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Public Pension Funds Protect the Integrity of United States Capital Markets by Leading Securities Fraud Class Actions Through Trial

By

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Following a two-and-a-half-month trial, a Phoenix, Arizona jury in January 2008 returned a unanimous verdict in the *Apollo Group Securities Litigation* in favor of the lead plaintiff Policeman's Annuity and Benefit Fund of Chicago ("PABF") and a class of investors, awarding the full amount of damages, on a per share basis, of \$5.55 per share. The case arose out of false and misleading statements made by Apollo, the parent company of University of Phoenix, and its CEO and CFO, about a scathing February 2004 Department of Education program review report that determined the company's compensation practices had resulted in numerous violations of federal law, required corrective action and imposed potentially hundreds of millions of dollars in fines. The defendants claimed that they had the right to withhold from investors material and relevant information associated with the report. To appeal the verdict the defendants posted a bond; Apollo has also established a reserve in excess of \$168 million.

John Gallagher, the Executive Director of the PABF, thanked the jurors for "their service[, which] was quite taxing on their personal lives, especially with this trial progressing through the holiday season." Mr. Gallagher stressed the importance of the verdict:

[T]heir verdict will help all of us as investors to incrementally increase the accuracy, reliability and ... timeliness of reporting critical information to the market, so that individual or institutional investors can fairly evaluate the risks involved in investing in public companies.

The *Apollo* verdict – by far the largest for investors since the passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA") – has prompted some public pension and institutional investor representatives to ask basic questions about the benefits, responsibilities and value associated with the decision to take a federal securities case to trial. The purpose of this column is to provide brief answers to those frequently asked questions.

Do Benefits Arise from a Genuine Threat of Trial?

Numerous benefits are associated with the decision to seek appointment as a lead plaintiff and prosecute a securities case to trial. But in the first instance, presenting a genuine threat of trial demonstrates strength to an adversary and amplifies the plaintiff's power to negotiate or otherwise secure a higher recovery for the class.

By serving as a lead plaintiff presenting a genuine threat of trial, public pensions fulfill the regulatory role that the PSLRA established for institutional investors in securities cases. Institutional investor leadership has since demonstrated that Congress correctly determined that investors with large amounts at stake tend to represent the interests of class members more effectively than investors with small amounts at stake. An August 2003 report issued by the New York State Comptroller's Office concluded that an institutional investor serving as a lead plaintiff in a securities case provides a benefit by "maximize[ing] the recovery of damages suffered by the class as the result of fraud...."

When it comes to the threshold tactical decision of whether to take a case to trial, no decision-maker is more crucial than the lead plaintiff. In the *Apollo* litigation, the defendants made it clear that they had every intention of trying the case to verdict. Stephen R. Basser, the lead trial counsel on the *Apollo* trial team, explained to *Conde Nast Portfolio* that the PABF "would never cave and made it abundantly clear that we try cases to verdict." And the PABF did not back down, demonstrating that public pension plans need not countenance low-ball pre-trial settlement offers where there is a fair chance of success at trial. Echoing the sentiment of a prudent class representative calling the shots in the litigation, Lieutenant James P. Maloney, Commanding Officer of the Chicago Police Department's Financial Crimes Investigations and trustee of the PABF, commented that "[w]e are willing to take securities cases to trial, even where there may be costs and risks, because we are obligated as fiduciaries to fight for truth on behalf of victims of fraud."

While the dynamics of the decision to proceed to trial often involve complex variables and considerations, the decision is rooted in common sense business judgment involving careful cost-benefit analysis. By taking charge of that decision, a public pension or other institutional investor presenting a genuine threat of trial to an adversary amplifies its ability to maximize class-wide recovery and to police our capital markets through its congressionally established role as lead plaintiff in civil securities litigation.

What Responsibilities Are Involved with Taking a Securities Case to Trial?

The decision to take a case to trial requires the lead plaintiff to consider how the trial will be conducted and how it will participate during trial. The decision to try a case thereby carries with it the responsibility to satisfy the needs of the case, the Court and the

jury; in other words, the trial needs to be adequately staffed and the jury needs an opportunity to get to know the lead plaintiff and its presentation of the case.

The lead plaintiff must select competent and experienced trial counsel because litigating a securities case requires both talent and preparation. The technical preparation, the preparation for examination and cross-examination of witnesses, the preparation for evidentiary objections and responses to those objections must be thorough and foresighted. The arguments must be well-prepared and well-presented throughout the case. A successful securities fraud trial requires nothing less.

In addition, the lead plaintiff must anticipate that it will perform a function during the trial. The PABF demonstrated its interest in the outcome of the trial to the *Apollo* jury by actively participating during trial. The PABF's Executive Director, Mr. Gallagher, assisted in the jury selection process, he was introduced to jurors during the opening statement and re-introduced during closing argument. PABF trustee, Mr. Maloney, also attended the trial during the examination of critical witnesses and was introduced to jurors during closing argument. A group of the PABF's beneficiaries and annuitants who reside in the Phoenix area attended the trial on a daily basis. These efforts contributed to the effectiveness of the PABF's case and familiarized jurors with the real people -- the human faces -- associated with the lead plaintiff. Judges, including the Honorable Denise L. Cote in *WorldCom*, have universally cited this critically important role that institutional lead plaintiffs perform in securities litigation.

Does Taking a Securities Case to Trial Serve the Public Good?

Commenting on the *WorldCom* trial strategy, the lead plaintiff then-New York State Comptroller said that the case "should help prevent" more massive frauds with the "multi-billions of dollars in costs they impose on millions of Americans and on our economy." He noted "evidence that underwriters are improving their diligence, accounting firms are strengthening their audits and boards of directors are empowered to ask tougher questions of management. Those protections will restore confidence in our capital markets and encourage millions of Americans to continue to invest." The willingness of institutional investors to aggressively prosecute securities class actions to trial thereby serves the public interest by protecting the integrity of our capital markets.

As the Ninth Circuit's model jury instructions state: "Congress has enacted securities laws designed to protect the integrity of the financial markets. ... [that] in essence prohibit[] acts of deception in connection with the purchase or sale of a securities...." The Congressional record reflects that purpose of the federal securities laws:

Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.

Courts have long ruled that "society depends upon private attorneys general to vindicate the policies embodied" in the federal securities laws by prosecuting civil securities cases, explaining that among Congress's objectives when passing the Securities Exchange Act of 1934 was "to ensure honest securities markets and thereby promote investor confidence." Courts explain that Congress sought "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* [-- or, let the buyer beware --] and thus to achieve a high standard of business ethics in the securities industry." Indeed, courts recognize that cases zealously litigated to vindicate the rights of shareholders "provide corporate therapy protecting the public investor who might otherwise be victimized." A federal securities fraud trial thereby serves the policy of transparency codified in the securities laws and to deter future distortion of truth in the marketplace by holding persons accountable for their wrongful conduct. Prosecuting a securities fraud claim to trial certainly serves the public good.

What Was It Like When The Jury Delivered The Verdict?

When the foreman of the jury in the *Apollo* trial delivered the unanimous verdict, and the deputy clerk of the Court read aloud the nineteen page verdict form with the federal seal above the Court overseeing the courtroom -- a moment in time when "hearts and minds are blinded either by the agony of defeat or ecstasy of a victory" -- justice was delivered. While the lead plaintiff agreed with the verdict, and the defendants did not, the American form of justice of the federal securities fraud class action jury trial delivered its result. It is this form of justice that carries with it benefits and responsibilities designed to protect and serve the integrity of our capital markets.