FOLEY & LARDNER LLP

Why Do Institutional Shareholders Sue You?

2007 NATIONAL DIRECTORS INSTITUTE

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At Foley's sixth annual National Directors Institute on March 8, 2007 in Chicago, "Why Do Institutional Shareholders Sue You?" was a featured session moderated by Nancy Sennett, partner Foley & Lardner LLP. Panelists included Phillip Angelides, former California State Treasurer and Trustee of CalPERS and CalSTRS; Jane Hamblen, chief legal counsel, State of Wisconsin Investment Board; Darren Robbins, Lerach Coughlin Stoia Geller Rudman & Robbins, LLP; and Steve Shappell, managing director, Aon Corporation.

The panel discussion focused on the role of institutional shareholders in securities class action litigation. Due to the enactment of the Private Securities Litigation Reform Act (PSLRA) in 1995, institutional shareholders are far more active in litigation than they were prior to the change in the law. The panel's discussion included changes in the way that the cases are prosecuted; why and how institutional shareholders step into their roles as lead class action plaintiffs against corporations; what corporations should do to minimize the risk of litigation; the rising trend of institutional shareholders deciding to opt out of shareholder class actions; the increase in the number of derivative actions; and the rise of actions filed upon merger and acquisition announcements by large corporations.

Trends In Institutional Shareholder Litigation

Studies show that shareholder class action litigation against corporations and individual board members is less frequent since institutional shareholders have come to the forefront of these cases. Nevertheless, the cases that are commenced appear to be focused on egregious fraud, and yield more severe results than in the past with average settlement amounts having increased substantially. The remedies sought by institutional shareholders, however, are not limited to monetary damages. In most cases, institutional shareholders seek and receive corporate governance reforms. In other words, institutional shareholders strive to ensure that their litigation results in corporate structures and policies that provide an environment that protects shareholders and a focus on corporate board members exercising their fiduciary responsibilities seriously. The consensus of the panel was that these institutional shareholders' goals represent a significant change in the way that shareholder class actions are selected and prosecuted.

How Institutional Shareholders Step Into Their Roles as Lead Plaintiffs

Institutional shareholders follow a thorough evaluation process in connection with making a decision to assume the role of lead plaintiff. First, institutional shareholders assess the extent of the monetary loss to the fund. Second, often with the assistance of outside counsel, institutional shareholders evaluate the facts involved in the proposed case and the likelihood of success on various cases of action. Litigation is reserved for the most egregious cases of wrongdoing. In sum, institutional shareholders want to ensure that their role as lead plaintiffs will add value to the case, and result in corporate reform.

What Corporations Should Do To Minimize The Risk Of Litigation

Darren Robbins observed that almost every major corporate meltdown can be traced to board failure. The panelists were unanimous in their view of what corporations must do to avoid the risk of litigation:

- Implement good corporate governance structures and policies
- Demand mechanisms to ensure that the board maintains its ethics and transparency
- Require that the board is "awake," and doing its "homework"
- Make decisions with respect for shareholders
- Focus on long term value

The Rise In Class Members Opting Out

Many institutional shareholders have opted out of shareholder class actions in recent years. Panelists expressed the view that the opportunity for recovery of more dollars and/or the opportunity to impact corporate reform often drives opt-out decisions. The panel observed, however, that opting out requires a careful risk/reward assessment as the cost of pursuing a separate action can be high and requires extensive time and energy from an institutional shareholder.

The Increase In Derivative Actions

The panel briefly discussed the rise in derivative actions, noting that these actions are viewed as a vehicle to effect corporate governance and improvements. Because these actions often follow class action litigation, they can be less costly to pursue. As a result of the combined goal of reform with less cost, many institutional shareholders have participated in derivative actions.

The Merger & Acquisition Announcement Lawsuit Trend

The panel also touched upon the notable rise in lawsuits filed almost immediately upon the announcement by large corporations of a merger and acquisition transaction. The issue in these cases is whether the board of the company being acquired has properly exercised its fiduciary duty and has maximized shareholder value. Panelists expressed views that acquisitions by private equity firms with representatives on boards, create conflicts of interest that are being scrutinized by institutional shareholders.

Summing It Up

Despite a recent trend of fewer shareholder class actions, institutional shareholder litigation remains vibrant. The cases being pursued are yielding large damages and significant corporate governance reform.

For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.

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Save the date! The 7th Annual National Directors Institute will be held on March 6, 2008 in Chicago. Learn more at Foley.com/ndi.