

WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP

**A SCALPEL IN YOUR HAND:
LITIGATION AS A TOOL FOR ENFORCING
RESPONSIBLE CORPORATE GOVERNANCE**

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Dear Socially Responsible Investors:

Thank you for taking the time to review our presentation. We hope it has sparked consideration of the ways socially responsible investors can pursue their goals for changes in corporate behavior, and protect their assets through litigation as shareholders of public corporation.

Our firm has an unusual New York history. It was founded no later than 1888. It is the culture and personality of our firm to provide individualized services to each of our clients. We make it our business to be attentive and, therefore, are particularly concerned that our attorneys and our firm not be overextended. This approach informs how we undertake major litigation. When we commit, we know we have the personnel and the time to devote our energies and attention to the matter, and to bring focused pressure to bear to obtain recovery of losses.

We are a full service firm, allowing our litigators to call upon the expertise of our firm's attorneys who specialize in non-litigation areas including bankruptcy, ERISA, labor law, trusts and estates, real estate, and not-for-profit corporate work. Our approximately 60 lawyers are concentrated in New York. We have small satellite offices in Chicago and San Diego.

The firm's litigation department has substantial experience in plaintiff's class action litigation of all types. Our firm resume, available at the conference, lists a small number of examples of decisions from cases in the federal and state courts arising under the federal securities and antitrust laws in which our firm had a lead or other important role. Also included are examples of judgments and settlements. In total, we have recovered close to \$2 billion dollars, and we have made new law in several areas

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Because of our history and tradition of personalized attention, our insistence on maximum attention to matters which are our responsibility, and our unique, broad based national practice, among the firms that do class action work, we believe we are particularly suited to provide not only litigation services but services including: monitoring pending class actions; assisting clients in analyzing potential loss recovery litigation; and suggesting legal action to advance corporate behavior modification goals as appropriate, including initiating actions, seeking to be lead plaintiff, remaining in the plaintiff class or opting out and pursuing single-party litigation, among other options.

I realize that many of you are familiar with the procedural advantages that class actions bring to shareholders litigation and that a class action is considered the best available course to pursue for investors seeking to recover fraud-related losses. Many socially responsibility investors, however, may not have considered the larger role of litigation in creating more financially responsible and socially conscious corporations. That is the dialog we hope to begin at this conference.

I appreciate the opportunity to provide this very short description. I would be pleased to speak with you and your colleagues at your convenience.

Very truly yours,



Fred Taylor Isquith

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SCALPEL IN YOUR HAND: LITIGATION AS A TOOL FOR ENFORCING RESPONSIBLE CORPORATE GOVERNANCE

The course of international events since September 11, 2001 has, to some extent, obscured the wound which threatens greater long-term harm to the United States and the world economy. These scandals are a multi-headed hydra: systematic management looting of corporations like Enron, Tyco and Adelphia; false accounting designed to create the appearance of financial success, like Enron, Global Crossing and WorldCom; manipulation of Initial Public Offerings, grants of stock options essentially as bribes in exchange for investment banking business, and the use of equity analysts as a marketing arm for investment bankers.

This tragedy should be a learning moment, when everyone who is concerned about the transparency of corporate America and accountability of our major economic actors can come together and share knowledge about solutions. Some of those solutions involve direct action, a subject to which I will return in a moment.

The recent scandals - - analysts acting as the marketing arm of investment banking, market manipulation of public offerings, lenders and accountants assisting in the construction of transactions to create a false appearance of financial stability - - have done damage to the public trust which will take years to recover. Not for 70 years, not since the great scandals of the 1920's and 1930's, has such injury been inflicted upon the capital markets of the United States. Perfectly good, solid, companies are unable to raise money for their businesses because of astounding abuses of greed which are imbedded in the major investment banking firms, including such names as Morgan Stanley, Goldman Sachs, Lehman Brothers, Merrill Lynch, Credit Suisse First Boston, JP Morgan Chase, among others. Money for investment has disappeared. Some of the lawyers who regularly represent investors have claimed, correctly, the right to say, "we told you so."

The community of socially responsible investors also has the distinct right to say, "I told you so." The SRI community told Americans about toxic waste problems, about dangers to the environment. It has raised red flags about what was happening to our forests and wildlife. It has shamed all that we were not living up to our promises to provide every child a proper education and every person the right to work with dignity and every person the right to be judged by the quality of his character. The SRI community is working to assure that every American has the best healthcare.

However, the SRI community has also thus far missed an opportunity to change America. Socially responsible investors have not been cognizant of all the tools at their disposal, and particularly of the kinds of litigation available in applying pressure to change corporate behavior.

Legislation as a way to change corporate behavior is a powerful, but blunt and unwieldy instrument. Major legislation has provided the backbone of change in so many areas - - from the Sherman Antitrust Act to the Clean Air Act, the Foreign Corrupt Practices Act, the Fair Debt Collection Practices Act, to name a few. But often, such legislation is enacted only over tremendous opposition. "Compromise" is often the alternative to defeat. Even the best of legislation is written broadly and requires interpretation and refinement through the day-to-day, example by example, fact specific, application to the particular problem. The body of antitrust law, for example, is deeply rooted in the fabric of our nation, but like an old tree, it grows and spreads every season. The process of real change takes decades. The very process by which legislation is enacted, too, is the result of compromising various interests. Compromising legislation more often limits the process of reform for decades. Once Congress has dealt with an issue it is loathe revisit it.

Similarly, regulation is a potentially powerful, but often frustrating engine for change. Regulators are subject to the control of political masters, some of whom have an agenda to defeat any effective regulation of corporate behavior. Even when free to point in the right direction, regulators have very limited resources, and are underfunded and stretched too thin.

It is unusual for groups such as corporate governance and social responsibility advocates to challenge corporate conduct through the use of those rights which are given to investors in public corporations. Interest groups are often reluctant to take their concerns into the courts and seek, through process of litigation, to create reform which has the weight of law as great as legislation or regulation. While not-for-profit organizations and charitable foundations are often hard pressed for funds and rightly harbor those funds, often overlooked are the services provided by contingency lawyers in the private bar. Such lawyers are prepared to incur the risk and expenditures of time, energy or funds, which permits an issue-oriented investor to have an impact disproportionate to the funds it has available.

Litigation contrasts with legislative and regulatory remedies in that it is often a more exacting tool. Perhaps no instrument is more potent in the hands of experienced counsel challenging corporate misconduct than the shareholder derivative action and class action on behalf of investors targeted at reforming corporate conduct. In our experience, however, these devices are often misunderstood by laymen (and, indeed, by other lawyers). We began by noting that the current spate of scandals was a teaching moment. What we hope to do here is to raise consciousness about the litigation tools at the disposal of a determined reformer, whether individual or institution, and to impress on you that sometimes, contingency litigation as a plaintiff can apply focused pressure for change, faster and with less resources than is possible by any other means.

The Class Action Device

Essentially, a class action is a device by which litigation otherwise impractical to bring from an economic standpoint become feasible by aggregation of damages. An individual plaintiff may have injury simply too small to justify the major efforts involved to prove a case. A class action is a remedy that renders an action economically viable by aggregating the damages of the many in the Class.

- In a class action, the judge approves one or more persons, or institutions, to act as representatives for everyone in the class -- including people affected by the wrongdoing, who may not even know that litigation is going on.
- A class representative is a person whose injury is typical of that of other members of the class, and who is adequate to speak intelligently with the lawyers and represent all the class members -- for example, a class representative must be someone with no interests adverse to the rest of the class.
- Any person or entity with what lawyers call "standing," that is, the right to bring a case on their own, can also bring a case on behalf of a class.
- A successful result in a class action for damages generally results in creation of a fund for class members. Class members receive notice by mail or publication, and can file a form to receive their portion of the fund.

Many kinds of litigation can be done on a class basis -- you probably all have some knowledge of securities fraud class actions, which are a particular subset with their own rules.

Among the other types of litigation sometimes suitable for class action treatment are:

- Antitrust class actions where purchasers of products challenge anticompetitive conduct such as price fixing or the creation of monopolies.
- Consumer protection cases of many varieties. For example, victims of predatory lending may be protected by state statutes, and may be able to sue as a class in each state where they have those protections.
- Environmental litigation.
- Employment litigation.
- Toxic tort litigation where, for example, a homeowner who had his property value or health diminished, as have his neighbors, brings a class action on that basis.

To give just one example of an area where focused pressure can change corporate behavior, our firm is involved in a series of antitrust class actions to prevent generics blocking by major pharmaceutical companies. When a drug patent runs out, the generics companies are supposed to be permitted to make the drug as a generic brand, creating competition and lowering the price to consumers who need the drug. However, patent-holders often collude with generics makers to buy off the generics makers and keep them from bringing the lower-cost drug to market. We argue that this is a combination in restraint of trade, and a violation of the antitrust laws. Those cases are making their way through the courts now, and we believe they will end some of the most egregious generics blocking practices and bring drug prices down. We hope both to recover damages for our clients, who buy the drugs now, and to change the practice in the future, to the benefit of the entire healthcare system.

Another example of a class action aimed at irresponsible corporate behavior is Wolf Haldenstein's ongoing litigation against Aventis CropScience for its mishandling of genetically modified corn. When Aventis' StarLink corn seed, which was not approved by the EPA for human consumption, spread to contaminate the American corn market, the world markets began turning away U.S. corn. As a result, prices for American corn plummeted, causing economic loss to the more than 330,000 non-StarLink corn farmers whose interests we represent in this litigation. Wolf Haldenstein filed suits against Aventis throughout the corn belt. These cases were eventually centralized for pre-trial proceedings before a federal judge in Chicago. In these cases, Wolf Haldenstein seeks to hold Aventis and Advanta USA, Inc. (one of its seed licensees) accountable for the economic damage to all of the non-StarLink U.S. corn farmers.

Class Actions Under the Securities Laws

A person who purchases stock on the open market may claim she and other persons were lied to by corporate executives. Everyone was told the same lie. This is one of the situations

which best lends itself to the use of a class action. It may be that the individual shareholder stands to recover only a few hundred dollars -- not enough to justify the effort of suing. However, the compensable losses of all the shareholders combined may be millions or hundreds of millions -- in fact, Wolf Haldenstein is part of the team of lawyers which is presently seeking approval for a \$490 million settlement against Bank America. With that much at stake, lawyers can seek recovery for the entire class, and can then ask the judge to award attorneys' fees out of the total recovery, if the case is won.

Securities class actions have particular rules which do not apply to other class actions:

- In a securities class action, the Court must approve the institution or investor with the largest interest in the class recovery -- that is, the largest loss -- as long as that institution or investor is fit to represent the class.
- When a shareholder brings a case, her lawyers must publicize that filing, and if a major institution, such as a union pension fund, a state retirement system, or any other institution wishes to become involved, the Court will name the institution with the largest loss "Lead Plaintiff, as long as that institution is adequate as a representative and its claim is typical of other investors' claims."
- The Lead Plaintiff then chooses a lawyer it trusts to run the litigation, and that lawyer controls the case for the entire class.

Some kinds of institutions have begun to regularly step forward and lead securities class actions -- again, mostly union and government controlled pension funds. Absent a union or political involvement, the largest investor to seek a leadership role is often an individual investor. There is a tier of institutions, however, into which most of the socially responsible investors fall, which have been absent from the process -- the SRI funds, religious pensions, and other small, socially conscious investors, who are exactly the sort of savvy institutional investors judges trust to represent a class, have not taken that role.

An exhaustive list of potential class action cases is not possible. In addition to the broad areas outlined, there are a tremendous number of state and federal statutes. If class-wide

damages are available, or if a statute provides for the defendants to pay the plaintiffs' attorneys (called "fee shifting"), it may be possible to bring a case. One short story illustrates how such class actions can work hand-in-hand with reform-oriented legislation.

In the mid 1980s, Wolf Haldenstein brought the first case certified for class treatment under the federal WARN act, the so-called "plant closing law." The plant closing law permitted class action suits against companies which closed plants without giving sixty days' notice. We brought a case against L.F. Rothschild, when that company closed an office without giving sufficient notice. We won money and continued health benefits for the displaced workers, and convinced the higher-paid workers to shift some of their back pay to the lower-paid workers. Almost every other major company took the hint, read the statute, and most companies now give the proper notice when closing plants or offices of significant size rather than get sued for it -- we have made it cheaper for them to do the right thing than face the consequences.

The Shareholder Derivative Device:

Derivative claims are perplexing to those not educated in this area of the law. The so-called "derivative" right, however, makes intuitive sense to many socially responsible investors:

- In a derivative case, a shareholder brings an action in the name of the corporation to vindicate a right of that corporation.
- In a derivative case, a shareholder says to the judge, in effect, "the corporation ought to be suing someone who has injured it, but it is not. I want permission to sue on the corporation's behalf." The judge will permit this when the Board of Directors, because of conflicts of interest, cannot make an independent determination on the matter. The shareholder, even if she owns only one share of stock, can then pursue the lawsuit.

Why is a shareholder permitted to do this? Because, as socially responsible investors so often remind professional managers, the shareholders own the company. The management are employees, and the Board of Directors is a body of overseers with an obligation to the owners. So, when the Board is not independent, one of the owners can step up and direct the Corporation

to bring a lawsuit which is in the owners' best interest. And when the case is over, if the corporation is entitled to any money, it goes to the corporation itself.

The classic shareholder derivative case is one where management is looting the company. In Tyco, for example, our firm is suing in state court in New York, seeking to force former CEO and current criminal defendant Dennis Kozlowski to return hundreds of millions of dollars to the corporation. Similarly, years ago, Computer Associates executives engineered a compensation package that allowed them to avail themselves of a fortune in stock from the company by manipulating its financial results to meet certain performance targets. In a derivative suit litigated by Wolf Haldenstein and some others, a handful of small shareholders forced those executives to give back more than \$500 million in stock they received.

Among the most effective were a series of cases which Wolf Haldenstein pioneered about 15 years ago concerning the nuclear power industry. Electric utility companies operated through a rate setting system which provides them with a percentage return on their assets. The theory was that electric utilities will be able to raise money from investors and bondholders for the construction of lines and power plants for the delivery of electricity if there are guarantees of a return for these large scale projects. The larger the project, therefore, the more expensive in its construction, the more funds ultimately are paid, so the thinking goes. In the 1970's public utilities in this country went on a nuclear power plant buying spree. Encouraged both by the regulatory environment and General Electric and Westinghouse Corps., which supplied the generators and turbines for these plants, and other vendors, an entire industry grew around the construction of these plants. One would say that the constructing companies were exactly that: in the business of constructing but not completing. Rank incompetence, waste, and controversy

followed in the trail of the decision to build these plants. Billions of dollars were raised and spent.

Amazingly, however, the plants were often poorly designed - in one situation, Diablo Canyon in California, the plans for the plant actually provided a mirror image of what was supposed to be done and equipment was placed the wrong way. In another case a plant in Indiana was built on ground that sank while the plant was being built. Years went by and the companies attempted to retrieve their cost by passing it along to the consumer. A political fight over increased electricity rates was fierce. Among the cases that were brought, were cases for consumers on Long Island, represented by an attorney at our firm, and a derivative case against management seeking directly to recover from the individual members of the board of directors, the costs of these plants were never going to be recoverable and indeed many of the plants could never open. Of course, when billions of dollars are spent it is extremely unlikely that anywhere close to those sums of money could be recovered. However, those cases in the public utility industry not only recovered funds for the corporations and their investors, they also helped change the environment of decision making in those corporations. New management structures were put into place. In some cases, if not directly as a result of the litigation but certainly as part of what happened, senior management was replaced. Transparency was required and disclosures made.

These cases serve a restorative function, getting the company's money back and benefiting every investor. However, these cases also serve a deterrent function. Executives often have personal relationships or financial ties which insulate them from board criticism or replacement, but where they are so insulated, the courts may permit small shareholders to vindicate the company's interests directly. The only thing worse than having a nuclear power

plant in your town, is having one that is poorly constructed. But when the management which permitted these boondoggles got sued, haled into court and in some cases replaced, it sent a clear message that investors were watching.

When the Bhopal plant exploded in India, the American derivative case, brought by Wolf Haldenstein, was the only one that led to a recovery and management changes.

In derivative litigation, particular problems are targeted, and addressed by directly challenging management. As such, they are a supplement to the pressure that may be brought upon management through direct lobby by large shareholders with a threat of proxy contents. Other cases being brought by investors are occasioned when corporate decision making has led to cover-ups of terrible decisions to the detriment of the corporation (but often not to management who nevertheless profit by selling their stock before the news get out and by handsomely rewarding each other with large salaries and perks).

Lobbying, legislative action and regulatory intervention can be effective but do no more than set broad policy and general guidelines which are often the work of competing and clashing interests. Once an issue is in play before the legislature, the outcome can be risky and unpredictable. Litigation in the hands of competent counsel pinpoints a particular problem and addresses it. In so doing, precedent is set which then impacts entire industries. For example, every child may very well be entitled to a proper education. Many state constitutions and statutes say as much. The political process often fails to address exactly how the law is to be implemented or funded. It is left to litigation to define and enforce these obligations.

It is all well and good to be concerned about the environment but it is particular corporations that pollute or fail to clean up what they have left behind. It is all well and good to say that you are going to lay optic cable up and down the length of the country and across the

ocean, but when corporate management takes investors' money and pockets it, as appears to be the case in Global Crossing, investors and pension plans are devastated. Enron, Imclone and Adelphia have become curse words for a more systemic problem. When accountants corrupt themselves, billions of dollars are drained from the economy and the lives of working people are destroyed. Vigorous action by institutions such as socially responsible investors is required to correct corporate abuse.

Do not be mistaken: the core economy has not been injured by the American people suddenly deciding to get lazy. What happened in the late 90's was no hysteria over tulips. Rather, an intentional bubble was created by Wall Street and individual management in the high tech industry who profited, and some of whom have become unimaginably wealthy. This last scandal of the 20th century has been allowed to go on by Congress and the regulators and (except for an occasional courageous public official, such as Elliot Spitzer of New York) the U.S. Attorney General's Office, the Justice Department, the SEC, and antitrust officials have largely watched in silence. Only now, two years after the private bar began to bring actions against Wall Street firms over the creation of the bubble, have the political sectors of our society become at all serious about addressing the problem. The heat has gotten too great after disclosure by the plaintiffs' lawyers has exposed a degree of corporate malfeasance. As evidenced by the IPO and analyst scandals, there are problems which will only be tackled, and reforms which will only be addressed, by private litigants, and by lawyers who will represent them on contingency.

In short, litigation can be in your hands the means to reform. Lawyers are no more than scalpels in the hands of clients such as yourselves. We invite the community of socially

responsible investors to see us and what we do as another instrument or tool among the many that are available to effect reforms in our society.