104TH CONGRESS } HOUSE OF REPRESENTATIVES { REPT. 104–50
1st Session } { Part 1

COMMON SENSE LEGAL REFORMS ACT OF 1995

FEBRUARY 24, 1995.—Ordered to be printed

Mr. BLILEY, from the Committee on Commerce,
submitted the following

REPORT

together with

MINORITY AND ADDITIONAL DISSENTING VIEWS

[To accompany H.R. 10]

[Including cost estimate of the Congressional Budget Office]

The Committee on Commerce, to whom was referred title II of the bill (H.R. 10) to reform the Federal civil justice system; to reform product liability law, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

CONTENTS

The amendment is as follows:

99–006

Page 18, beginning on line 5, strike all of title II and insert the following:

TITLE II—REFORM OF PRIVATE SECURITIES LITIGATION

SEC. 201. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This title may be cited as the "Securities Litigation Reform Act".

(b) TABLE OF CONTENTS.—The table of contents for this title is as follows:

SEC. 202. PREVENTION OF LAWYER-DRIVEN LITIGATION.

(a) PLAINTIFF STEERING COMMITTEES TO ENSURE CLIENT CONTROL OF LAWSUITS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end the following new section:

"SEC. 36. CLASS ACTION STEERING COMMITTEES.

"(a) CLASS ACTION STEERING COMMITTEE.—In any private action arising under this title seeking to recover damages on behalf of a class, the court shall, at the earliest practicable time, appoint a committee of class members to direct counsel for the class (hereafter in this section referred to as the 'plaintiff steering committee') and to perform such other functions as the court may specify. Court appointment of a plaintiff steering committee shall not be subject to interlocutory review.

"(b) MEMBERSHIP OF PLAINTIFF STEERING COMMITTEE.—

"(1) QUALIFICATIONS.—

"(A) NUMBER.—A plaintiff steering committee shall consist of not fewer than 5 class members, willing to serve, who the court believes will fairly represent the class.

"(B) OWNERSHIP INTERESTS.—Members of the plaintiff steering committee shall have cumulatively held during the class period not less than—

"(i) the lesser of 5 percent of the securities which are the subject matter of the litigation or $10,000,000 in market value of the securities which are the subject matter of the litigation; or

"(ii) such smaller percentage or dollar amount as the court finds appropriate under the circumstances.

"(2) NAMED PLAINTIFFS.—Class plaintiffs serving as the representative parties in the litigation may serve on the plaintiff steering committee, but shall not comprise a majority of the committee.

"(3) NONCOMPENSATION OF MEMBERS.—Members of the plaintiff steering committee shall serve without compensation, except that any member may apply to the court for reimbursement of reasonable out-of-pocket expenses from any common fund established for the class.

"(4) MEETINGS.—The plaintiff steering committee shall conduct its business at one or more previously scheduled meetings of the committee, of which prior notice shall have been given and at which a majority of its members are present in person or by electronic communication. The plaintiff steering committee shall decide all matters within its authority by a majority vote of all members, except that the committee may determine that decisions other than to accept or reject a settlement offer or to employ or dismiss counsel for the class may be delegated to one or more members of the committee, or may be voted upon by committee members seriatim, without a meeting.

"(5) RIGHT OF NONMEMBERS TO BE HEARD.—A class member who is not a member of the plaintiff steering committee may appear and be heard by the court on any issue relating to the organization or actions of the plaintiff steering committee.

"(c) FUNCTIONS OF PLAINTIFF STEERING COMMITTEE.—The authority of the plaintiff steering committee to direct counsel for the class shall include all powers normally permitted to an attorney's client in litigation, including the authority to retain or dismiss counsel and to reject offers of settlement, and the authority to accept an offer of settlement subject to final approval by the court. Dismissal of counsel other than for cause shall not limit the ability of counsel to enforce any contractual fee agreement or to apply to the court for a fee award from any common fund established for the class.

"(d) IMMUNITY FROM CIVIL LIABILITY; REMOVAL.—Any person serving as a member of a plaintiff steering committee shall be immune from any civil liability for any negligence in performing such service, but shall be not be immune from liability for intentional misconduct or from the assessment of costs pursuant to section 20B(c). The court may remove a member of a plaintiff steering committee for good cause shown.

"(e) EFFECT ON OTHER LAW.—This section does not affect any other provision of law concerning class actions or the authority of the court to give final approval to any offer of settlement.".

(b) PROHIBITION ON ATTORNEYS' FEES PAID FROM COMMISSION DISGORGEMENT FUNDS.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end the following new paragraph:

"(4) PROHIBITION ON ATTORNEYS' FEES PAID FROM COMMISSION DISGORGEMENT FUNDS.—Except as otherwise ordered by the court, funds disgorged as the result of an action brought by the Commission, or of any Commission proceeding, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.".

SEC. 203. PREVENTION OF ABUSIVE PRACTICES THAT FOMENT LITIGATION.

(a) ADDITIONAL PROVISIONS APPLICABLE TO PRIVATE ACTIONS.—The Securities Exchange Act of 1934 is amended by inserting after section 20A (15 U.S.C. 78t-1) the following new section:

"PROCEDURES APPLICABLE TO PRIVATE ACTIONS

"SEC. 20B. (a) ELIMINATION OF BONUS PAYMENTS TO NAMED PLAINTIFFS IN CLASS ACTIONS.—In any private action under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the portion of any final judgment or of any settlement that is awarded to class plaintiffs serving as the representative parties shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this subsection shall be construed to limit the award to any representative parties of actual expenses (including lost wages) relating to the representation of the class.

"(b) RESTRICTIONS ON PROFESSIONAL PLAINTIFFS.—Except as the court may otherwise permit for good cause, a person may be a named plaintiff, or an officer, director, or fiduciary of a named plaintiff, in no more than 5 class actions filed during any 3-year period.

"(c) AWARDS OF FEES AND EXPENSES.—

"(1) AUTHORITY TO AWARD FEES AND EXPENSES.—If the court in any private action arising under this title enters a final judgment against a party litigant on the basis of a motion to dismiss, motion for summary judgment, or a trial on the merits, the court shall, upon motion by the prevailing party, determine whether (A) the position of the losing party was not substantially justified, (B) imposing fees and expenses on the losing party or the losing party's attorney would be just, and (C) the cost of such fees and expenses to the prevailing party is substantially burdensome or unjust. If the court makes the determinations described in clauses (A), (B), and (C), the court shall award the prevailing party reasonable fees and other expenses incurred by that party. The determination of whether the position of the losing party was substantially justified shall be made on the basis of the record in the action for which fees and other expenses are sought, but the burden of persuasion shall be on the prevailing party.

"(2) SECURITY FOR PAYMENT OF COSTS IN CLASS ACTIONS.—In any private action arising under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the court shall require an undertaking from the attorneys for the plaintiff class, the plaintiff class, or both, in such proportions and at such times as the court determines are just and equitable, for the payment of the fees and expenses that may be awarded under paragraph (1).

"(3) APPLICATION FOR FEES.—A party seeking an award of fees and other expenses shall, within 30 days of a final, nonappealable judgment in the action, submit to the court an application for fees and other expenses that verifies that the party is entitled to such an award under paragraph (1) and the amount sought, including an itemized statement from any attorney or expert witness representing or appearing on behalf of the party stating the actual time expended and the rate at which fees and other expenses are computed.

"(4) ALLOCATION AND SIZE OF AWARD.—The court, in its discretion, may—

"(A) determine whether the amount to be awarded pursuant to this section shall be awarded against the losing party, its attorney, or both; and

"(B) reduce the amount to be awarded pursuant to this section, or deny an award, to the extent that the prevailing party during the course of the proceedings engaged in conduct that unduly and unreasonably protracted the final resolution of the action.

"(5) AWARDS IN DISCOVERY PROCEEDINGS.—In adjudicating any motion for an order compelling discovery or any motion for a protective order made in any private action arising under this title, the court shall award the prevailing party reasonable fees and other expenses incurred by the party in bringing or defending against the motion, including reasonable attorneys' fees, unless the court finds that special circumstances make an award unjust.

"(6) RULE OF CONSTRUCTION.—Nothing in this subsection shall be construed to limit or impair the discretion of the court to award costs pursuant to other provisions of law.

"(7) PROTECTION AGAINST ABUSE OF PROCESS.—In any action to which this subsection applies, a court shall not permit a plaintiff to withdraw from or voluntarily dismiss such action if the court determines that such withdrawal or dismissal is taken for purposes of evasion of the requirements of this subsection.

"(8) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'fees and other expenses' includes the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorneys' fees and expenses. The amount of fees awarded under this section shall be based upon prevailing market rates for the kind and quality of services furnished.

"(B) The term 'substantially justified' shall have the same meaning as in section 2412(d)(1) of title 28, United States Code.

"(d) PREVENTION OF ABUSIVE CONFLICTS OF INTEREST.—In any private action under this title pursuant to a complaint seeking damages on behalf of a class, if the class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall, on motion by any party, make a determination of whether such interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the class.

"(e) DISCLOSURE OF SETTLEMENT TERMS TO CLASS MEMBERS.—In any private action under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, any settlement agreement that is published or otherwise disseminated to the class shall include the following statements:

"(1) STATEMENT OF POTENTIAL OUTCOME OF CASE.—

"(A) AGREEMENT ON AMOUNT OF DAMAGES AND LIKELIHOOD OF PREVAILING.—If the settling parties agree on the amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title and the likelihood that the plaintiff would prevail—

"(i) a statement concerning the amount of such potential damages; and

"(ii) a statement concerning the likelihood that the plaintiff would prevail on the claims alleged under this title and a brief explanation of the reasons for that conclusion.

"(B) DISAGREEMENT ON AMOUNT OF DAMAGES OR LIKELIHOOD OF PREVAILING.—If the parties do not agree on the amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title or on the likelihood that the plaintiff would prevail on those claims, or both, a statement from each settling party concerning the issue or issues on which the parties disagree.

"(C) INADMISSIBILITY FOR CERTAIN PURPOSES.—Statements made in accordance with subparagraphs (A) and (B) concerning the amount of damages and the likelihood of prevailing shall not be admissible for purposes of any Federal or State judicial action or administrative proceeding.

"(2) STATEMENT OF ATTORNEYS' FEES OR COSTS SOUGHT.—If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on a per-share basis, together with the amount of the settlement proposed to be distributed to the parties to suit, determined on a per-share basis), and a brief explanation of the basis for the application. Such information shall be clearly summarized on the cover page of any notice to a party of any settlement agreement.

"(3) IDENTIFICATION OF LAWYERS' REPRESENTATIVES.—The name and address of one or more representatives of counsel for the class who will be reasonably available to answer written questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

"(4) OTHER INFORMATION.—Such other information as may be required by the court, or by any plaintiff steering committee appointed by the court pursuant to section 36.

"(f) ENCOURAGEMENT OF FINALITY IN SETTLEMENT DISCHARGES.—

"(1) DISCHARGE.—A defendant who settles any private action arising under this title at any time before verdict or judgment shall be discharged from all claims for contribution brought by other persons with respect to the matters that are the subject of such action. Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling defendant arising out of the action. The order shall bar all future claims for contribution or indemnity arising out of the action—

"(A) by nonsettling persons against the settling defendant; and

"(B) by the settling defendant against any nonsettling defendants.

"(2) REDUCTION.—If a person enters into a settlement with the plaintiff prior to verdict or judgment, the verdict or judgment shall be reduced by the greater of—

"(A) an amount that corresponds to the percentage of responsibility of that person; or

"(B) the amount paid to the plaintiff by that person.

"(g) CONTRIBUTION FROM NON-PARTIES IN INTERESTS OF FAIRNESS.—

"(1) RIGHT OF CONTRIBUTION.—A person who becomes liable for damages in any private action under this title (other than an action under section 9(e) or 18(a)) may recover contribution from any other person who, if joined in the original suit, would have been liable for the same damages.

"(2) STATUTE OF LIMITATIONS FOR CONTRIBUTION.—Once judgment has been entered in any such private action determining liability, an action for contribution must be brought not later than 6 months after the entry of a final, nonappealable judgment in the action.

"(h) DEFENDANT'S RIGHT TO WRITTEN INTERROGATORIES ESTABLISHING SCIENTER.—In any private action under this title in which the plaintiff may recover money damages, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.".

(b) PROHIBITION OF REFERRAL FEES THAT FOMENT LITIGATION.—Section 15(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(c)) is amended by adding at the end the following new paragraph:

"(8) RECEIPT OF REFERRAL FEES.—No broker or dealer, or person associated with a broker or dealer, may solicit or accept remuneration for assisting an attorney in obtaining the representation of any customer in any private action under this title.".

SEC. 204. PREVENTION OF "FISHING EXPEDITION" LAWSUITS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 10 the following new section:

"SEC. 10A. REQUIREMENTS FOR SECURITIES FRAUD ACTIONS.

"(a) SCIENTER.—

"(1) IN GENERAL.—In any private action arising under this title based on a fraudulent statement, liability may be established only on proof that—

"(A) the defendant directly or indirectly made a fraudulent statement;

"(B) the defendant possessed the intention to deceive, manipulate, or defraud; and

"(C) the defendant made such fraudulent statement knowingly or recklessly.

"(2) FRAUDULENT STATEMENT.—For purposes of this section, a fraudulent statement is a statement that contains an untrue statement of a material fact, or omits a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.

"(3) KNOWINGLY.—For purposes of paragraph (1), a defendant makes a fraudulent statement knowingly if the defendant knew that the statement of a material fact was untrue at the time it was made, or knew that an omitted fact was necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.

"(4) RECKLESSNESS.—For purposes of paragraph (1), a defendant makes a fraudulent statement recklessly if the defendant, in making such statement, is guilty of highly unreasonable conduct that (A) involves not merely simple or even gross negligence, but an extreme departure from standards of ordinary care, and (B) presents a danger of misleading buyers or sellers that was either known to the defendant or so obvious that the defendant must have been consciously aware of it. For example, a defendant who genuinely forgot to disclose, or to whom disclosure did not come to mind, is not reckless.

"(b) REQUIREMENT FOR EXPLICIT PLEADING OF SCIENTER.—In any private action to which subsection (a) applies, the complaint shall specify each statement or omission alleged to have been misleading, and the reasons the statement or omission was misleading. The complaint shall also make specific allegations which, if true, would be sufficient to establish scienter as to each defendant at the time the alleged violation occurred. It shall not be sufficient for this purpose to plead the mere presence of facts inconsistent with a statement or omission alleged to have been misleading. If an allegation is made on information and belief, the complaint shall set forth with specificity all information on which that belief is formed.

"(c) DISMISSAL FOR FAILURE TO MEET PLEADING REQUIREMENTS; STAY OF DISCOVERY; SUMMARY JUDGMENT.—In any private action to which subsection (a) applies, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of subsection (b) are not met, except that the court may, in its discretion, permit a single amended complaint to be filed. During the pendency of any such motion to dismiss, all discovery and other proceedings shall be stayed unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party. If a complaint satisfies the requirements of subsection (b), the plaintiff shall be entitled to conduct discovery limited to the facts concerning the allegedly misleading statement or omission. Upon completion of such discovery, the parties may move for summary judgment.

"(d) RELIANCE AND CAUSATION.—

"(1) IN GENERAL.—In any private action to which subsection (a) applies, the plaintiff shall prove that—

"(A) he or she had knowledge of, and relied (in connection with the purchase or sale of a security) on, the statement that contained the misstatement or omission described in subsection (a)(1); and

"(B) that the statement containing such misstatement or omission proximately caused (through both transaction causation and loss causation) any loss incurred by the plaintiff.

"(2) FRAUD ON THE MARKET.—For purposes of paragraph (1), reliance may be proven by establishing that the market as a whole considered the fraudulent statement, that the price at which the security was purchased or sold reflected the market's estimation of the fraudulent statement, and that the plaintiff relied on that market price. Proof that the market as a whole considered the fraudulent statement may consist of evidence that the statement—

"(A) was published in publicly available research reports by analysts of such security;

"(B) was the subject of news articles;

"(C) was delivered orally at public meetings by officers of the issuer, or its agents;

"(D) was specifically considered by rating agencies in their published reports; or

"(E) was otherwise made publicly available to the market in a manner that was likely to bring it to the attention of, and to be considered as credible by, other active participants in the market for such security.

Nonpublic information may not be used as proof that the market as a whole considered the fraudulent statement.

"(3) PRESUMPTION OF RELIANCE.—Upon proof that the market as a whole considered the fraudulent statement pursuant to paragraph (2), the plaintiff is entitled to a rebuttable presumption that the price at which the security was purchased or sold reflected the market's estimation of the fraudulent statement and that the plaintiff relied on such market price. This presumption may be rebutted by evidence that—

"(A) the market as a whole considered other information that corrected the allegedly fraudulent statement; or

"(B) the plaintiff possessed such corrective information prior to the purchase or sale of the security.

"(4) REASONABLE EXPECTATION OF INTEGRITY OF MARKET PRICE.—A plaintiff who buys or sells a security for which it is unreasonable to rely on market price to reflect all current information may not establish reliance pursuant to paragraph (2). For purposes of paragraph (2), the following factors shall be considered in determining whether it was reasonable for a party to expect the market price of the security to reflect substantially all publicly available information regarding the issuer of the security:

"(A) The weekly trading volume of any class of securities of the issuer of the security.

"(B) The existence of public reports by securities analysts concerning any class of securities of the issuer of the security.

"(C) The eligibility of the issuer of the security, under the rules and regulations of the Commission, to incorporate by reference its reports made pursuant to section 13 of this title in a registration statement filed under the Securities Act of 1933 in connection with the sale of equity securities.

"(D) A history of immediate movement of the price of any class of securities of the issuer of the security caused by the public dissemination of information regarding unexpected corporate events or financial releases.

In no event shall it be considered reasonable for a party to expect the market price of the security to reflect substantially all publicly available information regarding the issuer of the security unless the issuer of the security has a class of securities listed and registered on a national securities exchange or quoted on the automated quotation system of a national securities association.

"(e) ALLOCATION OF LIABILITY.—

"(1) JOINT AND SEVERAL LIABILITY FOR KNOWING FRAUD.—A defendant who is found liable for damages in a private action to which subsection (a) applies may be liable jointly and severally only if the trier of fact specifically determines that the defendant acted knowingly (as defined in subsection (a)(3)).

"(2) PROPORTIONATE LIABILITY FOR RECKLESSNESS.—If the trier of fact does not make the findings required by paragraph (1) for joint and several liability, a defendant's liability in a private action to which subsection (a) applies shall be determined under paragraph (3) of this subsection only if the trier of fact specifically determines that the defendant acted recklessly (as defined in subsection (a)(4)).

"(3) DETERMINATION OF PROPORTIONATE LIABILITY.—If the trier of fact makes the findings required by paragraph (2), the defendant's liability shall be determined as follows:

"(A) The trier of fact shall determine the percentage of responsibility of the plaintiff, of each of the defendants, and of each of the other persons or entities alleged by the parties to have caused or contributed to the harm alleged by the plaintiff. In determining the percentages of responsibility, the trier of fact shall consider both the nature of the conduct of each person and the nature and extent of the causal relationship between that conduct and the damage claimed by the plaintiff.

"(B) For each defendant, the trier of fact shall then multiply the defendant's percentage of responsibility by the total amount of damage suffered by the plaintiff that was caused in whole or in part by that defendant and the court shall enter a verdict or judgment against the defendant in that amount. No defendant whose liability is determined under this subsection shall be jointly liable on any judgment entered against any other party to the action.

"(C) Except where contractual relationship permits, no defendant whose liability is determined under this paragraph shall have a right to recover any portion of the judgment entered against such defendant from another defendant.

"(4) EFFECT OF PROVISION.—This subsection relates only to the allocation of damages among defendants. Nothing in this subsection shall affect the standards for liability under any private action arising under this title.

"(f) DAMAGES.—In any private action to which subsection (a) applies, and in which the plaintiff claims to have bought or sold the security based on a reasonable belief that the market value of the security reflected all publicly available information, the plaintiff's damages shall not exceed the lesser of—

"(1) the difference between the price paid by the plaintiff for the security and the market value of the security immediately after dissemination to the market of information which corrects the fraudulent statement; and

"(2) the difference between the price paid by the plaintiff for the security and the price at which the plaintiff sold the security after dissemination of information correcting the fraudulent statement.".

SEC. 205. ESTABLISHMENT OF "SAFE HARBOR" FOR PREDICTIVE STATEMENTS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end the following new section:

"SEC. 37. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

"(a) SAFE HARBOR DEFINED.—In any action arising under this title based on a fraudulent statement (within the meaning of section 10A), a person shall not be liable for the publication of any projection if—

"(1) the basis for such projection is briefly described therein, with citations (which may be general) to representative sources or authority, and a disclaimer is made to alert persons for whom such information is intended that the projections should not be given any more weight than the described basis therefor would reasonably justify; and

"(2) the basis for such projection is not inaccurate as of the date of publication, determined without benefit of subsequently available information or information not known to such person at such date.

"(b) AUTOMATIC PROTECTIVE ORDER STAYING DISCOVERY; EXPEDITED PROCEDURE.—In any action arising under this title based on a fraudulent statement (within the meaning of section 10A) by any person, such person may, at any time beginning after the filing of the complaint and ending 10 days after the filing of such person's answer to the complaint, move to obtain an automatic protective order under the safe harbor procedures of this section. Upon such motion, the protective order shall issue forthwith to stay all discovery as to the moving party, except that which is directed to the specific issue of the applicability of the safe harbor. A hearing on the applicability of the safe harbor shall be conducted within 45 days of the issuance of such protective order. At the conclusion of the hearing, the court shall either (1) dismiss the portion of the action based upon the use of a projection to which the safe harbor applies, or (2) determine that the safe harbor is unavailable in the circumstances.

"(c) REGULATORY AUTHORITY.—In consultation with investors and issuers of securities, the Commission shall adopt rules and regulations to facilitate the safe harbor provisions of this section. Such rules and regulations shall—

"(1) include clear and objective guidance that the Commission finds sufficient for the protection of investors,

"(2) prescribe such guidance with sufficient particularity that compliance shall be readily ascertainable by issuers prior to issuance of securities, and

"(3) provide that projections that are in compliance with such guidance and that concern the future economic performance of an issuer of securities registered under section 12 of this title will be deemed not to be in violation of section 10(b) of this title.''.

SEC. 206. RULE OF CONSTRUCTION.

Nothing in the amendments made by this title shall be deemed to create or ratify any implied private right of action, or to prevent the Commission by rule from restricting or otherwise regulating private actions under the Securities Exchange Act of 1934.

SEC. 207. EFFECTIVE DATE.

This title and the amendments made by this title are effective on the date of enactment of this Act and shall apply to cases commenced after such date of enactment.

PURPOSE AND SUMMARY

The purpose of Title II of H.R. 10, the Common Sense Legal Reforms Act of 1995, is to reform the Federal civil justice system with regard to private securities litigation. It eliminates certain abusive practices, provides for greater plaintiff control over litigation, and defines or modifies the legal standards establishing liability in actions based on securities fraud.

BACKGROUND AND NEED FOR THE LEGISLATION

America has become an excessively litigious society. We sue each other too often and too easily, and the consequences affect all of us. The dramatic growth in litigation carries high costs for the American economy—manufacturers withdraw products from the market, discontinue product research, reduce their workforces, and raise their prices.

The federal securities laws specifically endow the Securities and Exchange Commission (SEC) with broad regulatory and enforcement powers. In contrast, however, Congress wrote quite narrowly in authorizing private parties to file lawsuits. Notably, those remedies did not include an express private right of action under Section 10(b) of the Securities Exchange Act of 1934. The ''10b–5 cause of action'' was created entirely by judges. Congress enacted the Federal securities laws in 1933 and 1934 to protect investors and promote the efficient functioning of our capital markets. Today, private lawsuits under those statutes create precisely the opposite effect.

The securities litigation system was designed to achieve several goals. These include the prevention of fraudulent statements by corporate insiders; encouragement of companies to make full disclosure to investors; compensation of investors when they lose money due to fraud; encouragement of participation in American capital markets; and strengthening of the American economy. Arthur Levitt, the Chairman of the SEC, has stated publicly that in order for investors to have confidence in the securities markets, they must have confidence in their right to seek fair recovery from those that may defraud them. Private actions serve a crucial role as a deterrent and are a vital supplement to the SEC's enforcement resources. However, Chairman Levitt noted the system should not only assure that fraud victims recover their loss, but that the system works well enough to serve the interests of all investors: "private actions are intended to compensate defrauded investors and deter securities violations. If the current system fails to distinguish between strong cases and weak cases, it serves neither purpose effectively."[1]

Many executives of companies in the accounting, securities, and manufacturing industries believe that the civil liability system has been twisted and is operating unfairly against them. They maintain it no longer channels benefits to investors who are actually damaged; and it does not focus the burdens of litigation and liability for damages upon those who engage in fraud.

Today, our litigation system allows, indeed encourages, abusive "strike suits"—class actions typically brought under the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder. Strike lawsuits are lawsuits filed by class action attorneys on behalf of shareholders whose once attractive stock purchases have failed to live up to their expectations. Volatile stock prices, rapid product development, and technological changes make growing companies a target. As a result, high technology, biotechnology, and other growth companies are hardest hit.

Whether a shareholder lawsuit is meritorious or not, the corporation sued must spend a great deal of money to defend itself. It is common for a corporation simply to agree to a substantial settlement out of court. Despite the absence of wrongdoing by managers, corporations are essentially forced to pay large sums of money to avoid even larger expenses associated with legal defense. This has been described by some as legal extortion. Advocates of litigation reform cite empirical studies that show virtually all claims in 10b–5 class actions, meritorious or not, are settled. The settlement bears no relationship to the underlying damages, but instead is related principally to the amount claimed or the defendants' insurance coverage.

A SUMMARY OF A TYPICAL CASE

A typical case involves a stock, usually of a high-growth, high-tech company, that has performed well for many quarters, but ultimately misses analysts' expectations:

> Whenever there is any sudden change in stock price, there is, by definition some surprise (e.g., a disappointing earnings announcement or an adverse product development). Securities class action lawyers can then file a complaint (frequently many are filed immediately after any sudden price drop) claiming that some group of defendants "knew or should have known" about the negative information and disclosed it earlier.[2]

Officers, directors, accountants, and consultants are also named as defendants. Damages sought by plaintiffs—on behalf of anyone who bought the company's stock prior to the earnings announce-

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[1] Speech by Arthur Levitt, "Private Litigation Under the Federal Securities Laws", The University of California, San Diego, Securities Regulation Institute, (Jan. 26. 1994).

[2] Testimony of Professor Daniel R. Fischel before the House Subcommittee on Telecommunications and Finance, Hearings on H.R. 10, January 19, 1995, p.3.

ment—amount to hundreds of millions of dollars. The plaintiffs who bring the suit typically hold only a handful of shares in the company. They almost certainly have filed such cases before, usually working with the same law firm. Known as "professional plaintiffs," they sue companies many times throughout the year, and receive bonuses above what they recover in the settlement. The driving force behind many of these suits are not angry investors, but entrepreneurial trial lawyers who use the "professional plaintiff."[3]

Using professional plaintiffs, law firms often file complaints within days of a substantial movement in stock price. The leading plaintiffs' law firm reported that 69 percent of the cases it filed over a three year period were filed within 10 days of the event or disclosure that gave rise to the allegations of fraud.[4] Firms are able to do this by keeping a stable of professional plaintiffs who hold a few shares in a broad range of companies. As William Lerach, whose firm filed 229 different suits over forty-four months—one every 4.2 business days—told Forbes magazine: "I have the greatest practice of law in the world. I have no clients."[5]

As noted, in many instances, the suits are filed just hours after the news of a stock price decline, with no evidence of wrongdoing. High technology companies are easy prey for plaintiffs' lawyers who want to file speculative suits. If a company's stock moves significantly, up or down, it will likely be hit with a strike suit. Typically, plaintiffs' attorneys file suit within hours or days alleging fraud, while citing a laundry list of cookie-cutter complaints.

One recent case is illustrative of the current state of affairs. On April 2, 1993, Philip Morris announced that it would reduce the average price of its cigarettes, and therefore, that it expected earnings in the future to decline. Less than five hours later, the first of several lawsuits were filed on behalf of a plaintiff who had bought 60 shares during the alleged class period. Four more lawsuits were filed the same day. And on the next day, five additional lawsuits were filed. Two of the complaints contained identical allegations "that the defendants * * * engaged in conduct to create and prolong the illusion of Philip Morris' success in the toy industry" (emphasis supplied).[6] Apparently, these complaints are lodged in some computer bank of fraud complaints, available for quick access but without much regard to accuracy.

In the typical case, after some legal skirmishing, the court refuses to dismiss the complaints and discovery begins. With relatively little specific evidence other than a drop in stock price, the plaintiffs have succeeded in filing a lawsuit, triggering the costly discovery process, and imposing massive costs on the defendant who possesses the bulk of the relevant information. As Dennis W. Bakke, President and Chief Executive Officer of the AES Corporation testified:

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[3] Andrew Leigh, "Being a Plaintiff Sometimes Amounts to a Profession", Investors Business Daily, Nov. 1, 1991. Professor John C. Coffee, Jr. of Columbia University Law School noted in the article that Harry Lewis, a retired lawyer, had been the named plaintiff in over 300 cases.

[4] Private Litigation Under the Federal Securities Law: Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, 103rd Cong., 1st Session (June 17, and July 21, 1993). (Hereinafter cited "Senate Securities Hearings.")

[5] William P. Barrett, "I Have No Clients," Forbes, Oct. 11, 1993.

[6] Theodore J. Boutrous, Jr., "Out of Control Securities Suits", Washington Times, February 9, 1995, p. 1. Also, Junda Woo, "Judges Show Growing Skepticism in Class-Action Securities Cases", Wall Street Journal, January 11, 1995, p. C1.

> After the motion to dismiss was decided, the financial blood letting began in earnest with the onset of the discovery process as the rest of the suit proceeded. Discovery is an extremely broad and a formidable weapon in the hands of skilled plaintiffs attorneys. Our business is enormously paper intensive. Therefore, we were immediately served with document production requests that resulted in us reviewing enormous numbers of boxes of paper. Depositions for a significant amount of our staff at our plant, plus a number of executive officers, were served. Worse yet, we were not the only people served with intrusive discovery requests. Plaintiffs served notice of depositions, and incredibly broad requests for document production, on at least four of our potential customers, various suppliers, certain of our lenders, and our largest construction contractor. I cannot begin to describe the disruption to important business relationships that this caused.[7]

Indeed, the U.S. Supreme Court has taken note of this situation. In *Blue Chip Stamps* v. *Manor Drug Stores,* the Court opined that the potential for abuse of the liberal discovery rules might be greater in this type of case than in other litigation: ''[A] plaintiff with a largely groundless claim [may] simply take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value * * *'' [8]

As the costs of discovery rise, the pressure to settle becomes enormous. Many cases settle before the completion of discovery. Others will go as far as a summary judgment motion and if that is unsuccessful, settle immediately with defendants paying a substantial sum. The plaintiffs' lawyers take one third of the settlement, and the rest is distributed to the members of the class, resulting in pennies of return for each individual plaintiff. There is no adjudication of the merits of the case. James Kimsey, Chairman of America Online Inc., testified: ''Even when a company committed no fraud, indeed no negligence, there is still the remote possibility of huge jury verdicts, not to mention the costs of litigation. In the face of such exposure, defendant companies inevitably settle these suits rather than go to trial.'' [9]

Throughout the process, it is clear that the plaintiff class has difficulty in exercising any meaningful direction over the case brought on its behalf. Class counsel may also have incentives that differ from those of the underlying class members. Because class counsels' fees and expenses sometimes amount to one-third or more of recovery, class counsel frequently has a significantly greater interest in the litigation than any individual member of the class. [10]

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[7] Testimony of Dennis W. Bakke, President and Chief Executive Officer of the AES Corporation before the House Subcommittee on Telecommunications and Finance. Hearing on H.R. 10, January 19, 1995, p. 8.

[8] 421 U.S. 723 at 741.

[9] Testimony of James Kimsey, Chairman, America Online, Inc. before the House Subcommittee on Telecommunications and Finance, hearing on H.R. 10, January 19, 1995, p. 7.

[10] Letter from State of Wisconsin Investment Board to Senator Pete Domenici (Sept. 27, 1993). Similar statements were elicited during hearings before the Senate Banking Committee on S. 1976 during the 103rd Congress from the Director of the Division of Enforcement of the SEC, William McLucas, and the State Securities Commissioner of Utah, Mark Griffin. See Senate Securities Hearings, supra.

Furthermore, class counsel usually advances the costs of the litigation, which means that counsel may have a greater incentive than the members of the class to accept a settlement that provides a significant fee and eliminates any risk of failure to recoup funds already invested in the case. Even if a substantially higher recovery might be obtained through litigation, the return on counsel's investment might be lower than that provided by the settlement, especially if lost opportunity costs are taken into account.

As a practical matter, members of the class who object must opt out of the class, obtain separate counsel, and oppose a settlement that is supported both by class counsel and the corporate defendant. The expense and difficulty of this process makes it unusable for most plaintiffs, although in light of plaintiff attorney conflicts of interest, this effort may be worthwhile. The Corporations Commissioner of the State of California submitted a statement to the Subcommittee outlining his experience in connection with a class action brought by the leading plaintiffs' law firm:

> In the VMS Realty Partnership case, limited partnerships interests were sold to thousands of unsuitable investors, often on the basis of materially misleading statements. A class action suit based upon these abuses was brought by Milberg, Weiss, Bershad, Hynes & Lerach, the nation's largest class action law firm. Despite the strong evidence of securities law violations, this case was settled for less than 8 cents on the dollar. While this may have represented a significant recovery for the lawyers, it woefully undervalued the investors claims. Investors who opted out of the class action settlement and are now participating in the independent arbitration process are frequently receiving 100% of their losses. In addition, these investors haven't had to share their recovery with a lawyer "representing their interest. [11]

Finally, although class actions require judicial approval, courts have a natural incentive to clear complicated cases from their dockets and have been known to adopt the premise that a bad settlement is almost always better than a good trial.

ABUSE AND HARM IN THE CURRENT SYSTEM

Perhaps the most offensive fact about strike suits is that studies show that a very large percentage of securities fraud class action suits settle and that the average investor recovers pennies on the dollar. A study by the National Economic Research Associates concluded the average investor recovers only seven cents for every dollar lost in the market, prior to the award of attorney's fees.[12] Dr. Vincent O'Brien, of the Law and Economics Consulting Group, Inc. found that the average settlement provided investors with only six cents for every dollar lost in the market prior to an award of attor-

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[11] Testimony of Gary S. Mendoza, Commissioner of Corporations, State of California, submitted to the House Subcommittee on Telecommunications and Finance, Hearings on H.R. 10, February 10, 1995, p. 2.

[12] Frederick C. Dunbar and Vinita M. Juneja, "Recent Trends II: What Explains Settlements in Shareholder Class Actions," National Economic Research Associates, Inc. (1993).

neys fees.[13] And an analysis by Professor Janet Cooper Alexander of Stanford Law School established an average gross settlement of 26 cents for every dollar of potential damages, with another 27 percent subtracted for attorney's fees, or a net recovery for plaintiffs of 19 cents on the dollar.[14] On the other end of the scale, a plaintiffs' attorney, appearing before the Subcommittee on behalf of the trade association of plaintiffs' attorneys, disputed these figures and alleged that 83 cents of every dollar is distributed to shareholders.[15]

Only slightly less offensive is the fact that abuse of the 10b–5 system deprives investors of information they need because it deters the voluntary disclosure of information that the Federal securities laws were designed to promote. Given the threat of a lawsuit based on voluntarily disclosed information, the wisest thing for management to do is to volunteer nothing. That appears to be precisely what companies are doing. An American Stock Exchange survey found that 75 percent of corporate chief executive officers have limited the information disclosed to investors out of fear that greater disclosure would lead to a meritless lawsuit.[16] A survey by Venture One of two hundred and twelve entrepreneurial companies found that seventy one percent were reluctant to discuss company performance with analysts or otherwise disclose information for fear that an unjustified lawsuit would result.[17] In a study of information disclosure patterns of 550 companies, two University of California, Berkeley professors found that fewer than 50 percent of companies with earnings results significantly above or below analysts' expectations released information voluntarily. The professors concluded that fear of litigation was the reason for the low disclosure rate.[18]

Finally, American society as a whole is a victim of strike suit abuse. As noted by Professor Fischel:

> Similarly situated companies who become aware of this debacle will not stand still. To avoid a similar problem they have several options, none of which are socially desirable. Some companies may decide not to go public. In this way, they can avoid possible liability but only by incurring the costs associated with more expensive private financing. Other companies may decide not to experiment with risky drugs. By avoiding risky projects, firms can avoid adverse outcomes that result in dramatic stock price declines. This solution, too, is undesirable, because society does not get the benefit of products that are never developed. The drug in the above example, after all, should be introduced be-

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[13] Vincent O'Brien & Richard Hodges, "A Study of Class Action Securities Fraud Cases" (1993).

[14] Janet Cooper Alexander, Do the Merits Matter? A Study of Settlements in Securities Class Actions, 43 "Stanford Law Review" 497 (1991).

[15] Testimony of William S. Lerach before the House Subcommittee on Telecommunications and Finance, hearings on H.R. 10, January 19, 1995, pp. 17–18.

[16] American Stock Exchange, "CEOs Would Release More Financial Information if Litigation Albatross Were Removed" (May 17, 1994).

[17] Venture One for the National Venture Capital Association and American Entrepreneurs for Economic Growth, "The Impact of Securities Fraud Suits on Entrepreneurial Companies" (January 1994).

[18] Ron Kasznik & Baruch Lev, "To Warn or Not To Warn: A Manager's Dilemma When Facing an Earnings Surprise" (University of California, Berkeley, November 1993).

> cause it is beneficial even though its benefits were less than was [sic] initially anticipated. A third solution is to remain silent about the drug because the company cannot later be accused of "fraud" if it chose not to speak in the first place. These "solutions" are perverse because investors—the supposed beneficiaries of the existing law—are denied the opportunity to invest in and learn about attractive but risky ventures. Even though suits like this are socially undesirable, plaintiffs' attorneys have powerful incentives to bring them since they can expect a court to award them a substantial fraction of the settlement as compensation for their time and expenses.[19]

As a result, the goals of the securities laws have been skewed. Fraud is not deterred, because these suits are filed regardless of fraud. Fear of unjustified litigation has forced companies to curtail disclosure of information. Injured investors obtain little compensation but their lawyers recover exorbitant fees. Fear of litigation keeps companies out of the capital markets. Finally, businesses suffer as auditors and directors decline engagements and board positions.

The consequences of the current system are serious and diverse. Strike suits are money makers for the lawyers, but such claims destroy jobs and hurt the economy. Instead of spending money on research and development or hiring more employees or reducing the cost of their products, companies spend that money on strike suit insurance and legal fees. And, the problem is rapidly getting worse.

SUBCOMMITTEE HEARINGS

The Subcommittee on Telecommunications and Finance held two hearings in the 103rd Congress on the subject of securities litigation reform on July 22, 1994, and August 10, 1994. The Subcommittee held two hearings on Title II of H.R. 10, The Common Sense Legal Reforms Act of 1995, on January 19, 1995, and February 10, 1995.

The witnesses at the hearing on July 22, 1994 included the Honorable Howard Metzenbaum, U.S. Senator, State of Ohio; and the Honorable Arthur Levitt, Chairman, SEC.

Witnesses at the August 10, 1994 hearing included two panels. The first panel consisted of Joel Seligman, Professor of Law, Hutchins Hall, University of Michigan; Donald C. Langevoort, Lee S. & Charles A. Speir, Professor of Law, Vanderbilt University; Abraham J. Briloff, Emanuel Saxe Distinguished Professor of Accounting, Emeritus, Baruch College; Arthur Miller, Bruce Bromley, Professor of Law, Harvard University; Adolf A. Berle, Professor of Law, Columbia University; and Janet Cooper Alexander, Professor of Law, Stanford University. The second panel included J. Michael Cook, Chairman and CEO, Deloitte & Touche; Mark J. Griffin, Director, Securities Division, Utah Department of Commerce; Ralph Nader, Consumer Advocate, Center for the Study of Responsive Law; Alan C. Hevesi, Comptroller, City of New York; Leonard B.

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[19] Testimony of Professor Daniel R. Fischel, before the House Subcommittee on Telecommunications and Finance, Hearings on H.R. 10, January 19, 1995, pp. 5–6.

Simon, Partner, Milberg Weiss Bershad Hynes & Lerach; and Stephen Smith, General Counsel, Exabyte Corporation.

The January 19, 1995 hearing consisted of one panel including Daniel R. Fischel, the Lee and Brena Freeman Professor of Law, The University of Chicago Law School; William Lerach, Partner, Milberg Weiss Bershad Hynes & Lerach; James Kimsey, Chairman, America Online, Inc.; and Dennis Bakke, President, the AES Corporation.

The February 10, 1995 hearing included The Honorable Arthur Levitt, Chairman, SEC. There was a panel of eight witnesses including: Richard Breeden, Coopers & Lybrand; Saul S. Cohen, Rosenman & Colin; Gregory P. Joseph, Fried, Frank, Harris, Shriver & Jacobson; John F. Olsen, Gibson, Dunn & Crutcher; Daniel L. Goelzer, Baker & McKenzie; Sheldon Elsen, Orans, Elsen & Lupert, representing the Association of the Bar of the City of New York; Mark Griffin, Director of the Utah Department of Commerce's Division of Securities, representing the North American Securities Administrators Association; and Joseph Seligman, Professor, The University of Michigan Law School.

Committee Consideration

On February 14, 1995, the Subcommittee on Telecommunications and Finance met in open markup session and ordered the bill, H.R. 10, as amended, reported to the Full Committee by a voice vote, a quorum being present. Mr. Cox offered an amendment in the nature of a substitute, which was approved by a roll call vote of 16–10.

The following amendments to the amendment in the nature of a substitute were offered but none were approved by the Subcommittee. Mr. Dingell offered an amendment to strike the definition of recklessness and insert a new definition. The Dingell amendment was defeated by a roll call vote of 15–11. Mr. Manton offered an amendment that would have deleted the fee-shifting provisions. It was defeated by a roll call vote of 16–10. Mr. Gordon of Tennessee offered an amendment that would have changed the burden of persuasion from the losing party, as provided in the substitute, to the prevailing party as to whether a court should award reasonable fees and other expenses to the prevailing party. It was defeated by a roll call vote of 15–11. Mr. Markey offered an amendment that would have provided for a private right of action for aiding and abetting in the Securities Act and the Exchange Act, thereby overturning *Central Bank of Denver* v. *First Interstate Bank of Denver*, in which the Supreme Court held that there is no private implied right of action for aiding and abetting under section 10(b) of the Exchange Act. It was defeated by voice vote.

On February 16, 1995, the Committee met in open markup session and ordered the bill, H.R. 10 as amended, reported by a recorded vote of 32 to 10, with 3 voting present, a quorum being present. The bill, as amended, will be described in greater detail in the Section-by-Section Analysis.

ROLLCALL VOTES

Pursuant to clause 2(l)(2)(B) of rule XI of the Rules of the House of Representatives, following are listed the recorded votes on the motion to report H.R. 10 and on amendments offered to the measure, including the names of those Members voting for and against.

COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #14

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Dingell re: definition of recklessness

DISPOSITION: **NOT AGREED TO**, by a roll call vote of 18 ayes to 27 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley		X		Mr. Dingell	X		
Mr. Moorhead		X		Mr. Waxman	X		
Mr. Fields		X		Mr. Markey	X		
Mr. Oxley		X		Mr. Tauzin		X	
Mr. Bilirakis		X		Mr. Wyden	X		
Mr. Schaefer		X		Mr. Hall		X	
Mr. Barton		X		Mr. Bryant	X		
Mr. Hastert		X		Mr. Boucher	X		
Mr. Upton		X		Mr. Manton	X		
Mr. Stearns		X		Mr. Towns	X		
Mr. Paxon		X		Mr. Studds			
Mr. Gillmor		X		Mr. Pallone	X		
Mr. Klug		X		Mr. Brown	X		
Mr. Franks		X		Mrs. Lincoln	X		
Mr. Greenwood		X		Mr. Gordon	X		
Mr. Crapo		X		Ms. Furse	X		
Mr. Cox		X		Mr. Deutsch	X		
Mr. Burr		X		Mr. Rush	X		
Mr. Bilbray		X		Ms. Eshoo	X		
Mr. Whitfield		X		Mr. Klink	X		
Mr. Ganske		X		Mr. Stupak	X		
Mr. Frisa		X					
Mr. Norwood		X					
Mr. White		X					
Mr. Coburn		X					

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COMMITTEE ON COMMERCE -- 104TH CONGRESS
ROLL CALL VOTE #15

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Cox re: definition of recklessness

DISPOSITION: AGREED TO by a roll call vote of 31 ayes to 12 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin	X		
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall	X		
Mr. Barton	X			Mr. Byrant		X	
Mr. Hastert	X			Mr. Boucher			
Mr. Upton	X			Mr. Manton		X	
Mr. Stearns	X			Mr. Towns	X		
Mr. Paxon	X			Mr. Studds			
Mr. Gillmor	X			Mr. Pallone	X		
Mr. Klug	X			Mr. Brown		X	
Mr. Franks	X			Mrs. Lincoln	X		
Mr. Greenwood	X			Mr. Gordon	X		
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch	X		
Mr. Burr	X			Mr. Rush		X	
Mr. Bilbray	X			Ms. Eshoo		X	
Mr. Whitfield	X			Mr. Klink		X	
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood							
Mr. White	X						
Mr. Coburn	X						

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COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #16

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

MOTION: Motion by Mr. Stearns to close the debate on the Fields Amendment in the Nature of a Substitute and all amendments and motions thereto at 2:30 p.m. on February 16, 1995

DISPOSITION: AGREED TO, by a roll call vote of 24 ayes to 19 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin		X	
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall		X	
Mr. Barton	X			Mr. Bryant		X	
Mr. Hastert	X			Mr. Boucher			
Mr. Upton	X			Mr. Manton		X	
Mr. Stearns	X			Mr. Towns		X	
Mr. Paxon	X			Mr. Studds			
Mr. Gillmor	X			Mr. Pallone		X	
Mr. Klug	X			Mr. Brown		X	
Mr. Franks	X			Mrs. Lincoln		X	
Mr. Greenwood	X			Mr. Gordon		X	
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch		X	
Mr. Burr	X			Mr. Rush		X	
Mr. Bilbray	X			Ms. Eshoo		X	
Mr. Whitfield	X			Mr. Klink		X	
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood							
Mr. White	X						
Mr. Coburn	X						

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COMMITTEE ON COMMERCE -- 104TH CONGRESS
ROLL CALL VOTE #17

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Wyden re: fraud detection and disclosure

DISPOSITION: NOT AGREED TO, by a roll call vote of 18 ayes to 23 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley		X		Mr. Dingell	X		
Mr. Moorhead		X		Mr. Waxman	X		
Mr. Fields		X		Mr. Markey	X		
Mr. Oxley		X		Mr. Tauzin	X		
Mr. Bilirakis		X		Mr. Wyden	X		
Mr. Schaefer		X		Mr. Hall	X		
Mr. Barton		X		Mr. Bryant	X		
Mr. Hastert				Mr. Boucher	X		
Mr. Upton		X		Mr. Manton	X		
Mr. Stearns		X		Mr. Towns	X		
Mr. Paxon		X		Mr. Studds			
Mr. Gillmor				Mr. Pallone			
Mr. Klug		X		Mr. Brown	X		
Mr. Franks		X		Mrs. Lincoln			
Mr. Greenwood		X		Mr. Gordon	X		
Mr. Crapo		X		Ms. Furse	X		
Mr. Cox		X		Mr. Deutsch	X		
Mr. Burr		X		Mr. Rush	X		
Mr. Bilbray		X		Ms. Eshoo	X		
Mr. Whitfield		X		Mr. Klink	X		
Mr. Ganske		X		Mr. Stupak	X		
Mr. Frisa		X					
Mr. Norwood		X					
Mr. White		X					
Mr. Coburn		X					

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COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #18

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: En bloc Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Tauzin re: scienter and fee shifting

DISPOSITION: AGREED TO, by a roll call vote of 32 ayes to 13 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin	X		
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall	X		
Mr. Barton	X			Mr. Byrant		X	
Mr. Hastert	X			Mr. Boucher		X	
Mr. Upton	X			Mr. Manton	X		
Mr. Stearns	X			Mr. Towns	X		
Mr. Paxon	X			Mr. Studds		X	
Mr. Gillmor				Mr. Pallone		X	
Mr. Klug	X			Mr. Brown	X		
Mr. Franks	X			Mrs. Lincoln	X		
Mr. Greenwood	X			Mr. Gordon	X		
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch	X		
Mr. Burr	X			Mr. Rush		X	
Mr. Bilbray	X			Ms. Eshoo		X	
Mr. Whitfield	X			Mr. Klink	X		
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood	X						
Mr. White	X						
Mr. Coburn		X					

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COMMITTEE ON COMMERCE -- 104TH CONGRESS
ROLL CALL VOTE #19

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Manton re: fee shifting

DISPOSITION: NOT AGREED TO, by a roll call vote of 20 ayes to 25 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley		X		Mr. Dingell	X		
Mr. Moorhead		X		Mr. Waxman	X		
Mr. Fields		X		Mr. Markey	X		
Mr. Oxley		X		Mr. Tauzin	X		
Mr. Bilirakis		X		Mr. Wyden	X		
Mr. Schaefer		X		Mr. Hall		X	
Mr. Barton		X		Mr. Byrant	X		
Mr. Hastert		X		Mr. Boucher	X		
Mr. Upton		X		Mr. Manton	X		
Mr. Stearns		X		Mr. Towns	X		
Mr. Paxon		X		Mr. Studds	X		
Mr. Gillmor				Mr. Pallone	X		
Mr. Klug		X		Mr. Brown	X		
Mr. Franks		X		Mrs. Lincoln	X		
Mr. Greenwood		X		Mr. Gordon	X		
Mr. Crapo		X		Ms. Furse	X		
Mr. Cox		X		Mr. Deutsch	X		
Mr. Burr		X		Mr. Rush	X		
Mr. Bilbray		X		Ms. Eshoo	X		
Mr. Whitfield		X		Mr. Klink	X		
Mr. Ganske		X		Mr. Stupak	X		
Mr. Frisa		X					
Mr. Norwood		X					
Mr. White		X					
Mr. Coburn		X					

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COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #20

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Deutsch re: reliance/fraud on the market

DISPOSITION: **NOT AGREED TO**, by a roll call vote of 21 ayes to 24 nays.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley		X		Mr. Dingell	X		
Mr. Moorhead		X		Mr. Waxman	X		
Mr. Fields		X		Mr. Markey	X		
Mr. Oxley		X		Mr. Tauzin	X		
Mr. Bilirakis		X		Mr. Wyden	X		
Mr. Schaefer		X		Mr. Hall	X		
Mr. Barton		X		Mr. Bryant	X		
Mr. Hastert		X		Mr. Boucher	X		
Mr. Upton		X		Mr. Manton	X		
Mr. Stearns		X		Mr. Towns	X		
Mr. Paxon		X		Mr. Studds	X		
Mr. Gillmor		X		Mr. Pallone	X		
Mr. Klug		X		Mr. Brown	X		
Mr. Franks		X		Mrs. Lincoln	X		
Mr. Greenwood		X		Mr. Gordon	X		
Mr. Crapo		X		Ms. Furse	X		
Mr. Cox				Mr. Deutsch	X		
Mr. Burr		X		Mr. Rush	X		
Mr. Bilbray		X		Ms. Eshoo	X		
Mr. Whitfield		X		Mr. Klink	X		
Mr. Ganske		X		Mr. Stupak	X		
Mr. Frisa		X					
Mr. Norwood		X					
Mr. White		X					
Mr. Coburn		X					

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COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #21

BILL: Title II. Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Tauzin re: reliance/fraud on the market

DISPOSITION: **AGREED TO**, by a roll call vote of 30 ayes to 15 nays, with 1 voting present.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin	X		
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall	X		
Mr. Barton	X			Mr. Byrant		X	
Mr. Hastert	X			Mr. Boucher		X	
Mr. Upton	X			Mr. Manton		X	
Mr. Stearns	X			Mr. Towns		X	
Mr. Paxon	X			Mr. Studds			X
Mr. Gillmor	X			Mr. Pallone		X	
Mr. Klug	X			Mr. Brown		X	
Mr. Franks	X			Mrs. Lincoln	X		
Mr. Greenwood	X			Mr. Gordon	X		
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch	X		
Mr. Burr	X			Mr. Rush		X	
Mr. Bilbray	X			Ms. Eshoo		X	
Mr. Whitfield	X			Mr. Klink		X	
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood	X						
Mr. White	X						
Mr. Coburn	X						

2/16/95

COMMITTEE ON COMMERCE -- 104TH CONGRESS
ROLL CALL VOTE #22

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Amendment to the Fields Amendment in the Nature of a Substitute by Mr. Markey re: aiding and abetting in SEC actions

DISPOSITION: NOT AGREED TO, by a roll call vote of 19 ayes to 25 nays, with 1 voting present.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley		X		Mr. Dingell	X		
Mr. Moorhead		X		Mr. Waxman	X		
Mr. Fields		X		Mr. Markey	X		
Mr. Oxley		X		Mr. Tauzin	X		
Mr. Bilirakis		X		Mr. Wyden	X		
Mr. Schaefer		X		Mr. Hall		X	
Mr. Barton				Mr. Bryant	X		
Mr. Hastert		X		Mr. Boucher	X		
Mr. Upton		X		Mr. Manton	X		
Mr. Stearns		X		Mr. Towns	X		
Mr. Paxon		X		Mr. Studds			X
Mr. Gillmor		X		Mr. Pallone	X		
Mr. Klug		X		Mr. Brown	X		
Mr. Franks		X		Mrs. Lincoln	X		
Mr. Greenwood		X		Mr. Gordon	X		
Mr. Crapo		X		Ms. Furse	X		
Mr. Cox		X		Mr. Deutsch	X		
Mr. Burr		X		Mr. Rush	X		
Mr. Bilbray		X		Ms. Eshoo	X		
Mr. Whitfield		X		Mr. Klink	X		
Mr. Ganske		X		Mr. Stupak	X		
Mr. Frisa		X					
Mr. Norwood		X					
Mr. Frisa		X					
Mr. White		X					
Mr. Coburn		X					

2/16/95

COMMITTEE ON COMMERCE -- 104TH CONGRESS
ROLL CALL VOTE #23

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

AMENDMENT: Fields Amendment in the Nature of a Substitute

DISPOSITION: **AGREED TO**, by a roll call vote of 28 ayes to 16 nays, with 1 voting present.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin	X		
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall	X		
Mr. Barton				Mr. Bryant		X	
Mr. Hastert	X			Mr. Boucher		X	
Mr. Upton	X			Mr. Manton		X	
Mr. Stearns	X			Mr. Towns		X	
Mr. Paxon	X			Mr. Studds			X
Mr. Gillmor	X			Mr. Pallone	X		
Mr. Klug	X			Mr. Brown		X	
Mr. Franks	X			Mrs. Lincoln	X		
Mr. Greenwood	X			Mr. Gordon		X	
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch		X	
Mr. Burr	X			Mr. Rush		X	
Mr. Bilbray	X			Ms. Eshoo		X	
Mr. Whitfield	X			Mr. Klink		X	
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood	X						
Mr. Frisa	X						
Mr. White	X						
Mr. Coburn	X						

2/16/95

COMMITTEE ON COMMERCE – 104TH CONGRESS
ROLL CALL VOTE #24

BILL: Title II, Reform of Private Securities Litigation, of H.R. 10, the Common Sense Legal Reforms Act

MOTION: Motion by Mr. Fields to order H.R. 10 reported to the House, as amended

DISPOSITION: AGREED TO, by a roll call vote of 32 ayes to 10 nays, with 3 voting present.

REPRESENTATIVE	AYE	NAY	PRESENT	REPRESENTATIVE	AYE	NAY	PRESENT
Mr. Bliley	X			Mr. Dingell		X	
Mr. Moorhead	X			Mr. Waxman		X	
Mr. Fields	X			Mr. Markey		X	
Mr. Oxley	X			Mr. Tauzin	X		
Mr. Bilirakis	X			Mr. Wyden		X	
Mr. Schaefer	X			Mr. Hall	X		
Mr. Barton				Mr. Byrant		X	
Mr. Hastert	X			Mr. Boucher		X	
Mr. Upton	X			Mr. Manton	X		
Mr. Stearns	X			Mr. Towns	X		
Mr. Paxon	X			Mr. Studds		X	
Mr. Gillmor	X			Mr. Pallone	X		
Mr. Klug	X			Mr. Brown	X		
Mr. Franks	X			Mrs. Lincoln			X
Mr. Greenwood	X			Mr. Gordon			X
Mr. Crapo	X			Ms. Furse		X	
Mr. Cox	X			Mr. Deutsch	X		
Mr. Burr	X			Mr. Rush	X		
Mr. Bilbray	X			Ms. Eshoo			X
Mr. Whitfield	X			Mr. Klink		X	
Mr. Ganske	X			Mr. Stupak		X	
Mr. Frisa	X						
Mr. Norwood	X						
Mr. Frisa	X						
Mr. White	X						
Mr. Coburn	X						

2/16/95

Committee Oversight Findings

Pursuant to clause 2(l)(3)(A) of rule XI of the Rules of the House of Representatives, the Subcommittee held oversight hearings and made findings that are reflected in the legislative report.

Committee on Government Oversight and Reform

Pursuant to clause 2(l)(3)(D) of rule XI of the Rules of the House of Representatives, no oversight findings have been submitted to the Committee by the Committee on Government Reform and Oversight.

Committee Cost Estimate

Pursuant to clause 7(a) of rule XIII of the rules of the House of Representatives, the Committee is required to estimate the costs that would be incurred in carrying out Title II of H.R. 10. The Committee has serious concerns with the cost estimate prepared by the Director of the Congressional Budget Office (CBO), pursuant to section 403 of the Congressional Budget Act of 1974.

The Committee disagrees strongly with the CBO estimate that enacting the provisions of Title II would cost the federal government between $125 million and $250 million over the next five years, assuming the appropriation of the necessary amounts. The main purpose of H.R. 10 is to deter abusive "strike suits," class action lawsuits that are brought under the anti-fraud provisions of the Exchange Act, but that are generally without merit. The Committee has found that these lawsuits are brought by entrepreneurial lawyers against a corporation simply because of a drop in its stock price. Despite the absence of wrongdoing by corporate managers, the corporation is forced to settle to avoid the expense of defending against a frivolous lawsuit. Enactment of Title II of H.R. 10 would ensure that lawyers bring meritorious lawsuits only after careful deliberation and for good cause.

Since the overwhelming majority of those shareholder lawsuits that will be deterred by H.R. 10 are abusive and without merit, there should be no noticeable increase in the number of enforcement actions brought by the Securities Exchange Commission as asserted by the Director of CBO. Certainly, the Committee strongly disagrees with CBO that the SEC's enforcement efforts would double or triple. While the Committee agrees that the SEC may incur some negligible costs for promulgating rules, the estimate of between $125 million and $250 million for additional enforcement actions is incorrect.

Congressional Budget Office Estimate

Pursuant to clause 2(l)(3)(C) of Rule XI of the rules of the House of Representatives, following is the cost estimate provided by the Congressional Budget Office pursuant to section 403 of the Congressional Budget Act of 1974:

U.S. SENATE,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 24, 1995.

Hon. THOMAS J. BLILEY, Jr.,
Chairman, Committee on Commerce,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed Title II of H.R. 10, the Securities Litigation Reform Act, as ordered reported by the House Committee on the Commerce on February 16, 1995. CBO estimates that enacting the provisions of Title II would cost the federal government between $125 million and $250 million over the next five years, assuming appropriation of the necessary amounts.

Title II of H.R. 10 would require a court, when hearing class action litigation brought under the Securities Exchange Act of 1934, to appoint a steering committee of class members to direct counsel for the class. The title would require the full disclosure of the terms of settlement for any such class action lawsuit and would prohibit the payment of attorneys' fees from certain funds. In addition, the title would establish various procedures and restrictions to discourage litigation, restrict the liability of those persons who make forward-looking statements regarding securities or markets, and require the Securities and Exchange Commission (SEC) to promulgate rules establishing such limited liability. CBO estimates that promulgating these rules would result in increased costs to the federal government of approximately $150,000 in 1996, primarily for personnel costs, assuming appropriation of the necessary amounts.

By discouraging private litigation under the Securities Exchange Act of 1934, enacting Title II of H.R. 10 would result in an increase in the number of enforcement actions brought by the SEC. In 1994, there were about 50 enforcement actions due to financial fraud, resulting in administrative costs to the federal government of approximately $24 million. Although the impact on the SEC's workload from enacting Title II is highly uncertain, CBO expects that the number of financial fraud enforcement actions would at least double, and possibly triple. Therefore, CBO estimates that enactment of Title II would increase costs to the SEC for enforcement actions by $25 million to $50 million annually, or $125 million to $250 million over the next five years, assuming appropriation of the necessary amounts.

Enacting Title II of H.R. 10 would not affect direct spending or receipts; therefore, pay-as-you-go procedures would not apply to the bill. Enacting Title II of H.R. 10 would not affect the budgets of state or local governments.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is John Webb.

Sincerely,

PAUL VAN DE WATER
(For Robert D. Reischauer, Director).

Inflationary Impact Statement

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee finds that the bill would have no inflationary impact.

Section-by-Section Analysis of Title II of H.R. 10 Securities Litigation Reform Act

SECTION 201. SHORT TITLE; TABLE OF CONTENTS

Section 201 provides that Title II of H.R. 10 may be cited as the "Securities Litigation Reform Act" (the "Act"), and sets out a table of contents for the title.

SECTION 202. PREVENTION OF LAWYER-DRIVEN LITIGATION

Section 202(a) amends the Securities Exchange Act of 1934 (the "Exchange Act") by adding a new Section 36, which includes five new subsections. Subsection (a) requires the court to appoint a plaintiff steering committee in securities class actions to direct counsel for the class and to perform other functions specified by the court. Court appointment of a plaintiff steering committee is not subject to interlocutory review.

Subsection (b)(1) provides that the plaintiff steering committee shall consist of not fewer than 5 willing class members who the court believes will fairly represent the class. Committee members must have cumulatively held during the class period the lesser of 5 per cent of the securities which are the subject of the litigation, or securities which are the subject of the litigation with a market value of $10,000,000. This subsection also permits the court to appoint a committee which meets a smaller percentage test of dollar amount if the court finds it appropriate under the circumstances.

Under subsection (b)(2), class members who are named plaintiffs in the litigation may serve on the plaintiff steering committee, but shall not comprise a majority of the committee. Subsection (b)(3) provides that members of the plaintiff steering committee shall serve without compensation, but may apply to the court for reasonable out-of-pocket expenses from any common fund established for the class. Subsection (b)(4) provides that the committee shall conduct previously scheduled meetings with at least a majority of committee members present in person or by electronic communication. All matters must be decided by majority vote, except that decisions on matters other than whether to accept or reject a settlement offer or to hire or dismiss counsel may be delegated to one or more members of the committees, or may be voted upon by committee members seriatim, without a meeting. Subsection (b)(5) allows any class member who is not a member of the committee to appear and be heard by the court on any issue in the case.

Subsection (c) provides that the authority of the plaintiff steering committee to direct counsel for the class shall include all powers normally permitted to a client in litigation. The steering committee has the authority to retain or dismiss class counsel and to reject offers of settlement or preliminarily accept offers of settlement. Counsel dismissed other than for cause may enforce any contractual fee agreement or apply to the court for a fee award from any common fund established for the class.

Subsection (d) provides that any person who is appointed as a member of a plaintiff steering committee shall be immune from any civil liability for any negligence in performing such service, but shall not be immune from liability for intentional misconduct or from the assessment of attorneys' fees and costs as provided in proposed new Section 20B(c) of the Exchange Act, set out in Section 203 of the Act.

Subsection (e) states that this section does not affect any other provision of law concerning class actions or the authority of the court to give final approval to any offer of settlement.

Section 202(b) amends Section 21(d) of the Exchange Act to prevent distribution of funds disgorged pursuant to an action by the Securities and Exchange Commission (the "Commission") as attorneys' fees or expenses unless otherwise ordered by the court.

SECTION 203. PREVENTION OF ABUSIVE PRACTICES THAT FOMENT LITIGATION

Section 203(a) amends the Exchange Act by adding a new Section 20B, which includes eight new subsections. Subsection (a) requires that, in any private action under the Exchange Act that is certified as a class action, the portion of any final judgment or settlement that is awarded to class plaintiffs serving as the representative parties shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class, except that the representative parties may be awarded lost wages and other actual expenses related to their representation of the class.

Subsection (b) requires that, unless the court otherwise permits, a person may not be a named plaintiff, or an officer, director, fiduciary, or beneficiary of a named plaintiff, in more than 5 class actions filed during any 3-year period.

Subsection (c) provides for an award of reasonable attorneys' fees to the prevailing party in private actions under the Exchange Act. If a final judgment is entered on the basis of a motion to dismiss, a motion for summary judgment, or a trial on the merits, the prevailing party may move for its reasonable attorneys' fees and costs. If the court determines that (i) the position taken by the losing party was not substantially justified, (ii) an award against the losing party would be just, and (iii) the cost of such fees to the prevailing party is substantially burdensome or unjust, the court shall award such fees and costs. The burden of persuasion is on the prevailing party.

The subsection also requires that, in any private action under the Exchange Act that is certified as a class action, the court shall require an undertaking from the plaintiff for the payment of fees and expenses. This undertaking may be required from the plaintiff class, its attorneys, or both, as the court finds just and equitable. The subsection also sets out certain procedural requirements for seeking attorneys' fees and costs, permits a reduction or denial of the fee award to the extent that the prevailing party engaged in conduct that unduly protracted the proceedings, and provides for awarding attorneys' fees and costs in connection with any adjudicated discovery issue.

Subsection (d) requires the court to determine whether an attorney has a conflict of interest sufficient to disqualify the attorney from representing a party in a securities class action if the attorney owns (or has a beneficial interest in) the securities that are the subject of the litigation.

Subsection (e) requires additional disclosures of settlement terms to class members in a securities class action. Any proposed settlement agreement that is sent to the class members must include information about (1) the amount of damages per share the class would recover if it continued to pursue the litigation and was successful, (2) the likelihood of success if the class continued to pursue the litigation, (3) the amount of attorneys' fees and costs proposed to be deducted from the settlement amount, and (4) the name and address of a representative of the class counsel who would be available to answer any written questions concerning the proposed settlement.

Subsection (f) relieves a settling defendant from claims for contribution from other defendants. Any verdict or judgment against the other defendants would be reduced by the greater of (1) an amount that corresponds to the settling defendant's degree of responsibility or (2) the amount paid in the settlement (determined pursuant to the factors set forth in new Section 10A(e)).

Subsection (g) expressly provides for a right of contribution in private actions under the Exchange Act, subject to a six-month statute of limitations.

Subsection (h) requires the court to submit to the jury a written interrogatory to the jury requiring it to specifically make a finding on the issue of the defendant's state of mind at the time of the violation. This provision applies only in actions in which the plaintiff may recover money damages.

Section 203(b) amends Section 15(c) of the Exchange Act by adding a new paragraph prohibiting brokers, dealers, or their affiliated persons from soliciting or accepting fees for assisting attorneys in obtaining representation of their customers.

SECTION 204. PREVENTION OF "FISHING EXPEDITION" LAWSUITS

Section 204 amends the Exchange Act by adding a new Section 10A, which includes six new subsections. Subsection (a) provides that in any private action under the Exchange Act based on a misstatement or omission of a material fact, liability could only be established on proof that: (i) the defendant directly or indirectly made a fraudulent statement; (ii) the defendant possessed the intention to deceive, manipulate, or defraud; and (iii) the defendant made such fraudulent statement knowingly or recklessly. The phrase "directly or indirectly" mirrors the existing language of Section 10(b) and SEC Rule 10b–5 and is not intended to expand the class of persons currently subject to liability under those provisions. The term "fraudulent statement" means a statement that contains an untrue statement of a material fact or omits a material fact necessary in order to make the statements made not misleading. The term "recklessly" is defined to include conduct that is highly unreasonable, and that involved an extreme departure from standards of ordinary care, and that presents a danger of misleading buyers or sellers that was either known to the defendant or so obvious that the defendant must have been consciously aware of it. The provision specifically cites the instance where a defendant genuinely forgot to disclose as an illustration of a situation where a defendant would not be reckless.

Subsection (b) provides that, in any private action to which subsection (a) applies, the plaintiff must specify each statement or omission alleged to have been misleading and must make specific allegations which, if true, would be sufficient to establish that the defendant acted knowingly or recklessly. It is not sufficient for this purpose to plead the mere presence of facts inconsistent with a statement or omission alleged to have been misleading.

The Committee did not intend to overrule Supreme Court precedent on scienter. Rather, given the conflicting lower court decisions in this area, the Committee's purpose was to clearly codify the definition of scienter in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976). In that leading case, the Court made clear that "the language of section 10(b) * * * clearly connotes intentional misconduct," and "its history reflects no more expansive intent."

In footnote 12 of the *Hochfelder* opinion, the Court reserved for later decision whether "recklessness" might, in some cases, reach the level of intentional wrongdoing in section 10(b). Exploiting the opening provided by that footnote, lower federal courts have found, under varying standards, that certain aggravated forms of recklessness amount to intentional misconduct. Across the federal Circuits, however, the courts have been unable either to formulate a clear standard or to apply it consistently. As a result, current case law is a hodgepodge of conflicting decisions, interpreted inconsistently not only from one Circuit to the next but even within Circuits.

The Committee's task was to resolve these inconsistencies and produce a standard that is clear, consistent with the *Hochfelder* standard of intentionality, and capable of being applied in a uniform and consistent manner. As the Second Circuit has explained, "the adjudication process is not well suited to the formulation of a universal resolution of [these] tensions * * *" *In re Time Warner Inc.*, 9 F.3d 259, 263 (2d Cir. 1993). The legislative process is the better way to establish clear rules.

The Committee determined that a standard that includes language quoted from *Sundstrand Corp.* v. *Sun Chem. Corp.*, 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 875 (1977), together with restatement of the type of "intentionality or willfulness" that *Hochfelder* had found is required for liability under section 10(b), would best reconcile the tensions in this area. See *In re Fischbach Corporation Securities Litigation*, No. 89 CIV. 5826 (KMW) (S.D.N.Y. January 15, 1992). The Committee believes that this standard, particularly as it has been applied in the case law of the Second and Seventh Circuits, will provide the degree of consistency and certainty that has been lacking heretofore. In adopting a standard that includes language from the *Sundstrand* case, however, the Committee notes that it in no way intends to codify all of the prior case law—indeed, any particular case—purporting to apply that decision. For example, many of the cases purporting to apply *Sundstrand* have applied negligence concepts that fall far short of "an extreme departure from the standard of ordinary care * * * which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand*, supra, 553 F.2d at 1045 (emphasis added). The Committee expressly disapproves these lax applications of the high standard laid out in that case, and has included language expressly confirming the scienter requirements mandated by *Hochfelder*.

Subsection (c) provides that, in any private action to which subsection (a) applies, if the complaint is dismissed for failure to meet the requirements of subsection (b), the court may permit one amended complaint to be filed. During the pendency of a motion to dismiss pursuant to subsection (b), all discovery and other proceedings are stayed unless the court finds that particularized discovery is necessary to preserve evidence or prevent undue prejudice. This provision also limits a plaintiff's ability to conduct discovery to the facts concerning the allegedly misleading statement or omission.

Subsection (d) provides that, in any private action to which subsection (a) applies, a plaintiff must prove that he or she had knowledge of, and relied on, the misleading statement or omission and that the statement caused the transaction which injured the plaintiff and the loss itself. The subsection provides that in "fraud-on-the-market" cases, reliance may be proven by establishing that the market as a whole considered the fraudulent statement, that the price at which the security was purchased or sold reflected the market's estimation of the fraudulent information, and that the plaintiff reasonably relied on the market price. Where it is shown that the market as a whole considered the fraudulent statement, reliance may be presumed with respect to securities that are listed on a national securities exchange or quoted on the automated quotation system of a national securities association unless such reliance would be unreasonable. In determining reasonableness, the following factors are to be considered:

(A) the weekly trading volume of any class of securities of the issuer of the security;

(B) the existence of public reports by securities analysts concerning any class of securities of the issuer of the security;

(C) the eligibility of the issuer of the security, under the rules and regulations of the Commission, to incorporate by reference its reports made pursuant to section 13 of this title in a registration statement filed under the Securities Act of 1933 in connection with the sale of equity securities; and

(D) a history of immediate movement of the price of any class of securities of the issuer of the security caused by the public dissemination of information regarding unexpected corporate events or financial releases.

Subsection (e) provides that a defendant who is found liable for damages in any private action to which subsection (a) applies, and who is specifically found to have acted knowingly, is jointly and severally liable. If the defendant is not found to have acted knowingly, but merely recklessly, liability is limited to the defendant's percentage of responsibility. In making the determination of responsibility, the fact finder must consider the nature of the conduct of each person, including persons not parties to the action, and the nature and extent of the causal relationship between that conduct and the damage claimed by the plaintiff. This subsection permits contractual indemnification agreements between defendants who are proportionally liable.

Subsection (f) provides that, in a private action under the Exchange Act based on a material misstatement or omission, and in which the plaintiff alleges a fraud-on-the-market theory, a plaintiff's damages are limited to the lesser of: (1) the difference between the price paid by the plaintiff and the market value of the security immediately after dissemination to the market of information correcting the misstatement or omission, or (2) the difference between the price paid by the plaintiff and the price at which the plaintiff sold the security after dissemination to the market of information correcting the misstatement or omission.

SECTION 205. ESTABLISHMENT OF "SAFE HARBOR" FOR PREDICTIVE STATEMENTS

Section 205 amends the Exchange Act by adding a new Section 37, which includes three new subsections. Subsection (a) creates a statutory safe harbor for forward-looking information. Under this provision, in any action (whether it is a Commission action or a private action) arising under the Exchange Act and based on a misstatement or omission of a material fact, a person is not liable for the publication of any forward-looking information if (i) the portion of the information identified as the basis for any projection is "not inaccurate" as of the date of publication, and (ii) the basis for any projections is briefly described therein, and a disclaimer is made concerning the reliability of the projection.

Subsection (b) allows a defendant, in an action based on a misleading forward-looking statement, to move for summary judgment on the basis that the forward-looking statement was within the coverage of this statutory safe harbor, and to obtain a stay of discovery on all issues in the litigation except discovery directed to the specific issue of the applicability of the safe harbor. A hearing on the applicability of the safe harbor must be conducted within 45 days of the issuance of the protective order.

Subsection (c) directs the Commission to adopt rules to facilitate the safe harbor provisions.

SECTION 206. RULE OF CONSTRUCTION

Section 206 provides that nothing in the amendments made by the Act shall be deemed to create or ratify any implied private right of action or prevent the Commission by rule from restricting or otherwise regulating private actions.

SECTION 207. EFFECTIVE DATE

Section 207 provides that the date of enactment shall be the effective date of the amendments made by the Act. The Act shall apply to cases commenced after such date of enactment.

SECURITIES AND EXCHANGE COMMISSION,
Washington, DC, February 23, 1995.

Hon. THOMAS BLILEY,
Chairman, Committee on Commerce, Rayburn House Office Building, Washington, DC.

DEAR MR. CHAIRMAN: On behalf of the Securities and Exchange Commission, I have attached a document that presents our views regarding Title II of H.R. 10, "The Common Sense Legal Reforms Act of 1995."

I respectfully request that the SEC's views be included in the Committee report accompanying Title II of H.R. 10.

Thank you for your consideration.

Sincerely,

ARTHUR LEVITT.

Attachment.

AGENCY VIEWS

The Commission believes that the current version of H.R. 10 represents an improvement over the bill as originally introduced. The Commission greatly appreciates the Committee's responsiveness to our concerns, as reflected by the amendments which have moderated the effect of the fee shifting provisions, preserved liability based on reckless conduct, and preserved the fraud on the market theory of liability.

Although there are provisions in H.R. 10 that the Commission supports, the benefits of these provisions are, in part, offset by the effects of other provisions within H.R. 10. We support the measures that would eliminate some of the most prevalent abuses associated with class action lawsuits, eliminate civil RICO liability predicated on securities law violations (as provided by Title I of H.R. 10), and enact a proportionate scheme of contribution among defendants.

The following discussion addresses provisions of the bill with which the Commission continues to have concerns. With respect to most of these provisions, the Commission is confident that there are solutions that would address the Commission's concerns without sacrificing the objectives of the Committee.

Fee Shifting: Section 203 of H.R. 10 would amend the Securities Exchange Act of 1934 (Exchange Act) by adding new Section 20B. Subsection (c) of new Section 20B would provide that, in any private action under the Exchange Act that is resolved on any basis other than settlement, the court shall award fees to the prevailing party if the prevailing party meets its burden in showing that:

a. The position taken by the losing party was not "substantially justified;"

b. An award against the losing party would be "just;" and

c. The cost of such fees to the prevailing party is "substantially burdensome or unjust."

The bill also contains a special provision for class actions instructing the court to require an undertaking for the payment of fees and expenses, from either the plaintiff class or class counsel, once a case is certified as a class action. Finally, the bill provides the court with discretion to determine whether fees should be awarded against the losing party, its attorneys, or both.

The current fee shifting provisions are less onerous than those included in the original bill, and the Commission appreciates the Committee's sensitivity to the concerns raised by automatic fee shifting. We also recognize that plaintiffs, as well as defendants, may recover fees and expenses. We have concerns, however, about whether the undertaking provision would deter the filing of meritorious suits. Moreover, as pointed out in the Commission's testimony, the "substantially justified" standard is drawn from a statute that applies fee shifting only against the government in cases brought against individuals and small businesses. The use of such a standard in investor lawsuits may also deter the filing of meritorious suits, especially when combined with a requirement to provide security for costs.

The Commission believes that it is important to deter frivolous lawsuits, but to do so in a manner that does not have a chilling effect on investors with legitimate claims. In our view, the key is to provide that judges exercise their discretion to award fees and costs in appropriate cases. The Commission therefore recommends that Congress amend the Exchange Act by adding a provision analogous to Section 11(e) of the Securities Act, coupled with a requirement that courts make findings as to why fees should or should not be awarded whenever cases are decided by means of a dispositive motion. This would help to ensure that judges give effect to the Congressional intent to free the system of meritless litigation. Congress should also make it clear, in such a provision, that a fee award may be awarded against counsel.

Scienter: Section 204 of H.R. 10 would amend the Exchange Act by adding a new Section 10A. Subsection (a) of a new Section 10A would establish scienter standards for "any private action arising under this title based on a misstatement or omission of a material fact." This would have the effect of requiring a showing of scienter in proxy cases brought under Section 14 of the Exchange Act and disclosure cases brought under Section 18, neither of which currently has a scienter requirement, in addition to cases under Section 10(b). It may also redefine the elements of a violation under the proxy provisions. The Commission recommends that an appropriate amendment be made to limit the scienter standards to those sections that require a showing of scienter under current law. The Commission also recommends that the second part of the three part test in Subsection 10A(a) be deleted as redundant, as a defendant's intent to deceive, manipulate or defraud is established by evidence that the defendant knowingly or recklessly made a fraudulent statement.

Subsection 10A(a) would provide that liability in a private action may be based on conduct that satisfies a definition of recklessness based generally on the standard enunciated by the Seventh Circuit Court of Appeals in *Sunstrand Corporation* v. *Sun Chemical Corporation*.[1]

The *Sunstrand* definition has been altered by adding the word "consciously" near the end of the first sentence, and by adding the second sentence, which paraphrases a footnote in the *Sunstrand*

[1] 553 F.2d 1033 (7th Cir.) cert. denied sub nom., *Meers* v. *Sunstrand Corp.*, 434 U.S. 875 (1977).

opinion. The extent to which these amendments would change the result in any particular case is unclear, but the Commission believes that it would be preferable simply to codify the *Sunstrand* definition as currently applied by a majority of the federal circuit courts.

Pleading: For purposes of pleading scienter, subsection (b) of new Section 10A would require a plaintiff to make specific allegations which, if true, would be sufficient to "establish" that the defendant acted knowingly or recklessly. It then adds that "it shall not be for this purpose to plead the mere presence of facts inconsistent with a statement or omission alleged to have been misleading."

As the Commission noted in its testimony, it would be beneficial to resolve the existing split between the circuit courts regarding pleading requirements under Rule 9(b) of the Federal Rules of Civil Procedure. In the Commission's view, however, the standard in H.R. 10 would place unrealistic demands on plaintiffs. The Second Circuit Court of Appeals currently requires that plaintiffs plead with some particularity facts giving rise to a "strong inference" of fraudulent intent on the part of the defendant. This test is regarded as being the most stringent used today, and the Commission recommends that Congress not enact any pleading requirements that go beyond those used by the Second Circuit.

Reliance and Fraud on the Market: The original version of H.R. 10 would have required actual reliance on a fraudulent misstatement or omission, a requirement which would have effectively eliminated cases brought under a fraud on the market theory of liability. The current bill preserves fraud on the market liability in cases involving securities that are listed on a national securities exchange or quoted on an automatic quotation system (e.g. NASDAQ). The Commissions's appreciates the Committee's recognition of the need to preserve this important concept.

The Commission nevertheless has concerns regarding the effect that the reliance requirement in new Section 10A(d) would have in cases involving securities, such as municipal securities, that are not traded on a national securities exchange or quoted on an automatic quotation system. By requiring the plaintiff to establish actual knowledge of, and reliance on, a fraudulent statement, H.R. 10 would eliminate the possibility of recovery for investors in such securities who indirectly rely on the misstatement. Many investors who are injured by fraudulent statements would not be able to meet this test. An investor who did not read a fraudulent statement, for example, may have purchased a stock because he relied on a recommendation from a broker based on the fraudulent statement. The Commission recommends that the language be amended to clarify that both direct and indirect reliance would suffice.

The actual reliance requirement would also overturn existing law in cases based on an omission, as opposed to an affirmative misrepresentation. As the Supreme Court held in *Affiliate Ute Citizens* v. *United States,* 406 U.S. 128 (1972), a positive proof of reliance is not a prerequisite to recovery in a case involving primarily a failure to disclose. It would be preferable simply to codify existing law in this area.

Proportionate Liability: H.R. 10 as introduced did not alter joint and several liability in cases brought under the antifraud provisions. The current bill provides that where the liability of a defendant is based on reckless conduct, as opposed to actual knowledge, the liability of that defendant shall be proportionate rather than joint and several. Unlike other provisions in the bill, this switch to proportionate liability would affect cases that are clearly meritorious (i.e., those in which the plaintiff establishes that the defendants recklessly participated in a fraud).

Joint and several liability is based on the equitable principle that, as between innocent investors and defendants who are found to have knowingly or recklessly participated in a fraud, the risk that one of the defendants will be unable to satisfy its portion of a judgment should fall on the other defendants. The goal of ensuring that defrauded investors are compensated for their losses, in other words, overrides any distinction based on the relative culpability of the defendants.

The Commission has consistently opposed proportionate liability. As stated in the Commission's testimony, if Congress determines to change the liability standards, the Commission recommends that any such change limit the application of proportionate liability to fraud on the market cases involving reckless conduct. Even in such cases, the Commission recommends that Congress ensure that defrauded investors are fairly compensated by adopting an appropriately modified form of such liability. Finally, an issuer of securities should always be held jointly and severally liable.

It should also be noted that new Section 10A(e) would require the trier of fact to determine the percentage of responsibility of the plaintiff in addition to each of the defendants. This appears to incorporate a contributory negligence concept into the calculation, which would be inappropriate in cases based on a defendant's knowing or reckless conduct. This provision should be deleted.

Calculation of Damages: As the Commission noted in its testimony, the proposed limitation on recoverable damages in fraud on the market cases, as set forth in new Section 10A(f), might not reach the appropriate result in certain types of cases. These principally would be cases in which losses attributable to fraudulent statements are offset by other price rises that are unrelated to the fraudulent activity.

Safe Harbor Provisions: The safe harbor provisions have been substantially rewritten since H.R. 10 was originally introduced. The current provisions in Section 205 of H.R. 10 appear to be intended to codify the "bespeaks caution" doctrine and to negate any duty to update statements. The provisions would apply only to cases brought under the Exchange Act.

Because the Commission is in the midst of a rulemaking proceeding, it would be inappropriate to take a position on the substantive safe-harbor provisions. The most appropriate solution to the issue, from the Commission's perspective, would be a provision directing the Commission's perspective, would be a provision directing the Commission to complete its rulemaking proceeding and report back to Congress. This would leave Congress with the option of revisiting the issue if it determined that the Commission had failed appropriately to address the issues.

The provisions mandating the Commission to promulgate rules are also problematic because they can be read to limit the Commission's flexibility. Section (a) of new Exchange Act Section 37, for example, would define a safe harbor that applies to any action under the Exchange Act, including Commission actions. In addition, subsection (c) would instruct the Commission to adopt rules and regulations that "facilitate" the provision in H.R. 10. This would seem to imply that the Commission could not adopt a broader or narrower safe harbor than the one set forth in the statute. Finally, subsection (c) would instruct the Commission to provide a safe harbor only from actions brought under Section 10(b) of the Exchange Act.

The Commission appreciates the Committee's recognition of the important need for reform in the area of private securities litigation, as well as the cooperation you and your staff have extended to us in the course of working to resolve problems raised by the bill as originally introduced. We look forward to working with the Congress as this important legislation progresses.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by title II of the bill, as reported, are shown as follows (new matter is printed in italic and existing law in which no change is proposed is shown in roman):

SECURITIES EXCHANGE ACT OF 1934

* * * * * * *

TITLE I—REGULATION OF SECURITIES EXCHANGES

* * * * * * *

SEC. 10A. REQUIREMENTS FOR SECURITIES FRAUD ACTIONS.

(a) SCIENTER.—

(1) IN GENERAL.—In any private action arising under this title based on a fraudulent statement, liability may be established only on proof that—

(A) the defendant directly or indirectly made a fraudulent statement;

(B) the defendant possessed the intention to deceive, manipulate, or defraud; and

(C) the defendant made such fraudulent statement knowingly or recklessly.

(2) FRAUDULENT STATEMENT.—For purposes of this section, a fraudulent statement is a statement that contains an untrue statement of a material fact, or omits a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.

(3) KNOWINGLY.—For purposes of paragraph (1), a defendant makes a fraudulent statement knowingly if the defendant knew that the statement of a material fact was untrue at the time it was made, or knew that an omitted fact was necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.

(4) RECKLESSNESS.—For purposes of paragraph (1), a defendant makes a fraudulent statement recklessly if the defendant, in

making such statement, is guilty of highly unreasonable conduct that (A) involves not merely simple or even gross negligence, but an extreme departure from standards of ordinary care, and (B) presents a danger of misleading buyers or sellers that was either known to the defendant or so obvious that the defendant must have been consciously aware of it. For example, a defendant who genuinely forgot to disclose, or to whom disclosure did not come to mind, is not reckless.

(b) REQUIREMENT FOR EXPLICIT PLEADING OF SCIENTER.—In any private action to which subsection (a) applies, the complaint shall specify each statement or omission alleged to have been misleading, and the reasons the statement or omission was misleading. The complaint shall also make specific allegations which, if true, would be sufficient to establish scienter as to each defendant at the time the alleged violation occurred. It shall not be sufficient for this purpose to plead the mere presence of facts inconsistent with a statement or omission alleged to have been misleading. If an allegation is made on information and belief, the complaint shall set forth with specificity all information on which that belief is formed.

(c) DISMISSAL FOR FAILURE TO MEET PLEADING REQUIREMENTS; STAY OF DISCOVERY; SUMMARY JUDGMENT.—In any private action to which subsection (a) applies, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of subsection (b) are not met, except that the court may, in its discretion, permit a single amended complaint to be filed. During the pendency of any such motion to dismiss, all discovery and other proceedings shall be stayed unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party. If a complaint satisfies the requirements of subsection (b), the plaintiff shall be entitled to conduct discovery limited to the facts concerning the allegedly misleading statement or omission. Upon completion of such discovery, the parties may move for summary judgment.

(d) RELIANCE AND CAUSATION.—

(1) IN GENERAL.—In any private action to which subsection (a) applies, the plaintiff shall prove that—

(A) he or she had knowledge of, and relied (in connection with the purchase or sale of a security) on, the statement that contained the misstatement or omission described in subsection (a)(1); and

(B) that the statement containing such misstatement or omission proximately caused (through both transaction causation and loss causation) any loss incurred by the plaintiff.

(2) FRAUD ON THE MARKET.—For purposes of paragraph (1), reliance may be proven by establishing that the market as a whole considered the fraudulent statement, that the price at which the security was purchased or sold reflected the market's estimation of the fraudulent statement, and that the plaintiff relied on that market price. Proof that the market as a whole considered the fraudulent statement may consist of evidence that the statement—

(A) was published in publicly available research reports by analysts of such security;

(B) was the subject of news articles;

(C) was delivered orally at public meetings by officers of the issuer, or its agents;

(D) was specifically considered by rating agencies in their published reports; or

(E) was otherwise made publicly available to the market in a manner that was likely to bring it to the attention of, and to be considered as credible by, other active participants in the market for such security.

Nonpublic information may not be used as proof that the market as a whole considered the fraudulent statement.

(3) PRESUMPTION OF RELIANCE.—Upon proof that the market as a whole considered the fraudulent statement pursuant to paragraph (2), the plaintiff is entitled to a rebuttable presumption that the price at which the security was purchased or sold reflected the market's estimation of the fraudulent statement and that the plaintiff relied on such market price. This presumption may be rebutted by evidence that—

(A) the market as a whole considered other information that corrected the allegedly fraudulent statement; or

(B) the plaintiff possessed such corrective information prior to the purchase or sale of the security.

(4) REASONABLE EXPECTATION OF INTEGRITY OF MARKET PRICE.—A plaintiff who buys or sells a security for which it is unreasonable to rely on market price to reflect all current information may not establish reliance pursuant to paragraph (2). For purposes of paragraph (2), the following factors shall be considered in determining whether it was reasonable for a party to expect the market price of the security to reflect substantially all publicly available information regarding the issuer of the security:

(A) The weekly trading volume of any class of securities of the issuer of the security.

(B) The existence of public reports by securities analysts concerning any class of securities of the issuer of the security.

(C) The eligibility of the issuer of the security, under the rules and regulations of the Commission, to incorporate by reference its reports made pursuant to section 13 of this title in a registration statement filed under the Securities Act of 1933 in connection with the sale of equity securities.

(D) A history of immediate movement of the price of any class of securities of the issuer of the security caused by the public dissemination of information regarding unexpected corporate events or financial releases.

In no event shall it be considered reasonable for a party to expect the market price of the security to reflect substantially all publicly available information regarding the issuer of the security unless the issuer of the security has a class of securities listed and registered on a national securities exchange or quoted on the automated quotation system of a national securities association.

(e) ALLOCATION OF LIABILITY.—

(1) JOINT AND SEVERAL LIABILITY FOR KNOWING FRAUD.—A defendant who is found liable for damages in a private action to which subsection (a) applies may be liable jointly and severally only if the trier of fact specifically determines that the defendant acted knowingly (as defined in subsection (a)(3)).

(2) PROPORTIONATE LIABILITY FOR RECKLESSNESS.—If the trier of fact does not make the findings required by paragraph (1) for joint and several liability, a defendant's liability in a private action to which subsection (a) applies shall be determined under paragraph (3) of this subsection only if the trier of fact specifically determines that the defendant acted recklessly (as defined in subsection (a)(4)).

(3) DETERMINATION OF PROPORTIONATE LIABILITY.—If the trier of fact makes the findings required by paragraph (2), the defendant's liability shall be determined as follows:

(A) The trier of fact shall determine the percentage of responsibility of the plaintiff, of each of the defendants, and of each of the other persons or entities alleged by the parties to have caused or contributed to the harm alleged by the plaintiff. In determining the percentages of responsibility, the trier of fact shall consider both the nature of the conduct of each person and the nature and extent of the causal relationship between that conduct and the damage claimed by the plaintiff.

(B) For each defendant, the trier of fact shall then multiply the defendant's percentage of responsibility by the total amount of damage suffered by the plaintiff that was caused in whole or in part by that defendant and the court shall enter a verdict or judgment against the defendant in that amount. No defendant whose liability is determined under this subsection shall be jointly liable on any judgment entered against any other party to the action.

(C) Except where contractual relationship permits, no defendant whose liability is determined under this paragraph shall have a right to recover any portion of the judgment entered against such defendant from another defendant.

(4) EFFECT OF PROVISION.—This subsection relates only to the allocation of damages among defendants. Nothing in this subsection shall affect the standards for liability under any private action arising under this title.

(f) DAMAGES.—In any private action to which subsection (a) applies, and in which the plaintiff claims to have bought or sold the security based on a reasonable belief that the market value of the security reflected all publicly available information, the plaintiff's damages shall not exceed the lesser of—

(1) the difference between the price paid by the plaintiff for the security and the market value of the security immediately after dissemination to the market of information which corrects the fraudulent statement; and

(2) the difference between the price paid by the plaintiff for the security and the price at which the plaintiff sold the security after dissemination of information correcting the fraudulent statement.

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REGISTRATION AND REGULATION OF BROKERS AND DEALERS

SEC. 15. (a)(1) * * *

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(c)(1)(A) No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange of which it is a member by means of any manipulative, deceptive, or other fraudulent device or contrivance.

* * * * * * *

(8) RECEIPT OF REFERRAL FEES.—No broker or dealer, or person associated with a broker or dealer, may solicit or accept remuneration for assisting an attorney in obtaining the representation of any customer in any private action under this title.

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PROCEDURES APPLICABLE TO PRIVATE ACTIONS

SEC. 20B. (a) ELIMINATION OF BONUS PAYMENTS TO NAMED PLAINTIFFS IN CLASS ACTIONS.—In any private action under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the portion of any final judgment or of any settlement that is awarded to class plaintiffs serving as the representative parties shall be equal, on a per share basis, to the portion of the final judgment or settlement awarded to all other members of the class. Nothing in this subsection shall be construed to limit the award to any representative parties of actual expenses (including lost wages) relating to the representation of the class.

(b) RESTRICTIONS ON PROFESSIONAL PLAINTIFFS.—Except as the court may otherwise permit for good cause, a person may be a named plaintiff, or an officer, director, or fiduciary of a named plaintiff, in no more than 5 class actions filed during any 3-year period.

(c) AWARDS OF FEES AND EXPENSES.—

(1) AUTHORITY TO AWARD FEES AND EXPENSES.—If the court in any private action arising under this title enters a final judgment against a party litigant on the basis of a motion to dismiss, motion for summary judgment, or a trial on the merits, the court shall, upon motion by the prevailing party, determine whether (A) the position of the losing party was not substantially justified, (B) imposing fees and expenses on the losing party or the losing party's attorney would be just, and (C) the cost of such fees and expenses to the prevailing party is substantially burdensome or unjust. If the court makes the determinations described in clauses (A), (B), and (C), the court shall award the prevailing party reasonable fees and other expenses incurred by that party. The determination of whether the position of the losing party was substantially justified shall be made on the basis of the record in the action for which fees and other expenses are sought, but the burden of persuasion shall be on the prevailing party.

(2) SECURITY FOR PAYMENT OF COSTS IN CLASS ACTIONS.—In any private action arising under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, the court shall require an undertaking from the attorneys for the plaintiff class, the plaintiff class, or both, in such proportions and at such times as the court determines are just and equitable, for the payment of the fees and expenses that may be awarded under paragraph (1).

(3) APPLICATION FOR FEES.—A party seeking an award of fees and other expenses shall, within 30 days of a final, nonappealable judgment in the action, submit to the court an application for fees and other expenses that verifies that the party is entitled to such an award under paragraph (1) and the amount sought, including an itemized statement from any attorney or expert witness representing or appearing on behalf of the party stating the actual time expended and the rate at which fees and other expenses are computed.

(4) ALLOCATION AND SIZE OF AWARD.—The court, in its discretion, may—

(A) determine whether the amount to be awarded pursuant to this section shall be awarded against the losing party, its attorney, or both; and

(B) reduce the amount to be awarded pursuant to this section, or deny an award, to the extent that the prevailing party during the course of the proceedings engaged in conduct that unduly and unreasonably protracted the final resolution of the action.

(5) AWARDS IN DISCOVERY PROCEEDINGS.—In adjudicating any motion for an order compelling discovery or any motion for a protective order made in any private action arising under this title, the court shall award the prevailing party reasonable fees and other expenses incurred by the party in bringing or defending against the motion, including reasonable attorneys' fees, unless the court finds that special circumstances make an award unjust.

(6) RULE OF CONSTRUCTION.—Nothing in this subsection shall be construed to limit or impair the discretion of the court to award costs pursuant to other provisions of law.

(7) PROTECTION AGAINST ABUSE OF PROCESS.—In any action to which this subsection applies, a court shall not permit a plaintiff to withdraw from or voluntarily dismiss such action if the court determines that such withdrawal or dismissal is taken for purposes of evasion of the requirements of this subsection.

(8) DEFINITIONS.—For purposes of this subsection—

(A) The term "fees and other expenses" includes the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorneys' fees and expenses. The amount of fees awarded under this section shall be based upon prevailing market rates for the kind and quality of services furnished.

(B) The term "substantially justified" shall have the same meaning as in section 2412(d)(1) of title 28, United States Code.

(d) PREVENTION OF ABUSIVE CONFLICTS OF INTEREST.—In any private action under this title pursuant to a complaint seeking damages on behalf of a class, if the class is represented by an attorney who directly owns or otherwise has a beneficial interest in the securities that are the subject of the litigation, the court shall, on motion by any party, make a determination of whether such interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the class.

(e) DISCLOSURE OF SETTLEMENT TERMS TO CLASS MEMBERS.—In any private action under this title that is certified as a class action pursuant to the Federal Rules of Civil Procedure, any settlement agreement that is published or otherwise disseminated to the class shall include the following statements:

(1) STATEMENT OF POTENTIAL OUTCOME OF CASE.—

(A) AGREEMENT ON AMOUNT OF DAMAGES AND LIKELIHOOD OF PREVAILING.—If the settling parties agree on the amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title and the likelihood that the plaintiff would prevail—

(i) a statement concerning the amount of such potential damages; and

(ii) a statement concerning the likelihood that the plaintiff would prevail on the claims alleged under this title and a brief explanation of the reasons for that conclusion.

(B) DISAGREEMENT ON AMOUNT OF DAMAGES OR LIKELIHOOD OF PREVAILING.—If the parties do not agree on the amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title or on the likelihood that the plaintiff would prevail on those claims, or both, a statement from each settling party concerning the issue or issues on which the parties disagree.

(C) INADMISSIBILITY FOR CERTAIN PURPOSES.—Statements made in accordance with subparagraphs (A) and (B) concerning the amount of damages and the likelihood of prevailing shall not be admissible for purposes of any Federal or State judicial action or administrative proceeding.

(2) STATEMENT OF ATTORNEYS' FEES OR COSTS SOUGHT.—If any of the settling parties or their counsel intend to apply to the court for an award of attorneys' fees or costs from any fund established as part of the settlement, a statement indicating which parties or counsel intend to make such an application, the amount of fees and costs that will be sought (including the amount of such fees and costs determined on a per-share basis, together with the amount of the settlement proposed to be distributed to the parties to suit, determined on a per-share basis), and a brief explanation of the basis for the application. Such information shall be clearly summarized on the cover page of any notice to a party of any settlement agreement.

(3) IDENTIFICATION OF LAWYERS' REPRESENTATIVES.—The name and address of one or more representatives of counsel for the class who will be reasonably available to answer written questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

(4) OTHER INFORMATION.—Such other information as may be required by the court, or by any plaintiff steering committee appointed by the court pursuant to section 36.

(f) ENCOURAGEMENT OF FINALITY IN SETTLEMENT DISCHARGES.—

(1) DISCHARGE.—A defendant who settles any private action arising under this title at any time before verdict or judgment shall be discharged from all claims for contribution brought by other persons with respect to the matters that are the subject of such action. Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling defendant arising out of the action. The order shall bar all future claims for contribution or indemnity arising out of the action—

(A) by nonsettling persons against the settling defendant; and

(B) by the settling defendant against any nonsettling defendants.

(2) REDUCTION.—If a person enters into a settlement with the plaintiff prior to verdict or judgment, the verdict or judgment shall be reduced by the greater of—

(A) an amount that corresponds to the percentage of responsibility of that person; or

(B) the amount paid to the plaintiff by that person.

(g) CONTRIBUTION FROM NON-PARTIES IN INTERESTS OF FAIRNESS.—

(1) RIGHT OF CONTRIBUTION.—A person who becomes liable for damages in any private action under this title (other than an action under section 9(e) or 18(a)) may recover contribution from any other person who, if joined in the original suit, would have been liable for the same damages.

(2) STATUTE OF LIMITATIONS FOR CONTRIBUTION.—Once judgment has been entered in any such private action determining liability, an action for contribution must be brought not later than 6 months after the entry of a final, nonappealable judgment in the action.

(h) DEFENDANT'S RIGHT TO WRITTEN INTERROGATORIES ESTABLISHING SCIENTER.—In any private action under this title in which the plaintiff may recover money damages, the court shall, when requested by a defendant, submit to the jury a written interrogatory on the issue of each such defendant's state of mind at the time the alleged violation occurred.

INVESTIGATIONS; INJUNCTIONS AND PROSECUTION OF OFFENSES

SEC. 21. (a) * * *

* * * * * * *

(d)(1) Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Muncipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

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(4) PROHIBITION ON ATTORNEYS' FEES PAID FROM COMMISSION DISGORGEMENT FUNDS.—Except as otherwise ordered by the court, funds disgorged as the result of an action brought by the Commission, or of any Commission proceeding, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.

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SEC. 36. CLASS ACTION STEERING COMMITTEES.

(a) CLASS ACTION STEERING COMMITTEE.—In any private action arising under this title seeking to recover damages on behalf of a class, the court shall, at the earliest practicable time, appoint a committee of class members to direct counsel for the class (hereafter in this section referred to as the "plaintiff steering committee") and to perform such other functions as the court may specify. Court appointment of a plaintiff steering committee shall not be subject to interlocutory review.

(b) MEMBERSHIP OF PLAINTIFF STEERING COMMITTEE.—

(1) QUALIFICATIONS.—

(A) NUMBER.—A plaintiff steering committee shall consist of not fewer than 5 class members, willing to serve, who the court believes will fairly represent the class.

(B) OWNERSHIP INTERESTS.—Members of the plaintiff steering committee shall have cumulatively held during the class period not less than—

(i) the lesser of 5 percent of the securities which are the subject matter of the litigation or $10,000,000 in market value of the securities which are the subject matter of the litigation; or

(ii) such smaller percentage or dollar amount as the court finds appropriate under the circumstances.

(2) NAMED PLAINTIFFS.—Class plaintiffs serving as the representative parties in the litigation may serve on the plaintiff steering committee, but shall not comprise a majority of the committee.

(3) NONCOMPENSATION OF MEMBERS.—Members of the plaintiff steering committee shall serve without compensation, except that any member may apply to the court for reimbursement of reasonable out-of-pocket expenses from any common fund established for the class.

(4) MEETINGS.—The plaintiff steering committee shall conduct its business at one or more previously scheduled meetings of the committee, of which prior notice shall have been given and at which a majority of its members are present in person or by electronic communication. The plaintiff steering committee shall decide all matters within its authority by a majority vote of all members, except that the committee may determine that decisions other than to accept or reject a settlement offer or to employ or dismiss counsel for the class may be delegated to one or more members of the committee, or may be voted upon by committee members seriatim, without a meeting.

(5) RIGHT OF NONMEMBERS TO BE HEARD.—A class member who is not a member of the plaintiff steering committee may appear and be heard by the court on any issue relating to the organization or actions of the plaintiff steering committee.

(c) FUNCTIONS OF PLAINTIFF STEERING COMMITTEE.—The authority of the plaintiff steering committee to direct counsel for the class shall include all powers normally permitted to an attorney's client in litigation, including the authority to retain or dismiss counsel and to reject offers of settlement, and the authority to accept an offer of settlement subject to final approval by the court. Dismissal of counsel other than for cause shall not limit the ability of counsel to enforce any contractual fee agreement or to apply to the court for a fee award from any common fund established for the class.

(d) IMMUNITY FROM CIVIL LIABILITY; REMOVAL.—Any person serving as a member of a plaintiff steering committee shall be immune from any civil liability for any negligence in performing such service, but shall not be immune from liability for intentional misconduct or from the assessment of costs pursuant to section 20B(c). The court may remove a member of a plaintiff steering committee for good cause shown.

(e) EFFECT ON OTHER LAW.—This section does not affect any other provision of law concerning class actions or the authority of the court to give final approval to any offer of settlement.

SEC. 37. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

(a) SAFE HARBOR DEFINED.—In any action arising under this title based on a fraudulent statement (within the meaning of section 10A), a person shall not be liable for the publication of any projection if—

(1) the basis for such projection is briefly described therein, with citations (which may be general) to representative sources or authority, and a disclaimer is made to alert persons for whom such information is intended that the projections should not be given any more weight than the described basis therefor would reasonably justify; and

(2) the basis for such projection is not inaccurate as of the date of publication, determined without benefit of subsequently

available information or information not known to such person at such date.

(b) AUTOMATIC PROTECTIVE ORDER STAYING DISCOVERY; EXPEDITED PROCEDURE.—In any action arising under this title based on a fraudulent statement (within the meaning of section 10A) by any person, such person may, at any time beginning after the filing of the complaint and ending 10 days after the filing of such person's answer to the complaint, move to obtain an automatic protective order under the safe harbor procedures of this section. Upon such motion, the protective order shall issue forthwith to stay all discovery as to the moving party, except that which is directed to the specific issue of the applicability of the safe harbor. A hearing on the applicability of the safe harbor shall be conducted within 45 days of the issuance of such protective order. At the conclusion of the hearing, the court shall either (1) dismiss the portion of the action based upon the use of a projection to which the safe harbor applies, or (2) determine that the safe harbor is unavailable in the circumstances.

(c) REGULATORY AUTHORITY.—In consultation with investors and issuers of securities, the Commission shall adopt rules and regulations to facilitate the safe harbor provisions of this section. Such rules and regulations shall—

(1) include clear and objective guidance that the Commission finds sufficient for the protection of investors,

(2) prescribe such guidance with sufficient particularity that compliance shall be readily ascertainable by issuers prior to issuance of securities, and

(3) provide that projections that are in compliance with such guidance and that concern the future economic performance of an issuer of securities registered under section 12 of this title will be deemed not to be in violation of section 10(b) of this title.

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MINORITY VIEWS

We strongly support the goal of deterring meritless securities class action lawsuits. The record before this Committee establishes that such lawsuits can be costly to defend and may needlessly distract corporate officials who work honestly and diligently to help their companies prosper in an increasingly competitive economic climate.

But the record before this Committee also establishes—unequivocally—that our system of private litigation under the federal securities laws has functioned effectively as a "necessary"[1] and "essential"[2] supplement to the enforcement program of the U.S. Securities and Exchange Commission (SEC). Private class actions are "crucial to the integrity of our disclosure system "[3] because they provide a "powerful deterrent"[4] to those who might consider ignoring or fraudulently evading their obligations to the investing public. Private class actions also provide an irreplaceable means of compensating millions of defrauded individual investors. According to a staff report on private securities litigation prepared by the Senate Subcommittee on Securities, "a long list of notorious cases have recovered billions of dollars for defrauded investors."[5]

The conclusion to be drawn from these facts is clear. Legislative reforms aimed at frivolous or meritless securities class action lawsuits are needed. But the reforms must be carefully crafted, because the antifraud provisions of the federal securities laws are one of the nation's most important weapons in the continuing response to ever larger and more complex financial scandals that recur too frequently on Wall Street. At the first hearing on the subject of securities litigation reform held by the Subcommittee on Telecommunications and Finance last year, Arthur Levitt, Chairman of the SEC implored Members to keep these facts in mind:

> I thought during my service as head of Shearson and then head of the American Stock Exchange, that I had seen just about every kind of public fraud that could possible be perpetrated on individual investors. And then I

[1] See, e.g., *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 310 (1985); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

[2] See e.g., "Hearing on Securities Fraud Litigation Reform Proposals Before the Subcommittee on Telecommunications & Finance of the House Committee on Commerce," (Feb. 10, 1995) (Oral testimony of Arthur Levitt, Chairman, SEC); "Securities Investor Protection Act of 1991: Hearing Before the Subcommittee on Securities of the Senate Committee on Banking, Housing & Urban Affairs," (Oct. 2, 1991) at 3–4 (Testimony of Richard C. Breeden, Chairman, SEC) ("[p]rivate litigation is an essential element in enforcing the rights of the more than 50 million Americans who participate in the U.S. securities markets").

[3] "Hearing on Securities Fraud Litigation Reform Proposals Before the Subcommittee on Telecommunications & Finance of the House Committee on Commerce," (Feb. 10, 1995) (Testimony of Arthur Levitt, Chairman, SEC) at 1.

[4] Id. at 30.

[5] "Private Securities Litigation, Staff Report Prepared At The Direction of Senator Christopher J. Dodd, Chairman, Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs," United States Senate, (May 17, 1994) at 10.

> came to the Commission, and week by week hearing cases, seeing what is going on in this country, how many people are out there taking advantage of innocent individual shareholders dwarfed anything I had ever experienced before and convinced me in a way that no amount of experience or reading or anecdotal information could possibly have persuaded me of the vital and compelling importance and mandate of the Commission, above everything else that it has to do in terms of governance issues and legislative issues, the critical important of protecting individual investors. So anything that is suggested which raises the hurdle for those investors to right these wrongs is something that I have to look at with great care and circumspection. The abuses you speak of are there. * * * But, again, in the balance between the interests of investors and the interests of a better system, a better system is important, but it can't be at the expense of those investors.

Rather than cutting off access to the courts, we must ensure that the private litigation system works more responsibly and effectively. Abusive practices must be deterred and, where appropriate, sternly sanctioned. But individual investors, who honestly believe they have been defrauded, must also be assured that the doorway to the American system of civil justice remains open, and that the law remains available to protect them and their families. Every Democrat on this Committee is prepared to support enthusiastically legislation that strikes this crucial balance. But legislation that succeeds in stopping frivolous cases only by making it equally impossible to pursue those who were responsible for calamities like the billion dollar frauds at Drexel Burnham Lambert, Lincoln Savings and Loan, Prudential Securities, the Washington Public Power Supply System, Salomon Brothers, CenTrust Savings, and perhaps even the Orange County bankruptcy, to name but a few, obviously fails to achieve this needed balance and will not have our support.

In our judgment, Title II of H.R. 10, as reported by the Committee, utterly fails to pass this simple test of balance and fairness. Notwithstanding hastily drafted last-minute changes,[6] this bill represents a drastic overreaction to the problem of meritless class action lawsuits.[7] The misguided and counterproductive approach set forth in the bill will have profoundly harmful consequences for small individual investors and, ultimately, for their confidence in the fairness of our capital markets. Many of the bill's sweeping pro-

[6] As enshrined in the Republicans' Contract With America, Title II of H.R. 10 was even more draconian. It removed from the securities laws prohibitions against reckless conduct by corporate officials and their financial advisers. In effect, it also ensured that no class action lawsuit for securities fraud would or could be brought in the federal courts. It accomplished this by eliminating the ability of investors to argue that the market itself had been defrauded, by imposing an absolute "loser pays" attorney fee shifting requirement in all securities fraud cases, and by requiring that investors plead at the outset of the case specific facts demonstrating a defendant's state of mind, a task most legal experts view as impossible at any time during a lawsuit.

[7] In a speech delivered in early 1994, SEC Chairman Levitt noted that "the number of securities law cases has not increased during the past two decades. Class action filings have increased over the past three years, but they do not exceed the levels that prevailed during the 1970's. When measured against the number of public offerings and the volume of trading on NASDAQ and the exchanges, the amount of securities litigation has actually declined." Speech by Arthur Levitt, Chairman, SEC, January 26, 1994.

visions bear no logical relation to the evidence and testimony presented to the Congress during the last two years.[8] And, paradoxically, the bill's contradictory, confused, and ambiguous provisions, if enacted, would cause years of needless and enormously wasteful litigation in the federal courts.

In light of the failure of the Republicans to respond adequately to concerns about the egregious impact this bill will have on average investors and on the integrity of the market,[9] the breadth of opposition to the bill that continues to emerge is not surprising. On the day before this Committee marked up Title II of H.R. 10, the SEC stated that:

> Because of the potential impact on U.S. investors and markets, the Commission cannot support the proposed provisions. * * * While the SEC supports Congressional efforts to curb abuses, we reiterate our first priority: the rights of American investors and the integrity of the American capital markets must be held paramount.

We agree:

In addition to the SEC, the securities regulators from the fifty states, and municipal finance officers from across the nation oppose all of the key elements of Title II of H.R. 10. So do groups that represent retirees, many of whom have invested their life's savings, or insurance proceeds, or the equity from their homes in the securities market. These groups include the American Association of Retired Persons, the National Council of Senior Citizens, and the Gray Panthers. As of February 22, 1995, ninety-five of the nation's leading scholars in the field of corporate and securities law had signed a petition opposing the enactment of H.R. 10. Major consumer organizations, including the Consumer Federation of America, Consumer's Union (publisher of the widely respected Consumer Reports), Public Citizen, and the U.S. Public Interest Research Group, are unified in their opposition to Title II of H.R. 10. So too are many large pension funds, including those representing present and future retirees from the AFL–CIO, the Teamsters, the Machinists, and the Fraternal Order of Police. The American Bar Association, the well respected group that represents lawyers from every field of law, and the Association of the Bar of the City of New York, the nation's most respected group of securities law experts, also oppose the key elements of H.R. 10.

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[8] For example, the onerous new rules established by this legislation are not limited to class actions brought under Section 10(b) of the Securities Exchange Act of 1934 (''Exchange Act''), about which the Subcommittee on Telecommunications and Finance received ample testimony. Instead, for reasons that have never been explained and have no basis in the record, they will apply to all private actions brought under the Exchange Act. We have been unable to locate any testimony presented to the Subcommittee which analyzes or argues in support of these changes. Moreover, the most significant decisions in the federal courts draw important distinctions between, for example, the culpability standards under Sections 10(b) and 14(e) of the Exchange Act. Yet, with one entirely unexplained sweep of its hand, the Committee upsets decades of thoughtful and careful securities caselaw by superimposing it proposed new Section 10(b) requirements to actions brought under Section 14(a).

[9] Among other things, the Republicans made changes that deleted the guardian ad litem and the alternative dispute resolution procedure provisions; deleted the discriminatory investment restrictions on potential named plaintiffs with small holdings; ameliorated the potentially unconstitutional aspects of the restrictions on professional plaintiffs; removed SEC enforcement actions from the bill's restrictions; restored controlling person liability, liability for recklessness, and the fraud on the market theory of reliance; and modified the loser pays, scienter, pleading, and safe harbor for predictive statement provisions. However, as discussed infra, some of these revisions have served to make the bill worse rather than better.

Even Herbert Stein, a resident scholar at the conservative American Enterprise Institute and former Chairman of the Council of Economic Advisers under Presidents Nixon and Ford, believes that Title II of H.R. 10 is badly out of balance. In a recent article in The New York Times,[10] he suggests that H.R. 10's authors and principal supporters have lost touch with the real concerns of middle class Americans and the complex realities of our financial markets.

> [F]rivolous lawsuits can be an unnecessary drain on the system. But a much more serious problem is assuring the middle-class investor that the people to whom he entrusts his money will look after his interest honestly and diligently. The possibility of recourse to the judicial system is integral to that assurance, and the proposals in the [Contract With America] would weaken it.

THE LOSER ALMOST ALWAYS PAYS PROVISION: BARRICADING THE COURTHOUSE DOOR TO SMALL INVESTORS

Since the nation's founding over 200 years ago, our national policy has consistently favored fair and equal access to justice. Title II of H.R. 10 would significantly undermine this longstanding and treasured national policy by imposing a version of the so-called "English Rule" on American litigants and federal courts. Under the English Rule, the losing party must pay all of the attorneys' fees and other costs and expenses of the prevailing party.

Contrary to claims advanced in support of H.R. 10's version of the English Rule, the award of fees to the prevailing party will be mandatory. A court would be able to prevent the shifting of fees to the losing party only if each of three demanding (and somewhat confusing) conditions are met. First, the court must conclude that the losing party's "position" was "substantially justified." Second, the court must find that imposing the fees on the losing party is not unjust. And third, the court must find that the prevailing party would be substantially burdensome or unjust if imposed on the losing party. Again, unless all three requirements are satisfied, the court must shift all of the prevailing party's fees and expenses to the losing party.

In addition to establishing a "loser almost always pays" rule of fee shifting, H.R. 10 imposes a costly and hopelessly burdensome requirement applicable only to the investors. Either the investors or their attorneys will be required to post security at the beginning of the case to provide for the payment of the defendant's attorneys' fees and other expenses in the event that fees are shifted. While no such requirement is imposed on defendants (even though, in almost all instances, it would be much easier for them to do so), the lack of equivalent treatment misses the point.

During hearings before the Subcommittee on Telecommunications and Finance, numerous witnesses and Members warned that this fee shifting provision (and its even more onerous predecessor) would effectively end all private actions by small investors who are victims of fraud.[11] Victims—including even those with the

[10] "Letting Wall Street Off Easy," New York Times, Wednesday, February 15, 1995, at A21.
[11] See, e.g., "Hearings on Federal Securities Fraud Litigation Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce." (Aug. 10,

strongest cases—will not be able to stand up and sue, either on their own, or as the champion of a class of similarly situated investors, if by doing so they are exposed to the risk of paying millions in legal fees to large public corporations, investment banking houses, accounting firms, and law firms.[12]

SEC Chairman Arthur Levitt emphasized this point in his recent appearance before the Subcommittee. "In class action lawsuits, in particular, individual plaintiffs frequently stand to recover only a small amount if they prevail. Their potential liability under an automatic fee shifting provision would be totally disproportionate to their potential recovery."

The arguments in opposition to the various forms of the English Rule that have been proposed were also recently buttressed by a surprising but powerful and authoritative source: the respected conservative weekly, The Economist. In its British edition of January 14, 1995, the magazine forcefully argued that Britain should abandon its "loser pays" rule. According to The Economist, this rule was dramatically eroding the legitimacy of the British civil justice system. "Enormous numbers of mostly middle-class people" simply cannot use the courts, The Economist said, because they must pay for the other side's lawyers if they lose. "For most people, this means that they are risking financial ruin" if they choose to go to court, no matter how justified or serious their underlying complaint may be. Today in Britain, The Economist noted, "only the very wealthy can afford the costs and risks of most litigation. This offends one of the most basic principles of a free society: equality before the law."

Common sense suggests to us that the standards for shifting fees and the provision requiring investors to post security that are contained in the present version of H.R. 10 have been poorly thought out and will likely have highly undesirable consequences. For example, while the term "substantially justified" is apparently borrowed from the Equal Access to Justice Act ("EAJA"), none of the provisions of that statute that modify and limit its applicability have been included in H.R. 10.[13]

1994) (testimony of Professor Arthur Miller) at 14 ("As a practical matter, fee shifting is almost invariably in intimidation device designed to inhibit people from seeking access to the courts. Fee shifting would eviscerate all—or virtually all—plaintiffs' securities claims, the meritorious along with the meritless."); (testimony of Professor John Coffee, Jr.) at 16 ("Clearly, some proposed reforms—such as the English rule under which the loser pays the winner's legal expenses—would probably end securities class actions in all except rare cases of flagrant fraud."); (oral testimony of Professor Joel Seligman) ("[T]he one proposal that is on the table that I find most objectionable and [am] most strongly troubled by is the English fee shifting rule. * * * This is the rule, if adopted, that would basically have the tendency to prevent meritorious lawsuits from going forward."). It should be noted that this testimony was received in opposition to the fee shifting provision in H.R. 417 in the 103d Congress, a proposal that was less demanding on investors than the provision presently contained in H.R. 10.

[12] See, e.g., "Hearings on Private Litigation Under the Federal Securities Laws, Senate Subcommittee on Securities of the Senate Committee on Banking, Housing & Urban Affairs," (June 17 & July 21, 1993) (testimony of Gordon Billip, defrauded investor) at 71 ("If the law had required [my wife] Betty and me and other bond-holders and our lawyers to pay the defendants' exorbitant legal fees if we were to lose the case, we never would have stuck our necks out to represent the 2,000 investors, many of whom had invested the savings of a lifetime."); (testimony of Russell E. Ramser, Jr., defrauded investor) at 74 ("Although I was comfortable in my belief that the bondholders had been wronged by the accounting firms, I would not have filed this suit if, in addition to devoting my time to the case, I would have been required to pay their millions of dollars of attorneys' fees in the event that the jury, or a judge, did not agree with me.").

[13] See Pub. L. No. 96–481, 94 Stat. 2325 (1980) (codified at 5 U.S.C. § 504 and 28 U.S.C. § 2412). Under the EAJA, the federal government can be required to pay a private party's attor-

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Notwithstanding our objections to the 'loser almost always pays" provision in H.R. 10, we would support a reasonable fee-shifting proposal. In fact, Congressman Manton offered an amendment at the full Committee mark-up that would have established a fair and balanced mandatory fee-shifting scheme for cases (or defenses) that were frivolous or asserted in bad faith. But, because debate was cut off by the Republicans, there was no opportunity for Mr. Manton or his colleagues to present to the Committee the strong policy arguments that support his approach. In the absence of any debate on the issue, it came as no surprise that Mr. Manton's amendment was defeated in a straight party line vote.

Because of the deep and lasting chilling effect it will have on investors who have a legitimate basis for pursuing a securities fraud claim in court, we strongly oppose H.R. 10's "lower almost always pays" provision and its requirement that investors post security before being allowed to proceed with their case.

RECKLESS CONDUCT AS EVIDENCE OF SCIENTER: ITS RESTORATION IS AN ILLUSION

As introduced, Title II of H.R. 10 proposed to radically increase the burden on investors seeking to prove a case of fraud under the federal securities laws, and to dramatically restrict the circumstances in which a corporation or one of its financial advisors could be charged with fraud.[14] One of the bill's most troubling provisions was its extraordinary reversal of an unbroken string of court rulings over the last twenty years. In this long series of decisions, every federal appellate court that considered the issue concluded that a defendant who acted recklessly would be deemed to have acted with the "scienter" needed to prove securities fraud.[15]

The original version of H.R. 10 assigned no value to the fact that the recklessness standard had for twenty years been a crucial element of our public policy of maintaining fair and honest financial markets. As initially proposed in the Contract With America, even extreme types of recklessness would no longer have been prohibited by the antifraud provisions of the securities laws.

But virtually all experts in the field of securities law believe that liability for recklessness is critical if the antifraud laws are to suc-

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neys' fees and other costs if a court determines that the government's position was not "substantially justified." But fees cannot be shifted onto any party other than the government. And attorneys' fees and costs may only be pursued against the government under this unusual statute if the party seeking the sanction is either an individual with a net worth of under $200,000, a tax-exempt organization, or a business with a net worth of under $7 million and fewer than 500 employees. While we obviously are not familiar with all the details that led to the promulgation of the EAJA's "substantially justified" standard, it is evident that care was taken to limit its applicability so as not to preclude the government from pursuing legitimate cases. There are no such limitations in this bill.

[14] As originally drafted, these new liability standards were intended to cut back on the ability of the SEC to bring enforcement actions as well as to restrict individual investors who sought to bring private actions. In part because of strenuous objections from Members and other concerned observers, the language that had applied these provisions to the SEC was removed. We have now been assured by the Republicans that H.R. 10 will not affect (and is not intended to affect) any aspect of the SEC's enforcement of the antifraud provisions of the securities laws.

[15] See, e.g., *Rolf* v. *Blyth, Eastman Dillon & Co.,* 570 F.2d 38, 46–47 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); *McLean* v. *Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Broad* v. *Rockwell Int'l Corp.,* 642 F.2d 929, 961–962 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981); *Mansbach* v. *Prescott, Ball & Turben,* 598 F.2d 1017, 1024 (6th Cir. 1979); *Sundstrand Corp.* v. *Sun Chem. Corp.,* 553 F.2d 1033, 1044 (7th Cir.), cert. denied, 434 U.S. 875 (1977); *Van Dyke* v. *Coburn Enterprises, Inc.,* 873 F.2d 1094, 1100 (8th Cir. 1989); *Nelson* v. *Serwold,* 576 F.2d 1332, 1337 (9th Cir.), cert. denied, 439 U.S. 970 (1978); *Hackbart* v. *Holmes,* 675 F.2d 1114, 1117 (10th Cir. 1982); *SEC* v. *Carriba Air, Inc.,* 681 F.2d 1318, 1324 (11th Cir. 1982).

cessfully deter fraudulent activity in the market. Indeed, providing that defendants who recklessly disregard the truth may be liable to investors, or subject to an enforcement action by the SEC, discourages "head in the sand" passivity on the part of senior corporate officials and their financial advisers, and creates an essential and powerful incentive to proper disclosure and good corporate governance.

During a Subcommittee hearing on H.R. 10, several witnesses and Members advanced similar reservations about the consequences of abandoning the recklessness standard. Member were particularly concerned that abandoning all liability for reckless conduct would effectively inoculate auditors, underwriters, and corporate counsel from any risks associated with fraudulent misstatements, and thus greatly erode the ability of private actions to deter fraud and defrauded investors to obtain justice. Chairman Levitt made it clear that this proposal would make it virtually impossible for investors who had clearly been defrauded and suffered substantial losses from pursuing compensation from professionals whose work may have been instrumental to the fraud's success:

> [Abandoning the recklessness standard] would reduce the degree to which such professional advisers encourage full and complete disclosure. There are relatively few cases in which it is established that professional advisers acted with actual, subjective knowledge that the representations made by an issuer were false. Rather, the liability of such advisers typically is predicated on a finding that they participated in the dissemination of false statements while recklessly ignoring indications of fraud.

We have written at some length about H.R. 10's initial proposal to eliminate the recklessness standard, even though amendments at both the Subcommittee and Committee mark-ups were said to have restored the standard to the antifraud laws. However, the language that supposedly restored recklessness at the Subcommittee mark-up, was, we believe, a charade. It established extraordinary and utterly unattainable requirements of proof that no investor could ever satisfy.

The recklessness standard that was proposed and enacted by the Committee is, at first glance, a considerable improvement over the language adopted by the Subcommittee. The first sentence in the definition, with one significant exception,[16] codifies the recklessness standard that was adopted by the Seventh Circuit Court of Appeals in *Sundstrand Corp.* v. *Sun Chemical Corp.*,[17] a version of which is applied by at least 75% of the nation's federal courts. We believe that the original *Sundstrand* standard represents a perfectly adequate definition of recklessness, and we would all be pleased to support it.

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[16] The only material change to the first sentence of the definition is the addition of the word "consciously" to modify the word "aware." We believe this is a last-ditch effort to ratchet up the burdens placed on investors who have been defrauded because of reckless conduct, and is entirely unnecessary. We therefore continue to oppose this formulation of the *Sundstrand* standard.

[17] 553 F.2d 1033 (7th Cir.), *cert. denied sub nom., Meers* v. *Sundstrand Corp.*, 434 U.S. 875 (1977).

Unfortunately the amendment that was adopted by the Committee purporting to restore liability for recklessness to the antifraud laws contained two sentences rather than one. And the second sentence included in the amendment takes away virtually everything that was provided by the first.

The second sentence establishes as a matter of federal law the following unprecedented affirmative defense to a claim of reckless securities fraud: "For example, a defendant who genuinely forgot to disclose, or to whom disclosure did not come to mind, is not reckless."

This "I forgot" defense is not only unprecedented under federal securities law, it does not appear to be recognized in any other area of federal law, or in any other jurisdiction in this country. We are not aware of a single securities fraud case in which any defendant has ever successfully argued that he or she was excused from and not responsible for their otherwise reckless conduct because they "forgot" to obey the law, or because fulfilling their legal responsibilities to shareholders just "did not come to mind."

For centuries this country has, with great justification, prided itself on the fact that we are governed by the rule of law rather than by the whim of individuals. With just one sentence, however, the majority proposes a complete reversal of this principle, and its corollary, which is that ignorance of the law is no excuse. From now on in federal securities fraud cases—where during the course of the last ten years hundreds of thousands of small investors have lost their life's savings and seen their faith in the American dream shaken—the Committee proposes to sanctify ignorance of the law by elevating it into the statute that has been our most important weapon against fraud.

We strenuously object.

H.R. 10 IS UNNECESSARILY AND UNJUSTIFIABLY BROAD IN SCOPE

As reported by the Committee, the scienter provisions in title II of H.R. 10 apply to "any private action" arising under the Securities Exchange Act of 1934 (Exchange Act). By extending the bill's application to "any private action," the bill will have the effect of requiring proof of scienter in proxy cases brought under Section 14 and disclosure cases brought under Section 8, neither of which currently has a scienter requirement. This is absurd public policy. It is entirely unrelated to the objective of reducing meritless securities fraud lawsuits, and has no support in the otherwise voluminous record assembled by this Committee over the course of the last year.

It also appears that H.R. 10 may redefine the elements of a violation under the proxy provisions. Current law allows a case to be brought under Section 14(a) against any person who solicits or permits the use of his name to solicit a proxy by means of a proxy statement that is false or misleading. H.R. 10 would limit recovery to cases against persons who directly or indirectly "make" a fraudulent statement.

Again, this has nothing to do with the stated goals of this legislation and would only serve to shield unlawful conduct from liability. Because there is no information in the record describing or discussing these matters, we do not know if these effects are intended. We do know that unintended consequences are the foreseeable result when politics rather than policy directs the process.

This provision was poorly thought out, and we are convinced that H.R. 10's supporters are not aware of the many harmful effects it may have. We oppose the provision.

H.R. 10'S HARSH PLEADING REQUIREMENTS ARE UNATTAINABLE

In its original form, Title II of H.R. 10 required investors to plead "specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred." At one point during Committee consideration, we were informed that the bill would likely be amended to require that investors allege specific facts giving rise to a "strong inference" that the defendant acted knowingly or recklessly. This is the test used today by the Second Circuit Court of Appeals, and it is generally regarded as more stringent than the test used by the other circuits.

H.R. 10 as reported does not codify the Second Circuit test. It provides that investors who bring securities fraud cases must make specific allegations which, if true, would be sufficient to "establish" that the defendant acted knowingly or recklessly. It than adds that "it shall not be sufficient for this purpose to plead the mere presence of facts inconsistent with a statement of omission alleged to have been misleading."

There is a significant difference between having to allege facts that give rise to a "strong inference" that the defendant acted knowingly or recklessly, and having to plead facts that "establish" that the defendant had the requisite state of mind. We believe that it is inappropriate to establish any test more stringent than the Second Circuit test, which many experts already believe is already too severe.

Because we believe that the bill as reported may result in meritorious fraud cases being dismissed, we are unable to support this provision.

ESTABLISHING RELIANCE BY MEANS OF THE FRAUD ON THE MARKET THEORY

Title II of H.R. 10 as introduced would have eliminated the ability of defrauded investors to demonstrate that they relied on the market price of a security, which in turn relied on or was adversely affected by a fraudulent misstatement or omission. This method of establishing indirect reliance was accepted by the Supreme Court in the landmark case of *Basic* v. *Levinson,* and is popularly known as the fraud on the market theory. By repealing the *Basic* decision, H.R. 10 would have required that each of the thousands of investors who typically comprise a class present proof to the court that they actually relied on a specific fraudulent misstatement or omission made by a defendant. Because such a requirement destroys one of the foundational elements needed to proceed on a classwide basis, this requirement by itself would have precluded all future class actions for securities fraud.

As reported by the Committee, however, H.R. 10 has, at least in part, reversed its approach to this issue. The bill now appears to preserve the ability of investors to plead fraud on the market in many cases, a welcome and laudable development, and the Republicans deserve thanks for recognizing the importance of this issue.

Despite this important improvement, however, a serious problem remains. H.R. 10 as reported appears to attempt to limit the availability of the fraud on the market theory for fraud cases involving securities that are deemed to be "illiquid." While, in theory, such a limitation may be justified, attempting to formulate the complex contours of such a limitation virtually overnight, without doing more harm than good, strikes us as virtually impossible.

An article in the February 23, 1995 Bond Buyer appears to prove the point. The article reports that this provision may preclude any class action from ever proceeding if the underlying security is a municipal bond.[18] The article notes, rather ironically, that two of the largest securities fraud cases in history—the litigation surrounding the default by the Washington Public Power Supply System, and the developing litigation resulting from Orange County's bankruptcy—both involved municipal securities. The idea that investors in these securities will be precluded from pursuing their case as a class because of this provision strikes us as absurd, and cannot possibly be the result intended by the Republicans.

We think a much simpler approach is to assign responsibility to the SEC to develop rules that determine when the fraud on the market theory should be available to protect investors, and when it might be unfair to permit them to use it. Unfortunately, the Republicans opposed a sensible amendment that would have permitted this issue to be analyzed in a more thoughtful and deliberate way.

We continue to believe that this provision is seriously flawed.

CALCULATION OF DAMAGES

The provision in section 204 addressing the calculation of damages has been amended to apply only to fraud on the market cases, which is an improvement. The provision continues to place somewhat arbitrary limits on recoverable damages, however, for reasons that are unclear. In a typical case, damages are based on the difference between the price paid for a security and the market value of that security after information correcting prior fraudulent statements is disclosed. H.R. 10 as reported would provide that, if the plaintiff subsequently sells the stock at a higher price, the plaintiff's recoverable damages must be offset by the amount by which the stock price increased *after* the corrective information was disclosed. Because this subsequent increase in the price will, by definition, be unrelated to the fraud, there is no apparent justification for offsetting it against the plaintiff's damages.

We believe that this provision is unfair to defrauded investors.

CONCLUSION

As this legislation advances to the floor of the House, we will continue to support meaningful efforts to deter the filing of meritless securities fraud class action lawsuits, and to sanction those who proceed in bad faith and abuse the process. We cannot,

[18] "House Panel's Bill Could Prohibit Class Action Suits in Muni Market," The Bond Buyer, February 23, 1995.

however, countenance efforts that promise to eviscerate the ability of individual investors to protect themselves in the guise of remedying what we all agree have sometimes been excessive and abusive litigation practices.

As we have repeated in the past and will repeat again in the future, the provisions of our securities laws that prohibit fraud are one of this country's most important and powerful weapons in the battle against financial wrongdoing. The record of enforcement of these laws, whether by the SEC, by state securities regulators, or by groups of small individual investors who in effect serve as private attorneys general, demonstrates overwhelmingly that effective laws against fraudulent and corrupt practices are essential to maintaining honest, fair and efficient financial markets.

Legislation that would substantially alter the well-established enforcement mechanisms that exist under the antifraud provisions of the nation's securities laws must be closely scrutinized to ensure that it is has been carefully drafted and is well-tailored to the problems it seeks to address. Title II of H.R. 10 as reported by the Committee fails this crucial test. We again express our hope that our Republican colleagues, who in the past have expressed great concern with undertaking grand social experiments through ill-conceived but well-intended legislation, will abandon their newly found affection for their unprecedented effort to severely cut back the laws that protect investors against financial fraud. If they are willing to commit themselves to working cooperatively with us to develop a careful and responsible bill, we will commit ourselves to working with them to ensure that it is enacted into law.

JOHN D. DINGELL.
EDWARD J. MARKEY.
RON KLINK.
GERRY STUDDS.
JOHN BRYANT.
ELIZABETH FURSE.
HENRY A. WAXMAN.
BART STUPAK.
RICK BOUCHER.
RON WYDEN.
EDOLPHUS TOWNS.
BART GORDON.

ADDITIONAL DISSENTING VIEWS OF MR. MARKEY

I find it curious that a securities litigation reform bill as broad in scope as Title II of H.R. 10 entirely ignores the devastating practical effects of one of the most important securities-related decisions to be handed down in years by the U.S. Supreme Court. I am referring to the *Central Bank of Denver*[1] decision in which a divided Court held that there is no implied private right of action for aiding and abetting under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder.

Aiding and abetting is rooted in the common-law doctrine that provides liability for those who do not directly violate the law but who provide assistance to the unlawful acts of others. Until the Supreme Court altered the landscape in May 1994, aiding and abetting liability was an important tool in encouraging honesty and high professional standards by individual professionals—such as lawyers and accountants—who facilitate access to the capital markets. Aiding and abetting played a crucial role in helping taxpayers and investors recover some of their losses from the unprecedented financial frauds of the last decade. Perhaps even more important, the prospect of potential liability for aiding and abetting has served as a powerful deterrent to wrongdoing.

Investors in publicly traded securities often rely on professionals when evaluating investments. Recent scandals on Wall Street, and in the savings and loan debacle, illustrate how important it is for these professional roles to be fulfilled responsibly. Judge Stanley Sporkin—a Reagan appointee who served as General Counsel of the Central Intelligence Agency under William Casey and former head of the Enforcement Division of the SEC—focused the issue with crystal clarity in the Charles Keating securities fraud case (in connection with the Lincoln Savings and Loan debacle) in a series of pointed questions:

> There are other unanswered questions presented by this case. Keating testified that he was so bent on doing the 'right thing' that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. The questions that must be asked are:
>
> Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?
>
> Why didn't any of them speak up or disassociate themselves from the transaction?
>
> Where also were the outside accountants and attorneys when these transactions were effectuated?
>
> What is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not have blown the whistle to stop the overreaching that took place in this case.

[1] *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.* 114 S. Ct. 1439 (1994).

Absent aiding and abetting civil liability, many of the professionals who act as "gatekeepers," and on whose credibility both buyers and sellers depend, may be essentially immune from liability.

While the *Central Bank* decision clearly foreclosed the ability of private litigants to pursue aiders and abettors, it was less clear in its application to actions initiated by the SEC. However, the decision created enough uncertainty that the Securities and Exchange Commission (SEC) asked Congress to provide explicit authority for the SEC to pursue aiders and abettors directly. SEC Chairman Arthur Levitt testified before the Telecommunications and Finance Subcommittee that: "Legislation expressly providing that the Commission can seek injunctions and other relief against aiders and abettors is necessary to preserve fully the strength and flexibility that Congress intended to provide when it enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990."

Echoing these sentiments were the state securities regulators and several prominent legal scholars. Toward that end, I offered an amendment at the full Committee markup to provide explicit authority for the SEC to pursue aiders and abettors. While many commentators urged that aiding and abetting also be restored for private actions, and I offered such an amendment at the Subcommittee markup, I chose to focus my amendment at full Committee on what should have been the non-controversial issue of restoring this legal remedy to the SEC's arsenal against wrongdoers. However, I was unable to present the strong public policy case for this amendment because the Republicans Majority inexplicably and unfairly cut off debate. It should come as no surprise, therefore, that my amendment was defeated on a party line vote. The rejection of this amendment vividly demonstrates that H.R. 10 is not about "reform" or about protecting the rights of truly defrauded investors; it is about protecting a class of special interests who want immunity from all lawsuits, no matter how meritorious.

EDWARD J. MARKEY.

ADDITIONAL DISSENTING VIEWS OF MR. WYDEN

At the full Committee markup of H.R. 10, I offered an amendment that would have amended the Securities Exchange Act of 1934 (Exchange Act) to improve fraud detection and disclosure with respect to public companies in order to facilitate the detection of fraudulent financial reports and assist the Securities and Exchange Commission (SEC) in meeting its responsibility to enforce the antifraud provisions of the Exchange Act. It would accomplish this by codifying existing auditing standards that are pertinent to the detection of financial fraud, and by requiring earlier and more direct reporting to the SEC when independent accountants uncover financial fraud during their audits of Exchange Act registrants.

The Republicans cut off debate and, since there was no opportunity for me or my colleagues to explain to the Committee the strong policy arguments supporting my amendment, it was defeated in a straight party line vote.

The amendment was based on legislation (H.R. 725) that I introduced on January 30, 1995 along with Reps. Dingell and Markey. This legislation represents the response of this Committee [1] to the public record, including extensive Congressional hearings,[2] regarding the administration and enforcement of the antifraud and other provisions of the federal securities laws in the areas of auditing, accounting, and financial reporting. One of the major problems reflected in the record is the rather widespread perception that the accounting profession has filed in its responsibilities, as evidenced by a succession of business failures seemingly related to negligent audits. The Oversight and Investigations Subcommittee hearings, for example, closely examined auditing and accounting problems associated with the failures, among others, of E.S.M. Government Securities Inc., American Savings and Loan Association of Florida, Home State Savings and Loan of Ohio, Beverly Hills Savings and Loan Association, ZZZZ-Best Company, Mission Insurance Company, Transit Casualty Company, and First Executive Corporation. "Investors, regulators, politicians, and accountants themselves are

[1] Substantially similar legislation has been reported unanimously by this Committee and passed by the House previously. During House consideration of the Comprehensive Crime Control Act of 1990 (H.R. 5269), the House adopted an amendment based on auditor responsibility legislation (H.R. 4886 and H.R. 5439) that I introduced in the 99th Congress. That provision was dropped in conference with the Senate. Similar legislation was included as section 487 of the Financial Institutions Safety and Consumer Choice Act of 1991 (H.R. 6), an early version of banking reform legislation that was defeated for reasons unrelated to the auditing provisions. Title II to the Securities Investor Protection Amendments of 1992 (H.R. 5726), passed by the House on September 22, 1992, included the Financial Fraud Detection and Disclosure Act (H.R. 4313, H. Rpt. 102–890) as amended. The legislation, however, failed to pass in the Senate. And in the 103rd Congress, this Committee ordered reported a substantially similar bill (H.R. 574) but no further action was taken due to a jurisdictional dispute involving the House Banking Committee.

[2] Since 1985, the Committee's Subcommittee on Oversight and Investigations has held 34 days of hearings on the accuracy and quality of audits and financial reporting by publicly owned companies and the independent public accountants which are hired to complete the audit. Testimony was received from approximately 200 witnesses.

asking how so many insolvent and fraud-riddled industrial corporations, banks, savings-and-loan associations, and insurance companies could have received clean audits from major firms shortly before they collapsed.[3] Such failures have resulted in substantial harm to the investing public and increased financial burdens on the taxpayer.

Last year, this legislation was supported by the accounting profession. The opposition of the Republican Majority to this common sense provision is inexplicable, and only enhances my serious concerns about whether H.R. 10 represents the best public policy that this Committee could report. I strongly believe that it is not. I hope by Republican colleagues will consider working with me cooperatively to secure passage of my amendment when the bill is taken up on the floor of the House. My amendment will help detect and correct frauds before they become private lawsuits and thus will further the goals of H.R. 10.

RON WYDEN.

[3] See William Sternberg, "Washington: Cooked Books," The Atlantic, Volume 269, No. 1 (January 1992) at 20.