INVESTOR'S BUSINESS DAILY
THURSDAY, SEPTEMBER 23, 2004

ISSUES & INSIGHTS

PERSPECTIVE

Pension Politics Foils Curbs On Shareholder Strike Suits

BY JIM COPLAND

In 1995, Congress passed the Private Securities Litigation Reform Act in an attempt to curb shareholder "strike suits" in which class-action plaintiffs' lawyers would file a legal action within days of a drop in a company's stock price, often lacking any real proof of corporate wrongdoing.

High-growth technology stocks with naturally high share-price volatility were frequently subjected to such suits. Companies so besieged inevitably settled rather than face the long and expensive discovery process, the risk of a trial and the hits their share prices faced while their legal fate remained uncertain.

Although President Clinton vetoed the measure (even before Sen. John Edwards came on the scene, a Democratic presidential candidate was dependent on trial lawyer largesse), Congress overrode the veto in swift, bipartisan fashion. Even Sens. John Kerry and Ted Kennedy signed on.

Lawmakers hoped the reforms would make shareholder litigation better meet its purpose of deterring fraudulent misconduct on the part of corporate management while eliminating many of the frivolous claims that were so taxing to the shareholding public.

Doesn't Need Clients

Unfortunately, the reforms didn't work as planned. Academic studies show that securities class actions actually increased after passage of the securities reforms. And as the investing public is well aware, through coverage of major scandals from Enron to WorldCom, corporate malfeasance since 1995 was far from effectively deterred.

What happened? Well, the reasons for the failure of the reform act are many, but it is becoming clearer that a major culprit is the political takeover by trial lawyers of many of the largest shareholders around, the state employee pension funds.

The reform act tried to solve what legal scholars call the "agency cost" problem inherent in any class-action litigation.

By definition, individual claims are small for class litigation, so no individual plaintiff typically has sufficient interest to monitor or control the class attorneys.

Securities class-action king Bill Lerach boasted to Forbes magazine, "I have the greatest practice in the world. I have no clients."

Political Game

To remedy this problem, Congress quite sensibly directed the courts to appoint lead plaintiffs in charge of the litigation who were "most capable of adequately representing the interests of class members." Presumptively, such plaintiffs would be the shareholders with "the largest financial interest in the relief sought by the class."

Large institutional investors would realize that securities class actions merely redistribute wealth among shareholders (with a sizable cut for Trial Lawyers Inc.) Because these big investors held shares across a diversified portfolio of businesses, they would siphon away the good cases from the bad and introduce needed oversight over the "lawyers without clients" who had historically managed such suits.

Or so the congressional reformers thought. What they did not seem to anticipate is that the largest shareholders in our economy are typically state employee pension funds, such as Calpers (California Public Employees' Retirement System) and the New York State Common Retirement Fund, and that such state funds are politically directed and thus subject to an unseemly political influence game that trial lawyers have long mastered.

In May, The New York Sun reported that the two law firms that represented a class of plaintiffs suing Citigroup on behalf of WorldCom shareholders and bondholders had been responsible for $121,800 in donations to New York State Comptroller Alan Hevesi. By virtue of his office, Hevesi controlled the lead plaintiff in the suit, the New York State Common Retirement Fund. The firms that donated to Hevesi stand to gain $144.5 million from Citigroup.

Incredibly, the New York Fund that led the suit owns almost $1 billion in Citigroup stock.

Hevesi also took in at least $137,000 in contributions from Milberg Weiss, the heavyweight that controlled more than 50% of all securities litigation until Lerach split off his West Coast office earlier this year. Hevesi selected Milberg as class counsel for the state fund's suit against pharmaceutical giant Bayer. *(Continued)*

Nor are the New York comptroller's abuses unique. The highly litigious Calpers fund is run by a board of union and political appointees, including the state treasurer and controller.

In the last political cycle, Milberg Weiss gave $250,000 to the California Democratic Party. In the most recent reporting period, its two successor firms gave $47,500 to the political action committee for state controller Steve Westly — almost 10% of the PAC's total take.

In some smaller states, the pension funds have entered the litigation market with a zeal that would be laughable were it not such an abuse of public trust.

As was reported last month, the Teachers' Retirement System of Louisiana — whose trustees have already been reprimanded for accepting gifts from the funds in which they invest — has been involved in no fewer than 60 class-action suits in the last eight years.

Huey Long Lives

In May, district judges in both Tennessee and Ohio denied the Louisiana teachers' fund lead plaintiff status because the fund was already lead plaintiff in eight separate suits. The Ohio judge remarked that the fund was a "professional plaintiff" and that it wastefully sought to appoint four separate firms as counsel for the case.

In the fund's recent suit against Regal Entertainment, the fund sought to block a dividend payment, even though it would flow equally to all shareholders and even though the fund held only about $30,000 in the company's stock. Somewhere, Huey Long is smiling.

The lawyers without any clients have become those who buy their clients through the political process. To regain the public's trust in the markets — and protect the public employees' trusts themselves — something must be done.

Jim Copland is director of the Center for Legal Policy at the Manhattan Institute and managing editor of PointOfLaw.com.