SECURITIES FRAUD
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BERMAN DEVALERIO PEASE TABACCO BURT & PUCILLO

Berman DeValerio Celebrates Silver Anniversary

Three Original Partners Remain Active in Litigating Securities Cases

An inventory at Berman DeValerio & Pease in the summer of 1982 wouldn't have taken very long. There were a couple of electric typewriters, a few desks, a copier and some hand-me-down telephones. There was a secretary. And there were three young lawyers who were ready to work for themselves.

Oh, yes. There were files from a handful of clients who believed the new firm would last long enough to win their cases. It turned out to be a pretty good bet.

Twenty-five years later, Berman DeValerio is a national leader in securities and antitrust class actions. Its 78 employees include 35 lawyers in Boston, San Francisco and West Palm Beach. Its clients now number more than 60 public and Taft Hartley pension funds.

And the three Boston lawyers who set up shop in 1982 – Norman Berman, Glen DeValerio and Peter Pease – are still active litigators.

"If you had asked us back then, 'Do you think we would be together in 25 years?' the answer would have been, 'Yes, probably,'" Berman said. "We all shared the same enthusiasms and the same values and we each cared passionately about doing our jobs well. We just never imagined that we would be particularly successful. I think what we dreamt about then was solvency."

And with good reason. Just days after quitting their jobs as associates at the one-partner Boston firm where they first met, DeValerio and Pease flew to Cincinnati to woo a group of print shop owners in the midst of a bitter contractual dispute with their national franchise.

> *"If you had asked us back then, 'Do you think we would be together in 25 years?' the answer would have been, 'Yes, probably.'"*

Getting the printers to sign on as the fledgling firm's first clients was by no means a given.

"They thought they were going to retain a high-powered Boston lawyer with a national reputation in franchise law and they ended up with these 32-year-old kids," DeValerio said.

The printers' $10,000 retainer check, coupled with a trio of bank loans totaling $30,000 and a steady stream of $15-an-hour consultation referrals, carried them through that first year.

"We were everything – we were our own associates, our own paralegals, our own copy boys," Pease said, recalling

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Challenges to Class Certification Place Additional Burdens on Plaintiffs

By Julie Richmond

Two years ago in this newsletter, Berman DeValerio highlighted a new and troubling trend in securities lawsuits: a rise in defense challenges to class certification. Since then, these challenges have gained ground, forcing plaintiffs to expend substantial resources on a procedural milestone that was once largely a *fait accompli*.

Class certification is fundamental to every class action, and essential to preserving the vitality of the private right of action to enforce the securities laws. Without a class, individual plaintiffs have few realistic options to take on large, deep-pocketed corporate defendants.

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Berman DeValerio Pease
Tabacco Burt & Pucillo

Berman DeValerio Pease Tabacco Burt & Pucillo prosecutes class actions nationwide on behalf of institutions and individuals, chiefly victims of securities fraud and antitrust law violations. The firm, which was founded in 1982, has offices in Boston, San Francisco and West Palm Beach. In addition to conducting litigation, the firm provides securities fraud monitoring, evaluation and advisory services to public pension funds and other institutional investors.

The *Securities Fraud Monitor* is published by the law firm of Berman DeValerio Pease Tabacco Burt & Pucillo, One Liberty Square, Boston, MA 02109, (800) 516-9926. This newsletter is designed to inform Berman DeValerio's clients and friends about current securities fraud and corporate governance issues. It is not a substitute for legal advice.

If you would like to receive additional copies of this issue, or if you would like to be added to our mailing list for future issues, please contact Richard Lorant, Director of Marketing & Client Relations, at (617) 646-1825 or rlorant@bermanesq.com.

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EDITORIAL

SEC v. Investing Public

Watch out, investors. The Bush administration is making yet another assault on your rights of action for damages caused by securities fraud. And this time, the SEC is helping to lead the charge.

Secretary of the Treasury Henry Paulson has decried the American legal system as "an Achilles' Heel for our economy." The Committee on Capital Markets Regulation (CCMR) recommends that securities fraud class actions no longer be prosecutable in court, and instead be forced to arbitration before industry panels.

The CCMR also recommends that there be limitations on the liability of outside directors, and caps on the damages that could be recovered from accounting firms.

It is suggested that these changes in the law be accomplished by the SEC pursuant to its rule-making authority. That would get around the pesky Democrat-controlled Congress.

We have no doubt that Secretary Cox would be delighted to do so. After all, his SEC just filed an amicus brief *in support of securities fraud defendants* seeking certiorari to review the 7th Circuit's decision that upheld the plaintiffs' complaint in *Tellabs, Inc. v. Makor Issues & Rights, Ltd., et al.*

In its brief, the SEC described private securities litigation as generally abusive, and argued that the already high pleadings bar should be raised higher still, to better protect business from the indignity of being held accountable.

Thank goodness some voices of reason have sided with investors. A number of groups have filed briefs urging the Supreme Court to adopt a more balanced approach. These include two dozen attorneys general, the Council of Institutional Investors and the National Conference on Public Employee Retirement Systems, among others. "'Strike suits' are bad for business, but fraud is worse," the attorneys general write in their brief.

As far as the CCMR is concerned, it apparently matters not that fraud complaint filings are now at historic lows, probably due in large part to the fact that Sarbanes-Oxley reforms have required auditors and audit committees to take their jobs seriously.

Nor does it matter that fraud recoveries are at all time highs due to the breathtakingly brazen schemes of defendants, and the serious prosecutorial attention of sophisticated institutional plaintiffs who have suffered massive losses.

Nor does it matter that the "factual" predicate advanced by the CCMR about the resulting migration of IPO business to overseas markets has been proven false in countless reports by prominent firms, including Goldman Sachs and Ernst & Young.

As always, one need only follow the money. Who are the members of the CCMR? Why, they are the representatives of the major auditing firms, investment banks and major corporations. Who paid for their work? None other than prominent defendant Hank Greenberg, former chairman of AIG.

One would think that the SEC's interest would be in preserving investors' rights, and ensuring that there should be recovery for losses caused by fraud. Think again. You are on your own. ■

Supreme Court Case Could Further Heighten Pleading Standards in Securities Class Actions

By Joseph Merschman

Shareholders' ability to successfully pursue securities fraud lawsuits may be significantly hampered if the U.S. Supreme Court sides with the defendants in a pending case.

The issue centers on the pleading standards established under the Private Securities Litigation Reform Act of 1995 (PSLRA), which overhauled securities law and increased the requirements for investors seeking legal recourse against companies that mislead shareholders.

Under the PSLRA, plaintiffs must demonstrate a "strong inference" of *scienter* for a case to move forward. (*Scienter* is a legal term indicating that the defendants knew – or were extremely reckless in not knowing – that they were doing something illegal.)

Federal appeals courts have offered varying interpretations of exactly what constitutes a "strong inference." The lawyers for Tellabs Inc., an Illinois-based telecommunications equipment manufacturer, have asked the Supreme Court for clarification, hoping a stricter standard will prevail.

Specifically, Tellabs argues that the U.S. Court of Appeals for the Seventh Circuit in Chicago erred by allowing a securities fraud plaintiff to plead facts that might lead a "reasonable person" to infer that the defendants intended to mislead investors. Tellabs argues that the 7th Circuit should have applied the standard used by some circuits, requiring the plaintiff to show that fraudulent intent was the "most plausible" conclusion – a much higher hurdle.

Already, the PSLRA forces plaintiffs to meet a considerably higher pleading burden than any other form of private litigation. Outside the securities context, courts always assume that the plaintiffs' claims are true and read all inferences in the plaintiffs' favor. In other words, the court allows the case to proceed if the allegations, as presented by the plaintiffs, would constitute a legal violation.

The strong inference clause in securities actions already ups the ante. And a "most plausible" interpretation would make it that much more difficult for investors to bring meritorious securities claims.

If adopted by the Supreme Court, the standard would open the door for defendants to introduce a host of issues not alleged in the complaint. In the hopes of muddying the waters and getting a case dismissed, defense lawyers would bombard the court with every conceivable explanation for their clients' conduct. This not only would pit the plaintiffs' allegations against facts not alleged in the complaint, it would invite the court to look at the complaint piecemeal, rather than considering the plaintiffs' allegations as a whole.

Because the PSLRA prohibits discovery in the pleading stage of the case – further tilting the field toward defendants – the plaintiffs rarely have a smoking gun at the pleadings stage showing that corporate officers acted knowingly to commit a fraud. Instead, plaintiffs must marshal the available facts as best as they can so a court can infer that the behavior was intentional or extremely reckless.

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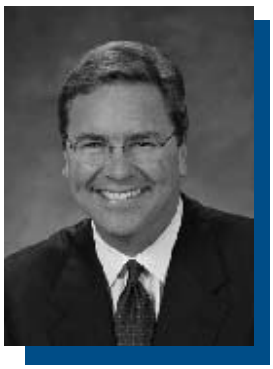
"Hold it! We almost forgot your backdated stock options."

Former California Secretary of State Joins Firm

Kevin Shelley, former California Secretary of State, has joined Berman DeValerio's San Francisco office as special counsel.



Kevin Shelley

As an elected official, Shelley tirelessly advocated for labor legislation to improve the rights of employees. As special counsel, he will continue to work with unions to protect their members' pensions.

"Kevin spent his political career fighting on behalf of working people and public employees. His knowledge of the issues our clients are concerned about – such as matters of corporate governance and fairness – will be a real asset to our firm," said Joseph J. Tabacco, Jr., managing partner of Berman DeValerio's San Francisco office.

Shelley, a former assemblyman, served as secretary of state from 2002 to 2005. Over the course of his political career, he championed the rights of workers and fought to protect civil rights.

Among his accomplishments, he improved conditions at nursing homes, drafted new corporate accountability requirements and created a restitution fund for victims of corporate fraud.

His political involvement began in 1978 as a staff member to U.S. Representative Philip Burton and, later, to Burton's widow, Sala Burton, who replaced her husband after his death in 1983.

Shelley then played a key role in electing their successor, Nancy Pelosi, who is now speaker of the U.S. House of Representatives. His own political career began in 1990, when he won a seat on the San Francisco Board of Supervisors.

Shelley earned a B.A. in political science from the University of California-Davis in 1978 and a law degree from the University of California Hastings College of the Law in 1983. A member of the California Bar, he is the son of Jack Shelley, a former San Francisco mayor, U.S. congressman and California state senator. ■

U.S. Supreme Court

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In the Tellabs litigation, plaintiffs provided the court with 27 confidential sources who stated that the company and its former CEO knew Tellabs had illegally inflated revenues at the end of 2000 and that officials were aware of an eroding market, despite telling analysts the contrary.

But because these informants could not provide precise details about exactly what the CEO knew, the district court dismissed the case, agreeing with defense claims that it was just as plausible that the CEO did not know about slowing demand.

On appeal, the 7th Circuit reversed the decision and reinstated the case. The Supreme Court is expected to issue a ruling this summer.

The case has drawn support from the usual pro-business suspects, including the U.S. Chamber of Commerce, which has filed an amicus brief in support of Tellabs. But in a particularly troubling sign for investors, the defendants have also found a friend in the SEC, which filed a pro-Tellabs amicus brief in conjunction with the Justice Department.

SEC Chairman Christopher Cox has been quoted as saying that a stricter pleading standard is just one mechanism to reduce "fraudulent lawsuits" filed by "professional plaintiffs."

Fortunately, several institutions and investors' groups have stepped forward to urge the court to protect the rights of shareholders. Among those that filed briefs: two dozen attorneys general, the Council of Institutional Investors and the National Conference on Public Employee Retirement Systems.

If the court sides with Tellabs, "meritorious complaints will be dismissed along with frivolous ones; fraud on the market will increase; and state pension funds, state employees, and state taxpayers will suffer," argue the AGs, in a brief led by Ohio Attorney General Marc Dann.

Just a few short years after investors lost billions of dollars due to frauds at some of America's biggest companies, the business community – and the SEC – are trying to make it harder for investors to hold corporate wrongdoers accountable. ■

Joseph Merschman is an attorney in the firm's Boston office.

Class Certification

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Historically, courts have certified classes in shareholder lawsuits almost automatically. That's because securities fraud fact patterns present the archetypal example of a defendant's fraudulent conduct affecting every purchaser of the stock identically. These automatic certifications are no longer, thanks largely to the somewhat obscure economic debate over what constitutes an "efficient" securities market.

To appreciate the relevance of market efficiency, one must first understand the fraud-on-the-market presumption, which was adopted by the Supreme Court in a crucial 1988 decision.

Under this presumption, the court presumes that all investors have relied on a corporation's public statements and the integrity of the market price of the company's stock when deciding whether to buy or sell shares, as long as the stock in question was traded on an efficient market.

Defendants' challenges to the underlying efficient-market hypothesis are appearing in recent oppositions to class certification. This has placed a heavier burden on plaintiffs.

A recent high-profile example of a class certification challenge stems from the more than 300 class actions involving initial public offerings issued between 1998 and 2000. The IPO action alleges that hundreds of public offerings during this period were manipulated by the investment banks that underwrote them.

In October 2004, a federal judge certified six selected "focus" cases among the 300 actions as appropriate for class action treatment. In her decision, Judge Shira Scheindlin of the U.S. District Court for the Southern District of New York held that a plaintiff must make only "some showing" of each of the elements for class certification established under the federal legal procedures known as Rule 23.

Defendants appealed, and on Dec. 5, 2006, the U.S. Court of Appeals for the Second Circuit reversed the order for class certification, ruling that courts must resolve any factual disputes relevant to each Rule 23 requirement.

In other words, instead of the generous "some showing" standard used by Judge Scheindlin, which typically would not require factual findings on the relevant issues, going forward a more rigorous "merits based" determination would be needed for each category under Rule 23.

These categories include the number of people involved in the class, the common issues and claims they share, and the adequacy of their legal representatives.

Using this stricter test for the IPO appeal, the 2nd Circuit held that individual issues predominated over common questions of law or fact, making class certification inappropriate. In particular, the appeals court found the market for IPO shares was not efficient, thus rendering the fraud-on-the-market presumption unavailable.

The particular characteristics of a market for an IPO are quite distinct from the market for the same stock after the "quiet period" is over, and public comment and analysis are encouraged. At that time, the market is highly likely to be "efficient."

But until then, reliance on misstatements would have to be established on an individual basis.

In confirming that the new merits-based standard requires findings of fact, the court noted that judges may be required to resolve "factual disputes" tied to Rule 23 requirements. Counsel may take more discovery concerning the Rule 23 requirements and courts may begin conducting more mini trials concerning class certification.

Berman DeValerio is no stranger to such heightened class certification burdens. In the firm's case against Xcelera, an Internet holding company, the defendants argued that the market for Xcelera's stock was irrational and inefficient, in an attempt to destroy the presumption of reliance.

Unfortunately for plaintiffs, these class certification challenges have nothing to do with allegations of corporate fraud or the merits of a case.

After a two-day evidentiary hearing, the judge sided with the plaintiffs, granting the motion for class certification in September 2004. U.S. District Judge Rya W. Zobel wrote: "The position of defendants' expert suggests that market efficiency is a rare phenomenon. Whether or not that is true as a matter of pure economics, it does not function to shield defendants who mislead the public from the laws regulating securities."

Unfortunately for plaintiffs, these class certification challenges have nothing to do with allegations of corporate fraud or the merits of a case. They are simply another tactical maneuver by defense lawyers to delay and deny shareholder claims. ■

Julie Richmond is an attorney in the firm's Boston office.

Anniversary

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the briefs typed out on IBM Selectrics and the dashes to the courthouse to meet filing deadlines.

About six months into their endeavor, they realized their enterprise lacked one key ingredient: gray hair. So they signed on Harry A. (Gus) Garfield II, the 50-something son of a founding partner of an old-line Boston law firm and a descendant of the nation's 20th president.

"There was a degree of culture shock for poor Gus," DeValerio said. "We were kind of rough and ready, and he was used to a more genteel style of practice. It took him a while to get acclimated."

Norman Berman, Glen DeValerio and Peter Pease at the young firm's 1983 Christmas party. (Pictured l to r.)

As the years passed, the firm earned a reputation for strong performance, which, in turn, was rewarded with more prominent litigation positions.

Berman DeValerio & Pease began filing more and more securities cases, a natural crossover from franchise law. At that time, an individual investor with just 100 shares in a company could be lead plaintiff in a securities case – as long as he showed up at the courthouse first.

As the years passed, the firm earned a reputation for strong performance, which, in turn, was rewarded with more prominent litigation positions. First came document reviews, then plaintiffs' executive committee positions and, with increasing frequency, lead counsel appointments.

At the start of the fifth year, the firm jettisoned its last hourly-rate client to focus exclusively on complex securities and antitrust class action cases, which could take years to resolve. "The potential return for the securities work was higher, but it was much riskier," Pease

The following timeline highlights some milestones in the history of the firm.

1982: Berman DeValerio & Pease, LLP founded in Boston.

1994: Burt & Pucillo, LLP founded in West Palm Beach, Fla.

1995: Congress overhauls securities laws with the Private Securities Litigation Reform Act of 1995.

1995: The California office, headed by Joseph J. Tabacco, Jr., joins the firm.

1998: Congress further restricts plaintiffs with the Securities Litigation Uniform Standards Act.

1999: Firm negotiates a settlement with Digital Lightwave that gives class members more than 200% of their losses after the payment of attorneys' fees and expenses.

2000: Burt & Pucillo's settlement with UCAR International Inc. on behalf of the Florida State Board of Administration sets new standards for corporate governance provisions in securities class actions.

2001: Court approves settlement, negotiated by firm, of approximately $104 million in cash and stock in the Prison Realty case. At the time, it was one of the 10 largest settlements in securities class action history.

2001: Firms unite to form Berman DeValerio Pease Tabacco Burt & Pucillo. The new firm has more than a dozen institutional clients.

1982 1990 1995 2000 2001

said. "You didn't get paid until you were done with the case and you had to pay hundreds of thousands of dollars of expenses. It was a scary proposition to devote ourselves more fully to it."

Gradually, as the caseload grew, the firm added staff. There were many weeks when they could pay their employees, but not themselves. There was one entire year when the three partners didn't collect a single paycheck.

And then there was the year when, in a Dickensian move just days before Christmas, the Bank of New England pulled the firm's line of credit.

"We were dressed and on our way to our Christmas party when this guy from the bank calls to say the line of credit is cancelled and they're not going to honor any checks we have written," Berman said. "They eventually changed their minds when we told them we would put them out of business."

(Talk about just deserts. Years later, the firm ran a securities fraud case against the bank, which did, in fact, go under.)

For the lawyers of Berman DeValerio & Pease, securities law offered a chance to help investors who had little recourse against corporations that had done wrong. And in the 1980s, no one else was doing such work in Boston.

"There was a period of time when there were a lot of securities cases being filed against Massachusetts companies, but the securities bar was controlled by firms out of New York and Philadelphia," Pease said. "There was an opening for us to come in and take a significant role."

Securities law offered a chance to help investors who had little recourse against corporations that had done wrong. And in the 1980s, no one else was doing such work in Boston.

The New England banking crisis of the late 1980s further cemented the firm's reputation as a leader in securities cases and a number of successful settlements followed.

But the political winds shifted in the mid-1990s, when the Republicans, led by Newt Gingrich, took control of the House of Representatives and fixed plaintiffs' attorneys squarely in their sights. Over the veto of President Clinton, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA), raising the bar for securities class action pleadings and making corporate fraud cases considerably harder to prosecute.

The lawyers of Berman DeValerio & Pease envisioned disaster.

Normal pleading rules required plaintiffs to put defendants on notice of the claims. Now plaintiffs would be forced to describe their claims and plead evidence to support them – a level of detail not required in any other form of litigation. At the same time, in a vicious Catch-22, the PSLRA stayed discovery until after the motion to dismiss, leaving plaintiffs with no legal means to obtain the evidence they needed for their pleadings.

And, just as significantly, the law changed the lead plaintiff appointment

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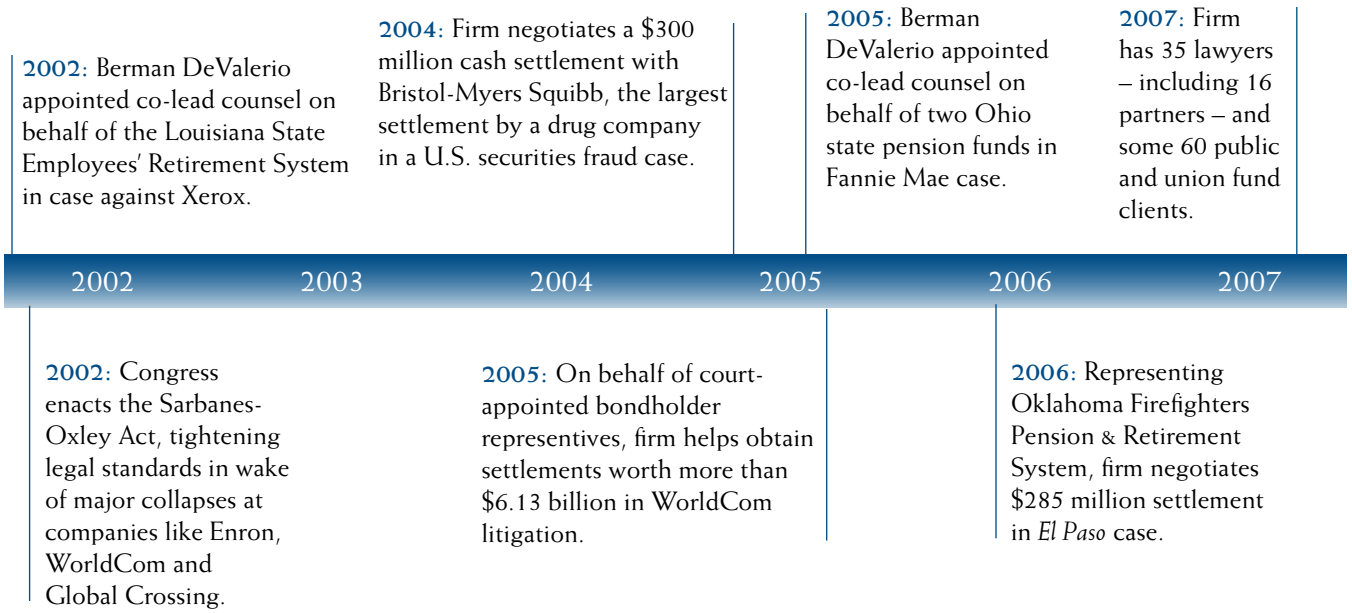

Anniversary

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procedure. No longer would it matter who filed first. What mattered was the size of an investor's losses.

"Congress was thinking that by getting institutional funds to take over the cases that these funds would never hire the plaintiffs' bar and many cases would probably be dismissed," Pease said. "But unfortunately for them, they woke up the sleeping giants. The pension funds were the major losers in these corporate frauds – much more so than any individual investor."

The PSLRA did, in fact, severely damage many plaintiffs' class action firms. With higher pleading standards and no discovery powers, old fashioned lawyering no longer worked. Only the resourceful survived.

Plaintiffs and their counsel were now forced to determine intimate details about corporate frauds before the complaint was filed. That meant hiring investigators to interview former employees and enlisting forensic accountants to analyze financial statements. (Today, Berman DeValerio uses two full-time forensic accountants and a team of investigators.)

Smaller plaintiffs' firms already knew the importance of working together effectively in order to compete against the enormous legal teams marshaled by corporate defendants. Berman, DeValerio and Pease often found themselves collaborating with three highly skilled attorneys in particular: Joseph J. Tabacco, Jr., first of New York and later of California; and C. Oliver Burt III and Michael J. Pucillo, who started their own class action firm in Florida.

Pooling resources made sense. In 1999, Tabacco, a former trial attorney with the U.S. Department of Justice, opened Berman DeValerio's California office. Two years later, the lawyers in Massachusetts, Florida and California formed Berman DeValerio Pease Tabacco Burt & Pucillo.

"We all realized, especially after the PSLRA was passed, that having as large a firm and as great a geographic reach as possible was important in terms of the client base," Berman said. "Together, as a group, we made ourselves that much more attractive to our clients."

Berman DeValerio was competing against larger law firms for institutional investors, but its case selectivity and strong record of successful prosecutions made it particularly attractive to public fund clients. Today, the firm's lengthy client list includes public employee retirement systems in 21 states, three of the top four public pension funds in the country and 11 of the top 25. In all, Berman DeValerio represents more than a quarter of all U.S. public funds with more than $5 billion in assets under management.

"Congress was thinking that by getting institutional funds to take over the cases that these funds would never hire the plaintiffs' bar and many cases would probably be dismissed," Pease said.

Some of the country's bigger pension funds took to their new post-PSLRA activist roles very quickly; others took a more guarded wait-and-see approach. Then everything changed again after the massive frauds at Enron and WorldCom.

Instantly, the public had a better appreciation for the importance of the firm's work. Securities fraud was now front page news, and everyone began to realize that it affected firefighters and police officers and teachers – ordinary individuals whose retirement funds were eviscerated by corporate wrongdoing.

"It made it real – and it suddenly made us popular and appreciated," Pease said.

But the shelf life of collective national outrage is apparently finite, and firms like Berman DeValerio are finding themselves in the political crosshairs yet again.

"There seems to be this sense that with Enron and WorldCom behind us, that everyone has cleaned up their acts and that lawsuits are an unwarranted irritant," Berman said.

In fact, restatements for large companies are at their lowest level in years and securities cases are being filed at nearly half the usual rate. But large-scale fraud cases are continuing to wend their way through the courts. Berman DeValerio, for example, is co-lead counsel on behalf of shareholders in major fraud cases against Fannie Mae and Xerox. And other brazen examples of wrongdoing continue to make headlines, such as the stock options backdating scandals of the last year.

For the attorneys at Berman DeValerio, fighting securities fraud provides an opportunity to practice in a demanding and complex area of the law in prominent cases. Yet there's more to it than just the pleasure of interesting work.

"We believe in the fundamental rightness of what we're trying to do – to secure a recovery on behalf of people who have been lied to and who lost money as a result," Berman said. "It's an honor and a privilege to stand up for folks who otherwise would have absolutely no remedy to get their money back, and help insure the integrity of our capital markets." ■