Corporate Governance Bulletin

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THE POWER IN THE BOARDROOM

FEATURE 1

For decades there has been much discussion about the importance of the board of directors and the governance structures that guide the board's actions. After the scandals that surfaced over the last decade, and as our economy struggles to recover from the current financial crisis, these discussions have intensified. Debate is now focused on how to improve board behavior and on who bears the responsibility for imposing those improvements. In the spirit of corporate reform, there have been calls for many different groups, including government, shareholders, and companies and boards themselves, to determine the perfect governance structure – one which ensures that the interests of all of the appropriate constituents are considered and fair decisions are made at every turn. However, there is never going to be a one-size-fits-all governance structure that is appropriate for all companies at all times.

"[T]here is never going to be a one-size-fits-all governance structure that is appropriate for all companies at all times. Instead, it all comes down to the people in the boardroom making the decisions."
-Annalisa Barrett, The Corporate Library

Instead, it all comes down to the people in the boardroom making the decisions. How do the members of the board work together as a team? Is there one strong personality that dominates the discussion? Are there too many strong personalities in the room, preventing decisions from being made? What other relationships are influencing each board member and do any of those impair their ability to fulfill their fiduciary duties? What is the dynamic between company management and the board and how does that affect decision-making? No one can know the answers to these and similar important questions without being in the boardroom while decisions are being made.

As corporate reform is debated and designed, this fact must be remembered so that the reforms do not include checklist-type requirements to change governance practices that do not acknowledge the importance of the dynamics among people in the boardroom. While it may be easy for legislators or regulatory agencies to develop lists of rules for corporate boards to follow, this is not the most effective way to effect change in the boardroom. It is more valuable for shareholders to take an active role in monitoring the performance of the board and to voice their opinion when they have concerns.

While potential and current investors who do not have a representative on the board cannot know the dynamics in the boardroom, there are certain governance structures that investors should keep an eye out for, as they can indicate a board dynamic that is not conducive to effective decision-making and the fulfillment of fiduciary duties. Many of these structures – such as the presence of a classified board or a dominant shareholder, the independence of key committees, etc. – have been discussed and addressed by shareholders for years. There are two other red flags that have not garnered much attention – the presence of an executive committee or an executive chair – which are also worthy of discussion.

Executive Committees

Hundreds of corporate boards in the U.S. have a standing board committee – the "Executive Committee" – which is empowered to act in circumstances where the board cannot come together to take action. While this type of committee can serve an important role in times of true emergency, the potential for abuse of the power delegated to it can outweigh the benefits. Taking on the role of director of a publicly traded company implies that one will be available on very short notice in the event of a company-related emergency. Given the availability of technology such as cell phones and video conferencing in today's corporate world, it is difficult to imagine a scenario where the majority of the members of the board would not be available to convene a meeting. As a result, it does not seem necessary to provide a smaller group of directors with the power to make decisions on the board's behalf.

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FEATURE 2

NINTH CIRCUIT VICTORY IN *MATRIXX INITIATIVES*

In a significant win for defrauded investors, a unanimous three-judge panel of the Ninth Circuit Court of Appeals has ruled that plaintiffs' allegations in the *Matrixx Initiatives* securities class action both met the Private Securities Litigation Reform Act's heightened pleading standards and passed muster under the Supreme Court's seminal pleading decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

The lawsuit alleges that Matrixx, a healthcare company that develops over-the-counter products, misled the public about Zicam, its popular over-the-counter cold remedy. Unbeknownst to consumers, some users experienced a loss of the sense of smell, or "anosmia," after using Zicam in nasal spray or gel form. Plaintiffs alleged that the horrific potential side effect had been brought to defendants' attention over several years through a variety of means – including consumer complaints, presentations by researchers outside the company, and numerous product liability suits around the nation. Despite this knowledge, the investor class alleged, Matrixx and its top executives made a series of misstatements in late 2003 about Zicam's supposed safety and effectiveness, boasting about the product's continued contributions to the company's financial success.

On February 6, 2004, the national news program *Good Morning America* aired a broadcast that featured a medical researcher reporting on Zicam research results, the adverse health risks associated with the product, and four lawsuits that had already been filed alleging Matrixx's products caused loss of the sense of smell. Following the broadcast, Matrixx's common stock price plunged nearly 24% in just one day, on unusually heavy trading volume.

Defendants disputed the disclosures, insisting that any reports linking Zicam and anosmia were "completely unfounded and misleading." Only later, in response to the outside researchers' findings, did defendants admit that Matrixx had convened a panel of scientists and physicians to review Zicam's effect on the sense of smell.

Despite these damning revelations, the district court granted the defendants' motion to dismiss the securities class action complaint. The district court reasoned that plaintiffs had not alleged that a material "statistically significant" number of anosmia reports had been communicated to defendants. Further, the court held that plaintiffs had not adequately pled defendants' scienter, or state of mind.

In a detailed order, the Ninth Circuit reversed the dismissal, cataloguing the numerous instances of Zicam-related anosmia that had been brought to defendants' attention.

First, the Ninth Circuit rejected the district court's reliance on a "statistical significance" standard, explaining that the bright-line requirement applied by the district court ran afoul of the materiality precedent established by both the Ninth Circuit and the U.S. Supreme Court. The Ninth Circuit held that the determination of materiality requires "delicate assessments of the inferences" that a "reasonable shareholder" would draw from a given set of facts – and the district court had erred by making a decision better left to a trier of fact.

The Ninth Circuit next reversed the lower court on the issue of scienter, holding that defendants were aware of at least 14 complaints regarding Zicam-linked anosmia, even as they were reassuring the market otherwise. The Ninth Circuit further held that risk warnings placed in Matrixx's financial filings ignored the fact that some of the risks may have already come to fruition. The panel also found that there was a sufficiently strong inference that high-level executives like the named defendants would know that the company was named in several product liability lawsuits. Ultimately, the Ninth Circuit rejected defendants' insistence that any links between anosmia and Zicam were "completely unfounded and misleading," and held that the totality of the alleged facts suggested otherwise.

All in all, in a "holistic review" of the complaint's allegations – as the Supreme Court instructed in the *Tellabs* decision – the inference that defendants withheld damaging Zicam information "intentionally or with deliberate recklessness" was at least as compelling as the inference that defendants had withheld the information innocently.

Coughlin Stoia appellate partner **Joseph Daley** briefed and argued the appeal. As Mr. Daley recognized, "It was gratifying after several years of litigating to have the Ninth Circuit come to the right conclusion based upon the facts and the law."

Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167 (9th Cir. 2009).

LITIGATION update

United States Supreme Court Hears Argument in *Merck*

In a step forward for investors defrauded by Big Pharma, the United States Supreme Court recently heard argument in *In re Merck & Co. Securities, Derivative & ERISA Litigation*. The tone of the argument bodes well for investors, and the Court is expected to rule by June of this year.

The class action arose out of Merck's promotion of its new blockbuster anti-inflammatory drug, Vioxx. The complaint alleges that the drug's manufacturer was aware that Vioxx had serious safety issues, notably the potential to increase the likelihood of heart attack or stroke. Plaintiffs allege that Merck covered up its concerns and downplayed Vioxx's potentially fatal side effects in its marketing campaign, going so far as to advance a spurious explanation for the disconcertingly high number of heart attacks seen in Vioxx users in a clinical study of the drug. After investors filed suit in November 2003, the district court dismissed the action, finding that the lawsuit was filed after the two-year statute of limitations had run out. In its defense, Merck had advanced the argument – and the New Jersey district court agreed – that warnings from the FDA that required Merck to present more balanced advertising should have alerted investors to the possibility of fraud.

The Third Circuit reversed, holding that nothing in the public domain – including the FDA warnings concerning Merck's advertising – would have suggested to a reasonable investor that Merck's statements about Vioxx's safety were made in bad faith.

Merck appealed to the United States Supreme Court, arguing that whenever an investor is faced with inconsistent information, the burden should fall on investors to investigate fraudulent intent. At oral argument, Justice Scalia objected: "You can misrepresent something without having [intent] to defraud." Nor did the Justices seem to agree that Merck investors should have their claims tossed out on the basis that they conducted no investigation. Justice Ginsburg pointedly asked Merck's counsel how even "the most diligent plaintiffs" could have found out "whether Merck really had no good faith belief" in its alternative explanation for the discrepancy in heart attack numbers. An incredulous Justice Alito asked whether Merck was suggesting that plaintiffs should have "uncovered facts about the safety of Vioxx that the FDA was not aware of."

The United States participated in oral argument as *amicus curiae*, supporting the investors. The ultimate question for the Court to resolve, the government said, is when a reasonable investor would have known facts sufficient to support a complaint for securities fraud.

Coughlin Stoia filed an *amicus curiae* brief supporting the plaintiffs. Coughlin Stoia advanced the argument that until they are aware of facts to suggest that a company has acted with the intent to defraud them, a reasonable investor cannot be placed "on inquiry notice" of potential securities-fraud claims. Coughlin Stoia's position was echoed by the government, who pointed out at oral argument that "the statute refers to facts constituting the violation, and it's absolutely essential to this Court's section 10(b) jurisprudence that there can be no 10(b) violation without scienter." Commented Coughlin Stoia partner **Eric Alan Isaacson**, "We presented a common-sense argument to the Court. You don't cry 'foul' until you realize you've been cheated. Likewise, reasonable investors don't file fraud claims until they discover they have been defrauded."

The Court is expected to issue its ruling in early 2010.

Merck & Co. Inc., et al. v. Richard Reynolds, et al., No. 08-905 (U.S. Nov. 30, 2009).

NEWS BRIEF

Coughlin Stoia Recognized as One of the Top Securities Law Firms

Law360, the newswire for business lawyers, lawsuit filings, litigation, settlements, verdicts and court news, named Coughlin Stoia as one of its "plaintiff-side securities firms of the year" for its 2009 accomplishments in cases against Ernst & Young, TD Banknorth, UnitedHealth and Household International. Coughlin Stoia also made *Law360's* list of largest securities firms, the only plaintiffs' firm to be named in both categories.

According to Dan Newman, a spokesman for the firm, the formula for Coughlin Stoia's success in winning recoveries for its clients is simple: the firm is comprised of the best attorneys in the business, including numerous federal and state prosecutors. Additionally, the firm offers more expertise and a wider range of services than any of its rivals.

Coughlin Stoia has secured the largest securities class action recovery in history, winning over $7 billion for Enron shareholders; the largest options backdating recovery in history, recovering nearly $1 billion for UnitedHealth shareholders; the largest opt-out recovery ever of more than $650 million for WorldCom investors; and a successful jury verdict for plaintiffs after seven years of litigation against Household International.

Newman said Coughlin Stoia will carry its winning formula into the future. "The firm's size and strength means Coughlin Stoia can dedicate the resources necessary to properly develop a case and do what it takes to achieve a successful result for its clients – including going up to the Supreme Court and back down again when necessary."

SETTLEMENT update

Aon
Insurance Giant Pays Premium

Good news for plaintiffs **Monroe County Employees' Retirement System**, **Teamsters Local 408 Pension Fund**, **Western Pennsylvania Electrical Employees Pension Fund** and **Hawaii Reinforcing Ironworkers Pension Trust Fund** in their class action lawsuit against Aon Corporation. Judge Charles R. Norgle granted final approval of a settlement that provides for a cash payment of $30 million for the benefit of investors who suffered financial losses as a result of the fraudulent conduct by Aon, a Chicago-based insurance broker.

The action arose from Aon's fraudulent scheme to generate hundreds of millions of dollars in ill-gotten revenue from undisclosed agreements with insurance corporations. In these agreements, the companies were required to make "contingent commission" payments to the broker based on the volume of business that Aon "steered" to the insurer. As part of the overall scheme, the complaint alleged that Aon also entered into "clawback" arrangements where Aon leveraged its retail insurance services by demanding that the insurers use Aon's reinsurance services in exchange for Aon's agreement to increase retail placements with these carriers. The defendants' fraudulent conduct was successful in inflating Aon's reported financial results, allowing Aon to meet critical quarterly earnings estimates, salvage Aon's reputation as a thriving, expanding insurance broker, and, in turn, collect more than $200 million in incentive payments.

For nearly five years, plaintiffs vigorously pursued these allegations, successfully opposing two motions to dismiss and obtaining certification of the class. Plaintiffs also conducted extensive discovery, ultimately reviewing millions of pages of documents, taking and defending more than 40 depositions, including those of each of the individual defendants, and filing six different expert reports. The settlement was reached four months before trial was to commence before Judge Norgle.

Plaintiffs' accumulation of damning evidence proving Aon's fraudulent conduct gave the insurance broker little choice but to settle the action. Just prior to summary judgment briefing, the parties agreed to resolve the case by establishing a $30 million fund for defrauded shareholders.

Commented **Tor Gronborg**, a Coughlin Stoia partner representing plaintiffs, "This settlement is ultimately a testament to the fortitude of each of the plaintiffs and the demonstrated commitment of counsel to prepare the case for trial. Following on the heels of Coughlin Stoia's victory in the *Household* securities litigation trial, the *Aon* settlement once again establishes the value of counsel who aggressively litigate claims to their successful conclusion."

Roth v. Aon Corp., et al., No. 04-c-6835, Final Judgment and Order of Dismissal with Prejudice (N.D. Ill. Nov. 18, 2009).

Dura
Plaintiffs Outlast, Outwit in Marathon Litigation

After ten years of litigation, a federal judge has announced final approval of a $14 million settlement deal in a securities class action against Dura Pharmaceuticals, Inc. The case led the U.S. Supreme Court in 2005 to establish new standards for loss causation in securities fraud suits.

On December 4, 2009, Judge Janis L. Sammartino of the U.S. District Court for the Southern District of California approved the decision. The original complaint filed in 1999 charged Dura (now part of Elan Corp.) and certain of its officers and directors with violations of the Securities Exchange Act of 1934. The complaint alleged that defendants made false and misleading statements about the successful development of Dura's new Spiros drug delivery system, which was to be used for the delivery of asthma medication, as well as misled investors about sales of a Dura drug called Ceclor CD. The allegedly false representations inflated Dura's stock to a high of $53 in October 1997. When the truth came out, Dura's stock value plummeted.

Litigation and appeals in the case resulted in the Supreme Court increasing the burden on securities fraud plaintiffs regarding "loss causation," requiring plaintiffs to now prove a defendant's misrepresentations were the cause of stock losses. Dura's counsel publicly claimed that the Supreme Court's decision was "one of the most important tools available to defense counsel in dealing with securities cases." Nevertheless, plaintiffs and their counsel at Coughlin Stoia persevered, amending the complaint to meet the Supreme Court's newly articulated standard.

Plaintiffs claimed that Dura rushed their Spiros delivery device through development, misled investors about the strength of other Dura drug sales, and in the process artificially inflated the stock price. The alleged motive was to accomplish a new major debt offering, which boosted the value of insiders' stock options, which were later sold off. Plaintiffs also linked the drops in Dura's stock price to the alleged fraud, obtaining orders that favorably interpreted the Supreme Court's loss causation standard.

Nearly ten years after the case was initially filed and after many observers declared the case unwinnable, the district court denied defendants' motion to dismiss. Rather than face discovery and depositions, defendants quickly settled. As Coughlin Stoia partner **Henry Rosen** noted, "Plaintiffs' counsel demonstrated that a law firm with the tenacity and resources to go the distance can bring a case to conclusion, despite an unfavorable ruling by the highest court."

In re Dura Pharmaceuticals, Inc. Sec. Litig., No. 99-CV-0151-L(WMC), Final Judgment and Order of Dismissal with Prejudice (S.D. Cal. Dec. 4, 2009).

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Settlement Update continued from page 4

For more information on these and other cases, check out our website at csgrr.com

Mattel
Consumers Say "Get the Lead Out"

Corporate governance reforms often bring more than just financial relief to defrauded investors. Reforms achieved in a class action against Mattel, Inc. concerning lead in children's toys will not only provide monetary relief to consumers, but also help ensure that children's toys are safe. In a proposed settlement announced on October 13, 2009, **John J. Stoia, Jr.**, Of Counsel at Coughlin Stoia, revealed that Mattel and Fisher-Price had agreed to provide refunds and other monetary relief to millions of families who purchased children's toys that were found to exceed legal limits of lead or contain dangerous magnets. Implementation of the new court-overseen quality assurance programs will help protect consumers from similar hazards in the future.

The proposed consumer class action settlement resolves 22 class action lawsuits filed against Mattel and Fisher-Price and major retailers on behalf of millions of American children and families who purchased or received the defective toys as gifts. Mattel entered into the settlement on behalf of itself, its subsidiary Fisher-Price, and the retailer defendants.

The affected toys include popular lines such as Sesame Street, Dora the Explorer and Diego made by Fisher-Price, and certain Mattel toys, including Batman, Polly Pocket, and Barbie accessories.

If approved by the court, the settlement will require Mattel and Fisher-Price to provide refunds to consumers who purchased or acquired the toys, as well as reimburse families who incurred costs for testing their children for lead exposure. Members of the class action who participated in the prior recalls of the affected toys will automatically receive reimbursements. Critically, Mattel will also implement a quality assurance program, overseen by the court, which will ensure the safety of Mattel and Fisher-Price toys all around the world, and will donate $275,000 to the National Association of Children's Hospitals and Related Institutions, a not-for-profit association of 150 children's hospitals, pediatric units of medical centers and related health systems.

"Families deserve to trust that toys labeled as safe won't harm their kids," said Mr. Stoia. "This landmark settlement allows families to shop with a greater sense of security when purchasing toys."

For more information about the settlement or to file a claim for relief, visit www.mattelsettlement.com.

In re Mattel, Inc., Toy Lead Paint Products Liability Litigation, No. 2:07-ml-01897-DSF-AJW (C.D. Cal.).

Currency Conversion
Debit and Credit Card Rip-off Exposed

Travelers can now use their credit and debit cards overseas without being hit with undisclosed and collusively set fees. On October 22, 2009, a federal court in New York granted final approval of a $336 million settlement in an antitrust lawsuit brought by credit and debit cardholders. Plaintiffs challenged the practices of Visa, MasterCard, Diners Club and several large banks that imposed a fee of between 1% and 3% on every transaction conducted in a foreign currency. The case alleged that defendants violated federal antitrust law by colluding in imposing the fees, and that they failed to adequately disclose what they were charging the cardholder.

Acting as co-lead counsel for the plaintiff class, Coughlin Stoia successfully litigated the case for more than eight years, overcoming repeated motions to dismiss, successfully certifying a class over defendants' objections and litigating several appeals. The case settled just before defendants were to serve plaintiffs with motions for summary judgment.

The lawsuit accused Bank of America, Capital One, Chase, Citibank, and others of violating antitrust laws. Plaintiffs alleged that the defendants agreed with each other to impose the fees each time a cardholder made a purchase in a foreign currency, and that they failed to disclose the fees adequately.

In his ruling approving the settlement, Judge William H. Pauley III of the Southern District of New York praised Coughlin Stoia and its co-lead counsel, describing the attorneys as "highly competent and experienced." Judge Pauley recognized that counsel for the class provided "extraordinarily high-quality representation," did their work with "enormous attention to detail and unflagging devotion to the cause," and were "indefatigable." Judge Pauley further stated that the attorneys "represented the Class with a high degree of professionalism, and vigorously litigated every issue against some of the ablest lawyers in the antitrust defense bar."

The class was represented in the district court by Coughlin Stoia partner **Bonny E. Sweeney**, and in the courts of appeal by Coughlin Stoia appellate attorneys **Joseph D. Daley**, **Pamela M. Parker** and **Kevin K. Green**.

Said Bonny E. Sweeney, "This settlement was a result of hard work by a very professional team."

In re Currency Conversion Fee Antitrust Litigation, MDL No. 1409, Memorandum & Order (S.D.N.Y. Oct. 22, 2009).

Boardroom continued from page 1

Investors should consider the structure and composition of the Executive Committee, as well as the specific powers delegated to it. For example, at Simon Property Group, the members of the Executive Committee include Herbert Simon and Melvin Simon, brothers who are the co-founders, Chairman Emeriti and large shareholders of the company; David Simon, Melvin's son and the current Chairman of the Board and CEO; and Richard S. Sokolov, the current President and COO. Another concerning example is Vishay Intertechnology, where the members of the Executive Committee are Dr. Felix Zandman, Founder and Executive Chairman of the company; Marc Zandman, Vice Chairman of the Board and son of the Executive Chairman; Dr. Gerald Paul, the company's CEO; and Ziv Shoshani, the company's COO and nephew of the Executive Chairman. In situations like these, the benefits of having independent directors serving on the board are undermined by the power wielded by these insiders who have been given the ability to make decisions on behalf of the entire board.

Whether this structure poses a threat to the board's overall effectiveness ultimately depends on the people involved, and the particular circumstances and personalities of the members of both the Executive Committee and the other members of the board. Therefore, disallowing boards to create such a committee is not likely the solution. That being said, it should be raised as a red flag for shareholders when monitoring a board's actions.

Executive Chairs

At more than 100 U.S. companies, the roles of CEO and Chair of the Board are separate, but the person serving as Chair of the Board is also an employee of the company. There are many potential problems with this board leadership structure.

The company can claim to have followed so-called "best practice" by separating the roles of CEO and Chair of the Board; however, the fact that the Chair of the Board is not independent negates many of the benefits claimed by some to be the purpose for separating the roles. In fact, one of the key benefits professed by advocates of separating the roles of CEO and Chair is the fact that it allows for the clear identification of a leader for the board of directors, separate from the person leading the company. However, recent research indicates that many of the boards that have an Executive Chair have also named a Lead Director. This is presumably because the Executive Chair is not independent and therefore should not lead executive sessions and fill other roles where an independent director is needed. In these cases, the company has a CEO and the board has an Executive Chair and a Lead Director. To whom would the directors go in an emergency? Whom should shareholders approach with concerns with the company's performance and governance practices?

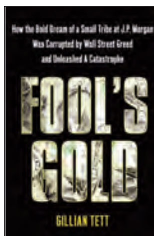
Another concern about the companies with Executive Chairs is the fact that they are spending a large sum of the shareholders' money on this possibly redundant and less-than-optimal leadership structure. A study of most of the companies with this structure reveals that the Executive Chair was paid enough to warrant him or her being classified as a Named Executive Officer in the company's proxy statement, meaning, generally, that he or she was one of the three most highly paid individuals at the company other than the CEO and CFO. In fact, in some cases the Executive Chair was paid a salary the same as, or larger than, the CEO of the company. For example, Blake Roney, the Executive Chairman at Nu Skin Enterprises, Inc., a Russell 2000 company, received the highest base salary of all executives at the company. In 2008, Mr. Roney received a base salary of $750,000, while the company's CEO Truman Hunt received a base salary of $673,077. Additionally, William J. Pulte, Executive Chairman of Pulte Homes – a company that made news earlier this year for its unresponsiveness regarding the majority withhold votes for several board members – received a base salary of $1 million in 2008, which was the same as the base salary of the company's CEO, Richard J. Dugas, Jr.

In such cases, the question must be asked: is this person's role so valuable to the company that the shareholders should be paying CEO-level salaries to two people? Of course, the answer may be yes, but it all depends on the people involved and their relationship with the other members of the board. Therefore, again, banning the role of Executive Chair may not be the answer. Rather, shareholders should be aware of the potential concerns associated with this board leadership structure.

These are but a few examples of situations where rules or legislation banning such a governance structure for all companies may not be appropriate, but shareholder awareness and action is important. As the future of corporate reform as it relates to board governance is discussed and debated, the importance of the dynamics between people in the boardroom should always be paramount. The focus should be on changes that allow shareholders to have more opportunity to fairly examine such dynamics, identify and scrutinize red flags such as those discussed above, and meaningfully voice their concerns.

This article was written by Annalisa Barrett, Senior Research Associate, Board and Governance Practices at The Corporate Library. The Corporate Library is the leading independent source for U.S. corporate governance information and analysis. For information on The Corporate Library, visit: www.thecorporatelibrary.com

Recommended Reading



Fool's Gold: How the Bold Dream of a Small Tribe at J.P. Morgan Was Corrupted by Wall Street Greed and Unleashed a Catastrophe

Gillian Tett
Free Press, May 2009

We've heard a lot about "derivatives" in the financial news lately, but how did these financial innovations come to dominate the markets, issued in quantities that dwarf the GDP of the planet many times over? In *Fool's Gold*, financial news journalist Gillian Tett tells a story about how a forward-looking team at the J.P. Morgan bank stitched together new ways of repackaging risk of loan defaults, and how the modern derivative inventions morphed into a "Frankenstein's monster" of finance.

In 1994, the story goes, the derivatives team of J.P. Morgan met up for a Boca Raton corporate bender – and over that intoxicated weekend, brainstormed how to industrialize production of what was to become an alphabet soup of structured financial products (e.g., ABS, CDS, CDO) that derived their value from another underlying asset, such as a mortgage or loan repayment. Bankers at J.P. Morgan (later JPMorgan Chase) became highly skilled at creating and selling credit default swaps (CDS), and even more complex vehicles called collateralized debt obligations (CDO), which further distanced the derivative buyer from the asset being securitized.

What was the advantage to the banks? First, it was an end-run around capital requirements. Regulations like the Basel Accord stipulated that banks must maintain reserves equivalent to 8% of the value of their assets, adjusted for risk. In other words, for every billion dollars in reserves, a bank could theoretically loan out up to $12 billion, through the (completely legal) magic of fractional reserve lending, with the loans becoming "assets" on the bank's books. What a "small tribe" at J.P. Morgan did was to repackage the risk of loan default through novel financial instruments like credit default swaps. By cleverly repackaging and redistributing the risk of a loan default (which J.P. Morgan could sell to investors for a fee), they could technically comply with the reserve requirement rules. Thus, the risk of default was off J.P. Morgan's books, having been either diluted or minimized, and the bank could re-lend more and more money against their reserves. With more to lend, it seemed like gravity had been conquered, and capitalism would blossom like indoor ski resorts in Dubai hotels.

Or so it seemed. Tett's central idea is that the new products in structured finance, which these J.P. Morgan pioneers industrialized, were then copied, distorted, and perverted by an unholy cadre of Wall Street players from Citigroup to UBS and hedge funds, leaving the J.P. Morgan tribe "shocked" and "horrified" to see their dream go awry. According to Tett, it is this "Wall Street Greed" that is to blame for the meltdown and not the innovations created by J.P. Morgan. However, Tett looks past the fact that in 2008, J.P. Morgan held nearly $87 trillion in exposure to credit derivatives.

There are a few other small holes in Tett's otherwise well-written and entertaining story. Tett quietly sidesteps the derivatives danger wake-up call offered by the implosion of the hedge fund Long-Term Capital Management in 1998, when complicated derivatives in the hands of Ph.Ds and Nobel laureates led to a near-meltdown of the entire financial system. Tett also gives short shrift to J.P. Morgan's role in the Enron scandal, particularly the use of J.P. Morgan-crafted derivative alchemy to hide Enron's debt in off-balance-sheet vehicles.

Ms. Tett might consider the thesis advanced by securities law professor Frank Partnoy, who has written extensively about complex derivative instruments. As Partnoy has it, major financial disasters are not the fault of the financial innovations alone, nor is the blame to be laid solely on de-personified "Wall Street Greed." It's both: a serious catastrophe requires the nexus of the two, complex instruments in the hands of the unscrupulously greedy. Nonetheless, "Fool's Gold" is both readable and timely.

FAT CAT

After helping steer Citigroup into an iceberg, former Director **Robert Rubin** has fled from the bridge of the Wall Street banking-insurance-investment giant. Mr. Rubin was last seen motoring away in a personal lifeboat worth over $126 million in cash and stock. For this and other feats, *MarketWatch* named Rubin one of the "10 most unethical people in business."

Robert Rubin

During the late '90s, Rubin moved over to Treasury Secretary after 26 years with investment bank Goldman Sachs, where he facilitated the massive deregulation of Wall Street. A cheerleader for the repeal of the Glass-Steagall Act, Rubin joined Messrs. Summers and Greenspan in opposing financial market regulators like Brooksley Born and prescient calls for greater oversight on credit derivatives trades.

Subsequently, Rubin was hired by Citigroup, which found itself directly implicated in the Enron scandal, allegedly helping hide Enron's off-balance-sheet debts from investors. Now, just prior to Rubin's defection, Citigroup's own $400 billion off-balance-sheet "shadow bank" entities appear to have put U.S. taxpayers on the hook for federal bailout guarantees of up to 90% of Citigroup's losses.

"He ruined his career, he is resigning in disgrace," said Citigroup investor Richard Steinberg. However, don't look for Rubin to disappear like his predecessor, Charles Prince, as he is now Chair of the Council on Foreign Relations, a prestigious think tank.

CALENDAR
of Upcoming Events

January 21-23, 2010

AFL-CIO Building & Construction Trades Department
25th Silver Anniversary Labor of Love Golf Tournament

Walt Disney's Yacht and Beach Club Resort
Orlando, FL

The mission is three days of golf while raising awareness and funds to support the Diabetes Research Institute's fight against diabetes.

For more information, visit: www.projecttypezero.org/Fundraising-Events/Labor-of-Love/Labor-of-Love-Golf-Tournament-2010.aspx

January 24-26, 2010

Financial Research Associates, LLC
Made in America
The 2010 Taft-Hartley Benefits Summit

Mandalay Bay Resort & Casino
Las Vegas, NV

This 7th annual conference will cover key issues on pension/investment and health and welfare funds. Trustees and administrators have sought an advanced forum which enables free-flowing, unfiltered and direct dialog between all fund players for years, and Made in America was created with that in mind.

For more information, visit: www.frallc.com

February 3-5, 2010

Institutional Investor Conferences
18th Annual European Pensions Symposium

St. Regis Grand Hotel
Rome, Italy

This conference focuses primarily on investment issues facing pension funds. The entire program is driven by an expert advisory board representing corporate and public pension funds with varied structures, liabilities and investment strategies. The program is designed to meet the specific needs of European investment executives and will explore ways to invest in these difficult times.

For more information, visit: www.iiconferences.com

February 8-10, 2010

Financial Research Associates, LLC
National Association of Police Organizations (NAPO)
The NAPO 22nd Annual Police, Fire and Municipal Employee Pension & Benefits Seminar

Caesar's Palace
Las Vegas, NV

Ensure that you fulfill your fiduciary obligation to your fund by educating yourself on the latest issues surrounding the pension and benefit industry. This year's event attendees will learn the practical tools needed to preserve, defend and enhance their plans.

For more information, visit: www.frallc.com

February 12, 2010

8th Annual International Litigation and Arbitration Conference (ILAC)

The Conrad Hotel
Miami, FL

Featured Speaker: **Paul J. Geller,**
Coughlin Stoia Geller Rudman & Robbins LLP

This conference will include information on international implications of the current Chinese Drywall cases, developments in international litigation, regional developments in international arbitration, developments in international intellectual property litigation, the rise of class actions in arbitration, managing the multi-jurisdictional case, and much more.

For more information, visit: www.internationallawsection.org

February 16, 2010

Swiss-American Chamber of Commerce

Milan, Italy

Featured Speaker: **Patrick W. Daniels,**
Coughlin Stoia Geller Rudman & Robbins LLP

This event will address the current banking crisis and breakdown in corporate governance for senior executives from the leading asset management firms in Italy and Switzerland. The event is invitation only and part of a regular program of educational and networking opportunities supported by The Chamber.

For more information, visit: www.amcham.ch

March 1-3, 2010

Information Management Network
15th Annual Public Funds Summit

Hyatt Regency Huntington Beach
Huntington Beach, CA

This conference is the premier conference for the public pension plan community and will focus on asset allocation and investment strategies, manager selection, and trustee and governance issues through interactive panel discussions.

For more information, visit: www.imn.org

March 1-3, 2010

Information Management Network
The 2nd Annual Distressed Investment Summit
A Return to Value

Hyatt Regency Huntington Beach
Huntington Beach, CA

This conference will focus on innovative strategies emerging in today's equity and debt markets for public funds and other institutional investors and will analyze best practices and innovations designed to bring about the upside potential of today's highly volatile capital markets.

For more information, visit: www.imn.org

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