PANEL ONE: PRIVATE SECURITIES LITIGATION REFORM ACT

SECURITIES LITIGATION AND ITS LAWYERS: CHANGES DURING THE FIRST DECADE AFTER THE PSLRA

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Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA, Act) to address problems plaguing securities class action litigation. This study surveys the empirical evidence on the impact of the PSLRA, examining the specific categories of reforms introduced by the Act. We look at the existing evidence relating to three areas of study: substantive changes in the definition of fraud necessary to bring a securities class action; the congressional effort to empower lead plaintiffs relative to the plaintiffs' bar; and the direct sanctioning of lawyers authorized in the Act. Given the PSLRA's focus on changing the incentives and behavior of plaintiffs' lawyers, we also provide preliminary data on the role of the lead plaintiff law firm. We report that few plaintiff law firms either entered or exited the market after the enactment of the PSLRA. Furthermore, individual law firms' market shares, which were determined by settlement amounts, suffered no appreciable change in the wake of the PSLRA. However, the tendency of top-tier law firms to associate with lower-tier firms did increase significantly in the post-PSLRA period. We also report that institutional investors taking on the role of lead plaintiffs in the post-PSLRA period tended to develop repeat relationships with select top-tier law firms. Our survey of the existing evidence and study of new evidence relating to the role of plaintiff law firms leads us to raise several questions for possible new lines of research into the effectiveness of the PSLRA.

INTRODUCTION

Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA, Act)[1] to target the perceived abuse by plaintiffs' lawyers in class action securities litigation. Put forth as part of the "Contract with America" leading up to the 1994 congressional elections and passed over President Clinton's veto in 1995, the PSLRA combined three separate mechanisms: raising the bar as to what constitutes securities fraud, empowering lead plaintiffs to rein in their lawyers in class actions, and requiring judges to sanction securities lawyers for frivolous litigation. In

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1. Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

this study, we compare the effectiveness of each mechanism over the PSLRA's first decade by examining the existing empirical evidence and analyzing the sometimes unexpected results that have ensued.

Much work remains in developing the empirical evidence on the impact of the PSLRA. Since all three PSLRA reform tactics are directed at the behavior of plaintiffs' lawyers, we provide in this study the first systematic evidence on how this behavior has changed after the PSLRA. We find substantial continuity in the plaintiffs' bar in securities class actions; the legislation did not dislodge the dominant plaintiff law firms nor did it encourage substantial new entrants. At the same time, we find two distinct changes in how plaintiff law firms have organized their participation in class actions. In the immediate aftermath of the 1995 legislation, larger plaintiff law firms became much more willing to join with lower-ranked law firms in acting as lead plaintiffs' counsel. This collaboration was an effort to build a client group with the largest financial interest, a new requirement for lead plaintiffs which had been specified in the PSLRA. After 2000, with the rise of institutional investors as lead plaintiffs, we observe the beginning of another pattern: repeat relationships between the larger plaintiff law firms and specific institutional investors. This preliminary evidence, in turn, suggests new lines of research to assess the value of the PSLRA for investors.

In Part I of this study, we briefly introduce the reforms mandated by the PSLRA. In Part II, we survey the empirical evidence on the PSLRA. We focus in particular on the impact of the PSLRA in raising the substantive bar as to securities fraud, empowering lead plaintiffs, and mandating judicial sanctions for frivolous litigation. Our analysis of judicial sanctions is the first empirical study on this portion of the Act and reveals the surprising result that these sanctions are rarely used in class actions, but instead show up more frequently in securities claims that are not class actions. In Part III, we report our empirical evidence on the behavior of plaintiffs' lawyers, the common targets of the various parts of the PSLRA.

I. The PSLRA Reforms

The debate surrounding the enactment of the PSLRA reflected several core assertions that had been part of the push for the legislation:

- plaintiffs' attorneys initiated and managed securities class actions;
- attorneys had incentives to pursue claims that were not optimal for corporations, shareholders, and the larger society;
- settlement was independent of the merits.[2]

2. See Janet Cooper Alexander, Do the Merits Matter? A Study of Settlements in Securities Class Actions, 43 Stan. L. Rev. 497, 524–28 (1991) (arguing that settlement amounts in securities class actions do not take into account litigation merits). But see Leonard B. Simon & William S. Dato, Legislating on a False Foundation: The Erroneous Academic Underpinnings of the Private Securities Litigation Reform Act of 1995, 33 San

The PSLRA was not the first time policymakers had sought to curb the abuses of representative litigation brought to police management behavior within corporations. In addition to voting and selling, litigation has long been one of the great triumvirate of actions available to shareholders to counter the plenary power that corporate law places in the hands of directors.[3] State corporate law has long authorized individual shareholders to bring a claim in the name of and on behalf of the corporation, but any recovery in these derivative suits typically went to the corporate treasury. Individual shareholders therefore gained only indirectly via a proportionate increase in the value of the overall corporate entity. As a result, individual shareholders had little incentive to bring derivative suits and plaintiff law firms did much of the work.

A report by Franklin Wood to the New York Chamber of Commerce in 1944 about derivative suits found such suits to be filed by shareholders "having no real financial interest in the corporation," with it "being obvious that the only one likely to profit substantially in the event of success is the [plaintiffs'] attorney."[4] Wood found that a small group of plaintiffs' attorneys filed most of these cases, that they earned very substantial fees when they were successful in court or struck a settlement, and that they frequently jockeyed for position as "general" counsel, all of which led to the filing of many duplicative, substantially identical, complaints.[5] Wood also pointed to the fact that on average these cases settled for less than three percent of the amounts demanded in the complaints, that the courts approved these settlements as adequate in almost every case, and that "derivative actions more than most others lend themselves to settlement as an insurance measure."[6]

Based on Wood's report, the New York legislature enacted a new provision of its corporate code, requiring plaintiffs in derivative actions who held less than five percent or $50,000 of the defendant company's stock to post bond for the company's expenses in defending the action.[7]

Diego L. Rev. 959, 966–84 (1996) (criticizing methodological errors and erroneous conclusions of Alexander study).

3. See, e.g., Del. Code Ann. tit. 8, § 141(a) (2006) (outlining that all corporate power exists by or under authority of board of directors); see also Robert B. Thompson, Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue, Law & Contemp. Probs., Summer 1999, at 215 (providing overview of rights of shareholders to vote, sell their shares, and bring lawsuits).

4. Franklin Wood, N.Y. Chamber of Commerce, Survey and Report Regarding Stockholders' Derivative Suits 112 (1944). Wood and his team interviewed a large number of lawyers and collected data on all derivative suits filed in two counties of the State of New York and in the United States District Court for the Southern District of New York for 1932–1942. Id. at 2.

5. Id. at 57, 75, 78, 82. The term general counsel refers to what would now be called lead counsel.

6. Id. at 42.

7. See 1944 N.Y. Laws 1455 (repealed 1973). The five percent threshold appears to have been derived by examining the size of the stakes of shareholders filing derivative actions against close corporations. See Wood, supra note 4, at 30–31. In such cases where

In reviewing a subsequent challenge to a similar New Jersey law, the U.S. Supreme Court in *Cohen v. Beneficial Industrial Loan Corp.* observed that the derivative suit was "the chief regulator of corporate management."[8] But the Court was more concerned about the potential for abusive "strike suits" that would generate high litigation costs and upheld the state law. Since the *Cohen* decision and Wood's report, courts and legislatures have subjected derivative suits to additional limitations including the contemporaneous ownership requirement,[9] and most importantly, the demand requirement.[10] A recent empirical study showed only about thirty derivative claims against Delaware public companies per year.[11]

Derivative suits have been eclipsed in recent years by another form of representative litigation: class actions brought under federal securities laws alleging fraud.[12] Class action claims typically are brought for the benefit of all shareholders who purchased (or sometimes sold) stock during a class period in which misrepresentations about the stock had been made, but not corrected. Unlike the state law derivative claims, any recovery in a class action goes directly to the shareholders. Nonetheless, the typically wide dispersal of shareholdings in a large public corporation and the small amount of any one shareholder's holdings has meant that few shareholders possess sufficient incentive to initiate these suits. As a result, securities class actions often (at least prior to the PSLRA) resemble traditional derivative suits in that plaintiff law firms in fact have the greatest incentive to prosecute the suits. Commentators have often linked de-

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the plaintiffs' holdings were stated, the average shareholder plaintiff held more than thirty percent of the company's stock, and in less than seven percent of these cases did the plaintiff hold less than five percent of the company's stock. See id. at 31. As of 2002, sixteen states had these security-for-expenses statutes. See Deborah A. DeMott, Shareholder Derivative Actions: Law and Practice § 3:2 (2003).

8. 337 U.S. 541, 548 (1949).

9. The contemporaneous ownership requirement mandates that the named plaintiff in a derivative suit be a shareholder at the time of the transaction and at the time of the filing of the suit. See James D. Cox et al., Corporations 424 (1997). Alternatively, the named plaintiffs may have obtained their shares by operation of law from someone who was a shareholder at the time of the filing of the suit. See id. at 424–25.

10. The demand requirement forces a potential plaintiff to first make a demand on the company's board of directors to remedy the alleged misconduct, or to allege why such demand would be futile. See Charles R.T. O'Kelley & Robert B. Thompson, Corporations and Other Business Associations 325–69 (4th ed. 2003).

11. See Robert B. Thompson & Randall S. Thomas, The Public and Private Faces of Derivative Lawsuits, 57 Vand. L. Rev. 1747, 1749 (2004). In comparison, between 1996 and 2004, the number of federal securities fraud class action filings has averaged 195 filings per year. See Cornerstone Research, Securities Class Action Case Filings, 2005: A Year in Review 3 (2006), available at http://www.cornerstone.com/pdfs/YIR2005.pdf (on file with the *Columbia Law Review*).

12. In the case of secondary market fraud, suits are typically brought under Rule 10b-5, 17 C.F.R. § 240.10b-5 (2006), which was promulgated under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2000). In the case of fraud arising in a public offering, suits are brought under sections 11 and 12(a)(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l(a)(2), as well as under Rule 10b-5.

rivative and class action shareholder suits, observing, among other things, that the collective action and free rider problems in both types of litigation allow the plaintiffs' attorney "to operate with nearly total freedom from traditional forms of client monitoring."[13]

In addressing representative suits brought by means of class actions under the federal securities laws, the PSLRA reshaped securities litigation from three directions. First, Congress raised the substantive bar as to the elements that must be proved to recover for securities fraud, changing the rules as to pleading, discovery, scienter, causation, and damages.[14] Second, Congress sought to insert an empowered institutional investor-client in place of the ubiquitous passive client who had failed to constrain lawyer self-interest in pre-PSLRA securities class actions.[15] Third, Congress sought to ratchet up judicial supervision of lawyers by mandating judicial review of possible attorney and client misconduct and the possibility of sanctions in every private securities case.[16]

In the immediate aftermath of the PSLRA and in the decade since its passage, most of the academic and judicial focus has been on the first category of changes: the substantive changes relating to the fraud cause of action aimed at eliminating nonmeritorious suits. These were the most numerous of the PSLRA provisions and the ones that achieved the highest visibility in judicial opinions and commentary. They included the following:

- Providing a safe harbor for forward-looking statements;[17]
- Raising the bar for what must be pled about a defendant's mental state;[18]
- Barring discovery prior to a motion to dismiss;[19]
- Requiring loss causation;[20]
- Inserting a damage cap;[21]

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13. Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 20 (1991). There is yet a third form of representative litigation in corporate law that has not received the same attention. Class actions brought under state law can be brought as direct, instead of derivative, suits in situations such as mergers where the shareholders have received too little for their shares in what is characterized as a direct loss. These state court suits are typically brought as class actions in which the lead plaintiff, with that plaintiff's law firm, is representative of all the participants in the class. These suits raise many of the same concerns. For a discussion of acquisition-related state law class actions, see generally Robert B. Thompson & Randall S. Thomas, The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions, 57 Vand. L. Rev. 133 (2004) [hereinafter Thompson & Thomas, New Look].

14. PSLRA, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 and 18 U.S.C.).

15. Id.

16. Id.

17. See Securities Act of 1933 § 27A; Securities Exchange Act of 1934 § 21E.

18. See Securities Exchange Act of 1934 § 21D(b)(2).

19. See id. § 21D(b)(3); Securities Act of 1933 § 27(b).

20. See Securities Exchange Act of 1934 § 21D(b)(4).

21. See id. § 21D(e).

- Shifting from joint and several liability to proportionate liability;[22]
- Eliminating RICO claims for securities.[23]

A secondary focus of the existing empirical literature is on the effort contained within the PSLRA to empower investor members of the plaintiff class to supervise class actions being brought in their name. These statutory changes included:

- Specifying that the lead plaintiff should be chosen by reference to the largest financial interest at stake in the litigation (thereby displacing the prior common pattern of selecting the first plaintiff to file as the lead plaintiff);[24]
- Banning incentives paid to persons to become lead plaintiffs;[25]
- Restricting professional plaintiffs.[26]

A third focus was on direct regulation of the lawyers themselves. The PSLRA requires a court hearing in every securities fraud class action to review the case for whether sanctions should be imposed for bringing frivolous claims.[27] In addition, the statute specifically limits fees to those that are "reasonable."[28] The existing empirical evidence is largely silent on the impact of these mandatory sanctions. In this study, we provide the first empirical evidence on the incidence and nature of post-PSLRA court-imposed sanctions.

II. Empirical Studies of the Impact of the PSLRA

The PSLRA has generated an enormous body of empirical work by scholars in both finance and law. This section surveys general empirical findings as to securities litigation over the last decade with specific attention to the three prongs of reform found in the Act. Much of the empirical work has focused on the substance of the lawsuits, examining in particular whether nonmeritorious suits have been blocked by the new rules.

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22. See id. § 21D(f). Although primarily aimed at claims under the Securities Exchange Act of 1934, proportionate liability also applies to outside directors involved in section 11 claims under the Securities Act of 1933. Securities Act of 1933 § 11(f)(2)(A).

23. See 18 U.S.C. § 1964(c) (2000) (incorporating amendments included in section 107 of PSLRA).

24. See Securities Act of 1933 § 27(a)(3)(B) (specifying rebuttable presumption of person or group of persons with largest financial interest in relief sought by class as most adequate plaintiff); Securities Exchange Act of 1934 § 21D(a)(3) (same).

25. See Securities Act of 1933 § 27(a)(2)(A)(vi) (requiring that certificate state that plaintiff will not accept payment in excess of pro rata share); Securities Exchange Act of 1934 § 21D(a)(4) (requiring that payment be made to all plaintiffs, including lead plaintiff, only on pro rata basis).

26. See Securities Act of 1933 § 27(a)(3)(B)(vi) (specifying that person may not be lead plaintiff in more than five securities class actions brought during three-year period, except as court may permit); Securities Exchange Act of 1934 § 21D(a)(3)(B)(vi) (same).

27. See Securities Act of 1933 § 27(c); Securities Exchange Act of 1934 § 21D(c).

28. See Securities Act of 1933 § 27(a)(6); Securities Exchange Act of 1934 § 21D(a)(6).

Less attention has been paid within the existing literature to whether more meritorious suits are also blocked.

A. *Impact of the PSLRA on the Value of Companies*

Some of the earliest empirical work addressed whether passage of the PSLRA impacted the value of companies that faced a higher risk of securities litigation. An event study by Spiess and Tkac reports significant positive abnormal returns around the time of the congressional override of President Clinton's veto.[29] A subsequent study by Johnson, Kasznik, and Nelson also reports significant positive abnormal returns around the time of the override.[30] Using a broad set of market-based and reporting variables to estimate the risk of litigation, Johnson, Kasznik, and Nelson also found that market returns were higher for high technology firms at relatively greater risk of litigation.[31] Johnson and Nelson, joined by Pritchard, tested the market reaction to *Silicon Graphics*, the decision by the Ninth Circuit that applied a seemingly higher scienter standard for securities fraud in the post-PSLRA period than other circuits.[32] Johnson, Nelson, and Pritchard found the promulgation of the Ninth Circuit's prodefendant pleading standard resulted in significant positive abnormal stock market returns, particularly for firms at higher risk of litigation.[33]

Not all the event study evidence points to increased stock market valuation due to the PSLRA's effect on litigation. Ali and Kallapur provide an event study examining a number of events leading up to Congress's override of President Clinton's veto of the PSLRA.[34] Among other things, they report significant negative cumulative returns for companies in high-litigation risk industries from the day before the congressional vote on the conference committee bill on the PSLRA to the next

29. D. Katherine Spiess & Paula A. Tkac, The Private Securities Litigation Reform Act of 1995: The Stock Market Casts Its Vote . . ., 18 Managerial & Decision Econ. 545, 553–54 (1997).

30. Marilyn F. Johnson, Ron Kasznik & Karen K. Nelson, Shareholder Wealth Effects of the Private Securities Litigation Reform Act of 1995, 5 Rev. Acct. Stud. 217, 223, 224 tbl.1 (2000).

31. Id. at 224–30. Consistent with the argument that the PSLRA may have also reduced the incidence of meritorious lawsuits, the authors report a negative correlation between the market reaction and firms with a higher probability of being subject to a meritorious suit prior to the PSLRA. Id. ("[O]ur findings suggest that the PSLRA was less beneficial for firms at greater risk of litigation for fraudulent activity, but that these negative effects were dominated, on average, by the positive wealth effects associated with restricting frivolous securities litigation.").

32. In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999); see Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *In re Silicon Graphics Inc.*: Shareholder Wealth Effects Resulting from the Interpretation of the Private Securities Litigation Reform Act's Pleading Standard, 73 S. Cal. L. Rev. 773, 774 (2000) [hereinafter Johnson, Nelson & Pritchard, *Silicon Graphics*].

33. See Johnson, Nelson & Pritchard, *Silicon Graphics*, supra note 32, at 796–97.

34. Ashiq Ali & Sanjay Kallapur, Securities Price Consequences of the Private Securities Litigation Reform Act of 1995 and Related Events, 76 Acct. Rev. 431 (2001).

trading day after the Act's passage into law.[35] Professor Coffee, in his contribution to this Symposium, argues that negative market reaction should more fairly be attributed to what he terms a "circularity problem"—that the costs of securities class action litigation, meritorious or not, principally fall on innocent shareholders.[36]

B. *General Empirical Findings*

In looking at securities class action filings after the enactment of the PSLRA as compared to pre-PSLRA filings, empirical studies have suggested the following observations:

1. *The Number of Filings Has Not Gone Down.* — There were about 200 securities class actions filed per year in the pre-PSLRA period[37] and there continue to be about the same number of filings per year.[38] If anything, it is more likely that litigation has gone up rather than gone down over the entire period.[39] There have been yearly fluctuations. For example, in 1996, the year immediately after the passage of the PSLRA, the number of suit filings was at the low end for the decade.[40] The number of filings for 1996 may nonetheless reflect a brief migration of suits to state court prior to the passage of the Securities Litigation Uniform Standards Act in 1998, which preempted securities fraud class actions filed in state courts.[41] After Congress preempted such state court class actions, the number of federal suits quickly returned to near its pre-PSLRA level. Results from 2005 reflect a decline from the ten-year average.[42] We will have to await future data to evaluate whether that year began a trend of fewer fraud suits, which could perhaps be due to the increased account-

35. Id. at 437–47.

36. John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1536 n.5, 1556–57 (2006).

37. Ronald I. Miller et al., NERA Econ. Consulting, Recent Trends in Shareholder Class Action Litigation: Beyond the Mega-Settlements, Is Stabilization Ahead? 2 (2006), available at http://www.nera.com/image/BRO_RecentTrends2006_SEC979_PPB-FINAL.pdf (on file with the *Columbia Law Review*) (reporting 201 cases per year from 1991–1995).

38. See id. (reporting average of about 223 cases for 1996–2005 period); Cornerstone Research, supra note 11, at 2 (reporting average of 195 cases per year for nine years since enactment of PSLRA).

39. See Michael A. Perino, Did the Private Securities Litigation Reform Act Work?, 2003 U. Ill. L. Rev. 913, 931 [hereinafter Perino, PSLRA] (arguing that litigation has increased); Miller, supra note 37; see also James G. Bohn, Securities Litigation in the Utility Sector, 26 Energy L.J. 473, 481–83 (2005) (reporting that incidence of litigation involving utility sector companies increased between 1996 and 2003).

40. PricewaterhouseCoopers, 2005 Securities Litigation Study 8 (2005), available at http://www.pwc.com/extweb/pwcpublications.nsf/docid/7999A70324592B738525715C0059A948 (on file with the *Columbia Law Review*).

41. Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, § 101(b)(1)(B), 112 Stat. 3227, 3230 (1998) (codified as amended at 15 U.S.C. § 78bb(f)(2) (2000)) (preempting most state-filed class actions involving nationally traded securities).

42. See Cornerstone Research, supra note 11, at 2–3 (reporting 176 class action filings in 2005 as compared with average of 195 per year for nine years since enactment of PSLRA).

ing rigor imposed by the Sarbanes-Oxley reforms, enacted in 2002 following the Enron and WorldCom scandals.[43]

There have been several spikes in securities class actions during the post-PSLRA period, which do not appear to reflect general trends. For example, in 2001, plaintiffs' attorneys filed a host of cases in the wake of "laddering" allegations regarding IPOs.[44] These suits ran their course by the following year.[45] Shortly thereafter came a rash of class action suits related to analyst conflicts,[46] mutual fund late trading, and market timing,[47] also confined to a discrete time period.[48]

2. *Filings Have Shifted Away from Lower Value Claims.* — Despite the lack of drop in the number of filings, evidence exists that filings are shifting disproportionately to higher-value claims. Choi reports that lower value claims face fewer class actions in the post-PSLRA period, all other things being equal.[49] The higher costs imposed on plaintiffs' attorney firms due to the PSLRA raised the required potential damages a potential suit must present before plaintiffs' attorneys will file suit. The fact that a claim may have low value in an absolute sense, nonetheless, does not mean that there is an absence of fraud. Particularly for smaller compa-

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43. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

44. Elaine Buckberg et al., NERA Econ. Consulting, Recent Trends in Securities Class Action Litigation: Will Enron and Sarbanes-Oxley Change the Tides? 2 (2003), available at http://www.nera.com/image/6143.pdf (on file with the *Columbia Law Review*) [hereinafter NERA, Enron] (reporting that 2001 had 303 laddering cases). For a study on whether issuers should be held culpable in the IPO laddering litigation, see Stephen J. Choi & A.C. Pritchard, Should Issuers Be on the Hook for Laddering? An Empirical Analysis of the IPO Market Manipulation Litigation, 73 U. Cin. L. Rev. 179 (2004).

45. See, e.g., Court Grants Preliminary Approval to Settlement with Issuers in IPO Litigation, 37 Sec. Reg. & L. Rep. (BNA) 305 (Feb. 21, 2005) (reporting settlement that guaranteed investors recovery of at least $1 billion in their consolidated class actions).

46. For a discussion of the analyst conflict of interest in class actions, see Barbara Moses, They Were Shocked, Shocked: The "Discovery" of Analyst Conflicts on Wall Street, 70 Brook. L. Rev. 89, 93–95 (2004) (arguing that brokerage firm reliance on positive analyst recommendations creates "structural pressure" to produce positive reviews).

47. For a description of the late-trading and market-timing mutual fund scandals, see Laura Johannes, John Hechinger & Karen Damato, Fraud Charges Widen Scope of Scandal Facing Mutual Funds, Wall St. J., Dec. 12, 2003, at C1 (describing regulatory investigation of more than two dozen financial firms for late-trading and market-timing scandals).

48. See NERA, Enron, supra note 44, at 2 (noting that federal courts received 123 filings from January to late June 2006). The government has achieved settlements against various defendants. See, e.g., Former Executives of PIMCO Entity Settle SEC Charges in Market-Timing Case, 38 Sec. Reg. & L. Rep. (BNA) 1071 (June 19, 2006). Private suits remain pending. See, e.g., In re Mut. Funds Inv. Litig., 384 F. Supp. 2d 845 (D. Md. 2005).

49. See Stephen J. Choi, Do the Merits Matter Less After the Private Securities Litigation Reform Act?, 23 J.L. Econ. & Org. (forthcoming 2007) (manuscript at 16, on file with the *Columbia Law Review*); see also Stephen J. Choi, Karen Nelson & A. C. Pritchard, The Screening Effect of the Private Securities Litigation Reform Act 17–29 (Aug. 2006) (unpublished manuscript, on file with the *Columbia Law Review*) (examining whether merits matter more or less in case of secondary market fraud class actions).

nies, fraud may represent a high relative percentage of a company's valuation, but still present a lower absolute potential damage award for plaintiffs and plaintiffs' attorneys.[50] One impact of the PSLRA, therefore, is to expand the area of small fraud situations where private litigation provides an ineffective deterrent.[51]

3. *Most Cases Continue to Settle, but the Time to Settlement Has Lengthened.* — As is true with litigation generally, most securities class actions settle, and that basic fact changed little after the passage of the Act. Yet, for those cases that do settle, the time from the filing of the suit until settlement has increased. For example, Bajaj, Mazumdar, and Sarin found that the number of cases that settled within the first four years after the filing of a suit decreased from 57.6% of cases filed in the pre-PSLRA period down to 26.1% in the post-PSLRA period.[52] A 2005 NERA study reports that an increase in the amount of time to settlement is the sole statistically significant long-term impact of the PSLRA.[53]

4. *Data on the Percentage of Dismissals Have Varied During the Period.* — Obtaining data on dismissals requires waiting some period to allow the resolution of the suits to play out. One of the earlier studies, using data through 1999, found dismissals less than four years after the filing of a suit declined after the PSLRA.[54] Somewhat later studies by Johnson, Nelson, and Pritchard and by Choi both report a greater incidence of cases being dismissed as a fraction of filed cases after the enactment of the PSLRA.[55] In contrast, NERA's 2003 study concludes that dismissal rates are statistically unchanged.[56]

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50. See Choi, Nelson & Pritchard, supra note 49, at 19–29.

51. Bohn and Choi provide related evidence from the pre-PSLRA period that only IPOs over a minimum offering size faced an appreciable number of class actions. James Bohn & Stephen Choi, Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions, 144 U. Pa. L. Rev. 903, 928–45 (1996). They report, for example, that less than one percent of IPOs with an offering amount of less than $5 million faced a class action. In contrast, over twelve percent of IPOs with an offering amount of approximately $40 million and above faced a lawsuit. Id. at 936 tbl.2.5.

52. Mukesh Bajaj, Sumon C. Mazumdar & Atulya Sarin, Securities Class Action Settlements, 43 Santa Clara L. Rev. 1001, 1010 & tbl.4 (2003).

53. Elaine Buckberg et al., NERA Econ. Consulting, Recent Trends in Shareholder Class Action Litigation: Bear Market Cases Bring Big Settlements 4 (2005), available at http://www.nera.com/image/Recent_Trends_Final_2.28.05.pdf (on file with the *Columbia Law Review*) [hereinafter NERA, Bear Market].

54. See Bajaj et al., supra note 52, at 1011.

55. Choi, supra note 49 (manuscript at 40 tbl.6); Marilyn F. Johnson, Karen K. Nelson & Adam C. Pritchard, Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act, 23 J.L. Econ. & Org. (forthcoming 2007) (manuscript at 43 tbl.1, on file with the *Columbia Law Review*) [hereinafter Johnson, Nelson & Pritchard, Merits]. Work by Pritchard and Sale also found differences in dismissal rates between different federal circuits, reporting a greater dismissal rate in the Ninth Circuit compared with the Second Circuit in the post-PSLRA period. A.C. Pritchard & Hillary A. Sale, What Counts as Fraud? An Empirical Study of Motions to Dismiss Under the Private Securities Litigation Reform Act, 2 J. Empirical Legal Stud. 125, 142 (2005).

56. NERA, Enron, supra note 44, at 5.

5. *Mean Settlement Has Increased Somewhat and There Have Been More Large Settlements.* — Several studies report higher settlement awards in the post-PSLRA period and an increased incidence of larger settlements. Cornerstone reports that for 2005 there was a decline in the percentage of smaller settlements (less than $10 million) and an increase from seven to nine of settlements that were $100 million or more.[57] Large settlements in the Enron and WorldCom cases show up in this period, but the increase in large settlements seems to extend past these specific cases.[58]

Such an increase would not be surprising if settlements now included a higher percentage of meritorious suits and a reduced incidence of nonmeritorious suits. Yet as discussed above, the pattern of higher post-PSLRA settlements is also consistent with the view that plaintiffs' attorneys are simply avoiding all smaller value claims (both meritorious and frivolous) due to the increased difficulty in proving a securities fraud case because of the PSLRA changes.[59]

6. *Investors Recover a Smaller Percentage of Their Loss in Post-PSLRA Cases.* — Potential investor losses can be measured in multiple ways and critics of representative litigation have long criticized the low percentage of recovery.[60] For securities class actions, some data suggest that investors are recovering a smaller percentage of their losses than before the PSLRA[61] and that the percentage may be declining.[62] Nevertheless, one valuation firm reports that investor losses are the single most powerful determinant of the amount of settlements that will result from a securities class action.[63]

7. *The Share of Cases in the Ninth Circuit and Against Technology Companies Has Declined.* — Cornerstone reports from an analysis of 2005 cases that more cases were filed in the Second Circuit than the Ninth Circuit and that cases against both technology and communication companies had declined in the Ninth Circuit relative to prior years.[64] Part of the motivation for the PSLRA reflected a concern that litigation was disproportionately targeted at technology firms, particularly those in Silicon

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57. See Laura E. Simmons & Ellen M. Ryan, Cornerstone Research, Post-Reform Act Securities Settlements: 2005 Review and Analysis 3 (2006), available at http://securities.cornerstone.com/pdfs/settlements_2005.pdf (on file with the *Columbia Law Review*).

58. Id. (noting that settlement values increased in 2005 even excluding WorldCom and Enron).

59. See supra notes 49–50 and accompanying text.

60. See, e.g., Wood, supra note 4, at 2 (noting extremely low number of recoveries in stockholders' actions).

61. See James D. Cox & Randall S. Thomas with Dana Kiku, Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 106 Colum. L. Rev. 1587, 1592 (2006).

62. See NERA, Enron, supra note 44, at 10 (graphing declining median ratio of settlement values to investor losses from 1991 to 2002).

63. Id. at 9.

64. See Cornerstone Research, supra note 11, at 13.

Valley.[65] The 2005 Cornerstone study suggests that the PSLRA has recently reduced litigation against Silicon Valley companies (at least in the Ninth Circuit), although the study makes no attempt to distinguish between meritorious and frivolous litigation.[66] Perino provides evidence that the trend away from litigation in the Ninth Circuit began earlier, even before the *Silicon Graphics* opinion.[67] The drop in litigation in the Ninth Circuit is consistent with other studies suggesting differences in specific circuits; as reported above, Pritchard and Sale find that the Ninth Circuit, with its more stringent scienter pleading standard, is more likely to dismiss cases compared with the Second Circuit.[68]

C. *Empirical Findings on the Merits of Post-PSLRA Claims*

Most provisions of the PSLRA sought to raise the bar for those seeking to show fraud rather than to effect direct regulation of plaintiffs or plaintiffs' lawyers. Much of the empirical work since the enactment of the PSLRA has focused on the effectiveness of these provisions in reducing frivolous litigation. Some studies report that settlements after the enactment of the PSLRA include a higher percentage of meritorious litigation.[69] Johnson, Nelson, and Pritchard argue that by raising the bar as to the elements required to show fraud, the PSLRA increased the importance of merit-related factors.[70] They report that the relationship between accounting restatements (which they take as a merit-related factor) and the filing of lawsuits increased between the pre- and post-PSLRA periods.[71] Johnson, Nelson, and Pritchard also report that the relationship between abnormal insider trading and the filing of lawsuits increased between the pre- and post-PSLRA periods.[72] In addition, they report that while an accounting restatement is not significantly correlated with a high value settlement (used as a proxy for merit) in the pre-PSLRA pe-

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65. See Richard M. Phillips & Gilbert C. Miller, The Private Securities Litigation Reform Act of 1995: Rebalancing Litigation Risks and Rewards for Class Action Plaintiffs, Defendants and Lawyers, 51 Bus. Law. 1009, 1012 (1996) (reporting on estimates that half of 100 largest firms in Silicon Valley had been subject to suit).

66. See Cornerstone Research, supra note 11, at 2.

67. In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999); Perino, PSLRA, supra note 39, at 942–57 (" A . . . moving average . . . suggests that the decline in Ninth Circuit filings began before the . . . decision in *Silicon Graphics*.").

68. Pritchard & Sale, supra note 55, at 140–42. Perino reports a greater frequency of actions in the Ninth Circuit alleging both accounting misrepresentations and insider trading and lower frequency of actions based solely on allegedly false or misleading statements, suggesting quality of cases may be better in the Ninth Circuit. Perino, PSLRA, supra note 39, at 950–51.

69. See Johnson, Nelson & Pritchard, Merits, supra note 55.

70. Id. (manuscript at 5–6).

71. Id. (manuscript at 6–7).

72. Id.

riod, accounting restatements are significantly related to high value settlements in the post-PSLRA period.[73]

Most of the analysis on the effect of the PSLRA has focused on deterrence of nonmeritorious suits and how that affects the census of suits and recovery. Measures of the effectiveness of litigation should also reflect the impact on meritorious suits to determine the overall benefit (or cost) of the new rules to investors. This question has been less examined. A recent study by Choi compares firms that were sued against matched firms that were not sued both in the pre- and post-PSLRA periods.[74] Among other things, Choi reports that a significant fraction of non-nuisance suits lacking prefiling indicia of fraud (which Choi defines to include a prefiling public announcement of an accounting restatement or SEC investigation or enforcement action) that were filed in the pre-PSLRA period would not have been brought in the post-PSLRA period.[75] A study by Talley and Johnsen similarly suggests that the PSLRA may have discouraged meritorious litigation as well as frivolous litigation.[76] However, Talley and Johnsen do report that in companies with highly volatile stocks, the PSLRA may have come closer to its intended effect of discouraging frivolous litigation, but not meritorious litigation.[77]

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73. The difference between the pre- and post-PSLRA periods is significant at the one percent confidence level. See id. (manuscript at 25).

74. Choi, supra note 49.

75. Id. (manuscript at 5) (noting that 66.7% of cases without evidence of fraud resulted in nonnuisance outcome pre-PSLRA, compared with predicted 28.7% nonnuisance outcome post-PSLRA).

76. Eric Talley & Gudrun Johnsen, Corporate Governance, Executive Compensation and Securities Litigation 25 (Univ. of S. Cal. Law Sch., Olin Research Paper No. 04-7, 2004), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=536963 (on file with the *Columbia Law Review*) (noting that reported coefficient suggests PSLRA discourages more meritorious than frivolous litigation).

77. Id. In a related study, Eric Helland conducted an indirect examination of whether securities fraud class actions are meritorious by looking at the market for outside directorship. Eric Helland, A Secondary Market Test of the Merits of Class Action Securities Litigation: Evidence from the Reputation of Corporate Directors 4–5 (Contracting & Orgs. Research Inst., Working Paper No. 04-05, 2004), available at http://ssrn.com/abstract=517183 (on file with the *Columbia Law Review*). Helland hypothesizes that if a company truly engaged in fraud then that company's outside directors would suffer a reputational loss that would translate into fewer board positions at other companies. Conversely, if there was no fraud (and a lawsuit was frivolous) then there should be no effect on the number of board positions for outside directors at the sued firm. Id. at 4. Helland's study covers directors and firms from 1994 to 2002. Id. at 11. He reports little evidence of a negative impact on director reputation associated with a firm where there is an allegation of fraud. Directors suffer a drop in their total number of outside directorships only for fraud allegations that resulted in the top quartile of settlements and awards. Helland also reports that in the post-PSLRA period, outside directors of firms that faced a fraud allegation experienced a positive (although less positive than in the pre-PSLRA period) change in the number of outside directorships. Id. at 27–28. Helland takes this evidence as consistent with the view that lawsuits were largely frivolous in the time period of his study. Id. at 28.

An important part of the debate leading up to the enactment of the PSLRA focused on the pattern of suits based on predictive statements made by companies and their officers that later turned out to be incorrect (although not necessarily false at the time the predictions were made).[78] Courts had developed the "bespeaks caution" doctrine to protect such statements[79] and an SEC rule provided additional protection.[80] Congress enacted two additional safe harbors as part of the PSLRA—one for the 1933 Act and another for the 1934 Act.[81] These forward-looking information safe harbors have generated surprisingly little discussion since their enactment. Pritchard and Sale conclude that the safe harbors do not appear as protective of defendants in court as one might expect from the language of the statute itself.[82] Yet that does not necessarily mean that the safe harbors have had little impact. Perino, for example, notes a post-PSLRA decline in suits based solely on allegedly false or misleading forward-looking statements—those more likely to come within the safe harbor. He also notes a corresponding increase in the suits outside the safe harbor based on accounting misrepresentations and trading by insiders.[83] However, the drop Perino observes may reflect the post-PSLRA change in pleading standards more than the forward-looking information safe harbor change.[84] Looking directly at how firm behavior changed in the post-PSLRA period, Johnson, Kasznik, and Nelson compared how computer hardware, software, and pharmaceutical firms changed their voluntary reporting of earnings and sales forecasts between 1994 (pre-PSLRA) and 1996 (post-PSLRA).[85] They report that firms increased the frequency of their forecasts in the post-PSLRA period, including in particular "bad news" forecasts.[86]

While most of the empirical work has been directed toward examining the effect of the PSLRA on litigation, reforms that followed the Enron and WorldCom debacles suggest additional factors that could affect litigation rates. The Sarbanes-Oxley Act overhauled government supervision of the auditing function and required chief officers to certify financial

78. For a pre-1995 analysis of these types of suits, see generally Jennifer Francis, Donna Philbrick & Katherine Schipper, Determinants and Outcomes in Class Action Securities Litigation (1994) (unpublished manuscript, on file with the *Columbia Law Review*).

79. See, e.g., In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 371–73 (3d Cir. 1993).

80. See 17 C.F.R. § 230.176 (2006).

81. See supra note 17 and accompanying text.

82. Pritchard & Sale, supra note 55, at 148.

83. Perino, PSLRA, supra note 39, at 949 ("At the same time, complaints based solely on false or misleading forward-looking information, which were a particular concern for Congress, were relatively infrequent in the first year of litigation . . . .").

84. See supra note 18 and accompanying text.

85. Marilyn F. Johnson, Ron Kasznik & Karen K. Nelson, The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms, 39 J. Acct. Res. 297, 297–99 (2001).

86. Id. at 306–07.

statements.[87] About the same time, listing standards of the major American stock exchanges bumped up the governance obligations and independence requirements for corporate directors.[88] The changes suggest possible outcomes in more than one direction. The increased vigilance from these monitors may reduce fraud and thereby contribute to a drop in the frequency of litigation or settlement. At the same time, the increased governance burdens placed on managers and gatekeepers counter some of the liability-insulating provisions of the PSLRA. Early studies suggest that the incidence of securities litigation has been largely unaffected by the passage of the Sarbanes-Oxley Act.[89]

D. *Empirical Findings Regarding Lead Plaintiffs*

A second major focus of the PSLRA was to empower the plaintiffs in securities fraud class actions to take a greater role in directing this litigation and to be a more effective monitor of the plaintiff law firms. Given the large change in the census of shareholders of American corporations over the preceding several decades, particularly the movement from individual "mom and pop" investors to institutional investors, the expectation on the part of Congress was that institutional shareholders would eagerly step into the role of lead plaintiff.[90] Congress sought to encourage this trend by enacting a presumption that courts should select the party (among those seeking to become lead plaintiff) with the largest financial interest in the litigation as lead plaintiff and by seeking to exclude investors who were professional plaintiffs.[91]

The participation rate of institutional investors was low initially after the enactment of the PSLRA, but has grown significantly since 2000. Choi, Fisch, and Pritchard report that there were small numbers of institutional lead plaintiffs prior to 1995 and there were similarly small numbers in the first years after the PSLRA.[92] Phillips and Miller, in an early analysis of the changes brought about by the Act, opined: "There is considerable question whether the 'most adequate plaintiff' provision will fulfill its intended purpose of significantly increasing the likelihood that

87. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

88. See, e.g., Press Release, N.Y. Stock Exch., NYSE Approves Measures to Strengthen Corporate Accountability (Aug. 1, 2002), at http://www.nyse.com/press/1044027444976.html (on file with the *Columbia Law Review*).

89. See NERA, Bear Market, supra note 53, at 3.

90. The impetus behind Congress's focus on institutional investors came from Elliott J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J. 2053, 2105–09 (1995) (proposing reforms to securities class actions to encourage greater institutional investor participation).

91. See supra notes 24–26 and accompanying text.

92. Stephen J. Choi, Jill E. Fisch & A.C. Pritchard, Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act, 83 Wash. U. L.Q. 869, 888–89 (2005).

institutional investors will seek to serve as lead plaintiffs."[93] The number of cases with pension funds as lead plaintiffs hovered between ten and twenty for the period 1997 through 2000, but then began to grow dramatically to thirty-one in 2001 and fifty-six in 2002.[94] The *Cendant* litigation, settled at the end of 1999, was a high profile case in which institutional shareholders served as lead plaintiffs[95] and may have marked a turning point in institutional investor participation.[96] In 2005, over thirty-five percent of all settlements reported for that year involved institutional investors as lead plaintiffs, a notable change from the early years after the passage of the PSLRA.[97]

This dramatic rise in the participation rate of institutional investors masks a bifurcated pattern among institutional investors. There has been a substantial increase in participation of public pension firms, a group that includes well-known public employees' funds such as CalPERS, NYCERS, and funds related to various unions. At the same time, there has not been substantial involvement by private institutional investors, such as mutual funds, banks, and insurance companies.[98] In the words of one federal appellate judge, "the mutual funds won't touch it."[99]

The lack of private institutional involvement likely reflects that litigation is not a positive net present value transaction for institutional investors. Serving as a lead investor and monitoring litigation costs money and takes the time of employees who otherwise could be engaged in alternative income-producing activities. Litigation may expose the institution to

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93. Phillips & Miller, supra note 65, at 1040.

94. See Simmons & Ryan, supra note 57, at 9.

95. In re Cendant Corp. Sec. Litig., 404 F.3d 173 (3d Cir. 2005). For a discussion of this case, see Panel Discussion: The Private Securities Law Reform Act: Is It Working?, 71 Fordham L. Rev. 2363, 2369 (2003) [hereinafter Panel Discussion] (statement of Judge Edward Becker) ("[T]he mutual funds was the group that I think Congress had in mind . . . but the mutual funds won't touch it. Doing a cost/benefit analysis, they think that it just ain't worth it for them to get involved.").

96. See Stanford Law Sch. Sec. Clearinghouse, Court Approves $3.1 Billion Settlement in Action Against Cendant, Aug. 23, 2000, at http://securities.stanford.edu/news-archive/2000/082300Settlement110200.html (on file with the *Columbia Law Review*) (noting, based on information from BNA Securities Law Daily, that *Cendant* involved institutional investors who hired traditional plaintiff law firms and secured extremely large settlement); see also *Cendant*, 404 F.3d at 182–86.

97. Simmons & Ryan, supra note 57, at 9.

98. See Choi, Fisch & Pritchard, supra note 92, at 888–90 (reporting that private institutions accounted for little over fifteen percent of lead plaintiffs in sample of post-PSLRA class action suits). While private institutional investor involvement as lead plaintiff has been low, mutual funds have attempted in a number of cases (sometimes unsuccessfully) to act as lead plaintiffs. For a list of such instances, see Posting of Adam T. Savett, Mutual Funds as Lead Plaintiffs, to Lies, Damn Lies, & Forward Looking Statements, at http://liesdamnlies.blogspot.com/2006/03/mutual-funds-as-lead-plaintiffs.html (Mar. 20, 2006) (on file with the *Columbia Law Review*); see also Cox & Thomas, supra note 61, at 1590 (showing low percentage of institutions serving as lead plaintiffs in sample).

99. Panel Discussion, supra note 95, at 2369 (statement of Judge Edward Becker).

expensive discovery and unwanted revelation of information about its investments and strategy. It may also subject the fund to adverse responses from those with whom it does business (including, for example, if it manages funds in a 401(k) plan for other corporations). A successful claim may provide a higher recovery for the fund than would otherwise have been the case had the fund not been directly involved, but the lead plaintiff gets only a proportional part of the benefit, as the PSLRA explicitly bars differential recovery for lead plaintiffs.[100] The other shareholders of the company will thus get the same proportional benefit without having to offset any of the recovery against the expenses which the lead plaintiff has incurred.

In a world where investment manager performance is regularly measured by relative returns, the possibility of competing managers free riding on your efforts, or the comparative option of your free riding on other investors, operates as a disincentive to participate as a lead plaintiff. To the extent that a lead plaintiff is a larger investor in a specific company, being able to recover a larger, albeit proportionate, share may provide a valuable return that will widen that manager's return over competitors who are not invested in that company. Nonetheless, it is unclear that this economic calculation produces enough of a benefit absent a more general desire on the part of the specific institutional investor to improve corporate governance.

Several studies have shown that cases with institutional investors as lead plaintiffs have higher settlement amounts than other class action securities fraud cases, often showing impressive differences.[101] There are competing theories as to why settlements in cases involving institutional investors are larger. A more positive view suggests institutional investors have greater capacity to monitor litigation and control costs and thereby produce higher recoveries. There is some evidence that at least some institutional investors negotiate fee agreements with lead plaintiff law firms that are more favorable to the shareholder group[102] and some evi-

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100. See supra note 25 and accompanying text.

101. See Cox & Thomas, supra note 61, at 1636 (showing statistically significant increase in settlements in cases with institutions serving as lead plaintiffs relative to other types of lead plaintiffs); Michael A. Perino, Markets and Monitors: The Impact of Competition and Experience on Attorneys' Fees in Securities Class Actions 22 (St. John's Univ. Sch. of Law, Legal Studies Research Paper No. 06-0034, 2006), available at http://ssrn.com/abstract=870577 (on file with the *Columbia Law Review*) [hereinafter Perino, Markets and Monitors] ("[I]nstitutions dominate the largest cases and are absent from the smallest ones . . . ."); see also Choi, Fisch & Pritchard, supra note 92, at 891 (providing evidence that public pension funds in post-PSLRA period act as lead plaintiff for securities class actions with, on average, nearly three times the potential damage award as for actions involving individual lead plaintiff).

102. See Keith L. Johnson, Selecting Lead Counsel in the Midst of Judicial Chaos, Inst. Investor Advoc. (Bernstein, Litowitz, Berger & Grossman LLP, New York, N.Y.), 2001, at 1, 2 (noting specific institutional investor's success in reducing fees); Perino, Markets and Monitors, supra note 101, at 23–24 (finding that participation of public pension funds

dence that when institutional investors object to fee awards, fees are significantly lower, all else being equal.[103]

A less positive explanation of the larger settlements is that institutional investors are cherry picking their cases.[104] Nothing compels them to seek lead plaintiff status in any particular case, and it would be rational to pursue those that promised the greatest return. In an effort to assess that possibility, Cox and Thomas measure recoveries against provable losses. They report: "Our real concern about institutions is that they do not seem to be able to increase dollar recoveries at the same pace as provable losses. This is disappointing and facially inconsistent with institutional lead plaintiffs' belief that they can double or triple recoveries overall."[105]

Weiss and Beckerman, whose timely law review article greatly influenced the lead plaintiff provision of the PSLRA, contemplated that institutional investors might develop continuing relationships with plaintiff law firms.[106] As repeat and sophisticated investors, institutional investors would then be able to develop more effective case supervision and fee agreements. Anecdotal evidence suggests that the institutional investors who are engaging in securities fraud litigation are able to do exactly that.[107] For example, the New York State Comptroller's Office is reported to have three-year contracts with about fifteen firms.[108] Fisch reports that institutional investors are identifying quality law firms, establishing long term relationships with these firms, and using the negotiation process to minimize price and obtain a fee structure that minimizes agency costs.[109]

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as lead plaintiffs is correlated with lower fee requests and awards and finding no significant correlation with participation of union pension funds).

103. See Perino, Markets and Monitors, supra note 101, at 21 (reporting that mean attorney fees in cases with institutional objectors are significantly less than those without institutional objectors).

104. See Choi, Fisch & Pritchard, supra note 92, at 870 ("Our results are, however, consistent with the possibility that public pensions 'cherry pick' the actions in which they seek to become lead plaintiff, selecting only the cases with the largest potential damages and the strongest evidence of fraud. Further analysis is necessary to evaluate this possibility.").

105. Cox & Thomas, supra note 61, at 1636.

106. Weiss & Beckerman, supra note 90, at 2106–07 ("One possibility is that many institutions, over time, will develop continuing relationships with one or more plaintiffs' attorneys. . . . [P]laintiffs' attorneys' reputations as effective advocates of investors' interests will become increasingly important. That, in turn, should reduce significantly the resources that institutions will need to devote to monitoring their attorneys . . . .").

107. See Keith L. Johnson, Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors, Law & Contemp. Probs., Autumn 1997, at 155, 156 (suggesting that institutions develop more graduated fee structures to discourage class counsel from bringing "unnecessary" suits).

108. Leigh Jones, Securities Litigators Vie for Lists, 27 Nat'l L.J. 1, 11 (2004).

109. Jill E. Fisch, Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction, 102 Colum. L. Rev. 650, 703–10 (2002).

In the early years after the enactment of the PSLRA there were few institutional investors seeking to be lead plaintiffs. In an effort to be selected as the lead plaintiffs (in the absence of large institutional investors), investors often joined in groups that would provide a larger financial footprint to best fit the PSLRA's lead plaintiff presumption. Such combinations raised the concern as to whether such groups of small investors could effectively monitor law firms.[110] As institutional investors became more willing to join the litigation, courts sometimes chose lead plaintiffs that included both an institutional plaintiff and an individual plaintiff.[111] More recently, as previously noted, the number of institutional lead plaintiffs, particularly public pension funds, has grown. As the Third Circuit in *Cendant* concluded in 2005: "The PSLRA has shifted the balance of power away from plaintiffs' attorneys, who traditionally controlled common fund cases, to the institutional plaintiffs who now supervise securities class actions."[112] At the same time, the institutional investors mostly have been choosing from the same group of plaintiff law firms that traditionally have been active in securities class action litigation.[113] There has been increasing discussion of pay-to-play issues, including law firm contributions to political campaigns related to the public pension funds that act as lead plaintiffs.[114] Such pay-to-play issues could counter this newfound optimism about lead plaintiffs and their law firms.

E. *Empirical Findings Regarding Direct Sanctioning of Lawyers*

Congress did not limit itself just to raising the bar for what it takes to show securities fraud or to empowering lead plaintiffs to supervise lawyers in representative litigation. In addition, Congress mandated judicial review of every private securities fraud action, with specific findings of compliance as to each party and each attorney with each requirement of Rule 11 of the Federal Rules of Civil Procedure as to the complaint, responsive pleading, and dispositive motion.[115] If that mandatory review finds a violation, Congress specified that sanctions would be mandatory and specified a presumption that the appropriate sanctions would be an award of the opposing party's attorney's fees and other expenses.[116]

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110. See In re Pfizer Inc. Sec. Litig., 233 F.R.D. 334, 337 (S.D.N.Y. 2005) ("To allow an aggregation of unrelated plaintiffs to serve as lead plaintiffs defeats the purpose of choosing a lead plaintiff. . . . To allow lawyers to designate unrelated plaintiffs as a 'group' and aggregate their financial stakes would allow and encourage lawyers to direct the litigation." (quoting In re Donnkenny Inc. Sec. Litig., 171 F.R.D. 156, 157–58 (S.D.N.Y. 1997))).

111. See, e.g., In re Cable & Wireless, PLC, Sec. Litig., 217 F.R.D. 372, 376–77 (E.D. Va. 2003) (appointing institutional investor as co-lead plaintiff with individual).

112. In re Cendant Corp. Sec. Litig., 404 F.3d 173, 193 (3d Cir. 2005).

113. See discussion infra Part III.A.

114. See Cox & Thomas, supra note 61, at 1612–13.

115. See Securities Exchange Act of 1934 § 21D(c)(1), 15 U.S.C. § 78u-4(c)(1) (2000).

116. See id. § 21D(c)(2)–(3).

To date, the existing empirical evidence has largely ignored the impact of the PSLRA's mandatory sanction provision on securities class action litigation. We provide some preliminary evidence to fill the gap. Despite the recurring use of adjectives like "mandatory," "specific," and "each" in the sanction provision and the hundreds of class actions brought since the Act was enacted, we find that the sanction provision has been little used as a weapon against possibly abusive class actions. We performed a Westlaw search for cases addressing the question of sanctions under the PSLRA. This search produced only twenty-two opinions discussing sanctions in a class action suit and twenty-eight discussions of sanctions outside of a class action suit.[117] Table 1 breaks down the outcomes for our sample of fifty sanction-related opinions.

TABLE 1: BREAKDOWN OF SANCTION-RELATED PSLRA CASES

Class Action Sanction-Related Cases	
Sanctions imposed	4
Sanctions outside PSLRA	2
Sanctions not imposed	13
Remanded or rescheduled	3
Total	22

Non-Class Action Sanction-Related Cases	
Sanctions imposed	7
Sanctions not imposed	16
Remanded or rescheduled	5
Total	28

Of this group of twenty-two class action cases, there were thirteen instances in which sanctions were denied or found not warranted, three cases that were remanded or scheduled for a further hearing, and two instances in which sanctions of striking a pleading were awarded under Rule 37[118] or Rule 11, outside of the PSLRA provisions.[119] Only four

117. The search on Westlaw's "allfeds" database was for "sanctions & PSLRA & 'Rule 11'" and returned eighty-six opinions that, after appeals and remands, covered sixty-eight litigated matters. In eighteen of these sixty-eight cases, the reference to sanctions or Rule 11 was not the subject of the court's decision, leaving fifty cases for analysis. Of these, twenty-two arose in class actions and twenty-eight arose outside of class actions as discussed more in the text accompanying notes 118–120 infra.

118. See, e.g., Danis v. USN Commc'ns, Inc., No. 1:98CV07482, 2000 WL 1694325, at *51 (N.D. Ill. Oct. 20, 2000) (awarding monetary sanction and giving jury instruction on defendant's lack of cooperation as per Rule 37(b)–(c)).

119. See, e.g., Trovato v. Coopers & Lybrand, L.L.P., No. 1:97CV03374, 1998 WL 7214, at *6 (S.D.N.Y. Jan. 8, 1998) (noting that proceeding arose under Rule 11, but not

courts imposed sanctions under the PSLRA structure, or about one every two-and-a-half years.[120]

What is striking and somewhat surprising is that the class action cases comprise less than half of the PSLRA sanction cases. The sanction provisions of the PSLRA described above appear in a part of the Act not limited to class actions, but are applicable to any private securities claim.[121] Most of the sanctions cases occur in disputes between individual investors and their broker or money manager in contexts far removed from the class action context that generated the motivation for the passage of the PSLRA. These non-class action cases generated a majority of the examples (seven cases) in which sanctions were imposed (a total of eleven cases in our sample).[122]

Within the class actions group, each of four cases applying sanctions in a class action setting followed a judicial dismissal of the underlying cause of action. In one case, sanctions were imposed against the plaintiff; in another, sanctions were imposed upon plaintiff and plaintiff's counsel equally; and in two cases, sanctions were imposed against plaintiffs' counsel alone (in each case two law firms). None of the cases discuss the distinction between the plaintiffs and their lawyers. In the three cases where amounts were determined, *Corroon v. Reeve*,[123] *De La Fuente v. DCI Telecommunications, Inc.*,[124] and *Oxford Asset Management, Ltd. v. Jaharis*,[125] the sanctions imposed were roughly $84,000, $120,000, and $520,000, respectively. These cases do provide some illustration of what could be considered frivolous litigation. In *Corroon v. Reeve*,[126] the trial judge had earlier rejected a proposed settlement of a class action alleging fraud in a tender offer that would have produced no money for the shareholders and $200,000 for the plaintiff law firm.[127] The judge informed plaintiff's counsel that the claim under section 14(e) of the Securities Exchange Act

under PSLRA portion of Rule 11 since there had not been final determination of securities claim).

120. See supra note 111 and accompanying text. There is no requirement that all sanctions cases be included in an electronic database, and therefore this number may be underinclusive, although we do not have any reason to expect a systematic publication bias on this point. A similar search to the one described supra note 117, performed in the Lexis database, returned the same class action cases in which sanctions were applied.

121. See Securities Exchange Act of 1934 § 21D(b) ("Requirements for Securities Fraud Actions"). See generally Simon Debartolo Group, L.P. v. R.E. Jacobs Group, Inc., 186 F.3d 157, 166–67 (2d Cir. 1999) (stating, in non-class action context, that PSLRA requires that courts make findings regarding Rule 11 compliance in securities cases).

122. Of the twenty-eight total cases discussing sanctions that were not class actions, the court imposed sanctions in seven cases, denied them in sixteen cases, and in five cases, the court remanded or determined the sanctions question was premature.

123. 258 F.3d 86, 89 (2d Cir. 2001), aff'g Polar Int'l Brokerage Corp. v. Reeve, 108 F. Supp. 2d 225 (S.D.N.Y. 2000).

124. 82 F. App'x 723, 724–25 (2d Cir. 2003).

125. 297 F.3d 1182, 1187 (11th Cir. 2002).

126. 258 F.3d 86.

127. See Polar Int'l Brokerage Corp. v. Reeve, 187 F.R.D. 108, 121 (S.D.N.Y. 1999) (rejecting settlement proposal as class had received "nothing of any real value").

of 1934 appeared weak and was unlikely to survive dismissal. When the revised complaint included what the judge viewed as identically flawed allegations, the stage was set for sanctions, which the Second Circuit affirmed.[128]

In another Second Circuit case, *De La Fuente v. DCI Telecommunications, Inc.,* sanctions followed after twelve of thirteen claims were blocked by statutes of limitations claims.[129] The trial court's ruling, which was affirmed, divided the fees fifty-fifty between the two lead law firms, but then reduced the presumption of full sanctions for one of the firms due to its "precarious" financial situation, a procedure contemplated by the PSLRA.[130] The appellate court did remand the portion of the case addressing whether sanctions encompassed attorneys' fees on appeal.[131] The sole case in which sanctions were levied against the plaintiff, and not against the attorneys, arose from an alleged claim arising under fiduciary duty, common law fraud, and perhaps Rule 10b-5 against a seventy-one percent shareholder whose pledging of stock and its subsequent call by various brokers contributed to a selling frenzy.[132] The court found a violation of Rule 11 because there was no existing law supporting the plaintiff's case, nor any attempt by the plaintiff to argue why the law should be changed.[133] The case producing the largest sanction to date ($520,000), *Oxford Asset Management, Ltd. v. Jaharis*, arose out of an IPO.[134] Even though fraud relating to an IPO usually is easier for a plaintiff to prove, the court found both the plaintiff and the lead firm liable as a result of deliberate indifference to factual support.[135]

Some of the opinions denying sanctions note that although the party's argument was ultimately rejected, the argument was not frivolous

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128. *Corroon*, 258 F.3d at 93 (affirming trial court's imposition of sanctions). The trial court had initially apportioned the fees seventy-thirty between the two lead law firms, Polar Int'l Brokerage Corp. v. Reeve, 196 F.R.D. 13, 20 (S.D.N.Y. 1999), but subsequently reduced the thirty percent to ten percent without increasing the seventy percent, reflecting the second firm's late entry into the case. Polar Int'l Brokerage Corp. v. Reeve, 120 F. Supp. 2d 267, 270 (S.D.N.Y. 1999).

129. 82 F. App'x at 724–25.

130. De La Fuente v. DCI Telecomms. Inc., 269 F. Supp. 2d 229, 236 (S.D.N.Y 2003), aff'd, 82 F. App'x 723; see Securities Exchange Act of 1934 § 21D(c)(3)(B), 15 U.S.C. § 78u-4(c)(3)(B) (2000) (providing for presumption that appropriate sanction includes award of attorneys' fees and expenses unless rebutted by showing that such sanction would impose "an unreasonable burden . . . and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed").

131. 82 F. App'x at 726.

132. See Burekovitch v. Hertz, No. 01-CV-1277(ILG), 2001 WL 984942 (E.D.N.Y. July 24, 2001).

133. See id. at *13.

134. 297 F.3d 1182 (11th Cir. 2002). The circuit court did remand to exclude fees and expenses from the one nonfrivolous count. The fee award was for 1900 hours spent by attorneys for the issuers and the underwriter. The sanctions were affirmed despite a fee application judged "likely inadequate." Id. at 1196.

135. Id. at 1197.

and was adequately supported.[136] More of the class action opinions addressing sanctions (nine of twenty-two) were from courts in the Second Circuit than from any other circuit; three of the four cases applying sanctions arose from courts in the Second Circuit. In contrast, courts in the Ninth Circuit, the other hot spot for securities class actions, declined to apply sanctions in all of the six cases which arose there.

Overall, with four examples of sanctions in a class action case in the ten years since the enactment of the PSLRA, it appears that the direct judicial supervision of lawyers has had less of an impact than either of the other two main areas of reform. On the other hand, our data are only preliminary. Further research should compare the incidence of Rule 11 sanctions for securities class actions from the pre-PSLRA period against the post-PSLRA period. It is also conceivable that the mere possibility of judicially imposed sanctions may have deterred plaintiffs from filing frivolous lawsuits to such an extent that sanctions are only rarely applied. Our preliminary data gathering also focuses solely on reported opinions. Judges may engage in a variety of more informal sanctions (outside Rule 11), as well as formal but unreported Rule 11 sanctions not tracked in Westlaw. Nonetheless, our initial data suggest that, despite Congress's focus on using the courts to directly sanction those involved in frivolous litigation, courts have not responded with a large number of sanctions.

The recent indictment of Milberg Weiss, the largest player in securities class actions over the last decade, illustrates an alternative vehicle for direct sanctioning of lawyers.[137] Federal prosecutors included the Milberg Weiss firm and two former partners in the indictment, which targeted the practice of paying individuals to be clients in representative suits.[138] Of the fifty-six transactions listed in the indictment, only three are post-PSLRA federal securities class actions.[139] The remainder is made up of state court class actions and pre-PSLRA federal suits.[140] The small percentage of post-PSLRA federal securities class actions suggests the focus of the indictment is on long ago behavior on the part of Milberg Weiss. The feds may be attacking behavior that the Act has already modified substantially. Yet the three post-PSLRA transactions alleged to involve illicit payments to lead plaintiffs suggest that the statutory reform did not fully curb the perceived abusive behavior.[141] It is notable, given

136. See Liu v. Credit Suisse First Boston Corp. (In re Initial Pub. Offering Sec. Litig.), 399 F. Supp. 2d 369, 372 (S.D.N.Y. 2005).

137. See Press Release, U.S. Attorney, Cent. Dist. of Cal., Milberg Weiss Law Firm, Two Senior Partners Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (May 18, 2006), available at http://www.usdoj.gov/usao/cac/pr2006/061.html (on file with the *Columbia Law Review*).

138. First Superseding Indictment at 1–23, United States v. Milberg Weiss Bershad & Schulman LLP, No. CR-05-587(A)-DDP (C.D. Cal. May 18, 2006), available at http://www.abanet.org/journal/ereport/milberg.pdf (on file with the *Columbia Law Review*).

139. Id at 14–23.

140. Id.

141. See id.

the two distinct periods of post-PSLRA law firm behavior identified infra (initial and mature), that the three class action securities transactions occurred in 1997 and 1998. At that point institutional investors had not yet become lead plaintiffs in large numbers; the dominant business plan among plaintiff law firms was to seek individual clients who could be grouped to form a plaintiff with the largest financial interest.

III. Has Plaintiff Law Firm Behavior Changed After the PSLRA?

The PSLRA aimed directly at changing the conduct of a specific group: plaintiffs' lawyers. Congress sought to influence plaintiffs' attorney behavior in the three ways described above. It mandated judicial review as to the appropriateness of sanctions in every case. It empowered shareholders, particularly institutional shareholders, to be a real check on law firms. This was in contrast to the pre-PSLRA period when it was perceived that clients were figureheads or paid professionals, merely doing what the law firms said. Even the substantive changes in what constitutes fraud were aimed principally at affecting the investment calculus of the plaintiff law firm, by increasing the costs of bringing securities fraud suits, particularly frivolous suits.

The present empirical literature nonetheless has not addressed the question of how the PSLRA impacted the behavior of plaintiff law firms. Each of the substantive changes wrought by the PSLRA raised the cost to plaintiffs' attorneys in filing a securities class action suit. A direct examination of plaintiffs' attorney behavior may shed additional light on the impact of the PSLRA. We provide new empirical data in this study to help assess how the PSLRA affected the practices of plaintiff law firms.

Our dataset consists of a total of 419 securities class actions from the pre- and post-PSLRA periods. The dataset is drawn from 200 IPO-related class actions as identified by Choi[142] and 219 secondary market class actions as identified by Choi, Nelson, and Pritchard.[143] The 200 IPO-related class actions from Choi represent a comprehensive list of class actions involving issuers that sold securities in an initial public offering from 1990 to 1999.[144] The 219 secondary market class actions from Choi, Nelson, and Pritchard are randomly selected from secondary market fraud suits filed from 1991 to 2000, equally divided between the computer hardware and software industries and other industries.[145]

142. Choi, supra note 49 (manuscript at 9).

143. Choi, Nelson & Pritchard, supra note 49, at 37 tbl.1, panel A.

144. Choi, supra note 49 (manuscript at 9). We determined that the IPO-related securities class action suits in the Choi dataset were filed from 1990 to 2001.

145. The data for the computer hardware (SIC Codes 3570–77) and computer software (SIC Codes 7370–79) industries come originally from Johnson, Nelson & Pritchard, Merits, supra note 55 (manuscript at 16). The SIC (Standard Industrial Classification) Codes classify establishments by the type of activity in which they are engaged. Choi, Nelson, and Pritchard expand on the original Johnson, Nelson, and Pritchard secondary market class action dataset to include an approximately equal number

Table 2 provides a year-by-year breakdown of the sample, based on when suits were filed. Suits filed prior to 1996 are in the pre-PSLRA period and those filed in 1996 or thereafter are in the post-PSLRA period. Most of the data that follow relate to the settlement or other resolution of those suits, which may be several years after the filing.

TABLE 2: SUMMARY STATISTICS

Year Suit Filed	Number of Suits
1990	4
1991	25
1992	43
1993	32
1994	56
1995	38
1996	31
1997	57
1998	57
1999	36
2000	33
2001	5
Total	417

For two suits in our dataset we are unable to identify the precise year the suit was filed, although we were able to identify (based on the class period) whether the suit was filed in the pre- or post-PSLRA period. With these two suits, our total dataset size is 419.

For each class action in our sample, we identify the lead and co-lead counsel firms. Where possible, we collect information on lead counsel firms from the settlement notice, obtained from the Stanford Securities Class Action Clearinghouse as well as various claim administrator sites including www.gilardi.com. We also look to the court docket (available on Westlaw) for information on the lead counsel firm. Not all of our class actions identified specific attorney firms as the lead counsel. For example, some class actions were dismissed before the designation of lead counsel firms. In such situations, we treated the plaintiff law firms that filed the complaint as the lead counsel firm.

While a more comprehensive study of plaintiffs' attorney law firm behavior is beyond the scope of this survey, we use our dataset to examine whether the PSLRA has changed: (1) the composition of law firms in this market, or such law firms' market share; (2) the tendency of plaintiff law firms to work together in a class action and how the PSLRA affected this

of secondary market fraud cases involving companies in other industries. Choi, Nelson & Pritchard, supra note 49, at 2–3.

tendency; (3) the relationship between lead plaintiffs, focusing particularly on institutional lead plaintiffs and plaintiff law firms.

A. *The PSLRA and Its Impact on the Census of the Plaintiffs' Bar*

Our dataset permits us to compare participation in the plaintiffs' bar before and after the PSLRA. There is substantial continuity in the bar across the entire time period of our study. Our data suggest that the plaintiffs' bar consists of about fifty to seventy active firms nationwide. Our complete dataset includes more than 150 firms, but below the top fifty no firm had more than two suits in either the pre- or post-PSLRA periods.[146] The largest firms in the two periods tended to be the same, as shown in Table 3, which indicates market shares for the top five firms. To calculate market share in the pre-PSLRA period, we summed all settlement amounts (all in 1999 adjusted dollars) in the pre-PSLRA period, obtaining a total aggregate settlement amount. For each particular settlement, we then allocated the settlement amount pro rata to the different co-lead counsel firms. For example, if Milberg Weiss and Weiss & Yourman (now Weiss & Lurie) were the two lead counsel firms in a litigation that resulted in a ten million dollar settlement, we assigned five million dollars to each plaintiffs' attorney firm.[147] The market share for a plaintiff law firm is then equal to the settlement dollars assigned to that one firm divided by the total aggregate settlement amount. We perform a similar calculation to determine market shares in the post-PSLRA period. Table 3 reports the market share of the top five firms in the pre- and post-PSLRA periods.

Looking beyond the largest five firms, we do not see substantial entry or exit after the enactment of the PSLRA. Of all plaintiff lead or co-lead law firms that appear in our survey post-PSLRA but did not appear pre-PSLRA, the average number of suits was only 1.51; only three firms in this group had at least four suits. Put another way, new plaintiff law firm entrants in the post-PSLRA period represented only a small fraction of the total market share of firms. Appendix Table A reports on those plaintiff law firms in our dataset that acted as lead or co-lead counsel in the post-PSLRA period but not in the pre-PSLRA period. Of those who were in

146. An Institutional Shareholders Services Report of top plaintiff law firms ranked in order of dollar amount of final securities class action settlements reaches down to include firms with as few as one settlement per year. Sec. Class Action Servs., The SCAS 50 for 2003, available at http://issproxy.com/pdf/THESCAS502003.pdf (2004) (on file with the *Columbia Law Review*); Sec. Class Action Servs., The SCAS 50 for 2004, available at http://www.issproxy.com/pdf/SCAS50for2004.pdf (2005) (on file with the *Columbia Law Review*). The firms on that list parallel the list of top firms in state court representative litigation. See Thompson & Thomas, New Look, supra note 13, at 185–87 (providing list of law firms bringing largest number of Delaware acquisition-oriented class action complaints and noting overlap between these firms and firms that bring securities fraud class actions).

147. Thus, our data differ from the SCAS data discussed supra note 146, providing settlement market share, which assigns the full settlement amount to *each* lead counsel involved in the same litigation.

TABLE 3: TOP FIVE LAW FIRMS

For purposes of determining market share, for each lawsuit that settled in the dataset, the law firm involved as lead counsel is allocated the settlement amount of the litigation. Where more than one co-lead counsel is involved in the litigation, the co-lead counsels are allocated equal shares of the settlement amount (for example, if two lead counsel are involved then both are assigned one-half of the settlement amount).

Pre-PSLRA Top Five Firms	Pre-PSLRA Settlement Amount (millions of dollars*)	Market Share Percentage
Milberg Weiss	316.2	27.9%
Wolf Haldenstein Adler Freeman & Herz	124.3	11.0%
Bernstein Litowitz Berger & Grossmann	91.9	8.1%
Berger & Montague	54.0	4.8%
Abbey & Ellis/Abbey Gardy	49.6	4.4%
Total Settlement Amount (All Law Firms)	1134.7	
Herfindahl-Hirschman Five Firm Index	1003.8	

*All settlement amounts are in 1999 dollars.

Post-PSLRA Top Five Firms	Post-PSLRA Settlement Amount (millions of dollars*)	Market Share Percentage
Milberg Weiss	559.9	27.4%
Bernstein Litowitz Berger & Grossmann	183.5	9.0%
Wolf Popper	117.3	5.7%
Wolf Haldenstein Adler Freeman & Herz	110.6	5.4%
Barrack, Rodos & Bacine	95.9	4.7%
Total Settlement (All Law Firms)	2043.3	
Herfindahl-Hirschman Five Firm Index	915.7	

*All settlement amounts are in 1999 dollars.

the pre-PSLRA list but do not appear on the post-PSLRA list, only three firms had greater than three suits in the pre-PSLRA period. Appendix Table B reports on those plaintiff law firms in our dataset that acted as lead or co-lead counsel in the pre-PSLRA period but not in the post-PSLRA period. In both directions (those present in the pre-PSLRA period but not in the post-PSLRA period and vice versa), the movement in or out among the set of plaintiff law firms is entirely comprised of smaller market share law firms. An exception is Grant & Eisenhofer, a firm founded in 1997, which has carved out a niche for itself representing institutional clients and was fifth on the 2005 SCAS list ranked by settlements.[148]

148. Sec. Class Action Servs., The SCAS 50 for 2005, available at http://www.issproxy.com/pdf/SCAS50for2005.pdf (2006) (on file with the *Columbia Law Review*). Due to the random selection procedure used to construct our dataset, Grant & Eisenhofer does not appear in our dataset for our post-PSLRA period, which runs to 2001.

Yet even if there were no new entry or exit, we might still expect to see shifts within the group of plaintiff law firms given the changes mandated by the PSLRA. We hypothesize that the PSLRA's effort to discourage nonmeritorious claims and empower plaintiff selection of class counsel increased the emphasis on expertise within plaintiff law firms. Plaintiff law firms with superior ability to identify meritorious claims and successfully guide meritorious suits through dismissal and to a settlement in the post-PSLRA period should, to the extent the PSLRA worked as intended, increase their market share during the post-PSLRA period. Identifying which firms have objectively greater "expertise," however, is difficult. No law firm will identify itself as lacking expertise. As a proxy for expertise, we look at the pre-PSLRA market share of settlement dollars of the plaintiffs' attorney firms.

Greater market share in the pre-PSLRA period likely correlates with expertise. Firms with a greater market share of settlement dollars will have the economy of scale to develop the ability and expertise to identify potentially meritorious litigation. One could argue that firms that successfully bring nuisance suits may build a large market share of the total settlement dollars. Nonetheless, we contend that even in the pre-PSLRA period, meritorious litigation likely resulted in greater settlement awards. Issuers facing frivolous litigation may settle, but only for nuisance value.[149] Firms with greater ability at identifying and prosecuting more meritorious litigation, all other things being equal, will tend to have a greater market share of the total settlement amount compared with plaintiff law firms focusing more on nuisance litigation.

If the PSLRA in fact increased the emphasis on plaintiff law firm expertise, we predict that the firms with the largest pre-PSLRA market share, our proxy for expertise, should have experienced an increase in market share in the post-PSLRA period. As Table 3 above shows, Milberg

149. As Joseph Grundfest notes:

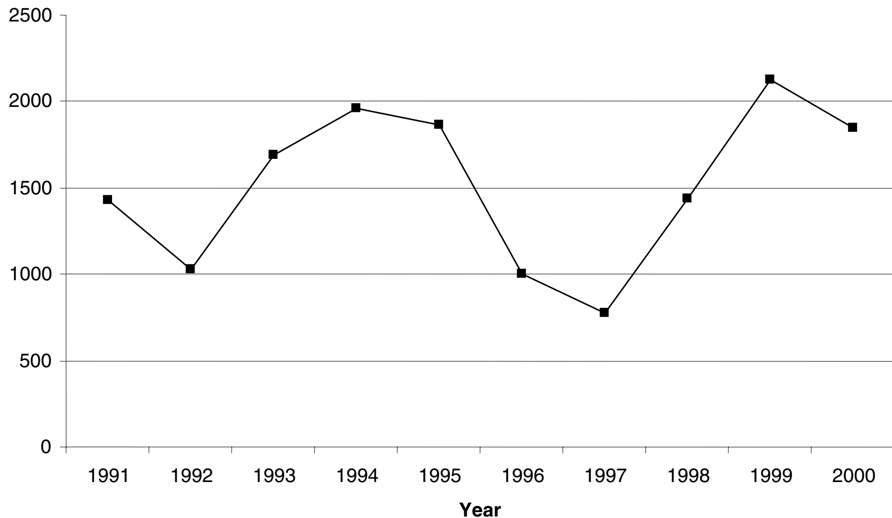
> [A] key statistic in the merits debate is the difference between the observed settlement amount and the amount a defendant would be willing to pay simply to avoid the costs of mounting a defense. A defendant always has an incentive to settle a case for an amount less than avoidable defense costs because any such settlement is less costly than pursuing the case to verdict and prevailing at trial. In contrast, a defendant never has an incentive to settle for an amount in excess of avoidable defense costs unless the defendant recognizes some probability, however small, that a jury will rule in plaintiffs' favor. It follows that the difference between the observed settlement and the defendants' avoidable litigation costs at the time of settlement (the "settlement differential") is a critical signal of the defendants' own perception of the merits of plaintiffs' claims.

Joseph A. Grundfest, Commentary, Why Disimply?, 108 Harv. L. Rev. 727, 740–41 (1995) (footnote omitted). In reviewing settlement data from other studies, Grundfest adopted the rule of thumb that settlements for less than a cutoff ranging from $1.5 to $2.5 million may be nuisances in the sense that "the merits may not have mattered at all in the resolution of the litigation." Id. at 742–43.

Weiss (at a time prior to that firm's splitting into two firms in 2003)[150] was the dominant firm in both periods, holding about a twenty-seven percent market share in each. However, the cumulative share of the next four firms drops in the post-PSLRA period as opposed to the next four firms during the pre-PSLRA period. Cumulatively the Herfindahl-Hirschman five firm index drops from 1003.8 in the pre-PSLRA period to 915.7 in the post-PSLRA period.[151] The drop in the Herfindahl-Hirschman index is not consistent with the hypothesis that expertise increased in the post-PSLRA period. Instead, the concentration of law firms, if anything, falls in the post-PSLRA period.

We also examine whether any year-to-year trends exist in the market concentration of plaintiff law firms. Figure 1 provides a graphical depiction of the Herfindahl-Hirschman index for each year in our dataset.

FIGURE 1: HERFINDAHL-HIRSCHMAN INDEX



No settlements were recorded in the dataset for suits filed in 2001.

The concentration of plaintiff law firms drops immediately after the enactment of the PSLRA and rises eventually back to its pre-PSLRA levels by the end of our dataset in 2000. The year-by-year comparison suggests

150. In 2003, Milberg Weiss Bershad Hynes & Lerach LLP split into Milberg Weiss Bershad & Schulman LLP and Lerach Coughlin Stoia Geller Rudman & Robbins LLP. Information on Milberg Weiss Bershad & Schulman LLP can be found at http://www.milbergweiss.com (last visited Oct. 6, 2006). Information on Lerach Coughlin Stoia Geller Rudman & Robbins LLP can be found at http://www.lerachlaw.com (last visited Oct. 6, 2006).

151. For a discussion of the Herfindahl-Hirschman index of market concentration, see Department of Justice and Federal Trade Commission Horizontal Merger Guidelines §§ 1.4–1.5, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569 (issued Apr. 2, 1992, revised Apr. 8, 1997).

the possibility of two distinct periods post-PSLRA. In the first few years when there were few institutional investors seeking to be lead plaintiffs and the focus was on assembling groups of individual plaintiffs, the concentration of plaintiffs' attorney firms went down. In the later part of the period as institutional investors began to grow, the need for expertise and thus concentration returned to or exceeded the pre-PSLRA levels.

Our analysis opens up several questions for future research. First, are there alternative (and superior) measures of expertise? We use the pre-PSLRA market share of settlements because of its availability, ease of measurement, and at least theoretical link with expertise. Future research may examine the background of specific plaintiffs' attorneys involved in litigation to see whether experience, education, and other factors may correlate with expertise.

Second, assuming our proxy for expertise is valid, our results call into question whether the PSLRA really resulted in a wholesale shift away from nuisance litigation toward meritorious litigation. Unlike other studies that focus on observable factors relating to the substance of the suit (such as the presence of accounting restatements, insider trading, and SEC enforcement actions),[152] our evidence focuses directly on the plaintiffs' attorneys themselves. Future research could focus more carefully on the specific practices of plaintiffs' attorneys. In the post-PSLRA period, discovery is stayed until after the motion to dismiss. For suits that do not involve any observable indicia of possible fraud, what do plaintiff law firms investigate both during the period prior to filing suit and in the period after filing suit but before the motion to dismiss? What types of motions are filed by both plaintiffs and defendants aside from the motion to dismiss? And how do these practices differ between the pre- and post-PSLRA time periods? In addition, how much time do plaintiffs' attorneys spend investigating claims once they learn about potential wrongdoing and before filing a complaint in federal court? If the PSLRA really worked to increase the attention focused on merit and reduce the incentive to race to the courthouse, we expect an increase in the amount of time prior to filing that plaintiffs' attorneys spend on investigation.

B. *Interaction Among Plaintiff Law Firms as Lead or Co-Lead Counsel*

If expertise in identifying and prosecuting meritorious claims is not more important in the post-PSLRA period, what does change for plaintiff law firms? We know that the PSLRA radically changed the process of selection of lead counsel, replacing the previous norm that the first plaintiff to file became the lead plaintiff, which was a norm not enshrined in any statute or rule, but was rather the result of both law firm and judicial

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152. See, e.g., Choi, supra note 49 (examining SEC enforcement actions against companies engaging in IPOs in United States from 1990 to 1999); Johnson, Nelson & Pritchard, Merits, supra note 55 (examining role of voluntary earnings disclosures, accounting restatements, and insider trading in filing and resolution of lawsuits against high technology companies).

behavior. With the enactment of the PSLRA came a statutorily mandated focus on the plaintiff with the largest financial interest at stake in the litigation as lead plaintiff.[153] We also know that while the Act sought to encourage institutional shareholders to participate as lead plaintiffs, institutional participation did not increase substantially until around 2000 (and then primarily for public pension funds).[154]

We suspect that there could well be two post-PSLRA periods with different patterns of plaintiff law firm behavior. The first encompasses several years immediately following the enactment of the PSLRA, when law firm behavior likely reflected the need to find a plaintiff or group of plaintiffs with the largest financial stake, likely outside the group of institutional investors who initially remained by choice on the sidelines (the "initial" post-PSLRA period). The second encompasses the time period after the initial several years (2000 and beyond) when plaintiff law firm behavior reflected the need to respond to institutional investors as they came to play a greater role as lead plaintiffs (the "mature" post-PSLRA period).

For our dataset, which focuses primarily on the initial post-PSLRA period, we hypothesize that plaintiff law firms are more likely to join with other plaintiff law firms as co-lead counsel, compared with the pre-PSLRA period, in an effort to assemble the plaintiffs with the largest financial stake. We also hypothesize that top-tier law firms, as measured by market share of settlements, are much more likely to associate with lower ranked law firms in the post-PSLRA period. That hypothesis is tested as described in this section. In the mature post-PSLRA period, we hypothesize that there will be less need for a plaintiffs' attorney firm to aggregate disparate groups of plaintiffs (and other plaintiffs' attorney firms) to the extent that institutional investors have a preference for one lead counsel. We test this hypothesis in the following section, albeit with somewhat limited data.

Even in the pre-PSLRA period, plaintiff law firms had an incentive to join together in bringing lawsuits. In the pre-PSLRA period, courts did not rigidly apply the rule of thumb that the first to file would become the lead plaintiff.[155] Given some uncertainty in how a court would select the lead plaintiff, plaintiffs' attorney firms could increase the likelihood that the first to file would not be challenged when they filed together as a group. In addition, participating together with other plaintiffs' attorney firms across multiple suits helped diversify the risk that any one lawsuit may not return a large settlement award.

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153. See supra note 24 and accompanying text.

154. See supra Part II.D (documenting evidence on lead plaintiffs).

155. See H.R. Rep. No. 104-369, at 33 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 732 (describing general approach); Third Circuit Task Force Report on Selection of Class Counsel, 74 Temp. L. Rev. 689, 721 n.106 (noting that appointment of class action counsel through traditional method should not mean automatic appointment based on first to file status).

Plaintiff law firms, nonetheless, faced a distinct disincentive to have multiple co-lead counsel in the pre-PSLRA period. Members of the securities plaintiffs' bar have suggested that the common method to organize the distribution of work in a class action case in the pre-PSLRA period was to have a steering committee with plaintiff law firm members, who would parcel out the work to be done by firms who were not lead counsel or on the committee, in an elaborate and perhaps sometimes inefficient manner.[156] One attorney we talked to characterized this structure as "Byzantine" in its complexity and rationality.[157] One firm would handle accountant depositions, another investment banker depositions, another settlement, and so forth. A similar pattern can still be found in antitrust litigation and class actions brought under state law. In such a setting, who would be lead counsel or co-lead counsel? In this context, we are told that a single firm as lead counsel made it more likely that the legal work would be shared by firms outside the executive committee. As the number of co-lead counsel or the executive committee grew, say to four or five, these lead counsel firms may begin to resist sharing with firms outside the committee in an effort to keep a required minimum amount of work for themselves.[158] Thus, a sole lead counsel provided a commitment that more work would be available to be shared (and kept open the possibility of diversification of risk across multiple cases)—a point not lost on members of the plaintiffs' attorney bar who interacted across multiple cases. This possibility for sharing and diversifying is unlike the current pattern in which lead counsel firms, working for institutional investors, are likely to require that the work be done within the firm. Repeat relationships with specific institutional investors who are active as lead plaintiffs in litigation make risk diversification less important for these favored plaintiff law firms.[159]

In the post-PSLRA period, particularly in the initial era before institutional investors became active players, we hypothesize that the incentive to cooperate with other plaintiff law firms in pursuing class action litigation as lead plaintiff counsel increased relative to the pre-PSLRA period. In the initial post-PSLRA period, plaintiff law firms had an increased incentive to combine together to build lead plaintiff groups that would represent the largest financial stake at interest in the litigation (in order to obtain lead plaintiff status). We predict that in the initial post-PSLRA

156. Confidential Telephone Interviews with Securities Plaintiffs' Attorneys, in New York, N.Y. (May 16, 2006) (on file with the *Columbia Law Review*).

157. Id.

158. Id.

159. Confidential Telephone Interviews with Securities Plaintiffs' Attorneys, in New York, N.Y. (May 16–17, 2006) (on file with the *Columbia Law Review*). Beyond the preferences of clients, judges also have this preference. See, e.g., Gluck v. CellStar Corp., 976 F. Supp. 542, 549 (N.D. Tex. 1997) ("Increasing the number of Lead Plaintiffs would detract from the Reform Act's fundamental goal of client control, as it would inevitably delegate more control and responsibility to the lawyers . . . and make the class representatives more reliant on the lawyers.").

period the frequency of sole lead plaintiff law firms should decrease and the frequency of multiple co-lead counsel driven lawsuits should correspondingly increase.

Table 4 reports the number of securities class actions in our sample sorted by the number of firms who serve as co-lead plaintiffs. In the pre-PSLRA period, one firm as the sole lead plaintiff was the second largest observation (representing 31.9% of the pre-PSLRA suits) just behind the number of cases with two firms as co-lead plaintiffs (representing 35.7% of pre-PSLRA suits). For the period after the enactment of the PSLRA, the number of cases in which there is only one lead plaintiff law firm drops dramatically to 19.6%. As reported in Table 4, the drop in the fraction of suits involving only one lead counsel firm from the pre- to post-PSLRA periods is significant at the <1% confidence level. The difference is reflected in the increase of cases in which there are two or three firms sharing the lead plaintiff role. The increase is consistent with the hypothesis that plaintiff law firms in the initial post-PSLRA period felt it necessary to join investors together to form the group with the largest financial interest and to diversify the increased risk facing plaintiff law firms.

TABLE 4: NUMBER OF CO-LEAD COUNSEL FIRMS

	Pre-PSLRA		Post-PSLRA	
Number of Co-Lead Counsel Firms	Number of Suits	Percent of Total	Number of Suits	Percent of Total
1	58	31.9	43	19.6
2	65	35.7	98	44.8
3	41	22.5	48	21.9
4	11	6.0	20	9.1
5	3	1.7	3	1.4
>5	4	2.2	7	3.2
Total	182	100.0	219	100.0

$\chi 2(5) = 9.5578$; Prob. = 0.089.
t-test of difference in fraction of suits involving only one lead counsel between pre- and post-PSLRA periods = 2.83 (prob. = 0.005).

We also hypothesize that in the initial post-PSLRA period, top plaintiff law firms are more likely to join together with lower-ranked law firms compared with the pre-PSLRA period. Top law firms may be more willing to join with lower-ranked law firms in the initial post-PSLRA period for at least two reasons. First, the need to create a large group of lead plaintiffs, at least when institutional investors do not act as lead plaintiffs, may lead top law firms to join with lower-ranked law firms that bring specific lead plaintiffs to the group. Regional law firms, for example, may have closer contacts with plaintiffs with large interests at stake in a particular litigation. Joining with such regional firms may increase the ability of a top-tier plaintiff law firm to become co-lead counsel in the initial post-PSLRA period. Second, the PSLRA imposed severe limits on discov-

ery prior to the hearing on the motion to dismiss. Without discovery, plaintiff law firms face greater uncertainty as to the value of any given case, increasing the value of diversification. To the extent diversification simply requires that other firms be willing to help pay the costs of pursuing any particular litigation, we predict that an increased diversification motivation will lead to less discriminate pairing among plaintiff law firms. So long as a lower-tier law firm is willing to help shoulder the expense of litigation, their attractiveness as a source of risk diversification can be just as great as a top-tier law firm.

To examine the mix of co-lead counsels in the pre- and post-PSLRA periods, we divide law firms into five tiers based on their market share (in terms of settlement dollars) in the pre- and post-PSLRA periods. Table 5 reports how our sample of plaintiff law firms breaks down into the five tiers and describes the breakdown of the tiers. Panel A of Table 5 reports the highest ranked lead counsel involved in a law suit. Where there is only one lead counsel, then it is the ranking of the lead counsel. Where there is more than one lead counsel, it is the highest ranking of the two lead counsel firms. Panel A shows that Tier 1 firms show up after the PSLRA as the highest tiered lead counsel involved in litigation in the same (high) percentage as occurred in the pre-PSLRA period.

Panel B of Table 5 looks at the lowest-ranked tier co-lead counsel firms that associate with Tier 1 (highest ranked) firms. Do the Tier 1 law firms tend to associate only with other Tier 1 firms—or do they associate with lower-ranked law firms (for example, Milberg Weiss and Law Offices of Michael C. Addison as co-lead counsel firms)?[160] Panel B shows a shift downward in ranking in the firms that associate as co-lead counsel with Tier 1 law firms (significant at the <1% level). This is consistent with our hypothesis that top-tier lead counsel firms were more willing to associate with lower-ranked law firms in the initial post-PSLRA period.

To test whether the pattern of increased mixing among Tier 1 and non-Tier 1 firms shifted from the initial to mature post-PSLRA period, we subdivided the post-PSLRA period in our dataset between the "initial" period (suits filed from 1996 to 1999) and the "mature" period (suits in 2000 and beyond). Panel C of Table 5 reports that the amount of mixing between Tier 1 and non-Tier 1 dropped in the mature post-PSLRA period (significant at the 6.6% level). This drop is consistent with the hypothesis that mixing as a means of assembling a viable lead plaintiff group became less important as institutional investors started taking a more active role in securities class action litigation in the mature post-PSLRA period.

Many factors may affect the decision on the part of a law firm to associate with another law firm in a securities class action as co-lead counsel. To provide a multivariate test, we estimate a logit model where the dependent variable is equal to one if at least two different law firms act as

160. Where a Tier 1 law firm is alone as lead counsel, we classify the lowest-ranked firm as Tier 1.

TABLE 5

Each law firm involved as a lead plaintiff counsel is classified into one of five tiers in the pre- and post-PSLRA periods based on its ranking in terms of total settlement dollars for the lawsuits in which it participated as a lead plaintiff counsel, or co-lead counsel (Tier 1 = highest ranked and Tier 5 = lowest ranked). In the case of co-lead counsels, each law firm is allocated a corresponding fraction of the settlement amount (e.g., two co-counsel firms would each get one-half of the settlement amount). We calculated the five Tiers for the pre- and post-PSLRA periods separately as follows: Tiers 1 through 5 each consist of one-fifth of the plaintiff law firms with a positive share of settlement dollars (with Tier 1 corresponding to the top one-fifth of plaintiff law firms with a positive share of settlement dollars). Tier 5 consists of the bottom one-fifth of plaintiff law firms with a positive share of settlement dollars and all plaintiff law firms with zero settlement dollars.

Panel A: The highest ranked tier of law firm acting as lead counsel in the litigation.

Tier	Pre-PSLRA	Percent	Post-PSLRA	Percent
1	143	78.1%	176	80.4%
2	20	10.9%	25	11.4%
3	8	4.4%	8	3.7%
4	7	3.8%	3	1.4%
5	5	2.7%	7	3.2%
Total	183	100.0%	219	100.0%

$\chi 2(4) = 2.700$
Prob. = 0.609

Panel B: For subset of lawsuits with at least one law firm in Tier 1, the lowest ranked tier of law firm also acting as lead counsel in the litigation.

Tier	Pre-PSLRA	Percent	Post-PSLRA	Percent
1	81	56.7%	64	36.4%
2	28	19.6%	39	22.2%
3	12	8.4%	24	13.6%
4	10	7.0%	19	10.8%
5	12	8.4%	30	17.1%
Total	143	100.0%	176	100.0%

$\chi 2(4) = 15.054$
Prob. = 0.005

Panel C: For subset of lawsuits with at least one law firm in Tier 1, the lowest ranked tier of law firm also acting as lead counsel in the litigation. Comparison is between suits filed in the initial post-PSLRA period (1996 to 1999) and suits filed in the mature post-PSLRA period (2000 and beyond).

Tier	Initial Post-PSLRA Period	Percent	Mature Post-PSLRA Period	Percent
1	49	32.5%	15	60.0%
2	34	22.5%	5	20.0%
3	22	14.6%	2	8.0%
4	19	12.6%	0	0.0%
5	27	17.9%	3	12.0%
Total	151	100.0%	25	100.0%

$\chi 2(4) = 8.800$
Prob. = 0.066

co-lead counsel with different ranking categories (e.g., a Tier 1 firm acting as co-lead with a Tier 2 firm) and zero otherwise. We estimate the model only for the subset of suits where a Tier 1 law firm is present as a lead or co-lead counsel. Thus, the model provides evidence on the incentive of Tier 1 firms to associate only with other Tier 1 firms or with non-Tier 1 firms.

As our main independent variable of interest, we include a dummy variable set equal to one if the suit is filed in the post-PSLRA period and zero otherwise (Suit Post-PSLRA). A greater propensity on the part of Tier 1 firms to associate with non-Tier 1 firms in the post-PSLRA period will result in a significant positive coefficient for the Suit Post-PSLRA dummy variable.

We then include a number of control variables. We include the logarithm of the market capitalization of the targeted firm defendant (in 1999 adjusted dollars),[161] the turnover of the stock of the firm defendant,[162] and the minimum one-day return of the defendant firm's shares[163] as measures of the potential damage amount available from litigation. As Johnson, Nelson, and Pritchard discuss, the minimum one-day return embodies the (at least perceived) tendency of plaintiff law firms to file suit whenever they observe a large negative one-day stock return for a public company.[164] Similarly, studies indicate a positive correlation between share turnover (a factor in determining Rule 10b-5 secondary market damages) and an increased risk of securities litigation.[165] We include a dummy variable for the presence of a pre-filing public announcement of an accounting restatement or an SEC investigation or enforcement ac-

161. For IPO firms, the market capitalization is determined immediately after the IPO. See Choi, supra note 49 (manuscript at 13). For non-IPO firms, the market capitalization is determined at the end of the fiscal year preceding the beginning of the class period. See Choi, Nelson & Pritchard, supra note 49, at 33. Several researchers have documented evidence of a positive correlation between share turnover (leading to potentially higher Rule 10b-5 damages) and an increased risk of securities litigation. See Christopher L. Jones & Seth E. Weingram, The Determinants of 10b-5 Litigation Risk 28 (on file with the *Columbia Law Review*); Christopher L. Jones & Seth E. Weingram, The Effects of Insider Trading, Seasoned Equity Offerings, Accounting Restatements, SEC Enforcement Actions, Earnings Management, and Corporate Announcements on 10b-5 Litigation Risk 1 (on file with the *Columbia Law Review*).

162. For IPO firms, the turnover is calculated for the first year after the IPO as follows: $1-(1-Turn)^{250}$, where Turn is average daily trading volume divided by the number of shares outstanding. See Choi, supra note 49 (manuscript at 32). For non-IPO firms, the turnover is calculated based on $1-(1-Turn)^{X}$, where Turn is average daily trading volume divided by the number of shares outstanding, and X is the number of trading days during the class period. See Choi, Nelson & Pritchard, supra note 49, at 33.

163. For IPO firms, the minimum one-day return is measured during the first year after the IPO. See Choi, supra note 49 (manuscript at 13). For non-IPO firms, the minimum one-day return is measured during the class period plus one day after the end of the class period. See Choi, Nelson & Pritchard, supra note 49, at 20, 33.

164. Johnson, Nelson & Pritchard, *Silicon Graphics*, supra note 32, at 782.

165. See sources cited supra note 161.

tion ("Pre-Filing Hard Evidence"[166]). The presence of Pre-Filing Hard Evidence may indicate to plaintiffs' attorneys that less risk is involved in the litigation, leading to a reduced incentive to diversify through association with other attorney law firms. We also include controls for litigation in the districts with the highest volume of securities class action litigation in our sample (High Volume Court),[167] and for whether the defendant firm is in a high technology industry (High Tech Industry).[168] We also include corporate governance controls for the presence of an independent board, independent audit committee, and the mean number of external directorships of public companies held by outside directors (Busy Board). Model 1 of Table 6 reports the results of our multivariate logit model.

As reported in Table 6, note that the coefficient on the Suit Post-PSLRA variable is positive and significant at the <1% level. This result is consistent with the hypothesis that, even after taking into account our various controls, Tier 1 firms are more likely to associate with non-Tier 1 firms in the post-PSLRA time period.

To test the difference between the initial and mature post-PSLRA periods, we replace the Suit Post-PSLRA variable with separate variables for the Initial Suit Post-PSLRA period and the Mature Suit Post-PSLRA period. As reported in Model 2 of Table 6, the coefficient on the Initial Suit Post-PSLRA indicator variable is positive and significant at the <1% level, indicating a rise in mixing in the initial post-PSLRA period. The coefficient on the Mature Suit Post-PSLRA indicator variable, however, is not statistically different from zero, consistent with the view that the increase in mixing among different tier law firms was only a temporary phenomenon before the rise of institutional investor lead plaintiffs.

The increased tendency of top-tier law firms to associate with lower-tier firms in the initial post-PSLRA period leads us to at least two further questions. First, what does the fact that Tier 1 firms are more likely to associate with lower-tier firms indicate about the merits of post-PSLRA securities fraud litigation? On the one hand, expertise is perhaps not as important and risk diversification (or the need to build up a large plaintiff group) may be driving associations between Tier 1 and non-Tier 1 firms. Such a hypothesis is consistent with the view that the PSLRA did not increase the frequency of merit-related litigation. Nonetheless, it is possible to hypothesize in the alternative that expertise in fact became more important in the post-PSLRA period. We observe Tier 1 firms associating with non-Tier 1 firms, according to this hypothesis, only in those situations where the non-Tier 1 firm provides special expertise or infor-

166. Choi, supra note 49 (manscript at 32).

167. These include the Southern District of New York and the Northern, Central, and Southern Districts of California.

168. We define high technology industries to include the biotechnology, computer, and electronics industries, corresponding to SIC codes 2833–36, 3570–77, and 7370–79. This characterization follows Choi, supra note 49 (manuscript at 23).

TABLE 6

The dependent variable is equal to one if a Tier 1 law firm acts as co-lead counsel with a non-Tier 1 law firm and zero otherwise. Only suits involving a Tier 1 law firm are fitted in the logit model.

Variable	Model 1	Model 2
Suit Post-PSLRA	0.955*** (3.57)	
Initial Suit Post-PSLRA		1.077*** (3.91)
Mature Suit Post-PSLRA		0.091 (0.18)
Log(Market Cap.)	–0.210** (–2.23)	–0.188** (–1.97)
Turnover	–1.337** (–2.22)	–1.323** (–2.18)
Minimum 1 Day Return	1.139 (1.25)	1.268 (1.37)
Pre-Filing Hard Evidence	0.019 (0.06)	0.112 (0.34)
High Volume Court	–0.470* (–1.88)	–0.473* (–1.88)
High Tech Industry	0.473* (1.81)	0.446* (1.69)
Independent Board	–0.224 (–0.31)	–0.136 (–0.19)
Independent Audit Committee	–0.306 (–1.02)	–0.323 (–1.07)
Busy Board	–0.047 (–0.36)	–0.054 (–0.41)
Constant	2.604*** (3.13)	2.483*** (2.95)
N	317	317
Pseudo Adj R2	0.076	0.086
Log Likelihood	–201.756	–199.612

z-statistics in parenthesis. *** significant at the one percent level, ** significant at the five percent level, * significant at the ten percent level.

mation relevant to the particular litigation in question. Further research examining the specific non-Tier 1 firms that associate with Tier 1 firms may help distinguish between these hypotheses. Are non-Tier 1 firms in such situations primarily regional firms? Is it the case that the non-Tier 1 firm typically initiates the litigation and a Tier 1 firm joins only later? Or is it the case that the non-Tier 1 firm is included solely because of its relationship with a potential lead plaintiff? Which law firms are more

involved with bringing forward motions (a proxy for the amount of time and expense a particular law firm expends on the litigation)?

Second, what is the actual process by which a lead plaintiff law firm is selected? Our hypothesis about the increased importance of risk diversification and the need to assemble lead plaintiff groups in the post-PSLRA period assumes that plaintiff law firms are driving the patterns of association we observe. Is it possible that judges instead are simply forcing certain associations among plaintiff law firms? Future research may focus on the frequency with which opposing plaintiff law firms appear before a judge or magistrate seeking lead counsel status and what outcome results from such opposition. If judges tend to force opposing plaintiff law firms to join as co-lead plaintiffs then this provides a very different view of the mixing among different tier firms during the initial post-PSLRA period. Future research may also benefit from examining the influence of specific lead plaintiffs (particularly institutional lead plaintiffs) on the selection process of lead counsel. We provide some preliminary evidence on the relationship of institutional lead plaintiffs and plaintiff law firms in the next section.

C. *Plaintiff Law Firms and Institutional Lead Plaintiffs*

The rise of institutions as lead plaintiffs, described in Part II.D of this study, suggests that institutions may relate to lead plaintiff law firms differently than individual lead plaintiffs and even that certain institutions may act as repeat lead plaintiffs across multiple suits. Institutions often hold large stakes in a large number of companies, making it likely that many institutions will have the ability to obtain lead plaintiff status. The increased repeat nature of lead plaintiffs, in turn, leads to the possibility that plaintiff law firms may develop ongoing relationships with such institutions. An institution, for example, may maintain contacts with several plaintiff law firms, relying on the firms for information about potential and ongoing litigation. Once the institution decides to get involved in a particular class action, the institution may then select from among this subset of plaintiff law firms with which the institution has maintained a relationship. We hypothesize that (a) the number of repeat institutional lead plaintiffs increased in the post-PSLRA period and that (b) these repeat institutional lead plaintiffs would typically associate with the same plaintiff law firms. To assess the importance of repeat relationships between institutional lead plaintiffs and plaintiff law firms, we examined all instances where an institution acted as a lead or co-lead plaintiff in multiple actions in the pre- and post-PSLRA periods. Table 7 reports our results.

Table 7

The table reports all institutions that acted as a lead (or co-lead) plaintiff in multiple actions. Only plaintiffs' attorney firms that served as lead counsel for multiple actions for the same institutional lead plaintiff are reported.

Institutional Lead Plaintiff	Sued Company	Year Suit Filed	Milberg Weiss	Berger & Montague, P.C.	Bernstein Litowitz Berger & Grossmann
Philadelphia Board of Pensions & Retirement	Scholastic Corp.	1997		X	X
Philadelphia Board of Pensions & Retirement	Compaq Computer	1999	X	X	
Philadelphia Board of Pensions & Retirement	Lockheed Martin Corp.	1999	X		X
Philadelphia Board of Pensions & Retirement	BMC Software Inc.	1999		X	
Philadelphia Board of Pensions & Retirement	Network Associates Inc.	1999			
Louisiana Municipal Police Employees' Retirement System/ Louisiana School Employees' Retirement System	3COM	1997			X
Louisiana State Employees Retirement System	Motocar Parts & Accessories	1999			
Louisiana State Employees Retirement System	Sykes Enterprises	2000			X
New Hampshire Retirement System	Ashworth Inc.	1999	X (now Lerach Coughlin)		
New Hampshire Retirement System	AT&T	2000	X (now Lerach Coughlin)		
Local 144 Nursing Home Pension Fund	Computer Assoc. Int'l Inc.	1998	X		
Local 144 Nursing Home Pension Fund	Microstrategy	2000	X		
TAAM Associates Inc.	Housecall Medical Resources	1996			
TAAM Associates Inc.	Fine Host Corp.	1997	X		
TAAM Associates Inc.	American Pad and Paper	1998	X		

Note from Table 7 that no institutional investor acted as a lead plaintiff for more than one class action suit in the dataset for the pre-PSLRA period. In the post-PSLRA period, five institutions acted as lead plaintiffs across multiple law suits. All five institutions associated with at least one plaintiff law firm in more than one of the suits. The three plaintiff law firms that enjoyed repeat relationships with the five institutions—Milberg Weiss, Berger & Montague, and Bernstein Litowitz Berger &

Grossmann—are all Tier 1 ranked law firms. These results are consistent with the hypothesis that institutional investors that potentially may act as lead plaintiffs tend to develop repeat relationships with only a handful of the top-tier plaintiff law firms.

The presence of repeat relationships between lead plaintiff law firms and institutional investors opens up several questions, such as, exactly why do we see these repeat relationships? One hypothesis is that the repeat relationships arise due to a lack of expertise on the part of institutional investors. Institutional investors may lack the time, resources, or ability to distinguish among companies in deciding where to bring a fraud suit. Instead of developing such costly expertise in-house, institutional investors may turn to a select group of plaintiff law firms for ongoing information and advice. Once such relationships develop, an institution that becomes lead plaintiff may then choose to stay with one of their relationship law firms when choosing a lead counsel firm.

If institutional lead plaintiffs both rely on their plaintiff law firm as a source of ongoing expertise and information and tend not to look beyond these relationship law firms for candidates to become lead counsel, we can question whether the lead plaintiff provision really encourages greater monitoring of plaintiff law firms. Other studies have found that the presence of an institutional lead plaintiff in the post-PSLRA period did not significantly correlate with a reduction in attorney fees as a percentage of the settlement amount.[169] Institutions that depend on particular lead plaintiff law firms for information and expertise about litigation across repeat litigation are unlikely to negotiate vigorously with plaintiff law firms for lower fees. One can possibly test such a hypothesis by comparing the fees charged by plaintiff law firms associating with repeat player institutional lead plaintiffs compared with one-shot institutional lead plaintiffs. Future research may also wish to look at the actual process by which a lead plaintiff is selected. Are institutions that have repeat relationships with a group of large plaintiff law firms typically selected as lead plaintiff without opposition?

Conclusion

Over a decade has passed since the enactment of the PSLRA. With time, we now have the benefit of hindsight in determining the impact of the PSLRA on securities fraud class actions. In theory, the provisions of the PSLRA work by affecting the incentives of plaintiffs' attorneys. Heightened pleading requirements, the stay on discovery, an increased risk of sanctions, and the prospect of greater judicial review of attorney fees, among other consequences of the PSLRA, all work to increase the costs for plaintiffs' attorneys seeking to bring a class action. Despite the focus of the Act on the incentives of plaintiffs' attorneys, the existing empirical research we survey examines more indirect measures of the

169. See Choi, Fisch & Pritchard, supra note 92, at 870.

PSLRA's effectiveness. Studies, for example, look at the stock market reaction to the enactment of the PSLRA and the presence of merit-related indicia associated with litigation.

We call for greater research attention on the specific practices of plaintiffs' attorney firms. In this study, we provide preliminary evidence directly on the behavior of plaintiffs' attorneys both pre- and post-PSLRA. We demonstrate that the concentration of plaintiffs' attorney firms did not increase in the post-PSLRA period. This is consistent with the hypothesis that expertise at identifying meritorious law suits did not become relatively more important in the post-PSLRA period. Our findings are, nonetheless, subject to alternative interpretations. It is possible, for example, that expertise is not concentrated in the largest pre-PSLRA law firms. Future research may therefore wish to examine other proxies for expertise and how they relate to market share in the securities plaintiffs' attorney industry.

We also demonstrate a marked increase in the willingness of plaintiffs' attorney firms to associate with other law firms as co-lead counsel in the initial post-PSLRA period. In addition, top-tier law firms (as defined by market share of settlement amounts) are more likely to associate as co-lead counsel with nontop-tier law firms in the post-PSLRA period. Again, as with the lack of change in market concentration, several possible interpretations exist. On the one hand, the increase in "mixing" among different tier law firms may indicate that in the post-PSLRA period, expertise (which may be more specific to only a few firms) lost importance, while risk diversification (something any firm with financial resources can help provide) gained importance. On the other hand, it is possible that lower-tier law firms sometimes bring with them specialized expertise or knowledge, explaining their presence in litigation together with the top-tier plaintiff law firms. Future research should focus on the process by which co-lead counsel law firms are chosen. Do judges impose such coalitions? Are they formed prior to litigation? Or are they formed only after litigation is commenced? And what is the role of the lead plaintiff in forming such coalitions of law firms?

Finally, we examine the relationship between institutional lead plaintiffs and plaintiffs' attorney firms. No institution acted as lead plaintiff in more than one suit in our sample for the pre-PSLRA period. Several institutions, in contrast, acted as lead or co-lead plaintiff in multiple cases in the post-PSLRA period. These repeat institutions tended to utilize the same lead plaintiff law firm as co-lead counsel in their litigation. These lead plaintiff law firms were all top-tier law firms. Future research may wish to explore the implication of such repeat relationships. If they indicate an ongoing dependency of certain institutions on plaintiff law firms for advice and expertise then such relationships may undermine the impact of the PSLRA in increasing competition among plaintiff law firms to become lead counsel.

APPENDIX TABLE A: PLAINTIFF LAW FIRMS THAT FIRST APPEARED IN THE POST-PSLRA PERIOD

Plaintiff Law Firm	Number of Post-PSLRA Law Suits	Post-PSLRA Tier Rank	First Year in Dataset
Law Offices of Lionel Z. Glancy/Glancy Binkow & Goldberg LLP	5	2	1997
Moulton & Gans LLP	5	4	1998
Morris and Morris	4	2	1996
Dyer & Shuman LLP	4	2	1997
Finkelstein & Krinsk LLP	4	5	1997
Reinhardt & Anderson/Reinhardt, Wendorf & Blanchfield	4	5	1997
Shalov Stone & Bonner	4	4	1998
Finkelstein, Thompson & Loughran	3	5	1998
Beatie & Osborn LLP	2	4	1997
Bingham & Lea	2	4	1997
Law Offices of James V. Bashian P.C.	2	4	1997
Piven Law Office/Law Offices of Charles J. Piven, PA	2	5	1998
Scott & Scott LLC	2	5	1998
The Rosen Law Firm, P.A. P.C.	2	5	2000
Law Offices of Miles M. Tepper	1	5	1996
Alpert Barker & Calcutt	1	5	1996
Carr, Tabb & Pope	1	5	1996
John A. Maher, Esq.	1	3	1996
Krause & Kalfayan	1	5	1996
Murray, Frank & Sailer LLP	1	5	1996
Futterman & Howard	1	1	1997
Akerman, Senterfitt & Eidson	1	5	1997
Barrett Law Office, PA	1	4	1997
Brobeck, Phleger & Harrison LLP	1	3	1997
Cohn, Lifland, Pearlman, Herrmann & Knopf LLP	1	5	1997
Cuneo Law Group	1	4	1997
Lite, DePalma, Greenberg & Rivas	1	5	1997
Goldstein Lite & DePalma	1	5	1997
James Hoyer Newcomer & Smiljanich	1	5	1997
Richards McGettigan Reilly & West	1	2	1997
Trujillo Rodriguez & Richards	1	5	1997
Wampler, Buchanan & Breen P.A	1	5	1997
Gerard Singer & Levick, P.C.	1	5	1998
Greenberg, Peden, Siegmyer & Oshman	1	5	1998
Innelli and Molder	1	3	1998
Law Office of Klari Neuwelt	1	5	1998
Law Offices of F. James Donnelly, P.C.	1	4	1998
Neligan & Averch	1	5	1998
The Van Steenberg Firm	1	3	1998
Ziegler, Ziegler & Altman	1	5	1998
Beasley, Leacock & Hauser, P.A.	1	5	1999
Boies, Schiller & Flexner LLP	1	4	1999
Caddell and Chapman	1	5	1999
Donovan Miller LLC/Donovan Searles	1	4	1999

APPENDIX TABLE A (CONTINUED)

Plaintiff Law Firm	Number of Post-PSLRA Law Suits	Post-PSLRA Tier Rank	First Year in Dataset
Emmons & Associates	1	5	1999
Faruqi & Faruqi	1	5	1999
Ken Slater Esq.	1	5	1999
Klafter & Olsen LLP	1	3	1999
Kroger, Gardis & Regas	1	5	1999
Law Office of Richard D. Kranich	1	5	1999
Law Offices of Stanley P. Kops	1	5	1999
Mann & Just	1	5	1999
Rosenthal, Monhait, Gross & Goddess	1	5	1999
Shepherd & Geller	1	5	1999
The Law Offices of Brian M. Felgoise	1	5	1999
Bull & Lifshitz	1	5	2000
Doffermyre Shields Canfield Knowles & Devine	1	5	2000
Hale & Dorr	1	5	2000
Law Office of Leo W. Desmond	1	5	2000
Law Offices of Mark S Henzel	1	5	2000
Vianale & Vianale LLP	1	5	2000
MEAN	1.51	4.41	—

Appendix Table B: Plaintiff Law Firms That Acted as Lead Counsel in the Pre-PSLRA Period but Were Absent in the Post-PSLRA Period

Law Firm	Pre-PSLRA Number of Suits	Pre-PSLRA Tier
Gold Bennett Cera & Sidener LLP	5	1
Garwin, Bronzaft, Gerstein, & Fisher	4	2
Law Offices of Dennis J. Johnson	4	2
Dyer Donnelly & Lilley	2	1
Elwood S. Simon & Associates	2	3
Greenfield & Rifkin	2	2
Kaufman Malchman Kaufmann & Kirby	2	5
Law Offices of J. Garrett Kendrick	2	3
Meredith & Cohen, P.C/Meredith, Cohen & Greenfogel, P.C.	2	5
Mika Meyers Beckett & Jones	2	4
Susman Saunders & Buehler	2	3
Wechsler Skirnick Harwood Halebian & Feffer	2	3
Anderson & Karrenberg	1	5
Bach & Burcke	1	4
Baskin Bennett & Komkov	1	5
Beckett and Lolli	1	5
Beigel Schy Lasky Rifkind Fertik & Gelber	1	5
Bouchard & Kleinman	1	5
David B. Gold, A Professional Law Corp.	1	5
Davis & Ceriani, P.C.	1	5
Edelstein & Faegenburg	1	5
Faggert & Frieden	1	5
Hoeffner Bilek & Eidman	1	4
Kimball Parr Waddoups Brown & Gee	1	5
Kipnis, Tescher, Lippman, Valinksy & Kain	1	5
Kohn, Savett, Klien & Graf, P.C.	1	5
Law Office of Klari Neuwelt	1	5
Law Offices Lawrence G. Soicher	1	5
Law Offices of John W. Allured	1	5
Law Offices of Michael C. Addison	1	5
Law Offices of Richard Appleby	1	5
Law Offices of Steven M. Sherman	1	5
Murray & Curl	1	4
Parsons Davies Kinghorn Peters	1	5
Sachnoff & Weaver	1	3
Schlusser Reiver Hughes & Sisk	1	4
Sirota & Sirota	1	4
Stinson Laswell & Wilson	1	4
Stoll Stoll Berne Lokting & Schlachter	1	1
Sullins, Johnston, Rohrbach & Magers	1	5
Weisman Goldberg & Weisman Co.	1	4
Wolf Slatkin	1	5
Zarian & Duncan	1	5
Zlotnick & Thomas	1	4
MEAN	1.43	4.09