Introduction

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Although we planned this program more than a year ago, I don't think we could have chosen a more appropriate time than this spring for Professor Cox's lecture on the social meaning of shareholder suits. Recent financial and legal developments are forcing us to think about both the public benefits and the problems that come with these suits.

Last month the Dow Jones Industrial Average crossed the symbolic mark of 10,000. Other stock indexes have set records, reflecting a surge of interest in high-flying technology stocks. As the price-earnings ratios of these issues—assuming they have earnings—reach unprecedented levels, many company managements undoubtedly feel pressure to maintain the growth rate of their earnings.

It is hardly surprising that the Securities and Exchange Commission has taken a keen interest in the accounting methods of some of these companies. But it is a truism that the SEC lacks the resources to investigate more than a fraction of the questionable situations that arise. To some extent, the shareholder suit fills the gap. One of the values of these suits is the deterrence they provide against corporate misconduct.
Although the market is said to be dominated by institutional investors, individual investors are in the market for technology stocks. Yesterday's New York Times had an article about day traders, which said: "Having evolved from a nation of savers to one of investors, America is rapidly becoming a country of traders." These new traders, many of whom cannot afford big losses, nevertheless find the low cost and ease of trading through the Internet impossible to resist.

While shareholder litigation is important today, it is likely to become even more so in coming years, or perhaps months. Kenneth Galbraith, in his book The Great Crash, writes about the "bezzle," describing missing corporate funds—like the ring around the bathtub—that varies in size with the business cycle. The funds tend not to be noticed during times of prosperity, but they come to light when earnings turn downward. When that time comes, we can expect a lot of investor unhappiness and, inevitably, more derivative suits and class actions.

In 1995, Congress, acting in the belief that the shareholder suit often victimizes companies, but fails to provide just compensation to investors, enacted the Private Securities Litigation Reform Act. The 1995 Reform Act was intended to create a more even playing field. As many of you know, the legislation includes several important changes. For example, one of its provisions is designed to encourage shareholders with the largest financial interest, usually institutional investors, to play a larger role as lead plaintiffs in shareholder suits than they have in the past.

Perhaps it is too early to tell whether the legislative reforms are working in the way that Congress contemplated. Legislative changes sometimes have unanticipated consequences. I hope that this afternoon's discussion will provide some insights into the role that the shareholder suit is likely to play under the new legislative regime.

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3 See id. at 137-38.