REMARKS OF HORACE SCHOW II

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BEFORE

THIRD CIRCUIT TASK FORCE ON SELECTION OF CLASS COUNSEL

United States Courthouse
Philadelphia, Pennsylvania

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Good morning. My name is Horace Schow. I am the General Counsel of the Florida State Board of Administration. It is a privilege for me to appear before this distinguished Task Force on important issues of judicial administration and conflict resolution in the complex area of class litigation. The Chief Judge of this Circuit is to be commended for his initiative in forming the Task Force and calling for these public hearings.

I am appearing here primarily in response to questions of the Task Force which are directed to the auctioning of class counsel appointments in litigations governed by the Private Securities Litigation Reform Act of 1995 (PSLRA). The Florida State Board of Administration has little experience in class action litigation in areas of the law removed from securities law violations and the corporate governance issues typical of those that figure in the kinds of actions in which the Chancellor from Delaware who sits on this Task Force is involved.

A bit of background: The Florida State Board of Administration, established in 1928 pursuant to the laws of the State of Florida, is one of the nation's largest public pension

systems. FSBA's assets under management for its fiscal year ended June 30, 2000, exceeded $128 billion. The FSBA has as its investment responsibilities the following: i) managing the assets of the Florida Retirement System Trust Fund; ii) managing the assets of the Local Government Surplus Funds Trust Fund; iii) managing debt service accounts for the State of Florida bond issues; iv) managing the Florida Hurricane Catastrophe Fund; and v) managing the Lawton Chiles Endowment and various other trust fund assets.

The FSBA conducts its myriad of financial and managerial services under the direction of the three members of the Board, a constitutional body comprised of the Governor, State Treasurer and State Comptroller, as well as through the Executive Director and a staff of some 200 investment professionals and the in-house legal department which I have headed for the last 17 years. Florida law also provides for external oversight of the activities of the FSBA by an Investment Advisory Council, composed of six individuals having the necessary financial expertise, whose appointments are confirmed by the Florida Senate. In connection with the FSBA's prosecution of securities fraud and related actions, it has acted pursuant to its statutory authority and with all required approvals, including that of the Executive Director of the Board.

The FSBA is committed to shareholder activism especially in the corporate governance area, voting proxies on issues presented at annual meetings of companies in which it invests. In addition to voting over 2,600 proxies on various management and shareholder proposals, the FSBA continues to actively prosecute both direct and derivative securities actions to combat financial fraud, improve corporate disclosures and attempt to recover investment losses sustained by it and other similarly situated investors which do not possess the FSBA's impressive resources.

Confining myself just to the most recent past, FSBA has served as lead plaintiff in the following securities class actions: Vesta Insurance Group; Northrop Grumman; Sykes Enterprises, Inc.; Pediatrix Medical Group; Parametric Technology Corp.; UCAR International, Inc.; and the Samsonite securities litigations. It is serving currently as a co-lead plaintiff in the DaimlerChrysler Securities Litigation and has moved for appointment as lead plaintiff in the Rent-Way securities case, which motion is pending. FSBA has used various law firms throughout the United States to represent it in connection with these lawsuits. The UCAR International and Samsonite cases have been successfully concluded, with significant settlements paid to the settling class. The Northrop Grumman case has been dismissed and is on appeal. FSBA continues to serve as lead or co-lead plaintiff in the remaining cases.

In several cases, the FSBA has opted out of the putative class in relatively early stages of the class litigation in order to commence, alone or with institutional co-plaintiffs whose interests coincide with our own, non-class suits for damages against alleged securities fraud perpetrators and their auditing firms. Generally our objective is to achieve a settlement or recovery of a higher percentage of our claimed losses than we could hope for as our pro rata share of a class-action settlement pool in which we are one of thousands of passive claimants. In these non-class actions, of course, the issue of an auction of the class counsel appointment does not arise. We engage various law firms for these opt-out cases on the basis of the same criteria we employ in engaging counsel for class litigation. We would not think of bidding out these assignments seeking out the low-price provider. Legal services are not a commodity. The quality of counsel, their reputation and experience in the field, knowledge of the FSBA, and their openness to negotiating with us on a fee structure appropriate to the case as we assess it at the

outset, are all factors to be considered together.

At the very least, the FSBA is indirectly interested in most of the high-profile securities fraud class cases, since almost inevitably we are among the class members which have sustained large losses as a result of alleged wrongdoing by the defendants. The issue of auctioning class counsel in PSLRA cases is one that we are forced by circumstances to take an interest in, and I believe our views are well known in at least the public pension fund community. The FSBA believes that auctioning class counsel is wholly inconsistent with both the express letter and the spirit

of the PSLRA. The letter of the law is that the district court seized with jurisdiction of the case determines the most appropriate person or group to be designated as lead plaintiff and, once that determination is made, the lead plaintiff designates the lead counsel, subject to the court's approval of its selection.

We would not disagree with the proposition that the statutory requirement of the court's approval of lead counsel implies a modicum of discretion in the court to disapprove lead plaintiff's choice. The court's exercise of this discretion, however, is invariably guided by the presentation the lead plaintiff has already made to the court in the motion for appointment, part of which is the moving party's counsel's compendium of its qualifications and experience to provide adequate, or more than adequate, representation to the class in securities fraud litigation. In the case of an institutional investor like FSBA, the court will have already satisfied itself that we ourselves are sophisticated in the subject matter and that we have the most significant stake in the outcome of the litigation, and can presume that we have wielded our own strong bargaining power on the issue of fees to serve both our own advantage and that of the class we have stepped

forward to represent. I would submit to the Task Force that the selection of class counsel by institutions like us is entitled to a high degree of deference, as Congress intended us to enjoy in the reform era that PSLRA ushered in. Lawyers cannot and do not select FSBA as a plaintiff. FSBA selects its litigation and selects its lawyers. When FSBA litigates, it is the opposite of lawyer-driven litigation: It is FSBA-driven litigation.

The early timing of the lead counsel selection decision, usually well prior to Rule 23 certification, militates against the propriety or appropriateness of auctioning. Auctioning will necessary slow down the pace of the litigation and delay moving forward with a range of satellite issues that commonly arise before and during the class certification process. Other institutions might differ but our own view is that, after FSBA has clearly been determined to be the most appropriate person to serve as lead plaintiff, we would not care to work with counsel other than that of our own choosing, if that other counsel had prevailed in an auction process on criteria heavily reliant on price, slighting our own experience and judgment in identifying and working with highly qualified law firms many times before and negotiating the fee. In fact, in certain courts, one of the reasons we may choose to opt out from the class at an early stage of a class litigation and institute our own action is that by doing so, we avoid not only the risk of an auction determining who our counsel will be but also the possibility of having to share control over the litigation with "co-lead" plaintiffs and counsel foisted on us by a court tolerant of unaffiliated "group" plaintiffs.

The Task Force has asked for suggestions for improving what it calls the "traditional process" of appointing class counsel. The traditional process, as I understand the Task Force's use of that term, was for the court to appoint whoever appeared for the lead

plaintiff, and pre- the PSLRA, that usually meant the lawyer who won the race to the courthouse with a figurehead plaintiff in tow already named in the first-filed complaint. PSLRA has improved on that process immensely by making the winner of the race to the courthouse irrelevant as soon as the required 20-day notice goes out to attract the attention of institutional and other stakeholders in the litigation, thus to afford them an opportunity to move for the lead plaintiff designation. But the pre-PSLRA problem persists when, as in many cases, no recognizable institutional player comes forward and the bid for lead plaintiff degenerates into an unseemly competition among competing alliances of lawyers — each of which may represent an ersatz group of small shareholders drawn in by law firms' announcements on the Internet and in the media. The remedy for this seems to be twofold: (1) The courts should follow the thoughtful recommendations of the SEC on placing limits on the number of persons or entities which can be aggregated into a "group" for purposes of the lead plaintiff provisions of the PSLRA. (2) A lesser degree of judicial deference should be accorded the lawyer or firm that represents an aggregation of plaintiffs, which translates to the court's applying a higher level of scrutiny to counsel's qualifications to handle the particular case. So far as the fee issue is concerned, this may also involve the court's inquiring into the existence of any pre-existing fee arrangement and, if there is one, perhaps screening it for the existence of any provisions which on their face do not adequately align the interests of counsel with the class or appear designed to hamstring the full range of the court's discretion under Rule 23 in the end-game of any settlement and its fee provisions.

The FSBA has lesser experience in derivative actions than it has in federal securities fraud actions, but we agree with the suggestion inherent in the Task Force's question

that derivative actions pose special questions for appointment of counsel by the auction procedure. Delaware and other important states do not require a derivative plaintiff to meet a minimum number or value of shares held at either the time of the allegedly wrongful conduct or on the date the action is filed in order to have "standing" to maintain the action. There is no presumption, as there is under the PSLRA, that the institutional shareholder, with its typically larger holdings in any single company than most individual holders, is a more appropriate plaintiff who should ordinarily be allowed to oust small holders from control over the litigation. To us, this means that, more like the situation that existed before the PSLRA, derivative litigation remains exposed to the abuses of "strike suits" by lawyer-controlled figurehead plaintiffs with small and, most likely, not very permanent stakes in the future of the companies that are the nominal defendants in these cases. There is therefore an obvious tension between the principle that every shareholder should have the right to protect his own property rights against the depredations of unfaithful agents — members of company management — and the reality that "strike suits" are against the interest of every direct and indirect shareholder, most of all the large institutional funds that have truly permanent stakes in the integrity and loyalty of company managements generally. When institutional holders are all absent class members in a derivative case, it is one indication that the action may be lacking in merit, or it may simply be that in the absence of a lead plaintiff reform similar to that embodied in the PSLRA, the institutional investor has little incentive (and is not equipped by its internal processes) to compete in the surviving tradition of the race to the courthouse. State legislatures or the state courts that have rule-making powers to deal with these issues probably should devote their attention, not to the auction process as a check on protecting class member recoveries — in derivative cases,

recoveries go to the company, not the settling class members — but rather on altering the playing field to encourage institutional involvement in meaningful ways in derivative actions initially commenced by others.

This concludes my prepared remarks. I will be glad to respond to any questions Task Force members may have, and I wish to express my appreciation to the Task Force for the effort it is bringing to bear on important issues of deep public interest.