Elena Kagan
278-0

THE WHITE HOUSE

WASHINGTON

January 16, 1997

MEMORANDUM FOR ERSKINE BOWLES

THROUGH: GENE SPERLING

FROM: Ellen Seidman

SUBJECT: Securities litigation reform

Background

At the end of 1995, President Clinton vetoed a securities litigation reform bill that, among other things, limited discovery, changed pleading standards and created a "safe harbor" for forward-looking information. Congress overrode the veto. Concerned that plaintiffs' attorneys would bring actions in state courts that had been made more difficult or impossible in federal court, during the California Republican primary California business interests attempted to pass referenda that would have instituted changes such as "loser pays." These failed.

The plaintiffs' bar, supported by labor and some parts of the pension community, as well as the California Democratic Party, then proposed Proposition 211, which was on the November ballot. Business interests vigorously opposed Prop 211. The referendum would have established procedural rules for securities fraud suits in California courts that not only were far more favorable to plaintiffs than the federal rules, but that also applied to any company with any California shareholders. Business interests asserted this would have effectively overriden the federal statute, making California a haven for frivolous securities fraud suits from all over the country.

On a campaign trip to California, which included a dinner with representatives of the high tech community, the President and Leon Panetta stated (and were quoted in the press) that Prop 211 was a bad idea. They also said it was a mistake for each state to establish its own rules regarding an essentially federal body of law. There are certainly people in the community who believe the President said he would support a preemptive federal statute.

Prop 211 lost 75% to 25%. And as Congress adjourned last year, it passed a securities law reform bill that preempts state registration laws for most corporations and can be read, aggressively, as preempting state fraud actions based on those laws.

Current state of play

In February, the SEC will deliver to the President a report he requested outlining the impact of the securities litigation reform law. Their preliminary conclusion appears to be that, while it is very early in the process, the act does not seem to have had much impact either in reducing litigation or in increasing information available under the "safe harbor." It is far too early to know the impact on potential litigation of the 1996 statute.

Passing preemptive federal statutes -- particularly laws that interfere with the procedures and operations of state courts -- is extremely difficult. Senator Dodd made this point last fall in wondering why we would favor preemption, although he thought there might be a case for such a statute if Prop 211 passed. We understand that Congressman Oxley (R-Ohio), who business interests expected to sponsor a preemptive statute, has declined on the grounds that it's unneeded, too difficult, and not the kind of thing conservative Republicans like to do. Some of the California Representatives on both sides of the aisle, as well as Congressman Joe Kennedy, are said to be working on a preemptive statute, but it is unclear how far they have gotten.

We have been silent on the issue since the election.

Recommendation

At a meeting attended by John Podesta, Bruce Lindsey, Kathy Wallman, Elena Kagan, Tim Newell, Paul Carey, Dan Tate and me, we concluded that it will be extremely important to walk the fine line between encouraging the high tech group to believe that the Administration favors preemption -- particularly the kind of broad preemption they have had drafted -- and leading them to conclude that we are going back on what they think the President had agreed to. The attached talking points attempt to guide you through the thicket.

Attachments:
Talking points
Veto message
Letter to Arthur Levitt

Talking Points for Meeting with High Tech Leaders
Securities Litigation Reform (Preemption)

- Last time we (Leon) talked together about this issue, we were all concerned that Prop 211 would pass, potentially making California a mecca for securities fraud litigation under less rigorous standards than those in federal law.

- Through all our efforts, that crisis was, fortunately, averted.

- We understand that you remain concerned that similar efforts to establish minimal state standards that apply to out-of-state companies might appear in other states, and that fighting these one by one seems inefficient and counterproductive.

- As the President and I (Leon) said, we too are concerned about state by state action altering what is essentially a federal system.

- On the other hand, the securities laws have 60 years of history with concurrent federal and state jurisdiction. Efforts to limit state jurisdiction, particularly access to state courts, need to be undertaken carefully. They will be successful only if they are directly responsive to a proven problem, and only if there is broad consensus (which will almost certainly have to include the SEC) to take the action. [Last year's preemption of state securities registration laws in most cases is an example of a long-developing response to a well understood and documented problem.]

- Now that we are not under the imperative that passage of Prop 211 would have created, it is critical that we carefully work through the nature and extent of any state law problem and whether and what type of federal action might be needed.

- We welcome the opportunity to work with you on this. Kathy Wallman, who has been the Deputy White House Counsel and is now the Chief of Staff and Counselor at the National Economic Council, will be leading our team.