The Price of Pay To Play in Securities Class Actions

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Draft Date: 21 January 2010

Abstract

This paper studies the effect of campaign contributions to lead plaintiffs—"pay to play''—on the level of attorneys' fees in securities class actions. We find that state pension funds generally pay lower attorneys' fees when they serve as lead plaintiffs in securities class actions than do individual investors serving in that capacity, and larger funds negotiate for lower fees. This differential disappears, however, when we control for campaign contributions made to officials with influence over state pension funds. This effect is most pronounced when we focus on state pension funds that receive the largest campaign contributions and that associate repeatedly as lead plaintiff with a single plaintiffs' attorney firm. Thus, pay to play appears to increase agency costs borne by shareholders in securities class actions, undermining one of Congress's principal goals in adopting the Private Securities Litigation Reform Act.

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1. Introduction

One of the main goals of the Private Securities Litigation Reform Act (PSLRA) was to "empower investors so that they, not their lawyers, control securities litigation."[1] Congress believed that individual investors who served as class representatives prior to the enactment of the PSLRA were largely figureheads dominated by class action lawyers. Because class action lawyers typically had a much greater interest in the class recovery than the named class representatives, plaintiffs may have lacked the incentive to monitor class counsel. To remedy that imbalance, the PSLRA created a presumption that courts should appoint as lead plaintiff the class member seeking appointment with the largest financial interest in the relief sought.[2] Large shareholders, the theory went, would have more of an incentive to oversee lawyers who represent the class. Congress hoped that institutional shareholders serving as lead plaintiffs would negotiate with class counsel over attorneys' fees, ensuring that a larger share of the recovery would accrue to the class members.

In some ways, it appears that the PSLRA's lead plaintiff provision has succeeded. After a slow beginning, institutional investors have stepped forward to serve as lead plaintiffs in a substantial number of cases. The PSLRA has changed the game for class action lawyers, who must now compete for the favor of institutional investors in order to be selected as counsel. There is evidence that this competition has played an important role in reducing the percentage of the class recovery that goes to paying lawyers post-PSLRA.

[1] S. REP. NO. 104-98 (1995). *See also* H.R. CONF. REP. NO. 104-369, at 32 (1995).
[2] Securities Exchange Act of 1934 § 21D.

There have been rumors, however, of another form of competition to garner the favor of institutional lead plaintiffs. Most of the institutional investors that have agreed to serve as lead plaintiffs have been government-sponsored pension funds. Many of these funds are managed directly by politicians, such as state comptrollers, who must campaign to retain their current positions, or may have designs on higher offices. Alternatively, these funds are managed by political appointees, who typically owe their position to the state's governor. The political influence over these funds raises the question whether law firms are making campaign contributions to politicians to enhance their chances of being selected to represent the funds. The available evidence raises suspicion that class action law firms are buying lead counsel status with campaign contributions, i.e., lawyers are paying to play. But do campaign contributions affect the level of attorneys' fees paid in securities class actions? In other words, what is the price paid by class members if lawyers are paying to play?

This paper presents the results of an empirical study shedding light on that question. Looking at securities class actions filed between 2002 and mid-2007, we find that the presence of a state pension fund as lead plaintiff correlates with significantly lower attorneys' fees**.** We also find that larger funds, of all types, tend to negotiate lower attorneys' fees. State pension funds whose managers have received campaign contributions, however, appear to be less vigorous in negotiating over attorneys' fees. The state pension funds whose officials received the largest contributions from the lead attorney firms negotiate for attorneys' fees that are statistically indistinguishable from the fees in cases with individual investors serving as lead plaintiffs. Thus, political

contributions to lead plaintiffs appear to undermine at least one of Congress's objectives in enacting the PSLRA's lead plaintiff provision.

We proceed as follows. Part 2 provides background on the lead plaintiff provision and develops hypotheses relating to political influence on lead plaintiff pension funds. Part 3 describes our sample and sources of data. Part 4 presents the results of the empirical tests of our hypotheses. Part 5 concludes with a discussion of the legal and policy implications of our findings.

2. Background and Hypotheses

2.1. Prior Literature

One of the abuses of securities class actions that Congress attempted to address in enacting the PSLRA was "the manipulation by class action lawyers of the clients whom they purportedly represent."[3] Congress found a potential solution to that problem in a proposal by Weiss and Beckerman (1995). Weiss and Beckerman argued that institutional investors, if placed in the lead plaintiff role, would act as effective monitors of plaintiffs' attorneys' actions in securities class action litigation. Congress acted on Weiss and Beckerman's proposal in adopting the PSLRA's lead plaintiff provision. That provision established a "rebuttable presumption . . . that the most adequate plaintiff . . . is the person or group of persons that . . . has the largest financial interest in the relief sought by the class."[4] The PSLRA also stated that the most adequate plaintiff will "select

[3] See H.R. Rep. No. 369, at 31 (1995), reprinted in 1996 U.S.C.C.A.N. 730, 1103.
[4] 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I).

and retain counsel to represent the class."[5] The premise of the PSLRA's lead plaintiff provision is that larger investors, with larger stakes in the class recovery, would serve as more effective monitors of class counsel. By providing effective monitoring, the lead plaintiff would protect the interests of the absent class members.

Congress worried, however, about the potential for lead plaintiff monitoring to be undermined by side payments, leading Congress to include a provision in the PSLRA prohibiting non pro-rata payments to the lead plaintiff.[6] Such payments were rumored to have been an issue in securities class actions prior to the adoption of the PSLRA. (Those rumors appear to have been well founded; several former partners of the Milberg Weiss law firm, now "Milberg," have gone to prison for hiding such payments from courts overseeing securities class actions (Selvin 2008).) Those payments raised concerns that class representatives would not have an incentive to protect the interests of absent class members. One measure of lead plaintiff monitoring is attorneys' fees; vigilant monitors presumably would negotiate lower fees, which would mean a greater net recovery for class members. Consistent with this theory, Perino (2008) finds that Milberg Weiss's attorneys' fees were significantly higher for cases in which side payments were made to lead plaintiffs than in those cases in which payments were not made, as identified in the indictment against the firm.

Subsequent to the adoption of the PSLRA, there is considerable evidence that the lead plaintiff provision has led to improved monitoring of class counsel. Choi, Fisch and Pritchard (2005) report that public pension funds' participation as lead plaintiff

[5] 15 U.S.C. § 78u-4(a)(3)(B)(v).
[6] 15 U.S.C. § 78u-4(a)(4).

increased significantly after the PSLRA's enactment. They also report that the presence of public pension funds correlates with high value settlements. Simmons and Ryan (2005) and Cox and Thomas (2006) also report that institutional lead plaintiffs correlate with increased settlement amounts. Cox, Thomas, and Bai (2008) similarly report that institutional investor lead plaintiffs, in particular public pension funds and labor unions, are positively related to larger settlement amounts. These studies suggest that institutional investors who serve as lead plaintiffs may be promoting larger recoveries for shareholder class members.[7]

Choi, Fisch and Pritchard (2005) also examine the relationship of lead plaintiffs and attorneys' fees. They report that attorneys' fees, measured as a percentage of recovery, if anything, are higher with private institutional lead plaintiffs after the enactment of the PSLRA compared with the pre-PSLRA period; they also report no significant correlation exists between fees and public pension funds post-enactment once they control for the size of the case. Their study looked only at cases filed from 1991 to 2000, so it antedates the time that institutional investors stepped forward in large numbers to serve as lead plaintiff. Perino (2006), looking at a larger sample of cases from 1995 to 2004, reports that attorneys' fees granted by a court are lower with public pension fund lead plaintiffs, even after controlling for the presence of accounting restatements and SEC investigations.

[7] There may be a selection effect at work. If public pension funds choose only to participate as lead plaintiff when the litigation involves large potential damage amounts and a higher probability of recovery, there may be a correlation between public pension funds' participation and larger settlement amounts, but not a direct causal relationship. Because of the uncertain causality, we do not directly examine the link between pay-to-play and settlement amounts.

There have been media reports of political contributions to the lead plaintiff being linked to the plaintiff's lead counsel selection for some time, but little systematic analysis. For example, *Fortune* magazine ran a story detailing political contributions received by former New York State Comptroller Carl McCall from the partners at Bernstein, Litowitz, Berger & Grossman (BLBG) (Weinberg & Fisher, 2004). McCall received these contributions shortly before McCall chose BLBG to serve as the New York public pension fund's counsel in the *WorldCom* securities class action.

McCall was also involved in perhaps the most frequently cited example of pay to play in securities cases, *In re Cendant Corp. Litigation*. The district court in *Cendant* discovered that two law firms selected as lead counsel contributed nearly $200,000 to McCall's campaign, who was the sole director of the New York public pension fund that was a lead plaintiff in the case (Dewan 2002). The district court in *Cendant*, however, refused to find that pay to play took place, and this finding was affirmed by the Court of Appeals for the Third Circuit.[8] The *Cendant* court's skepticism that pay to play had an important influence on counsel selection is typical; a district court in California recently rebuffed as "speculative" arguments that political contributions created a conflict between the attorney and the class.[9] The court noted that: "Courts have long been less enamored of securities litigation pay-to-play arguments than litigants and the press."

Johnson-Skinner (2009) provides the first systematic effort to document pay to play. He presents summary statistics of law firm political contributions side-by-side with pension funds' selection of law firms as counsel in securities class actions from

[8] *In re Cendant Corp. Litig.*, 264 F.3d 201, 269 (3d Cir. 2002).
[9] *In re Countrywide Fin. Corp. Sec. Litig.*, Case No. CV-07-05295 (C.D. Cal., Dec. 9, 2009).

2002 to 2006. He finds that law firms do contribute to the officials of funds that select them as class counsel in a substantial number of cases. By contrast, Webber (2009) rejects arguments that pay to play has a substantial influence on counsel selection based on his finding that the number of politicians on pension funds' board correlates negatively with selection as lead counsel. Unlike Johnson-Skinner, however, Webber does not examine the influence of campaign contributions, which would seem to be a more direct measure of the incidence of pay to play.

Neither Johnson-Skinner nor Webber analyzes the connection between contributions and attorneys' fees. The conflict between lead counsel and the class is nonetheless potentially greatest over attorney fees, which typically come out of the class recovery. We study the effect of contributions on attorney fees in this study.

2.2. Hypotheses

As discussed above, Congress believed that individual investors who served as lead plaintiffs were ineffective monitors and plaintiffs with larger stakes in the class recovery were likely to negotiate with class counsel for lower attorneys' fees. The PSLRA's lead plaintiff provision encourages institutional investors to step forward to serve as lead plaintiffs. These institutional investors are quite varied in their size and sophistication. State level public pension funds are typically the largest and most sophisticated. Smaller institutions, however, such as local government and labor union pension funds, have also volunteered to serve as lead plaintiffs. Finally, individuals continue to serve as lead plaintiffs in a substantial percentage of cases.

We postulate a continuum of investor types when it comes to negotiating over attorneys' fees, with larger institutions, such as state pension funds, being the most effective in negotiating lower fees. With their large, diverse portfolios, state pension funds have the greatest leverage because they can offer lawyers additional opportunities to serve as lead counsel in subsequent cases. The PSLRA limits the number of times any one entity or individual may serve as lead plaintiff to no more than five times in any 3-year period.[10] This restriction, however, can be set aside by the court. Moreover, state pension officials may control a number of different states' pensions, enabling them to skirt the PSLRA's limit through the use of these different state funds. For example, in Louisiana, the Chairman of the Louisiana Senate Retirement Committee sits on the Board of Trustees for the Louisiana Municipal Police Employees' Retirement System, the Teachers' Retirement System of Louisiana, and the Louisiana Sheriffs' Pension and Relief Fund, among others.

Other institutions, such as local government pension funds and labor unions, may have a greater stake than individual investors, but they may lack the legal sophistication and bargaining power of the large state pension funds. We postulate that individuals will exercise the least influence in negotiating over attorneys' fees.

> **Hypothesis 1: State public pension funds will negotiate the lowest attorneys' fees, local government pension funds and labor unions will negotiate intermediate fees, and individual lead plaintiffs will negotiate the highest.**

Hypothesis 1 follows the governing premise of the PSLRA's lead plaintiff

[10] See Section 21D(a)(3)(B)(vi), Securities and Exchange Act of 1934.

provision in positing that investors with a larger stake in the class recovery will serve as better monitors of the class's interests. This incentive for better monitoring, however, may be undermined if the decisionmakers for the institutional lead plaintiffs have been receiving a selective benefit—e.g., campaign contributions—not shared by other class members. Congress worried about the effect of selective benefits when it adopted the prohibition against non-pro rata payments to class members discussed above.

We use attorneys' fees as our measure of lead plaintiff monitoring. We hypothesize that political contributions to state pension funds acting as the lead plaintiff—we call plaintiffs that have received contributions "conflicted"—may lead to diminished monitoring and correspondingly higher attorneys' fees. Moreover, we postulate that attorneys' fees are likely to correlate with the size of the contributions to the state pension funds—the greater the contribution, the greater the fee. In other words, size matters.

> **Hypothesis 2: Attorneys' fees negotiated by conflicted state pension fund lead plaintiffs will be no different than attorneys' fees negotiated by individual plaintiffs.**
>
> **Hypothesis 3: Attorneys' fees will correlate with the size of the political contributions made to the state pension fund lead plaintiffs.**

Hypothesis 3 postulates that larger political contributions create more conflict with the interests of class members. Another measure of that conflict is the pervasiveness of those contributions and the strength of the connection between state pensions and particular attorney firms. Do state pensions select different law firms as lead counsel for different cases, or do they frequently select the same law firm? Are

they more likely to select the same firm if the firm made campaign contributions to fund officials? If a fund is consistently represented by the same law firm, and that firm made campaign contributions to fund officials, the fund may be more tolerant of higher fees. Accordingly, we postulate that state pension fund lead plaintiffs who are frequently represented by class counsel that made campaign contributions are likely to agree to pay higher fees relative to other state pension funds.

Hypothesis 4: Attorneys' fees will be higher in cases in which the state pension fund lead plaintiffs are frequently represented by securities class actions attorneys that have made campaign contributions.

3. Sample and Descriptive Statistics

3.1 Sample

To test our hypotheses, we use the securities class actions filed from 2002 to mid-2007.[11] We obtain the suits from the Stanford Securities Clearinghouse. We exclude cases in which financial firms (SIC 6000 to 6999) are the primary defendant because of the different regulatory regime that applies to them; with this exception, we analyze the population of suits filed during this period.

[Insert Table 1 About Here].

Our main focus is on settled cases. Table 1 shows that slightly more than half of the cases filed during our sample period have been settled, giving us 382 settled class actions. The filing years for our settled cases are somewhat skewed toward the beginning of the sample period, as many of the suits filed in the later years remain

[11] The sample is based on the dataset in Choi (2009).

unresolved.

3.2 Control Variables

Descriptive statistics regarding the cases are presented in Table 2. We use the following set of variables in each of our multivariate models as controls (collectively referred as "Case Controls"). The controls are relevant to the strength of the case, which is likely to determine the difficulty of extracting a settlement. More difficult cases may generate higher attorneys' fees. We collect information on key aspects of the litigation from the last amended complaint available for each class action.[12]

From the complaints, we collect information about the causes of action alleged to create indicator variables for those causes. Over 95 percent of the cases alleged a Rule 10b-5 claim under the Securities Exchange Act of 1934; 21.8 percent of the cases alleged a § 11 claim under the Securities Act of 1933 (Section 11); 3.8 percent of the cases alleged a § 14(a) claim under the Securities Exchange Act of 1934. Section 11 is available only for material misstatements and certain omissions in the registration statement used in a public offering, but it allows for a substantially greater chance of surviving a motion to dismiss because § 11 does not require plaintiffs to plead fraudulent intent. Unlike the Rule 10b-5 cause of action, issues of loss causation and due diligence are affirmative defenses, rather than elements of the claim. Claims under § 14 of the Exchange Act relating to misstatements in a proxy statement also carry an easier standard for state of mind and loss causation (Section 14).

[12] As described in Choi (2009), the complaints and other securities-docket-related documents were collected from the PACER website.

[Insert Table 2 About Here].

We also include as controls certain indicator variables based on the allegations in the complaint. These allegations are intended to satisfy the pleading standards, which are the principal barriers to recovery in securities class actions. (Johnson, Nelson & Pritchard, 2007). We include in our Case Controls variables for SEC and other government investigations (Govt. Investigation) and accounting restatements (Restatement), each a high profile adverse event and the most common events triggering these suits. The presence of a government investigation or a restatement indicates a higher likelihood of wrongdoing and thus a stronger case for the plaintiffs. The overall strength of the case will also be bolstered if the firm has terminated a top officer, including the Chief Executive Officer, Chief Operating Officer, and Chief Financial Officer (Officer Term.) or its auditor (Auditor Term.), due to events relating to the fraud in question as described in the complaint. We also include whether the complaint alleges insider trading (Insider Trading Claim), which suggests fraudulent intent.

We also include variables in our Case Controls relating to the firm-specific characteristics of the defendant issuer, which correlate with the damages measure and the defendant's ability to pay a settlement. We include a measure of firm size, measured as market value of equity measured at the end of the fiscal year preceding the beginning of the class period (Market Capitalization). Larger firms may have greater resources to defend against a class action. On the other hand, larger firms may also be better able to pay a settlement, leading to more vigorous prosecution of the case by plaintiffs' attorneys. We also include the log of settlement amount because prior

studies report a close relationship between settlement amount and the attorneys' fee award (e.g., Eisenberg & Miller, 2004).

We also include two industry controls that may relate to case strength and loss causation. Firms in the high technology sector (High Tech)[13] may have stock prices that are particularly vulnerable to declines in sales or earnings. Additionally, firms involved in the pharmaceutical and medical devices industries may experience steep stock price declines if the U.S. Food and Drug Administration denies approval of their new products. To capture this effect, we include an indicator variable (FDA) equal to 1 if the last amended complaint for the class action contains allegations based on Food and Drug Administration-related disclosures and 0 otherwise.

3.3 Plaintiff Type

For each class action, we collect data from PACER, Westlaw, and the Securities Class Action Clearinghouse on the federal district court docket and the motions for lead plaintiff. Lead plaintiffs usually are combined in a lead plaintiff group of several investors. These groups typically are created to resolve disputes among class action firms competing to be named as counsel to the class.

Table 3, Panel A provides descriptive statistics regarding the type of investors selected as lead plaintiffs. Institutional investors appear as part of the lead plaintiff group in over half (58.1%) of the cases in our sample, confirming earlier work showing that institutional investors are important players securities class actions. Public pension

[13] We define High Tech as equal to 1 if the firm is in SIC codes 3570-3577 or 7370-7379 and 0 otherwise.

funds appear in a little over seventeen percent of the cases in our sample; with slightly more state (10.1%) than local (7.2%) funds. Labor unions (21.3%) and other institutions (27.5%) are also well represented. Individuals, however, continue to predominate as class representatives; they are the only members of the lead plaintiff group in 41.9% of the cases. State pension funds are the primary focus of our analysis; individual lead plaintiffs provide the baseline for comparison.

[Insert Table 3 About Here]

Table 3, Panel B provides descriptive statistics comparing the assets under management and losses related to the class actions for the different types of institutions acting as lead plaintiff.[14] As expected, the state pension funds are larger than their local counterparts and labor union funds. The average (median) state pension fund in our sample has nearly $20.8 billion ($11.2 billion) under management, while the local funds manage an average of $3.6 billion ($0.4 billion). The difference between the two means is significant at the 1% level. State pension funds also had larger securities losses related to the class action. The average (median) state pension fund in our sample had $10.4 million ($1.9 million) losses in cases where they acted as lead plaintiff while the local funds averaged losses of $0.7 million ($0.4 million). The difference between the two means is significant at the 5% level. Labor unions manage the least in assets, with an average of $1.2 billion ($0.6 billion). Labor unions also had relatively low securities losses with an average of $1.0 million ($0.3 million).

[14] Data on assets were collected from FreeERISA.com or from the pension fund's annual report. The assets measurement is for 2005. Data are not available on the assets of other institutions or individuals.

Panel C of Table 3 reports the mean requested attorneys' fees for the settlements in our sample broken down by plaintiff type. Overall, the mean fee request is 26.2% of the settlement amount. The smallest requested fee in our sample was 7% and the largest was 35%. The mean requested fee for cases involving at least one state pension lead plaintiff is 19.5% of the settlement amount. In comparison, the mean requested fee for cases where all the lead plaintiffs are individuals is 28.0% of the settlement amount.

3.4 Political Contributions

Having identified the lead plaintiffs in our sample, we collected data on contributions to politicians connected to state pension funds. We first identified the membership of the controlling boards of the plaintiff institutions at the time the case was filed. For board positions that were *ex officio*, we determined who held the relevant office at the time of filing of the complaint. For positions that were appointed by an elected official, we also determined who held that elected office at the time of filing.

Next, we identified the plaintiff law firms that were selected as counsel by the funds in each case. If there was more than one plaintiff law firm for a given case, which was typically the case when more than one institution filed to be lead plaintiff, all the filers and all the firms were grouped together. For purposes of matching firms with plaintiff pension funds, we assumed that all funds and all counsel for a particular case were affiliated.

We then used state-level campaign finance filings to find instances of political contributions from the identified law firms to any of the elected officials associated with the pension funds that actually selected the firms.[15] We searched for contributions from 1998 through 2008. The search allowed us to look for both contributions by the firm and by individuals who list the firm as their employer. Note that this method is underinclusive as it typically does not discover any donors who did not indicate their employer. We also searched for contributions to the relevant elected officials' state political party committees (e.g., the state Democratic Party for a Democrat) in an attempt to find indirect contributions.[16]

We use this contribution data to construct two variables. The first, Contribution–Fund Officials, includes contributions made to officials who serve on the governing body of the state pension fund, or who appoint members of the governing body of the fund. We include contributions from a four-year window, beginning two calendar years prior to the suit filing and ending one calendar year after. This four-year window allows us to limit the contributions to those most directly related to the suit filing, while still ensuring that one election cycle would be included.[17] The second, Contribution–All State Officials, is a broader measure of a law firm's political activity in

[15] The source of this data is followthemoney.org.

[16] Our data are underinclusive in another way because we were unable to locate systematic data for contributions to local, non-state level politicians affiliated with the local pension funds in our sample. We found press reports of such contributions in isolated cases, and a handful of large municipalities have websites showing such contributions. We could not collect this data for the majority the local government pension funds in our sample, however, so we have not relied on any contributions to local politicians in our analysis. Thus, our findings are likely to understate the influence of pay to play, which appears to also affect local pension funds.

[17] Use of this window required the exclusion of one observation which had two elections during the four year window.

the state that includes contributions not only to fund officials, but also to all elected officials and political committees in the state. This variable also uses the four-year window described above.

[Insert Table 4 About Here]

Table 4 presents descriptive statistics showing the results of this research into political contributions. Half (50.0%) of the state pension fund lead plaintiffs in our sample received campaign contributions from the lead attorneys associated with the case in which the fund was serving as lead plaintiff. For these pension funds, the mean contribution received by all of its officials was relatively small at $9,378 and the median contribution was $10,000**.** Using our broader measure of contributions to any state official, we find a mean of $56,040 and a median of $25,950.

4. Empirical Tests

4.1. Pension Fund Type, Assets, and Attorneys' Fees

We postulate in Hypothesis 1 the type of plaintiff will correlate with the size of attorneys' fees. To test this hypothesis, we estimate an ordinary least squares model with the log odds of the requested attorneys' fee percentage of the settlement as the dependent variable (using case level data and robust standard errors). Our main independent variable of interest is the fraction of the lead plaintiffs in a case that consist of a state pension fund (State Pension). We also include the fraction of the lead plaintiffs that consist of a local pension fund (Local Pension), or a labor union (Labor Union), and the fraction of lead plaintiffs that are institutions but not government

pension funds or labor unions (Other Institution). The regression assesses the effect of these variables relative to our baseline category of individual-only lead plaintiffs, the type of plaintiff that Congress found wanting pre-PSLRA. We also include the Case Controls described above.

$$\ln(\text{Atty\_Fee}_i/1\text{-Atty\_Fee}_i) = \alpha + ß_{1i}\text{State Pension}_i + ß_{2i}\text{Local Pension} + ß_{3i}\text{Labor Union} + ß_{4i}\text{Other Institution} + \text{Case Controls} + \varepsilon_i$$

The results are presented in Table 5, Model 1. Negative coefficients for the independent variables correlate with lower attorneys' fees, suggesting more diligent monitoring by the lead plaintiff. Consistent with Hypothesis 1, we find that state pension fund lead plaintiffs request significantly lower attorneys' fees, as do local pension funds. Both coefficients are significant at the one percent level. Assessed at the mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs that consists of state pension funds correlates with a 3.7 percentage point decrease in the attorneys' fee request (or 14.3% of the mean requested attorneys' fees). Similarly, a fifty percentage point increase in the fraction of lead plaintiffs that consists of local pension funds correlates with a 3.1 percentage point decrease in the attorneys' fee request (or 11.6% of the mean requested attorneys' fees). The coefficients for Labor Union and Other Institution are negative, but considerably smaller in magnitude and not significantly different from zero. Thus, these latter two categories of institutions appear to be not much different from individual plaintiffs when it comes to negotiating attorneys' fees with counsel.

[Insert Table 5 About Here]

Our next test assesses the relation between assets under management and attorneys' fees. The intuition behind Hypothesis 1 is that larger pension funds will negotiate for lower fees. We do not have assets data for all of the lead plaintiffs in our sample, so we limit our tests of this hypothesis to plaintiff types for which we are able to collect that data. As in Model 1, we estimate an ordinary least squares model with the log odds of the requested attorneys' fee percentage as the dependent variable (using case level data and robust standard errors). We use the same independent variables as in Model 1 but we replace State Pension with State Pension—Above Median Assets (the fraction of lead plaintiffs in a case that consists of state public pensions with total fund assets at the median or above for state public pensions in our sample) and State Pension—Below Median Assets (the fraction of lead plaintiffs in a case that consists of state public pensions with total fund assets below the median for state public pensions in our sample). We similarly replace the variables for Local Pension and Labor Union plaintiffs, dividing each by asset size in the same manner as the division for State Pensions described above.

We report the results in Table 5, Model 2. The results tell a consistent story. Across all types of institutions, larger institutions negotiate for lower attorneys' fees. The coefficients for the larger institutions are all negative and significant, and they are of larger magnitude than the corresponding variables for the smaller institutions. Assessed at the mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Above Median Assets funds

correlates with a 5.1 percentage point decrease in the attorneys' fee request (or 19.6% of the mean requested attorneys' fees). Using an F-test to assess the difference in coefficients for large and small institutions, we find that the difference is significant at the 1% level for State Pension and Local Pension, while the difference for the Labor Union coefficient just misses significance at conventional levels (at the 11.1% level). Thus, it appears that larger pension funds are more effective monitors than other types of investors who serve as lead plaintiffs. Larger institutions may have economies of scale in supervising their attorneys or they may simply have greater bargaining leverage because of the advantages they have in seeking lead plaintiff status. As seen in Table 3, Panel B, larger holdings correlate with larger losses, the relevant metric for awarding lead plaintiff status.

To check the robustness of the results in Table 5, we added year and circuit effects,[18] replaced the continuous versions of our lead plaintiff variables with binary variables,[19] and used a Heckman model to control for selection effects.[20] The results are consistent with those reported in Table 5.

[18] We re-estimated the models with the addition of year effects as well as indicator variables for those circuits with at least 30 class action settlements in our sample (the Second, Third, Fifth, Ninth, and Eleventh Circuits). Unreported, we obtained the same qualitative results with one difference. In Model 2, the difference between Labor Union—Above Median Assets and Labor Union—Below Median Assets is now significant at the 10% level.

[19] We re-estimated the models of Table 5 replacing State Pension, Local Pension, Labor Union, and Other Institution with binary versions of each variable equal to 1 if the lead plaintiff group has at least one lead plaintiff of the type in question (e.g., State Pension is redefined to equal 1 if at least one lead plaintiff is a state pension fund) and 0 otherwise. In Model 1, State Pension remains negative and significant at the 1% level. Local Pension, however, while negative is significant at only the 12.0% level. In Model 2, we obtained the same qualitative results except that Labor Union—Above Median Assets, although negative is not significantly different from zero.

[20] Our models focus only on those cases that were settled. To control for selection effects in our sample, we re-estimated the models of Table 5 with a Heckman two-stage model (Heckman 1979). Stage two was the models from Table 5. Stage one was a model for settlement. For an instrument, we used the total

4.2. Political Contributions and Attorneys' Fees

4.2.1. Size of Contribution and Attorneys' Fees

Do political contributions affect the incentive of pension funds to negotiate over attorneys' fees? For our analysis, we focus on the Contribution—Fund Officials measure of political contribution. We replace the State Pension variables used in Model 1 of Table 5 with two variables: the fraction of lead plaintiffs in the case that consists of state pension funds with officials that received political contributions from the lead attorneys (State Pension—Contribution), and the fraction of lead plaintiffs in the case that consists of state pension funds with officials that did not receive political contributions from the lead attorneys (State Pension—No Contribution).

$$\begin{aligned} \ln(\text{Atty\_Fee}_i/1\text{-Atty\_Fee}_i) = {} & \alpha + \beta_{1i}\text{State Pension—Contribution}_i \\ & + \beta_{2i}\text{State Pension—No Contribution}_i \\ & + \beta_{3i}\,\text{Local Pension} + \beta_{4i}\text{Labor Union} \\ & + \beta_{5i}\,\text{Other Institution} + \text{Case Controls} + \varepsilon_i \end{aligned}$$

number of securities class actions filed in the dataset time period for the district court in which the specific class action is filed. We assume this variable is correlated with the decision to settle. A particular district court with large numbers of securities class action may face greater pressure to dismiss such actions to clear their docket, leading to fewer settlements. On the other hand, we assume this variable is not correlated directly with requested attorney fees in a particular settled litigation. Unreported, the Heckman models returned the same qualitative results as in Table 5 with the following exception. In Model 2, the difference between Labor Union—Above Median Assets and Labor Union—Below Median Assets is now beyond statistical significance at the 20.1% level.

There are other possible selection effects. We only observe cases that are filed. If the decision to file a suit is correlated with the relationship between lead plaintiff composition and selection and attorney agency costs, then our results may be biased. Nonetheless, in an analysis of case outcomes (high value settlement versus nuisance-level settlements or dismissal), Choi (2007) reports no qualitative change in his results when controlling for the decision-to-file selection effect. Plaintiffs' attorneys also have a choice of forum. Cox, Thomas, and Bai (2008), however, report that most forum selection decisions are largely driven by geographical convenience and are thus unlikely to be correlated with the variables of interest in this paper.

Model 1 of Table 6 reports our results. We do not find any significant difference between state pension funds whose officials have received campaign contributions from class action attorneys and those that have not. The coefficients for State Pension–Contribution and State Pension–No Contribution are both negative and significant at the one percent level. The magnitude of the State Pension–No Contribution is greater than State Pension–Contribution, indicating higher attorneys' fees when officials received a contribution from the attorneys. An F-test, however, reveals that the difference is not statistically significant. Thus, we find only limited empirical support for Hypothesis 2.

[Insert Table 6 About Here]

The picture looks somewhat different, however, if we account for the size of the contributions. We divide the State Pension—Contribution variable in Model 1 of Table 6 into two categories. State Pension—Large Contribution is the fraction of lead plaintiffs in a case that consists of state pension funds which received a contribution from the lead attorneys of $15,000 or more during our four-year window around the suit filing; State Pension—Small Contribution is the fraction of lead plaintiffs that consists of state pension funds that received contribution of less than $15,000. In selecting the $15,000 threshold, we computed the average contribution amount from all donors for 2003 to 2006 to governor candidates in each state as tracked by followthemoney.org.[21] Our cutoff threshold for large contributions of $15,000 represents a little more than ten times the average contribution amount from all donors of $1,426 (and also represents

[21] We computed the average contribution amount by first averaging the state mean contribution amounts for the 2003 to 2006 years separately. We then computed the mean across the four years to give the overall average contribution amount.

roughly the top quintile of the contributions received by state pension fund officials in our dataset). We posit that for campaign contributions to be influential, they have to be substantially greater than the average.

The results from this regression are reported as Model 2 of Table 6. Here we find that the coefficient for State Pension—Large Contribution, while negative, is small in magnitude and statistically insignificant. The coefficient for State Pension—Small Contribution is negative and significant at the 1% level, and the difference between the two coefficients is significant at the 1% level. Assessed at the mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Small Contribution funds correlates with a 3.8 percentage point decrease in the attorneys' fee request (or 14.5% of the mean requested attorneys' fees); in contrast, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Large Contribution funds correlates with only a 0.1 percentage point decrease in the attorneys' fee request (or 0.4% of the mean requested attorneys' fees). These findings, consistent with Hypothesis 3, suggest that larger campaign contributions temper the zeal of state pension fund to squeeze lower fees out of their attorneys. Smaller contributions appear to have less effect.

In Model 3, we replace the Contribution variables in Model 2 with the broader Contribution—All State Officials measure defined above (generating State Pension—Large Contribution All State Officials, State Pension—Small Contribution All State Officials, State Pension—No Contribution All State Officials variables). The Contribution—All State Officials measure allows us to assess whether the benefit

plaintiffs' attorneys obtain from political contributions depends not only on direct contributions to fund officials, but also contributions more generally in the state. Because the aggregate amounts in our Contribution-All State Officials measure are larger than the contributions only to fund officials, we use $100,000 as our cutoff to divide large and small contribution amounts. We get similar results in Model 3 as in Model 2 of Table 6. The coefficient for State Pension—Large Contribution All State Officials is now positive although small in magnitude and not insignificant. The coefficient for State Pension—Small Contribution All State Officials is negative and significant at the 1% level, and the difference between the two coefficients is significant at the 1% level.

To check the robustness of the models in Table 6, we added year and circuit effects,[22] replaced the continuous versions of our lead plaintiff variables with binary variables,[23] and used a Heckman model to control for selection effects.[24] The results are consistent with those reported in Table 6. We re-estimated Model 2 of Table 6 with a

[22] We re-estimated the models of Table 6 with the addition of year effects as well as indicator variables for those circuits with at least 30 class action settlements in our sample (the Second, Third, Fifth, Ninth, and Eleventh Circuits). We obtained the same qualitative results in the three models in Table 6. In Model 2, the difference between State Pension—Large Contribution and State Pension—Small Contribution is now significant at the 5% level.

[23] We re-estimated the models of Table 6 replacing State Pension, Local Pension, Labor Union, and Other Institution with binary versions of each variable equal to 1 if the lead plaintiff group has at least one lead plaintiff of the type in question (e.g., State Pension is redefined to equal 1 if at least one lead plaintiff is a state pension fund) and 0 otherwise. We obtained the same qualitative results in the three models in Table 6.

[24] To control for selection effects, we re-estimated the models of Table 6 with a Heckman two-stage model (Heckman 1979). Stage two was the models from Table 6. Stage one was a model for settlement. For an instrument, we used the total number of securities class actions filed in the dataset time period for the district court in which the specific class action is filed. Unreported, the Heckman models returned the same qualitative results as in Table 6 with the following exceptions. The difference between State Pension—Large Contribution and State Pension—Small Contribution in Model 2 is significant at only the 11.9% level. The difference between State Pension—Large Contribution All State Officials and State Pension—Small Contribution All State Officials is significant at the 10% level.

number of alternate definitions for a Large Contribution and obtained similar qualitative results.[25]

4.2.2. Fund Asset Size and Contributions

Our next set of tests assesses the effect that attorney campaign contributions might have on attorneys' fees negotiated by larger state pension funds, we divide the State Pension—Above Median Assets variable used in Table 5, Model 2 into the following two variables. State Pension—Above Median Assets Contribution is the fraction of lead plaintiffs in a case that consists of state pension funds that received a contribution from one of the lead attorneys and that had total fund assets at the median or above for state pension funds in our sample. State Pension—Above Median Assets No Contribution is the fraction of lead plaintiffs in a case that consists of state

[25] First, we re-estimated Model 2 of Table 6 using contributions above $10,000 (the median contribution amount) to fund officials. Unreported, as in Model 2, the coefficient on State Pension—Large Contribution is small in magnitude and not significant while the coefficient on State Pension—Small Contribution is negative and significant at the 1% level. Similar with the results in Model 2, the difference between the coefficients for State Pension—Large Contribution and State Pension—Small Contribution is significant at the 5% level.

Second, we divided the contribution amounts by the total pension assets for the state pension funds measured in 2005. Officials who control a larger state pension fund may receive a greater overall level of contributions, possibly reducing the impact of any particular dollar level of donations from a plaintiffs' firm. We then defined large contributions as contributions above the median level of pension fund asset-adjusted contributions. Unreported, unlike in Model 2 of Table 6, the coefficients on both State Pension—Large Contribution and State Pension—Small Contribution are negative and significant at the 5% and 1% levels respectively. The negative magnitude of State Pension—Small Contribution is nonetheless much larger than State Pension—Large Contribution (difference significant at the 10% level)—consistent with the results in Model 2 of Table 6.

Third, we computed the average individual donation amount to governor candidates for each state during the 2003 to 2006 time period (a four-year time period) from data obtained from followthemoney.org. Fund officials in states where the governor receives large contributions are also likely receive a large amount of contributions, again possibly reducing the impact of any particular dollar level of donations from a plaintiffs' firm. Unreported, unlike in Model 2 of Table 6, the coefficient on State Pension—Large Contribution is negative and significant at the 1% level (and the coefficient on State Pension—Small Contribution remains negative and significant at the 1% level). The negative magnitude of State Pension—Small Contribution is nonetheless much larger than State Pension—Large Contribution (difference significant at the 1% level)—consistent with the results in Model 2 of Table 6.

pension funds that did not receive a contribution from any of the lead attorneys and that had total fund assets at the median or above for state pension funds in our sample.

$$\ln(\text{Atty\_Fee}_i/1\text{-Atty\_Fee}_i) = \alpha + ß_{1i}\text{State Pension—Above Median Assets Contrib.}_i + ß_{2i}\text{State Pension—Above Median Assets No Contribution}_i + ß_{3i}\text{State Pension—Below Median Assets}_i + ß_{4i}\text{Local Pension—Above Median Assets}_i + ß_{5i}\text{Local Pension—Below Median Assets}_i + ß_{6i}\text{Labor Union—Above Median Assets}_i + ß_{7i}\text{Labor Union—Below Median Assets}_i + ß_{8i}\text{Other Institution} + \text{Case Controls} + \varepsilon_i$$

We report the results as Model 1 in Table 7. The results are similar to those reported in Model 2 of Table 5. The coefficients for State Pension—Above Median Assets Contribution and State Pension—Above Median Assets No Contribution are both negative and strongly significant. The difference between the two coefficients is insignificant.

In Model 2, we divide State Pension—Above Median Assets Contribution into two categories based on the size of contributions received by fund officials, following the method described with respect to Table 6, Model 2 (defining Large as over $15,000). When we estimate this regression, we find that larger state pension funds that have received large contributions (State Pension—Above Median Assets Large Contribution) are statistically indistinguishable from individual lead plaintiffs when it comes to negotiating attorneys' fees. In contrast, the coefficient on State Pension—Above Median Assets Small Contribution is negative and significant at the 1% level; the difference between the two coefficients is significant at the 1% level. Assessed at the

mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Above Median Assets Small Contribution funds correlates with a 5.5 percentage point decrease in the attorneys' fee request (or 20.9% of the mean requested attorneys' fees); in contrast, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Above Median Assets Large Contribution funds correlates with a 0.4 percentage point decrease in the attorneys' fee request (or 1.4% of the mean requested attorneys' fees). We conclude that greater state public pension size does correlate with greater monitoring of plaintiffs' attorneys, but only if the state public pension officials have not received substantial contributions from the lead attorneys.

To check the robustness of the results in Table 7, we added year and circuit effects,[26] replaced the continuous versions of our lead plaintiff variables with binary variables,[27] and used a Heckman model to control for selection effects.[28] The results are consistent with those reported in Table 7.

4.2.3. Fund Losses and Contributions

[26] We re-estimated the models of Table 7 with the addition of year effects as well as indicator variables for those circuits with at least 30 class action settlements in our sample (the Second, Third, Fifth, Ninth, and Eleventh Circuits). Unreported, we obtained the same qualitative results.

[27] We re-estimated the models of Table 7 replacing State Pension, Local Pension, Labor Union, and Other Institution with binary versions of each variable equal to 1 if the lead plaintiff group has at least one lead plaintiff of the type in question (e.g., State Pension is redefined to equal 1 if at least one lead plaintiff is a state pension fund) and 0 otherwise. Unreported, we obtained the same qualitative results.

[28] To control for selection effects, we re-estimated the models of Table 7 with a Heckman two-stage model (Heckman 1979). Stage two was the models from Table 7. Stage one was a model for settlement. For an instrument, we used the total number of securities class actions filed in the dataset time period for the district court in which the specific class action is filed. Unreported, the Heckman models returned the same qualitative results as in Table 7 with one difference. In Model 2, the difference between State Pension—Above Median Assets Large Contribution and State Pension—Above Median Assets Small Contribution is now significant at the 5% level.

Greater size may give a pension fund greater leverage in negotiating with the class attorney, but it is also possible that greater losses will give a pension fund a heightened incentive to negotiate. If losses are substantial enough, the size of the attorneys' fee is likely to make a material difference to the pension fund's recovery. To assess this possibility we substitute two new variables, State Pension—Large Losses and State Pension—Small Losses, for the State Pension variable used in the regressions presented in Table 5, Model 1. State Pension—Large Losses is defined as a pension fund with a claim over $1 million in a given case; Small Losses is $1 million or lower.

$$\begin{aligned}\ln(\text{Atty\_Fee}_i/1\text{-Atty\_Fee}_i) = {} & \alpha + \beta_{1i}\text{State Pension—Large Losses}_i \\ & + \beta_{2i}\text{State Pension—Small Losses}_i \\ & + \beta_{3i}\,\text{Local Pension} + \beta_{4i}\text{Labor Union} \\ & + \beta_{5i}\,\text{Other Institution} + \text{Case Controls} + \varepsilon_i\end{aligned}$$

The results are presented in Table 8, Model 1. We find that the coefficients for State Pension—Large Losses is negative and significant (at the 5% level). In contrast, the coefficient for State Pension—Small Losses, while negative is small in magnitude and insignificant, indicating that funds with a lower stake in the litigation may not negotiate as vigorously on behalf of the class with the attorneys. An F-test, however, reveals that the difference between the two coefficients is not significant. Thus, this regression does not support the hypothesis that greater losses lead to more monitoring by state pension funds.[29]

[Insert Table 8 here]

[29] In contrast, Choi (2009) reports that lower losses across the set of all lead plaintiff types correlates significantly with higher attorney fees.

It is possible, however, that the incentive for monitoring created by larger losses might be undermined by campaign contributions. To test this possibility we split State Pension—Large Losses into two variables: State Pension—Large Losses Contribution and State Pension—Large Losses No Contribution. The other variables are the same as Model 1 of Table 8.

The results for regression are presented as Model 2 in Table 8. We find that the coefficient for State Pension—Large Losses Contribution is negative, but insignificant. By contrast, the coefficient for State Pension—Large Losses No Contribution is negative and significant at the one percent level. Assessed at the mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Large Losses No Contribution funds correlates with a 3.1 percentage point decrease in the attorneys' fee request (or 11.7% of the mean requested attorneys' fees); in contrast, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Large Losses Contribution funds correlates with only a 0.7 percentage point decrease in the attorneys' fee request (or 2.7% of the mean requested attorneys' fees). The F-test assessing the difference between the two coefficients, however, is just beyond significance at conventional levels (at the 12.7% level). We conclude that there is limited evidence that campaign contributions undermined the incentive of pension funds with large losses to negotiate for lower attorneys' fees.

To check the robustness of the results in Table 8, we added year and circuit effects,[30] replaced the continuous versions of our lead plaintiff variables with binary variables,[31] and used a Heckman model to control for selection effects.[32] The results largely remained consistent with those reported in Table 8. We also re-estimated the models in Table 8 using losses above $10 million as an alternate definition for Large Losses and obtained similar qualitative results.[33]

4.3. State Receptivity to Contributions

We postulated with Hypothesis 4 that the pervasiveness of the conflict created by campaign contributions might influence attorneys' fees. To test this possibility, we identified the state pension funds that appeared at least twice in our sample. For these funds, we then identified the law firm that had represented the fund most frequently

[30] We re-estimated the models of Table 8 with the addition of year effects as well as indicator variables for those circuits with at least 30 class action settlements in our sample (the Second, Third, Fifth, Ninth, and Eleventh Circuits). Unreported, we obtained the same qualitative results with one difference. The coefficient in Model 1 on State Pension-Small Losses is negative and now significant at the 5% level.

[31] We re-estimated the models of Table 8 replacing State Pension, Local Pension, Labor Union, and Other Institution with binary versions of each variable equal to 1 if the lead plaintiff group has at least one lead plaintiff of the type in question (e.g. State Pension is redefined to equal 1 if at least one lead plaintiff is a state pension fund) and 0 otherwise. Unreported, we obtained the same qualitative results with two differences. In Model 1, the coefficient on State Pension-Large Losses is now insignificant. In Model 2, the coefficient on State Pension-Large Losses No Contribution is negative but now significant at only the 11.7% level.

[32] To control for selection effects, we re-estimated the models of Table 8 with a Heckman two-stage model (Heckman 1979). Stage two was the models from Table 8. Stage one was a model for settlement. For an instrument, we used the total number of securities class actions filed in the dataset time period for the district court in which the specific class action is filed. Unreported, the Heckman models returned the same qualitative results as in Table 8.

[33] Unreported, the re-estimated models with Large Losses defined based on losses above $10 million instead of $1 million were qualitatively the same as the models in Table 8. In Model 1, the difference between coefficients on State Pension—Large Losses and State Pension—Small Losses is not significant. However, the difference in Model 2 between State Pension—Large Losses Contribution and State Pension—Large Losses No Contribution is now significant at the 1% level. At the higher threshold for Large Losses, our results are stronger. When political contributions are made, the attorneys' fee level is significantly higher than where no political contributions are made for the subset of state pension lead plaintiffs that experienced large losses.

for the cases in our sample and determined the fraction of those cases in which the law firm had represented the fund. Based on this fraction, we create an indicator variable, Frequent Attorney, equal to 1 if the law firm represented the pension fund in over 75% of the cases in which it appeared, and 0 otherwise. For our main independent variables of interest we then define State Pension—Frequent Attorney as the fraction of lead plaintiffs in a case that consists of state pension funds with a Frequent Attorney. We define State Pension—Infrequent Attorney as the fraction of lead plaintiffs in a case that consists of state pension funds not represented by a Frequent Attorney.

Using these variables, we again estimate an ordinary least squares model with the log odds of the requested attorneys' fee percentage as the dependent variable (using case level data and robust standard errors). The other independent variables are the same as those used in the regressions presented in Table 5.

$$\begin{aligned} \ln(\text{Atty\_Fee}_i/1\text{-Atty\_Fee}_i) = {} & \alpha + \beta_{1i}\text{State Pension—Frequent Attorney}_i \\ & + \beta_{2i}\text{StatePension—Infrequent Attorney}_i \\ & + \beta_{3i}\,\text{Local Pension} + \beta_{4i}\text{Labor Union} \\ & + \beta_{5i}\,\text{Other Institution} + \beta_{6i}\,\text{Low Loss} \\ & + \text{Case Controls} + \text{Circuit Effects} \\ & + \text{Year Effects} + \varepsilon_i \end{aligned}$$

We present the results in Model 1 of Table 9. The coefficients for both State Pension—Frequent Attorney and State Pension—Infrequent Attorney are negative and significant at the 5% and 1% levels respectively. The magnitude of State Pension—Infrequent Attorney, however, is considerably larger, indicating lower attorney fees. Moreover, an F-test confirms that the coefficient for funds represented by a Frequent Attorney and is significantly different (at the 1% level) from the coefficient for

Infrequent Attorney.

[Insert Table 9 About Here]

Frequent representation is ambiguous: it could signal satisfaction with the quality of legal representation, or it could signal satisfaction with the level of campaign contributions being received. To distinguish between these two possibilities, we replace the State Pension—Frequent Attorney variable with the following two variables. We define State Pension—Frequent Attorney Contribution as the fraction of lead plaintiffs in a case that consists of state public pensions with a Frequent Attorney and contributions from that firm or any plaintiffs' firm, and State Pension—Frequent Attorney No Contribution as the fraction of lead plaintiffs in a case that consists of state public pensions that have a Frequent Attorney, but have not taken campaign contributions.

We present the results as Model 2 of Table 9. As with our earlier regressions, controlling for contribution makes an important difference to the regression results. Recipients of contributions from a frequent attorney pay significantly higher attorneys' fees than do pension funds with a frequent representation, but which have not received campaign contributions. The coefficient for State Pension—Frequent Attorney Contribution is insignificant, suggesting that such pension funds negotiate fees similar to those negotiated by individual plaintiffs. The coefficient for State Pension—Frequent Attorney No Contribution is negative and significant at the 5% level. The difference between the two coefficients is significant at the 10% level. Assessed at the mean of all independent variables, a fifty percentage point increase in the fraction of lead plaintiffs

that consists of State Pension—Frequent Attorney No Contribution correlates with a 2.5 percentage point decrease in the attorneys' fee request (or 9.5% of the mean requested attorneys' fees); in contrast, a fifty percentage point increase in the fraction of lead plaintiffs that consists of State Pension—Frequent Attorney Contribution funds correlates with only a 0.4 percentage point decrease in the attorneys' fee request (or 1.4% of the mean requested attorneys' fees). In sum, it appears that the funds relying primarily on one law firm provide very little monitoring, at least with respect to attorneys' fees, if they have received campaign contributions from that firm.

To check the robustness of the results in Table 9, we added year and circuit effects,[34] replaced the continuous versions of our lead plaintiff variables with binary variables,[35] and used a Heckman model to control for selection effects.[36] The results are consistent with those reported in Table 9.

[34] We re-estimated the models with the addition of year effects as well as indicator variables for those circuits with at least 30 class action settlements in our sample (the Second, Third, Fifth, Ninth, and Eleventh Circuits). Unreported, we obtained the same qualitative results with one difference. In Model 2, the difference between State Pension—Frequent Attorney Contribution and State Pension—Frequent Attorney No Contribution is significant at the 5% level.

[35] We re-estimated the models of Table 9 replacing State Pension, Local Pension, Labor Union, and Other Institution with binary versions of each variable equal to 1 if the lead plaintiff group has at least one lead plaintiff of the type in question (e.g. State Pension is redefined to equal 1 if at least one lead plaintiff is a state pension fund) and 0 otherwise. Unreported, we obtained the same qualitative results with the following differences. In Model 1, the coefficient on State Pension-Frequent Attorney is negative but now significant at only the 10% level; the difference between State Pension-Frequent Attorney and State Pension-Infrequent Attorney is significant at the 5% level. In Model 2, the coefficient on State Pension-Frequent Attorney No Contribution is negative but significant at the 10% level; the difference between State Pension-Frequent Attorney Contribution and State Pension-Frequent Attorney No Contribution is significant now at only the 19.0% level.

[36] To control for selection effects, we re-estimate the models of Table 9 with a Heckman two-stage model (Heckman 1979). Stage two is the models from Table 9. Stage one is a model for settlement. For an instrument, we use the total number of securities class actions filed in the dataset time period for the district court in which the specific class action is filed. Unreported, the Heckman models returned the same qualitative results as in Table 9 with two one difference. In Model 2, the difference between State Pension-Frequent Attorney Contribution and State Pension-Frequent Attorney No Contribution is significant now at only the 11.3% level.

4.4. Case Quality

One question raised by the apparent agency cost problems raised by campaign contributions is whether such contributions might influence case selection. Are state pension funds induced to bring frivolous suits by campaign contributions?

To assess this possibility, we first estimate a logit regression with the same independent variables as Table 5, Model 1. Our binary dependent variable is coded as a 1 for cases that produced a dismissal or settlement for nuisance value, which we define as less than $3 million. This is a conservative estimate of defense costs, so we presume that settlements for less than that amount had little merit.

The results, untabulated, do not support the proposition that plaintiff type correlates with case quality. The coefficients for State Pension, Local Pension, Labor Union, and Other Institution are all insignificant. We find no evidence that institutions are either more or less likely to bring frivolous claims.

We then attempted to estimate the same logit regression with the independent variables from Table 6, Model 1. The regressions would not run. Further investigation revealed that Contribution was perfectly correlated with non-nuisance suits. We conclude that there is no evidence that campaign contributions induce state pension funds to appear as lead plaintiffs in cases of dubious merit. Rather, campaign contributions appear to be a tool that plaintiffs' lawyers use to gain advantage in the competition to be appointed class counsel in cases that attract multiple plaintiffs' firms,

which is likely to be the cases with the most obvious evidence of fraud and the greatest potential damages. There is no need to pay to gain lead counsel status in weaker cases because there is unlikely to be competition.

5. Conclusion

Congress adopted the lead plaintiff provision of the PSLRA because members of Congress believed that individual investors were mere figurehead plaintiffs who did little to monitor plaintiffs' attorneys. Institutional investors, it was thought, would serve as more active monitors. The evidence to date suggests that institutional investors have made a difference in bargaining for lower fees, which likely translates into greater net recovery for investors. Those findings are confirmed here with respect to state pension funds in general. We also find that local pension funds, while generally having smaller stakes in class action recoveries, appear to serve as active monitors.

Congress worried, however, that the benefits of the lead plaintiff provision could potentially be undermined by side payments from counsel to the lead plaintiffs. The PSRLA prohibits lead plaintiffs from obtaining more than their pro rata share of settlement amounts. The political contributions received by state pension funds documented here and elsewhere raise the question whether fund officials are indirectly receiving selective benefits from the class recovery (in the form of campaign contributions) in violation of that provision.

We find that political contributions have an impact on attorneys' fees. The evidence presented here shows that the greater monitoring produced by the lead

plaintiff provision in general for state pension funds largely disappears when state pensions are the recipients of large political contributions. Indeed, when it comes to negotiating for fees, state pension funds that take large contributions are indistinguishable from the figurehead individual investors that Congress targeted with the PSRLA.

Our findings have potentially important policy implications. Courts have generally been skeptical of allegations of pay to play in the selection of class counsel, with some suggesting that the problem is more theoretical than real. We have shown, however, that pay to play imposes a real cost on investors in class actions, who end up paying greater attorneys' fees. Courts may be justified in taking a closer look when state pension funds that have received political contributions from the firms representing them come forward to seek lead plaintiff status. The evidence presented here suggests that such institutions should not be presumed to be the vigorous monitors that Congress anticipated when it adopted the PSLRA.

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Table 1: Sample Description

Full Sample

Outcome	Freq.	Percent
Settlement	382	53.20
Settlement ≤ $3 M.	282	39.28
Settlement > $3 M.	100	13.93
Trial Verdict or Judgment on Pleadings for Plaintiff	2	0.28
Dismissal	324	45.13
Summary Judgment or Trial Verdict for Defendant	10	1.39
Total	718	100.00

Settlement Sample

Year of Filing	Freq.	Percent
2002	110	28.80
2003	77	20.16
2004	87	22.77
2005	63	16.49
2006	39	10.21
2007	6	1.57
Total	382	100

Table 2: Summary Statistics for Settled Class Actions

	N	Mean	Std. Dev.
Rule 10b-5	372	0.962	0.191
Section 11	372	0.218	0.413
Section 14	372	0.038	0.191
Restatement	370	0.457	0.499
Govt. Investigation	370	0.522	0.500
Officer Termination	370	0.386	0.488
Auditor Termination	370	0.076	0.265
Insider Trading	369	0.512	0.501
Settlement Amount	374	60.344	386.775
Market Capitalization	365	4370.190	16131.280
High Tech	371	0.162	0.369
FDA	370	0.041	0.197

Variable definitions are in the appendix.

Table 3: Lead Plaintiffs for Settled Class Actions

Panel A: Lead Plaintiff Types

Lead Plaintiff	Cases with at least One Lead Plaintiff of the Type	Percentage of Cases	Mean Fraction of Lead Plaintiffs Per Case
Institution	218	58.1%	
Public Pension	65	17.3%	0.135
State	38	10.1%	0.073
Local	27	7.2%	0.062
Labor Union	80	21.3%	0.154
Other Institution	103	27.5%	0.176

Lead Plaintiff	Cases	Percentage of Cases
Individual Only	157	41.9%
Total Cases with Lead Plaintiff Information	375	100.0%

The mean fraction of lead plaintiffs per case is computed based on the mean across all cases with a settlement where we had lead plaintiff information.

Panel B: Pension Fund Assets and Losses

Lead Plaintiff		N	Mean	p25	Median	p75	Std. Dev.
Public Pension	Assets	63	13933.3	705.9	5584.2	16522.3	20164.0
	Losses	41	5.2	0.2	0.7	2.5	13.1
State	Assets	38	20758.4	5584.2	11225.9	36422.3	23075.1
	Losses	19	10.4	0.7	1.9	14.4	18.1
Local	Assets	25	3559.2	92.9	429.4	3666.4	6604.4
	Losses	22	0.7	0.1	0.4	0.8	0.9
Labor Union	Assets	79	1217.3	217.1	553.7	1146.0	2982.1
	Losses	54	1.0	0.1	0.3	0.6	2.6

Pension fund and labor union assets are in millions of dollars, measured as of 2005. Losses are in millions of dollars.

Panel C: Requested Attorneys' Fees

Lead Plaintiff	Cases with at least One Lead Plaintiff of the Type	Mean	p25	Median	p75	Std. Dev.
Public Pension	56	0.213	0.170	0.223	0.250	0.059
State	34	0.195	0.165	0.195	0.250	0.053
Local	22	0.241	0.205	0.250	0.285	0.057
Labor Union	74	0.253	0.240	0.250	0.300	0.058
Other Institution	97	0.266	0.250	0.250	0.300	0.054
Individual Only	135	0.280	0.250	0.300	0.300	0.051
Total	342	0.262	0.250	0.250	0.300	0.058

Table 4: Campaign Contributions

Attorney Contribution to State Pension Fund Lead Plaintiffs

	Cases	Percentage of Cases with at least One State Pension Lead Plaintiff	Mean	Median	Std. Dev.
Contribution – Fund Official	19	50.0%	9378	10000	6403.8
Contribution – Any State Official	23	60.5%	56040	25950	111378.3

Table 5: Assets and Attorneys' Fees

	Model 1	Model 2
State Pension	-0.430**	
	(-5.47)	
State Pension—Above Median Assets		-0.599**
		(-5.93)
State Pension—Below Median Assets		-0.194*
		(-2.04)
Local Pension	-0.346**	
	(-3.90)	
Local Pension—Above Median Assets		-0.552**
		(-4.98)
Local Pension—Below Median Assets		-0.082
		(-1.34)
Labor Union	-0.066	
	(-1.62)	
Labor Union—Above Median Assets		-0.125*
		(-2.30)
Labor Union—Below Median Assets		-0.030
		(-0.69)
Other Institution	-0.083	-0.084+
	(-1.63)	(-1.67)
Constant	-0.033	-0.036
	(-0.87)	(-0.98)
Case Controls	Yes	Yes
N	314	314
R^2	0.335	0.388

t statistics in parentheses (determined with robust standard errors); + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Case Controls include the Section 11, Section 14, Govt. Investigation, Restatement, Officer Term., Auditor Term., Insider Trading Claim, ln(Settlement Amount), ln(Market Capitalization), High Tech, and FDA variables.

Table 6: Campaign Contributions and Attorneys' Fees

	Model 1	Model 2	Model 3
State Pension—Contribution	-0.386**		
	(-3.29)		
State Pension—Large Contribution		-0.011	
		(-0.15)	
State Pension—Small Contribution		-0.437**	
		(-3.46)	
State Pension—No Contribution	-0.459**	-0.457**	
	(-4.60)	(-4.60)	
State Pension—Large Contribution All State Officials			0.010
			(0.15)
State Pension—Small Contribution All State Officials			-0.462**
			(-4.40)
State Pension—No Contribution All State Officials			-0.436**
			(-3.88)
Local Pension	-0.348**	-0.340**	-0.341**
	(-3.89)	(-3.80)	(-3.80)
Labor Union	-0.065	-0.064	-0.065
	(-1.60)	(-1.57)	(-1.58)
Other Institution	-0.082	-0.081	-0.083
	(-1.62)	(-1.59)	(-1.63)
Constant	-0.785**	-0.783**	-0.784**
	(-12.84)	(-12.77)	(-12.77)
Case Controls	Yes	Yes	Yes
N	314	314	314
R^2	0.336	0.341	0.342

t statistics in parentheses (determined with robust standard errors); $^{+}$ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Case Controls include the Section 11, Section 14, Govt. Investigation, Restatement, Officer Term., Auditor Term., Insider Trading Claim, ln(Settlement Amount), ln(Market Capitalization), High Tech, and FDA variables.

Table 7: Pension Fund Assets and Attorneys' Fees

	Model 1	Model 2
State Pension—Above Median Assets Contribution	-0.533**	
	(-3.30)	
State Pension—Above Median Assets Large Contribution		-0.040
		(-0.56)
State Pension— Above Median Assets Small Contribution		-0.644**
		(-3.74)
State Pension— Above Median Assets No Contribution	-0.656**	-0.649**
	(-5.69)	(-5.71)
State Pension—Below Median Assets	-0.192*	-0.195*
	(-2.00)	(-2.02)
Local Pension—Above Median Assets	-0.555**	-0.544**
	(-4.97)	(-4.95)
Local Pension—Below Median Assets	-0.0808	-0.075
	(-1.32)	(-1.21)
Labor Union—Above Median Assets	-0.124*	-0.121*
	(-2.29)	(-2.22)
Labor Union—Below Median Assets	-0.029	-0.029
	(-0.66)	(-0.66)
Other Institution	-0.084+	-0.082
	(-1.66)	(-1.64)
Constant	-0.799**	-0.796**
	(-13.19)	(-13.14)
Case Controls	Yes	Yes
N	314	314
R^2	0.389	0.399

t statistics in parentheses (determined with robust standard errors); + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Case Controls include the Section 11, Section 14, Govt. Investigation, Restatement, Officer Term., Auditor Term., Insider Trading Claim, ln(Settlement Amount), ln(Market Capitalization), High Tech, and FDA variables.

Table 8: Pension Losses and Attorneys' Fees

	Model 1	Model 2
State Pension—Large Losses	-0.245*	
	(-2.30)	
State Pension— Large Losses Contribution		-0.080
		(-0.55)
State Pension— Large Losses No Contribution		-0.357**
		(-2.88)
State Pension—Small Losses	-0.089	-0.086
	(-0.95)	(-0.91)
Local Pension	-0.310**	-0.306**
	(-3.34)	(-3.29)
Labor Union	-0.006	-0.004
	(-0.14)	(-0.10)
Other Institution	-0.026	-0.026
	(-0.49)	(-0.49)
Constant	-0.733**	-0.720**
	(-10.78)	(-10.65)
Case Controls	Yes	Yes
N	314	314
R^2	0.272	0.278

t statistics in parentheses (determined with robust standard errors); $^{+}$ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Case Controls include the Section 11, Section 14, Govt. Investigation, Restatement, Officer Term., Auditor Term., Insider Trading Claim, ln(Settlement Amount), ln(Market Capitalization), High Tech, and FDA variables.

Table 9: State Receptivity to Contributions

	Model 1	Model 2
State Pension—Frequent Attorney	-0.206*	
	(-2.09)	
State Pension—Frequent Attorney Contribution		-0.040
		(-0.54)
State Pension—Frequent Attorney No Contribution		-0.277*
		(-2.28)
State Pension—Infrequent Attorney	-0.590**	-0.589**
	(-6.11)	(-6.10)
Local Pension	-0.346**	-0.348**
	(-3.96)	(-3.97)
Labor Union	-0.072+	-0.072+
	(-1.77)	(-1.76)
Other Institution	-0.086+	-0.087+
	(-1.70)	(-1.71)
Constant	-0.808**	-0.803**
	(-12.96)	(-13.02)
Case Controls	Yes	Yes
N	314	314
R^2	0.357	0.360

t statistics in parentheses (determined with robust standard errors); + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$. Case Controls include the Section 11, Section 14, Govt. Investigation, Restatement, Officer Term., Auditor Term., Insider Trading Claim, ln(Settlement Amount), ln(Market Capitalization), High Tech, and FDA variables.

Appendix: Variable Definitions

Key Independent Variables

Variable	Description
Public Pension	The fraction of lead plaintiffs in a case that consists of a public pension fund.
State Pension—Contribution	The fraction of lead plaintiffs in a case that consists of state pension funds with officials, or officials who appointed board members, who received political contributions from the lead attorneys.
State Pension— Contribution All State Officials	The fraction of lead plaintiffs in a case that consists of state pension funds where the lead attorneys have donated to any elected official or party committee in the state.
State Pension—Large Contribution	The fraction of lead plaintiffs in a case that consists of state pensions whose officials received contributions of $15,000 or more during the four-year period from two years prior to one year after the suit filing.
State Pension—Small Contribution	The fraction of lead plaintiffs in a case that consists of state public pensions whose officials received contributions of less than $15,000 during the four-year period from two years prior to one year after the suit filing.
State Pension—No Contribution	The fraction of lead plaintiffs in a case that consists of state pension funds with officials who did not receive political contributions from the lead attorneys.
State Pension—Large Losses	The fraction of lead plaintiffs in a case that consists of state pension funds with a claim over $1 million in a given case.
State Pension—Small Losses	The fraction of lead plaintiffs in a case that consists of state pension funds with a claim of $1 million or less in a given case.
State Pension—Frequent Attorney	The fraction of lead plaintiffs in a case that consists of state pension funds appearing at least twice in our sample that are represented by the same law firm in over 75% of the cases in our sample where the public pension fund acts as lead plaintiff.
State Pension—Infrequent Attorney	The fraction of lead plaintiffs in a case that consists of state pension funds that appeared only once in our sample or were not represented by the same law firm in over 75% of the cases in our sample where the public pension fund acts as lead plaintiff.
Local Pension	The fraction of lead plaintiff in a case that consists of local government pension funds.
Labor Union	The fraction of the lead plaintiffs that consists of a labor union.
Other Institution	The fraction of lead plaintiffs in a case that are institutions but not public pensions or labor unions.

Other Independent Variables

Case Control Variables	Description
Section 11	Indicator variable equal to 1 if the complaint for a particular class action alleged a Section 11 of the Securities Act of 1933 violation and 0 otherwise.
Section 14	Indicator variable equal to 1 if the complaint for a particular class action alleged a Section 14 of the Securities Exchange Act of 1934 violation and 0 otherwise.
Govt. Investigation	Indicator variable equal to 1 if the complaint indicated the presence of a SEC or other governmental investigation or enforcement action relating to the fraud at issue and 0 otherwise.
Restatement	Indicator variable equal to 1 if the complaint indicated that the company announced a restatement covering at least part of the class period and 0 otherwise.
Officer Term.	Indicator variable equal to 1 if the complaint indicated that a top officer of the defendant company resigned or was terminated during the class period and 0 otherwise.
Auditor Term.	Indicator variable equal to 1 if the complaint indicated that the auditor resigned or was terminated during the class period and 0 otherwise.
Insider Trading	Indicator variable equal to 1 if the complaint alleged insider trading and 0 otherwise.
Market Capitalization	Market value of a company's common equity (in $ millions) at the end of the fiscal year preceding the beginning of the class period.
Settlement Amount	The settlement amount for the class action.
High Tech	Indicator variable equal to 1 if the firm is in SIC codes 3570-3577 or 7370-7379 and 0 otherwise.
FDA	Indicator variable equal to 1 if the last amended complaint for a particular class action is based on U.S. Food and Drug Administration-related disclosures and 0 otherwise.