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Institutional Activism through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions

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Abstract

In the Private Securities Litigation Reform Act of 1995, Congress created the lead plaintiff provision in the hope that institutions would closely monitor class counsel and thereby curb the agency costs that typically plague securities class actions. This paper uses a random sample of 627 pre- and post-PSLRA settlements to examine the efficacy of this provision. Specifically, the paper analyzes whether there is any correlation between the participation of one kind of institutional investor, public pension funds, and settlement outcomes, attorney effort, or attorneys' fee requests or awards. The paper finds that cases with public pension lead plaintiffs have larger settlements, recover a greater percentage of the stakes at issue in the case, have greater attorney effort, and have lower fee requests and awards than cases with other types of lead plaintiffs. These findings suggest that public pensions do in fact act as effective monitors of class counsel.

1. INTRODUCTION

Institutional activism on corporate governance matters has been a fixture of United States capital markets since the late 1980s (Black 1990). While institutions expend significant time and money on these efforts, the jury is still out on whether they are effective. Institutions have frequently been successful in persuading companies to alter corporate governance practices (Smith 1996), but empirical studies diverge on whether activism actually translates into significant positive stock returns for the targeted

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firms (English, Smythe, and McNeil 2004; Nelson 2006) or improvements in accounting measures of firm value (Carleton, Nelson and Weisbach 1998).

While most existing empirical work focuses on corporate governance activism, there is a more recent and less studied avenue for institutional activism–active participation in securities class action litigation. In the Private Securities Litigation Reform Act of 1995 (PSLRA or the Act), Congress extended an invitation to institutions to become lead plaintiffs in these cases. Prior to passage of the Act, representative plaintiffs were invariably small shareholders, often with long-term relationships with class counsel. As a result, these class members typically had insufficient incentives to closely monitor class counsel, creating the opportunity for attorneys to act in their own best interests rather than the best interests of the class. Inspired by the work of Weiss and Beckerman (1995), Congress created the lead plaintiff position in the hope that institutions would, because of their larger financial stakes and greater sophistication, provide the monitoring necessary to curb these agency costs.

At first, institutions were reluctant to become lead plaintiffs (SEC 1997). Over time, however, some institutions, most notably the public pension funds that were active on corporate governance issues, increasingly began to assume that role, although typically only in very large cases with obvious earmarks of fraudulent activity, such as accounting restatements or SEC investigations (Choi, Fisch, and Pritchard 2005). This increased participation has given rise to anecdotal claims that institutional participation yields larger recoveries, better monitoring, and lower attorneys' fees. As with studies of corporate governance activism, however, the limited empirical evidence available is not so certain. It finds some support for the claim that institutional participation is correlated

with larger settlements, but questions remain over whether this result is really the product of enhanced institutional monitoring or simply a by-product of institutions selecting larger and easier cases to pursue (Choi, Fisch and Pritchard 2005).

This paper analyzes a random sample of 627 pre- and post-PSLRA settlements to examine empirically whether public pension fund monitoring is effective. More specifically, the paper examines whether there is any correlation between cases with public pension fund lead plaintiffs and settlement outcomes, attorney effort, or fee requests or awards. There are three central findings. First, cases with public pension participation are positively correlated with settlement amounts (measured both in absolute terms and as a proportion of investors' overall market losses), even when controlling for institutional self-selection of larger, more high profile cases. Second, cases with public pension lead plaintiffs are positively correlated with two proxies for attorney effort, the number of docket entries in the case and the ratio of settlement to docket entries, suggesting that institutional monitoring may reduce attorney shirking. Third, attorneys' fee requests and fee awards are lower in cases with public pension lead plaintiffs, either because public pensions are sophisticated repeat players or as a result of attorney competition to represent these institutions. These findings suggest that public pension funds do act as effective monitors of class counsel.

The remainder of this paper proceeds as follows. Section 2 discusses the traditional criticisms of private enforcement of the federal securities laws through class litigation and describes how the lead plaintiff provision was intended to address these concerns. Section 3 discusses the prior empirical literature. Section 4 describes the data. Section 5 reports the empirical results. Section 6 contains brief concluding remarks.

2. SECURITIES CLASS ACTIONS AND THE LEAD PLAINTIFF PROVISION

2.1. The Critique of Securities Class Actions

The debate over the costs and benefits of private enforcement of the federal securities laws is well-known. This summary is thus brief and focuses primarily on criticisms of class counsel monitoring mechanisms.

Proponents of private enforcement argue that securities class actions provide a vital supplement to under-resourced governmental enforcement authorities. It not only deters wrongdoing, but also provides compensation to defrauded investors (Seligman 1994). Critics counter that plaintiffs' lawyers typically control securities class actions because they are insufficiently monitored by the relatively unsophisticated individual investors that often serve as representative plaintiffs (Macey and Miller 1991). Due to their small stakes in the outcome of the action, such plaintiffs are rationally apathetic. They do not monitor because they would bear all the costs of doing so, but could expect to collect only a small portion of the gains that might accrue from their efforts.

To further exacerbate the situation, long-term relationships frequently existed between attorneys and individuals (dubbed, "professional plaintiffs"), who agreed to buy stock in likely litigation targets and to serve as representative plaintiffs in any ensuing action in exchange for payments from the lawyer (Weiss and Beckerman 1995). While such agreements made sense for plaintiffs' attorneys—who were able to reduce the search costs associated with initiating a case by having a ready stable of plaintiffs—these arrangements made it more unlikely that the named plaintiff would engage in meaningful monitoring. Indeed, to the extent that the lawyers agree to funnel a percentage of their fee to the representative plaintiff, as indictments against a prominent class action firm

allege (Creswell 2006), the representative plaintiff has an incentive to maximize rather than minimize fees.

Securities class actions thus represent a classic agency cost problem in which loosely monitored plaintiffs' lawyers have incentives to act opportunistically. Among other problems, insufficient monitoring might lead plaintiffs' attorneys to shirk by settling the case too early and too cheaply where the expected increase in attorneys' fees from continuing to litigate is less than the costs the attorney would incur in proceeding (Coffee 1987). An insufficiently monitored attorney might also barter a low settlement for an agreement that defendants would not oppose the attorneys' fee request (Macey and Miller 1991). In either case, the attorney may not have incentives to maximize net recovery for the class.

The traditional solution to the inadequacy of plaintiff monitoring is *ex post* judicial review of the settlement and fee award, but critics generally thought that solution was also inadequate (Alexander 1991). The primary litigation mechanism available to provide information to the court, adversarial testing of the proposed settlement and fee, may be largely ineffective because settling defendants have no incentive to challenge the terms and objectors from the class, who are subject to the same rational apathy problems as small stakes representative plaintiffs, are relatively infrequent (Weiss and Beckerman 1995).[1] With respect to fees, there is no readily ascertainable market rate for the services of plaintiffs' attorneys in class actions and therefore courts' fee determinations are

[1] In an empirical study of class actions in four district courts, researchers at the Federal Judicial Center found that objectors appeared at only 11% of class action settlement hearings. While objections were more frequent (some form of objection was lodged in 42% to 64% of the cases in the four districts studied), they were generally ineffective. Approximately 90% of the settlements analyzed were approved without changes. Objections to proposed fees were made in 18% of the cases with similar results—courts granted the proposed fee in 90% of the cases (Willging, Hooper, and Niemic 1996). The study looks at a variety of class action settings and does not separately break out these figures for the subset of securities class actions.

inherently imprecise. Moreover, because many fee decisions are unpublished, courts frequently rely on plaintiffs' attorneys' compilations of unpublished orders, which would likely be carefully selected to support the fee the attorney requested, a particular problem given that the factors courts generally list as relevant to fee determinations are sufficiently broad so as to support virtually any fee award.[2] Finally, courts may themselves be subject to significant agency costs because they have incentives to clear their dockets of time consuming and difficult cases and thus may give inadequate scrutiny to proposed settlements or fees (Alexander 1991; Macey and Miller 1991).

2.2. The PSLRA's Lead Plaintiff Provision

The academic debate over the costs and benefits of securities class actions moved to the political arena in the early 1990s when high technology and accounting firms began to complain that they were disproportionately targeted in these suits (Perino 2003). In response, Congress passed the PSLRA. The lead plaintiff provision is a key feature of the Act and represents Congress's primary solution to the monitoring problem.[3]

The provision seeks to encourage institutional investors, which to that point had been largely passive in securities class actions (Grundfest and Perino 1996), to assume

[2] *Gunter v. Ridgewood Energy Corp.* (223 F3d 190 [3d Cir 2000]), contains a frequently cited compilation of factors that courts generally view as relevant in setting fees:

> In common fund cases of this sort—in which the attorneys' fees and the clients' award come from the same source and the fees are based on a percentage amount of the clients' settlement award—district courts should consider several factors in setting a fee award. Among other things, these factors include: (1) the size of the fund created and the number of persons benefited; (2) the presence or absence of substantial objections by members of the class to the settlement terms and/or fees requested by counsel; (3) the skill and efficiency of the attorneys involved; (4) the complexity and duration of the litigation; (5) the risk of nonpayment; (6) the amount of time devoted to the case by plaintiffs' counsel; and (7) the awards in similar cases.

[3] Other provisions of the PSLRA may also be relevant to the settlement outcomes and attorneys' fees. For example, the PSLRA contains a higher pleading standard that might deter non-meritorious suits and therefore increase settlements in the remaining cases. The Act also codifies that the court has an independent obligation in approving any settlement to ensure that total fees and expenses awarded to counsel not exceed a reasonable percentage of the amount of damages, which might cause courts to give greater scrutiny to fee requests.

primary control over the prosecution of these cases. Modeled on a proposal by Weiss and Beckerman (1995), the provision recognizes that because institutions frequently have the largest claims in class actions and typically recover low percentages of their recognized losses, they may be able to capture enough of the gains from active monitoring to at least partially overcome the collective action problem.[4]

To assist institutions in identifying cases, the PSLRA requires the plaintiff filing the first complaint to publish a notice informing class members and that they may seek to become lead plaintiff. The court is then required to appoint the moving party that it determines is most capable of adequately representing the class. The PSLRA presumes that this "most adequate plaintiff" should be the moving party who, among other things, has the largest financial interest in the relief sought by the class. This presumption tends to favor large institutions willing to serve as lead plaintiffs. Once appointed, the lead plaintiff has the power to select a lead counsel for the class, subject to court approval.

Institutions, however, face significant constraints in identifying whether to participate in any given case. Many institutions have relatively small legal staffs that would have difficulty conducting in-depth investigations of the potential merits of cases in which they were considering seeking lead plaintiff status. This lack of resources is particularly problematic given the time frame in which these decisions must be made. The PSLRA requires lead plaintiff motions to be filed within 60 days of being notified that the case has been filed. Because the PSLRA also stays discovery of the defendants during this time period, institutions would likely have to rely on a limited set of

[4] In their study of pre-PSLRA class actions, Weiss and Beckerman (1995) examined claims data from 82 securities class actions settled in the early 1990s. They found that institutional investors accounted for a median of 57.8% of the allowed losses even though they represented only 1.7% of the claims filed.

observable case characteristics, such as the market losses and the allegations of the complaint, in determining whether to seek lead plaintiff status.

Due to their comparative sophistication, the size of their holdings, and their power to select lead counsel, institutional lead plaintiffs could provide significant benefits to the class. Institutions as repeat players may bring a level of expertise to the prosecution of securities class actions that few individual class members could match (Weiss and Beckerman 1995). The size of their holdings may make monitoring of plaintiffs' attorneys cost-effective and thus may increase attorney effort and reduce the incidence of quick, cheap settlements (Fisch 1997). If institutional monitoring is effective, then their participation should be positively correlated with case outcomes, measured either absolutely or as a proportion of the total investor losses at issue in the case.

At the same time, the PSLRA's presumption that the largest investor selects the lead counsel also has the potential to create a competitive market among law firms seeking to become lead counsel. Under the PSLRA, plaintiffs' lawyers increasingly have incentives to develop longstanding relationships with institutions willing to become active in class litigation because doing so should increase the number of lucrative lead counsel opportunities. Lawyers may thus compete for institutional representation by offering higher quality representation as well as on price. Indeed, since passage of the PSLRA some institutions have used competitive procedures to select counsel (Fisch 2002). Institutional repeat players may also be able to develop compensation arrangements that reduce both fees and agency costs (Fisch 2002). For broadly diversified institutions, these arrangements may create secondary benefits to the extent that they influence attorney fee requests or judicial fee awards in cases without

institutional investor participation. Thus, all else being equal, if the PSLRA worked as Congress intended cases with institutional investor lead plaintiffs should be positively correlated with attorney effort and negatively correlated with fee requests and awards.

Among institutional investors, public pension funds are generally viewed as the best potential monitors in securities class actions. They have among the largest portfolios and thus a substantial incentive to monitor class counsel and to negotiate lower fees. The public pension funds that have been active as lead plaintiffs have tended to be quite experienced as shareholder activists, with sophisticated legal staffs for overseeing litigation. They are also thought to be subject to far fewer conflicts of interest than other institutions (Black 1990) and are therefore more likely to seek lead plaintiff status. Since public pensions are arguably the best-positioned institutional investor to act as monitors, it makes sense to look to the cases in which they are active to find evidence of beneficial effects from institutional lead plaintiffs. If significant results are not found in those cases, it seems less likely that they will be found for other types of institutions.

Although institutional monitoring is theoretically beneficial, using institutions as monitors might be ineffective to the extent that they are subject to their own agency costs. Even with respect to public pension funds, potential issues arise. There have been, for example, pay-to-play allegations involving a number of law firms that reportedly contributed heavily to the campaigns of government officials who control public pension funds and who can therefore influence whether the fund will serve as a lead plaintiff and who it will select as counsel (Weinberg and Fisher 2004). Public officials might also seek lead plaintiff status for publicity purposes rather than to monitor closely class counsel (Romano 1993). How widespread these behaviors are remains uncertain, but

they potentially create much the same problem that existed prior to passage of the PSLRA, inadequate monitoring of the attorney by a conflicted representative plaintiff. If that were the case, then there should be no significant correlation between public pension lead plaintiffs and settlements, litigation effort, or attorneys' fees.

3. PRIOR RESEARCH

In the immediate aftermath of the Act, some institutions viewed participation in securities class actions as a logical extension of their activism on corporate governance matters (Grundfest and Perino 1996) and began to seek lead plaintiff status. These initial efforts were quite limited. The SEC (1997) found that institutional plaintiffs served as lead plaintiffs in only eight of 105 cases filed in the first year after passage of the PSLRA. That reluctance continued in the ensuing years, with PricewaterhouseCoopers (2006) finding that union and public pension funds served as lead plaintiffs in an average of 4.8% of the cases filed in the first three years (1996-1998) after passage of the Act.

The explanations institutions offered for their continued passivity suggested that the PSLRA did not do enough to overcome existing free rider problems. Many institutions were uncertain that their participation would yield any tangible benefits and, to the extent that such benefits did exist, they were concerned about whether they would be able to capture a large enough portion of the gains to make participation cost-effective (Grundfest and Perino 1996). Institutions also feared that the costs of participating, including the costs of monitoring plaintiffs' attorneys, the possibility that they would be subjected to burdensome discovery, the adverse reactions from company management, and the potential for liability to other class members, were too high (Fisch 1997).

But, participation by public pension funds has increased steadily over time. By 2002 public and union pension fund participation had grown to 27.2% of filed cases. From 2003-2005, these institutions appeared as lead plaintiffs in an average of 34.4% of filed cases (PricewaterhouseCoopers 2006). This increased activism is likely driven in part by changing perceptions of the cost-benefit calculus of becoming lead plaintiff. On the benefits side, in 1998 three public pension funds serving as lead plaintiffs in the *Cendant* litigation obtained a then-record $3.5 billion settlement, which likely suggested to institutions that increased monitoring could yield tangible benefits. Initial institutional experiences as lead plaintiffs also suggested that the costs of institutional participation were not as large as previously anticipated (Cox and Thomas 2006). At the same time, the publicity concerning Enron, WorldCom, and other corporate scandals undoubtedly led some institutions to seek a greater role in securities class actions, either as a means of enhancing their deterrent impact or because participation could lead to valuable publicity for the fund's political overseers.

There is thus little doubt that post-PSLRA public pension fund participation in securities class actions is greater than it was prior to passage of the Act (Choi, Fisch and Pritchard 2005).[5] The pattern of participation, however, is hardly uniform. Survey evidence suggests that at least some funds appear to consider participation as a lead plaintiff only in those cases in which they have suffered a multi-million dollar loss (Cox and Thomas 2006). That public pension funds rely on such thresholds should not come as a surprise. Monitoring costs are likely relatively insensitive to case size. Because the

[5] The other type of institution that has been increasingly active is union-affiliated pension funds. Whether these institutions are as effective as public pension funds at monitoring class counsel is the subject of a future research project. Other kinds of institutions (most notably, large mutual funds) have been entirely absent from the ranks of lead plaintiffs (Coffee 2001), likely because they fear that serving as a lead plaintiff might put them at a competitive disadvantage in obtaining work from publicly traded issuers.

lead plaintiff provision only partially overcomes the collective action problem, pension funds are more likely to serve as lead plaintiffs in cases with larger losses and larger defendant firms (Cox and Thomas 2006).[6] Existing research also shows that institutions are more likely to become lead plaintiffs in cases in which the defendant announced an accounting restatement or SEC investigation prior to the filing of the first class action complaint (Choi, Fisch, and Pritchard 2005), suggesting that institutions focus on cases that have obvious indicia of merit. These are the cases in which the institution can reasonably expect that the suit is meritorious and that the potential gains from monitoring will exceed the expected costs.[7] Any analysis of the impact of institutional monitoring thus must control for these differences.

What, if any, benefits have resulted in the cases where public pensions have served as lead plaintiffs is a separate and more difficult question. Choi, Fisch, and Pritchard (2005) study the impact of the lead plaintiff provision by comparing two relatively small samples of pre- and post-PSLRA settlements. This design may bias the results because they focus on the post-PSLRA time period (1996-2000) when institutions were just beginning to become active as lead plaintiffs. Even so, they find that public pension fund participation is significantly and positively correlated with a dichotomous variable, "high-value outcome case," which they define as settlements of more than five percent of the stakes in the case. While this result suggests that institutional monitoring

[6] This result is consistent with studies of corporate governance activism, which likewise find that institutions tend to target larger firms (Smith 1996).

[7] Public pension funds' focus on these cases is also likely the result of a provision in the PSLRA which prohibits incentive payments to the lead plaintiff, although such a provision would help alleviate the collective action problem. In addition, the PSLRA permits the court to compensate the lead plaintiff for costs and expenses directly related to the representation out of any final judgment or settlement. Thus, any institution considering whether to monitor actively will discount its potential recovery of costs by the probability that it will not prevail in the action. Under these conditions, it is reasonable to expect that institutions will only become lead plaintiffs in cases with relatively obvious markers of fraudulent activity.

is effective, the authors note that, due in part to their small sample size, they are unable to rule out the possibility that the result is driven by self-selection, *i.e.*, that public pension funds simply choose to become involved predominantly in high-profile or easier cases where recoverable damages are higher.

Cox and Thomas (2006) rely on a somewhat larger dataset and also find that the presence of an institutional lead plaintiff is correlated with larger settlements, even when controlling for a measure of provable losses, market capitalization, class period length, and the presence of an SEC enforcement action. Cox and Thomas, however, do not control for other factors that prior research has shown are correlated with settlement size. Simmons and Ryan (2005) add controls for the presence of certain types of allegations and co-defendants, the presence of certain settlement characteristics, and the presence of certain law firms. They conclude that even when controlling for these factors, the presence of an institutional lead plaintiff is correlated with higher settlements, but the study provides relatively few specifics about the regression results.

Several studies examine fees in securities class actions, but only one appears to examine the effect that institutional lead plaintiffs have on fees. Eisenberg and Miller (2004) find that fees (measured as a proportion of the settlement) are inversely related to settlement size. They also find no statistically significant correlation between passage of the PSLRA and fees, but do not control for institutional investor participation. Choi, Fisch, and Pritchard (2005), however, find no significant effect of institutional investor participation on fees, although this result is based on a sample of only 78 post-PSLRA cases. Even if such a correlation were found, unobserved characteristics of the cases public pensions select may remain a significant problem. If institutions pick only the

largest or easiest cases to litigate, then any evidence of lower fees may be result of the nature of the case rather than the active monitoring of the institutional lead plaintiff.

In sum, the prior literature evaluating the impact of institutional investors as lead plaintiffs is incomplete. In some cases, the sample sizes were small or focused on periods in which institutional investor activism was less frequent. Other studies did not include sufficient controls for institutional self-selection. No existing studies examine whether public pension monitoring is positively correlated with attorney effort. The sample selection and study design in this paper attempt to address these issues.

4. DATA

This paper relies on a hand-collected, random sample of 126 pre-PSLRA and 501 post-PSLRA settled securities fraud class filed from 1984 through 2004. Settlements were identified using Institutional Shareholder Service's Securities Class Action Services' database (ISS), which appears to be a comprehensive database of securities class action settlements. For each case, the type of lead plaintiff was identified through a variety of sources, including published settlement notices, the Stanford Securities Class Action Clearinghouse (SSCAC), and from docket sheets and court filings available through the federal courts' Case Management/Electronic Case Filing (CM/ECF) or PACER systems.

Table 1 reports the distribution of institutions by filing year, defined as public pension funds or other lead plaintiffs.[8] The sample closely tracks the increased

[8] Because this coding scheme defines only public pension funds as institutional investors it does not evaluate whether participation by other kinds of institutions, such as union-affiliated funds or hedge funds, is correlated with greater attorney effort, higher settlements, or lower fees. To the extent that these institutions have such an effect on securities class actions, the study design is biased against finding any significant correlations with respect to public pension lead plaintiffs.

participation of public pension funds identified in other studies. There are no public pension fund lead plaintiffs in pre-PSLRA cases and relatively little participation in the first three years of the Act. Public pension fund participation, however, increased markedly in 1999, constituting 18.5% of the sampled cases filed since that time. Moreover, approximately 20% of the sampled cases were filed after 2000, part of the period of increased activity that Choi, Fisch and Pritchard (2005) did not analyze.

Table 1. Sample Distribution of Institutional Lead Plaintiffs

	Lead Plaintiff Type		
	Public Pension	Other	Total Cases
Pre-1994	0 (0.0%)	42 (100.0%)	42
1994	0 (0.0%)	42 (100.0%)	42
1995	0 (0.0%)	40 (100.0%)	40
1996	3 (7.5%)	37 (92.5%)	40
1997	5 (8.3%)	55 (91.7%)	60
1998	8 (7.9%)	93 (92.1%)	101
1999	14 (17.5%)	66 (82.5%)	80
2000	12 (12.2%)	86 (87.8%)	98
2001	14 (22.2%)	49 (77.8%)	63
2002	12 (27.9%)	31 (72.1%)	43
Post-2002	4 (22.2%)	14 (77.8%)	18
Total	72 (11.5%)	555 (88.5%)	627

Note: Years refer to the year in which the action was filed. Other includes all non-public pension fund plaintiffs and thus includes other types of institutional investors and individuals.
SOURCES: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CM/ECF; PACER.

For each case, data was collected from ISS and SSCAC on the outcome of the case, including the size of any partial settlements (*Partial Settlement*) and the aggregate settlement (*Total Settlement*). Data was also collected on the attorneys' fee request (*Fee Request*) and the fee award (*Fee*), both measured as a proportion of the *Partial Settlement*. *Fee* was coded directly from the court's decision approving the settlement and not from the more widely available fee request reported in the settlement notice.[9] While this requirement had the effect of reducing by approximately 23% (627 to 481) the

[9] Published awards are from Lexis and Westlaw while unpublished orders were obtained using the CM/ECF or PACER systems or from attorneys involved in the cases.

sample size for fee awards, it was necessary to ensure reliable results. Analysis of the sample showed significant differences between the *Fee Request* and *Fee* variables.[10]

To control for potential institutional self-selection of larger, more meritorious, or easier cases and for other factors that might affect settlement outcomes, attorney effort, or fee requests or awards, data was also collected on issuer characteristics, case and settlement characteristics, and the presence of specified law firms. Information on the issuer defendants is from the University of Chicago Center for Research in Security Prices (CRSP), and from COMPUSTAT. To be included in the regression analyses, the firm had to have data available from both sources.

The most significant difference from prior studies is in the measure of damages at issue in the case. Prior studies (Cox and Thomas 2006; Choi, Fisch, and Pritchard 2005) rely on damage models typically employed by plaintiffs' experts, which they argue are a reasonable proxy for the stakes in the case. These models, however, have frequently been criticized for containing unrealistic assumptions that substantially overstate damages (Lev and de Villiers 1994) and the typical case usually involves a substantial dispute between plaintiff and defendant experts as to the true measure of damages. Given the well-documented shortcomings of plaintiff-style damages it is not clear that undertaking the substantial effort to calculate them is either necessary or worth the effort.

This paper uses two alternative and much simpler variables as a proxy for the stakes in the case: *MDL*, the maximum dollar loss during the class period alleged in the

[10] As shown in Table 2, the mean (median) fee request was .296 (.300), while the mean (median) fee award was .265 (.280). Requests are highly correlated with fees (r = .723), but a paired-sample t-test demonstrates significant differences between requests and awards (t = -15.032; p = .000).

complaint[11] and *Class Period Length*, the length in years from the beginning to the end of the class period. Three considerations led to the decision to use *MDL* rather than plaintiff-style damages. First, while *MDL* will also tend to overstate damages because it does not adjust for other market factors influencing stock price, prior research (Simmons and Ryan 2005) has shown that *MDL* is highly correlated with plaintiff-style damages and it has been used in other studies (Bajaj et al. 2006). *MDL* would also seem to better reflect the information available to institutions when they make their decisions to become lead plaintiffs, which will occur near the beginning of the case before any precise damage calculations. *MDL* is also significantly easier to calculate, an important consideration given that the sample used here is substantially larger than that employed in previous studies. *Class Period Length* should capture the variation in stakes due to the time period in which the alleged fraud was ongoing.

Three other issuer characteristics are included in the regression. First, the paper uses *Total Assets* as of the end of the class period as a measure of firm size rather than market capitalization (*Market Capitalization*) because the latter is highly correlated with *MDL*.[12] Second, data was collected on whether the issuer defendant declared *Bankruptcy* before the settlement,[13] which may lower settlement recoveries (Marino and Marino 1994; Simmons and Ryan 2005). Third, data was collected on the presence of an SEC or other governmental action (*Government Action*) involving the same allegations as are at issue in the securities class action, which may serve as a proxy for case quality (and

[11] Specifically, *MDL* is defined as the dollar value decrease (in constant 2005 dollars) of the defendant issuer's market capitalization from its peak market capitalization during the class period to the first trading day after the end of the class period.

[12] As is described more fully below, certain regressions replace *MDL* with *Market Capitalization*.

[13] This variable was coded using Westlaw's Bankruptcy database.

therefore may be correlated with larger settlements).[14] A *Government Action* may also suggest that less litigation effort was necessary to achieve the settlement, possibly resulting in lower fees. Unlike Choi, Fisch, and Pritchard (2005), who only examined announced SEC investigations prior to the filing of the complaint, *Government Action* is coded as 1 if there was any governmental enforcement action involving the same facts and circumstances alleged in the subject class action. This coding provides a better proxy for case quality because some announced investigations will not result in enforcement actions and because many enforcement actions are not announced until after a securities class action has been filed and a lead plaintiff selected.

Case and settlement characteristics were coded using data from ISS, SSCAS, and CM/ECF or PACER. The variables coded are: (1) the presence of certain allegations in the complaint (that the issuer-defendant restated its financials (*Restatement*) or otherwise violated Generally Accepted Accounting Principles (*Accounting*), which may be correlated with the merits of that case); (2) the presence of additional defendants (*Auditor* or *Underwriter*), which may be the source of additional settlement dollars; (3) whether securities in addition to common stock were alleged to be damaged (*Multiple Securities*); (4) whether the settlement contained consideration other than cash (*Non-Cash Settlement*); (5) the number of docket entries in the case (*Total Docket Entries*) and the age of the case (in years) from first filing until settlement (*Case Age*), both of which serve as proxies for case complexity and litigation effort; and (6) whether the case was filed before or after passage of the PSLRA (*PSLRA*). To further control for institutional self-selection of easier, more high profile cases, the paper defines an indicator variable

[14] This variable was coded using the SEC's Litigation Releases, Lexis, and Westlaw.

(*High Profile*) that takes a value of 1 if the case involves an *MDL* in the top quartile of the sample, an alleged *Accounting* violation, and a *Government Action* and 0 otherwise.

Table 2. Descriptive Statistics

	N	Mean/Proportion	Median	SD
Partial Settlement	627	47.263	6.746	262.216
Total Settlement	627	61.813	7.782	402.626
Total Settlement/MDL	579	.070	.018	.462
Fee Request	619	.296	.300	.057
Fee	528	.265	.280	.067
MDL	579	4,337.980	499.058	17,930.889
Market Capitalization	579	5,314.029	464.597	22,353.611
Class Period Length (Years)	624	1.307	1.007	1.011
Total Assets	593	7,410.454	310.320	40,969.850
Bankruptcy	627	.204	–	–
Government Action	627	.360	–	–
Restatement Allegation	627	.303	–	–
Accounting Allegation	627	.574	–	–
Auditor	627	.171	–	–
Underwriter	627	.153	–	–
Multiple Securities	627	.107	–	–
Non-Cash Settlement	627	.150	–	–
Total Docket Entries	625	172.165	109.000	248.817
Case Age (Years)	627	2.960	2.619	1.613
PSLRA Case	627	.799	–	–
High Profile	627	.086	–	–
Bernstein Litowitz	627	.083	–	–
Milberg Weiss	627	.463	–	–

NOTE: Partial Settlement, Total Settlement, MDL, Market Capitalization, and Total Assets are reported in millions of constant 2005 dollars.
Sources: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CRSP; COMPUSTAT; CM/ECF; PACER.

Finally, prior research has found that the presence as lead counsel in the case of a leading class action firm, Milberg, Weiss, Bershad, Hynes & Lerach (*Milberg Weiss*), is correlated with increased settlements (Simmons and Ryan 2005).[15] Another firm, Bernstein Litowitz Berger & Grossman (*Bernstein Litowitz*) has pursued a strategy of courting public pension fund clients (Grow 2005). Data on the participation of these firms was collected to control for whether differences in law firms explain any observed differences in the relevant dependent variables.

[15] In May 2004, Milberg Weiss split into two firms. Cases in which the predecessor firm or either successor firm appear as lead counsel or coded 1 for the *Milberg Weiss* variable.

Table 3. Comparison of Cases With and Without Public Pension Lead Plaintiffs

	Public Pension Lead Plaintiff			Other Lead Plaintiff		
	N	Mean/Proportion	SD	N	Mean/Proportion	SD
Partial Settlement	72	278.285**	727.972	555	17.292	44.047
Total Settlement	72	376.371**	1,137.595	555	21.005	52.867
Total Settlement/MDL	72	.069	.318	507	.070	.484
Fee Request	72	.212***	.081	547	.307	.041
Fee	67	.200***	.080	461	.273	.058
MDL	72	18,051.991***	39,955.796	507	2,390.428	10,615.755
Market Capitalization	72	17,956.442**	43,955.388	507	3,518.657	16,544.219
Class Period Length (Years)	72	1.610**	.934	552	1.267	1.015
Total Assets	72	12,624.183	36,606.568	521	6,689.939	41,517.336
Bankruptcy	72	.194		555	.205	–
Government Action	72	.542***		555	.337	–
Restatement	72	.472***	–	555	.281	–
Accounting	72	.806***		555	.544	–
Auditor	72	.389***		555	.142	–
Underwriter	72	.139		555	.155	–
Multiple Securities	72	.153		555	.101	–
Non-Cash Settlement	72	.153		555	.150	–
Total Docket Entries	72	420.347***	569.478	553	140.101	138.535
Case Age (Years)	72	2.795	1.083	555	2.981	1.669
PSLRA Case	72	1.000***		555	.773	–
High Profile	72	.361***		555	.050	–
Bernstein Litowitz	72	.375***	–	555	.045	–
Milberg Weiss	72	.264***	–	555	.488	–

* significant at .05; ** significant at .01; *** significant at .001

NOTE: *Partial Settlement*, *Total Settlement*, *MDL*, *Market Capitalization*, and *Total Assets* are reported in millions of constant 2005 dollars.

Sources: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CRSP; COMPUSTAT; CM/ECF; PACER.

Descriptive statistics for the full sample are contained in Table 2, while Table 3 compares cases with public pensions to those with other types of lead plaintiffs. The sample here is consistent with those in employed in previous analyses with respect to revealing institutional self-selection of larger, higher profile cases with obvious indicia of merit. Mean *MDL* for cases with public pension lead plaintiffs is approximately $18 billion, compared to only $2.4 billion for cases with other kinds of lead plaintiffs (a difference that is significant at less than .001).[16] Not surprisingly, mean *Market Capitalization* ($18 billion versus $3.5 billion) is significantly larger and mean *Class Period Length* significantly longer (1.6 years versus 1.3 years) for cases with public

[16] Because the distribution of *MDL* is skewed, mean comparisons were re-calculated using log-transformed values. The significant difference persisted. The same is true with respect to other variables with skewed distributions, *Market Capitalization*, *Partial Settlement*, and *Total Settlement.*

pension plaintiffs. Table 3 also shows that public pension fund plaintiffs are significantly more likely to be involved in *High Profile*, *Accounting*, and *Restatement* cases, cases with *Auditor* co-defendants, and cases with parallel governmental enforcement actions than non-institutional plaintiffs. Consistent with collective action theory, this finding suggests that institutions seek out large cases with large potential damages because they are the ones in which the benefits of monitoring are most likely to outweigh the costs.

5. EMPIRICAL RESULTS

This section presents results from the empirical tests of the hypotheses developed in Section 2. Sections 5.1 through 5.3 present the results for settlement outcomes, attorney effort, and fee requests and awards.

5.1. Settlement Outcomes

If public pension lead plaintiffs are more effective monitors of class counsel than other types of plaintiffs, then settlements in cases with public pension leads should be larger, all else being equal, and public pension funds should recover more of the available settlement dollars. The univariate tests in Table 3 only partially support these hypotheses. Both *Partial Settlement* ($278.29 million versus $17.29 million) and *Total Settlement* ($376.37 million versus $21.01 million) are significantly larger in cases with public pension lead plaintiffs than non-institutional lead plaintiffs, a not surprising result given that institutions become lead plaintiffs primarily in cases with larger market losses and therefore higher potential damages.[17] By contrast, Table 3 reveals no significant

[17] In the five largest cases in the sample (each with settlements in excess of $1 billion) a public pension fund served as the lead plaintiff. Even if these cases are excluded, *Partial Settlement* ($96.92 million versus $17.29 million) and *Total Settlement* ($108.30 million versus $21.01 million) are significantly larger for cases with public pension lead plaintiffs.

differences in the ratio of *Total Settlement* to *MDL*, suggesting that public pensions may be no better than other types of plaintiffs in maximizing recoveries.

To test whether public pension lead plaintiffs have any beneficial impact on settlement size, two sets of regressions were run, the first using the log-transformed settlement as the dependent variable and the second using the log-transformed ratio of settlement to *MDL* (both in constant 2005 dollars). In addition to the controls for issuer, case, settlement, and law firm characteristics, the regressions also control for any potential differences among circuits by including circuit dummy variables (although the circuit controls are omitted from Table 4 for ease of presentation). Finally, the sample contains five outlying values for *Total Settlement* that were in excess of $1 billion. As a robustness check to ensure that these five outliers were not biasing the results, the regressions were re-run on a restricted sample that excludes these settlements.[18]

Table 4 reports the regression results. If public pension self-selection of larger, higher profile, and easier cases were driving the result, we would expect to see a positive and significant correlation between *Total Settlement* and firm and case characteristic controls and no significant correlation with *Public Pension.* That, however, is not the case. For *Total Settlement*, firm and case characteristics are correlated with settlement size. All else being equal, settlements are larger as *MDL*, *Class Period Length*, and *Total Assets* increase. There is also a significant positive correlation between settlement size and *High Profile* cases and those involving government actions or accounting restatements. These characteristics, however, do not explain all of the variation in

[18] Of the 627 cases in the initial sample, 49 did not have stock price data available on CRSP. Of the remaining cases, six did not have data available on COMPUSTAT for total assets and one did not have a docket sheet available on PACER. Only one case in the sample was from the District of Columbia Circuit. All of these cases were eliminated from the sample, leaving a final sample of 570 (565 for the regressions that omit settlements in excess of $1 billion).

settlement size. The public pension variable is positive and significant for the full sample and for the sample of settlements less than $1 billion.[19] This result is consistent with the hypothesis that public pension fund monitoring is effective in enhancing class recoveries.

Table 4. Regression Models for *Total Settlement* and *Ratio Total Settlement to MDL*

	Total Settlement		*Ratio Total Settlement to MDL*	
	Full Sample	*Settlements < $1B*	*Full Sample*	*Settlements < $1B*
Constant	1.940 (.223)***	2.013 (.225)***	1.430 (.268)***	1.523 (.273)***
Public Pension	.241 (.060)***	.222 (.061)***	.185 (.072)**	.166 (.072)*
MDL	.226 (.032)***	.228 (.032)***	–	–
Market Capitalization	–	–	-.721 (.044)***	-.720 (.045)***
Class Period Length	.049 (.020)*	.042 (.020)*	-.038 (.024)	-.045 (.024)
Total Assets	.184 (.024)***	.177 (.024)***	.247 (.035)***	.241 (.035)***
Bankruptcy	-.104 (.042)**	-.093 (.042)*	-.216 (.051)***	-.207 (.051)***
Government Action	.079 (.041)*	.076 (.041)	.107 (.048)*	.103 (.048)*
Restatement	.127 (.045)**	.118 (.045)**	.177 (.054)***	.168 (.054)**
Accounting	-.071 (.041)	-.064 (.041)	-.083 (.049)	-.076 (.049)
High Profile	.148 (.072)*	.151 (.073)*	.004 (.086)	.015 (.087)
Auditor	.092 (.050)	.083 (.050)	.069 (.060)	.063 (.060)
Underwriter	.128 (.046)**	.116 (.047)**	.161 (.055)**	.143 (.055)**
Non-Cash Settlement	.075 (.046)	.086 (.046)	-.004 (.055)	.006 (.055)
Multiple Securities	.182 (.059)**	.183 (.059)**	.208 (.070)**	.208 (.071)**
PSLRA Case	.003 (.048)	.001 (.048)	-.127 (.056)*	-.129 (.056)*
Total Docket Entries	.631 (.062)***	.610 (.063)***	.545 (.073)***	.518 (.075)***
Bernstein Litowitz	.034 (.062)	.031 (.063)	-.004 (.073)	-.008 (.075)
Milberg Weiss	.155 (.034)***	.156 (.034)***	.082 (.041)*	.082 (.041)*
Adj. R^2	.694	.653	.472	.463
N	570	565	570	570

* significant at .05; ** significant at .01; *** significant at .001

Standard errors in parentheses.

NOTE: Although not reported in Table 3, regressions control for circuit in which case was filed with the Second Circuit as the reference circuit. Only one case in the sample is from the DC Circuit, which was excluded from the analysis. The dependent variables and *Total Docket Entries*, *MDL*, *Market Capitalization*, *Total Assets*, and *Case Age* are log-transformed. *MDL* and *Total Assets* are in constant 2005 dollars.

SOURCES: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CRSP; COMPUSTAT; CM/ECF; PACER.

To be sure, it remains possible that some unobserved case characteristic or issuer variable related to the merits of the case explains these results. But, there is at least some reason to believe that self-selection is not a significant problem here. As noted previously, public pension funds operate under significant time and informational

[19] Two additional sets of regressions were run to examine the robustness of the results. First, a regression was run using interactions among *MDL*, *Government Action*, and *Accounting* in lieu of the *High Profile* indicator variable. Although not reported here, *Public Pension* remained positive and significant in these regressions. Second, public pension funds are not evenly distributed throughout the sample, but are (as the descriptive statistics in Table 3 suggest) concentrated in cases with large *MDL*. To test whether this distribution was biasing the results, the same regression models were fit to restricted samples consisting of cases with a *MDL* in the top half and the top quartile of sampled cases. *Public Pension* remained positive and significant in both regressions.

constraints in determining whether to become lead plaintiffs. As a result, they may well rely on the same readily observable case and issuer characteristics that are included in the regressions. Consequently, the results strongly suggest that public pension participation in securities class actions does indeed lead to higher settlement amounts, all else being equal.

If public pensions are more effective monitors, then not only should total settlements be larger, but the ratio of settlement to total potential damages should also be larger, *i.e.*, institutions should be able to obtain a higher proportion of the stakes at issue in the case. Table 4 also reports the results of the regressions that use the ratio of *Total Settlement* to *MDL* as the dependent variable.[20] The same pattern emerges. Firm and case characteristics are significantly correlated with how much of their damages plaintiffs recover from defendants. For example, *Total Assets*, *Restatement*, and *Government Action* are positively correlated with the ratio of *Total Settlement* to *MDL.*[21] But *Public Pension* remains positive and significant for both the full sample and the sample of settlements less than $1 billion. Again, it remains possible that self-selection issues

[20] Because *MDL* is on the left-hand side of the regression equation, *Market Capitalization* is used in lieu of *MDL* on the right hand side of the equation.

[21] Although not the primary focus of this paper, this result is inconsistent with Alexander (1991), who claimed that the merits of the action played little if any role in settlement size.

plague the estimates,[22] but the results are consistent with the hypothesis that public pensions do a better job of maximizing recoveries than other types of lead plaintiffs.[23]

5.2. Attorney Effort

An agency cost typically associated with securities class actions is the possibility that insufficiently monitored attorneys might shirk. While it is not possible to test directly using available evidence whether institutional investors engage in more monitoring than non-institutional investors and thereby reduce attorney shirking, it is possible to run regressions using *Total Docket Entries*, a proxy for litigation effort, as the dependent variable. All else being equal, cases in which the plaintiffs' attorneys work harder and in which they are unable to settle the case early and cheaply in exchange for a high fee should have more docket entries. Indeed, as shown in Table 4, *Total Docket Entries* is positively and significantly correlated with both the total size of the settlement

[22] Self-selection, however, might explain another finding reported in Table 4—that *Milberg Weiss* is positively and significantly correlated with both aggregate settlements and the ratio of settlement to stakes. While public pension funds, given small legal staffs, discovery stays, and short decision-making time frames, face considerable constraints in determining whether to become lead plaintiffs and thus may look at the same case characteristics included in the regressions, the same cannot be said for Milberg in its decisions about which cases to pursue the lead counsel role. The firm possesses significant resources, claims it investigates cases thoroughly, and has substantial experience identifying which cases to pursue. So it may well be that the average case Milberg pursues and obtains lead counsel in is higher quality, thereby explaining the positive correlation.

[23] One noteworthy result in Table 4 is for the *PSLRA* dummy variable. *PSLRA* is positively correlated with *Total Settlements*, but the result is insignificant. By contrast, the regressions find that cases filed after passage of the PSLRA have, all else being equal, lower ratios of settlements to stakes, a result consistent with prior research (Cox and Thomas 2006). Cox and Thomas suggest that this result calls into question the efficacy of the PSLRA, but such a conclusion is likely premature. The negative sign with respect to *PSLRA* may simply be the product of an omitted variable bias in the regressions. Anecdotal evidence suggests that the amount of directors' and officers' liability insurance coverage strongly influences the size of the ultimate settlement in the case (Cox 1997). Two pieces of evidence suggest that the size of such coverage did not keep pace with the larger stakes found in post-PSLRA cases, likely explaining the negative coefficient for *PSLRA*. In constant 2005 dollars, the mean (median) *MDL* in pre-PSLRA cases in the sample was $1.24 billion ($256.10 million) compared to $5.02 billion ($673.49 million) in post-PSLRA cases, a difference that is statistically significant at less than .001. Survey evidence (Towers Perrin 2006) indicates that from 2001-2005, the mean coverage limits for large issuers (those with Total Assets in excess of $ 5 billion) was $112.46 million, while mean *MDL* for the same issuers in the sample was $23.48 billion. Indeed, this explanation is consistent with the negative sign for *Market Capitalization* in Table 4. Unfortunately, this hypothesis is difficult to test empirically because there is no readily available data on the amount of available insurance coverage in the sampled cases.

and with the ratio of settlement to *MDL*, suggesting that more work yields better outcomes.[24] A positive correlation between *Public Pension* and *Total Docket Entries* suggests that increased institutional monitoring prevents some shirking by class counsel.

The univariate comparisons in Table 3 provide some support for this hypothesis. While there is no significant difference in the case age (2.80 years for public pension funds versus 2.98 years for other lead plaintiffs), cases with public pension lead plaintiffs exhibit significantly more litigation activity as measured by *Total Docket Entries*. This higher level of activity may be evidence of more effective monitoring and therefore increased litigation effort, or may simply be the byproduct of the larger and more complex cases that public pension funds seek.

Due to extreme values in some cases, the regressions for *Total Docket Entries* use log-transformed values for the dependent variable. As in previous regressions, these regressions are for the full sample and for the sample of cases with total settlements of less than $1 billion. The regressions use the same law firm controls and controls for case size and complexity as the previous regressions and also control for potential differences among circuits (again, the circuit controls are omitted for ease of presentation).

Table 5 reports the regression results. As one would anticipate, older cases, cases with larger potential damages, and cases with additional underwriter or auditor defendants are positively correlated with *Total Docket Entries.* The public pension variable, however, is also positive and significant in both specifications—all else being

[24] Alternatively, there is likely some correlation between the stage of the litigation (*e.g.*, pre- or post-motion to dismiss or pre- or post-summary judgment) and the merits of the case. A case that survives a summary judgment motion will have more docket entries, is likely to be more meritorious, and is likely to command a higher settlement than a case that settles earlier. *Total Docket Entries* may thus have some positive correlation with merits.

equal, cases with public pension lead plaintiffs exhibit more litigation activity than cases with other lead plaintiff types.

Table 5. Regression Models for Attorney Effort

	Total Docket Entries		*Ratio Total Settlement to Total Docket Entries*	
	Full Sample	*Settlements < $1B*	*Full Sample*	*Settlements < $1B*
Constant	.996 (.132)***	1.054 (.129)***	1.573 (.213)***	1.599 (.214)***
Public Pension	.200 (.037)***	.190 (.036)***	.161 (.059)**	.142 (.059)*
MDL	.075 (.018)***	.068 (.019)***	.207 (.031)***	.212 (.031)***
Class Period Length	.011 (.012)	.004 (.012)	.038 (.020)	.034 (.020)
Total Assets	.000 (.015)	.000 (.015)	.192 (.024)***	.185 (.024)***
Bankruptcy	.003 (.026)	.004 (.026)	-.084 (.042)*	-.074 (.043)
Government Action	.054 (.025)*	.054 (.024)*	.060 (.040)	.055 (.040)
Restatement	.043 (.028)	.036 (.027)	.088 (.045)*	.082 (.046)
Accounting	-.014 (.025)	-.008 (.025)	-.051 (.041)	-.047 (.041)
High Profile	.109 (.044)*	.092 (.044)*	.105 (.072)	.115 (.073)
Auditor	.153 (.030)***	.146 (.030)***	.061 (.049)	.051 (.049)
Underwriter	.073 (.028)**	.050 (.028)	.101 (.046)*	.097 (.046)*
Non-Cash Settlement	.074 (.029)**	.087 (.028)**	.028 (.046)	.033 (.046)
Multiple Securities	.094 (.036)**	.063 (.036)	.141 (.058)*	.155 (.059)**
PSLRA Case	-.077 (.029)**	-.071 (.029)**	-.002 (.047)	-.004 (.047)
Case Age	.571 (.047)***	.586 (.046)***	-.495 (.076)***	-.500 (.076)***
Bernstein Litowitz	.008 (.038)	-.029 (.038)	.032 (.061)	.046 (.062)
Milberg Weiss	-.022 (.021)	-.021 (.021)	.153 (.034)***	.153 (.034)***
Adj. R^2	.520	.501	.529	.500
N	570	565	570	565

* significant at .05; ** significant at .01; *** significant at .001
Standard errors in parentheses.
NOTE: Although not reported in Table 5, regressions control for circuit in which case was filed with the Second Circuit as the reference circuit. Only one case in the sample is from the DC Circuit, which was excluded from the analysis. The dependent variable and, *MDL*, *Market Capitalization*, *Total Assets*, and *Case Age* are log-transformed.
SOURCES: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CRSP; COMPUSTAT; CM/ECF; PACER.

There are obvious limits to relying on *Total Docket Entries* to measure monitoring. Some kinds of litigation activity, most obviously discovery, may significantly enhance recoveries but are generally not reflected in the court docket sheet. Other kinds of activity, such as competing lead plaintiff applications are simply disputes among competing lawyers for control of the case and likely contribute little to maximizing recoveries. Moreover, lead counsel trying to impress a public pension with its diligence might engage in make-work that contributes little to overall recoveries.

For these reasons, the paper tests an alternative measure of monitoring, the ratio of *Total Settlement* to *Total Docket Entries.* This variable is a measure of the attorneys'

efficiency—it shows not only that the attorneys are working hard, but also that the work they are doing is producing results.[25] If public pension funds are effective monitors of class counsel, then their participation should be positively correlated with this variable. Table 5 reports the regression results and finds just such a relationship. Not only do attorneys appear to work harder in cases with active monitoring from public pension funds, they also appear to work more efficiently to maximize recoveries. While it remains possible that the controls used in both sets of regressions do not account fully for case complexity or other factors that may cause filings to increase, the results provide some evidence that public pension monitoring leads to reduced shirking by class counsel.

5.3. Attorneys' Fee Requests and Fee Awards

Public pensions that are sophisticated repeat players should be able to bargain for lower attorneys' fees than other types of lead plaintiffs. Plaintiff's attorneys should also be willing to compete for public pension fund business as a way to increase the likelihood of becoming lead counsel in large and lucrative class actions. As a result, public pension participation should be negatively correlated with fee requests and fee awards.

Consistent with this hypothesis, Table 3 shows significant differences in fee requests and fee awards. Mean fee requests (.212 versus .307) and fee awards (.200 versus .274) are significantly lower in cases with public pensions than in cases with other kinds of lead plaintiffs. Here too, however, these results may be the result of institutional preferences for higher profile and easier cases. Alternatively, law firm differences might explain the results. Tables 2 and 3 show, consistent with prior research (Choi, Fisch, and Pritchard 2005) that *Milberg Weiss* appears to dominate the securities class action field,

[25] Choi (2004) suggests a similar measure for attorney efficiency, the ratio of settlement to case age.

appearing in 46.3% of the sampled cases, but has less success in attracting public pension plaintiffs, appearing in only 26.4% of those cases. *Bernstein Litowitz*, by contrast, appears in only 8.3% of the sampled cases, but represents 37.5% of public pension funds.

To test whether public pensions affect attorney compensation, regressions were run that take as a dependent variable the fee request and the fee award, both measured as a proportion of the total settlement size.[26] The controls used in these regressions are similar to those already reported, but there are some differences. First, Perino (2006) has shown that experiments with court-sponsored auctions of the lead counsel position are negatively correlated with fees. For this reason, an indicator variable for *Auction* is included in the regression. Second, court decisions and prior research (Eisenberg and Miller 2004) show that the age of the case is positively correlated with fees, so *Case Age* is included as an independent variable.[27] While prior research (Eisenberg and Miller 2004) has shown that settlement size is the overwhelming determinant of fees, when the dependent variable is the fee or fee request measured as a proportion of the settlement, including settlement as an independent variable would effectively place the settlement on both the right and left hand sides of the equation. The reported regressions thus use the

[26] Some previous research on attorneys' fees in securities class actions have transformed these dependent variables. Eisenberg and Miller (2004), for example, use square roots of fee proportions in their regressions while Choi, Fisch, and Pritchard (2005) transform attorneys' fee using log odds. This paper follows Helland and Klick (2004) in using untransformed fee proportions. As a robustness check, the regressions were re-run using both square root and log odds transformations. The *Public Pension* variable remained negative and significant in all of the regressions.

[27] *Case Age* is correlated with *Total Docket Entries* and so the latter variable was omitted from these regressions. Replacing *Case Age* with *Total Docket Entries* does not significantly alter the coefficient for *Public Pension.*

variables previously shown to be correlated with settlement size rather than the settlement itself as independent variables.[28]

Table 6. Regression Models for *Fee Request* and *Fee*

	Fee Request		*Fee*	
	Full Sample	*Settlements < $1b*	*Full Sample*	*Settlements < $1b*
Constant	.466 (.023)***	.450 (.023)***	.469 (.034)***	.465 (.034)***
Public Pension	-.055 (.006)***	-.052 (.006)***	-.039 (.009)***	-.038 (.009)***
MDL	-.012 (.003)***	-.011 (.003)***	-.019 (.005)***	-.018 (.005)***
Class Period Length	-.005 (.002)*	-.004 (.002)	-.005 (.003)	-.004 (.003)
Total Assets	-.003 (.003)	-.003 (.003)	-.006 (.004)	-.006 (.004)
Bankruptcy	.006 (.005)	.005 (.005)	.002 (.007)	.002 (.007)
Government Action	-.008 (.004)	-.008 (.004)	-.008 (.007)	-.009 (.007)
Restatement	-.008 (.005)	-.006 (.005)	-.009 (.007)	-.008 (.007)
Accounting	.001 (.004)	-.001 (.004)	.001 (.007)	.000 (.007)
High Profile	-.009 (.008)	-.008 (.008)	-.013 (.011)	-.010 (.011)
Auditor	-.003 (.005)	.000 (.005)	-.004 (.008)	-.004 (.008)
Underwriter	-.011 (.005)*	-.008 (.005)	-.005 (.007)	-.003 (.008)
Non-Cash Settlement	-.005 (.005)	-.007 (.005)	-.010 (.007)	-.012 (.007)
Multiple Securities	-.005 (.006)	-.003 (.006)	.004 (.009)	.008 (.009)
PSLRA Case	-.017 (.005)***	-.018 (.005)***	-.002 (.008)	-.003 (.008)
Case Age	.009 (.008)	.008 (.007)	.055 (.012)***	.054 (.012)***
Auction	-.108 (.014)***	-.110 (.014)***	-.090 (.019)***	-.083 (.019)***
Bernstein Litowitz	-.016 (.007)*	-.014 (.007)*	-.009 (.010)	-.004 (.010)
Milberg Weiss	.011 (.004)**	.011 (.004)**	.008 (.005)	.008 (.005)
Adj. R^2	.504	.460	.334	.294
N	565	560	481	478

* significant at .05; ** significant at .01; *** significant at .001
Standard errors in parentheses.
NOTE: Although not reported in Table 5, regressions control for circuit in which case was filed with the Second Circuit as the reference circuit. Only one case in the sample is from the DC Circuit, which was excluded from the analysis. *Settlement*, *Total Docket Entries*, and *Market Capitalization* are log-transformed. *Market Capitalization* and *Settlement* are in constant 2005 dollars.
SOURCES: Institutional Shareholder Services, *Securities Class Action Database*; Stanford Law School, *Securities Class Action Clearinghouse*; CRSP; COMPUSTAT; CM/ECF; PACER.

Table 6 reports the results for these regressions. Consistent with predictions, the cases with public pension lead plaintiffs have significantly lower fee requests than cases with other types of lead plaintiffs, even when controlling for other relevant case and firm

[28] As a robustness check, the regressions were re-run using the log-transformed settlement (in constant 2005 dollars) as an independent variable (not reported). The *Public Pension* variable remained negative and significant. Other work has shown that the relationship between fees and settlement may be curvilinear, with fees decreasing more rapidly with increases in settlement size than a linear relationship would predict (Perino 2006). To test this possibility, a quadratic regression model was fit to the data using both the log-transformed settlement and the square of the log-transformed settlement as independent variables. While the squared term was, consistent with theory, negative and significant, including such a term in the model led to no significant change in the *Public Pension* variable and did not significantly improve the overall explanatory power of the model. The paper thus presents the simpler OLS regression. As in previous regressions, to test whether the concentration of public pensions in large *MDL* cases was biasing the results, the same regression models were fit to restricted samples consisting of cases with a *MDL* in the top half and the top quartile of sampled cases. The coefficient for *Public Pension* remained positive and significant in both regressions and quantitatively similar to those reported in Table 6.

characteristics. The same result holds both for the full sample and the sample of cases with settlements less than $1 billion. Further evidence of the potential impact of public pension fund plaintiffs comes from the law firm variables. The presence of *Bernstein Litowitz*, which has pursued a strategy of courting institutional plaintiffs, as lead counsel is negatively correlated with fee requests, while *Milberg Weiss*, which less frequently represents such plaintiffs, is positively correlated with fee requests. Finally, fee requests are significantly lower in post-PSLRA cases, suggesting the possibility that the fee arrangements public pensions are negotiating are influencing requests in other cases.

Table 6 also reports regressions for *Fee* (again measured as a proportion of the total settlement). Many unpublished fee decisions were unavailable through PACER; consequently, the sample size for these regressions is substantially smaller than for the regressions on fee requests. Nonetheless, the *Public Pension* variable is again negative and significant in both specifications. While the signs of the law firm variables were consistent with the signs reported in the regressions for fee requests, neither was significantly related to *Fee.* The same was true for *PSLRA*—the sign remained negative but was insignificant. These results suggest that public pension fund participation does reduce fees, either because institutions are sophisticated consumers of legal services or because of increased competition for institutional representation.

VI. CONCLUSION

This paper finds that public pension fund participation as lead plaintiffs in securities class actions appears to achieve many of the benefits that its original proponents (Weiss and Beckerman 1995) and Congress anticipated. Cases with public pension fund lead plaintiffs settle for greater amounts, even when controlling for

institutional self-selection of larger, more high profile cases. Cases with public pension leads are also positively correlated with at least one proxy for attorney effort, the number of docket entries in the case, suggesting that institutional monitoring may be effective in reducing attorney shirking. At the same time, attorneys' fee requests and the fees courts ultimately award are lower, either because institutions are sophisticated repeat players or as a result of attorney competition to represent institutional plaintiffs. These results suggest that public pensions should continue to serve as lead plaintiffs and courts should prefer them over other members of the class for that position. Because institutions only partially overcome the collective action problems associated with monitoring class counsel, it is reasonable to anticipate that they will continue to appear predominantly in the largest cases where the benefits of monitoring are most likely to outweigh the costs.

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