justified, especially in light of the recent hack of the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") database.[209] Accordingly, any efforts to overhaul the claims administration process will have to come with stringent data security guidelines.

These guidelines should come from data security professionals, not lawyers. The goal of this Section is therefore not to spell out detailed security requirements that claims administration companies should follow. Instead, it is to stress that courts should not approve any automation plan that does not include appropriate data security measures. The premise of all securities class actions is that class members have already been defrauded in some way. It would be inexcusable, and more than a little ironic, if the lawsuit intended to compensate them for this harm led to them being defrauded again.

At the same time, there is reason to believe that many claims administration companies are capable of implementing appropriate data security measures. These companies are already thinking about data security, so these guidelines will not be entirely new to the industry. Nearly every claims administration company already has data security policies that it touts on its website. As one example, Epiq, which is one of the largest claims administration firms in the country, states on its website that it has a "multi-layered security program" to protect its clients' data that includes intrusion detection system ("IDS") technology with application and network firewalls, comprehensive anti-malware solutions, and a security event and incident management ("SEIM") deployment plan.[210] It also maintains a full-time staff of certified information security professionals to manage its security program and to run regular audits and risk assessments.[211] Similarly,

209. *See, e.g.*, Gina Chon, *Botched SEC Hack Probe a Warning for Other Agencies*, REUTERS (Sept. 26, 2017, 2:20 PM), https://www.reuters.com/article/us-usa-sec-breakingviews/breakingviews-botched-sec-hack-probe-a-warning-for-other-agencies-idUSKCN1C12RZ [https://perma.cc/L43J-C35A] (explaining that Congress had questioned whether the hack of the SEC's EDGAR system raised concerns about possible hacking of the CAT).

210. *Data Security*, EPIQ, https://www.epiqglobal.com/en-us/about/data-security (last visited Nov. 8, 2019) [https://perma.cc/A3WS-6GE3].

211. *Id.*

A.B. Data, another well-known claims administrator, states that it "is frequently subjected to physical, logical, data and information systems securities reviews and audits. We are compliant with our clients' security standards, as well as ISO/IEC 27001/2 and Payment Card Industry (PCI) data security standards; the Gramm-Leach-Bliley (GLB) Act of 1999; [and other private and statutory standards]."[212] Data security is part of nearly every aspect of the financial services industry, and the claims administration process is no different. Courts should obviously still ask hard questions before expanding these companies' access to sensitive financial data, but the good news is that companies are already thinking about these issues.

Moreover, claims administration companies already have a significant amount of sensitive data. Under current practices, courts require banks and brokers to turn over a list of their clients who transacted in the relevant securities during the class period, along with these clients' contact information.[213] The class members who choose to file a claim then detail their specific transactions, along with supporting documentation that includes sensitive account and other financial information. Automation expands the volume of data that these companies will have, but it does not change the nature of the data itself. Accordingly, if claims administrators do not have the necessary data security protocols to automate this process, then they should not have access to the information they already use in the claims administration process. In short, data security should be a crucial part of settlement claims administration regardless of whether the process is automated.

CONCLUSION

Securities class actions purport to be opt-out lawsuits, but they are not. To get any benefit from the litigation, class members must opt into a cumbersome claims process in which they are required to document their transactions and detail their losses. Faced with these hurdles, many class members never claim their share of the settlement. This Article outlines two approaches to modernize the settlement process. The first approach relies on market innovation, suggesting that claims administrators create an automated system that collects the relevant transaction data information from individual banks and brokers and uses this data to calculate and distribute each class member's pro rata share of the settlement. The second approach would

212. *Data Security and Certifications*, A.B. DATA, https://abdataclassaction.com/about-us/data-security-and-certifications/ (last visited on Nov. 8, 2019) [https://perma.cc/U86X-RC4H].

213. As detailed above, banks and brokers can alternatively pass on the claims administration packages to their clients themselves. *See* discussion *supra* note 38.

use the SEC's new Consolidated Audit Trail to identify potential class members and calculate their recovery. Both approaches would require the cooperation of lawmakers to make these lawsuits truly opt-out.

These proposals also open the door to considering broader changes to how settlement funds are distributed across the legal system. Securities class actions are an obvious starting point, given the low claims rates that have been documented in this area. If distribution of these settlements is automated, however, it might then be possible to use a similar approach in other types of corporate and securities litigation. The SEC, for example, typically uses the same methods used in securities class actions to distribute its Fair Funds recoveries, and shareholders also use similar methods in corporate lawsuits filed under state law. Reforming the claims administration process in securities class actions could pave the way for changes across the board, revolutionizing the way that investors recover money lost to corporate fraud.