United States Senate

WASHINGTON, DC 20510

March 15, 1994

Mr. Craig A. Goettsch
President
North American Securities Administrators
Association, Inc.
One Massachusetts Ave., N.W.
Suite 310
Washington, D.C. 20001

Dear Mr. Goettsch:

Thank you for your recent letter dated March 11, 1994 expressing the concerns of your organization about the Securities Private Enforcement and Integrity in Financial Disclosure Act of 1994. We assure you that investor protection remains the top priority of the securities laws and members of the Banking Committee. Given the excesses of the 1980s, we realize that private rights of action are essential tools in protecting innocent investors from fraud in the financial marketplace. For that reason, we undertook two days of hearings last year to examine whether private litigation is serving investors well.

As a result of those hearings, we discovered some disturbing problems with private securities litigation. For example, certain plaintiffs' class action attorneys have abused the private securities enforcement system. Frivolous suits filed for their settlement value within hours after an adverse earnings announcement continue to place an unfair burden on emerging companies and their shareholders.

In a speech to the Securities Regulation Institute in January, SEC Chairman Arthur Levitt called for changes to the securities class action system to address frivolous and abusive claims, while continuing to provide a method of recovery for truly defrauded investors. The bill we are developing is intended to balance these competing concerns.

We would like to address some of your specific concerns. First, you assert that Section 101(o) limits access to the courts to only wealthy shareholders. Section 101(o) is intended to ensure that those who represent the class truly have an interest in the outcome of the litigation. Whether this is best achieved through a percentage requirement or some other standard is a fair question, and we are open to other suggestions. Nothing in the draft bill prevents individual shareholders from becoming members of the class once a class action is certified. Nor does the draft bill prevent many investors who individually hold small numbers of shares from filing a class action.

Second, you believe that the fee shifting provision in Section 36 of the bill will deter suits by aggrieved investors, as they will be unwilling to risk liability for defendants' legal fees. You state that Rule 11 serves as a sufficient mechanism to deter and penalize those who bring meritless suits. As you may be aware, Rule 11 recently was modified, weakening its ability to deter meritless suits. The fee shifting provision to which you refer, at pages 8-10 of the bill, is based on provisions currently in the securities laws. Most of the private rights of action expressly set out in the securities laws, such as Section 11 of the Securities Act of 1933 and Sections 9(e) and 18 of the Securities Exchange Act of 1934, contain provisions that are construed to permit courts to impose reasonable attorneys' fees and costs against any party who asserts a position that is totally groundless and unwarranted. We fail to see how requiring judges to sanction frivolous suits will in any way deter truly defrauded investors from filing suit. The only parties who have anything to fear from this provision are those who take groundless positions, both plaintiffs and defendants.

Section 36 also encourages the use of alternative dispute resolution procedures. This procedure does not simply penalize parties who refuse to submit to ADR. It penalizes losing parties with unjustified cases who refuse requests by other parties to use ADR procedures recognized by the court. Again, the only parties who will be affected by this provision are plaintiffs or defendants who insist on "scorched earth" litigation, regardless of whether their position is substantially justified.

Concern also was expressed over the "exercise of reasonable diligence" standard in the statute of limitations provision of the bill. The argument is made in your letter that it will become "a trap for the unwary" and will be raised by defendants as a matter of course, which will create more litigation. First, all statutes of limitation technically constitute "traps for the unwary". Plaintiffs who fail to diligently pursue their rights often find themselves without a remedy. Second, we remind you that the bill's fee shifting provision prohibits meritless defenses as well as meritless claims. Thus, the fee shifting provision should deter defendants from raising the defense reflexively.

We also have reviewed your concerns about the proportionate and joint and several liability sections of the bill. You suggest that the bill excludes certain professionals from potential (we assume you mean joint and several) liability. In fact, the draft bill provides that any professionals, like accountants or attorneys, who act in concert with a primary violator are subject to joint and several liability. At a minimum, anyone who violates the securities laws would be liable to plaintiffs in proportion to their fault, even if their involvement in the transaction was slight. Far from exempting professionals from liability, this section ensures that all parties who break the law will shoulder their fair share of the blame.

Finally, we understand your concerns about the accounting self-disciplinary board. However, a close reading of the bill will demonstrate that the SEC has been given a substantial oversight function over the board. First, members elected to the board are subject to SEC approval. Second, in cases where the board decides to impose sanctions, the board must report its decision to the SEC. Third, rule changes by the board must be filed with the SEC and are subject to SEC approval. Finally, the bill allows the SEC to step in and conduct investigations into allegations of professional misconduct in cases where individuals refuse to comply with

board directives. These and other provisions in the bill will ensure that the board will prevent and sanction unprofessional conduct in the auditing business. If members of the board prove ineffective, they will answer to the SEC and Congress.

We appreciate your organization's ongoing commitment to protecting the investing public and your comments on this important piece of legislation. Providing better protection for all investors, including protection against entrepreneurial lawyers and litigation abuses, is the primary concern of this bill. We hope your organization will support our efforts to end these abusive practices and provide a more meaningful remedy for those who truly are victims of securities fraud. We look forward to working with NASAA as the legislation moves forward.

Sincerely,

Pete V. Domenici
U.S. Senate

Christopher J. Dodd
U.S. Senate