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A SECURITIES FRAUD AND CORPORATE GOVERNANCE QUARTERLY

CRACKING CRACKER BARREL...

THE 1998 AMENDMENTS TO THE SHAREHOLDER PROPOSAL RULE

By Darnley D. Stewart

In 1991, Cracker Barrel Old Country Store, Inc. announced its intention to exclude homosexuals from employment at the company's restaurants, and promptly fired eleven employees based solely on their sexual orientation. Firmly believing that this form of discrimination could both deprive the company of productive employees, and undermine consumer confidence in Cracker Barrel as a result of negative publicity and boycott campaigns, one Cracker Barrel shareholder took a stand: the New York City Employees' Retirement System (NYCERS) submitted a proposal under Rule 14a-8—generally known as the Shareholder Proposal Rule—to be included in the company's proxy statement for the 1992 annual shareholder meeting. The NYCERS proposal asked that Cracker Barrel add "sexual orientation" to the company's equal employment policy statement and implement further anti-discriminatory policies consistent with that statement.

Cracker Barrel refused to include the requested proposal, arguing that it fell under the "ordinary business exclusion" of Rule 14a-8 (the "registrant may omit a proposal... if the proposal deals with a matter relating to the conduct of the ordinary business operations of the registrant"). Upon Cracker Barrel's application, the SEC issued a "no-action" letter supporting the company's position, explaining that while shareholder employment proposals relating to company executives were "unique"and could not be excluded, proposals regarding rank-and-file employees were subject to the ordinary business exclusion and did not ever have to be included in the proxy statement.

In the years that followed, the SEC adhered to its *Cracker Barrel* ruling and socially conscious investors resorted to other means to address high performance workplace issues. This time, the California Public Employees' Retirement System ("CalPERS") led the charge. Since 1994, CalPERS has made it a point to invest in companies that meet its particular labor standards, and in 1997, CalPERS instituted a campaign against companies that over-compensate executives while engaging in corporate downsizing. According to CalPERS, evidence shows that positive workplace practices are an indicator of long-term corporate success.

> *"It is obvious to the point of banality to restate the proposition that Congress intended by its enactment of Section 14...to give true vitality to the concept of corporate democracy."*

In 1996, in response to institutional criticism of the SEC's *Cracker Barrel* decision, Congress requested that the SEC review the shareholder proposal process, and in May 1998, after a two-year study and much heated debate and

Continued on page 3.

Inside Look

With this issue we are celebrating the first anniversary of the *Institutional Investor Advocate*. As I take the luxury of looking back over the Quarters, I can't help but marvel at how far we've come and how quickly the year has passed. We started out with an ambitious goal: provide institutional investors with information that will help them become increasingly more aware of activities in the securities class action and corporate governance arenas. And, although we are lawyers, we were determined to present this information in English, not legalese.

We began by explaining the lead plaintiff provisions in the PSLRA. In a subsequent quarter, we followed-up with identifying the complications institutional plaintiffs face with aggregation. We explored corporate governance and auditor issues, insider trading and options repricing, Y2K disclosure, and the very real benefits to employees and shareholders resulting from institutional investor driven corporate reforms. We also noted legal decisions that had an impact on institutional plaintiffs.

We begin this year-end Quarter with one article celebrating the positive and another exploring the new. In *Cracking Cracker Barrel: the 1998 Amendments to the Shareholder Proposal Rule,* BLB&G partner Darnley D. Stewart highlights the determination of two institutional investors — NYCERS and CalPERS — to reverse the SEC's *Cracker Barrel* decision and make a difference in elevating the quality of the work place. Our second article explores an issue never before addressed that will undoubtedly arise in the new year: institutions recovering litigation costs and expenses. As yet, no institution serving as a lead plaintiff has submitted costs and expenses incurred on behalf of representing a class under the PSLRA. Associate Steven B. Singer, in his article *Having Your Cake and Eating It Too, Or, Recovering Costs and Expenses While Serving as Lead Plaintiff,* explores the provisions and suggests some "housekeeping" tips for the inevitable.

Included in this issue is an index to the articles published in all four quarters in Volume 1. If you are missing an issue or would like an additional copy, call or e-mail us and we'll gladly send you one. We'd also like to know how you think we're doing so we've included a Reader's Survey. Please take a moment to complete the questionnaire and fax it to us. We value your ideas and suggestions. Your feedback will help us determine what information to include in future issues.

We have made it through our first year and I am quite proud of how far we've come. Our deepest gratitude to you, our readers, who have responded to the *Advocate* with such enthusiasm and support. We, at Bernstein Litowitz Berger & Grossmann LLP, wish you, your colleagues, and your families all the joys of the holiday season and a happy, healthy and prosperous New Year.

As we stand at the brink of the new millennium, I am looking forward to celebrating future anniversaries with you all.

Max W. Berger

CRACKING CRACKER BARREL

Continued from page 1.

commentary, the SEC announced significant amendments to the Shareholder Proposal Rule. Those amendments — which can be found at 63 Fed.Reg. 29, 106, and as codified at 17 C.F.R. part 240— are as follows:

Question and Answer Format: The first amendment simply reformats the text of the Rule into questions and answers using plain English, thus making the Rule more readily accessible to an unsophisticated or novice reader— whether the reader be an investor, employee or company official.

Ordinary Business Exclusion: The second amendment is the most controversial: the SEC has reversed its *Cracker Barrel* ruling and now will review the inclusion

> *SEC reversed its Cracker Barrel ruling and now will review the inclusion of employment-related shareholder proposals in proxy materials on a case-by-case basis.*

of employment-related shareholder proposals in proxy materials on a case-by-case basis. Thus, although this change does not mean that any employment-related proposal must be included in proxy materials, they may no longer be excluded simply because they relate only to "rank and file" employees. In connection with this amendment, the SEC stated that it would revert to the standard set forth in a 1976 Interpretative Release (Exchange Act Release No. 12,999, 41 Fed.Reg. 52,994) that the only issue be whether or not the subject matter of the proposed amendment raises a "significant social policy issue," not whether the proposal is employment-based. *See* 1976 Release (for a proposal to be excluded under the ordinary business exclusion, it must "involve business matters that are mundane in nature and do not involve any substantial policy or other considerations").

> *Since 1992, the relative importance of certain social issues relating to employment matters has re-emerged as a consistent topic of widespread public debate. The SEC's reversal of the Cracker Barrel decision creates enormous opportunity for institutional investors to work toward effecting substantial programmatic changes in the workplace of the companies in which they invest through shareholder proposals.*

Definition of a "Proposal": The third amendment also provides for the first time a formal definition of a proper shareholder "proposal": a "proposal" is defined as "a request that the company or its board of directors take an action." Thus, a proposal seeking only to express the investor's opinion on a given issue is not within the Rule's purpose, and may be excluded from the proxy materials.

Eligibility Requirements: Prior to 1998, a shareholder had to own $1,000 worth of company stock in order to be able to submit a shareholder proposal to be included in proxy materials. Companies long have requested that the stock ownership requirement be increased so as to reduce the number of proposals that must be included annually. The SEC refused to alter the amount dramatically, stating that, "a more significant increase could restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders." Thus, the SEC only increased the requirement to $2,000 of continuous share ownership.

Although the Shareholder Proposal Rule is viewed and used as a means for investors to influence corporate governance on traditional "business issues" such as golden parachutes, greenmail and confidential voting, the significance of employment-related proposals cannot be ignored. Indeed, in connection with its reversal of its *Cracker Barrel* ruling, the SEC noted that "since 1992, the relative importance of certain social issues relating to employment matters has re-emerged as a consistent topic of widespread public debate." The SEC's reversal of the *Cracker Barrel* decision creates enormous opportunity for institutional investors to work toward effecting substantial programmatic changes in the workplace of the companies in which they invest through shareholder proposals. Put simply, contented workers are demonstrably more productive workers, and companies that value their employees are less likely to be the subject of expensive lawsuits and resultant negative publicity. As institutional investors such as NYCERS and CalPERS have shown, doing the right thing is not only good for the soul, it is good for the bottom line.

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HAVING YOUR CAKE AND EATING IT TOO...

OR RECOVERING COSTS AND EXPENSES INCURRED WHILE SERVING AS LEAD PLAINTIFF

By Steven B. Singer

It is a fundamental principle of class action litigation that a class representative may not recover more than his or her fair share of a settlement. While this is in accord with the notion that the class representative is a fiduciary to the absent class members, and cannot put his or her interests ahead of the class, it still seems a bit unfair. After all, class representatives are the ones who have come forward to carry the flag, so to speak, and to vindicate the rights of the class. Without them, there would be no class, and no one would recover. Moreover, there is no question that, in many instances, class representatives make substantial sacrifices in pursuit of litigation on behalf of the class. In addition to monitoring the litigation, class representatives might have to respond to document requests and interrogatories, and to have their depositions taken. They will surely participate in settlement negotiations and discussions about litigation strategy, and may even be called to testify at trial.

Class representatives are the ones who have come forward to carry the flag to vindicate the rights of the class. Without them, there would be no class, and no one would recover.

Further, class representatives frequently provide invaluable assistance to their attorneys. In an employment discrimination class action, for example, class representatives may provide counsel with extensive knowledge about their employer's organization, workforce and employment practices. Similarly, in an antitrust class action, the named plaintiffs may be able to provide counsel with detailed information about how a product is marketed or used. In sum, contrary to the notion that named plaintiffs in class actions are mere "figureheads," named plaintiffs often play an extremely valuable role in the litigation.

Contrary to the notion that named plaintiffs in class actions are mere "figureheads," named plaintiffs often play an extremely valuable role in the litigation.

As a result, while prohibited from receiving a greater share of the recovery than the class, courts frequently awarded named plaintiffs in class actions "incentive awards." The rationale for these awards was twofold: courts wanted to encourage people to come forward and act as "private attorneys general" in meritorious cases, and courts wanted to recognize the sacrifices which the plaintiffs had made to pursue the litigation — and to compensate them for those sacrifices. *See, e.g., In re Catfish Antitrust Litigation*, 939 F. Supp. 493, 504 (N.D. Miss. 1996); *Gaskill v. Gordon,* 942 F. Supp. 382, 384 (N.D. Ill. 1996); *White v. National Football League,* 822 F. Supp. 1389, 1406 (D. Minn. 1993).

The Private Securities Litigation Reform

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Bernstein Litowitz Berger & Grossmann LLP prosecutes class and private actions, nationwide, on behalf of institutional and individual investors. Founded in 1983, the firm's practice concentrates in the litigation of securities fraud; corporate governance; antitrust; employment discrimination; and consumer fraud actions. The firm also handles, on behalf of major institutional clients and lenders, more general complex commercial litigation. The firm's client base in securities fraud and corporate governance litigation includes large public pension funds and other institutional investors.

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Act ("PSLRA") provides a mechanism by which named plaintiffs — including institutions — can recover the costs and expenses that they incur while serving as class representatives. Specifically, the PSLRA provides that while the share of any final judgment or settlement that is awarded to a lead plaintiff shall be equal, on a per share basis, to the portion of the judgment or settlement awarded to the other members of the class, "nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of the class."

> *The PSLRA clearly provides that lead plaintiffs may be awarded their out-of-pocket costs, which directly relate to the litigation.*

Quarterly Quote

"In virtually all transactions, we rely on the word of those with whom we do business. If a significant number of business people violate the trust upon which our interactions are based, our court system and our economy would be swamped into immobility."

Alan Greenspan
Federal Reserve Chairman
Commencement Address at Harvard, June, 1999

This provision is particularly useful for institutional investors, who, encouraged by the PSLRA's call to arms, have begun to take an extremely active role in the prosecution of securities class actions. Indeed, while plaintiffs' counsel typically agree to advance the costs of the litigation (such as court reporters and expert fees), institutions themselves undoubtedly incur costs of their own — not to mention the significant amount of time that personnel must devote to the litigation. While there is little case law addressing exactly what constitutes "reasonable costs and expenses," it is crystal clear that institutions can recover many of their expenses—including expenses of which they may not even be aware. For example, institutions can undoubtedly recover the costs of telephone calls which they make to their counsel, and can also recover photocopying and postage costs. Similarly, institutions who incur travel costs—such as when they attend court hearings, settlement negotiations or meetings in connection with the case—will certainly be allowed to recover these costs.

While the PSLRA clearly provides that lead plaintiffs may be awarded their out-of-pocket costs which directly relate to the litigation, many institutions considering moving for appointment as lead plaintiff probably ask themselves if the substantial benefits of serving as lead plaintiff are worth the "burdens." Indeed, while the facts demonstrate that securities fraud class actions typically settle for a significantly greater percentage of the loss when institutions serve as lead plaintiff, institutions inevitably will need to devote a fair amount of time to the litigation. For example, institutional personnel might have to respond to discovery requests, produce documents, and be deposed. Can institutions be reimbursed for the time they spend on the litigation? The PSLRA says "yes."

The PSLRA specifically includes "lost wages" as costs which are recoverable. While no institution serving as lead plaintiff has yet to submit its costs and expenses incurred on behalf of representing a class under the PSLRA, we believe that, if proper record-keeping is maintained, wages paid to personnel involved in the litigation may be reimbursed. For example, if an employee who earns an annual salary of $1,000 per week is forced to devote two days to helping counsel respond to discovery requests, then we believe that the institution may submit $400 as reimbursable lost wages. This is obviously true if the institution was forced to pay the employee overtime; in such case, all of the overtime paid would be reimbursable costs. Indeed, if an individual was serving as lead plaintiff and was forced to take off from work to be deposed or otherwise participate in discovery, and was forced to take a vacation day or was docked a day's pay, there is no doubt that the individual would be

> *The PSLRA specifically includes "lost wages" as costs which are recoverable.*

Continued on page 9.

Eye On The Issues

LEGISLATIVE/REGULATORY UPDATES
AND RECENT DECISIONS OF INTEREST

By Rochelle Feder Hansen

Subject For Debate: Regulation Of A "Public" NYSE And NASD. With demutualization of NYSE and Nasdaq likely to occur in the year 2000, there has been ongoing dialogue between the SEC and the exchanges regarding the public policy considerations presented by the change. One of the biggest considerations is what regulatory structure will be utilized. Richard A. Grasso, chairman and chief executive officer of the NYSE believes that it could self-regulate through a separate division. NASD chairman and chief executive officer Frank G. Zarb testified that the NASD plans to spin off its regulatory arm once it becomes a public for-profit company. Commenting on the NYSE and NASDAQ's moves to demutualization a few days before the Senate Banking Committee hearing, SEC Chairman Levitt stated in a September 23 speech at Columbia Law School, that more attention must be paid to how self-regulation works if the exchanges have a profit interest in their own success. Levitt stated that "[a]t the very least, I believe that strict corporate separation of the self-regulatory role from the market place it regulates is a minimum for the protection of investors in a for-profit structure." As reported by the Council of Institutional Investors, Council Research Service ALERTS, Vol. 4, No. 34, general members of the council voted to send letters to Chairman Levitt expressing their strong opinion that when the exchanges become public they should not be self-regulating. The full text of Chairman Levitt's remarks can be found at:
http://www.sec.gov/news/speeches/spch 295.htm.

SEC Increasingly Concerned About Auditor Independence. In his remarks to the Corporate Bar Association on October 1, 1999, SEC Commissioner Norman S. Johnson stated that he "believe[s] that the principle of auditor independence is so crucial to the quality of financial reporting and faces such unprecedented threats, that it is a topic that deserves the attention of all who care about the financial reporting process..." In addition to the increasing number of cases of financial fraud that have raised questions regarding the independence of the auditor, Commissioner Johnson noted that he was concerned that many of the independence problems "are rooted in the dramatic organizational changes that have taken place in the accounting profession over the last several years driven by economic pressures." He noted that auditing fees are no longer the primary revenue source for the largest accounting firms. One of the most troubling developments noted by Commissioner Johnson is the efforts by accounting firms to expand into the legal services area. He stated that this development is currently being reviewed and considered by the Independence Standards Board under the leadership of Chancellor William Allen and by the American Bar Association. The full text of Commissioner Johnson's remarks can be accessed at:
http://www.sec.gov/news/speeches/spch300.htm

Audit Standards Proposal Enhances "Independence" Of Concurring Partner Review. Effective October 1, 1999: an AICPA rule revision providing that an audit partner who heads the audit of a public company's financial statements would be barred for two years from serving as the "concurring partner", *i.e.,* the partner charged with the responsibility for reviewing the work of the firm's audit engagement team. The revision was promulgated in the wake of the resolution of the SEC enforcement action that led to a nine-month suspension of a former Deloitte & Touche partner for improper professional conduct as a "concurring partner" and several other similar actions by the Commission. In addition to the "cooling off" period, the rule change provides that the concurring partner review must be completed before the release of the audit report and the reviewer is not allowed to serve on any part of the audit engagement. In addition to the clarification of the "concurring partner" role, the AICPA's Auditing Standards Board issued a proposal that would elevate the concurring partner review to the level of a professional standard. The draft rule calls for audit firms to set engagement performance policies and procedures that reflect the requirements for concurring partner review. If adopted, the proposed auditing standard would become effective on January 1, 2000. The proposal of the Auditing Standards Board can be found at:
http://www.aicpa.org/members/div/auditstd/index.htm.

Additional Courts Of Appeals Weigh In On Scienter Pleading Standard. ***The United States Court of Appeals for the Eleventh Circuit*** has taken the "middle ground" in articulating the standard for pleading *scienter* under the PSLRA. In *Bryant v. Avado Brands Inc.,* 11th Cir. No. 98-9253, 9/3/99, the Court held that a complaint alleging with particularity that a defendant acted with a "severely reckless state of mind" still suffices to state a claim for violation of 10(b) and Rule 10b-5, however, it ruled that allegations of defendant's motive and opportunity standing alone are not sufficient to satisfy the pleading requirement. The Court rejected the Ninth Circuit's view as expressed in *In re Silicon Graphics Securities Litigation,* to the extent that it suggests that Congress intended for the PSLRA

to raise the substantive state of mind requirement for pleading *scienter.* The Eleventh Circuit cited its basic agreement with the reasoning of the Sixth Circuit in *In re Comshares Inc. Sec. Litigation,* 183 F.3d 542, 550 (6th Cir. 1999). The full text of *Bryant* can be accessed at:
http://laws.findlaw.com/11th/989253MAN.html.

The United States Court of Appeals for the First Circuit, also articulated a rule that is close to the standard articulated by the Sixth Circuit in *Comshare.* In *Greebel v. FTP Software, Inc.,* No 98-2194, decided on October 11, 1999, the First Circuit said the PSLRA imposes a requirement that pleadings raise a "strong" inference of *scienter* rather than a merely "reasonable" inference. With respect to the issue of whether the pleading of motive and opportunity is sufficient, the Court noted that many different types of evidence are relevant to show *scienter*, but "[t]he most salient feature of the PSLRA is that whatever the characteristic pattern of the facts alleged, those facts must now present a *strong* inference of *scienter.*" The court rejected defendants' argument that facts showing motive and opportunity can never be enough to permit the drawing of the requisite strong inference of scienter. With respect to the question of whether the PSLRA altered the substantive standard for proving scienter, the Court rejected the Ninth Circuit's holding in *Silicon Graphics,* that the PSLRA elevated the standard to one of "deliberate recklessness." It expressed its agreement with other circuits that held that the PSLRA did not address the substantive definition of *scienter* which in the First Circuit has been stated to be a narrowly defined concept of recklessness that "is closer to being a lesser form of intent." The full text of *Greebel* can be accessed at:
http://www.law.emory.edu/1circuit/oct99/98-2194.01a.html.

Ninth Circuit Refuses To Grant Relief From PSLRA's Stay Of Discovery But Finds Open Market Purchasers Have Standing To Bring Section 11 Claim. The Ninth Circuit Court of Appeals issued two recent decisions that have major implications for securities class actions. In *S.G. Cowen, Securities Corp. v. U.S. Dist. Court for the Northern District of California,* 9th Cir. No. 98-71501 (Aug. 30, 1999), the Court of Appeals reversed a district court decision that afforded plaintiffs limited relief from the PSLRA's stay of discovery pending a decision on defendant's motion to dismiss. The district court, which had dismissed plaintiffs' complaint with leave to replead, partially granted plaintiffs' request for limited discovery after finding that the claims alleged were narrow, that plaintiffs had demonstrated facts that the evidence sought was of a type likely to be solely within the company's possession, and that specific facts had also been alleged in support of insider trading claims. The Court of Appeals reversed stating that it was error to grant the request because plaintiffs did not adequately allege undue prejudice as required by the PSLRA. The Court of Appeals stated that "Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than the information produced by the defendants after the action has been filed." The Court of Appeals found that the grant of plaintiffs' request would result in uncovering sufficient facts to satisfy the PSLRA's pleading requirements and this was not a permissible reason for lifting the stay. The Court's opinion can be accessed at: **http://laws.findlaw.com/9th/9871501.html.**

In a second decision, *Hertzberg v. Dignity Partners, Inc.,* 98: 16394 (August 27, 1999), the Court of Appeals upheld the right of open market purchasers of stock issued in an IPO to sue under Section 11 of the Securities Act. The district court had dismissed the class action for lack of standing because plaintiffs had not purchased their stock in the initial public offering or within the next twenty-five (25) days. The Court of Appeals reversed holding that the district court had erred in imposing the 25-day limit. It noted that the legislative history of Section 11 indicated that Congress intended for purchasers in the after market to have a cause of action. It stated that the language of the statute "only means that the person must have purchased a security issued under that, rather than some other registration statement." The Court's opinion can be accessed at: **http://laws.findlaw.com/9th/9816394.html.**

"Business as Usual" Expected for First Trading Day of the New Millennium. According to SEC Chairman Arthur Levitt and NYSE Chairman Richard Grasso, the first trading day of the new millennium "will be business as usual." Chairman Arthur Levitt recently stated that, [t]he most we have to fear right now is public misconception, public fear." According to Levitt, all of the SEC's mission critical and non-mission critical computer systems are now Y2K compliant. Additionally, under new rules adopted by the SEC in July, firms not ready for the transition by November 15, 1999, must cease doing new business and wind down operations by December 1, 1999. If a firm refuses to cooperate, Levitt said that the division of enforcement will file an injunctive action in federal district court seeking a court order that the firm cease doing business. Additionally, at the news conference on September 7, 1999, during which these assurances were given, a Year 2000 investor kit offering advice to assist individual investors in protecting themselves from Y2K problems was presented. The Year 2000 Investor Kit can be obtained through web sites for the SEC, **http://www.sec.gov; NASD, http://www.nasd.com;** the SIA, **http://www.sia.com;** or the ICI, **http://www.ici.org**.

Continued on next page.

Institutional Activism Briefs

CalPERS Intervenes—Company Adopts Strong Sexual Harassment Policy. CalPERS intervention in a derivative action involving W. R. Grace & Co. resulted in a significant benefit for shareholders and the implementation of strong corporate governance reforms. CalPERS challenged a proposed settlement of the action, which alleged breach of fiduciary duty and corporate waste stemming from the payment of a large severance package to the former CEO and President who had been accused of sexual harassment. The proposed settlement provided no monetary benefit to the company and would have implemented a harassment policy that CalPERS believed to be inadequate. As a result of CalPERS' intervention, a revised settlement recovered nearly $4 million and the company agreed to adopt a strong policy on sexual harassment. The settlement was approved by the Court.

FSBA Activism Garners $40.5 Million for Class Members. Florida State Board of Administration ("FSBA"), lead plaintiff in a securities class action against Ucar International, a company which admitted participating in a global price-fixing conspiracy, succeeded in obtaining $40.5 million for the benefit of the members of the class. In addition, the company agreed to appoint a new independent director recommended by the FSBA. The FSBA nominee will have antitrust compliance, corporate governance and other business and financial experience.

NYC Pension Funds to Increase Shareholder Activism. As reported by the Council of Institutional Investors, Council Research Service ALERTS, Vol. 4, No. 34, the New York City Pension Funds plan to increase their shareholder activism efforts in the coming proxy season. For the first time, the funds will use a proxy solicitation firm. Targeted companies will be those whose boards have refused to implement shareholder proposals, sponsored by the funds, that won a majority of the shares voted.

SEC Softens Stance on Audit Committees. Notwithstanding Chairman Levitt's statement that the recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees "deserve quick implementation," see Volume 1, Second Quarter page 6 of the Advocate, the SEC is considering easing one of the key proposals in response to worries expressed by audit committee members about increased risks of liability. The Committee urged the SEC to establish rules requiring the audit committee to confirm that the committee, "in relying on reviews and talks with management and external auditors, believes that the firm's financial statements conform to Generally Accepted Accounting Principles." Instead, the SEC staff plans to recommend that audit committees certify only that their firm's financial statements reflect what they believe to be "full and fair disclosure of the financial picture." See BNA, Securities Regulation and Law Report, Vol. 31, No. 28, p. 953 (July 16, 1999).

Year 2000 Liability A Possibility For U.S. Companies Doing Business Abroad. The ad hoc Senate Committee addressing Y2K issues released its last report warning that U.S. companies doing business abroad could have exposure under foreign laws. There were no specific cases reported that prompted the conclusion, according to Senator Christopher J. Dodd, vice chairman of the Special Committee on the Year 2000 Technology Problem, which compiled the report. Senator Dodd explained that the committee's concern is an outgrowth of initial estimates of total costs of Y2K-related litigation at $1 trillion worldwide. The international location most at risk for systems failure at the turn of the century is Eastern Europe, which has made slow progress toward becoming Y2K compliant, according to the report.

The report also states that while most U.S. major industrial sectors, including finance and key utilities appear ready for Y2K, small businesses continue to be a cause for concern. Even more troubling, however, from the committee's perspective, is the fact that the domestic health care industry—nursing homes, rural and inner-city hospitals, and individual physician's offices are most at risk for Y2K related problems. The 100 Day Report of the U.S. Senate Special Committee on the Year 2000 Technology Problem, which focusses in the main on Congress' efforts to pass Y2K liability limiting legislation, can be accessed at **http://y2k.senate.gov**.

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HAVING YOUR CAKE AND EATING IT TOO

Continued from page 5.

entitled to reimbursement for those "lost wages." There is simply no reason or basis to treat the institution any differently.

The legislative history of the PSLRA supports this interpretation. As an initial

Institutions serving as lead plaintiffs should maintain proper record-keeping procedures designed to keep track of their costs.

matter, the PSLRA evinces a clear Congressional mandate in support of institutions serving as lead plaintiffs. Moreover, the "Statement of Managers" to the PSLRA states that "[t]he Conference Committee recognizes that lead plaintiffs *should* be reimbursed for reasonable costs and expenses associated with service as lead plaintiff, including lost wages." Thus, we believe that the PSLRA provides strong support for the proposition that institutions can and should be reimbursed for the wages paid to their personnel for time devoted to the litigation.

Institutions serving as lead plaintiffs should maintain proper record-keeping procedures designed to keep track of their costs. With respect to their personnel costs, institutions should consider designating certain individuals who will have a primary role in the litigation, and use those individuals to perform whatever tasks are required. This will not only make it easier to keep track of the amount of time these individuals spend on matters relating to the litigation, but will also ensure that the tasks are performed economically and efficiently, by individuals who are familiar with the litigation. Institutions should also have their personnel document the tasks they have performed (such as searching for responsive documents or participating in settlement negotiations) and to record the amount of time they have spent on such tasks. If such records are maintained, they will go a long way toward convincing a court that the expenses were "reasonable" and "directly related" to the litigation.

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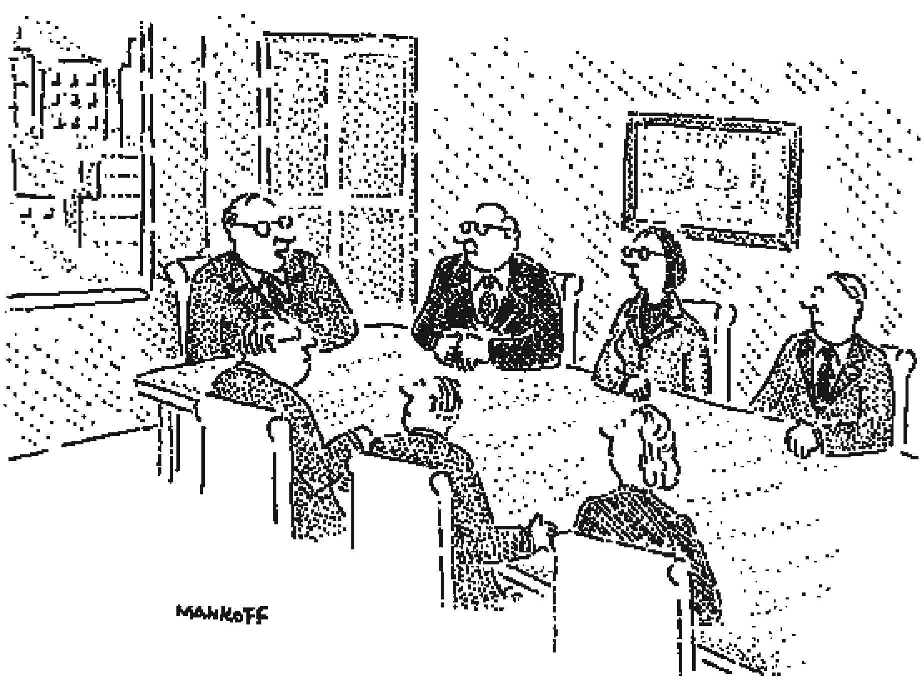

"We've agreed, then, to deck the halls, but the resolution to be jolly has been tabled."

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Q *Under the Private Securities Litigation Reform Act, may an institutional investor serve as a lead plaintiff in more than five securities class actions within a three-year period?*

A In a subparagraph of the Reform Act, entitled "Restrictions on professional plaintiffs," Congress directed that, "consistent with the purposes of this section," "a person may be a lead plaintiff… in no more than 5 securities class actions...during any 3-year period." How should this subparagraph be interpreted when an institutional investor seeks to be appointed lead plaintiff while already serving in that capacity in five securities class actions? We think that, while the actual language of the Reform Act is somewhat vague, this section should not restrict the appointment of an institutional investor as lead plaintiff in more than five securities class actions in a three-year period, as long as that institutional investor is capable of fulfilling its lead plaintiff duties.

Congress granted courts the discretion to permit the appointment of a lead plaintiff even if that appointment would violate the "five times in three years" restriction, as long as the exception was "consistent with the purposes of this section." There is no question that a central purpose of the lead plaintiff provisions of the Reform Act was to encourage a meaningful investor with a substantial stake in the litigation, preferably a large institutional investor, to initiate and control the litigation. Indeed, this very conclusion has been reached by courts in a multitude of securities class actions in which institutional investors were afforded the lead plaintiff preference intended by Congress. This purpose would be frustrated if institutions were prevented from serving as lead plaintiffs more than five times in three years.

Institutional Investors are not "Professional Plaintiffs"

Indeed, the Conference Report to the Reform Act defines "professional plaintiffs" as those "who own a nominal number of shares in a wide array of public companies [and who] permit lawyers readily to file abusive securities class action lawsuits." That Conference Report then explicitly states that institutional investors are not the "professional plaintiffs" whose appointment as lead plaintiff Congress sought to restrict:

> *Institutional investors seeking to serve as lead plaintiff may need to exceed this limitation and do not represent the type of professional plaintiff this legislation seeks to restrict. As a result, the Conference Committee grants courts discretion to avoid the unintended consequences of disqualifying institutional investors from serving more than five times in three years. The Conference Committee does not intend for this provision to operate at cross purposes with the "most adequate plaintiff" provision.*

This conclusion was reached in *Blaich v. Employee Solutions,* in which the court held that "the provision of the PSLRA concerning restrictions on professional plaintiffs do[es] not apply to institutional investors."

Courts Applying "Five Times in Three Years" Lead Plaintiff Restrictions

Incredibly, two cases have been decided, thus far, in which the "five times in three years" lead plaintiff restriction has been applied to institutions. In an unreported decision in *In re Telxon Corporation Securities Litigation,* a lead plaintiff application by an institutional investor was denied in part because the court there found that the restriction applied to the institution, the Florida State Board of Administration (the "Florida SBA"), and barred it from serving as a lead plaintiff. In *Telxon,* which is pending in the Northern District of Ohio, the court determined that the Florida SBA's losses were far less than the losses sustained by another lead plaintiff applicant. That court then addressed the restriction, finding that there was no authority in the Reform Act to support a blanket exemption for institutional investors. The court found that an institution seeking to be excused from the restriction must provide the court with a basis to do so without solely relying on its status as an institution. Focusing on the purpose of the Reform Act to put control of securities class actions in the hands of the plaintiff with the greatest financial interest in the relief sought, the court provided the following example of such a basis:

> *If, for instance, the Court were forced to choose between an institutional investor that had exceeded the five actions in three years rule and a single investor whose loss was dwarfed by that institutional investor, or a group of unrelated investors, then it certainly would be consistent with the purposes of the PSLRA to allow the institutional investor to serve as lead plaintiff, finding that the presumption arising under [the restriction] had been adequately rebutted.*

Even under this holding, therefore, as long as the institutional investor had the largest interest in the relief sought, that institutional investor would qualify to serve as lead plaintiff even if it had already served as lead plaintiff in five securities class actions in three years. In *Telxon*, however, the Florida SBA's losses were actually less than the losses of the competing lead plaintiff applicant.

Following *Telxon,* the court in *Aronson v. McKesson HBOC, Inc.,* currently pending in the Northern District of California, also held that, with respect to the "five times in three years" lead plaintiff restriction, "[t]he text of the statute contains no flat exemption for institutional investors." In that case, the Florida SBA, with losses of approximately $185 million — at least two times greater than the losses of any other lead plaintiff applicant — had joined with the New York State Common Retirement Fund, the Anchorage Police & Fire Retirement System and the Public School Teachers' Pension and Retirement Fund of Chicago, to become lead plaintiff. While this decision surely will be the subject of a future article, it is important to note here that the court disqualified the Florida SBA from serving as a lead plaintiff because the Florida SBA was currently serving as a lead plaintiff in six securities fraud class actions.

Going beyond the holding in *Telxon,* the court in *McKesson* did not find that the Florida SBA's substantial losses were a sufficient basis to rebut the presumption against serving as a lead plaintiff in more that five securities class actions in a three-year period. In fact, the court found that serving as lead plaintiff in six class actions was inconsistent with Congress's goal to increase client control over plaintiff's counsel. Finding that the Florida SBA was not the only lead plaintiff applicant, that the other lead plaintiff applicants did not have an even longer record of participation in securities class actions, or that the Florida SBA was not the only institutional investor applying for the lead plaintiff appointment, the court held that there were no "special circumstances" present to overcome the presumptive bar.

Obviously, this issue is open and will garner further attention as institutional investors continue to pick up the gauntlet thrown by Congress to take control of federal securities class actions.

There is no question that a central purpose of the lead plaintiff provisions of the Reform Act was to encourage a meaningful investor with a substantial stake in the litigation, preferably a large institutional investor, to initiate and control the litigation. This purpose would be frustrated if institutions were prevented from serving as lead plaintiffs more than five times in three years.

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