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# Experimenting with the Lead Plaintiff Selection Process in Securities Class Actions: A Suggestion for PSLRA Reform

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# EXPERIMENTING WITH THE LEAD PLAINTIFF SELECTION PROCESS IN SECURITIES CLASS ACTIONS: A SUGGESTION FOR PSLRA REFORM

*Andrew S. Gold\**

## INTRODUCTION

Reform proposals for securities class actions are not a novel development. The selection of securities lead plaintiffs has been a source of substantial innovation over the past dozen years, and many of these developments are only now providing insights into their litigation effects.

The lead plaintiff and lead counsel selection process for securities class actions, however, is now the subject of several additional reform proposals.<sup>1</sup> A central concern is whether securities class actions remain an attorney-directed form of litigation, one in which the interests of plaintiffs' counsel and the plaintiff class may be imperfectly aligned. Ideally, the lead plaintiff will adequately monitor the course of the lawsuit, but the practice of lead plaintiff selection—particularly in cases of “pay-to-play” relationships—does not always inspire confidence.

This Article will not offer a specific solution to this agency cost concern. Instead, it suggests legislative reform aimed at producing such solutions in the future. Rather than just enact legislation that directly targets the lead plaintiff's monitoring role, legislatures should also allocate additional authority to courts to refine existing measures. Greater judicial discretion over the lead plaintiff selection process would permit judges to make adjustments as needed and would provide more useful evidence as to which practices are successful.

If Congress wishes to narrowly adjust the law to test a particular lead plaintiff or lead counsel selection device, several options would

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\* Associate Professor, DePaul University College of Law. I would like to thank John Beckerman and Stephan Landsman for their helpful comments on the ideas in this Article. I would also like to thank Michael Pullos for his excellent research assistance. Any errors are my own.

1. Securities Litigation Attorney Accountability and Transparency Act, H.R. 5491, 109th Cong. (2006) (proposing reforms to lead plaintiff selection process); INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 82–84 (Nov. 30, 2006), available at <http://www.capmktreg.org/research.html>. See also *infra* notes 69–78 and accompanying text (providing examples of recent reform proposals).

be available. For example, a recent bill would have explicitly recognized auctions for lead counsel as a judicial option.<sup>2</sup> The bill also called for enhanced disclosure requirements to address pay-to-play concerns.<sup>3</sup> In addition, commentators recently suggested measures to entice additional institutional investors to seek lead plaintiff status through payment of litigation expenses.<sup>4</sup> Any of these changes, or some combination, might be helpful.

This Article suggests a more structural approach to resolving the relationship between lead plaintiff and lead counsel. The drafters of the Private Securities Litigation Reform Act (the PSLRA) were appropriately concerned with inducing improvements in lead plaintiffs' monitoring of securities class action litigation. However, the relevant actors are dynamic—not static—entities. Further, the full effects of the PSLRA are both evolving and difficult to measure. In light of the ways in which institutional investors, plaintiffs' counsel, and courts have already responded to the PSLRA, there is a risk that any targeted legislative revision to the PSLRA will be outdated shortly after enactment.

Thus, Congress should retain the overall PSLRA framework, but provide courts with more flexibility in selecting lead plaintiffs and lead counsel. Adjudicative problem solving is an imperfect process, but it enables incremental adjustments to take into account the interactions among the relevant parties. Judicial experimentation could also provide a more complete picture as to which approaches actually work and which do not.

Part II of this Article describes the evolving impact of the PSLRA, including unanticipated outcomes under the statute.<sup>5</sup> That Part outlines the pay-to-play concern and its possible significance for the attorney-client relationship. It also reviews recent empirical data suggesting that aggregation—and perhaps auctions—may have positive effects upon securities class actions in certain contexts. In light of these developments, Part III discusses the role that courts might take

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2. See H.R. 5491, 109th Cong. (2006) (providing language that would state the following: “In exercising the discretion of the court over the approval of lead counsel, the court may employ alternative means in the selection and retention of counsel for the most adequate plaintiff, including a competitive bidding process.”).

3. *Id.* (requiring a disclosure “that identifies any conflict of interest, including any direct or indirect payment, between such attorney and such plaintiff and between such attorney and any affiliated person of such plaintiff”). This proposed section of the statute would also require the court to “make a determination of whether such conflict is sufficient to disqualify the attorney from representing the plaintiff.” *Id.*

4. See *infra* notes 77–78 and accompanying text.

5. See *infra* notes 9–85 and accompanying text.

under the present statutory text.<sup>6</sup> This discussion develops the idea of judicial experimentation as a response to the complexities of the lead plaintiff selection process. However, the current statutory text substantially limits such judicial discretion. Part IV suggests legislative reform to provide courts with greater discretion in this area.<sup>7</sup> Part V concludes that an enhanced role for judicial experimentation would be a desirable reform.<sup>8</sup>

## II. A REVIEW OF POST-PSLRA DEVELOPMENTS

In 1995, Congress enacted the PSLRA to address the misuse of securities class actions.<sup>9</sup> Although private securities litigation is an important supplement to the Securities and Exchange Commission's enforcement role, it also provides opportunities for strike suits: weak claims brought for their settlement value.<sup>10</sup> The PSLRA implemented a series of reforms to address this risk, including heightened pleading requirements,<sup>11</sup> a discovery stay prior to the resolution of a motion to dismiss,<sup>12</sup> and a mandatory Rule 11 inquiry.<sup>13</sup> The Act also substantially revised the lead plaintiff selection process.<sup>14</sup>

Prior to the PSLRA, courts typically chose class action lead plaintiffs on a first-come, first-serve basis.<sup>15</sup> The first to file became class representative.<sup>16</sup> This resulted in a race to the courthouse, in which claims were sometimes triggered by a drop in the defendant's stock price, thus increasing the risk of nonmeritorious suits.<sup>17</sup> It also produced a largely lawyer-driven form of litigation in the securities class action context. Lawyers sought out their client, not the other way around.<sup>18</sup> Class counsel would often make the important litigation de-

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6. See *infra* notes 86–114 and accompanying text.

7. See *infra* notes 115–121 and accompanying text.

8. See *infra* notes Part V.

9. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67 109 Stat. 737 (1995).

10. Cf. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740–48 (1975) (describing the dangers of “vexatious litigation” in private securities suits).

11. See 15 U.S.C. § 78u-4(b)(1)–(2) (2000).

12. See § 78u-4(b)(3)(B).

13. See § 78u-4(c)(1).

14. See § 78u-4(a)(3)(B).

15. See Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 *YALE L.J.* 2053, 2062 (1995) (“Courts most often appoint as lead counsel the lawyer who files the first complaint. Thus, plaintiffs’ lawyers race to the courthouse.” (internal quotation marks omitted)). As Weiss and Beckerman note, courts also sometimes allowed lawyers who filed suits with the same or similar claims to decide who should be appointed as lead counsel. See *id.*

16. See *id.*

17. See *id.* at 2060.

18. See *id.* at 2060–61.

cisions—including those on settlement terms—with little outside monitoring.

Commentators suggested that this ended in settlement values that were lower than they might have been,<sup>19</sup> with an overly large portion of the recovery going to class counsel rather than class members.<sup>20</sup> In other words, there were substantial agency costs associated with the attorney-client relationship.<sup>21</sup>

Congress intended to rectify this agency cost problem by favoring class representatives that were more capable of overseeing the case, with stronger incentives to do so.<sup>22</sup> Prior to the PSLRA, an influential article by Elliott Weiss and John Beckerman suggested that large institutional shareholders would be better suited to monitor securities class action litigation than most individual investors.<sup>23</sup> The PSLRA lead plaintiff provisions reflected this idea by creating a presumption in favor of plaintiffs with large holdings in the defendant's securities.

In theory, institutional plaintiffs offer several advantages. The size of their holdings gives them a financial stake in the outcome of the litigation. In addition, they have the necessary sophistication to closely monitor decisions made by class counsel. Investment holdings are also a relatively objective basis for plaintiff selection and may limit the incentive to rush to the courthouse that resulted under a first-to-file system.

Under the PSLRA, district courts must select a lead plaintiff that is the “most capable of adequately representing the interests of class members.”<sup>24</sup> The Act further creates a presumption that the plaintiff that is most capable of adequately representing the class is the person or group with “the largest financial interest in the relief sought by the class.”<sup>25</sup> This presumption, in turn, may be rebutted “only upon proof . . . that the presumptively most adequate plaintiff” does not meet typicality or adequacy requirements.<sup>26</sup>

Recent empirical studies suggest that the PSLRA functions as intended, at least in terms of increasing the role of institutional investors

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19. See Jill E. Fisch, *Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 *LAW & CONTEMP. PROBS.* 53, 57 (Spring/Summer 2001).

20. See *id.*

21. For an analysis of the problem in agency cost terms, see Weiss & Beckerman, *supra* note 15, at 2064–88.

22. See Fisch, *supra* note 19, at 60–61 (reviewing the legislative history).

23. See generally Weiss & Beckerman, *supra* note 15.

24. 15 U.S.C. § 78u-4(a)(3)(B)(i) (2000).

25. § 78u-4(a)(3)(B)(iii)(I)(bb).

26. § 78u-4(a)(3)(B)(iii)(II).

in securities class action litigation.<sup>27</sup> In other respects, the law has produced unanticipated consequences—notably, the dominant role of public pension funds as lead plaintiff participants.<sup>28</sup>

However, it is still somewhat early to judge the success of the PSLRA lead plaintiff provision. Initially, the PSLRA simply failed to produce the anticipated shift toward institutional investors as lead plaintiffs.<sup>29</sup> Institutional investors were apparently uninterested in a guiding role in securities class actions. For example, a 1997 study found only 9 institutional lead plaintiffs out of 175 cases.<sup>30</sup> But, several years later, the litigation landscape looked quite different. One study found that institutional investors comprised 51% of lead plaintiffs in 2002 and 42% of lead plaintiffs in 2003.<sup>31</sup> Thus, empirical research in recent years indicates dramatically different results from earlier studies.

Despite the PSLRA's evolving impact, many institutions with large securities holdings avoid securities class actions. Mutual funds, for example, do not take advantage of the opportunities to become lead plaintiffs.<sup>32</sup> As noted, a subset of the institutional shareholder group has acquired real importance in this context—public pension funds

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27. For recent analyses of the impact of the PSLRA lead plaintiff provisions, see Stephen J. Choi et al., *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869 (2005); Stephen J. Choi & Robert B. Thompson, *Securities Litigation and its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489 (2006); James D. Cox & Randall S. Thomas with Dana Kiku, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1637–39 (2006); and Michael A. Perino, *Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions* (St. John's Univ. Legal Studies Research Paper Series, Paper No. 06-0034, Jan. 2006), available at <http://ssrn.com/abstract=870577>.

28. See Cox & Thomas, *supra* note 27, at 1609 (noting the absence of private institutional investors serving as lead plaintiffs).

29. See Choi et al., *supra* note 27, at 877.

30. *Id.* (citing Elayne Demby, *Ducking Lead Plaintiff Status* (May 1999), available at <http://www.assetpub.com/archive/ps/99-psmay/may99PS58a.html>).

31. *Id.* at 877–88 (citing PRICEWATERHOUSECOOPERS LLP, 2003 SECURITIES LITIGATION STUDY 6 (2004), [http://www.10b5.pwc.com/PDF/2003\\_study\\_final.pdf](http://www.10b5.pwc.com/PDF/2003_study_final.pdf)).

32. One study of recent settlements found “no settlement where a bank, mutual fund, or insurance company has served as a lead plaintiff in a securities class action.” See Cox & Thomas, *supra* note 27, at 1609; see also Choi et al., *supra* note 27, at 880 (“Mutual funds have failed to participate in securities fraud litigation, at all, despite their substantial holdings.”). Cf. 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) (determining, based on a study of settlements, that less than 30% of institutional investors with provable losses perfect their claims).

are now common participants in private securities class actions.<sup>33</sup> A recent study suggests that the PSLRA's primary effect on institutional investor participation is its effect on public pension funds.<sup>34</sup> For the most part, private institutional investors have not served as lead plaintiffs.

A predominance of public pension funds could be desirable. Public pension fund plaintiffs correlate with higher value outcomes in securities class actions.<sup>35</sup> On the other hand, it is unclear whether this result is due to the ability of public pension funds to monitor the litigation. The authors of one recent empirical study indicated that their results could be due to pension fund cherry picking of the more significant class actions.<sup>36</sup> Nevertheless, the consequences of public pension fund participation may be beneficial to the class; the ultimate impact of this set of lead plaintiffs is yet to be determined.

#### A. *Pay to Play and Agency Costs*

The arrival of new candidates for class representative has also created a new set of agency cost concerns. Hopefully, the lead plaintiff and its counsel will largely share the goals of the class as a whole. But this particular type of institutional shareholder displays unique features. Public pension funds may be more susceptible to political considerations, causing their interests to diverge from those of other class members.<sup>37</sup> Perhaps of greater concern, there is evidence that some of these lead plaintiffs have been subject to pay-to-play practices.

Critics fear that this development results in the selection of plaintiffs affected by pay-to-play schemes that distort class action monitoring.<sup>38</sup> In pay-to-play cases, plaintiffs' firms make significant contributions to the individuals responsible for the pension fund's choice of lead counsel. Unsurprisingly, pay-to-play practices raise doubts whether such a pension fund will adequately supervise class counsel.

James Cox, Randall Thomas, and Dana Kiku collected evidence that suggests that the problem is not just hypothetical. As they note,

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33. Another group of institutional investors with a significant presence are labor union pension funds. See Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471 (2008).

34. Choi et al., *supra* note 27, at 902.

35. *Id.* at 870.

36. See *id.*

37. See Silver & Dinkin, *supra* note 33.

38. See, e.g., John C. Coffee, Jr., *Litigation Governance: A Gentle Critique of the Third Circuit Task Force Report*, 74 TEMP. L. REV. 805, 809-10 (2001); Cox & Thomas, *supra* note 27, at 1611-14.

such payments are “not well regulated.”<sup>39</sup> Moreover, such cases create skepticism that the resulting lead plaintiff will be an active monitor.

In *In re Cendant Corp. Litigation*, for example, New York State Comptroller H. Carl McCall was responsible for selecting counsel for the New York State Common Retirement Fund.<sup>40</sup> He received \$100,000 in campaign contributions from three plaintiffs’ firms from 1999 to 2001—the time period for selecting counsel in *Cendant*.<sup>41</sup> Two of these firms were selected as counsel.<sup>42</sup> The attorneys’ fee was \$55 million.<sup>43</sup> It was estimated that, in 2002, these two firms, their partners, and their families donated nearly \$200,000 to McCall.<sup>44</sup>

As Cox and Thomas explain, *Cendant* is not the sole cause for concern. For example, the Milberg Weiss firm, a dominant player in securities class actions, allegedly paid to obtain a lead counsel position.<sup>45</sup> Campaign contributions from law firms in one state to public officials that are elected in other states have also raised questions.<sup>46</sup> Furthermore, there are indications that plaintiffs’ firms have begun hiring lobbyists to assist in attaining a lead counsel selection.<sup>47</sup>

There is nothing wrong with an institutional investor plaintiff developing long-term relations with law firms for securities class action work. A law firm that works well with an institutional investor may enable that client to monitor the litigation more efficiently, which ultimately benefits the class.<sup>48</sup> However, to the extent that the initial hiring is the product of a pay-to-play scheme, development of repeat transactions could be less desirable. It may create a relationship where lead counsel is the true party in interest, with an agreeable, passive client.<sup>49</sup>

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39. Cox & Thomas, *supra* note 27, at 1614.

40. 264 F.3d 201 (3d Cir. 2001); Cox & Thomas, *supra* note 27, at 1611.

41. See Cox & Thomas, *supra* note 27, at 1611.

42. *Id.*

43. *Id.*

44. *Id.* at 1611–12.

45. *Id.* at 1612.

46. *Id.* at 1613–14.

47. Cox & Thomas, *supra* note 27, at 1613 (“[W]e were informed by several public pension fund officials that at least some of these lobbyists are engaged in efforts to persuade funds to assume the lead plaintiff position in securities fraud class actions and retain the law firm to act as lead counsel.”).

48. Cf. Fisch, *supra* note 19, at 92 (suggesting that the lead plaintiff cannot “be expected to monitor court-appointed counsel effectively, absent control over counsel’s compensation in the case at bar and the potential for repeat business in comparable cases”).

49. As John Coffee explains, “[a]lthough law firms may be agents to their clients in theory, the reality is that ‘pay-to-play practices’ allow them to become *de facto* principals and to acquire control over a given jurisdiction’s pension fund.” Coffee, Jr., *supra* note 38, at 809–10.



*B. Judicial Refinements of the Lead Plaintiff and  
Lead Counsel Selection Process*

If Congress ultimately revisits the PSLRA, pay to play is not the only development worthy of review. In addition, Congress should consider the growing number of suggestions to further refine the PSLRA's terms. For example, post-PSLRA courts have adopted a variety of approaches to lead plaintiff selection. Lower courts' experiences with lead plaintiff and lead counsel selection techniques have thus led to additional reform ideas.

Subsequent to the PSLRA, lower courts developed methods for responding to agency costs that are not expressly described in the PSLRA. Certain courts have used lead counsel auctions as a method to address attorneys' fee concerns.<sup>50</sup> Courts have also permitted aggregation of plaintiffs into groups for purposes of assessing the financial stake of would-be lead plaintiffs.<sup>51</sup>

The merits of these PSLRA interpretations are controversial. Some scholars have suggested, on policy grounds, that courts should use auctions to address lead counsel selection.<sup>52</sup> Yet it does not appear that the current statute permits this option.<sup>53</sup> Even if the statute did permit auctions, scholars have also questioned their use on policy grounds.<sup>54</sup> It is unclear whether these variations on the conventional lead plaintiff or counsel selection process generate net costs or benefits. Each merits a closer look.

*1. Aggregation*

As noted, one post-PSLRA development is the use of lead plaintiff groups. The PSLRA states that courts should "adopt a presumption that the most adequate plaintiff . . . is the person or group of persons that . . . has the largest financial interest in the relief sought by the class."<sup>55</sup> Certain courts interpret this language to permit small, cohe-

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50. See, e.g., *In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780 (N.D. Ill. 2000). An important pre-PSLRA example is *In re Oracle Securities Litigation*, 132 F.R.D. 538 (N.D. Cal. 1990).

51. See, e.g., *Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d 1146, 1153-54 (N.D. Cal. 1999) (describing different judicial approaches to aggregation).

52. See James L. Tuxbury, *A Case for Competitive Bidding for Lead Counsel in Securities Class Actions*, 2003 COLUM. BUS. L. REV. 285 (suggesting an amendment to the PSLRA to permit auctions for lead counsel).

53. See *In re Cavanaugh*, 306 F.3d 726, 739 (9th Cir. 2002) (noting that "[n]othing in our pre-Reform Act jurisprudence gives the district court the sweeping authority to deny a plaintiff the status of class representative because the court disagrees with his choice of counsel, and nothing in the Reform Act adds such a power").

54. See Fisch, *supra* note 19, at 91-95.

55. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I) (2000).

sive groups of investors to serve in a lead plaintiff capacity, while other courts allow large, unrelated groups of investors to act as the lead plaintiff.<sup>56</sup> This aggregation has proven controversial.

A major concern with aggregation is that it may limit the ability of the lead plaintiff to monitor class counsel. As Jill Fisch notes, “[a] collection of unrelated individuals cannot effectively exercise client control.”<sup>57</sup> “Group decisionmaking is . . . less efficient than individual decisionmaking” and suffers from collective action problems.<sup>58</sup> Lawyers may also select the group members, which contradicts the PSLRA concept that investors should control the litigation.

Despite these considerations, aggregation may still result in higher awards. In a recent empirical study, Cox and Thomas conclude that “groups perform better than individuals as lead plaintiffs in larger cases, while groups that include an entity yield larger settlements and greater provable loss ratios than those that occur with mere aggregation of individuals.”<sup>59</sup> These results were unanticipated. To the contrary, commentators were skeptical of aggregation as a lead plaintiff selection method.<sup>60</sup>

It is certainly plausible, based on the legislative history, that Congress did not intend aggregation in the form recognized by several courts. Without a limiting factor, thousands of plaintiffs could be joined into a single plaintiff group, producing results quite unlike the institutional investor model that Congress intended under the PSLRA.<sup>61</sup> The policy arguments against aggregation are also reasonable. However, the empirical data thus far have not demonstrated that aggregation is an undesirable practice, and the study by Cox and Thomas should encourage further inquiry.<sup>62</sup>

## 2. *Lead Counsel Actions*

Another potential means to address agency cost concerns for securities class actions is the lead counsel auction. Under this practice, the court creates an auction for lead counsel based upon the fee structure and other factors the court considers relevant. In 2006, a bill in the

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56. See Fisch, *supra* note 19, at 65–66 (describing the case law regarding aggregation).

57. *Id.* at 71.

58. *Id.*; accord Cox & Thomas, *supra* note 27, at 1617 (noting the collective action problem faced by aggregated plaintiffs seeking to monitor class counsel).

59. Cox & Thomas, *supra* note 27, at 1638–39.

60. See *id.*

61. See Fisch, *supra* note 19, at 67 (noting the possibility of very large plaintiff groups).

62. See Cox & Thomas, *supra* note 27.

House of Representatives sought to expressly permit the use of lead counsel auctions.<sup>63</sup>

A perceived advantage of an auction method is the objective nature of the process.<sup>64</sup> Courts need not subjectively judge what counsel and fee arrangements would be ideal. In theory, an auction allows for lower attorneys' fees, benefiting the class by permitting it to obtain a larger share of an ultimate damages award. Notably, this choice could limit the incentives for pay-to-play activity, because the lead plaintiff would not have sole discretion over its choice of counsel.

Yet commentators have pointed out a variety of problems with the lead counsel auction process. The auction system does not truly replicate market forces.<sup>65</sup> For example, in the ordinary world of counsel selection, a client will not be solely concerned with the price of the attorney's fee.<sup>66</sup> The quality of the legal representation is also important.<sup>67</sup> The competitive bidding process is unlikely to take full account of qualitative distinctions, such as the counsel's fit with the case or interaction with the plaintiff, instead emphasizing counsel's price. Further, auctions may harm the class, even in cases where qualitative dimensions are identical among participants.<sup>68</sup> The risk is that the fee structure will fall below the optimal level needed to provide counsel with appropriate litigation incentives.

Other concerns include the issue of judicial impartiality. A court's involvement in counsel selection and fee arrangement may impact its assessment of the litigation.<sup>69</sup> It is also possible that the institutional investors that the PSLRA seeks to encourage will not wish to partici-

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63. H.R. 5491, 109th Cong. (2006).

64. See Fisch, *supra* note 19, at 80–81 (“[C]ourts that have experimented with auctions in securities litigation seem to be motivated by the possibility that an auction will provide a more objective way of selecting lead counsel and a better way of determining an appropriate fee award.”).

65. See Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 672 (2002). “[A]uctions do not simply replicate the market” but, instead, are a “stylized process for addressing two problems that contribute to market failure: lack of information and inadequate competition.” *Id.* It should be noted that other types of auction may avoid standard critiques of the lead counsel auction process. For an example of an alternative auction approach, see Silver & Dinkin, *supra* note 33, at 488.

66. See Fisch, *supra* note 19, at 83 (noting that the auction process's emphasis on price is inconsistent with this feature of the market for legal services).

67. See *id.*

68. See Lucian Arye Bebchuk, *The Questionable Case for Using Auctions to Select Lead Counsel*, 80 WASH. U. L.Q. 889 (2002).

69. See Fisch, *supra* note 19, at 95 (“[T]he court's selection of counsel, which includes a determination that counsel is qualified and has made a reasonable evaluation of the case, may create an unintentional bias that the defendant cannot overcome.”).

pate on these terms.<sup>70</sup> For that matter, the attorney-client relationship may suffer.<sup>71</sup> Lead plaintiffs that do not have a preexisting relationship with their class counsel may be less successful monitors.

Despite these concerns, recent empirical analysis of auctions suggests that the auction process may be less troubling than its critics have anticipated. This is not to say that auctions are successful, as the sample size for assessing lead counsel auctions is limited. Nevertheless, auctions may lower attorneys' fees without negative effects on settlement value.

Michael Perino recently studied the effects of lead counsel auctions, and his tentative conclusion is that they can be beneficial, especially in cases where public pension funds are not selected as the lead plaintiff.<sup>72</sup> Perino suggests that there is a significant correlation between the use of auctions and lower attorneys' fees.<sup>73</sup> Whether auctions are otherwise harmful is another matter. The ability to reach more certain conclusions is limited. Based on interpretation of the PSLRA, several courts have expressed skepticism regarding the auction process.<sup>74</sup> Accordingly, adequately assessing the merits of counsel auctions under the current legal framework may prove difficult.

### C. Reform Proposals

Courts are not the only source of potential reform ideas. In light of the post-PSLRA results, commentators have also suggested a variety of reforms to the lead plaintiff selection process. Some of these reforms target specific practices, such as pay to play. Others are aimed at improving the monitoring role of the lead plaintiff. For example, several proposals seek to increase the likelihood that private institutional investors will serve in a lead plaintiff capacity. A brief overview of these suggestions follows.

Cox and Thomas suggest that a plaintiff group's monitoring ability may be positively correlated to the largest group member's financial stake in the lawsuit.<sup>75</sup> They propose that, when a court compares competing groups, "the relative inquiry should not be which group has

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70. *Id.* at 93 (suggesting that institutional investors may not wish to serve as lead plaintiffs if they did not receive their choice of counsel).

71. *Id.* at 92 ("The lead plaintiff cannot be expected to develop a close working relationship with a lawyer appointed by the court.").

72. See Perino, *supra* note 27, at 26.

73. *Id.* at 33.

74. See, e.g., *In re Cavanaugh*, 306 F.3d 726, 734 (9th Cir. 2002); *In re Cendant Corp. Litig.*, 264 F.3d 201, 279–80 (3rd Cir. 2001).

75. See Cox & Thomas, *supra* note 27, at 1639. Cox and Thomas note that they have not tested this hypothesis.

the largest financial loss but rather the relative size of the financial loss suffered by the biggest owner in each group.<sup>76</sup> Their suggestion, however, does not track the language of the PSLRA, which fails to distinguish between members within a group. Consideration of the largest owner within a group may be good policy, but it is not specified by the presumption set forth in the statutory text.

Another type of reform would increase the lead plaintiff's compensation for litigation costs. One possibility, also suggested by Cox and Thomas, would provide for the award of indirect costs experienced by the lead plaintiff, rather than just direct costs like the expense of deposition time.<sup>77</sup> This change might encourage greater involvement of institutional investors. An alternative, suggested by Perino, proposes that courts allocate a larger share of cost savings to lead plaintiffs, based on negotiating lower attorneys' fees.<sup>78</sup>

Silver and Dinkin offer several different options. They also seek to improve institutional investor incentives, but through a substantial lead plaintiff bonus.<sup>79</sup> One proposed method would tie lead plaintiff bonuses to the size of their securities holdings.<sup>80</sup> Another method would offer 20% of the eventual recovery to the class member willing to pay the most for lead plaintiff status.<sup>81</sup> Under this proposal, the lead plaintiff would pay half of the class attorneys' fees from this bonus. A third method would raise the bonus level to 30%, but the lead plaintiff would have to pay all of the attorneys' fees from this bonus.<sup>82</sup>

Additionally, disclosure reforms could target the existence of pay-to-play relationships. Courts might require attorneys to disclose campaign contributions to those who control the public pension fund. Further, a positive disclosure might have consequences attached. John Coffee, for example, argues that a pension fund's choice of counsel should be disqualified if the law firm or its partners "contributed to the campaign of any elected official administering or holding substantial influence over the fund."<sup>83</sup>

A final issue is how to implement such reforms. Cox and Thomas suggest that "courts should be more willing, indeed activist, in awarding costs to institutional lead plaintiffs for *all* expenses related to an

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76. *Id.*

77. *Id.* at 1637.

78. See Perino, *supra* note 27, at 31.

79. See Silver & Dinkin, *supra* note 33, at 488.

80. *See id.*

81. *See id.*

82. *See id.*

83. Coffee, Jr., *supra* note 38, at 810.

institution's participation as a lead plaintiff."<sup>84</sup> Perino, in contrast, indicates that his proposed reform would require legislative action, and Silver and Dinkin also suggest statutory amendments.<sup>85</sup> Again, additional legislative guidance could be useful in this area, as courts may be constrained by existing statutory language.

### III. ALLOCATING DECISION-MAKING AUTHORITY AND THE POTENTIAL FOR JUDICIAL EXPERIMENTATION

Each of these reforms, or some combination, has the potential to address agency costs for securities class actions. But these reforms could also be harmful or, at least, less desirable than other, untried alternatives. Given the large number of affected parties with distinct interests, predicting outcomes is difficult.

For example, Coffee's suggestion of law firm disqualification based on political contributions sounds like a useful way of staving off pay-to-play practices. The added risks associated with political contributions could drive off law firms that seek to effectively purchase the lead counsel role. With sufficiently strong penalties where pay-to-play activities come to light, the practice may vanish. Alternatively, the pay-to-play practice may continue to flourish, but become less visible to courts. Only implementation of this plan would determine its true effect upon agency costs.

Silver and Dinkin argue that such disclosure-based proposals could backfire, assuming that they actually eliminate pay to play:

[T]hese measures would remove the cloud that presently hangs over public sector and union funds. . . . By eliminating the selective incentives political contributions provide, they might reduce the rate at which public sector and union funds volunteer as lead plaintiffs, restoring the status quo that existed prior to the PSLRA, in which individual investors led the vast majority of cases.<sup>86</sup>

If the current post-PSLRA environment is an improvement over the pre-PSLRA environment, it is far from clear that removing public pension funds and labor unions from the mix would be helpful.

If the original goals of the PSLRA are to be met in full, reform is desirable. Yet it is hard to determine which reforms will succeed. Reforms may not turn out to be improvements once implemented. A successful effort to remove pay-to-play practices could produce a diminished pool of institutional lead plaintiffs, while a monetary incentive to serve as lead plaintiff could diminish the class's award without

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84. See Cox & Thomas, *supra* note 27, at 1637 (emphasis in original).

85. See Perino, *supra* note 27, at 31; Silver & Dinkin, *supra* note 33.

86. Silver & Dinkin, *supra* note 33, at 506.

attracting the desired institutional investors.<sup>87</sup> On the other hand, aggregation and auctions may have all the negative effects their critics describe, yet empirical data suggest that they may be beneficial.

It could also be hard to assess these costs and benefits even after a PSLRA revision. For instance, much of the interaction between attorneys and lead plaintiffs is invisible to outside parties. Additionally, an across-the-board reform may preclude a comparison with the effects of alternative reform proposals.

#### A. *PSLRA Reform as an Institutional Question*

In light of this backdrop, a legislated rule has different implications from a delegation to the judiciary. The choice of decision-making authority raises a significant institutional question. Given the PSLRA's apparent effects, what institution is best suited to implement further adjustments to lead plaintiff or lead counsel selection?

Determining the best means of reform requires a comparative institutional analysis.<sup>88</sup> If the goal is to produce the most efficient solution to the agency-cost problem, then it is not enough to merely focus on the courts' blind spots or the idiosyncrasies of attorney-client relationships. Likewise, comparison of one plaintiff category with another provides insufficient information, especially given the tendency of private institutions to avoid this type of litigation altogether. The lead plaintiff selection process implicates the combined role of several legal institutions, including the courts, the legislature, and the legal services market.

As is often the case when comparing institutions as a source of regulation, the analysis is complex. One participant may impact others in unanticipated ways. Lead plaintiffs, plaintiffs' attorneys, and defendants may each alter their actions in light of the roles courts and legislatures adopt. Accordingly, a good rule for the current litigation context could be a poor fit for later scenarios.

An interesting feature of the lead plaintiff selection process is that each available institution is poorly equipped to resolve agency-cost concerns in a way that still provides for quality legal counsel. Courts suffer from cognitive biases and are unable to assimilate much of the

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87. The lack of interest in being lead plaintiff among private institutional investors is pronounced. See Cox & Thomas, *supra* note 27, at 1609–10 (suggesting potential reasons for this reluctance).

88. For an informative discussion of such institutional comparisons, see generally NEAL K. KOMESAR, *LAW'S LIMITS: THE RULE OF LAW AND THE SUPPLY AND DEMAND OF RIGHTS* (2001); and NEAL K. KOMESAR, *IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY* (1994).

information important to lead plaintiff policy.<sup>89</sup> The judiciary is not always well suited to apply social science research. Legislatures are unable to address the nuances of particular cases and may react slowly when the lead plaintiff selection process is distorted by such factors as pay to play. In addition, market forces may have unexpected effects given the regulatory context.

It is unlikely that courts or legislatures have discovered the best combination of participants and incentives to address the lead plaintiff conundrum. In part, this is the product of a limited—and still changing—set of empirical data. The role of institutional plaintiffs today is different from ten years ago, and the ultimate effects of the PSLRA remain unclear. Even if the impact of the PSLRA stabilizes and becomes clear, it will be hard to assess how well an alternative approach would have worked in comparison. Given the lack of transparency, it may always be hard to measure the full effects of the various influences on class representation.

Some institution must decide whether auctions are appropriate or whether to permit aggregation into plaintiff groups. Unfortunately, the effect of these methods is highly uncertain. For example, critics have cogent arguments against auctions, but these arguments are based on undemonstrated assumptions about how auctions would function.<sup>90</sup> At present, the empirical data do not indicate that lead plaintiff auctions are harmful or that aggregation detracts from the interests of the class.<sup>91</sup>

There are two common approaches to addressing these types of concern. One is for the legislature to set out rules or standards that courts must implement. This is a top-down measure effectively represented by the PSLRA. The bottom-up approach, on the other hand,

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89. See Jeffrey J. Rachlinski, *Bottom-Up versus Top-Down Lawmaking*, 73 U. CHI. L. REV. 933 (2006) (discussing distinctions between courts and legislatures when addressing disputes); see also Frederick Schauer, *Do Cases Make Bad Law?*, 73 U. CHI. L. REV. 883 (2006) (critiquing common law adjudication).

90. See Perino, *supra* note 27, at 33 (“[T]here is at this point too little experience with auctions to draw definitive conclusions about whether the problems that critics have identified in theory will in fact exist.”).

91. It would be helpful to know more about the effects of these practices:

[C]ourts should continue to experiment with auctioning the role of lead counsel, at least as a second-best solution in those cases in which public pension funds do not participate and in which the available lead plaintiffs do not appear to have used competition or otherwise to have engaged in arm’s length bargaining to select class counsel.

*Id.*; see also Tuxbury, *supra* note 52, at 333–34 (“Since a movement towards some type of competitive bidding or increased judicial discretion in the selection of class counsel is occurring in class actions in general, now is not the time to close the door on competitive bidding in securities class actions.”).



would allow courts to gradually develop answers through case-by-case adjudication.<sup>92</sup> Should courts have that option?

While it is hard to choose among these approaches with complete confidence, it is significant that the consequences of the PSLRA lead plaintiff provision are equivocal and that the impact of the several reform proposals is hard to determine *ex ante*. There is a developing sense that the statute does not produce the lead plaintiff type intended. With a high risk of error, it therefore makes sense for policy-makers to implement tentative changes in a decentralized fashion. A bottom-up, judicially crafted approach could be a mistake—certainly the race to the courthouse prior to the PSLRA was undesirable—but refinement of the PSLRA could also benefit from gradualism.

Before looking further at this issue, however, it is important to determine whether judicial experimentation is an option under current law. If courts may opt for the suggested reforms without legislative change to the PSLRA, it would be unnecessary to amend the securities laws.

### B. *Statutory Interpretation and Judicial Flexibility*

In one sense, judge-made law is flexible, regardless of the statutory setting. Much statutory language is indeterminate or ambiguous. In addition, judicial understandings of a statute often change over time, thus resembling common-law adjudication. But judicial readings of statutes do not “work themselves pure” in the way that the common law sometimes does.<sup>93</sup> To the extent that judges are bound to a legislative choice, courts are not as free to make new law when reading statutes as they are when developing common-law doctrine.

Occasionally, courts reconsider statutory interpretation precedents when it becomes clear that a prior holding rested on an incomplete understanding of empirical realities.<sup>94</sup> In such cases, the court’s understanding of a statute’s meaning may be left unchanged at a high

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92. See generally Rachlinski, *supra* note 89 (discussing the respective advantages of top-down and bottom-up approaches to law making). An alternative would be to rely on administrative agencies. For the most part, however, the primary sources of amendment to the law governing private securities litigation are Congress and the judiciary. This Article focuses on these two institutions, but it should be recognized that the SEC could also contribute.

93. Cf. Michael C. Dorf, *Foreword: The Limits of Socratic Deliberation*, 112 HARV. L. REV. 4, 28–29 (1998) (describing how the Supreme Court’s interpretation of statutes does not create “much real common law” but resembles the common law in the sense that it includes judge-made law and relies on case-by-case development). Of course, it is debatable whether the common law does work itself pure. See Schauer, *supra* note 89, at 906–11.

94. See, e.g., *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (rejecting a *per se* rule against vertical price fixing under the Sherman Act based upon the potential for both pro-competitive and anti-competitive effects).

level of generality, but the application of that meaning to concrete fact patterns becomes substantially different. Courts sometimes also reconsider their prior holdings for normative reasons. The power to overrule or distinguish prior decisions allows for substantial revisions of judge-made law.<sup>95</sup> Courts may rethink the meaning of a statutory text, perhaps based upon the negative consequences of the old reading or a shift in interpretive philosophy.

Taking these practices a step further, some commentators argue that courts should engage in dynamic statutory interpretation.<sup>96</sup> A theory of dynamic statutory interpretation suggests that a statute's meaning changes over time and that courts should take such changes into account. Depending on one's view of language and the judiciary's role, this type of interpretation may provide judicial flexibility when an old reading of a statute becomes obsolete. But the legitimacy of dynamic interpretation remains unsettled.<sup>97</sup> Although dynamic interpretation has its adherents, it is not the dominant strain of statutory interpretation among judges.

Conventional judicial understandings of statutory interpretation fall into standard categories. They generally look to several sources of meaning: the statutory text as it would be understood by a competent reader (textualism); Congress's intent in enacting a statute (intentionalism); or the statute's apparent purpose (purposivism).<sup>98</sup> These interpretive theories provide judges with varying degrees of flexibility, but tend to constrain statutory interpretation in ways that the common law would not constrain judicial law making. Whichever interpretive method is followed, when *stare decisis* is added to the picture, statutory understandings acquire a certain fixity.

As a policy matter, there are circumstances where it could be beneficial if judges were able to try out a variety of statutory choices. The

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95. Distinguishing and overruling allow judges to make law in different ways, under different constraints. For a helpful discussion of the distinctions between judicial overruling and distinguishing of precedent, see JOSEPH RAZ, *Law and Value in Adjudication*, in *THE AUTHORITY OF LAW: ESSAYS ON LAW AND MORALITY* 183-92 (1979).

96. For a thorough explanation and defense of dynamic statutory interpretation, see WILLIAM N. ESKRIDGE, JR., *DYNAMIC STATUTORY INTERPRETATION* (1994).

97. Textualist judges, for example, reject the idea of dynamic statutory interpretation. See, e.g., Antonin Scalia, *Common Law Courts in a Civil-Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws*, in *A MATTER OF INTERPRETATION 22* (1997) (critiquing William Eskridge's dynamic theory of statutory interpretation). For a recent institution-based critique of dynamic statutory interpretation, see ADRIAN VERMEULE, *JUDGING UNDER UNCERTAINTY: AN INSTITUTIONAL THEORY OF LEGAL INTERPRETATION* 46-50 (2006).

98. For analysis of the distinctions between textualism and intentionalism, see Andrew S. Gold, *Absurd Results, Scrivener's Errors, and Statutory Interpretation*, 75 U. CIN. L. REV. 25, 41-52 (2006). For analysis of the distinctions between textualism and purposivism, see generally John F. Manning, *What Divides Textualists from Purposivists?*, 106 COLUM. L. REV. 70 (2006).

selection of lead plaintiffs for securities class actions plausibly fits this category. Assuming that the statutory language is sufficiently indeterminate, the most efficient means to reform the lead plaintiff selection process might be for courts to experiment with such measures as auctions or aggregation in response to practices like pay to play. If so, there would be no need for the legislature to amend the statute itself.

The idea of judicial experimentation in statutory or constitutional interpretation has been proposed in other contexts.<sup>99</sup> For example, Michael Dorf suggests that judicial experimentation should be considered as an alternative to textualism and purposivism when courts read statutes.<sup>100</sup> He argues that courts could reach provisional adjudicative results. A judicial determination of this sort would be understood as a temporary solution to a problem, subject to limited stare decisis protection.<sup>101</sup>

The potential benefits of this approach for lead plaintiff selection are significant. Courts may jettison a poorly functioning selection technique. A reasonable alternative can be compared to other options and further refined over time. Courts might adjust their statutory interpretations in response to behavior changes among the relevant parties to litigation, altering applicable rules and standards as they affect the regulatory environment. In the process, courts would be able to acquire valuable experience with each plaintiff selection method.

From a consequentialist perspective, judicial experimentation could also have substantial negatives. There is some question whether provisional interpretations would erode judicial legitimacy.<sup>102</sup> Provisional decisions look more like the actions of administrative agencies than judges, and the lack of finality when a court establishes a legal outcome could lower the esteem with which parties hold judicial prece-

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99. See, e.g., Michael C. Dorf, *Legal Indeterminacy and Institutional Design*, 78 N.Y.U. L. REV. 875 (2003).

100. See Dorf, *supra* note 93, at 7–8 (suggesting that both textualism and purposivism have affinities with the case-by-case, common-law method and that this method does not provide adequate means for adjusting legal doctrine); *id.* at 9 (suggesting that courts could construct a “model of *provisional adjudication*” (emphasis in original)).

101. See *id.* at 73 (suggesting that the Supreme Court could “designate some doctrines or decisions as provisional, promising to revisit these matters at some future date”); see also Dorf, *supra* note 99, at 969 (suggesting that courts might “resolv[e] a legal question for the time being, subject to being overruled on something less than the standard ordinarily required to depart from stare decisis should experience demonstrate a superior solution”).

102. Dorf, *supra* note 99, at 947 (noting the concern that “[o]nce courts become active problem-solvers enmeshed in the messy business of ordering real-world institutions, they will no longer be perceived as neutral”).

dents.<sup>103</sup> In addition, the stability of legal doctrine is an important value. Transition costs can be high when legal rules shift.<sup>104</sup> Firms may not seek lead plaintiff status if they are uncertain which approach a court will use.

Granting these concerns, an experimental approach to the PSLRA lead plaintiff selection process might enable courts to more effectively select the plaintiff best suited to oversee the litigation and would have a more fact-specific perspective than a broad legislative rule. Courts could plausibly work toward an improved response to agency cost concerns by refining the lead plaintiff selection process over time, taking into account attorneys' fee considerations, counsel incentives, and other issues that may arise as the various actors adjust to different legal approaches. To a limited degree, this is already occurring.

### C. *The Conceptual Objection to Judicial Experimentation*

Putting to one side the merits of judicial experimentation as a policy matter, proponents of this technique face real conceptual challenges. Judges are not necessarily free to undertake this approach. As Dorf notes, "[s]o long as the Court conceives of its role as finding the meaning of constitutional and statutory provisions, the notion of experimentation and provisional adjudication will be tinged with illegitimacy."<sup>105</sup> For many courts, a statutory text that has received a particular reading is decisive, even if it is indeterminate on the margins. Provisional holdings suggest that a court is not really saying what the law is when it interprets the text.

This challenge to an experimental approach would readily apply to the PSLRA. The difficulty with testing different approaches to the lead plaintiff selection process is that Congress's guidance in the PSLRA simply does not provide for this degree of judicial choice. The statute creates a straightforward presumption in favor of the investor with the largest holding. The courts, quite appropriately, take the PSLRA's text into account. Judicial precedents are closing off district court discretion as it relates to lead counsel auctions and, in some instances, plaintiff aggregation.<sup>106</sup>

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103. *Id.* at 948 (noting that the traditionalists may question "what makes a problem-solving court a court rather than an (admittedly newfangled) administrative agency superintended by a person wearing a robe?" (emphasis in original)).

104. See Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789 (2002) (discussing the import of legal transition costs).

105. See Dorf, *supra* note 93, at 71.

106. For a discussion of negative judicial responses to lead counsel auctions, see Tuxbury, *supra* note 52, at 323–37. For a discussion of the varying judicial responses to aggregation, see Fisch, *supra* note 19, at 65–66.

Consider *In re Cavanaugh*, a case in which the Ninth Circuit reaffirmed the lead plaintiff presumption and indicated its disapproval of auctions under the PSLRA.<sup>107</sup> In that case, the district court refused to give the Cavanaugh plaintiff group the full benefit of the PSLRA's presumption based on the size of the group's financial stake.<sup>108</sup> The district court concluded that the presumption was "an effort by Congress to encourage the involvement of institutional investors in securities class actions" and noted that the Cavanaugh group did not include institutional investors.<sup>109</sup> Accordingly, the district court limited the effect of the PSLRA lead plaintiff presumption, treating it as merely an "important element" of its decision.<sup>110</sup> As a result, the district court linked class counsel fees to its selection of the lead plaintiff.<sup>111</sup>

Judge Kozinski, writing for the panel, overturned the lower court's determinations. He explains as follows:

Congress enacts statutes, not purposes, and courts may not depart from the statutory text because they believe some other arrangement would better serve the legislative goals. Here, the Reform Act provides in categorical terms that the *only* basis on which a court may compare plaintiffs competing to serve as lead is the size of their financial stake in the controversy.<sup>112</sup>

According to the Ninth Circuit, the statute precluded the district court's reasoning. Assuming that such a plaintiff meets the PSLRA's financial stake requirement, "the court must appoint that plaintiff as lead, unless it finds that he does not satisfy the typicality or adequacy requirements."<sup>113</sup> The Ninth Circuit pointedly critiqued the use of auctions for class counsel, emphasizing that the PSLRA leaves the choice of class counsel "in the hands of the lead plaintiff."<sup>114</sup>

Decisions like *Cavanaugh* constrain the availability of new approaches to selecting the best lead plaintiff or lead counsel. Such decisions are also reasonable statutory interpretations, and it is entirely appropriate for judges to reach such holdings given the existing statutory limits. It could, nevertheless, be desirable for courts to test different methods for selecting lead plaintiffs and their counsel. Courts may not be in a position to choose provisional adjudication under the

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107. 306 F.3d 726 (9th Cir. 2002).

108. See *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 487 (N.D. Cal. 2001).

109. See *id.*

110. See *In re Quintus Sec. Litig.*, 148 F. Supp. 2d 967, 972 (N.D. Cal. 2001).

111. See *id.*

112. *Cavanaugh*, 306 F.3d at 731–32 (emphasis in original).

113. *Id.* at 732.

114. *Id.* at 734 & n.14.

current statutory framework, but Congress might enable courts to innovate.

#### IV. THE OPPORTUNITY FOR LEGISLATIVE REFORM

As empirical data are collected and studied, the evidence invites policymakers to reassess aggregation, auctions, and other options to refine the lead plaintiff selection process. Yet the available empirical data are limited respecting these techniques, and it is also unclear that better data will be forthcoming. Over time, courts may actually produce less useful data. As noted, courts have called the lead counsel auction into question on the basis that the PSLRA precludes the practice, and the broader forms of aggregation have not always fared well.

Courts should hesitate before engaging in provisional adjudication against the current statutory backdrop.<sup>115</sup> Moreover, many courts will be unwilling to experiment, even if doing so would produce desirable results. Instead of relying upon judicial initiative, Congress might explicitly empower judicial experimentation within certain established parameters. Congress should revise the PSLRA to permit judicial experimentation regarding lead plaintiff selection, with the restriction that this adjudication be informed by legislatively determined factors.

Legislative guidelines should include the PSLRA's current emphasis on lead plaintiffs' financial stakes, as this feature increases the odds of a lead plaintiff that actively monitors the case. Courts should also be permitted to consider the apparent ability of the lead plaintiff to monitor the litigation; the potential relevance of the lead plaintiff's choice of counsel, including the fee arrangement; and any evidence that there is a pay-to-play arrangement or corruption of the process. Lead counsel auctions should be allowed, but not mandated.

In other words, the agency cost concerns that motivated Congress when enacting the PSLRA—those identified by Weiss and Beckerman—should serve as factors for courts selecting a lead plaintiff. An express legislative endorsement of this approach would not be a radical shift. The original Weiss and Beckerman article called for an ac-

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115. This is not just because of the question of legitimacy in cases where the legislature has not endorsed judicial experimentation. In addition, provisional adjudication may be beneficial in one context and harmful in another. On a system-wide scale, it might be far better for the judiciary to avoid the practice altogether than to encourage individual judges to adopt this approach on an ad hoc basis. Once judges feel free to choose experimental approaches, the practice may be misused, or at least poorly exercised. *Cf. VERMEULE, supra* note 97, at 166 (noting that "it is itself an empirical question of interpretive choice whether the costs of instability, disuniformity, and repeated decision and reevaluation imposed by [provisional adjudication and decentralization] are worth the information obtained").

tive judiciary as the means to address agency costs.<sup>116</sup> The judiciary already engages in some experimentation, albeit within the awkward confines of a statute that does not support a provisional approach. Congress should now invite additional judicial efforts to this end.

Hopefully, this suggestion avoids the nirvana fallacy and does not take an overly optimistic view of judicial acts.<sup>117</sup> There is little cause to think that the judiciary is an ideal institution for addressing agency costs in class action litigation.<sup>118</sup> Courts might do a poor job of making lead plaintiff selections as a result of bounded rationality, cognitive bias, institutional inertia, or other influences.<sup>119</sup> They are also not skilled at gathering and analyzing large-scale empirical data.<sup>120</sup> Even if biases are removed, courts may not learn if their efforts produce a poor attorney-client relationship in individual cases.

Courts are unlikely to see a complete picture of the quality of legal representation behind the scenes. They can recognize incompetent counsel, but it is hard for them to know when a shift in the lead plaintiff or lead counsel selection procedure produces subtle changes in legal strategy. Would a legal argument have been marginally better but for the limits on counsel fees produced by an auction? Did some sort of quid pro quo occur unbeknownst to the court? Despite these uncertainties, however, it is plausible that, over time, experienced courts will be able to determine when one method works better than another.

Legislatures have their own foibles. Congress may be more likely to respond to a serious problem with the lead plaintiff process than courts, but Congress may also be more limited in its ability to respond in a nuanced way to changes in the way securities cases are litigated. Congress also has different information sources from courts. Judges see the specifics of actual litigation. Lobbying may reflect legitimate

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116. See Weiss & Beckerman, *supra* note 15, at 2127 (“The first steps, however, must be taken by the courts. A federal district judge acting *sua sponte* in some given class action could adopt the practices we propose relating to selection of lead counsel . . .”).

117. See VERMEULE, *supra* note 97, at 41 (“A familiar shorthand for asymmetrical institutionalism is the nirvana fallacy, in which an excessively optimistic account of one institution is compared with an excessively pessimistic account of another.”).

118. See Fisch, *supra* note 19, at 94 (noting that “[t]he legislative history of the PSLRA reflects congressional frustration over many attributes of the litigation system that developed under judicial oversight”).

119. *Id.* at 94–95. “The pressures imposed by limited resources and crowded dockets” have made courts more managerial. *Id.* Thus, in class actions, “judges have extensive power to dictate the litigation process and results, [and] there is a risk that they will use this power in a manner that does not reflect the best interests of the plaintiff class.” *Id.*

120. See Dorf, *supra* note 93, at 53 (noting that “generalist judges simply cannot keep up with the latest developments in all of the fields relevant to their work”).

concerns with flaws in the judicial system, but could also reflect interests unrelated to the agency cost problems of securities class action representation.

Presumably, some courts could perform well in this capacity and build experience in the area. They may adapt their plaintiff selection procedures over time in response to the changing behavior of the relevant actors. Furthermore, potential lead plaintiffs and their law firms will have an incentive to notify the court of flaws in established selection methods. Whether or not litigants' objections would be reliable, courts could at least attempt to minimize the risks of specific weaknesses in their chosen approach.<sup>121</sup>

The most important feature of a judicial response could be the information it provides. In the end, the current empirical data show that we need more empirical data. Decentralized adjudication across different federal circuits allows for a comparative analysis of selection processes. To the extent that this produces useful information, it would assist Congress if it becomes necessary to revisit lead plaintiff selection procedures. For this reason, judicial experimentation would be a valuable addition to the lead plaintiff selection process, at the least as an interim approach.

## V. CONCLUSION

The current lead plaintiff selection process improves upon the pre-PSLRA system. However, it raises concerns about pay-to-play distortions. In addition, there is empirical evidence that suggests room for further refinements to the statute. Requiring disclosures when counsel has made political contributions to pension fund managers is a sensible revision to the law. But it may be that additional reforms would also assist in aligning the interests of lead plaintiffs and their counsel more fully with the class as a whole.

The record under the PSLRA shows a good deal of flux. The participation of institutional lead plaintiffs in the first few years after enactment was quite different from participation today. Perhaps the data will dramatically change in a few years. The prosecution of Milberg Weiss suggests major alterations in the lead counsel market. In addition, some of the current data were unanticipated. For example, the impact of aggregation runs contrary to commentators' predictions. The effects of future reforms could be equally surprising.

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121. Notice, for example, that the auction process has changed over the years as courts grew more sophisticated in using the technique. *See* Fisch, *supra* note 19, at 82–86 (describing the evolution of the auction process and noting the strengths and weaknesses of different auction approaches).



A more complete data set could better enable Congress or courts to decide how best to select lead plaintiffs and offer insights into how the choice of lead counsel should relate to the lead plaintiff question. Which variations on the basic lead plaintiff selection process would be worthwhile, or most worthwhile, is unknown. It would be useful to test some of the proposed reforms. As written, however, the PSLRA limits the available judicial options, especially where courts have adopted a textualist mode of statutory interpretation. Ultimately, the ideal allocation of legislative and judicial decision-making authority over these issues is hard to pinpoint. Despite the uncertainties, one need not generally favor courts over legislatures to see the advantages of increasing judicial discretion in the present context.

Without question, courts are imperfect when it comes to making decisions regarding lead plaintiffs. Legislatures also have their shortcomings. Courts, however, can provide an opportunity to compare the effects of different approaches to lead plaintiff selection. This benefit is not readily available to Congress when it provides top-down legal results. Legislative rules at the federal level are hard to assess in comparative terms. Even if individual courts are not situated to see all of the effects of their chosen approaches, securities litigation outcomes may be assessed in the aggregate.

When enacting the PSLRA, Congress was correct to focus on which lead plaintiffs are most likely to be good monitors of securities class action litigation. The presumption in favor of institutional investors was a step in the right direction. If Congress permitted courts to more fully compensate for lead plaintiff expenses; allow for aggregation; use auctions; increase disclosure regarding conflicts of interest; and, perhaps, try options not yet considered, it should help further limit agency costs. If any of the reform ideas function well under this judicial experimentation, courts could move toward adopting them, and Congress could as well.