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## And the Winner Is - Interpreting the Lead Plaintiff and the Lead Counsel Provisions of the Private Securities Litigation Reform Act of 1995

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2002]

AND THE WINNER IS . . . INTERPRETING THE LEAD PLAINTIFF  
AND THE LEAD COUNSEL PROVISIONS OF THE  
PRIVATE SECURITIES LITIGATION REFORM  
ACT OF 1995

*“The overriding purpose of our Nation’s securities laws is to protect investors and to maintain confidence in the securities markets . . . .”*<sup>1</sup>

I. INTRODUCTION

A corporation announces that it discovered “accounting irregularities” in its financial statements.<sup>2</sup> As a result, the value of its stock drops by more than 47% and shareholders lose more than \$20 billion in market capitalization.<sup>3</sup> The injured investors decide to join their claims and file a

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1. PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, H.R. CONF. REP. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 761.

2. See generally Paul A. Ferrillo, *New Tide Rising in Securities Class Action Litigation*, N.Y. L.J., Aug. 8, 2000, at 1 n.8 (defining accounting “irregularity” as “intentional misstatements or omissions of disclosures”); Lawrence Richter Quinn, *Accounting Sleuths*, STRATEGIC FINANCE, Oct. 1, 2000, at 1, *available at* 2000 WL 11723026 (discussing reasons for number of highly publicized accounting irregularities cases over past couple of years). “The pressure to meet Wall Street expectations apparently remains the predominant reason why companies commit accounting fraud.” *Id.* at 4-5.

3. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 221-22 (3d Cir. 2001) (stating that defendant announced accounting irregularities in its Form 10-K Annual Report filed with SEC, which caused its stock to fall 47% next day, additional 9% four months later and additional 11% one month later); *In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1019 (N.D. Cal. 1999) (stating that stock declined in value during alleged fraud from \$67 to \$13); *Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d 1146, 1150 (N.D. Cal. 1999) (stating that defendant announced in press release that defendant would have to restate its earnings for past year based on “improperly recognized” \$40 million causing stock to decrease dramatically).

Public acknowledgment of accounting irregularities may cause a loss in share value that may result in a substantial loss in market capital. See *Cendant*, 264 F.3d at 221-22 (recognizing that shareholders of defendant corporation lost more than \$20 billion in market capital); *Network Assocs.*, 76 F. Supp. 2d at 1019 (stating that firms represented institutional and individual investors with losses exceeding \$120 million).

class action lawsuit for securities fraud.<sup>4</sup> The court now must decide who will represent the class as the lead plaintiff and the lead counsel.<sup>5</sup>

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4. *See generally*, FED. R. CIV. P. 23(a) (listing rules for filing class action suit). Rule 23(a) of the Federal Rules of Civil Procedure states:

One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

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

Class actions alleging securities fraud are brought to court pursuant to § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. *See* Elliot 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, 2054 n.1 (1995) (listing categories of class action suits). Rule 10b-5 states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ a device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2000).

5. *See generally*, FED. R. CIV. P. 23 (stating that in class action court appoints class representatives); 5-23 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 23.25 (2001) (stating conditions for appointing lead plaintiff and lead counsel). Rule 23, at the outset, requires that the representative parties fairly and adequately protect the interest of the class as a condition to maintenance of a class action. *See id.* It has been noted that to determine whether the interests of the class will be represented adequately:

courts consider the adequacy of both the named representative and class counsel. Thus, adequate representation requires two elements: (1) the class representative must not have interests antagonistic to those of the class, and (2) class counsel must be qualified, experienced, and generally able to conduct the proposed litigation. In determining the adequacy of the named representative, courts also consider whether the representative will vigorously advocate the class claims.

*Id.*

There are benefits and drawbacks in having class representatives act on behalf of the class. *See* Sylvia R. Lazos, Note, *Abuse in Plaintiff Class Action Settlements: The Need for a Guardian During Pretrial Settlement Negotiations*, 84 MICH. L. REV. 308, 308 n.1 (1985) (comparing benefits and potential conflicts arising from courts hearing class actions by representative parties). "The class action device enables courts to hear the claims of a large group of individuals through class representatives and class attorneys. . . . [T]he absentee plaintiffs must rely on the class representatives and class attorneys for the adequate representation of their rights." *Id.* at 308 n.3.

The class representatives have a fiduciary duty to act on behalf of the class. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 549 (1949) (stating that class representative is volunteer who assumes position of fiduciary nature); *In re Oxford*

In recognizing the need to guide courts in appointing the lead plaintiff and the lead counsel, Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA).<sup>6</sup> The PSLRA was expected to revolutionize securities fraud class actions by encouraging greater participation by the investor clients, who traditionally were prevented by counsel from exercising any decisions in the class action suit.<sup>7</sup>

Yet, in the six years since its passage, the PSLRA has caused a great deal of confusion among federal district courts which are struggling to manage class action suits.<sup>8</sup> Specifically, courts disagree whether the PSLRA permits them to aggregate the financial interests of multiple unrelated investors in deciding whether to appoint the group as lead plaintiff.<sup>9</sup>

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Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 46 (S.D.N.Y. 1998) (stating that class representative, once designated by court, is fiduciary for absent class members).

6. Pub L. No. 104-67, 109 Stat. 737 (codified at 15 U.S.C. §§ 77z-1 to 78u-5 (1994 & Supp. 1996)). Congress overrode President Clinton's veto when it passed the PSLRA in December 1995 with a House vote of 319-100 and Senate vote of 68-30 in December of 1995. See PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, VETO MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, H.R. DOC. NO. 104-150 (1995), reprinted in 141 CONG. REC. H15214-06 (1995); Note, *Investor Empowerment Strategies in the Congressional Reform of Securities Class Action*, 109 HARV. L. REV. 2056, 2056 (1996) (emphasizing congressional effort to pass bill over President Clinton's veto) (citing Aaron Zitner, *For First Time, Veto by Clinton Overridden*, BOSTON GLOBE, Dec. 23, 1995, at 1, 16).

The PSLRA establishes procedural requirements to allow other lead plaintiffs the opportunity to seek appointment. See 15 U.S.C. §§ 77z-1 to 78u-5 (stating filing requirements for securities fraud class action). Following the initial filing of a securities fraud class action, the filing plaintiff must publish notice of the suit to allow other class members the opportunity to file a motion for lead plaintiff appointment. See 15 U.S.C. § 78u-4(a)(3)(B)(i) (stating filing requirements for securities fraud class action). Within ninety days after the notice is published, the court must appoint the most adequate plaintiff. See *id.* (stating filing requirements for securities fraud class action). For a further discussion of the statutory requirements for appointing the lead plaintiff and lead counsel, see *infra* notes 31-39 and accompanying text.

7. See PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, S. REP. NO. 104-98, at 6 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 685 (noting Congress' intent to empower investors so that they, not their lawyers, control securities litigation); see also William B. Rubenstein, *A Transactional Model of Adjudication*, 89 GEO. L.J. 371, 397 (2001) (describing that "PSLRA was meant, in no uncertain terms, to return securities class actions to clients"); Weiss & Beckerman, *supra* note 4, at 2065 (stating that plaintiffs' attorneys "typically do not rely on named plaintiffs for vital testimony, do not bargain with them over fees they will be paid, and do not require named plaintiffs' approval of proposed settlements"). For a further discussion of problems associated with securities fraud class actions before the enactment of the PSLRA, see *infra* notes 23-27 and accompanying text.

8. See Jill E. Fisch, *Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 LAW & CONTEMP. PROBS., Spring/Summer 2001, at 53, 54 (recognizing substantial uncertainty that remains about operation of lead plaintiff provision and appropriate method for selecting lead counsel); Andrew K. Niebler, *In Search of Bargained-For Fees for Class Action Plaintiffs' Lawyers: The Promise and Pitfalls of Auctioning the Position of Lead Counsel*, 54 BUS. LAW. 763, 764 (1999) (recognizing problems associated with lead counsel auctions).

9. Compare *In re Cendant Corp. Litig.*, 264 F.3d 201, 269 (3d Cir. 2001) (finding that PSLRA permits aggregating financial interests of unrelated investors), *In*

Further, courts disagree whether the PSLRA permits them to auction the position of lead counsel to the lowest bidder without the plaintiff's prior approval.<sup>10</sup>

This disagreement among federal courts has received considerable attention, especially within the past year.<sup>11</sup> In August 2001, the United States Court of Appeals for the Third Circuit became the first federal appellate court to address both issues, and found that aggregation was permissible but court-ordered auctions were impermissible.<sup>12</sup> Concerned, however, by the growing use of auctions by federal courts, the Third Circuit appointed a Task Force to evaluate their permissibility under the PSLRA.<sup>13</sup> In October 2001, the Task Force concluded, in a finding that

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*re* Ribozyne Pharm., Inc. Sec. Litig., 192 F.R.D. 656, 662 (D. Colo. 2000) (discussing that unrelated investors may aggregate their financial interests), *In re* Nice Sys. Sec. Litig., 188 F.R.D. 206, 210 (D.N.J. 1999) (same), and *In re* The Baan Co. Sec. Litig., 186 F.R.D. 214, 217 (D.D.C. 1999) (same), with *Sakhrani v. Brightpoint, Inc.* 78 F. Supp. 2d 845, 854 (S.D. Ind. 1999) (rejecting aggregation in favor of appointing single investor as lead plaintiff), *In re* Donnkenny Inc. Sec. Litig., 171 F.R.D. 156, 157-58 (S.D.N.Y. 1997) (same), *In re* Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 813 (N.D. Ohio 1999) (same), and *In re* Waste Mgmt., Inc. Sec. Litig., 128 F. Supp. 2d 401, 413 (S.D. Tex. 2000) (same).

10. Compare *In re* Comdisco Sec. Litig., 141 F. Supp. 2d 951, 953 (N.D. Ill. 2001) (finding auction appropriate), *In re* Bank One S'holders Class Actions, 96 F. Supp. 2d 780, 784-85 (N.D. Ill. 2000) (same), *In re* Commtouch Software Ltd. Sec. Litig., No. 01-C-00719, (N.D. Cal. June 27, 2001) (same), cited in LAURA L. HOOPER & MARIE LEARY, AUCTIONING THE ROLE OF CLASS COUNSEL IN CLASS ACTION CASES: A DESCRIPTIVE STUDY 3 n.17 (2001), available at [http://www.ca3.uscourts.gov/classcounsel/fjcauctioning\\_rtf\\_.pdf](http://www.ca3.uscourts.gov/classcounsel/fjcauctioning_rtf_.pdf), *In re* Quintus Sec. Litig., 201 F.R.D. 475, 482 (N.D. Cal. 2001) (same), *In re* Network Assocs. Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1033-34 (N.D. Cal. 1999) (same), *Wenderhold v. Cylink Corp.*, 188 F.R.D. 577, 587-88 (N.D. Cal. 1999) (same), *In re* Cal. Micro Devices Sec. Litig., 168 F.R.D. 257, 270-71 (N.D. Cal. 1996) (same), *In re* Lucent Techs. Inc. Sec. Litig., 194 F.R.D. 137, 156-58 (D.N.J. 2000) (same), and *Sherleigh Assocs. LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 696 (S.D. Fla. 1999) (same), with *Cendant*, 264 F.3d at 220 (refusing to conduct auction), and *In re* Razorfish, Inc. Sec. Litig., 143 F. Supp. 2d 304, 310 (S.D.N.Y. 2001) (same).

11. See, e.g., *Cendant*, 264 F.3d at 268-83 (deciding this case on August 28, 2001); Third Judicial Circuit, Third Circuit Task Force Report (draft report Oct. 3, 2001), available at <http://www.ca3.uscourts.gov/classcounsel/report-finalchng.pdf> (releasing its preliminary findings in October 2001).

Commentators have also published in 2001 their findings and opinions about aggregation and auctions. See *Fisch*, *supra* note 8, at 53-104 (discussing problems associated with aggregation and court-ordered auctions in Spring/Summer 2001 issue); HOOPER & LEARY, *supra* note 10, at 1-120 (discussing auctions in descriptive study published on August 29, 2001).

12. See *Cendant*, 264 F.3d at 268-83 (finding that aggregating multiple unrelated investors is permissible under PSLRA and finding that auction is impermissible as matter of first resort). For a further discussion of the Third Circuit's decision in *Cendant* pertaining to the issue of aggregation, see *infra* notes 47-55 and accompanying text. For a further discussion of the Third Circuit's decision on auctions, see *infra* notes 149-55 and accompanying text.

13. See Third Circuit Task Force Report, *supra* note 11, at 1 (stating that Task Force was convened to "evaluate emerging practice of several district court judges throughout country of selecting class counsel and setting fees through a bidding or auction process"). The Task Force Report specifically stated:

may significantly impact securities fraud class actions, that courts should defer to the lead plaintiff's choice of counsel under a standard of review similar to the business judgment rule.<sup>14</sup> Although time will tell how much of an impact this finding will have among federal courts, the business judgment rule is an appropriate standard of review.<sup>15</sup>

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On January 30, 2001, the opinion author, acting as Chief Circuit Judge and Presiding Officer of the Third Circuit Judicial Council, announced the formation of a Task Force on the Selection of Class Counsel whose primary duty is to assess the propriety and efficacy of the use of the auction method in its various applications, and to formulate recommendations for the bench, bar, and public.

*Cendant*, 264 F.3d, at 258 n.36. The press release containing this announcement is available at <http://www.ca3.uscourts.gov/classcounsel/taskforce.pdf>. Other press releases relating to the 2001 Task Force, a list of questions that it is addressing, witness statements, and transcripts of the proceedings are all available at <http://www.ca3.uscourts.gov/classcounsel/public.htm>.

Some of the questions presented to the Task Force included: (1) whether auctioning tends to create a better result for class members than traditional appointment, (2) whether the auction process unfairly benefits large firms over small firms, (3) whether auction discourages plaintiff's attorneys from conducting a thorough pre-complaint investigation, (4) whether the costs associated with traditional appointment of class counsel (e.g., ex post fee determinations) are eliminated or reduced by auctioning and (5) whether the costs associated with auctioning are greater or less than those associated with traditional appointment. See Third Judicial Circuit, *List of Questions to Be Addressed by Third Circuit Task Force on Appointment of Counsel in Class Actions*, available at <http://www.ca3.uscourts.gov/classcounsel/Questions/Listofquestions.pdf>. For a discussion of the Third Circuit Task Force's findings, see *infra* notes 180-83 and accompanying text.

14. See Third Circuit Task Force Report, *supra* note 11, at 88 (recommending that "scrutiny akin to the business judgment rule, ordinarily applied in the context of corporate board decisions, should be applied to the lead plaintiff's choice of counsel and to the fee arrangements"). In reaching its decision, the Task Force received information from practicing attorneys who supported the use of the business judgment rule. See *id.* app. B, at 5-6 (statement by Keith Johnson) (stating that court must defer to counsel selection decisions made by lead plaintiff under business judgment rule). According to other practicing attorneys, the business judgment rule would create a presumption that the decision will be left undisturbed as long as it was made in good faith and on an informed basis. See *id.* app. B, at 5 (statement by Stuart M. Grant & Jay W. Eisenhofer) (supporting use of business judgment rule).

15. For a discussion and analysis of the applicability of the business judgment rule to court-ordered auctions, see *infra* notes 184-235 and accompanying text. Courts and scholars found that the results of the 1985 Third Circuit Task Force Report had a significant impact on the method in which courts considered the lodestar method. See *Goodrich v. E.F. Hutton Group*, 681 A.2d 1039, 1047 (Del. 1996) (stating that 1985 Third Circuit Task Force report was significant event that led courts to reconsider lodestar method of calculating common fund fee awards) (citing Report of the Third Circuit Task Force, *Court Awarded Attorney Fees*, 108 F.R.D. 237, 255 (1985)); MELVIN A. EISENBERG, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS* 1012 (2000) (recognizing impact of 1985 Third Circuit Task Force Report). For a discussion of the business judgment rule and its applicability to the lead plaintiff's choice of counsel, see *infra* notes 124-30 and accompanying text.

This Comment argues that, consistent with the statutory text of the PSLRA, aggregating the financial interests of a small number of investors is permissible; however, auctions as a first choice among courts are impermissible under the business judgment rule.<sup>16</sup> Part II of this Comment discusses the PSLRA.<sup>17</sup> Part III summarizes court analyses of aggregation.<sup>18</sup> Part IV argues that the PSLRA permits aggregating a small number of investors.<sup>19</sup> Part V discusses court-ordered auctions and the business judgment rule.<sup>20</sup> Part VI summarizes court analyses of court-ordered auctions and the Task Force's analysis of auctions.<sup>21</sup> Part VII argues that a court must defer to the lead plaintiff's choice of counsel under a standard of review similar to the business judgment rule, but under limited circumstances may order an auction.<sup>22</sup>

## II. THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Before Congress enacted the PSLRA, securities class actions typically were characterized as "abusive" and "lawyer-driven" lawsuits in which client investors had little or no control over their counsel's decisions.<sup>23</sup> Courts traditionally appointed the lead plaintiff and the lead counsel on a "first come, first serve" basis.<sup>24</sup> As a result, lawyers were anxious to file the first

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16. For a discussion and analysis of aggregation, see *infra* notes 75-115 and accompanying text. For a discussion and analysis of the business judgment rule and its applicability on auctions, see *infra* notes 184-235 and accompanying text.

17. For a discussion of the PSLRA, see *infra* notes 23-43 and accompanying text.

18. For a discussion and summary of court analyses of aggregation, see *infra* notes 44-74 and accompanying text.

19. For a discussion and analysis that the PSLRA permits aggregation, see *infra* notes 75-102 and accompanying text.

20. For a discussion of court-ordered auctions and the background of the business judgment rule, see *infra* notes 119-43 and accompanying text.

21. For a discussion of court analyses and the Third Circuit Task Force findings on court-ordered auctions, see *infra* notes 144-83.

22. For a discussion and analysis of the business judgment rule as applied to court-ordered auctions, see *infra* notes 184-239 and accompanying text.

23. See S. REP. NO. 104-98, at 4-12, *reprinted in* 1995 U.S.C.C.A.N. 679, 683-691 (determining, based on extensive testimony, that lawyers engaged in abusive practices in federal system by filing "strike suits"). The Securities Subcommittee recognized that lawyers filed suits on behalf of "professional plaintiffs" who made it "easy for lawyers to find individuals willing to play the role of wronged investor for purposes of filing a class action lawsuit." See *id.* at 10, *reprinted in* 1995 U.S.C.C.A.N. 679, 689 (recognizing need to eliminate abusive practice of lawyers selecting professional plaintiff in order to file frivolous suit). As a result, lawyers were known to have used securities class actions as their own personal vehicles. See Weiss & Beckerman, *supra* note 4, at 2065 (acknowledging that plaintiffs' attorneys seek to advance their own financial interests, rather than interests of investors they purport to represent).

24. See S. REP. NO. 104-98, at 6, *reprinted in* 1995 U.S.C.C.A.N. 679, 685 (stating that courts appointed plaintiff and counsel based on who filed first complaint); Weiss & Beckerman, *supra* note 4, at 2062 (stating that plaintiffs' lawyers created "race to the courthouse" to file the first complaint).

complaint and refrained from engaging in adequate discovery or using diligence to draft it.<sup>25</sup> Further, lawyers selected “professional plaintiffs” because these types of plaintiffs had little financial stake in the litigation and therefore lacked incentive to monitor the lawyers effectively.<sup>26</sup> As a result, lawyers used class actions as their “personal vehicles” and made decisions that reflected their personal financial interests rather than the interests of the class.<sup>27</sup>

As a means of preventing abusive practices and increasing client control, Congress had two goals.<sup>28</sup> First, Congress sought to have courts appoint a plaintiff with the largest financial stake in the suit because presumably this type of plaintiff actively would monitor decisions made by the lead counsel and seek the highest return.<sup>29</sup> Second, Congress sought

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25. See S. REP. NO. 104-98, at 6, *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (recognizing that lawyers spent minimal time preparing complaints in securities class actions because first lawsuit filed also renders lead plaintiff); Fisch, *supra* note 8, at 57 (same). Three problems emerged as a consequence of appointing the lawyer who filed the first complaint:

First, lawyers [were] encouraged to file complaints rapidly and defer their investigation of the merits of those complaints until after filing. Second, to file a complaint rapidly, lawyers [were required to] seek out prospective plaintiffs rather than wait[ ] to be approached by a disgruntled investor. Finally, class counsel [was] appointed with little consideration given to qualifications.

*Id.*

26. See S. REP. NO. 104-98, at 10, *reprinted in* 1995 U.S.C.C.A.N. 679, 689 (stating that “proliferation of professional plaintiffs made it easy for lawyers to find individuals willing to play role of wronged investor for purposes of filing class action lawsuit”); H.R. CONF. REP. 104-369, at 32, *reprinted in* 1995 U.S.C.C.A.N. 730, 732 (noting that professional plaintiffs often received bounty payments or bonuses by counsel for serving as lead plaintiff); *In re* Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 813 (N.D. Ohio 1999) (“All professional plaintiff share one very important characteristic in common, however: they have relatively small amounts of money invested in any one security and typically suffer relatively small financial losses.”).

27. See generally Weiss & Beckerman, *supra* note 4, at 2065 (recognizing that plaintiffs’ attorneys advanced their own financial interests, rather than interests of investors they purported to represent, not only by taking initiative in filing class actions, but by manner in which they conducted and agreed to settle such litigation). In a settlement agreement, “plaintiffs’ attorneys typically did not rely on [the] plaintiffs for vital testimony, did not bargain with plaintiffs over the fees they [would] be paid, and did not require plaintiffs’ approval of the terms on which they propose[d] to settle class actions.” See *id.*

Further, the Rules of Professional Conduct rarely constrained attorneys in class actions because class members failed to actively monitor their attorney’s conduct. See CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 8.14 (1986) (noting continued difficulty in preventing lawyer-driven litigation).

28. For a further discussion of reform of the securities class action system, see *infra* notes 29-31 and accompanying text.

29. See S. REP. NO. 104-98, at 11, *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (recognizing that courts would be more confident of settlements negotiated under supervision of large investors because such investors have same interests as plaintiff class generally). The Senate Committee on Banking, Housing and Urban Affairs intended this provision to increase the likelihood that institutional investors would serve as lead plaintiff by requiring that the plaintiff have the largest financial inter-



to have the lead plaintiff select and retain lead counsel as a further means for the plaintiff to control counsel's decisions.<sup>30</sup> Therefore, in adopting the PSLRA, Congress incorporated both goals within the lead plaintiff provision and the lead counsel provision.<sup>31</sup>

The lead plaintiff provision states, in pertinent part, that the court appoint as lead plaintiff "the member *or members* of the purported plaintiff class that the court determines to be most capable of *adequately* representing the interests of class members . . . ."<sup>32</sup> The provision further requires

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est. *See id.* (noting that system before PSLRA often prevented institutional investors from selecting counsel or serving as lead plaintiff in class actions). As one representative of institutional investors stated before the Committee, "[a]s the largest shareholders in most companies, we are the ones who have the most to gain from meritorious securities litigation." *Private Litigation Under Federal Securities Laws: Hearing on H.R. 1058 Before the Senate Committee on Banking, Housing, and Urban Affairs*, 103d Cong. (1993) (statement of Maryellen F. Andersen, Council of Institutional Investors).

Monitoring of counsel by institutional investors was expected to yield three benefits. *See* Weiss & Beckerman, *supra* note 4, at 2121-23 (recognizing benefits of institutional investors serving as lead plaintiff). First, the size of the institutional investors' stakes suggests that they are likely to be reasonably diligent to ensure that plaintiffs' counsel effectively represent their interests and the interest of the plaintiff class. *See id.* at 2121 (stating larger stakes corresponds to increase in diligence in monitoring counsel).

Second, the number of frivolous suits filed would supposedly decrease because the institutional plaintiffs would be more sensitive to their costs on publicly traded companies. *See id.* at 2122 (noting that investors would want to discourage strike suits because such suits impose substantial costs directly on defendant corporations and indirectly on corporations' shareholders); R. Chris Heck, Comment, *Conflict and Aggregation: Appointing Institutional Investors as Sole Lead Plaintiffs Under the PSLRA*, 66 U. CHI. L. REV. 1199, 1205 (1999) (recognizing that lawyers would hesitate to file frivolous suits if their actions were effectively monitored). Third, institutional investors would prevent more cases from settling because actual litigation would clarify substantive law and provide a public benefit. *See* Weiss & Beckerman, *supra* note 4, at 2123 (stating that clarifying rules governing corporations' disclosure responsibilities should reduce corporations' costs).

As a result of the PSLRA, institutional investors "are developing ongoing relationships with plaintiffs' firms and increasing sophistication in evaluating and negotiating fee arrangements." *See* Fisch, *supra* note 8, at 62 (discussing one result of encouraging institutional investors under PSRLA).

30. *See* 15 U.S.C. § 78u-4(a)(3)(B)(v) (stating that plaintiff selects and retains counsel with approval of court); *see also* S. REP. NO. 104-98, at 11-12, *reprinted in* 1995 U.S.C.C.A.N. 679, 690-91 (stating that Congress intended to permit most adequate plaintiff to choose counsel rather than have counsel choose plaintiff); Fisch, *supra* note 8, at 78 (stating that lead counsel provision enhances lead plaintiff's ability to monitor the litigation) (citing Weiss & Beckerman, *supra* note 4, at 2107).

31. *See* 15 U.S.C. § 78u-4(a)(3)(B) (referring to statutory text of lead plaintiff and lead counsel provisions); Fisch, *supra* note 8, at 60-62 (stating that Congress incorporated in PSLRA means to create greater client control).

32. 15 U.S.C. § 78u-4(a)(3)(B)(i) (emphasis added). The lead plaintiff provision states, in scattered parts:

(i) IN GENERAL – Not later than 90 days after the date on which a notice is published . . . the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the com-

that the court adopt a rebuttable presumption that “the most adequate plaintiff . . . is the person or *group of persons* that . . . in the determination of the court, has the *largest financial interest* in the relief sought by the class; and . . . otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.”<sup>33</sup> The lead counsel provision states that “[t]he most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.”<sup>34</sup>

Based on the lead plaintiff provision, courts must determine whether the prospective lead plaintiff has the largest financial interest, can adequately represent the interests of the class and can satisfy the requirements of Rule 23 of the Federal Rules of Civil Procedure.<sup>35</sup> In determining a plaintiff’s financial interest, courts typically evaluate three factors: (1) the number of shares purchased by the prospective plaintiff during the class period, (2) the total net funds expended by the plaintiffs during the class period and (3) the approximate losses suffered during the class period.<sup>36</sup>

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plaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines the most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the ‘most adequate plaintiff’) in accordance with this subparagraph. . . .

(iii) REBUTTABLE PRESUMPTION –

IN GENERAL – . . . [F]or purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that –

(aa) has either filed the complaint or made a motion in response to a notice . . .

(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

15 U.S.C. § 78u-4(a)(3)(B)(i)-(iii).

The lead counsel provision provides:

(v) SELECTION OF LEAD COUNSEL – The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

15 U.S.C. § 78u-4(a)(3)(B)(v).

33. 15 U.S.C. § 78u-4(a)(3)(B)(iii) (emphasis added).

34. 15 U.S.C. § 78u-4(a)(3)(B)(v).

35. See 15 U.S.C. § 78u-4(a)(3)(B)(iii) (stating three factors that courts evaluate in securities class action); see also *In re Cendant Corp. Litig.*, 264 F.3d 201, 262-68 (3d Cir. 2001) (identifying presumptive lead plaintiff by evaluating plaintiff’s financial interest and adequacy as required under lead plaintiff provision and Rule 23); *In re The Baan Company Sec. Litig.*, 186 F.R.D 214, 216-18 (D.D.C. 1999) (determining whether group of investors has largest financial interest and can adequately represent class); *In re Microstrategy Inc. Sec. Litig.*, 110 F. Supp. 2d 427, 433 n.11 (E.D. Va. 2000) (stating that more than one class member may satisfy adequacy requirement, but only one person may have largest financial stake in litigation).

36. See *Cendant*, 264 F.3d at 262 (identifying factors to consider in determining financial interest); *Lax v. First Merchants Acceptance Corp.*, 1997 WL 461036, at \*5 (N.D. Ill. Aug. 11, 1997) (same); *In re Olsten Corp. Sec. Litig.*, 3 F. Supp. 2d 286, 295 (E.D.N.Y. 1998) (same); *In re Ribozyme Pharm. Inc. Sec. Litig.*, 192 F.R.D.

As discussed later, when multiple investors are seeking appointment, some courts have aggregated or combined their financial interests in determining which plaintiff group has the largest financial interest.<sup>37</sup>

Rule 23 of the Federal Rules of Civil Procedure, like the PSLRA, requires that the plaintiff adequately represent the interests of the class.<sup>38</sup> In determining the adequacy of the prospective plaintiff under the PSLRA and Rule 23, several courts have evaluated whether the investor is able and willing to vigorously represent the claims of the class, has no conflicting claims with those of the class and can select competent class counsel to represent the class.<sup>39</sup>

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656, 660-61 (D. Colo. 2000) (same). In *Ribozyme*, the court evaluated two groups of investors, the “Ribozyme Lead Plaintiffs” and the “Ribozyme Shareholders.” *See id.* (utilizing four-part test in determining lead plaintiff). The Ribozyme Lead Plaintiff purchased 8,500 shares during the class period, purchased 8,500 net shares during the class period, expended \$154,250 in total net funds and suffered approximate losses of \$75,093.75. *See id.* The Ribozyme Shareholders purchased 7,000 shares during the class period, purchased 5,000 net shares during the class period, expended \$96,075 in net funds during the class period, and lost \$53,428. *See id.* Based on this careful evaluation, the court determined that the Ribozyme Lead Plaintiff had the largest financial interest in the lawsuit. *See id.*

37. *See, e.g., Cendant*, 264 F.3d at 223 (finding district court decision appropriate in appointing presumptive lead plaintiff group whose alleged combined losses totaled more than \$89 million while largest amount alleged by other movant group was \$10.6 million); *In re Horizon/CMS Healthcare Corp. Sec. Litig.*, 3 F. Supp. 2d 1208, 1211 (D.N.M. 1998) (finding that financial loss by six investors can be aggregated in appointing them as lead plaintiff); *In re Informix Corp. Sec. Litig.*, 1997 U.S. Dist. LEXIS 23687, at \*7-8 (N.D. Cal. Oct. 17, 1997) (evaluating aggregate losses of two movant groups before appointing lead plaintiff group); *In re Ride, Inc. Sec. Litig.*, 1997 U.S. Dist. LEXIS 23689 (W.D. Wash. Aug. 5, 1997) (stating that “it is clear that the ‘financial interest’ of plaintiffs aligned together should be computed by aggregating their claims”). For a further discussion of aggregation, see *infra* notes 44-115 and accompanying text.

38. *Compare* FED. R. Civ. P. 23 (stating “representative parties will fairly and adequately protect the interests of the class”), with 15 U.S.C. § 78u-4(a)(3)(B)(i) (stating that court “shall appoint as lead plaintiff the member or members or the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members . . .”).

39. *See, e.g., Cendant*, 264 F.3d at 265 (discussing criteria of court’s inquiry into adequacy of prospective plaintiffs); *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 291 (2d Cir. 1992) (“Under Rule 23(a)(4), adequacy of representation is measured by two standards. First, class counsel must be ‘qualified, experienced and generally able’ to conduct the litigation. Second, the class members must not have interests that are ‘antagonistic’ to one another.”); *Lerwill v. Inflight Motion Pictures, Inc.*, 582 F.2d 507, 512 (9th Cir. 1978) (“[T]wo criteria for determining the adequacy of representation have been recognized. First, the named representatives must appear able to prosecute the action vigorously through qualified counsel, and second, the representatives must not have antagonistic or conflicting interests with the unnamed members of the class.”); *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 482 (N.D. Cal. 2001) (stating court must determine whether plaintiff with largest loss has negotiated with counsel adequately in determining whether adequacy requirement is met); *The Baan Co.*, 186 F.R.D. at 225 (stating that proposed lead plaintiff should provide full information about “group” in order for court to analyze group’s adequacy). The court in *The Baan Co.* stated:

Since Congress adopted the PSLRA, courts have disagreed over the proper interpretation of the lead plaintiff provision and the lead counsel provision.<sup>40</sup> First, courts have disagreed over whether they can appoint multiple unrelated investors to serve as lead plaintiff and whether it can aggregate their financial interests in the litigation in determining which prospective lead plaintiff has the largest financial stake.<sup>41</sup> Second, courts have disagreed over whether they should defer to the lead plaintiff's choice of counsel or actively engage in the selection process for lead counsel.<sup>42</sup> A proper interpretation of these two provisions is necessary to pro-

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[T]he proposed lead plaintiff should provide full information about the "group" . . . includ[ing] detailed descriptions of its members, including their background, experience, and capabilities relating to the role of lead plaintiff; any pre-existing relationships among them; the manner in which the "group" was formed; an explanation of how its members would function collectively; and a description of the mechanism that the group members and lead counsel have established to communicate with one another about the litigation.

*The Baan Co.*, 186 F.R.D. at 225.

The group is deemed adequate if they have no competing interests with another and they are able to select counsel that is sufficiently competent to conduct litigation. See Heck, *supra* note 29, at 1209 (stating that adequacy requires class counsel selected by class representative be sufficiently competent to conduct litigation and class members not have antagonistic interests).

40. For a discussion of the disagreement among courts over the proper interpretation of the lead plaintiff provision, see *infra* notes 44-74 and accompanying text.

41. Compare *Cendant*, 264 F.3d at 265 (determining that three unrelated pension funds can adequately represent class upon showing "willingness and ability to select competent class counsel and negotiate reasonable retainer agreement with that counsel"), and *In re Oxford Health Plans, Inc. Sec. Litig.*, 182 F.R.D. 42, 50 (S.D.N.Y. 1998) (holding that three unrelated investors satisfy adequacy requirement because no conflict of interest between any of plaintiffs and members of class existed and plaintiff obtained qualified, experienced counsel), with *In re Waste Mgmt. Inc.*, 128 F. Supp. 2d 401, 413 (S.D. Tex. 2000) (finding pre-litigation relationship must exist based on more than their losing investment to satisfy terms of PSLRA), *In re Razorfish, Inc. Sec. Litig.*, 143 F. Supp. 2d 304, 308 (S.D.N.Y. 2001) (finding that group of unrelated investors "cobbled together" by efforts of lawyer renders them inadequate), and *In re Donnkenny Inc. Sec. Litig.*, 171 F.R.D. 156, 157 (S.D.N.Y. 1997) (rejecting group of unrelated investors).

Some courts have found that aggregation may be permitted when the investors are related, meaning they have a union that exists by more than the mere happenstance, such as in a partnership, members of a family or among various subsidiaries of a corporation. See, e.g., *The Baan Co.*, 186 F.R.D. at 225 (stating that court may aggregate larger number of investors if pre-existing relationship among group members exists); *In re Telxon Corp. Sec. Litig.*, 67 F. Supp. 2d 803, 816 (N.D. Ohio 1999) (stating that large group cannot adequately control counsel unless there is relationship among them); *Razorfish*, 143 F. Supp. 2d at 309 (stating that eighteen-member group is inadequate based on fact that they have no prior relationship and therefore cannot "collectively ride herd on counsel anywhere as well as could a single sophisticated entity").

42. Compare *Cendant*, 264 F.3d at 276 (stating that court will defer to lead plaintiff's choice of counsel if it was result of good faith selection and negotiation process, and was arrived at through meaningful arms-length bargaining), and *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 482 (N.D. Cal. 2001) (stating that court should

vide the courts with an appropriate method of selecting the class representatives.<sup>43</sup>

### III. SUMMARY OF COURT ANALYSES OF AGGREGATION

Courts disagree over whether they can aggregate the financial interests of multiple unrelated investors in deciding which prospective plaintiff has the largest financial interest.<sup>44</sup> In making this decision, courts have examined the statutory text and the legislative history of the PSLRA to determine whether more than one investor can serve as lead plaintiff.<sup>45</sup> Then, courts have evaluated whether multiple investors, with no common bond other than a similarly suffered financial loss, can vigorously serve the interests of the class, select competent counsel and monitor the litigation; in other words, can unrelated investors “adequately” serve the interests of the class.<sup>46</sup>

#### A. Courts that Permit Aggregation

Recently, in *In re Cendant Corporation Litigation*,<sup>47</sup> the United States Court of Appeals for the Third Circuit decided that the PSLRA permits

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not substitute its judgement for that of lead plaintiff if lead plaintiff adequately negotiated with counsel), *with In re Bank One S'holder Class Actions*, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (finding auction appropriate to obtain lower fee for class counsel).

43. For a discussion and analysis of the PSLRA's lead plaintiff and lead counsel provisions, see *infra* notes 75-115, 185-239 and accompanying text.

44. Compare *Cendant*, 264 F.3d at 269 (holding that PSLRA permits aggregating financial interests of unrelated investors), *In re Ribozyme Pharms., Inc., Sec. Litig.*, 192 F.R.D. 656, 662 (D. Colo. 2000) (same), *In re Nice Sys. Sec. Litig.*, 188 F.R.D. 206, 214-17 (D.N.J. 1999) (same), and *The Baan Co.*, 186 F.R.D. at 217 (same), *with Sakhrani*, 78 F. Supp. 2d at 854 (rejecting aggregation in favor of appointing single investor as lead plaintiff), *Donnkenny*, 171 F.R.D. at 157-58 (same), *Telxon*, 67 F. Supp. 2d at 813 (“Such a ‘group’ would be a ‘lead’ plaintiff in name only, in substance, those individuals would essentially constitute a collection of lead plaintiffs, unbound by any allegiance to one another and unlikely to function as a unified whole.”), and *Waste Mgmt.*, 128 F. Supp. 2d at 413 (S.D. Tex. 2000) (rejecting aggregation).

45. See, e.g., *Cendant*, 264 F.3d at 266 (evaluating statutory text of PSLRA and finding that multiple investors can serve as lead plaintiff); *Waste Mgmt.*, 128 F. Supp. 2d at 412 (finding that “group” must demonstrate cohesiveness to be appointed lead plaintiff).

46. Compare *Cendant*, 264 F.3d at 266 (permitting unrelated investors to aggregate), *Ribozyme*, 192 F.R.D. at 662 (appointing lead plaintiff group of four investors); *Nice Sys.*, 188 F.R.D. at 210 (D.N.J. 1999) (allowing aggregation of proposed plaintiffs who met requirements), and *The Baan Co.*, 186 F.R.D. at 217 (appointing triumvirate of investors), *with Waste Mgmt.*, 128 F. Supp. 2d at 412-13 (declining to appoint unrelated investors as lead plaintiff); *Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d 1146, 1153-54 (N.D. Cal. 1999) (same); *Telxon*, 67 F. Supp. 2d at 809-13 (same); *Donnkenny*, 171 F.R.D. at 157-58 (same).

47. 264 F.3d 201 (3d Cir. 2001).

aggregation.<sup>48</sup> In that case, several individual investors, as appellants, appealed the district court's decision to appoint three unrelated institutional investors as lead plaintiff.<sup>49</sup> First, the appellants argued that the PSLRA does not permit more than one investor to serve as lead plaintiff and, second, that unrelated investors cannot adequately serve the interests of the class.<sup>50</sup> The Third Circuit rejected both arguments and first determined that the term "group of persons" under the lead plaintiff provision means that more than one investor can serve as lead plaintiff.<sup>51</sup>

Second, the court agreed with the district court that a relationship between the investors prior to the litigation is unnecessary in order to serve as lead plaintiff.<sup>52</sup> According to the Third Circuit, the correct construction of the PSLRA is whether the group can serve the interests of the class adequately, not whether they are related.<sup>53</sup> In evaluating the group's adequacy, the court determined that: (1) the group demonstrated a willingness and ability to represent the claims of the class vigorously, (2) its members had experience serving as plaintiffs in prior lawsuits, (3) it selected competent class counsel and (4) it negotiated a reasonable fee agreement with counsel.<sup>54</sup> As a result, the Third Circuit affirmed the district court's decision to appoint three institutional investors as lead plaintiff.<sup>55</sup>

The Central District of California in *Takeda v. Turbodyne Technologies, Inc.*<sup>56</sup> and other district courts have likewise found that aggregation is permissible.<sup>57</sup> In *Takeda*, the court agreed to aggregate the financial interests

48. See *Cendant*, 264 F.3d at 266-68 (holding that three unrelated investors can be aggregated).

49. See *id.* at 221-24 (stating facts of case). In this case, fifteen individuals filed motions to serve as lead plaintiff. See *id.* at 223. One of the plaintiff groups, the CalPERS Group, was a consortium of three of the largest publicly-managed pension funds in the United States. See *id.* The District Court appointed this group as the lead plaintiff. See *id.* Four investors who sought lead plaintiff appointment appealed this decision to the Third Circuit. See *id.* at 230.

50. See *id.* at 243 (stating facts of case).

51. See *id.* at 266-67 (finding that court must make threshold adequacy determination whether movant with largest interest in relief sought is group rather than individual person or entity) (citing 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)).

52. See *Cendant*, 264 F.3d at 268 (stating that district court identified most adequate plaintiff).

53. See *id.* at 266 ("The statute contains no requirement mandating that the members of a proper group be 'related' in some manner; it requires only that any such group 'fairly and adequately protect the interests of the class.'").

54. See *id.* at 267-68 (affirming district court's decision that adequacy requirement under Rule 23 and PSLRA was satisfied). The court also recognized that there was no indication that the group was created artificially by its lawyers, and the fact that the group contains three members offers no reason to doubt that its members could operate effectively as a single unit. See *id.* (agreeing that adequacy requirement satisfied).

55. See *id.* at 268 (finding district court did not abuse its discretion).

56. 67 F. Supp. 2d 1129 (C.D. Cal. 1999).

57. See e.g., *In re The First Union Corp. Sec. Litig.*, 157 F. Supp. 2d 638, 641-44 (W.D.N.C. 2000) (appointing three individuals and one institutional investor as

of seven non-institutional investors.<sup>58</sup> The court found that these members were adequate to serve together as lead plaintiff because: (1) they had a sufficient interest in the outcome of the case to ensure that the action would be prosecuted vigorously, (2) they had a common interest in the litigation and (3) they had retained adequate counsel.<sup>59</sup> As a result, the court appointed the group as lead plaintiff.<sup>60</sup>

### B. Courts Refusing to Aggregate Unrelated Investors in PSLRA Cases

Some courts have argued that the PSLRA does not permit aggregation if either counsel forms the group for the purpose of obtaining lead counsel appointment, or if the group consists of unrelated investors.<sup>61</sup> In the first instance, several courts followed the line of reasoning of the Southern District of New York in *In re Razorfish, Inc. Securities Litigation*<sup>62</sup> by refusing to permit “lawyer-driven aggregation.”<sup>63</sup> In contrast to the facts in *Cendant*, where the investors joined together and selected their counsel as part of a group decision, the investors in *Razorfish* did not select their counsel or join together on their own initiative, but rather were grouped

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lead plaintiff); *In re Party City Sec. Litig.*, 189 F.R.D. 91, 114-15 (D.N.J. 1999) (appointing institutional investor and individual investor as lead plaintiff); *In re Nice Sys. Sec. Litig.*, 188 F.R.D. 206, 220-223 (D.N.J. 1999) (appointing group of five individuals as lead plaintiff); *In re Olsten Corp. Sec. Litig.*, 3 F. Supp. 2d 286, 296-97 (E.D.N.Y. 1998) (consolidating action of four investors to serve as group and subsequently appointing this group as lead plaintiff).

58. *See Takeda v. Turbodyne Tech., Inc.*, 67 F. Supp. 2d 1129, 1137-38 (C.D. Cal. 1999) (finding adequacy of group, not relationship, as proper threshold question). In this case, two plaintiff groups, each with hundreds of class plaintiffs, moved for appointment as lead plaintiff. *See id.* at 1130 (stating facts of case). The court denied the motion, finding that both groups were unwieldy and not capable of directing the litigation effectively. *See id.* at 1131. The groups then proposed that a smaller subset of persons be collectively denominated as lead plaintiffs. *See id.* The court appointed one group with seven members that had suffered losses approaching \$1 million. *See id.*

59. *See id.* at 1137 (identifying factors to determine group’s adequacy).

60. *See id.* (holding that group of seven was adequate to serve as lead plaintiff).

61. *See, e.g., Sakhmani v. Brightpoint, Inc.*, 78 F. Supp. 2d 845, 854 (S.D. Ind. 1999) (rejecting aggregation of unrelated investors in favor of appointing one investor as lead plaintiff); *Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d 1146, 1154 (N.D. Cal. 1999) (same); *In re Razorfish, Inc. Sec. Litig.*, 143 F. Supp. 2d 304, 309 (S.D.N.Y. 2001) (stating that because group of unrelated investors “has no independent existence and its composite members have no prior relationship, there is nothing to suggest that they will collectively ride herd on counsel anywhere as well as could a single sophisticated entity”).

62. 143 F. Supp. 2d 304 (S.D.N.Y. 2001).

63. *See Razorfish*, 143 F. Supp. 2d at 307 (refusing to appoint group organized by lawyer’s desire to “obtain oligopolistic profits”); *Aronson*, 79 F. Supp. 2d at 1152-54 (N.D. Cal. 1999) (recognizing purpose of PSLRA is to replace lawyer-driven litigation); *In re Donnkenny Inc. Sec. Litig.* 171 F.R.D. 156, 157-58 (S.D.N.Y. 1997) (stating that one principal purpose of PSLRA is to prevent lawyer-driven litigation).

together by counsel.<sup>64</sup> The court denied this group's motion for lead plaintiff appointment because the group could not vigorously represent the interests of the class or effectively communicate with one another.<sup>65</sup> In addition, the court found that this type of "lawyer-driven" litigation runs afoul of the legislative history of the PSLRA in which Congress sought to prevent lawyer-driven litigation in favor of client-driven litigation.<sup>66</sup>

Some district courts have followed the Northern District of Ohio's reasoning in *In re Telxon Corp. Securities Litigation*<sup>67</sup> by refusing to aggregate investors when their only common relationship is based on a financial interest in the litigation.<sup>68</sup> In *Telxon*, two groups filed a motion for lead counsel appointment, the first having eighteen unrelated investors and the second having two unrelated investors.<sup>69</sup> The court rejected the motion by the group of eighteen investors because, according to the court, such a large group precludes any single member of the group and the group as a whole from exercising control over the litigation.<sup>70</sup> The court reasoned that it is more difficult for each member to communicate with

64. See *Razorfish*, 143 F. Supp. 2d at 308 (stating that members of group had no prior connection with each other or with each other's counsel). In this case, counsel grouped together a large financial institution, two smaller "day-trading" companies and an individual investor, and then moved the court to appoint them as lead plaintiff. See *id.* (stating facts of case).

65. See *id.* at 308-09 (finding that group could not satisfy adequacy requirement under PSLRA and Rule 23 and therefore could not be appointed lead plaintiff).

66. See *id.* at 308 (recognizing that group was "simply an artifice cobbled together by cooperating counsel"). For a further discussion and analysis of the legislative history of the PSLRA, see *infra* notes 85-86, 105-08 and accompanying text.

67. 67 F. Supp. 2d 803 (N.D. Ohio 1999).

68. See *In re Telxon Corp. Sec. Litig.*, 67 F. Supp. 2d 803, 823 (N.D. Ohio 1999) (refusing to aggregate group when members of group have no pre-existing relationship or association); *Aronson v. McKesson HBCO, Inc.*, 79 F. Supp. 2d 1146, 1153-54 (N.D. Cal. 1999) (adopting narrow view in which unrelated investors cannot aggregate); *Sakhrani v. Brightpoint*, 78 F. Supp. 2d 845, 854 (S.D. Ind. 1999) (rejecting aggregation in favor of appointing single investor as lead plaintiff); *In re Donnkenny Inc. Sec. Litig.* 171 F.R.D. 156, 157-58 (S.D.N.Y. 1997) (same).

69. See *Telxon*, 67 F. Supp. 2d at 809-10 (stating facts of case). In this case, the Alsin Group and the Hayman Group sought lead plaintiff appointment. See *id.* at 808 (stating facts). The Alsin Group consisted of eighteen individual plaintiffs who collectively held approximately 332,000 shares of Telxon common stock and allegedly suffered losses of approximately \$3.0 million during a class period defined as May 8, 1998 through January 27, 1999. See *id.* The Hayman Group consisted of three individuals, two of whom were brothers who collectively lost \$1.24 million. See *id.* at 809. The third member had lost \$156,643 but had no apparent prior or contemporaneous relationship or association with the brothers. See *id.*

70. See *id.* 809-10 (finding that eighteen-member group cannot call itself "group" under PSLRA). The court examined the plain and ordinary meaning of the term "group" in the dictionary and found that the term refers to a relatively small number of individuals assembled together. See *id.* at 811 (interpreting language of PSLRA).



the other members and to speak with a single coherent voice when counsel “drives” the group together.<sup>71</sup>

As to the group of two unrelated investors, the court similarly rejected aggregating their financial interests.<sup>72</sup> According to the court, unrelated investors cannot speak or act with a uniform purpose and therefore cannot monitor effectively the decisions by their counsel.<sup>73</sup> As a result of this decision, and the courts that follow its line of reasoning, a disagreement exists among courts in deciding whether more than one investor can serve as lead plaintiff and whether they must have a pre-litigation relationship.<sup>74</sup>

#### IV. THE PSLRA PERMITS AGGREGATION

The statutory text of the PSLRA permits a court to aggregate the financial interests of unrelated investors provided that the group adequately represents the interests of the class.<sup>75</sup> In order for a group to demonstrate their adequacy, the legislative history provides only that the group demonstrate that they can actively represent the class and that it can drive the litigation.<sup>76</sup> Neither the statutory language nor the legislative history, however, supports aggregating a large number of investors having small financial interests in the litigation.<sup>77</sup>

##### A. *Aggregating a Small Number of Investors Is Consistent with the PSLRA*

In order to accept aggregation, it must be determined that: (1) the PSLRA permits multiple investors to serve as the lead plaintiff, (2) a prior relationship to the litigation is not required and (3) the financial interests of the individual group members should be aggregated.<sup>78</sup> As to the first determination, the statutory text of the PSLRA explicitly permits more

71. *See id.* at 816 (describing primary difficulty of having large numbers of persons comprising group).

72. *See id.* at 813 (stating that group must consist of more than “mere assemblage of unrelated persons who share nothing in common *other than* the twin fortuities that (1) they suffered losses and (2) they entered into retainer agreements with the same attorney or attorneys”).

73. *See id.* at 815-16 (noting that in larger groups there is less incentive for any member of group, or group as whole to supervise litigation).

74. *Compare In re Cendant Corp. Litig.*, 264 F.3d 201, 268-69 (3d Cir. 2001) (holding that three member group of unrelated investors can be aggregated), *and Takeda v. Turbodyne Tech., Inc.*, 67 F. Supp. 2d 1129, 1137-38 (C.D. Cal. 1999) (holding that group of seven unrelated investors can be aggregated), *with Telxon*, 67 F. Supp. 2d at 823 (refusing to aggregate multiple investors solely because of their lack of relationship).

75. For a further discussion of the statutory interpretation of aggregation, see *infra* notes 79-94 and accompanying text.

76. For a further discussion of the legislative history as applied to the permissibility of aggregation, see *infra* notes 86-87 and accompanying text.

77. For a further discussion of the impermissibility of a large number of investors serving as the lead plaintiff under the PSLRA, see *infra* notes 101-08 and accompanying text.

78. *See Fisch, supra* note 8, at 69 (stating premises to accept aggregation).

than one investor to serve as the lead plaintiff.<sup>79</sup> The lead plaintiff provision states that the court can appoint as lead plaintiff the “member or members” of the class, and that the plaintiff be a “person or group of persons.”<sup>80</sup> The PSLRA has therefore made clear that courts may appoint more than one investor to serve as the lead plaintiff.<sup>81</sup>

As to the second and third determination, the statutory text is silent over whether multiple investors must have a prior relationship to the litigation and whether courts can aggregate their financial interests.<sup>82</sup> Despite this silence, appointing unrelated investors as lead plaintiff does not violate the lead plaintiff provision.<sup>83</sup> The text requires only that the court inquire into the adequacy of the group and not into the relationship of the group’s members.<sup>84</sup> To determine, however, whether aggregating multiple unrelated investors satisfies the adequacy requirement, the legislative history offers support, and simply requires that the lead plaintiff actively represent the class and drive the litigation as opposed to the lead counsel.<sup>85</sup> As a result, in certain instances, aggregating investors may satisfy both of these conditions.<sup>86</sup>

For example, the *Cendant* case illustrates a situation in which the court properly evaluated the group’s adequacy in deciding whether the group can be appointed as lead plaintiff.<sup>87</sup> In determining whether the group of three “unrelated” institutional investors could actively represent the class and drive the litigation, the court properly considered, consistent with the legislative history of the PSLRA, whether each member could exercise authority without interference by the other group members, moni-

79. See 15 U.S.C. § 78u-4(a)(3)(B) (providing textual support for allowing more than one investor to serve as lead plaintiff).

80. See 15 U.S.C. §§ 78u-4(a)(3)(B)(i) & (iii) (emphasis added) (illustrating that language of PSLRA allows more than one investor to serve as lead plaintiff).

81. See *id.* (recognizing explicit language to appoint multiple investors).

82. See *id.* (noting lack of explicit language as to second and third criteria).

83. For a further discussion of the permissibility of aggregation, see *infra* notes 83-100 and accompanying text.

84. See 15 U.S.C. §§ 78u-4(a)(3)(B)(i) (stating that court shall appoint plaintiff most capable of adequately representing interests of class members); see also *In re Cendant Corp. Litig.*, 264 F.3d 201, 266 (3d Cir. 2001) (disagreeing with those courts that have held that PSLRA invariably precludes group of “unrelated individuals” from serving as lead plaintiff). But see Fisch, *supra* note 8, at 69 (“It is a mistake, however, to conclude that the appearance of the term [“group”] mandates, or even permits, the appointment of large groups of unrelated investors.”); Heck, *supra* note 29, at 1218 (“Permitting courts to aggregate the financial losses of individual plaintiffs to determine what group has the largest financial interest in the litigation is one way in which the congressional purpose of favoring institutional investors can be frustrated.”).

85. See S. REP. NO. 104-98, at 10, reprinted in 1995 U.S.C.C.A.N. 679, 689 (“The lead plaintiff should actively represent the class. The Committee believes that the lead plaintiff—not lawyers—should drive the litigation.”).

86. For a further discussion and analysis of the adequacy requirement, see *infra* notes 87-100 and accompanying text.

87. See *Cendant*, 264 F.3d at 262-68 (evaluating statutory structure and legislative history in appointing most adequate plaintiff).

tor the lead counsel's decisions and work with rather than under the other investors.<sup>88</sup>

Requiring the court to assess the adequacy and financial interests of the group arguably burdens the judicial system.<sup>89</sup> Specifically, critics argue that by endorsing lead plaintiff groups, even those of reasonable size, courts transform the appointment process from a relatively objective inquiry into a subjective inquiry subject to unwarranted judicial intervention.<sup>90</sup> The statutory text, however, imposes a duty on the court to determine the adequacy of the lead plaintiff groups.<sup>91</sup> In particular, the PSLRA states that the court will appoint as lead plaintiff the "members of the purported class that the *court determines* to be most capable of adequately representing the interests of the class members . . . ."<sup>92</sup> Further, the text states that the most adequate plaintiff "in the *determination* of the court, has the largest financial interest . . . ."<sup>93</sup> Therefore, an independent inquiry by the district court is not only consistent with the PSLRA, but also required.<sup>94</sup>

It has been argued that a court appointment of multiple investors as lead plaintiff may divide the decision-making among the members of the group.<sup>95</sup> Members may disagree over how the litigation should proceed, resulting in an inefficient litigation.<sup>96</sup> Courts will have to consider this consequence when determining whether a group of investors is adequate.<sup>97</sup> Again, if a court finds that group members can monitor and drive the litigation without undue interference by other members, then the court can appoint the group.<sup>98</sup> As illustrated in the *Cendant* case, the court properly considered whether the group's size interfered or diluted

88. *See id.* (stating criteria evaluated in determining adequacy).

89. *See* Fisch, *supra* note 8, at 76-77 (stating that if "court actively evaluates the composition of the lead plaintiff group, it initiates an arbitrary and wasteful process") (citation omitted).

90. *See id.* at 76 (stating that aggregation "converts the selection of the lead plaintiff from an objective process into an unwieldy and easily manipulated procedure").

91. *See* 15 U.S.C. §§ 78u-4(a)(3)(B)(i) & (iii) (requiring court to determine adequacy and financial interest of prospective plaintiff).

92. 15 U.S.C. § 78u-4(a)(3)(B)(i).

93. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb).

94. *See* 15 U.S.C. § 78u-4(a)(3)(B) (recognizing that PSLRA requires active role by court).

95. *See* Heck, *supra* note 29, at 1221 (stating that aggregated group divides decision-making and "slow[s] litigation when they disagree on how to proceed"); *see also* Fisch, *supra* note 8, at 79 (stating that group of unrelated investors has "no inherent decision making structure").

96. *See* Heck, *supra* note 29, at 1221 (discussing how coordination problems among multiple investors may seriously effect litigation).

97. *See* 15 U.S.C. § 78u-4(a)(3)(B)(i) (stating that court determines adequacy).

98. *See* S. REP. NO. 104-98, at 10, *reprinted in* 1995 U.S.C.C.A.N. 679, 689 (referring to requirements set forth in legislative history in determining group's adequacy).

the members' decision-making power and control over the litigation.<sup>99</sup> Because the court determined that aggregation would not dilute any member's control, it properly appointed the group.<sup>100</sup>

Not all situations, however, justify aggregating multiple unrelated investors.<sup>101</sup> In determining a group's adequacy, a court must also evaluate whether the group has aggregated its members solely to attain the greatest financial interest or whether the group legitimately and adequately can serve the interests of the class.<sup>102</sup> As to the former inquiry, if a large number of investors join together in order to attain the greatest financial interest, then the court properly may refuse to appoint this type of group.<sup>103</sup> In this situation, a group comprising many individual investors with little financial interest in the litigation may be inadequate to serve the class's interests.<sup>104</sup> According to the legislative history, the members in this type of group lack any incentive to participate in the litigation and monitor counsel's decisions.<sup>105</sup> The legislative history of the PSLRA further indicates that aggregating a large number of investors conflicts with the goal of PSLRA, which is to increase control of the plaintiff over the litigation.<sup>106</sup> By enacting the PSLRA, Congress sought to deter lawyers from making personal decisions and negotiating settlement agreements without consulting the plaintiffs.<sup>107</sup> In short, a large group restricts each member's ability to monitor the litigation and serve the interests of the class.<sup>108</sup>

99. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 267 (3d Cir. 2001) (inquiring into whether movant group was too large to represent class adequately).

100. See *id.* (stating that group could operate effectively as single unit).

101. For additional discussion of situations militating against aggregation, see *infra* notes 102-08 and accompanying text.

102. See 15 U.S.C. § 78u-4(a)(3)(B)(i) (requiring court to determine adequacy of group); see also Fisch, *supra* note 8, at 74-75 (recognizing undesirability of having massive lead plaintiff groups); Heck, *supra* note 29, at 1220-21 (same).

103. Cf. S. REP. NO. 104-98, at 10, *reprinted in* 1995 U.S.C.C.A.N. 679, 689 (stating that lead plaintiff must be able to actively monitor counsel and litigation). One commentator has stated that "[t]he efforts of some firms to create massive lead plaintiff groups to secure the lead counsel appointment are not socially productive." Fisch, *supra* note 8, at 75 (describing how aggregating financial interest of investors for purposes of obtaining lead counsel appointment leads to inadequate monitoring and apathy by plaintiff).

104. See Fisch, *supra* note 8, at 71-72 (explaining that group with small individual stakes reduce likelihood that group members will participate actively in litigation process).

105. See *id.* (explaining that group with small individual stakes reduce likelihood that group members will participate actively in litigation process).

106. S. REP. NO. 104-98, at 10, *reprinted in* 1995 U.S.C.C.A.N. 679, 689 (stating that purpose of PSLRA is to encourage lead plaintiff, not lawyers, to drive litigation).

107. See *id.* at 6, *reprinted in* 1995 U.S.C.C.A.N. 679, 685 (recognizing that Congress sought to deter "lawyer-driven" litigation).

108. Cf. *id.* at 6, *reprinted in* 1995 U.S.C.C.A.N. 679, 685 (noting similarity between professional plaintiffs and large number of unrelated investors).

B. *The Third Circuit Correctly Interpreted the Lead Plaintiff Provision; the Northern District of Ohio Misinterpreted the Provision*

The Third Circuit in *Cendant* adopted the appropriate test of adequacy, not relatedness, in deciding whether to appoint a group of investors as lead plaintiff.<sup>109</sup> In that case, three unrelated institutional investors demonstrated that they could represent the claims vigorously, select competent counsel and monitor all decisions made on behalf of the class.<sup>110</sup> Even though the three investors were not related, the court applied the correct test in determining whether the group could adequately protect the interests of the class and monitor the litigation based on their financial interest in the suit and bargaining power with counsel.<sup>111</sup>

The court in *Telxon*, however, misconstrued this test by refusing to appoint a group of two unrelated members.<sup>112</sup> The court failed to consider whether the members could vigorously represent the interests of the class and monitor the litigation as a group.<sup>113</sup> Rather, the court based its decision solely on the fact that the members were unrelated.<sup>114</sup> As a result, the court improperly denied the group lead plaintiff consideration.<sup>115</sup>

#### V. COURT-ORDERED AUCTIONS AND THE BUSINESS JUDGMENT RULE

Court-ordered auctions emerged in 1990 as a means of selecting class counsel among a pool of bidders.<sup>116</sup> When Congress enacted the PSLRA in 1995, the question emerged whether court-ordered auctions were per-

109. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 266 (3d Cir. 2001) (stating appropriate test for appointing lead plaintiff).

110. See *id.* at 268-69 (stating group satisfied adequacy requirement).

111. See *id.* (holding that adequacy, not relationship, is issue).

112. See *In re Telxon Corp. Sec. Litig.*, 67 F. Supp. 2d 803, 823 (N.D. Ohio 1999) (holding that lack of relationship barred group from serving as lead plaintiff).

113. See *id.* at 815-28 (neglecting to assess adequacy of investors).

114. See *id.* at 823 (identifying relationship of proposed group members as crucial criteria).

115. See *id.* at 828 (denying appointment of plaintiff group).

116. See *In re Oracle Sec. Litig.*, 131 F.R.D. 688, 697 (N.D. Cal. 1990) (establishing first court-ordered auction in country). In *Oracle*, two law firms argued over which group of lawyers would be designated class counsel. See HOOPER & LEARY, *supra* note 10, at 15 (quoting Third Circuit Task Force on Selection of Class Counsel, Reporters Transcript of Proceedings, Judge Vaughn Walker at 38 (Mar. 16, 2001)). One of the attorneys approached Judge Walker of the Northern District of New York and told him “don’t worry about the case. We’ve got the whole thing worked out.” See *id.* (quoting Third Circuit Task Force on Selection of Class Counsel at 38-39). Judge Walker of the Northern District of California interpreted the parties’ conduct to mean that the arrangement “was at the lawyer’s benefit and not at the benefit of the class.” See *id.* (quoting Third Circuit Task Force on Selection of Class Counsel at 39). As a result, the court ordered an auction, reasoning that “[t]hat process most closely approximates the way class members would make these decisions and should result in selection of the most appropriately qualified counsel at the best available price.” *Oracle*, 131 F.R.D. at 690.

missible under the terms of the lead counsel provision.<sup>117</sup> Currently, courts disagree over whether they can auction the position of lead counsel or whether the PSLRA requires that they defer to the lead plaintiff's choice of counsel.<sup>118</sup>

#### A. Court-Ordered Auctions

A court-ordered auction is a court's request to each lawyer to submit a bid proposing fees and expenses to litigate the class action.<sup>119</sup> Among those courts that have ordered auction, bidders typically have submitted either to the court or to the plaintiff qualitative and quantitative information, which typically have included the bidder's qualifications, prior exper-

117. For a discussion and analysis of the permissibility of auctions under the PSLRA, see *infra* notes 184-239 and accompanying text.

118. Compare *In re Network Assocs. Inc., Sec. Litig.*, 76 F. Supp. 2d 1017, 1033-34 (N.D. Cal. 1999) (employing auction) and *In re Cal. Micro Devices Sec. Litig.*, 168 F.R.D. 257, 259 (N.D. Cal. 1996) (same), with *In re Cendant Corp. Sec. Litig.*, 264 F.3d 201, 220 (3d Cir. 2001) (holding that auctions are impermissible as matter of first resort), and *In re Razorfish, Inc. Sec. Litig.*, 143 F. Supp. 2d 304, 310 (S.D.N.Y. 2001) (refusing to conduct auction because plaintiff was able to conduct negotiation with counsel).

119. See HOOPER & LEARY, *supra* note 10, at 2-3 (defining auction process). The purpose of the auction originally was to find a more objective way to award attorneys' fees without relying on the standard percentages routinely awarded in class actions. See *id.* (setting forth objectives of court-ordered auctions).

Courts primarily have used two methods of awarding attorneys fees, the lodestar method and the percentage of recovery method. See S. REP. NO. 104-98, at 12, reprinted in 1995 U.S.C.C.A.N. 679, 691 (describing fee calculation methods). Under the lodestar method, a court multiplies the number of hours by a reasonable hourly fee, which may be increased by an additional amount based on risk or other relevant factors. See *id.* (stating one method in which courts currently award attorney's fees). The court may opt to adjust that figure, the lodestar, by applying a multiplier either upward or downward. See *Pennsylvania v. Del. Valley Citizens' Council for Clean Air*, 478 U.S. 546, 565 (1986) (recognizing purpose of multiplier). The United States Supreme Court presumed that the lodestar figure, the product of reasonable hours multiplied by a reasonable rate, represents a "reasonable" fee. See *id.* (exploring consistency associated with fee-shifting). Factors such as novelty and complexity of the issues, special skill and experience of counsel, the quality of representation, and the results obtained from the litigation are reflected in the lodestar amount. See *id.* (noting that upward adjustment of lodestar is rare because these factors are not considered in multiplier).

Under the percentage-of-recovery method, the court awards attorneys' fees as a certain percentage of the settlement. See HOOPER & LEARY, *supra* note 10, at 1-2 (describing alternative method of awarding attorneys' fees in securities class actions); *In re Activision Sec. Litig.*, 723 F. Supp. 1373, 1378 (N.D. Cal. 1989) (concluding that percentage of recovery approach in common fund cases is better practice than lodestar approach). The court found that the attorney's fee award ranges about 30% of the fund in nearly all common fund cases, absent extraordinary circumstances. See *id.* at 1377 (accounting for range of attorney fees in average cases). As a result, the court set a percentage of recovery approach at thirty percent. See *id.* at 1378 (rejecting lodestar approach as method of calculating attorney fees).

iences and fees.<sup>120</sup> Courts have evaluated these bids *ex ante*, at the beginning of the litigation, to determine which prospective counsel is the most qualified at the lowest price.<sup>121</sup>

Since 1990 courts have ordered auctions in three pre-PSLRA and nine post-PSLRA securities class actions.<sup>122</sup> In ten of these class actions, the court itself evaluated the bids and conducted the auction.<sup>123</sup> In the other two class actions, the court ordered the lead plaintiff to evaluate the bids and conduct the auction.<sup>124</sup>

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120. See HOOPER & LEARY, *supra* note 10, at 29-31 (analyzing qualitative guidelines requested by Judge Walker, Judge Shadur and Judge Alsup). Judge Walker required that bidders seeking lead counsel status submit information on the firm's qualifications, including detailed descriptions of other class actions in which the firm was involved. See *id.* (citing *Oracle*, 131 F.R.D. at 697)). In *Wenderhold v. Cylink Corp.*, the court requested each bidder to submit:

[T]itle, court, docket number, and date field for each securities class action in which the bidder served as sole class counsel during the past three years; the amount of recovery obtained on behalf of the class; the percentage of securities in the class for which claims were submitted; the amount of recovery (if any) distributed to the class, and total amounts received by the bidder, including fees and costs (if any).

*Id.* at 30 (citing *Wenderhold v. Cylink Corp.*, 188 F.R.D. 577, 587-88 (N.D. Cal. 1999)).

121. See *In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190, 1193 (N.D. Ill. 1996) (advocating use of auctions as less expenditure of time); HOOPER & LEARY, *supra* note 10, at 18 (stating that "judges who advocate auctioning suggest that there is less expenditure of judicial time, compared to an *ex post* review of fee petitions required under other methods").

122. See *In re Commtouch Software Ltd. Sec. Litig.*, No. 01-C-00719 (N.D. Cal. June 27, 2001) (conducting post-PSLRA auction), *cited in* HOOPER & LEARY, *supra* note 10, at 3 n.17; *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 482-88 (N.D. Cal. 2001) (approving post-PSLRA auction under limited circumstances); *Network*, 76 F. Supp. 2d at 1033 (same); *Wenderhold*, 188 F.R.D. at 587 (ordering post-PSLRA auction); *Cal. Micro Devices*, 168 F.R.D. at 259 (ordering pre-PSLRA auction); *In re Wells Fargo Sec. Litig.*, 157 F.R.D. 467, 468 (N.D. Cal. 1994) (same); *In re Oracle Sec. Litig.*, 131 F.R.D. 688, 697 (N.D. Cal. 1990) (same); *In re Lucent Techs. Inc. Sec. Litig.*, 194 F.R.D. 137, 157 (D.N.J. 2000) (same); *In re Cendant Corp. Litig.*, 182 F.R.D. 144 (D.N.J. 1998) (ordering auction), *vacated by*, 264 F.3d 201 (3d Cir. 2001); *In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951, 954 (N.D. Ill. 2001) (approving use of auction); *In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (analyzing competing bids); *Sherleigh Assocs. LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 694 (S.D. Fla. 1999).

123. See *Quintus*, 201 F.R.D. at 482-88 (holding that court will conduct auction rather than ordering plaintiff to conduct auction); *Wenderhold*, 188 F.R.D. at 587 (same); *Oracle*, 131 F.R.D. at 697 (same); *Cal. Micro Devices*, 168 F.R.D. at 259 (same); *Wells Fargo*, 157 F.R.D. at 468 (same); *Lucent*, 194 F.R.D. at 154 (same); *Cendant*, 182 F.R.D. at 151 (same); *Sherleigh Assocs.*, 184 F.R.D. at 694 (same); *Comdisco*, 141 F. Supp. 2d at 954 (same); *Bank One S'holders*, 96 F. Supp. 2d 780 (N.D. Ill. 2000) (same).

124. See *Commtouch*, No. 01-C-00719 (holding that plaintiff rather than court will conduct auction), *cited in* HOOPER & LEARY, *supra* note 10, at 3 n.17; *Network*, 76 F. Supp. 2d at 1033 (same).

Supporters of court-ordered auctions have advanced several arguments in favor of their use.<sup>125</sup> According to one of the arguments, auctions allow smaller firms to bid lower fees and obtain lead counsel appointment when they otherwise would not be able to do so.<sup>126</sup> Another argument advanced is that auctions, as a competitive process, lower attorneys' fees and therefore increase the amount distributed, or damage recovery, to the class.<sup>127</sup>

Critics of court-ordered auctions argue that large individual investors or institutional investors already engage in a practice known as "legal beauty contests" in which the client seeks prospective attorneys and requests their proposals as to how they would handle the matter.<sup>128</sup> The investor then compares each lawyer's expertise and understanding of the risks involved in the class action.<sup>129</sup> According to the critics, by engaging in this practice, investors adequately assess a fee structure that takes into account both the price and the quality of services.<sup>130</sup>

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125. See Third Circuit Task Force Report, *supra* note 11, at 38-39 (listing benefits of auction method). The Third Circuit Task Force listed the following benefits of auctions: (1) benefits to the class from attorney fees—percentage of recovery awarded to counsel in auction cases is often less than that awarded by traditional methods; (2) judicial economy—the judges who have used auctioning contend that there is less expenditure of judicial resources, compared to the *ex post* assessments of attorney fees required for fee awards in cases of traditional appointment; (3) eliminates "race to the courthouse"; (4) Ex ante Fee Determination; and (5) competition—auctions provide a market test for cost of lawyer's services because there is a competition among firms. See *id.* at 38-39 (listing arguments in favor of auctions).

Among those judges that have auctioned the position of lead counsel, they generally advance five reasons in favor of auctions: (1) replicating the marketplace for legal services and reducing attorneys' fees, (2) improving attorney-proposed case representation, (3) giving the class the benefit of the low risk of nonrecovery, (4) reducing the expenditure of judicial time and (5) compensating for the presence of an inadequate or uninterested plaintiff. See HOOPER & LEARY, *supra* note 10, at 15 (explaining courts' rationales for conducting auctions).

126. See Third Circuit Task Force Report, *supra* note 11, at 38-41 (stating that auctions increase pool of attorneys because all lawyers are vying for position of lead counsel).

127. See *id.* (stating difference in awards to attorneys under auction approach, lodestar approach and percentage of recovery approach).

128. *Id.* at app. B, at 4 (statement by Grant & Eisenhofer) (describing beauty contest as process routinely employed by institutional investors); see Symposium, *The Law and Economics of Lawyering: Second Opinion in Litigation*, 84 VA. L. REV. 1411, 1427-28 (1998) (explaining that legal beauty contest occurs when client initially selects lawyer to take case, which affords attorney opportunity to compare initial advice of several lawyers with present situation and to assess lawyers' expertise and predisposition toward risk).

129. See Third Circuit Task Force Report, *supra* note 11, app. B, at 4-5 (statement by Grant & Eisenhofer) (obtaining assessment of problem from various attorneys to get better perspective of risk and also to decide which attorney offers higher quality legal assistance at better price).

130. See *id.* (recognizing that institutional investors already seek advice and assess quality).



Critics also argue that auctions undermine one of the purposes of the PSLRA, which is to increase plaintiff activism in selecting their own counsel.<sup>131</sup> They further argue that auctions sacrifice quality of representation with cheaper and less experienced attorneys.<sup>132</sup> Last, they argue that auctions prevent courts from acting impartially during the litigation because they become engaged as “auctioneers.”<sup>133</sup>

Based on these criticisms, an issue has arisen whether a court should defer to the lead plaintiff’s choice of counsel under a standard of review similar to the business judgment rule and therefore not second-guess the plaintiff’s judgment.<sup>134</sup> Those in favor of this standard of review argue that the statutory text and the legislative history require deference; those against it argue that auctions provide an important means to lower attorney’s fees while allowing a significant recovery to the class.<sup>135</sup> In order to understand how the business judgment rule applies, it is important to understand what the doctrine represents.<sup>136</sup>

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131. *See id.* at 56 (stating that auctions have risk of discouraging prospective lead plaintiff because they are deprived of their choice of counsel and it interferes with their ability to take active and meaningful role in class action).

132. *See id.* at 46 (stating risk that low fee will lead to low quality representation). The Task Force Report notes:

The auction method could encourage firms to submit unduly low bids in order to win the position of class counsel. Underbidding can result in lawyers cutting corners or settling too early in order to maintain a profit margin. Where the winning firm’s bid is too low – as it will often be due to the pressures of competitive bidding and the imperfect information available at the time of the auction – the firm will have a conflict of interest. Its own interest in securing reasonable compensation for time spent would be in conflict with its duty to prosecute the case with vigor and dedication to maximize the class recovery.

*Id.* (citation omitted).

133. *See id.* at 57 (discussing risk of compromising judicial impartiality); *see also* Fisch, *supra* note 8, at 95 (“By casting the court as auctioneer and referee, lead counsel auctions also threaten the court’s neutrality.”).

134. *Compare* Third Circuit Task Force Report, *supra* note 11, at 88 (recommending that “scrutiny akin to the business judgment rule” should be applied to lead plaintiff’s choice of counsel and to fee arrangements), *id.* app. B, at 5 (statement by Stuart M. Grant & Jay W. Eisenhofer) (“The court should review the lead plaintiff’s choice of counsel applying the tenets of the business judgment rule.”), *and id.* app. B, at 5-6 (statement by Keith Johnson) (stating courts must defer to counsel selection decisions made by plaintiffs under business judgment rule), *with In re Bank One S’holders Class Actions*, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (finding auction appropriate rather than deferring to lead plaintiff’s choice of counsel), *and In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1033-34 (N.D. Cal. 1999) (same).

135. For a further discussion of the disagreement among courts in deciding whether to defer to the lead plaintiff’s choice of counsel, *see infra* notes 144-79 and accompanying text.

136. For a discussion of the business judgment rule, *see infra* notes 137-43 and accompanying text.

### B. *Background of the Business Judgment Rule*

The business judgment rule developed over a century and a half ago as the primary means by which courts review business decisions by corporate directors.<sup>137</sup> Under this rule, courts presume that in making a business decision the directors of a corporation acted on an informed basis, in good faith and with an honest belief that the action taken was in the best interest of the company.<sup>138</sup> In order to state a claim, therefore, a shareholder plaintiff has a “heavy burden” of pleading and proving facts to overcome this presumption.<sup>139</sup> If the party challenging the board’s decision does establish facts sufficient to overcome the presumption, the court will examine the decision-making process of the board member.<sup>140</sup> If the court finds that the board member approved a transaction without being informed and without a good faith or honest belief that the transaction was in the best interest of the corporation, then the business judgment rule is inapplicable and the court will scrutinize the fairness of the transaction to the shareholders.<sup>141</sup>

In determining whether the business judgment rule applies in a PSLRA case, courts, commentators and the Third Circuit Task Force disagree over the proper interpretation of the lead counsel provision.<sup>142</sup> In

137. See DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 4-5 (1993) (stating historical background to business judgment rule); see also Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors’ Duties in Delaware: The Rules of the Game (Part I)*, 40 VILL. L. REV. 1297, 1302-03 (1995) (recognizing that business judgment rule was developed to give board of directors “significant protection and discretion in making business decisions”).

138. See *Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1356 (Del. 1985) (stating standard of review under business judgment rule that court applies to director’s business decision); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (same); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (same); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (same); see also EISENBERG, *supra* note 15, at 545 (stating conditions of business judgment review to apply to director’s decision).

139. See BLOCK ET AL., *supra* note 137, at 14 (stating heavy burden on plaintiff to overcome business judgment rule) (citing *Lewis v. S. L. & E., Inc.*, 629 F.2d 764, 768 (2d Cir. 1980)).

140. See *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (“Due care in the decisionmaking context is *process* due care only.”).

141. See BLOCK ET AL., *supra* note 137, at 15 (stating that fairness is standard of review if presumption under business judgment rule is defeated); see also *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993) (stating that entire fairness standard applies if presumption overcome); EISENBERG, *supra* note 15, at 545 (stating that if conditions of business judgment rule are not satisfied, then standard by which quality of decision is reviewed is entire fairness or reasonability).

142. Compare *In re Candant Corp. Litig.*, 264 F.3d 201, 274 (3d Cir. 2001) (finding district court erred by conducting auction without reviewing plaintiff’s choice of counsel), and *In re Copper Mountain Networks Sec. Litig.*, 201 F.R.D. 475, 482 (N.D. Cal. 2001) (stating court should not substitute its judgement for that of lead plaintiff if lead plaintiff adequately negotiated with counsel), with *In re Bank One S’holders Class Actions*, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (stating

particular, they disagree over whether the provision permits a deferential standard of review of the lead plaintiff's choice of counsel.<sup>143</sup>

## VI. SUMMARY OF COURT AND TASK FORCE ANALYSES OF AUCTIONS

Courts and the Third Circuit Task Force disagree over whether they must defer to the lead plaintiff's choice of counsel.<sup>144</sup> Those courts that have deferred to the lead plaintiff's choice have argued that auctions are inappropriate as a matter of first choice.<sup>145</sup> The Third Circuit Task Force found that a court likewise should defer to the plaintiff's choice of counsel, but under a standard of review similar to the business judgment rule.<sup>146</sup>

### A. Courts that Defer to the Lead Plaintiff's Choice of Counsel

The Third Circuit, the Southern District of New York and the Northern District of California have interpreted the lead counsel provision to mean that courts should defer to the lead plaintiff's choice of counsel if that choice resulted from a good faith selection and meaningful arms-length bargaining.<sup>147</sup> Those courts have urged that they should not evaluate whether they believe the lead plaintiff could have made a better choice or received a better deal.<sup>148</sup>

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that court would be remiss if it did not auction lead counsel position to obtain potentially lower fee for class members).

The Third Circuit Task Force and some commentators have found that a standard of review similar to the business judgment review is appropriate. See Third Circuit Task Force Report, *supra* note 11, at 87-88 (stating that "scrutiny akin to business judgment rule" is appropriate); *id.* app. B, at 5 (statement of Grant & Eisenhofer) (stating that review under business judgment rule is appropriate); *id.* app. B, at 5-6 (stating of Keith Johnson) (same).

143. For a further discussion of the court analyses of appropriate standard of review given to lead plaintiff's choice of counsel, see *infra* notes 144-79 and accompanying text. For a further discussion of the Task Force's analysis of appropriate standard of review given to lead plaintiff's choice of counsel, see *infra* notes 180-83 and accompanying text.

144. For a further discussion of the court and Task Force's analyses of the auction process, see *infra* notes 144-83 and accompanying text.

145. See *Cendant*, 264 F.3d at 274-75 (finding that if plaintiff has employed reasonable decision-making process in selecting counsel, it is inappropriate to conduct auction); *Quintus*, 201 F.R.D. at 482 (same).

146. See Third Circuit Task Force Report, *supra* note 11, at 87-88 (stating business judgment rule is appropriate standard of review).

147. See *Cendant*, 264 F.3d at 274 (stating that "court should generally employ a deferential standard in reviewing the lead plaintiff's choices"); *Copper Mountain*, 201 F.R.D. at 486 (stating that plaintiff's choice of counsel should not be disturbed when plaintiff adequately negotiates with counsel and obtains superior fee agreement).

148. See *Cendant*, 264 F.3d at 286 (stating that ultimate inquiry is always whether lead plaintiff's choices were arrived at via meaningful arms-length bargaining); *Copper Mountain*, 201 F.R.D. at 489 (stating that if fee arrangement demonstrates adequate negotiation then court will not disturb this decision); *In re Razorfish, Inc. Sec. Litig.*, 143 F. Supp. 2d 304, 310 (S.D.N.Y. 2001) (stating that

For instance, in *Cendant*, the Third Circuit held that the district court abused its discretion in conducting an auction.<sup>149</sup> In that case, the lead plaintiff negotiated a retainer agreement with counsel before litigating its claim.<sup>150</sup> The district court did not evaluate whether the retainer agreement was agreed upon at arms-length and in good faith but, instead, ordered an auction.<sup>151</sup> An investor of the corporation appealed the district court's decision in conducting the auction and argued that the fee the court accepted was actually \$76 million more than the price agreed upon in the retainer agreement.<sup>152</sup> The Third Circuit found that the auction was improper and inconsistent with the terms of the lead counsel provision of the PSLRA.<sup>153</sup> The court reasoned that the PSLRA restricts the court's role to approving the lead plaintiff's choice of counsel.<sup>154</sup> Further, the Third Circuit reasoned that the district court failed to evaluate the parties' decision-making process in negotiating the retainer agreement and to determine whether the agreement was at arms-length.<sup>155</sup>

Both the Northern District of California in *In re Copper Mountain Network Securities Litigation*<sup>156</sup> and the Southern District of New York in *Razorfish* have followed a line of reasoning similar to that of the Third Circuit.<sup>157</sup> Both courts rejected the use of an auction and agreed that if the lead plaintiff negotiates a reasonable fee with counsel, then the court must defer to the lead plaintiff's choice of counsel.<sup>158</sup> By deferring to the

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court will not conduct auction when plaintiff is able to conduct negotiation with other counsel).

149. See *Cendant*, 264 F.3d at 278-83 (finding that district court failed to review lead plaintiff's decision-making process in selecting counsel).

150. See *id.* at 224 (stating facts).

151. See *id.* at 276 (stating facts).

152. See *id.* at 220 (stating facts). The counsel obtained by the lead plaintiff pursuant to the retainer was the same counsel appointed to the case under the auction. See *id.* (stating facts).

153. See *id.* at 273 (stating holding).

154. See *id.* at 273 (stating facts).

155. See *id.* at 276 (stating facts).

156. 201 F.R.D. 475, 487 (N.D. Cal. 2001). For purposes of this Comment, *In re Copper Mountain Networks Securities Litigation* and *In re Quintus Securities Litigation* will be treated as two separate cases even though the court addressed both cases in one opinion.

157. See *In re Razorfish, Inc. Sec. Litig.*, 143 F. Supp. 2d 304, 310 (S.D.N.Y. 2001) (finding, similar to Third Circuit, that auction is inappropriate when plaintiff is able to negotiate reasonable fee with counsel); *In re Copper Mountain Networks Sec. Litig.*, 201 F.R.D. 475, 487 (N.D. Cal. 2001) (finding, similar to Third Circuit, that it would not conduct auction because investor negotiated fee agreement that appeared reasonable).

158. See *Copper Mountain*, 201 F.R.D. at 487 (stating that court is willing to defer to plaintiff's choice where reasonable fee is negotiated); cf. *Razorfish*, 143 F. Supp. 2d at 310-11 (finding auction was inappropriate and that under PSLRA primary focus should not be on selection of counsel).

lead plaintiff's choice, those courts will not substitute their judgment for that of the lead plaintiff if the fee arrangement is reasonable.<sup>159</sup>

Additionally, the court in *Razorfish* found that even if the lead plaintiff's first choice of counsel is inadequate, the court should allow the plaintiff to select another lead counsel as opposed to ordering an auction.<sup>160</sup> In that case, the court refused to conduct an auction after it rejected lead plaintiff's first choice of counsel.<sup>161</sup> The court concluded that the text of the lead counsel provision does not give a court the right to arrange a "shot-gun marriage between strangers" even if it disapproves of the lead plaintiff's choice of counsel.<sup>162</sup> According to the court, such an intrusive measure is inconsistent with the PSLRA, which requires that the lead plaintiff select and retain counsel.<sup>163</sup>

As a result, the Third Circuit, the Northern District of California and the Southern District of New York have found that a court should defer to the lead plaintiff's choice of counsel if the agreement of the group member was a product of reasonable negotiation and arms-length bargaining.<sup>164</sup> According to these courts, auctions are impermissible when such factors are present.<sup>165</sup>

#### B. Courts Permitting Auctions

Nine post-enactment PSLRA cases have permitted auctions.<sup>166</sup> In those cases, however, the courts advanced three different situations in

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159. See *Razorfish*, 143 F. Supp. 2d at 311 (stating that lead plaintiff should exercise conduct of litigation); *Copper Mountain*, 201 F.R.D. at 489 (stating that court will not disturb plaintiff's decision).

160. See *Razorfish*, 143 F. Supp. 2d at 310 (refusing to auction lead counsel position as matter of first choice).

161. See *id.* (stating facts).

162. See *id.* (discussing conclusion).

163. See *id.* (discussing role of lead plaintiff in choice of counsel).

164. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 274 (3d Cir. 2001) (stating that "court should generally employ a deferential standard in reviewing the lead plaintiff's choices"); *Copper Mountain*, 201 F.R.D. at 487 (noting that court is willing to defer to plaintiff's choice where reasonable fee is negotiated); cf. *Razorfish*, 143 F. Supp. 2d at 310 (stating that presumptive lead plaintiff is plaintiff with biggest stake in litigation who then selects lead counsel).

165. See, e.g., *Cendant*, 264 F.3d at 276 (stating that auction is impermissible when fee arrangement between plaintiff and counsel resulted from good faith selection and negotiation process and arrived from meaningful arms-length bargaining); *Razorfish*, 143 F. Supp. 2d at 310 (refusing to conduct auction even though it refused to appoint lead plaintiff's choice of counsel); *Copper Mountain*, 201 F.R.D. at 489 (stating that auction is inappropriate when plaintiff and counsel negotiated reasonable fee agreement).

166. See *In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951 (N.D. Ill. 2001) (ordering auction); *In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780, 784-85 (N.D. Ill. 2000) (same); *In re Commtouch Software Ltd. Sec. Litig.*, No. 01-C-00719, (N.D. Cal. June 27, 2001) (ordering lead plaintiff to conduct auction), cited in HOPPER & LEARY, *supra* note 10, at 3 n.17; *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 482 (N.D. Cal. 2001) (ordering auction when court determined that plaintiff unable to negotiate reasonable fee agreement with counsel); *In re Network Assocs. Inc.*

which an auction is permissible: (1) when the court has not yet appointed the lead plaintiff; (2) when all prospective plaintiffs are unable or incapable of negotiating a competitive fee arrangement with any class counsel, but the class action is well-suited to proceed; and (3) when the lead plaintiff's choice of counsel is unable to serve as lead counsel.<sup>167</sup>

Illustrating the first situation, the Northern District of California in *In re Bank One Shareholders Class Actions*<sup>168</sup> ordered an auction before appointing the lead plaintiff.<sup>169</sup> According to the court, it had a duty to choose a lead counsel at a reasonable price, and an auction typically provides a lower fee for counsel than a plaintiff's negotiated fee.<sup>170</sup> The court continued by noting that if the auction resulted in counsel who requested a lower fee than that requested by a presumptive plaintiff's counsel, the plaintiff would be required to accept representation by the lowest bidder.<sup>171</sup> Otherwise, the court would select the next presumptive lead plaintiff.<sup>172</sup>

Illustrating the second situation, the Northern District of California in *In re Quintus Securities Litigation*<sup>173</sup> ordered an auction because the pre-

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Sec. Litig., 76 F. Supp. 2d 1017, 1033-34 (N.D. Cal. 1999) (ordering plaintiff rather than court to conduct auction); *Wenderhold v. Cylink Corp.*, 188 F.R.D. 577, 587-88 (N.D. Cal. 1999) (ordering auction); *In re Cal. Micro Devices Sec. Litig.*, 168 F.R.D. 257, 270-71 (N.D. Cal. 1996) (finding PSLRA permits auctions); *In re Lucent Techs. Inc. Sec. Litig.*, 194 F.R.D. 137, 156-58 (D.N.J. 2000) (same); *In re Cendant Corp. Litig.* 182 F.R.D. 144, 151 (D.N.J. 1998) (finding auctions permissible as matter of first resort rather than deferring to lead plaintiff's choice of counsel), *vacated by*, 264 F.3d 201 (3d Cir. 2001); *Sherleigh Assocs. LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 696 (S.D. Fla. 1999) (ordering auction).

167. *See Copper Mountain*, 201 F.R.D. at 491 (holding that auctions are appropriate only when plaintiff is incapable of negotiating reasonable fee agreement and all other prospective plaintiffs are inadequate to serve as lead plaintiff); *Bank One S'holders*, 96 F. Supp. 2d at 784 (holding that auctions were appropriate as matter of first resort); *Network Assocs.*, 76 F. Supp. 2d at 1033-34 (holding that auction was appropriate because lead counsel was unable to serve in litigation).

168. 96 F. Supp. 2d 780 (N.D. Ill. 2000).

169. *See Bank One S'holders*, 96 F. Supp. 2d at 784 (requiring that presumptive lead plaintiff accept most qualified bidder as counsel). In *Bank One S'holders*, the court held a bid among law firms before appointing the lead plaintiff. *See id.* (stating facts of case). The court held that if the presumptive lead plaintiff were to insist on their class counsel handling the action on a hypothesized materially less favorable contractual basis, this insistence would effectively rebut the presumption that the putative class representatives were the most adequate plaintiffs. *See id.* (stating conclusion). The court suggests, however, that if "the presumptive class representative was willing to be represented by the most favorable qualified bidder among the lawyers submitting bids, with that bidder either supplanting the presumptive lead plaintiff's original choice of counsel or working together with that original counsel," the presumptive "most adequate" plaintiff would be appointed as lead plaintiff. *See id.* (describing process for determining lead plaintiff when auction is employed).

170. *See id.* (arguing in favor of ordering auction).

171. *See id.* at 783-84 (stating factors in choosing lead counsel).

172. *See id.* at 784 (stating means for selecting next plaintiff).

173. 201 F.R.D. 475 (N.D. Cal. 2001).

sumptive lead plaintiff was unwilling to negotiate a reasonable fee agreement with counsel, and all other prospective plaintiffs were inadequate to serve as lead plaintiff.<sup>174</sup> Because the class action appeared well-suited to proceed, the court appointed the presumptive lead plaintiff to the litigation but auctioned the lead counsel position to ensure class representation at a reasonable price.<sup>175</sup>

With respect to the final situation, in *In re Network Associates, Inc. Securities Litigation*,<sup>176</sup> the Northern District of California ordered an auction when the lead plaintiff's first choice of counsel was unable to serve as lead counsel.<sup>177</sup> The court ordered the lead plaintiff, rather than the court, to conduct the auction.<sup>178</sup> The court reasoned that because the lead plaintiff owes the class a fiduciary duty to obtain the highest quality representation at the lowest price, it should be the plaintiff, not the court, who conducts the auction.<sup>179</sup>

### C. Task Force Findings

Recently, the Third Circuit appointed a Task Force, composed of judges, scholars and practicing attorneys, to evaluate the appropriate method for selecting class counsel and to determine whether court-ordered auctions are permitted under the PSLRA lead counsel provision.<sup>180</sup> The Task Force released its preliminary findings in which it concluded that a court should defer to the plaintiff's choice of counsel under a standard of review similar to the business judgment rule.<sup>181</sup> The Task Force

174. See *In re Quintus Sec. Litig.*, 201 F.R.D. at 481 (stating facts of case).

175. See *id.* (describing formalities of auction).

176. 76 F. Supp. 2d 1017 (N.D. Cal. 1999).

177. See *Network Assocs.*, 76 F. Supp. 2d at 1033 (stating facts).

178. See *id.* (stating facts). In ordering the plaintiff to conduct the auction, the court required the lead plaintiff to publicize a request for written proposals from counsel, evaluate all of the proposals received and interview any candidates deemed appropriate. See *id.* at 1033-34 (stating facts). The lead plaintiff was then ordered to submit his recommendations for his first and second choices as class counsel, including a full description of his selection process, his conclusions and his reasons. See *id.* (stating facts).

179. See *id.* (discussing rationale for plaintiff to conduct auction).

180. See Third Circuit Task Force Report, *supra* note 11, at 1-4 (stating purpose of convening Task Force). On January 30, 2001, Chief Judge Edward R. Becker of the United States Court of Appeals for the Third Circuit convened this Third Circuit Task Force on the Selection of Class Counsel to "evaluate the emerging practice of several district court judges throughout the country of selecting class counsel and setting fees through [an] auction process." See *id.* at 1 (stating background). The primary duty of the Task Force was to assess the propriety and efficacy of the use of the auction method in its various applications, and to formulate recommendations for the bench, bar and public. See Press Release, Third Judicial Circuit, Creation of Task Force (Jan. 30, 2001) (on file with Villanova Law Review), available at <http://www.ca3.uscourts.gov/classcounsel/taskforce.pdf> (stating goals in press release that task force sought to evaluate).

181. See Third Circuit Task Force Report, *supra* note 11, at 87-93 (concluding that deferential standard of review must be applied to most adequate plaintiff's choice of counsel). The Task Force made several important recommendations in

concluded that “once the court has identified the most adequate plaintiff under the terms of the Act, that party’s choice of counsel should be reviewed with the deference given to any other business decision.”<sup>182</sup> Therefore, the Task Force recommended that “scrutiny akin to the business judgment rule” should be applied to the lead plaintiff’s choice of counsel and to the fee arrangements if that decision was independent and careful.<sup>183</sup>

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concluding that auctions are generally disfavored under the PSLRA. *See id.* at 17-18 (listing recommendations). First, the Task Force concluded that auctions are inconsistent with the goal of the PSLRA, which is to assure that the “most adequate” plaintiff chooses counsel and negotiates a reasonable fee. *See id.* at 18 (recommending that courts not employ auctions). The PSLRA, according to the Task Force, mandates that “class actions are to be client-driven, not court-driven.” *Id.* In adopting the business judgment rule as the appropriate standard of review, the Task Force found that:

To the extent that an auction is even permissible under the PSLRA, it should only be conducted if the lead plaintiff’s choice of counsel, or process in choosing counsel, is so infirm as to rebut the presumption that the plaintiff is “most adequate” under the statute, and then only if the alternative candidates for the “most adequate plaintiff” do not appear willing or able to engage in a meaningful search for and negotiation with counsel.

*Id.*

The Task Force also disputes the contention that auctions do not require an *ex post* determination of fees at the end of the litigation. *See id.* (finding that auction requires both *ex ante* and *ex post* determinations). According to the Task Force, Rule 23 ultimately requires the court to examine the fairness of the fees requested by counsel at the conclusion of the case. *See id.* at 19 (noting judge’s obligations).

182. *Id.* at 87.

183. *See id.* at 88 (noting that courts should not second-guess lead plaintiff’s choice of counsel if it is result of careful and independent process). In determining whether the decision-making process was independent and reasonable, the Task Force referred to a five-factor test outlined by the Securities and Exchange Commission in its brief submitted to the Third Circuit in *Cendant*. *See id.* at 89-90 (stating method to determine whether decision was independent and reasonable). According to this test, the lead plaintiff should: (1) follow procedures to identify a reasonable number of counsel with the skill and ability necessary to represent the class in the pending matter, (2) demonstrate the procedures used in inviting competent counsel to compete for the right to represent the class, (3) negotiate a fee and expense reimbursement arrangement that promotes the best interests of the class, (4) reasonably conclude that it has canvassed and actively negotiated with a sufficient number of counsel and obtained the counsel that is likely to obtain the highest net recovery to the class and (5) ensure that the counsel would not adversely affect the exercise of the plaintiff’s or counsel’s fiduciary obligations to the class. *See id.* at 87-93 (listing five-factor test in assessing decision-making process for lead plaintiff) (citing Brief for Appellant at 3-5, *In re Cendant Corp. Litig.*, 264 F.3d 201 (3d Cir. 2001)).



## VII. ANALYSIS OF THE BUSINESS JUDGMENT RULE AND ITS APPLICATION TO COURT-ORDERED AUCTIONS

Courts should defer to the lead plaintiff's choice of counsel under the business judgment rule.<sup>184</sup> The statutory text and the legislative history of the lead counsel provision support this finding.<sup>185</sup> As a matter of public policy, deference is appropriate because it encourages institutional investors to serve as lead plaintiff.<sup>186</sup>

### A. Auctions Are Impermissible As a Matter of First Choice Among Courts

Under the statutory text of the PSLRA, auctions are impermissible as a matter of first choice among courts.<sup>187</sup> The text explicitly provides that the lead plaintiff, not the court, has the right to select and retain class counsel.<sup>188</sup> Auctions interfere with their right to select counsel.<sup>189</sup> Auctions, instead, vest the court, not the lead plaintiff, with the authority to select lead counsel.<sup>190</sup> In no manner does the PSLRA permit a court to remove the plaintiff's ability to select and retain counsel.<sup>191</sup>

184. For a further discussion on the business judgment rule as the appropriate standard of review, see *infra* notes 215-27 and accompanying text.

185. For a further discussion of statutory language and legislative history supporting the business judgment rule standard of review, see *infra* notes 187-209 and accompanying text.

186. For a further discussion of the public policy supporting the business judgment rule as the appropriate standard of review, see *infra* notes 210-14 and accompanying text.

187. See 15 U.S.C. § 78u-4(a)(3)(B)(iii) (stating that most adequate plaintiff must have largest financial interest and therefore must be most capable of selecting adequate counsel); *id.* at § 78u-4(a)(3)(B)(v) (stating that lead counsel provision vests lead plaintiff with authority to select and retain counsel). Commentators have argued that the statutory text vests the plaintiff with the authority to select lead counsel. See Fisch, *supra* note 8, at 91 ("The statutory text clearly vests the plaintiff, not the court, with the authority to select lead counsel. . . . [T]he statute provides no basis for the court to override the plaintiff's selection and to impose its choice of counsel . . . with respect to such selection."). As a matter of policy, the courts are poorly suited to make business decisions. See *id.* at 94 (stating that selection of counsel is business decision and courts are inadequate forum to make such business decision). The Third Circuit Task Force found that the business judgment rule provides sufficient flexibility in its application and that courts will develop a framework for review that will provide appropriate deference to lead plaintiffs. See Third Circuit Task Force Report, *supra* note 11, at 87 (refuting commentator's opinion that business judgment rule is too strong of standard to apply).

188. See 15 U.S.C. § 78u-4(a)(3)(B)(v) (stating that lead plaintiff selects and retains class counsel).

189. See generally, HOOPER & LEARY, *supra* note 10, at 3 (recognizing that court develops guidelines of bidding procedures and requirements and selects winning bidder); Fisch, *supra* note 8, at 92 ("Lead plaintiff auctions interfere with the statutory objective of client empowerment . . .").

190. See HOOPER & LEARY, *supra* note 10, at 29-34 (stating procedures courts employed in selecting lead counsel); Fisch, *supra* note 8, at 91-92 (stating consequence of court-ordered auctions in lead counsel selection).

191. See 15 U.S.C. § 78u-4(a)(3)(B) (recognizing no provision under the PSLRA that allows court to select lead counsel).

Further, the court already has appointed a lead plaintiff whom it should have determined is capable of selecting class counsel.<sup>192</sup> Under the text of the PSLRA, the court must appoint the lead plaintiff who can adequately represent the class and has the largest financial stake in the litigation.<sup>193</sup> As already indicated, adequacy means that the plaintiff is empowered with the ability to select class counsel and monitor the counsel's decisions.<sup>194</sup> Further, by stipulating that the lead plaintiff must have the largest financial interest in the litigation, the PSLRA seeks a plaintiff who would have the resources and the incentive to choose capable counsel, monitor class counsel's performance and negotiate a reasonable fee.<sup>195</sup>

It has been argued that auctions may reduce counsel's fees and therefore potentially increase the damage recovery to the injured class.<sup>196</sup> This argument, however, has two problems.<sup>197</sup> First and foremost, the issue is not whether auctions are an alternate means for determining counsel fees, but rather, whether they are permitted after the adoption of the PSLRA.<sup>198</sup> As indicated, the PSLRA does not permit auctions.<sup>199</sup> Second, auctions do not guarantee that counsel's fees in fact will be reduced.<sup>200</sup> To illustrate, in *Cendant*, the district court approved class counsel's bid that was higher in price as a result of the auction than originally was stipu-

192. See 15 U.S.C. § 78u-4(a)(3)(B)(i), (iii) (stating that court appoints most adequate plaintiff). For a further discussion on the requirements for selecting the lead plaintiff, see *supra* notes 32-39 and accompanying text.

193. See 15 U.S.C. § 78u-4(a)(3)(B)(iii) (stating requirements of lead plaintiff provision).

194. For a further discussion on the adequacy requirement under the lead plaintiff provision, see *supra* notes 38-39 and accompanying text.

195. Cf. S. REP. NO. 104-98, at 11 *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (stating Congress' belief that court should appoint plaintiff with largest financial interest and that plaintiff should select lead counsel). For a further discussion on the legislative history in having the plaintiff with the largest financial interest appointed as the lead plaintiff, see *infra* notes 203-09 and accompanying text.

196. See Comments on Class Counsel, Vaughn R. Walker, Comment on the Draft Report of Third Circuit Task Force on Selection of Class Counsel 17 (Dec. 3, 2001) (on file with Villanova Law Review), *available at*, <http://www.ca3.uscourts.gov/classcounsel/comments/Walker-statement/pdf> (stating that "bidding securities cases recovered a significantly greater proportion of the potential for damage recovery than average"). In fact, one study revealed that "the bidding cases recovered 19.6% of potential investor losses while the average of all comparable cases was only 4.25%." *Id.*

197. For a further discussion on the problems associated with auctions, see *infra* notes 198-202 and accompanying text.

198. Cf. 15 U.S.C. § 78u-4(a)(3)(B)(iii) (stating whether PSLRA permits auctions after being adopted in 1995); Fisch, *supra* note 8, at 91 ("[T]here are serious reasons to question whether courts have authority under the PSLRA to employ an auction to select lead counsel.").

199. For a discussion of the impermissibility of auctions under the PSLRA, see *supra* notes 187-91 and accompanying text.

200. For a further discussion why auctions may not increase damage recovery to the class, see *infra* notes 201-02 and accompanying text.

lated in the retainer agreement.<sup>201</sup> As a result, the class received a lower amount of damage recovery due to the auction.<sup>202</sup>

The legislative history further supports the argument that auctions are impermissible as a matter of first choice among courts.<sup>203</sup> It demonstrates that Congress wanted securities class actions to be more plaintiff-centered with the plaintiff, not the court, choosing the class counsel.<sup>204</sup> As a result, Congress entrusted the court to appoint the lead plaintiff who can make informed decisions in selecting lead counsel.<sup>205</sup> Further, by requiring that the lead plaintiff have the largest financial interest in the litigation, Congress sought institutional investors to serve as lead plaintiff.<sup>206</sup> Again, institutional investors have a significant financial stake in the litigation and therefore have the incentive to seek class counsel who will obtain the highest return.<sup>207</sup> Further, they already engage in a lengthy selection process, called “legal beauty contests,” to assess the expertise and cost of a number of lawyers before selecting counsel.<sup>208</sup> As a result, large investors have the resources and the ability to properly select and retain class counsel.<sup>209</sup>

201. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 220 (3d Cir. 2001) (stating facts).

202. See *id.* (recognizing that auction resulted in less damages received to class).

203. See S. REP. NO. 104-98, at 8-11, *reprinted in* 1995 U.S.C.C.A.N. 679, 687-90 (stating that Conference Committee recognized that problem in class actions was that plaintiff investors lacked control in litigation).

204. *Cf. id.* (recognizing that PSLRA sought to increase client-driven litigation and prevent lawyer-driven litigation, but did not mention anything about court-driven litigation). Commentators and the Third Circuit Task Force agree that the PSLRA rejects the court-centered auctions in favor of empowering the lead plaintiff to select lead counsel. See Fisch, *supra* note 8, at 95 (stating that PSLRA reduces court’s supervisory role in favor of client empowerment structure); Third Circuit Task Force Report, *supra* note 11, at 18 (“The PSLRA mandates that class actions are to be client-driven, not court-driven.”).

205. See S. REP. NO. 104-98, at 11, *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (“[T]he Committee permits the lead plaintiff to choose the class counsel. This provision is intended to permit the plaintiff to choose counsel rather than have counsel choose the plaintiff.”).

206. See *id.* (seeking to increase likelihood that institutional investors would serve as lead plaintiffs).

207. See *id.* (recognizing that institutional investors have most to gain from serving as lead plaintiff and that their role will benefit class and assist courts).

208. See Third Circuit Task Force Report, *supra* note 11, app. B, at 4 (statement by Grant & Eisenhofer) (stating beauty contests employed by institutional investors seeking lead counsel). *But see In re Comdisco Sec. Litig.*, 150 F. Supp. 2d 943, 949 (N.D. Ill. 2001) (stating that beauty contests are ineffective because no plaintiff can engage in comprehensive study of law firms).

209. *Cf.* S. REP. NO. 104-98, at 11, *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (recognizing that institutional investors as lead plaintiffs can properly serve interests of class).

As a matter of public policy, auctions may discourage large investors and institutional investors from serving as lead plaintiff.<sup>210</sup> It has been indicated that although the lead plaintiff is not compensated in class actions, the plaintiff expects to significantly influence the conduct of the litigation.<sup>211</sup> Auctions, however, may preclude the plaintiff from working with his or her choice of counsel and exercising any influence over the litigation.<sup>212</sup> As a result, if institutional investors as lead plaintiff lack influence over the litigation, they may decline to seek lead plaintiff appointment.<sup>213</sup> Such an outcome is contrary to the intent and spirit of the PSLRA, which is to attract large investors to serve and represent the interests of the class.<sup>214</sup>

Therefore, in accordance with the statutory text of the PSLRA and its legislative history, courts should defer to the plaintiff's choice of counsel under a standard of review similar to business judgment rule.<sup>215</sup> Deference will allow the plaintiff to select and retain class counsel without undue interference by the court.<sup>216</sup> Also, it should encourage large investors

210. See Fisch, *supra* note 8, at 93 ("Auctions would likely deter institutional investors from seeking appointment as lead plaintiffs because of their reluctance to take on the responsibility of the lead plaintiff position without the ability to work with their choice of counsel.").

211. See Third Circuit Task Force Report, *supra* note 11, app. B, at 19-20 (statement by Lucian Bebchuck) (stating lead plaintiff's incentive for serving as lead plaintiff). Because the lead plaintiff is not compensated for serving in the litigation, one incentive to become an effective and active lead plaintiff in the interest of the class—of a type contemplated by the PSLRA—arises "from combination of (i) having substantial stake and (ii) expecting that becoming lead plaintiff would enable having significant influence of conduct of litigation." See *id.* (recognizing reasons to serve as lead plaintiff).

212. See Third Circuit Task Force Report, *supra* note 11, at 56 (recognizing auctions "interfere with ability of institutional investors to take active and meaningful role in class action").

213. See Fisch, *supra* note 8, at 93 (stating "auctions likely will deter institutional investors from seeking appointment as lead plaintiffs because of their reluctance to take on responsibility of lead plaintiff position without ability to work with their choice of counsel").

214. See 15 U.S.C. § 78u-4(a)(3)(B)(iii) (requiring that court appoint lead plaintiff with largest financial interest); S. REP. NO. 104-98, at 11, *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (seeking to increase likelihood that institutional investors would serve as lead plaintiffs).

215. Cf. *In re Cendant Corp. Litig.*, 264 F.3d 201, 274 (3d Cir. 2001) (stating that courts should employ deferential standard in reviewing lead plaintiff's choice of counsel); *In re Copper Mountain Networks Sec. Litig.*, 201 F.R.D. 475, 486 (N.D. Cal. 2001) (stating that deference should be given to lead plaintiff's choice of counsel); Fisch, *supra* note 8, at 94 (stating that courts are unsuited to choose class counsel when lead plaintiff already negotiated with counsel); Third Circuit Task Force Report, *supra* note 11, at 87 ("The PSLRA requires that the most adequate plaintiff's choice of counsel is entitled to deference if it is the result of careful and independent process.").

216. Cf. 15 U.S.C. § 78u-4(a)(3)(B)(v) (stating that plaintiff will select and retain counsel).

or institutional investors to serve as lead plaintiff because the court will not interfere or second guess their choice of counsel.<sup>217</sup>

The business judgment rule, however, still provides the court with the ability to review the decision-making process of the plaintiff in selecting class counsel.<sup>218</sup> For instance, it allows the court to determine whether the lead plaintiff negotiated at arms length with counsel, whether a reasonable fee was made at the time of the agreement, and whether the lead plaintiff was informed about the subject.<sup>219</sup> It does not, however, allow the court to substitute its judgment for lead counsel over the judgment of the lead plaintiff.<sup>220</sup> As a result, the Task Force appropriately decided that the business judgment rule provides the adequate protection and appropriate deference to the lead plaintiff's choice of counsel.<sup>221</sup>

The Third Circuit in *Cendant* and the Northern District of California in *Copper Mountain* correctly applied a deferential standard of review similar to the business judgment rule.<sup>222</sup> To illustrate, the Third Circuit found that auctions are impermissible, and concluded that a "court should generally employ a deferential standard in reviewing the lead plaintiff's choices. It is not enough that the lead plaintiff selected counsel or negotiated a retainer agreement that is different than what the court would have done . . . ." <sup>223</sup> In other words, the Third Circuit recognized that a court should review the plaintiff's decision-making process and defer to that choice provided it resulted from a reasonable and good faith process.<sup>224</sup>

Likewise, in *Copper Mountain*, the Northern District of California properly found that a court should defer to the lead plaintiff's choice of counsel if the plaintiff employed a reasonable decision-making process for

217. See Fisch, *supra* note 8, at 93 ("Auctions would likely deter institutional investors from seeking appointment as lead plaintiffs because of their reluctance to take on the responsibility of the lead plaintiff position without the ability to work with their choice of counsel.").

218. Cf. *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (applying business judgment rule but evaluating decisionmaking process to determine if informed and reasonable).

219. Cf. BLOCK ET AL., *supra* note 137, at 45-47 (recognizing protections afforded under business judgment rule); EISENBERG, *supra* note 15, at 545 (same).

220. See Third Circuit Task Force Report, *supra* note 11, at 91 (stating that court may not "impose its own counsel, by way of auction, against the lead plaintiff's wishes").

221. See *id.* at 87-88 (concluding that business judgment rule is appropriate deference given to lead plaintiff's choice of counsel).

222. See *In re Cendant Corp. Litig.*, 264 F.3d 201, 274-77 (3d Cir. 2001) (stating courts should defer to business judgment of lead plaintiff unless it can be shown that decision-making process was not arms-length or good-faith bargain); *In re Copper Mountain Networks Sec. Litig.*, 201 F.R.D. at 475, 486 (N.D. Cal. 2001) (refusing to conduct auction if fee arrangement was reasonable and deferring instead to lead plaintiff's choice of counsel).

223. *Cendant*, 264 F.3d at 274.

224. See *id.* at 276 (stating that court will evaluate decisionmaking process under business judgment rule and if it finds plaintiff negotiated reasonably with counsel then it will not second guess that decision).

retaining counsel.<sup>225</sup> Consistent with the principles of the business judgment rule, the court stated that “[i]f the court determines that the plaintiff with the largest loss has adequately negotiated with counsel, then the adequacy requirement . . . is met. . . . In the event of such a showing, the court need not, and indeed should not, substitute its judgment for that of the lead plaintiff.”<sup>226</sup> In short, both courts found, consistent with the Task Force’s findings, that a court should not interfere with a plaintiff’s choice of counsel if the decision was based on a reasonable, good-faith selection process.<sup>227</sup>

### B. *Appropriate Conditions for Conducting an Auction*

Under a standard of review similar to the business judgment rule, an auction is appropriate only under very limited circumstances without violating the text of the PSLRA.<sup>228</sup> Consistent with the statutory text, the court is authorized only to approve or disapprove the lead plaintiff’s choice of counsel.<sup>229</sup> The court, however, is authorized to appoint the most adequate plaintiff.<sup>230</sup> If, for instance, the plaintiff consistently fails to negotiate a fee that the court finds reasonable, the court can review the adequacy of an alternate plaintiff who possess the next highest financial interest.<sup>231</sup> If, however, no other plaintiffs are willing or able to serve as lead plaintiff, the court properly may assume control of the litigation in order to serve the interests of the class without violating the terms of the PSLRA.<sup>232</sup>

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225. See *Copper Mountain*, 201 F.R.D. at 486-89 (N.D. Cal. 2001) (stating that deference is given to plaintiff’s choice of counsel because fee arrangement appeared reasonable).

226. *Id.* at 482.

227. See *id.* at 486 (stating that court will defer to plaintiff’s choice of counsel if negotiated reasonably); *Cendant*, 264 F.3d at 276 (stating that court will defer if lead plaintiff’s choices were result of good faith selection and negotiation process and were arrived at via meaningful arms-length bargaining).

228. See, e.g., *Cendant*, 264 F.3d at 277 (stating circumstances that might arise when auction is permissible); Third Circuit Task Force Report, *supra* note 11, at 91 (acknowledging that case might arise when auction could be permitted). The Task Force realized that a situation might arise in which “lead plaintiff ha[d] failed to conduct adequate search for qualified counsel, and no other party has stepped up with resources, experience and interest to conduct a true market search for and negotiation with counsel.” *Id.* In such circumstances, the Task Force admits that it may designate a “most adequate plaintiff,” as required under the statute, and find it appropriate to conduct an auction. See *id.* (finding auction may be appropriate).

229. See 15 U.S.C. § 78u-4(a)(3)(B)(v) (2000) (recognizing that lead plaintiff’s choice of counsel is subject to approval by court pursuant to lead counsel provision).

230. See 15 U.S.C. § 78u-4(a)(3)(B)(i) (providing court with authority to select most adequate plaintiff). For a further discussion on the selection of the lead plaintiff, see *supra* notes 32-39 and accompanying text.

231. See 15 U.S.C. § 78u-4(a)(3)(B) (providing that lead plaintiff provision requires court to choose most adequate plaintiff).

232. Cf. *id.* (finding that lead plaintiff and lead counsel must be appointed in order for class action to proceed).

In support, the Northern District of California, the Third Circuit and the Third Circuit Task Force agree that under these limited circumstances a court-ordered auction may be appropriate without violating the PSLRA.<sup>233</sup> Because the court must obtain a reasonable fee arrangement, it may opt for an auction to achieve this result.<sup>234</sup>

C. *The Court, Not the Lead Plaintiff, Should Conduct the Auction*

As shown, an auction may be appropriate in a situation where a court finds no adequate plaintiff who is willing or able to negotiate a fee agreement with counsel and the class action is well-suited to proceed.<sup>235</sup> In *Network Associates*, the Northern District of California misconstrued this test by requiring the lead plaintiff to conduct the auction when the plaintiff's counsel was unable to serve as lead counsel.<sup>236</sup> Rather than determining the plaintiff's ability to seek another counsel, the court improperly ordered the plaintiff to conduct an auction.<sup>237</sup> The auction, as a result, interfered with the plaintiff's ability to choose its own counsel.<sup>238</sup> Instead, the court should have afforded the lead plaintiff with an opportunity to choose counsel before even considering an auction.<sup>239</sup>

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233. See *Cendant*, 264 F.3d at 277 (stating that if none of possible lead plaintiffs are adequate then it might be permissible for court to conduct auction); *In re Quintus Sec. Litig.*, 201 F.R.D. 475, 491 (N.D. Cal. 2001) (same); Third Circuit Task Force Report, *supra* note 11, at 91 (same). The Task Force agreed that there may exist circumstances when an auction may be appropriate:

a case might arise in which the putative lead plaintiff has failed to conduct an adequate search for qualified counsel, and no other party has stepped up with the resources, experience and interest to conduct a true market search for and negotiation with counsel, i.e., a sophisticated investor who has suffered substantial economic loss. In these very limited circumstances, the Task Force does not rule out the possibility that the court may designate a "most adequate plaintiff"—as is required under the statute—and yet find it appropriate to employ [ ] an auction.

*Id.*

234. Compare *Quintus*, 201 F.R.D. at 490 (stating that auction is appropriate because plaintiff was unable to select lead counsel, all other prospective plaintiffs were incapable of negotiating competitive fee arrangement and class action was well-suited to proceed), with *Cendant*, 264 F.3d at 277 (stating that if litigant repeatedly undertakes flawed process of selecting and retaining lead counsel and none of possible lead plaintiffs are capable of serving as lead plaintiff, then court may assume direct control over counsel selection and hold auction).

235. For a discussion on permissibility of auctions, see *supra* notes 228-34 and accompanying text.

236. See *In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017, 1033 (N.D. Cal. 1999) (noting that court held auction before determining whether plaintiff was incapable of making this decision).

237. See *id.* (holding that plaintiff conduct auction).

238. See 15 U.S.C. § 78u-4(a)(3)(B) (stating that lead plaintiff chooses counsel); S. REP. NO. 104-98, at 11 *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (stating that investors should be empowered to choose counsel).

239. See 15 U.S.C. § 78u-4(a)(3)(B) (recognizing that court only has authority under PSLRA to approve lead plaintiff's choice of counsel).

## VIII. CONCLUSION

In selecting the lead plaintiff, the PSLRA permits a court to aggregate the financial interests of a small number of investors provided the court determines that the group adequately represents the interests of the class. This conclusion is consistent with the statutory text and the legislative history of the PSLRA. Aggregating, however, a large number of investors with small financial interests in the outcome of the litigation is inconsistent with the statutory text. In selecting the lead counsel, a court must defer to a lead plaintiff's choice of counsel under the business judgment rule but may consider auctioning this position only if all plaintiffs are inadequate to select competent counsel and the class action is well suited to proceed.

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