

Advocate

A SECURITIES FRAUD AND CORPORATE
GOVERNANCE QUARTERLY

DECIDING WHEN TO SERVE AS LEAD PLAINTIFF: A Seasoned Perspective

By Ronald Zajac, Esq.

Ronald Zajac has served as General Counsel to the Policemen and Firemen Retirement System of the City of Detroit and the General Retirement System of the City of Detroit since 1982. Together, these two funds have assets in excess of seven billion dollars. During the course of Mr. Zajac's distinguished career, he has represented more than forty public pension funds, as well as similar retirement systems throughout the State of Michigan, and has provided legal counsel on all aspects of fund management.



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TO BE (THE LEAD PLAINTIFF) OR NOT TO BE...

That is the question...that each Board of Trustees of public employee retirement systems should be asking in light of recent changes to the federal securities laws. I am and have been General Counsel to the General Retirement System of the City of Detroit and the Policemen and Firemen Retirement System of the City of Detroit since 1982 and have provided legal services to both retirement systems since 1971. The Boards of Trustees of each of the two Detroit Retirement Systems are very active managers, fiduciaries and trustees. Each Board of Trustees meets weekly, and all matters under the jurisdiction of each Board are carefully reviewed, discussed, argued and questioned as befitting trustees that are very much concerned about their fiduciary responsibilities.

Other retirement systems that have trustees who meet monthly or quarterly likely delegate substantial decision-making responsibilities to administrators, staff and advisors before ultimate decisions are made by the trustees.

Among the clear responsibilities of a trustee is to preserve plan assets and collect all amounts due the trust fund. Until recently, my clients,

upon being advised of actual or potential class action suits, would generally rely upon the filing of a Proof of Claim as the sole action of preserving the assets of the trust and seeking to collect amounts due the trust. The thought process was to rely upon others to represent the class and hope that after attorneys' fees (usually significant) there would be some payment to class members. We deemed any payment to be a plus, and relatively little attention was given to the class action litigation other than completing the Proof of Claim and reading any notices provided by class counsel or the Court.

Until recently, the chief financial benefactors of class action litigation were the attorneys involved, and the actual payments to class members were relatively small. The Private Securities Litigation Reform Act (PSLRA), however, was adopted in 1995 with the intention of having institutional investors replace nominal investors as lead plaintiffs and maximize any recovery.

If you accept the position (as I do) that a claim in a class action (or potential class action) is a plan asset, you will agree that pension plan trustees and their legal counsel must take

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WHEN TO SERVE AS LEAD PLAINTIFF

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steps to educate themselves about this new development in the law, and must rely upon experienced class action litigation specialists as a part of fulfilling fiduciary obligations.

As you read this, boards of trustees for public pension funds will be contacted by class action attorneys, seeking to be lead counsel by proposing that the public pension fund serve as lead plaintiff in class actions. These boards will have to decide whether to seek to be a lead plaintiff and which law firm to use in this specialized area of the law. I suggest the checklist on the following page to aid in the decision-making process.

The Policemen and Firemen Retirement System of the City of Detroit had sought (and prevailed) to be lead plaintiff in three cases: *Legato*, *Navigant* and

Guess, Inc. In these three cases, we were the only institutional investor with significant losses to seek lead plaintiff status. Although the *Legato* and *Guess* cases are ongoing, *Navigant* settled for more than \$24 million, which is an excellent result. We believe that our status as a pension fund maximized the recovery for the class.

In *Legato*, one group which competed with us for lead plaintiff status was represented by a law firm which had recruited various unrelated investors. Using their total losses as a group loss, the firm argued that the unrelated group should select the lead counsel and be able to protect the interests of the class. However, the group's motion was rejected and instead, the court appointed the Policemen and Firemen Retirement System of Detroit, noting: "as a large institutional investor with significant monetary losses, [it] is exactly the type

of lead plaintiff envisioned by Congress." In contrast, the competing group of investors had, according to the Court, been "hand-picked" by the law firm "for the sole purpose of obtaining lead plaintiff status, thus conferring lead plaintiff's counsel status" on the law firm. *Bowman v. Legato*, 195 F.R.D. 655, 658 (N.D. Cal. 2000). By seeking to be lead plaintiff, we prevented the appointment of a figurehead plaintiff group, and we believe that we will maximize the recovery for members of the class.

The experience of my clients is that our actual time involved is minimal. When the Board decides that serving as the lead plaintiff advances the retirement system's interests, I, as General Counsel, monitor the litigation and keep in regular contact with our outside class action counsel. I review the pleadings and also report developments to the Board of Trustees. When necessary, a

Inside Look

One of the *Advocate's* primary goals is to provide the views of members of the institutional investor community, in their words, on subjects that are important to them, like improving corporate governance and evaluating securities litigation. In this issue, we are extremely pleased that Ron Zajac contributed our cover article, *Deciding When to Serve as Lead Plaintiff*. Ron serves as General Counsel to the General Retirement System of the City of Detroit and the Policemen and Firemen System of the City of Detroit. The latter was lead plaintiff in the *Navigant* case, which recently settled for over \$24 million, and presently serves as lead plaintiff in two ongoing cases.

Ron's insight is very valuable, and we greatly appreciate his contribution to this issue. In his article, Ron addresses a subject that has grown increasingly important to public pension funds in recent

years, namely, how to evaluate potential cases in light of the Reform Act and how to retain the appropriate law firm. Drawing from his own experience, Ron emphasizes the importance of considering active participation in class litigation as a means of fulfilling fiduciary duties to preserve trust assets and recover losses. To assist institutional investor who may have no experience in this area, Ron lists specific factors for trustees and others to consider when their funds suffer losses due to possible securities fraud.

Also in this issue, we follow up on the tremendous victory that several institutional investors scored in the *Columbia/HCA* case. In the previous issue, we noted that the Court of Appeals for the Sixth Circuit reversed the lower court's dismissal of the case. Jeff Leibel now provides a full account of the appeal, explains its importance to shareholders, and describes the critical role played by some of the largest pension funds in the country.

We have departed from our usual practice of printing a short, poignant quote and have, instead, reprinted an excerpt from Warren E. Buffet's letter to the shareholders of Berkshire Hathaway, Inc. Mr. Buffet provides his definition of "full and fair reporting" by public companies. The excerpt is an engaging read, and I direct your attention to it.

I also direct your attention to Steve Mellen's *Eye on the Issues*. As always, Steve's sensitive antennae have detected emerging trends and events, such as the recent SEC enforcement action against Sunbeam's auditors, as well as a recent study confirming the superior results achieved when institutional investors serve as lead plaintiffs in securities class actions.

We always enjoy hearing from our readers. Feel free to contact me, and I hope that you find this issue of the *Advocate* to be interesting and informative.

Max W. Berger

Advocate

representative from the retirement system (usually a trustee) attends important court hearings and settlement conferences. Our class action counsel provides frequent reports to me and makes telephone or personal presentations to the Board. We oversee and coordinate all settlement negotiations. This does not require any out-of-pocket expenses or significant expenditures of staff time, and I firmly believe that our involvement as an institutional investor maximizes the recovery for the retirement system and for the other shareholders in the class.

We oversee and coordinate all settlement negotiations. This does not require any significant out-of-pocket expenses or expenditures of staff time, and I firmly believe that our involvement as an institutional investor maximizes the recovery for the retirement system and for the other shareholders in the class.

It should be remembered that the lead plaintiff (with the assistance of lead counsel) makes many decisions regarding the litigation, such as its scope, the applicable period of harm, the selection of lead counsel, the trial strategy, settlement strategy and amount of legal fees. Of course, many such decisions are also subject to review and approval by the Court.

Although other institutions may do it differently, the retirement systems that I counsel reach an agreement with our class action counsel at the outset of the case providing for a fee that is much lower

Should our retirement system seek to be lead plaintiff in a class action litigation?

- A. What is our claim? What was the alleged wrongdoing?
- B. What is the degree to which we are offended by the wrongdoing?
- C. What is the amount of our loss?
- D. What are the defenses? What are the merits of the case? Are we likely to prevail? (We want to be involved in a strong case on the merits, not a weak or marginal claim.)
- E. Are the losses collectable? What is the defendants' financial condition? Are insurance carriers involved? How many defendants will there be?
- F. Will there be other consequences if we win or lose? For instance, will success bankrupt the company or adversely affect other investments that we have in the same company?
- G. Are there others who are more deserving to be lead plaintiff? (In which case, we may defer to them or seek to join them as co-lead plaintiff.)
- H. What economic and administrative costs will be involved? (Typically, all out-of-pocket costs should be advanced and paid by litigation counsel who accepts the case on a contingency basis.)
- I. Does my trust fund have a separate claim due to unusual facts which suggests separate litigation (as opposed to class action litigation)?
- J. Would failure in the litigation adversely affect the reputation of the retirement fund or Board of Trustees? Are there other possible adverse consequences?
- K. Do we have the time to interact with legal counsel and make decisions as required?
- L. Should we consider seeking to serve as co-lead plaintiff with others?

Who should I select as lead counsel?

- A. What is the experience and track record of legal counsel?
- B. What is the reputation of legal counsel?
- C. Does legal counsel understand the special responsibilities of a public fund trustee and how public employees' retirement systems function?
- D. Does legal counsel know the distinction between ERISA plans and governmental plans and the difference in fund operation and special considerations applicable to governmental plans?
- E. What is the overall comfort level with the law firm and its representatives?
- F. Does legal counsel accept that decisions are made by the lead plaintiff and not the law firm?

than the amount typically paid in these cases. Indeed, the judge in *Navigant* specifically commended this approach when commenting on our counsel's fee request:

As to the attorneys' fees, I find that the 20% percent amount, which is a negotiated amount, is really exceptionally fair in this case for the sophisticated counsel that did represent the plaintiffs in this case.

In a sense, the plaintiffs have benefitted from the levered position of the lead plaintiff, the Policemen and Firemen Retirement System of the City of Detroit, which I know has operated as lead plaintiff in other situations and used their position to negotiate this fee, which inures to the benefit of all class members.

The judge's comments in *Navigant* underscore the importance of having an institutional investor serve as the lead

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Quarterly Quote

At Berkshire, full reporting means giving you the information that we would wish you to give us if our position were reversed. What Charlie and I would want under that circumstance would be all the important facts about current operations as well as the CEO's frank view of the long-term economic characteristics of the business. We would expect both a lot of financial details and a discussion of any significant data we would need to interpret what was presented.

We applaud the work that Arthur Levitt, Jr., until recently Chairman of the SEC, has done in cracking down on the corporate practice of "selective disclosure" that had spread like cancer in recent years. Indeed, it had become virtually standard practice for major corporations to "guide" analysts of large holders to earnings expectations that were intended either to be on the nose or a tiny bit below what the company truly expected to earn. Through the selectively dispersed hints, winks and nods that companies engaged in, speculatively-minded institutions and advisors were given an information edge over investment-oriented individuals. This was corrupt behavior, unfortunately embraced by both Wall Street and corporate America.

Thanks to Chairman Levitt, whose general efforts on behalf of investors were both tireless and effective, corporations are now required to treat all of their owners equally. The fact that this reform came about because of coercion rather than conscience should be a matter of shame for CEOs and their investor relations departments.

One further thought while I'm on my soapbox: Charlie and I think it is both deceptive and dangerous for CEOs to predict growth rates for their companies. They are, of course, frequently egged on to do so by both analysts and their

own investor relations departments. They should resist, however, because too often these predictions lead to trouble.

It's fine for a CEO to have his own internal goals and, in our view, it's even appropriate for the CEO to publicly express some hopes about the future, if these speculations are accompanied by sensible caveats. But for a major corporation to predict that its per-share earnings will grow over the long term at, say, 15% annually is to court trouble.

That's true because a growth rate of that magnitude can only be maintained by a very small percentage of large businesses. Here's a test: Examine the record of, say, the 200 highest earning companies from 1970 or 1980 and tabulate how many have increased per-share earnings by 15% annually since those dates. You will find that only a handful have. I would wager you a very significant sum that fewer than 10 of the 200 most profitable companies in 2000 will attain 15% annual growth in earnings-per-share over the next 20 years.

The problem arising from lofty predictions is not just that they spread unwarranted optimism. Even more troublesome is the fact that they corrode CEO behavior. Over the years, Charlie and I have observed many instances in which CEOs engaged in uneconomic maneuvers so that they could meet earnings targets they had announced.

Worse still, after exhausting all that operating acrobatics would do, they sometimes played a wide variety of accounting games to "make the numbers." These accounting shenanigans have a way of snowballing. Once a company moves earnings from one period to another, operating shortfalls that occur thereafter require it to engage in further accounting maneuvers that must be even more "heroic." These can turn fudging into fraud. (More money, it has been noted, has been stolen with the point of a pen than at the point of a gun.)

I tend to be leery of companies run by CEOs who woo investors with fancy predictions. A few of these managers will prove prophetic but others will turn out to be congenial optimists or even charlatans.

Charlie and I tend to be leery of companies run by CEOs who woo investors with fancy predictions. A few of these managers will prove prophetic but others will turn out to be congenial optimists or even charlatans. Unfortunately, it's not easy for investors to know in advance which species they are dealing with.

— Excerpt from the letter of Warren E. Buffett, Chairman of the Board of Berkshire Hathaway, Inc., to shareholders in Berkshire Hathaway's 2000 Annual Report

Eye On The Issues

LEGISLATIVE/REGULATORY UPDATES
AND RECENT DECISIONS OF INTEREST

By Steven E. Mellen

A Peerless victory for stockholders. The recent settlement of the shareholder lawsuit brought by the State of Wisconsin Investment Board (SWIB) against Peerless Systems represents a big win for investors and champions of corporate governance everywhere. The lawsuit involved a company-backed proposal which failed to garner the necessary votes at the shareholder meeting, whereupon Peerless improperly decided to adjourn the vote and keep the polls open, hoping to win more affirmative votes. The settlement negotiated by SWIB includes a number of favorable corporate governance provisions, among them: the board must consist of a majority of independent directors; the nominating and compensation committees must be entirely independent; no discount options will be allowed; and no existing options may be repriced or replaced without shareholder approval. *State of Wisconsin Investment Board v. Peerless Systems Corp., et al., Case No. SN-17637-NC (Del. Ch., filed December 7, 1999). See also Council Research Service Alerts, May 9, 2001.*

Corporate governance makes the world go around. Savvy investors know that good corporate governance is an important factor to consider when picking winners in the stock market the same reason why many institutional lead plaintiffs insist that settlements in securities fraud cases include strong corporate governance measures. A recent study by CLSA Emerging Markets found that the link between corporate governance and stock performance holds true in the international arena, as well. CLSA looked at 495 international companies and found that while the stocks of the largest 100 fell by an average of 8.7% last year, the stocks of the 25 companies rated best for corporate governance actually rose by 3.3%. CLSA concluded that the correlation between good corporate governance and share performance is "a near perfect fit." *The Wall Street Journal, May 1, 2001.*

SEC cracks down on Sunbeam auditors. Nearly three years after Sunbeam's controversial CEO, Al "Chainsaw" Dunlap, was fired amidst a storm of negative publicity concerning the company's accounting practices, the SEC has begun to name names. Notably, named as a defendant in the SEC's recently-filed civil enforcement proceedings, in addition to five former Sunbeam executives, is the Arthur Andersen partner responsible for Sunbeam's audits. The SEC alleges Arthur Andersen had a key role in perpetrating the accounting fraud at Sunbeam and issued clean audit opinions with full knowledge of Sunbeam's improper accounting. Even in the face of the most damning evidence against them, auditors repeatedly insist that they would never knowingly risk their reputations by

participating in a fraud; it is comforting to see the SEC take a contrary position. *Securities and Exchange Commission v. Albert J. Dunlap, et al., Case No. 01-CV-8437 (S.D. Fla., filed May 15, 2001).*

New disclosures raise serious questions regarding auditor independence. Last year, the SEC announced new rules requiring publicly-traded companies to disclose how much they pay their auditors for non-audit services. Based upon filings under these new rules, a recent *Wall Street Journal* study of 307 S&P500 companies found that those companies paid their auditors \$2.65 billion for non-audit services, compared with the mere \$909 million they paid for audit services. Many observers believe that the size of these fees creates an incentive for auditors to "look the other way" when problems arise, rather than jeopardize their relationship with their clients and put their firms' substantial non-auditing fees at risk. SEC Chief Accountant Lynn Turner agreed with this concern, stating that he had expected to find that fees for non-audit services were about 25-40% of audit fees. "I'm a firm believer that economics does have a firm impact on people's behavior," he said. *The Wall Street Journal, April 10, 2001.*

Shareholder proposals face obstacles. Last issue's Eye reported on a successful shareholder proposal at ICN Pharmaceuticals. Although some had hoped that this might be the start of a trend, the results from the latest round of shareholder proposals are quite troubling. In a number of recent instances including corporate governance proposals at AT&T, Marriott International, and Bank of America, the SEC has permitted companies to omit the proposals from their proxy statements altogether. Specifically, the SEC stated that shareholder proposals regarding director independence are properly objectionable because directors are elected by shareholders, not the company, and thus the company lacks the power to ensure that a sufficient number of independent directors will be available. Some commentators view these SEC rulings as evidencing a disturbing hostility towards shareholder proposals, while others believe that the SEC's concerns can be fully addressed by careful drafting. Stay tuned for further developments. *Council Research Service Alerts, March 8, 2001.*

Institutional lead plaintiffs draw rave reviews. Even those skeptical of the securities class-action process in general cannot help but recognize the extraordinary results that have been obtained by institutional lead plaintiffs. A recent Smartmoney.com article, critical of the relatively small recoveries in some securities class actions, nonetheless cited the Cendant litigation as a textbook example of an outstanding settlement, noting that the institutional lead plaintiffs in that case "had the know-how and resources to force such a settlement." Harvey J. Goldschmid, former general counsel to the SEC, commented that: "What we do know — at least anecdotally — is that the involvement of large institutions adds to the quality of the claim." How can investors know which shareholder class-actions are likely to result in large recoveries? Smartmoney's answer is simple: "Look for big institutional names among the plaintiffs." *Smartmoney.com, April 5, 2001.*

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INSTITUTIONAL INVESTORS PERSIST IN COLUMBIA/HCA DERIVATIVE ACTION

By Jeffrey N. Leibel

Prosecuting major shareholder litigation provides institutional investors with the opportunity to effect significant corporate change. That was the goal of the New York State Common Retirement Fund, CalPERS, LaCERA and nine other public pension systems and institutional investors when they joined together in 1997 to prosecute a derivative action on behalf of shareholders of Columbia/HCA Healthcare Corporation. At the time, Columbia/HCA stood accused of perpetrating the largest healthcare fraud in U.S. history. Because these institutional investors believed that Columbia/HCA's officers and directors caused or willfully ignored years of company-wide healthcare fraud, they sued those officers and directors for the damage they caused the Company, seeking to compel changes to Columbia/HCA's corporate governance and healthcare compliance structures and to ensure that this episode is not repeated.

When the district court dismissed the complaint on a technicality, these twelve institutional investors, including several of the largest public pension funds in the U.S., appealed. Their efforts to hold the wrongdoers accountable to Columbia/

HCA's shareholders were vindicated when the Court of Appeals reversed the dismissal and upheld the complaint.

The institutional investor plaintiffs charged Columbia/HCA's directors and officers with breaches of their fiduciary duty of care. It was on their watch that Columbia/HCA perpetrated the largest healthcare fraud in U.S. history. The fraudulent schemes ran the gamut. Columbia/HCA "upcoded," which means that the company charged the government and private insurers for illnesses that were more severe, and, therefore, more costly, than were actually warranted by patients' conditions. The Company also improperly shifted costs among hospitals and other healthcare facilities to obtain greater-than-allowable reimbursements. And these were just some of the aspects of Columbia/HCA's improper schemes. As a result of these devices, Columbia/HCA was subject to over fifty search warrants, issued only after it was judicially determined that *probable cause* existed that evidence would be found, as articulated in the sworn affidavit of the FBI Special Agent in charge of the federal

criminal investigations, of "a systemic corporate scheme perpetrated by corporate officers and managers...to defraud Medicare [and] Medicaid."

Columbia/HCA's directors had extensive healthcare experience and substantial evidence of ongoing fraud. They knew about (i) the contents of reports to Columbia/HCA's Audit Committee, which included descriptions of improper Medicare and Medicaid reporting practices; (ii) the illegal incentives Columbia/HCA provided to recruit physicians and to acquire hospitals; (iii) the healthcare fraud alleged in a whistleblower action; and (iv) several federal criminal investigations and a separate investigation by *The New York Times* into Columbia/HCA's improper Medicare and Medicaid reporting practices. Those directors also knew that if Columbia/HCA was convicted of violating the healthcare statutes, the Company could lose all of its Medicare and Medicaid business, which amounted to some 40% of the Company's annual revenues. Nevertheless, the Board allowed the massive healthcare fraud to continue unabated and thus violated their fiduciary duties to Columbia/HCA's shareholders.

Under Delaware law, a company's decision to commence a lawsuit, like other decisions concerning how a company should be run, lies squarely within the discretion, or "business judgment," of a



Bernstein Litowitz Berger & Grossmann LLP prosecutes class and private actions, nationwide, on behalf of institutions and individuals. 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.

BLB&G: INSTITUTIONAL INVESTOR ADVOCATE is published quarterly by Bernstein Litowitz Berger & Grossmann LLP, 1285 Avenue of the Americas, New York, NY 10019, 212-554-1400 or 800-380-8496. The materials in this newsletter have been prepared for information purposes only and are not intended to be, and should not be taken as, legal advice.

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company's board of directors. Under the business judgment rule, the directors' decisions are protected from second-guessing unless a majority of the board is interested in the challenged conduct or fails to act in good faith. Thus, the business judgment rule requires that a shareholder, if it believes that the company should commence a lawsuit, make a "demand" on the board to commence the action. The decision then rests with the board. If a shareholder fails to make a demand, choosing instead to commence on his own a lawsuit on behalf of the company's shareholders, the lawsuit will be dismissed unless the shareholder alleges sufficient facts to create a reasonable doubt that making a demand of the board would have been futile.

Derivative cases can be difficult to prosecute under Delaware law, which generally favors management over shareholders. In this case, the institutional

The directors knew that if Columbia/HCA was convicted of violating the federal healthcare statutes, the Company could lose all of its Medicare and Medicaid business, which amounted to some 40% of the Company's annual revenues.

investors were advised that sufficiently pleading "demand futility" would be difficult in light of the outward appearance

that a majority of Columbia/HCA's directors were technically "outside" directors and not employed by the Company. However, the institutional investor plaintiffs believed, and continued to believe, that there was a reasonable doubt about the ability of a majority of the directors to impartially consider a demand.

Under the law, the institutional plaintiffs only had to plead facts that supported a reasonable doubt as to whether *five* of Columbia/HCA's ten directors could be impartial. The complaint went even further, alleging facts that supported a reasonable doubt as to the lack of impartiality of *nine* directors. In particular, the complaint alleged facts to show that these directors were subject to a significant risk of liability for their conduct,

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Informed Sources

INFORMED SOURCES features questions and answers that address issues presented by our readers. If you wish to submit a question, and we encourage you to do so, E-mail us at blbg@blbglaw.com, call us at 800-380-8496, or write to us at the firm address.

Q *Can an investor recover losses due to fraud by the Company, if the investor sells the stock after the drop in the stock price?*

A The short answer is yes. The investor incurs damages when he or she purchases the stock at "artificially inflated" prices, regardless of whether the investor keeps the stock after the corrective disclosure or decides to sell it.

Suppose that Company X supplies false information to the market, causing its stock price to increase from \$10 to \$20. Also assume that the price returns to \$10 when the truth is revealed. If an investor bought the stock for more than \$10 per share before the corrective disclosure and sold after the disclosure, the investor can recover its damages because the stock price was "artificially inflated" when the investor purchased the stock.

This example is very simple. Every case, however, is different, and there are many factors that require evaluation in order to assess damages. If you are uncertain about the measure of damages for specific investments, you should consult with a lawyer familiar with the securities laws.

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WHEN TO SERVE AS LEAD PLAINTIFF

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plaintiff. Individual investors with relatively small losses generally lack the clout to negotiate seriously with plaintiffs' counsel. Institutional investors, on the other hand, have a statutory mandate to control these cases and have the ability to negotiate substantially reduced, but fair, attorney fees. If you have attended an institutional investor conference recently, you know that the number of plaintiffs' lawyers seeking to represent institutions has grown dramatically.

Of course, I am not saying that every public plan with losses due to alleged securities fraud has a duty *to seek* to be

a lead plaintiff in every class action lawsuit. Rather, I am saying that you have a duty *to consider* being a lead plaintiff because serving as lead plaintiff may maximize recovery for your trust fund.

Since the early 1930's the Federal Securities laws have provided a remedy for losses due to fraud and corporate wrongdoing. Congress, in 1995, created a mechanism for institutional investors to maximize their recovery for these losses and to reduce the number of small, lawyer-driven settlements. I believe that all employee benefit plans should utilize the new tools. Recent history shows that institutional investor participation is worth it. Indeed, many of

the largest recoveries have been obtained in cases where the lead plaintiff was an institutional investor, including *Cendant* (\$3.2 billion) and *3Com* (\$259 million).

TO BE OR NOT TO BE?

It all depends...

To consider or not to consider? It is clear to me that you must at least consider seeking to be lead plaintiff (in order to fulfill your fiduciary duties). I hope the checklists provided above are helpful to other pension plans and their boards of trustees in exercising their fiduciary duties. Greater recoveries are likely with the leadership of the institutional investor.

While individual investors generally lack negotiating clout, institutional investors have a statutory mandate to control these cases and have the ability to negotiate substantially reduced, but fair, attorney fees.

INSTITUTIONAL INVESTORS OBTAIN LANDMARK DECISION

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making it likely that they could not impartially consider a demand. The District Court disagreed and dismissed the action.

That was not the end of the story. On February 13, 2001, the Court of Appeals for the Sixth Circuit, agreeing with the institutional plaintiffs, reversed in substantial measure the District Court's decision. The Sixth Circuit upheld the main claim against Columbia/HCA's directors and officers, finding that "the particularized facts, when taken together, are sufficient to present a substantial likelihood of liability on the part of at least five of Columbia's directors, which creates a reasonable doubt as to the disinterestedness of a majority of the Board as of April 8, 1998." The Sixth

Circuit stated that a "significant factor" in its assessment of demand futility was the extensive health care experience possessed by the Columbia/HCA directors. The well-reasoned Sixth Circuit opinion is a significant development in the law: It is the first federal Court of Appeals decision on pleading "demand futility" under Delaware law and Rule 23.1 of the Federal Rules of Civil Procedure.

This decision is a testament to the resolve of the institutional investors to continue to pursue this case. It also puts corporate directors on notice that institutional investors will take all necessary steps to hold directors and officers responsible for the harm caused by a breach of their responsibilities.

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We at BLB&G welcome input from our readers. If you would like to comment on any of the articles in this newsletter, or have any suggestions for articles that may be of interest to you, please contact Editor David R. Stickney, at 858-793-0070 or by E-mail at davids@blbglaw.com. Questions for our INFORMED SOURCES question and answer column may also be submitted to David R. Stickney. If you would like more information about our practice, please visit our website at

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