U.S. Senator Howard M.
METZENBAUM
of Ohio

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MAY 12, 1994

STATEMENT OF SENATOR HOWARD M. METZENBAUM
TO THE SECURITIES SUBCOMMITTEE OF THE SENATE BANKING COMMITTEE
ON THE SUPREME COURT'S CENTRAL BANK OF DENVER DECISION

MR. CHAIRMAN, I THANK THE COMMITTEE FOR HAVING ME HERE TODAY. THE SUBJECT OF THIS HEARING IS OF GREAT IMPORTANCE AND OF PARTICULAR INTEREST TO ME AS A LONG-TIME ADVOCATE OF STRONG AND EFFECTIVE SECURITIES LAWS. I FIRMLY BELIEVE THAT, IF ALLOWED TO STAND, THE CENTRAL BANK OF DENVER CASE WILL WEAKEN THOSE LAWS MORE THAN ANY OTHER CASE IN THE 60-YEAR HISTORY OF THE FEDERAL SECURITIES LAWS.

LET ME SPELL OUT THE DAMAGE THAT THE SUPREME COURT'S BIZARRE LEGAL REASONING WILL CAUSE. IT GIVES CLEARLY FRAUDULENT BEHAVIOR THE GREEN LIGHT! IT IMMUNIZES THOSE WHO HAVE CLEARLY HELPED OTHERS TO COMMIT SECURITIES FRAUD. IT SAYS TO THOSE WHO ASSISTED S & L EXECUTIVES, BCCI, AND DREXEL BURNHAM IN COMMITTING SECURITIES FRAUD -- PEOPLE LIKE MICHAEL MILKEN WHO HAVE CAUSED INNOCENT INVESTORS TO LOSE HUNDREDS OF MILLIONS OF DOLLARS -- "GO HOME, YOU'RE PROTECTED FROM LIABILITY, SORRY TO HAVE BOTHERED YOU, FEEL FREE TO DO THIS AGAIN".

THE SURPRISING 5 TO 4 RULING IS SHOCKING BECAUSE IT OVERTURNS 25 YEARS OF ESTABLISHED FEDERAL COURT PRECEDENTS THAT HAVE PERMITTED PRIVATE INVESTORS TO SUE AIDERS AND ABETTORS OF SECURITIES FRAUD. THAT INCLUDES 11 CIRCUIT COURTS OF APPEAL -- EVERY SINGLE CIRCUIT THAT HAS ADDRESSED THE ISSUE. BUT MUCH MORE THAN JUST A BAD DECISION, THIS CASE UNDERMINES FUNDAMENTAL PROTECTIONS FOR INVESTORS AND THE SECURITIES MARKETS.

INVESTORS HAVE LONG HAD THE RIGHT TO SUE LAWYERS, ACCOUNTANTS, BANKERS, BROKERS, AND OTHERS WHO ASSIST OTHERS IN COMMITTING SECURITIES FRAUD. THIS RIGHT OF ACTION HAS PLAYED A VITAL ROLE IN COMPENSATING SWINDLED INVESTORS IN THE MAJOR FINANCIAL FRAUDS OF THE LAST THREE DECADES.

INNOCENT VICTIMS WHO LOSE MONEY, AND SOMETIMES THEIR LIFE SAVINGS, IN FRAUDULENT SECURITIES SCHEMES HAVE RECOVERED HUNDREDS OF MILLIONS OF DOLLARS FROM AIDERS AND ABETTORS. JUST RECENTLY, 23,000 BOND HOLDERS SUCCESSFULLY SUED THE LAWYERS AND ACCOUNTANTS IN A SAVINGS AND LOAN CASE AND RECOVERED $275 MILLION. IF THIS

RULING HAD BEEN ON THE BOOKS AT THAT TIME, IT WOULD HAVE WIPED OUT THE RECOVERY -- INVESTORS WOULD NOT HAVE RECOVERED A PENNY.

UNLESS THIS COURT DECISION IS REVERSED BY CONGRESS, MOST DEFRAUDED INVESTORS WILL NOT RECOVER THEIR LOSSES BECAUSE, TYPICALLY, THE PERPETRATOR OF THE FRAUD IS INSOLVENT BY THE TIME THE CASE IS FILED OR COMPLETED. FOR EXAMPLE, THE CHEATED INVESTORS WHO RECOVERED THE $275 MILLION IN THE CASE I JUST REFERRED TO HAD WON A $1.5-BILLION JUDGMENT AGAINST THE EXECUTIVES DIRECTLY RESPONSIBLE, BUT THAT JUDGMENT WAS UNCOLLECTIBLE BECAUSE THEY HAD NO MONEY LEFT.

IN ADDITION, THIS CASE ALSO CASTS DOUBT UPON THE SEC'S OWN ABILITY TO GO AFTER AIDERS AND ABETTORS. ABOUT 15% OF THE SEC'S ENFORCEMENT ACTIONS INCLUDE CHARGES OF AIDING AND ABETTING. IN THOSE CASES, THE ESTABLISHED RIGHT TO PROCEED AGAINST AIDERS AND ABETTORS IS CRITICAL TO EFFECTIVE ENFORCEMENT.

FINALLY, THE CENTRAL BANK DECISION SEVERELY WEAKENS THE DETERRENCE OF SECURITIES FRAUD. IT SENDS A DANGEROUS SIGNAL TO THE SECURITIES MARKETS THAT A PRIMARY ENFORCEMENT TOOL HAS BEEN ELIMINATED -- AND THAT INCLUDES ALL THE INDEPENDENT BANKERS, ACCOUNTANTS, AND ATTORNEYS. THIS NOT ONLY HURTS DEFRAUDED INVESTORS, IT HURTS ALL INVESTORS.

IT IS IMPERATIVE THAT CONGRESS ACT SWIFTLY TO RECTIFY THIS SITUATION BECAUSE THE CENTRAL BANK DECISION ALREADY IS HAVING IMMEDIATE IMPLICATIONS IN A HUGE NUMBER OF FRAUD CLAIMS. AS WE SPEAK, PEOPLE ARE WRITING UP MOTIONS TO DISMISS AND REOPEN CASES. AT LEAST ONE MAJOR FRAUD CASE HAS ALREADY BEEN DISMISSED. A JUDGE HAS THROWN OUT A $70 MILLION LAWSUIT BY THE SHAREHOLDERS OF THE BANKRUPT BONNEVILLE PACIFIC CORPORATION AGAINST THE ACCOUNTANTS FOR THE COMPANY, WHO ALLEGEDLY MISREPRESENTED THE COMPANY'S FINANCIAL CONDITION AND ARE NOW OFF THE HOOK.

A FORMER GENERAL COUNSEL OF THE SEC WHO NOW IS A PROMINENT SECURITIES DEFENSE LAWYER HAS SAID: "I AM RECOMMENDING TO CLIENTS THAT IF THEY'VE SETTLED A CASE IN THE PAST WITH THE SEC UNDER AIDING AND ABETTING, THEY COULD GET OUT OF ANY INJUNCTIONS." A MAJOR DEFENSE LAW FIRM (GIBSON, DUNN & CRUTCHER) HAS ALERTED ITS CLIENTS IN A SPECIAL DISPATCH: "THERE ARE REPORTS THAT LEGISLATION WILL BE INTRODUCED IN CONGRESS IN RESPONSE TO THE COURT'S DECISION. THEREFORE, THOSE CLIENTS WHO ARE DEFENDANTS IN SECTION 10(B) CASES INVOLVING PRIVATE CLAIMS THAT ALLEGE AIDING AND ABETTING SHOULD IMMEDIATELY SEEK A FINAL JUDGMENT DISMISSING THOSE CLAIMS TO MINIMIZE THE IMPACT OF NEW LEGISLATION." ANOTHER MAJOR SECURITIES DEFENSE FIRM (FREED, FRANK) HAS SENT AN ALERT TO CLIENTS TO REOPEN SEC INJUNCTIONS BASED ON AIDING AND ABETTING, MOVE TO DISMISS CURRENT SEC AIDING AND ABETTING CASES, AND TAKE THE POSITION THAT CENTRAL BANK WIPES OUT ALL FORMS OF SECONDARY LIABILITY UNDER ALL PROVISIONS OF THE FEDERAL SECURITIES LAWS.

OBVIOUSLY, THE CENTRAL BANK DECISION HAS OPENED A PANDORA'S BOX OF SECURITIES FRAUD AND WE MUST SLAM IT SHUT!

I URGE THIS SUBCOMMITTEE AND THE BANKING COMMITTEE TO ACT IMMEDIATELY TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO RESTORE THE RIGHT OF PRIVATE PLAINTIFFS, AND PRESERVE THE RIGHT OF THE SEC, TO SUE AIDERS AND ABETTORS OF SECURITIES FRAUD.

AS YOU KNOW, I HAVE ALREADY DRAFTED LEGISLATION TO ACHIEVE THIS GOAL. I AGREED TO WITHHOLD OFFERING IT AS AN AMENDMENT TO BILLS PENDING ON THE SENATE FLOOR, SO THAT MY COLLEAGUES COULD REVIEW THE DEVASTATING IMPACT OF THIS SUPREME COURT DECISION. I HOPE WE CAN WORK TOGETHER AS EXPEDITIOUSLY AS POSSIBLE TO MOVE THIS LEGISLATION THROUGH THE SENATE. I WOULD PREFER THAT ROUTE, BUT DELAY CAN BE SO COSTLY THAT I WILL FIND A LEGISLATIVE VEHICLE IF THIS COMMITTEE DOES NOT SEE FIT TO ACT PROMPTLY.