

WHEN CONGRESS ACTS: JUDICIAL PROCEDURAL INNOVATION AND THE PSLRA

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In her Essay, *Fact or Fiction: Flawed Approaches to Evaluating Market Behavior in Securities Litigation*,¹ Prof. Lipton describes a judiciary locked in an ongoing struggle to shape the private securities fraud remedy in the class action context. In her Essay, Prof. Lipton focuses on, and laments, the evidentiary presumptions that courts have created to “ensure that . . . investors would have a remedy—and that markets would not be left vulnerable to manipulation.”² Prof. Lipton explains that these presumptions, designed to simplify a complex body of substantive law and related evidence, also result in “near-arbitrary” class certification decisions in the securities litigation context.³ In this Comment, I use these presumptions as inspiration for an inquiry into effects that the Private Securities Litigation Reform Act (PSLRA) specifically, and Congressional procedural rulemaking more generally, have had on the procedural rulemaking choices of the Supreme Court.

Like Prof. Lipton, I too see a conflicted judiciary in the securities litigation context. On the one hand, the PSLRA sharply limits the class action device in the securities context.⁴ As compared to general class action practice, class actions in the securities context are subject to increased oversight, heightened pleading standards, and more restrictive discovery. On the other hand, the PSLRA also expressly creates a right to enforce securities fraud violations through aggregate litigation. Thus,

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¹ Ann M. Lipton, *Fact or Fiction: Flawed Approaches to Evaluating Market Behavior in Securities Litigation*, 20 TENN. J. BUS. L. 741 (2019).

² *Id.* at 744

³ *Id.*

⁴ See 15 U.S.C. § 78u-4(b) (2000). In 1998, Congress limited the securities class action still further by preempting most state securities class actions through Securities Litigation Uniform Standards Act of 1998. Pub. L. No. 105-353, 112 Stat. 3227.

courts are left to harmonize two potentially conflicting aims: the resolution of complex merits issues involved in Section 10(b) fraud claims, and the application of class actions procedures that necessarily require some kind of generalization, simplification, or aggregation of data.

The result, according to Prof. Lipton, is grim. Prof. Lipton describes a judiciary that is stymied in the development of law that should guide courts' decisions regarding class certification. For example, she explains that the fraud-on-the-market presumption, which allows a plaintiff to meet the reliance element for an entire class action merely by showing that markets were running efficiently at the time of a misrepresentation, has no grounding in an empirical understanding of how markets work, and is often unprovable.⁵ Nevertheless, these presumptions also make it easier to bring class actions. As she argues, presumptions unique to securities doctrine "smooth out the most significant differences among class members," and thus "facilitate the aggregation of claims into a single class action."⁶ Thus, "presumptions translate what would otherwise be a series of individual questions about investors' reliance on the alleged fraud into a common question regarding the fraud's effect on the market."⁷ This "transformation," Prof. Lipton explains, is what allows plaintiffs in securities class actions to meet the requirement in Rule 23(b)(3) that common questions predominate over individual ones.⁸

Despite this uncertainty (or, perhaps because of this uncertainty some argue),⁹ securities class actions continue to thrive. In fact, securities litigation is one of the few areas where class action litigation is still going

⁵ Lipton, *supra* note 1, at 744.

⁶ *Id.*

⁷ *Id.* at 766.

⁸ *Id.*

⁹ For critiques of class actions in the securities litigation context post-PSLRA, *see, e.g.*, Marilyn F. Johnson et al., *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 J. L. ECON. & ORG. 627 (2007); Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151 (2009); Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711 (1996); Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913 (2003).

strong.¹⁰ It is also one of the few substance-specific areas where Congress has enacted major procedural reform, specifically through the PSLRA.¹¹ In most other areas, litigants are finding it harder to seek aggregate judicial solutions for private harms. Thus, scholars have documented the tightening of procedural mechanisms, ultimately resulting in narrowing access to judicial processes, particularly in the context of aggregate litigation.¹² Examples include Supreme Court cases making motions to dismiss harder to bring, class actions harder to certify, and waivers of class actions easier to enforce.¹³ Thus, procedural scholars opine that we are in an era of procedural retrenchment, resulting in decreased access to judicial processes.

Although this retrenchment of judicial access is primarily thought to be a result of judicial action, elsewhere, I argue that Congress plays a significant role in litigation reform and procedural retrenchment.¹⁴ It does so both through “major,” trans-substantive procedural reforms, like the Class Action Fairness Act, and through targeted procedural reforms, such as the PSLRA.¹⁵

¹⁰ See JOHN C. COFFEE JR., *ENTREPRENEURIAL LITIGATION: ITS RISE, FALL, AND FUTURE* 132 (Harvard Univ Press 2015) (explaining that only federal securities laws are “generally amenable to class action treatment,” although “even here the Court has reinterpreted the Fraud-on-the-Market Doctrine to impose additional burdens on the plaintiff”); Robert H. Klonoff, *The Decline of Class Actions*, 90 WASH. U.L. REV. 729, 827 (2013) (listing securities fraud as an area where class actions “continue to thrive,” along with wage and hour cases, Employee Retirement Income Security Act cases, and “to a lesser extent,” antitrust cases).

¹¹ Briana L. Rosenbaum, *The Legislative Role in Procedural Rulemaking Through Incremental Reform*, 72 NEB. L. REV. (forthcoming 2019).

¹² See *id.* at 103 (citing authorities).

¹³ See *infra* notes 37 through 39 and accompanying text (describing cases).

¹⁴ See Rosenbaum, *supra* note 12, at 104-06.

¹⁵ Other examples of targeted reforms include Congressional legislation related to class action cases involving immigrants, Omnibus Consolidated Appropriations Act, Pub. L. No. 104-208, § 306(a)(2), 110 Stat. 3009-607, litigation filed by inmates, Prison Litigation Reform Act of 1995, Pub. L. No. 104-134, 110 Stat. 1321 (codified as amended in scattered sections of 11, 18, 28, & 42 U.S.C.), and employment discrimination cases, see Kermit Roosevelt III, *Exhaustion Under the Prison Litigation Reform Act: The Consequence of Procedural Error*, 52 EMORY L.J. 1771, 1777 (2003) (describing legislation).

Of Congress's targeted reforms, the PSLRA's reform of securities litigation may be one of the most cited examples of Congressional interest in the procedural rulemaking role.¹⁶ Congress's express purpose was to discourage abuses in securities litigation, including the filing of lawsuits for the singular purpose of obtaining a settlement.¹⁷ To accomplish this, Congress implemented a complex procedural and substantive reform package. Key provisions include requiring plaintiffs to plead with particularity when bringing claims based on misleading statements or omissions and scienter, strengthening Rule 11 by requiring mandatory findings at the final stage, and imposing a discovery stay during pre-trial motions.¹⁸

The success of the PSLRA as a measure of litigation reform has been much debated, with some calling it an outright failure, and others noting cautious optimism.¹⁹ For the purpose of this Comment, though, I will assume that Congress's choice to implement targeted reforms like the PSLRA has, as noted above, led to the limited development of law that should guide courts' class certification decisions. If this is so, it leaves one to question how a Congressional choice to regulate procedure could lead to lack of procedural innovation in the judiciary.

To be clear, I do not mean to question the direct effects that the PSLRA has had on access to courts. Those direct limitations—such as the

¹⁶ Congress's success in passing legislation expressly designed to curb seemingly unmeritorious suits in the securities context stood in stark contrast to similarly intended, but failed, legislative efforts in other areas. For example, the same year that Congress passed the PSLRA, it failed to pass the Attorney Accountability Act of 1995, which included trans-substantive amendments to Rule 11 similar those in the PSLRA, including making sanctions mandatory for all cases. However, while Congress had the political ability to tackle the perceived problem of frivolous litigation in a targeted litigation environment, it could not do so for general litigation. Rosenbaum, *supra* note 12, at 148.

¹⁷ See Shannon Rose Selden, *(Self-)policing the Market: Congress's Flawed Approach to Securities Law Reform*, 33 J. LEGIS. 57, 73-76 (2006) (discussing the "distrust of litigation" that drove the PSLRA).

¹⁸ See *id.* at 76-78; Rosenbaum, *supra* note 12, at 124-25 (and accompanying citations).

¹⁹ See sources cited *supra* note 10. See also Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 976 (2003) (conducting empirical studies and concluding that, while there was no reduction in the rate of securities litigation "there is statistically significant evidence suggesting that the PSLRA improved overall case quality at least in the circuit that most strictly interprets the Reform Act's heightened pleading standard").

heightened pleading requirement—are both clear and much debated.²⁰ The focus instead is on indirect effects of the Congressional choice to enact targeted procedural rules, particularly on the institutional procedural rulemaking role of the judiciary. A useful, but imperfect, analogy is the constitutional doctrine of field preemption. Under this doctrine, the Supreme Court has interpreted the Supremacy Clause to bar state action when a “scheme of federal regulation is ‘so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it.’”²¹ Under this theory of field preemption, the Court has prohibited state action regarding regulation of ship vessels²² and of immigration.²³

Here, too, it is possible to see Congress’s decision to regulate procedure in targeted areas, such as securities litigation through the PSLRA, as “covering the field” of procedural rulemaking in that substantive area. The effect here could be similar to that in field preemption: it may be to prevent procedural rulemaking by the judiciary in the same field. This would be so even if, like the states under the preemption doctrine, the judiciary would normally have rulemaking power in the area. Thus, the question still remains, has Congress’s choice to enact legislation in the area of securities litigation affected the procedural rule-making choices of the judiciary? There is some evidence that it has.

Prof. Lipton argues that, through cases like *Basic*, the Supreme Court has “crafted ‘ham-fisted’ mechanisms for distinguishing meritorious cases from frivolous ones.”²⁴ Although she presents many reasons to criticize these mechanisms, I will focus on her critique of their motives. As noted above, the PSLRA was motivated, in large part, by a desire to curb frivolous litigation. But Prof. Lipton argues that judicial presumptions in the securities context are, in fact, unable to distinguish “meritorious cases from frivolous ones” and can “insulate even ‘dastardly’ frauds so long as defendants can manipulate their disclosures sufficiently

²⁰ See, e.g., sources cited *supra* note 10, 20.

²¹ *Gade v. National Solid Wastes Mgmt. Ass’n*, 505 U.S. 88, 98 (1992) (internal quotation marks and case citations omitted).

²² *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 165–66 (1978).

²³ *Hines v. Davidowitz*, 312 U.S. 52, 73–74 (1941).

²⁴ Lipton, *supra* note 1, at 772.

to match doctrinal rigidities.”²⁵ She paints a picture of a judiciary refusing to make deliberate choices of “where to allocate the burden of uncertainty for an injury” that is inherently uncertain and complex.²⁶

The Court has declined to adopt some of the more obvious solutions to curtailing perceived abuses in securities litigation on a number of occasions. This, despite urging by parties and amici in multiple cases. For example, in *Halliburton Co. v. Erica P. John Fund, Inc.* (“*Halliburton II*”), the Supreme Court rejected the request to reverse the fraud on the market (and efficient markets) standard, citing the PSLRA.²⁷ In doing so, the Court explained that Congress, by enacting the PSLRA, had “responded” to the frivolous litigation and efficiency concerns.²⁸ Such legislative action demonstrated for the Court not only the Congress had addressed the very concerns raised, but also “Congress’s willingness” to do to.²⁹ In short, the Court said, take this up with Congress if you want to address frivolous litigation in a different way.³⁰

The Supreme Court said something similar in *Amgen Inc. v. Connecticut Ret. Plans & Tr. Funds* when it declined to change the *Basic* presumption.³¹ The Court explained that Congress had enacted the PSLRA specifically to prevent “abuse, including the ‘extract[ion]’ of ‘extortionate settlements’ of frivolous claims.”³² Congress “fortified the

²⁵ *Id.*

²⁶ *Id.*

²⁷ 573 U.S. 258, 277 (2014).

²⁸ *Id.*

²⁹ *Id.*

³⁰ See Ann M. Lipton, *Halliburton and the Dog That Didn't Bark*, 10 DUKE J. CONST. L. & PUB. POL'Y 1, 25 (2015) (arguing that, since the Court in *Halliburton II* refused to consider settlement pressure as a reason to change the *Basic* presumption, they also should not “stand sentry” over the related the efficiency and price impact determinations at the class certification stage).

³¹ 568 U.S. 455, 475 (2013); COFFEE, *supra* note 11, at 130 (noting that, while *Halliburton II* did not reject the *Basic* presumption, it did “tilt the playing field marginally in defendant’s favor” by making the presumption rebuttable). Cf. Richard A. Posner, *Statutory Interpretation—In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 811–14 (1983) (critiquing cannons of statutory construction that “impute omniscience to Congress”).

³² 568 U.S. at 475 (quoting H.R. Conf. Rep. No. 104–369, pp. 31–32 (1995)).

PSLRA,” the Court reasoned, by later enacting the Securities Litigation Uniform Standards Act of 1998, which preempted most state securities class actions.³³ Furthermore, the Court was persuaded by the fact that Congress rejected a number of proposals to undo the fraud-on-the-market presumption endorsed in *Basic*, all “[w]hile taking these steps to curb abusive securities-fraud lawsuits.”³⁴ For the Court, this all amounted to both Congressional approval of both the *Basic* presumption and a reason to reject calls to “reinterpret[] Rule 23.”³⁵

The Court’s hesitancy to make changes in the securities litigation context stands in sharp contrast to the judicial procedural innovation in a host of other areas, such as in general pleadings standards, discovery, class actions. Notably, Congress has either failed to act in these areas, or only acted in incremental ways. I will use class certification standards as an example.

As noted, the Supreme Court has, over several cases, made it harder for plaintiffs to bring class action lawsuits. Beginning in 2011, the Court in *Wal-Mart Stores, Inc. v. Dukes* precluded all but “incidental” damages in (b)(2) class actions and raised the standard for commonality in all class actions, requiring not just a single “common question,” but a “common contention” that will “resolve an issue that is central to the validity of each one of the claims in one stroke.”³⁶ That same year, the Court upheld arbitration and class action waiver clauses in *AT&T Mobility LLC v. Concepcion*, finding that the Federal Arbitration Act preempted California state law classifying most class arbitration waivers as unconscionable.³⁷ Two years later in 2013, the Court made it more difficult to bring Rule 23(b)(3) claims in cases in which there are questions about the ability of damages to be measured on a class wide basis.³⁸

³³ *Id.* at 476 (citing 112 Stat. 322).

³⁴ *Id.* at 476.

³⁵ *Id.* at 477.

³⁶ *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011).

³⁷ *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 344 (2011); *see also Spokeo v. Robins*, 136 S.Ct. 1540, 1548 (2016) (holding that mere statutory violations did not equate to cognizable real-world harm).

³⁸ *Comcast Corp. v. Behrend*, 569 U.S. 27, 34 (2013). For an analysis of the Court’s trend restricting class actions, *see* Robert H. Klonoff, *Class Actions Part II: A Respite from the Decline*, 92 N.Y.U.L. REV. 971 (2017).

By contrast, Congress has attempted, largely unsuccessfully, to change the class action certification requirements numerous times. For example, the Fairness in Class Action Litigation Act of 2017 (FICALA), which passed the House but not the Senate in 2017, would have restricted class actions in a number of ways, including by limiting fees in class actions to a percentage of money actually distributed to the class and adopting a class ascertainability standard.³⁹ Similar measures exist in previous failed proposals, such in the Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2016.⁴⁰

What does all of this show? First, in a broad sense, the Court is quite willing to address the problem of frivolous litigation. It has acted through cases like *Wal-mart* and *Comcast* to further this goal.⁴¹ The Court's choice to further such a policy should not come as a surprise, as two of the three principles embodied in the Federal Rules governing the judiciary are "speed" and lack of expense (the third being "just" resolution of actions).⁴²

Second, and by contrast, in the securities litigation context, the Court shows reluctance to address the same problem, specifically citing Congressional action in the area. As the Court explained in *Amgen*, "[b]ecause Congress has homed in on the precise policy concerns raised" by *Amgen*, "[w]e do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits."⁴³ Thus, at least in the context of aggregate litigation and the perceived problem of frivolous litigation, the Court appears reluctant to utilize its

³⁹ Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2017, H.R. 985, 115th Cong., at § 105 (2017) (as passed by the House on Mar. 9, 2017).

⁴⁰ Fairness in Class Action Litigation and Furthering Asbestos Claim Transparency Act of 2016, H.R. 1927, 114th Cong. (2016)

⁴¹ Coffee, *supra* note 11, at 135 (explaining that the Court in *Wal-mart* impliedly addressed the problem of the theory of extortion, or the fact that "inevitable aggregation of strong individual cases with weak cases in a class action may give enhanced (and unjustified) settlement value to weak claims").

⁴² FED. R. CIV. P. 1.

⁴³ *Amgen*, 568 U.S. at 477.

inherent procedural rulemaking role, at least when Congress has itself considered the problem, and thus “covered the field.”

Robert Klonoff, in his article reviewing developments in class action jurisprudence, has suggested that in cases like *Amgen*, the Supreme Court may be pulling back on its class action reform stance and rejecting the “mantra” that class actions inevitably lead to “blackmail settlements” induced by “intense pressure to settle.”⁴⁴ While this may be true, it may also be that the Court is selectively choosing the contexts in which it is willing to engage in the frivolous litigation debate. We may soon have an answer to this quandary, as the Court is soon expected to issue a decision in *Frank v. Gaos*, which concerns when courts may approve class action settlements that distribute portions of proceeds to third parties.⁴⁵ As Congress has specifically chosen not to act on the cy pres issue⁴⁶ (thus, theoretically, leaving the “field” open), it will be interesting to see if the Court does.

If judicial procedural innovation is being stalled by targeted Congressional procedural efforts, one might also wonder if any potential change in the area of securities litigation will happen some other way. As Richard Marcus has said, “One seeming constant is the urge to reform.”⁴⁷ One answer could be through parties and interest groups.⁴⁸ These groups may be emboldened and mobilized by targeted Congressional reform like the PSLRA, and thus could be uniquely able to affect future procedural reform, either through further legislative change, lobbying for federal rules changes, or litigation advocacy.⁴⁹ Another possibility is that other

⁴⁴ See Klonoff, *supra* note 39, at 980-82.

⁴⁵ Ronald Mann, *Argument analysis: Justices skeptical of “cy pres” class-action settlements*, SCOTUSBLOG (Nov. 1, 2018, 1:28 PM), <https://www.scotusblog.com/2018/11/argument-analysis-justices-skeptical-of-cy-pres-class-action-settlements/>

⁴⁶ Fairness in Class Action Litigation Act of 2017, H.R. 985, 115th Cong., at § 1718 (2017) (as passed by the House on Mar. 9, 2017).

⁴⁷ Richard L. Marcus, *Modes of Procedural Reform*, 31 HASTINGS INT’L & COMP. L. REV. 157, 185 (2008).

⁴⁸ See Robert G. Bone, *The Process of Making Process: Court Rulemaking, Democratic Legitimacy, and Procedural Efficacy*, 87 GEO. L.J. 887, 922-26 (1999) (describing the role of interest groups in the public choice problems that arise in rulemaking).

⁴⁹ *Id.* at 904 & nn. 60, 175-97 and accompanying text (discussing lobbying in the rulemaking process).

institutions might pick up the baton, taking on the role of reform in the area. As an example, SEC Commissioner Jay Clayton announced in April 2018 that the SEC had begun reviewing its rule prohibiting mandatory arbitration in corporate by-laws.⁵⁰ According to John Coffee, such a move would “effectively preclude” securities class actions.⁵¹

Ultimately, this Comment cannot fully answer the question regarding the institutional effects of targeted Congressional rulemaking on the procedural rulemaking choices of the judiciary.⁵² However, it is hoped that the examples described here and in Prof. Lipton’s Essay will shed further light on Congress’s role in the current development of securities class actions in the courts, and in judicial procedural rulemaking more broadly. Sarah Staszak, a leading institutional scholar focusing on access to courts, posited that, “[i]n a complex governing arrangement where institutions, each with their own entrenched interests, have to negotiate how best to govern, institutional change (of any kind) must be explained in an interbranch context.”⁵³ That is certainly true of the change wrought by Congress through the PSLRA.

⁵⁰ Alison Frankel, *SEC Chair Clayton is in no rush for mandatory shareholder arbitration*, REUTERS (April 27, 2018, 2:58 PM), (<https://www.reuters.com/article/legal-us-otc-arbitration/sec-chair-clayton-is-in-no-rush-for-mandatory-shareholder-arbitration-idUSKBN1HY2QL>).

⁵¹ Coffee, *supra* note 11, at 132.

⁵² See Bone, *supra* note 49 at 921 (1999) (arguing that greater involvement by Congress in procedural rulemaking had resulted in concrete changes to the court-centered rulemaking process); Richard D. Freer, *Civil Procedure: The Continuing Gloom About Federal Judicial Rulemaking*, 107 NW. U. L. REV. 447, 455 (2013) (explaining that “[b]ecause it acts in the shadow of Congress—under the threat that those it disappoints can go to the Capitol—the [Federal Rules] Committee may have an incentive to stay away from topics that will push too many hot buttons” but “[i]t does so sporadically and unpredictably”).

⁵³ Sarah Staszak, *Realizing the Rights Revolution: Litigation and the American State*, 38 L. & SOC. INQUIRY 222, 241 (2013).