BARRACK BULLETIN

THE INSTITUTIONAL INVESTOR'S GUIDE TO SECURITIES CLASS ACTION LITIGATION

Volume 5, Fall 2002 Barrack, Rodos & Bacine

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Maxine S. Goldman
Institutional Relations Manager

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If you are interested in learning about this new service, please contact either Maxine S. Goldman or Scott Freeda, at (215) 963-0600. ❖

INSIDE THIS ISSUE

The Sarbanes-Oxley Act of 2002: A Good Start For Investors

Stephen R. Basser, Esquire
Partner, Barrack, Rodos & Bacine

The rising tide of corporate financial fraud and scandal by avaricious corporate officers was predicted long ago by investor rights activists when Congress passed the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Post-PSLRA corporate collapses such as Enron, WorldCom and the like have spawned a bipartisan outcry from government and the public for both a new corporate ethic and a crackdown on corporate misbehavior. From President Bush's call for "truthful books and honest people and well enforced laws against fraud and corruption" to Senator Sarbanes' admonition that "unless we come to grips with this current crisis in accounting and corporate governance, we run the risk of seriously undermining our long-term world economic leadership," politicians have responded to investors' demands for stronger laws to deter corporate corruption and to hold violators fully accountable for the damages that they cause to individual companies and the market economy as a whole.

On July 30, 2002 the Sarbanes-Oxley Act of 2002 (the "Act") became law. The Act makes sweeping and historic changes to laws addressing corporate governance and disclosure issues. Simply put, the Act constitutes the most radical redesign of the federal securities laws since the 1930's and, unlike the PSLRA, is a serious attempt to strengthen and protect our capital markets. The Act establishes new or improved legal requirements in several important areas affecting public companies, their auditors and counsel.

Certification of Financial Reports. The Act codifies and builds upon the June 27, 2002, order by the Securities and Exchange Commission ("SEC") requiring Chief Executive Officers and Chief Financial Officers of very large companies to personally certify the accuracy of their financial results. The Act imposes fines of $1 million and up to 10 years in prison on certifying officers who make a false certification if the violation was "knowing" and $5 million

continued on page 2

Sarbanes-Oxley

continued from page 1

and up to 20 years in prison if the violation was "willful." Beyond this, the Act also directs the SEC to require the same corporate officers to personally certify in their company's quarterly and annual reports filed with the SEC that they have read the report being filed, there are no material misstatements, the financial information is fairly presented, they reviewed their company's internal financial controls, and they have disclosed any fraud or any significant deficiency in the design or operation of the company's internal controls to the company's audit committee and to its outside auditors.

While the Act was a good opening salvo in the fight against corporate corruption, Congress must go further.

Insider Transactions. The Act changes the deadline for "insiders" (executive officers, directors and 10% shareholders) to report their trades of their company's securities to just two business days after the execution date of the transaction. By the middle of 2003, insiders must file these reports electronically and post them on their company's website. In addition, new loans to directors and officers are prohibited in virtually all circumstances and a company cannot extend, modify or renew existing personal loans to executive officers or directors.

Beginning in 2003, the Act will prohibit insider trades during pension fund blackout periods. *Any* profits realized by an officer or director as a result of a violation of this prohibition, regardless of intent, may be recovered by a company, including through a shareholder derivative suit. In addition, a company's CEO and CFO must reimburse any bonus or other incentive or equity-based compensation they received during the 12 month period preceding the filing of a restated financial report.

Criminal and Civil Penalties for Securities Violations. Effective immediately, the Act creates new criminal penalties for securities violations, including penalties for:

- Altering, falsifying or destroying records with an intent to impede or influence a federal investigation in a bankruptcy proceeding;
- A knowing and willful failure by an accountant to maintain all audit workpapers for a prescribed period of time; and
- A knowingly participation in a scheme to defraud investors.

The Act directs the U.S. Sentencing Commission to adopt sentencing guidelines that reflect the "serious nature of the offenses and the penalties set forth in the Act, the growing incidence of serious fraud offenses … and the need to deter, prevent and punish such offenses."

The Act also makes the following immediate changes to civil liabilities:

- Amendments to the Bankruptcy Code to prevent the use of bankruptcy to avoid liability arising from the violation of federal or state securities laws;
- Expansion of the deadline for investors to file a civil action for securities fraud to two years after discovery of the facts about the fraud and to five years after the actual occurrence of the fraud; and
- Improved protections for "whistle blowers" who provide information regarding conduct he or she reasonably believes constitutes improper or illegal conduct to a federal agency, a congressional member or committee, or any supervisor of the employee.

Reporting Obligations of Counsel. The Act imposes an unprecedented requirement on all attorneys appearing and practicing before the SEC on behalf of public companies. Counsel for these reporting companies now have a duty to report a material violation of the securities laws or breach of fiduciary duty directly to the issuer's chief legal officer or CEO, and then to the company's independent directors, its board of directors or its audit committee, if no response from the board (or an inadequate one) is forthcoming.

Adoption of Code of Ethics for Senior Financial Officers. The Act requires companies to disclose whether or not they have adopted a Code of Ethics for senior financial officers, and to provide an explanation if they have not. The Act defines a "Code of Ethics" as standards reasonably necessary to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interests; full, fair, accurate, timely and understandable disclosure and periodic reports; and compliance with applicable government rules and regulations.

The Act also increases oversight of independent auditors and corporate audit committees:

- *Conflicts of Interest*. The Act prohibits a company from hiring a public accounting firm to provide audit services if the company's CEO or senior

continued on page 3

Sarbanes-Oxley

continued from page 2

accounting employees participated in the company's audit during the preceding year as an employee or member of that public accounting firm;

- *Audit Committee Independence*. A company's audit committee must be composed solely of independent directors;
- *Auditor Independence*. The Act prohibits accounting firms from providing many non-audit services for the public companies they audit;
- *Employee Protection*. A company's audit committee is required to establish procedures for handling employee complaints and for the confidential and anonymous submission by employees of information about suspect accounting matters; and
- *Misleading Statements to Auditors*. The Act makes it unlawful for a company's senior management to mislead or fraudulently influence, coerce or manipulate any independent accountant performing a company audit.

While the Act is an important development in the fight against corporate fraud, more is needed for the restoration and preservation of the integrity of our capital market system. We recommend the following additional reforms to secure investor rights and remedies and to prevent a future filled with similar frauds:

Change Accounting for Stock Options. Stock options are a highly lucrative element of executive compensation packages and are generally linked to corporate earnings and financial performance. The promise of significant grants of stock options is a powerful motive for dishonest corporate executives to falsify corporate financial results. A fundamental concept fueling these practices is the man-ner in which stock options are treated in corporate financial statements. Under present rules of accounting, corporations report the proceeds they receive from employees from the grant and exercise of stock options as revenue, thus creating inflated earnings and cash flows that have nothing to do with actual results. Additionally, when an employee exercises an option, the tax the employee owes on the transaction become a corporate deduction to its own tax bill — an accounting phenomenon that has allowed several companies to eliminate massive taxes they would otherwise owe to the federal government. Enron, for example, eliminated $625 million in federal taxes between 1996-2000 by taking advantage of stock option related tax deductions.

Investors would be well served if corporations accounted for options as the employee cost that they are. Had WorldCom, for example, accounted for options as an employee cost, its earnings would have fallen by about 30% in 2000 and about 22% in 1999. Financial reports that realistically account for stock options will be less likely to mask inflated earnings, improperly reduced taxes and inaccurate cash flow. Revisions of these accounting principles should be a high priority.

Increase Protections for Whistle Blowers. While the Act does require corporations to establish procedures to protect whistle blowers when they reveal accounting misconduct to corporate officers or to government agencies, it fails to address the use of non-disclosure or confidentiality agreements to coerce silence from current and former employees. These employees should be entitled to speak freely to investigators about known or suspected fraudulent activity, accounting or otherwise, without fear of retaliation or litigation. As an added measure of protection, the identity of individuals who assist shareholders pursuing civil remedies in discovering the truth about corporate misdeeds should be protected from disclosure. True deterrence of fraud will not occur until ethical employees who are willing to step forward in defense of the truth are fully protected from retaliation.

Fix the PSLRA. It is now evident that passage of the PSLRA gave Corporate America a "green light" to cheat, while severely restricting investors' ability to deter wrongdoing. It is not a coincidence that the unprecedented escalation of major corporate financial fraud occurred after passage of the PSLRA. As noted in these pages before, several provisions of the PSLRA preclude a shareholder from effectively pursuing the corporate frauds that have so shaken investor confidence.

Stephen R. Basser

While the Act was a good opening salvo in the fight against corporate corruption, Congress must go further. Until corporations realistically account for the stock options liberally granted to executives, until whistle blowers are protected from retaliation for "doing the right thing," and until the PSLRA no longer allows corporate wrongdoers to hide behind the procedural hurdles that impede shareholder lawsuits, corporate fraud and the greed driving it will not disappear. Sarbanes-Oxley is a good start. The next step, if Congress has the willpower to take it, will restore confidence in the markets that are the bedrock of the American economy. ❖

Accounting Fraud: Why Does It Happen?

Edward M. Gergosian, Esquire
Partner, Barrack, Rodos & Bacine

The last issue of the Barrack Bulletin explained the mechanics of the accounting shenanigans at Enron, Adelphia, AOL Time Warner, Global Crossing and Homestore.com. Since then, revelations about accounting frauds, sham deals, and the improper use of corporate funds by executives have sent the stocks of other major corporations reeling. In all, about 1,000 corporations have restated earnings in the last five years. Why has accounting fraud permeated such a wide spectrum of American business? The answer, unfortunately, is simple: greed. In the past decade, it has become easier and less risky for corporate officers to line their own pockets at the expense of the corporations they work for (and the shareholders who own those corporations) by engaging in a variety of accounting frauds.

How do corporate executives get their hands on the money? Since the early 1990's, a substantial portion of management's compensation has come in the form of stock options. In order for an officer to make money from those options, the market price of the company's stock must exceed the exercise price, generally set at the market price when the options are awarded. Corporate executives thus have a powerful incentive to boost the price of the company's stock. Indeed, according to Alan Greenspan, chairman of the Federal Reserve Board, "[a]n infectious greed seemed to grip much of our business community." As management sought ways to "harvest" their stock market gains, the once "highly desirable spread of shareholding and options" among corporate executives created perverse incentives to artificially inflate reported earnings to keep stock prices high and rising.

Stock prices are sensitive to many influences, but none is so important as the market's hunger for steady revenue and earnings growth. Market analysts who evaluate and recommend stocks of publicly-traded companies look for smooth and growing quarter-to-quarter revenue and earnings trends. Companies that deviate from that trend are often harshly penalized by the market. As a result, corporate officers, acutely aware of the importance of a positive market reaction, often abandon traditional management tools, which compare results to the company's budget and measure the anticipated results against the analysts' "consensus" forecast. By doing so, however, management faces substantial pressure at the end of a quarter to report results in line with the market analysts' expectations. Failure to produce the anticipated revenues and earnings, causing a significant drop in the company's stock price, will directly and adversely impact the value of management's stock option-based compensation.

Management responses to this pressure vary widely, from promptly alerting the market that consensus estimates will not be met, to aggressive accounting and outright fraud. In many cases, the path to committing fraud is usually a slippery slope. In the first quarter in which management anticipates a shortfall, the company may meet the market's expectation by "channel stuffing" – inducing a customer to purchase more product than it currently needs by offering a discount or right of return. Alternatively, the company may engage in a swap or barter transaction. Whatever the method, the goal is to permit the company to report results in line with the "consensus." The market is pleased and the price of the company's stock rises.

How did the existing system of corporate governance checks and balances break down? In a phrase, lax oversight.

If however, the company faces another shortfall in the next quarter, the disparity between reality and market perception will grow. The tricks used to cover the disparity become more egregious, until an external force (or internal whistle blower) causes the company to disclose the truth. Between the first false report and the disclosure, however, two important events will have occurred: investors will have purchased shares of the company's stock at prices inflated by the fraud, and management will have sold their own shares at the same inflated prices.

In Greenspan's view, "options were poorly structured," as they "failed to properly align the long-term interests of shareholders and managers, the paradigm so essential for effective corporate governance." Perhaps there is another explanation. Until 1991, the SEC required corporate executives to hold the stock they acquired (either in the market or through option exercise) for at least six months before selling it. Any profits from sales before the end of the six months had to be paid over to the company. In 1991, the SEC changed the rule to start the six month holding period to when the *option* is acquired, regardless of when the stock itself is acquired. This single rule change has had a dramatic effect. According to one study, reported in the New York Times, before this change, corporate managers who had to hold their shares for six months

continued on page 5

Why?

continued from page 4

before selling them, exercised options when the market price of the shares was likely to rise. Under the new rule, chief executives of smaller companies tended to sell the stock they acquired through option exercise shortly before the market price of the stock declined.

What happened at WorldCom highlights the problem. WorldCom Chief Financial Officer Scott Sullivan improperly classified expenses as assets, and did so in a regular and systematic fashion beginning as early as 1999. This fraud allowed WorldCom to report over $7.2 billion in profits that never existed, which artificially inflated the market price of WorldCom common stock, benefiting both CFO Sullivan, who reaped over $18 million in insider trading profits from option exercises, and CEO Bernie Ebbers, who had secured over $400 million in loans with WorldCom stock.

Why weren't the perpetrators of these corporate fiascos caught sooner? Where were the traditional protectors of shareholders while management was manipulating corporate earnings for their own ends? How did the existing system of corporate governance checks and balances break down? In a phrase, lax oversight. Those with the oversight duties have botched that responsibility time and again. Given the likelihood that management will succumb to the lure inherent in their stock option-based compensation, the current system of board and auditor oversight has repeatedly failed. At WorldCom, CEO Ebbers handpicked the members of the board. At Homestore.com, a majority of the board of directors were also officers of the company. Moreover, director fees paid in stock options offer the Board the incentive to participate, collude or go along with management when questionable accounting practices arise. Management oversight will not be effective unless a majority of a board is truly independent of management. Similarly, audit committees with no responsibilities and comprised of directors without accounting knowledge will necessarily fail in their duties. At Enron and Homestore.com, for example, the audit committees simply accepted management conduct without question, while collecting substantial director and committee member fees. In Homestore.com's proxy statement for fiscal 2000, the audit committee admitted that:

Edward M. Gergosian

> The members of the Committee are not professionally engaged in the practice of auditing or accounting and are not experts in the fields of accounting or auditing, including in respect of auditor independence. Members of the Committee rely without independent verification on the information provided to them and on the representations made by management and the independent auditors. Accordingly, the Committee's oversight does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Committee's considerations and discussions referred to above do not assure that the audit of the Company's financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted accounting principles or that PricewaterhouseCoopers LLP is in fact "independent" as required by the Nasdaq National Market.

If Homestore.com's Audit Committee could not provide "an independent basis to determine that management maintained appropriate accounting and financial reporting principles," what exactly could they do for the company and its shareholders?

Public auditors also have not fulfilled the charter they accepted long ago to be the public's watchdog. In response to the market crash of the 1929, the newly established SEC mandated that public companies include audited financial statements in their public filings. The public accounting firms lobbied long and hard against the proposal that the government conduct the audits, and ultimately won the charter to provide the oversight on behalf of the public. However, as the demise of Arthur Andersen has shown, our basic assumption that the watchdogs are on guard is false. That Andersen could have been involved with and complicit in the frauds at Enron, Global Crossing, Sunbeam, WorldCom and Waste Management (among others) is shocking in and of itself. Yet Andersen's fall from grace did not occur in a vacuum. The passage of the Private Securities Litigation Reform Act of 1995 (the "PSLRA") allowed auditors to abandon their post. Because of the PSLRA, auditors are no longer subject to joint and several liability for securities fraud – they can no longer be held financially liable for the full impact of a fraud, even though their lack of diligence or outright collusion allowed the fraud

continued on page 6

Why?

continued from page 5

to continue. Because of the PSLRA, the auditor – if found liable – would have to pay only the portion of the damages that the jury finds was the direct result of the auditor's activities. The PSLRA thus reduced the risk that an auditor would be liable for large judgments should their clients engage in securities fraud.

In addition, the standards under which auditors purportedly operate impose important duties to detect management fraud. These standards require an auditor to operate with a healthy skepticism for management's representations to insure that the financial statements follow the fundamental generally accepted accounting principles: economic reality, conservatism, fair presentation, matching, and transparency. Auditor independence, though mandatory, has been sorely compromised. It is clear from each of the recently revealed financial frauds that the auditors ignored their mandate and bent over backwards to permit management to present materially deceptive and misleading financial statements to the public. The auditor's incentive to ignore the obvious has come in the past from both the lucrative nature of accounting engagements for large public companies as well as the collateral consulting services provided by non-audit arms of public accounting firms for the companies they audit.

The substantial cash flowing from public companies to public accounting firms has substantially contributed to the failure of those firms to protect the investing public from the types of fraud that make up today's headlines. Similarly, directors (including audit committee members) receive hundreds of thousands of dollars in fees and stock options for their "services." How independent will oversight be if the auditors and directors are being handsomely compensated by the management they are charged with overseeing?

Oversight mechanisms will deter fraud only if they work. Truly independent board members, audit committees comprised of independent members with a substantial knowledge of accounting standards and practices, and credible auditors, reinforced by effective deterrents, are the only way to diminish and perhaps eradicate financial fraud. With the Sarbanes-Oxley Act of 2002 (discussed at length in "The Sarbanes-Oxley Act of 2002: A Good Start For Investors" beginning on page 1of this issue of the Barrack Bulletin), Congress has begun to address many of these issues. The next article in this series will examine what the accounting profession is doing to rehabilitate itself in the eyes of the investing public.❖

Ninth Circuit Says "No" To Interference With Lead Plaintiff's Choice of Counsel

David E. Robinson, Esquire
Barrack, Rodos & Bacine

Federal district courts' ability to question the validity of an institutional investor's choice of counsel in securities fraud class action lawsuits was dealt a severe blow recently by the United States Court of Appeals for the Ninth Circuit. In an important decision reiterating a lead plaintiff's right to choose the most effective, rather than the cheapest, legal representation, the Ninth Circuit (with jurisdiction over California, Oregon, Washington, Arizona, Montana, Idaho, Nevada, Alaska, Hawaii, Guam and the Northern Mariana Islands) ruled that courts must primarily focus on the amount of an investor's losses – and not its fee arrangement with counsel – when determining which investor is most adequate to serve as lead plaintiff. The decision upholds the statutory rule that the investor with the greatest losses in a case should be appointed lead plaintiff.

The goal of the Private Securities Litigation Reform Act of 1995 (the "PSLRA") was to encourage institutional investors to become involved in securities fraud class action lawsuits as plaintiffs, replacing the "race to the courthouse" that was the norm in the pre-PSLRA era, when lead plaintiffs were often selected based on who was the "first to file" a securities fraud class action. The PSLRA instructs the district courts to select as lead plaintiff the investor "most capable of adequately representing the interests of class members." The statute defines the term "most capable plaintiff" as the investor who has the greatest financial stake in the outcome of the case. As the House and Senate conferees noted in their report on the PSLRA:

> These provisions are intended to increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff's counsel.

H.R. Conf. Rep. No. 104-369, at p. 32 (1995).

The PSLRA established a procedure for choosing a lead plaintiff. The first investor to file an action must publicize the existence of the lawsuit through a posting in a

continued on page 7

Ninth Circuit Says "No"

continued from page 6

widely circulated national business-oriented publication or wire service, and must state that any member of the purported class may ask the court to appoint that member as lead plaintiff. Requests to become lead plaintiff must be made within 60 days of the notice. When the deadline has passed, the court compares the financial stakes of the various investors who wish to become lead plaintiff to identify which has the greatest stake in the outcome of the lawsuit. Once identified, that investor becomes the presumptive lead plaintiff and the court must determine whether that plaintiff's claims are *typical* of the claims of the class, and whether that plaintiff can fairly and *adequately* protect the interests of the class. Other plaintiffs in the action may challenge the adequacy of the presumptive lead plaintiff. If the presumptive lead plaintiff fails to meet the typicality and adequacy requirements, the court must then repeat the process with the plaintiff with the next highest stake in the outcome of the litigation, until the court can find a lead plaintiff who meets all criteria.

The Ninth Circuit's decision in Cavanaugh is an important win for institutional investors in their pursuit of meaningful involvement in securities fraud class action lawsuits.

The Ninth Circuit recently addressed the issue of how a court should determine who is an appropriate lead plaintiff in *In Re: Cavanaugh*, 2002 WL 31051543 (9th Cir., Sept. 16, 2002), a securities fraud class action brought by investors in Copper Mountain Networks, Inc. Judge Vaughn Walker of the U.S. District Court for the Northern District of California had consolidated over twenty class action complaints, each alleging securities fraud by the same defendants over the same time period. At the case management hearing, Judge Walker interviewed lead plaintiff candidates, primarily about their fee arrangements with their chosen counsel. The court determined that a group of investors, the Cavanaugh Group, whose combined losses were much larger than the other lead plaintiff candidates combined, was presumptively the most adequate plaintiff because it had the greatest financial stake in the outcome of the case. However, the court awarded the lead plaintiff position to an individual investor whose damages were only a fraction of the Cavanaugh Group's damages because he had negotiated lower legal fees with his counsel than the Cavanaugh Group had negotiated with theirs.

The district court concluded that because the individual appointed as lead plaintiff negotiated a better fee schedule proved that the individual was *more adequate* than the Cavanaugh Group to best serve the interests of the class. The Cavanaugh Group asked that the U.S. Court of Appeals for the Ninth Circuit reverse the district court's selection, and appoint it lead plaintiff. The Ninth Circuit vacated the district court's appointment and ordered that the Cavanaugh Group be awarded the lead position. On behalf of the three-judge panel that decided the appeal, Judge Alex Kozinski wrote:

> That the district court believes another plaintiff may be 'more typical' or 'more adequate' is of no consequence. So long as the plaintiff with the largest losses satisfies the typicality and adequacy requirements, he is entitled to lead plaintiff status, even if the district court is convinced that some other plaintiff would do a better job….
>
> *[T]he district court has no authority to select for the class what it considers to be the best possible lawyer or the lawyer offering the best possible fee schedule. Indeed, the district court does not select class counsel at all.* Rather such information is relevant only to determine whether the presumptive lead plaintiff's choice of counsel is so irrational, or so tainted by self-dealing or conflict of interest, as to cast genuine doubt on that plaintiff's willingness or ability to perform the functions of lead plaintiff.

2002 WL 31051543 at *4 (emphasis added). Judge Kozinski emphasized that actual legal fees paid to class counsel are subject to judicial scrutiny based on counsel's actual work done and results achieved and that an adequate plaintiff would be less concerned with negotiating the lowest fee schedule and more concerned with securing the services of a lawyer whom he believes will obtain the best results for the class:

> Selecting a lawyer in whom a litigant has confidence is an important client prerogative and we will not lightly infer that Congress meant to take away this prerogative from securities plaintiffs. And, indeed, it did not. While the appointment of counsel is made subject to the approval of the court, the Reform Act clearly leaves the choice of class counsel in the hands of the lead plaintiff.

2002 WL 31051543 at *5. Judge Kozinski reasoned that choosing the lead plaintiff based on his or her fee negotiations undermines the statutory presumption that the

continued on page 8

BRB Welcomes...

David E. Robinson and Pearlette V. Toussant

Barrack, Rodos & Bacine recently welcomed attorneys David E. Robinson and Pearlette V. Toussant to its Philadelphia, Pennsylvania practice.

Mr. Robinson is a graduate of Dickinson College (1993, B.A., English Literature), the University of Pennsylvania (1994, M.A., East Asian/Japanese Studies), and Temple University School of Law (1997, J.D.). At Temple, Mr. Robinson received a Freeman Foundation Scholarship to study Asian and Japanese law in Tokyo, Japan, and was an executive member of the Japan-America Law Student Alliance. In addition to his active securities and antitrust litigation practice, Mr. Robinson is fluent in Japanese and has served as an attorney/Japanese translator in a number of antitrust cases involving Japanese corporations.

Pearlette V. Toussant

Ms. Toussant is a graduate of Reed College (B.A., 1996) and the University of Pennsylvania Law School (J.D., 2000). At Reed, Ms. Toussant was the President of the Black Student Union and was awarded the McCree Memorial Scholarship and the U.S. West Scholarship. Ms. Toussant has served as an intern with the Appeals Division of the Philadelphia District Attorneys' Office and worked for the Gender Fairness Task Force of the Philadelphia Bar Association as a volunteer drafting materials for pro se litigants. Prior to coming to the firm, Ms. Toussant litigated a broad range of complex commercial litigation matters in addition to her extensive community service involvement.

Both Mr. Robinson and Ms. Toussant will be participating in all aspects of the firm's practice. We look forward to their contributions.❖

DID YOU KNOW...

In February 2002, the Accounting Standards Board of the American Institute of Certified Public Accountants proposed new procedures for auditors to use to detect fraud.

LOOK FOR OUR ARTICLE ABOUT AUDITORS AND FRAUD DETECTION IN THE NEXT ISSUE OF THE BARRACK BULLETIN

Ninth Circuit Says "No"

continued from page 7

plaintiff with the most to lose in the controversy normally **serves as lead plaintiff.** *Id.*

The *Cavanaugh* decision reclaims the institutional lead plaintiff's right to select class counsel. In it, the Ninth Circuit endorsed the importance of giving those competing for the lead plaintiff position the opportunity to assemble the legal team most capable of obtaining the best outcome for the class. According to *Cavanaugh*, adequacy should be decided on the analysis of the size of plaintiffs' financial stake in the controversy, and not the negotiation of the lowest fee schedule. When lawyers are forced to participate in auctions where they compete against one another to submit the lowest bid, the class is denied representation by the most *adequate* plaintiff – the investor with the greatest stake in the successful outcome of the lawsuit represented by the legal team that investor thinks will get the job done. The Ninth Circuit's decision in *Cavanaugh* is an important win for institutional investors in their pursuit of meaningful involvement in securities fraud class action lawsuits.❖

David E. Robinson

About the Publisher…

Barrack, Rodos & Bacine is a boutique law firm that has been extensively involved in class and derivative actions alleging violations of securities laws for more than twenty-five years. The firm, with attorneys in offices located in Philadelphia, San Diego, New York, and New Jersey, has been appointed by federal judges throughout the country as lead counsel in over 30 cases since the passage of the PSLRA and represents a number of institutional investors in securities class actions. The Barrack Bulletin, edited by Leslie Bornstein Molder, Esquire, is published four times a year.

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