FILED
20-0197
11/18/2020 2:09 PM
tex-48215803
SUPREME COURT OF TEXAS
BLAKE A. HAWTHORNE, CLERK

No. 20-0197

IN THE SUPREME COURT OF TEXAS

IN RE SOUTHWESTERN ENERGY COMPANY, *et al.*,
Relators

On Petition for Writ of Mandamus
to the 61st Judicial District Court, Harris County, Texas
St. Lucie Cty. Fire Dist. Firefighters' Pension Tr. v. *Sw. Energy Co.*, *et. al.*,
No. 2016-70651
The Honorable Fredericka Phillips, presiding

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR WRIT OF MANDAMUS

Judson O. Littleton
State Bar No. 24065635
SULLIVAN & CROMWELL LLP
1700 New York Avenue, NW
Suite 700
Washington, D.C. 20006
Tel: (202) 956-7500
Fax: (202) 293-6330
littletonj@sullcrom.com

Robert J. Giuffra Jr.
Matthew A. Schwartz
Justin J. DeCamp
Andrew J. Finn
Joshua D. Tannen
SULLIVAN & CROMWELL LLP
125 Broad Street
New York, New York 10004
Tel: (212) 558-4000
Fax: (212) 558-3588
giuffrar@sullcrom.com
schwartzmatthew@sullcrom.com
decampj@sullcrom.com
finna@sullcrom.com
tannenj@sullcrom.com

November 18, 2020

Attorneys for Amici Curiae

TABLE OF CONTENTS

Page

INTEREST OF *AMICI CURIAE* 1

SUMMARY OF THE ARGUMENT 2

ARGUMENT 8

I. THE '33 ACT REFLECTS A STRONG FEDERAL INTEREST IN UNIFORM APPLICATION OF THE FEDERAL SECURITIES LAWS TO PREVENT ABUSIVE LITIGATION IN ALL COURTS. 8

A. Congress Has Clearly and Repeatedly Underscored the Federal Interest in Uniform Application of the Federal Securities Laws. 9

B. Texas Should Join the Other States That Have Applied the Federal Standards on the Scope of Required Securities Offering Disclosures at the Motion-to-Dismiss Stage. 14

C. The Federal Defenses That Texas Courts Should Apply at the Motion-to-Dismiss Stage Include Those Based on Materiality and the Statute of Repose. 19

1. The Materiality of an Alleged Misstatement or Omission Must Be Considered in the Context of the Disclosure as a Whole. 19

2. The Federal Statute of Repose Is Strictly Applied. 22

II. ALLOWING THE TRIAL COURT'S DECISION TO STAND WILL ENCOURAGE STRIKE SUITS AGAINST TEXAS COMPANIES AND WILL DISINCENTIVIZE PUBLIC COMPANIES FROM LOCATING IN THE STATE. 24

CONCLUSION 31

INDEX OF AUTHORITIES

Page(s)

CASES

AC Interests, L.P. v. *Tex. Comm'n on Envtl. Quality*,
543 S.W.3d 703 (Tex. 2018) 21

In re Ally Fin. Sec. Litig.,
No. 16-013616-CB, slip op. (Mich. Circ. Ct. Jan. 11, 2019) 15

Basic Inc. v. *Levinson*,
485 U.S. 224 (1988) 19

Blue Chip Stamps v. *Manor Drug Stores*,
421 U.S. 723 (1975) 6, 10

Cal. Pub. Emps.' Ret. Sys. v. *ANZ Sec., Inc.*,
137 S. Ct. 2042 (2017)...22

Caldwell v. *Berlind*,
543 F. App'x 37 (2d Cir. 2013)..23

City of Dallas v. *Sanchez*,
494 S.W.3d 722 (Tex. 2016) 6, 17

City of Livonia Retiree Health & Disability Benefits Plan v. *Pitney Bowes, Inc.*,
2019 WL 2293924 (Conn. Super. Ct. May 15, 2019) 16

Cyan, Inc. v. *Beaver Cty. Emps. Ret. Fund*,
138 S. Ct. 1061 (2018).. 1, 3, 10, 13

In re Dentsply Sirona, Inc. S'holders Litig.,
2019 WL 4695724 (N.Y. Sup. Ct. Sept. 26, 2019) 15

In re Everquote, Inc. Sec. Litig.,
106 N.Y.S.3d 828 (Sup. Ct. 2019) 16

FDIC v. *First Horizon Asset Sec. Inc.*,
291 F. Supp. 3d 364 (S.D.N.Y. 2018) 23

In re FireEye, Inc.,
2015 WL 13546104 (Cal. Super. Ct. Aug. 11, 2015) 25

Fortunato v. *Akebia Therapeutics, Inc.*,
2017 WL 716356 (Mass. Super. Ct. Feb. 21, 2017) 15, 17

In re Funko, Inc. Sec. Litig.,
2019 WL 3805227 (Wash. Super. Ct. Aug. 2, 2019)..15

Gasner v. *Bd. of Supervisors*,
103 F.3d 351 (4th Cir. 1996)..20

Gorman v. *Life Ins. Co. of N. Am.*,
811 S.W.2d 542 (Tex. 1991) 19

Greenberg v. *Sunrun Inc.*,
233 F. Supp. 3d 764 (N.D. Cal. 2017)...28

In re GreenSky, Inc. Sec. Litig.,
2019 WL 6310525 (N.Y. Sup. Ct. Nov. 25, 2019) 16–17

Holmes v. *Greyhound Lines, Inc.*,
757 F.2d 1563 (5th Cir. 1985)...23

Houser v. *CenturyLink, Inc.*,
2020 WL 4032184 (Colo. Dist. Ct. May 14, 2020) 15

Hromyak v. *Tyco Int'l Ltd.*,
2005 WL 5872097 (Fla. Circ. Ct. Aug. 23, 2005) 15–16

John Hancock Life Ins. Co. (U.S.A.) v. *JPMorgan Chase & Co.*,
938 F. Supp. 2d 440 (S.D.N.Y. 2013)...23

Kapps v. *Torch Offshore, Inc.*,
379 F.3d 207 (5th Cir. 2004).. 19, 20

Merrill Lynch, Pierce, Fenner & Smith Inc. v. *Dabit*,
547 U.S. 71 (2006) .... *passim*

Milano v. *Auhll*,
1996 WL 33398997 (Cal. Super. Ct. Oct. 2, 1996)..17

Morrison v. *Nat'l Austl. Bank Ltd.*,
561 U.S. 247 (2010) 5

In re Natera, Inc. Sec. Litig.,
2018 WL 11028766 (Cal. Super. Ct. Aug. 7, 2018) 15, 16

In re Netshoes Sec. Litig.,
64 Misc. 3d 926 (N.Y. Sup. Ct. 2019)...15

Omnicare, Inc. v. *Laborers Dist. Council Constr. Indus. Pension Fund*,
575 U.S. 175 (2015) 20

In re Pac. Biosciences of Cal., Inc.,
No. CIV 509210, slip op. (Cal. Super. Ct. May 25, 2012)..................................18

Pinter v. *Dahl*,
486 U.S. 622 (1988) 10

Pub. Emps. Ret. Sys. of Miss. v. *Sprouts Farmers Mkt., Inc.*,
2017 WL 3741229 (Ariz. Super. Ct. Aug. 25, 2017)..18

Pytel v. *Elmore*,
Case Management Order, No. CIV538215 (Cal. Super. Ct. Jan. 17, 2017) 28

Saltzberg v. *TM Sterling/Austin Assocs.*,
45 F.3d 399 (11th Cir. 1995)...20

Salzburg v. *Sciabacucchi*,
227 A.3d 102 (Del. 2020)..27

In re Sundial Growers Inc.,
2020 WL 2543817 (N.Y. Sup. Ct. May 15, 2020).. 14–15

Switzer v. *W.R. Hambrecht & Co.*,
2018 WL 4704776 (Cal. Super. Ct. Sept. 19, 2018) 18

Truk Int'l Fund LP v. *Wehlmann*,
737 F. Supp. 2d 611 (N.D. Tex. 2009)..20

TSC Indus., Inc. v. *Northway, Inc.*,
426 U.S. 438 (1976) 19–20

In re Uxin Ltd. Sec. Litig.,
2020 WL 1146636 (N.Y. Sup. Ct. Mar. 9, 2020)...14

W. & S. Life Ins. Co. v. *JPMorgan Chase Bank, N.A.*,
54 F. Supp. 3d 888 (S.D. Ohio 2014) 22

Wilkins v. *Hogan Drilling Co.*,
471 So. 2d 863 (La. Ct. App. 1985) 15

Wooley v. *Schaffer*,
447 S.W.3d 71 (Tex. App.—Houston [14th Dist.] 2014, pet. denied) 5, 17–18

STATUTES AND RULES

15 U.S.C. § 77k 10

15 U.S.C. § 77*l* 10

15 U.S.C. § 77m 22

15 U.S.C. § 77p 12

28 U.S.C. § 1407 27

Tex. R. Civ. P. 59 21

Tex. R. Civ. P. 91a.6 21

LEGISLATIVE AND ADMINISTRATIVE MATERIALS

House Research Org., Bill Analysis, Tex. H.B. 274, 82nd Leg. (2011),
https://bit.ly/38x5qxh 17

H.R. Rep. No. 104-369 (1995) (Conf. Rep.) 10

H.R. Rep. No. 105-803 (1998) (Conf. Rep.) 12

H.R. Rep. No. 104-50 (1995) 29

Misc. Docket No. 12–9191, Adoption of Rules for Dismissals and Expedited
Actions (Tex. Nov. 13, 2012) 17

S. Rep. No. 104-98 (1995) 10–11

S. Rep. No. 105-182 (1998) 12

Securities Litigation Uniform Standards Act of 1998,
Pub. L. No. 105-353, 112 Stat. 3227 .... 12, 27

OTHER AUTHORITIES

Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, NERA Economic Consulting (2019), https://bit.ly/3mH3kQ7 ....3, 14

Brief of Alibaba Group Holding Limited et al., as *Amici Curiae* in Support of Petitioners, *Cyan, Inc.* v. *Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018) (No. 15-1439) 25

Capital Markets in Texas, SIFMA, states.sifma.org/#state/tx 25, 29, 30

D&O Insurance Costs Soar as Investors Run to Court Over IPOs, Insurance Journal (June 18, 2019), https://bit.ly/2YmLV5s 30

H.R. 1058 (104th): Private Securities Litigation Reform Act of 1995: House, GovTrack.us, https://bit.ly/2Yl4TJL 11

H.R. 1058 (104th): Private Securities Litigation Reform Act of 1995: Senate, GovTrack.us, https://bit.ly/3aRs7dk 11

Jayme Herschkopf, *Securities Litigation*, Federal Judicial Center (2017), https://bit.ly/2xBQfTs 13

Michael Klausner et al., *State Section 11 Litigation in the Post-*Cyan *Environment (Despite* Sciabacucchi), 75 Bus. Law. 1769 (2020) 6, 7–8, 26, 28

S. 1260 (105th): Securities Litigation Uniform Standards Act of 1998: House, GovTrack.us, https://bit.ly/2VQnb3S 12

S. 1260 (105th): Securities Litigation Uniform Standards Act of 1998: Senate, GovTrack.us, https://bit.ly/35ixOzN 12

Securities Class Action Filings: 2019 Year in Review, Cornerstone Research, https://bit.ly/2FEabcd 7, 29

Securities Class Action Filings: 2020 Midyear Assessment, Cornerstone Research, https://bit.ly/3mqIOD6 ....4, 7

Laurie Smilan & Nicki Locker, *Saying So Long to State Court Securities Litigation*, Harvard Law School Forum on Corporate Governance (Feb. 11, 2019), https://bit.ly/2KPqr9k 29

SmileDirectClub, Inc., Quarterly Report (Form 10-Q) (Nov. 16, 2020).................26

U.S. Chamber Institute for Legal Reform, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System* (2019), https://bit.ly/3jJfFk 28–29

U.S. Chamber Institute for Legal Reform, *ILR Briefly: An Update on Securities Litigation* (2020), https://bit.ly/3kHtJvT 26, 30

U.S. Dep't of Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets* (2017), https://bit.ly/32ACReS.........................29

Venator Materials PLC, Quarterly Report (Form 10-Q) (May 6, 2020) 26

INTEREST OF AMICI CURIAE

SIFMA. The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of more than 650 securities firms, banks, and asset managers, including 40 headquartered in Texas. SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA works to represent its members' interests locally, nationally, and globally. Many of SIFMA's members serve as underwriters for, or otherwise participate in, securities offerings, including by Texas companies, and, as such, they have a vital interest in the issues raised by this petition, particularly given the increase in state-court securities class action lawsuits filed since the U.S. Supreme Court's decision in *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018). SIFMA regularly files *amicus* briefs in cases with broad implications for financial markets.

U.S. Chamber. The Chamber of Commerce of the United States of America ("U.S. Chamber") is the world's largest business federation. It directly represents approximately 300,000 members and indirectly represents more than three million businesses and professional organizations of every size, in every sector, and from every geographic region of the country. An important function of the U.S. Chamber is to represent the interests of its members in matters before Congress, the Executive

Branch, and the courts. To that end, the U.S. Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community, and it has frequently appeared as *amicus curiae* in this Court. *See, e.g.*, *Amicus Curiae* Brief of the Chamber of Commerce of the United States of America et al., *Energy Transfer Partners, L.P.* v. *Enter. Prods. Partners, L.P.*, 593 S.W.3d 732 (Tex. 2020) (No. 17-0862); Brief of *Amici Curiae* Alliance of Automobile Manufacturers and Chamber of Commerce of the United States of America in Support of Appellants/Defendants, *Nabors Well Servs., Ltd.* v. *Romero*, 456 S.W.3d 553 (Tex. 2015) (No. 13-0136).

The undersigned attorneys represent to the Court that *amici* are paying the fee for preparing this brief. *See* Tex. R. App. P. 11(c).

SUMMARY OF THE ARGUMENT

This case is one of a growing number of class actions filed in Texas and other state courts asserting claims against companies and their directors, officers, and underwriters under the federal Securities Act of 1933 ("'33 Act"). As in this case, such claims are often based on nothing more than (i) a drop in a company's stock price following a public offering of shares, and (ii) a plaintiff's conclusory assertions that the company's disclosures in its federally mandated offering documents must have been materially false or misleading as a result.

Federal courts and Congress have long recognized the potentially abusive

nature of such claims. In the 1990s, Congress investigated the rise of so-called "strike suits" under the federal securities laws and amended the '33 Act through the Private Securities Litigation Reform Act of 1995 ("PSLRA") and the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). The PSLRA and SLUSA put in place additional procedural and substantive protections against meritless securities class actions, including a safe harbor for forward-looking statements, an automatic stay of discovery pending a motion to dismiss, and a prohibition on state-law securities class actions in state and federal court. Courts have relied on these provisions and a well-developed body of federal case law defining the scope of public companies' disclosure obligations to effectively weed out baseless suits at the motion-to-dismiss stage and avoid the tremendous time and costs of litigating them. One analysis of putative securities class actions filed and resolved between 2000 and 2018 showed that federal courts dismissed nearly half of them at the motion-to-dismiss stage. Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, NERA Economic Consulting 20 (2019), https://bit.ly/3mH3kQ7.

Following the U.S. Supreme Court's 2018 decision in *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*, 138 S. Ct. 1061, clarifying that '33 Act class actions cannot be removed from state courts, plaintiffs' attorneys across the country have filed more than eighty '33 Act cases in Texas and other state courts in the hope

that those courts will apply a less demanding pleading standard than federal courts have applied. *Securities Class Action Filings: 2020 Midyear Assessment* ("Cornerstone 2020 Midyear Report"), Cornerstone Research 14, https://bit.ly/3mqIOD6.

Because this lawsuit is part of the first wave of Texas cases, this Court's decision will have significant implications for how Texas courts handle federal securities cases beyond this one, and whether Texas companies (compared to companies in other States) will be subjected to the abusive securities litigation tactics that federal courts and Congress have sought to prevent. Plaintiff in this action bases its principal claim on a reserve estimate that defendant Southwestern made for oil-and-gas properties as of June 2014, and Southwestern's incorporation of that estimate into a registration statement that became effective in January 2015. Plaintiff contends that Southwestern should have said more in its registration statement about how a market-wide decline in oil and gas prices and operations-related factors that occurred or became apparent after the estimate affected the value of the reserves. Defendants moved to dismiss, relying on disclosures in the registration statement itself about the very risks Plaintiff claimed were omitted, and arguing that Plaintiff's claim, which appeared for the first time in a May 2018 amended petition, was time-barred by the '33 Act's three-year statute of repose.

Plaintiff urged in its briefs and at oral argument that, contrary to the decisions

from courts in other States, the District Court below should not decide Southwestern's disclosure and statute-of-repose arguments on a motion to dismiss, *see* R. at 805–06, 885–86, contentions which the District Court may have accepted in denying Defendants' Rule 91a motion. If the District Court's decision stands, it will not only undermine uniform nationwide treatment of claims based on federal law, but will turn Texas into a "Shangri-La" for vexatious '33 Act class actions. *Morrison* v. *Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 270 (2010). This development will disadvantage Texas businesses that seek access to capital markets and rely on longstanding federal law developed by the courts to determine what and how information should be disclosed in a registration statement and prospectus. This Court should reject Plaintiff's attempts to strip Texas companies of the basic defenses that Congress specifically provided against the abuse of federal securities claims.

First, determining timeliness and disclosure obligations at the motion-to-dismiss stage is crucial to preventing an influx of frivolous and costly securities class actions in this State. These requirements are fundamental to ensure that courts can act as effective gatekeepers. Doing so would be fully consistent with Rule 91a, which the majority of Texas appellate courts have held requires a complaint to "contain enough facts to state a claim to relief that is plausible on its face." *Wooley* v. *Schaffer*, 447 S.W.3d 71, 76 (Tex. App.—Houston [14th Dist.] 2014, pet. denied)

(internal quotation marks omitted); *see also City of Dallas* v. *Sanchez*, 494 S.W.3d 722, 724 (Tex. 2016) (Rule 91a motion presents a "question of law and the rule's factual-plausibility standard is akin to a legal-sufficiency review").

The alternative is a result that Congress sought to avoid: opportunistic securities plaintiffs proceeding to discovery in search of a claim, while imposing astronomical costs and distraction on publicly traded companies and their management, in the hope of extracting an outsized settlement. Indeed, this legislative priority, embodied in the PSLRA and SLUSA, is a primary reason that Section 11 cases are ideal candidates for Rule 91a dismissal at an early stage of the litigation. As Chief Justice Rehnquist warned almost fifty years ago in writing for the U.S. Supreme Court, discovery in securities class actions may "permit[] a plaintiff with a largely groundless claim to 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, rather than a reasonably founded hope that the process will reveal relevant evidence." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741 (1975). This concern is manifested in the underlying data: of the forty-one Section 11 cases filed and resolved from 2011 through 2019 where a motion to dismiss was denied, all of them ended in settlement. Michael Klausner et al., *State Section 11 Litigation in the Post-*Cyan *Environment (Despite* Sciabacucchi), 75 Bus. Law. 1769, 1777–78 & tbls. 1 & 2 (2020).

Second, if Texas does not rigorously apply the federal law at the pleading stage, it will become a haven for meritless '33 Act claims, to the detriment of Texas companies. Following *Cyan*, the plaintiffs' bar has set its sights on state courts with vigor. From 2010 through 2017, an average of just over nine '33 Act class actions were filed annually in state court. *Securities Class Action Filings: 2019 Year in Review*, Cornerstone Research 19, https://bit.ly/2FEabcd. By contrast, there were 35 such filings in 2018 and 49 in 2019. *Id.*[1] From 2010 through 2018, the yearly average of such filings in States outside California and New York was less than three, but in 2019, that number ballooned to 16, a more than 500% increase, and included cases filed in Florida, Illinois, Nevada, Tennessee, Texas, and Wisconsin. *Id.* The surge in state filings may be driven by the perception that state courts have lower thresholds to survive dismissal motions, which some evidence suggests has resulted in state courts attracting less meritorious cases than federal courts. *See*

[1] Cornerstone Research's *Securities Class Action Filings: 2020 Midyear Assessment* report, released in July 2020, identified 11 state-court '33 Act filings in the first half of 2020. *See* Cornerstone 2020 Midyear Report, *supra*, at 3. When extrapolated over a full year, this would imply a slower rate than the number of such filings in 2018 and 2019, but would still put 2020 on pace to more than double the average number of state-court securities class action filings from 2011 through 2017. *See id.* at 14. Furthermore, the spread of the COVID-19 pandemic in March 2020 may have played a role in the downturn in state-court '33 Act filings, including because the pandemic has reduced merger activity. For instance, only one of the state-court '33 Act filings in the first half of 2020 related to a merger, as compared to seven such merger-related filings in 2018 and ten in 2019. *See id.* at 4, 17.

Klausner, *supra*, at 1777–78, 1780–82.

While there have been fewer '33 Act cases filed in Texas post-*Cyan* than in certain other States to date, this is likely only because uncertainty remains as to whether Texas courts will enforce uniform federal standards in securities class actions at the motion-to-dismiss stage. Cases like this one are therefore important to establish statewide guidance. If this Court gives the securities plaintiffs' bar across the country reason to believe that Texas will not apply well-established limitations on federal securities claims at the motion-to-dismiss stage, then plaintiffs will shift their attention from other States' courts (which do impose the federal protections) to the courts of Texas. As a consequence, companies, including those in the securities industry that employ over 70,000 Texas residents, will be discouraged from maintaining their bases of operations in Texas. Texas companies will suffer: increased securities litigation inflates the risk of raising capital, increases insurance costs, and distracts executives from running their businesses. And companies in the energy sector would be especially vulnerable, given the historical volatility in oil and gas prices and the capital-intensive nature of those businesses.

ARGUMENT

I. THE '33 ACT REFLECTS A STRONG FEDERAL INTEREST IN UNIFORM APPLICATION OF THE FEDERAL SECURITIES LAWS TO PREVENT ABUSIVE LITIGATION IN ALL COURTS.

In this action, Plaintiff, a Florida-based pension fund, filed a complaint

asserting federal statutory claims under the '33 Act—not under Texas law—for purported material misstatements and omissions in a registration statement issued by a Texas oil-and-gas company. *See* R. at 393–98. In response to a Rule 91a motion to dismiss, Plaintiff argued that the District Court should not conduct a meaningful review of the underlying offering documents that form the basis for Plaintiff's claims to determine whether any plausible false statement or omission of material fact had been pled in a timely manner. Permitting this end run around the gateway mechanisms of the federal securities laws runs contrary to the federal interest in their uniform enforcement. Congress's emphasis on turning away meritless Section 11 claims, wherever brought, at an early stage is a primary reason why such claims constitute ideal candidates for Rule 91a dismissal.

A. Congress Has Clearly and Repeatedly Underscored the Federal Interest in Uniform Application of the Federal Securities Laws.

"The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities," such as the shares of defendant Southwestern, "cannot be overstated." *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 78 (2006). The federal securities laws, passed "[i]n response to the sudden and disastrous collapse in prices of listed stocks in 1929, and the Great Depression that followed," have, since their enactment in 1933 and 1934, "anchored federal regulation of vital elements of our economy." *Id.* The '33 Act "require[s] companies offering securities to the public to make 'full and fair

disclosure' of relevant information" about the company and the offered securities. *Cyan,* 138 S. Ct. at 1066 (quoting *Pinter* v. *Dahl*, 486 U.S. 622, 646 (1988)). The statute also "created private rights of action" for the enforcement of certain of its provisions, *id.*, including Section 11's and Section 12(a)(2)'s prohibitions on misstatements or omissions of material facts in registration statements and prospectuses, *see* 15 U.S.C. §§ 77k(a), 77*l*(a)(2).

By the 1970s, however, it had become clear that the plaintiffs' bar was abusing securities class actions to extort costly settlements from publicly traded companies. *See Blue Chip Stamps*, 421 U.S. at 738 ("There has been widespread recognition that [securities fraud] litigation . . . presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."). In 1995, Congress investigated and addressed these "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." *Dabit*, 547 U.S. at 81. The relevant House report found evidence of "the routine filing of lawsuits against issuers of securities . . . whenever there is a significant change in an issuer's stock price," "the targeting of deep pocket defendants," and "the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle," resulting in injury to "the investing public and the entire U.S. economy." H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.); *see also* S. Rep. No. 104-98, at 4, 9 (1995) (the Senate Committee on Banking, Housing, and Urban Affairs had

"heard substantial testimony that today certain lawyers file frivolous 'strike' suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation," and that the mere filing of such suits has an "in terrorem" effect).

Accordingly, Congress amended the '33 Act through the PSLRA. Twenty-one of the 30 members of Texas's House delegation voted in favor, as did both of Texas' Senators. *See H.R. 1058 (104th): Private Securities Litigation Reform Act of 1995: House*, GovTrack.us, https://bit.ly/2Yl4TJL; *H.R. 1058 (104th): Private Securities Litigation Reform Act of 1995: Senate*, GovTrack.us, https://bit.ly/3aRs7dk. The PSLRA erected various safeguards, including "heightened pleading requirements" in fraud actions, "limit[s] [on] recoverable damages and attorney's fees," "a 'safe harbor' for forward-looking statements," "imposition of sanctions for frivolous litigation," and "a stay of discovery pending resolution of any motion to dismiss." *Dabit*, 547 U.S. at 81. The Senate report noted the utility of the protections in "obtaining early dismissal of abusive securities suits, or discouraging them entirely." S. Rep. No. 104-98, at 35; *see* Relators' Br. 17.

The reforms introduced by Congress in the PSLRA prompted the plaintiffs' bar to begin bringing securities claims under state law, often in state courts, in an effort to circumvent these safeguards. *See Dabit*, 547 U.S. at 82. In response, to combat this "shift[] from Federal to State courts," which Congress found had

"prevented [the PSLRA] from fully achieving its objectives," Congress determined that it was "appropriate to enact national standards for securities class action lawsuits involving nationally traded securities." Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 2, 112 Stat. 3227. The result was SLUSA, which expressly called for "uniform standards" and prohibited certain securities class actions under state law, including those based on purported "untrue statement[s] or omission[s] of [ ] material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 77p(b)(1). Twenty-four of 30 members of Texas's House delegation voted in favor of SLUSA, as did both of the State's Senators. *See S. 1260 (105th): Securities Litigation Uniform Standards Act of 1998: House,* GovTrack.us, https://bit.ly/2VQnb3S; *S. 1260 (105th): Securities Litigation Uniform Standards Act of 1998: Senate*, GovTrack.us, https://bit.ly/35ixOzN.

The House's Conference Report for SLUSA underscored that its "purpose . . . [was] to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court." H.R. Rep. No. 105-803, at 13 (1998) (Conf. Rep.); *see* S. Rep. No. 105-182, at 3 (1998) (emphasizing, in section entitled "Purpose and Scope" of SLUSA, that one Senate witness "pointed out the dangers of maintaining differing federal and state standards of liability for nationally-traded securities"); *Dabit*, 547 U.S. at 86–87 (observing that "prospect . . . of parallel class actions proceeding in state and

federal court, with different standards governing claims asserted on identical facts . . . squarely conflicts with the congressional preference" embodied by SLUSA).

In light of this history, while the U.S. Supreme Court in *Cyan* acknowledged state courts' jurisdiction to hear '33 Act class claims, the Court also rejected the argument that such jurisdiction would undermine the purpose of the PSLRA and SLUSA by emphasizing that "SLUSA's bar on state-law class actions . . . guaranteed that the [PSLRA's] heightened substantive standards would govern all future securities class litigation." 138 S. Ct. at 1072. In other words, although the text of SLUSA permits a plaintiff to bring a '33 Act class action in a state court, *Cyan* reaffirmed that such actions could only proceed with due regard for the protections put in place by the '33 Act, PSLRA, SLUSA, and case law interpreting those federal statutes. *See id.* at 1072–73 ("For wherever ['33 Act] suits go forward, the [PSLRA's] substantive protections necessarily apply.").

Rigorous application of these uniform standards at the pleading stage has allowed federal courts to weed out many meritless lawsuits. Indeed, because of the potential costs and distraction of litigating a putative securities class action, "[m]ost securities lawsuits are resolved early in litigation, and the motion to dismiss in particular is a critical step. A case is often reconfigured or shut down entirely at this point." Jayme Herschkopf, *Securities Litigation*, Federal Judicial Center 16 (2017), https://bit.ly/2xBQfTs. According to one study, over an eighteen-year period, about

half of all putative securities class actions were dismissed at the motion-to-dismiss stage. Boettrich & Starykh, *supra*, at 20.

B. Texas Should Join the Other States That Have Applied the Federal Standards on the Scope of Required Securities Offering Disclosures at the Motion-to-Dismiss Stage.

In recognition of the interest in uniform national interpretation of the federal securities laws and of the gatekeeping role these laws assigned to the courts, state courts, including in New York, Michigan, California, Colorado, Massachusetts, Washington, Louisiana, and Florida, have applied federal standards to '33 Act claims to determine public companies' disclosure obligations in connection with securities offerings, often at the motion-to-dismiss stage.[2] *See, e.g.*, *In re Uxin Ltd. Sec. Litig.*, 2020 WL 1146636, at *7–9 (N.Y. Sup. Ct. Mar. 9, 2020) (citing federal precedent as relevant even under New York's notice-pleading standard to dismiss '33 Act claims, including in determining that "accurate statements about past performance . . . are not actionable under the securities laws"); *In re Sundial Growers Inc.*, 2020 WL 2543817, at *5–6 (N.Y. Sup. Ct. May 15, 2020) (citing federal precedent to dismiss '33 Act claims, including in determining that claims were

---

[2] Although there has been an influx of '33 Act claims following the Supreme Court's decision in *Cyan* in March 2018, such claims occasionally were brought in certain state courts even before *Cyan*, particularly in States such as California that recognized jurisdiction over the claims and where federal courts were not likely to recognize defendants' ability to remove the claims. As a result, certain of the decisions cited below pre-date the *Cyan* decision.

refuted by, *inter alia*, "the context of the alleged misrepresentations . . . and their placement amongst robust risk disclosures"); *In re Netshoes Sec. Litig.*, 64 Misc. 3d 926, 932, 938–39 (N.Y. Sup. Ct. 2019) (citing federal precedent to dismiss '33 Act claims, including in determining that alleged misstatements were immaterial because "Netshoes disclosed the information that the plaintiffs claim was omitted"); *In re Ally Fin. Sec. Litig.*, No. 16-013616-CB, slip op. at 6–7 (Mich. Circ. Ct. Jan. 11, 2019) (citing federal precedent to dismiss '33 Act claims on lack of materiality because "disclosures made by defendants were sufficient to cover the deficiencies plaintiffs alleged in the amended complaint"); *In re Natera, Inc. Sec. Litig.*, 2018 WL 11028766, at *3, 6 (Cal. Super. Ct. Aug. 7, 2018) (similar); *Houser* v. *CenturyLink, Inc.*, 2020 WL 4032184, at *4–10 (Colo. Dist. Ct. May 14, 2020) (looking to federal precedent to dismiss '33 Act claims on the merits); *In re Dentsply Sirona, Inc. S'holders Litig.*, 2019 WL 4695724, at *7 (N.Y. Sup. Ct. Sept. 26, 2019) (same); *Fortunato* v. *Akebia Therapeutics, Inc.*, 2017 WL 716356, at *13–14 (Mass. Super. Ct. Feb. 21, 2017) (same); *In re Funko, Inc., Sec. Litig.*, 2019 WL 3805227, at *4–5 (Wash. Super. Ct. Aug. 2, 2019) (same); *Wilkins* v. *Hogan Drilling Co.*, 471 So. 2d 863, 866 (La. Ct. App. 1985) (looking to federal precedent in affirming dismissal on motion to dismiss of '33 Act claims based on statute of limitations); Order Granting Defendant Tyco's Motion to Dismiss the Complaint at 2–3, *Hromyak* v. *Tyco Int'l Ltd.*, 2005 WL 5872097 (Fla. Circ. Ct. Aug. 23, 2005) (No.

2002 CA 015010) (same); *see also City of Livonia Retiree Health & Disability Benefits Plan* v. *Pitney Bowes, Inc.*, 2019 WL 2293924, at *5 (Conn. Super. Ct. May 15, 2019) (applying PSLRA discovery stay to '33 Act claims).

Certain of these state courts have explained why it is appropriate to apply federal standards in such cases. For instance, in dismissing a Section 11 claim as "at direct odds with the judicially noticeable evidence of the [defendant's] actual adequate disclosure," a California court recently underscored the importance of maintaining "consistency and uniformity in the handling of such cases as between the Federal and State courts" in light of *Cyan*'s "confirmation of concurrent jurisdiction." *Natera*, 2018 WL 11028766, at *3, 6. A New York court adopted similar reasoning in holding that the '33 Act's mandatory stay of discovery pending a motion to dismiss applies in state court—another protection reflecting Congress's desire for courts to act as gatekeepers to weed out strike suits early on. The court explained:

> [A] divergence in the application of the [PSLRA] discovery stay in state and federal court would create the undesirable (and unsupported by the text of the statute or its purpose) and absurd incentive for lawsuits brought under the 1933 Act to be brought in state court as opposed to federal court to avoid the very protection supporting the enactment of the [PSLRA] and necessarily confounding Congress' acknowledged intention that the lion's share of securities litigation would occur in federal courts.

In re Everquote, Inc. Sec. Litig., 106 N.Y.S.3d 828, 837 (Sup. Ct. 2019); *see also In re GreenSky, Inc. Sec. Litig.*, 2019 WL 6310525, at *2 (N.Y. Sup. Ct. Nov. 25, 2019)

("The important purpose underlying enactment of the [PSLRA] automatic stay—ensuring that cases have merit at the outset—should not be disregarded merely because a federal cause of action is being prosecuted in state court."); *Milano* v. *Auhll*, 1996 WL 33398997, at *4 (Cal. Super. Ct. Oct. 2, 1996) ("The intent of Congress to provide a broad and effective method of weeding out frivolous and unsupported suits . . . would be frustrated if plaintiffs could evade the new restrictions simply by filing in state courts"); *Fortunato*, 2017 WL 716356, at *9 (state courts must, in construing '33 Act, abide by "uniform national standards").

Rigorously applying federal substantive law at the motion-to-dismiss stage would also be fully consistent with Texas law. Rule 91a was adopted as "a significant [legislative] effort to improve the efficiency of the Texas court system" by "reduc[ing] the expense and delay of litigation." See Misc. Docket No. 12–9191, Adoption of Rules for Dismissals and Expedited Actions (Tex. Nov. 13, 2012) (per curiam); *see also* House Research Org., Bill Analysis, Tex. H.B. 274, 82nd Leg. (2011), https://bit.ly/38x5qxh (supporters of bill prompting issuance of Rule 91a identified that it would provide "a procedure for early dismissal of meritless claims among other reforms"). This Court has recognized that Rule 91a sets a "factual-plausibility standard" that "is akin to a legal sufficiency review." *City of Dallas*, 494 S.W.3d at 724; *see also* Relators' Br. 23–25. That means that for a claim to survive a Rule 91a motion to dismiss, "it must contain enough facts to state a claim that is

plausible on its face." *Wooley*, 447 S.W.3d at 76 (internal quotation marks omitted). This is the functional equivalent to the federal standard pursuant to which federal courts assess most '33 Act claims that do not sound in fraud.

The District Court below erred by failing to conduct a meaningful review of the sufficiency of the allegations in light of well-understood limits on Plaintiff's claims. Failure to correct this error would place Texas courts firmly in the camp of state courts that have not consistently applied federal precedent and have instead undermined the federal interest in the uniform interpretation and application of the federal securities laws. *See, e.g.*, *In re Pac. Biosciences of Cal., Inc.*, No. CIV 509210, slip op. at 9–10 (Cal. Super. Ct. May 25, 2012) (rejecting applicability of automatic PSLRA discovery stay in state court); *Switzer* v. *W.R. Hambrecht & Co.*, 2018 WL 4704776, at *1 (Cal. Super. Ct. Sept. 19, 2018) (similar); *cf. Pub. Emps. Ret. Sys. of Miss.* v. *Sprouts Farmers Mkt., Inc.*, 2017 WL 3741229, at *6 (Ariz. Super. Ct. Aug. 25, 2017) (discounting defendant's reliance on federal precedent in denying motion to dismiss Section 11 claims based on cases having been "decided under the more exacting standards of federal pleading and not Arizona law").

C. The Federal Defenses That Texas Courts Should Apply at the Motion-to-Dismiss Stage Include Those Based on Materiality and the Statute of Repose.

1. The Materiality of an Alleged Misstatement or Omission Must Be Considered in the Context of the Disclosure as a Whole.

Federal courts have long held that, to survive a motion to dismiss, a plaintiff bringing federal securities claims premised on alleged misstatements or omissions must plead facts demonstrating that those misstatements or omissions are material to investors as a matter of law when viewed in the entirety of an issuer's disclosures. *See Basic Inc.* v. *Levinson*, 485 U.S. 224, 231–32 (1988) (holding that, for a fact to be deemed material, "there must be a substantial likelihood that [its] disclosure . . . would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (internal quotation marks omitted)); *Kapps* v. *Torch Offshore, Inc.*, 379 F.3d 207, 213–14, 216 (5th Cir. 2004) (emphasizing "substantial likelihood" and "significantly altered" aspects of materiality test in affirming dismissal of '33 Act claims); *see also Gorman* v. *Life Ins. Co. of N. Am.*, 811 S.W.2d 542, 549 (Tex. 1991) (stating that a "federal cause of action . . . is governed by federal law" and applying federal precedent). The U.S. Supreme Court has directed that this materiality threshold is not to be set "unnecessarily low," lest "the corporation and its management be subjected to liability for insignificant omissions or misstatements" and management then "bury

the shareholders in an avalanche of trivial information." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 448 (1976).

Significantly, for a '33 Act claim, it is well settled that materiality is to be assessed by "viewing the [purportedly misrepresented or omitted] information in the context of the Offering Documents as a whole." *Truk Int'l Fund LP* v. *Wehlmann*, 737 F. Supp. 2d 611, 620 (N.D. Tex. 2009); *see Omnicare, Inc.* v. *Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175, 190 (2015) ("[A]n investor reads each statement within [a registration statement] . . . in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information."); *Kapps*, 379 F.3d at 211 (concluding, at dismissal stage, that "[w]e do not find the statement that the price of natural gas 'increased by approximately 133%' to be materially misleading when read in the context of the prospectus as a whole"); *Gasner* v. *Bd. of Supervisors*, 103 F.3d 351, 358 (4th Cir. 1996) (alleged misstatements "must be considered in the full context in which they were made"); *see also Saltzberg* v. *TM Sterling/Austin Assocs.*, 45 F.3d 399, 400 (11th Cir. 1995) ("[S]pecific warnings of the risks involved . . . may be sufficient to render the alleged omissions . . . immaterial as a matter of law.").

The particular context of Section 11 cases warrants rigorous application of this federal standard on a Rule 91a motion. As noted above, Congress's manifest preference for courts to act in a gatekeeper role, *see supra* Section I.A, and the well-

developed federal precedent on point, *see supra* at 19–20, make dismissal of such cases on the pleadings especially appropriate. Beyond that, Section 11 claims also necessarily rely on and invariably quote from a company's registration statement or prospectus, and thus incorporate those materials into the complaint. Looking to the contents of such company disclosures in deciding a Rule 91a motion falls comfortably within the court's authority provided for by that rule. *See AC Interests, L.P.* v. *Tex. Comm'n on Envtl. Quality*, 543 S.W.3d 703, 706 (Tex. 2018) (when deciding a Rule 91a motion, the trial court should consider the petition "together with any pleading exhibits permitted by Rule 59" (quoting Tex. R. Civ. P. 91a.6)); Tex. R. Civ. P. 59 (providing that "written instruments" can be "made a part of the pleadings" where they are "cop[ied] . . . in the body of the pleading in aid and explanation of the allegations in the petition"). The contents of these company disclosures are often dispositive at the motion-to-dismiss stage in Section 11 cases involving application of the materiality standard.

Applying these federal standards in this case makes clear that, as Defendants argue, *see* Relators' Br. at 6–8, 44–47, the District Court should have evaluated the *whole* of Southwestern's January 2015 registration statement and prospectus. These materials merely included a reserve estimate as of a particular date in the past, while simultaneously reporting, among other things, that gas prices had declined since then, that lower prices could affect asset values, and that reserves could vary from

estimates, including based on the company's ability to transport and sell the reserves extracted from its oil and gas properties. By failing to undertake such an evaluation, the District Court ignored a key threshold factual-plausibility burden on plaintiffs bringing '33 Act claims, and thus thwarted important protections that Congress and the federal courts have given to securities defendants.

2. The Federal Statute of Repose Is Strictly Applied.

Beyond the requirements to plead the materiality element of a '33 Act claim, Texas courts should also apply the Act's statute of repose at the pleading stage. As Defendants explain, *see* Relators' Br. 27–29, the '33 Act expressly provides for a three-year statute of repose for claims under Sections 11 and 12(a)(2), 15 U.S.C. § 77m. This time bar "reflects the legislative objective to give a defendant a complete defense to any suit after a certain period," and it cannot be tolled. *Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, 137 S. Ct. 2042, 2049 (2017). As the U.S. Supreme Court has observed, the statute "provides in clear terms that '[i]n no event' shall an action be brought more than three years after the securities offering on which it is based," *id.* (quoting 15 U.S.C. § 77m), an "instruction [that] admits of no exception and on its face creates a fixed bar against future liability," *id.*

Courts routinely apply the statute of repose at the pleading stage to dismiss time-barred lawsuits where there is no factual dispute. *See, e.g.*, *W. & S. Life Ins. Co.* v. *JPMorgan Chase Bank, N.A.*, 54 F. Supp. 3d 888, 911–12 (S.D. Ohio 2014);

John Hancock Life Ins. Co. (U.S.A.) v. *JPMorgan Chase & Co.*, 938 F. Supp. 2d 440, 445–48 (S.D.N.Y. 2013). In addition, federal courts have rejected amendments to '33 Act claims made after the three-year repose period has passed that are based on "an entirely new theory encompassing different conduct" from the original claims. *Caldwell* v. *Berlind*, 543 F. App'x 37, 39–40 (2d Cir. 2013) (affirming dismissal of amended '33 Act claims on motion to dismiss based on statute of repose); *FDIC* v. *First Horizon Asset Sec. Inc.*, 291 F. Supp. 3d 364, 372 (S.D.N.Y. 2018) (after expiration of repose period, "[a]ny liability created under . . . the 1933 Act . . . no longer exists for the acts [newly] alleged" in the amended complaint, even if initial complaint pointed to purported misstatements in same offering documents, and permitting such claims to go forward "would contradict Section 13's purpose of freeing defendants absolutely from liability"); *cf. Holmes* v. *Greyhound Lines, Inc.*, 757 F.2d 1563, 1566 (5th Cir. 1985) (affirming dismissal of amended complaint as time-barred where initial and amended complaints arose from same overall incident but amended claims were premised on different facts related to incident and thus different theory of liability); *see also* Relators' Br. 31–33.

Here, Plaintiff's original October 17, 2016 petition alleged only that certain statements in Southwestern's registration statement were misleading because they "failed to disclose that the Company was experiencing severe liquidity and debt issues." R. at 4. The word "Chesapeake," referring to the acquired property to which

Plaintiff's later claims related, appeared only twice in the original petition. It was only a year-and-a-half later on May 25, 2018, that Plaintiff decided to pivot and assert in its amended petition that the registration statement's disclosures about reserves at the Chesapeake property were false or misleading; the word "Chesapeake" appeared more than 70 times in the amended petition. *Compare* R. 1–27, *with* R. 351–99; *see also* Relators' Br. 34–36. The District Court should have followed the clear federal precedent requiring rigorous application of the statute of repose at the dismissal stage. Had it done so, it would have dismissed Plaintiff's claim based on the reserve estimate, which Plaintiff asserted more than three years after the January 2015 offering.

II. ALLOWING THE TRIAL COURT'S DECISION TO STAND WILL ENCOURAGE STRIKE SUITS AGAINST TEXAS COMPANIES AND WILL DISINCENTIVIZE PUBLIC COMPANIES FROM LOCATING IN THE STATE.

Cyan has sparked a wave of securities class actions asserting federal claims in state courts across the country. *See supra* at 7–8. Plaintiff's contention that this wave has not yet reached Texas, *see* Mandamus Resp. at 1–2, suggests nothing more than that plaintiffs' attorneys still do not know how Texas courts will handle these cases, and rings hollow in the face of Plaintiff's request that this Court resolve that uncertainty in a way that would create the very wave that Plaintiff contends is absent. This case thus provides an important opportunity for this Court to set a statewide standard and resolve that uncertainty. If Texas courts do not apply rigorous scrutiny

to ’33 Act complaints on a Rule 91a motion, they run the risk of turning themselves into a magnet jurisdiction for federal securities strike suits. California offers a warning. Before *Cyan*, California courts recognized their jurisdiction to consider class actions bringing ’33 Act claims and often did not apply federal standards for evaluating such claims. *E.g.*, *In re FireEye, Inc.*, 2015 WL 13546104, at *12 (Cal. Super. Ct. Aug. 11, 2015). As a result, from 2011 to 2017, plaintiffs brought at least 50 putative class actions under the ’33 Act in California courts against some of the largest public companies headquartered in that State.[3]

Texas companies in the energy industry—a category that includes three of its largest public companies, *see Capital Markets in Texas*, SIFMA, states.sifma.org/#state/tx—are particularly enticing targets for strike suits because of the regular fluctuation in oil and gas prices and the capital-intensive nature of resource extraction and energy production that may lead to public securities offerings. As set forth *supra* at Section I.B, many state courts have applied federal substantive rules interpreting the ‘33 Act at the motion-to-dismiss stage in securities suits, including post-*Cyan* (and some have also applied other protections like the mandatory stay of discovery pending a motion to dismiss). If Texas does not enforce

[3] *See* Brief of Alibaba Group Holding Limited et al., as *Amici Curiae* in Support of Petitioners at 8–9, *Cyan, Inc.* v. *Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018) (No. 15-1439).

these protections, it risks becoming the preferred forum for vexatious '33 Act litigation, with a particular threat to Texas energy companies.

The burden of such abusive litigation on Texas companies would be exacerbated by the increasing prevalence of multiple, overlapping securities actions across state and federal courts. State-court cases frequently involve claims that are asserted in parallel federal litigation. *See* U.S. Chamber Institute for Legal Reform, *ILR Briefly: An Update on Securities Litigation* 4 (2020) ("U.S. Chamber 2020 Report"), https://bit.ly/3kHtJvT. From 2011 through 2019, there were 84 instances of parallel actions filed; 51 of them were filed after *Cyan*. Klausner, *supra*, at 1783. Those 51 parallel actions constitute nearly half of all Section 11 litigation since *Cyan*. *Id.* at 1775, fig. 2. As an example, Texas-based Huntsman Corporation has faced '33 Act claims in state and federal courts in Texas and in federal court in New York following its 2017 spin-off of its pigments and additives business into a new public company, while other parties involved in the same offering, including the spun-off company and the underwriting banks, were also sued in state court in New York. *See* Venator Materials PLC, Quarterly Report (Form 10-Q), at 38 (May 6, 2020). Similarly, in 2019, SmileDirectClub faced securities class action filings in state and federal court in New York, Tennessee, and Michigan. *See* SmileDirectClub, Inc., Quarterly Report (Form 10-Q), at 33 (Nov. 16, 2020). As the U.S. Supreme Court recognized in the context of concluding that state-law "holder"

securities fraud claims were preempted by SLUSA, the "[t]he prospect . . . of parallel class actions proceeding in state and federal court, with different standards governing claims asserted on identical facts . . . squarely conflicts with the congressional preference for 'national standards for securities class action lawsuits involving nationally traded securities.'" *Dabit*, 547 U.S. at 86–87 (quoting Securities Litigation Uniform Standards Act of 1998, § 2, 112 Stat. 3227).

Companies subject to parallel state and federal litigation do not have easy recourse, especially where state courts do not faithfully apply federal substantive standards. As the Delaware Supreme Court has explained, "When parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court." *Salzburg* v. *Sciabacucchi*, 227 A.3d 102, 115 (Del. 2020).[4] Litigating multiple cases simultaneously in state and federal court creates "obvious" "costs and inefficiencies." *Id.* For example, the inability to consolidate parallel litigation leads to duplicative motion practice and the potential for overlapping discovery and inconsistent rulings. *See id.* Parties may also face a race to competing class certification and judgments. Texas companies, their directors, and securities industry participants thus would be forced to defend

[4] In federal court, the Judicial Panel on Multidistrict Litigation ("JPML") is empowered to appoint a single judge to preside over actions that share "one or more common questions of fact." 28 U.S.C. § 1407(a). The JPML regularly consolidates federal securities litigation.

sprawling class actions in state court under one set of rules and in federal court under another.

Compounding these problems, state-court class actions are less likely to be dismissed than their federal counterparts. *See* U.S. Chamber Institute for Legal Reform, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System* 12 (2019) ("U.S. Chamber 2019 Report"), https://bit.ly/3jJfFk0; Klausner, *supra*, at 1777. For example, while a California federal court dismissed a Section 11 claim against Sunrun, Inc., its officers and directors, and the underwriters of its IPO, a California state court refused to dismiss similar claims in parallel state-court litigation. *Compare Greenberg* v. *Sunrun Inc.*, 233 F. Supp. 3d 764 (N.D. Cal. 2017) (dismissing claim that defendant's non-inclusion of Nevada as a strategically significant market susceptible to adverse policy changes in its prospectus was an actionable omission because, *inter alia*, the prospectus did include language disclosing the risk), *with* Case Management Order, *Pytel* v. *Elmore*, No. CIV538215 (Cal. Super. Ct. Jan. 17, 2017) (concluding in the parallel litigation that complaint adequately alleged that defendant knew that Nevada was considering regulatory change and that Nevada was strategically significant to its business, which was sufficient to survive the issuer defendant's demurrer). Parallel litigation thus gives plaintiffs' lawyers an opportunity to "exploit these dual forums to pressure defendants to settle regardless of the merits of the cases." U.S. Chamber 2019

Report, *supra*, at 13.

If plaintiffs target Texas companies in state-court securities class actions, it will harm not only Texas companies, but also the State of Texas and its citizens. Such litigation would drive up the cost of raising capital for Texas companies, lower their investors' returns, and discourage them from maintaining their bases of operations in the State, including reducing the likelihood that they will expand and create jobs in Texas. *See* U.S. Dep't of Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets* 33 (2017), https://bit.ly/32ACReS ("The potential for class action securities litigation may discourage companies from listing their shares on public markets . . . ."); *see also* H.R. Rep. No. 104-50, at 20 (1995) (House report from early draft of PSLRA observing that "[f]ear of litigation keeps companies out of the capital markets").[5] Texas companies raised more than $15 billion in equity and $100 billion in corporate debt in 2019, *see* SIFMA, *supra*, economic growth that might not persist in Texas were such companies forced to grapple with an uptick in Section 11 suits following such issuances.

---

[5] With respect to the IPO market in particular, IPOs following the financial crisis of 2008 have already faced a higher likelihood of follow-on litigation than did those before the crisis, *see* Cornerstone Research, *2019 Year in Review*, *supra*, at 28, and "the threat of protracted and often frivolous securities class action litigation has contributed to a decades-long decline in IPOs," as companies elect to pursue funds through "private capital transactions or strategic combinations," Laurie Smilan & Nicki Locker, *Saying So Long to State Court Securities Litigation*, Harvard Law School Forum on Corporate Governance (Feb. 11, 2019), https://bit.ly/2KPqr9k.

Moreover, companies have already begun to face massive increases in director-and-officer insurance premiums due to the wave of federal securities claims brought in state courts in the last two years, and Texas companies may face added costs if Texas courts apply less rigorous pleading standards than federal courts have to '33 Act claims. *See D&O Insurance Costs Soar as Investors Run to Court Over IPOs*, Insurance Journal (June 18, 2019), https://bit.ly/2YmLV5s (describing increase in D&O insurance costs of as much as 200% as a result of the rise in securities class actions). Insurers are also lowering the amount of D&O coverage offered and may be generally less inclined to renew policies or underwrite new ones. *See* U.S. Chamber 2020 Report, *supra*, at 6. Finally, a dramatic increase in litigation costs would also threaten underwriters and other securities industry participants, the employers of more than 70,000 Texas residents. *See* SIFMA, *supra*.

Accordingly, failing to apply federal substantive standards in evaluating the legal sufficiency of federal securities class action claims opens the door to the very ills Congress sought to eliminate with the '33 Act, the PSLRA, and SLUSA, risks turning Texas courts into a haven for baseless securities suits, and threatens to dramatically increase the cost of Texas companies accessing capital through public offerings.

CONCLUSION

For the foregoing reasons, *amici* respectfully urge this Court to grant the petition for mandamus.

Respectfully submitted,

/s/ *Judson O. Littleton*

Judson O. Littleton
State Bar No. 24065635
SULLIVAN & CROMWELL LLP
1700 New York Avenue, NW, Suite 700
Washington, D.C. 20006
Tel: (202) 956-7500
Fax: (202) 293-6330
littletonj@sullcrom.com

Robert J. Giuffra Jr.
Matthew A. Schwartz
Justin J. DeCamp
Andrew J. Finn
Joshua D. Tannen
SULLIVAN & CROMWELL LLP
125 Broad Street
New York, New York 10004
Tel: (212) 558-4000
Fax: (212) 558-3588
giuffrar@sullcrom.com
schwartzmatthew@sullcrom.com
decampj@sullcrom.com
finna@sullcrom.com
tannenj@sullcrom.com

Attorneys for Amici Curiae

CERTIFICATE OF COMPLIANCE

As required by Texas Rule of Appellate Procedure 9.4(i)(3), I certify that, according to the word count of the computer program used to prepare this document, the document contains 7,512 words.

/s/ *Judson O. Littleton*
Judson O. Littleton

CERTIFICATE OF SERVICE

I certify that true and correct copies of this Brief of the Securities Industry and Financial Markets Association and Chamber of Commerce of the United States of America as *Amici Curiae* in Support of the Petition for Writ of Mandamus were served on all parties by the means listed below on the 18th day of November 2020, addressed as follows:

Counsel for Relators:

Thomas R. Phillips
tom.phillips@bakerbotts.com
BAKER BOTTS L.L.P.
98 San Jacinto Blvd., Ste. 1500
Austin, Texas 78701
(*By E-File*)

Aaron M. Streett
aaron.streett@bakerbotts.com
J. Mark Little
mark.little@bakerbotts.com
Anthony J. Lucisano
anthony.lucisano@bakerbotts.com
BAKER BOTTS L.L.P.
910 Louisiana Street
Houston, Texas 77002
(*By E-File*)

Ellen Sessions
ellen.sessions@nortonrosefulbright.com
Rodney Acker
rodney.acker@nortonrosefulbright.com
NORTON ROSE FULBRIGHT US LLP
2200 Ross Avenue, Ste. 3600
Dallas, Texas 75201
(*By E-File*)

Noelle M. Reed
noelle.reed@skadden.com
Wallis M. Hampton
wallis.hampton@skadden.com
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
1000 Louisiana Street, Ste. 6800
Houston, Texas 77002
(*By E-File*)

Scott D. Musoff
scott.musoff@skadden.com
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036
(*By E-File*)

Mark Oakes
mark.oakes@nortonrosefulbright.com
NORTON ROSE FULBRIGHT US LLP
98 San Jacinto Boulevard, Ste. 1100
Austin, Texas 78701
(*By E-File*)

Counsel for Real Party in Interest:

Thomas E. Bilek
tbilek@bileklaw.com
THE BILEK LAW FIRM, L.L.P.
700 Louisiana Street, Ste. 3950
Houston, Texas 77002
(*By E-File*)

Beth A. Kaswan
bkaswan@scott-scott.com
Donald A. Broggi
dbroggi@scott-scott.com
Thomas L. Laughlin
tlaughlin@scott-scott.com
Randy L. Moonan
rmoonan@scott-scott-.com
SCOTT + SCOTT ATTORNEYS AT LAW LLP
230 Park Avenue, 17th Floor
New York, New York 10169
(*By E-File*)

David R. Scott
david.scott@scott-scott.com
Amanda Lawrence
alawrence@scott-scott.com
SCOTT + SCOTT ATTORNEYS AT LAW LLP
156 South Main Street
P.O. Box 192
Colchester, Connecticut 06415
(*By E-File*)

John T. Jasnoch
jjasnoch@scott-scott.com
SCOTT + SCOTT ATTORNEYS AT LAW LLP
600 West Broadway, Ste. 3300
San Diego, California 92101
(*By E-File*)

Respondent:

The Honorable Fredericka Phillips
Harris County Civil Courthouse
201 Caroline St. 9th Floor
Houston, Texas 77002
(*By E-file*)

/s/ *Joshua D. Tannen*
Joshua D. Tannen

NERA
ECONOMIC CONSULTING

29 January 2019

Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review

Record Pace of Filings, Despite Slower Merger-Objection Growth
Average Case Size Surges to Record High
Settlement Values Rebound from Near-Record Lows

By Stefan Boettrich and Svetlana Starykh

Insight in Economics™

Foreword

I am excited to share NERA's *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review* with you. This year's edition builds on work carried out over numerous years by many members of NERA's Securities and Finance Practice. In this year's report, we continue our analyses of trends in filings and settlements and present new analyses, such as how post-class-period stock price movements relate to voluntary dismissals. While space does not permit us to present all the analyses the authors have undertaken while working on this year's edition, or to provide details on the statistical analysis of settlement amounts, we hope you will contact us if you want to learn more about our work related to securities litigation. On behalf of NERA's Securities and Finance Practice, I thank you for taking the time to review our work and hope you find it informative.

Dr. David Tabak
Managing Director

Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review

Record Pace of Filings, Despite Slower Merger-Objection Growth
Average Case Size Surges to Record High
Settlement Values Rebound from Near-Record Lows

By Stefan Boettrich and Svetlana Starykh[1]

29 January 2019

Introduction and Summary[2]

In 2018, the pace of securities class action filings was the highest since the aftermath of the 2000 dot-com crash, with 441 new cases. While merger objections constituted about half the total, filing growth of such cases slowed versus 2017, indicating that the explosion in filings sparked by the *Trulia* decision may have run its course.[3] Filings alleging violations of Rule 10b-5, Section 11, and/or Section 12 of the Securities Act of 1933 ("Securities Act") were roughly unchanged compared to 2017, but accelerated over the second half of the year, with the fourth quarter being one of the busiest on record.

The steady pace of new securities class actions masked fundamental changes in filing characteristics. Aggregate NERA-defined Investor Losses, a measure of total case size, came to a record $939 billion, nearly four times the preceding five-year average. Even excluding substantial litigation against General Electric (GE), aggregate Investor Losses doubled versus 2017. Most growth in Investor Losses stemmed from cases alleging issues with accounting, earnings, or firm performance, contrasting with prior years when most growth was tied to regulatory allegations. Filings against technology firms jumped nearly 70% from 2017, primarily due to cases alleging accounting issues or missed earnings guidance.

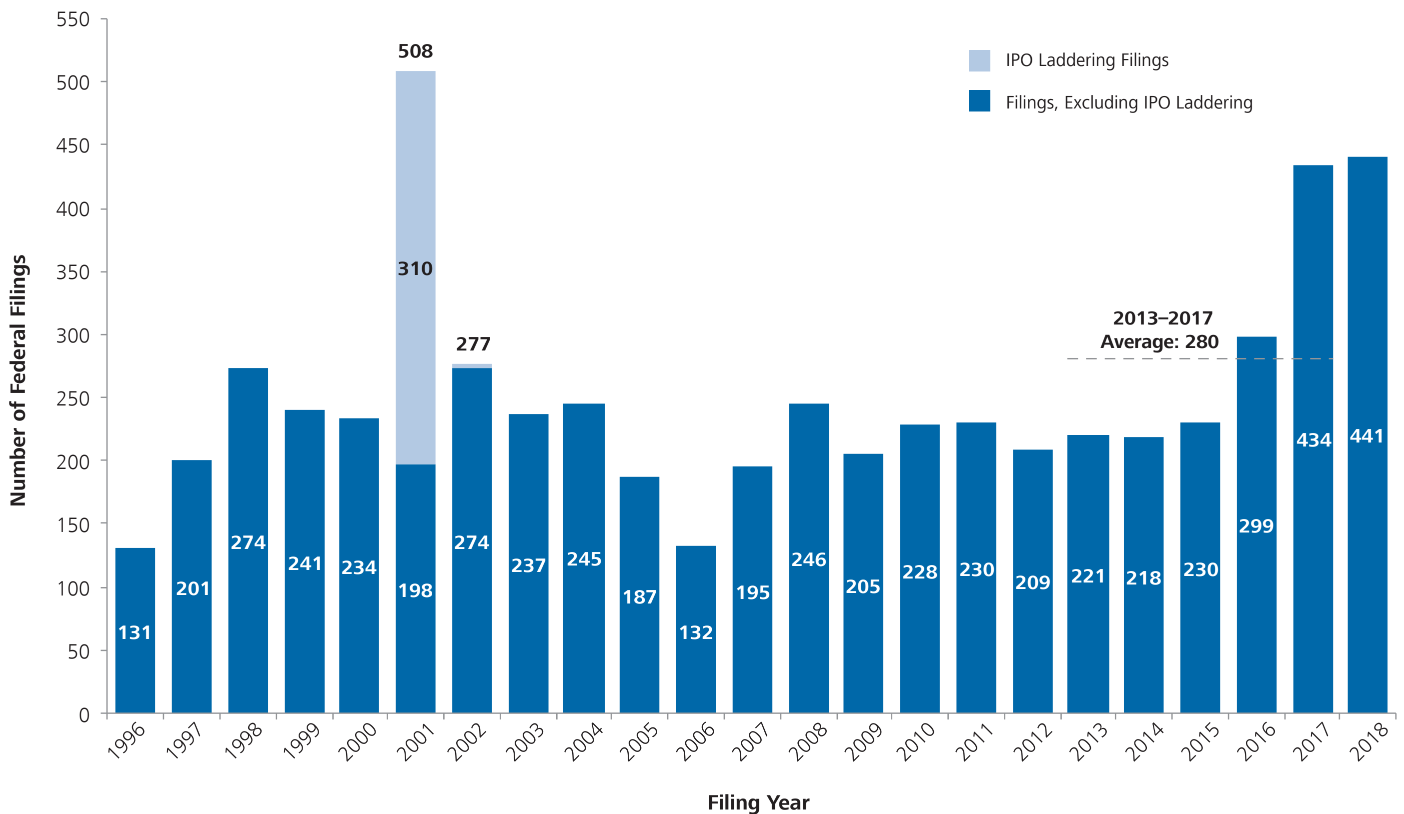
The average settlement value rebounded from the 2017 near-record low, mostly due to the $3 billion settlement against Petróleo Brasileiro S.A.—Petrobras. The median settlement nearly doubled, primarily due to higher settlements of many moderately sized cases. Despite a rebound in settlement values in 2018, the number of settlements remained low, with dismissals outnumbering settlements more than two-to-one. An adverse number of cases were voluntarily dismissed, which can partially be explained by positive returns of targeted securities during the PSLRA bounce-back periods. The robust rate of case resolutions has not kept up with the record filing rate, driving pending litigation up more than 6%.

Trends in Filings

Number of Cases Filed

There were 441 federal securities class actions filed in 2018, the fourth consecutive year of growth (see Figure 1). The filing rate was the highest since passage of the PSLRA, with the exception of 2001 when new IPO laddering cases dominated federal dockets. The dramatic year-over-year growth seen in each of the past few years resulted in a near doubling of filings since 2015, but growth moderated considerably in 2018 to 1.6%. The 2018 filing rate is well above the post-PSLRA average of approximately 253 cases per year, and solidifies a departure from the generally stable filing rate in the years following the 2008 financial crisis.

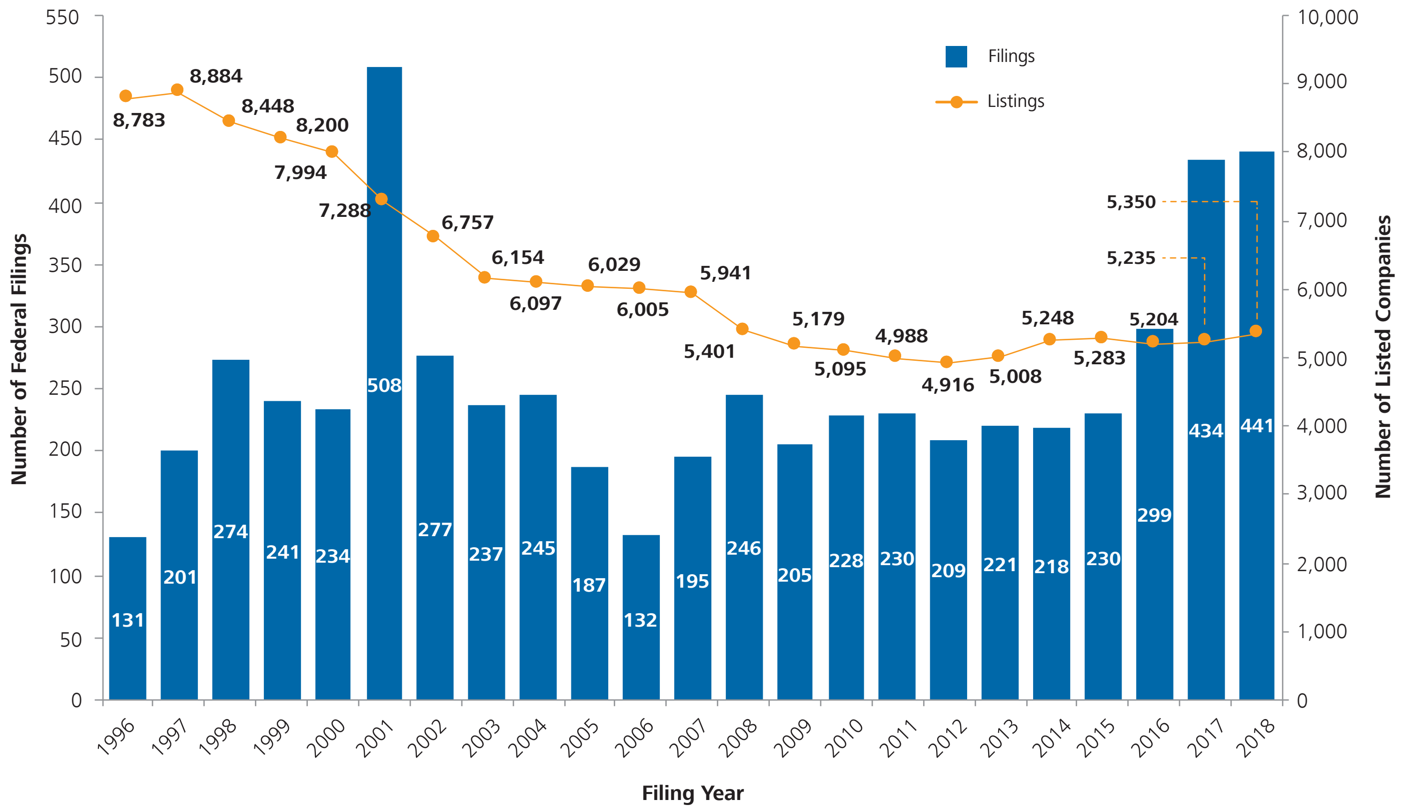
Figure 1. **Federal Filings**
January 1996–December 2018



As of November 2018, there were 5,350 companies listed on the major US securities exchanges (see Figure 2). The 441 federal securities class action suits filed in 2018 involved approximately 8.2% of publicly listed companies. The overall risk of litigation to listed firms has increased substantially since early in the decade, when only about 4.0% of public companies listed on US exchanges were subject to a securities class action.

Broadly, the chance of a publicly listed company being subject to securities litigation depends on the number of filings relative to the number of listed companies. While the number of listed companies has increased by 7% over the last five years, the longer-term trend is toward fewer listings. Since the passage of the PSLRA in 1995, the number of listings on major US exchanges has steadily declined by about 3,000, or nearly 40%. Recent research attributed this decline to fewer new listings and an increase in delistings, mostly through mergers and acquisitions.[4]

Figure 2. **Federal Filings and Number of Companies Listed in the United States**
January 1996–December 2018



Note: Listed companies include those listed on the NYSE and Nasdaq. Listings data from 2016 through 2018 were obtained from World Federation of Exchanges (WFE). The 2018 listings data is as of November 2018. Data for prior years was obtained from Meridian Securities Markets and WFE.

Despite the long-term drop in the number of listed companies, the average number of securities class action filings has *increased* from 216 per year over the first five years after the PSLRA to about 324 per year over the past five years. The long-term trend toward fewer listed companies coupled with more class actions implies that the average probability of a listed firm being subject to such litigation has increased from about 2.6% after passage of the PSLRA to 3.7% over the past five years, and 8.0% over the past two years.

Recently, the rising average risk of class action litigation was driven by dramatic growth in merger-objection cases that, prior to 2016, were mostly filed in various state courts. Since then, state court rulings have driven such litigation onto federal dockets. Hence the increase in the typical firm's litigation risk might be less than indicated above, since 1) the risk of merger-objection litigation is specific to firms planning or engaged in M&A activity and 2) many merger-objection cases would otherwise have been filed in state courts.

The average probability of a firm being targeted by what is often regarded as a "Standard" securities class action—one that alleges violations of Rule 10b-5, Section 11, and/or Section 12—was only 4.0% in 2018, albeit higher than the average probability of about 2.6% following the PSLRA and 3.5% between 2013 and 2017.

Filings by Type

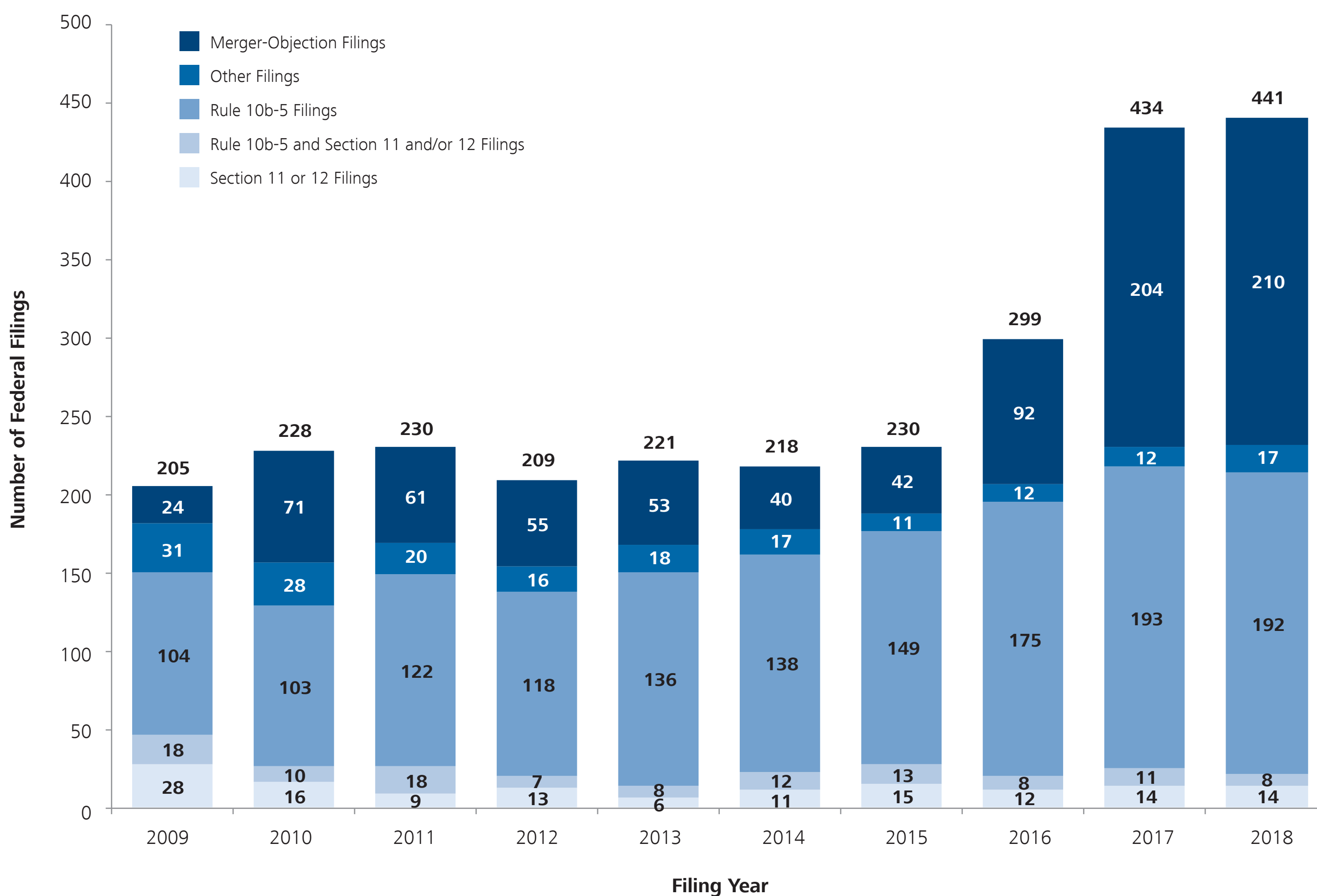
In 2018, the 441 securities class action filings were about evenly split between Standard securities class actions and merger objections, roughly matching the number seen in 2017 (see Figure 3). There were 214 Standard securities cases filed, down slightly from 2017. Prior to 2018, Standard filings grew for five consecutive years, the longest expansion on record, and by over 50% since 2013. Despite the slowdown in 2018, monthly filing growth over the second half of the year was robust, and capped by 64 filings in the fourth quarter, one of the busiest quarters on record.

Despite the 210 merger-objection filings in 2018 making up about half of all filings, yearly filing growth of such cases slowed to almost zero, as the number of filings roughly matched the level seen in 2017. The tepid filing growth implies that the rapid growth following various state-level decisions limiting "disclosure-only" settlements (including the *Trulia* decision) has likely run its course.[5] Rather, the stagnant growth in federal merger-objection filings was likely driven by relatively stagnant M&A activity.[6]

Although aggregate merger-objection filings (including those at the state level) may correspond with the rate of mergers and acquisitions, such deal activity does not appear to have historically been the primary driver of federal merger-objection filings over multiple years. The number of federal merger-objection filings generally fell between 2010 and 2015, despite increased M&A activity. The higher filing counts in 2016 and 2017 likely stemmed from trends in the choice of jurisdiction rather than trends in deal volume.[5]

Besides Standard and merger-objection cases, a variety of other filings rounded out 2018. Several filings alleged fraudulent initial coin and cryptocurrency offerings, manipulation of derivatives (e.g., VIX products and metals futures), and breaches of fiduciary duty (including client-broker disputes involving churning and improper asset allocation).

Figure 3. **Federal Filings by Type**
January 2009–December 2018



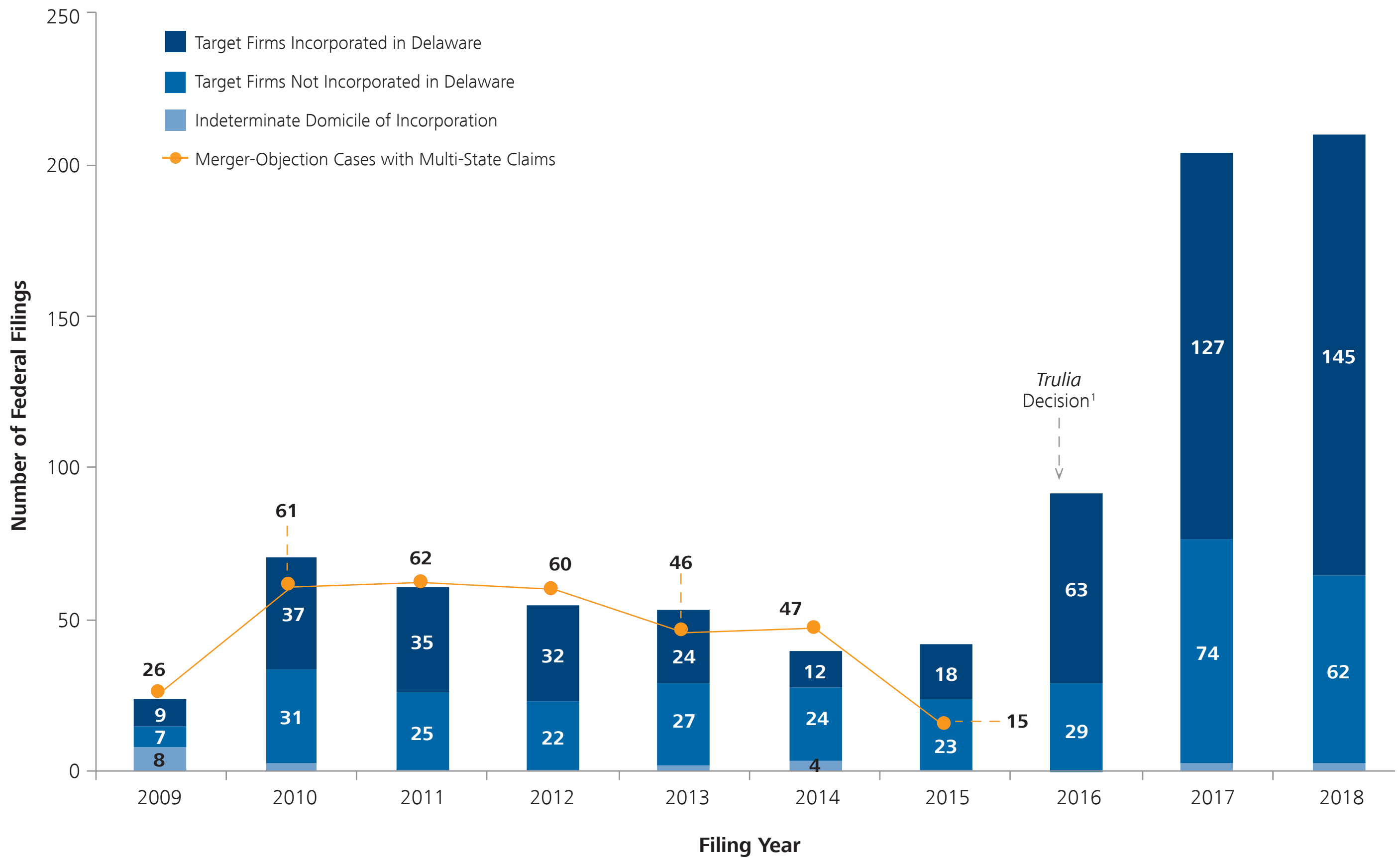
Merger-Objection Filings

In 2018, federal merger-objection filings were relatively unchanged versus 2017 (see Figure 4). Growth in federal merger-objection filings in 2016 and 2017 largely followed various state court rulings barring disclosure-only settlements, the most notable being the 22 January 2016 *Trulia* decision in the Delaware Court of Chancery.[7] Research suggested that such state court decisions would simply drive merger objections to alternative jurisdictions, such as federal courts.[8] This has largely been borne out thus far.

The dramatic slowdown in merger-objection filings growth implies that plaintiff forum selection is less of a growth factor; in 2018 and going forward, merger and acquisition activity will likely be the primary driver of federal merger-objection litigation. This assumes, however, that corporations don't increasingly adopt forum selection bylaws, and that federal courts don't increasingly follow the Delaware Court of Chancery's lead on rejecting disclosure-only settlements.[9] For instance, after the Seventh Circuit ruled strongly against a disclosure-only settlement in *In re: Walgreen Co. Stockholder Litigation*, the proportion of merger objections filed in that circuit fell by more than 60% the following year.[10]

Federal merger-objection filings typically allege a violation of Section 14(a), 14(d), and/or 14(e) of the Securities Exchange Act of 1934, and/or a breach of fiduciary duty by managers of a firm being acquired. Such filings are frequently voluntarily dismissed.

Figure 4. **Federal Merger-Objection Cases and Merger-Objection Cases with Multi-State Claims**
January 2009–December 2018



Notes: Counts of merger-objection cases with multi-state claims based on data obtained from Matthew D. Cain and Steven D. Solomon, "Takeover Litigation in 2015," Berkeley Center for Law, Business and the Economy, 14 January 2016. Data on multi-state claims unavailable for 2016–2018. State of incorporation obtained from the Securities and Exchange Commission.

[1] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

Filings Targeting Foreign Companies

Foreign companies with securities listed on US exchanges have been disproportionately targeted in Standard securities class actions since 2010 (see Figure 5).[11] In 2018, foreign companies were targeted in about 25% fewer cases than in 2017, and in only about 20% of complaints, just above the share of listings. This contrasts with persistent growth in foreign firm exposure to securities litigation over the preceding four years.

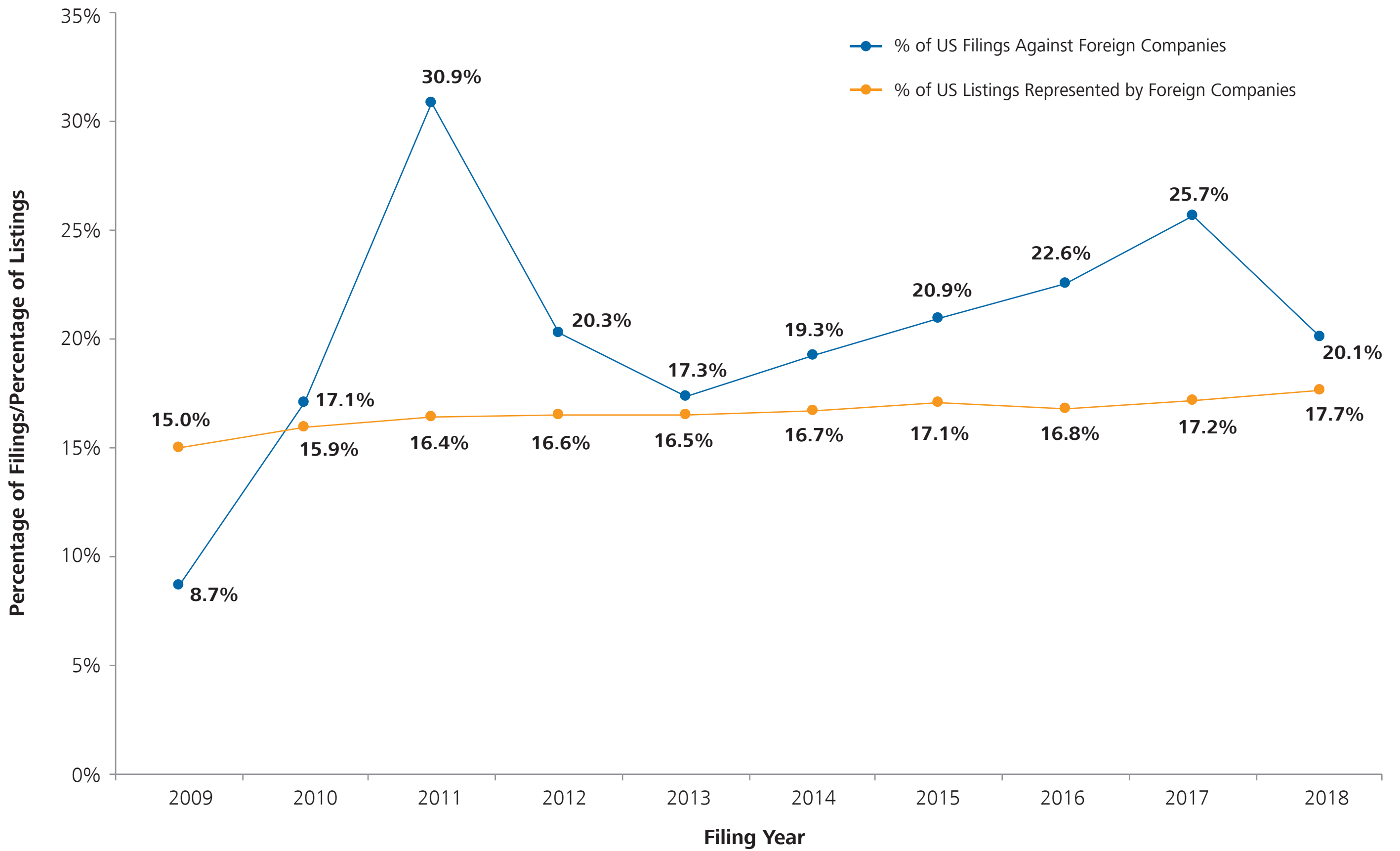
The reversion in claims against foreign firms mirrors a wider slowdown in filings with regulatory allegations. Over the last few years, growth in regulatory filings explained much of the growth in foreign filings, with 50% to 80% of new foreign cases including such allegations. That trend has reversed; in 2018, 75% of the drop in foreign filings stemmed from fewer claims related to regulation.

The slowdown in foreign regulatory filings can also be tied to fewer complaints in 2018 alleging similar regulatory violations, which adversely targeted foreign firms and particularly those domiciled in Europe. For instance, in 2017 there were multiple filings related to pharmaceutical price fixing, emissions defeat devices, and financing schemes by Kalani Investments Limited.

Filings against foreign companies spanned several economic sectors, led by a considerable jump against firms in the Electronic Technology and Technology Services sector (accounting issues were most common). Filings against foreign companies in the Health Technology and Services sector dropped by half. In past years, such filings usually claimed regulatory violations; none did in 2018.

In 2011, a record 31% of filings targeted foreign companies, mostly due to a surge in litigation against Chinese companies, which was mainly related to a proliferation in so-called "reverse mergers" years earlier. A reverse merger is a merger in which a private company merges with a publicly traded company listed in the US, thereby enabling access to US capital markets without going through the process of obtaining a new listing.

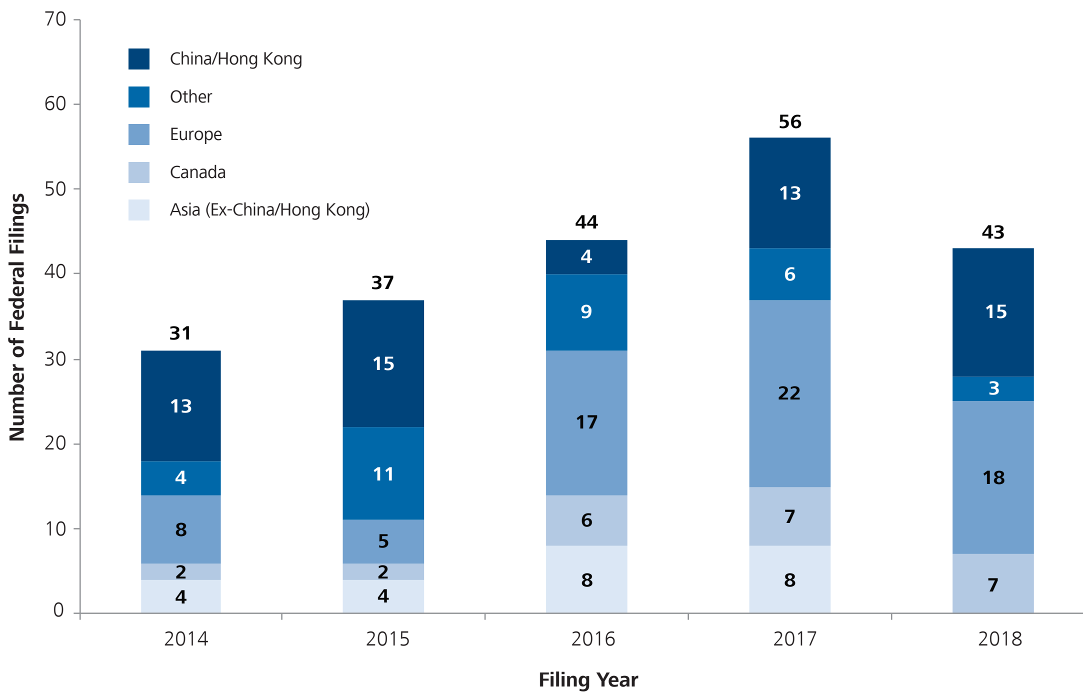
Figure 5. **Foreign Companies: Share of Filings and Share of Companies Listed on US Exchanges**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12
January 2009–December 2018



Note: Foreign issuer status determined based on location of principal executive offices.

Internationally, only Chinese firms listed on US exchanges were subject to more securities class actions in 2018 than in 2017 (see Figure 6). Filings against European firms slowed, partially due to fewer regulatory filings. There were zero filings against Israeli companies, despite an increase in listings and litigation against such companies in previous years.

Figure 6. **Filings Against Foreign Companies**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12 by Region
January 2014–December 2018



Note: Foreign issuer status determined based on location of principal executive offices.

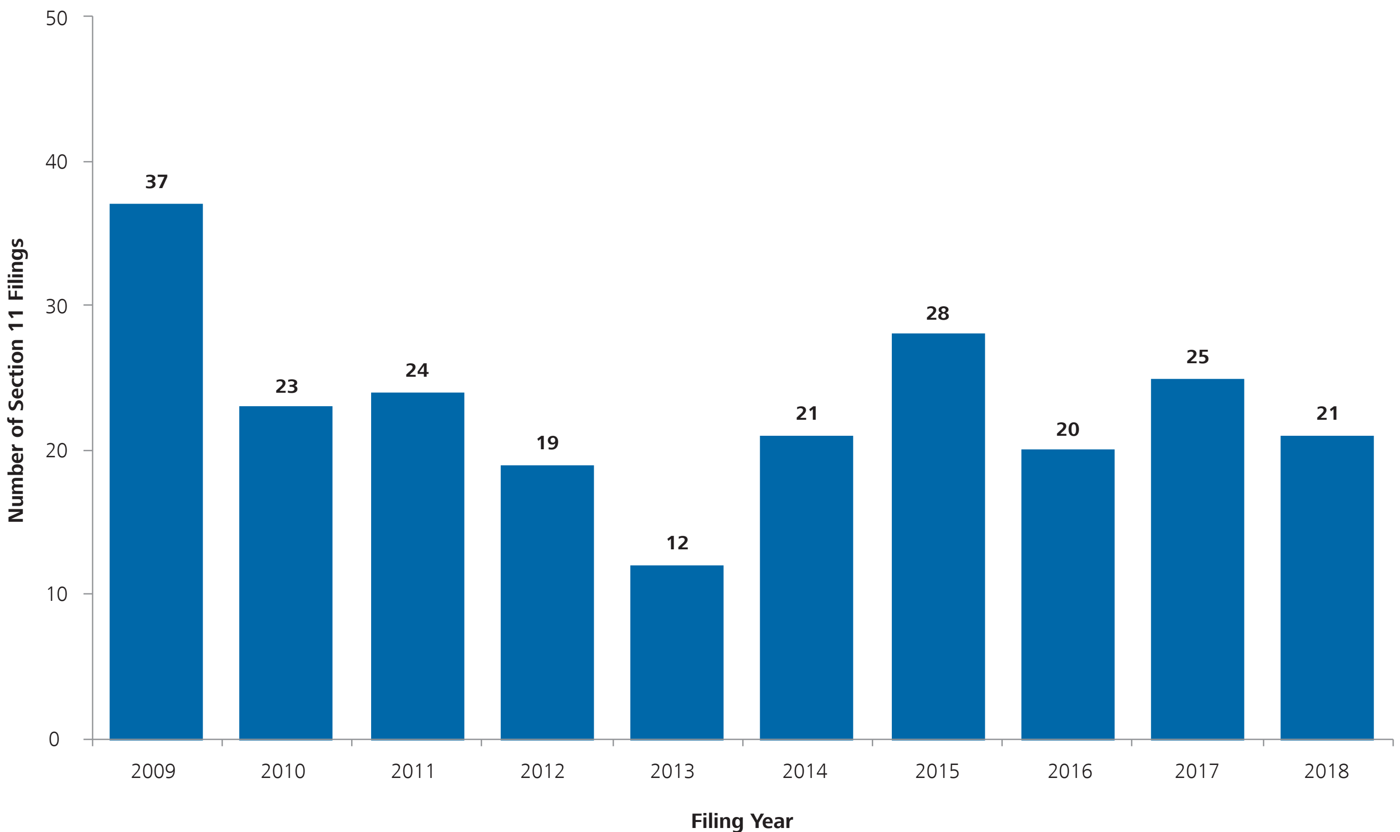
Section 11 Filings

There were 21 federal filings alleging violations of Section 11 in 2018, which approximates the five-year average (see Figure 7).

On 20 March 2018, the US Supreme Court ruled in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that state courts have jurisdiction over class actions with claims brought under the Securities Act.[12] The ruling allows plaintiffs to litigate Section 11 claims in state courts, including plaintiff-friendly California state courts.

The full effect of the *Cyan* decision on federal filing trends remains to be seen, but of the 21 Section 11 filings in 2018, 14% involved firms headquartered in California, down from a quarter in 2016 (prior to the US Supreme Court granting certiorari). Of the three California firms, at least two have stated in filings with the SEC that claims under the Securities Act must only be brought in federal courts.[12]

Figure 7. **Section 11 Filings**
January 2009–December 2018



Aggregate NERA-Defined Investor Losses

In addition to the number of cases filed, we also consider the total potential size of these cases using a metric we label "NERA-defined Investor Losses."

NERA's Investor Losses variable is a proxy for the aggregate amount that investors lost from buying the defendant's stock, rather than investing in the broader market during the alleged class period. Note that the Investor Losses variable is not a measure of damages because any stock that underperforms the S&P 500 would have Investor Losses over the period of underperformance; rather, it is a rough proxy for the relative size of investors' potential claims. Historically, Investor Losses have been a powerful predictor of settlement size. Investor Losses can explain more than half of the variance in the settlement values in our database.

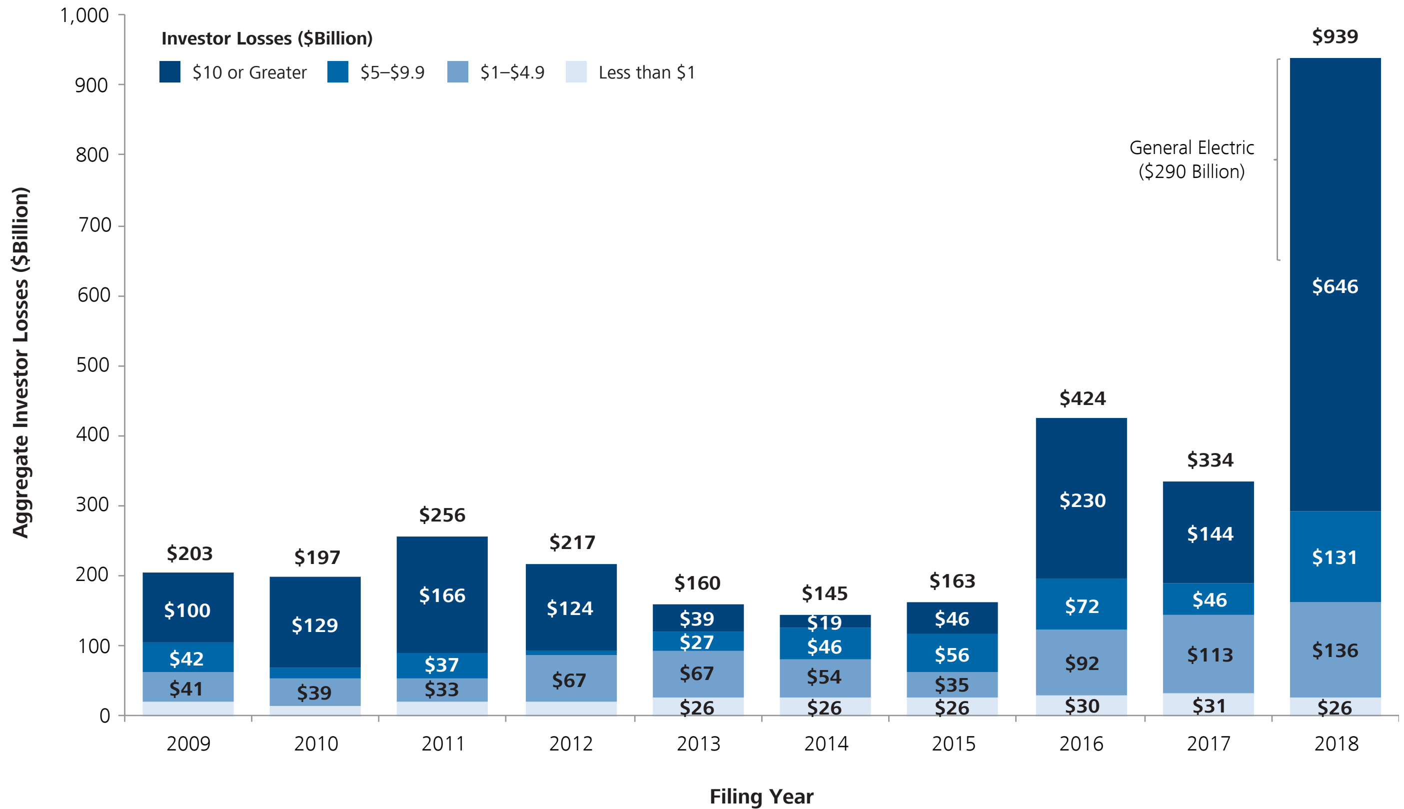
We do not compute NERA-defined Investor Losses for all cases included in this publication. For instance, class actions in which only bonds and not common stock are alleged to have been damaged are not included. The largest excluded groups are IPO laddering cases and merger-objection cases.

Despite a relatively constant rate of Standard filings in 2018, the size of those filings (as measured by NERA-defined Investor Losses) surged to nearly $1 trillion (see Figure 8). Total Investor Losses were dominated by litigation against GE, equal to about 45% of Investor Losses from all other cases combined, an especially impressive metric given the record aggregate case size.

NERA-defined Investor losses in 2018 totaled $939 billion, more than double that of any prior year and nearly four times the preceding five-year average of $245 billion. The total size of filings in all but the smallest strata grew, led by cases with more than $10 billion in Investor Losses. Coupled with the relatively stable overall filing rate, this suggests a systematic shift toward larger filings. In 2018, there were a record number of filings in each of the three largest strata, while only 88 cases had Investor Losses less than $1 billion, a record low.

Once again, there were several very large filings alleging regulatory violations, including a stock drop case against Johnson & Johnson related to claims of allegedly carcinogenic talcum powder, and a data privacy case against Facebook. Besides cases alleging regulatory violations, other very large cases included a filing against NVIDIA regarding excess inventory of GPUs (used for cryptocurrency mining) and large drug development cases against Bristol-Myers Squibb and Celgene.

Figure 8. **Aggregate NERA-Defined Investor Losses**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12
January 2009–December 2018



Over the past couple of years, growth in aggregate Investor Losses was concentrated in filings alleging regulatory violations, a substantial number of which were also *event-driven* securities cases (i.e., stock drop cases stemming from a specific event or occurrence). Between 2015 and 2017, growth in the total size of regulatory cases was due to an increased filing rate (from 31 to 57 cases) and higher median Investor Losses (from $308 million to $811 million).

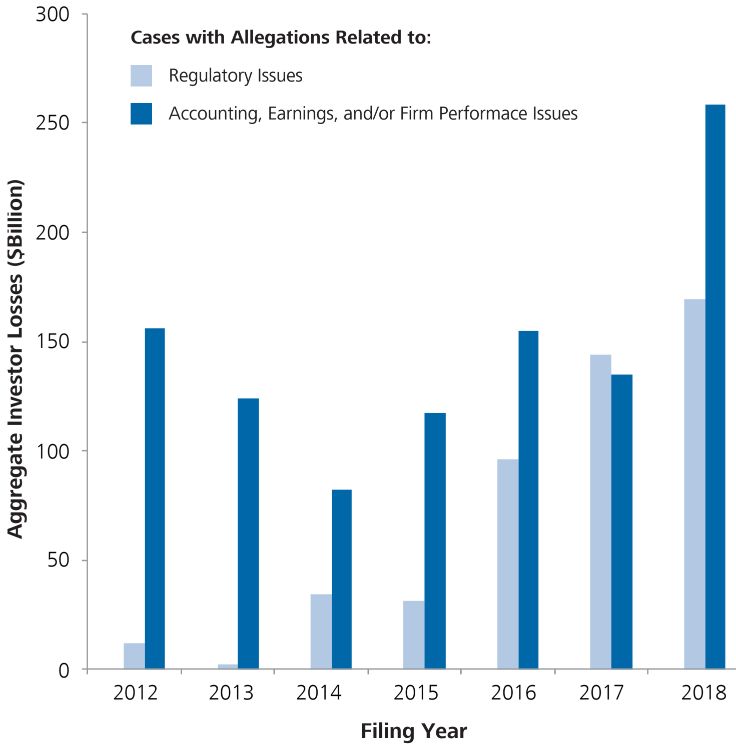
In 2018, regulatory cases were again large (half had Investor Losses greater than $4 billion), but the vast majority of total Investor Losses stemmed from what have historically been more typical securities cases, namely those that allege accounting issues, misleading earnings guidance, and/or firm performance issues.[14] This was led by litigation related to accounting issues at GE. Excluding GE, aggregate Investor Losses of such cases nearly doubled to a record $258 billion (see Figure 9).

Growth in the total size of cases alleging accounting, earnings, and/or performance issues primarily stems from growth in individual case size, as opposed to more filings. The median case with such allegations had more than $650 million in Investor Losses, about twice the average of $322 million over the preceding five years.

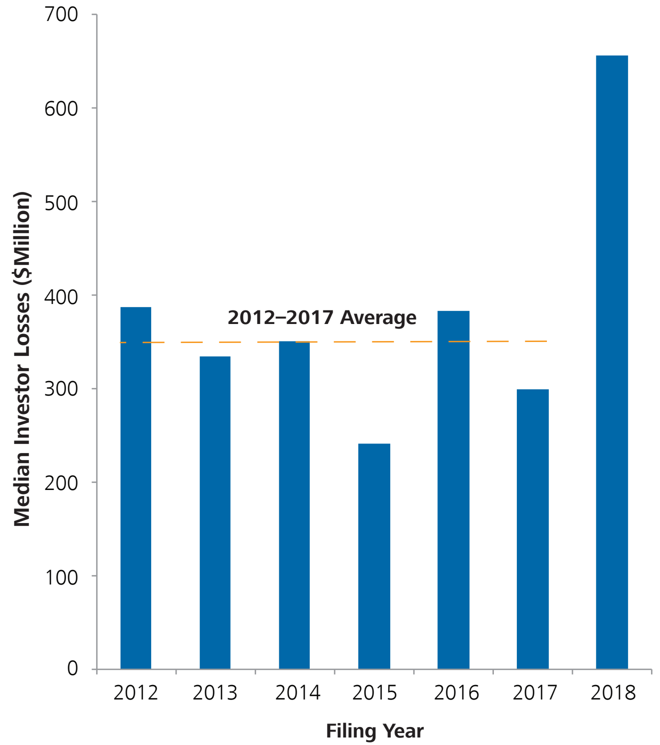
Details of the size of cases with specific types of allegations are discussed in the *Allegations* section below.

Figure 9. **NERA-Defined Investor Losses**
Filings Alleging Accounting Issues, Missed Earnings Guidance, and/or Misleading Future Performance
Excludes 2018 GE Filings

Aggregate NERA-Defined Investor Losses
January 2012–December 2018



Median NERA-Defined Investor Losses
January 2012–December 2018



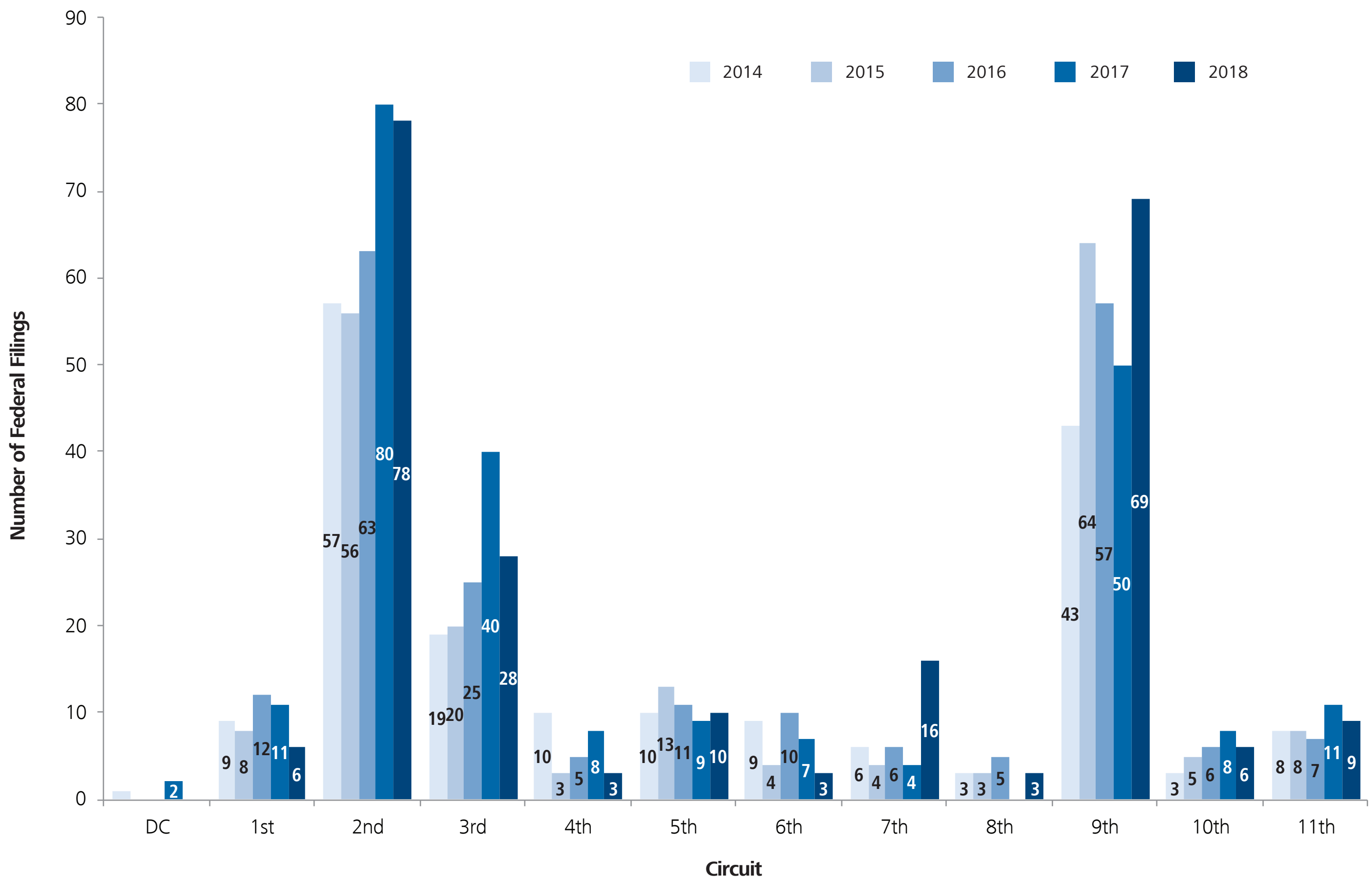
Note: Regulatory cases with parallel accounting, performance, or missed earnings claims are excluded.

Filings by Circuit

Filings in 2018 (excluding merger objections) were again concentrated in the Second and Ninth Circuits. The concentration of filings in these circuits has increased in 2018, during which they received 64% of filings, up from an average of 57% over the prior two years (see Figure 10). While the Second Circuit received the most filings, the most growth was in the Ninth Circuit, which includes Silicon Valley, mostly due to more litigation against firms in the Electronic Technology and Technology Services sector.

Merger-objection filings, not included in Figure 10, have become increasingly active in the Third Circuit, which includes Delaware. The Third Circuit received 82 merger-objection cases in 2018, double the number in 2017 and more than an eightfold increase over 2016. Nearly four-in-ten merger-objection cases were filed in the Third Circuit, twice the concentration of 2017 and coming amidst only a slight increase in the percentage of target firms incorporated in Delaware (see Figure 4). This corresponds with a decline in filings in every other circuit except the Second Circuit, where filings increased from 15 to 26.

Figure 10. **Federal Filings by Circuit and Year**
Excludes Merger Objections
January 2014–December 2018

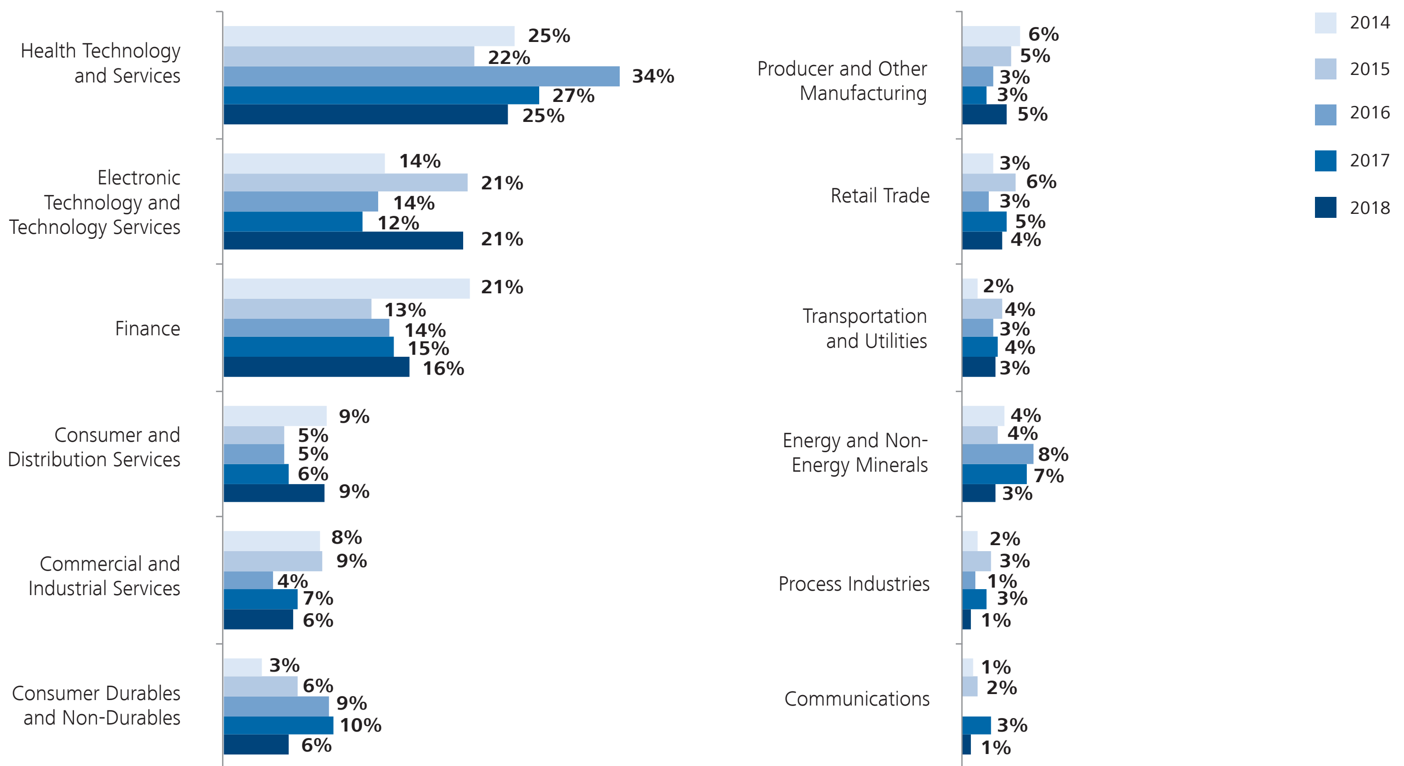


Filings by Sector

In 2018, filing counts were highest in the three historically dominant sectors, which include firms involved in health care, technology, and financial services (see Figure 11). The share of filings in these sectors increased to 62% in 2018 from about 54% in 2017, primarily due to a surge in filings against firms in the technology sector. Despite the drop in the percentage of health care companies targeted, the percentage of targeted firms in the Drugs industry (SIC 283) was nearly unchanged from 2017.

Firms in technological industries were especially at risk of securities class actions alleging accounting issues, misleading earnings guidance, or firm performance issues.[15] The industry with the highest percentage of constituent companies targeted with such allegations was the Computer and Office Equipment industry (SIC 357), with more than 9% of listed companies subject to litigation. This was followed by the Electronic Components and Accessories industry (SIC 367), with 6% of firms targeted. In the Drugs industry (SIC 283), 5% of firms were targeted with a filing with such claims (mostly related to misleading announcements regarding future performance).

Figure 11. **Percentage of Filings by Sector and Year**
Excludes Merger Objections
January 2014–December 2018



Note: This analysis is based on the FactSet Research Systems, Inc. economic sector classification. Some of the FactSet economic sectors are combined for presentation.

Allegations

In contrast with growth observed in recent years, filings with regulatory claims (i.e., those alleging a failure to disclose a regulatory issue) slowed to 41 in 2018 from 57 in 2017, a drop from 26% of Standard cases to 19% (see Figure 12). While fewer regulatory cases were filed, the median case size grew fourfold to over $4 billion (as measured by NERA-defined Investor Losses). The slowdown in regulatory filings was partially offset by more allegations of accounting issues and missed earnings guidance, which grew 8% and 13%, respectively.

While the size of filed cases (as measured by NERA-defined Investor Losses) grew in each allegation category, those alleging accounting issues and missed earnings guidance were especially large and more frequently targeted technology firms. The median size of accounting claims exceeded $600 million in 2018 (a level not seen since 2008), with filings over the second half of the year being especially large. Firms in the technology sector had the most accounting claims, making up 29% of the total (up from 21% in 2017). Moreover, more than one-in-three filings against firms in the technology sector alleged accounting issues.

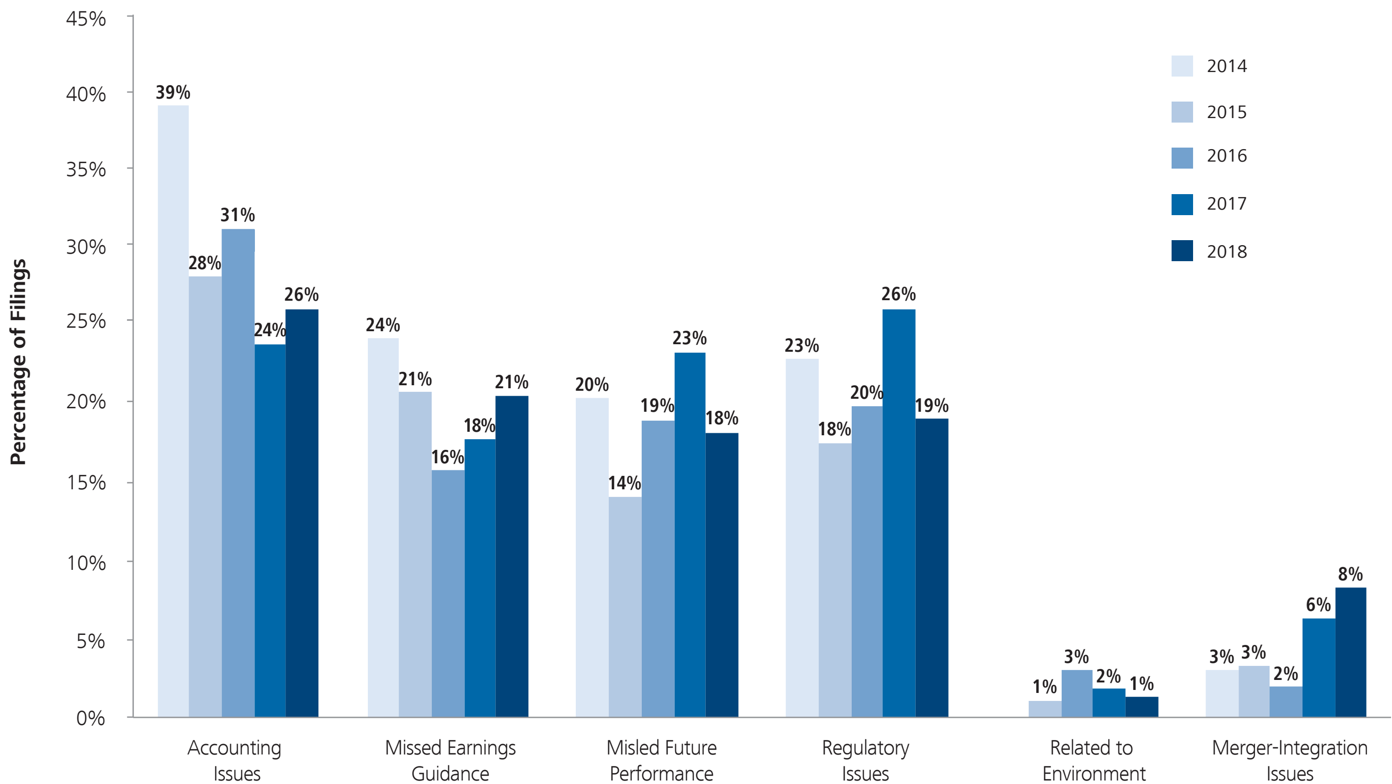
Filings claiming missed earnings guidance grew for the second straight year. Although the percentage of filings alleging missed guidance roughly matched that of 2015, the median case size (as measured by Investor Losses) was three times larger in 2018 than in 2015. Filings against firms in the technology sector with missed earnings guidance claims grew 70% since 2017 and constituted the largest share of such claims (at 27%).

In 2018, 8% of filings included merger integration allegations (i.e., claims of misrepresentations by a firm involved in a merger or acquisition). The substantial increase in litigation in 2017 corresponded with a 14% increase in announced M&A deals with US targets.[16] However, in 2018, despite a 12% slowdown in announced deal activity over the first three quarters, the number of federal merger integration filings rose.[17] The largest merger integration filing related to the failed Tribune Media/Sinclair merger, making up 20% of total Investor Losses.

As in prior years, most allegations related to misleading firm performance in 2018 were against firms in the health care sector. Within health care, firms in the Drugs industry (SIC 283) were subject to two-in-three filings.

Most complaints include a wide variety of allegations, not all of which are depicted here. Due to multiple types of allegations in complaints, the same case may be included in multiple categories.

Figure 12. **Allegations**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12
January 2014–December 2018

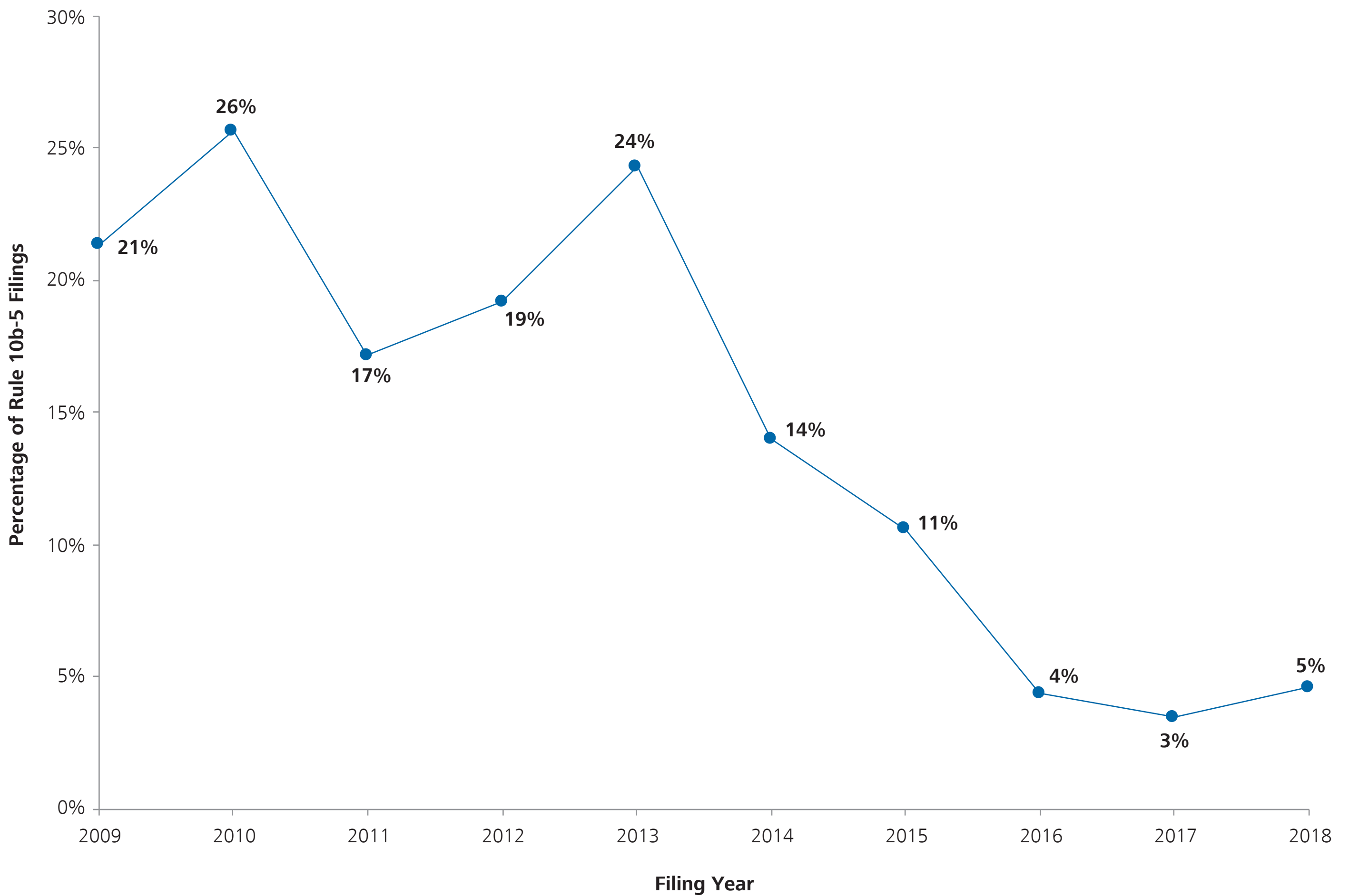


Alleged Insider Sales

Historically, Rule 10b-5 class action complaints have frequently alleged insider sales by directors and officers, usually as part of a scienter argument. Since 2013, in the wake of a multiyear crackdown on insider trading by prosecutors, the percentage of 10b-5 class actions that alleged insider sales has decreased nearly every year (see Figure 13).[18] This trend also corresponds with increased corporate adoption of 10b5-1 trading plans, allowing insiders to plan share sales while purportedly not in possession of material non-public information.[19]

Cases alleging insider sales were more common in the aftermath of the financial crisis, when a quarter of filings included insider trading claims. In 2005, half of class actions filed included such claims.

Figure 13. **Percentage of Rule 10b-5 Filings Alleging Insider Sales by Filing Year**
January 2009–December 2018



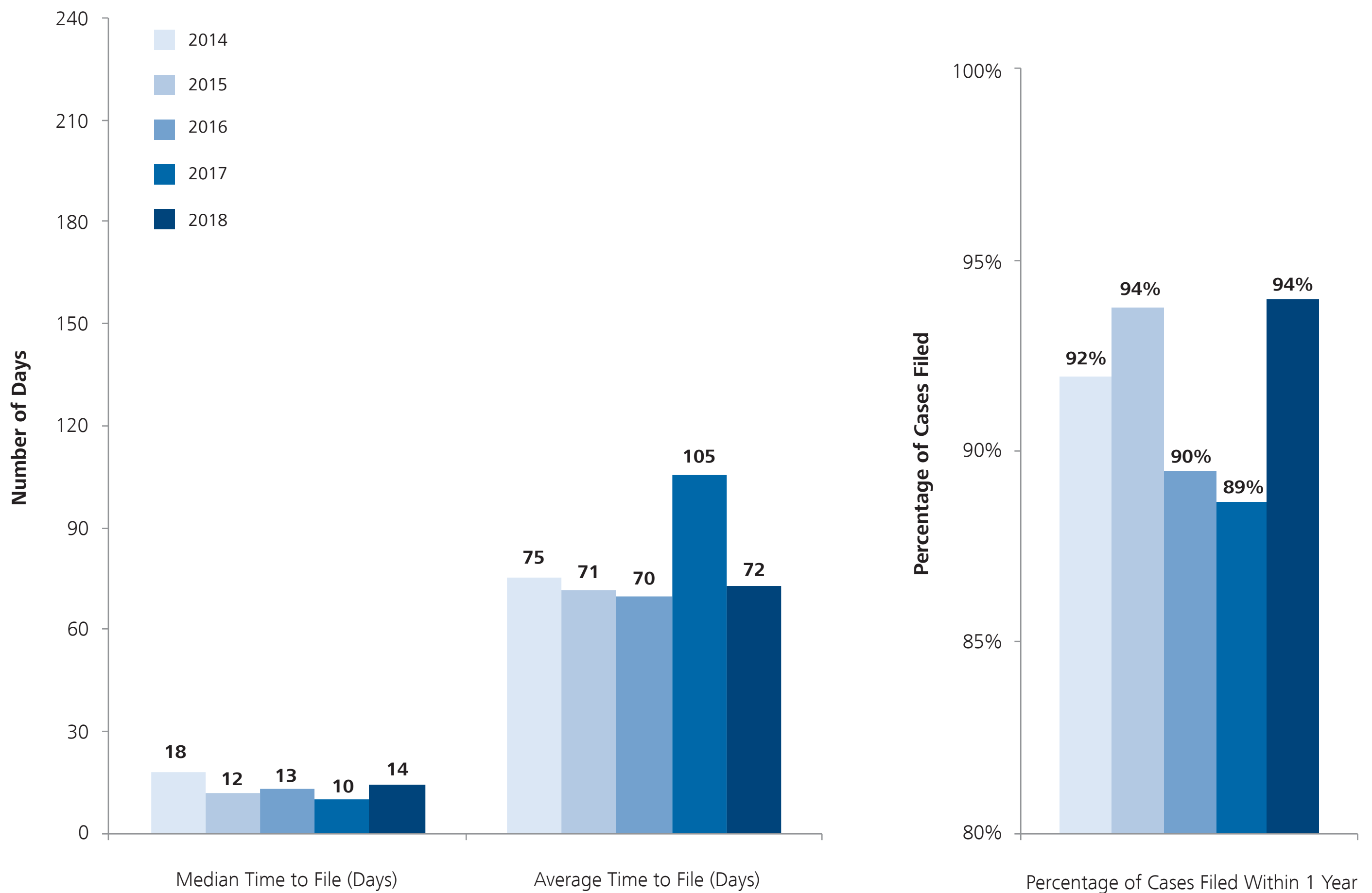
Time to File

The term "time to file" denotes the time that has elapsed between the end of the alleged class period and the filing date of the first complaint. Figure 14 illustrates how the median time and average time to file Rule 10b-5 cases (in days) have changed over the past five years.

The median time to file fell by about half over the last decade, to 14 days in 2018, indicating that it took 14 days or less to file a complaint in 50% of cases. Since the beginning of the decade, there has been a lower frequency of cases with long periods between the point when an alleged fraud was revealed and the filing of a related claim. The average time to file has followed a similar trajectory, but in 2017 was affected by 10 cases with very long filing delays. In 2017, one case against Rio Tinto, regarding the valuation of mining assets in Mozambique, took more than 4.5 years to file and boosted the average time to file by nearly 9%.[20]

Despite the small minority of cases with very long times to file, the data generally point toward a lower incidence of cases with long periods between revelations of alleged fraud and the date a related claim is filed.

Figure 14. **Time to File Rule 10b-5 Cases from End of Alleged Class Period to File Date**
January 2014–December 2018



Note: This analysis excludes cases where the alleged class period could not be unambiguously determined.

Analysis of Motions

NERA's statistical analysis has found robust relationships between settlement amounts and the stage of the litigation at which settlements occur. We track filings and decisions on three types of motions: motion to dismiss, motion for class certification, and motion for summary judgment. For this analysis, we include securities class actions in which purchasers of common stock are part of the class and in which a violation of Rule 10b-5, Section 11, and/or Section 12 is alleged (i.e., Standard cases).

As shown in the figures below, we record the status of any motion as of the resolution of the case. For example, a motion to dismiss that had been granted but was later denied on appeal is recorded as denied.

Motions for summary judgment were filed by defendants in 7.1%, and by plaintiffs in only 1.9%, of the securities class actions filed and resolved over the 2000–2018 period, among those we tracked.[21]

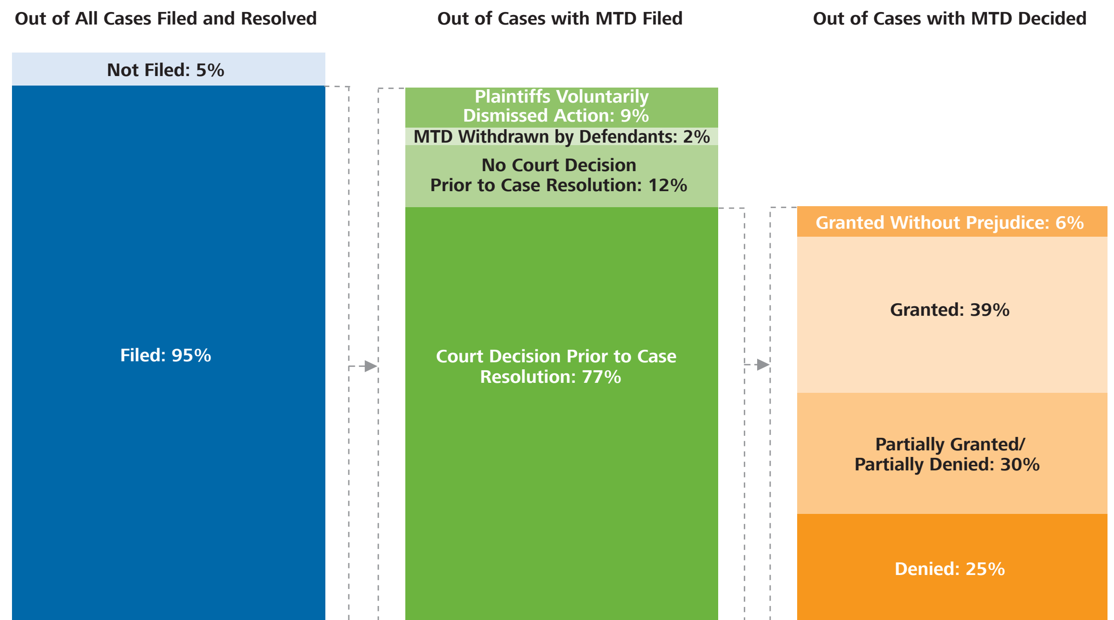
Outcomes of motions to dismiss and motions for class certification are discussed below.

Motion to Dismiss

A motion to dismiss was filed in 95% of the securities class actions tracked. However, the court reached a decision on only 77% of the motions filed. In the remaining 23% of cases, either the case resolved before a decision was reached, plaintiffs voluntarily dismissed the action, or the motion to dismiss was withdrawn by defendants (see Figure 15).

Out of the motions to dismiss for which a court decision was reached, the following three outcomes classify all of the decisions: granted with or without prejudice (45%), granted in part and denied in part (30%), and denied (25%).

Figure 15. **Filing and Resolutions of Motions to Dismiss**
Cases Filed and Resolved January 2000–December 2018



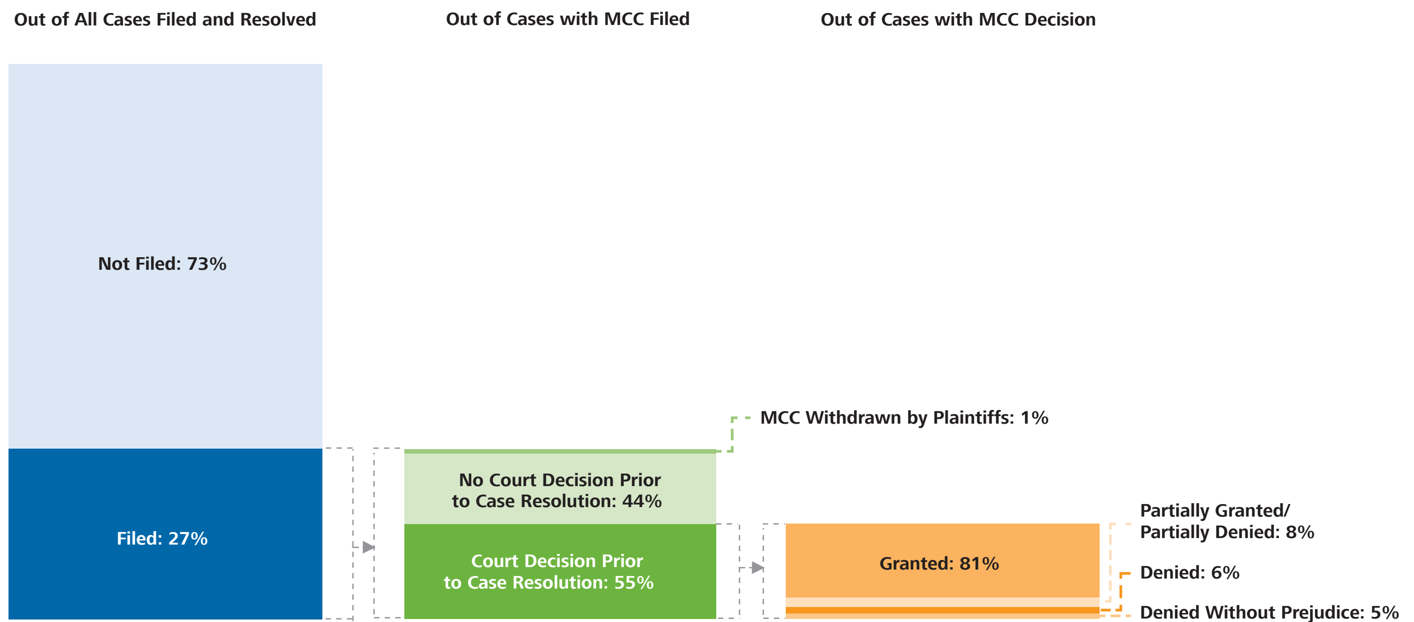
Note: Includes cases in which holders of common stock are part of the class and a Rule 10b-5, Section 11, and/or Section 12 is alleged. Excludes IPO laddering cases.

Motion for Class Certification

Most cases were settled or dismissed before a motion for class certification was filed: 73% of cases fell into this category. Of the remaining 27% (in which a motion for class certification was filed), the court reached a decision in only 55% of cases. Overall, only 15% of the securities class actions filed (or 55% of the 27%) reached a decision on the motion for class certification (see Figure 16).

According to our data, 89% of the motions for class certification that were decided were granted partially or in full.

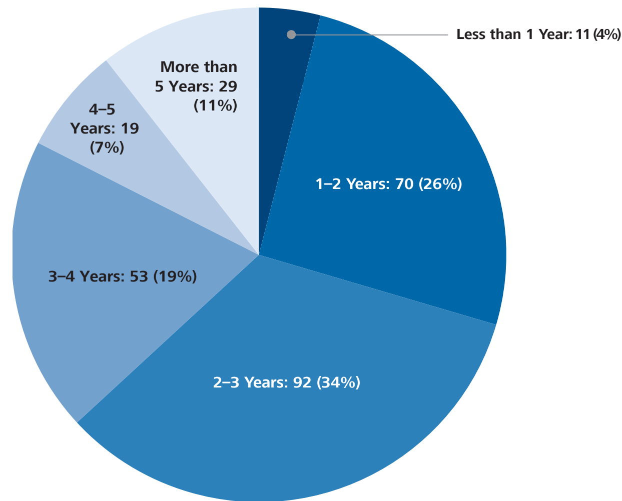
Figure 16. **Filing and Resolutions of Motions for Class Certification**
Cases Filed and Resolved January 2000–December 2018



Note: Includes cases in which holders of common stock are part of the class and a Rule 10b-5, Section 11, and/or Section 12 is alleged. Excludes IPO laddering cases.

Approximately 64% of the decisions handed down on motions for class certification were reached within three years of the complaint's original filing date (see Figure 17). The median time was about 2.5 years.

Figure 17. **Time from First Complaint Filing to Class Certification Decision**
Cases Filed and Resolved January 2000–December 2018



Note: Includes cases in which holders of common stock are part of the class and a 10b-5 or Rule 10b-5, Section 11, and/or Section 12 is alleged. Excludes IPO laddering cases.

Trends in Case Resolutions

Number of Cases Settled or Dismissed

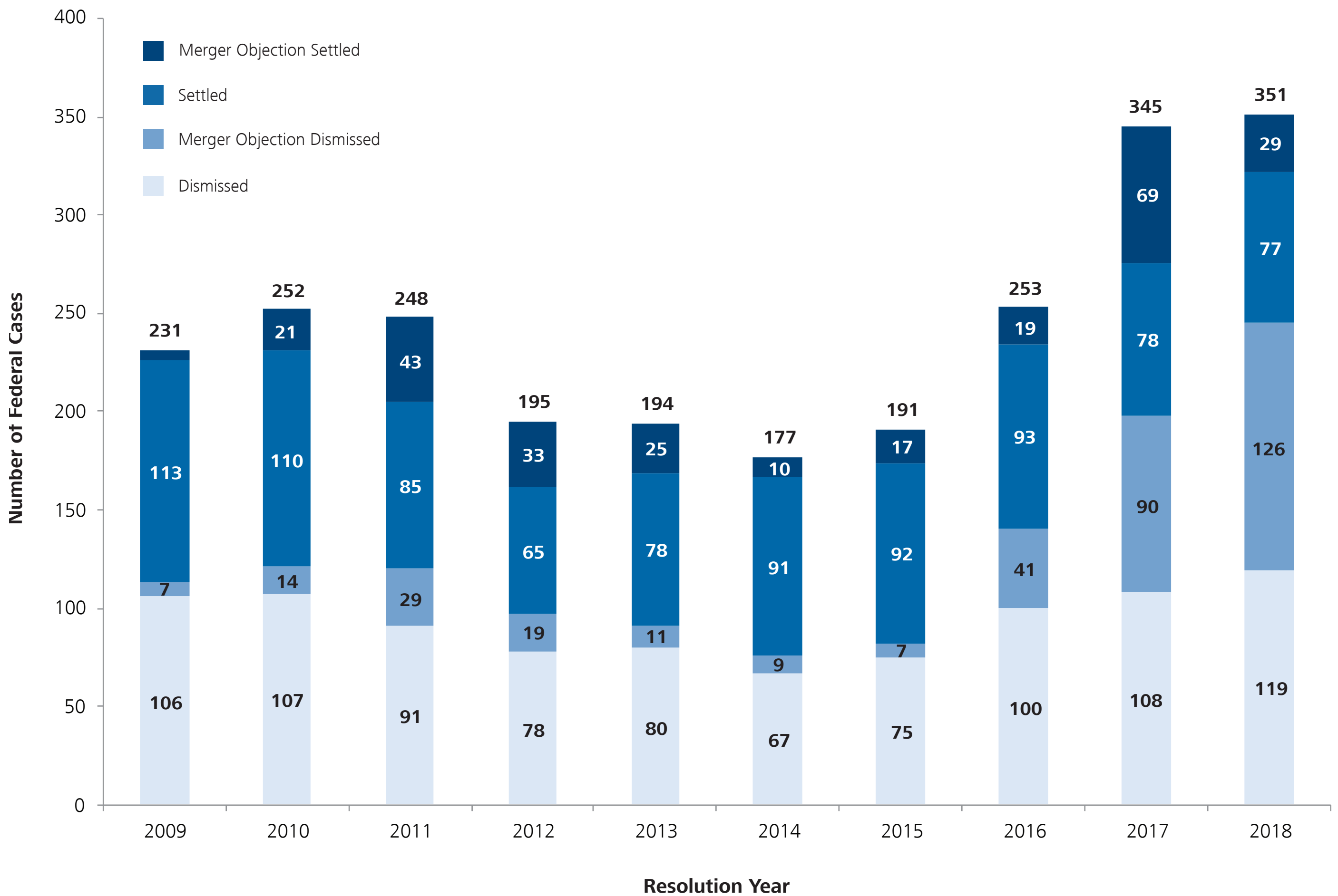
In total, 351 securities class actions were resolved in 2018, the second consecutive year in which a record number of cases concluded (see Figure 18). Resolution numbers were once again dominated by a record number of dismissals, which outnumbered settlements two-to-one for the first time.

Of the 351 resolutions, slightly less than half were resolutions of merger-objection cases (most of which were voluntarily dismissed). The uptick in resolutions over the last few years is largely due to the surge of federal merger-objection cases in the wake of the *Trulia* decision in early 2016.[22] Prior to *Trulia*, only about 13% of resolutions concerned merger-objection litigation. Merger objections had an outsized impact on resolution statistics: despite making up only about 33% of all active cases, they constituted 44% of resolutions.[23]

In 2018, 196 resolutions were of "Standard" securities class actions—those alleging violations of Rule 10b-5, Section 11, and/or Section 12. Standard settlement and dismissal counts closely matched those of 2017, and again more cases were dismissed than settled.

For the second consecutive year, an inordinate number of Standard cases were dismissed within a year of filing, most of which were voluntary dismissals. As shown in Figure 31, the decision to voluntarily dismiss litigation may change with the size of estimated damages to the class. For instance, plaintiffs may be more likely to voluntarily dismiss litigation if the price of the security at issue subsequently increases during the PSLRA bounce-back period.

Figure 18. **Number of Resolved Cases: Dismissed or Settled**
January 2009–December 2018



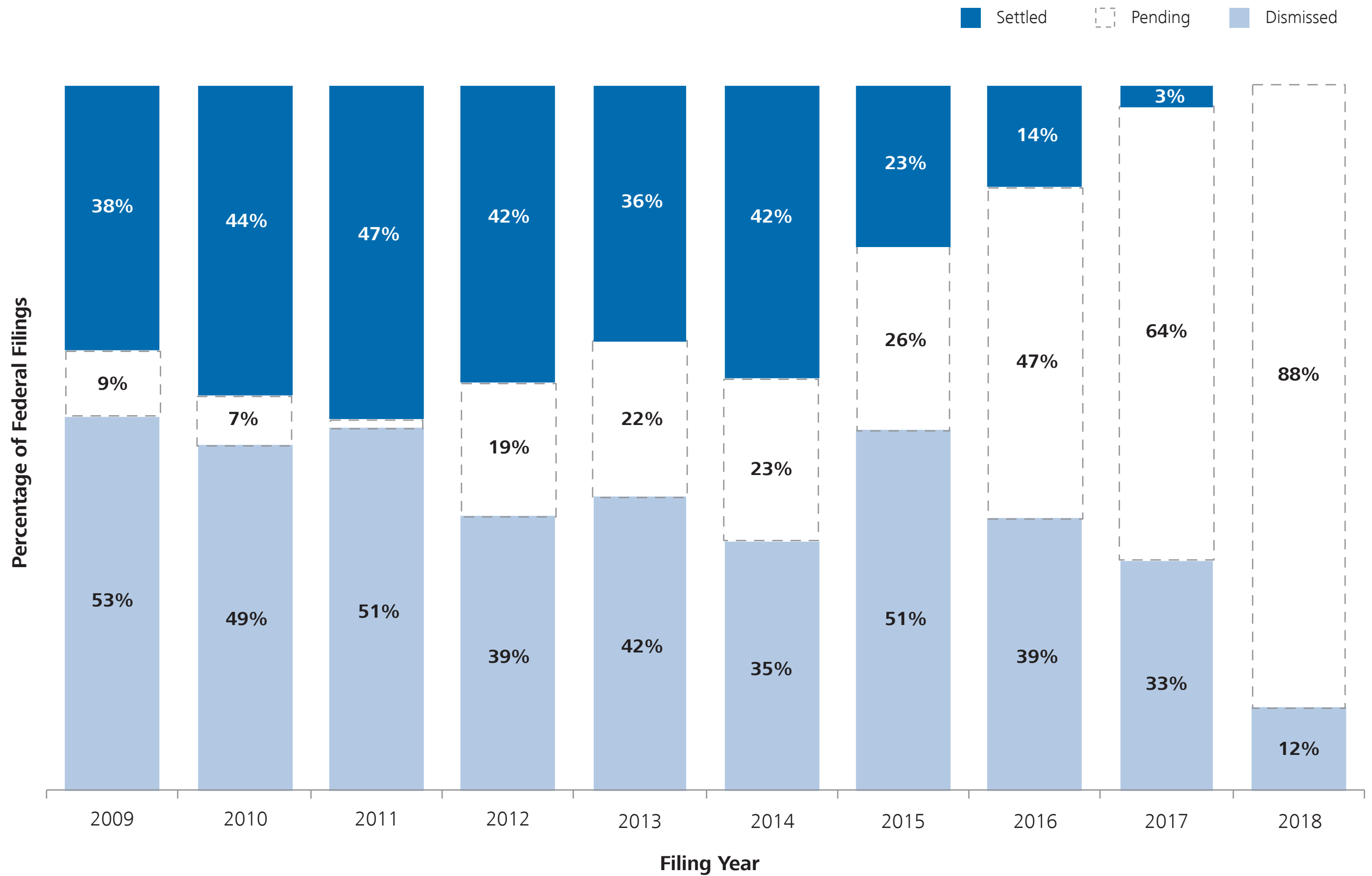
Case Status by Year

Figure 19 shows the current resolution status of cases by filing year. Each percentage represents the current resolution status of cases filed in each year as a proportion of all cases filed in that year. Merger-objection cases are excluded, as are verdicts.

Historically, more cases settled than were dismissed. However, the rate of case dismissal has steadily increased. While only about a third of cases filed between 2000 and 2002 were dismissed, in 2015, the most recent year with substantial resolution data, at least half of filed cases were dismissed.[24]

While dismissal rates have been climbing since 2000, the ultimate dismissal rate for cases filed in more recent years is less certain. On one hand, the dismissal rate may increase further, as there are more pending cases awaiting resolution. On the other hand, it may decrease because recent dismissals have more potential than older ones to be appealed or re-filed, and cases that were recently dismissed without prejudice may ultimately result in settlements.

Figure 19. **Status of Cases as Percentage of Federal Filings by Filing Year**
Excludes Merger Objections and Verdicts
January 2009–December 2018



Note: Dismissals may include dismissals without prejudice and dismissals under appeal.

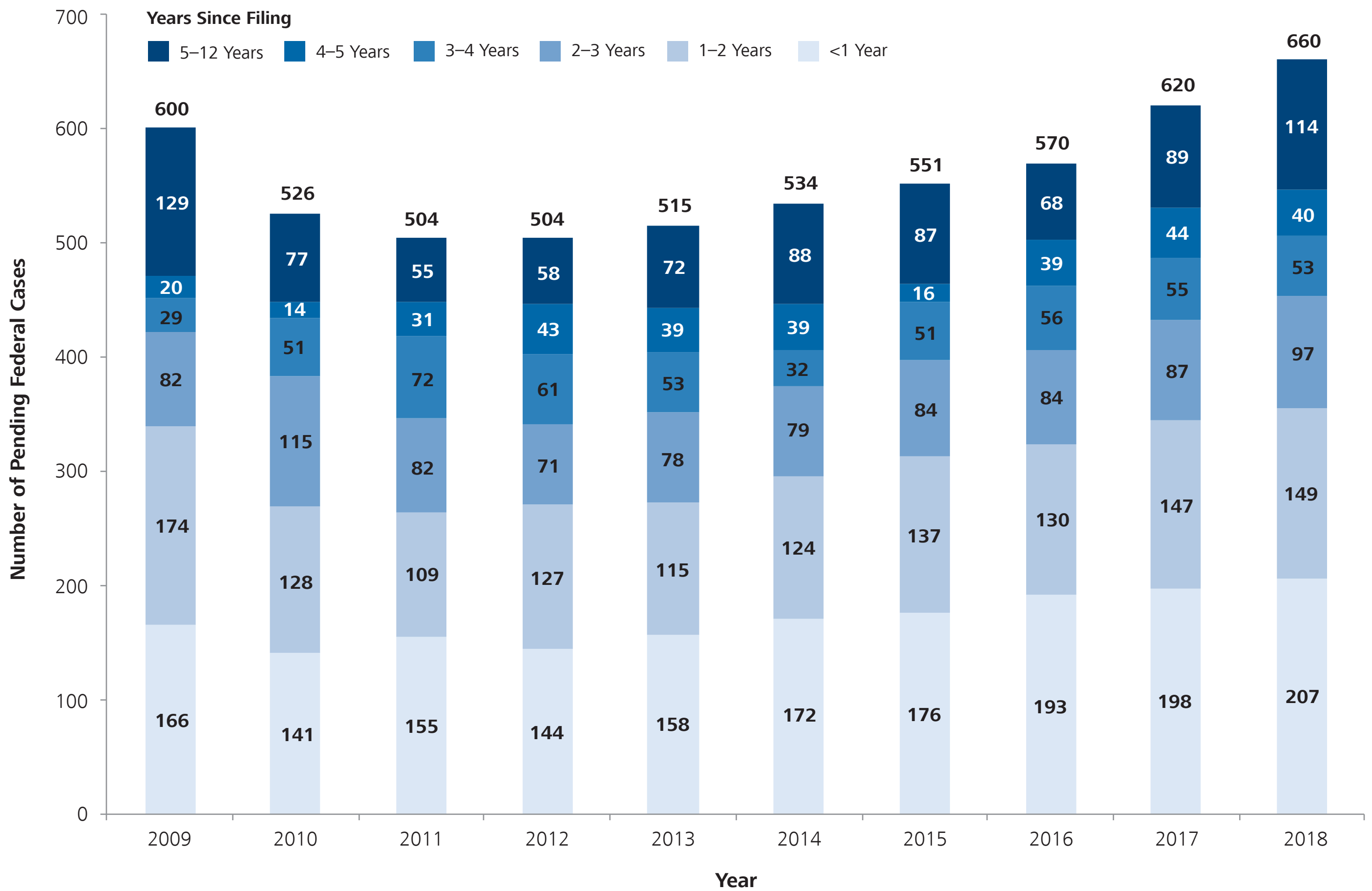
Number of Cases Pending

The number of Standard securities class actions pending in the federal system has steadily increased from a post-PSLRA low of 504 in 2012 (see Figure 20).[25] Since then, pending case counts have increased between 2% and 9% annually. In 2018, the number of pending Standard cases on federal dockets increased to 660, up 6% from 2017 and 31% from 2012.

Generally, since cases are either pending or resolved, a change in filing rate or a lengthening of the time to case resolution potentially contributes to changes in the number of cases pending. If the number of new filings is constant, the change in the number of pending cases can be indicative of whether the time to case resolution is generally shortening or lengthening.

About 50% of the long-term growth in pending litigation can be explained by recent filing growth (filed over the past two years), the vast majority of which is simply due to more cases being filed that have yet to be resolved. Delayed resolution of older filings (i.e., cases filed before 2017) explains the other 50% or so of growth in pending litigation since 2011. More old cases on federal dockets has driven the median age of pending cases up 14% since 2015 to about 1.9 years, the highest since 2010.[26]

Figure 20. **Number of Pending Federal Cases**
Excludes Merger Objections
January 2009–December 2018



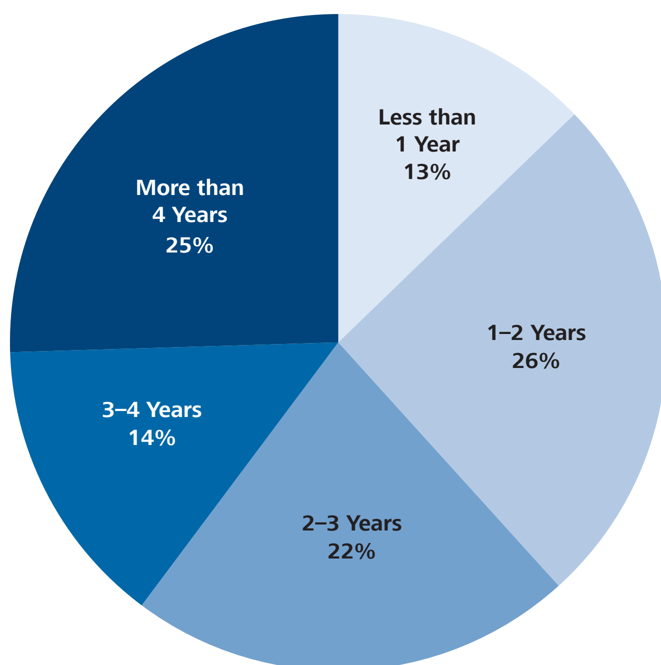
Note: The figure excludes, in each year, cases that had been filed more than 12 years earlier. Years since filing are end-of-year calculations. The figure also excludes IPO laddering cases. The 12-year limit ensure that all pending cases were filed post-PSLRA.

Time to Resolution

The term "time to resolution" denotes the time between the filing of the first complaint and resolution (whether through settlement or dismissal). Figure 21 illustrates the time to resolution for all securities class actions filed between 2001 and 2014, and shows that about 39% of cases are resolved within two years of initial filing and about 61% are resolved within three years.[27]

The median time to resolution for cases filed in 2016 (the last year with sufficient resolution data) was 2.3 years, similar to the range over the preceding five years. Over the past decade, the median time to resolution declined by more than 10%, primarily due to an increase in the dismissal rate (dismissals are generally resolved faster than settlements).

Figure 21. **Time from First Complaint Filing to Resolution**
Cases Filed January 2001–December 2014



Trends in Settlements

We present several settlement metrics to highlight attributes of cases that settled in 2018 and to compare them with cases settled in past years. We discuss two ways of measuring average settlement amounts and calculate the median settlement amount. Each calculation excludes merger-objection cases and cases that settle with no cash payment to the class, as settlements of such cases may obscure trends in what have historically been more typical cases.

In 2018, the average settlement rebounded to $69 million from a near-record low in 2017, largely due to the $3 billion settlement involving Petróleo Brasileiro S.A.—Petrobras, the fifth-highest settlement ever. Even excluding Petrobras (the only settlement of the year exceeding $1 billion), the average settlement exceeded $30 million, which is about average in the post-PSLRA era (after adjusting for inflation). The median settlement in 2018 was more than twice that of 2017, primarily due to higher settlements of many moderately sized cases and, generally, fewer very small settlements.

The upswing in 2018 settlement metrics may be a prelude to higher settlements in the future. Aggregate NERA-defined Investor Losses of pending cases, a factor that has historically been significantly correlated with settlement amounts, increased for the third consecutive year and currently exceeds $1.4 trillion (or $1.1 trillion excluding 2018 litigation against GE). Excluding GE, average Investor Losses of pending Standard cases have also increased for the third consecutive year to $2.4 billion, but have receded from a 10-year high of $3.8 billion in 2011.

To illustrate how many cases settled over various ranges in 2017 compared with prior years, we provide a distribution of settlements over the past five years. We also tabulated the 10 largest settlements of the year.

Average and Median Settlement Amounts

The average settlement exceeded $69 million in 2018, somewhat less than three times the $25 million average settlement in 2017 (see Figure 22). Infrequent large settlements, such as the 2018 Petrobras settlement, are generally responsible for the wide variability in average settlements over the past decade. Similar spikes to the one observed this year were also seen in 2010, 2013, and 2016, each primarily stemming from mega-settlements.

Figure 22. **Average Settlement Value**
Excludes Merger Objections and Settlements for $0 to the Class
January 2009–December 2018

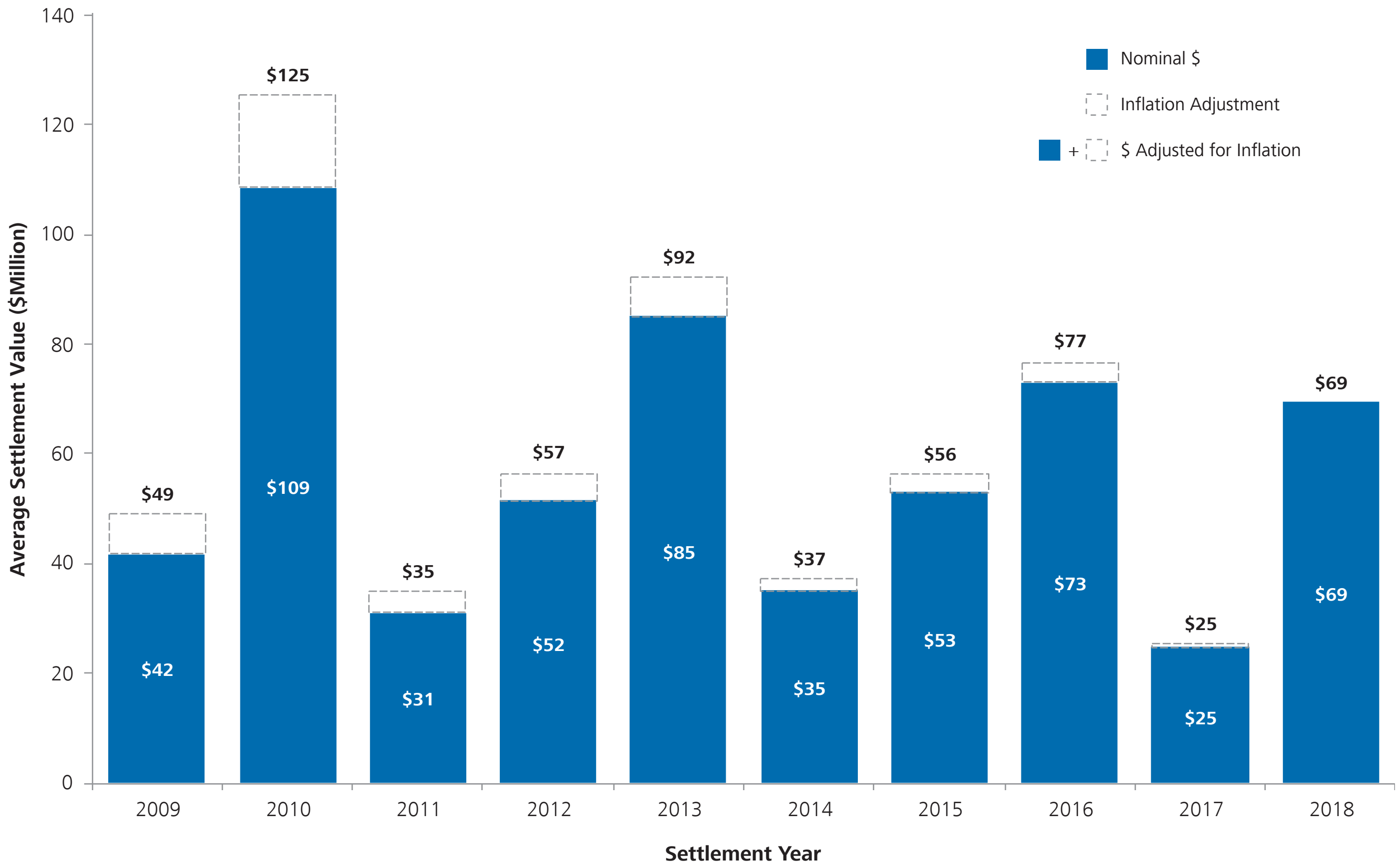
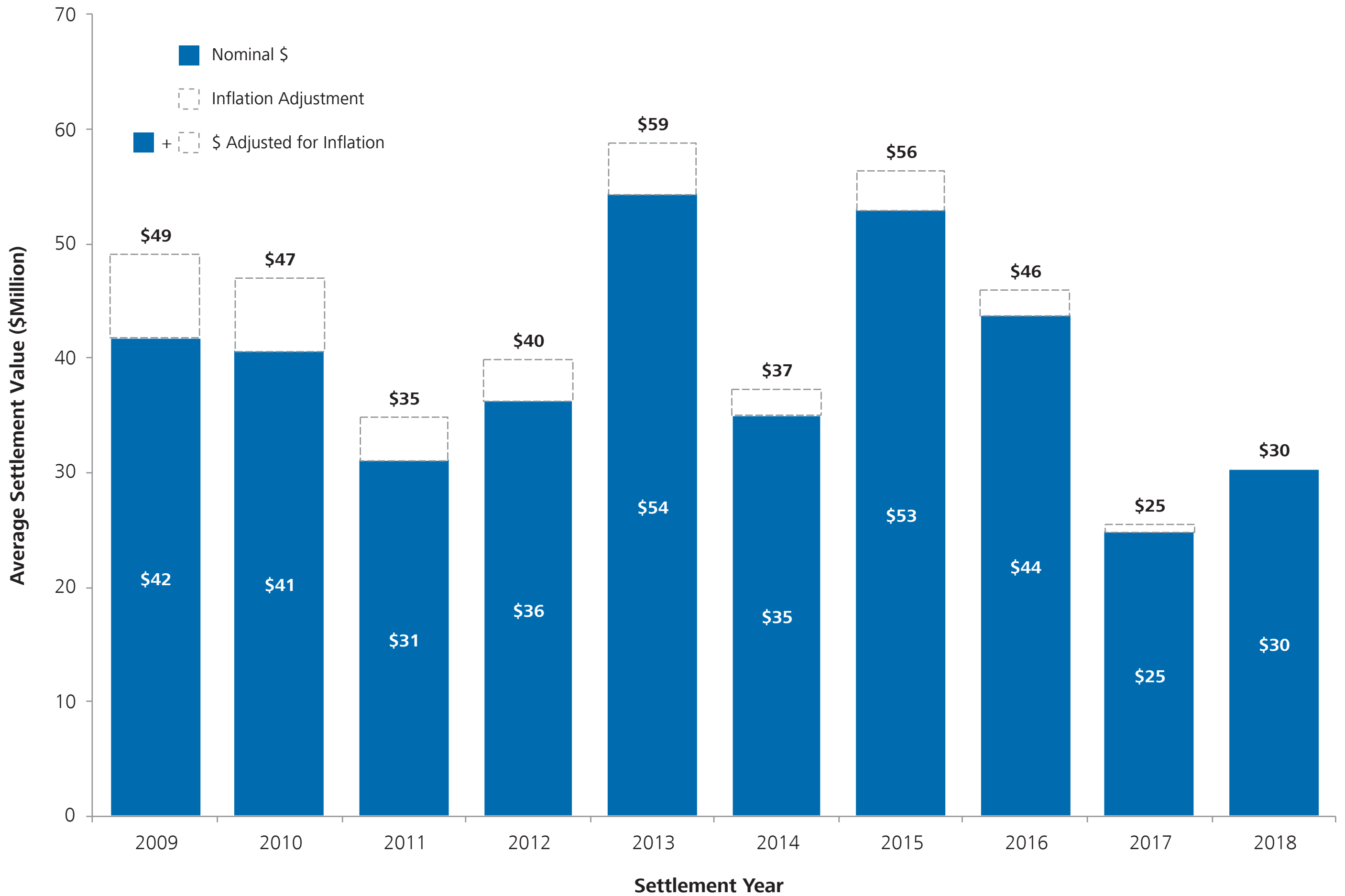


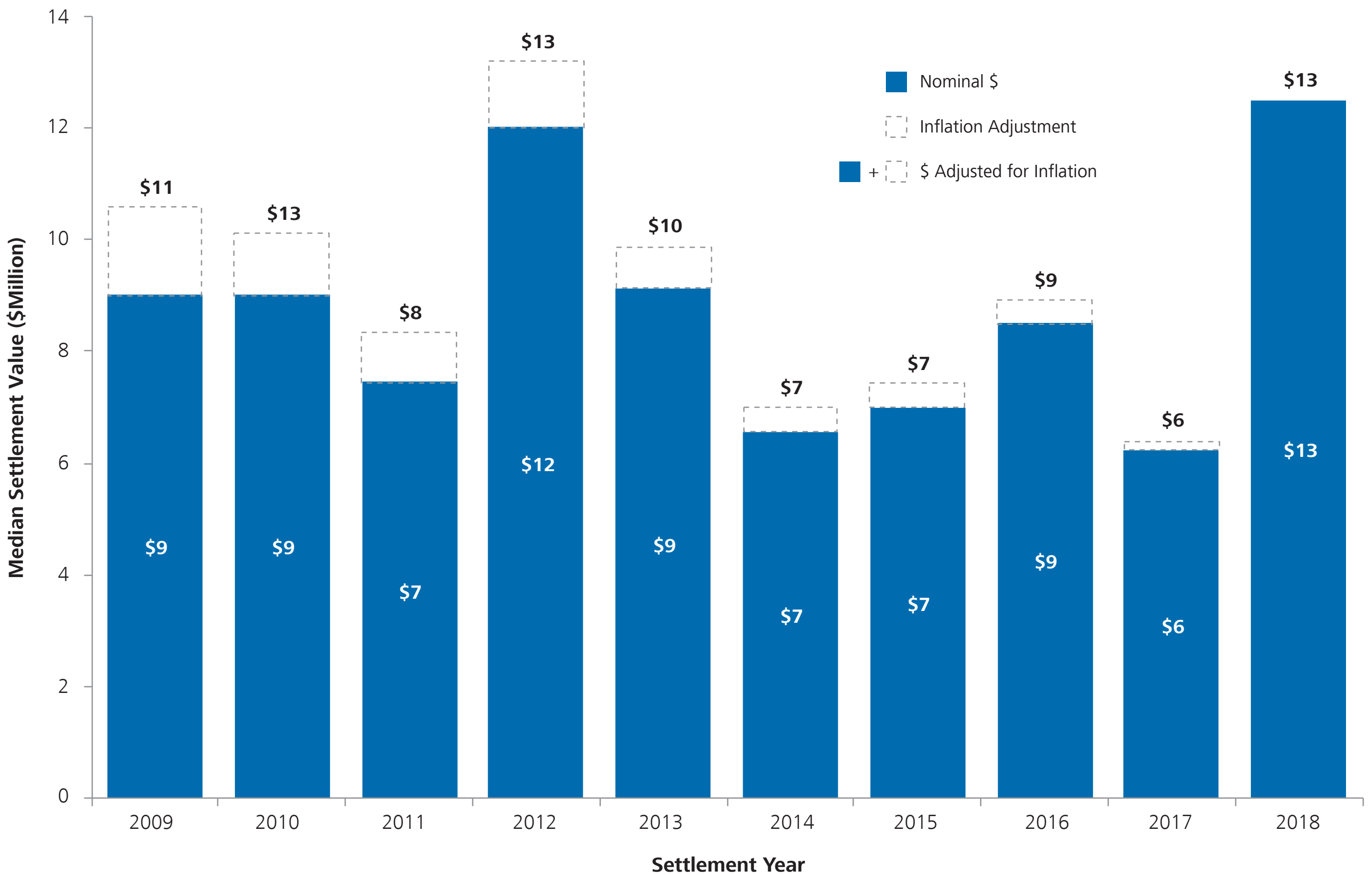
Figure 23 illustrates that, excluding settlements over $1 billion, the average settlement rebounded from the record low seen in 2017 to $30 million. Despite this rebound, and setting aside the $3 billion Petrobras settlement, the 2018 average settlement remained below average compared to the past decade. The metric would have roughly matched the near-record low seen in 2017 but for the $480 million Wells Fargo settlement that was finalized in mid-December 2018.

Figure 23. **Average Settlement Value**
Excludes Settlements over $1 Billion, Merger Objections, and Settlements for $0 to the Class
January 2009–December 2018



The 2018 median settlement was a near-record $13 million. This was driven primarily by relatively high settlements of moderately sized cases (as measured by NERA-defined Investor Losses). Cases of moderate size not only made up the bulk of settlements in 2018 but also had a median ratio of settlement to Investor Losses more than 50% higher than in past years. Moreover, unlike 2017, there were generally few very small settlements.

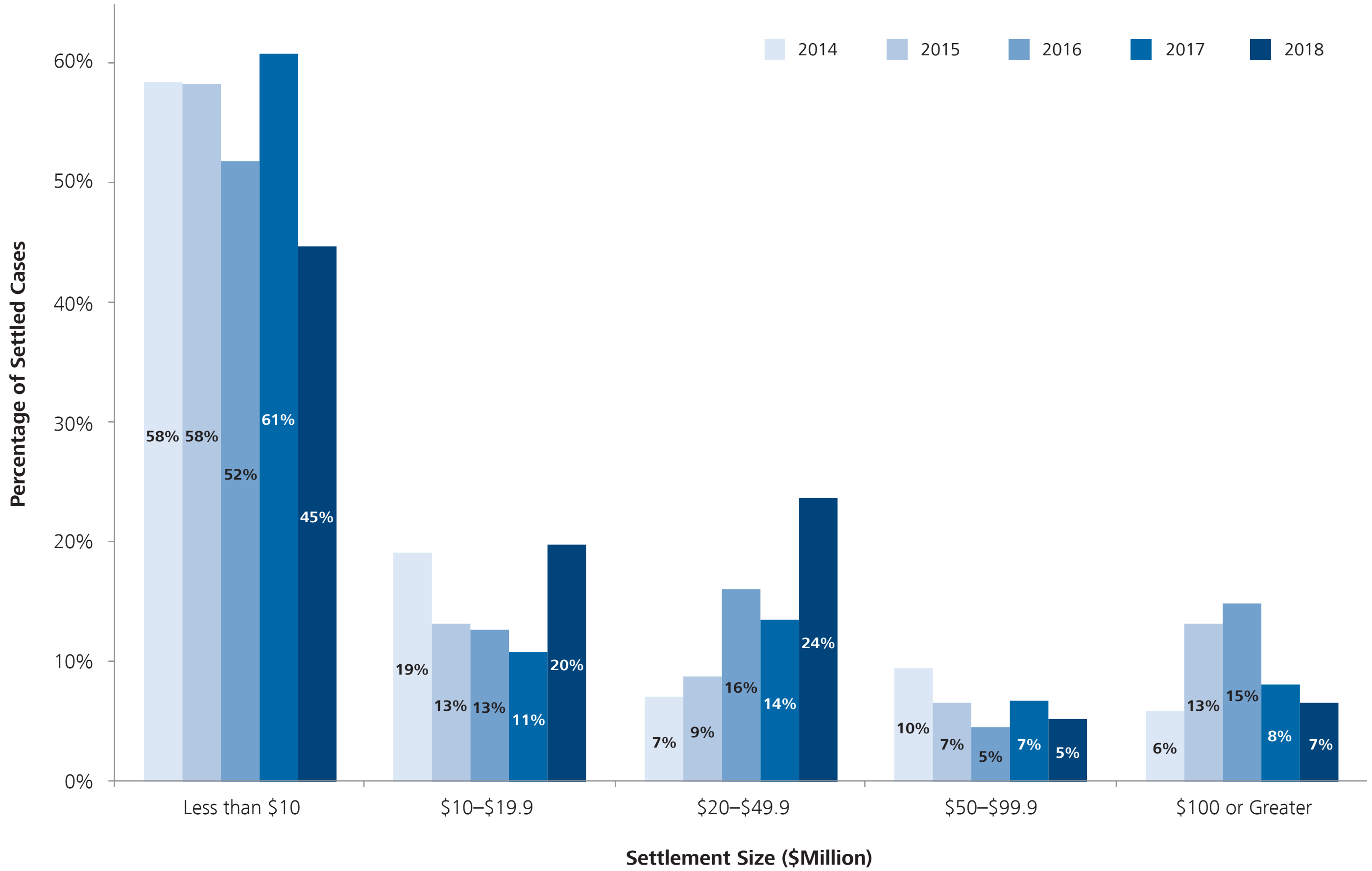
Figure 24. **Median Settlement Value**
Excludes Settlements over $1 Billion, Merger Objections, and Settlements for $0 to the Class
January 2009–December 2018



Distribution of Settlement Amounts

The relatively high settlements of moderately sized cases in 2018 are also captured in the distribution of settlement values (see Figure 25). In 2018, fewer than 45% of settlements were for less than $10 million (the lowest rate since 2010), which stands in stark contrast with 2017, when more than 60% of settlements were in the smallest strata (the highest rate since 2011).

Figure 25. **Distribution of Settlement Values**
Excludes Merger Objections and Settlements for $0 to the Class
January 2014–December 2018



The 10 Largest Settlements of Securities Class Actions of 2018

The 10 largest securities class action settlements of 2018 are shown in Table 1. The two largest settlements, against Petrobras and Wells Fargo & Company, are among many large regulatory cases filed in recent years. Three of the 10 largest settlements involved defendants in the Finance sector. Overall, these 10 cases accounted for about $4.4 billion in settlement value, a near-record 84% of the $5.3 billion in aggregate settlements.

Despite the size of the Petrobras settlement, it is not even half the size of the second-largest settlement since passage of the PSLRA, WorldCom, Inc., at $6.2 billion (see Table 2).

Table 1. **Top 10 2018 Securities Class Action Settlements**

Ranking	Case Name	Total Settlement Value ($Million)	Plaintiffs' Attorneys' Fees and Expenses Value ($Million)
1	Petróleo Brasileiro S.A.—Petrobras (2014)	$3,000.0	$205.0
2	Wells Fargo & Company (2016)	$480.0	$96.4
3	Allergan, Inc.	$290.0	$71.0
4	Wilmington Trust Corporation	$210.0	$66.3
5	LendingClub Corporation	$125.0	$16.8
6	Yahoo! Inc. (2017)	$80.0	$14.8
7	SunEdison, Inc.	$73.9	$19.0
8	Marvell Technology Group Ltd. (2015)	$72.5	$14.1
9	3D Systems Corporation	$50.0	$15.5
10	Medtronic, Inc. (2013)	$43.0	$8.6
	Total	**$4,424.4**	**$527.4**

Table 2. **Top 10 Securities Class Action Settlements**
As of 31 December 2018

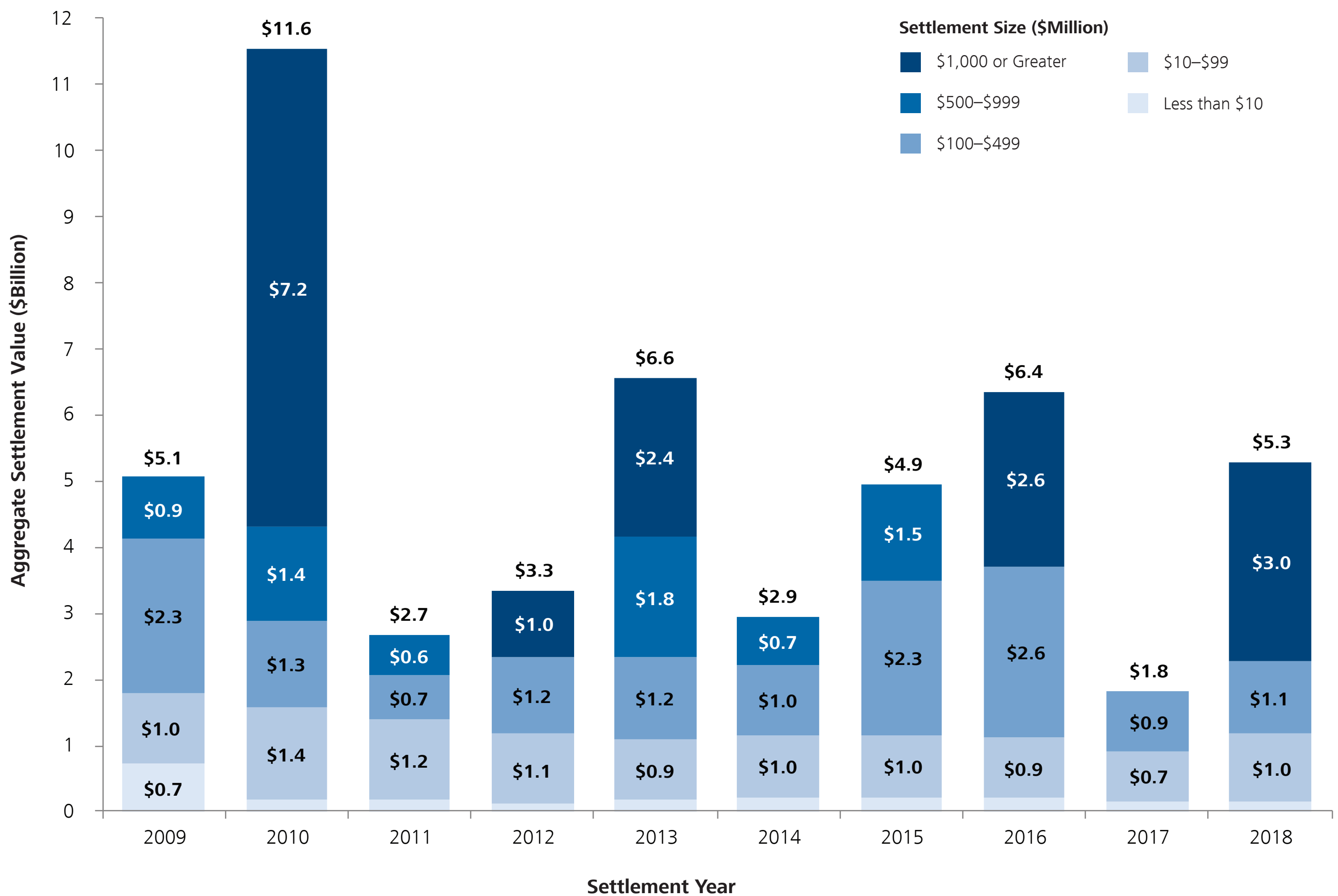
Ranking	Defendant	Settlement Year(s)	Total Settlement Value ($Million)	Codefendant Settlements		Plaintiffs' Attorneys' Fees and Expenses Value ($Million)
				Financial Institutions Value ($Million)	Accounting Firms Value ($Million)	
1	ENRON Corp.	2003–2010	$7,242	$6,903	$73	$798
2	WorldCom, Inc.	2004–2005	$6,196	$6,004	$103	$530
3	Cendant Corp.	2000	$3,692	$342	$467	$324
4	Tyco International, Ltd.	2007	$3,200	No codefendant	$225	$493
5	Petróleo Brasileiro S.A.—Petrobras	2018	$3,000	$0	$50	$205
6	AOL Time Warner Inc.	2006	$2,650	No codefendant	$100	$151
7	Bank of America Corp.	2013	$2,425	No codefendant	No codefendant	$177
8	Household International, Inc.	2006–2016	$1,577	Dimissed	Dismissed	$427
9	Nortel Networks (I)	2006	$1,143	No codefendant	$0	$94
10	Royal Ahold, NV	2006	$1,100	$0	$0	$170
	Total		**$32,224**	**$13,249**	**$1,017**	**$3,368**

Aggregate Settlements

We use the term "aggregate settlements" to denote the total amount of money to be paid to settle litigation by (non-dismissed) defendants based on the court-approved settlements during a year.

Aggregate settlements rebounded to nearly $5.3 billion in 2018, more than double the 2017 total (see Figure 26). More than 80% of the growth stems from the $3.0 billion Petrobras settlement. Excluding Petrobras and Wells Fargo, aggregate settlements are near the 2017 record low, reflecting a persistent slowdown in overall settlement activity.

Figure 26. **Aggregate Settlement Value by Settlement Size**
January 2009–December 2018



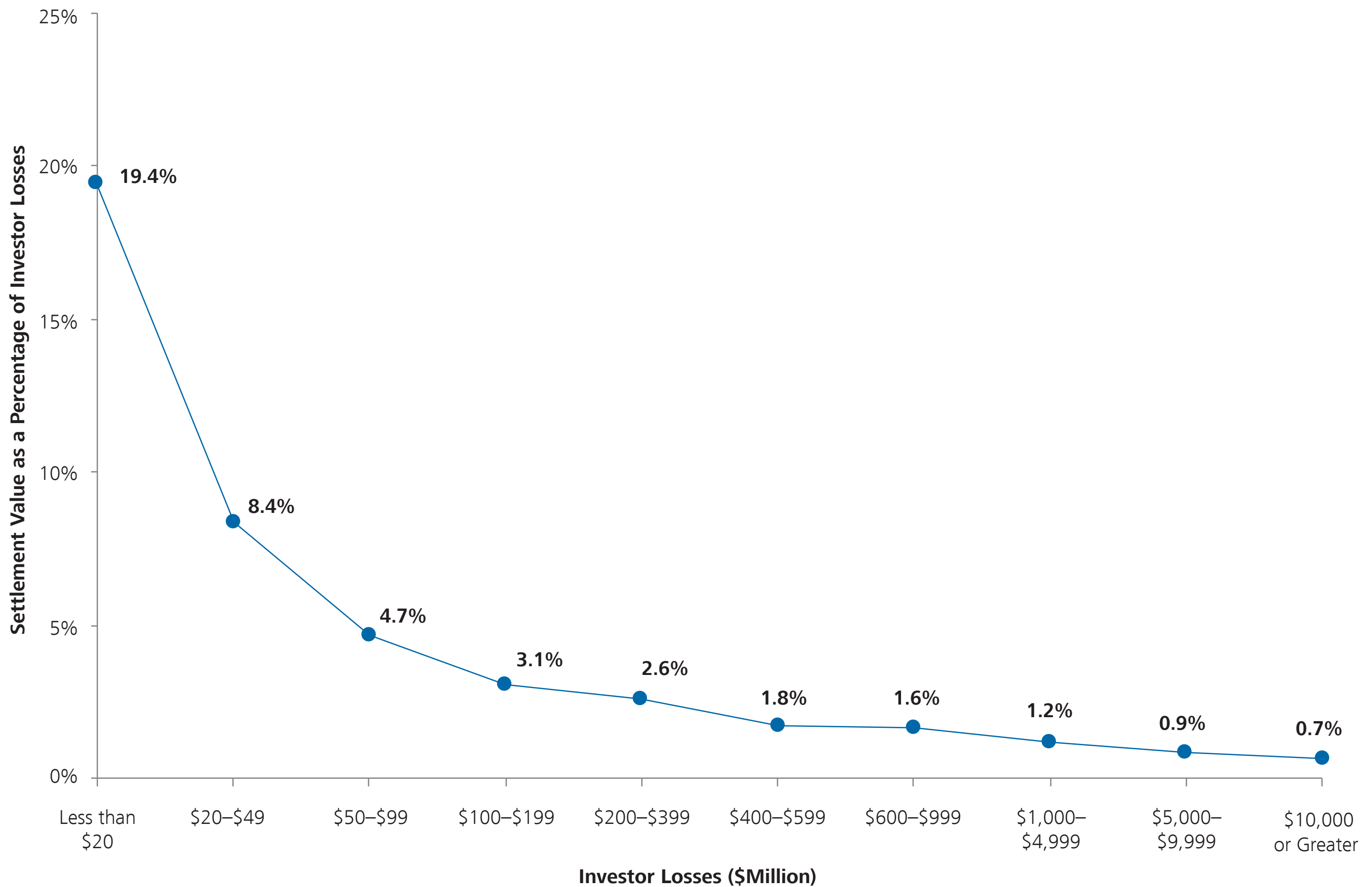
NERA-Defined Investor Losses vs. Settlements

As noted above, our proxy for case size, NERA-defined Investor Losses, is a measure of the aggregate amount investors lost from buying the defendant's stock rather than investing in the broader market during the alleged class period.

In general, settlement size grows as NERA-defined Investor Losses grow, but the relationship is not linear. Based on our analysis of data from 1996 to 2018, settlement size grows less than proportionately with Investor Losses. In particular, small cases typically settle for a higher fraction of Investor Losses (i.e., more cents on the dollar) than larger cases. For example, the ratio of settlement to Investor Loss for the median case was 19.4% for cases with Investor Losses of less than $20 million, while it was 0.7% for cases with Investor Losses over $10 billion (see Figure 27).

Our findings about the ratio of settlement amount to NERA-defined Investor Losses should not be interpreted as the share of damages recovered in settlement, but rather as the recovery compared to a rough measure of the "size" of the case. Notably, the percentages given here apply *only* to NERA-defined Investor Losses. Using a different definition of investor losses would result in a different ratio. Also, the use of the ratio alone to forecast the likely settlement amount would be inferior to a proper all-encompassing analysis of the various characteristics shown to impact settlement amounts, as discussed in the section *Explaining Settlement Values*.

Figure 27. **Median of Settlement Value as a Percentage of NERA-Defined Investor Losses by Level of Investor Losses**
Excludes Settlements for $0 to the Class
January 1996–December 2018

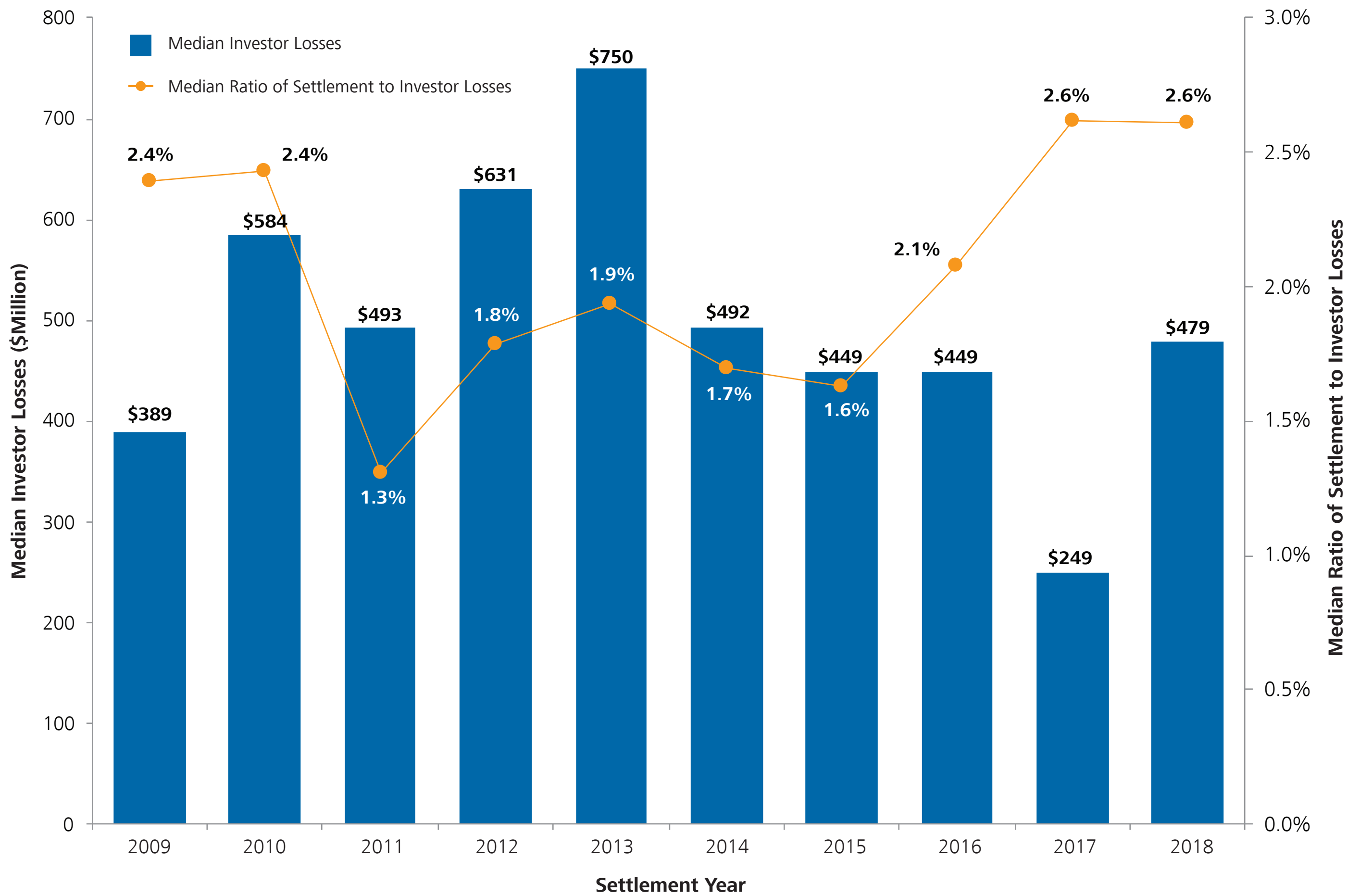


Median NERA-Defined Investor Losses over Time

Prior to 2014, median NERA-defined Investor Losses for settled cases had been on an upward trajectory since the passage of the PSLRA. As described above, the median ratio of settlement size to Investor Losses generally decreases as Investor Losses increase. Over time, the increase in median Investor Losses coincided with a decreasing trend in the median ratio of settlement to Investor Losses. Of course, there are also year-to-year fluctuations.

As shown in Figure 28, the median ratio of settlements to NERA-defined Investor Losses was 2.6% in 2018. This was the third consecutive year of at least a short-term reversal of a long-term downtrend of the ratio between passage of the PSLRA and 2015.

Figure 28. **Median NERA-Defined Investor Losses and Median Ratio of Settlement to Investor Losses by Settlement Year**
January 2009–December 2018



Explaining Settlement Amounts

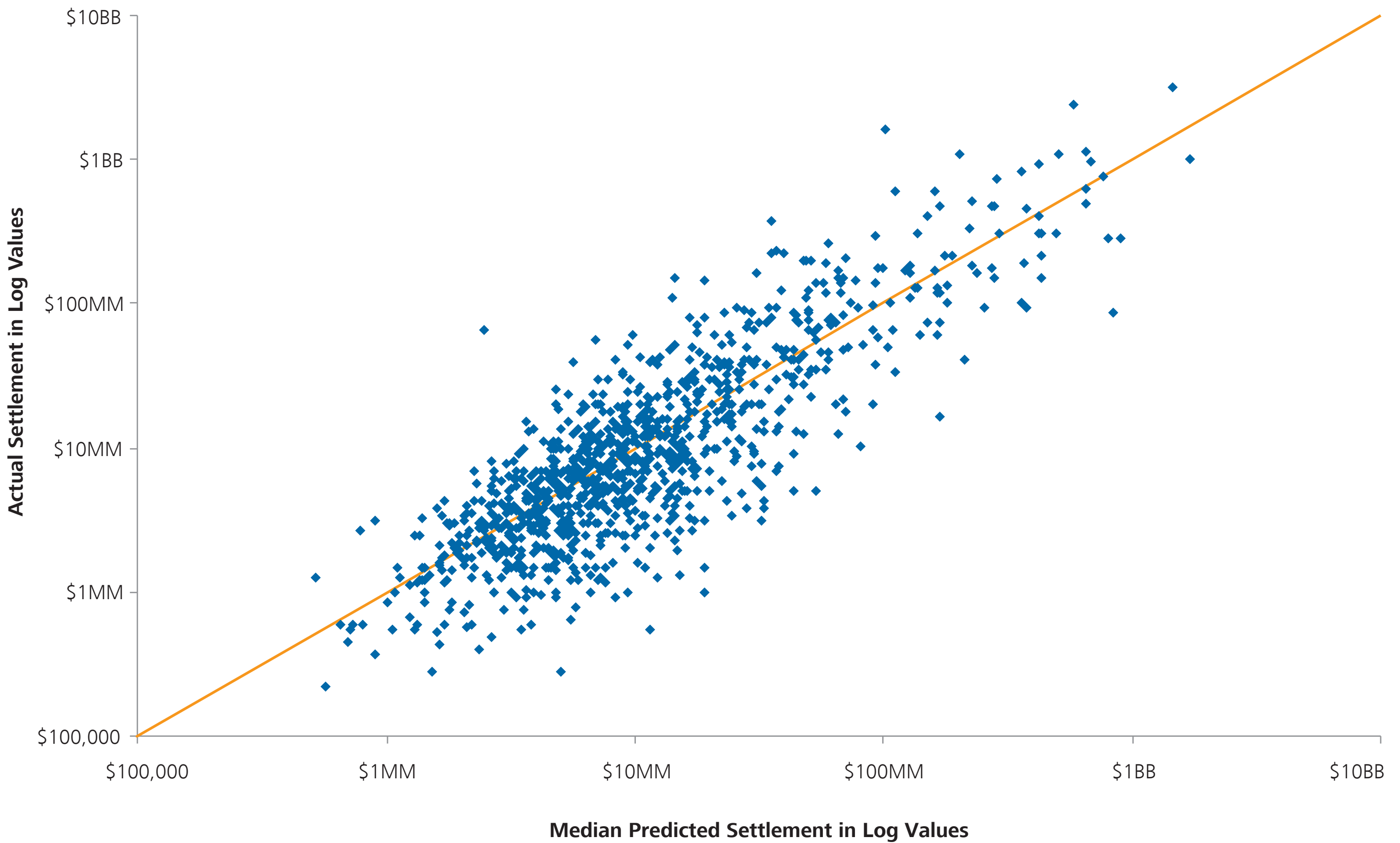
The historical relationship between case attributes and other case- and industry-specific factors can be used to measure the factors correlated with settlement amounts. NERA has examined settlements in more than 1,000 securities class actions and identified key drivers of settlement amounts, many of which have been summarized in this report.

Generally, we find that the following factors have historically been significantly correlated with settlements:

- NERA-defined Investor Losses (a proxy for the size of the case);
- The market capitalization of the issuer;
- Types of securities alleged to have been affected by the fraud;
- Variables that serve as a proxy for the "merit" of plaintiffs' allegations (such as whether the company has already been sanctioned by a governmental or regulatory agency or paid a fine in connection with the allegations);
- Admitted accounting irregularities or restated financial statements;
- The existence of a parallel derivative litigation; and
- An institution or public pension fund as lead plaintiff.

Together, these characteristics and others explain most of the variation in settlement amounts, as illustrated in Figure 29.[28]

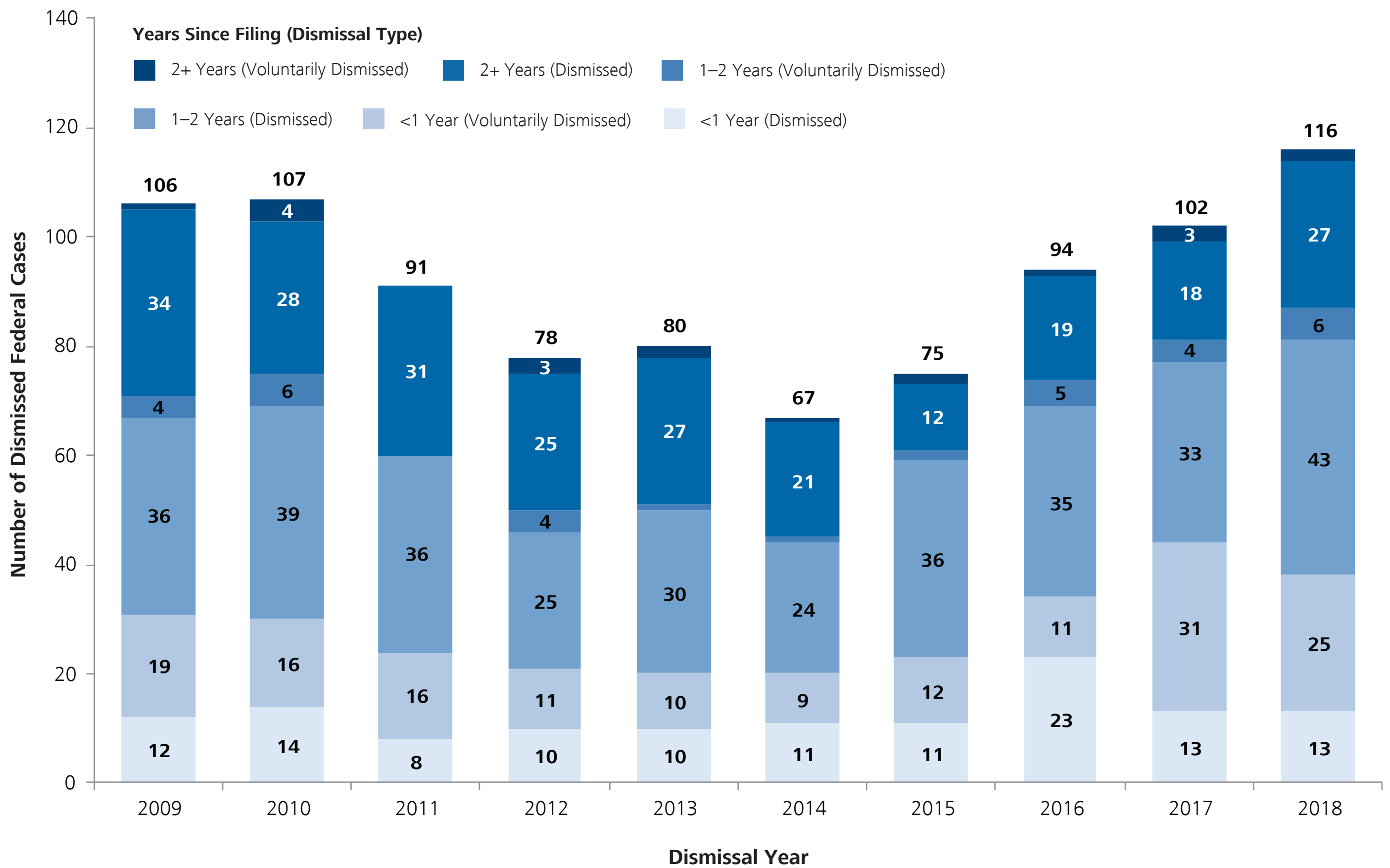
Figure 29. **Predicted vs. Actual Settlements**



Trends in Dismissals

The elevated rate of case dismissal persisted in 2018 (excluding merger objections), with more than 100 dismissals for the second consecutive year (see Figure 30). This partially stems from more cases being filed over the past couple of years, as 75% of dismissals are of cases less than two years old. Additionally, there were 25 voluntary dismissals within a year of filing, an elevated rate for the second year in a row.

Figure 30. **Number of Dismissed Cases by Case Age**
Excludes Merger Objections
January 2009–December 2018



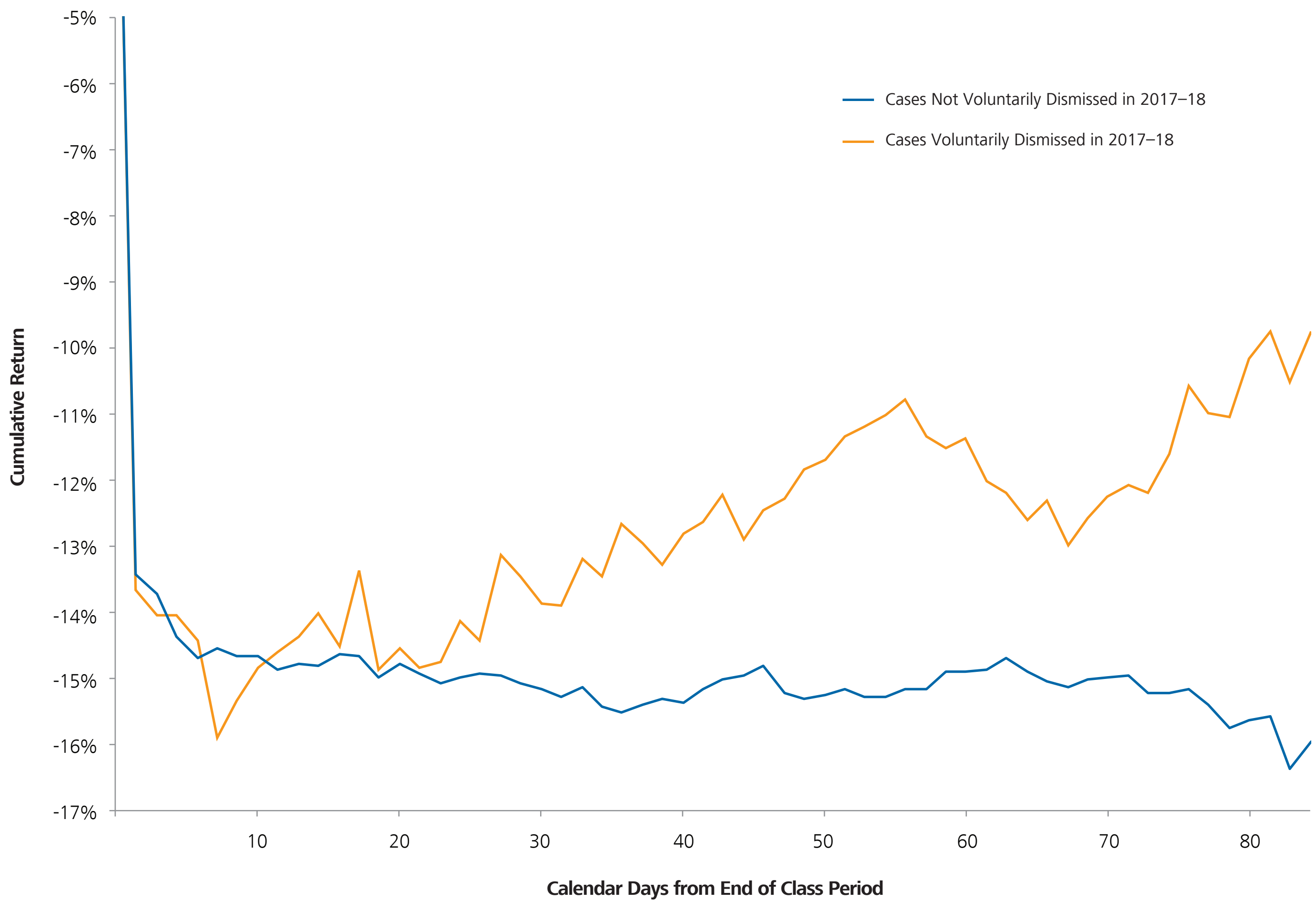
In 2018, about 12% of Standard cases were filed and resolved within the same calendar year, the second-highest rate in at least a decade (after 2017). By the end of the year, 8% of cases were voluntarily dismissed (down from 11% in 2017, but double the 2012–2016 average). Plaintiffs' voluntary dismissal of a case may be a result of perceived case weakness or changes in financial incentives. Recent research also documented forum selection by plaintiffs as a driver of voluntary dismissal without prejudice.[29]

The incentive for plaintiffs (and/or their counsel) to proceed with litigation may change with estimated damages to the class and expected recoveries since filing. For instance, the PSLRA 90-day bounce-back provision caps the award of damages to plaintiffs by the difference between the purchase price of a security and the mean trading price of the security during the 90-day period beginning on the date of the alleged corrective disclosure.

Since most securities class actions are filed well before the end of the bounce-back period (see Figure 14 for time-to-file metrics), plaintiffs may be more likely to voluntarily dismiss litigation if the price of the security at issue subsequently increases. As shown in Figure 31, in 2017 and 2018, the 90-day return of securities underlying cases voluntarily dismissed was about seven percentage points greater, on average, than securities underlying cases not voluntarily dismissed.[30]

The rate of voluntary dismissals was not particularly concentrated in terms of jurisdiction or the specific allegations we track.

Figure 31. **Average PSLRA Bounce-Back Period Returns of Voluntary Dismissals**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, or Section 12
January 2017–December 2018



Note: To control for the impact of outliers on the average of each group, for each day the most extreme 5% of cumulative returns are dropped. Observations on the three final trading days of the bounce-back period for each category are dropped due to incomplete return data.

Trends in Attorneys' Fees

Plaintiffs' Attorneys' Fees and Expenses

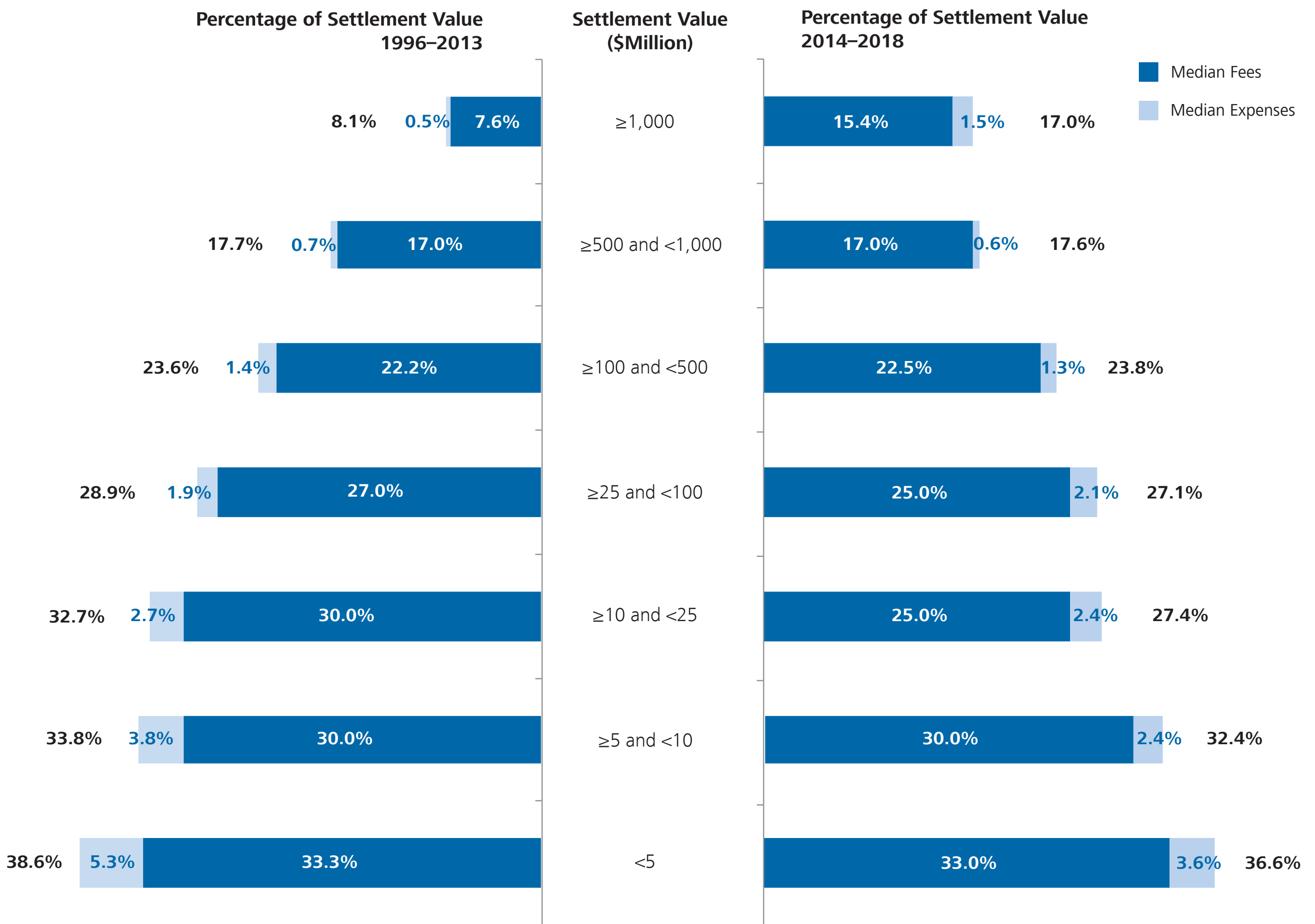
Usually, plaintiffs' attorneys' remuneration is determined as a fraction of any settlement amount in the form of fees, plus expenses. Figure 32 depicts plaintiffs' attorneys' fees and expenses as a proportion of settlement values over ranges of settlement amounts. The data shown in this figure excludes settlements for merger-objection cases and cases with no cash payment to the class.

A strong pattern is evident in Figure 32; typically, fees grow with settlement size, but less than proportionally (i.e., the fee percentage shrinks as the settlement size grows).

To illustrate that the fee percentage typically shrinks as settlement size grows, we grouped settlements by settlement value and reported the median fee percentage for each group. While fees are stable at around 30% of settlement values for settlements below $10 million, this percentage declines as settlement size increases.

We also observe that fee percentages have been decreasing over time, except for fees awarded on very large settlements. For settlements above $1 billion, fee rates have increased.

Figure 32. **Median of Plaintiffs' Attorneys' Fees and Expenses by Size of Settlement**
Excludes Merger Objections and Settlements for $0 to the Class



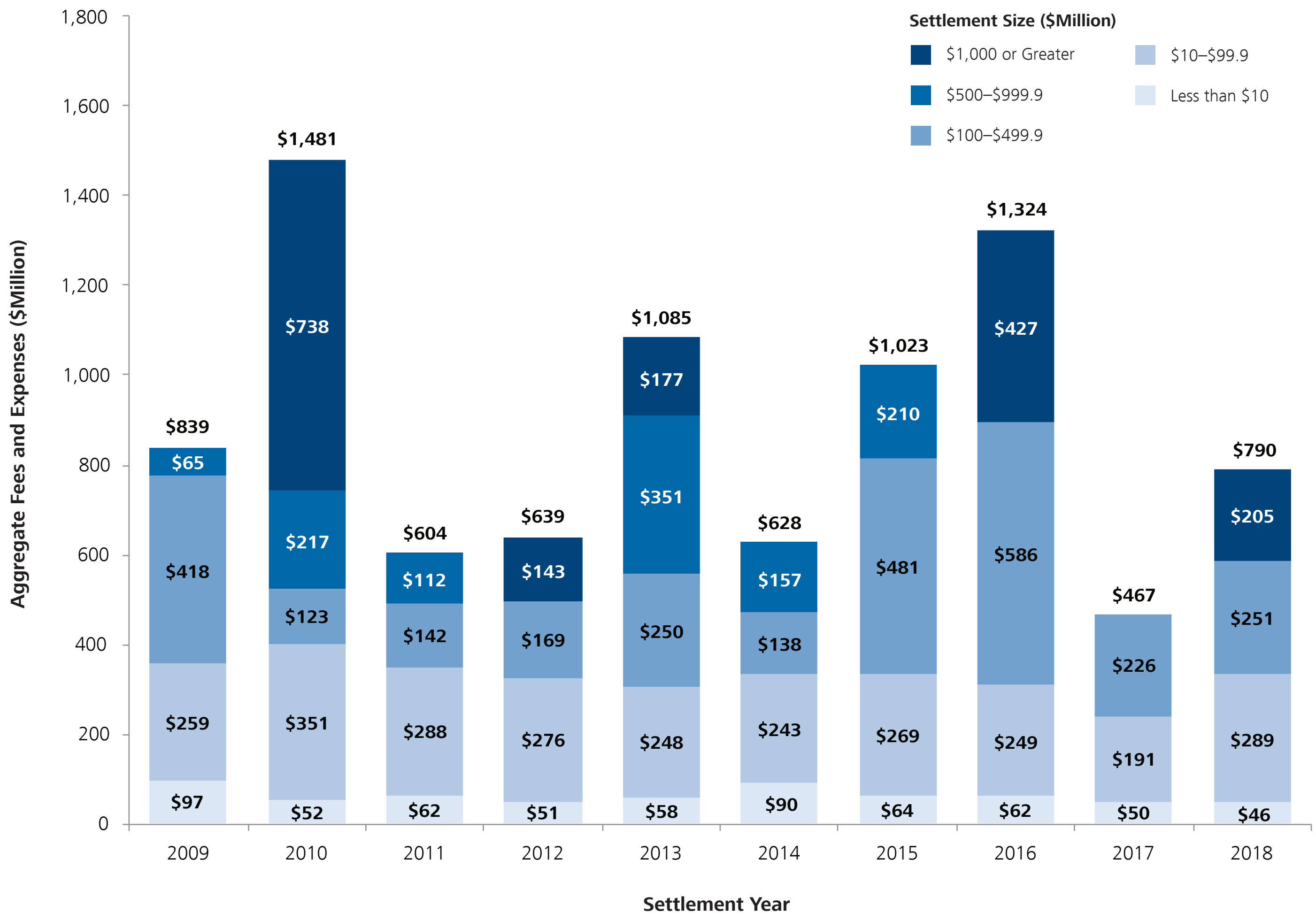
Aggregate Plaintiffs' Attorneys' Fees and Expenses

Aggregate plaintiffs' attorneys' fees and expenses are the sum of all fees and expenses received by plaintiffs' attorneys for all securities class actions that receive judicial approval in a given year.

In 2018, aggregate plaintiffs' attorneys' fees and expenses were $790 million, about 70% higher than in 2017 (see Figure 33). The increase in fees partially reflects the rebound in settlements, but fees grew substantially less than the near-tripling of aggregate settlements. This is partially due to the outsized impact of the $3 billion Petrobras settlement, one of several mega-settlements that historically generates lower fees as a percentage of settlement value.

Note that Figure 33 differs from the other figures in this section because the aggregate includes fees and expenses that plaintiffs' attorneys receive for settlements in which no cash payment was made to the class.

Figure 33. **Aggregate Plaintiffs' Attorneys' Fees and Expenses by Settlement Size**
January 2009–December 2018



Notes

[1] This edition of NERA's report on recent trends in securities class action litigation expands on previous work by our colleagues Lucy Allen, Dr. Vinita Juneja, Dr. Denise Neumann Martin, Dr. Jordan Milev, Robert Patton, Dr. Stephanie Plancich, and others. The authors also thank Dr. Milev for helpful comments on this edition. These individuals receive credit for improving this paper; all errors and omissions are ours.

[2] Data for this report are collected from multiple sources, including Institutional Shareholder Services Inc., complaints, case dockets, Dow Jones Factiva, Bloomberg Finance L.P., FactSet Research Systems, Inc., Nasdaq, Inc., Intercontinental Exchange, Inc., US Securities and Exchange Commission (SEC) filings, and public press reports.

[3] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

[4] Craig Doidge, G. Andrew Karolyi, and René M. Stulz, "The U.S. Listing Gap," National Bureau of Economic Research Working Paper No. 21181, May 2015.

[5] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

[6] For M&A statistics, see "Mergers & Acquisitions Review: First Nine Months 2018," Thomson Reuters, October 2018, available at http://dmi.thomsonreuters.com/Content/Files/3Q2018_MA_Legal_Advisor_Review.pdf.

[7] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

[8] Matthew D. Cain and Steven D. Solomon, "Takeover Litigation in 2015," Berkeley Center for Law, Business and the Economy, 14 January 2016.

[9] Warren S. de Wied, "Delaware Forum Selection Bylaws After Trulia," Harvard Law School Forum on Corporate Governance and Financial Regulation, 25 February 2016.

[10] *In re: Walgreen Co. Stockholder Litigation*, No. 15-3799 (7th Cir. Aug. 10, 2016).

[11] Federal securities class actions that allege violations of Rule 10b-5, Section 11, and/or Section 12 have historically dominated federal securities class action dockets and often been referred to as "Standard" cases.

[12] *Cyan, Inc. v. Beaver County Employees Retirement Fund*, Supreme Court No. 15-1439.

[13] See Restoration Robotics Inc. SEC Form 8-K, filed 17 October 2017, and Snap, Inc. SEC Form S-1, filed 2 February 2017.

[14] Regulatory cases with parallel accounting, performance, or missed earnings claims are excluded.

[15] Industries with fewer than 25 firms listed on US exchanges are dropped.

[16] For M&A statistics, see "Mergers & Acquisitions Review, Full Year 2017," Thomson Reuters, December 2017.

[17] For M&A statistics, see "Mergers & Acquisitions Review, First Nine Months 2018," Thomson Reuters, October 2018.

[18] "SAC to pay $1.8 billion to settle insider trading charges," Chicago Tribune, 4 November 2013, available at https://www.chicagotribune.com/business/ct-xpm-2013-11-04-chi-sac-to-pay-18-billion-to-settle-insider-trading-charges-20131104-story.html.

[19] Filings indicate that most firms in the SP 500 have adopted 10b5-1 plans as of 2014. See "Balancing Act: Trends in 10b5-1 Adoption and Oversight Article," Morgan Stanley, 2019.

[20] This case was filed after the SEC filed a complaint, more than four years after the end of the proposed class period, which plaintiffs in the class action state first revealed the alleged fraud.

[21] Outcomes of the motions for summary judgment are available from NERA but are not shown in this report.

[22] *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016).

[23] Active cases equals the sum of pending cases at the beginning of 2018 plus those filed during the year.

[24] Nearly 90% of cases filed before 2012 have been resolved, providing evidence of longer-term trends about dismissal and settlement rates. Data since then is inconclusive given pending litigation.

[25] We only consider pending litigation filed after the PSLRA.

[26] These metrics exclude merger objections.

[27] Each of the metrics in the *Time to Resolution* sub-section exclude IPO laddering cases and merger-objection cases because the former usually take much longer to resolve and the latter are usually much shorter to resolve.

[28] The axes are in logarithmic scale, and the two largest settlements are excluded from this figure.

[29] Commentary regarding a 2017 ruling in the Southern District of New York indicated that "[p]laintiffs in [*Cheung v. Bristol-Myers Squibb*] had originally filed their lawsuits in a federal district court, but after the federal district court issued a ruling that was unfavorable for the plaintiffs, the plaintiffs voluntarily dismissed their lawsuits without prejudice and then refiled them in Delaware state court." See Colin E. Wrabley and Joshua T. Newborn, "Getting Your Company's Case Removed to Federal Court When Sued in Your 'Home' State," *The Legal Intelligencer*, 19 December 2017. The case referred to is *Cheung v. Bristol-Myers Squibb*, Case No. 17cv6223(DLC), (S.D.N.Y. Oct. 12, 2017).

[30] To control for the impact of outliers on the average of each group, for each day the most extreme 5% of daily cumulative returns are dropped. Observations on the three final days of the bounce-back period for each category are dropped due to incomplete return data.

About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

Contacts

For further information, please contact:

Dr. David Tabak
Managing Director
New York City: +1 212 345 2176
david.tabak@nera.com

Stefan Boettrich
Senior Consultant
New York City: +1 212 345 1968
stefan.boettrich@nera.com

Svetlana Starykh
Senior Consultant
White Plains, NY: +1 914 448 4123
svetlana.starykh@nera.com

The opinions expressed herein do not necessarily represent the views of NERA Economic Consulting or any other NERA consultant.

To receive publications, news, and insights from NERA, please visit **www.nera.com/subscribe**.

NERA
ECONOMIC CONSULTING

Visit **www.nera.com** to learn more about our practice areas and global offices.

© Copyright 2019
National Economic Research Associates, Inc.

All rights reserved.
Printed in the USA.

CORNERSTONE RESEARCH

Economic and Financial Consulting and Expert Testimony

Securities Class Action Filings

2020 Midyear Assessment

Table of Contents

Executive Summary 1
Key Trends in Federal Filings 2
Featured: State Court 1933 Act Filings 3
Number of Federal and State Filings 4
New: S&P 500 Sector Performance 5
New: Filing Counts by Month 6
New: Summary of Trend Cases 7
Market Capitalization Losses for Federal and State Filings 8
U.S. Exchange-Listed Companies 10
Heat Maps: S&P 500 Securities Litigation™ for Federal Filings 11
Status of Federal Securities Class Action Filings 13
1933 Act Cases Filed in State Courts 14
Dollar Loss on Offered Shares Index™ (DLOS Index™) 15
Federal Section 11 Filings and State 1933 Act Filings—Pre- and Post-*Cyan* 16
Type of Security Issuance Underlying Federal Section 11 and State 1933 Act Filings 17
Combined Federal and State Filing Activity—Highlighting Federal Section 11 and State 1933 Act Filings 18
New: Performance of Recent IPOs 19
Federal Filings against Non-U.S. Issuers 20
Industry Comparison of Federal Filings 22
Federal Filings by Circuit 23
New: Most Frequent Plaintiff Counsel on Core Federal Filings 24
M&A Filings by Federal Circuit 25
New: Most Frequent Plaintiff Counsel on M&A Filings 26
New Developments 27
Glossary 28
Appendices 30
Research Sample 34

Table of Figures

Figure 1: Semiannual Class Action Filings Summary 1
Figure 2: State Court 1933 Act Filings Summary 3
Figure 3: Class Action Filings Index® (CAF Index®) Semiannual Number of Class Action Filings 4
Figure 4: S&P 500 Sector Performance—Returns and Maximum Declines 5
Figure 5: Number of Core Filings by Month 6
Figure 6: Summary of Trend Cases—Core Filings 7
Figure 7: Disclosure Dollar Loss Index® (DDL Index®) 8
Figure 8: Maximum Dollar Loss Index® (MDL Index®) 9
Figure 9: Percentage of U.S. Exchange-Listed Companies Subject to Federal or State Filings 10
Figure 10: Heat Maps of S&P 500 Securities Litigation™ Percentage of Companies Subject to Core Federal Filings 11
Figure 11: Heat Maps of S&P 500 Securities Litigation™ Percentage of Market Capitalization Subject to Core Federal Filings 12
Figure 12: Status of Filings by Year—Core Federal Filings 13
Figure 13: State 1933 Act Filings by State 14
Figure 14: Dollar Loss on Offered Shares Index™ (DLOS Index™) for Federal Section 11–Only and State 1933 Act Filings 15
Figure 15: Pre- and Post-*Cyan* Semiannual Federal Section 11 and State 1933 Act Filings 16
Figure 16: Federal Section 11 and State 1933 Act Class Action Filings by Type of Security Issuance 17
Figure 17: Federal Section 11 and State 1933 Act Class Action Filings by Venue 18
Figure 18: Performance of Recent IPOs 19
Figure 19: Annual Number of Class Action Filings by Location of Headquarters—Core Federal Filings 20
Figure 20: Non-U.S. Filings by Location of Headquarters—Core Federal Filings 21
Figure 21: Filings by Industry—Core Federal Filings 22
Figure 22: Filings by Circuit—Core Federal Filings 23
Figure 23: Most Frequent Plaintiff Counsel on Core Federal Filings 24
Figure 24: Semiannual M&A Filings by Federal Circuit 25
Figure 25: Most Frequent Plaintiff Counsel or Co-counsel on M&A Filings 26
Appendix 1: Filings Basic Metrics 30
Appendix 2A: S&P 500 Securities Litigation—Percentage of S&P 500 Companies Subject to Core Federal Filings 31
Appendix 2B: S&P 500 Securities Litigation—Percentage of Market Capitalization of S&P 500 Companies Subject to Core Federal Filings 31
Appendix 3: 1933 Act Filings in State Courts 32
Appendix 4: Filings by Industry—Core Federal Filings 32
Appendix 5: Filings by Circuit—Core Federal Filings 33

Executive Summary

In the first half of 2020, U.S. financial markets experienced extreme uncertainty and volatility as the economic consequences of the COVID-19 pandemic became apparent. Government stimulus efforts to assist companies negatively affected by shelter-in-place requirements and individuals furloughed from their jobs calmed financial markets to a degree.

Stock valuations rebounded from lows in late March and early April, but many industries still experienced meaningful declines in market capitalization from the beginning of the year through the end of June. Against this backdrop, filing activity increased in March and April, declined in May, but then rebounded in June.

Number and Size of Filings

- Plaintiffs filed 182 **new class action securities cases** (filings) across federal and state courts in the first half of 2020, 117 of which were core filings. While the total number of filings is high compared with historical averages, it is 18 percent lower than in the second half of 2019. (page 4)
- Federal and state court class actions alleging **claims under the Securities Act of 1933** (1933 Act) declined significantly in the first half 2020, despite recent initial public offerings (IPOs) trading below offering prices. (pages 3, 19)
- **Disclosure Dollar Loss (DDL)** decreased by 25 percent from $108 billion in the second half of 2019 to $81 billion in the first half 2020. (page 8)
- **Maximum Dollar Loss (MDL)** increased by 48 percent from $394 billion in the second half of 2019 to $584 billion, due in part to market capitalization losses in a broad swath of industry sectors during the first half of the year. (page 9)

Other Measures of Filing Intensity

- In the first half of 2020, the likelihood of core filing litigation against **U.S. exchange-listed companies** decreased to an annualized rate of 4.2 percent. This is comparable to rates observed in 2016 and 2017, but lower than 2018 and 2019 when the likelihood was 4.8 percent and 5.5 percent, respectively. (page 10)
- On an annualized basis, approximately one in 21 **S&P 500** companies (4.8 percent) was subject to litigation in federal courts in the first half of 2020. (pages 11–12)

117 core filings occurred in the first half of the year, a 13 percent decrease from the semiannual filing activity in both halves of 2019.

Figure 1: Semiannual Class Action Filings Summary

	Semiannual (1997 H1–2019 H2)			2019 H1	2019 H2	2020 H1
	Average	Maximum	Minimum			
Class Action Filings	112	222	55	207	221	182
Core Filings	95	134	55	*134*	*134*	*117*
Disclosure Dollar Loss ($ billions)	$68	$175	$11	$175	$108	$81
Maximum Dollar Loss ($ billions)	$331	$1,121	$52	$798	$394	$584

Key Trends in Federal Filings

Not surprisingly, allegations related to issuers' responses to COVID-19 began appearing in filings in mid-March. Several trends observed in prior years against issuers of cryptocurrencies and cannabis companies continued in 2020.

U.S. Companies

- Core federal filings against S&P 500 firms in 2020 occurred at an annualized rate of 4.8 percent, the lowest since 2015. (page 10)

Non-U.S. Companies

- Over 30 percent of core federal filings were against non-U.S. issuers, the highest rate observed since the wave of filings related to reverse mergers in 2011.
- Although annualized total core federal filings were down 9 percent, annualized core federal filings against non-U.S. issuers are on pace to be the highest on record.
- Approximately 20 percent of core federal filings against non-U.S. issuers had allegations related to cryptocurrencies. (page 20–21)

By Industry

- The number of **Technology** and **Communications** filings declined after rising in recent semiannual periods. Together they fell 37 percent compared with the second half of 2019.
- The first half of 2020 saw an increase in filing activity in the **Financial** sector compared to the year prior, with the number of filings increasing by 50 percent from 2019 H1, and MDL increasing tenfold. (page 22, 32)

By Circuit

- There were 40 core federal filings in the **Second Circuit**, dropping from 51 and 52 in 2019 H1 and 2019 H2, respectively.
- **Ninth Circuit** filings increased from 24 in the second half of 2019 to 35 in the first half of 2020.
- **Third Circuit** core filings declined to 11 in the first half of 2020 from 13 in the second half of 2019, but remained above the 1997–2019 average of nine. (page 23)

Trend Cases

- In March, securities class action complaints first began to reference issues related to COVID-19. In total, there were 11 complaints filed involving disclosures regarding companies' responses to the pandemic in 2020 H1.
- Many other event-driven filings (e.g., involving allegations of cybersecurity problems, stemming from the opioid epidemic, or containing allegations of sexual harassment) were infrequent or nonexistent in the first half of the year.
- Issuers representing more novel business propositions (e.g., companies issuing cryptocurrencies or facilitating the sale of these instruments, or companies involved in cannabis-related products or services) continued to be sued, although more sporadically. (page 7)

M&A Filings

- There were 65 federal M&A filings in the first half of 2020, the fewest in federal courts since the second half of 2016.
- Filings in the Third Circuit accounted for 91 percent of all M&A filings in the first half of 2020; all of these filings were brought in Delaware federal courts. The number of filings in all circuits decreased or remained unchanged relative to the second half of 2019. (page 25)

New Developments

- On March 18, 2020, the Delaware Supreme Court issued a decision in *Sciabacucchi v. Salzberg*. At issue was whether forum-selection provisions in corporate charters could require that some class action securities claims under the 1933 Act be adjudicated in federal courts. This decision reversed a December 2018 opinion of the Delaware Chancery Court that such charter provisions were invalid under Delaware law. (page 27)
- Legislation is pending that would delist the securities of companies in jurisdictions (such as China, France, and Belgium) that restrict Public Company Accounting Oversight Board (PCAOB) inspection. (page 27)

Featured: State Court 1933 Act Filings

Securities class action filings with 1933 Act claims decreased substantially in state courts in the first half of 2020, reversing an upward trend of state filings following the 2018 U.S. Supreme Court decision in *Cyan Inc. v. Beaver County Employees Retirement Fund*.

- The number of 1933 Act cases filed in state courts (state 1933 Act filings) decreased in California, New York, and other states. In California there appear to have been no state-only 1933 Act filings for the first time since 2017 H1. (page 14)
- The MDL of state 1933 Act filings in the first half of 2020 decreased by 52 percent from $31.5 billion to $14.9 billion. For state-only 1933 Act filings this decrease was more pronounced, declining 71 percent from $17.4 billion to $5.0 billion.
- Of all state 1933 Act filings in the first half of 2020, 45 percent had a parallel action in federal court. (page 16)
- Although parallel filings made up 45 percent of 1933 Act filings, they comprised 67 percent of the MDL for 1933 Act filings due to a single large company.

The number of state 1933 Act filings was the lowest it has been since 2017, before the Cyan decision.

Figure 2: State Court 1933 Act Filings Summary

	Semiannual Average (2011 H1–2019 H2)	2019 H1	2019 H2	2020 H1
1933 Act Class Action Filings				
Filings in State Courts Only	4	13	15	6
California	2	2	3	0
New York	1	5	8	4
All Other States	1	6	4	2
Parallel Filings in State and Federal Courts	4	11	14	5
Total	8	24	29	11
Maximum Dollar Loss ($ billions)				
MDL of Filings in State Courts Only	$5.6	$5.9	$17.4	$5.0
California	$4.3	$0.6	$0.2	$0.0
New York	$0.7	$1.1	$11.9	$3.2
All Other States	$0.6	$4.2	$5.4	$1.8
MDL of Parallel Filings in State and Federal Courts	$4.8	$12.5	$14.1	$10.0
Total MDL	$10.4	$18.4	$31.5	$14.9

Note:

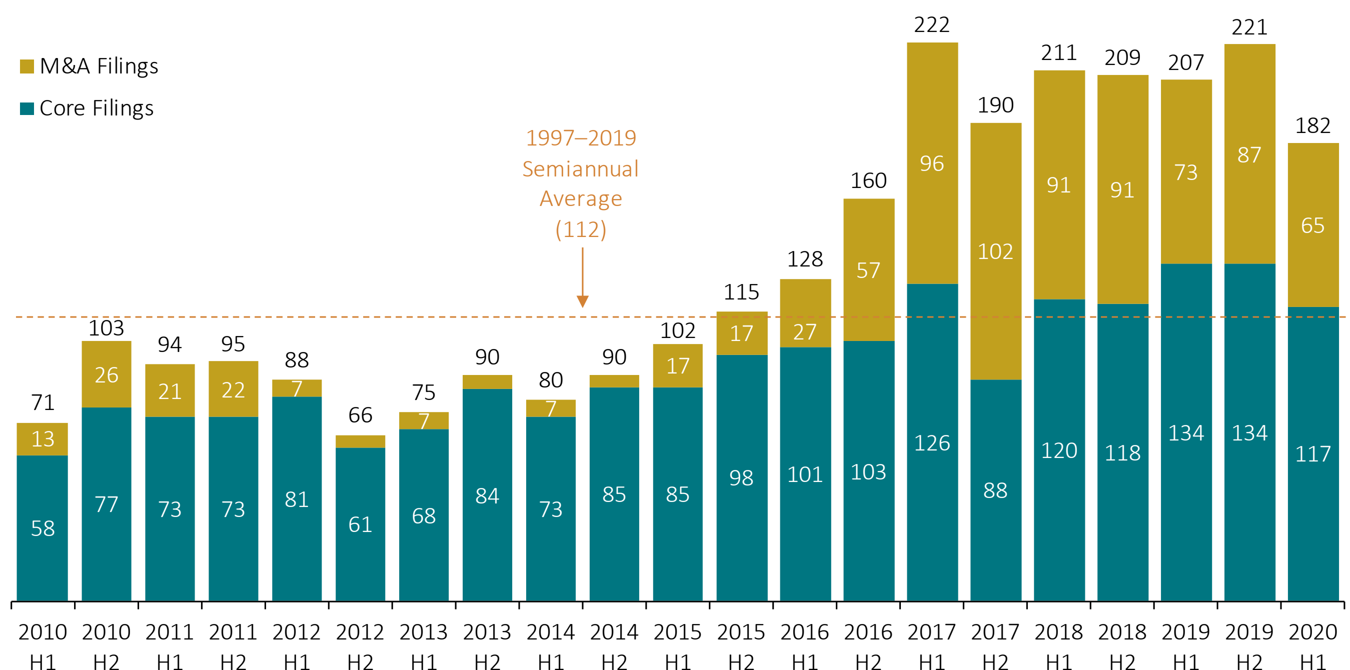
1. Filings in state courts may have parallel cases filed in federal courts. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year. Filings against the same company brought in different states without a filing brought in federal court are counted as unique state filings.
2. Beginning in 2018, the Securities Class Action Clearinghouse began tracking 1933 Act filings in California state courts containing Section 11 or Section 12 claims; there were six filings in California state courts with only Section 12 claims in 2018. Filings in other state courts are currently only those with Section 11 claims.
3. Figures may not sum due to rounding.
4. From 2011 through the first half of 2020, plaintiffs filed at least 172 state 1933 Act filings. At least 87 were filed in California and 41 in New York.

Number of Federal and State Filings

- There were 182 filings in the first half of 2020, the lowest number since 2016 H2. The decline in Section 11 filings was the primary reason for the overall reduction in filing activity in the first half of the year.
- The filing slowdown affected both core and M&A filings, which had drops in activity of 13 and 25 percent, respectively.
- As merger deal activity slowed, so did merger filing activity. The number of non-withdrawn mergers over $100 million with a public company target whose shares or American Depositary Receipts (ADRs) traded on a U.S. exchange fell from around 80 with announcement dates in 2019 H2 to approximately 30 with announcement dates in 2020 H1.

Total filing activity dropped by 18 percent in the first half of 2020 compared with the second half of 2019.

Figure 3: Class Action Filings Index® (CAF Index®) Semiannual Number of Class Action Filings
2010 H1–2020 H1



Note: This figure begins including state 1933 Act filings in the semiannual counts in 2010. Parallel class actions are only reflected as a single filing. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year.

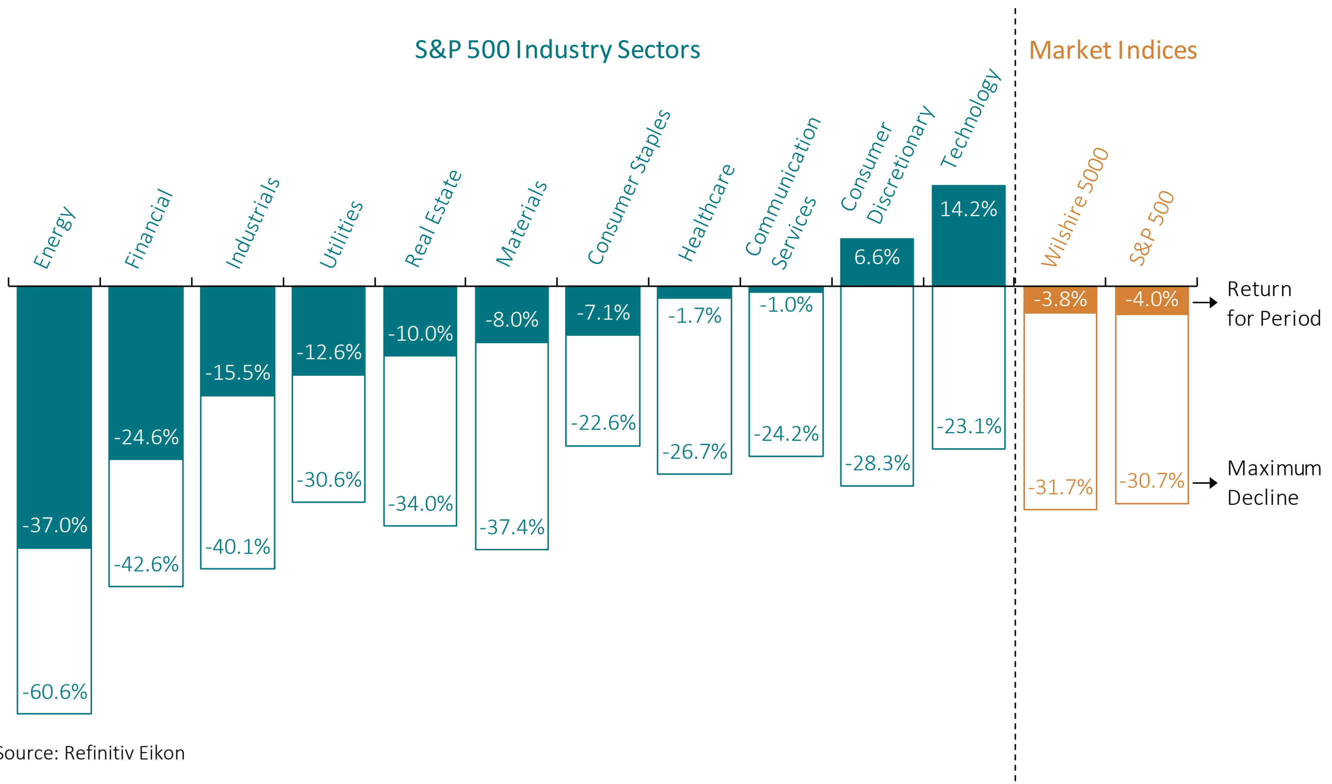
New: S&P 500 Sector Performance

Financial markets were volatile during the first half of 2020, falling dramatically during late February through mid-March before reversing peak losses to varying degrees starting in late March. This analysis shows the returns and maximum declines of S&P 500 industry sectors in comparison with broader market indices since the start of 2020.

The S&P 500 and the Wilshire 5000 experienced negative returns of 4.0 and 3.8 percent over the first half of the year, respectively, although both indices were substantially lower at interim points in the period.

- Of the 11 industry sectors analyzed, nine experienced negative returns over the first half of 2020.
- Every industry sector declined substantially in March. Consumer Staples companies experienced the smallest decline of 22.6 percent, while companies in the Energy sector declined 60.6 percent.
- The largest losses for the first half of the year were in the Energy and Financial sectors, with negative returns of 37.0 percent and 24.6 percent, respectively.
- The Technology sector experienced the highest positive return of 14.2 percent, although it too had declined by 23.1 percent earlier in first half of the year.

Figure 4: S&P 500 Sector Performance—Returns and Maximum Declines
2020 H1



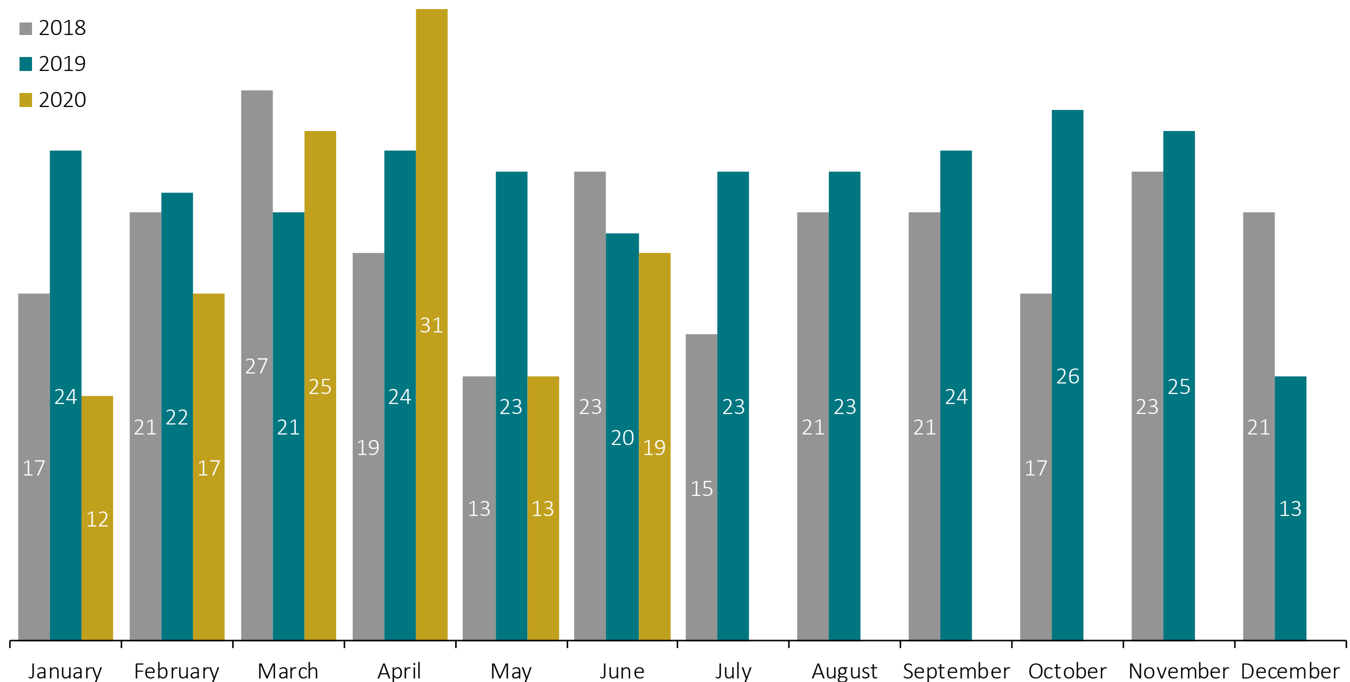
Source: Refinitiv Eikon

New: Filing Counts by Month

- After lower filing activity in January, the number of filings each month steadily increased through April before declining again in May. Filings in June then rebounded to monthly totals higher than those in January and February, prior to the onset of the COVID-19 pandemic.
- The peak in April was influenced by the filings on April 3, 2020, of 11 similar securities class actions brought by two law firms against companies that had initial coin offerings or that provided exchanges for the trading of cryptocurrencies.
- Plaintiffs filed 117 new core securities class actions across federal and state courts in the first half of 2020, the lowest number of core filings over a half-year period in the last three years and 13 percent lower than in 2019 H2 (134).

Filing activity fluctuated in the first half of the year, with both the lowest (January) and highest (April) monthly totals of core filings in the last three years.

Figure 5: Number of Core Filings by Month
2018–2020 H1



Source: Refinitiv Eikon

Note: Counts include core filings in federal court and 1933 Act filings in state court. Core filings exclude M&A filings. Filings in state courts may have parallel cases filed in federal courts. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year. On April 3, 2020, 11 similar securities class actions brought by two law firms were filed against companies that had initial coin offerings or that provided exchanges for the trading of cryptocurrencies.

New: Summary of Trend Cases

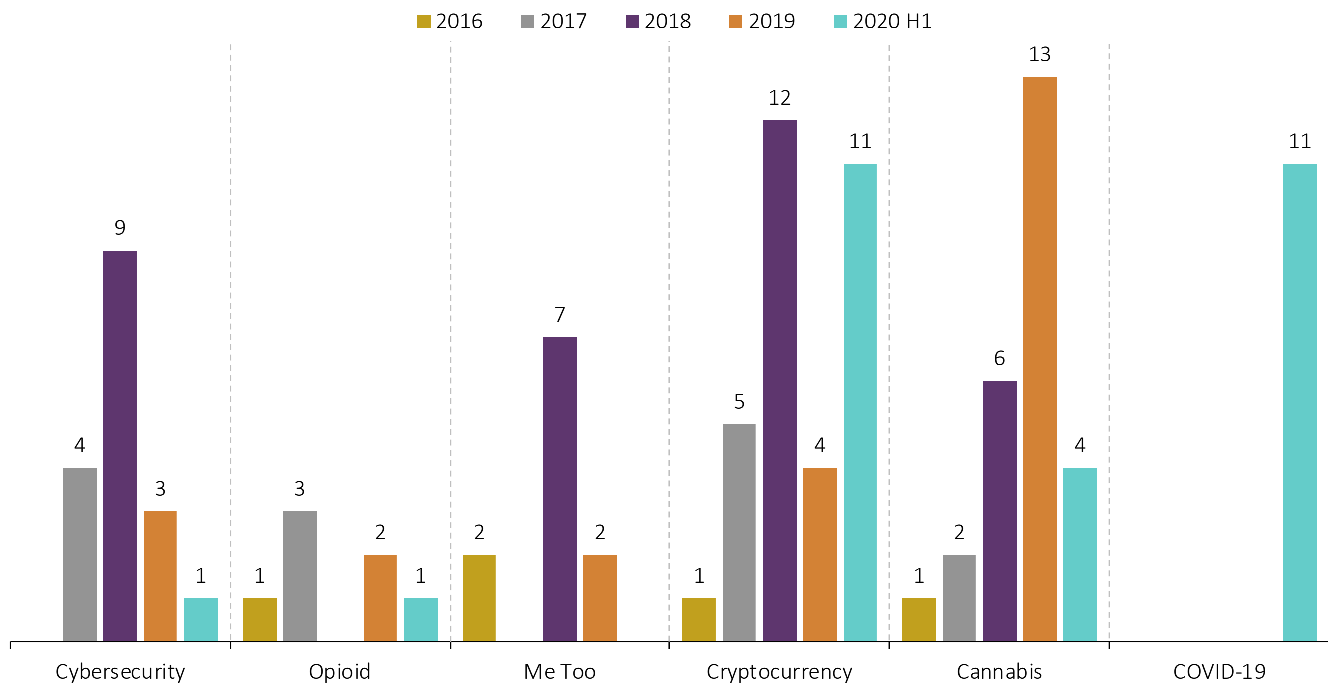
This exhibit highlights different trends that have appeared in core filing activity in recent years.

- Cybersecurity filings are those in which allegations relate to data breaches or security vulnerabilities.
- Opioid filings involve allegations related to opiate drugs that are addictive, were falsely marketed as non-addictive, or caused other opiate-related issues.
- Me Too filings involve allegations of sexual harassment that are central to the claims.
- Cryptocurrency filings include blockchain or cryptocurrency companies that engaged in the sale or exchange of tokens (commonly initial coin offerings), cryptocurrency mining, cryptocurrency derivatives, or that designed blockchain-focused software.
- Cannabis filings include companies financing, farming, distributing, or selling cannabis and cannabidiol products.
- COVID-19 filings include allegations related to companies negatively impacted by the virus or looking to address demand for products as a result of the virus.

Aside from a flurry of cryptocurrency filings and multiple cannabis-related filings, previous trend cases subsided while COVID-19-related filings emerged.

- In the first half of the year, there were 11 filings related to COVID-19.
- There were 11 cryptocurrency complaints filed on April 3, brought by two law firms against companies issuing ECR-20 digital tokens on the Ethereum blockchain or against companies that provided exchanges for those tokens. A majority of these issuers were headquartered outside the United States.
- Three of four cannabis-related filings in the first half of the year were against companies headquartered in Canada.

Figure 6: Summary of Trend Cases—Core Filings
2016–2020 H1



Note: There are six filings that appeared in multiple trend categories.

Market Capitalization Losses for Federal and State Filings

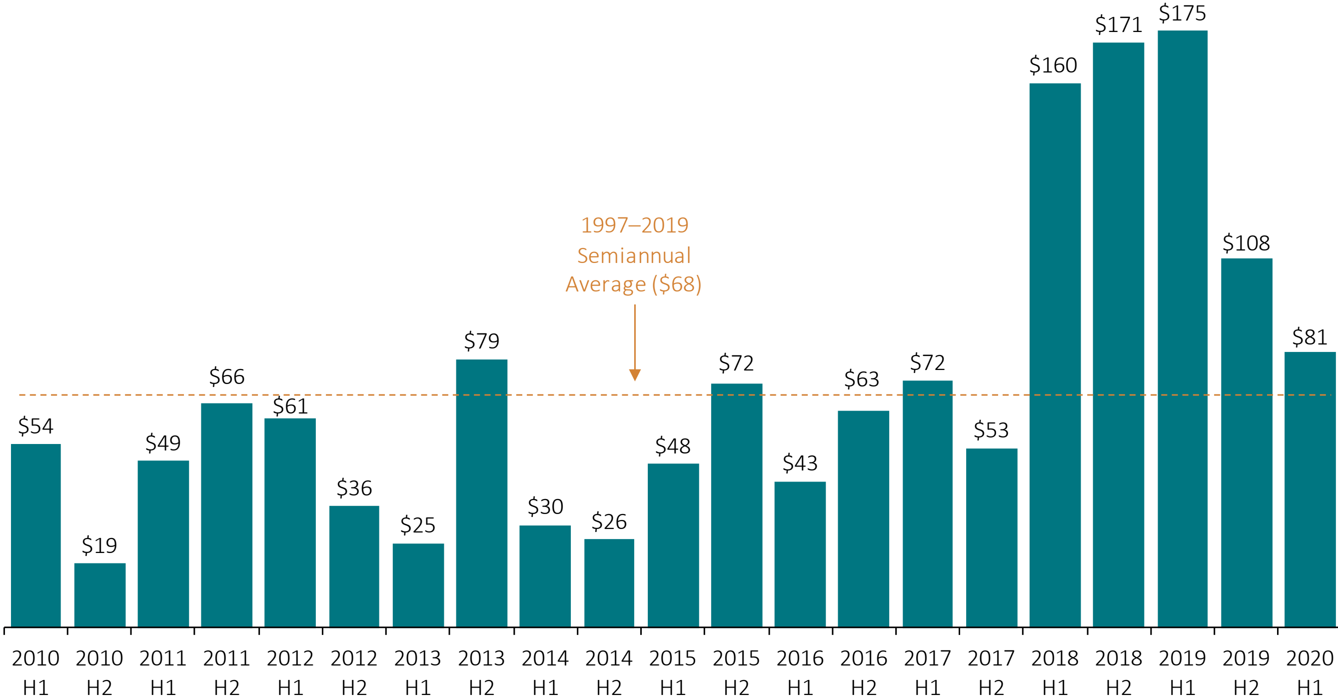
Disclosure Dollar Loss Index® (DDL Index®)

This index measures the aggregate annual DDL for all federal and state filings. DDL is the dollar value change in the defendant firm's market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. See the Glossary for additional discussion on market capitalization losses and DDL.

The DDL Index declined to its lowest semiannual level since 2017 H2, down 54 percent from its high in 2019 H1.

- The DDL Index fell to $81 billion in 2020 H1, down 25 percent from 2019 H2 and 54 percent below its all-time high in 2019 H1. This represents the lowest total for a half year since 2017 H2, but remains above the 1997–2019 semiannual average.
- A decrease in the number of core filings (down 13 percent from the second half of 2019) contributed to the decline in the DDL Index.
- The largest contributors to the DDL Index were the Consumer Non-Cyclical (41 percent) and Financial (25 percent) sectors (see Appendix 4).

Figure 7: Disclosure Dollar Loss Index® (DDL Index®)
2010 H1–2020 H1
(Dollars in billions)



Note: This figure begins including DDL associated with state 1933 Act filings in 2010. DDL associated with parallel class actions are only counted once.

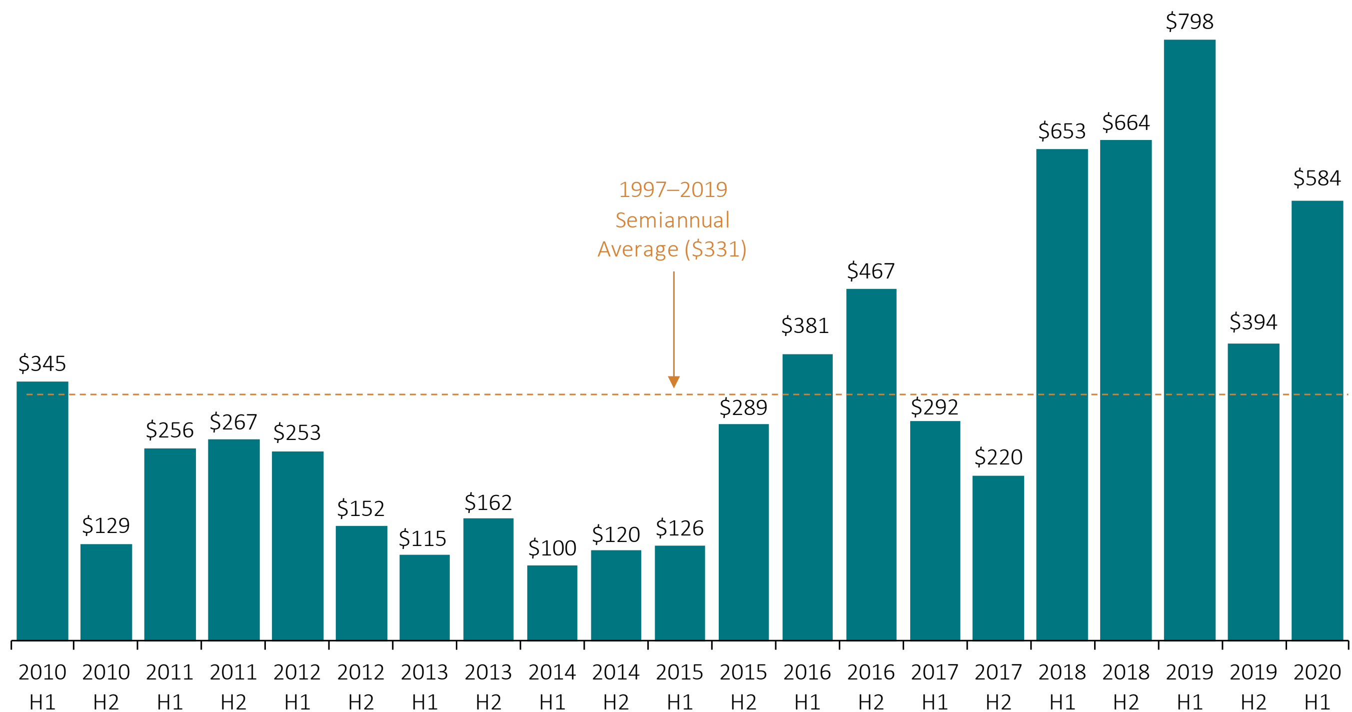
Maximum Dollar Loss Index® (MDL Index®)

This index measures the aggregate annual MDL for all federal and state filings. MDL is the dollar value change in the defendant firm's market capitalization from the trading day with the highest market capitalization during the class period to the trading day immediately following the end of the class period. See the Glossary for additional discussion on market capitalization losses and MDL.

- The MDL Index was $584 billion in the first half of 2020. Relative to the second half of 2019, the MDL Index increased by 48 percent even though the number of total core filings fell by 13 percent. This difference is partially due to one filing that made up 31 percent of total MDL for the first half of 2020.
- See Appendix 1 for MDL totals, averages, and medians from 1997 H1 to 2020 H1.
- The largest contributor to the MDL Index was the Financial sector, which comprised 42 percent of the total MDL (see Appendix 4).

The MDL Index rebounded sharply in the first half of the year, up 48 percent from the second half of 2019.

Figure 8: Maximum Dollar Loss Index® (MDL Index®)
2010 H1–2020 H1
(Dollars in billions)



Note: This figure begins including MDL associated with state 1933 Act filings in 2010. MDL associated with parallel class actions are only counted once.

U.S. Exchange-Listed Companies

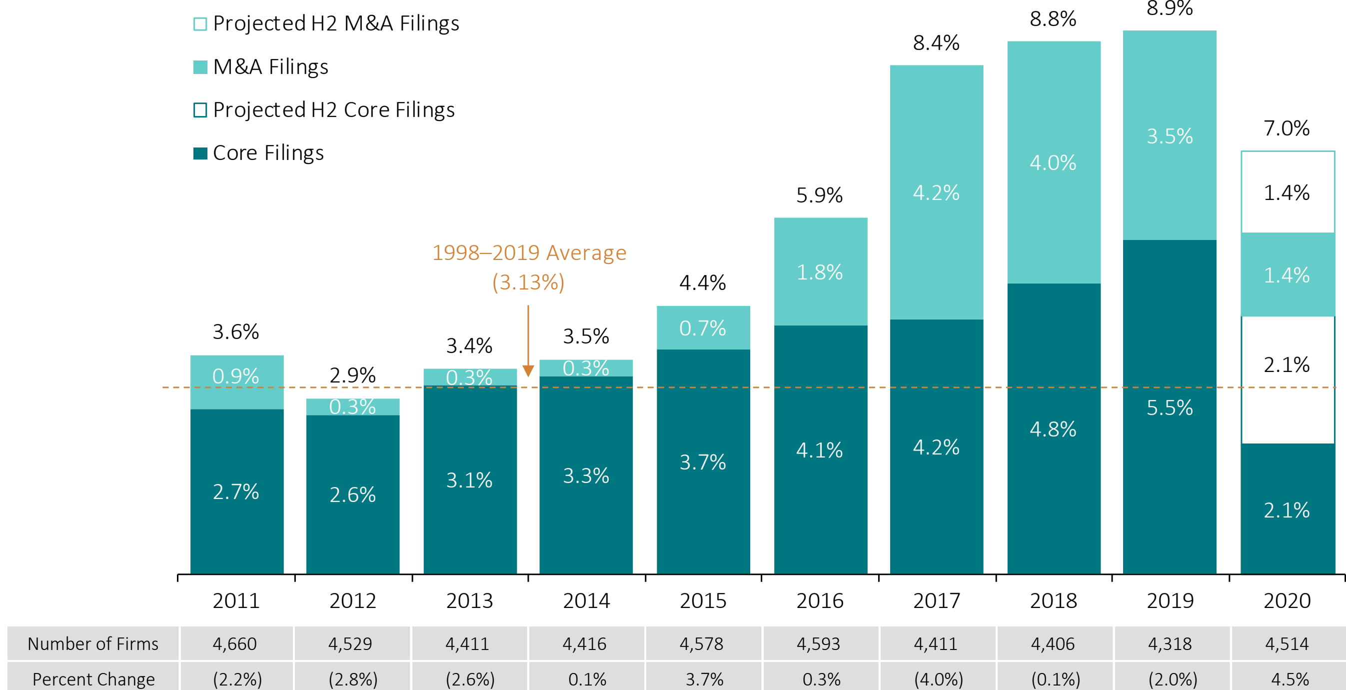
The percentages below are calculated as the unique number of companies listed on the NYSE or Nasdaq subject to federal or state securities fraud class actions in a given year divided by the unique number of companies listed on the NYSE or Nasdaq.

- Annualizing data from the first half of the year, 7.0 percent of companies listed on major U.S. exchanges may become subject to a filing in 2020. This is the first decrease since 2012, and represents a decline from 2018 and 2019 levels.
- Of U.S. exchange-listed companies, 2.1 percent, or 4.2 percent on an annualized basis, were the subject of a core filing in the first half of 2020. This would be the lowest exposure since 2017.

If core filings continue at the current rate, the percentage of firms subject to a core filing will decrease for the first time in eight years.

- The percentage of exchange-listed companies subject to M&A filings in 2020 is on pace to decline for the third straight year, after increasing between 2012 and 2017.

Figure 9: Percentage of U.S. Exchange-Listed Companies Subject to Federal or State Filings
2011–2020 H1



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Number of Firms	4,660	4,529	4,411	4,416	4,578	4,593	4,411	4,406	4,318	4,514
Percent Change	(2.2%)	(2.8%)	(2.6%)	0.1%	3.7%	0.3%	(4.0%)	(0.1%)	(2.0%)	4.5%

Source: Securities Class Action Clearinghouse; Center for Research in Security Prices (CRSP)

Note:

1. Percentages are calculated by dividing the count of issuers listed on the NYSE or Nasdaq subject to filings by the number of companies listed on the NYSE or Nasdaq as of the beginning of the year.
2. Listed companies were identified by taking the count of listed securities at the beginning of each year and accounting for cross-listed companies or companies with more than one security traded on a given exchange. Securities were counted if they were classified as common stock or ADRs and listed on the NYSE or Nasdaq.
3. Percentages may not sum due to rounding.
4. This figure begins including issuers facing suits in state 1933 Act filings in 2010.

Heat Maps: S&P 500 Securities Litigation™ for Federal Filings

The Heat Maps illustrate federal court securities class action activity by industry sector for companies in the S&P 500 index. Starting with the composition of the S&P 500 at the beginning of each year, the Heat Maps examine each sector by:

(1) The percentage of these companies subject to new securities class actions in federal court during each calendar year.

(2) The percentage of the total market capitalization of these companies subject to new securities class actions in federal court during each calendar year.

- Of the companies in the S&P 500 at the beginning of 2020, approximately one in 21 companies (4.8 percent) was a defendant in a core federal filing during the year, a 33.2 percent decrease from 2019. See Appendix 2A for percentage of companies by sector from 2001 to 2019.

The likelihood of an S&P 500 company being sued declined to pre-2016 levels after reaching 10-year highs in 2018 and 2019.

- The rate of core federal filings against Energy/Materials and Utilities firms fell to zero from 3.7 percent and 6.9 percent of companies, respectively, in 2019.
- All sectors except for Consumer Discretionary and Financials/Real Estate saw a decrease in core federal filings from 2019 to 2020 (annualized).
- The rate of core federal filings against Communication Services/Telecommunications/Information Technology firms dropped well below the 2001–2019 average of 6.5 percent to 2.2 percent in 2020 (annualized).

Figure 10: Heat Maps of S&P 500 Securities Litigation™ Percentage of Companies Subject to Core Federal Filings

	Average 2001–2019	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 (Annualized)
Consumer Discretionary	5.2%	3.8%	4.9%	8.4%	1.2%	0.0%	3.6%	8.5%	10.0%	3.1%	9.5%
Consumer Staples	3.8%	2.4%	2.4%	0.0%	0.0%	5.0%	2.6%	2.7%	11.8%	12.1%	6.1%
Energy/Materials	1.6%	0.0%	2.7%	0.0%	1.3%	0.0%	4.5%	3.3%	1.8%	3.7%	0.0%
Financials/Real Estate	7.7%	1.2%	3.7%	0.0%	1.2%	1.2%	6.9%	3.3%	7.0%	2.0%	6.2%
Health Care	9.1%	2.0%	1.9%	5.7%	0.0%	1.9%	17.9%	8.3%	16.1%	12.9%	10.0%
Industrials	4.2%	1.7%	1.6%	0.0%	4.7%	0.0%	6.1%	8.7%	8.8%	10.1%	2.9%
Communication Services/ Telecommunications/ Information Technology	6.5%	7.1%	3.8%	9.1%	0.0%	4.2%	6.8%	8.5%	12.7%	10.0%	2.2%
Utilities	5.2%	0.0%	0.0%	0.0%	0.0%	3.4%	3.4%	7.1%	7.1%	6.9%	0.0%
All S&P 500 Companies	5.5%	2.6%	3.0%	3.4%	1.2%	1.6%	6.6%	6.4%	9.4%	7.2%	4.8%

Note:

1. The figure is based on the composition of the S&P 500 as of the last trading day of the previous year.
2. Sectors are based on the Global Industry Classification Standard (GICS).
3. Percentage of Companies Subject to New Filings equals the number of companies subject to new securities class action filings in federal courts in each sector divided by the total number of companies in that sector.
4. In August 2016, GICS added a new industry sector, Real Estate. This analysis begins using the Real Estate industry sector in 2017. In 2018, the Telecommunication Services sector was incorporated into a new sector, Communication Services. This analysis begins using the Communication Services sector name in 2019. With this name change, all companies previously classified as Telecommunication Services and some companies classified as Consumer Discretionary (such as Netflix, Comcast, and CBS) and Information Technology (such as Alphabet and Facebook) were reclassified into the Communication Services sector.

- The percentage of total market capitalization of S&P 500 companies subject to core federal filings fell from 10.0 percent in 2019 to 4.0 percent in 2020 (annualized), the third-lowest percentage since 2001. This represents a decrease of 60.1 percent from the previous year. See Appendix 2B for market capitalization percentages by sector from 2001 to 2019.
- Companies in the Consumer Discretionary and Financials/Real Estate sectors subject to core federal filings more than doubled relative to 2019, but the percentage of these sectors' market capitalization grew by nearly six times year-over-year.
- All sectors other than Consumer Discretionary and Financials/Real Estate saw a decrease in the percentage of market capitalization subject to core federal filings compared with 2019.

In six of the eight industry sectors, the percentage of market capitalization subject to core federal filings fell from the previous year.

Figure 11: Heat Maps of S&P 500 Securities Litigation™ Percentage of Market Capitalization Subject to Core Federal Filings

	Average 2001–2019	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 (Annualized)
Consumer Discretionary	4.8%	4.6%	1.6%	4.4%	2.5%	0.0%	2.8%	8.2%	4.7%	0.5%	3.4%
Consumer Staples	4.4%	0.8%	14.0%	0.0%	0.0%	1.9%	1.0%	6.7%	15.2%	9.1%	3.5%
Energy/Materials	2.8%	0.0%	0.9%	0.0%	0.2%	0.0%	19.8%	2.3%	1.4%	1.2%	0.0%
Financials/Real Estate	14.3%	6.9%	11.0%	0.0%	0.3%	3.0%	11.9%	1.5%	12.5%	2.2%	13.6%
Health Care	12.3%	0.7%	0.8%	4.4%	0.0%	3.1%	13.2%	2.7%	26.3%	6.6%	5.5%
Industrials	9.3%	2.1%	1.2%	0.0%	1.7%	0.0%	8.7%	22.3%	19.4%	21.6%	2.3%
Communication Services/ Telecommunications/ Information Technology	10.4%	13.4%	2.2%	16.6%	0.0%	7.0%	12.3%	4.4%	19.4%	18.0%	0.6%
Utilities	6.1%	0.0%	0.0%	0.0%	0.0%	3.7%	4.4%	9.6%	6.5%	7.9%	0.0%
All S&P 500 Companies	9.0%	5.0%	4.3%	4.7%	0.6%	2.8%	10.0%	6.1%	14.9%	10.0%	4.0%

Note:

1. The figure is based on the composition of the S&P 500 as of the last trading day of the previous year.
2. Sectors are based on the Global Industry Classification Standard (GICS).
3. Percentage of Market Capitalization Subject to New Filings equals the market capitalization of companies subject to new securities class action filings in federal courts in each sector divided by the total market capitalization of companies in that sector.
4. In August 2016, GICS added a new industry sector, Real Estate. This analysis begins using the Real Estate industry sector in 2017. In 2018, the Telecommunication Services sector was incorporated into a new sector, Communication Services. This analysis begins using the Communication Services sector name in 2019. With this name change, all companies previously classified as Telecommunication Services and some companies classified as Consumer Discretionary (such as Netflix, Comcast, and CBS) and Information Technology (such as Alphabet and Facebook) were reclassified into the Communication Services sector.

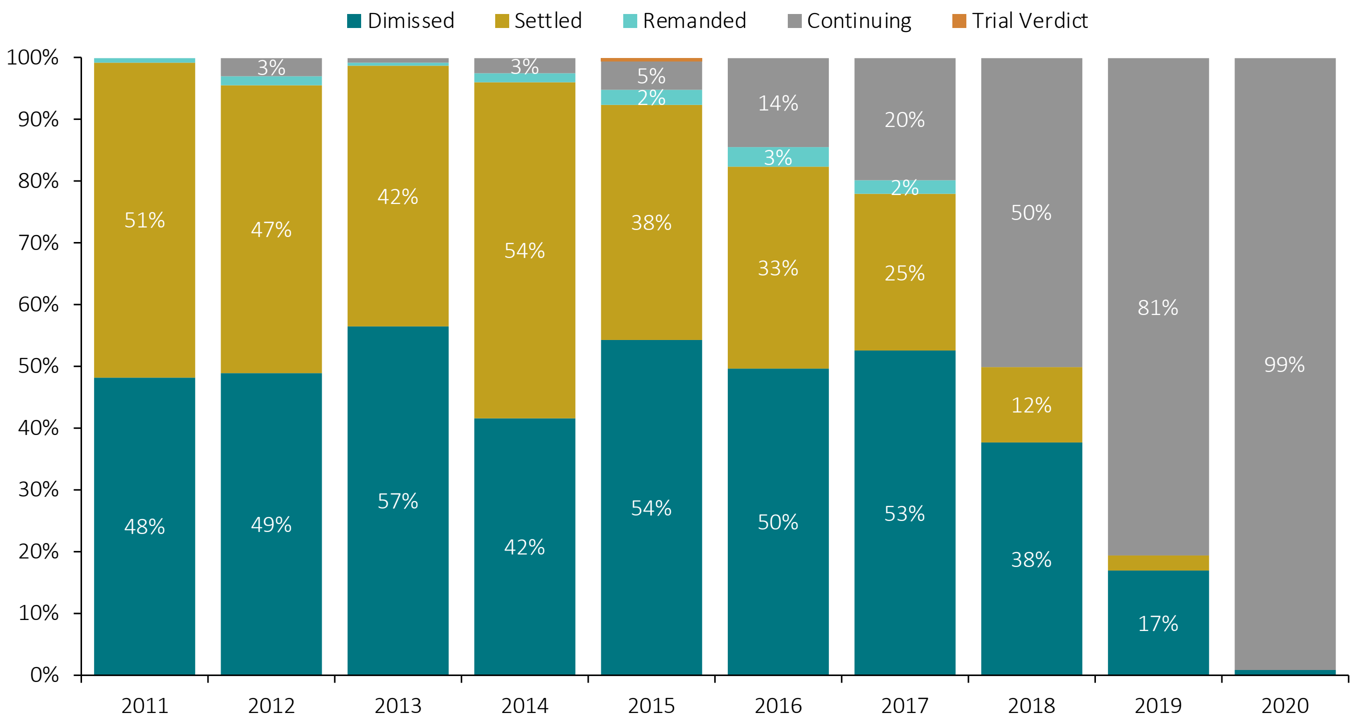
Status of Federal Securities Class Action Filings

This analysis compares filing groups to determine whether filing outcomes have changed over time. As each cohort ages, a larger percentage of filings are resolved—whether through dismissal, settlement, remand, or trial verdict.

Since 2015, dismissal rates for core federal filings have exceeded 50 percent for cohort years in which litigation has been substantially resolved.

- From 1997 to 2018, 50 percent of core federal filings were settled, 44 percent were dismissed, less than 1 percent were remanded, and 5 percent are continuing. Overall, less than 1 percent of core federal filings have reached a trial verdict.
- In the last 10 years, the cohorts with the most divergent dismissal rates—where litigation has been substantially resolved—were 2013 (at 57 percent) and 2014 (at 42 percent).

Figure 12: Status of Filings by Year—Core Federal Filings
2011–2020 H1



Note: Percentages may not sum to 100 percent due to rounding.

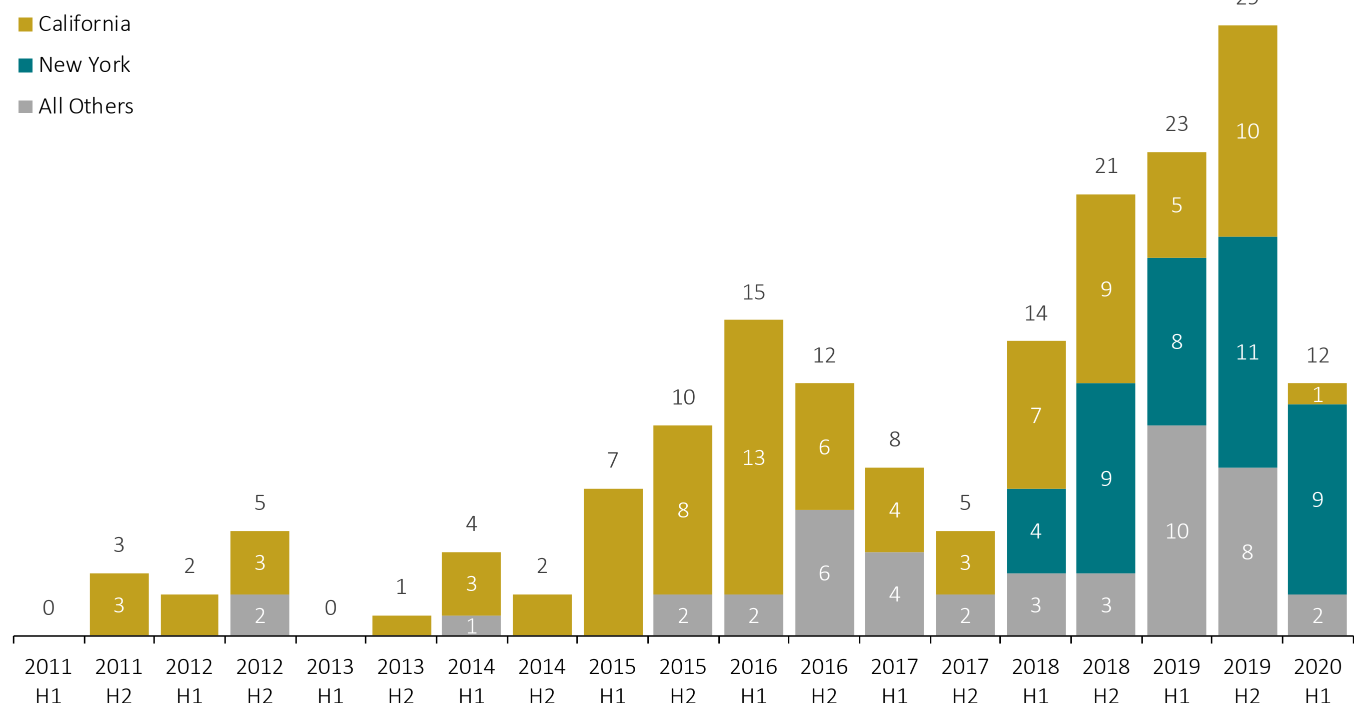
1933 Act Cases Filed in State Courts

The following data include 1933 Act filings in California, New York, and other state courts. The figure below illustrates all the filings currently in the dataset. Filings from prior years are added retrospectively when identified.

- The number of state 1933 Act filings in the first half of 2020 is lower than the past four semiannual periods, despite generally trending upward over the past six years.
- There was only one 1933 Act filing in California state court (which also had a parallel filing in federal court). The first half of 2020 had the fewest number of California 1933 Act state-court filings since 2013 H2.
- The Technology and Consumer Non-Cyclical sectors made up 67 percent of 1933 Act filings in the first half of 2020.
- In the first half of 2020, 83 percent of 1933 Act filings were against foreign companies, and 50 percent were against Chinese companies.

Filing activity of 1933 Act claims declined modestly in New York but dropped sharply in other states including California.

Figure 13: State 1933 Act Filings by State
2011 H1–2020 H1



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; Institutional Shareholder Services' Securities Class Action Services (ISS' SCAS)

Note:

1. "All Others" contains filings in Alabama, Arizona, Colorado, Florida, Georgia, Illinois, Iowa, Massachusetts, Michigan, Nevada, New Hampshire, New Jersey, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Washington, West Virginia, and Wisconsin.
2. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

Dollar Loss on Offered Shares Index™ (DLOS Index™)

This index measures the aggregate Dollar Loss on Offered Shares (DLOS) for federal Section 11–only filings and 1933 Act cases filed in state courts. This analysis calculates the loss in market value of shares purchased in securities issuances that became subject to 1933 Act or Section 11 claims. It is calculated as the number of shares offered in the issuance (e.g., in an IPO, a seasoned equity offering (SEO), or a corporate merger or spin-off) acquired by class members, multiplied by the difference between the offering price of the shares and their price on the complaint filing date.

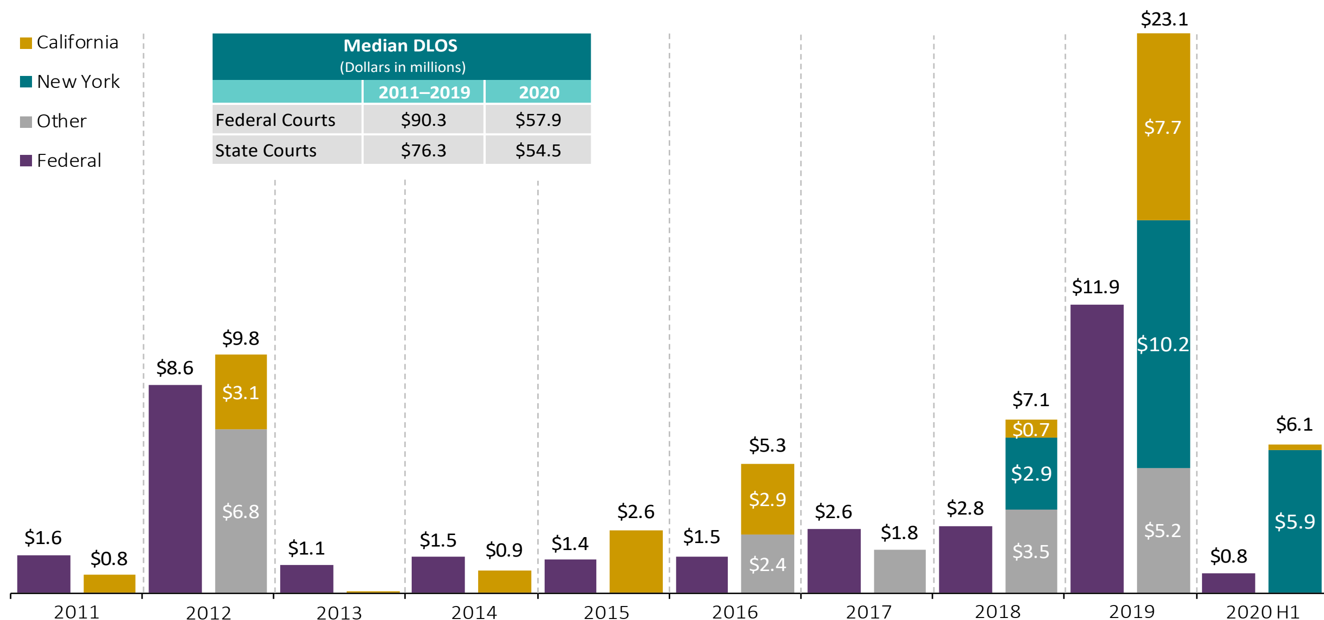
This alternative measure of losses has been calculated for federal filings involving only Section 11 claims (i.e., no Section 10b claims) and 1933 Act filings in state courts. DLOS aims to capture more precisely than MDL the dollar loss associated with the specific shares at issue as alleged in a complaint. See the Glossary for additional discussion of market capitalization losses and DLOS.

The DLOS Index for filings in New York state courts greatly exceeded that in all other state courts.

- Filings in New York made up 96 percent of state DLOS the first half of 2020. This continues a trend of an increasing percentage of DLOS being attributable to New York cases, with 41 percent in 2018 and 44 percent in 2019.

Figure 14: Dollar Loss on Offered Shares Index™ (DLOS Index™) for Federal Section 11–Only and State 1933 Act Filings 2011–2020 H1

(Dollars in billions)



Median DLOS (Dollars in millions)		
	2011–2019	2020
Federal Courts	$90.3	$57.9
State Courts	$76.3	$54.5

Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS; CRSP; SEC EDGAR

Note: Federal filings included in this analysis must contain a Section 11 claim and may contain a Section 12 claim, but do not contain Section 10b claims. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

Federal Section 11 Filings and State 1933 Act Filings—Pre- and Post-*Cyan*

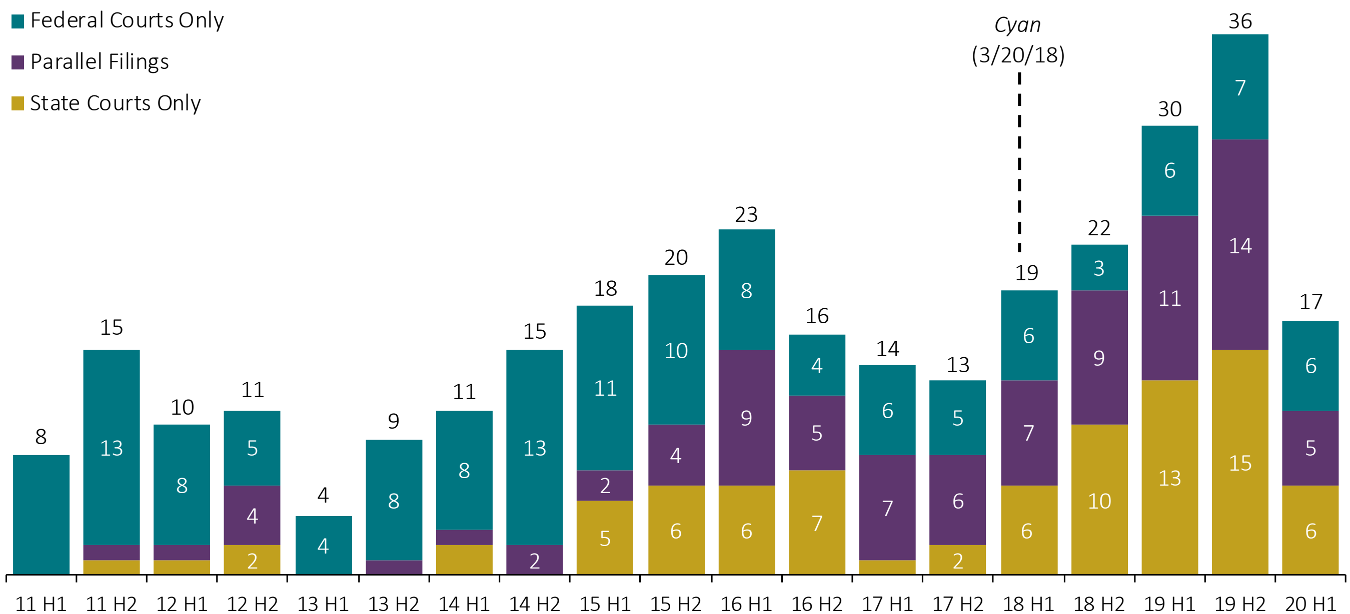
The figure below is a combined measure of Section 11 filing activity in federal courts and 1933 Act filings in state courts.

- In the first half of 2020, the combined number of federal Section 11 filings and state 1933 Act filings was 17, comprising five parallel filings, six state-only filings, and six federal-only filings.
- Federal Section 11 and state 1933 Act filing activity in the first half of 2020 was significantly slower than in the prior semiannual period. The decline in these types of filings was the primary reason for the lower level of filings observed in the first half of the year.

State 1933 Act filings decreased for the first time since the Cyan *decision, falling 62 percent from levels in the second half of 2019.*

- Only 18 percent of 1933 Act filings were against U.S.-headquartered companies. In contrast, 67 percent of federal-only Section 11 filings were against U.S. companies.

Figure 15: Pre- and Post-*Cyan* Semiannual Federal Section 11 and State 1933 Act Filings
2011 H1–2020 H1



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 filings displayed may include Rule 10b-5 claims, but state 1933 Act filings do not.

2. Section 11 filings in federal courts may include parallel (or related) cases filed in state courts. When these cases are filed in different semiannual periods, the earliest filing is counted. If filings against the same company are brought in different states in addition to a filing brought in federal court, the parallel filing is counted as a unique case and the state-only filing is treated as a unique case. Filings against the same company brought in different states without a parallel filing brought in federal court are counted as unique state filings.

3. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

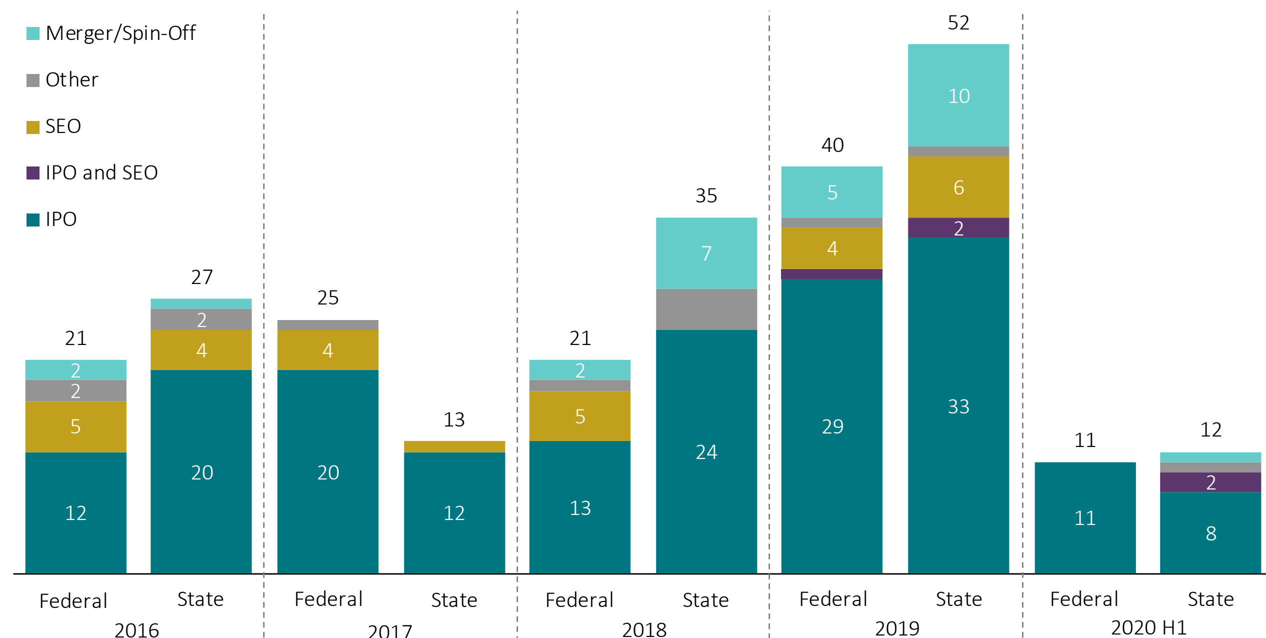
Type of Security Issuance Underlying Federal Section 11 and State 1933 Act Filings

The figure below illustrates Section 11 claims in federal courts and 1933 Act claims in state courts based on the type of security issuance underlying the lawsuit.

Claims based on IPO issuances were predominant in the first half of 2020, unlike recent years when other types of issuances (merger/spin-offs and SEOs) underlying the litigation were increasing.

- In the first half of 2020, there were no filings related to SEO-only issuances and only one related to mergers or spin-offs, which is contrary to the trend observed in the last two years, particularly in state courts.
- There were two state court filings based on both an IPO and an SEO in the first half of 2020; the first of such filings appeared in 2019.

Figure 16: Federal Section 11 and State 1933 Act Class Action Filings by Type of Security Issuance
2016–2020 H1



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 data displayed may contain Rule 10b-5 claims, but state 1933 Act filings do not. For this analysis, because state and federal filings are considered separately without accounting for parallel filings, counts may differ from those in other figures.
2. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.
3. There was one federal court filing in 2019 related to both a merger-related issuance and SEO. This analysis categorizes this filing as relating to a merger-related issuance to avoid double-counting.

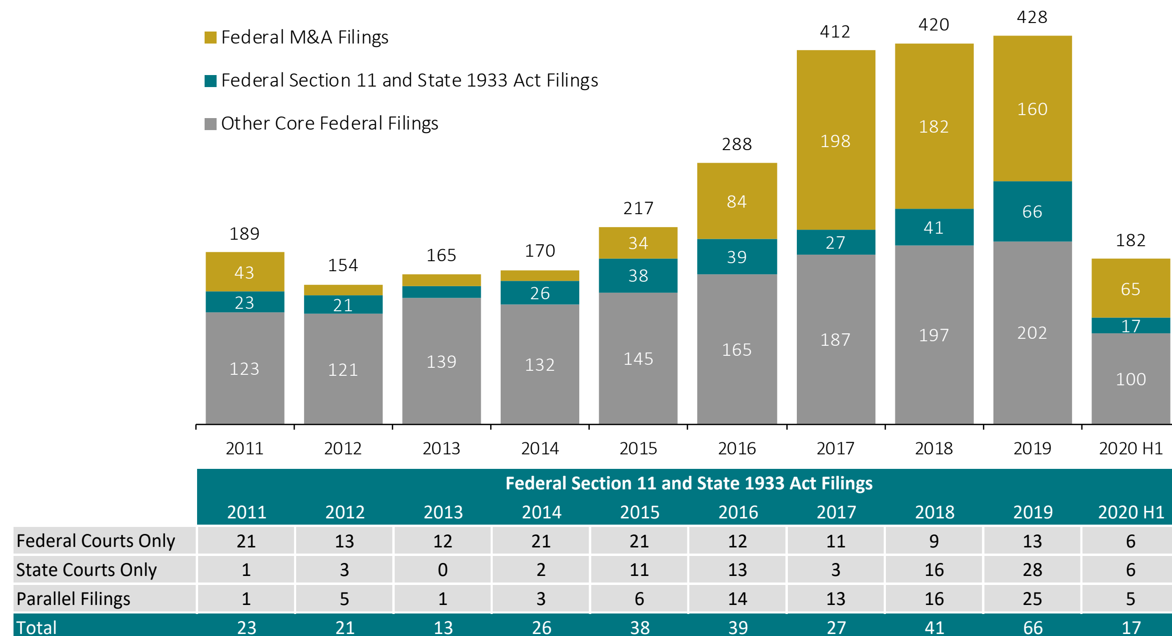
Combined Federal and State Filing Activity—Highlighting Federal Section 11 and State 1933 Act Filings

This analysis highlights federal Section 11 claims, state 1933 Act filings, and the extent to which parallel actions have been filed.

- The decline in Section 11 and 1933 Act filings in the first half of 2020 was driven by a steep decline in state court–only and parallel filings. State court–only filings and parallel filings were only 21 percent and 20 percent of 2020 values, respectively.
- Other core federal filings—those excluding Section 11 and state 1933 Act filings—were comparable on an annualized basis to levels in 2018 and 2019.

The number of Section 11 and state 1933 Act filings in the first half of 2020 was roughly a quarter of the number of such filings in 2019.

Figure 17: Federal Section 11 and State 1933 Act Class Action Filings by Venue
2011–2020 H1



	Federal Section 11 and State 1933 Act Filings									
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 H1
Federal Courts Only	21	13	12	21	21	12	11	9	13	6
State Courts Only	1	3	0	2	11	13	3	16	28	6
Parallel Filings	1	5	1	3	6	14	13	16	25	5
Total	23	21	13	26	38	39	27	41	66	17

Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 data displayed may contain Rule 10b-5 claims, but state 1933 Act filings do not.
2. Section 11 filings in federal courts may include parallel (or related) cases filed in state courts. When these cases are filed in different years, the earliest filing is counted. If filings against the same company are brought in different states in addition to a filing brought in federal court, the parallel filing is counted as a unique case and the state-only filing is treated as a unique case. Filings against the same company brought in different states without a parallel filing brought in federal court are counted as unique state filings. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year.
3. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

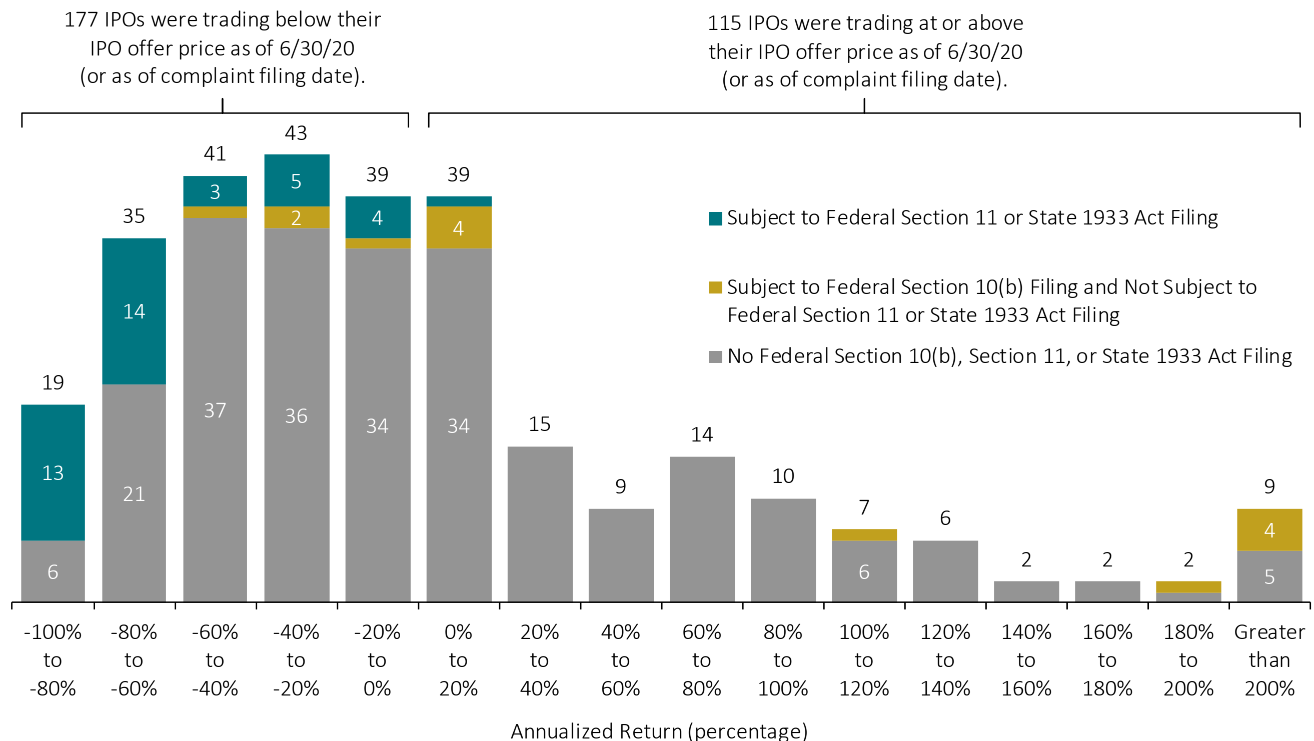
New: Performance of Recent IPOs

This analysis explores the relationship between a company's performance following its IPO and the degree to which these companies were the subject of a federal Section 11, state 1933 Act filing, or federal Section 10(b) filing. IPOs from January 2018 to June 2019 are analyzed. The performance of these IPOs is evaluated through June 2020.

40 out of 299 (13 percent) companies that undertook an IPO between January 2018 and June 2019 were later subject to a federal Section 11 or state 1933 Act filing.

- Post-IPO performance indicates that 59 percent of all companies that undertook an IPO since January 2018 were trading below their IPO offer price at the time of their complaint or as of June 30, 2020. Seven companies were delisted as of June 30, 2020.
- Perhaps not surprisingly, companies with poorer post-IPO returns were more likely to be the target of a federal Section 11 or state 1933 Act filing.
- Nearly all (39 out of 40) companies that were subject to a federal Section 11 or state 1933 Act filing were trading below their IPO offer price as of the complaint filing date.

Figure 18: Performance of Recent IPOs
2018–2019 H1



Source: Nasdaq; Bloomberg Law; ISS' SCAS; Refinitiv Eikon

Note:

1. IPOs examined exclude special-purpose acquisition companies, blank-check companies, and companies that were delisted or acquired before June 30, 2020. Bars that do not have a data label represent one filing. Companies that were subject to a federal Section 11 filing or state 1933 Act filing have their returns calculated as the most recent closing stock price as of the complaint filing date, divided by the split-adjusted IPO offer price, minus one. Otherwise, returns are calculated as the closing stock price on June 30, 2020, divided by the split-adjusted IPO offer price, minus one. Returns are then annualized using the following formula: annualized return = (1 + nominal return) ^ (1 / return period in years). For simplicity, this analysis does not account for dividends.

2. Among 734 Section 11 and state 1933 Act filings from January 1997 to June 2014, the lag between the IPO date and the date of a Section 11 filing had a 25th percentile of 6.7 months, median of 12.5 months, and 75th percentile of 22.8 months. The sample is therefore restricted to IPOs before June 30, 2019, one year before the publication of this report, to reflect the median filing lag.

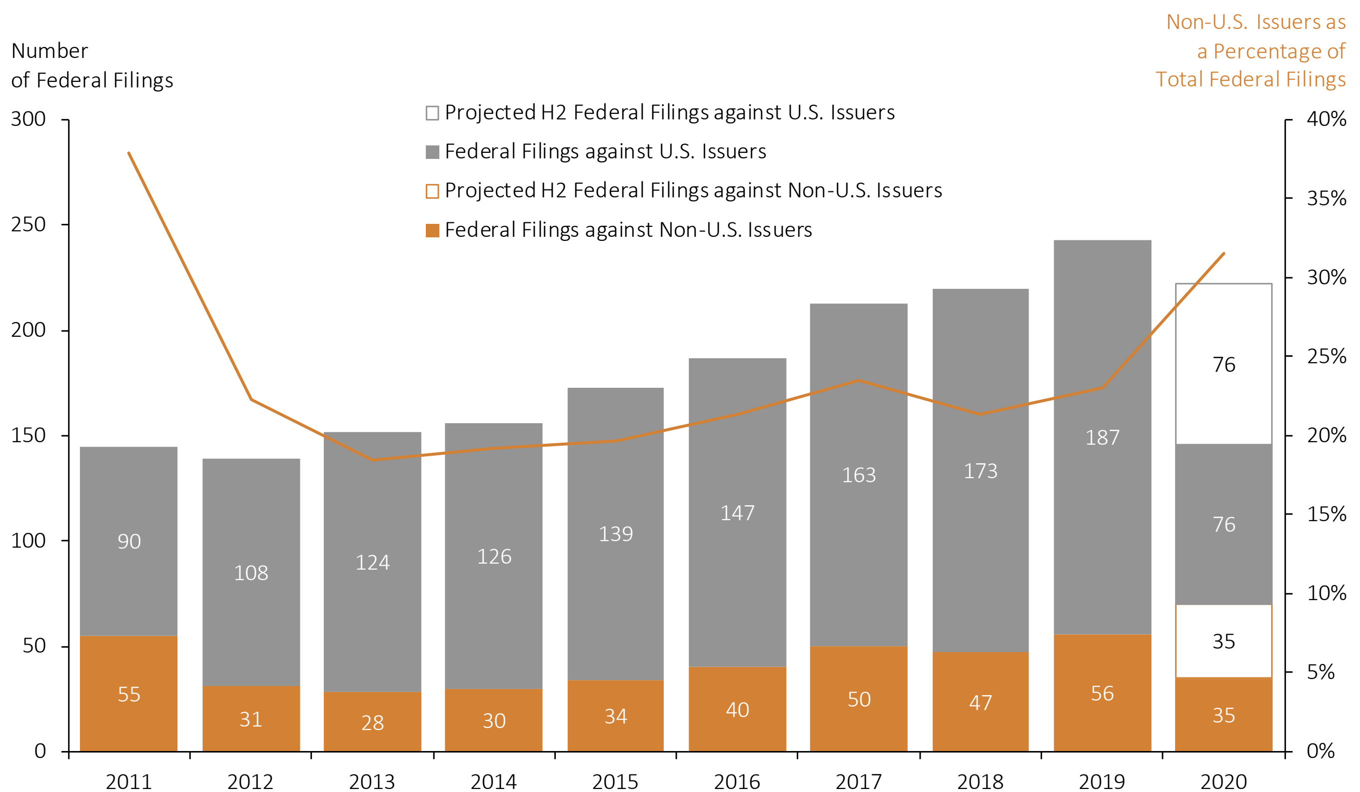
Federal Filings against Non-U.S. Issuers

This index tracks the number of core federal filings against companies headquartered outside the United States relative to total core federal filings.

- As a percentage of total core federal filings, core federal filings against non-U.S. issuers increased to 31.5 percent, the second-highest rate on record.
- Approximately 20 percent of core federal filings against non-U.S. issuers had allegations related to cryptocurrency.

Although annualized total core federal filings are down 9 percent, annualized core federal filings against non-U.S. issuers are on pace to be the highest on record.

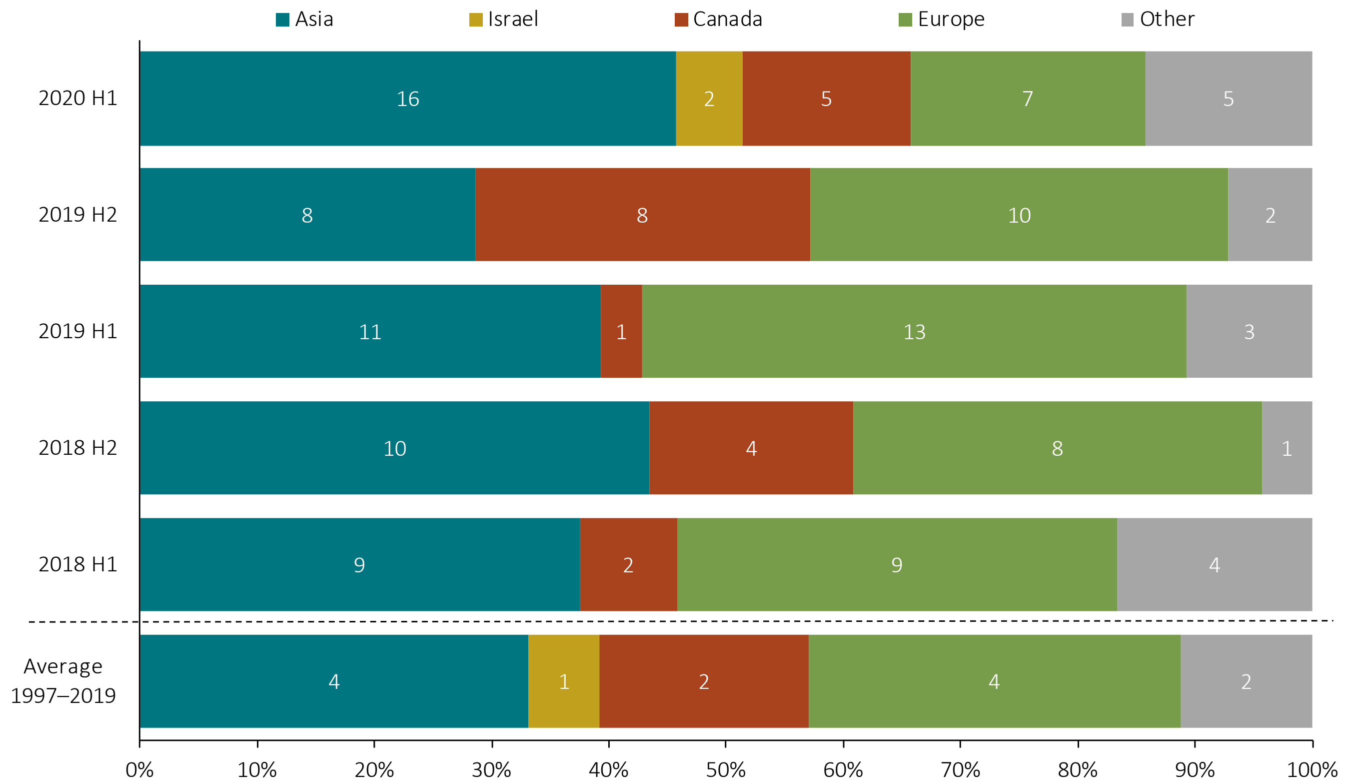
Figure 19: Annual Number of Class Action Filings by Location of Headquarters—Core Federal Filings 2011–2020 H1



- Of the 16 core filings against Asian firms, 13 were against Chinese firms and three were against Singaporean firms.
- All three core filings against Singaporean firms included allegations related to cryptocurrency.
- Of the five core filings against Canadian companies, three had allegations related to cannabis, continuing the trend of at least one Canadian cannabis filing in each half year since its legalization in Canada in October 2018.
- Israeli firms were subject to filings for the first time since the first half of 2017.
- Core filings against European firms declined to the lowest amount since the first half of 2017.

There were 16 core federal filings against Asian firms, the most in a half year since 2011 H1.

Figure 20: Non-U.S. Filings by Location of Headquarters—Core Federal Filings



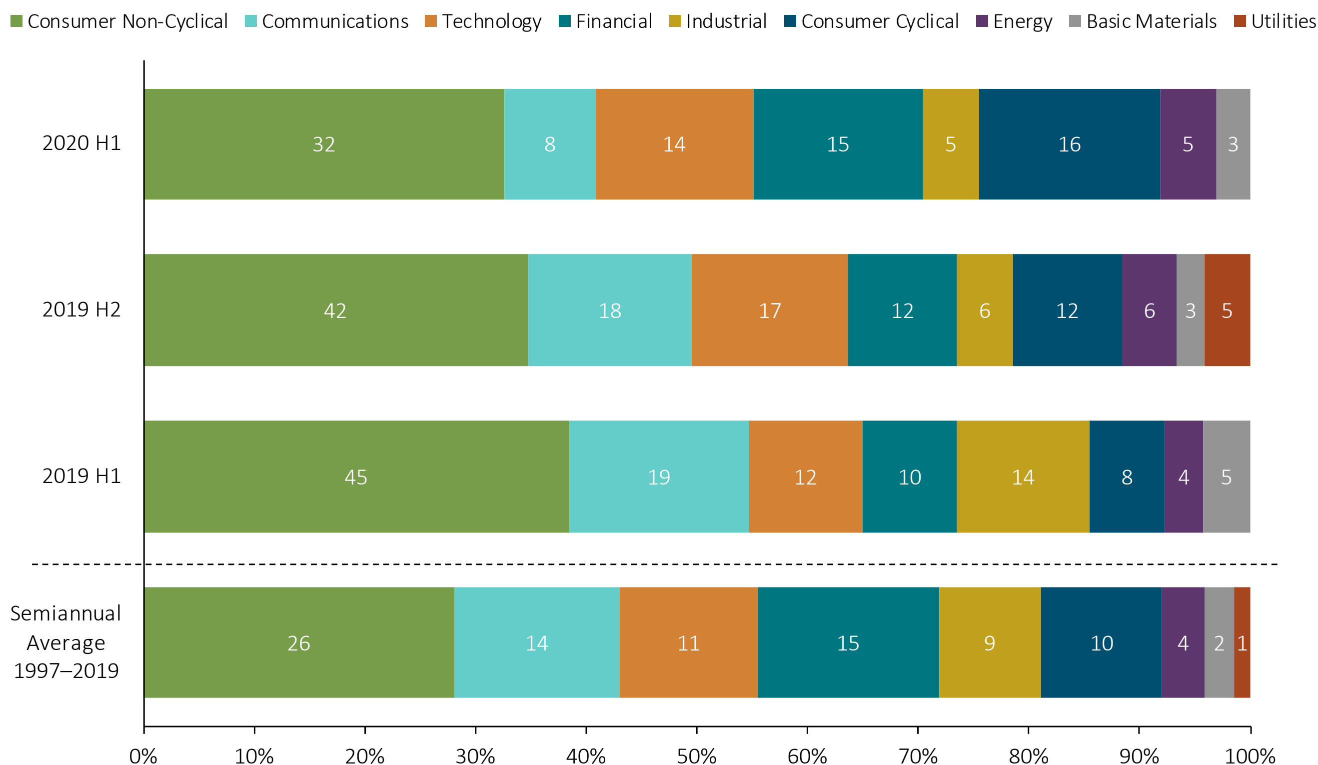
Industry Comparison of Federal Filings

This analysis of core federal filings encompasses both the large capitalization companies of the S&P 500 and smaller companies.

- Consumer Non-Cyclical continues to be the most common sector with 32 filings. Within this sector, pharmaceutical, biotechnology, and health care comprised 22 filings.
- The Consumer Cyclical sector experienced more activity in the first half of 2020 than it has on average or over both halves of 2019. The MDL for Consumer Cyclical in the first half of 2020 was more than double the historical average.
- The number of Communications filings decreased significantly relative to both halves of 2019 and the 1997–2019 semiannual average. Technology filings also decreased relative to the second half of 2019.

Consumer Non-Cyclical filings continue to be the most common, while Financial sector filing activity in the first half of 2020 rose relative to the prior year.

Figure 21: Filings by Industry—Core Federal Filings



Note:
1. Filings with missing sector information or infrequently used sectors may be excluded.
2. Sectors are based on the Bloomberg Industry Classification System.

Federal Filings by Circuit

- The Second and Ninth Circuits combined made up 68 percent of all core federal filings in the first half of 2020, in line with the first and second halves of 2019 (65 percent and 63 percent, respectively) and above the 1997–2019 semiannual average of 54 percent.
- Core filings in the Second Circuit decreased by 23 percent to 40 filings but still remained higher than the 1997–2019 semiannual average of 26. Core filings in the Ninth Circuit (35) increased by 46 percent relative to the second half of 2019 and to the 1997–2019 semiannual average.
- Core filings in the First, Fourth, Sixth, Eighth, Eleventh, and D.C. Circuits were below their 1997–2019 semiannual averages. At 111, total core federal filings for the first half of 2020 were 19 percent higher than the 1997–2019 historical semiannual average of 93.
- Total MDL for Second Circuit core filings increased from $118 billion in 2019 H1 to $227 billion in 2020 H1, a 92 percent increase that was largely driven by a single mega filing. See Appendix 5.

Core filings in the Ninth Circuit increased 46 percent to 35, its highest point since 2018 H1.

Figure 22: Filings by Circuit—Core Federal Filings

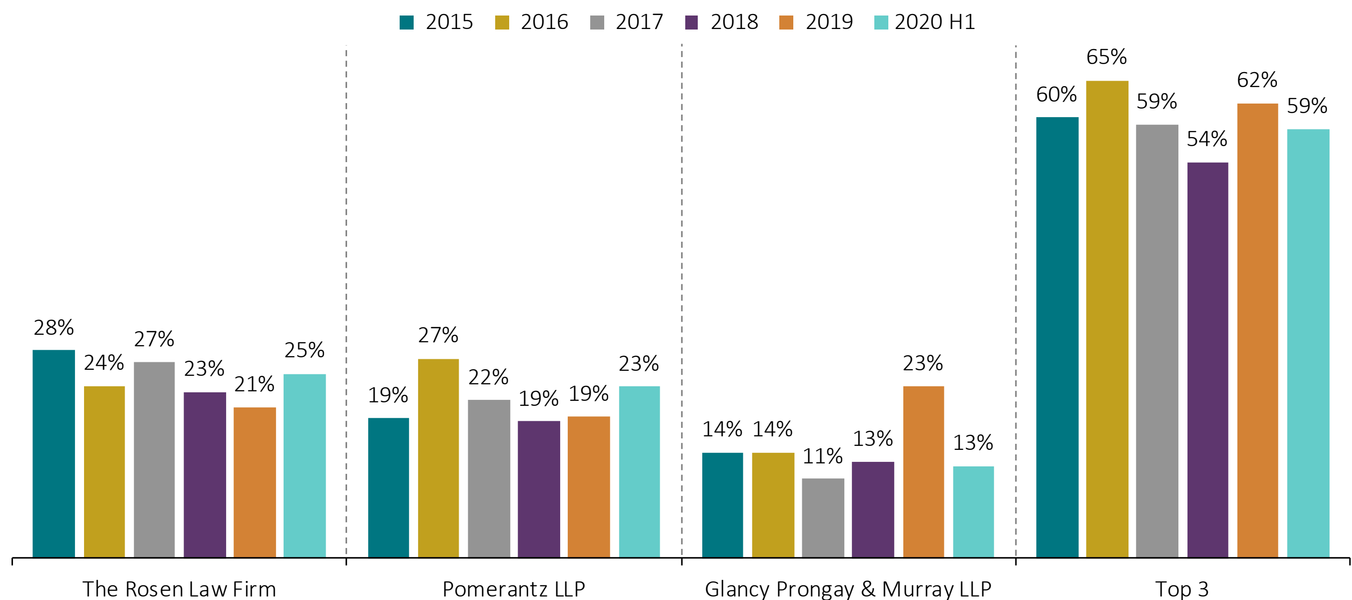
New: Most Frequent Plaintiff Counsel on Core Federal Filings

This figure focuses on three law firms—The Rosen Law Firm, Pomerantz LLP, and Glancy Prongay & Murray LLP. These three law firms have been responsible for the majority of first filed securities class action complaints in federal courts in each year since 2015.

- There were 111 core filings in federal courts in the first half of 2020. These plaintiff firms were listed as counsel on 65, or 59 percent, of first identified complaints.
- In each year since 2015, at least 54 percent of first identified complaints have had one of these plaintiff firms listed as counsel.
- While generally Rosen has been responsible for the largest share of first identified complaints, Pomerantz and Glancy had higher shares of first identified complaints in 2016 and 2019, respectively.

These plaintiff firms were listed as counsel on 59 percent of first identified complaints in the first half of 2020.

Figure 23: Most Frequent Plaintiff Counsel on Core Federal Filings
2015–2020 H1



Source: Cornerstone Research and Stanford Law School Securities Class Action Clearinghouse

Note:

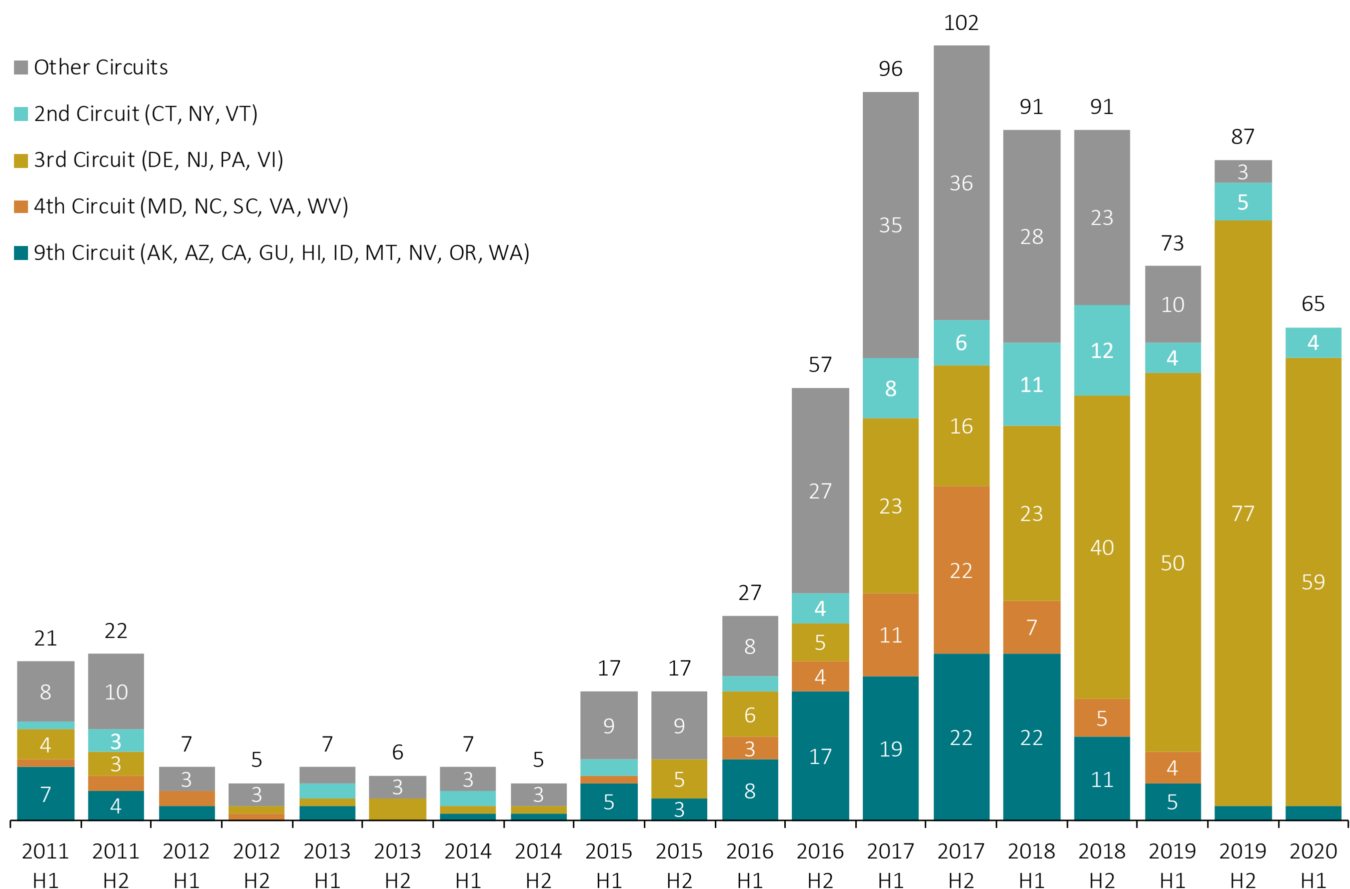
1. More than one plaintiff law firm can be listed on the first identified complaint. Therefore, the sums of individual filer shares presented may exceed the share of filings involving any one of the top three plaintiff firms.
2. These three firms were the most frequent filers from 2015 through June 2020. It is possible that they were not the three most frequent filers in every year.

M&A Filings by Federal Circuit

All of the M&A filings in the Third Circuit were brought in Delaware courts.

- There were 65 federal M&A filings in the first half of 2020, the fewest since 2016 H2.
- Filings in the Third Circuit accounted for 91 percent of all M&A filings in the first half of 2020; all of these filings were brought in Delaware federal courts.
- The number of filings in each circuit decreased or remained unchanged relative to the second half of 2019.
- M&A filings represented 84 percent of total filings in the Third Circuit, which was the highest percentage of any circuit.

Figure 24: Semiannual M&A Filings by Federal Circuit
2011 H1–2020 H1



Note:

1. In January 2016, the Delaware Court of Chancery rejected a disclosure-only settlement in Zillow's acquisition of Trulia. See *In re Trulia Inc. Stockholder Litigation*, 129 A.3d 884 (Del. Ch. 2016). As noted in prior semiannual reports, this decision appears to have resulted in some venue shifting for merger-objection lawsuits from state to federal courts.
2. The Securities Class Action Clearinghouse began tracking M&A filings as a separate category in 2009.

New: Most Frequent Plaintiff Counsel on M&A Filings

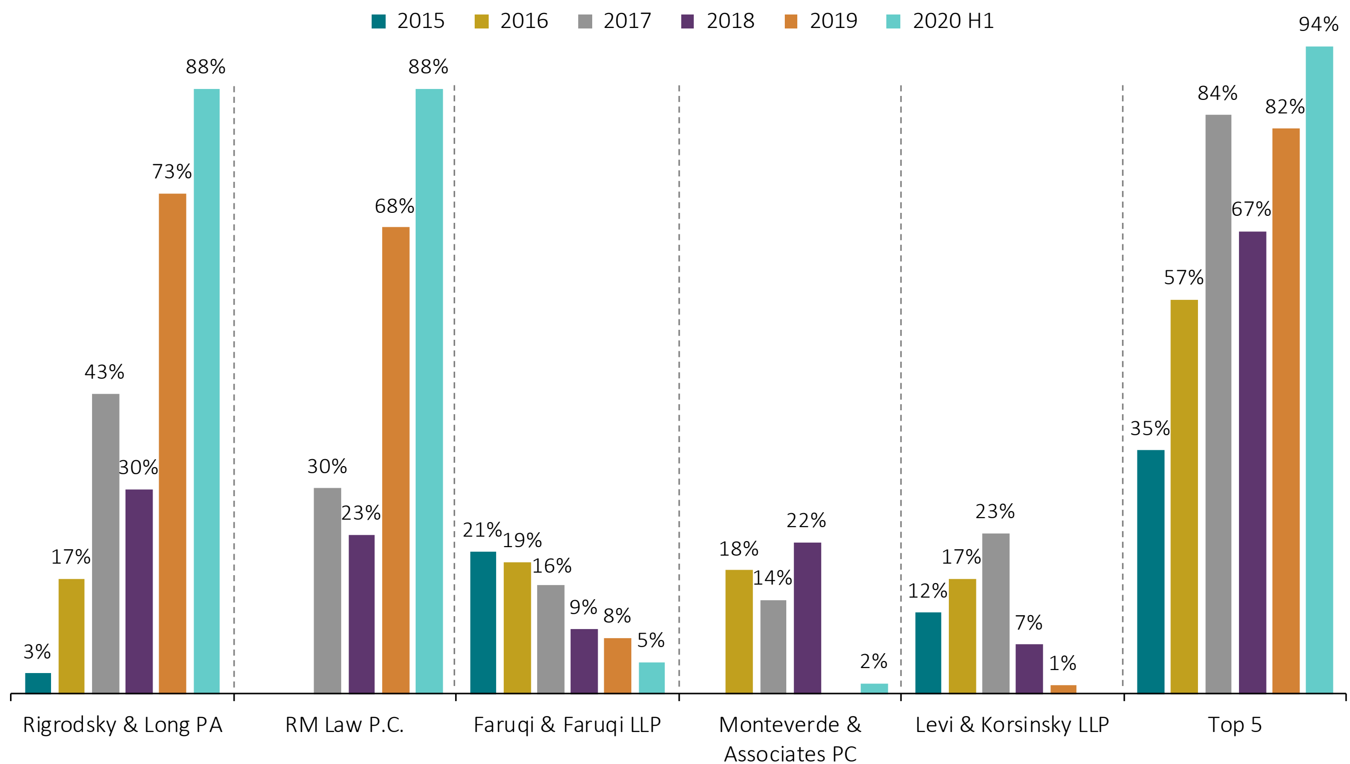
This analysis shows the five most frequent firms listed on first identified M&A complaints against a given company from 2015 through June 2020. Each instance in which they are counsel or co-counsel on a first identified complaint is presented.

- There were 65 M&A filings in federal courts in the first half of 2020. These plaintiff firms were listed as counsel or co-counsel on 61, or 93.8 percent, of first identified complaints.
- Since 2015, at least one of these plaintiff firms has been listed as counsel or co-counsel on 74.7 percent of M&A filings.

At least one of the top five firms was listed as plaintiff counsel or co-counsel on 94 percent of first identified M&A complaints in the first half of 2020.

- Rigrodsky & Long PA and RM Law P.C. and have commonly been co-counsel. They were co-counsel on all 57 of their filings in the first half of 2020.

Figure 25: Most Frequent Plaintiff Counsel or Co-counsel on M&A Filings
2015–2020 H1



Source: Cornerstone Research and Stanford Law School Securities Class Action Clearinghouse

Note:

1. These firms are the top five most frequent firms listed on first identified complaints from 2015 through June 2020, not necessarily the five most frequent filers in each year. More than one plaintiff law firm can be listed on the first identified complaint. Therefore, the sums of individual filer shares presented may exceed the share of filings involving any one of the top five plaintiff firms.
2. These five firms were the most frequent filers from 2015 through June 2020. It is possible that they were not the five most frequent filers in every year.

New Developments

State Court 1933 Act Claims

On March 18, 2020, the Delaware Supreme Court issued a decision in *Sciabacucchi v. Salzberg*. At issue was whether forum-selection provisions in corporate charters could require that some class action securities claims under the 1933 Act be adjudicated in federal courts. This decision reversed a December 2018 opinion of the Delaware Chancery Court that such charter provisions were invalid under Delaware law.

In recent years, multiple companies chartered in Delaware have adopted forum-selection provisions dictating that 1933 Act claims be adjudicated in federal rather than Delaware state courts. In the wake of the March 2018 U.S. Supreme Court ruling in *Cyan*—which confirmed that state courts have concurrent jurisdiction over 1933 Act claims and required federal courts to remand 1933 Act claims that had been removed to federal court—even more companies adopted federal forum-selection provisions.

Key questions to be resolved include whether states other than Delaware will enforce federal forum-selection provisions and whether corporate charters can require arbitration of internal corporate claims, including those involving violations of securities laws.

Legislation Prohibiting Listing of Securities of Companies in Jurisdictions That Restrict PCAOB Inspections

There were more than 150 China-based companies with a combined market value of $1.2 trillion listed on U.S. exchanges at the end of 2019. Although those companies filed financial statements that were audited by firms registered with the PCAOB, China prevents the PCAOB from inspecting the audits of those companies. Restrictions on PCAOB inspections are also in place in France and Belgium. Regulators and policymakers have raised concerns that these restrictions present significant risks to investors.

The Senate, the President, and Nasdaq have recently taken action to address these concerns. The Senate passed the Holding Foreign Companies Accountable Act to prohibit securities from being listed on U.S. securities exchanges or traded over-the-counter if a company's auditor has not been inspected by the PCAOB for three consecutive years. The President ordered the President's Working Group on Financial Markets (PWG) to recommend actions that the SEC or a federal agency or department should take to protect investors, including setting new rules for listing on U.S. securities exchanges. Nasdaq proposed a rule to deny listing to companies if the PCAOB cannot inspect the auditor, if the auditor has not been subject to an inspection, or when the auditor does not demonstrate sufficient resources, geographic reach, or experience.

Research has shown that delisting results in significant stock price declines, in the range of 30 percent or larger.[1] Therefore, the pending legislation to delist securities of companies in jurisdictions that restrict PCAOB inspections could increase securities litigation.

1. J. Macey, M. O'Hara, and D. Pompilio, "Down and Out in the Stock Market: The Law and Economics of the Delisting Process," *Journal of Law and Economics* 51, no. 4 (2008): 683–713; W. Beaver, M. McNichols, and R. Price, "Delisting Returns and Their Effect on Accounting-Based Market Anomalies," *Journal of Accounting and Economics* 43 (2007): 341–368.

Glossary

Annual Number of Class Action Filings by Location of Headquarters (formerly known as the Class Action Filings Non-U.S. Index) tracks the number of core filings against non-U.S. issuers (companies headquartered outside the United States) relative to total core filings.

Class Action Filings Index® (CAF Index®) tracks the number of federal securities class action filings.

Cohort is the group of securities class actions all filed in a particular calendar year.

Core filings are all federal and state 1933 Act securities class actions excluding those defined as M&A filings.

Cyan refers to *Cyan Inc. v. Beaver County Employees Retirement Fund.* In this March 2018 opinion, the U.S. Supreme Court ruled that 1933 Act claims may be brought to state venues and are not removable to federal court.

Disclosure Dollar Loss Index® (DDL Index®) measures the aggregate DDL for all federal and state filings over a period of time. DDL is the dollar value change in the defendant firm's market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. DDL should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed at the end of the class period, including information unrelated to the litigation.

Dollar Loss on Offered Shares Index™ (DLOS Index™) measures the aggregate DLOS for federal filings with only Section 11 claims and for state 1933 Act filings. DLOS is the change in the dollar value of shares acquired by class members. It is the difference in the price of offered shares (i.e., from offering until the complaint filing date) multiplied by the shares offered. DLOS should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed between the IPO date and the complaint filing date, including information unrelated to the litigation.

Filing lag is the number of days between the end of a class period and the filing date of the securities class action.

First identified complaint is the first complaint filed of one or more securities class action complaints with the same underlying allegations filed against the same defendant or set of defendants.

Heat Maps of S&P 500 Securities Litigation™ analyze securities class action activity by industry sector. The analysis focuses on companies in the Standard & Poor's 500 (S&P 500) index, which comprises 500 large, publicly traded companies in all major sectors. Starting with the composition of the S&P 500 at the beginning of each year, the Heat Maps examine each sector by: (1) the percentage of these companies subject to new securities class actions in federal court during each calendar year, and (2) the percentage of the total market capitalization of these companies subject to new securities class actions in federal court during each calendar year.

Market capitalization losses measure changes to market values of the companies subject to class action filings. This report tracks market capitalization losses for defendant firms during and at the end of class periods. They are calculated for publicly traded common equity securities, closed-ended mutual funds, and exchange-traded funds where data are available. Declines in market capitalization may be driven by market, industry, and/or firm-specific factors. To the extent that the observed losses reflect factors unrelated to the allegations in class action complaints, indices based on class period losses would not be representative of potential defendant exposure in class actions. This is especially relevant in the post-*Dura* securities litigation environment. In April 2005, the U.S. Supreme Court ruled that plaintiffs in a securities class action are required to establish a causal connection between alleged wrongdoing and subsequent shareholder losses. This report tracks market capitalization losses at the end of each class period using DDL, and market capitalization losses during each class period using MDL.

Maximum Dollar Loss Index® (MDL Index®) measures the aggregate MDL for all federal and state filings over a period of time. MDL is the dollar value change in the defendant firm's market capitalization from the trading day with the highest market capitalization during the class period to the trading day immediately following the end of the class period. MDL should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed during or at the end of the class period, including information unrelated to the litigation.

Mega filings include mega DDL filings, securities class action filings with a DDL of at least $5 billion; and mega MDL filings, securities class action filings with an MDL of at least $10 billion.

Merger and acquisition (M&A) filings are securities class actions filed in federal courts that have Section 14 claims, but no Rule 10b-5, Section 11, or Section 12(2) claims, and involve merger and acquisition transactions.

Securities Class Action Clearinghouse is an authoritative source of data and analysis on the financial and economic characteristics of federal securities fraud class action litigation, cosponsored by Cornerstone Research and Stanford Law School.

State 1933 Act filing is a class action filed in a state court that asserts claims under Section 11 and/or Section 12 of the Securities Act of 1933. These filings may also have Section 15 claims, but do not have Rule 10b-5 claims.

Appendices

Appendix 1: Filings Basic Metrics

Year	Class Action Filings	Disclosure Dollar Loss DDL Total ($ billions)	DDL Average ($ millions)	DDL Median ($ millions)	Maximum Dollar Loss MDL Total ($ billions)	MDL Average ($ millions)	MDL Median ($ millions)
1997 H1	79	$11	$169	$42	$52	$767	$396
1997 H2	95	$30	$354	$73	$93	$1,077	$411
1998 H1	115	$36	$347	$42	$88	$851	$269
1998 H2	127	$45	$381	$72	$136	$1,164	$337
1999 H1	126	$63	$568	$99	$146	$1,325	$339
1999 H2	83	$78	$1,048	$129	$218	$2,949	$453
2000 H1	111	$164	$1,708	$92	$331	$3,452	$444
2000 H2	105	$76	$793	$143	$429	$4,469	$975
2001 H1	103	$137	$1,473	$98	$990	$10,642	$990
2001 H2	77	$61	$872	$69	$497	$7,097	$657
2002 H1	109	$81	$776	$117	$926	$8,899	$1,402
2002 H2	115	$120	$1,212	$184	$1,121	$11,320	$1,547
2003 H1	105	$48	$493	$92	$335	$3,455	$531
2003 H2	87	$29	$394	$100	$240	$3,242	$368
2004 H1	111	$57	$641	$101	$307	$3,455	$428
2004 H2	117	$87	$821	$117	$418	$3,947	$622
2005 H1	109	$57	$618	$135	$245	$2,632	$463
2005 H2	73	$35	$562	$167	$117	$1,862	$513
2006 H1	65	$21	$390	$118	$125	$2,308	$413
2006 H2	55	$31	$611	$97	$169	$3,387	$439
2007 H1	69	$37	$650	$153	$171	$2,992	$763
2007 H2	108	$121	$1,222	$159	$530	$5,351	$660
2008 H1	111	$92	$1,340	$224	$471	$6,822	$1,361
2008 H2	113	$129	$1,674	$163	$346	$4,488	$1,001
2009 H1	82	$49	$1,290	$167	$352	$9,251	$1,176
2009 H2	82	$35	$552	$134	$199	$3,153	$935
2010 H1	71	$54	$1,168	$162	$345	$7,492	$730
2010 H2	103	$19	$318	$141	$129	$2,195	$392
2011 H1	94	$49	$740	$93	$256	$3,882	$384
2011 H2	95	$66	$956	$91	$267	$3,871	$685
2012 H1	88	$61	$841	$150	$253	$3,460	$659
2012 H2	66	$36	$648	$153	$152	$2,720	$542
2013 H1	75	$25	$407	$163	$115	$1,887	$531
2013 H2	90	$79	$1,022	$148	$162	$2,110	$538
2014 H1	80	$30	$431	$179	$100	$1,427	$541
2014 H2	90	$26	$330	$135	$120	$1,544	$517
2015 H1	102	$48	$577	$90	$126	$1,522	$403
2015 H2	115	$72	$754	$170	$289	$3,039	$644
2016 H1	128	$43	$452	$153	$381	$4,012	$1,031
2016 H2	160	$63	$654	$173	$467	$4,816	$1,059
2017 H1	222	$72	$608	$146	$292	$2,455	$521
2017 H2	190	$53	$683	$189	$220	$2,859	$871
2018 H1	211	$160	$1,534	$233	$653	$6,275	$1,016
2018 H2	209	$171	$1,633	$402	$664	$6,323	$1,134
2019 H1	207	$175	$1,507	$181	$798	$6,880	$828
2019 H2	221	$108	$886	$253	$394	$3,229	$1,237
2020 H1	182	$81	$815	$185	$584	$5,895	$1,014
Average (1997–2019)	112	$68	$807	$141	$331	$3,964	$699

Note:

1. 1933 Act filings in state courts are included in the data beginning in 2010.
2. Average and median numbers are calculated only for filings with MDL and DDL data. Filings without MDL and DDL data include M&A-only filings, initial coin offering filings, and other filings where calculations of MDL and DDL are non-obvious.
3. The number and percentage of U.S. exchange-listed firms sued are based on core filings.

Appendix 2A: S&P 500 Securities Litigation—Percentage of S&P 500 Companies Subject to Core Federal Filings

Year	Consumer Discretionary	Consumer Staples	Energy / Materials	Financials / Real Estate	Health Care	Industrials	Comm / Telecom / IT	Utilities	All S&P 500 Companies
2001	2.4%	8.3%	0.0%	1.4%	7.1%	0.0%	18.0%	7.9%	5.6%
2002	10.2%	2.9%	3.1%	16.7%	15.2%	6.0%	11.0%	40.5%	12.0%
2003	4.6%	2.9%	1.7%	8.6%	10.4%	3.0%	5.6%	2.8%	5.2%
2004	3.4%	2.7%	1.8%	19.3%	10.6%	8.5%	3.2%	5.7%	7.2%
2005	10.3%	8.6%	1.7%	7.3%	10.7%	1.8%	6.7%	3.0%	6.6%
2006	4.4%	2.8%	0.0%	2.4%	6.9%	0.0%	8.1%	0.0%	3.6%
2007	5.7%	0.0%	0.0%	10.3%	12.7%	5.8%	2.3%	3.1%	5.4%
2008	4.5%	2.6%	0.0%	31.2%	13.7%	3.6%	2.5%	3.2%	9.2%
2009	3.8%	4.9%	1.5%	10.7%	3.7%	6.9%	1.2%	0.0%	4.4%
2010	5.1%	0.0%	4.3%	10.3%	13.5%	0.0%	2.4%	0.0%	4.8%
2011	3.8%	2.4%	0.0%	1.2%	2.0%	1.7%	7.1%	0.0%	2.6%
2012	4.9%	2.4%	2.7%	3.7%	1.9%	1.6%	3.8%	0.0%	3.0%
2013	8.4%	0.0%	0.0%	0.0%	5.7%	0.0%	9.1%	0.0%	3.4%
2014	1.2%	0.0%	1.3%	1.2%	0.0%	4.7%	0.0%	0.0%	1.2%
2015	0.0%	5.0%	0.0%	1.2%	1.9%	0.0%	4.2%	3.4%	1.6%
2016	3.6%	2.6%	4.5%	6.9%	17.9%	6.1%	6.8%	3.4%	6.6%
2017	8.5%	2.7%	3.3%	3.3%	8.3%	8.7%	8.5%	7.1%	6.4%
2018	10.0%	11.8%	1.8%	7.0%	16.1%	8.8%	12.7%	7.1%	9.4%
2019	3.1%	12.1%	3.7%	2.0%	12.9%	10.1%	10.0%	6.9%	7.2%
2020 (Annualized)	9.5%	6.1%	0.0%	6.2%	10.0%	2.9%	2.2%	0.0%	4.8%
Average 2001–2019	5.2%	3.8%	1.6%	7.7%	9.1%	4.2%	6.5%	5.2%	5.5%

Appendix 2B: S&P 500 Securities Litigation—Percentage of Market Capitalization of S&P 500 Companies Subject to Core Federal Filings

Year	Consumer Discretionary	Consumer Staples	Energy / Materials	Financials / Real Estate	Health Care	Industrials	Comm / Telecom / IT	Utilities	All S&P 500 Companies
2001	1.3%	6.3%	0.0%	0.8%	5.4%	0.0%	32.6%	17.4%	10.9%
2002	24.7%	0.3%	1.2%	29.2%	35.2%	13.3%	9.1%	51.0%	18.8%
2003	2.0%	2.3%	0.4%	19.9%	16.3%	4.6%	1.7%	4.3%	8.0%
2004	7.9%	0.1%	29.7%	46.1%	24.1%	8.8%	1.2%	4.8%	17.7%
2005	5.7%	11.4%	1.6%	22.2%	10.1%	5.6%	10.3%	5.6%	10.7%
2006	8.9%	0.8%	0.0%	8.2%	18.1%	0.0%	8.3%	0.0%	6.7%
2007	4.4%	0.0%	0.0%	18.1%	22.5%	2.2%	3.4%	5.5%	8.2%
2008	7.2%	2.6%	0.0%	55.0%	20.0%	26.4%	1.4%	4.0%	16.2%
2009	1.9%	3.9%	0.8%	31.2%	1.7%	23.2%	0.3%	0.0%	7.7%
2010	4.9%	0.0%	5.2%	31.1%	32.7%	0.0%	5.9%	0.0%	11.1%
2011	4.6%	0.8%	0.0%	6.9%	0.7%	2.1%	13.4%	0.0%	5.0%
2012	1.6%	14.0%	0.9%	11.0%	0.8%	1.2%	2.2%	0.0%	4.3%
2013	4.4%	0.0%	0.0%	0.0%	4.4%	0.0%	16.6%	0.0%	4.7%
2014	2.5%	0.0%	0.2%	0.3%	0.0%	1.7%	0.0%	0.0%	0.6%
2015	0.0%	1.9%	0.0%	3.0%	3.1%	0.0%	7.0%	3.7%	2.8%
2016	2.8%	1.0%	19.8%	11.9%	13.2%	8.7%	12.3%	4.4%	10.0%
2017	8.2%	6.7%	2.3%	1.5%	2.7%	22.3%	4.4%	9.6%	6.1%
2018	4.7%	15.2%	1.4%	12.5%	26.3%	19.4%	19.4%	6.5%	14.9%
2019	0.5%	9.1%	1.2%	2.2%	6.6%	21.6%	18.0%	7.9%	10.0%
2020 (Annualized)	3.4%	3.5%	0.0%	13.6%	5.5%	2.3%	0.6%	0.0%	4.0%
Average 2001–2019	4.8%	4.4%	2.8%	14.3%	12.3%	9.3%	10.4%	6.1%	9.0%

Note: Average figures are calculated as the sum of the market capitalization subject to core filings in a given sector from 2001 to 2018, divided by the sum of market capitalization in that sector from 2001 to 2018.

Appendix 3: 1933 Act Filings in State Courts

	1933 Act Filings in State Courts						
Year	California	New York	Texas	Massachusetts	Pennsylvania	Others	All
2010	1	0	0	0	0	0	1
2011	3	0	0	0	0	0	3
2012	5	0	0	0	0	2	7
2013	1	0	0	0	0	0	1
2014	5	0	0	0	1	0	6
2015	15	0	0	2	0	0	17
2016	19	0	1	1	0	6	27
2017	7	0	1	0	1	4	13
2018	16	13	0	0	0	6	35
2019	15	19	2	1	3	12	52
2020 H1	1	9	0	1	0	1	12
Average (2010–2019)	9	3	0	0	1	3	16

Note:

1. Filings in 2010 through 2017 include Section 11 claims and may also include Section 12 and Section 15 claims, but do not include allegations of Rule 10b-5 violations. Beginning in 2018, the Securities Class Action Clearinghouse began tracking 1933 Act filings in California state courts with Section 11 or Section 12 claims.

2. "Others" includes filings in Alabama, Arizona, Colorado, Florida, Georgia, Illinois, Iowa, Michigan, Nevada, New Hampshire, New Jersey, Oregon, Rhode Island, Tennessee, Washington, West Virginia, and Wisconsin.

Appendix 4: Filings by Industry—Core Federal Filings

(Dollars in billions)

	Class Action Filings				Disclosure Dollar Loss				Maximum Dollar Loss			
Industry	Semiannual Average 1997–2019	2019 H1	2019 H2	2020 H1	Semiannual Average 1997–2019	2019 H1	2019 H2	2020 H1	Semiannual Average 1997–2019	2019 H1	2019 H2	2020 H1
Consumer Non-Cyclical	26	45	42	32	$20	$43	$25	$33	$78	$181	$143	$169
Communications	14	19	18	8	$12	$18	$37	$3	$74	$95	$68	$34
Technology	11	12	17	14	$11	$87	$13	$7	$48	$389	$37	$37
Financial	15	10	12	15	$9	$2	$8	$20	$54	$17	$24	$244
Industrial	9	14	6	5	$7	$16	$6	$1	$25	$60	$44	$9
Consumer Cyclical	10	8	12	16	$5	$3	$7	$6	$26	$7	$36	$55
Energy	4	4	6	5	$2	$2	$3	$4	$11	$8	$16	$26
Basic Materials	2	5	3	3	$1	$6	$4	$3	$8	$9	$14	$4
Utilities	1	0	5	0	$1	$0	$2	$0	$5	$0	$20	$0
Unknown/Unclassified	1	5	0	13	$0	$0	$0	$1	$0	$0	$0	$1
Total	93	122	121	111	$68	$176	$104	$80	$329	$766	$404	$579

Note:

1. Figures may not sum due to rounding.
2. Analysis excludes filings with missing sector information or infrequently used sectors.

Appendix 5: Filings by Circuit—Core Federal Filings

(Dollars in billions)

Circuit	Class Action Filings				Disclosure Dollar Loss				Maximum Dollar Loss			
	Semiannual Average 1997–2019	2019 H1	2019 H2	2020 H1	Semiannual Average 1997–2019	2019 H1	2019 H2	2020 H1	Semiannual Average 1997–2018	2019 H1	2019 H2	2020 H1
1st	4	3	3	1	$4	$1	-$2	$0	$11	$3	$27	$0
2nd	26	51	52	40	$22	$54	$28	$17	$117	$241	$118	$227
3rd	9	14	13	11	$9	$7	$11	$20	$34	$20	$79	$41
4th	3	2	5	1	$1	$0	$1	$0	$6	$0	$14	$3
5th	6	5	8	6	$3	$0	$4	$4	$17	$2	$18	$36
6th	4	5	6	3	$3	$1	$7	$1	$13	$3	$21	$4
7th	4	5	3	5	$4	$21	$8	$10	$16	$92	$14	$103
8th	3	0	2	0	$1	$0	$2	$0	$6	$0	$5	$0
9th	24	28	24	35	$17	$91	$43	$22	$91	$396	$105	$118
10th	3	2	4	4	$1	$1	$2	$1	$6	$4	$3	$5
11th	7	7	1	5	$2	$1	$0	$5	$10	$4	$0	$40
D.C.	0.4	0	0	0	$0.3	$0	$0	$0	$1.5	$0	$0	$0
Total	93	122	121	111	$6	$176	$104	$80	$27	$766	$404	$579

Note: Figures may not sum due to rounding.

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse, in collaboration with Cornerstone Research, has identified 5,764 federal securities class action filings between January 1, 1996, and June 30, 2020 (securities.stanford.edu). The analysis in this report is based on data identified by Stanford as of July 10, 2020.
- The sample used in this report includes federal filings that typically allege violations of the Securities Act of 1933 Section 11, the Securities Exchange Act of 1934 Section 10b, Section 12(a) (registration requirements), or Section 14(a) (proxy solicitation requirements).
- The sample is referred to as the “classic filings” sample and excludes IPO allocation, analyst, and mutual fund filings (313, 68, and 25 filings, respectively).
- Multiple filings related to the same allegations against the same defendant(s) are consolidated in the database through a unique record indexed to the first identified complaint.
- In addition to federal filings, class actions filed in state courts since January 1, 2010, alleging violations of the Securities Act of 1933 are separately tracked.
- An additional 180 class action filings in state courts from January 1, 2010, to June 30, 2020, have also been identified.

The views expressed in this report are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research.

The authors request that you reference Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse in any reprint of the information or figures included in this study.

Please direct any questions to:

Alexander Aganin
650.853.1660
aaganin@cornerstone.com

Cornerstone Research

Cornerstone Research provides economic and financial consulting and expert testimony in all phases of complex litigation and regulatory proceedings. The firm works with an extensive network of prominent faculty and industry practitioners to identify the best-qualified expert for each assignment. Cornerstone Research has earned a reputation for consistent high quality and effectiveness by delivering rigorous, state-of-the-art analysis for more than thirty years. The firm has over 700 staff and offices in Boston, Chicago, London, Los Angeles, New York, San Francisco, Silicon Valley, and Washington.

www.cornerstone.com

© 2020 by Cornerstone Research.
All rights reserved. Cornerstone Research is a registered service mark of Cornerstone Research, Inc.
C and design is a registered trademark of Cornerstone Research, Inc.

Stanford Law School

State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)

Michael Klausner

Stanford Law School; European Corporate Governance Institute (ECGI)

John M. Olin Program in Law and Economics
Stanford Law School
Stanford, California 94305

Working Paper Series
Paper No. 551

This paper can be downloaded without charge from the
Social Science Research Network Electronic Paper Collection
http://ssrn.com/abstract=3580368

Electronic copy available at: https://ssrn.com/abstract=3580368

State Section 11 Litigation in the Post-*Cyan* Environment (Despite *Sciabacucchi*)[†]

By Michael Klausner, Jason Hegland,** Carin LeVine,*** and Jessica Shin*****

In Cyan, Inc. v. Beaver County Employees Retirement Fund, *the U.S. Supreme Court held that the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") preserved state courts' jurisdiction to adjudicate cases brought under the Securities Act of 1933, with defendants having no right to remove a case to federal court. The result of this decision has been a dramatic increase in section 11 cases litigated in state court, often with a parallel case brought in federal court against the same defendants based on the same alleged misstatements. Just weeks ago, in* Salzberg v. Sciabacucchi, *the Delaware Supreme Court mitigated the impact of* Cyan *by upholding the facial validity of charter provisions requiring section 11 cases to be brought in federal court. That case provides some relief for Delaware corporations that have recently issued securities, or that plan to do so, if they have federal-forum charter provisions in place. The reach of* Sciabacucchi, *and the extent to which section 11 cases continue to be litigated in state court, will depend on a number of factors, most importantly the extent to which states in which these cases are litigated treat federal-form provisions as valid. Federal legislation, therefore, remains the most effective means of stemming the inefficiencies that this article documents empirically.*

Introduction

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, decided roughly two years ago, the U.S. Supreme Court held that plaintiffs may bring class actions in state court under the Securities Act of 1933 ("Securities Act").[1] Section 11 of the Securities Act provides a cause of action for misstatements and omissions in registration statements filed in connection with a public offering of securities,[2] and section 12(a)(2) provides a cause of action for misstatements and omissions in a prospectus or oral statements made in connection with a public offering.[3] The

† The authors thank Boris Feldman, Doug Greene, Sam Issacharoff, and Avi Josefson for their insights and we thank Sarah Leonard (Stanford Law School class of 2020) for her work on an earlier version of this article.

* Nancy and Charles Munger Professor of Business and Professor of Law.

** Executive Director, Stanford Securities Litigation Analytics.

*** Research Project Manager, Stanford Securities Litigation Analytics.

**** Research Fellow, Stanford Securities Litigation Analytics.

1. 138 S. Ct. 1061 (2018).
2. 15 U.S.C. § 77k (2018).
3. *Id.*

Electronic copy available at: https://ssrn.com/abstract=3580368

vast majority of these cases allege violations of section 11.[4] Before *Cyan*, some state courts heard section 11 cases and some did not, depending on whether their state's federal district courts interpreted the Securities Litigation Uniform Standards Act ("SLUSA")[5] as requiring them to remand section 11 cases back to state court in response to a defendant's removal. In *Cyan*, the Court held that SLUSA did not withdraw jurisdiction over section 11 cases from state courts, and that federal courts must remand those cases back to state court. As a result, plaintiffs may now litigate section 11 class actions in state court, federal court, or both simultaneously for the same underlying violations. The *Cyan* decision has made section 11 litigation considerably more complicated and presumably more expensive for defendants; it has raised challenges for courts with respect to judicial efficiency; and it has enhanced opportunities for plaintiffs' lawyers to profit from filing cases of questionable merit.

On March 19, 2020, in *Salzberg v. Sciabacucchi*,[6] the Delaware Supreme Court upheld the facial validity of charter provisions that require Section 11 claims to be filed in federal court ("federal-forum provisions" or "FFPs"). The *Sciabacucchi* case will mitigate the impact of *Cyan*. So long as other state courts accept the validity of FFPs, they will dismiss section 11 cases filed against Delaware corporations with FFPs in their charters, and section 11 litigation against these companies will be limited to federal court. Companies going public, those planning mergers in which they will issue shares, and those planning to issue securities in any other context should certainly adopt an FFP. There is no downside, and the provision may well protect the firm from inefficient and potentially abusive litigation.

The *Sciabacucchi* case, however, does not spell the end of section 11 litigation in state courts. First, the Delaware Supreme Court only upheld the facial validity of FFPs, which means it found that FFPs are valid in some, but not necessarily, all situations. The Court thus left open the possibility that FFPs will be ruled invalid in particular contexts, in which case state litigation against a Delaware corporation could proceed notwithstanding an FFP, even in a case filed in Delaware state court. Second, there is no assurance that other states will accept the validity of FFPs in the charters of Delaware corporations, facially or as applied. If a state court concludes that a Delaware corporations' FFP is invalid, it will allow the case to proceed. We could therefore find ourselves in a situation similar to where we were prior to *Cyan*, where some states recognize FFPs as valid and some do not—and where plaintiffs' attorneys understandably try to file state cases in the latter. Third, at this point, FFPs have not been validated in states other than Delaware. Companies preparing to issue securities, therefore, will

4. *Id*. § 771(a)(2). Since 2011, there have been only three cases filed in state court alleging section 12(a)(2) violations without also alleging section 11 violations. For simplicity, we refer to all Securities Act cases as "section 11" cases throughout this article. However, the points we make and data we report will cover all cases alleging section 11 and/or section 12(a)(2) violations.

5. Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as amended in scattered sections of 15 U.S.C.).

6. Salzberg v. Sciabacucchi, No. 346, 2019 (Del. Mar 18, 2020).

Electronic copy available at: https://ssrn.com/abstract=3580368

presumably incorporate in Delaware and adopt FFPs. This could lead other state legislatures to validate FFPs, but at this point we do not know how this will play out. Accordingly, federal legislation that accomplishes what Congress intended to accomplish in SLUSA would be the most effective way to address the problems that we document when section 11 cases are litigated in state court.

In this article, we use the Stanford Securities Litigation Analytics ("SSLA") database to analyze section 11 cases in state courts before *Cyan* and in the two years since *Cyan*.[7] First, we look at the increase in the filing volume of section 11 cases in state courts since *Cyan*. Second, we look at the outcomes of state section 11 cases to determine how dismissal rates and settlement sizes in state courts compare with section 11 cases brought solely in federal courts. Third, we investigate how state and federal courts have managed section 11 litigation. Specifically, we look at pleading rules, the use of discovery stays, and the handling of parallel litigation where different plaintiffs' lawyers have filed cases in state and federal court based on the same alleged facts.

Part I of this article explains the state court procedural rules that raise concerns regarding section 11 litigation. Part II provides data on the explosion of section 11 litigation in state court following *Cyan*. Part III analyzes the outcomes of section 11 cases litigated in state court compared with those litigated in federal court. Part IV analyzes cases litigated in state and federal court simultaneously, with respect to both the outcomes of those cases and with respect to how state and federal courts have managed or declined to manage this parallel litigation. Our empirical analysis covers the period from January 1, 2011, through December 31, 2019.

I. Background: Concerns Regarding Procedural Rules in State Section 11 Litigation

Section 11 provides a monetary remedy to shareholders who purchase shares directly in a public offering or traceable to a public offering. Typically, a section 11 suit is brought as a class action, with the class consisting of those shareholders. Although the substance of section 11 is the same regardless of whether a case is litigated in state or federal court, more plaintiff-friendly procedural rules in state court can have a significant impact on litigation costs to defendants, on the value of a suit to plaintiffs and their attorneys, on judicial efficiency, and on the opportunity for plaintiffs and plaintiffs' lawyers to profit from filing weak cases. Those

7. *Stanford Securities Litigation Analytics*, Stan. L. Sch., https://sla.law.stanford.edu (last visited Jan. 9, 2020). The primary sources of data are federal and state court dockets. In some instances, state court documents are not electronically available, in which case we rely on company disclosures and other information sources to fill in missing information.

The analysis in this article covers securities class actions filed in federal and state court against publicly traded companies between January 1, 2011, and December 31, 2019, that allege misstatements or omissions related to public offerings of securities in violation of either section 11 or 12 of the Securities Act of 1933. We exclude (i) actions related to initial coin offerings (ICOs), which raise new issues unrelated to the advent of state section 11 litigation that would confound comparisons between state and federal cases; (ii) cases involving solely unregistered securities; and (iii) cases that name only third-party defendants, such as underwriters and auditors.

Electronic copy available at: https://ssrn.com/abstract=3580368

procedural rules are: pleading standards governing motions to dismiss; the timing of discovery in relation to rulings on the motion to dismiss; and the coordination (or not) of parallel state and federal cases.

A. Pleading Standards

As applied to section 11 cases, state court pleading standards will be an important factor in determining the impact of litigating section 11 cases in state courts nationwide. Federal courts follow the *Twombly–Iqbal* pleading standard, under which a plaintiff can withstand a motion to dismiss only by alleging "enough facts to state a claim to relief that is plausible on its face"[8] in light of "judicial experience and common sense."[9] Facial plausibility is satisfied when a complaint permits a "court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[10] Conclusory statements are insufficient to demonstrate facial plausibility.[11] Federal courts applying this pleading standard to cases raising solely section 11 claims have granted motions to dismiss in 38 percent of rulings since 2011.

In contrast, many states generally follow a more lenient pleading standard than the *Twombly–Iqbal* plausibility standard.[12] In California—where section 11 cases had been litigated for several years before *Cyan*—a plaintiff must merely plead a "statement of the facts constituting the cause of action, in ordinary and concise language."[13] In New York, where 40 percent of section 11 cases have been filed since *Cyan*, the pleading standard is more stringent than the California standard but still more lenient that the federal standard.[14] In Part III, we discuss

8. Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007).

9. Ashcroft v. Iqbal, 556 U.S. 662, 679 (2009).

10. *Id.* at 678.

11. *Twombly*, 550 U.S. at 555; *Iqbal*, 556 U.S. at 678. In most federal circuits, section 11 cases that "sound in fraud" apply the higher pleading standard enacted in the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.) ("PSLRA"). That pleading standard requires that a complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2)(A) (2018); *see, e.g.*, *In re* Fuwei Films Sec. Litig., 634 F. Supp. 2d 419, 436 (S.D.N.Y. 2009). Only the Eighth Circuit has consistently declined to apply this heightened standard. Amy L. Craiger, *From Conceivable to Impossible: The Hurdles Plaintiffs Must Overcome When Pleading Section 11 and Section 12(a) Securities Claims*, 5 Brook. J. Corp. Fin. & Com. L. 549, 556, 571 (2011). The *Tellabs* case added a gloss to the PSLRA's heightened pleading standard, requiring that the strong inference "must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 314 (2007). To avoid the higher pleading standard, however, plaintiffs' attorneys generally try not to plead fraud in section 11 cases.

12. *See* Jane Willis & F. Turner Buford, *Pleading Standards in the Federal and State Trial Courts: The Evolving Impact of U.S. Supreme Court Precedent*, Litig. Comment. & Rev. (Aug. 2009), https://litigationcommentary.org/2009/2009-august/109-pleading-standards-in-the-federal-and-state-trial-courts-the-evolving-impact-of-us-supreme-court-precedent. On the other hand, Massachusetts has explicitly adopted the *Twombly–Iqbal* standard. Iannacchino v. Ford Motor Co., 888 N.E.2d 879, 890 (Mass. 2008).

13. Cal. Civ. Proc. Code § 425.10 (Deering 2019).

14. N.Y. C.P.L.R. 3013 (Consol. 2019) (requiring a pleading to be "suffiently particular to give . . . notice of the . . . transactions or occurrences . . . and the material elements of each cause of action");

Electronic copy available at: https://ssrn.com/abstract=3580368

how the California and New York courts and others have addressed motions to dismiss in section 11 cases since *Cyan*.

B. Discovery Stay

In federal court, there is an automatic stay of discovery under the PSLRA until a motion to dismiss is denied.[15] In combination with the *Twombly–Iqbal* pleading standard, the discovery stay poses a considerable hurdle for plaintiffs' attorneys, who must obtain detailed information about a defendant before discovery. With a 38 percent dismissal rate in federal court, this rule accounts for substantial savings in litigation expense for defendants, though plaintiffs' attorneys argue that it screens out meritorious cases. In contrast, state courts generally allow discovery to begin before they rule on a motion to dismiss.[16] All other factors being equal, an early start to discovery imposes costs on a defendant and creates pressure to settle a case before a ruling on a motion to dismiss.

The timing of discovery in section 11 cases litigated in state court will have a significant impact on section 11 litigation in state courts.[17] In Part III, we examine the extent to which state courts have adopted the PSLRA's discovery stay.

C. Coordination of Parallel State and Federal Cases

A third important procedural rule in securities class actions litigated in federal court is the process by which multiple cases are consolidated into a single case with lead plaintiffs and lead counsel selected.[18] Federal courts manage that process according to rules prescribed by the PSLRA.[19] States have their own consolidation processes when multiple class actions are brought within a single state, but where cases based on the same alleged violation are filed in multiple states

King v. Commercial Ins. Co., 275 N.Y.S.2d 975, 977 (App. Div. 1966); *see also* Lisa A. Zakolski & Judith Nichter Morris, Carmody Wait 2d New York Practice with Forms § 27:29 (2019).

15. 15 U.S.C. § 77z-1(b) (2018).

16. *See, e.g.*, Beaver Cty. Emps. Ret. Fund v. VHCP Mgmt., LLC, No. CIV536488 (Cal. Super. Ct. filed Dec. 7, 2015) (involving issuer defendant Avalanche Biotechnologies, Inc.); Geller v. Morris, No. CIV537300 (Cal. Super. Ct. filed Feb. 26, 2016) (involving issuer defendant LendingClub Corporation). On the other hand, some state courts have granted motions to stay discovery pending ruling on a motion to dismiss. *See* Order re Motion to Dismiss or Stay at 2, Book v. Pronai Therapeutics, Inc., No. 16CIV02473 (Cal. Super. Ct. Mar. 14, 2018) (No. 1031262); Endorsement on Motion to Stay Discovery, Carlson v. Ovascience Inc., No. 1584CV03087 (Mass. Super. Ct. June 2, 2016).

17. *See* Doug Greene, Jessie Gabriel, Marco Molina & Brian Song, *The Coming Securities Class Action Storm: Multijurisdictional Litigation After* Cyan, PLUS J., 3Q 2018, at 1, https://www.wileyrein.com/media/publication/486_Q32018.pdf; David M.J. Rein & Matthew A. Schwartz, *Expert Q&A on Securities Act Claims and SLUSA After* Cyan, Thomson Reuters Prac. L.J., June/July 2018, at 16, https://www.sullcrom.com/files/upload/Practical_Law_Rein_Schwartz_May2018.pdf.

18. 15 U.S.C. § 77z-1(a)(3)(B)(i)–(ii) (2018); Fed. R. Civ. P. 42(a); David M.J. Rein, Matthew A. Schwartz, & John P. Collins, Jr., *Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA)*, Thomson Reuters Prac. L.J., Oct./Nov. 2017, at 39, https://www.sullcrom.com/files/upload/ThomsonReutersJournal_Litigation_PSLRA_OctNov17.pdf. It is not unusual for a lead counsel to file a case with two or three lead plaintiffs.

19. The court accords a presumption in favor of selecting the plaintiff(s) with the "largest financial interest" in the case. 15 U.S.C. § 77z-1(a)(3)(B)(i), (iii)(bb) (2018); *see also* Rein & Schwartz, *supra* note 17; Rein et al., *supra* note 18.

Electronic copy available at: https://ssrn.com/abstract=3580368

or in state and federal courts, the litigation can get complicated—and inefficient. Where plaintiffs file multiple cases in state courts of different states, the doctrine of *forum non conveniens* may relieve a defendant of the burden of litigating in multiple states, but there is no assurance that a court will provide that relief. Similarly, where cases are filed in state and federal courts, the state court may stay its proceedings pending resolution of the federal case. A federal court could also stay state court proceedings under section 27(b)(4) of SLUSA, which authorizes a federal court to stay state court discovery "in aid of its jurisdiction" if necessary.[20] Stays of these sorts are not the same as the federal court consolidation process, but their use would at least reduce the burden on defendants and the inefficiency of litigating the same case simultaneously in state and federal courts.

The extent to which state and federal courts use their powers to coordinate state and federal cases will have a substantial impact on the burden imposed on defendants and on the efficiency of section 11 litigation in the post-*Cyan* environment. In Part IV, we examine how courts have managed parallel state and federal litigation so far.

In the wake of *Cyan*, and notwithstanding *Sciabacucchi* these three procedural concerns raise serious issues regarding whether (a) state courts will filter out non-meritorious section 11 cases at the motion-to-dismiss stage, (b) defendants will incur discovery costs in cases that are ultimately dismissed, (c) defendants will face high litigation costs simultaneously defending cases in state and federal courts, and (d) cases of doubtful merit will be filed in state court in anticipation of plaintiff-friendly procedural rules.[21] In the remainder of this article, we investigate actual experience with state section 11 litigation to evaluate the extent to which it supports these concerns.

II. State Section 11 Filing Volume Since *Cyan*

For the reasons explained above, the volume of section 11 cases filed in state court was expected to increase as a result of *Cyan*. As Figure 1 shows, that expectation has been borne out. Figure 1 includes cases (i) filed solely in state court, (ii) filed solely in federal court, and (iii) filed in both state and federal court based on the same alleged misstatement or omission. Parallel cases in state and federal courts appear in Figure 1 as both state and federal cases.[22] There have been seventy-five cases filed in state court since *Cyan* was decided in early 2018—a sharp increase over prior years.[23] Among those cases, thirty

20. 15 U.S.C. § 77z-1(b)(4) (2018) ("Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.").

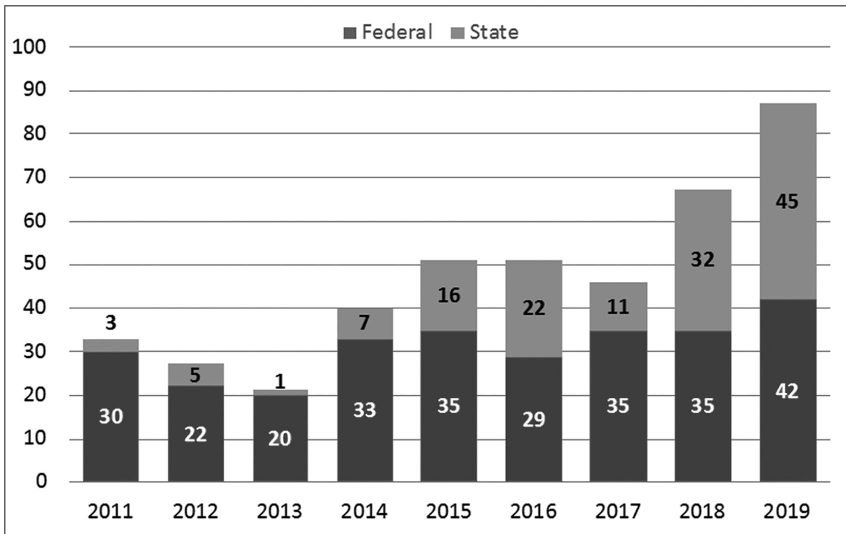
21. Greene et al., *supra* note 17; Rein & Schwartz, *supra* note 17; *The Supreme Court's* Cyan *Decision and What Happens Next*, DavisPolk (Apr. 13, 2018), https://www.davispolk.com/files/2018-04-13-supreme-courts-cyan-decision-what-happens-next.pdf.

22. Cases filed in state court and successfully removed to federal court are counted as federal cases. Cases filed in multiple state courts based on the same allegations are counted as a single case in the year the first case was filed.

23. All but two of the state cases filed in 2018 were filed after the *Cyan* decision came out.

Electronic copy available at: https://ssrn.com/abstract=3580368

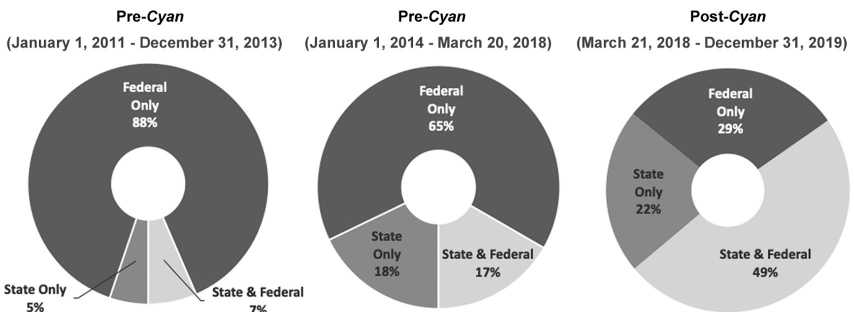
Figure 1
Forum Choice in Securities Act Cases Filed 2011 Through 2019



have been filed in New York, where defendants had successfully removed section 11 cases to federal court before *Cyan*, and twenty-five have been filed in California, which had previously heard the bulk of section 11 cases.

In Figure 2, which combines the pre-*Cyan* years into two periods for comparison with the post-*Cyan* period, we separate cases into those filed solely in state

Figure 2
Forum Mix in Securities Act Cases Filed 2011 Through 2019



Electronic copy available at: https://ssrn.com/abstract=3580368

court, those filed solely in federal court, and parallel pairs of cases filed in both state and federal courts (where a parallel pair is reflected as one case in this chart). Since *Cyan*, cases filed exclusively in federal court comprise only 29 percent of section 11 filings, compared to 88 percent between 2011 and 2013 and 65 percent between 2014 and March 20, 2018, when *Cyan* was decided. Furthermore, the opening of state courts to section 11 cases has contributed to an increase in the total volume of section 11 litigation. This increase is not explained by an increase in public offerings. This suggests that the increases may have been driven by an increase in low-merit cases that are attracted to state courts by lenient procedural rules. We analyze evidence of this below.

III. Outcomes of State Section 11 Cases Filed Solely in State Court

In the analysis below, we focus on dismissal and settlement rates and on settlement size in state section 11 cases filed solely in state court since 2011. We compare those outcomes to outcomes in section 11 cases litigated solely in federal court. For purposes of these comparisons, we consider federal cases with section 11 claims only—that is, we omit from the analysis federal cases with both section 11 claims and claims under section 10(b) of the Securities Exchange Act of 1934.[24] While this allows for a rough apples-to-apples comparison between state and federal cases,[25] it also means we omit many federal cases with section 11 claims. Between 2011 and 2019, there were fifty-three federal cases with solely a section 11 claim and no parallel suit filed in state court, forty-eight of which have been resolved. There were 139 federal cases with both section 10(b) and section 11 claims filed during the same period, with no parallel state cases. Of those 139 cases, 104 have been resolved.[26]

Our comparison of outcomes in cases filed solely in state court with those filed solely in federal court is confounded by two cross-cutting potential effects. On one hand, we are comparing the impact of plaintiff-friendly procedural rules in state court with stricter rules in federal court. We expect those differences to result in better state-court outcomes for plaintiffs. On the other hand, we expect that, on the whole, cases filed solely in state court may be weaker than cases filed solely in federal court. Not only would relatively weak procedural rules attract weak cases, but for a case to be filed *solely* in state court, it must be true that no plaintiffs' lawyer deemed it worthwhile to file a parallel case in federal court. The strength of a case presumably influences its outcome. Consequently, the differences in outcomes will reflect the net impact of the procedural differences and the selection effect that those procedural differences produce. In

24. 15 U.S.C. § 78j(b) (2018).

25. As we explain below, there may be selection effects with respect to plaintiffs' attorneys filing cases in either state or federal court, which would mean we do not have a perfect apples-to-apples comparison of state and federal court treatment of section 11 cases.

26. In this section, events in a case are reported as of December 31, 2019.

Electronic copy available at: https://ssrn.com/abstract=3580368

addition, because a large majority of cases filed in state court are California cases, our results are heavily influenced by what has occurred in California state courts.

A. Dismissal and Settlement Rates

As explained above, the differences in generally applicable pleading standards between state and federal courts mean that unless states adopt higher pleading standards for section 11 cases, dismissal rates will be lower in state court than in federal court, all other factors held constant. Holding all factors constant, however, may not be possible due to the selection effect that may drive cases into state court. We nevertheless compare final rulings on motions to dismiss and present those results in Table 1.[27] Notwithstanding the possibility that state cases may be weaker than federal cases, the dismissal rate in state court has been lower than in federal court—28 percent of motions to dismiss have been granted in state court, compared to 39 percent in federal court. If we include federal cases with section 10 and section 11 claims, the dismissal rate for those cases remains at 39 percent.[28] The low dismissal rate in state court is driven by California cases, which constitute a large majority of resolved state court cases. In cases filed solely in state court since 2011, California courts have granted motions to dismiss in only 18 percent of cases—and only 12 percent of cases if one includes those with parallel federal cases.

Table 2 shows all possible outcomes: settlements, dismissals, and dropped cases. This analysis is complicated by the fact that in some pending cases—both

Table 1

Rulings on Motions to Dismiss in Cases Filed 2011 Through 2019

		MTD Granted	MTD Denied	Total
State	n	8	21	29
	%	*(28%)*	*(72%)*	*(100%)*
Federal	n	13	20	33
	%	*(39%)*	*(61%)*	*(100%)*

27. This table includes only cases in which there has been a ruling on a motion to dismiss. We treat motions to dismiss as granted if either (a) the motion was granted with prejudice or (b) the motion was granted without prejudice and the plaintiff did not refile a complaint. If a motion was granted without prejudice and the plaintiff refiled a complaint but later dropped the case, that outcome is not treated as a motion to dismiss having been granted but rather as a dropped case and is excluded from the total in Table 1. Dropped cases are picked up in Table 2, as are cases that settled before a final ruling on a motion to dismiss.

28. In the small sample included in Table 1, where federal cases have only section 11 claims, the difference between state and federal dismissal rates is not statistically significant—the *p-value* is .138. If we include cases filed in both state and federal courts, the lower dismissal rate in state court is statistically significant at the 5 percent level.

Electronic copy available at: https://ssrn.com/abstract=3580368

Table 2

Outcomes in Cases Filed and Resolved from 2011 Through 2019[29]

		Dismissed	Settled*	Dropped	Total
State	n	8	24	4	36
	%	*(22%)*	*(67%)*	*(11%)*	*(100%)*
Federal	n	13	31	4	48
	%	*(27%)*	*(65%)*	*(8%)*	*(100%)*

* This count of settled actions includes pending cases—four state cases and one federal case—that have survived a motion to dismiss and continued to discovery. In the SSLA database of cases filed January 2000 to the present, there are only two cases with solely section 11 claims in which defendants ultimately prevailed following the denial of a dismissal motion.

state and federal—motions to dismiss have already been denied with prejudice and therefore the case will settle at some point. We therefore include those cases in the "Settled" column.[30] Although the rate at which motions to dismiss are granted in state court is substantially lower than in federal court, the percentage of cases that settle is essentially the same—67 percent in state court and 65 percent in federal court. This is because many federal cases settle before reaching a ruling on a motion to dismiss. Our data show that 35 percent of federal court settlements occur before a final ruling on a motion to dismiss, while only 20 percent of state court settlements do. The fact that the settlement rate in federal court is the same as that in state court despite the relatively strict procedural hurdles suggests that cases brought in federal court may be stronger than those brought in state court. The more plaintiff-friendly rules in state court may thus be attracting cases of relatively low merit. We continue to investigate that possibility in Section B, below, where we compare settlement sizes.

Might state pleading standards and discovery rules change as state courts continue hearing section 11 cases nationwide? Perhaps. There are some positive signs. One positive sign with respect to pleading standards is a post-*Cyan* New York case, *In re Dentsply Sirona, Inc. Shareholders Litigation*.[31] In *Dentsply Sirona*, Judge Scarpulla dismissed a complaint alleging that the defendants' registration statement had failed to disclose information required by Items 303 and 503 of Securities and Exchange Commission ("SEC") Regulation S-X.[32] Those provisions require a company to disclose, respectively, "known trends having an impact on sales, revenues or income" and "the most significant factors that make the offering

29. In Table 2, we show thirteen federal cases dismissed, whereas in Table 1, we show fourteen motions to dismiss granted. The discrepancy is due to the fact that there is one case in which the motion to dismiss was granted and the parties settled while the dismissal was on appeal. We therefore treat that case as settled.

30. Pending cases in which there has been no final ruling on a motion to dismiss are omitted from the figure.

31. No. 155393/2018 (N.Y. Sup. Ct. filed June 7, 2018).

32. *See* 17 C.F.R. §§ 229.303, 229.503 (2020).

Electronic copy available at: https://ssrn.com/abstract=3580368

speculative or risky."[33] With respect to "known trends,"[34] the court held that the plaintiffs had failed to "plead, with some specificity, facts establishing that defendant had actual knowledge of the purported trend."[35] The court held as well that the plaintiffs had failed to allege with sufficient specificity the defendants' failure to disclose relevant risk factors.[36] Forty percent of post-*Cyan* state cases have been filed in New York, which had heard no section 11 cases before *Cyan*. So this case could well pave the way for similar rulings in New York and may influence other state courts.

Even in California, which has applied its ordinary, permissive pleading standard to section 11 cases since it started hearing these cases well before *Cyan*—and has denied motions to dismiss in 88 percent of its cases—one court has taken a different approach in a post-*Cyan* case. In *In re Natera Securities Litigation*. Judge Buchwald dismissed a complaint that also alleged a misstatement with respect to Item 303 of Regulation S-X.[37] In so doing, he exercised judicial notice in reviewing the defendant's motion to a degree not ordinarily exercised by California courts. Judge Buchwald stated:

> [T]he Court believes that it has the discretion, under California's complex case [] rules to treat the pending Motion as would a Federal trial court when hearing and deciding a Rule 12(b) Motion to Dismiss . . . .
>
> . . . .
>
> Using this Federal motion procedure is also now even more warranted in the wake of the recent United States Supreme Court decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund* (2018) 138 S. Ct. 1061 validating the concurrent Federal and State court jurisdiction over 1933 Act cases . . . . This recent confirmation of concurrent jurisdiction would appear to call for some consistency and uniformity in the handling of such cases as between the Federal and State Courts.
>
> . . . .
>
> [T]he *Cyan* decision clearly contemplates uniform treatment of securities class actions in Federal and State courts, [so] it makes sense to apply here . . . the broader scope of judicial notice routinely used on early pleading motions in Federal courts.[38]

Applying this approach to judicial notice rather than the more restrictive approach that California courts generally apply, Judge Buchwald held that the plaintiffs' allegation of knowledge was "at direct odds with judicially noticeable evidence"[39] and dismissed the complaint.

In addition, post-*Cyan* cases provide some hope for state courts granting stays of discovery pending rulings on motions to dismiss. Since *Cyan*, there

33. *Id.* § 229.503(c).
34. *Id.* § 229.303(4)(i)(D).
35. *See* Decision and Order on Motion at 13, *In re* Dentsply Sirona, Inc. S'holders Litig., No. 155393/2018 (N.Y. Sup. Ct. Sept. 26, 2019) (No. 180) (quoting Opinion and Order at 7, *In re* Jumei Int'l Holdings Sec. Litig., No. 14-CV-09826 (S.D.N.Y. Jan. 10, 2017) (No. 105)).
36. *Id.* at 14.
37. No. CIV537409 (Cal. Super. Ct. filed Mar. 24, 2016).
38. Memorandum of Decision and Order at 4–5, *In re* Natera Sec. Litig., No. CIV537409 (Cal. Super. Ct. Aug. 7, 2018) (No. 1309959).
39. *Id.* at 9.

Electronic copy available at: https://ssrn.com/abstract=3580368

have been fifteen rulings in state courts on motions to stay discovery, ten of which were in New York. Of the ten New York rulings, four were granted, four were denied, and two were granted pursuant to the parties' stipulations. In one of the New York cases, and in a Connecticut case, the courts held that the language of the PSLRA's mandatory stay provision—which begins, "In *any* private action arising under this subchapter . . ."[40]—applies to cases tried in state courts.[41] In *In re Everquote*, New York Judge Borrock stated: "The simple, plain, and unambiguous language [of the PSLRA] expressly provides that discovery is stayed during a pending motion to dismiss '[i]n any private action arising under this subchapter.'"[42] Similarly, in the *Pitney Bowes* case, Connecticut Judge Lee held that the language of the PSLRA "compels the conclusion" that the discovery stay applies in state court.[43] In another New York case, *In re Greensky*, Judge Schecter stated that she was "not convinced that the PSLRA, by its terms, expressly mandates a stay in state court" but that "[t]he important purpose underlying enactment of the automatic stay—ensuring that cases have merit at the outset—should not be disregarded merely because a federal cause of action is being prosecuted in state court."[44] On the other hand, New York Judge Scarpulla has twice rejected the argument that the PSLRA discovery stay applies in state cases, simply asserting that "[a]pplication of the federal PSLRA's discovery stay would undermine *Cyan's* holding that '33 Act cases can proceed in state courts."[45] Other state courts have also denied motions to stay discovery.[46]

B. Settlement Size

In this section, we compare settlement size in state and federal cases, again looking at cases filed solely in state or federal court—and again, where a large majority of resolved state cases are in California. The implications of plaintiff-friendly state pleading standards and discovery rules for the size of settlements

40. 15 U.S.C. § 77z-1(b)(1) (2018) (emphasis added).

41. *See* Decision and Order at 11, *In re* Everquote, Inc. Sec. Litig., No. 651177/2019 (N.Y. Sup. Ct. Aug. 6, 2019) (No. 73).

42. *Id.*

43. *See* Memorandum of Decision Re Defendants' Motions for Protective Order Staying Discovery Pursuant to 15 U.S.C. Section 77z-1(b)(1) (#135 and #143) at 7–8, City of Livonia Retiree Health & Disability Benefits Plan v. Pitney Bowes Inc., No. FST-CV-18-6038160-S (Conn. Super. Ct. May 15, 2019) (No. 135.01).

44. *See* Decision and Order at 3, *In re* Greensky, Inc. Sec. Litig., No. 655626/2018 (N.Y. Sup. Ct. Nov. 25, 2019) (No. 91).

45. *See* Decision and Order on Motion at 14, *In re* Dentsply Sirona, Inc. S'holders Litig., No. 155393/2018 (N.Y. Sup. Ct. Aug. 2, 2019) (No. 174); Decision and Order at 12–13, *In re* PPDAI Grp. Sec. Litig., No. 654482/2018 (N.Y. Sup. Ct. July 5, 2019) (No. 91).

46. *See, e.g.*, Order Denying Defendants Arcimoto, Inc., Mark Frohnmayer, Douglas M. Campoli, Thomas Thurston, Terry Becker and Jefferson Curl's Motion to Stay Further Discovery Pending Ruling on Demurrer, Switzer v. W.R. Hambrecht & Co., No. CGC18564904 (Cal. Super. Ct. Sept. 19, 2018) (No. 001C06502186) (involving issuer defendant Arcimoto, Inc.); Order Denying Motion to Stay Proceedings at 2–3, Buelow v. Alibaba Grp. Holdings Ltd., No. CIV535692 (Cal. Super. Ct. Apr. 1, 2016); Order Denying Defendant's Motion to Stay Proceedings at 3–4, Young v. Pac. Biosciences of Cal., Inc., No. CIV509210 (Cal. Super. Ct. May 24, 2012).

Electronic copy available at: https://ssrn.com/abstract=3580368

we observe are once again ambiguous. On one hand, a lower likelihood of dismissal in state court—especially when coupled with early discovery—would give plaintiffs greater leverage to extract a settlement than they would have in federal court. But this leverage would only last until a ruling on a motion to dismiss. After the ruling, state and federal cases would be on equal footing from the perspective of the procedural rules discussed in Part I. On the other hand, for the reasons explained above, cases filed solely in state court may be relatively weak, in which case we could well observe *lower* settlements in state court than in federal court—especially for cases that settle after a ruling on a motion to dismiss. Presumably, the merits do matter in negotiating a settlement.

Table 3 compares settlement size in state and federal cases—both in dollar amounts and as a percentage of statutory damages, which we estimate as the difference between the price of a defendant's shares in its public offering and the market value of those shares at the time of a lawsuit. Consistent with our analysis of dismissal rates, and to maintain an apples-to-apples comparison, we include among federal cases only those with solely a section 11 claim. Both in dollar value and as a percentage of statutory damages, the median settlements are essentially the same in state and federal court. But the mean settlement in state court is much lower than the mean in federal court. The difference in means reflects the fact that federal cases include more large settlements than do state cases. This difference in state and federal court settlement size is consistent with the selection effect discussed above—relatively weak cases being brought in state court.

To look more closely at whether there is a selection effect driving weaker cases into state court, we look at settlements that occur after motions to dismiss have been denied—when the state procedural rules discussed above would not create pressure on defendants to settle. The results of this comparison are presented in Table 4. Among those cases, the mean dollar amount of settlements in federal cases is more than twice the mean of state cases, but the medians are essentially the same—again reflecting a substantially skewed distribution of federal

Table 3

Settlements in Cases Filed and Resolved from 2011 Through 2019

	Total Settlement in Dollars	
	State	Federal
Mean	$7,941,875	$17,900,000
Median	$7,800,000	$7,500,000
	Recovery as a Percent of Statutory Damages	
Mean	12.4%	27.5%
Median	11.0%	11.0%
Observations	20	31

Electronic copy available at: https://ssrn.com/abstract=3580368

Table 4

**Settlement Size in Cases Settled After Motion to Dismiss Ruling—
Cases Filed 2011 Through 2019**

	Total Settlement in Dollars	
	State	Federal
Mean	$8,317,969	$21,100,000
Median	$8,275,000	$7,750,000
	Recovery as a Percent of Statutory Damages	
Mean	12.6%	37.3%
Median	11.0%	20.0%
Observations	16	20

settlements toward the high end when measured in dollar amounts. But when settlements are measured as a percentage of potential statutory damages, both the mean and median settlements in state cases are much lower than those in federal cases. These findings further suggest that state courts have attracted weaker cases than those filed in federal court.

In sum, the outcomes of cases filed solely in state court—most of which are in California state court—are consistent with concerns regarding the leniency of state procedural rules toward plaintiffs. State courts have dismissed cases far less frequently than do federal courts. Furthermore, the leniency of state court rules appears to have attracted cases to state court that are weaker than those brought in federal court.

IV. Litigation of Parallel Pairs of State and Federal Cases

In the discussion below, we address the most complex aspect of the post-*Cyan* legal environment: litigating parallel lawsuits in state and federal courts. We define a federal case as parallel to a state section 11 case if the two cases include a cause of action based on the same alleged misstatements or omissions in the defendant's registration statement.[47] When parallel cases are filed in state and federal courts, the lead counsel and lead plaintiff are different, and counsel for the parallel cases generally do not coordinate with one another. Whereas the analysis in Part III required that we exclude federal cases with section 10(b) claims, the analysis below will include pairs of cases where the federal case has any of the following: (i) only a section 11 claim, (ii) only section 10(b) claims, or (iii) both section 11 and section 10(b) claims. Where the federal case includes section 10(b) claims, there typically is one claim based on offering documents

47. With respect to the three cases with section 12 counts and no section 11 counts, we define a parallel federal case as one that includes the same alleged misstatements or omissions in the prospectus or oral statement.

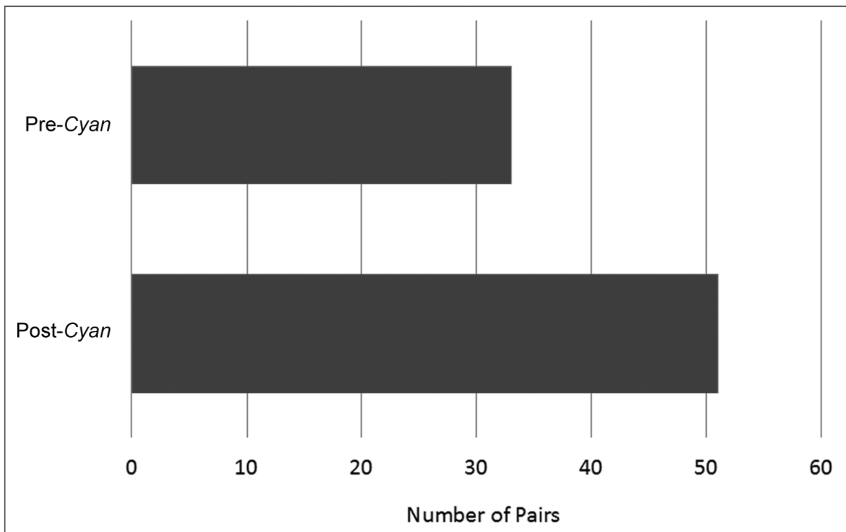
Electronic copy available at: https://ssrn.com/abstract=3580368

and additional claims based on alleged misstatements or omissions that occurred after the company went public. Throughout Part IV, we will refer to parallel lawsuits filed in state and federal court as "parallel pairs" or "pairs" of cases.

Since 2011, eighty-four parallel pairs have been filed. As shown in Figure 3, fifty-one of those have been filed since March 20, 2018, when *Cyan* was decided.[48] Twenty-eight of the eighty-four have been resolved—meaning that both the state and federal cases have been resolved. Thirteen of those are post-*Cyan* resolutions.

Figure 4 shows the outcomes of the twenty-eight parallel pairs that have been resolved as of the end of 2019. We treat a parallel pair as "dismissed" if a motion to dismiss has been granted in either the state or the federal case and the other case is either dismissed or voluntarily dropped. Recall from Table 2 that 67 percent of cases filed solely in state court and 65 percent of cases filed solely in federal court settled. In contrast, 82 percent of parallel pairs (23 out of 28) settled. This high rate of settlement is due in large part to California courts' disinclination to dismiss cases, as discussed in Part III, but the difference in settlement

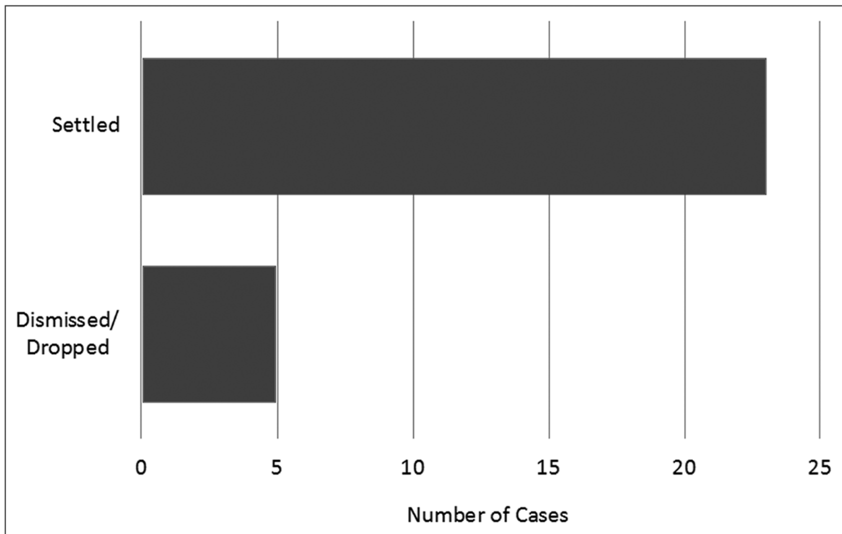
Figure 3
Parallel Pairs Filed 2011 Through 2019



48. This figure includes six pairs where one case was filed before *Cyan* was decided and the other after. In the remaining forty-five pairs, both federal and state cases were filed before *Cyan*. It also includes two pairs in which one of the paired cases was outside our sample range of 2011 through 2019.

Electronic copy available at: https://ssrn.com/abstract=3580368

Figure 4
Outcomes of Parallel Pairs Filed 2011 Through 2019



rates between cases litigated solely in state court and those litigated in parallel pairs presumably reflects as well the costs defendants face litigating simultaneously in state and federal court.

In litigating parallel cases in state and federal courts, there are tools potentially available to a defendant that can reduce litigation costs and the resultant pressure to settle—and enhance judicial efficiency as well. The tool that has been most successful—though by no means universally successful—has been a motion in state court to stay that court's proceedings pending resolution of the parallel federal case, or pending the federal court's ruling on its motion to dismiss.[49] These stays do not necessarily end the state case; if a state court grants a stay, the case can still be revived at a later time. Even if the federal case is dismissed, the state court may then lift its stay and proceed to rule on its own motion to dismiss. Because the federal plaintiff class will not be certified before the federal court's dismissal, the federal court's ruling will not have a preclusive effect on the

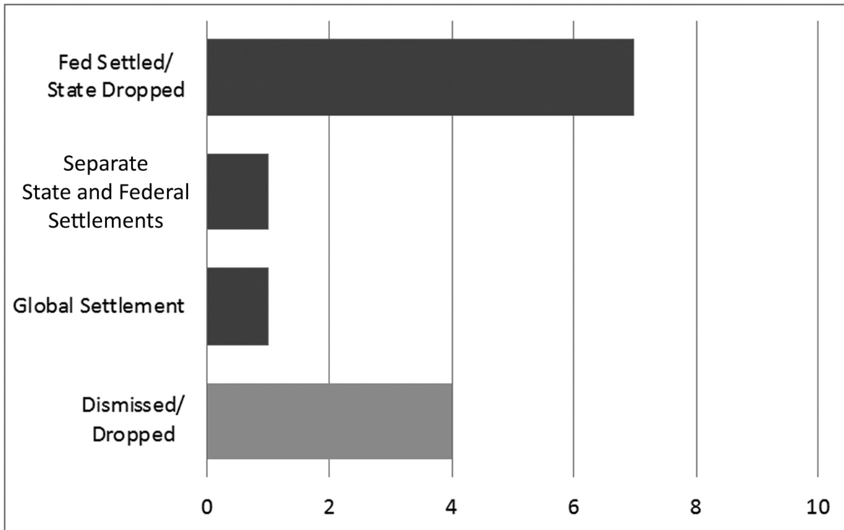
49. One California state court has occasionally stayed its proceedings on grounds of *forum non conveniens* when the parallel federal case is in another state. In those cases, the court has allowed the parties to return to court at any time to petition to have the stay lifted. So long as the stay remains in place and the plaintiffs do not refile a case in another state, these stays have the same effect as a stay pending resolution of the parallel federal case. *See* Order Granting Motion to Stay for *Forum Non Conveniens* at 1–2, Cervantes v. Allen & Co., No. Civ. 534768 (Cal. Super. Ct. Feb. 29, 2016) (involving issuer defendant Etsy, Inc.); Case Management Order #6 at 8–11, Ragsdale v. Micro Focus Int'l PLC, No. 18CIV01549 (Cal. Super. Ct. Dec. 3, 2018) (No. 1524575).

Electronic copy available at: https://ssrn.com/abstract=3580368

state case. Nonetheless, the state court may be influenced by the federal dismissal, and the defendant at least has the opportunity to negotiate a settlement before state discovery costs mount.

There have been twenty-seven cases in which courts have granted motions to stay a state case pending resolution of a parallel federal case or pending a ruling on a motion to dismiss the federal case,[50] and there have been twenty-six cases in which those motions were denied.[51] Of the twenty-seven pairs in which stays have been granted, thirteen have been resolved. Figure 5 shows the outcomes of those thirteen parallel pairs. These resolutions demonstrate how a stay can promote relatively efficient resolution of parallel litigation. As Figure 5 shows,

Figure 5
Outcomes of Parallel Pairs Where the State Case Was Stayed



50. *See, e.g.*, Decision and Order on Motion at 12–13, Mahar v. Gen. Elec. Co., No. 653648/2018 (N.Y. Sup. Ct. Oct. 15, 2019) (No. 155) (stay pending resolution of federal case); Order Re: Motions to Stay at 4–5, *In re* Arlo Techs., Inc. S'holder Litig., No. 18cv339231 (Cal. Super. Ct. June 21, 2019) (No. 3037496) (same); Order Granting Motion for a Stay of Proceedings at 1, Reyes v. Zynga Inc., No. CGC12522876 (Cal. Super. Ct. Aug. 26, 2013) (No. 001C04178178) (stay pending federal court ruling on motion to dismiss); Order, Rajasekaran v. Cytrx Corp., No. BC541426 (Cal. Super. Ct. Oct. 14, 2014) (same).

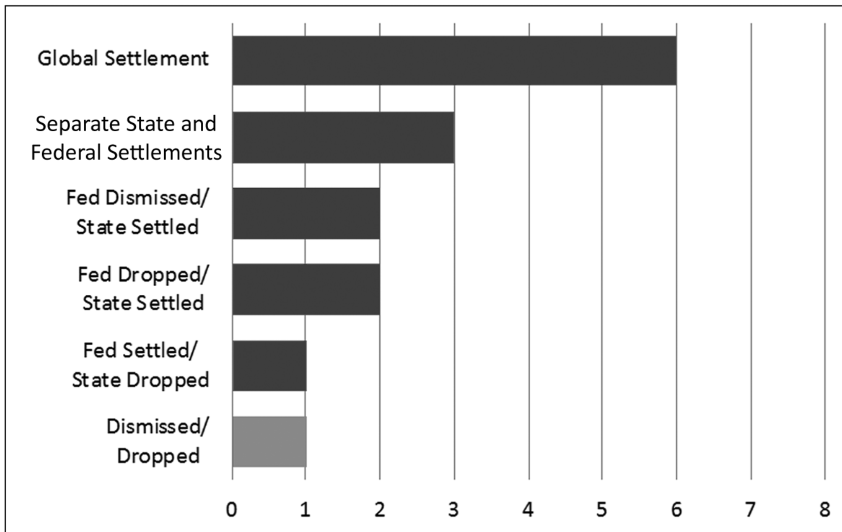
51. *See, e.g.*, Order After Hearing on October 25, 2019 at 6–8, Franchi v. Cloudera, Inc., No. 19CV348674 (Cal. Super. Ct. Oct. 29, 2019) (No. 3580010); Decision and Order on Motion at 2–3, Hoffman v. Stephenson, No. 650797/2019 (N.Y. Sup. Ct. June 24, 2019) (No. 89) (involving issuer defendant AT&T Inc.); Decision and Order at 7–12, *In re* PPDAI Grp. Sec. Litig., No. 654482/2018 (N.Y. Sup. Ct. July 5, 2019) (No. 91); Order Denying Venator and Huntsman Defendants' Motion to Stay Under Doctrine of Comity at 1, Macomb Cty. Emps. Ret. Sys. v. Venator Materials PLC, No. DC-19-02030 (Tex. Dist. Ct. Sept. 3, 2019).

Electronic copy available at: https://ssrn.com/abstract=3580368

four pairs were dismissed or dropped. In two of those, the federal court dismissed its case while a stay was in effect in the state action, and the state court plaintiff thereafter dropped its case.[52] In one pair, both the federal and state courts granted motions to dismiss, and in the other pair both the federal and state action were voluntarily dropped—all while the stay of the state case was in effect. The remaining nine pairs of cases settled while the stays were in place.

There have been fifteen parallel pairs in which no stay was granted, either because no motion was made or because a motion was denied. Figure 6 shows the outcomes of these cases. There are a few instructive scenarios here. First, of the ten pairs where the federal case settled, nine of the federal cases included section 10 claims. The presence of section 10 claims in the federal case is an important factor in litigating parallel pairs of cases. Typically, at least one of those claims is

Figure 6
Outcomes of Parallel Pairs Where State Case Was Not Stayed



52. *See* Yan v. ReWalk Robotics Ltd., No. 17-cv-10169 (D. Mass. Jan. 31, 2017); *In re* ReWalk Robotics Ltd., No. 1684CV03336 (Mass. Super. Ct. Oct. 31, 2016) (showing that the federal motion to dismiss was granted in part and denied in part while state case was stayed, after which the state case was voluntarily dropped and ultimately dismissed); *see also* Altayyar v. Etsy, Inc., No. 15-cv-02785 (E.D.N.Y. filed May 13, 2015); Cervantes v. Allen & Company LLC, No. Civ534768 (Cal. Super. Ct. filed July 21, 2015) (involving issuer Etsy, Inc.) (showing a similar pattern in which the state court stayed the case on grounds of *forum non conveniens* which remained in effect until the federal case was dismissed, and thereafter the state case was dropped).

Electronic copy available at: https://ssrn.com/abstract=3580368

based on alleged misstatements outside the defendant's offering documents. Consequently, the federal case includes one or more plaintiff classes in addition to the section 11 class (which is the same as the plaintiff class in the state case). Therefore, a settlement of the state case would have no impact on those section 10 claims in the federal case; the plaintiffs in the federal case would continue litigating those claims. On the other hand, because the federal case includes the state section 11 class (either in a section 11 claim or a section 10 claim based on the offering), a settlement of the federal case would end the entire litigation. Therefore, a defendant considering settlement of a parallel pair of cases in which the federal case has a section 10 claim based on statements or omissions outside the offering documents must focus primarily on the federal case to end the litigation. This is reflected in Figure 6. Five of the global settlements included federal cases with section 10 claims, as did all three of the separate state and federal settlements and the one pair where the federal case settled and the state case was dropped.

Second, there are two pairs where the state case settled and the federal case was dismissed. In one of these instances, the federal case had only a section 11 claim, which the federal court dismissed first. The state court then denied the defendant's motion to dismiss the section 11 claim—presumably because of a lenient state pleading standard—and the defendant had to settle the state case.[53] This is one of the troubling scenarios that litigation of parallel pairs of cases introduces. A defendant can go to the expense of having a federal complaint dismissed only to be forced to settle the state case after the state court denies the same motion.

Third, there are two parallel pairs where the state case settled and the federal case was dropped. In both those pairs, the state case settled before the federal court made a final ruling on a motion to dismiss. In one instance, the state court denied the defendants' motion to dismiss before a consolidated complaint was even filed in the federal case,[54] which presumably put pressure on the defendants to settle the state case. This too is a troubling scenario in that the state case drove up the defendants' litigation expense before the federal court ruled on a motion to dismiss.

The other instance in which a state case settled and a federal case was dropped is more ambiguous from the perspective of the defendant but not from a policy perspective. In that pair of cases, the initial federal complaint had been dismissed without prejudice.[55] The defendant then reached a settlement with the state plaintiff before the federal plaintiff filed an amended complaint. Although an outsider never knows what goes on in settlement negotiations, the defendant

53. *See* Greenberg v. Sunrun Inc., No. 3:16-cv-02480 (N.D. Cal. filed May 6, 2016); Pytel v. Elmore, No. CIV538215 (Cal. Super. Ct. filed Apr. 13, 2016) (involving issuer defendant Sunrun, Inc.). In the other instance of a federal court dismissal and a state court settlement, the federal case had only a section 10 claim, which is much harder for plaintiffs to plead successfully. Gregory v. ProNAi Therapeutics, Inc., No. 16-cv-08703 (S.D.N.Y. filed Nov. 9, 2016); Book v. Pronai Therapeutics, Inc., No. 16CIV02473 (Cal. Super. Ct. filed Nov. 18, 2016).

54. *See* Thomas v. Envivio, Inc., No. 3:12-cv-06464 (N.D. Cal. filed Dec. 20, 2012); Wiley v. Envivio, Inc., No. CIV517185 (Cal. Super. Ct. filed Oct. 5, 2012).

55. *See* Primo v. Pac. Biosciences of Cal., Inc., No. 11-cv-06599 (N.D. Cal. filed Dec. 21, 2011); Young v. Pac. Biosciences of Cal., Inc., No. CIV509210 (Cal. Super. Ct. filed Oct. 21, 2011).

Electronic copy available at: https://ssrn.com/abstract=3580368

may in effect have run a reverse auction between the state and federal plaintiffs and taken the lowest settlement bid to end the litigation. On the other hand, if the defendant did not have to litigate the state and federal cases simultaneously, it might well have preferred to litigate the federal case at least through the pleading stage. From a policy perspective, having a judicial evaluation of a complaint and motion to dismiss is probably better than having two plaintiffs' attorneys bid on a settlement—if that is in fact what occurred.

These last two pairs of parallel cases bring us back to the possibility of staying a state case while litigating the federal case, at least up to the point of the federal court's final ruling on a motion to dismiss. In both those pairs, a stay of the state case pending resolution of the federal case would have been a better way to manage the litigation from a policy perspective and—at least in the first pair—from the perspective of the defendant.

State court stays pending a parallel federal case are thus a potentially useful tool with which to reduce redundant litigation and enhance judicial efficiency. Some courts have granted these stays and some have denied them. In explaining denials of these motions, some courts have relied on the presence of a section 10(b) claim in the federal case. The logic of this position is not compelling. So long as the federal case includes a section 11 claim as well, a settlement of that claim, which necessarily will mean certification of the section 11 class, will terminate the state case. A dismissal of a section 11 claim in the federal case will not terminate the state case (because the class will not have been certified), but that is unrelated to the presence of a section 10(b) claim.

Another potential tool with which a defendant might stop or at least slow down two-track litigation is to ask the federal court to stay state court discovery under section 27(b)(4) of SLUSA, which provides that "a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction."[56] Only a few defendants have moved for such a stay, and none of those motions have been granted.[57] In addressing these SLUSA-based motions to stay discovery in a parallel state case, the federal courts have been solely concerned with the possibility of cross-discovery—that the federal plaintiffs' lawyers will gain access to documents and testimony obtained in state court discovery before the federal parties are allowed to proceed with their own discovery. While the courts have acknowledged this possibility, they have been satisfied that it will not occur because the plaintiffs' lawyers in the state case are different from those in the federal case and because the state court has issued a protective order prohibiting disclosure of any information obtained during discovery. The federal courts have apparently not deemed it problematic that the defendant must bear the cost of state court discovery early in the proceedings, even though

56. 15 U.S.C. § 77z-1(b)(4) (2018) ("Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.").

57. *See, e.g.*, Order Denying Motion to Stay State-Court Discovery at 3, Greenberg v. Sunrun Inc., No. 3:16-cv-02480 (N.D. Cal. May 1, 2017) (No. 93); Order at 1, Sommer v. comScore, Inc., No. 16-cv-01820 (S.D.N.Y. Oct. 27, 2016) (No. 137).

Electronic copy available at: https://ssrn.com/abstract=3580368

this is what the PSLRA aimed to stop. Whether federal courts will be more willing to grant these motions as the volume of two-track litigation grows remains to be seen.

Conclusion

The data on section 11 litigation in state court show that concerns regarding the impact of the *Cyan* decision are well founded. Section 11 filings in state court have skyrocketed, and there is evidence to suggest that part of what is fueling these state filings are cases that are weaker than those filed in federal court. Equally troubling is the fact that close to half of post-*Cyan* litigation is now proceeding on parallel state and federal tracks. As a policy matter, this dual track litigation cannot be justified.

The ability of plaintiffs' lawyers to litigate section 11 cases without the encumbrance of the PSLRA's mandatory discovery stay and without the *Tombly–Iqbal* pleading standard is at the heart of both these problems. Plaintiffs' lawyers file cases in state court because the playing field there is attractive relative to that of federal court. A more lenient pleading standard coupled with early discovery may allow them to force a defendant to settle even a weak case. Furthermore, once a plaintiffs' lawyer files a case in state court, there is nothing to stop another lawyer from filing a parallel case in federal court. The cost of litigating two cases simultaneously further increases the pressure on defendants to settle. This is reflected in an 82 percent settlement rate where a defendant faces a parallel pair of cases.

There are some indications that state courts, most importantly in New York, will manage section 11 cases in ways that respond to these concerns. Some state courts have applied pleading standards specifically tailored to section 11 cases, some have stayed discovery until they rule on a motion to dismiss, and some have stayed their proceedings pending resolution of a parallel federal suit. But so far, these adjustments have been far from universal. In addition, unless a stay is ordered immediately upon the filing of a complaint—which has not yet occurred—these cases will not be litigated efficiently and pressure on defendants to settle will remain heightened.

The *Sciabacucchi* case may well provide a substantial measure of relief. Firms planning to go public or otherwise issue securities should certainly adopt a federal-forum provision and, if necessary, reincorporate in Delaware. There is no reason not to. But the effectiveness of a Delaware FFP will be known only after it is tested in the states in which plaintiffs file section 11 cases. At this point, those states are predominately New York and California, but if those states recognize FFPs as valid, plaintiffs' lawyers will likely test their validity in other states. Resolving the validity of FFPs, and the scope of their validity on an as-applied basis, will be a slow process as these cases proceed through multiple state courts. For firms that have already issued securities, but have not adopted an FFP, or that are not incorporated in Delaware, section 11 cases will continue to be litigated in state court as they have been since *Cyan*. Those firms could

Electronic copy available at: https://ssrn.com/abstract=3580368

reincorporate in Delaware and adopt an FFP. It is unclear, however, whether an FFP will be upheld with respect to previously issued securities. That is an as-applied question state courts will have to decide.

Therefore, congressional intervention seems warranted. Although the Securities Act gave state courts jurisdiction to litigate section 11 cases from the start, the objective—if not the language—of SLUSA certainly appeared to be to shift jurisdiction exclusively to the federal courts. The most straightforward congressional intervention at this point would be to do just that—withdraw jurisdiction from state courts.

Might there be effective halfway measures Congress could adopt? There are some, but they would not solve the problem of costly and duplicative parallel litigation in state and federal court. Congress could enact a law providing that the PSLRA's discovery stay applies in state court. As explained above, some state courts have interpreted the PSLRA as doing just that, but others disagree. Legislation that makes this clear would be helpful, but a discovery stay coupled with a lenient pleading standard in state court would still mean onerous litigation for defendants—at least relative to litigating in federal court. Congress could also enact a heightened pleading standard to be applied in state courts and apply that standard to federal courts as well to avoid the possibility of different federal and state standards. This would go beyond what Congress did with respect to section 11 in the PSLRA, which applied a heightened pleading standard only to section 10(b) cases, but it is consistent with the concerns underlying that Act.

Addressing the problem of parallel litigation, however, can only be done by withdrawing state jurisdiction. One of the central reforms of the PSLRA was the rationalization of the consolidation process along with the selection of lead counsel and lead plaintiffs. That process replaced a race-to-the-courthouse regime in which plaintiffs' lawyers would attempt to get an inside track on becoming lead counsel by being the first to file a complaint. That regime was widely criticized as leading to the filing of non-meritorious lawsuits with little or no client oversight. Now, parallel litigation of section 11 cases potentially raises this problem again. First, there is no assurance that the selection of lead counsel and lead plaintiffs within each state will yield the best litigants. Second, there is no way to consolidate a state case with a federal case. Congress could provide that state courts shall immediately stay section 11 cases until a parallel federal case is resolved. This would be essentially a withdrawal of jurisdiction from the states where a parallel case in filed in federal court. But it would allow state courts to litigate cases where no parallel case is filed in federal court. If no plaintiffs' lawyer files a case in federal court, however, there is probably no good reason one should be filed in state court. Accordingly, the best reform would be to grant the federal courts exclusive jurisdiction over section 11 (and section 12) lawsuits.

Electronic copy available at: https://ssrn.com/abstract=3580368

CORNERSTONE RESEARCH

Economic and Financial Consulting and Expert Testimony

Securities Class Action Filings

2019 Year in Review

Table of Contents

Executive Summary 1
Key Trends in Federal Filings 2
Featured: Annual Rank of Filing Intensity 3
Featured: State Court 1933 Act Filings 4
Number of Federal and State Filings 5
Market Capitalization Losses for Federal and State Filings 7
Classification of Federal Complaints 10
U.S. Exchange-Listed Companies 11
Heat Maps: S&P 500 Securities Litigation™ for Federal Filings 12
M&A Filings by Federal Circuit 14
Status of M&A Filings in Federal Courts 15
Status of Federal Securities Class Action Filings 16
Timing of Dismissals of Federal Filings 17
Federal Filings by Lead Plaintiff 18
1933 Act Cases Filed in State Courts 19
1933 Act Cases Filed in State Courts—Size of Filings 20
New: Dollar Loss on Offered Shares™ in Federal Section 11–Only Filings and 1933 Act Cases Filed in State Courts 21
Comparison of Federal Section 11 Filings with State 1933 Act Filings—Pre- and Post-*Cyan* 22
New: Type of Security Issuance Underlying Federal Section 11 and State 1933 Act Filings 23
New: 1933 Act Filings by Venue—Post-*Cyan* 24
Combined Federal and State Filing Activity—Highlighting Federal Section 11 and State 1933 Act Filings 25
Section 11 Cases Filed in State Courts—Case Status 26
IPO Activity and Federal Section 11 and State 1933 Act Filings 27
IPO Litigation Likelihood 28
Federal Filing Lag 29
Non-U.S. Federal Filings 30
Non-U.S. Company Litigation Likelihood of Federal Filings 32
Mega Federal Filings 33
Industry Comparison of Federal Filings 36
Federal Filings by Circuit 38

Appointment of Plaintiff Lead Counsel in Federal Filings 39
Federal Case Status by Lead Plaintiff Counsel 40
New Developments 41
Glossary 42
Appendices 44
Research Sample 50

Table of Figures

Figure 1: Federal and State Class Action Filings Summary 1
Figure 2: Annual Rank of Measurements of Federal and State Filing Intensity 3
Figure 3: State Court 1933 Act Class Action Filings Summary 4
Figure 4: Class Action Filings Index® (CAF Index®) Annual Number of Class Action Filings 5
Figure 5: Class Action Filings Index® (CAF Index®) Semiannual Number of Class Action Filings 6
Figure 6: Disclosure Dollar Loss Index® (DDL Index®) 7
Figure 7: Median Disclosure Dollar Loss 8
Figure 8: Maximum Dollar Loss Index® (MDL Index®) 9
Figure 9: Allegations Box Score—Core Federal Filings 10
Figure 10: Percentage of U.S. Exchange-Listed Companies Subject to Federal or State Filings 11
Figure 11: Heat Maps of S&P 500 Securities Litigation™ Percentage of Companies Subject to Core Federal Filings 12
Figure 12: Heat Maps of S&P 500 Securities Litigation™ Percentage of Market Capitalization Subject to Core Federal Filings 13
Figure 13: Annual M&A Filings by Federal Circuit 14
Figure 14: Status of M&A Filings Compared to Core Federal Filings 15
Figure 15: Status of Filings by Year—Core Federal Filings 16
Figure 16: Percentage of Cases Dismissed within Three Years of Filing Date—Core Federal Filings 17
Figure 17: Percentage of Federal Class Action Filings by Lead Plaintiff—Core Federal Filings 18
Figure 18: State 1933 Act Filings by State 19
Figure 19: Maximum Dollar Loss (MDL) of State 1933 Act Filings 20
Figure 20: Dollar Loss on Offered Shares™ for Federal Section 11–Only and State 1933 Act Filings 21
Figure 21: Pre- and Post-*Cyan* Quarterly Federal Section 11 and State 1933 Act Filings 22
Figure 22: Federal Section 11 and State 1933 Act Class Action Filings by Type of Security Issuance 23
Figure 23: Frequency of Federal Section 11 and State 1933 Act Class Action Filings by Venue—Post-*Cyan* 24
Figure 24: Federal Section 11 and State 1933 Act Class Action Filings by Venue 25
Figure 25: Resolution of State Section 11 Filings Compared with Section 11–Only Federal Filings 26
Figure 26: Number of IPOs on Major U.S. Exchanges and Number of Filings of Federal Section 11 and State 1933 Act Claims 27
Figure 27: Likelihood of Litigation against Recent IPOs—Core Filings 28
Figure 28: Annual Median Lag between Class Period End Date and Filing Date—Core Federal Filings 29
Figure 29: Annual Number of Class Action Filings by Location of Headquarters—Core Federal Filings 30
Figure 30: Non-U.S. Filings by Location of Headquarters—Core Federal Filings 31

Figure 31: Percentage of Companies Sued by Listing Category or Domicile—Core Federal Filings 32
Figure 32: Mega Filings—Core Federal Filings 33
Figure 33: Distribution of Filings Based on DDL Size—Core Federal Filings 34
Figure 34: Distribution of Filings Based on MDL Size—Core Federal Filings 35
Figure 35: Filings by Industry—Core Federal Filings 36
Figure 36: Sector Comparison: Consumer Non-Cyclical Versus Technology and Communications—Core Federal Filings 37
Figure 37: Filings by Circuit—Core Federal Filings 38
Figure 38: Frequency of Three Law Firms' Appointment as Lead or Co-Lead Plaintiff Counsel—Core Federal Filings 39
Figure 39: Case Status by Plaintiff Law Firm Appointed Lead or Co-Lead Counsel—Core Federal Filings 40
Appendix 1: Basic Filings Metrics 44
Appendix 2A: S&P 500 Securities Litigation—Percentage of S&P 500 Companies Subject to Core Federal Filings 45
Appendix 2B: S&P 500 Securities Litigation—Percentage of Market Capitalization of S&P 500 Companies Subject to Core Federal Filings 45
Appendix 3: M&A Federal Filings Overview 46
Appendix 4: Case Status by Year—Core Federal Filings 46
Appendix 5: 1933 Act Filings in State Courts and Federal Section 11–Only Filings Overview 47
Appendix 6: Litigation Exposure for IPOs in the Given Periods—Core Filings 47
Appendix 7: Filings by Industry—Core Federal Filings 48
Appendix 8: Filings by Circuit—Core Federal Filings 48
Appendix 9: Filings by Exchange Listing—Core Federal Filings 49

Executive Summary

For a third consecutive year, the number of new class action securities filings based on federal statutes remained above 400. Most notably, core filings surged to record levels. Market capitalization losses, as in 2018, surpassed $1 trillion.

Number and Size of Filings

- Plaintiffs filed 428 **new class action securities cases** (filings) across federal and state courts in 2019, the most on record and nearly double the 1997–2018 average. "Core" filings—those excluding M&A filings—rose to the highest number on record. (pages 5–6)
- Federal and state court class actions alleging claims under the Securities Act of 1933 (1933 Act) helped push filing activity to record levels. The number of **1933 Act filings** themselves reached unprecedented levels. (page 25)
- **Disclosure Dollar Loss (DDL)** decreased by 14 percent to $285 billion in 2019. (pages 7–8)
- **Maximum Dollar Loss (MDL)** also fell by 9 percent to $1,199 billion. (page 9)
- In 2019, eight **mega filings** in federal courts made up 52 percent of federal core DDL and 21 mega filings in federal courts made up 71 percent of federal core MDL. Both of these percentages track closely with historical averages. Filings with a DDL of at least $5 billion or an MDL of at least $10 billion are considered mega filings. (pages 33–35)

Other Measures of Filing Intensity

- In 2019, the likelihood of litigation involving a core filing for **U.S. exchange-listed companies** increased for a seventh consecutive year. This measure reached record levels because of both the heightened filing activity against public companies and an extended decline in the number of public companies over the last 15 years. (page 11)
- One in about 14 **S&P 500** companies (7.2 percent) was subject to litigation in federal courts in 2019. Companies in the Health Care sector were the most frequent targets of new core federal filings. (pages 12–13)

Core filings in 2019 increased 13 percent compared to 2018.

Figure 1: Federal and State Class Action Filings Summary

(Dollars in Billions)

	Annual (1997–2018)			2018	2019
	Average	Maximum	Minimum		
Class Action Filings	215	420	120	420	428
Core Filings	*186*	*242*	*120*	*238*	*268*
Disclosure Dollar Loss (DDL)	$130	$331	$42	$331	$285
Maximum Dollar Loss (MDL)	$638	$2,046	$145	$1,317	$1,199

Key Trends in Federal Filings

Companies on U.S. exchanges were more likely to be sued in 2019 than in any previous year whether measured solely on core filings or on total filings. Core filings in federal courts (core federal filings) against non-U.S. issuers (i.e., companies headquartered outside the United States with securities trading on U.S. exchanges) also reached record levels.

U.S. Companies

- In 2019, 5.5 percent of **U.S. exchange-listed companies** were the subject of core filings. (page 11)
- Core federal filings against **S&P 500 firms** in 2019 occurred at a rate of 7.2 percent. (page 12)

Non-U.S. Companies

- Core federal filings against **non-U.S. companies** rose to 57, the highest level on record. (pages 30–31)
- The likelihood of a core federal filing against a non-U.S. company increased from 4.8 percent in 2018 to 5.6 percent in 2019. (page 32)

By Industry

- In 2019, 66 core federal filings were brought against companies in the **Technology** and **Communications** sectors combined, up 32 percent from 2018. (page 36)
- Core federal filings in the **Consumer Non-Cyclical** sector jumped from 67 in 2018 to 88 in 2019. Within this sector, combined filings against biotechnology, pharmaceutical, and healthcare companies also increased. (pages 36–37)

By Circuit

- There were 103 and 52 core federal filings in the **Second** and **Ninth Circuits**, respectively. Second Circuit core federal filings were at historically high levels, 45 percent greater than 2018. (page 38)
- **Third Circuit** filings remained at elevated levels with 28 in 2019 compared with the 1997–2018 historical average of 17. (page 38)

M&A Filings

- Federal filings of merger-objection class actions—those involving M&A transactions with Section 14 claims but no Rule 10b-5, Section 11, or Section 12(2) claims—decreased again, from 182 in 2018 to 160 in 2019. (page 5)
- M&A filings were concentrated in the Third Circuit. In 2019, 127 of the 160 M&A filings were in the Third Circuit, including 126 in Delaware federal court. (page 14)
- M&A filings had a much higher rate of dismissal (89 percent) than core federal filings (47 percent) from 2009 to 2018. (page 15)

Filings by Lead Plaintiff

- For 2019 core federal filings, individuals were appointed lead plaintiff more often than institutional investors, a pattern that has persisted since 2013. (page 18)

Appointment of Plaintiff Lead Counsel

- The growth in core federal filings over the last seven years has coincided with the activity of three plaintiff law firms that have increasingly been involved in securities class actions. (page 39)

New Developments

- There has been an increased number of core filings involving companies in and related to the cannabis industry. (page 41)
- The forum selection case, *Sciabacucchi v. Salzberg*, is currently before the Delaware Supreme Court. (page 41)

Featured: Annual Rank of Filing Intensity

Filing activity in federal and state courts accelerated in 2019. Each of the last three years—2017 through 2019—has been more active than any previous year. More core filings in federal and state courts occurred in 2019 than in any other year. Unlike in earlier years with heightened levels of filings (e.g., at the time of the dot-com bust or the financial crisis), the current peaks have occurred despite a lack of financial market turbulence.

Core federal filings against S&P 500 companies occurred with slightly lower frequency than in 2018, but remained elevated compared with historical measures. Given the number of filings and the frequency of filings involving larger companies, historically large amounts of market capitalization losses (as measured by DDL and MDL) are being litigated.

Figure 2: Annual Rank of Measurements of Federal and State Filing Intensity

	2017	2018	2019
Number of Total Filings	3rd	2nd	1st
Core Filings	8th	3rd	1st
M&A Filings	1st	2nd	3rd
Size of Core Filings			
Disclosure Dollar Loss	10th	1st	2nd
Maximum Dollar Loss	12th	3rd	4th
Percentage of U.S. Exchange-Listed Companies Sued			
Total Filings	3rd	2nd	1st
Core Filings	3rd	2nd	1st
Percentage of S&P 500 Companies Subject to Core Federal Filings	8th	2nd	4th

Note: Rankings cover 1997 through 2019 with the exceptions of M&A filings, which have been tracked as a separate category since 2009, and analysis of the litigation likelihood of S&P 500 companies, which began in 2001. Core filings are those excluding M&A claims. State 1933 Act filings filed exclusively in state courts are included in the rankings in all categories beginning in 2010, except the Percentage of S&P 500 Companies Subject to Core Federal Filings.

Featured: State Court 1933 Act Filings

Securities class action filings with 1933 Act claims increased in state courts in 2019 after the 2018 U.S. Supreme Court decision in *Cyan Inc. v. Beaver County Employees Retirement Fund*. This is one of the more meaningful trends in securities litigation in the last few years. In 2019, filings in state courts with 1933 Act claims exceeded those in federal courts.

- From 2010 through 2019, plaintiffs filed at least 159 1933 Act cases in state courts (state 1933 Act filings). (page 19)
- The number of state 1933 Act filings in 2019 increased by 40 percent from 2018, while the total MDL of state 1933 Act filings rose by 78 percent. (pages 19–20)
- About 45 percent of all state 1933 Act filings in 2019 had a parallel action in federal court. (page 25)
- While state 1933 Act filings exclusively filed in state courts decreased in California from 2018 to 2019, filings in both New York and other states rose substantially.

In 2019, New York state courts became the preferred state venue for plaintiffs bringing 1933 Act claims.

Figure 3: State Court 1933 Act Class Action Filings Summary
(Dollars in Billions)

	Average 2010–2018	2018	2019
State Court 1933 Act Class Action Filings			
Filings in State Courts Only	5	16	27
California	4	8	5
New York	1	5	13
All Other States	1	3	9
Parallel Filings in State and Federal Courts	7	16	22
Total	12	32	49
Maximum Dollar Loss of State Court 1933 Act Filings			
MDL of Filings in State Courts Only	$7.6	$4.3	$18.7
California	$7.2	$2.8	$0.8
New York	$0.2	$1.5	$12.9
All Other States	$0.2	$0.0	$5.0
MDL of Filings in State and Federal Courts	$7.7	$19.4	$25.7
Total MDL	$15.2	$23.7	$44.4

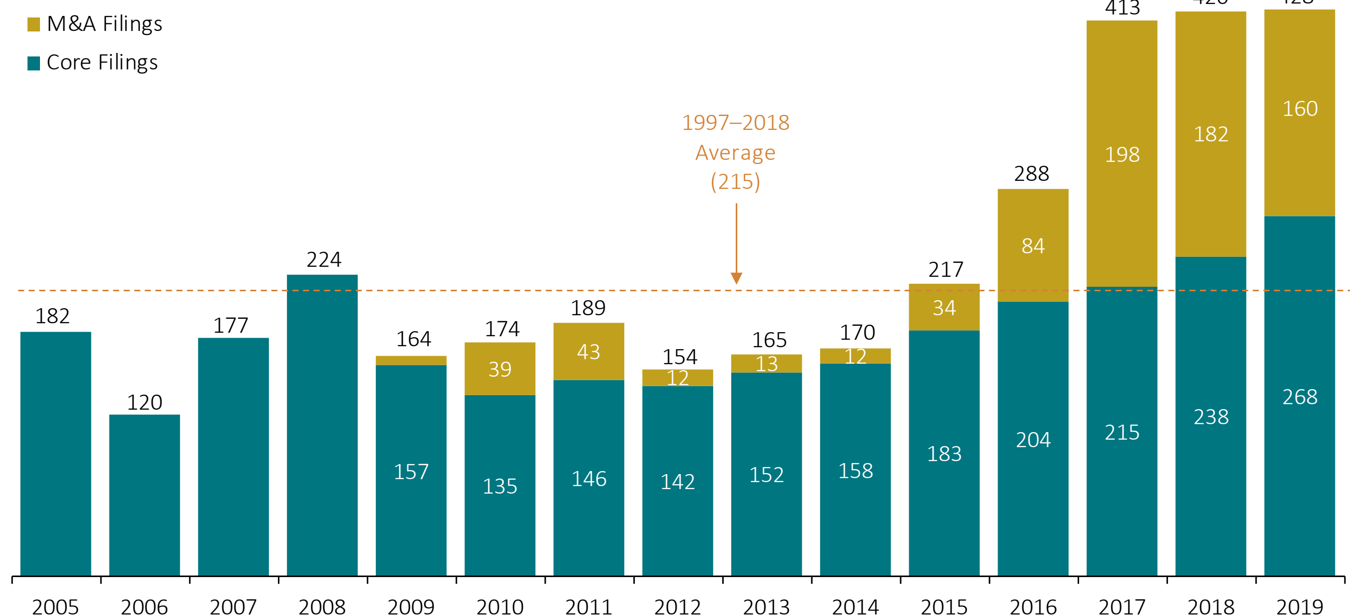
Note:
1. Filings in state courts may have parallel cases filed in federal courts. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Filings against the same company brought in different states without a filing brought in federal court are counted as unique state filings.
2. Beginning in 2018, the Securities Class Action Clearinghouse began tracking 1933 Act filings in California state courts containing Section 11 or Section 12 claims; there were six filings in California state courts with only Section 12 claims in 2018. Filings in other state courts are currently only those with Section 11 claims.
3. Figures may not sum due to rounding.

Number of Federal and State Filings

- Plaintiffs filed 428 new securities class actions across federal and state courts, the highest number on record and nearly double the 1997–2018 average.
- The 160 M&A filings in 2019 were the third-largest number since 2009 (when this report began separately identifying these filings).
- Core filings—those excluding M&A filings—were the highest on record, topping even 2008 when filings surged due to the volatility in U.S. and global financial markets. See Appendix 1 for litigation totals from 1997 to 2019.
- The growth in core federal filings over the last seven years has coincided with the activity of three plaintiff law firms that have increasingly been involved in securities class actions. See additional discussion at page 39.
- There were just three initial coin offering (ICO)/cryptocurrency-related filings in 2019. Emerging as a new trend were filings against issuers involved in the cannabis industry—13 such federal filings occurred in 2019, up from six in 2018.

The number of class action filings across federal and state venues was the highest on record as overall filing activity remained significantly above pre-2016 levels.

Figure 4: Class Action Filings Index® (CAF Index®) Annual Number of Class Action Filings
2005–2019

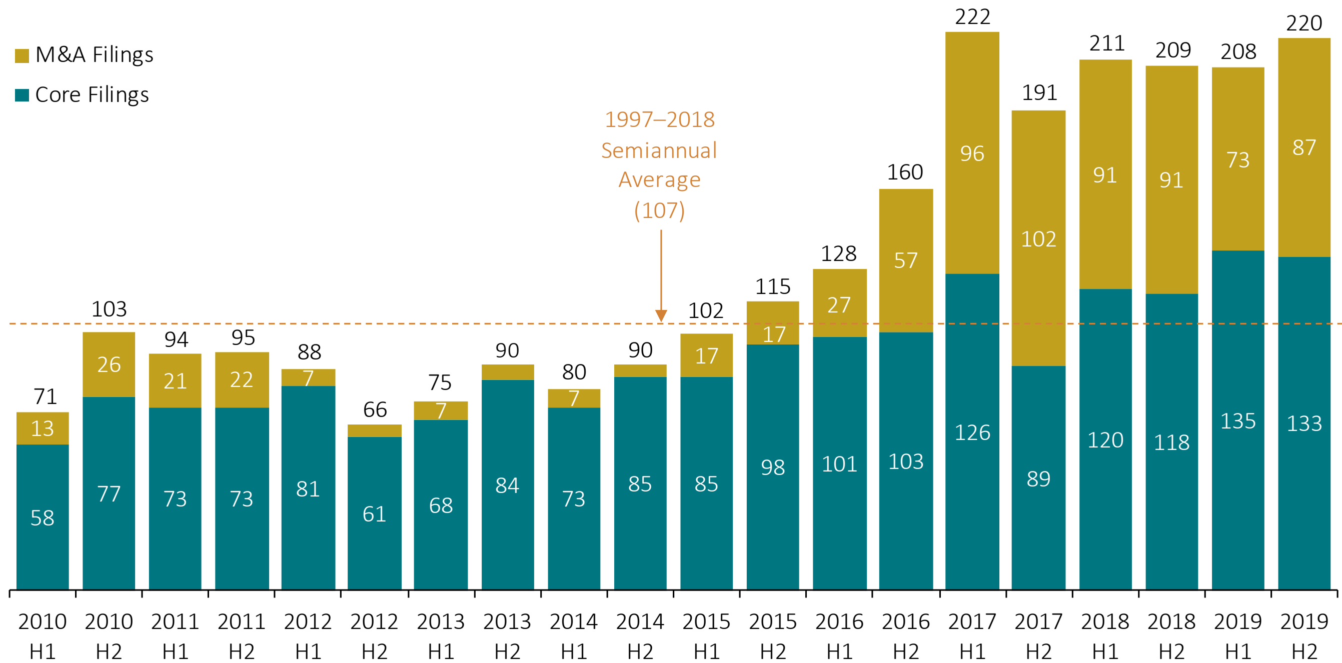


Note: This figure begins including state 1933 Act filings in the annual counts in 2010. Parallel class actions are only reflected as a single filing.

- The pace of core filings was essentially unchanged in the second half of 2019, while the pace of M&A filings was higher in the second half of the year.

Filing activity increased by 6 percent in the second half of 2019.

Figure 5: Class Action Filings Index® (CAF Index®) Semiannual Number of Class Action Filings 2010–2019



Note: This figure begins including state 1933 Act filings in the semiannual counts in 2010. Parallel class actions are only reflected as a single filing.

Market Capitalization Losses for Federal and State Filings

Disclosure Dollar Loss Index® (DDL Index®)

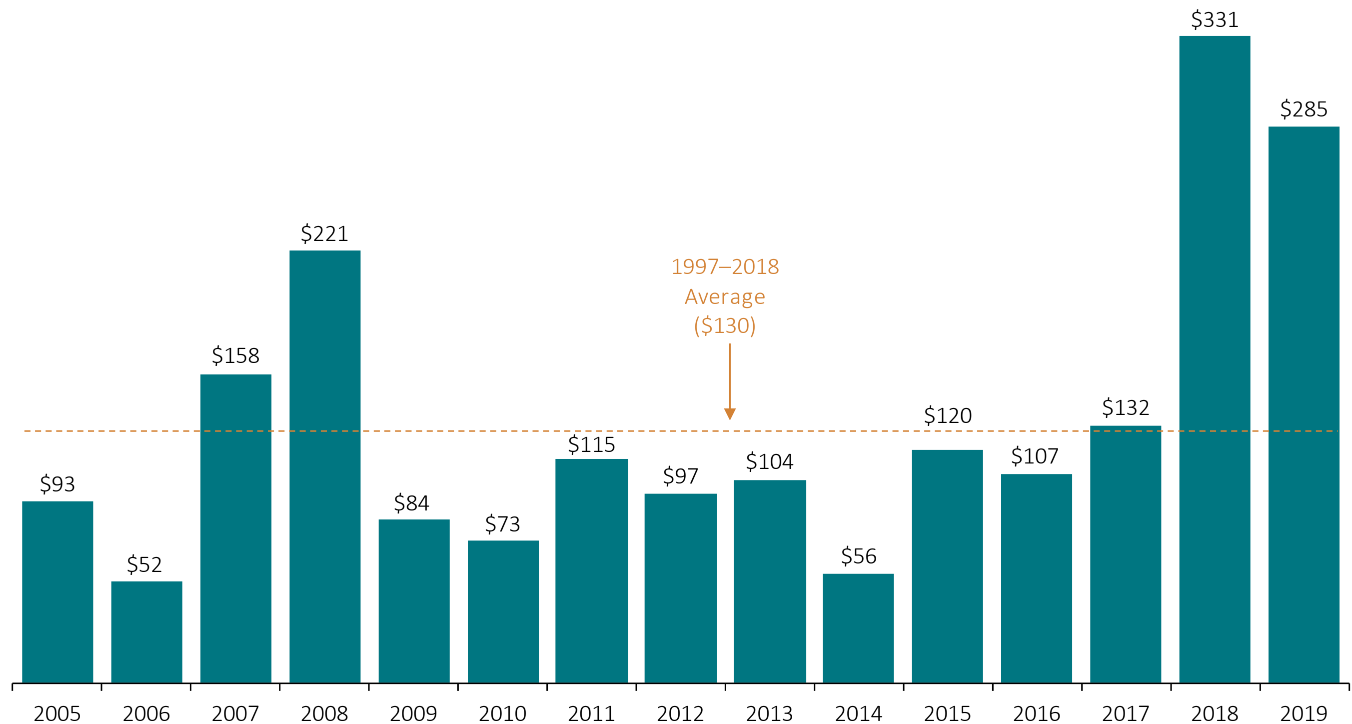
This index measures the aggregate annual DDL for all federal and state filings. DDL is the dollar value change in the defendant firm's market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. See the Glossary for additional discussion on market capitalization losses and DDL.

The DDL Index remained significantly elevated in 2019 despite a sizable decline from last year's record.

- The DDL Index fell to $285 billion in 2019, down 14 percent from 2018, but remained more than double the 1997–2018 average.
- Median DDL per filing in 2019 was the second-highest on record, trailing only 2018. See Appendix 1 for DDL totals, averages, and medians from 1997 to 2019.

Figure 6: Disclosure Dollar Loss Index® (DDL Index®) 2005–2019

(Dollars in Billions)

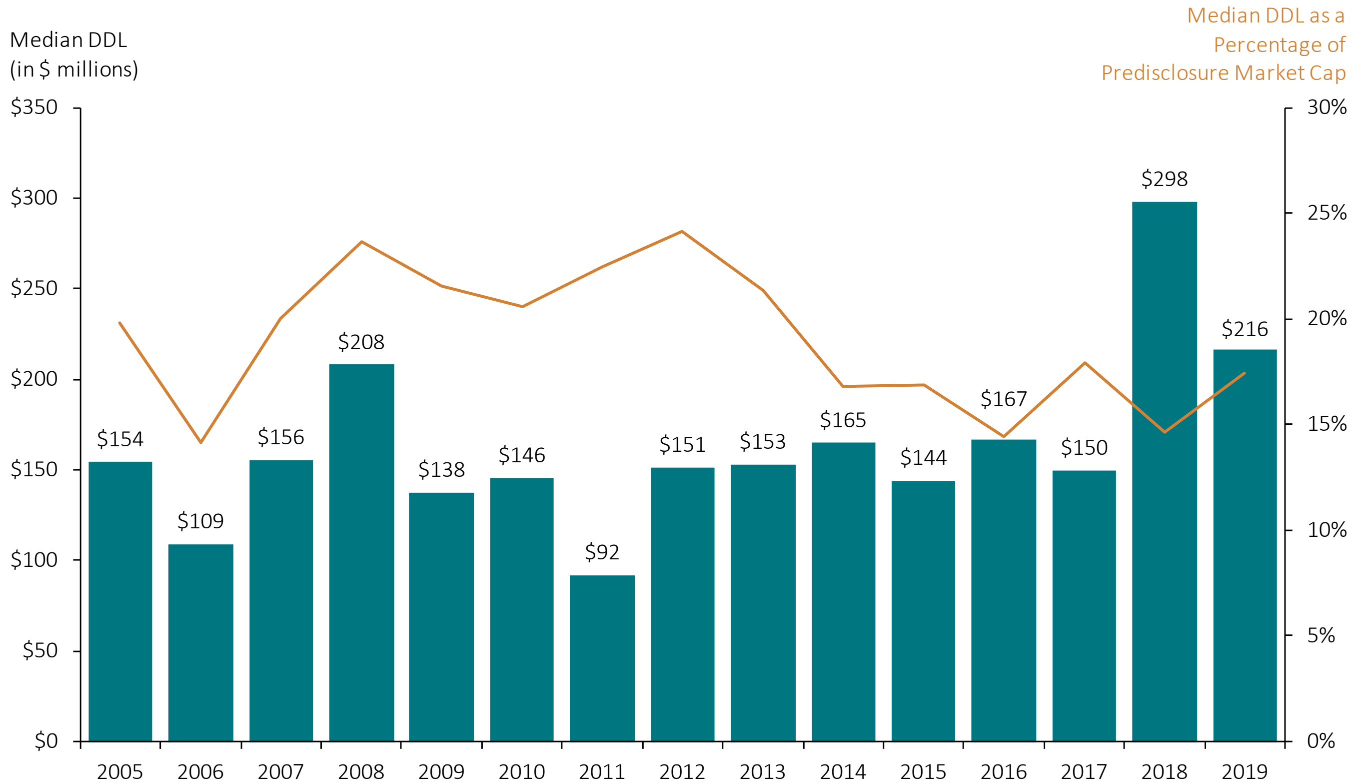


Note: This figure begins including DDL associated with state 1933 Act filings in 2010. DDL associated with parallel class actions are only counted once.

- The typical (i.e., median) percentage stock price drop at the end of the class period has generally oscillated between 14 percent and 18 percent since 2014, and in 2019 reached its second-highest level in the past six years.
- The median DDL decreased 28 percent from 2018 levels, although it was still 58 percent above the 1997–2018 average.

Median DDL fell noticeably from 2018 levels while the median value of DDL as a percentage of predisclosure market capitalization rebounded to 2017 levels.

Figure 7: Median Disclosure Dollar Loss
2005–2019



Maximum Dollar Loss Index® (MDL Index®)

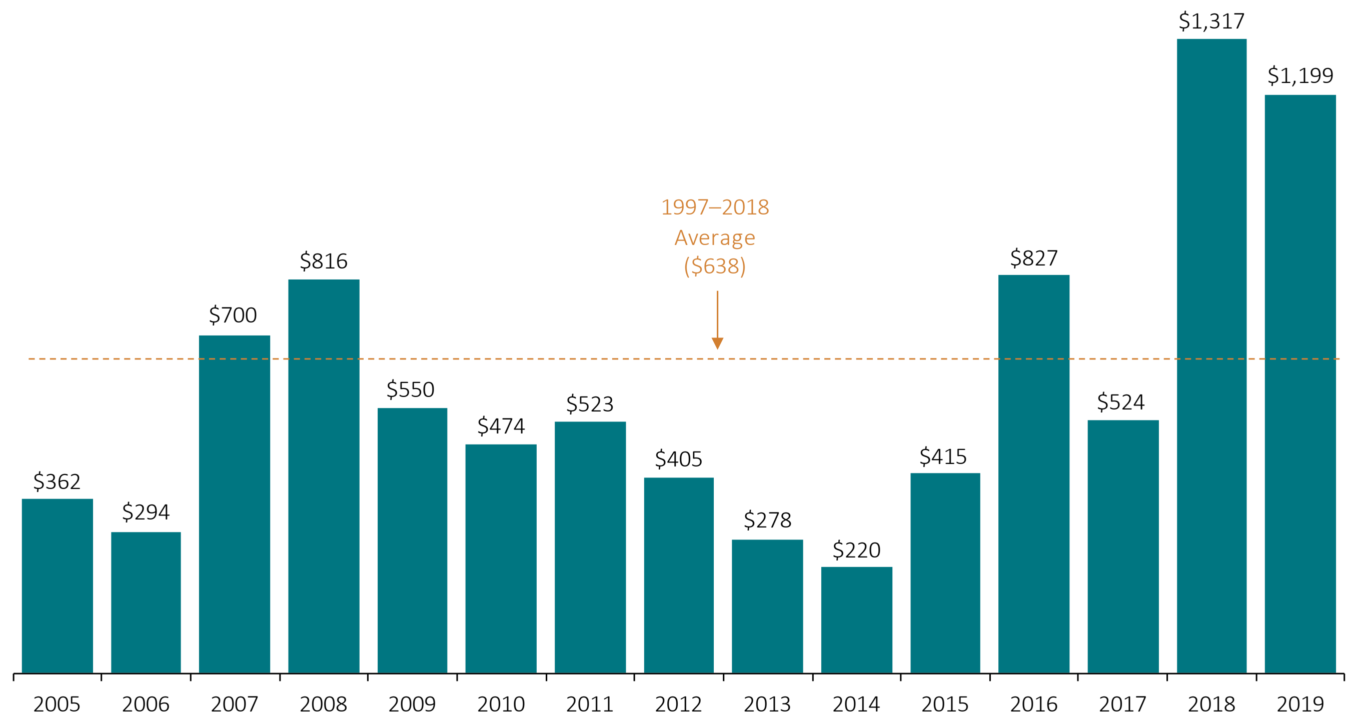
This index measures the aggregate annual MDL for all federal and state filings. MDL is the dollar value change in the defendant firm's market capitalization from the trading day with the highest market capitalization during the class period to the trading day immediately following the end of the class period. See the Glossary for additional discussion on market capitalization losses and MDL.

- The MDL Index reached $1.2 trillion in 2019, the fourth-largest year on record. Relative to 2018, the MDL Index declined by 9 percent. See Appendix 1 for MDL totals, averages, and medians from 1997 to 2019.
- For the second consecutive year, there were at least 20 mega MDL filings, compared to 14 in 2017. Mega MDL filings primarily involved pharmaceutical, technology, and communications companies.

The MDL Index eclipsed $1 trillion for a second consecutive year.

Figure 8: Maximum Dollar Loss Index® (MDL Index®)
2005–2019

(Dollars in Billions)



Note: This figure begins including MDL associated with state 1933 Act filings in 2010. MDL associated with parallel class actions are only counted once.

Classification of Federal Complaints

- Section 11 claims increased in federal courts even as filing activity continued to increase in state courts. See page 22.
- Section 12(2) claims decreased from 10 percent of core federal filings in 2018 to 7 percent in 2019.
- For the third consecutive year, around one-fourth of core federal filings included allegations related to accounting violations.
- Allegations of announced internal control weaknesses increased from 7 percent of core federal filings to 10 percent.

Section 11 claims were asserted in 16 percent of core federal filings in 2019, up from 10 percent in 2018.

- Underwriters were named as defendants in 11 percent of core federal filings, up from 8 percent in 2018. This increase is consistent with the higher numbers of Section 11 core federal filings.

Figure 9: Allegations Box Score—Core Federal Filings

	Percentage of Filings[1]				
	2015	2016	2017	2018	2019
Allegations in Core Federal Filings[2]					
Rule 10b-5 Claims	92%	94%	93%	86%	87%
Section 11 Claims	16%	12%	12%	10%	16%
Section 12(2) Claims	9%	6%	4%	10%	7%
Misrepresentations in Financial Documents	99%	99%	100%	95%	98%
False Forward-Looking Statements	53%	45%	46%	48%	47%
Trading by Company Insiders	16%	10%	3%	5%	5%
Accounting Violations[3]	38%	30%	22%	23%	23%
Announced Restatement[4]	12%	10%	6%	5%	8%
Internal Control Weaknesses[5]	26%	21%	14%	18%	18%
Announced Internal Control Weaknesses[6]	11%	7%	7%	7%	10%
Underwriter Defendant	12%	7%	8%	8%	11%
Auditor Defendant[7]	1%	2%	0%	0%	0%

Note:

1. The percentages do not add to 100 percent because complaints may include multiple allegations.
2. Core federal filings are all federal securities class actions excluding those defined as M&A filings.
3. First identified complaint (FIC) includes allegations of U.S. GAAP violations or violations of other reporting standards such as IFRS. In some cases, plaintiff(s) may not have expressly referenced accounting GAAP violations; however, the allegations, if true, would represent accounting GAAP violations.
4. FIC includes allegations of GAAP violations and refers to an announcement during or subsequent to the class period that the company will restate, may restate, or has unreliable financial statements.
5. FIC includes allegations of internal control weaknesses over financial reporting.
6. FIC includes allegations of internal control weaknesses and refers to an announcement during or subsequent to the class period that the company has internal control weaknesses over financial reporting.
7. In each of 2018 and 2019 there was one filing with allegations against an auditor defendant.

U.S. Exchange-Listed Companies

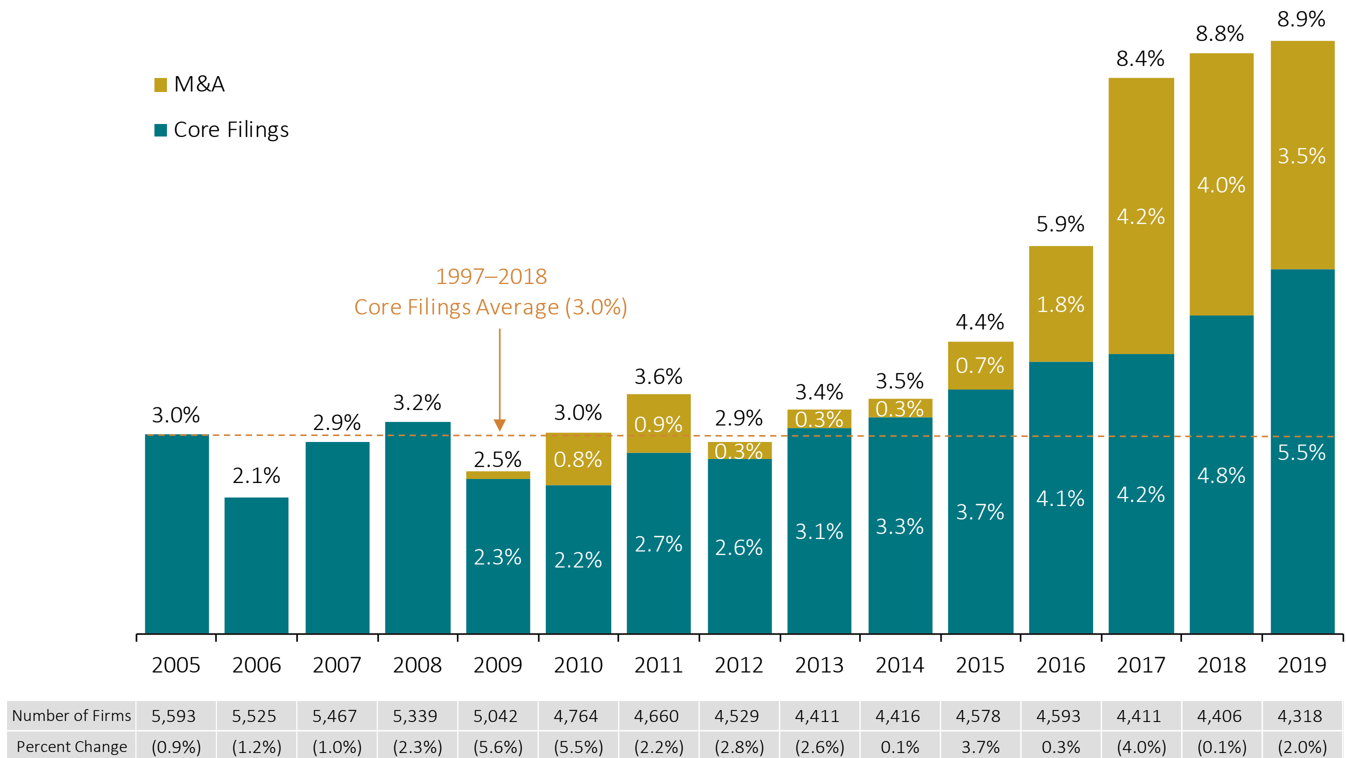
The percentages below are calculated as the unique number of companies listed on the NYSE or Nasdaq subject to federal or state securities fraud class actions in a given year divided by the unique number of companies listed on the NYSE or Nasdaq.

- The likelihood that U.S. exchange-listed companies were subject to core filings increased for a seventh consecutive year, from 2.6 percent in 2012 to 5.5 percent in 2019.
- Approximately one in 18 companies listed on U.S. exchanges was the subject of a core filing in 2019. See Appendix 1 for litigation likelihood from 1997 to 2019.

The likelihood of core filings targeting U.S. exchange-listed companies surpassed the previous record set in 2018, while M&A filings dropped to the lowest level since 2016.

- M&A filings decreased in 2019 to 3.5 percent, down from 4.0 percent in 2018.

Figure 10: Percentage of U.S. Exchange-Listed Companies Subject to Federal or State Filings 2005–2019



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Number of Firms	5,593	5,525	5,467	5,339	5,042	4,764	4,660	4,529	4,411	4,416	4,578	4,593	4,411	4,406	4,318
Percent Change	(0.9%)	(1.2%)	(1.0%)	(2.3%)	(5.6%)	(5.5%)	(2.2%)	(2.8%)	(2.6%)	0.1%	3.7%	0.3%	(4.0%)	(0.1%)	(2.0%)

Source: Securities Class Action Clearinghouse; Center for Research in Security Prices (CRSP)

Note:

1. Percentages are calculated by dividing the count of issuers listed on the NYSE or Nasdaq subject to filings by the number of companies listed on the NYSE or Nasdaq as of the beginning of the year.
2. Listed companies were identified by taking the count of listed securities at the beginning of each year and accounting for cross-listed companies or companies with more than one security traded on a given exchange. Securities were counted if they were classified as common stock or American Depository Receipts (ADRs) and listed on the NYSE or Nasdaq.
3. Percentages may not sum due to rounding.
4. This figure begins including issuers facing suits in state 1933 Act filings in 2010.

Heat Maps: S&P 500 Securities Litigation™ for Federal Filings

The Heat Maps illustrate federal court securities class action activity by industry sector for companies in the S&P 500 index. Starting with the composition of the S&P 500 at the beginning of each year, the Heat Maps examine each sector by:

(1) The percentage of these companies subject to new securities class actions in federal court during each calendar year.

(2) The percentage of the total market capitalization of these companies subject to new securities class actions in federal court during each calendar year.

- Of the companies in the S&P 500 at the beginning of 2019, approximately one in 14 companies (7.2 percent) was a defendant in a core federal filing during the year. See Appendix 2A for percentage of companies by sector from 2001 to 2019.

The likelihood of an S&P 500 company being sued declined after a decade high in 2018.

- The rate of core federal filings against Energy/Materials firms doubled from 2018 to 2019.
- The Consumer Staples, Industrials, Communication Services/Information Tech, and Utilities sectors continued to see higher likelihoods of core federal filings than prior to 2016, while rates in other sectors have plateaued or decreased.
- The percentage of companies in the Financials/Real Estate sector subject to core federal filings (2 percent) was 25 percent of the 2001–2018 average.

Figure 11: Heat Maps of S&P 500 Securities Litigation™ Percentage of Companies Subject to Core Federal Filings

	Average 2001–2018	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Consumer Discretionary	5.3%	5.1%	3.8%	4.9%	8.4%	1.2%	0.0%	3.6%	8.5%	10.0%	3.1%
Consumer Staples	3.4%	0.0%	2.4%	2.4%	0.0%	0.0%	5.0%	2.6%	2.7%	11.8%	12.1%
Energy/Materials	1.5%	4.3%	0.0%	2.7%	0.0%	1.3%	0.0%	4.5%	3.3%	1.8%	3.7%
Financials/Real Estate	8.0%	10.3%	1.2%	3.7%	0.0%	1.2%	1.2%	6.9%	3.3%	7.0%	2.0%
Health Care	8.8%	13.5%	2.0%	1.9%	5.7%	0.0%	1.9%	17.9%	8.3%	16.1%	12.9%
Industrials	3.8%	0.0%	1.7%	1.6%	0.0%	4.7%	0.0%	6.1%	8.7%	8.8%	10.1%
Communication Services / Information Tech	6.3%	2.4%	7.1%	3.8%	9.1%	0.0%	4.2%	6.8%	8.5%	12.7%	10.0%
Utilities	5.3%	0.0%	2.9%	0.0%	0.0%	0.0%	3.4%	3.4%	7.1%	7.1%	6.9%
All S&P 500 Companies	5.5%	4.8%	2.8%	3.0%	3.4%	1.2%	1.6%	6.6%	6.4%	9.4%	7.2%

Note:

1. The figure is based on the composition of the S&P 500 as of the last trading day of the previous year.
2. Sectors are based on the Global Industry Classification Standard (GICS).
3. Percentage of Companies Subject to New Filings equals the number of companies subject to new securities class action filings in federal courts in each sector divided by the total number of companies in that sector.
4. In August 2016, GICS added a new industry sector, Real Estate. This analysis begins using the Real Estate industry sector in 2017. In 2018, the Telecommunication Services sector was incorporated into a new sector, Communication Services.

- The percentage of total market capitalization of S&P 500 companies subject to core federal filings fell from 14.9 percent in 2018 to 10.0 percent in 2019. See Appendix 2B for market capitalization percentage by sector from 2001 to 2019.
- While the percentage of companies in the Energy/Materials sector subject to core federal filings more than doubled relative to 2018, the percentage of this sector's market capitalization subject to core federal filings fell 18 percent year-over-year.
- All sectors other than the Industrials and Utilities sectors saw a decrease in the percentage of market capitalization subject to core federal filings compared to 2018.

In six of the eight sectors, the percentage of market capitalization subject to core federal filings fell from the previous year.

Figure 12: Heat Maps of S&P 500 Securities Litigation™ Percentage of Market Capitalization Subject to Core Federal Filings

	Average 2001–2018	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Consumer Discretionary	5.2%	4.9%	4.6%	1.6%	4.4%	2.5%	0.0%	2.8%	8.2%	4.7%	0.5%
Consumer Staples	4.1%	0.0%	0.8%	14.0%	0.0%	0.0%	1.9%	1.0%	6.7%	15.2%	9.1%
Energy/Materials	2.9%	5.2%	0.0%	0.9%	0.0%	0.2%	0.0%	19.8%	2.3%	1.4%	1.2%
Financials/Real Estate	15.2%	31.1%	6.9%	11.0%	0.0%	0.3%	3.0%	11.9%	1.5%	12.5%	2.2%
Health Care	12.9%	32.7%	0.7%	0.8%	4.4%	0.0%	3.1%	13.2%	2.7%	26.3%	6.6%
Industrials	8.4%	0.0%	2.1%	1.2%	0.0%	1.7%	0.0%	8.7%	22.3%	19.4%	21.6%
Communication Services / Information Tech	9.5%	5.9%	13.4%	2.2%	16.6%	0.0%	7.0%	12.3%	4.4%	19.4%	18.0%
Utilities	6.0%	0.0%	0.6%	0.0%	0.0%	0.0%	3.7%	4.4%	9.6%	6.5%	7.9%
All S&P 500 Companies	8.9%	11.1%	5.0%	4.3%	4.7%	0.6%	2.8%	10.0%	6.1%	14.9%	10.0%

Note:

1. The figure is based on the composition of the S&P 500 as of the last trading day of the previous year.
2. Sectors are based on the Global Industry Classification Standard (GICS).
3. Percentage of Market Capitalization Subject to New Filings equals the market capitalization of companies subject to new securities class action filings in federal courts in each sector divided by the total market capitalization of companies in that sector.
4. In August 2016, GICS added a new industry sector, Real Estate. This analysis begins using the Real Estate industry sector in 2017. In 2018, the Telecommunication Services sector was incorporated into a new sector, Communication Services.

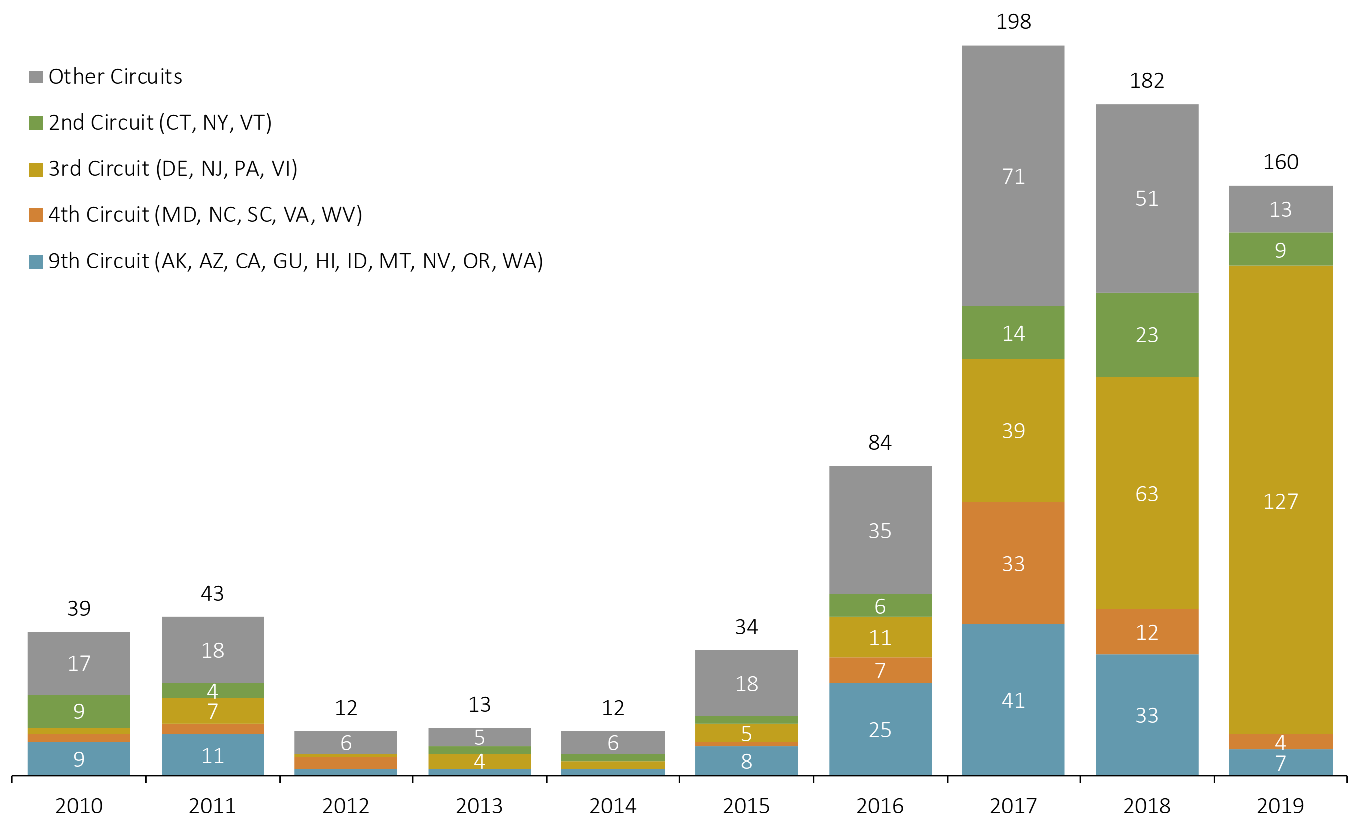
M&A Filings by Federal Circuit

In January 2016, the Delaware Court of Chancery rejected a disclosure-only settlement in Zillow's acquisition of Trulia.[1] This appears to have resulted in some venue shifting for merger-objection lawsuits from state to federal courts.

M&A filings were concentrated in the Third Circuit, where filings more than doubled.

- The number of M&A filings in the Third Circuit set a new record for the fourth consecutive year.
- The Third Circuit accounted for almost 80 percent of total M&A filings in 2019; all but one of these filings were brought in Delaware federal courts.
- The Fourth Circuit exhibited a 67 percent decline in M&A filings in 2019 for a two-year decline of 88 percent. M&A filings in the Ninth Circuit also declined nearly 80 percent from 2018 to 2019.

Figure 13: Annual M&A Filings by Federal Circuit
2010–2019



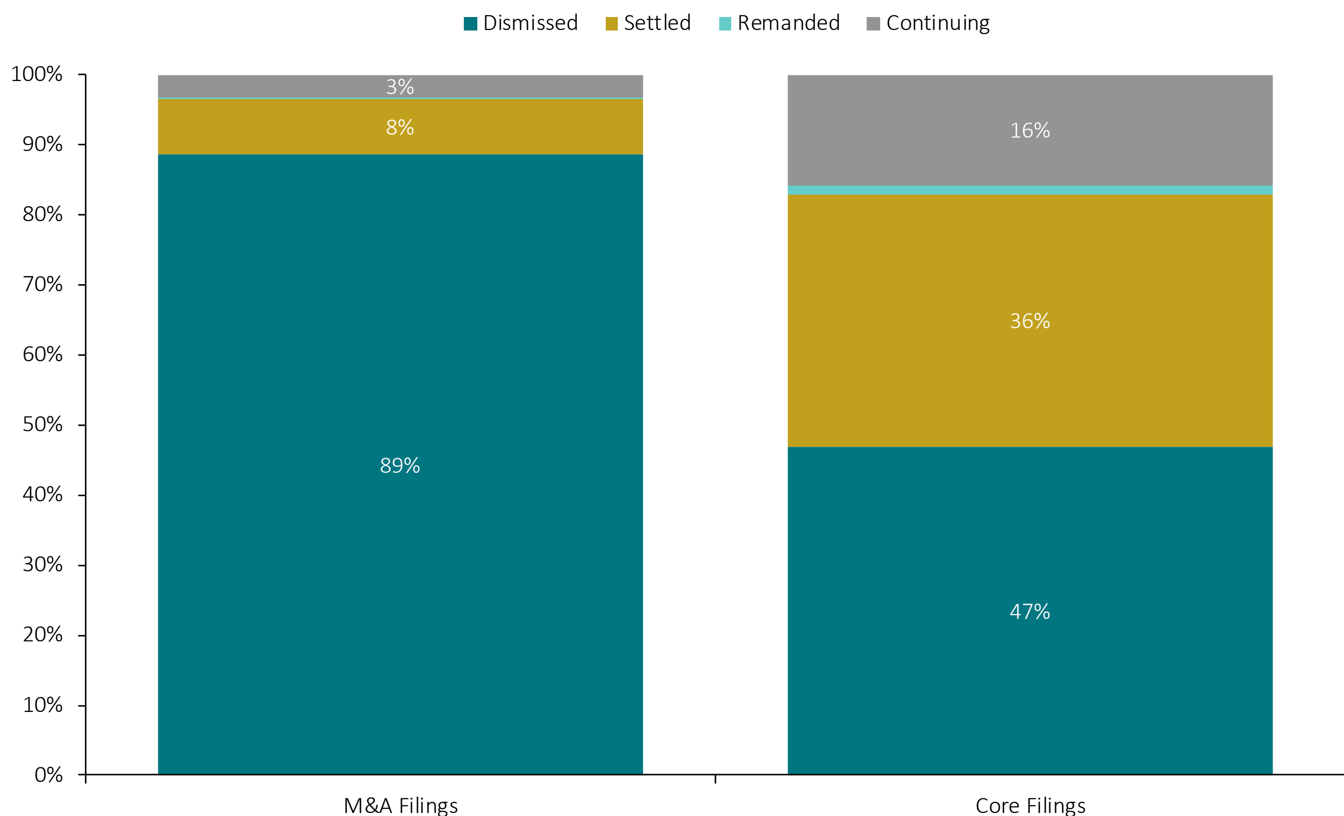
Note:
1. See http://courts.delaware.gov/opinions/download.aspx?ID=235370.
2. The Securities Class Action Clearinghouse began tracking M&A filings as a separate category in 2009.

Status of M&A Filings in Federal Courts

- There were 624 M&A filings between 2009 and 2018, compared to 1,679 core federal filings.
- M&A filings were dismissed at much higher rates and resolved more quickly than core federal filings.
- M&A filings exhibited settlement rates 28 percentage points below core federal filings. See Appendix 3 for a year-by-year overview of M&A and core filings status.

M&A filings were dismissed at a much higher rate and settled at a much lower rate than core federal filings.

Figure 14: Status of M&A Filings Compared to Core Federal Filings
2009–2018



Note:
1. The Securities Class Action Clearinghouse began tracking M&A filings as a separate category in 2009.
2. The 2019 filing cohort is excluded since a large percentage of cases are ongoing.

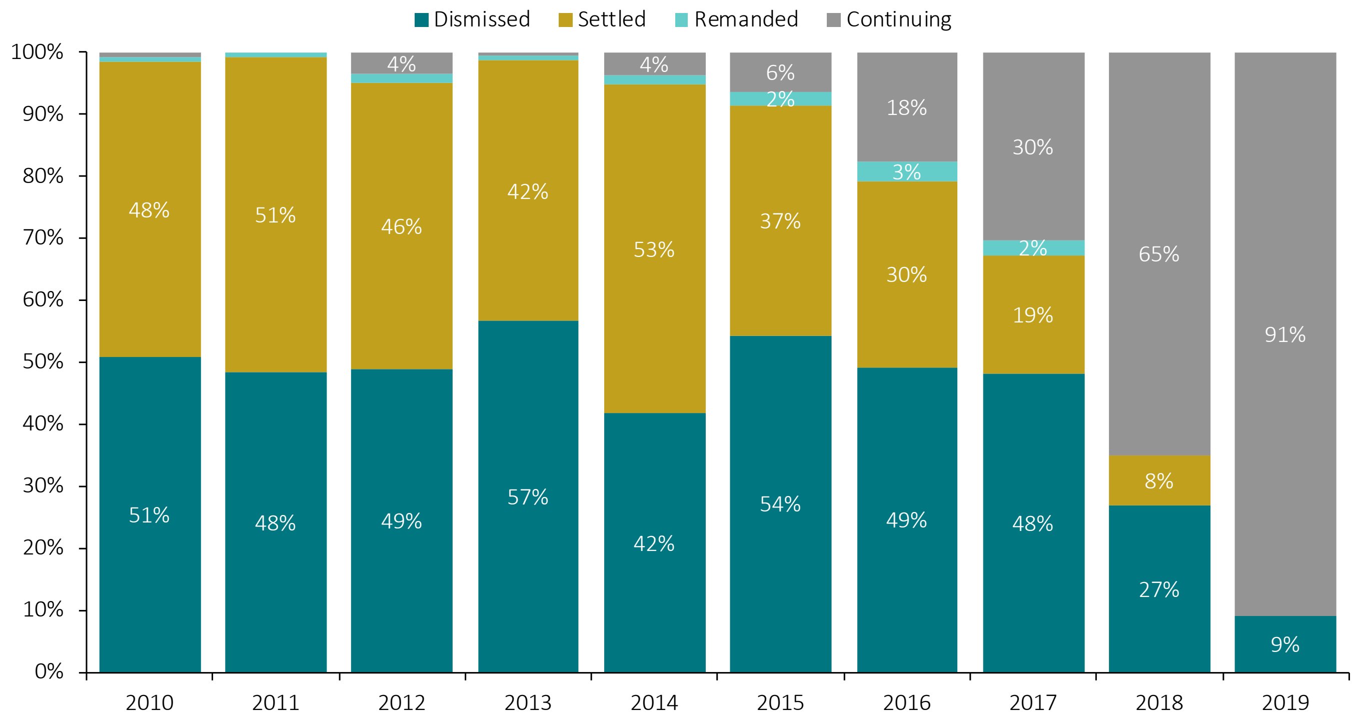
Status of Federal Securities Class Action Filings

This analysis compares filing groups to determine whether filing outcomes have changed over time. As each cohort ages, a larger percentage of filings are resolved—whether through dismissal, settlement, remand, or trial verdict.

The dismissal rate for the 2017 core federal filings cohort is currently nearly half of all cases, despite the fact that 30 percent of the cases are continuing.

- From 1997 to 2018, 49 percent of core federal filings were settled, 43 percent were dismissed, less than 1 percent were remanded, and 7 percent are continuing. Overall, less than 1 percent of core federal filings have reached a trial verdict.
- Recent annual dismissal rates have been closer to 50 percent. In the last 10 years the cohorts with the most divergent dismissal rates were 2014 (at 42 percent) and 2013 (at 57 percent).
- More recent cohorts have too many ongoing cases to determine their ultimate dismissal rates. However, the 2016 cohort will end up having a dismissal rate of at least 49 percent.

Figure 15: Status of Filings by Year—Core Federal Filings
2010–2019



Note: Percentages may not sum to 100 percent due to rounding.

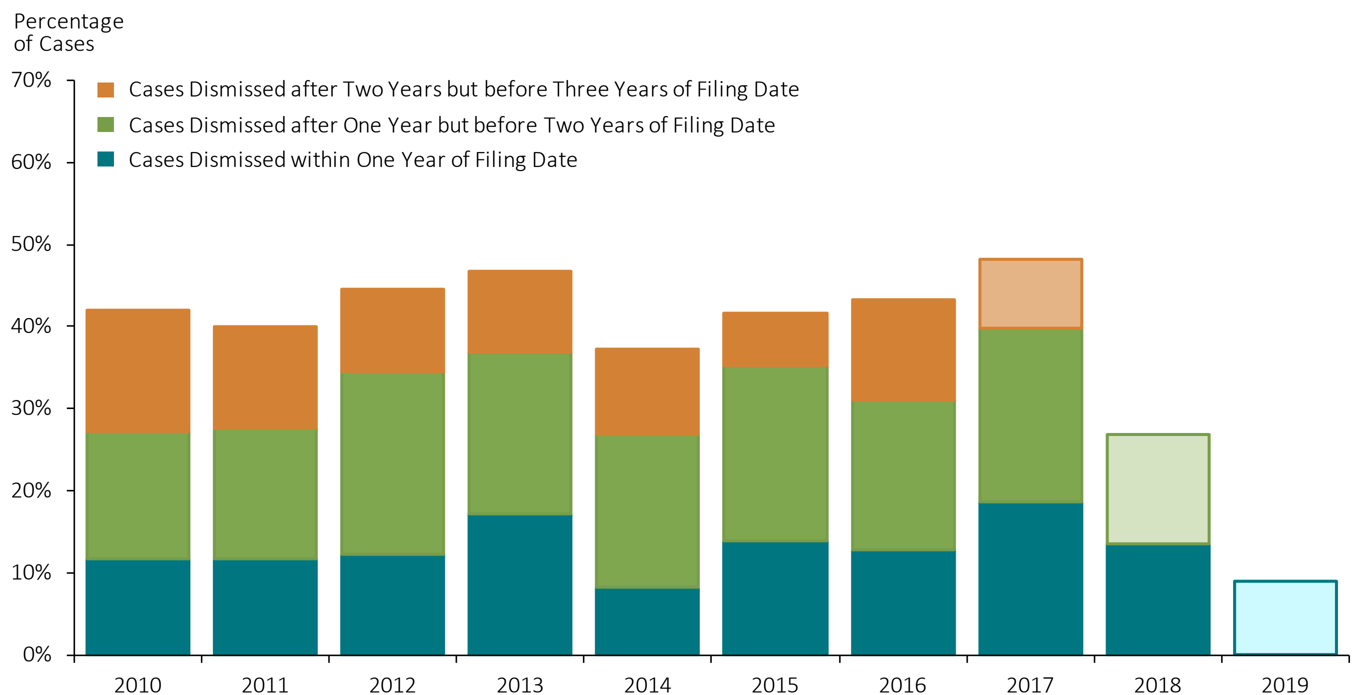
Timing of Dismissals of Federal Filings

Given the length of time that may exist between the filing of a class action and its outcome, it may not be possible to immediately determine whether trends in dismissal rates observed in earlier annual cohort years will persist in later annual cohorts. This analysis looks at dismissal trends within the first several years of the filing of a federal class action to gain insight on recent dismissal rates.

The percentage of core federal cases dismissed within the first three years for the 2017 cohort is the highest on record.

- While the percentage of core federal cases dismissed within three years of filing had generally increased for filing cohorts prior to 2013, it decreased for 2014 cohort filings before increasing again for 2015, 2016, and 2017 cohort filings.
- For 2017 cohort filings, three full years of observational history are not yet complete. Dismissal rates will therefore increase in 2020 as more 2017 core federal filings are resolved. See Appendix 4 for case status by year from 1997 to 2019.
- Early indications of the first-year dismissal rate for the 2019 cohort are inconclusive and do not reveal any obvious trends.

Figure 16: Percentage of Cases Dismissed within Three Years of Filing Date—Core Federal Filings
2010–2019



Note:

1. Percentage of cases in each category is calculated as the number of cases that were dismissed within one, two, or three years of the filing date divided by the total number of cases filed each year.

2. The outlined portions of the stacked bars for years 2017 through 2019 indicate the percentage of cases dismissed through the end of 2019. The outlined portions of these stacked bars therefore present only partial-year observed resolution activity, whereas their counterparts in earlier years show an entire year.

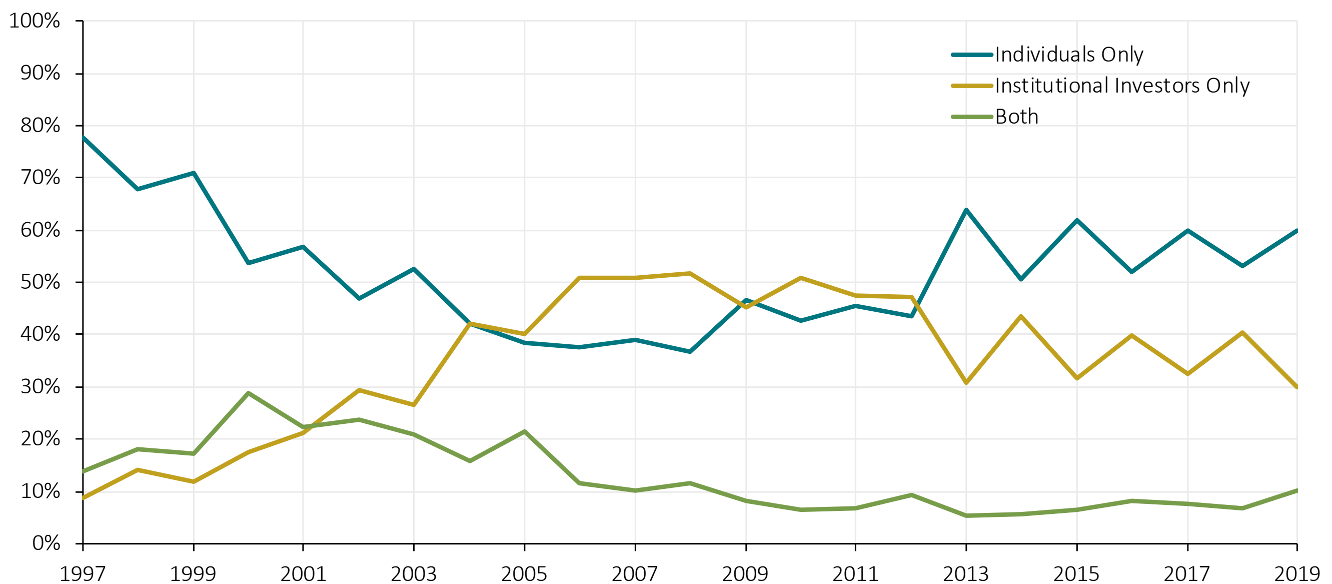
Federal Filings by Lead Plaintiff

This analysis examines how frequently individual or institutional investors were appointed as lead plaintiff in core federal filings.

- From 1997 to 2003, while individuals were appointed as lead plaintiff more often than institutional investors in core federal filings, the difference narrowed.
- From 2004 to 2012, institutional investors were generally as or more likely to be appointed lead plaintiff than were individuals.
- Starting in 2013, individuals were appointed as lead plaintiff more often than institutional investors. This suggests a shift in litigation strategies by some plaintiff law firms.
- Individuals were exclusively appointed as lead plaintiff in 60 percent of the core federal filings in 2019.

Individuals have been appointed as lead plaintiff more than institutional investors in each of the last seven years.

Figure 17: Percentage of Federal Class Action Filings by Lead Plaintiff—Core Federal Filings 1997–2019



Note:

1. Multiple plaintiffs can be designated as co-leads on a single case. This table separates percentages for which a case had only individuals as the lead/co-leads, institutional investors or investor groups as the lead/co-leads, or both individuals and institutional investors as the co-leads.

2. Cases may not have lead plaintiff data due to dismissal or settlement before a lead plaintiff is appointed or because the cases have not yet reached the stage when a lead plaintiff can be identified.

3. Lead plaintiff data are available for over 93 percent of core federal filings for each year from 1997 to 2018. Lead plaintiff data are available for 64 percent of 2019 core federal filings.

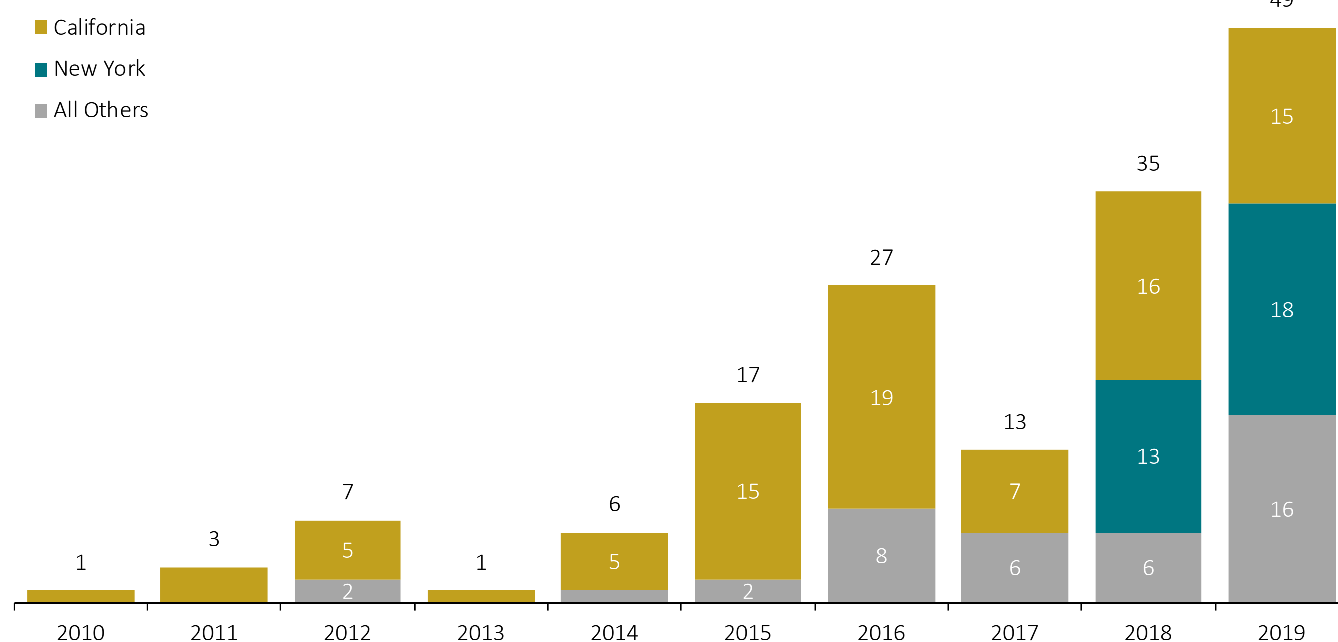
1933 Act Cases Filed in State Courts

The following data include 1933 Act filings in California, New York, and other state courts. The figure below illustrates all the filings currently in the dataset. Filings from prior years are added retrospectively when identified.

- In 2019, 15 class actions alleging violations of the 1933 Act were filed in California state courts, 18 were filed in New York state courts, and 16 were filed in other state courts. These filings may include Section 11, Section 12, and Section 15 claims, but do not include Rule 10b-5 claims.
- Since 2018, 81 percent of California state filings have involved companies headquartered in California and only 16 percent have involved non-U.S. companies. Conversely, in New York only 10 percent involved companies headquartered in New York and 42 percent involved non-U.S. companies.
- In 2019, filings in New York state courts overtook the number of filings in California state courts.
- State filings in states outside of New York and California almost tripled in 2019, from six filings in 2018 to 16 in 2019. These filings were in Florida, Illinois, Massachusetts, Michigan, Nevada, New Jersey, Pennsylvania, Rhode Island, Tennessee, Texas, and Wisconsin.

State 1933 Act filing activity continued to increase, driven largely by filings in state courts outside of New York and California.

Figure 18: State 1933 Act Filings by State
2010–2019



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; Institutional Shareholder Services' Securities Class Action Services (ISS' SCAS)

Note:

1. All others contains filings in Alabama, Arizona, Colorado, Florida, Georgia, Illinois, Iowa, Massachusetts, Michigan, Nevada, New Hampshire, New Jersey, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Washington, West Virginia, and Wisconsin.

2. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

1933 Act Cases Filed in State Courts—Size of Filings

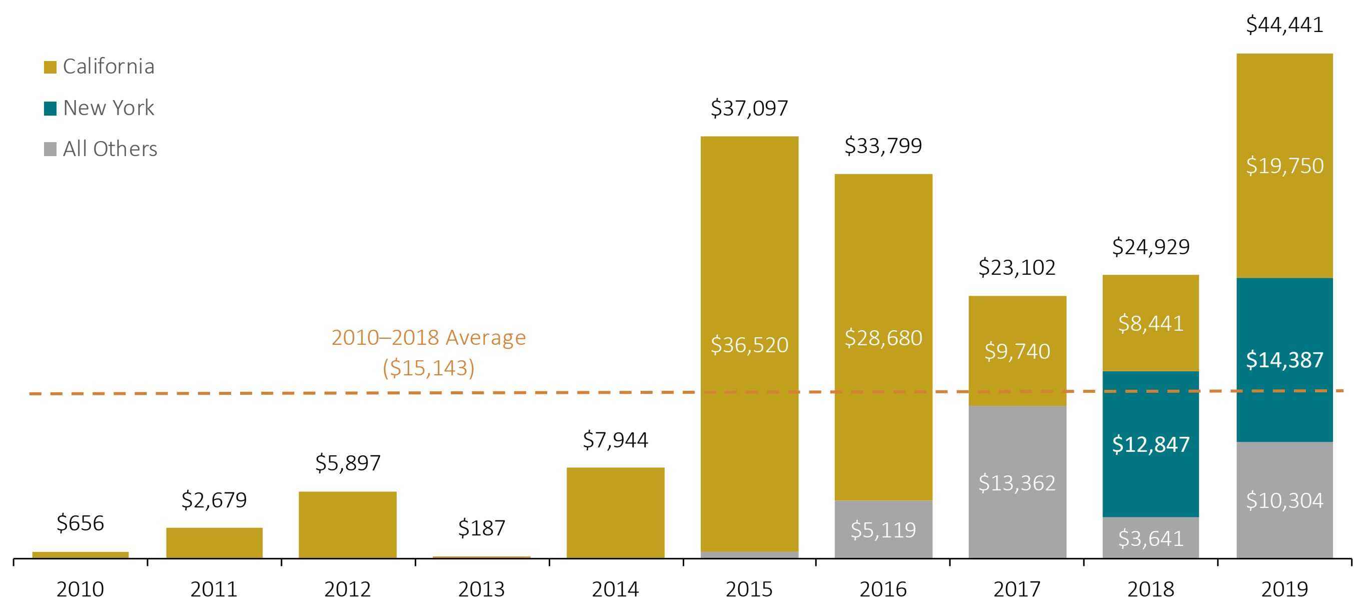
- In 2019, MDL for state 1933 Act filings increased to $44.4 billion, almost three times the 2010–2018 average.

California state 1933 Act filings made up nearly 45 percent of the MDL in 2019.

- Relative to 2018, MDL for all state 1933 Act filings increased by 78 percent compared to a 40 percent increase in the number of filings.
- MDL for California 1933 Act filings accounted for a significant share of MDL at $19.8 billion, or nearly 45 percent. Two companies with MDLs of around $6 billion each largely contributed to this total.

Figure 19: Maximum Dollar Loss (MDL) of State 1933 Act Filings 2010–2019

(Dollars in Millions)



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note: Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims. MDL calculations include all shares outstanding and not only shares traceable to offering materials. Therefore, these calculations overstate potential damages. MDL associated with filings related to a spin-off or merger-related issuance are excluded.

New: Dollar Loss on Offered Shares™ in Federal Section 11–Only Filings and 1933 Act Cases Filed in State Courts

This analysis calculates the loss of market value of class members' shares offered in securities issuances that are subject to 1933 Act claims. It is calculated as the shares offered at issuance (e.g., in an initial public offering (IPO), a seasoned equity offering (SEO), or a corporate merger or spin-off) acquired by class members multiplied by the difference between the offering price of the shares and their price at the end of the class period.

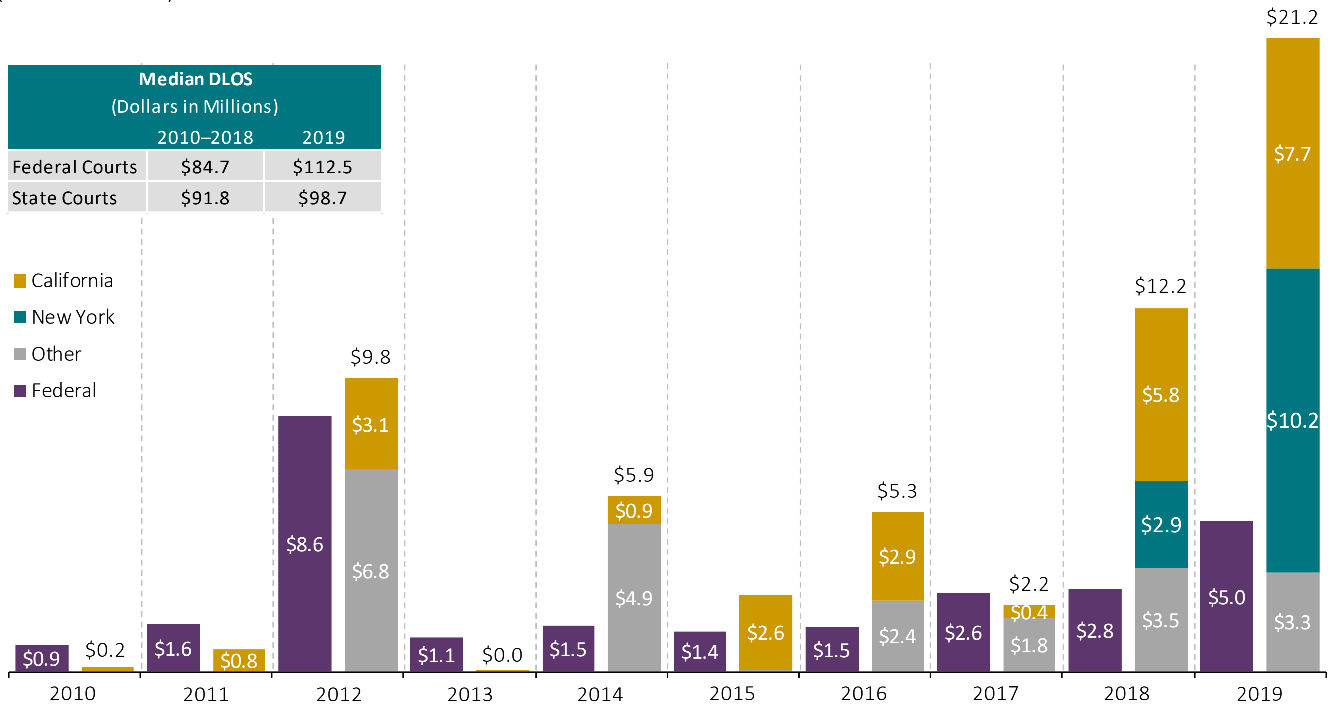
This alternative measure of losses has been calculated for federal filings involving only Section 11 claims (i.e., no Section 10b claims) and 1933 Act filings in state courts. This measure, Dollar Loss on Offered Shares (DLOS), aims to capture more precisely than MDL the dollar loss associated with the specific shares at issue as alleged in a complaint.

In 2019, the Dollar Loss on Offered Shares across state and federal courts was nearly four times the 2010–2018 average.

- DLOS in state courts has exceeded that in federal courts in five of the last six years.
- In 2019, state 1933 Act filings had the highest DLOS of the decade, regardless of venue.

Figure 20: Dollar Loss on Offered Shares™ for Federal Section 11–Only and State 1933 Act Filings 2010–2019

(Dollars in Billions)



Median DLOS (Dollars in Millions)	2010–2018	2019
Federal Courts	$84.7	$112.5
State Courts	$91.8	$98.7

Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS; CRSP; SEC EDGAR

Note: Federal filings included in this analysis must contain a Section 11 claim and may contain a Section 12 claim, but do not contain Section 10b claims. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

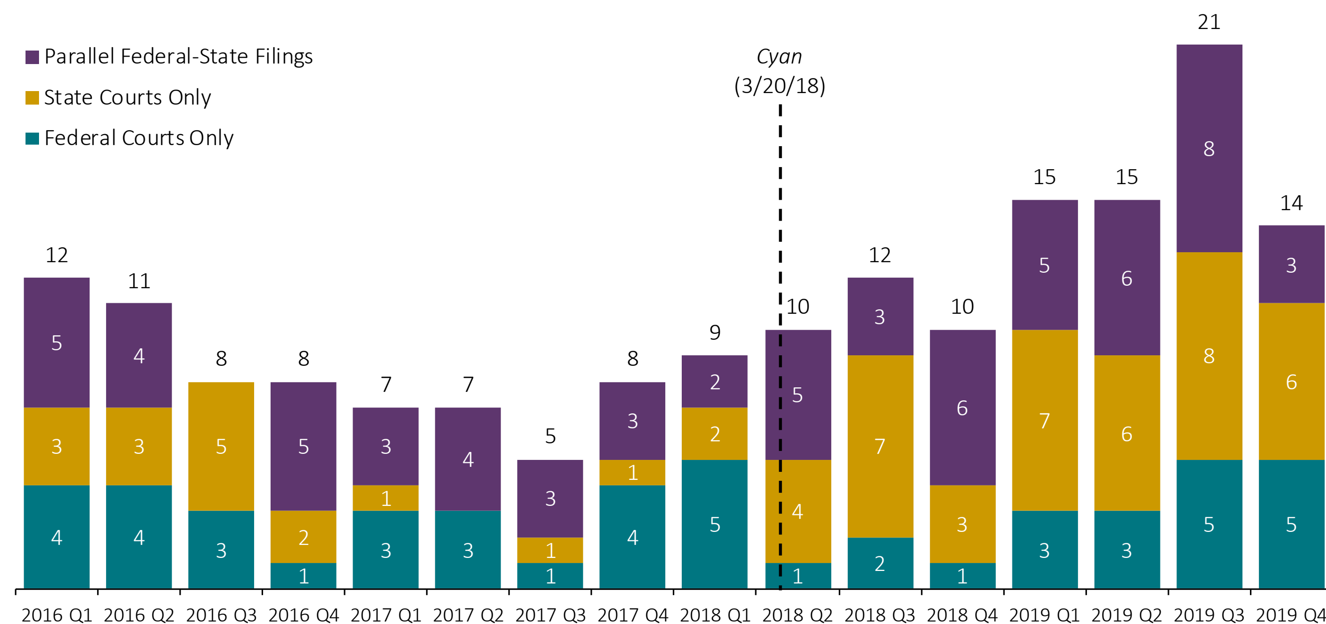
Comparison of Federal Section 11 Filings with State 1933 Act Filings—Pre- and Post-*Cyan*

The figure below is a combined measure of Section 11 filing activity in federal courts and 1933 Act filings in state courts. It highlights parallel (or related) class actions in federal and state courts.

- In 2019, the combined number of federal Section 11 filings and state 1933 Act filings was 65. This comprised 22 parallel filings, 27 state-only filings, and 16 federal-only filings.
- Overall, the 59 percent increase in these filings from 2018 can be attributed to increases in each category (i.e., parallel, state-only, and federal-only filings).
- The third quarter of 2019 had the largest quarterly number of combined federal Section 11 filings and state 1933 Act filings on record.
- While the increase in the aggregate number of federal Section 11 and state 1933 Act filings follows an increase in the number of IPOs (see p. 27), the change in the composition (federal vs. state) shows the effect of the *Cyan* decision.

State 1933 Act filings have continued to increase since the Cyan *decision, although new filing activity lessened in the fourth quarter relative to the peak in the third quarter of 2019.*

Figure 21: Pre- and Post-*Cyan* Quarterly Federal Section 11 and State 1933 Act Filings 2015–2019



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 filings displayed may include Rule 10b-5 claims, but state 1933 Act filings do not.

2. Section 11 filings in federal courts may include parallel (or related) cases filed in state courts. When these cases are filed in different quarters, the earliest filing is counted. If filings against the same company are brought in different states in addition to a filing brought in federal court, the parallel filing is counted as a unique case and the state-only filing is treated as a unique case. Filings against the same company brought in different states without a parallel filing brought in federal court are counted as unique state filings.

3. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

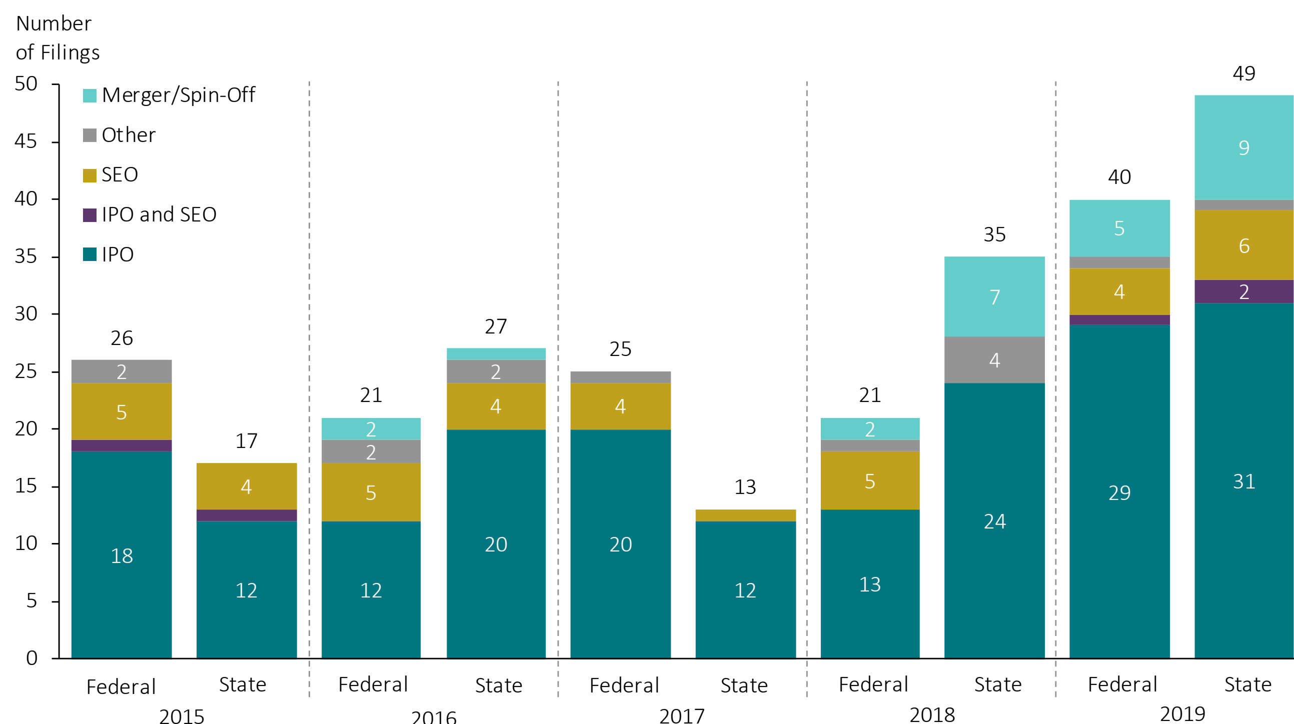
New: Type of Security Issuance Underlying Federal Section 11 and State 1933 Act Filings

The figure below illustrates Section 11 claims in federal courts and 1933 Act claims in state courts, based on the type of security issuance underlying the lawsuit.

Filings related to issuances due to mergers or spin-offs have accounted for more than 15 percent of all federal Section 11 and state 1933 Act filings since 2018.

- Filings related to issuances due to mergers or spin-offs have increased dramatically in the last two years, particularly in state courts. There were 14 such filings in 2019 across the federal and state venues, up from zero in 2017.
- There were three filings related to both an IPO and SEO in 2019—the first such filings since 2015.

Figure 22: Federal Section 11 and State 1933 Act Class Action Filings by Type of Security Issuance 2015–2019



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 data displayed may contain Rule 10b-5 claims, but state 1933 Act filings do not.
2. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.
3. There was one federal court filing in 2019 related to both a merger-related issuance and SEO. This analysis categorizes this filing as relating to a merger-related issuance to avoid double-counting.

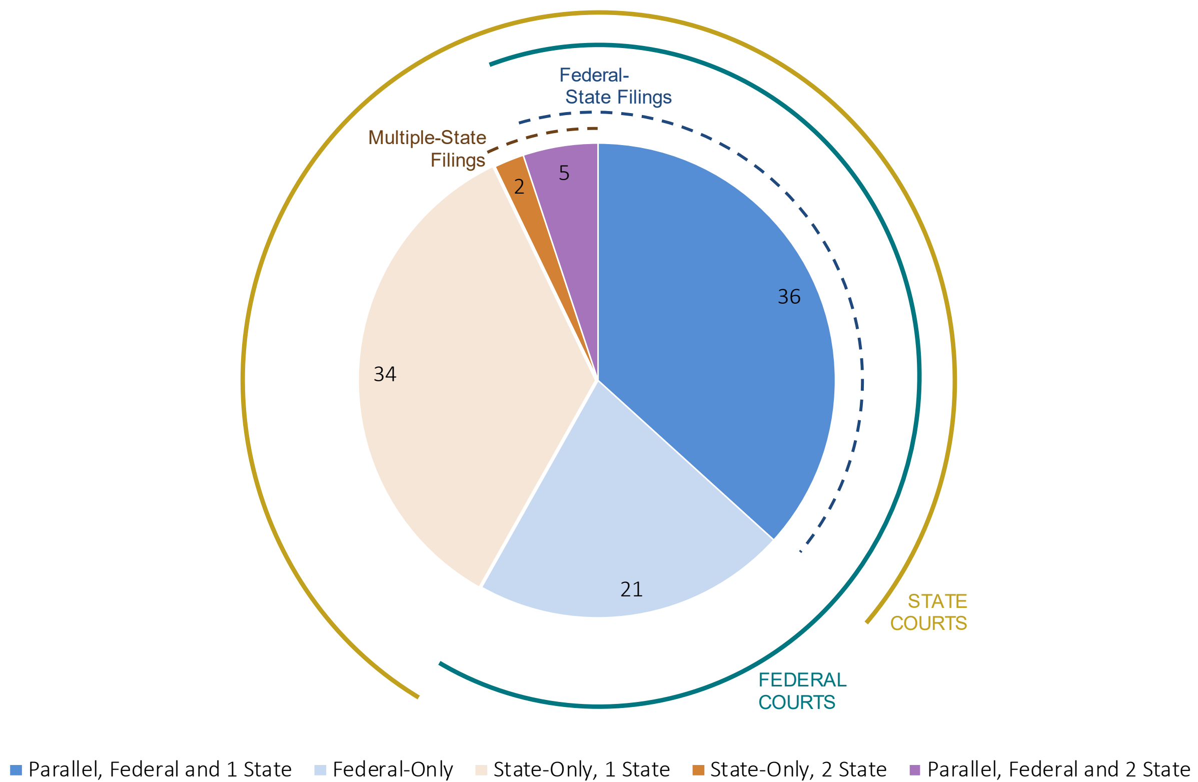
New: 1933 Act Filings by Venue—Post-*Cyan*

Parallel (or related) 1933 Act filings against the same issuer in different venues have increased post-*Cyan*. This figure presents the degree to which post-*Cyan* 1933 Act filings are being litigated in multiple jurisdictions at the same time. These parallel filings may be in federal and state courts (federal-state filings) or in different state courts (multiple-state filings).

Since the Cyan *ruling, 43 parallel class actions have been filed in multiple federal and state jurisdictions.*

- Multiple-state filings have increased post-*Cyan*. Between 2010 and 2018 there were only four companies facing multiple-state filings, whereas post-*Cyan* there have already been seven.
- As an example of post-*Cyan* jurisdictional complexities, in 2019 SmileDirectClub was the subject of securities class action filings in New York federal court, Tennessee federal court, Michigan federal court, Tennessee state court, and Michigan state court.
- Six of the seven companies facing multiple-state filings post-*Cyan* were sued in New York state courts.

Figure 23: Frequency of Federal Section 11 and State 1933 Act Class Action Filings by Venue—Post-*Cyan*



Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 data displayed may contain Rule 10b-5 claims, but state 1933 Act filings do not.
2. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.
3. Filings in state and federal courts may have related cases filed in other state courts or in federal court. In these instances, the later filing date was used in determining if the filing was post-*Cyan*. The U.S. Supreme Court ruled in March 2018 in *Cyan Inc. v. Beaver County Employees Retirement Fund*.

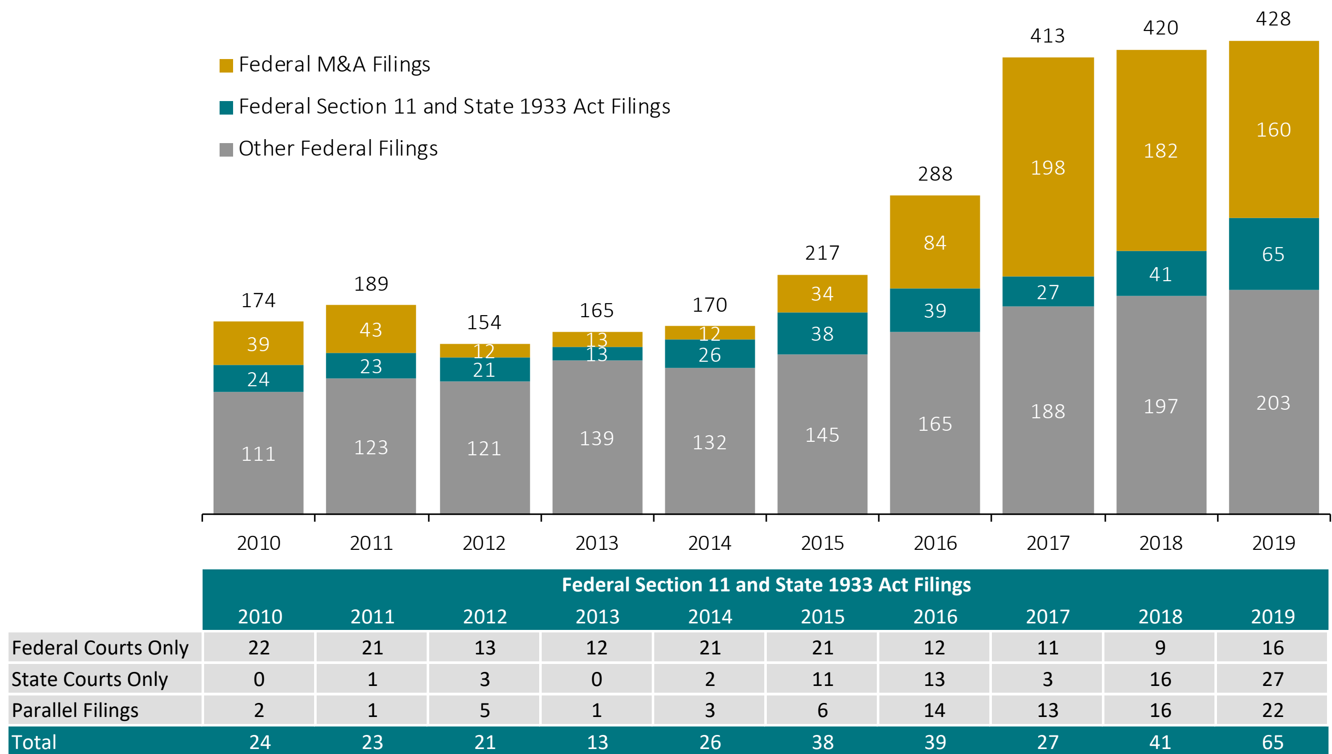
Combined Federal and State Filing Activity—Highlighting Federal Section 11 and State 1933 Act Filings

This analysis highlights federal Section 11 claims, state 1933 Act filings, and the extent to which parallel actions have been filed.

The 65 filings in federal and state courts alleging Section 11 and 1933 Act claims were a nearly 60 percent increase from 2018.

- Of the federal Section 11 and state 1933 Act filings, there were 27 state-only filings in 2019—a 69 percent increase from 2018.
- State-only and parallel filings made up over 75 percent of all federal Section 11 and state 1933 Act filings.
- The 65 filings in 2019 was historically unprecedented. Prior to 2015, there were only a handful of state court filings, and the highest number of federal Section 11 filings previously was 57 in 1998.

Figure 24: Federal Section 11 and State 1933 Act Class Action Filings by Venue 2010–2019



	Federal Section 11 and State 1933 Act Filings									
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Federal Courts Only	22	21	13	12	21	21	12	11	9	16
State Courts Only	0	1	3	0	2	11	13	3	16	27
Parallel Filings	2	1	5	1	3	6	14	13	16	22
Total	24	23	21	13	26	38	39	27	41	65

Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS

Note:

1. The federal Section 11 data displayed may contain Rule 10b-5 claims, but state 1933 Act filings do not.
2. Section 11 filings in federal courts may include parallel (or related) cases filed in state courts. When these cases are filed in different years, the earliest filing is counted. If filings against the same company are brought in different states in addition to a filing brought in federal court, the parallel filing is counted as a unique case and the state-only filing is treated as a unique case. Filings against the same company brought in different states without a parallel filing brought in federal court are counted as unique state filings.
3. Beginning in 2018, California state filings may contain either Section 11 or Section 12 claims. Of the 16 filings in California in 2018, six filings contained Section 12 claims without also containing Section 11 claims.

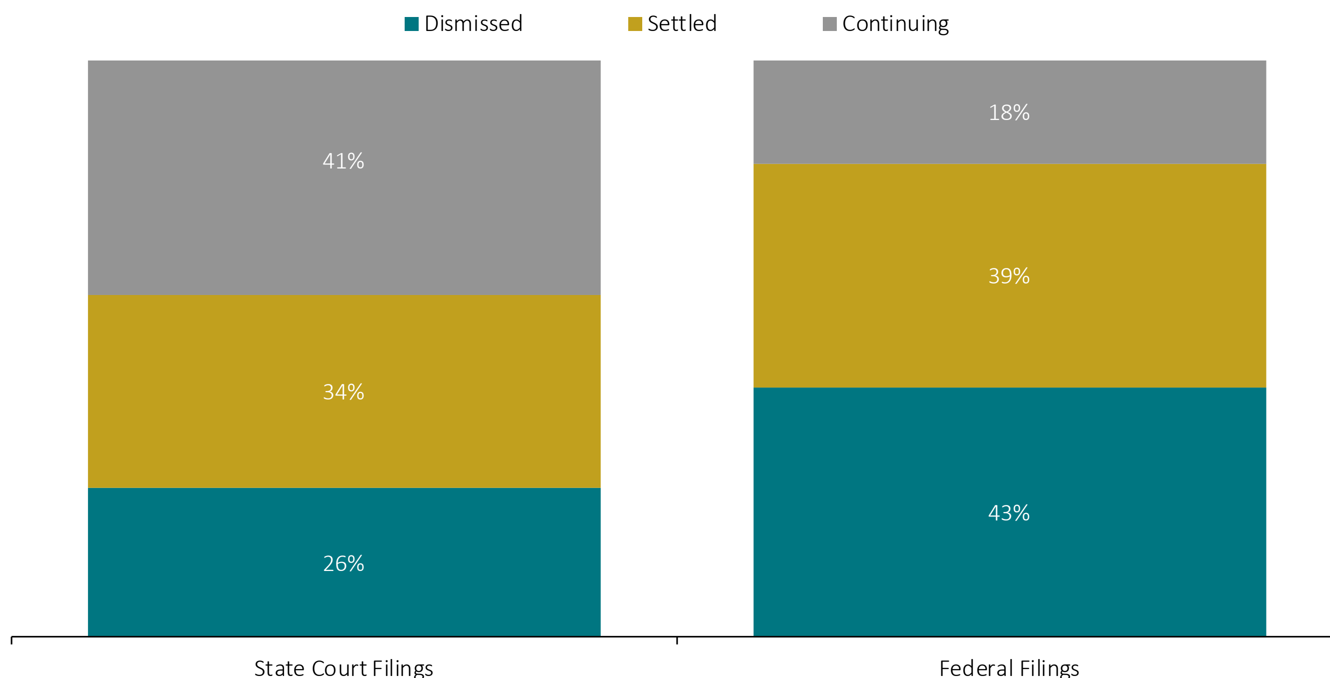
Section 11 Cases Filed in State Courts—Case Status

This figure compares the outcomes of state Section 11 filings to federal filings that assert Section 11 claims but no Rule 10b-5 claims.

A smaller portion of Section 11–only cases in 2010–2018 were dismissed in state courts compared to federal courts.

- A higher percentage of state Section 11 filings are continuing compared to Section 11–only federal filings. See Appendix 5 for a year-by-year overview.
- Only 26 percent of state Section 11 filings were dismissed in 2010–2018 compared to 43 percent of Section 11–only federal filings.

Figure 25: Resolution of State Section 11 Filings Compared with Section 11–Only Federal Filings
2010–2018



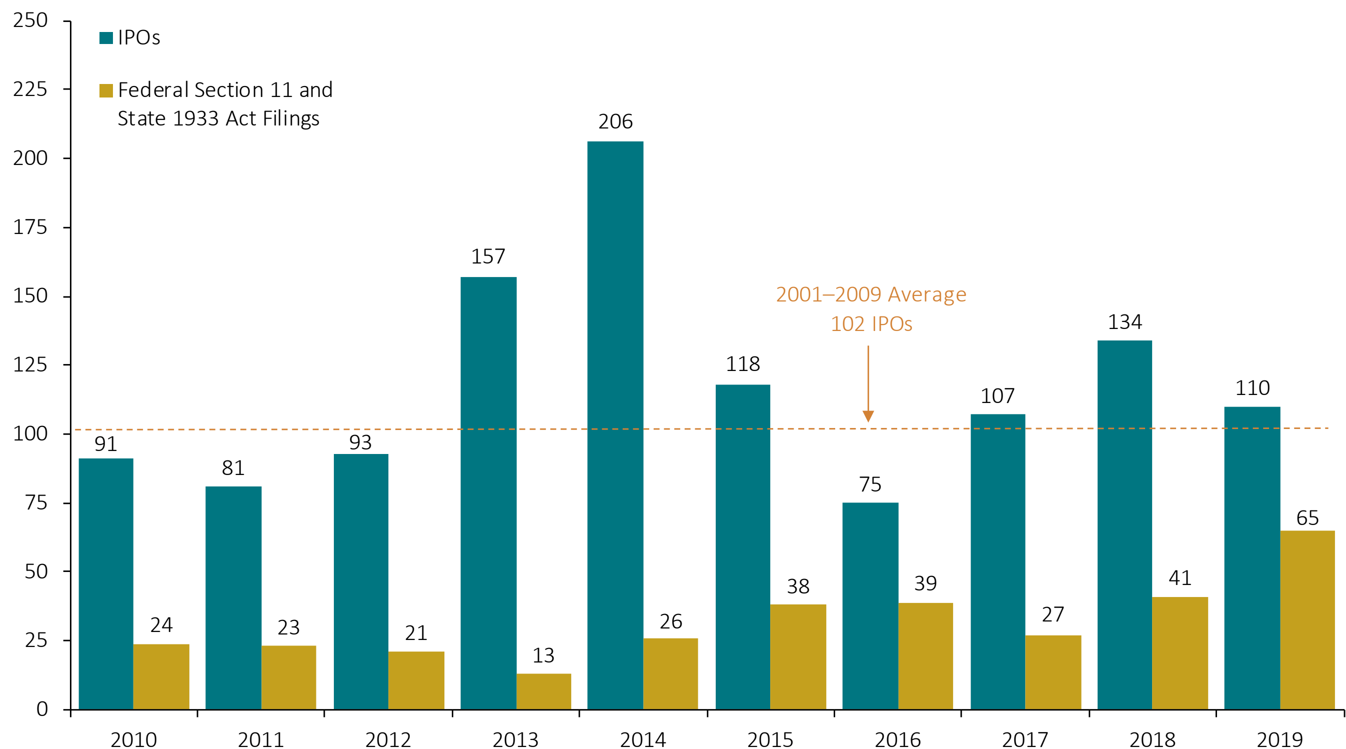
Source: Stanford Law School and Securities Class Action Clearinghouse; Bloomberg Law; ISS' SCAS
Note:
1. The 2019 filing cohort is excluded since a large percentage of cases are ongoing.
2. If a matter is remanded from federal court to a state court, it is recorded in the state court column based on its state court disposition. Alternatively, if a matter is removed from a state court to federal court, it is recorded in the federal court column based on its federal court disposition.
3. Figures may not sum to 100 percent due to rounding.

IPO Activity and Federal Section 11 and State 1933 Act Filings

- IPO activity decreased 18 percent from 2018 to 2019.
- With 110 IPOs, 2019 IPO activity was just above the 2001–2009 average of 102 IPOs per year.
- Heavier IPO activity appears to be correlated with increased levels of federal Section 11 and state 1933 Act filings in the ensuing years. Assuming that remains true, it is likely that Section 11 filing activity will increase in 2020 relative to 2019 due to the deferred effects of increased IPO activity in 2017, 2018, and 2019, as well as plaintiffs' increasing inclination to test state venues to bring 1933 Act filings.

IPO activity fell in 2019 after two consecutive years of growth, while filings with 1933 Act claims continued to rise.

Figure 26: Number of IPOs on Major U.S. Exchanges and Number of Filings of Federal Section 11 and State 1933 Act Claims 2010–2019



Source: Jay R. Ritter, "Initial Public Offerings: Updated Statistics," University of Florida, January 10, 2020

Note:

1. These data exclude the following IPOs: those with an offer price of less than $5, American Depository Receipts (ADRs), unit offers, closed-end funds, real estate investment trusts (REITs), natural resource limited partnerships, small best efforts offers, banks and S&Ls, and stocks not listed in the Center for Research in Security Prices (CRSP) database.

2. The number of federal Section 11 and state 1933 Act cases is displayed. In 2018, the Securities Class Action Clearinghouse began tracking 1933 Act filings in California state courts with Section 11 or Section 12 claims, as well as filings in other state courts with Section 11 claims. The federal Section 11 cases displayed may include Rule 10b-5 claims, but state 1933 Act filings do not.

IPO Litigation Likelihood

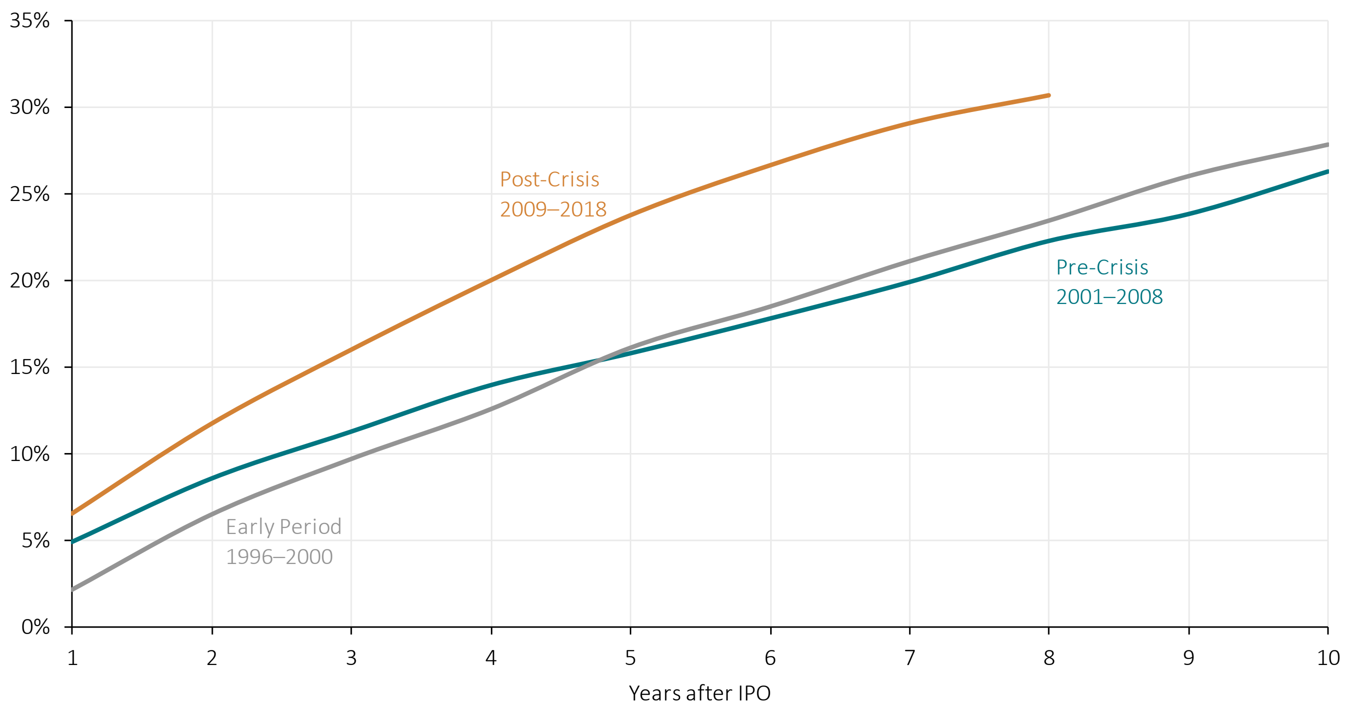
This figure compares the cumulative litigation exposure of IPOs to core federal and state 1933 Act filings since the 2008 credit crisis (post-crisis: 2009–2018) with two other groups of IPOs—core federal filings prior to the credit crisis (pre-crisis: 2001–2008) and prior to the dot-com collapse (early period: 1996–2000). The 1933 Act filings that are exclusively in the state courts enter into this analysis beginning in 2010.

- Post-crisis IPOs have faced higher litigation exposure in the first few years after an offering than IPOs in prior periods—for example, 20.0 percent of post-crisis IPOs have been subject to a core filing within four years of the IPO, compared to 14.0 percent for the pre-crisis cohort and 12.6 percent for the early period cohort.

IPOs from 2009 through 2018 have been subject to litigation at a steadily higher rate than earlier cohorts in the years after the IPO.

- For each IPO grouping, the incremental litigation exposure generally decreased with each year further removed from the IPO. See Appendix 6 for incremental exposure litigation values.

Figure 27: Likelihood of Litigation against Recent IPOs—Core Filings
2009–2018 IPOs versus Prior-Period IPOs



Source: Jay R. Ritter, "Founding Dates for Firms Going Public in the U.S. during 1975–2018," University of Florida, March 2019; CRSP

Note:

1. Cumulative litigation exposure measures the probability that a surviving company will be a defendant in at least one securities class action during the analysis period. For a detailed explanation about the methodology, see Cornerstone Research, *Securities Class Action Filings—2014 Midyear Assessment* (page 10 and Appendix 3).
2. The post-crisis IPO cumulative litigation exposure is not presented for 9–10 years after the IPO due to limited data for cohorts with an IPO date toward the end of this period.
3. State 1933 Act filings enter into this analysis beginning in 2010.

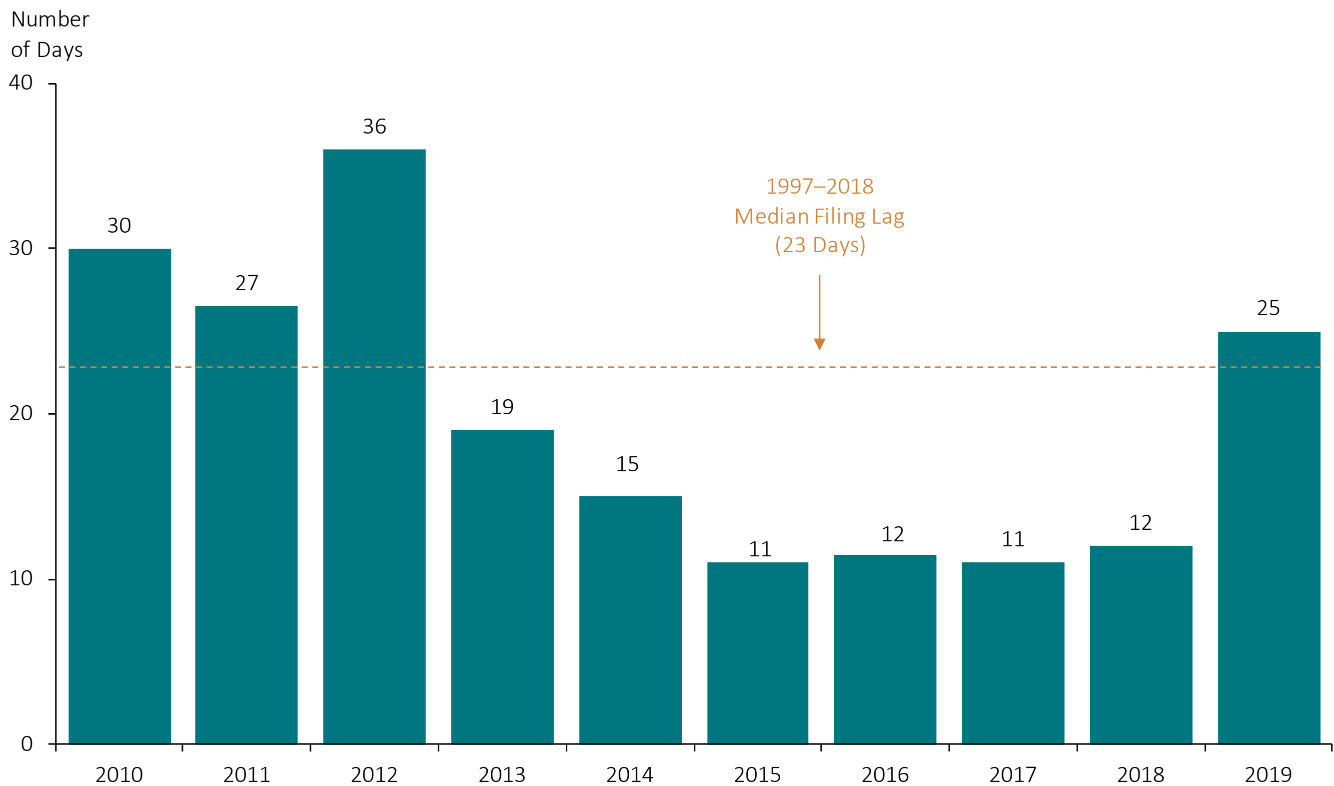
Federal Filing Lag

This analysis reviews the number of days between the end of the class period and the filing date of a core federal securities class action.

- The median filing lag in 2019 jumped to 25 days, which is slightly above the historical median value.
- In the four previous years, the median lag fluctuated between 11 and 12 days.
- Among the three plaintiff law firms discussed on pages 39–40, the median filing lag nearly doubled since 2018, growing from eight days to 15 days. Outside of this plaintiff group, median filing lag increased from 34 days to 72 days.

Filing lag more than doubled from 12 days in 2018 to 25 days in 2019, the highest since 2012.

Figure 28: Annual Median Lag between Class Period End Date and Filing Date—Core Federal Filings 2010–2019



Note: This analysis excludes filings with only Section 11 claims and ICO- or cryptocurrency-related filings because there is often no specified end of the class period.

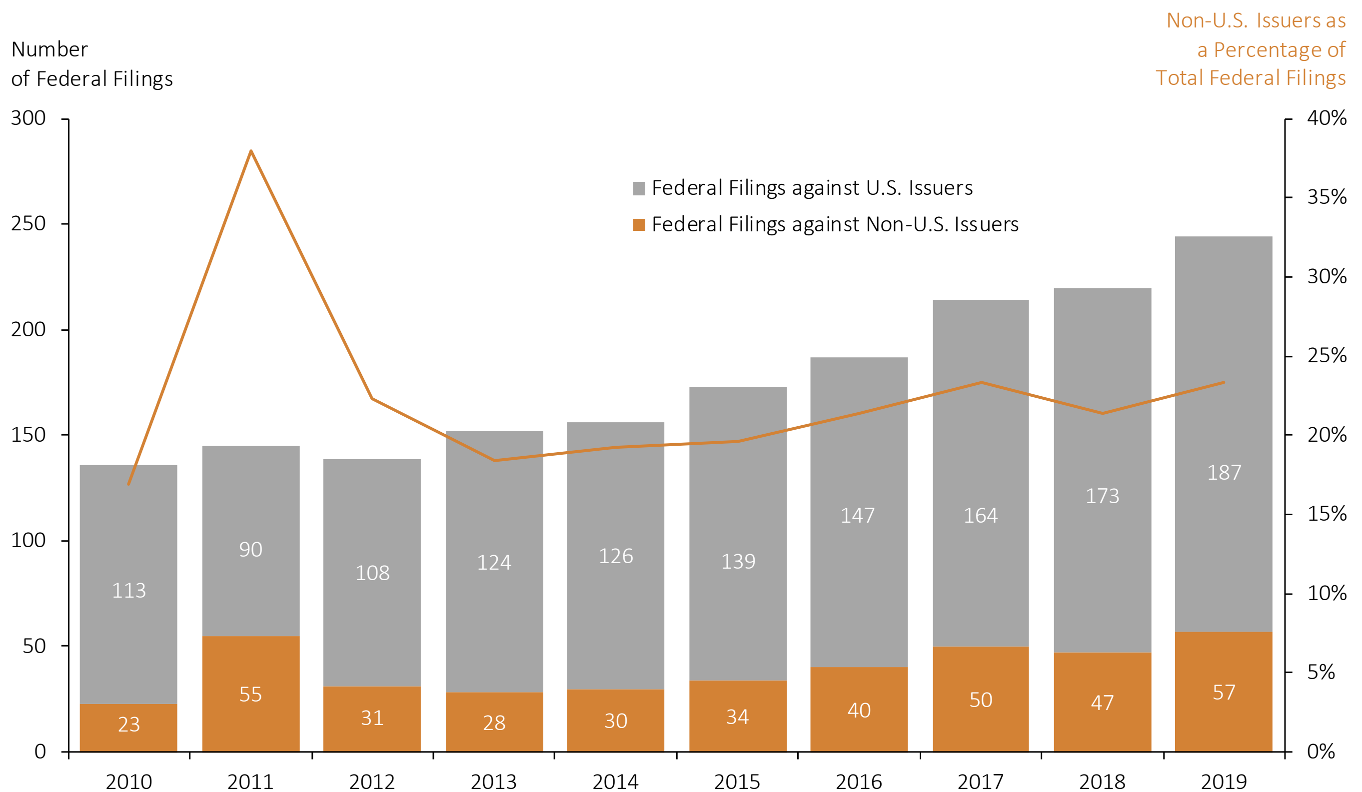
Non-U.S. Federal Filings

This index tracks the number of core federal filings against companies headquartered outside the United States relative to total core federal filings.

- The number of core federal filings against non-U.S. issuers increased to 57, the highest on record.
- As a percentage of total core federal filings, core federal filings against non-U.S. issuers increased to 23.4 percent, the second highest since 2011 and the third highest overall.

The number of filings against non-U.S. issuers as a percentage of total filings has generally been trending upwards over the last decade.

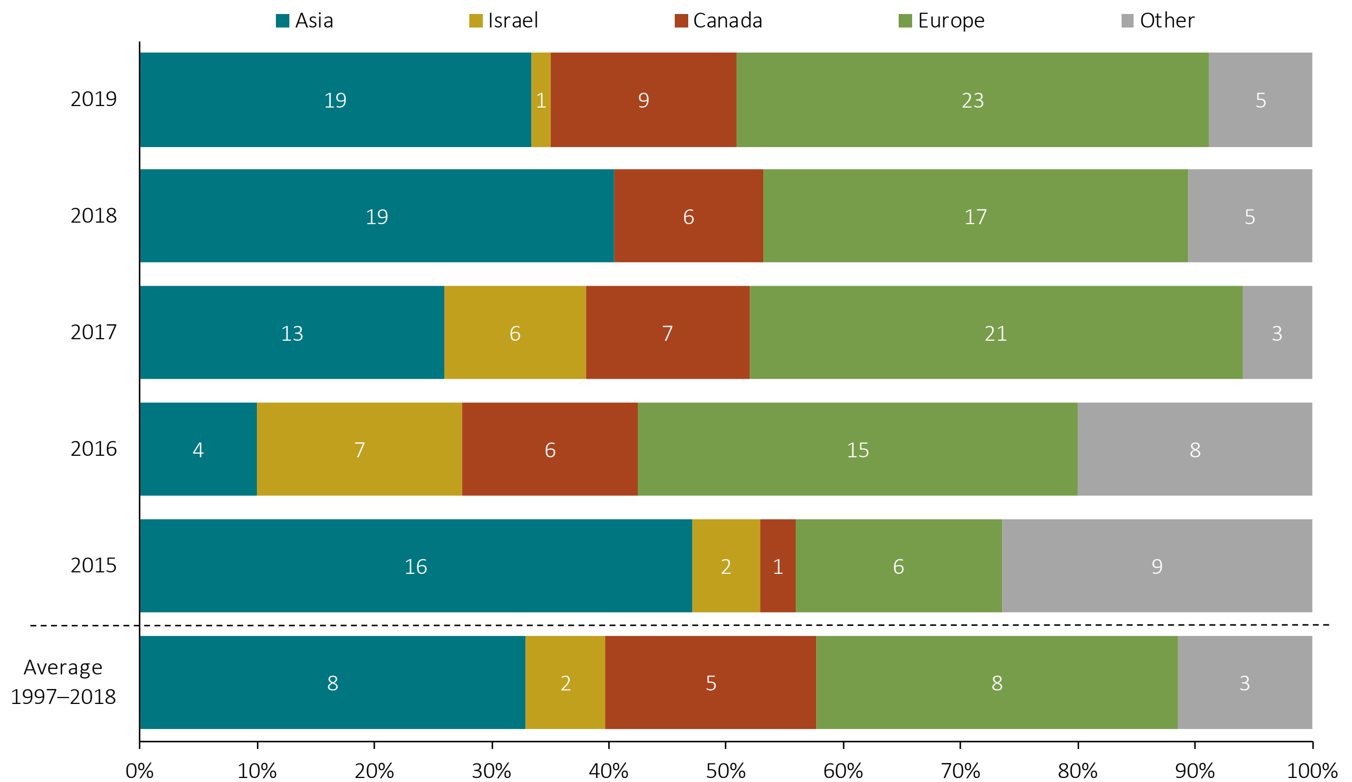
Figure 29: Annual Number of Class Action Filings by Location of Headquarters—Core Federal Filings
2010–2019



- There were nine core federal filings against Canadian firms, the highest since 1998. Of these, six involved cannabis- or CBD-related companies.
- Of the 23 core federal filings against European firms, nine were against firms headquartered in the United Kingdom. No other European country had more than three core federal filings against companies headquartered there.
- Of the 19 core federal filings against Asian firms, 17 involved Chinese firms. The remaining two involved a Taiwanese firm and an Indian firm.
- Of the 17 core federal filings against companies headquartered in China, 10 were against firms in the Communications sector, accounting for roughly 27 percent of core federal filings in that sector. See page 36.

The number of filings against European firms was the highest on record.

Figure 30: Non-U.S. Filings by Location of Headquarters—Core Federal Filings



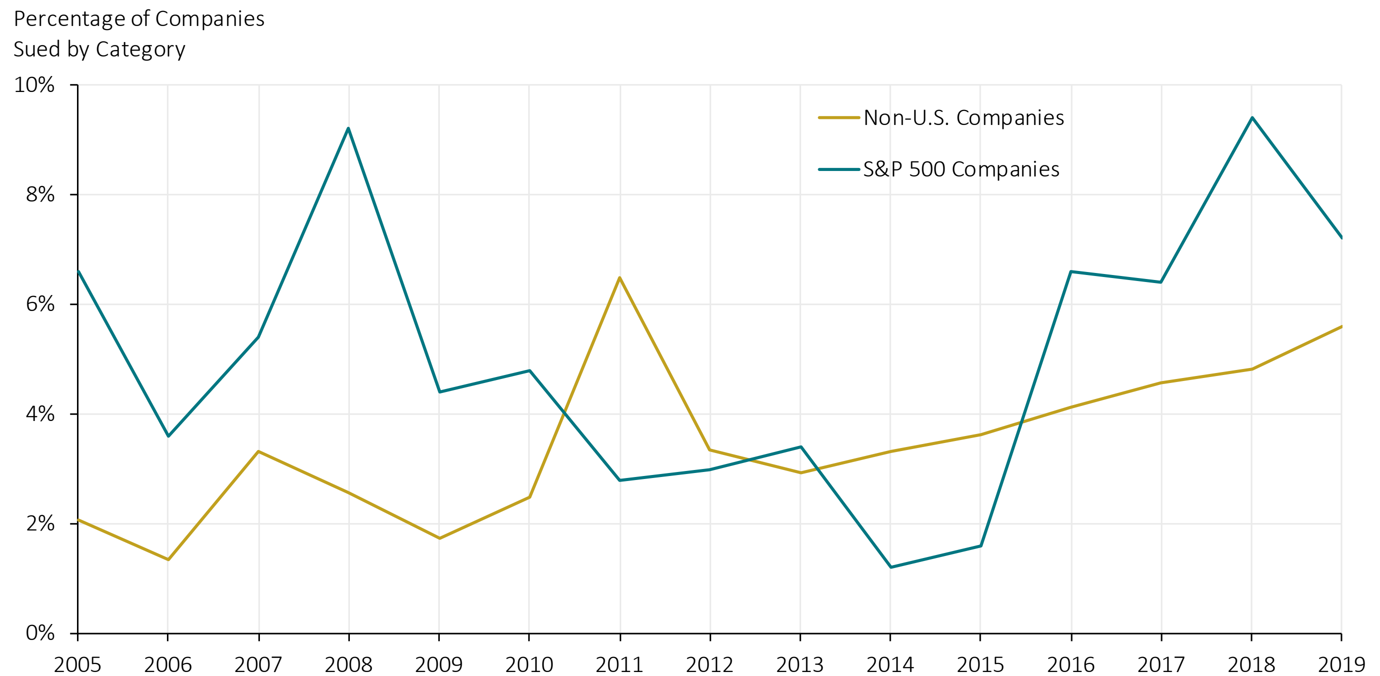
Non-U.S. Company Litigation Likelihood of Federal Filings

This figure examines the incidence of non-U.S. core federal filings relative to the likelihood of S&P 500 companies being the subject of a class action.

The percentage of S&P 500 companies sued dropped to 7.2 percent, reducing the gap between them and non-U.S. companies to 1.6 percentage points.

- For the sixth consecutive year, in 2019 the percentages of non-U.S. companies subject to core federal filings increased. For the past three years, the likelihood of a non-U.S. company being subject to a core federal filing has increased at roughly the same rate as all U.S. exchange-listed companies (see Figure 10).

Figure 31: Percentage of Companies Sued by Listing Category or Domicile—Core Federal Filings
2005–2019



Source: CRSP; Yahoo Finance

Note:

1. Non-U.S. companies are defined as companies with headquarters outside the United States, Puerto Rico, and Virgin Islands. Companies were counted if they issue common stock or ADRs and are listed on the NYSE or Nasdaq.
2. Percentage of companies sued is calculated as the number of filings against unique companies in each category divided by the total number of companies in each category in a given year.

Mega Federal Filings

Mega DDL filings have a DDL of at least $5 billion. Mega MDL filings have an MDL of at least $10 billion. MDL and DDL are only presented for core federal filings.

- In 2019, eight mega DDL filings accounted for $147 billion of federal DDL.
- Mega DDL in 2019 accounted for 52 percent of total federal DDL, close to the 1997–2018 average of 54 percent but well below the 2018 figure of 64 percent.
- There were 21 mega MDL filings in 2019 with a total federal MDL of $837 billion, a noticeable decrease from 2018.
- Although the mega MDL and DDL indices decreased both in the number of filings and in the associated dollar amounts, their share of overall federal MDL and DDL remained very close to the respective historical averages.
- Of the 21 mega MDL filings, pharmaceutical, technology, and communications companies were the most common defendants, with five, four, and four filings respectively.

The number of mega DDL and MDL filings decreased significantly.

Figure 32: Mega Filings—Core Federal Filings

(Dollars in Billions)

	Average 1997–2018	2017	2018	2019
Mega Disclosure Dollar Loss (DDL) Filings[1]				
Mega DDL Filings	6	7	17	8
DDL for Mega Core Federal Filings	$70	$47	$212	$147
Percentage of Total Federal DDL	54%	36%	64%	52%
Mega Maximum Dollar Loss (MDL) Filings[2]				
Mega MDL Filings	13	14	27	21
MDL for Mega Core Federal Filings	$445	$253	$963	$837
Percentage of Total Federal MDL	70%	49%	73%	71%

Note:

1. Mega DDL filings have a disclosure dollar loss of at least $5 billion.
2. Mega MDL filings have a maximum dollar loss of at least $10 billion.

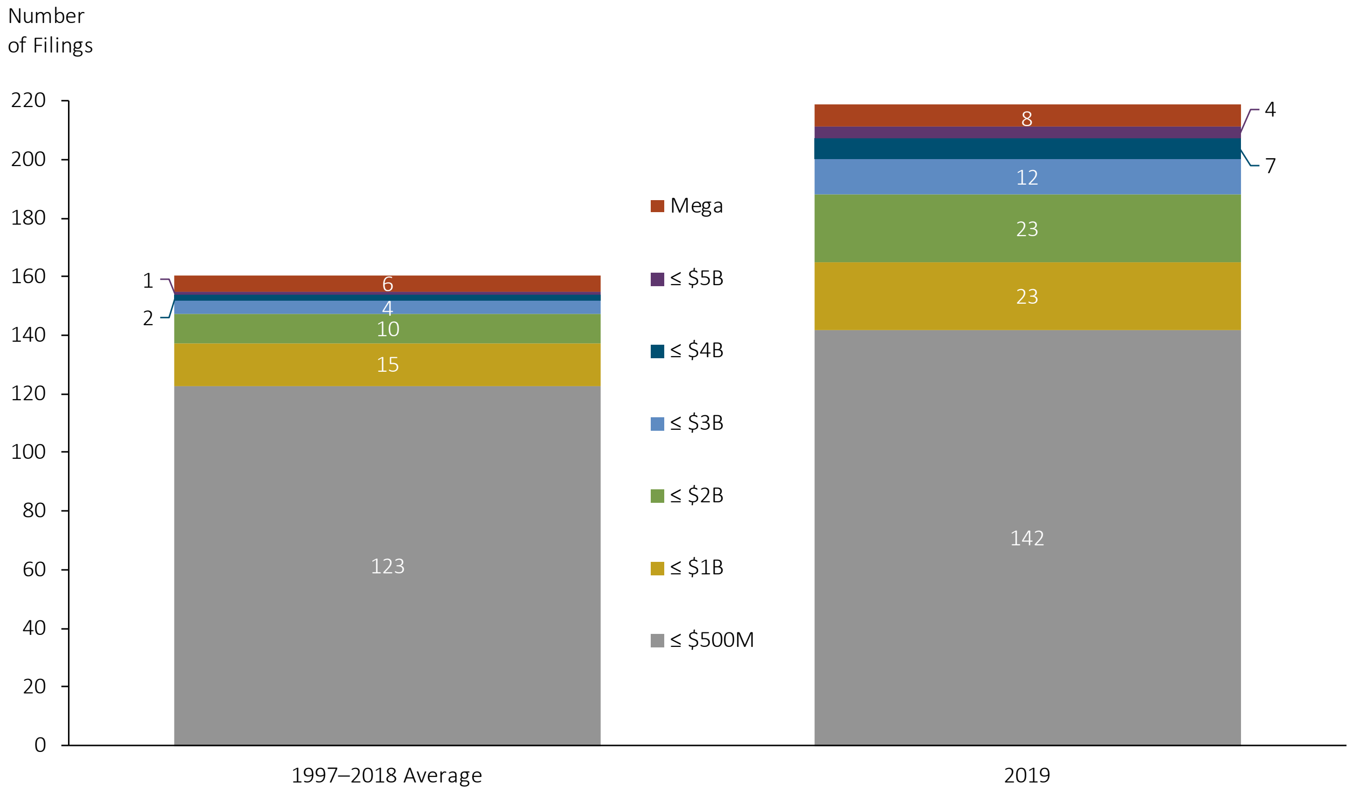
Distribution of DDL Values

The figure below compares the distribution of DDL attributable to filings of a given size in 2019 with the historical distribution of DDL.

- Mega DDL filings accounted for 4 percent of the total number of federal filings with DDL values and 52 percent of federal DDL in 2019.
- The number of small DDL filings (filings with DDL less than or equal to $500 million) in 2019 was 142, considerably more than both the historical average of 123 and the 2018 figure of 112. These filings accounted for 65 percent of federal filings with DDL values in 2019.
- Midsize DDL filings (filings with DDL greater than $500 million but less than or equal to $5 billion) accounted for 32 percent of federal filings with DDL values in 2019, above the 1997–2018 average of 20 percent but below the 2018 figure of 35 percent.

While they were numerically close to historical averages, mega DDL filings were a proportionally smaller percentage of core federal filings.

Figure 33: Distribution of Filings Based on DDL Size—Core Federal Filings



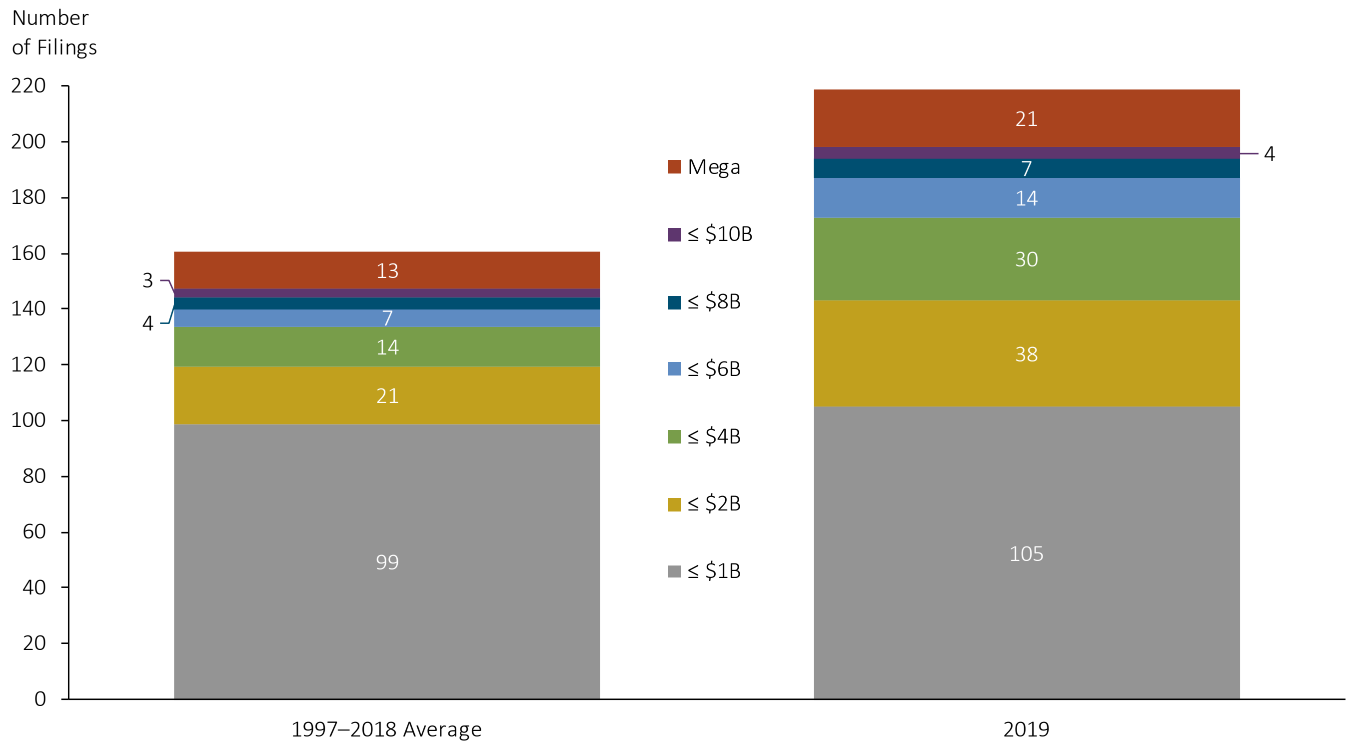
Distribution of MDL Values

The figure below compares the distribution of MDL attributable to filings of a given size in 2019 with the historical distribution of MDL.

- In 2019, mega MDL filings represented 10 percent of the total number of core federal filings with MDL values and 71 percent of total federal MDL.
- The number of mega MDL filings shrank from 27 in 2018 to 21 in 2019, while the number of filings with MDL less than or equal to $1 billion grew from 88 in 2018 to 105 in 2019.
- In 2019, the percentage of federal filings with MDL greater than $1 billion but less than or equal to $6 billion was 37 percent, compared to the 1997–2018 historical average of 26 percent.

Led by 21 mega MDL filings, the proportion of 2019 federal filings with MDL greater than $6 billion exceeded the historical average.

Figure 34: Distribution of Filings Based on MDL Size—Core Federal Filings



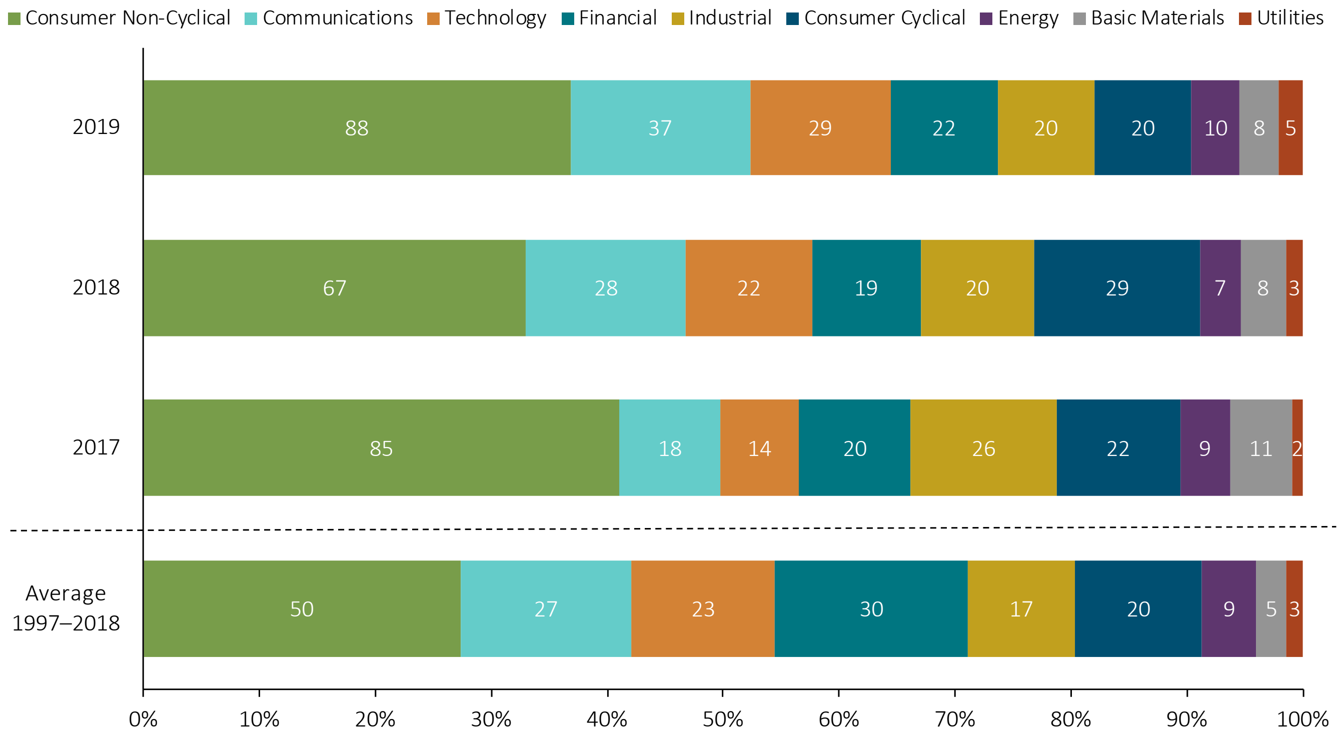
Industry Comparison of Federal Filings

This analysis of core federal filings encompasses both the large capitalization companies of the S&P 500 and smaller companies.

- The Communications sector had the greatest number of core federal filings since 2002 with 37 filings. Despite this increase, the MDL for the Communications sector decreased to $55 billion in 2019, down 16 percent from 2018.
- The number of technology filings has more than doubled since 2017, rising to 29 core federal filings in 2019, with the highest DDL on record.
- Core federal filings in the Financial sector were below the historical average for the ninth straight year.
- MDL and DDL for the Consumer Cyclical sector fell considerably as core federal filings decreased by nearly one-third. See Appendix 7.

Core federal filings against Consumer Non-Cyclical companies, primarily composed of pharmaceutical, healthcare, and biotechnology firms, were at record levels.

Figure 35: Filings by Industry—Core Federal Filings



Note:

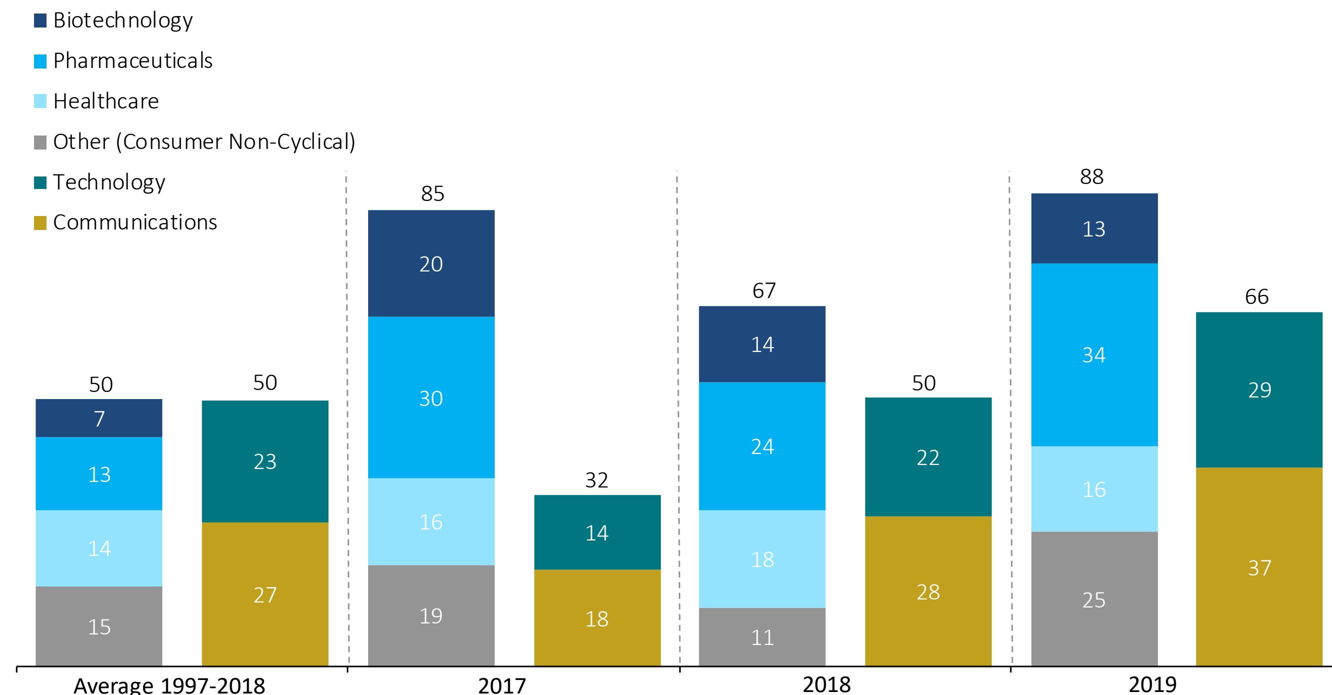
1. Filings with missing sector information or infrequently used sectors may be excluded.
2. Sectors are based on the Bloomberg Industry Classification System.

Sector Comparison: Consumer Non-Cyclical Versus Technology and Communications

- In line with 2018, Pharmaceuticals filings made up the largest proportion of Consumer Non-Cyclical filings in 2019 with 34 core federal filings. Core federal filings against biotechnology and healthcare companies decreased for the second straight year.
- The increase in other Consumer Non-Cyclical filings was driven by core federal filings against commercial services companies, an increase from six in 2018 to 12 in 2019. Core federal filings against agricultural companies also increased from one in 2018 to four in 2019; all Agricultural filings in the past two years were against tobacco or cannabis companies.

In 2019, core federal filings in the Technology and Communication sectors continued to grow, recording a combined 32 percent increase from 2018 and 106 percent increase from 2017.

Figure 36: Sector Comparison: Consumer Non-Cyclical Versus Technology and Communications—Core Federal Filings



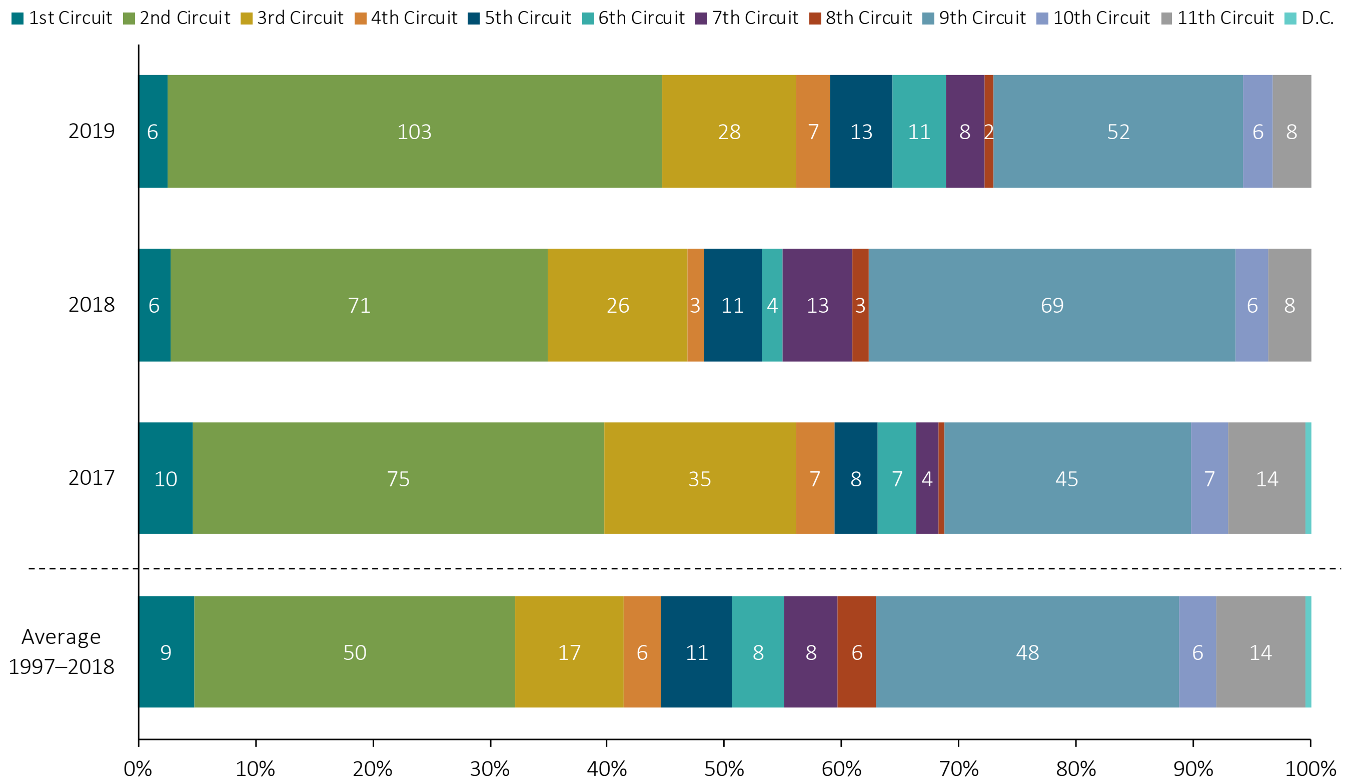
Note:
1. Sectors and subsectors are based on the Bloomberg Industry Classification System.
2. The "Other" category is a grouping primarily encompassing the Agriculture, Beverage, Commercial Services, and Food subsectors.
3. Average figures may not sum due to rounding.

Federal Filings by Circuit

- The Second and Ninth Circuits combined made up 64 percent of all core federal filings in 2019, in line with 2018 (64 percent) and above the 1997–2018 average of 53 percent.
- Core federal filings in the Second Circuit increased by 45 percent to 103 filings, the highest number on record. Core filings in the Ninth Circuit decreased by 25 percent to 52 filings, which is slightly above the 1997–2018 average of 48. The combined number of Second and Ninth Circuit core filings in 2019 (155) increased relative to 2018 (140).
- Core federal filings in the Seventh Circuit decreased by 38 percent to eight filings after the spike in 2018, in line with the 1997–2018 average. Despite this decrease, DDL and MDL in this circuit more than doubled.
- The total MDL for the Ninth Circuit increased from $489 billion in 2018 to $501 billion in 2019, three times the 1997–2018 average. See Appendix 8.

Core federal filings in the Second Circuit were the highest on record.

Figure 37: Filings by Circuit—Core Federal Filings



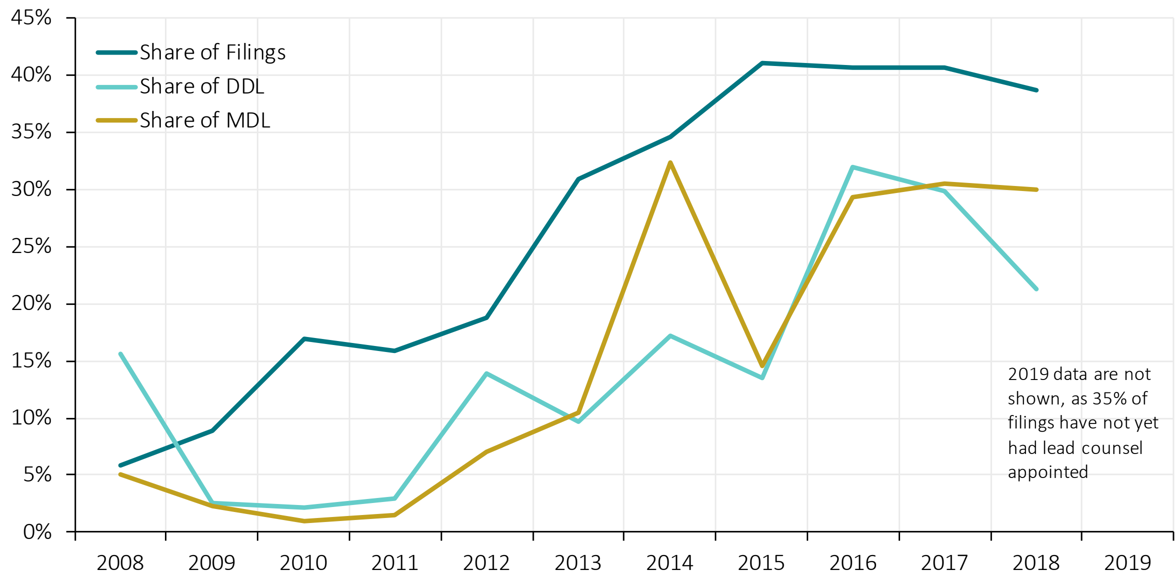
Appointment of Plaintiff Lead Counsel in Federal Filings

This figure focuses on three law firms—The Rosen Law Firm, Pomerantz LLP, and Glancy Prongay & Murray LLP. While these three law firms have been responsible for the majority of first identified complaints in each federal cohort since 2014, their rate of appointment as lead or co-lead counsel has been lower.

- The percentage of cases for which these firms were appointed lead counsel dropped slightly from 2017 to 2018.
- With the exception of 2008, these firms were typically appointed lead counsel for smaller cases (i.e., their share of filings exceeded their share of total MDL and DDL).
- These firms were largely responsible for the declining median filing lag between 2013 and 2018 discussed on page 29 and for the increasing frequency of the appointment of individuals, rather than institutional investors, as lead plaintiff, as discussed on page 18.

From 2015 through 2018, three plaintiff law firms were appointed lead or co-lead plaintiff counsel in approximately 40 percent of core federal filings.

Figure 38: Frequency of Three Law Firms' Appointment as Lead or Co-Lead Plaintiff Counsel—Core Federal Filings 2008–2019



Frequency of These Firms as the Counsel of Record on the First Identified Complaint												
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Number of Core Filings	22	23	26	35	40	66	83	104	122	126	119	151
% of Total Core Filings	10%	15%	19%	24%	29%	43%	53%	60%	65%	59%	54%	62%

Note:

1. This analysis considers law firms that were appointed lead or co-lead counsel by the court. For filings in which the case was resolved prior to the appointment of lead counsel, the counsel listed on the first identified complaint (FIC) are considered the lead counsel.
2. One percent of core federal filings in 2017, 2 percent of core federal filings in 2018, and 35 percent of core federal filings in 2019 have not yet had lead counsel appointed.
3. The counts in the table include circumstances when the FIC includes one or any of these law firms, regardless of whether other plaintiff counsel are also listed on the complaint.

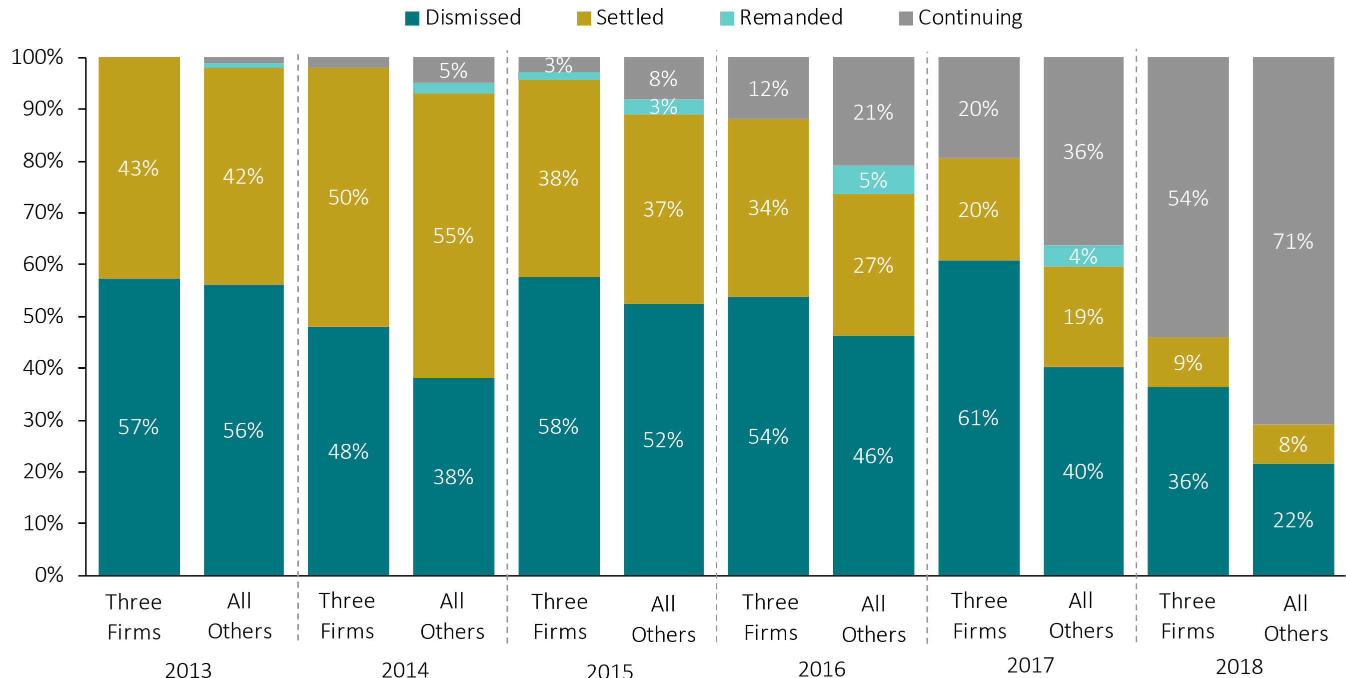
Federal Case Status by Lead Plaintiff Counsel

This figure examines the case outcomes for core federal filings in which The Rosen Law Firm, Pomerantz LLP, and Glancy Prongay & Murray LLP were appointed lead or co-lead counsel. The outcomes for these filings are compared with filings in which other plaintiff law firms are the lead counsel.

Core federal class actions filed in 2016, 2017, and 2018 in which these three plaintiff law firms were appointed lead or co-lead counsel have preliminarily exhibited higher dismissal rates than other plaintiff law firms.

- From 2013 through 2018, these three firms have had 52 percent of their class actions dismissed compared to 42 percent for all other plaintiff firms. However, a larger set of filings and more careful consideration of other factors such as circuit, court, industry, type of allegation, and other factors would be necessary to determine if these differences are statistically significant.
- Prior analysis of these three firms by Michael Klausner, Professor of Law at Stanford Law School, and Jason Hegland, Executive Director of Stanford Securities Litigation Analytics, indicated these firms had higher dismissal rates between 2006 and 2015 as well. See "Guest Post: Deeper Trends in Securities Class Actions 2006–2015," The D&O Diary, June 23, 2016.

Figure 39: Case Status by Plaintiff Law Firm Appointed Lead or Co-Lead Counsel—Core Federal Filings 2013–2018



Note:

1. This analysis considers law firms that were appointed lead or co-lead counsel by the court. For filings in which the case was resolved prior to the appointment of lead counsel, the counsel listed on the first identified complaint (FIC) are considered the lead counsel.

2. One percent of core federal filings in 2017 and 2 percent of core federal filings in 2018 have not yet had lead counsel appointed. These filings are not included in this analysis.

3. Percentages may not sum to 100 percent due to rounding.

New Developments

Cannabis-Related Filings

With the legalization of recreational marijuana in Canada in October 2018 and the increasing number of U.S. states permitting medicinal and recreational use, numerous corporations have entered the cannabis industry in recent years. These corporations are involved in the financing, farming, distribution, or sales of cannabis products. Peripheral businesses supporting the industry or developing products derived from cannabis (e.g., specialized drugs from cannabidiol) have grown in concert.

Beginning in the latter part of 2018, companies with connections to the cannabis industry were increasingly the target of federal class action filings. In 2018, six core federal filings involved companies selling cannabis or cannabidiol products. In 2019, 13 companies were sued in federal courts. Three of these companies also faced state 1933 Act claims.

Multiple Canadian cannabis-related companies with securities trading on U.S. exchanges were the subject of class action filings in 2018 and 2019. Nine of these filings involved many of the largest Canadian-licensed cannabis growers.

State Court 1933 Act Claims

Sciabacucchi v. Salzberg is a matter currently before the Delaware Supreme Court. At issue is whether provisions in corporate charters can dictate that class action securities claims under the 1933 Act be adjudicated in federal courts.

In recent years, multiple companies chartered in Delaware have adopted so-called Federal Forum Provisions dictating that 1933 Act claims be adjudicated in federal rather than state courts. In the wake of the March 2018 U.S. Supreme Court ruling in *Cyan* permitting plaintiffs to continue to file 1933 Act claims in state courts, even more companies have adopted Federal Forum Provisions.

In December 2018, the Delaware Chancery Court ruled that the charter provisions were invalid under Delaware law. The decision was appealed by defendants, with briefing before the Delaware Supreme Court in the fall of 2019.

Glossary

Annual Number of Class Action Filings by Location of Headquarters (formerly known as the Class Action Filings Non-U.S. Index) tracks the number of core filings against non-U.S. issuers (companies headquartered outside the United States) relative to total core filings.

Class Action Filings Index® (CAF Index®) tracks the number of federal securities class action filings.

Cohort is the group of securities class actions all filed in a particular calendar year.

Core filings are all federal and state 1933 Act securities class actions excluding those defined as M&A filings.

Cyan refers to *Cyan Inc. v. Beaver County Employees Retirement Fund.* In this March 2018 opinion, the U.S. Supreme Court ruled that 1933 Act claims may be brought to state venues and are not removable to federal court.

Disclosure Dollar Loss Index® (DDL Index®) measures the aggregate DDL for all federal and state filings over a period of time. DDL is the dollar value change in the defendant firm's market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. DDL should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed at the end of the class period, including information unrelated to the litigation.

Dollar Loss on Offered Shares Index™ (DLOS Index™) measures the aggregate DLOS for federal filings with only Section 11 claims and for state 1933 Act filings. DLOS is the change in the dollar value of shares acquired by class members. It is the difference in the price of offered shares (i.e., from offering until the end of the class period) multiplied by the shares offered. DLOS should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed during or at the end of the class period, including information unrelated to the litigation.

Filing lag is the number of days between the end of a class period and the filing date of the securities class action.

First identified complaint (FIC) is the first complaint filed of one or more securities class action complaints with the same underlying allegations filed against the same defendant or set of defendants.

Heat Maps of S&P 500 Securities Litigation™ analyze securities class action activity by industry sector. The analysis focuses on companies in the Standard & Poor's 500 (S&P 500) index, which comprises 500 large, publicly traded companies in all major sectors. Starting with the composition of the S&P 500 at the beginning of each year, the Heat Maps examine each sector by: (1) the percentage of these companies were subject to new securities class actions in federal court during each calendar year and (2) the percentage of the total market capitalization of these companies that was subject to new securities class actions in federal court during each calendar year.

Market capitalization losses measure changes to market values of the companies subject to class action filings. This report tracks market capitalization losses for defendant firms during and at the end of class periods. They are calculated for publicly traded common equity securities, closed-ended mutual funds, and exchange-traded funds where data are available. Declines in market capitalization may be driven by market, industry, and/or firm-specific factors. To the extent that the observed losses reflect factors unrelated to the allegations in class action complaints, indices based on class period losses would not be representative of potential defendant exposure in class actions. This is especially relevant in the post-*Dura* securities litigation environment. In April 2005, the U.S. Supreme Court ruled that plaintiffs in a securities class action are required to establish a causal connection between alleged wrongdoing and subsequent shareholder losses. This report tracks market capitalization losses at the end of each class period using DDL, and market capitalization losses during each class period using MDL.

Maximum Dollar Loss Index® (MDL Index®) measures the aggregate MDL for all federal and state filings over a period of time. MDL is the dollar value change in the defendant firm's market capitalization from the trading day with the highest market capitalization during the class period to the trading day immediately following the end of the class period. MDL should not be considered an indicator of liability or measure of potential damages. Instead, it estimates the impact of all information revealed during or at the end of the class period, including information unrelated to the litigation.

Mega filings include mega DDL filings, securities class action filings with a DDL of at least $5 billion; and mega MDL filings, securities class action filings with an MDL of at least $10 billion.

Merger and acquisition (M&A) filings are securities class actions that have Section 14 claims, but no Rule 10b-5, Section 11, or Section 12(2) claims, and involve merger and acquisition transactions.

Securities Class Action Clearinghouse is an authoritative source of data and analysis on the financial and economic characteristics of federal securities fraud class action litigation, cosponsored by Cornerstone Research and Stanford Law School.

State 1933 Act filing is a class action filed in a state court that asserts claims under Section 11 and/or Section 12 of the Securities Act of 1933. These filings may also have Section 15 claims, but do not have Rule 10b-5 claims.

Appendices

Appendix 1: Basic Filings Metrics

			Disclosure Dollar Loss			Maximum Dollar Loss			U.S. Exchange-Listed Firms: Core Filings		
Year	Class Action Filings	Core Filings	DDL Total ($ Billions)	Average ($ Millions)	Median ($ Millions)	MDL Total ($ Billions)	Average ($ Millions)	Median ($ Millions)	Number	Number of Listed Firms Sued	Percentage of Listed Firms Sued
1997	174	174	$42	$272	$57	$145	$940	$405	8,113	165	2.0%
1998	242	242	$80	$365	$61	$224	$1,018	$294	8,190	225	2.7%
1999	209	209	$140	$761	$101	$364	$1,978	$377	7,771	197	2.5%
2000	216	216	$240	$1,251	$119	$761	$3,961	$689	7,418	205	2.8%
2001	180	180	$198	$1,215	$93	$1,487	$9,120	$771	7,197	168	2.3%
2002	224	224	$201	$989	$136	$2,046	$10,080	$1,494	6,474	204	3.2%
2003	192	192	$77	$450	$100	$575	$3,363	$478	5,999	181	3.0%
2004	228	228	$144	$739	$108	$726	$3,722	$498	5,643	210	3.7%
2005	182	182	$93	$595	$154	$362	$2,321	$496	5,593	168	3.0%
2006	120	120	$52	$496	$109	$294	$2,827	$413	5,525	114	2.1%
2007	177	177	$158	$1,013	$156	$700	$4,489	$715	5,467	158	2.9%
2008	224	224	$221	$1,516	$208	$816	$5,591	$1,077	5,339	170	3.2%
2009	164	157	$84	$830	$138	$550	$5,447	$1,066	5,042	118	2.3%
2010	174	135	$73	$691	$146	$474	$4,515	$598	4,764	107	2.2%
2011	189	146	$115	$850	$92	$523	$3,876	$439	4,660	127	2.7%
2012	154	142	$97	$758	$151	$405	$3,139	$647	4,529	119	2.6%
2013	165	152	$104	$750	$153	$278	$2,011	$532	4,411	137	3.1%
2014	170	158	$56	$378	$165	$220	$1,489	$528	4,416	144	3.3%
2015	217	183	$120	$671	$144	$415	$2,332	$512	4,578	169	3.7%
2016	288	204	$107	$557	$167	$827	$4,308	$1,038	4,593	188	4.1%
2017	413	215	$132	$668	$150	$524	$2,660	$666	4,411	186	4.2%
2018	420	238	$331	$1,584	$298	$1,317	$6,299	$1,063	4,406	211	4.8%
2019	428	268	$285	$1,196	$216	$1,199	$5,037	$1,017	4,318	237	5.5%
Average (1997–2018)	215	186	$130	$791	$137	$638	$3,886	$673	5,661	167	3.0%

Note:

1. 1933 Act filings in state courts are included in the data beginning in 2010.
2. Average and median numbers are calculated only for filings with MDL and DDL data. Filings without MDL and DDL data include M&A-only filings, ICO filings, and other filings where calculations of MDL and DDL are non-obvious.
3. The number and percentage of U.S. exchange-listed firms sued are based on core filings.

Appendix 2A: S&P 500 Securities Litigation—Percentage of S&P 500 Companies Subject to Core Federal Filings

Year	Consumer Discretionary	Consumer Staples	Energy / Materials	Financials / Real Estate	Health Care	Industrials	Comm. / IT	Utilities	All S&P 500 Companies
2001	2.4%	8.3%	0.0%	1.4%	7.1%	0.0%	18.0%	7.9%	5.6%
2002	10.2%	2.9%	3.1%	16.7%	15.2%	6.0%	11.0%	40.5%	12.0%
2003	4.6%	2.9%	1.7%	8.6%	10.4%	3.0%	5.6%	2.8%	5.2%
2004	3.4%	2.7%	1.8%	19.3%	10.6%	8.5%	3.2%	5.7%	7.2%
2005	10.3%	8.6%	1.7%	7.3%	10.7%	1.8%	6.7%	3.0%	6.6%
2006	4.4%	2.8%	0.0%	2.4%	6.9%	0.0%	8.1%	0.0%	3.6%
2007	5.7%	0.0%	0.0%	10.3%	12.7%	5.8%	2.3%	3.1%	5.4%
2008	4.5%	2.6%	0.0%	31.2%	13.7%	3.6%	2.5%	3.2%	9.2%
2009	3.8%	4.9%	1.5%	10.7%	3.7%	6.9%	1.2%	0.0%	4.4%
2010	5.1%	0.0%	4.3%	10.3%	13.5%	0.0%	2.4%	0.0%	4.8%
2011	3.8%	2.4%	0.0%	1.2%	2.0%	1.7%	7.1%	2.9%	2.8%
2012	4.9%	2.4%	2.7%	3.7%	1.9%	1.6%	3.8%	0.0%	3.0%
2013	8.4%	0.0%	0.0%	0.0%	5.7%	0.0%	9.1%	0.0%	3.4%
2014	1.2%	0.0%	1.3%	1.2%	0.0%	4.7%	0.0%	0.0%	1.2%
2015	0.0%	5.0%	0.0%	1.2%	1.9%	0.0%	4.2%	3.4%	1.6%
2016	3.6%	2.6%	4.5%	6.9%	17.9%	6.1%	6.8%	3.4%	6.6%
2017	8.5%	2.7%	3.3%	3.3%	8.3%	8.7%	8.5%	7.1%	6.4%
2018	10.0%	11.8%	1.8%	7.0%	16.1%	8.8%	12.7%	7.1%	9.4%
2019	3.1%	12.1%	3.7%	2.0%	12.9%	10.1%	10.0%	6.9%	7.2%
Average 2001–2018	5.3%	3.4%	1.5%	8.0%	8.8%	3.8%	6.3%	5.3%	5.5%

Appendix 2B: S&P 500 Securities Litigation—Percentage of Market Capitalization of S&P 500 Companies Subject to Core Federal Filings

Year	Consumer Discretionary	Consumer Staples	Energy / Materials	Financials / Real Estate	Health Care	Industrials	Comm. / IT	Utilities	All S&P 500 Companies
2001	1.3%	6.3%	0.0%	0.8%	5.4%	0.0%	32.6%	17.4%	10.9%
2002	24.7%	0.3%	1.2%	29.2%	35.2%	13.3%	9.1%	51.0%	18.8%
2003	2.0%	2.3%	0.4%	19.9%	16.3%	4.6%	1.7%	4.3%	8.0%
2004	7.9%	0.1%	29.7%	46.1%	24.1%	8.8%	1.2%	4.8%	17.7%
2005	5.7%	11.4%	1.6%	22.2%	10.1%	5.6%	10.3%	5.6%	10.7%
2006	8.9%	0.8%	0.0%	8.2%	18.1%	0.0%	8.3%	0.0%	6.7%
2007	4.4%	0.0%	0.0%	18.1%	22.5%	2.2%	3.4%	5.5%	8.2%
2008	7.2%	2.6%	0.0%	55.0%	20.0%	26.4%	1.4%	4.0%	16.2%
2009	1.9%	3.9%	0.8%	31.2%	1.7%	23.2%	0.3%	0.0%	7.7%
2010	4.9%	0.0%	5.2%	31.1%	32.7%	0.0%	5.9%	0.0%	11.1%
2011	4.6%	0.8%	0.0%	6.9%	0.7%	2.1%	13.4%	0.6%	5.0%
2012	1.6%	14.0%	0.9%	11.0%	0.8%	1.2%	2.2%	0.0%	4.3%
2013	4.4%	0.0%	0.0%	0.0%	4.4%	0.0%	16.6%	0.0%	4.7%
2014	2.5%	0.0%	0.2%	0.3%	0.0%	1.7%	0.0%	0.0%	0.6%
2015	0.0%	1.9%	0.0%	3.0%	3.1%	0.0%	7.0%	3.7%	2.8%
2016	2.8%	1.0%	19.8%	11.9%	13.2%	8.7%	12.3%	4.4%	10.0%
2017	8.2%	6.7%	2.3%	1.5%	2.7%	22.3%	4.4%	9.6%	6.1%
2018	4.7%	15.2%	1.4%	12.5%	26.3%	19.4%	19.4%	6.5%	14.9%
2019	0.5%	9.1%	1.2%	2.2%	6.6%	21.6%	18.0%	7.9%	10.0%
Average 2001–2018	5.2%	4.1%	2.9%	15.2%	12.9%	8.4%	9.5%	6.0%	8.9%

Note: Average figures are calculated as the sum of the market capitalization subject to core filings in a given sector from 2001–2018, divided by the sum of market capitalization in that sector from 2001–2018.

Appendix 3: M&A Federal Filings Overview

		M&A Case Status				Case Status of Core Federal Filings			
Year	M&A Filings	Dismissed	Settled	Remanded	Continuing	Dismissed	Settled	Remanded	Continuing
2009	7	5	2	0	0	82	74	0	1
2010	39	33	6	0	0	69	65	1	1
2011	43	40	3	0	0	70	74	1	0
2012	12	9	3	0	0	68	64	2	5
2013	13	7	6	0	0	86	64	1	1
2014	12	9	3	0	0	65	83	2	6
2015	34	26	7	0	1	94	64	4	11
2016	84	66	13	0	5	92	56	6	33
2017	198	189	4	1	4	103	41	5	65
2018	182	169	2	0	11	59	18	0	143
2019	160	104	0	0	56	22	0	0	222
Average (2009–2018)	62	55	5	0	2	79	60	2	27

Note:

1. The Securities Class Action Clearinghouse began tracking M&A filings as a separate category in 2009.
2. Case status is as of the end of 2019.

Appendix 4: Case Status by Year—Core Federal Filings

	In the First Year				In the Second Year				In the Third Year			
Filing Year	Settled	Dismissed	Other	Total Resolved	Settled	Dismissed	Other	Total Resolved	Settled	Dismissed	Other	Total Resolved within Three Years
1997	0.0%	7.5%	0.6%	8.0%	14.9%	8.6%	0.0%	31.6%	16.7%	4.0%	0.0%	52.3%
1998	0.8%	7.4%	0.0%	8.3%	16.1%	12.4%	0.0%	36.8%	15.7%	7.9%	0.0%	60.3%
1999	0.5%	6.7%	0.0%	7.2%	11.0%	12.0%	0.0%	30.1%	18.2%	9.1%	0.0%	57.4%
2000	1.9%	4.2%	0.0%	6.0%	11.6%	13.0%	0.0%	30.6%	15.7%	10.6%	0.5%	57.4%
2001	1.7%	6.7%	0.0%	8.3%	11.7%	10.6%	0.0%	30.6%	17.8%	5.0%	0.0%	53.3%
2002	0.9%	5.8%	0.4%	7.1%	6.7%	9.4%	0.0%	23.2%	15.2%	11.6%	0.0%	50.0%
2003	0.5%	7.8%	0.0%	8.3%	7.8%	13.5%	0.0%	29.7%	14.6%	14.6%	0.0%	58.9%
2004	0.0%	10.5%	0.0%	10.5%	9.6%	16.2%	0.0%	36.4%	12.3%	9.6%	0.0%	58.3%
2005	0.5%	11.5%	0.0%	12.1%	8.2%	19.8%	0.0%	40.1%	17.6%	8.8%	0.0%	66.5%
2006	0.8%	9.2%	0.0%	10.0%	8.3%	16.7%	0.0%	35.0%	14.2%	6.7%	0.0%	55.8%
2007	0.6%	6.8%	0.0%	7.3%	7.9%	13.6%	0.0%	28.8%	17.5%	14.1%	0.0%	60.5%
2008	0.0%	13.0%	0.9%	13.9%	3.6%	18.4%	0.0%	35.9%	9.9%	11.2%	0.0%	57.0%
2009	0.0%	9.6%	0.0%	9.6%	4.5%	19.7%	0.0%	33.8%	8.3%	6.4%	0.0%	48.4%
2010	1.5%	11.8%	0.7%	14.0%	7.4%	15.4%	0.0%	36.8%	3.7%	14.7%	0.0%	55.1%
2011	0.0%	11.7%	0.7%	12.4%	2.8%	15.9%	0.0%	31.0%	18.6%	12.4%	0.0%	62.1%
2012	0.7%	12.2%	1.4%	14.4%	4.3%	22.3%	0.0%	41.0%	8.6%	10.1%	0.0%	59.7%
2013	0.0%	17.1%	0.7%	17.8%	5.3%	19.7%	0.0%	42.8%	9.2%	9.9%	0.0%	61.8%
2014	0.6%	8.3%	1.3%	10.3%	5.1%	18.6%	0.0%	34.0%	9.6%	10.3%	0.0%	53.8%
2015	0.0%	13.9%	2.3%	16.2%	2.3%	21.4%	0.0%	39.9%	9.2%	6.4%	0.0%	55.5%
2016	0.0%	12.8%	1.6%	14.4%	4.3%	18.2%	0.5%	37.4%	13.4%	12.3%	1.1%	64.2%
2017	0.0%	18.7%	1.9%	20.6%	4.7%	21.0%	0.5%	46.7%	14.5%	8.4%	0.0%	69.6%
2018	0.5%	13.6%	0.0%	14.1%	7.7%	13.2%	0.0%	35.0%	-	-	-	-
2019	0.0%	9.0%	0.0%	9.0%	-	-	-	-	-	-	-	-

Note: Percentages may not sum due to rounding. Percentages below the dashed lines indicate cohorts for which data are not complete. Other represents cases that were remanded or went to trial.

Appendix 5: 1933 Act Filings in State Courts and Federal Section 11–Only Filings Overview

	1933 Act Filings in State Courts			Status of 1933 Act Filings in State Courts			Status of Federal Section 11–Only Filings		
Year	California	New York	Other	Ongoing	Settled	Dismissed	Ongoing	Settled	Dismissed
2010	1	0	0	0	1	0	0	8	9
2011	3	0	0	0	1	2	0	4	5
2012	5	0	2	0	3	3	0	6	3
2013	1	0	0	0	1	0	0	2	5
2014	5	0	1	0	5	1	1	4	5
2015	15	0	2	0	9	5	1	4	6
2016	19	0	8	4	11	10	0	4	2
2017	7	0	6	5	2	5	3	3	5
2018	16	13	6	32	1	0	12	2	1
2019	15	18	16	20	0	1	23	0	2
Average (2010–2018)	8	1	3	5	4	3	2	4	4

Note: If a matter is remanded from federal court to a state court, it is recorded in the state court column based on its state court disposition. Alternatively, if a matter is removed from a state court to federal court, it is recorded in the federal court column based on its federal court disposition.

Appendix 6: Litigation Exposure for IPOs in the Given Periods—Core Filings

	Cumulative Exposure			Incremental Exposure		
Years Since IPO	2009–2018	2001–2008	1996–2000	2009–2018	2001–2008	1996–2000
1	6.6%	5.0%	2.2%	6.6%	5.0%	2.2%
2	11.8%	8.6%	6.5%	5.2%	3.7%	4.3%
3	16.0%	11.3%	9.7%	4.3%	2.7%	3.2%
4	20.0%	14.0%	12.6%	4.0%	2.7%	2.9%
5	23.8%	15.8%	16.1%	3.8%	1.8%	3.5%
6	26.7%	17.9%	18.5%	2.9%	2.0%	2.4%
7	29.1%	20.0%	21.1%	2.4%	2.1%	2.6%
8	30.7%	22.3%	23.5%	1.6%	2.4%	2.3%
9	-	23.9%	26.0%	-	1.6%	2.6%
10	-	26.4%	27.8%	-	2.5%	1.8%

Note:

1. The post-crisis IPO cumulative litigation exposure is not presented for 9–10 years after the IPO due to limited data for cohorts with an IPO date toward the end of this period. 1933 Act filings that are exclusively in the state courts enter into this analysis beginning in 2010.
2. Cumulative litigation exposure correcting for survivorship bias is calculated using the following formula:

$$(\text{cumulative litigation exposure in year } t) = 1 - \prod_{i=1}^{t} (1 - p_i)\text{, where:}$$

$$p_i = \frac{\text{number of companies sued in year } i}{\text{number of companies surviving at the end of year } (i-1)}$$

Appendix 7: Filings by Industry—Core Federal Filings

(Dollars in Billions)

	Class Action Filings				Disclosure Dollar Loss				Maximum Dollar Loss			
Industry	Average 1997–2018	2017	2018	2019	Average 1997–2018	2017	2018	2019	Average 1997–2018	2017	2018	2019
Financial	30	20	19	22	$19	$14	$25	$10	$111	$48	$138	$41
Consumer Non-Cyclical	50	85	67	88	$39	$42	$104	$70	$150	$165	$435	$336
Industrial	17	26	20	20	$13	$26	$28	$22	$48	$85	$240	$105
Technology	23	14	22	29	$19	$8	$65	$100	$80	$58	$150	$426
Consumer Cyclical	20	22	29	20	$10	$15	$28	$10	$53	$84	$120	$43
Communications	27	18	28	37	$23	$13	$65	$55	$147	$37	$166	$163
Energy	9	9	7	10	$4	$5	$1	$5	$22	$20	$4	$25
Basic Materials	5	11	8	8	$2	$7	$10	$9	$15	$17	$33	$23
Utilities	3	2	3	5	$1	$1	$3	$2	$9	$8	$25	$20
Unknown/ Unclassified	2	7	17	5	$0	$0	$0	$0	$0	$0	$2	$0
Total	184	214	220	244	$130	$131	$330	$283	$635	$521	$1,311	$1,182

Note: Figures may not sum due to rounding.

Appendix 8: Filings by Circuit—Core Federal Filings

	Class Action Filings				Disclosure Dollar Loss				Maximum Dollar Loss			
Circuit	Average 1997–2018	2017	2018	2019	Average 1997–2018	2017	2018	2019	Average 1997–2018	2017	2018	2019
1st	9	10	6	6	$7	$1	$3	-$1	$21	$6	$18	$30
2nd	50	75	71	103	$42	$46	$88	$82	$229	$161	$494	$360
3rd	17	35	26	28	$18	$27	$44	$20	$67	$106	$190	$110
4th	6	7	3	7	$2	$5	$3	$1	$12	$17	$11	$14
5th	11	8	11	13	$7	$4	$3	$4	$35	$16	$11	$20
6th	8	7	4	11	$7	$4	$6	$8	$27	$36	$19	$24
7th	8	4	13	8	$7	$3	$11	$29	$28	$20	$50	$106
8th	6	1	3	2	$3	$0	$2	$2	$13	$0	$7	$5
9th	48	45	69	52	$29	$31	$162	$133	$167	$114	$489	$501
10th	6	7	6	6	$3	$2	$2	$2	$13	$14	$9	$7
11th	14	14	8	8	$5	$8	$5	$1	$21	$20	$14	$4
D.C.	1	1	0	0	$1	$0	$0	$0	$6	$11	$0	$0
Total	184	214	220	244	$130	$131	$330	$283	$635	$521	$1,311	$1,182

Note: Figures may not sum due to rounding.

Appendix 9: Filings by Exchange Listing—Core Federal Filings

	Average (1997–2018)		2018		2019	
	NYSE/Amex	Nasdaq	NYSE	Nasdaq	NYSE	Nasdaq
Class Action Filings	86	109	157	216	195	187
Core Filings	75	93	87	111	118	111
Disclosure Dollar Loss						
DDL Total ($ Billions)	$88	$41	$168	$152	$118	$164
Average ($ Millions)	$1,290	$453	$1,995	$1,418	$1,076	$1,543
Median ($ Millions)	$274	$106	$611	$285	$340	$150
Maximum Dollar Loss						
MDL Total ($ Billions)	$422	$209	$814	$458	$557	$623
Average ($ Millions)	$6,129	$2,263	$9,688	$4,284	$5,065	$5,874
Median ($ Millions)	$1,351	$471	$2,384	$901	$1,764	$735

Note:

1. Average and median numbers are calculated only for filings with MDL and DDL data.
2. NYSE/Amex was renamed NYSE MKT in May 2012.

Research Sample

- The Stanford Law School Securities Class Action Clearinghouse, in collaboration with Cornerstone Research, has identified 5,590 federal securities class action filings between January 1, 1996, and December 31, 2019 (securities.stanford.edu). The analysis in this report is based on data identified by Stanford as of January 10, 2020.
- The sample used in this report includes federal filings that typically allege violations of the Securities Act of 1933 Section 11, the Securities Exchange Act of 1934 Section 10b, Section 12(a) (registration requirements), or Section 14(a) (proxy solicitation requirements).
- The sample is referred to as the "classic filings" sample and excludes IPO allocation, analyst, and mutual fund filings (313, 68, and 25 filings, respectively).
- Multiple filings related to the same allegations against the same defendant(s) are consolidated in the database through a unique record indexed to the first identified complaint.
- In addition to federal filings, class actions filed in state courts since January 1, 2010, alleging violations of the Securities Act of 1933 are also separately tracked.
- An additional 159 state class action filings in state courts from January 1, 2010, to December 31, 2019, have also been identified.

The views expressed in this report are solely those of the authors, who are responsible for the content,
and do not necessarily represent the views of Cornerstone Research.

The authors request that you reference Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse in any reprint of the information or figures included in this study.

Please direct any questions to:

Alexander Aganin
650.853.1660
aaganin@cornerstone.com

Cornerstone Research

Cornerstone Research provides economic and financial consulting and expert testimony in all phases of complex litigation and regulatory proceedings. The firm works with an extensive network of prominent faculty and industry practitioners to identify the best-qualified expert for each assignment. Cornerstone Research has earned a reputation for consistent high quality and effectiveness by delivering rigorous, state-of-the-art analysis for more than thirty years. The firm has over 700 staff and offices in Boston, Chicago, London, Los Angeles, New York, San Francisco, Silicon Valley, and Washington.

www.cornerstone.com

© 2020 by Cornerstone Research.
All rights reserved. Cornerstone Research is a registered service mark of Cornerstone Research, Inc.
C and design is a registered trademark of Cornerstone Research, Inc.

H.R. CONF. REP. 104-369, H.R. Conf. Rep. No. 369, 104TH Cong.,
1ST Sess. 1995, 1995 U.S.C.C.A.N. 730, 1995 WL 709276 (Leg.Hist.)
****730** P.L. 104-67, PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

***1** SECURITIES LITIGATION REFORM

DATES OF CONSIDERATION AND PASSAGE

House: March 7, 8, December 5, 1995
Senate: June 22, 23, 26, 27, 28, December 5, 1995
Cong. Record Vol. 141 (1995)
Senate Report (Banking, Housing, and Urban Affairs Committee) No. 104-98,
June 19, 1995
(To accompany S. 240)
House Conference Report No. 104-369,
Nov. 28, 1995
(To accompany H.R. 1058)

HOUSE CONFERENCE REPORT NO. 104-369

November 28, 1995

****0** Mr. Bliley, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 1058]

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 1058), to reform Federal securities litigation, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate to the text of the bill and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) Short Title.-This Act may be cited as the "Private Securities Litigation Reform Act of 1995".

(b) Table of Contents.-The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

TITLE I-REDUCTION OF ABUSIVE LITIGATION

Sec. 101. Private securities litigation reform.

Sec. 102. Safe harbor for forward-looking statements.

Sec. 103. Elimination of certain abusive practices.

Sec. 104. Authority of Commission to prosecute aiding and abetting.

Sec. 105. Loss causation.

Sec. 106. Study and report on protections for senior citizens and qualified retirement plans.

Sec. 107. Amendment to Racketeer Influenced and Corrupt Organization Act.

Sec. 108. Applicability.

TITLE II-REDUCTION OF COERCIVE SETTLEMENTS

Sec. 201. Proportionate liability.

Sec. 203. Applicability.

Sec. 204. Rule of construction.

TITLE III-AUDITOR DISCLOSURE OF CORPORATE FRAUD

Sec. 301. Fraud detection and disclosure.

***2** TITLE I-REDUCTION OF ABUSIVE LITIGATION

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

SEC. 101. PRIVATE SECURITIES LITIGATION REFORM.

(a) Securities Act of 1933.-Title I of the Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by adding at the end the following new section:

"SEC. 27. PRIVATE SECURITIES LITIGATION.

"(a) Private Class Actions.-

"(1) In general.-The provisions of this subsection shall apply to each private action arising under this title that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

"(2) Certification filed with complaint.-

"(A) In general.-Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that-

"(i) states that the plaintiff has reviewed the complaint and authorized its filing;
"(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiff's counsel or in order to participate in any private action arising under this title;
"(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;
"(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;
"(v) identifies any other action under this title, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve, or served, as a representative party on behalf of a class; and
"(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

"(B) Nonwaiver of attorney-client privilege.-The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

"(3) Appointment of lead plaintiff.-

"(A) Early notice to class members.-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

***3** "(i) In general.-Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class-

"(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

"(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

"(ii) Multiple actions.-If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

"(iii) Additional notices may be required under federal rules.-Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

"(B) Appointment of lead plaintiff.-

"(i) In general.-Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the 'most adequate plaintiff') in accordance with this subparagraph.

"(ii) Consolidated actions.-If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title has been filed, and any party has sought to consolidate those actions for pretrial purposes or for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this subparagraph.

"(iii) Rebuttable presumption.-

"(I) In general.-Subject to subclause (II), for purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that-

***4** "(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

"(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

"(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(II) Rebuttal evidence.-The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff-

"(aa) will not fairly and adequately protect the interests of the class; or

"(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

"(iv) Discovery.-For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

"(v) Selection of lead counsel.-The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

"(vi) Restrictions on professional plaintiffs.-Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

"(4) Recovery by plaintiffs.-The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class 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 paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party serving on behalf of the class.

"(5) Restrictions on settlements under seal.-The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or ***5** provision of a settlement agreement would cause direct and substantial harm to any party.

"(6) Restrictions on payment of attorneys' fees and expenses.-Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

"(7) Disclosure of settlement terms to class members.-Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

"(A) Statement of plaintiff recovery.-The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

"(B) Statement of potential outcome of case.-

"(i) Agreement on amount of damages.-If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement concerning the average amount of such potential damages per share.

"(ii) Disagreement on amount of damages.-If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement from each settling party concerning the issue or issues on which the parties disagree.

"(iii) Inadmissibility for certain purposes.-A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

"(C) 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 an average per share basis), and a brief explanation supporting the fees and costs sought.

"(D) Identification of lawyers' representatives.-The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

"(E) Reasons for settlement.-A brief statement explaining the reasons why the parties are proposing the settlement.

***6** "(F) Other information.-Such other information as may be required by the court.

"(8) Attorney conflict of interest.-If a plaintiff 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 make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

"(b) Stay of Discovery; Preservation of Evidence.-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(1) In general.-In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, 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.

"(2) Preservation of evidence.-During the pendency of any stay of discovery pursuant to this subsection, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

"(3) Sanction for willful violation.-A party aggrieved by the willful failure of an opposing party to comply with paragraph (2) may apply to the court for an order awarding appropriate sanctions.

"(c) Sanctions for Abusive Litigation.-

"(1) Mandatory review by court.-In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

"(2) Mandatory sanctions.-If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

"(3) Presumption in favor of attorneys' fees and costs.-

"(A) In general.-Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction-

***7** "(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

"(B) Rebuttal evidence.-The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that-

"(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

"(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

"(C) Sanctions.-If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

"(d) Defendant's Right to Written Interrogatories.-In any private action arising under this title in which the plaintiff may recover money damages only on proof that a defendant acted with a particular state of mind, 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) Securities Exchange Act of 1934.-Title I of the Securities Exchange Act of 1934 (78a et seq.) is amended by inserting after section 21C the following new section:

"SEC. 21D. PRIVATE SECURITIES LITIGATION.

"(a) Private Class Actions.-

"(1) In general.-The provisions of this subsection shall apply in each private action arising under this title that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.

"(2) Certification filed with complaint.-

"(A) In general.-Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that-

"(i) states that the plaintiff has reviewed the complaint and authorized its filing;

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction ***8** of plaintiff's counsel or in order to participate in any private action arising under this title;

"(iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;

"(iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;

"(v) identifies any other action under this title, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve as a representative party on behalf of a class; and

"(vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

"(B) Nonwaiver of attorney-client privilege.-The certification filed pursuant to subparagraph (A) shall not be construed to be a waiver of the attorney-client privilege.

"(3) Appointment of lead plaintiff.-

"(A) Early notice to class members.-

"(i) In general.-Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class-

"(I) of the pendency of the action, the claims asserted therein, and the purported class period; and

"(II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

"(ii) Multiple actions.-If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title is filed, only the plaintiff or plaintiffs in the first filed action shall be required to cause notice to be published in accordance with clause (i).

"(iii) Additional notices may be required under federal rules.-Notice required under clause (i) shall be in addition to any notice required pursuant to the Federal Rules of Civil Procedure.

"(B) Appointment of lead plaintiff.-

"(i) In general.-Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or ***9** complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

adequately representing the interests of class members (hereafter in this paragraph referred to as the 'most adequate plaintiff') in accordance with this subparagraph.

"(ii) Consolidated actions.-If more than one action on behalf of a class asserting substantially the same claim or claims arising under this title has been filed, and any party has sought to consolidate those actions for pretrial purposes or for trial, the court shall not make the determination required by clause (i) until after the decision on the motion to consolidate is rendered. As soon as practicable after such decision is rendered, the court shall appoint the most adequate plaintiff as lead plaintiff for the consolidated actions in accordance with this paragraph.

"(iii) Rebuttable presumption.-

"(I) In general.-Subject to subclause (II), for purposes of clause (i), the court shall adopt a presumption that the most adequate plaintiff in any private action arising under this title is the person or group of persons that-

"(aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);

"(bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

"(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

"(II) Rebuttal evidence.-The presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff-

"(aa) will not fairly and adequately protect the interests of the class; or

"(bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

"(iv) Discovery.-For purposes of this subparagraph, discovery relating to whether a member or members of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class.

"(v) Selection of lead counsel.-The most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class.

***10** "(vi) Restrictions on professional plaintiffs.-Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

"(4) Recovery by plaintiffs.-The share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of a class 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 paragraph shall be construed to limit the award of reasonable costs and expenses

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(including lost wages) directly relating to the representation of the class to any representative party serving on behalf of a class.

"(5) Restrictions on settlements under seal.-The terms and provisions of any settlement agreement of a class action shall not be filed under seal, except that on motion of any party to the settlement, the court may order filing under seal for those portions of a settlement agreement as to which good cause is shown for such filing under seal. For purposes of this paragraph, good cause shall exist only if publication of a term or provision of a settlement agreement would cause direct and substantial harm to any party.

"(6) Restrictions on payment of attorneys' fees and expenses.-Total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class.

"(7) Disclosure of settlement terms to class members.-Any proposed or final settlement agreement that is published or otherwise disseminated to the class shall include each of the following statements, along with a cover page summarizing the information contained in such statements:

"(A) Statement of plaintiff recovery.-The amount of the settlement proposed to be distributed to the parties to the action, determined in the aggregate and on an average per share basis.

"(B) Statement of potential outcome of case.-

"(i) Agreement on amount of damages.-If the settling parties agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement concerning the average amount of such potential damages per share.

"(ii) Disagreement on amount of damages.-If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this title, a statement from each settling party concerning the issue or issues on which the parties disagree.

***11** "(iii) Inadmissibility for certain purposes.-A statement made in accordance with clause (i) or (ii) concerning the amount of damages shall not be admissible in any Federal or State judicial action or administrative proceeding, other than an action or proceeding arising out of such statement.

"(C) 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 an average per share basis), and a brief explanation supporting the fees

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

and costs sought. Such information shall be clearly summarized on the cover page of any notice to a party of any proposed or final settlement agreement.

"(D) Identification of lawyers' representatives.-The name, telephone number, and address of one or more representatives of counsel for the plaintiff class who will be reasonably available to answer questions from class members concerning any matter contained in any notice of settlement published or otherwise disseminated to the class.

"(E) Reasons for settlement.-A brief statement explaining the reasons why the parties are proposing the settlement.

"(F) Other information.-Such other information as may be required by the court.

"(8) 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 may require an undertaking from the attorneys for the plaintiff class, the plaintiff class, or both, or from the attorneys for the defendant, the defendant, or both, in such proportions and at such times as the court determines are just and equitable, for the payment of fees and expenses that may be awarded under this subsection.

"(9) Attorney conflict of interest.-If a plaintiff 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 make a determination of whether such ownership or other interest constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class.

"(b) Requirements for Securities Fraud Actions.-

"(1) Misleading statements and omissions.-In any private action arising under this title in which the plaintiff alleges that the defendant-

"(A) made an untrue statement of a material fact; or

"(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

***12** the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(2) Required state of mind.-In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

"(3) Motion to dismiss; stay of discovery.-

"(A) Dismissal for failure to meet pleading requirements.-In any private action arising under this title, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

"(B) Stay of discovery.-In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, 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.

"(C) Preservation of evidence.-

"(i) In general.-During the pendency of any stay of discovery pursuant to this paragraph, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

"(ii) Sanction for willful violation.-A party aggrieved by the willful failure of an opposing party to comply with clause (i) may apply to the court for an order awarding appropriate sanctions.

"(4) Loss causation.-In any private action arising under this title, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages.

"(c) Sanctions for Abusive Litigation.-

"(1) Mandatory review by court.-In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(2) Mandatory sanctions.-If the court makes a finding under paragraph (1) that a party or attorney violated any requirement ***13** of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

"(3) Presumption in favor of attorneys' fees and costs.-

"(A) In general.-Subject to subparagraphs (B) and (C), for purposes of paragraph (2), the court shall adopt a presumption that the appropriate sanction-

"(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

"(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

"(B) Rebuttal evidence.-The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that-

"(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

"(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

"(C) Sanctions.-If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

"(d) Defendant's Right to Written Interrogatories.-In any private action arising 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.

"(e) Limitation on Damages.-

"(1) In general.-Except as provided in paragraph (2), in any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security ***14** and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

"(2) Exception.-In any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

"(3) Definition.-For purposes of this subsection, the 'mean trading price' of a security shall be an average of the daily trading price of that security, determined as of the close of the market each day during the 90-day period referred to in paragraph (1).".

SEC. 102. SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

(a) Amendment to the Securities Act of 1933.-Title I of the Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by inserting after section 27 (as added by this Act) the following new section:

"SEC. 27A. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

"(a) Applicability.-This section shall apply only to a forward-looking statement made by-

"(1) an issuer that, at the time that the statement is made, is subject to the reporting requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934;

"(2) a person acting on behalf of such issuer;

"(3) an outside reviewer retained by such issuer making a statement on behalf of such issuer; or

"(4) an underwriter, with respect to information provided by such issuer or information derived from information provided by the issuer.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(b) Exclusions.-Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, this section shall not apply to a forward-looking statement-

"(1) that is made with respect to the business or operations of the issuer, if the issuer-

"(A) during the 3-year period preceding the date on which the statement was first made-

"(i) was convicted of any felony or misdemeanor described in clauses (i) through (iv) of section 15(b)(4)(B) of the Securities Exchange Act of 1934; or

"(ii) has been made the subject of a judicial or administrative decree or order arising out of a governmental action that-

"(I) prohibits future violations of the antifraud provisions of the securities laws;

***15** "(II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or

"(III) determines that the issuer violated the antifraud provisions of the securities laws;

"(B) makes the forward-looking statement in connection with an offering of securities by a blank check company;

"(C) issues penny stock;

"(D) makes the forward-looking statement in connection with a rollup transaction; or

"(E) makes the forward-looking statement in connection with a going private transaction; or

"(2) that is-

"(A) included in a financial statement prepared in accordance with generally accepted accounting principles;

"(B) contained in a registration statement of, or otherwise issued by, an investment company;

"(C) made in connection with a tender offer;

"(D) made in connection with an initial public offering;

"(E) made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program; or

"(F) made in a disclosure of beneficial ownership in a report required to be filed with the Commission pursuant to section 13(d) of the Securities Exchange Act of 1934.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(c) Safe Harbor.-

"(1) In general.-Except as provided in subsection (b), in any private action arising under this title that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that-

"(A) the forward-looking statement is-

"(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

"(ii) immaterial; or

"(B) the plaintiff fails to prove that the forward-looking statement-

"(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

"(ii) if made by a business entity; was-

"(I) made by or with the approval of an executive officer of that entity, and

"(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

"(2) Oral forward-looking statements.-In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 13(a) or section ***16** 15(d) of the Securities Exchange Act of 1934, or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied-

"(A) if the oral forward-looking statement is accompanied by a cautionary statement-

"(i) that the particular oral statement is a forward-looking statement; and

"(ii) that the actual results could differ materially from those projected in the forward-looking statement; and

"(B) if-

"(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statement is contained in a readily available written document, or portion thereof;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, that contains the additional information about those factors relating to the forward-looking statement; and

"(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

"(3) Availability.-Any document filed with the Commission or generally disseminated shall be deemed to be readily available for purposes of paragraph (2).

"(4) Effect on other safe harbors.-The exemption provided for in paragraph (1) shall be in addition to any exemption that the Commission may establish by rule or regulation under subsection (g).

"(d) Duty To Update.-Nothing in this section shall impose upon any person a duty to update a forward-looking statement.

"(e) Dispositive Motion.-On any motion to dismiss based upon subsection (c)(1), the court shall consider any statement cited in the complaint and cautionary statement accompanying the forward-looking statement, which are not subject to material dispute, cited by the defendant.

"(f) Stay Pending Decision on Motion.-In any private action arising under this title, the court shall stay discovery (other than discovery that is specifically directed to the applicability of the exemption provided for in this section) during the pendency of any motion by a defendant for summary judgment that is based on the grounds that-

"(1) the statement or omission upon which the complaint is based is a forward-looking statement within the meaning of this section; and

"(2) the exemption provided for in this section precludes a claim for relief.

"(g) Exemption Authority.-In addition to the exemptions provided for in this section, the Commission may, by rule or regulation, provide exemptions from or under any provision of this title, including with respect to liability that is based on a statement or that is based on projections or other forward-looking information, if ***17** and to the extent that any such exemption is consistent with the public interest and the protection of investors, as determined by the Commission.

"(h) Effect on Other Authority of Commission.-Nothing in this section limits, either expressly or by implication, the authority of the Commission to exercise similar authority or to adopt similar rules and regulations with respect to forward-looking statements under any other statute under which the Commission exercises rulemaking authority.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

“(i) Definitions.-For purposes of this section, the following definitions shall apply:

“(1) Forward-looking statement.-The term ‘forward-looking statement’ means-

“(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

“(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;

“(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

“(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

“(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

“(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

“(2) Investment company.-The term ‘investment company’ has the same meaning as in section 3(a) of the Investment Company Act of 1940.

“(3) Penny stock.-The term ‘penny stock’ has the same meaning as in section 3(a)(51) of the Securities Exchange Act of 1934, and the rules and regulations, or orders issued pursuant to that section.

“(4) Going private transaction.-The term ‘going private transaction’ has the meaning given that term under the rules or regulations of the Commission issued pursuant to section 13(e) of the Securities Exchange Act of 1934.

“(5) Securities laws.-The term ‘securities laws' has the same meaning as in section 3 of the Securities Exchange Act of 1934.

“(6) Person acting on behalf of an issuer.-The term ‘person acting on behalf of an issuer’ means an officer, director, or employee of the issuer.

“(7) Other terms.-The terms ‘blank check company’, ‘rollup transaction’, ‘partnership’, ‘limited liability company’, ‘executive officer of an entity’ and ‘direct participation investment program’, ***18** have the meanings given those terms by rule or regulation of the Commission.”.

(b) Amendment to the Securities Exchange Act of 1934.-The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 21D (as added by this Act) the following new section:

“SEC. 21E. APPLICATION OF SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.

“(a) Applicability.-This section shall apply only to a forward-looking statement made by-

“(1) an issuer that, at the time that the statement is made, is subject to the reporting requirements of section 13(a) or section 15(d);

“(2) a person acting on behalf of such issuer;

“(3) an outside reviewer retained by such issuer making a statement on behalf of such issuer; or

“(4) an underwriter, with respect to information provided by such issuer or information derived from information provided by such issuer.

“(b) Exclusions.-Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, this section shall not apply to a forward-looking statement-

“(1) that is made with respect to the business or operations of the issuer, if the issuer-

“(A) during the 3-year period preceding the date on which the statement was first made-

“(i) was convicted of any felony or misdemeanor described in clauses (i) through (iv) of section 15(b)(4)(B); or

“(ii) has been made the subject of a judicial or administrative decree or order arising out of a governmental action that-

“(I) prohibits future violations of the antifraud provisions of the securities laws;

“(II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or

“(III) determines that the issuer violated the antifraud provisions of the securities laws;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(B) makes the forward-looking statement in connection with an offering of securities by a blank check company;

"(C) issues penny stock;

"(D) makes the forward-looking statement in connection with a rollup transaction; or

"(E) makes the forward-looking statement in connection with a going private transaction; or

"(2) that is-

"(A) included in a financial statement prepared in accordance with generally accepted accounting principles;

"(B) contained in a registration statement of, or otherwise issued by, an investment company;

"(C) made in connection with a tender offer;

"(D) made in connection with an initial public offering;

***19** "(E) made in connection with an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program; or

"(F) made in a disclosure of beneficial ownership in a report required to be filed with the Commission pursuant to section 13(d).

"(c) Safe Harbor.-

"(1) In general.-Except as provided in subsection (b), in any private action arising under this title that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that-

"(A) the forward-looking statement is-

"(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
"(ii) immaterial; or
"(B) the plaintiff fails to prove that the forward-looking statement-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

"(ii) if made by a business entity; was-

"(I) made by or with the approval of an executive officer of that entity; and

"(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

"(2) Oral forward-looking statements.-In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 13(a) or section 15(d), or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied-

"(A) if the oral forward-looking statement is accompanied by a cautionary statement-

"(i) that the particular oral statement is a forward-looking statement; and

"(ii) that the actual results might differ materially from those projected in the forward-looking statement; and

"(B) if-

"(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statement is contained in a readily available written document, or portion thereof;

"(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, ***20** that contains the additional information about those factors relating to the forward-looking statement; and

"(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

"(3) Availability.-Any document filed with the Commission or generally disseminated shall be deemed to be readily available for purposes of paragraph (2).

"(4) Effect on other safe harbors.-The exemption provided for in paragraph (1) shall be in addition to any exemption that the Commission may establish by rule or regulation under subsection (g).

"(d) Duty To Update.-Nothing in this section shall impose upon any person a duty to update a forward-looking statement.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(e) Dispositive Motion.-On any motion to dismiss based upon subsection (c)(1), the court shall consider any statement cited in the complaint and any cautionary statement accompanying the forward-looking statement, which are not subject to material dispute, cited by the defendant.

"(f) Stay Pending Decision on Motion.-In any private action arising under this title, the court shall stay discovery (other than discovery that is specifically directed to the applicability of the exemption provided for in this section) during the pendency of any motion by a defendant for summary judgment that is based on the grounds that-

"(1) the statement or omission upon which the complaint is based is a forward-looking statement within the meaning of this section; and

"(2) the exemption provided for in this section precludes a claim for relief.

"(g) Exemption Authority.-In addition to the exemptions provided for in this section, the Commission may, by rule or regulation, provide exemptions from or under any provision of this title, including with respect to liability that is based on a statement or that is based on projections or other forward-looking information, if and to the extent that any such exemption is consistent with the public interest and the protection of investors, as determined by the Commission.

"(h) Effect on Other Authority of Commission.-Nothing in this section limits, either expressly or by implication, the authority of the Commission to exercise similar authority or to adopt similar rules and regulations with respect to forward-looking statements under any other statute under which the Commission exercises rulemaking authority.

"(i) Definitions.-For purposes of this section, the following definitions shall apply:

"(1) Forward-looking statement.-The term 'forward-looking statement' means-

"(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

***21** "(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;

"(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

“(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

“(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

“(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

“(2) Investment company.-The term ‘investment company’ has the same meaning as in section 3(a) of the Investment Company Act of 1940.

“(3) Going private transaction.-The term ‘going private transaction’ has the meaning given that term under the rules or regulations of the Commission issued pursuant to section 13(e).

“(4) Person acting on behalf of an issuer.-The term ‘person acting on behalf of an issuer’ means any officer, director, or employee of such issuer.

“(5) Other terms.-The terms ‘blank check company’, ‘rollup transaction’, ‘partnership’, ‘limited liability company’, ‘executive officer of an entity’ and ‘direct participation investment program’, have the meanings given those terms by rule or regulation of the Commission.”.

SEC. 103. ELIMINATION OF CERTAIN ABUSIVE PRACTICES.

(a) Prohibition of Referral Fees.-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) Prohibition of referral fees.-No broker or dealer, or person associated with a broker or dealer, may solicit or accept, directly or indirectly, remuneration for assisting an attorney in obtaining the representation of any person in any private action arising under this title or under the Securities Act of 1933.”.

(b) Prohibition of Attorneys' Fees Paid From Commission Disgorgement Funds.-

(1) Securities act of 1933.-Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following new subsection:

“(f) Prohibition of Attorneys' Fees Paid From Commission Disgorgement Funds.-Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses ***22** incurred by private parties seeking distribution of the disgorged funds.".

(2) Securities exchange act of 1934.-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 of attorneys' fees paid from commission disgorgement funds.-Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.".

SEC. 104. AUTHORITY OF COMMISSION TO PROSECUTE AIDING AND ABETTING.

Section 20 of the Securities Exchange Act of 1934 (15 U.S.C. 78t) is amended-

(1) by striking the section heading and inserting the following:

"LIABILITY OF CONTROLLING PERSONS AND
PERSONS WHO AID AND ABET VIOLATIONS";

and

(2) by adding at the end the following new subsection:

"(f) Prosecution of Persons Who Aid and Abet Violations.-For purposes of any action brought by the Commission under paragraph (1) or (3) of section 21(d), any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.".

SEC. 105. LOSS CAUSATION.

Section 12 of the Securities Act of 1933 (15 U.S.C. 77*l*) is amended-

(1) by inserting "(a) In General.-" before "Any person";

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) by inserting ", subject to subsection (b)," after "shall be liable"; and

(3) by adding at the end the following:

"(b) Loss Causation.-In an action described in subsection (a)(2), if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.".

***23** SEC. 106. STUDY AND REPORT ON PROTECTIONS FOR SENIOR CITIZENS AND QUALIFIED RETIREMENT PLANS.

(a) In General.-Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall-

(1) determine whether investors that are senior citizens or qualified retirement plans require greater protection against securities fraud than is provided in this Act and the amendments made by this Act;

(2) determine whether investors that are senior citizens or qualified retirement plans have been adversely impacted by abusive or unnecessary securities fraud litigation, and whether the provisions in this Act or amendments made by this Act are sufficient to protect their investments from such litigation; and

(3) if so, submit to the Congress a report containing recommendations on protections from securities fraud and abusive or unnecessary securities fraud litigation that the Commission determines to be appropriate to thoroughly protect such investors.

(b) Definitions.-For purposes of this section-

(1) the term "qualified retirement plan" has the same meaning as in section 4974(c) of the Internal Revenue Code of 1986; and

(2) the term "senior citizen" means an individual who is 62 years of age or older as of the date of the securities transaction at issue.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

SEC. 107. AMENDMENT TO RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT.

Section 1964(c) of title 18, United States Code, is amended by inserting before the period ", except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962. The exception contained in the preceding sentence does not apply to an action against any person that is criminally convicted in connection with the fraud, in which case the statute of limitations shall start to run on the date on which the conviction becomes final".

SEC. 108. APPLICABILITY.

The amendments made by this title shall not affect or apply to any private action arising under title I of the Securities Exchange Act of 1934 or title I of the Securities Act of 1933, commenced before and pending on the date of enactment of this Act.

TITLE II-REDUCTION OF COERCIVE SETTLEMENTS

SEC. 201. PROPORTIONATE LIABILITY.

(a) Amendment to Securities and Exchange Act of 1934.-Section 21D the Securities Exchange Act of 1934 (as added by this Act) is amended by adding at the end the following new subsection:

"(g) Proportionate Liability.-

"(1) Applicability.-Nothing in this subsection shall be construed to create, affect, or in any manner modify, the standard ***24** for liability associated with any action arising under the securities laws.

"(2) Liability for damages.-

"(A) Joint and several liability.-Any covered person against whom a final judgment is entered in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.

"(B) Proportionate liability.-

"(i) In general.-Except as provided in paragraph (1), a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

corresponds to the percentage of responsibility of that covered person, as determined under paragraph (3).

"(ii) Recovery by and costs of covered person.-In any case in which a contractual relationship permits, a covered person that prevails in any private action may recover the attorney's fees and costs of that covered person in connection with the action.

"(3) Determination of responsibility.-

"(A) In general.-In any private action, the court shall instruct the jury to answer special interrogatories, or if there is no jury, shall make findings, with respect to each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff or plaintiffs, concerning-

"(i) whether such person violated the securities laws;

"(ii) the percentage of responsibility of such person, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff; and

"(iii) whether such person knowingly committed a violation of the securities laws.

"(B) Contents of special interrogatories or findings.-The responses to interrogatories, or findings, as appropriate, under subparagraph (A) shall specify the total amount of damages that the plaintiff is entitled to recover and the percentage of responsibility of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs.

"(C) Factors for consideration.-In determining the percentage of responsibility under this paragraph, the trier of fact shall consider-

"(i) the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs; and

"(ii) the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff or plaintiffs.

***25** "(4) Uncollectible share.-

"(A) In general.-Notwithstanding paragraph (2)(B), upon motion made not later than 6 months after a final judgment is entered in any private action, the court determines that all or part of the share of the judgment of the covered person is not collectible against that covered person, and is also not collectible against a covered person described in paragraph (2)(A), each covered person described in paragraph (2)(B) shall be liable for the uncollectible share as follows:

"(i) Percentage of net worth.-Each covered person shall be jointly and severally liable for the uncollectible share if the plaintiff establishes that-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(I) the plaintiff is an individual whose recoverable damages under the final judgment are equal to more than 10 percent of the net worth of the plaintiff; and

"(II) the net worth of the plaintiff is equal to less than $200,000.

"(ii) Other plaintiffs.-With respect to any plaintiff not described in subclauses (I) and (II) of clause (i), each covered person shall be liable for the uncollectible share in proportion to the percentage of responsibility of that covered person, except that the total liability of a covered person under this clause may not exceed 50 percent of the proportionate share of that covered person, as determined under paragraph (3)(B).

"(iii) Net worth.-For purposes of this subparagraph, net worth shall be determined as of the date immediately preceding the date of the purchase or sale (as applicable) by the plaintiff of the security that is the subject of the action, and shall be equal to the fair market value of assets, minus liabilities, including the net value of the investments of the plaintiff in real and personal property (including personal residences).

"(B) Overall limit.-In no case shall the total payments required pursuant to subparagraph (A) exceed the amount of the uncollectible share.

"(C) Covered persons subject to contribution.-A covered person against whom judgment is not collectible shall be subject to contribution and to any continuing liability to the plaintiff on the judgment.

"(5) Right of contribution.-To the extent that a covered person is required to make an additional payment pursuant to paragraph (4), that covered person may recover contribution-

"(A) from the covered person originally liable to make the payment;

"(B) from any covered person liable jointly and severally pursuant to paragraph (2)(A);

"(C) from any covered person held proportionately liable pursuant to this paragraph who is liable to make the same payment and has paid less than his or her proportionate share of that payment; or

***26** "(D) from any other person responsible for the conduct giving rise to the payment that would have been liable to make the same payment.

"(6) Nondisclosure to jury.-The standard for allocation of damages under paragraphs (2) and (3) and the procedure for reallocation of uncollectible shares under paragraph (4) shall not be disclosed to members of the jury.

"(7) Settlement discharge.-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(A) In general.-A covered person who settles any private action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons. 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 covered person arising out of the action. The order shall bar all future claims for contribution arising out of the action-

"(i) by any person against the settling covered person; and

"(ii) by the settling covered person against any person, other than a person whose liability has been extinguished by the settlement of the settling covered person.

"(B) Reduction.-If a covered person enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of-

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

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

"(8) Contribution.-A covered person who becomes jointly and severally liable for damages in any private action may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages. A claim for contribution shall be determined based on the percentage of responsibility of the claimant and of each person against whom a claim for contribution is made.

"(9) Statute of limitations for contribution.-In any private action determining liability, an action for contribution shall be brought not later than 6 months after the entry of a final, nonappealable judgment in the action, except that an action for contribution brought by a covered person who was required to make an additional payment pursuant to paragraph (4) may be brought not later than 6 months after the date on which such payment was made.

"(10) Definitions.-For purposes of this subsection-

"(A) a covered person 'knowingly commits a violation of the securities laws'-

"(i) with respect to an action that is based on an untrue statement of material fact or omission of a material fact necessary to make the statement not misleading, if-

"(I) that covered person makes an untrue statement of a material fact, with actual knowledge that the representation is false, or omits to state a ***27** fact necessary in order to make the statement made not misleading, with actual knowledge that, as a result of the omission, one of the material representations of the covered person is false; and

"(II) persons are likely to reasonably rely on that misrepresentation or omission; and

"(ii) with respect to an action that is based on any conduct that is not described in clause (i), if that covered person engages in that conduct with actual knowledge of the facts and circumstances that make the conduct of that covered person a violation of the securities laws;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(B) reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person;

"(C) the term 'covered person' means-

"(i) a defendant in any private action arising under this title; or

"(ii) a defendant in any private action arising under section 11 of the Securities Act of 1933, who is an outside director of the issuer of the securities that are the subject of the action; and

"(D) the term 'outside director' shall have the meaning given such term by rule or regulation of the Commission.".

(b) Amendments to the Securities Act of 1933.-Section 11(f) of the Securities Act of 1933 (12 U.S.C. 77k(f)) is amended-

(1) by striking "All" and inserting "(1) Except as provided in paragraph (2), all"; and

(2) by adding at the end the following new paragraph:

"(2)(A) The liability of an outside director under subsection (e) shall be determined in accordance with section 38 of the Securities Exchange Act of 1934.

"(B) For purposes of this paragraph, the term 'outside director' shall have the meaning given such term by rule or regulation of the Commission .".

SEC. 202. APPLICABILITY.

The amendments made by this title shall not affect or apply to any private action arising under the securities laws commenced before and pending on the date of enactment of this Act.

SEC. 203. RULE OF CONSTRUCTION.

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

***28** TITLE III-AUDITOR DISCLOSURE OF CORPORATE FRAUD

SEC. 301. FRAUD DETECTION AND DISCLOSURE.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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

"SEC. 10A. AUDIT REQUIREMENTS.

"(a) In General.-Each audit required pursuant to this title of the financial statements of an issuer by an independent public accountant shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission-

"(1) procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts;

"(2) procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein; and

"(3) an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.

"(b) Required Response To Audit Discoveries.-

"(1) Investigation and report to management.-If, in the course of conducting an audit pursuant to this title to which subsection (a) applies, the independent public accountant detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the accountant shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission-

"(A)(i) determine whether it is likely that an illegal act has occurred; and

"(ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and

"(B) as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such accountant in the course of the audit, unless the illegal act is clearly inconsequential.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(2) Response to failure to take remedial action.-If, after determining that the audit committee of the board of directors of the issuer, or the board of directors of the issuer in the absence of an audit committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of the accountant in the course of the ***29** audit of such accountant, the independent public accountant concludes that-

"(A) the illegal act has a material effect on the financial statements of the issuer;

"(B) the senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial actions with respect to the illegal act; and

"(C) the failure to take remedial action is reasonably expected to warrant departure from a standard report of the auditor, when made, or warrant resignation from the audit engagement;

the independent public accountant shall, as soon as practicable, directly report its conclusions to the board of directors.

"(3) Notice to commission; response to failure to notify.-An issuer whose board of directors receives a report under paragraph (2) shall inform the Commission by notice not later than 1 business day after the receipt of such report and shall furnish the independent public accountant making such report with a copy of the notice furnished to the Commission. If the independent public accountant fails to receive a copy of the notice before the expiration of the required 1-business-day period, the independent public accountant shall-

"(A) resign from the engagement; or

"(B) furnish to the Commission a copy of its report (or the documentation of any oral report given) not later than 1 business day following such failure to receive notice.

"(4) Report after resignation.-If an independent public accountant resigns from an engagement under paragraph (3)(A), the accountant shall, not later than 1 business day following the failure by the issuer to notify the Commission under paragraph (3), furnish to the Commission a copy of the accountant's report (or the documentation of any oral report given).

"(c) Auditor Liability Limitation.-No independent public accountant shall be liable in a private action for any finding, conclusion, or statement expressed in a report made pursuant to paragraph (3) or (4) of subsection (b), including any rule promulgated pursuant thereto.

"(d) Civil Penalties in Cease-and-Desist Proceedings.-If the Commission finds, after notice and opportunity for hearing in a proceeding instituted pursuant to section 21C, that an independent

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

public accountant has willfully violated paragraph (3) or (4) of subsection (b), the Commission may, in addition to entering an order under section 21C, impose a civil penalty against the independent public accountant and any other person that the Commission finds was a cause of such violation. The determination to impose a civil penalty and the amount of the penalty shall be governed by the standards set forth in section 21B.

"(e) Preservation of Existing Authority.-Except as provided in subsection (d), nothing in this section shall be held to limit or otherwise affect the authority of the Commission under this title.

"(f) Definition.-As used in this section, the term 'illegal act' means an act or omission that violates any law, or any rule or regulation having the force of law.".

***30** (b) Effective Dates.-The amendment made by subsection (a) shall apply to each annual report-

(1) for any period beginning on or after January 1, 1996, with respect to any registrant that is required to file selected quarterly financial data pursuant to the rules or regulations of the Securities and Exchange Commission; and

(2) for any period beginning on or after January 1, 1997, with respect to any other registrant.

And the Senate agree to the same.

That the House recede from its disagreement to the amendment of the Senate to the title of the bill, and agree to the same.

From the Committee on Commerce, for consideration of the House bill, and the Senate amendment, and modifications committed to conference:

Thomas Bliley,
Billy Tauzin,
Jack Fields,
Chris Cox,
Richard F. White,
Anna G. Eshoo,

As additional conferees from the Committee on the Judiciary, for consideration of the House bill, and the Senate amendment, and modifications committed to conference:

Bill McCollum,
Managers on the Part of the House.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Alfonse D'Amato,
Phil Gramm,
Robert F. Bennett,
Rod Grams,
Pete V. Domenici,
Christopher Dodd,
John F. Kerry,
Managers on the Part of the Senate.

***31** JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 1058) to reform Federal securities litigation, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

STATEMENT OF MANAGERS-THE "PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995"

The overriding purpose of our Nation's securities laws is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans.

The private securities litigation system is too important to the integrity of American capital markets to allow this system to be undermined by those who seek to line their own pockets by bringing abusive and meritless suits. Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs. This legislation seeks to return the securities litigation system to that high standard.

Congress has been prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets. The House and Senate Committees heard evidence that abusive practices committed in private securities litigation include: (1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters,

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent. These serious injuries to innocent parties are compounded by the reluctance of many judges to impose sanctions under Federal Rule of Civil Procedure 11, except in those cases involving truly outrageous misconduct. At the same time, the investing public and the entire U.S. economy have been injured by the ****731 *32** unwillingness of the best qualified persons to serve on boards of directors and of issuers to discuss publicly their future prospects, because of fear of baseless and extortionate securities lawsuits.

In these and other examples of abusive and manipulative securities litigation, innocent parties are often forced to pay exorbitant "settlements." When an insurer must pay lawyers' fees, make settlement payments, and expend management and employee resources in defending a meritless suit, the issuers' own investors suffer. Investors always are the ultimate losers when extortionate "settlements" are extracted from issuers.

This Conference Report seeks to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation. This legislation implements needed procedural protections to discourage frivolous litigation. It protects outside directors, and others who may be sued for non-knowing securities law violations, from liability for damage actually caused by others. It reforms discovery rules to minimize costs incurred during the pendency of a motion to dismiss or a motion for summary judgment. It protects investors who join class actions against lawyer-driven lawsuits by giving control of the litigation to lead plaintiffs with substantial holdings of the securities of the issuer. It gives victims of abusive securities lawsuits the opportunity to recover their attorneys' fees at the conclusion of an action. And it establishes a safe harbor for forward looking statements, to encourage issuers to disseminate relevant information to the market without fear of open-ended liability.

PRIVATE SECURITIES LITIGATION REFORM

Section 101 contains provisions to reform abusive securities class action litigation. It amends the Securities Act of 1933 (the "1933 Act") by adding a new section 27 and the Securities Exchange Act of 1934 (the "1934 Act") by adding a new section 21D. These provisions are intended to encourage the most capable representatives of the plaintiff class to participate in class action litigation and to exercise supervision and control of the lawyers for the class. These provisions are intended to increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff's counsel. The legislation also provides that all discovery is stayed during the pendency of any motion to dismiss or for summary judgment.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

These stay of discovery provisions are intended to prevent unnecessary imposition of discovery costs on defendants.

THE PROFESSIONAL PLAINTIFF AND LEAD PLAINTIFF PROBLEMS

House and Senate Committee hearings on securities litigation reform demonstrated the need to reform abuses involving the use of "professional plaintiffs" and the race to the courthouse to file the complaint.

Professional plaintiffs who own a nominal number of shares in a wide array of public companies permit lawyers readily to file abusive securities class action lawsuits. Floor debate in the Senate highlighted that many of the "world's unluckiest investors" repeatedly ****732 *33** appear as lead plaintiffs in securities class action lawsuits. These lead plaintiffs often receive compensation in the form of bounty payments or bonuses.

The Conference Committee believes these practices have encouraged the filing of abusive cases. Lead plaintiffs are not entitled to a bounty for their services. Individuals who are motivated by the payment of a bounty or bonus should not be permitted to serve as lead plaintiffs. These individuals do not adequately represent other shareholders-in many cases the "lead plaintiff" has not even read the complaint.

The Conference Committee believes that several new rules will effectively discourage the use of professional plaintiffs.

Plaintiff certification of the complaint

This legislation requires, in new section 27(a)(2) of the 1933 Act and new section 21D(a)(2) of the 1934 Act, that the lead plaintiff file a sworn certified statement with the complaint. The statement must certify that the plaintiff: (a) reviewed and authorized the filing of the complaint; (b) did not purchase the securities at the direction of counsel or in order to participate in a lawsuit; and (c) is willing to serve as the lead plaintiff on behalf of the class. To further deter the use of professional plaintiffs, the plaintiff must also identify any transactions in the securities covered by the class period, and any other lawsuits in which the plaintiff has sought to serve as lead plaintiff in the last three years.[1]

Method for determining the "most adequate plaintiff"

The Conference Committee was also troubled by the plaintiffs' lawyers "race to the courthouse" to be the first to file a securities class action complaint. This race has caused plaintiffs' attorneys to become fleet of foot and sleight of hand. Most often speed has replaced diligence in drafting complaints. The Conference Committee believes two incentives have driven plaintiffs' lawyers to be the first to file. First, courts traditionally appoint counsel in class action lawsuits on a "first come, first serve" basis. Courts often afford insufficient consideration to the most thoroughly researched, but later filed, complaint. The second incentive involves the court's decision as to who will become lead plaintiff. Generally, the first lawsuit filed also determines the lead plaintiff.

The Conference Committee believes that the selection of the lead plaintiff and lead counsel should rest on considerations other than how quickly a plaintiff has filed its complaint. As a result, this legislation establishes new procedures for the appointment of the lead plaintiff and lead counsel in securities class actions in new section 27(a)(3) of the 1933 Act and new section 21D(a)(3) of the 1934 Act.

A plaintiff filing a securities class action must, within 20 days of filing a complaint, provide notice to members of the purported class in a widely circulated business publication. This notice must identify the claims alleged in the lawsuit and the purported class period and inform potential class members that, within 60 days, they may move to serve as the lead plaintiff. Members of the purported ****733 *34** class who seek to serve as lead plaintiff do not have to file the certification filing as part of this motion. "Publication" includes a variety of media, including wire, electronic or computer services.[2]

Within 90 days of the published notice, the court must consider motions made under this section and appoint the lead plaintiff. If a motion has been filed to consolidate multiple class actions brought on behalf of the same class, the court will not appoint a lead plaintiff until after consideration of the motion.

The current system often works to prevent institutional investors from selecting counsel or serving as lead plaintiff in class actions.[3] The Conference Committee seeks to increase the likelihood that institutional investors will serve as lead plaintiffs by requiring courts to presume that the member of the purported class with the largest financial stake in the relief sought is the "most adequate plaintiff."

The Conference Committee believes that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions. Institutional investors are America's largest shareholders, with about $9.5 trillion in assets, accounting for 51% of the equity market. According to one representative of institutional investors: "As the largest shareholders in most companies, we are the ones who have the most to gain from meritorious securities litigation."[4]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Several Senators expressed concern during floor consideration of this legislation that preference would be given to large investors, and that large investors might conspire with the defendant company's management. The Conference Committee believes, however, that with pension funds accounting for $4.5 trillion[5] or nearly half of the institutional assets, in many cases the beneficiaries of pension funds-small investors-ultimately have the greatest stake in the outcome of the lawsuit. Cumulatively, these small investors represent a single large investor interest. Institutional investors and other class members with large amounts at stake will represent the interests of the plaintiff class more effectively than class members with small amounts at stake. The claims of both types of class members generally will be typical.

The Conference Committee recognizes the potential conflicts that could be caused by the shareholder with the "largest financial stake" serving as lead plaintiff. As a result, this presumption may be rebutted by evidence that the plaintiff would not fairly and adequately represent the interests of the class or is subject to unique defenses. Members of the purported class may seek discovery on whether the presumptively most adequate plaintiff would not adequately represent the class. The provisions of the bill relating to the appointment of a lead plaintiff are not intended to affect current law with regard to challenges to the adequacy of the class representative or typicality of the claims among the class.

Although the most adequate plaintiff provision does not confer any new fiduciary duty on institutional investors-and the courts should not impose such a duty-the Conference Committee nevertheless intends that the lead plaintiff provision will encourage institutional investors to take a more active role in securities class action lawsuits. Scholars predict that increasing the role of institutional ****734 *35** investors will benefit both injured shareholders and courts: "Institutions with large stakes in class actions have much the same interests as the plaintiff class generally; thus, courts could be more confident settlements negotiated under the supervision of institutional plaintiffs were 'fair and reasonable' than is the case with settlements negotiated by unsupervised plaintiffs' attorneys."[6]

Finally, this lead plaintiff provision solves the dilemma of who will serve as class counsel. Subject to court approval, the most adequate plaintiff retains class counsel. As a result, the Conference Committee expects that the plaintiff will choose counsel rather than, as is true today, counsel choosing the plaintiff. The Conference Committee does not intend to disturb the court's discretion under existing law to approve or disapprove the lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class.

The Conference Report seeks to restrict professional plaintiffs from serving as lead plaintiff by limiting a person from serving in that capacity more than five times in three years. Institutional investors seeking to serve as lead plaintiff may need to exceed this limitation and do not represent

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

the type of professional plaintiff this legislation seeks to restrict. As a result, the Conference Committee grants courts discretion to avoid the unintended consequence of disqualifying institutional investors from serving more than five times in three years. The Conference Committee does not intend for this provision to operate at cross purposes with the “most adequate plaintiff” provision. The Conference Committee does expect, however, that it will be used with vigor to limit the activities of professional plaintiffs.

Limitation on lead plaintiff's recovery

This legislation also removes the financial incentive for becoming a lead plaintiff. New section 27(a)(4) of the 1933 Act and section 21D(a)(4) of the 1934 Act limits the class representative's recovery to his or her pro rata share of the settlement or final judgment. The lead plaintiff's share of the final judgment or settlement will be calculated in the same manner as the shares of the other class members. The Conference Committee recognizes that lead plaintiffs should be reimbursed for reasonable costs and expenses associated with service as lead plaintiff, including lost wages, and grants the courts discretion to award fees accordingly.

IMPROVEMENTS TO THE SETTLEMENT PROCESS

Restriction on sealed settlement agreements

New section 27(a)(5) of the 1933 Act and section 21D(a)(5) of the 1934 Act generally bar the filing of settlement agreements under seal. The Conference Committee recognizes that legitimate reasons may exist for the court to permit the entry of a settlement or portions of a settlement under seal. A party must show “good cause,” i.e., that the publication of a portion or portions of the settlement agreement would result in direct and substantial harm to any party, whether or not a party to the action. The Conference Committee intends “direct and substantial harm” to include proof of reputational injury to a party.

****735 *36** Limitation on attorney's fees

The House and Senate heard testimony that counsel in securities class actions often receive a disproportionate share of settlement awards.

Under current practice, courts generally award attorney's fees based on the so-called “lodestar” approach-i.e., the court multiplies the attorney's hours by a reasonable hourly fee, which may be increased by an additional amount based on risk or other relevant factors.[7] Under this approach, attorney's fees can constitute 35% or more of the entire settlement awarded to the class. The Conference Committee limits the award of attorney's fees and costs to counsel for a class in new

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

section 27(a)(6) of the 1933 Act and new section 21D(a)(6) of the 1934 Act to a reasonable percentage of the amount of recovery awarded to the class. By not fixing the percentage of fees and costs counsel may receive, the Conference Committee intends to give the court flexibility in determining what is reasonable on a case-by-case basis. The Conference Committee does not intend to prohibit use of the lodestar approach as a means of calculating attorney's fees. The provision focuses on the final amount of fees awarded, not the means by which such fees are calculated.

Improved settlement notice to class members

The House and Senate heard testimony that class members frequently lack meaningful information about the terms of the proposed settlement.[8] Class members often receive insufficient notice of the terms of a proposed settlement and, thus, have no basis to evaluate the settlement. As one bar association advised the Senate Securities Subcommittee, “settlement notices provided to class members are often obtuse and confusing, and should be written in plain English.”[9] The Senate received similar testimony from a class member in two separate securities fraud lawsuits: “Nowhere in the settlement notices were the stockholders told of how much they could expect to recover of their losses. . . . I feel that the settlement offer should have told the stockholders how little of their losses will be recovered in the settlement, and that this is a material fact to the shareholder's decision to approve or disapprove the settlement.”[10]

In new section 27(a)(7) of the 1933 Act and new section 21D(a)(7) of the 1934 Act, the Conference Committee requires that certain information be included in any proposed or final settlement agreement disseminated to class members. To ensure that critical information is readily available to class members, the Conference Committee requires that such information appear in summary form on the cover page of the notice. The notice must contain a statement of the average amount of damages per share that would be recoverable if the settling parties can agree on a figure, or a statement from each settling party on why there is disagreement. It must also explain the attorney's fees and costs sought. The name, telephone number and address of counsel for the class must be provided. Most importantly, the notice must include a brief statement explaining the reason for the proposed settlement.

****736** ***37** MAJOR SECURITIES CLASS ACTION ABUSES

Limits on abusive discovery to prevent “fishing expedition” lawsuits

The cost of discovery often forces innocent parties to settle frivolous securities class actions. According to the general counsel of an investment bank, “discovery costs account for roughly 80% of total litigation costs in securities fraud cases.”[11] In addition, the threat that the time of

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

key employees will be spent responding to discovery requests, including providing deposition testimony, often forces coercive settlements.

The House and Senate heard testimony that discovery in securities class actions often resembles a fishing expedition. As one witness noted, "once the suit is filed, the plaintiff's law firm proceeds to search through all of the company's documents and take endless depositions for the slightest positive comment which they can claim induced the plaintiff to invest and any shred of evidence that the company knew a downturn was coming."[12]

The Conference Committee provides in new section 27(b) of the 1933 Act and new section 21D(b)(3) of the 1934 Act that courts must stay all discovery pending a ruling on a motion to dismiss, unless exceptional circumstances exist where particularized discovery is necessary to preserve evidence or to prevent undue prejudice to a party. For example, the terminal illness of an important witness might require the deposition of the witness prior to the ruling on the motion to dismiss.

To ensure that relevant evidence will not be lost, new section 27(b) of the 1933 Act and new section 21D(b)(3) of the 1934 Act make it unlawful for any person, upon receiving actual notice that names that person as a defendant, willfully to destroy or otherwise alter relevant evidence. The Conference Committee intends this provision to prohibit only the willful alteration or destruction of evidence relevant to the litigation. The provision does not impose liability where parties inadvertently or unintentionally destroy what turn out later to be relevant documents. Although this prohibition expressly applies only to defendants, the Conference Committee believes that the willful destruction of evidence by a plaintiff would be equally improper, and that courts have ample authority to prevent such conduct or to apply sanctions as appropriate.

"Fair share" rule of proportionate liability

One of the most manifestly unfair aspects of the current system of securities litigation is its imposition of liability on one party for injury actually caused by another. Under current law, a single defendant who has been found to be 1% liable may be forced to pay 100% of the damages in the case. The Conference Committee remedies this injustice by providing a "fair share" system of proportionate liability. As former SEC Chairman Richard Breeden testified, under the current regime of joint and several liability, "parties who are central to perpetrating a fraud often pay little, if anything. At the same time, those whose involvement might be only peripheral and lacked any deliberate and knowing participation in the fraud often pay the most in damages."[13]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The current system of joint and several liability creates coercive pressure for entirely innocent parties to settle meritless claims ****737 *38** rather than risk exposing themselves to liability for a grossly disproportionate share of the damages in the case.

In many cases, exposure to this kind of unlimited and unfair risk has made it impossible for firms to attract qualified persons to serve as outside directors. Both the House and Senate Committees repeatedly heard testimony concerning the chilling effect of unlimited exposure to meritless securities litigation on the willingness of capable people to serve on company boards. SEC Chairman Levitt himself testified that "there [were] the dozen or so entrepreneurial firms whose invitations [to be an outside director] I turned down because they could not adequately insure their directors . . . . [C]ountless colleagues in business have had the same experience, and the fact that so many qualified people have been unable to serve is, to me, one of the most lamentable problems of all."[14] This result has injured the entire U.S. economy.

Accordingly, the Conference Committee has reformed the traditional rule of joint and several liability. The Conference Report specifically applies this reform to the liability of outside directors under Section 11 of the 1933 Act,[15] because the current imposition of joint and several liability for non-knowing Section 11 violations by outside directors presents a particularly glaring example of unfairness. By relieving outside directors of the specter of joint and several liability under Section 11 for non-knowing conduct, Section 201 of the Conference Report will reduce the pressure placed by meritless litigation on the willingness of capable outsiders to serve on corporate boards.

In addition, Section 201 will provide the same "fair share" rule of liability, rather than joint and several liability, for all 1934 Act cases in which liability can be predicated on non-knowing conduct.[16]

In applying the "fair share" rule of proportionate liability to cases involving non-knowing securities violations, the Conference Committee explicitly determined that the legislation should make no change to the state of mind requirements of existing law. Accordingly, the definition of "knowing" conduct in the Conference Report is written to conform to existing statutory standards, and Section 201 of the Conference Report makes clear that the "fair share" rule of proportionate liability does not create any new cause of action or expand, diminish, or otherwise affect the substantive standard for liability in any action under the 1933 Act or the 1934 Act. This section of the Conference Report further provides that the standard of liability in any such action should be determined by the pre-existing, unamended statutory provision that creates the cause of action, without regard to this provision, which applies solely to the allocation of damages.

The Conference Report imposes full joint and several liability, as under current law, on defendants who engage in knowing violations of the securities laws. Defendants who are found liable but have not engaged in knowing violations are responsible only for their share of the

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

judgment (based upon the fact finder's apportionment of responsibility), with two key exceptions. First, all defendants are jointly and severally liable with respect to the claims of certain plaintiffs. Such plaintiffs are defined in the Conference Report as those who establish that (i) they are entitled to damages ****738 *39** exceeding 10% of their net worth, and (ii) their net worth is less than $200,000. The $200,000 net worth test does not reflect a judgment by the Conference Committee that investors who fall below this standard are "small," unsophisticated, or in need of or entitled to any special protection under the securities laws. Second, if a defendant cannot pay their allocable share of the damages due to insolvency, each of the other defendants must make an additional payment-up to 50% of their own liability-to make up the shortfall in the plaintiff's recovery.

The Conference Committee recognizes that private parties may wish to allocate attorney's fees and costs according to a formula negotiated previously by contract. Accordingly, the Conference Report provides that where authorized by contract a prevailing defendant may recover attorney's fees and costs. The Conference Report does not change the enforceability of indemnification contracts in the event of settlement.

Attorneys' fees awarded to prevailing parties in abusive litigation

The Conference Committee recognizes the need to reduce significantly the filing of meritless securities lawsuits without hindering the ability of victims of fraud to pursue legitimate claims. The Conference Committee seeks to solve this problem by strengthening the application of Rule 11 of the Federal Rules of Civil Procedure in private securities actions.

Existing Rule 11 has not deterred abusive securities litigation.[17] Courts often fail to impose Rule 11 sanctions even where such sanctions are warranted. When sanctions are awarded, they are generally insufficient to make whole the victim of a Rule 11 violation: the amount of the sanction is limited to an amount that the court deems sufficient to deter repetition of the sanctioned conduct, rather than imposing a sanction that equals the costs imposed on the victim by the violation. Finally, courts have been unable to apply Rule 11 to the complaint in such a way that the victim of the ensuing lawsuit is compensated for all attorneys' fees and costs incurred in the entire action.

The legislation gives teeth to Rule 11 in new section 27(c) of the 1933 Act and new section 21D(c) of the 1934 Act by requiring the court to include in the record specific findings, at the conclusion of the action, as to whether all parties and all attorneys have complied with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure.

These provisions also establish the presumption that the appropriate sanction for filing a complaint that violates Rule 11(b) is an award to the prevailing party of all attorney's fees and costs incurred in the entire action. The Conference Report provides that, if the action is brought for an improper purpose, is unwarranted by existing law or legally frivolous, is not supported by

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

facts, or otherwise fails to satisfy the requirements set forth in Rule 11(b), the prevailing party presumptively will be awarded its attorneys' fees and costs for the entire action. This provision does not mean that a party who is sanctioned for only a partial failure of the complaint under Rule 11, such as one count out of a 20-count complaint, must pay for all of the attorney's fees and costs associated with the action. The Conference Committee expects that courts will ****739 *40** grant relief from the presumption where a de minimis violation of the Rule has occurred. Accordingly, the Conference Committee specifies that the failure of the complaint must be "substantial" and makes the presumption rebuttable.

For Rule 11(b) violations involving responsive pleadings or dispositive motions, the rebuttable presumption is an award of attorneys' fees and costs incurred by the victim of the violation as a result of that particular pleading or motion.

A party may rebut the presumption of sanctions by providing that: (i) the violation was de minimis; or (ii) the imposition of fees and costs would impose an undue burden and be unjust, and it would not impose a greater burden for the prevailing party to have to pay those same fees and costs. The premise of this test is that, when an abusive or frivolous action is maintained, it is manifestly unjust for the victim of the violation to bear substantial attorneys' fees. The Conference Committee recognizes that little in the way of justice can be achieved by attempting to compensate the prevailing party for lost time and such other measures of damages as injury to reputation; hence it has written into law the presumption that a prevailing party should not have the cost of attorney's fees added as insult to the underlying injury. If a party successfully rebuts the presumption, the court then impose sanctions consistent with Rule 11(c)(2).[18] The Conference Committee intends this provision to impose upon courts the affirmative duty to scrutinize filings closely and to sanction attorneys or parties whenever their conduct violates Rule 11(b).

Limitation on attorney's conflict of interest

The Conference Committee believes that, in the context of class action lawsuits, it is a conflict of interest for a class action lawyer to benefit from the outcome of the case where the lawyer owns stock in the company being sued. Accordingly, new section 27(a)(8) of the 1933 Act and new section 21D(a)(9) requires the court to determine whether a lawyer who owns securities in the defendant company and who seeks to represent the plaintiff class in a securities class action should be disqualified from representing the class.

Bonding for payment of fees and expenses

The house hearings on securities litigation reform revealed the need for explicit authority for courts to require undertakings for attorney's fees and costs from parties, or their counsel, or both, in

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

order to ensure the viability of potential sanctions as a deterrent to meritless litigation.[19] Congress long ago authorized similar undertakings in the express private right of action in Section 11 of the 1933 Act and in Sections 9 and 18 of the 1934 Act. The availability of such undertakings in private securities actions will be an important means of ensuring that the provision of the Conference Report authorizing the award of attorneys' fees and costs under Rule 11 will not become, in practice, a one-way mechanism only usable to sanction parties with deep pockets.[20]

The legislation expressly provides that such undertakings may be required of parties' attorneys in lieu of, or in addition to, the parties themselves. In this regard, the Conference Committee intends to preempt any contrary state bar restrictions that much inhibit ****740 *41** attorneys' provision of such undertakings in behalf of their clients. The Conference Committee anticipates, for example, that where a judge determines to require an undertaking in a class action, such an undertaking would ordinarily be imposed on plaintiffs' counsel rather than upon the plaintiff class, both because the financial resources of counsel would ordinarily be more extensive than those of an individual class member and because counsel are better situated than class members to evaluate the merits of cases and individual motions. This provision is intended to effectuate the remedial purposes of the bill's Rule 11 provision.

REQUIREMENTS FOR SECURITIES FRAUD ACTIONS

Heightened pleading standard

Naming a party in a civil suit for fraud is a serious matter. Unwarranted fraud claims can lead to serious injury to reputation for which our legal system effectively offers no redress. For this reason, among others, Rule 9(b) of the Federal Rules of Civil Procedure requires that plaintiffs plead allegations of fraud with "particularity." The Rule has not prevented abuse of the securities laws by private litigants.[21] Moreover, the courts of appeals have interpreted Rule 9(b)'s requirement in conflicting ways, creating distinctly different standards among the circuits.[22] The House and Senate hearings on securities litigation reform included testimony on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits.

The Conference Committee language is based in part on the pleading standard of the Second Circuit. The standard also is specifically written to conform the language to Rule 9(b)'s notion of pleading with "particularity."

Regarded as the most stringent pleading standard, the Second Circuit requirement is that the plaintiff state facts with particularity, and that these facts, in turn, must give rise to a "strong inference" of the defendant's fraudulent intent. Because the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

interpreting this pleading standard.[23] The plaintiff must also specifically plead with particularity each statement alleged to have been misleading. The reason or reasons why the statement is misleading must also be set forth in the compliant in detail. If an allegation is made on information and belief, the plaintiff must state with particularity all facts in the plaintiff's possession on which the belief is formed.

Loss causation

The Conference Committee also requires the plaintiff to plead and then to prove that the misstatement or omission alleged in the complaint actually caused the loss incurred by the plaintiff in new Section 21D(b)(4) of the 1934 Act. For example, the plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as the result of the misstatement or omission.

****741 *42** DAMAGES

Written interrogatories

In an action to recover money damages, the Conference Committee requires the court to submit written interrogatories to the jury on the issue of defendant's state of mind at the time of the violation. In expressly providing for certain interrogatories, the Committee does not intend to otherwise prohibit or discourage the submission of interrogatories concerning the mental state or relative fault of the plaintiff and of persons who could have been joined as defendants. For example, interrogatories may be appropriate in contribution proceedings among defendants or in computing liability when some of the defendants have entered into settlement with the plaintiff prior to verdict or judgment.

Limitation on “windfall” damages

The current method of calculating damages in 1934 Act securities fraud cases is complex and uncertain. As a result, there are often substantial variations in the damages calculated by the defendants and the plaintiffs. Typically, in an action involving a fraudulent misstatement or omission, the investor's damages are presumed to be the difference between the price the investor paid for the security and the price of the security on the day the corrective information gets disseminated to the market.

Between the time a misrepresentation is made and the time the market receives corrected information, however, the price of the security may rise or fall for reasons unrelated to the alleged fraud. According to an analysis provided to the Senate Securities Subcommittee,

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

on average, damages in securities litigation comprise approximately 27.7[24] of market loss. Calculating damages based on the date corrective information is disclosed may end up substantially overestimating plaintiff's damages.[25] The Conference Committee intends to rectify the uncertainty in calculating damages in new section 21D(e) of the 1934 Act by providing a “look back” period, thereby limiting damages to those losses caused by the fraud and not by other market conditions.

This provision requires that plaintiff's damages be calculated based on the “mean trading price” of the security. This calculation takes into account the value of the security on the date plaintiff originally bought or sold the security and the value of the security during the 90-day period after dissemination of any information correcting the misleading statement or omission. If the plaintiff sells those securities or repurchases the subject securities during the 90-day period, damages will be calculated based on the price of that transaction and the value of the security immediately after the dissemination of corrective information.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

The muzzling effect of abusive securities litigation

Abusive litigation severely affects the willingness of corporate managers to disclose information to the marketplace. Former SEC Chairman Richard Breeden testified in a Senate Securities Subcommittee hearing on this subject: “Shareholders are also damaged ****742 *43** due to the chilling effect of the current system on the robustness and candor of disclosure. . . . Understanding a company's own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm.”[26]

Fear that inaccurate projections will trigger the filing of securities class action lawsuit has muzzled corporate management. One study found that over two-thirds of venture capital firms were reluctant to discuss their performance with analysts or the public because of the threat of litigation.[27] Anecdotal evidence similarly indicates corporate counsel advise clients to say as little as possible, because “legions of lawyers scrub required filings to ensure that disclosures are as milquetoast as possible, so as to provide no grist for the litigation mill.”[28]

Technology companies-because of the volatility of their stock prices-are particularly vulnerable to securities fraud lawsuits when projections do not materialize. If a company fails to satisfy its announced earnings projections-perhaps because of changes in the economy or the timing of an order or new product-the company is likely to face a lawsuit.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

A statutory safe harbor for forward-looking statements

The Conference Committee has adopted a statutory "safe harbor" to enhance market efficiency by encouraging companies to disclose forward-looking information. This provision adds a new section 27A to the 1933 Act and a new section 21E of the 1934 Act which protects from liability in private lawsuits certain "forward-looking" statements made by persons specified in the legislation.[29]

The Conference Committee has crafted a safe harbor that differs from the safe harbor provisions in the House and Senate passed bills. The Conference Committee safe harbor, like the Senate safe harbor, is based on aspects of SEC Rule 175 and the judicial created "bespeaks caution" doctrine. It is a bifurcated safe harbor that permits greater flexibility to those who may avail themselves of safe harbor protection. There is also a special safe harbor for issuers who make oral forward-looking statements.

The first prong of the safe harbor protects a written or oral forward-looking statement that is: (i) identified as forward-looking, and (ii) accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement.

Under this first prong of the safe harbor, boilerplate warnings will not suffice as meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement. The cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement, such as, for example, information about the issuer's business.

As part of the analysis of what constitutes a meaningful cautionary statement, courts should consider the factors identified in the statements. "Important" factors means the stated factors identified in the cautionary statement must be relevant to the projection ****743 *44** and must be of a nature that the factor or factors could actually affect whether the forward-looking statement is realized.

The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially-but not all factors. Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor. The Conference Committee specifies that the cautionary statements identify "important" factors to provide guidance to issuers and not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made.

The use of the words “meaningful” and “important factors” are intended to provide a standard for the types of cautionary statements upon which a court may, where appropriate, decide a motion to dismiss, without examining the state of mind of the defendant. The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. Courts should not examine the state of mind of the person making the statement.

Courts may continue to find a forward-looking statement immaterial-and thus not actionable under the 1933 Act and the 1934 Act-on other grounds. To clarify this point, the Conference Committee includes language in the safe harbor provision that no liability attaches to forward-looking statements that are “immaterial.”

The safe harbor seeks to provide certainty that forward-looking statements will not be actionable by private parties under certain circumstances. Forward-looking statements will have safe harbor protection if they are accompanied by a meaningful cautionary statement. A cautionary statement that misstates historical facts is not covered by the Safe harbor, it is not sufficient, however, in a civil action to allege merely that a cautionary statement misstates historical facts. The plaintiff must plead with particularity all facts giving rise to a strong inference of a material misstatement in the cautionary statement to survive a motion to dismiss.

The second prong of the safe harbor provides an alternative analysis. This safe harbor also applies to both written and oral forward-looking statements. Instead of examining the forward-looking and cautionary statements, this prong of the safe harbor focuses on the state of mind of the person making the forward-looking statement. A person or business entity will not be liable in a private lawsuit for a forward-looking statement unless a plaintiff proves that person or business entity made a false or misleading forward-looking statement with actual knowledge that it was false or misleading. The Conference Committee intends for this alternative prong of the safe harbor to apply if the plaintiff fails to prove the forward-looking statement (1) if made by a natural person, was made with the actual knowledge by that person that the statement was false or misleading; or (2) if made by a business entity, was made by or with the approval of an executive officer of the entity with actual knowledge by that officer that the statement was false or misleading.

****744 *45** The Conference Committee recognizes that, under certain circumstances, it may be unwieldy to make oral forward-looking statements relying on the first prong of the safe harbor. Companies who want to make a brief announcement of earnings or a new product would first have to identify the statement as forward-looking and then provide cautionary statements identifying important factors that could cause results to differ materially from those projected in the statement. As a result, the Conference Committee has provided for an optional, more flexible rule for oral forward-looking statements that will facilitate these types of oral communications by an issuer while still providing to the public information it would have received if the forward-looking

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

statement was written. The Conference Committee intends to limit this oral safe harbor to issuers or the officers, directors, or employees of the issuer acting on the issuer's behalf.

This legislation permits covered issuers, or persons acting on the issuer's behalf, to make oral forward-looking statements within the safe harbor. The person making the forward-looking statement must identify the statement as a forward-looking statement and state that results may differ materially from those projected in the statement. The person must also identify a "readily available" written document that contains factors that could cause results to differ materially. The written information identified by the person making the forward-looking statement must qualify as a "cautionary statement" under the first prong of the safe harbor (i.e., it must be a meaningful cautionary statement or statements that identify important factors that could cause actual results to differ materially from those projected in the forward-looking statement.) For purposes of this provision, "readily available" information refers to SEC filed documents, annual reports and other widely disseminated materials, such as press releases.

Who and what receives safe harbor protection

The safe harbor provision protects written and oral forward-looking statements made by issuers and certain persons retained or acting on behalf of the issuer. The Conference Committee intends the statutory safe harbor protection to make more information about a company's future plans available to investors and the public. The safe harbor covers underwriters, but only insofar as the underwriters provide forward looking information that is based on or "derived from" information provided by the issuer. Because underwriters have what is effectively an adversarial relationship with issuers in performing due diligence, the use of the term "derived from" affords underwriters some latitude so that they may disclose adverse information that the issuer did not necessarily "provide." The Conference Committee does not intend the safe harbor to cover forward-looking information made in connection with a broker's sales practices.

The Conference Committee adopts the SEC's present definition, as set forth in Rule 175, of forward-looking information, with certain additions and clarifying changes. The definition covers: (i) certain financial items, including projections of revenues, income and earnings, capital expenditures, dividends, and capital structure; (ii) management's statement of future business plans and objectives, ****745 *46** including with respect to its products or services; and (iii) certain statements made in SEC required disclosures, including management's discussion and analysis and results of operations; and (iv) any statement disclosing the assumptions underlying the forward-looking statement.

The Conference Committee has determined that the statutory safe harbor should not apply to certain forward-looking statements. Thus, the statutory safe harbor does not protect forward-looking statements: (1) included in financial statements prepared in accordance with generally

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

accepted accounting principles; (2) contained in an initial public offering registration statement; (3) made in connection with a tender offer; (4) made in connection with a partnership, limited liability company or direct participation program offering; or (5) made in beneficial ownership disclosure statements filed with the SEC under Section 13(d) of the 1934 Act.

At this time, the Conference Committee recognizes that certain types of transactions and issuers may not be suitable for inclusion in a statutory safe harbor absent some experience with the statute. Although this legislation restricts partnerships, limited liability companies and direct participation programs from safe harbor protection, the Conference Committee expects the SEC to consider expanding the safe harbor to cover these entities where appropriate. The legislation authorizes the SEC to adopt exemptive rules or grant exemptive orders to those entities for whom a safe harbor should be available. The SEC should consider granting exemptive orders for established and reputable entities who are excluded from the safe harbor.

Moreover, the Committee has determined to extend the statutory safe harbor only to forward-looking information of certain established issuers subject to the reporting requirements of section 13(a) or section 15(d) of the 1934 Act. Except as provided by SEC rule or regulation, the safe harbor does not extend to an issuer who: (a) during the three year period preceding the date on which the statement was first made, has been convicted of a felony or misdemeanor described in clauses (i) through (iv) of Section 15(b)(4) or is the subject of a decree or order involving a violation of the securities laws; (b) makes the statement in connection with a “blank check” securities offering, “rollup transaction,” or “going private” transaction; or (c) issues penny stock.

The Committee intends for its statutory safe harbor provisions to serve as a starting point and fully expects the SEC to continue its rulemaking proceedings in this area. The SEC should, as appropriate, promulgate rules or regulations to expand the statutory safe harbor by providing additional exemptions from liability or extending its coverage to additional types of information.

This legislation also makes clear that nothing in the safe harbor provision imposes any duty to update forward-looking statements.

The Conference Committee does not intend for the safe harbor provisions to replace the judicial “bespeaks caution” doctrine or to foreclose further development of that doctrine by the courts.

****746 *47** The safe harbor and stay of discovery

The legislation provides that, on any motion to dismiss the compliant based on the application of the safe harbor, the court shall consider the statements cited in the complaint and statements identified by the defendant in its moving papers, including any cautionary statements accompanying the forward-looking statement that are not subject to material dispute. The

applicability of the safe harbor provisions under subsection (c)(1)(B) shall be based on the "actual knowledge" of the defendant and does not depend on the use of cautionary language. The applicability of the safe harbor provisions under subsections (c)(1)(A)(I) and (c)(2) shall be based upon the sufficiency of the cautionary language under those provisions and does not depend on the state of mind of the defendant. In the case of a compliant based on an oral forward-looking statement in which information concerning factors that could cause actual results to differ materially is contained in a "readily available" written document, the court shall consider statements in the readily available written documents.

INAPPLICABILITY OF RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO) TO PRIVATE SECURITIES ACTIONS.

The SEC has supported removing securities fraud as a predicate offense in a civil action under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). SEC Chairman Arthur Levitt testified: "Because the securities laws generally provide adequate remedies for those injured by securities fraud, it is both necessary and unfair to expose defendants in securities cases to the threat of treble damages and other extraordinary remedies provided by RICO."[30]

The Conference Committee amends section 1964(c) of title 18 of the U.S. Code to remove any conduct that would have been actionable as fraud in the purchase or sale of securities as racketeering activity under civil RICO. The Committee intends this amendment to eliminate securities fraud as a predicate offense in a civil RICO action. In addition, the Conference Committee intends that a plaintiff may not plead other specified offenses, such as mail or wire fraud, as predicate acts under civil RICO if such offenses are based on conduct that would have been actionable as securities fraud.

AUDITOR DISCLOSURE OF CORPORATE FRAUD

The Conference Report requires independent public accountants to adopt certain procedures in connection with their audits and to inform the SEC of illegal acts. These requirements would be carried out in accordance with generally accepted auditing standards for audits of SEC registrants-as modified from time to time by the Commission-on the detection of illegal acts, related party transactions and relationships, and evaluation of an issuer's ability to continue as a going concern.

The Conference Committee does not intend to affect the Commission's authority in areas not specifically addressed by this provision. The Conference Committee expects that the SEC will continue its longstanding practice of looking to the private sector to set ****747 *48** and to improve auditing standards. The SEC should not act to "modify" or "supplement" generally accepted auditing standards for SEC registrants until after it has determined that the private sector is unable

or unwilling to do so on a timely basis. The Conference Committee intends for the SEC to have discretion, however, to determine the appropriateness and timeliness of the private sector response. The SEC should act promptly if required by the public interest or for the protection of investors.

FOOTNOTES

****748 *49** From the Committee on Commerce, for consideration of the House bill, and the Senate amendment, and modifications committed to conference:

Thomas Bliley,
Billy Tauzin,
Jack Fields,
Chris Cox,
Richard F. White,
Anna G. Eshoo,

As additional conferees from the Committee on the Judiciary, for consideration of the House bill, and the Senate amendment, and modifications committed to conference:

Bill McCollum,
Managers on the Part of the House.

Alfonse D'Amato,
Phil Gramm,
Robert F. Bennett,
Rod Grams,
Pete V. Domenici,
Christopher Dodd,
John F. Kerry,
Managers on the Part of the Senate.

1 This certification should not be construed to waive the attorney-client privilege.

2 The notice provisions in this subsection do not replace or supersede other notice provisions provided in the Federal Rules of Civil Procedure.

3 See Elliott J. Weiss and John S. Beckerman, "Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions," 104 Yale L.J. 2053 (1995).

4 See testimony of Maryellen Anderson, Investor and Corporate Relations Director of the Connecticut Retirement & Trust Funds and Treasurer of the Council of Institutional Investors

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, July 21, 1993.

5 See The Brancato Report on Institutional Investment, "Total Assets and Equity Holdings," Vol. 2, Ed. 1.

6 See "Let the Money do the Monitoring," note 3, supra.

7 See generally Majority Staff Report, May 17, 1994 at page 81 et seq.

8 See testimony of Patricia Reilly before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993.

9 See NASCAT Analysis of Pending Legislation on Securities Fraud Litigation, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

10 See testimony of Patricia Reilly, note 8 supra.

11 See testimony of former SEC Commissioner J. Carter Beese, Jr., Chairman of the Capital Markets Regulatory Reform Project Center for Strategic and International Studies, before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995 (citing testimony of Philip A. Lacavara before the Telecommunications and Finance Subcommittee of the House Committee on Energy and Commerce, hearing on H.R. 3185.)

12 See testimony of Richard J. Egan, Chairman of the Board of EMC Corporation before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993. See also testimony of Dennis Bakke, President and CEO, AES Corporation, before the Telecommunications and Finance Subcommittee of the House Committee on Commerce, January 19, 1995.

13 See testimony of Hon. Richard Breeden, former Chairman, Securities and Exchange Commission, before the Subcommittee on Telecommunications and Finance, House Commerce Committee, February 10, 1995. See also testimony of Daniel Gelzer, id. at 274.

14 See testimony of Hon. Arthur Levitt, Chairman, Securities and Exchange Commission, before the Subcommittee on Telecommunications and Finance of the House Commerce Committee, February 10, 1995, at 192. See also id. at 116, 126 (testimony of Dennis W. Bakke, Chairman and CEO, AES Corporation); id. at 137-8 (testimony of James Kimsey, Chairman, America Online).

15 The Conference Report makes no change in the law with respect to Section 11 claims against other types of defendants. Section 11 expressly provides for a right of contribution, see Section 11(f), and this right has been construed to establish contribution and settlement standards like those

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

set forth in the Conference Report. This section has no effect on the interpretation of Section 11(f) with respect to defendants other than outside directors.

16 See Section 16(b) (short-swing transactions) and Section 18 (liability for misleading statements).

17 See, e.g., testimony of Saul S. Cohen, Rosenman & Colin, before the Telecommunications and Finance Subcommittee of the House Committee on Commerce, February 10, 1995. ("In our experience, Rule 11 has been largely ineffective in deterring strike suits. As a general matter, courts rarely grant Rule 11 sanctions in all but the most egregious circumstances".)

18 Rule 11(c)(2) limits sanctions to "what is sufficient to deter the repetition of such conduct or comparable conduct by others similarly situated".

19 See testimony of John Olson, Chairman, American Bar Association Business Law Section, before the Subcommittee on Telecommunications and Finance, House Commerce Committee, February 10, 1995.

20 See id.

21 See, e.g., testimony of Saul S. Cohen, Rosenman & Colin, before the Telecommunications and Finance Subcommittee of the House Committee on Commerce at 234-35 (February 10, 1995).

22 See id.

23 For this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness.

24 The percentages of damages as market losses in the analysis ranged from 7.9% to 100% See Princeton Venture Research, Inc., "PVR Analysis, Securities Law Class Actions, Damages as a Percent of Market Losses," June 15, 1993.

25 See Lev and de Villiers, "Stock Price Crashes and 10b-5 Damages: A Legal, Economic and Policy Analysis," Standford Law Review, 7, 9-11 (1994).

26 See testimony of Hon. Richard C. Breeden, former Chairman, SEC, before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, April 6, 1995.

27 See testimony of the National Venture Capital Association before the Securities Subcommittee on the Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

28 See testimony of Hon. J. Carter Beese, former SEC Commissioner, at id.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

29 The concept of a safe harbor for forward-looking statements made under certain conditions is not new. In 1979, the SEC promulgated Rule 175 to provide a safe harbor for certain forward looking statements made with a "reasonable basis" and in "good faith." This safe harbor has not provided companies meaningful protection from litigation. In a February 1995 letter to the SEC, a major pension fund stated: "A major failing of the existing safe harbor is that while it may provide theoretical protection to issuers from liability when disclosing projections, it fails to prevent the threat of frivolous lawsuits that arises every time a legitimate projection is not realized." See February 14, 1995 letter from the California Public Employees' Retirement System to the SEC. Courts have also crafted a safe harbor for forward-looking statements or projections accompanied by sufficient cautionary language. The First, Second, Third, Sixth and Ninth Circuits have adopted a version of the "bespeaks caution" doctrine. See, e.g., In re Worlds of Wonder Securities Litigation, 35 F. 3d 1407 (9th Cir. 1994); Rubinstein v. Collins, 20 F.3d 169 (5th Cir. 1994): Kline v. First Western Government Securities, Inc., 24 F. 3d 480 (3d Cir. 1994); Sinay v. Lamson & Sessions Company, 948 F.2d 1037 (6th Cir. 1991); I. Meyer Pincus & Associates v. Oppenheimer & Co., Inc., 936 F.2d 759 (2d Cir. 1991); Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991); Luce v. Edelstein, 802 F.2d 49 (2d Cir. 1986); In re Donald J. Trump Casino, 7 F.3d 357 (3d Cir. 1993).

30 See testimony of Hon. Arthur Levitt, Chairman, SEC, before the Telecommunications and Finance Subcommittee of the House Commerce Committee, February 10, 1995.

H.R. CONF. REP. 104-369, H.R. Conf. Rep. No. 369, 104TH Cong., 1ST Sess. 1995, 1995 U.S.C.C.A.N. 730, 1995 WL 709276 (Leg.Hist.)

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

S. REP. 104-98, S. Rep. No. 98, 104TH Cong., 1ST Sess.
1995, 1995 U.S.C.C.A.N. 679, 1995 WL 372783 (Leg.Hist.)
****679** P.L. 104-67, ***1** PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

DATES OF CONSIDERATION AND PASSAGE

House: March 7, 8, December 5, 1995
Senate: June 22, 23, 26, 27, 28, December 5, 1995
Cong. Record Vol. 141 (1995)
Senate Report (Banking, Housing, and Urban Affairs Committee) No. 104-98,
June 19, 1995
(To accompany S. 240)
House Conference Report No. 104-369,
Nov. 28, 1995
(To accompany H.R. 1058)

SENATE REPORT NO. 104–98

June 19, 1995

Mr. D'Amato, from the Committee on Banking,
Housing, and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 240]

****680** The Committee on Banking, Housing and Urban Affairs, to which was referred the bill (S. 240), to amend the Securities Exchange Act of 1934 to establish a filing deadline and to provide certain safeguards to ensure that the interests of investors are well protected under the implied private action provisions of the Act, having considered the same, reports favorably thereon with an amendment in the nature of a substitute, and recommends that the bill as amended do pass.

CONTENTS

Page

History of the legislation.. 1

Purpose and summary.. 4

Purpose and scope of the legislation:

Background.. 8

Elimination of abusive practices in securities litigation.. 10

Removing the incentives to participate in abusive class action litigation.. 10

New rules relating to the settlement process.. 12

Attorney Sanctions for pursuing meritless litigation.. 13

Stay of discovery.. 14

A strong pleading requirement.. 15

A safe harbor for forward-looking statements or projections.. 15

Written interrogatories.. 18

Limiting civil RICO actions.. 19

A grant of authority to the SEC to prosecute certain aiding and abetting cases.. 19

Limitation on damages.. 19

Modification of joint and several liability.. 20

Loss Causation requirement for section 12(2) of the 1933 Act.. 23

Auditor disclosure of corporate fraud.. 23

Section-by-section analysis of S. 240.. 24

Title I-Reduction of Abusive Litigation:

Section 101. Elimination of Certain Abusive Practices.. 24

Section 102. Securities Class Action Reform.. 24

Section 103. Sanctions for Abusive Litigation.. 26

Section 104. Requirements for Securities Fraud Actions.. 26

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section 105. Safe Harbor for Forward-Looking Statements.......... 26
Section 106. Written Interrogatories.......... 27
Section 107. Amendment to Racketeer Influenced and Corrupt Organizations Act.......... 28
Section 108. Authority of Commission to Prosecute Aiding and Abetting.......... 28
Section 109. Limitation on Rescission.......... 28
Section 110. Applicability.......... 28
Title II-Reduction of Coercive Settlements:
Section 201. Limitation on Damages.......... 28
Section 202. Proportionate Liability.......... 29
Section 203. Applicability.......... 29
Title III-Auditor Disclosure of Corporate Fraud:
Section 301. Fraud Detection and Disclosure.......... 29
Regulatory impact statement.......... 30
Changes in existing law.......... 30
Cost of the legislation.......... 30
Additional views of Senators Gramm, Mack, Faircloth, Bennett, Grams, and Frist.......... 33
Additional views of Senators Sarbanes, Bryan, and Boxer.......... 36
Additional views of Senator Dodd.......... 51

HISTORY OF THE LEGISLATION

On January 18, 1995, Senators Domenici and Dodd introduced S. 240, the "Private Securities Litigation Reform Act of 1995." This legislation, which was cosponsored by Senators Hatch, Mikulski, Bennett, Moseley-Braun, Lott, Murray, Mack, Johnston, Faircloth, Conrad, Burns, Chafee, Gorton, Helms, Kyl, Thomas, Hutchinson, Santorum, and Pell, contains provisions identical to those contained in S. 1976, which was introduced in the 103d Congress. Legislation to reform private litigation under the Federal securities laws, S. 3181, also was introduced in the 102d Congress.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

On June 17, 1993 and July 21, 1993, the Subcommittee on Securities held hearings on private securities litigation. Witnesses testifying on June 17 included Edward R. McCracken, President and ****681 *2** CEO, Silicon Graphics, Inc.; John G. Adler, President and CEO, Asaptec, Inc.; Richard J. Egan, Chairman, EMC Corp.; Thomas Dunlap, Jr., General Counsel, Intel Corp.; William R. McLucas, Director of the Division of Enforcement, Securities and Exchange Commission ("SEC"); Mark J. Griffin, Director, Securities Division of the Department of Commerce of the State of Utah, who testified on behalf of the North American Securities Administrators Association, Inc.; Joel Seligman, Professor, University of Michigan Law School; Patricia Reilly, an investor; Vincent E. O'Brien, Law and Economics Consulting Group, Inc.; William S. Lerach, Partner, Milberg Weiss Bershad Hynes & Lerach; Gordon K. Billipp, an investor; Russell E. Ramser, Jr., an investor; and Edward J. Radetich, President, Heffler & Co.

Witnesses testifying on July 21 included Representative W.J. "Billy" Tauzin; Representative Ron Wyden; Jake L. Netterville, Managing Partner, Postlethwaite & Netterville, who testified on behalf of the American Institute of Certified Public Accountants; A.A. Sommer, Jr., Chairman, Public Oversight Board, American Institute of Certified Public Accountants; Ralph V. Whitworth, President, United Shareholders Association; Abraham J. Briloff, Professor, Baruch College, CUNY; Melvyn I. Weiss, Partner, Milberg Weiss Bershad Hynes & Lerach; Richard A. Bowman, Executive Vice President and CFO, ITT Corp., who testified on behalf of the Financial Executives Institute; Marc E. Lackritz, President, Securities Industry Association; Ralph Nader, Public Citizen; and Maryellen F. Andersen, Investor and Corporate Relations Director, Connecticut Retirement & Trust Funds and Treasurer of the Council of Institutional Investors. Additional material was supplied for the record by a large number of parties.

On March 24, 1994, Senators Dodd, Domenici, Mikulski, Johnston, and Faircloth introduced S. 1976, the "Private Securities Litigation Reform Act of 1994."

On May 12, 1994, the Subcommittee on Securities held a hearing on the Supreme Court's decision in Central Bank of Denver v. First Interstate Bank of Denver,[1] which held that private parties could not bring suit under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and SEC Rule 10b–5 against alleged aiders and abettors of persons violating the Federal securities laws. Witnesses included Senator Howard Metzenbaum; Arthur Levitt, Chairman, SEC; Donald C. Langevoort, Professor, Vanderbilt Law School; Mark J. Griffin, Director, Securities Division of the Department of Commerce of the State of Utah, who testified on behalf of the North American Securities Administrators Association, Inc.; Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association; Harvey J. Goldschmid, Professor, Columbia University School of Law; Eugene I. Goldman, Partner, McDermott, Will & Emery; and David S. Ruder, former Chairman, SEC, and Professor, Northwestern University School of Law. Harvey I.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Pitt, Partner, Fried, Frank, Harris, Shriver & Jacobson, and Joel Seligman, Professor, University of Michigan Law School supplied additional material for the record.

****682** ***3** On May 17, 1994, the Subcommittee on Securities issued a 163 page Staff Report on private securities litigation.

On March 2 and 22, 1995, and April 6, 1995, the Subcommittee on Securities held hearings on securities litigation reform legislation. Witnesses testifying on March 2 included Senator Christopher J. Dodd; Senator Pete V. Domenici; Marc E. Lackritz, President, Securities Industry Association; J. Carter Beese, former Commissioner, SEC, and Chairman, Capital Markets Regulatory Reform Project of the Center for Strategic and International Studies; Nell Minow, Principal, LENS, Inc.; James F. Morgan, Founder and Chairman, Morgan, Holland Ventures, who testified on behalf of the National Venture Capital Association; Christopher J. Murphy III, President and CEO, 1st Source Corp., who testified on behalf of the Association of Publicly Traded Companies; and George Sollman, CEO, Centigram Communications Corp., who testified on behalf of the American Electronics Association.

Witnesses testifying on March 22 included Mark J. Griffin, Director, Securities Division of the Department of Commerce of the State of Utah, who testified on behalf of the North American Securities Administrators Association, Inc.; Joan R. Gallo, City Attorney, San Jose, California; Sheldon H. Elsen, who testified on behalf of The Association of the Bar of the City of New York; David Guin, Partner, Ritchie and Rediker, who testified on behalf of the National Association of Securities and Commercial Law Attorneys; and Bartlett Naylor, National Coordinator, Office of Corporate Affairs, International Brotherhood of Teamsters.

Witnesses testifying on April 6 included Senator Barbara Mikulski; The Honorable Arthur Levitt, Chairman, SEC; Richard C. Breeden, former Chairman, SEC; and Charles Cox, former Commissioner and former Acting Chairman, SEC.

On May 25, 1995, the Committee met in Executive Session to consider S. 240 and adopted an amendment in the nature of a substitute that was offered by Chairman Alfonse M. D'Amato and, by a vote of 11–4, ordered S. 240 favorably reported. Senators Shelby, Sarbanes, Bryan, and Boxer voted against this legislation. Senator Bond recused himself from voting. The Committee adopted by a voice vote an amendment offered by Senator Bennett to amend section 12(2) of the Securities Act of 1933 (the "1933 Act"). The Committee did not adopt amendments offered by Senator Bryan to extend the statute of limitations for private actions under the 1934 Act (6–9) (with Senators Shelby, Sarbanes, Dodd, Kerry, Bryan, and Boxer voting in favor of the amendment); by Senator Sarbanes to delegate promulgation of a safe harbor provision for forward looking statements to SEC rulemaking (5–10) (with Senators Sarbanes, Kerry, Bryan, Boxer and Murray voting in favor of the amendment); by Senator Sarbanes to revise the scienter language of the safe harbor provision

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

adopted by the Committee (4–11) (with Senators Sarbanes, Kerry, Bryan and Boxer voting in favor of the amendment); by Senator Boxer to exempt from the statutory safe harbor retirement plans for senior citizens (4–11) (with Senators Sarbanes, Kerry, Bryan, and Boxer voting in favor of the amendment); and by Senator Bryan to revise the proportionate liability provision adopted by the Committee (5–10) (with Senators Shelby, ****683 *4** Sarbanes, Kerry, Bryan, and Boxer voting in favor of the amendment).

The Committee withheld consideration of two amendments pending further review: (i) to increase the uncollectible share provision for proportionate liability from 50% to 100%; and (ii) to provide for liability in private actions under Rule 10b–5 for aiders and abettors of primary securities law violators.

PURPOSE AND SUMMARY

During the Great Depression, Congress enacted the 1933 and 1934 Acts to promote investor confidence in the United States securities markets and thereby to encourage the investment necessary for capital formation, economic growth, and job creation. The Committee heard substantial testimony that today certain lawyers file frivolous "strike" suits alleging violations of the Federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation. These suits, which unnecessarily increase the cost of raising capital and chill corporate disclosure, are often based on nothing more than a company's announcement of bad news, not evidence of fraud. All too often, the same "professional" plaintiffs appear as name plaintiffs in suit after suit.

S. 240, the "Private Securities Litigation Reform Act of 1995," is intended to lower the cost of raising capital by combatting these abuses, while maintaining the incentive for bringing meritorious actions. Specifically, S. 240 intends: (1) to encourage the voluntary disclosure of information by corporate issuers; (2) to empower investors so that they–not their lawyers–exercise primary control over private securities litigation; and (3) to encourage plaintiffs' lawyers to pursue valid claims and defendants to fight abusive claims. Senator Pete Domenici, one of two original co-sponsors of this legislation, expects that S. 240 "will return some fairness and common sense to our broken securities class action litigation system, while continuing to provide the highest level of protection to investors in our capital markets."[2]

The federal securities laws and SEC rules prohibit the making of false and misleading statements or omissions in connection with the purchase and sale of securities. Under these provisions, the SEC has broad regulatory and enforcement powers. In addition, investors may bring private actions for violations of the federal securities laws. These actions typically rest upon the so called "catchall" fraud provision in Section 10(b) of the 1934 Act and SEC Rule 10b-5.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Congress has never expressly provided for private rights of action when it enacted Section 10(b). Instead, courts have held that Congress impliedly authorized such actions. As a result, 10(b) litigation has evolved out of judicial decisionmaking, not specific legislative action. The lack of congressional involvement has left judges free to develop conflicting legal standards, thereby creating substantial uncertainties and opportunities for abuses of investors, issuers, professional firms and others.

****684 *5** The Committee has determined that now is the time for Congress to reassert its authority in this area. As Chairman D'Amato made clear: "There is broad agreement on the need for reform. Shareholders' groups, Corporate America, the SEC, and even lawyers all want to curb abusive practices. Lawyers who bring meritorious suits do not benefit when strike suit artists wreak havoc on the Nation's boardrooms and courthouses. Our economy does not benefit when the threat of litigation deters capital formation."[3] Senator Dodd similarly said: "The flaws in the current private securities litigation system are simply too obvious to deny. The record is replete with examples of how the system is being abused and misused."[4] SEC Chairman Arthur Levitt concurred: "[T]here is no denying that there are real problems in the current system-problems that need to be addressed not just because of abstract rights and responsibilities, but because investors and markets are being hurt by litigation excesses."[5]

The purposes of S. 240 are threefold.

1.–S. 240 is intended to encourage the voluntary disclosure of information by issuers. The hallmark of our securities laws is broad, timely disclosure to investors of information about the financial condition of publicly traded companies. The mere specter of 10b–5 liability, however, has become more than a deterrent to fraud. Private securities class actions under 10b–5 inhibit free and open communication among management, analysts, and investors. This has caused corporate management to refrain from providing shareholders forward-looking information about companies. According to the SEC: "the threat of mass shareholder litigation, whether real or perceived," has had adverse effects, especially in "chilling * * * disclosure of forward-looking information."[6] Public companies–particularly high-tech, bio-tech and other growth companies, which are sued disproportionately in 10b–5 litigation–fear that releasing such information makes them even more vulnerable to attack. As a result, investors often receive less, not more, information, which makes investing more risky and increases the cost of raising capital.

To reduce this chill on voluntary disclosures by issuers, S. 240 creates a carefully tailored safe harbor for forward-looking statements. This safe harbor applies only to projections or estimates that are identified as forward-looking statements and that refer "clearly" and "proximately" to "the risk that actual results may differ materially from" the projection or estimate. The safe harbor has several other important limitations. For example, the safe harbor would not apply to initial public

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

offerings of securities. In addition, the SEC's enforcement authority would not be limited by the provisions in S. 240. To the contrary, S. 240 expands the SEC's enforcement ****685 *6** authority with respect to forward-looking statements by authorizing the SEC to recover damages on behalf of investors injured by such statements.

2.–S. 240 is intended to empower investors so that they, not their lawyers, control securities litigation. Under the current system, the initiative for filing 10b–5 suits comes almost entirely from the lawyers, not from genuine investors. Lawyers typically rely on repeat, or "professional," plaintiffs who, because they own a token number of shares in many companies, regularly lend their names to lawsuits. Even worse, investors in the class usually have great difficulty exercising any meaningful direction over the case brought on their behalf. The lawyers can decide when to sue and when to settle, based largely on their own financial interests, not the interests of their purported clients.

Numerous studies show that investors recover only 7 to 14 cents for every dollar lost as a result of securities fraud. Indeed, a 1994 Securities Subcommittee Staff Report found "evidence * * * that plaintiffs' counsel in many instances litigate with a view toward ensuring payment for their services without sufficient regard to whether their clients are receiving adequate compensation in light of evidence of wrongdoing."[7] The comment by one plaintiffs' lawyer–"I have the greatest practice of law in the world. I have no clients."[8]-aptly summarizes this flaw in the current system.

S. 240 contains several provisions to transfer primary control of private securities litigation from lawyers to investors. First, S. 240 creates a presumption, rebuttable under certain conditions, that the member of a purported class of investors with the largest financial interest in the case will serve as the lead plaintiff, thereby increasing the role of institutional investors in securities class actions. Second, S. 240 requires greater disclosure of settlement terms, including the reasons for a settlement, to class members, allowing them to object to, or raise questions about, the settlement. Third, S. 240 prohibits several abusive practices, such as the payment of bounties to named plaintiffs, that have enabled lawyers to exercise nearly total fiat over the course of private securities litigation.

3.–S. 240 is intended to encourage plaintiffs' lawyers to pursue valid claims for securities fraud and to encourage defendants to fight abusive claims. The dynamics of private securities litigation create powerful incentives to settle, causing securities class actions to have a much higher settlement rate than other types of class actions. Many such actions are brought on the basis of their settlement value. The settlement value to defendants turns more on the expected costs of defense than the merits of the underlying claim. The Supreme Court has recognized that "litigation under Rule 10b–5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."[9]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

As SEC Chairman Levitt explained, because class counsel usually advances the costs of litigation, “counsel may have a greater ****686 *7** 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.”[10] If a defendant cannot win an early dismissal of the case, “the economics of litigation may dictate a settlement even if the defendant is relatively confident that it would prevail at trial.”[11]

This incentive to settle stems not only from legal fees incurred but also from the doctrine of joint and several liability, which requires a defendant to pay 100 percent of the damages even if the defendant is only one percent responsible. As Chairman D'Amato stressed: “the threat of such liability often forces innocent ‘deep pocket’ defendants to settle frivolous suits.”[12] Chairman Levitt similarly concluded: “Because the existing safeguards provided by the system are imperfect, there is a danger that weak claims may be overcompensated while strong claims are undercompensated.”[13]

S. 240 includes several provisions to reduce the settlement value of frivolous securities class actions. First, S. 240, while retaining joint and several liability for defendants who knowingly engage in securities fraud, adopts a modified proportionate liability standard for defendants found to be less culpable. In cases involving insolvent co-defendants who are found to be proportionately liable, a remaining defendant must pay the share reflecting his or her degree of responsibility plus all or part of the uncollectible amount but only up to 50 percent of its share of the original judgment. Joint and several liability is also retained for all small investors whose net worth is $200,000 or less and who lose more than ten percent of their net worth as a result of the fraud. Second, S. 240 clarifies the pleading requirements for bringing securities fraud claims by adopting a standard modelled on that currently applied by the United States Court of Appeals for the Second Circuit, the leading circuit court in this area. Third, S. 240 requires courts to make findings regarding compliance by all attorneys and all parties with Rule 11(b) of the Federal Rules of Civil Procedure, which authorizes the imposition of sanctions when a complaint is legally frivolous, lacks evidentiary support, or is otherwise abusive.

S. 240 includes several other provisions intended to reduce the cost of raising capital. These provisions include establishing guidelines for calculating damages; codifying the requirement under current law that plaintiffs prove that the loss in the value of their stock was caused by the Section 10(b) violation and not by other factors; requiring auditors to notify the SEC of illegal acts that management has not adequately addressed; prohibiting the use of conduct actionable as securities fraud as the basis of private treble damages actions under the Racketeer Influenced and Corrupt Organizations Act (“RICO”); and clarifying the ability of the SEC to bring aiding and abetting claims. None of the provisions in S. 240 affects the SEC's ability to bring enforcement actions.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

****687 *8** PURPOSE AND SCOPE OF THE LEGISLATION

BACKGROUND

The United States securities markets are the most liquid and deep in the world. In just the past ten years, capital raised has risen by 1,000%. Over the last three years, the U.S. securities industry has set new records in corporate underwriting and raising capital for new businesses.[14] In 1994, the industry raised $1 trillion for businesses, including $34 billion for small businesses making their first foray into the capital markets.[15]

The Nation's capital markets play a critical role in our domestic economy by creating jobs and expanding businesses. Small and emerging businesses now account for two-thirds of the new jobs in America.[16] Strong capital markets enhance the United States' competitiveness in the global markets.

The success of the U.S. securities markets is largely the result of a high level of investor confidence in the integrity and efficiency of our markets. The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of the securities laws. As noted by SEC Chairman Levitt, “private rights of action are not only fundamental to the success of our securities markets, they are an essential complement to the SEC's own enforcement program.”[17] The Supreme Court has also described private securities actions as a “necessary supplement” to the SEC's enforcement regime.[18]

Although private securities class actions can complement SEC enforcement actions, the evils flowing from abusive securities litigation start with the filing of the complaint and continue through to the final disposition of the action. A complaint alleging violations of the Federal securities laws is easy to craft and can be filed with little or no due diligence. A drop in a public company's stock price, a failed product development project, or even unpredictable adverse market conditions that affect earnings results for a quarter can trigger numerous securities fraud lawsuits against a company.

One study concluded that, in the early 1980's, every company in one business sector that suffered a market loss of $20 million or more in its capitalization was sued.[19] Another survey of venture-backed companies in existence for less than ten years revealed that one in six had been sued at least once, and that such lawsuits had already consumed an average of 1,055 hours of management time and $692,000 in legal fees.[20]

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

****688 *9** Most defendants in securities class action lawsuits choose to settle rather than face the enormous expense of discovery and trial. Of the approximately 300 securities lawsuits filed each year, almost 93% settle at an average settlement cost of $8.6 million.[21] These cases are generally settled based not on the merits but on the size of the defendant's pocketbook.

The fact that many of these lawsuits are filed as class actions has had an in terrorem effect on Corporate America. A whole stable of “professional plaintiffs,” who own shares–or sometimes fractions of shares–in many companies, stand ready to lend their names to class action complaints. These lawsuits have added significantly to the cost of raising capital and represent a “litigation tax” on business.[22] Smaller start-up companies bear the brunt of abusive securities fraud lawsuits. Many of these companies are high-technology companies which, by their very nature, have unpredictable business prospects and, consequently, volatile stock prices.[23]

This abusive litigation also threatens to undermine one of the underpinnings of the Federal securities laws–disclosure to investors. Risk-averse corporate management avoid discussions of future business plans. Many companies refuse to talk or write about future business plans, knowing that projections that fail to materialize will inevitably result in a lawsuit.[24]

Underwriters, lawyers, accountants, and other professionals are prime targets of abusive securities lawsuits. The deeper the pocket, the greater the likelihood that a marginal party will be named as a defendant in a securities class action. The availability of insurance also drives these lawsuits. In 1994 alone, $1.4 billion was paid out by corporations or their insurers to settle securities lawsuits.[25]

The “victims” on whose behalf these lawsuits are allegedly brought often receive only pennies on the dollar in damages.[26] Even worse, long-term investors ultimately end up paying the costs associated with the lawsuits. As the Council for Institutional Investors advised: “We are * * * hurt if a system allows someone to force us to spend huge sums of money in legal costs by merely paying ten dollars and filing a meritless cookie cutter complaint against a company or its accountants when that plaintiff is disappointed in his or her investment.”[27]

****689 *10** In crafting this legislation, the Committee has sought to strike the appropriate balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless litigation. Our economy does not benefit when strike suit artists wreak havoc on our Nation's boardrooms and deter capital formation.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

ELIMINATION OF ABUSIVE PRACTICES IN SECURITIES LITIGATION

Removing the incentives to participate in abusive class action litigation

The Securities Subcommittee heard extensive testimony concerning certain areas of abuse involving class actions. These abuses include the use of professional plaintiffs and the race to the courthouse to be the first to file the complaint.[28] State securities regulators testified that reform in both of these areas would “create a more rational system for the filing of these cases.”[29]

The proliferation of “professional” plaintiffs has made it particularly easy for lawyers to find individuals willing to play the role of wronged investor for purposes of filing a class action lawsuit. Professional plaintiffs often are motivated by the payment of a “bonus” far in excess of their share of any recovery.

The Committee believes that lead plaintiffs are not entitled to a bounty for their service. Thus, the lead plaintiff's share of any final judgment of any settlement should be calculated in the same manner as the shares of the other class members. Recognizing that service as the lead plaintiff may require court appearances or other duties involving time away from work, the Committee grants courts discretion to award the lead plaintiff reimbursement for “reasonable costs and expenses” (including lost wages) directly relating to representation of the class.

The Committee recognizes that certain basic information about the lead plaintiff should be provided at the outset of litigation. Accordingly, the Committee requires that the lead plaintiff file a sworn certified statement with the complaint. The plaintiff must certify that he or she: (a) reviewed and authorized the filing of the complaint; (b) did not purchase the securities at the direction of counsel or to participate in a lawsuit; and (c) is willing to serve on behalf of the class. To further deter professional plaintiffs, the plaintiff must also identify any transactions in the securities covered by the class period, and the other lawsuits in which the plaintiff has sought to serve as lead plaintiff in the last three years.

The lead plaintiff should actively represent the class. The Committee believes that the lead plaintiff–not lawyers–should drive the litigation. As one witness testified: “One way of addressing this problem is to restore lawyers and clients to their traditional roles by making it harder for lawyers to invent a suit and then attach a plaintiff.”[30]

****690 *11** Courts traditionally appoint the lead plaintiff and lead counsel in class action lawsuits on a “first come, first serve” basis. Since no deference is given to the most thoroughly researched complaint, the lawyers spend minimal time preparing complaints in securities class actions. The first lawsuit filed also renders the lead plaintiff.

The Committee believes that the selection of the lead plaintiff should rest on considerations other than a speedy filing of the complaint. The Committee establishes procedures for the appointment of the lead plaintiff in class actions brought under both the 1933 Act and 1934 Act. Within 20 days of filing a complaint, the plaintiff must publish in a widely circulated business publication notice of the complaint, and that members of the purported class may move the court to serve as lead plaintiff within 60 days. The Committee does not intend for the members of the purported class who seek to serve as lead plaintiff to file with this motion the certification described above. The Committee intends "publication" to encompass a variety of mediums, including wire, electronic, or computer services.

The Committee intends to increase the likelihood that institutional investors will serve as lead plaintiffs by requiring the court to presume that the member of the purported class with the largest financial stake in the relief sought is the "most adequate plaintiff." Institutional investors are America's largest shareholders, with about $9.5 trillion in assets, accounting for 51% of the equity market. Pension funds total $4.5 trillion of institutional assets.[31] The current system often works to prevent institutional investors from selecting counsel or serving as lead plaintiff in class actions.[32]

The Committee believes that increasing the role of institutional investors in class actions will ultimately benefit the class and assist the courts. According to one representative of institutional investors: "As the largest shareholders in most companies, we are the ones who have the most to gain from meritorious securities litigation."[33]

Scholars predict that increasing the role of institutional investors will benefit both injured shareholders and courts: "Institutions with large stakes in class actions have much the same interests as the plaintiff class generally; thus, courts could be more confident settlements negotiated under the supervision of institutional plaintiffs were 'fair and reasonable' than is the case with settlements negotiated by unsupervised plaintiffs' attorneys"[34] The Committee believes that an institutional investor acting as lead plaintiff can, consistent with its fiduciary obligations, balance the interests of the class with the long-term interests of the company and its public investors.

Finally, the Committee permits the lead plaintiff to choose the class counsel. This provision is intended to permit the plaintiff to choose counsel rather than have counsel choose the plaintiff. Although the Committee permits the most adequate plaintiff to ****691 *12** choose class counsel, the Committee does not intend to disturb the court's discretion under existing law to approve or disapprove the lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

New rules relating to the settlement process

The Securities Subcommittee also heard testimony that counsel in securities class actions receive a disproportionate share of the settlement award and that class members frequently lack meaningful information about the terms of the proposed settlement.[35]

Under current practice, courts generally award attorney's fees based on the so-called "lodestar" approach–i.e., the court multiplies the attorney's hours by a reasonable hourly fee, which may be increased by an additional amount based on risk or other relevant factors.[36] As a result of this methodology, attorney's fees have exceeded 50% or more of the settlement awarded to the class. The Committee limits the award of attorney's fees and costs to a reasonable percentage of the amount of recovery awarded to the class. By not fixing the percentage of attorney's fees and costs that may be awarded, the Committee intends to give the court flexibility in determining what is reasonable on a case-by-case basis. The provision focuses on the final amount of damages awarded, not the means by which they are calculated.

Class members often receive insufficient notice of the terms of a proposed settlement and, thus, have little basis to evaluate the settlement. As one bar association advised, "settlement notices provided to class members are often obtuse and confusing, and should be written in plain English."[37] The Committee received similar testimony from an investor who was a class member in two separate securities fraud lawsuits: "Nowhere in the settlement notices were the stockholders told of how much they could expect to recover of their losses. * * * I feel that the settlement offer should have told the stockholders how little of their losses will be recovered in the settlement, and that this is a material fact to the shareholder's decision to approve or disapprove the settlement."[38]

The Committee requires that certain information be included in any proposed or final settlement agreement disseminated to class members. To ensure that critical information is readily ascertainable to class members, the Committee requires that such information appear in summary form on the cover page of the notice. The notice must contain a statement of the average amount of damages per share that would be recoverable if the settling parties can agree on a figure, or a statement from each settling party on why there is disagreement. It must also explain the attorney's fees and costs sought. The name, telephone number, and address of counsel for the class must be provided, and such counsel must be reasonably available to answer class members' questions about the settlement. Perhaps most importantly, the notice must include a brief statement explaining the reason for the proposed settlement.

****692 *13** Although generally barring the filing of settlement agreements under seal, the Committee recognizes that legitimate reasons may exist for the court to permit the entry of a settlement or portions of a settlement under seal. A party must show "good cause," i.e.,

that the publication of a portion or portions of the settlement agreement would result in direct and substantial harm. The Committee intends that "direct and substantial harm" would include reputational injury to a party.

Attorney sanctions for pursuing meritless litigation

The Securities Subcommittee heard ample testimony on the need to reduce the economic incentive to file meritless claims. Under Rule 11 of the Federal Rules of Civil Procedure, the courts may impose sanctions against an attorney or party for the filing of an abusive lawsuit.[39] Many believe that Rule 11 has not been an effective tool in limiting abusive litigation. Complaints about the current system include the high cost of making a Rule 11 motion, and the unwillingness of courts to impose sanctions, even when the rule is violated.[40]

Several proposals have been advanced to reduce the economic incentive to file abusive securities fraud suits.[41] The Committee recognizes the need to reduce significantly the economic incentive to file meritless lawsuits without hindering the ability of the victims of fraud to pursue legitimate claims.

Upon the final adjudication of an action, the Committee requires the court to include in the record specific findings as to whether all parties and all attorneys have complied with the requirements of Rule 11(b) of the Federal Rules of Civil Procedure. If the court finds that either a party or an attorney violated Rule 11(b), the court must impose sanctions. Section 103 adopts a rebuttable presumption that the appropriate sanction for the filing of a complaint in violation of Rule 11(b) is an award of attorney's fees and costs. A party may rebut this presumption by proof: (i) that the violation was de minimis, or (ii) that the imposition of fees and costs would impose an undue burden on that party. The Committee does not intend ****693 *14** the court to establish a specific income or other financial threshold that would automatically carve out a category of individuals for which imposing sanctions would always cause an "undue burden." Rather, the Committee expects that the court will take into account the relevant circumstances of each case.

If a party successfully rebuts the presumption, the court then must impose sanctions consistent with Rule 11(c)(2).[42] The Committee intends for this provision to impose upon courts the affirmative duty to scrutinize closely filings and to sanction attorneys whenever their conduct violates Rule 11(b).

Stay of discovery

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The cost of discovery often forces defendants to settle abusive securities class actions. According to the general counsel of an investment bank, “discovery costs account for roughly 80% of total litigation costs in securities fraud cases.”[43] In addition, the threat that the time of key employees will be spent responding to discovery requests, such as providing deposition testimony, may force coercive settlements.

The Securities Subcommittee heard testimony that discovery in securities class actions resembles a fishing expedition. As one corporate executive testified, “once the suit is filed, the plaintiff's law firm proceeds to search through all of the company's documents and take endless depositions for the slightest positive comment which they can claim induced the plaintiff to invest and any shred of evidence that the company knew a downturn was coming.”[44] Thus, plaintiffs sometimes file frivolous lawsuits in order to conduct discovery in the hopes of finding a sustainable claim not alleged in the complaint. Accordingly, the Committee has determined that discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint. Courts should stay all discovery pending a ruling on a motion to dismiss a securities class action, except in the exceptional circumstance where particularized discovery is necessary to preserve evidence or to prevent undue prejudice to a party. The Committee recognizes, for example, that a motion to dismiss may remain pending for a period of time, and that the terminal illness of an important witness may necessitate the deposition of the witness prior to ruling on the motion to dismiss.

Because the imposition of a stay of discovery may increase the likelihood that relevant evidence may be lost, the Committee makes it unlawful for any person, upon receiving actual notice that names that person as a defendant, to destroy or otherwise alter relevant evidence. The Committee intends this provision to prohibit only the willful alteration or destruction of evidence relevant to the allegations in the complaint. This provision does not impose liability ****694 *15** for the inadvertent or unintentional destruction of documents. Although this prohibition expressly applies only to defendants, the Committee believes that the willful destruction of evidence by a plaintiff would be equally improper, and that courts have ample authority to prevent such conduct or to apply sanctions as appropriate.

A strong pleading requirement

The Securities Subcommittee has heard ample testimony on the need to establish a uniform and stringent pleading requirement to curtail the filing of abusive lawsuits. Rule 9(b) of the Federal Rules of Civil Procedure requires a plaintiff to plead allegations of fraud with “particularity.” The courts of appeals have interpreted Rule 9(b) in different ways, creating distinctly different pleading standards among the circuits.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The Committee does not adopt a new and untested pleading standard that would generate additional litigation. Instead, the Committee chose a uniform standard modeled upon the pleading standard of the Second Circuit. Regarded as the most stringent pleading standard,[45] the Second Circuit requires that the plaintiff plead facts that give rise to a "strong inference" of defendant's fraudulent intent.[46] The Committee does not intend to codify the Second Circuit's caselaw interpreting this pleading standard, although courts may find this body of law instructive.

The plaintiff must also specifically identify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if the allegation is made on information and belief, the plaintiff must set forth all information in plaintiff's possession on which the belief is formed.

The Committee also requires the plaintiff to show that the misstatement or loss alleged in the complaint caused the loss incurred by the plaintiff. For example, the plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as the result of the misstatement or omission. The defendant would then have the opportunity to prove any mitigating circumstances, or that factors unrelated to the fraud contributed to the loss.

A safe harbor for forward-looking statements or projections

Abusive litigation severely impacts the willingness of corporate managers to disclose information to the marketplace. Former SEC Chairman Richard Breeden testified: "Shareholders are also damaged due to the chilling effect of the current system on the robustness and candor of disclosure. * * * Understanding a company's own assessment of its future potential would be among the ****695 *16** most valuable information shareholders and potential investors could have about a firm."[47]

Fear that inaccurate projections will trigger the filing of a securities fraud lawsuit has muzzled corporate management. One study found that over two-thirds of venture capital firms were reluctant to discuss their performance with analysts or the public because of the threat of litigation.[48] Anecdotal evidence similarly indicates company's counsel advises clients to say as little as possible, because "legions of lawyers scrub required filings to ensure that disclosures are as milquetoast as possible, so as to provide no grist for the litigation mill."[49]

Small, high-growth businesses–because of the volatility of their stock prices–are particularly vulnerable to securities fraud lawsuits when projections do not materialize. If a company fails to satisfy its announced earnings projections–perhaps because of changes in the business cycle or a change in the timing of an order or new product–the company is likely to face a lawsuit. In many cases, the discovery process is then used to look for evidence of fraud. One witness described the

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

broad discovery requests that resulted in the company producing over 1,500 boxes of documents at an expense of $1.4 million.[50]

The Committee's statutory "safe harbor" is intended to enhance market efficiency by encouraging companies to disclose forward-looking information. This provision protects from liability certain "forward-looking" statements that are accompanied by sufficient cautionary language.

The concept of a safe harbor for forward-looking statements made under certain conditions is not new. In 1979, the SEC promulgated Rule 175 to provide a safe harbor for certain forward looking statements made with a "reasonable basis" and in "good faith." This safe harbor has not provided companies meaningful protection from litigation. In a February 1995 letter to the SEC, a leading pension fund stated: "A major failing of the existing safe harbor is that while it may provide theoretical protection to issuers from liability when disclosing projections, it fails to prevent the threat of frivolous lawsuits that arises every time a legitimate projection is not realized."[51]

Courts have also crafted a safe harbor for forward-looking statements or projections accompanied by sufficient cautionary language. At least five courts of appeals have recognized the so-called ***17 **696** "bespeaks caution" doctrine.[52] In an oft-cited case,[53] the Third Circuit articulated this doctrine as follows:

> We can state as a general matter that, when an offering document's forecasts, opinions, or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provides investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.[54]

The Committee's safe harbor is based on aspects of SEC Rule 175 and the bespeaks caution doctrine. This provision applies to both oral and written statements that describe, project or estimate future events. The Committee adopts the SEC's present definition, as set forth in Rule 175, of forward-looking information. The SEC's definition covers: (i) certain financial items, including projections of revenues, income, and earnings, capital expenditures, dividends, and capital structure; (ii) management's statement of future business plans and objectives; and (iii) certain statements made in SEC required disclosures, including management's discussion and analysis and results of operations; and (iv) any statement disclosing the assumptions underlying the forward-looking statement.

The safe harbor provision protects written and oral forward-looking statements made by issuers and certain persons retained or acting on behalf of the issuer. To come within the safe harbor, the statement must "project, estimate, or describe" future events and be accompanied by sufficient

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

notice that the information is forward-looking and that actual results may be materially different from such projections. In the case of oral statements, the Committee expects that the notice will be provided at the outset of any general discussion of future events and that further notice will not be necessary during the course of that discussion.

The Committee intends that the phrase "a person acting on behalf of such issuer" be construed in a manner that will promote the purposes of the safe harbor in accordance with securities industry practice. In this regard, the Committee intends that the safe harbor protect, not merely the statements of the issuer, but also those of employees of the issuer and of persons acting on the issuer's behalf.

The Committee has determined that the statutory safe harbor should not apply to certain forward-looking statements. Thus, the statutory safe harbor does not protect forward-looking statements: (1) included in financial statements prepared in accordance with generally accepted accounting principles; (2) contained in an initial public offering registration statement; (3) made in connection with ****697 *18** a tender offer; (4) made in connection with a partnership, limited liability corporation, or direct participation program offering; or (5) made in beneficial ownership disclosure statements filed with the SEC under Section 13(d) of the 1934 Act. The Committee expressly authorizes the SEC to consider the adoption of a regulatory safe harbor for such statements.

Moreover, the Committee has determined to extend the statutory safe harbor only to forward-looking information of certain established issuers subject to the reporting requirements of Section 15(d) of the 1934 Act. Except as provided by SEC rule or regulation, the safe harbor does not extend to an issuer who: (a) during the three year period preceding the date on which the statement was first made, has been convicted of a felony or misdemeanor described in clauses (i) through (iv) of Section 15(b)(4) of the 1934 Act or is the subject of a decree or order involving a violation of the federal securities laws; (b) makes the statement in connection with a "blank check" securities offering, "rollup transaction," or "going private" transaction; or (c) issues penny stock.

Although the Committee believes that market discipline will most likely provide sufficient disincentives for using the safe harbor as a "license to lie," the safe harbor does not protect forward-looking statements "knowingly made with the expectation, purpose, and actual intent of misleading investors." The Committee intends that the pleading requirements under new Section 36 of the 1934 Act will apply to a complaint alleging that a forward-looking statement is not within the safe harbor. Accordingly, the plaintiff would have to allege "facts giving rise to a strong inference" that the forward-looking statement was "knowingly made with the expectation, purpose, and actual intent of misleading investors." "Expectation," "purpose," and "actual intent" are independent elements of the exclusion, and plaintiffs have the burden of pleading and proving each of these elements.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The court must stay discovery (other than discovery that is specifically directed to the applicability of the safe harbor) when a defendant moves for summary judgment based on the ground that the safe harbor bars a claim for relief. Courts should, to the fullest extent possible, limit discovery to facts directly bearing upon the applicability of the safe harbor and not permit plaintiffs to engage in fishing expeditions. The Committee expects that the stay will significantly reduce the costs of discovery.

The Committee intends for its statutory safe harbor provisions to serve as a starting point and fully expects the SEC to continue its rulemaking proceedings in this area. The SEC should, as appropriate, promulgate rules or regulations to expand the statutory safe harbor by providing additional exemptions from liability or extending its coverage to additional types of information.

Written interrogatories

In an action to recover money damages, the Committee requires the court to submit written interrogatories to the jury on the issue of defendant's state of mind at the time of the violation. In expressly providing for certain interrogatories, the Committee does not intend to prohibit otherwise or discourage the submission of interrogatories concerning the mental state or relative fault of the ****698 *19** plaintiff and of persons who could have been joined as defendants. For example, interrogatories may be appropriate in contribution proceedings among defendants or in computing liability when some of the defendants have entered into settlement with the plaintiff prior to verdict or judgment.

Limiting civil RICO actions

The SEC has supported removing securities fraud as a predicate act of racketeering in a civil action under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). SEC Chairman Arthur Levitt testified: "Because the securities laws generally provide adequate remedies for those injured by securities fraud, it is both unnecessary and unfair to expose defendants in securities cases to the threat of treble damages and other extraordinary remedies provided by RICO."[55]

The Committee amends Section 1964(c) of Title 18 of the U.S. Code to remove any conduct that would have been actionable as fraud in the purchase or sale of securities as a predicate act of racketeering under civil RICO. The Committee intends this amendment to eliminate securities fraud as a predicate act of racketeering in a civil RICO action. In addition, a plaintiff may not plead other specified offenses, such as mail or wire fraud, as predicate acts of racketeering under civil RICO if such offenses are based on conduct that would have been actionable as securities fraud.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

A grant of authority to the SEC to prosecute certain aiding and abetting cases

Prior to the Supreme Court's decision in Central Bank of Denver v. First Interstate Bank of Denver,[56] courts of appeals had recognized that private parties could bring actions against persons who “aided and abetted” primary violators of the securities laws. In Central Bank, the Court held that there was no aiding and abetting liability for private lawsuits involving violations of the securities antifraud provisions.

The Committee considered testimony endorsing the result in Central Bank and testimony seeking to overturn this decision. The Committee believes that amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to S. 240's goal of reducing meritless securities litigation. The Committee does, however, grant the SEC express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary violators of the securities laws.

Limitation on damages

The current method of calculating damages in 1934 Act securities fraud cases is complex, with no statutory guidance to provide certainty. As a result, there are often substantial variations in the damages calculated by the defendants and the plaintiffs. Typically, in an action involving a fraudulent misstatement or omission, the investor's damages are presumed to be the difference between the ****699 *20** price he or she paid for the security and the price of the security on the date the corrective information is disseminated to the market.

Between the time a misrepresentation is made and the time the market receives corrected information, however, the price of the security may rise or fall for reasons unrelated to the alleged fraud. According to an analysis provided to the Securities Subcommittee, damages in securities litigation amount to approximately 27.7%[57] of an investor's market loss. Calculating damages based on the date corrective information is disclosed may substantially overestimate plaintiff's actual damages.[58] The Committee intends to rectify the uncertainty in calculating damages by providing a “bounce back” period, thereby limiting damages to those losses caused by the fraud and not by other market conditions.

This provision requires that plaintiff's damages be calculated by taking into account the value of the security on the date plaintiff originally bought or sold the security and the median market value of the security during the 90-day period after dissemination of any information correcting the misleading statement or omission. If the plaintiff sells those securities or repurchases the subject securities during the 90-day period, damages will be calculated based on the price of that

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

transaction and the median market value of the security immediately after the dissemination of corrective information and ending with the plaintiff's sale or repurchase of the security.

Modification of joint and several liability

The Committee heard considerable testimony about the impact of joint and several liability on private actions under the Federal securities laws. Under joint and several liability, each defendant is liable for all of the damages awarded to the plaintiff. Thus, a defendant found responsible for only 1% of the harm could be required to pay 100% of the damages.

Former SEC Commissioner J. Carter Beese, Jr., observed that "[t]his principle has a legitimate public policy purpose, but, in practice, it encourages plaintiffs to name as many deep-pocket defendants as possible, even though some of these defendants may bear very little responsibility for any injuries suffered by the plaintiff."[59] He noted that "[a]s a result, whenever a company is sued under Rule 10b–5, there is a strong likelihood that lawyers, accountants, underwriters and directors will be sued, as well."[60] Several other witnesses, including former SEC Chairmen David S. Ruder and Richard C. Breeden and former SEC Commissioner Charles C. Cox, acknowledged this problem.[61]

****700 *21** When peripheral defendants are sued, the pressure to settle is overwhelming–regardless of the defendant's culpability. Former SEC Chairman Ruder stated that defendants are under "enormous pressure to settle" because of "the possibility that they will be required to pay the entire amount claimed."[62] The exposure in securities fraud class actions is enormous because of the amount of total damages claimed. In one sample of cases the average claim was $40 million, with 10% of the cases seeking more than $100 million in damages.[63] The cost of discovery also contributes to this pressure to settle.[64] As a result, oftentimes peripheral defendants are joined simply to obtain a settlement. As Chairman D'Amato observed, "[t]he threat of [joint and several] liability often forces innocent 'deep pocket' defendants to settle frivolous suits."[65]

The resulting litigation burden–the combination of legal fees and settlement costs–on peripheral defendants has significant consequences. "The fact that a director of a publicly-held company faces the prospect of being sued regardless of how well he or she performs is driving some directors off corporate boards, and precluding other companies from attracting qualified board members."[66] Jean Head Sisco, testifying on behalf of the National Association of Corporate Directors, stated that "the proliferation of abusive 10b–5 securities suits is making it extremely difficult to attract qualified, independent people to sit on corporate boards."[67] Several surveys have confirmed that directors are increasingly concerned about litigation risk and are reluctant to serve on boards of start-up and high-technology companies.[68]

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

At a minimum, qualified individuals insist that the company obtain substantial D&O insurance coverage. SEC Chairman Levitt himself refused to serve on boards of companies with insufficient insurance.[69] But that prerequisite imposes a high cost: D&O insurance premiums have increased seven-fold over the last decade,[70] in large part because of the cost of this litigation. "Within the past two years, several of the major D&O insurers have priced D&O insurance out of existence for many companies, or have stopped writing policies for companies in particular industries, such as the technology sector. All investors are at risk as these growing companies put increasingly large sums of money into D&O policies instead of into developing the long-term strength of the company."[71]

Accounting firms particularly have been hard hit by securities litigation. The six largest firms face $10 billion in 10b–5 claims.[72] Their gross audit-related litigation costs amounted to $783 million in 1992–more than 14% of their audit revenues for that year.[73] ****701 *22** Former SEC Commissioner A.A. Sommer, who heads the Public Oversight Board, the independent body that oversees the accounting profession's self-regulatory efforts, testified that, in view of "some recent judgments and the amounts being sought in pending cases, it is not beyond the pale to believe, and some responsible people do believe–that one or more major [accounting] firms may ultimately be bankrupted.[74]

Because of concern about the fairness of 10b–5 litigation and because of concern about the adverse consequences of joint and several liability, a number of witnesses, including SEC Chairman Levitt,[75] former SEC Chairmen Ruder and Breeden,[76] and former SEC Commissioners Beese and Sommer,[77] advocated modification of the doctrine of joint and several liability in securities actions. For example, Ralph V. Whitworth, president of the United Shareholders Association, stated that in cases where there was no proof of actual fraud "[e]liminating joint and several liability * * * will significantly reduce the number of strike suits brought against defendants who have done nothing wrong but are seen as having deep pockets."[78] Marc Lackritz, President of the Securities Industry Association, identified proportionate liability as the most important provision to be included in securities litigation reform legislation.[79]

The Committee modifies joint and several liability to eliminate unfairness and to reconcile the conflicting interests of investors in a manner designed to best protect the interests of all investors–those who are plaintiffs in a particular case, those who are investors in the defendant company, and those who invest in other companies.

The provision imposes full joint and several liability, as under current law, on all defendants who engage in knowing securities fraud. Defendants who are found liable but who did not engage in

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

knowing securities fraud are liable only for their share of the judgment (based upon the fact finder's apportionment of responsibility), with two key exceptions. First, in the event some defendant is insolvent, and therefore cannot pay his or her share of the liability, and the jointly and severally liable defendants cannot make up the difference, each of the other proportionally liable defendants must make an additional payment–up to 50% of his or her own liability–to make up the shortfall in the plaintiff's recovery.

Second, proportionally liable defendants will be liable for the uncollectible share if the plaintiff establishes that (i) the damages are more than 10% of the plaintiff's net worth, and (ii) the plaintiff's net financial worth is less than $200,000. In this scenario, there is no limitation on the amount proportionally liable defendants will be required to pay. The $200,000 financial net worth test does not reflect a judgment by the Committee that investors who fall below this standard are "small," unsophisticated, or in need of, ****702 *23** or entitled to, special protection under the securities laws. The Committee intends "financial net worth" to include all of the plaintiff's financial assets including stocks, bonds, real estate, and jewelry.

Loss causation requirement for Section 12(2) of the 1933 Act

Congress adopted Section 12(2) of the 1933 Act to deter material misrepresentations and omissions in the purchase or sale of securities. Some courts have held that a plaintiff suing under Section 12(2) need not prove that the misstatement or omission caused the loss.[80] As a result, issuers have been put in the position of insuring shareholders and purchasers against normal market risk. An issuer that makes a material misstatement or omission in its prospectus can be liable for losses to shareholders–even if the losses have nothing to do with the misstatement or omission.

This interpretation of Section 12(2) provides an unfair windfall to shareholders who have not in any way been harmed by the misstatement or omission. For example, a company might fail to state in a public offering prospectus that it conducts business in a foreign country. Even if the company's foreign business is highly profitable, if its overall profits decline as the result of unrelated factors (such as a downturn in its domestic business), any purchaser of the securities in the offering could rescind his or her purchase.

The Committee amends Section 12(2) to clarify that defendants may raise the absence of "loss causation" as an affirmative defense. If a defendant in a Section 12(2) action demonstrates that part or all of the decline in the value of the security was caused by factors other than the misstatement or omission alleged in the complaint, the plaintiff may not recover damages based on that portion of the decline. The defendant must bear the burden of affirmatively demonstrating the absence of loss causation. This provision does not place any additional burden on plaintiffs to demonstrate that loss causation existed, nor does it deprive investors of Section 12(2) remedies when they have

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

incurred losses caused by inadequate disclosure. The amendment to Section 12(2) is modeled after Section 11 of the Securities Act, which provides for a similar affirmative defense.

Auditor Disclosure of Corporate Fraud

This provision requires independent public accountants to adopt certain procedures in connection with their audits and to inform the SEC of illegal acts of their auditing clients. These requirements should be carried out in accordance with generally accepted auditing standards for audits of SEC registrants–as modified from time to time by the Commission–on the detection of illegal acts, related party transactions and relationships, and evaluation of an issuer's ability to continue as a going concern.

The Committee does not intend to affect the Commission's authority in areas not specifically addressed by this provision. The Committee expects that the SEC will continue its long-standing ****703 *24** practice of looking to the private sector to set and to improve auditing standards. The SEC should not act to “modify” or “supplement” generally accepted auditing standards for SEC registrants until after it has determined that the private sector is unable or unwilling to do so on a timely basis. The Committee intends for the SEC to have discretion, however, to determine the appropriateness and timeliness of the private sector response. The SEC should act promptly if required by the public interest or for the protection of investors.

SECTION-BY-SECTION ANALYSIS OF S. 240 THE “PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995”

Section 1. Short title; table of contents

Section 1 provides that S. 240 may be cited as the “Private Securities Litigation Reform Act of 1995” (the “Act”) and sets out a table of contents for the Act.

TITLE I–REDUCTION OF ABUSIVE LITIGATION

Section 101. Elimination of certain abusive practices

Section 101(a) amends the Securities Exchange Act of 1934 (the “1934 Act”) by adding a new paragraph (8) to Section 15(c), prohibiting brokers or dealers or any associated persons from soliciting or receiving any type of fee or remuneration for assisting an attorney in obtaining representation of any person in private actions under the Securities Act of 1933 (the “1933 Act”) or the 1934 Act.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section 101(b) amends Section 20 of the 1933 Act by adding a new subsection (f) and Section 21 of the 1934 Act by adding a new subsection (i), requiring the court to determine whether a plaintiff's attorney who owns, or has a beneficial interest in, securities that are the subject of litigation has a disqualifying conflict of interest.

Section 101(c) amends Section 20 of the 1933 Act by adding a new subsection (g) and Section 21(d) of the 1934 Act by adding new paragraph (4), prohibiting the payment of attorneys' fees or expenses incurred by private parties out of funds disgorged as the result of action by the Securities and Exchange Commission (the “Commission” or “SEC”), except as otherwise ordered by the court upon motion by the Commission and, in the case of SEC administrative actions, by order of the Commission.

Section 102. Securities class action reform

Section 102(a) establishes five new recovery rules for private class actions under the 1933 and 1934 Acts. Section 102(a)(1) of the Act amends Section 20 of the 1933 Act by adding a new subsection (h) and Section 102(a)(2) of the Act amends Section 21 of the 1934 Act by adding new subsection (j).

The first rule requires every plaintiff seeking to serve as a representative party on behalf of a class to file a sworn certification with the complaint, stating: (i) the plaintiff reviewed the complaint and authorized its filing; (ii) the plaintiff did not purchase the securities at the direction of counsel or to participate in a lawsuit; (iii) the plaintiff is willing to serve as a representative party on behalf of the class; (iv) the plaintiff's transactions during the class period in the security that is the subject of the complaint; (v) other lawsuits ****704 *25** in which the plaintiff has sought to serve as representative party in the prior three years; and (vi) the plaintiff will not receive any bonus for serving as the class representative. This certification will not be construed to waive the attorney-client privilege.

The second rule limits the class representative's recovery to his or her pro rata share of the settlement or final judgment. The court may also reimburse the class representative for “reasonable costs and expenses,” including lost wages directly relating to the representation of the class.

The third rule prohibits the filing of settlements under seal except if “good cause” is shown, i.e., publication of a portion or portions of the settlement agreement would result in direct and substantial harm to a party.

The fourth rule limits the award of fees and expenses to counsel for a plaintiff class to a reasonable percentage of the amount of recovery awarded to the class.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The fifth rule specifies the information that must be included in any proposed or final settlement agreement disseminated to the class. The rule requires the settling parties, if they can agree, to state the average amount of damages per share that would be recoverable if the plaintiff prevailed. If the parties cannot agree, each party must provide a statement on the issues on which they disagree. Such statements are inadmissible in any court action or administrative proceeding unless the action or proceeding concerns the statement itself. The rule also requires the parties or counsel who intend to seek an award of attorneys' fees or costs to state the amount sought–on an average per share basis–and to provide an explanation supporting the fees and costs sought. Any settlement agreement must also include the name, telephone number, and address of plaintiff class counsel who will answer questions from class members, and a brief statement explaining the reasons for the proposed settlement. The required information must appear, in summary form, on a cover page. The court may order disclosure of additional information.

Section 102(b)(1) amends the 1933 Act by adding a new subsection (i) to Section 20, and Section 102(b)(2) amends the 1934 Act by adding a new subsection (k) to Section 21; establishing procedures for the appointment of the lead plaintiff in class actions. A plaintiff filing a securities class action must, within 20 days of filing a complaint, provide notice to members of the purported class in a widely circulated business publication. This notice must: (i) identify the claims alleged in the lawsuit and the purported class period, and (ii) inform potential class members that, within 60 days, they may move to serve as the lead plaintiff. The notice provisions in this subsection do not replace or supersede other notice provisions provided in the Federal Rules of Civil Procedure.

Within 90 days of the published notice, the court must consider motions made under this section and appoint the lead plaintiff. If a motion has been filed to consolidate multiple class actions brought on behalf of the same class, the court shall not appoint a lead plaintiff until after consideration of any such motion. In appointing the lead plaintiff, the court shall presume that the "most adequate plaintiff" is the member of the purported class (who has moved for such appointment and otherwise satisfies ****705 *26** Rule 23 of the Federal Rules of Civil Procedure) with the largest financial interest in the relief sought by the class. This presumption may be rebutted by evidence that the plaintiff would not fairly and adequately represent the interests of the class or is subject to unique defenses.

Members of the purported class may seek discovery into whether the presumptively most adequate plaintiff would not adequately represent the class. Subject to court approval, the most adequate plaintiff shall retain class counsel.

Section 103. Sanctions for abusive litigation

Section 103(a) amends Section 20 of the 1933 Act by adding a new subsection (j) and Section 103(b) amends Section 21 of the 1934 Act by adding a new subsection (l), requiring the court

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(i) to make specific findings, upon adjudication of a private action, regarding compliance by all parties and all attorneys with each requirement of Rule 11(b), and (ii) to impose sanctions for any violations. In imposing sanctions for failure of the complaint to comply with Rule 11(b), the court will presume that the appropriate sanction is the reasonable attorneys' fees and expenses of the opposing party. This presumption may be rebutted by evidence that the imposition of sanctions would impose an undue burden on the violator or that the Rule 11 violation was de minimis.

Section 104. Requirements for securities fraud actions

Section 104(a)(1) amends Section 20 of the 1933 Act by adding a new subsection (k) and (l) and adds a new Section 36(c) to the 1934 Act, (i) requiring the court to stay discovery during the pendency of any motion to dismiss the complaint, unless particularized discovery is needed to preserve evidence or prevent undue prejudice, and (ii) prohibiting parties from wilfully destroying or altering evidence they know is relevant to the allegations in the complaint.

Section 104(b) amends the 1934 Act by adding a new Section 36, establishing pleading standards for Section 10(b) actions alleging untrue statements or omissions of a material fact. The complaint must specifically identify each misleading statement and the reason or reasons why it is misleading. In any private action to recover money damages, the plaintiff must, for each misstatement or omission, specifically allege facts giving rise to a strong inference that the defendant acted with the required state of mind.

This section also requires plaintiffs to show “loss causation,” i.e., that the alleged violation caused plaintiff's loss. The defendant may mitigate the damages arising from such loss by showing that unrelated factors contributed to the loss.

Section 105. Safe harbor for forward-looking statements

Section 105 establishes a “safe harbor” protecting certain forward-looking statements from liability in private actions under the 1933 Act and the 1934 Act and grants the SEC authority to promulgate safe harbor rules under the Investment Company Act of 1940. Section 105(a) amends the 1933 Act by adding a new Section 13A; Section 105(b) amends the 1934 Act by adding a new Section 37; and Section 105(c) amends Section 24 of the Investment Company Act by adding a new subsection (g).

****706 *27** The safe harbor provision protects written and oral forward-looking statements that “project, estimate, or describe” future events made by issuers and certain persons retained or acting on behalf of issuers. To be protected, the statement must be accompanied by sufficient notice that

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

the information is forward-looking and that actual results may be materially different from such projections, estimates, or descriptions.

The definition of "forward-looking" information is the same as contained in the SEC's present Rule 175 safe harbor. The definition includes: (i) certain financial items, including projections of revenues, income, earnings, capital expenditures, dividends, and capital structure; (ii) management's statement of future business plans and objectives; (iii) certain statements made in required SEC disclosures, including management's discussion and analysis and results of operations; and (iv) any disclosed statement of the assumptions underlying the forward-looking statement. The SEC may expand the definition by rule or regulation.

The safe harbor does not protect forward-looking statements "knowingly made with the expectation, purpose, and actual intent of misleading investors."

In order to qualify for the safe harbor, the issuer must be subject to the reporting requirements of Section 13(a) or Section 15(d) of the 1934 Act. Except as provided by SEC rule or regulation, the safe harbor does not extend to an issuer who: (a) during the three year period preceding the date on which the statement was first made, has been convicted of a felony or misdemeanor described in clauses (i) through (iv) of Section 15(b)(4) or is the subject of a decree or order involving a violation of the securities laws; (b) makes the statement in connection with a "blank check" securities offering, "rollup transaction," or "going private" transaction; or (c) issues penny stock.

The safe harbor does not cover certain statements that may otherwise qualify as forward-looking statements. Except as provided by SEC rule or regulation, the safe harbor does not cover forward-looking statements: (i) included in financial statements prepared in accordance with generally accepted accounting principles; (ii) contained in an initial public offering registration statement; (iii) made in connection with a tender offer; (iv) made in connection with a partnership, limited liability corporation or direct participation program offering; or (v) made in beneficial ownership disclosure statements filed with the SEC under Section 13(d) of the 1934 Act.

The court must stay discovery (other than discovery that is specifically directed to the applicability of the safe harbor) pending its decision on a motion for summary judgment based on the grounds that the statement or omission is protected by the safe harbor.

The SEC may promulgate rules or regulations to expand the statutory safe harbor by providing additional exemptions from liability. This section also grants the SEC authority to recover damages on behalf of investors injured by reason of violations involving a forward-looking statement not protected by the safe harbor.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section 106. Written interrogatories

Section 106(a) amends Section 20 of the 1933 Act by adding a new subsection (m) and Section 21 of the 1934 Act by adding a new ****707 *28** subsection (m), requiring the court, in actions in which the plaintiff may recover money damages, to submit written interrogatories to the jury on the issue of defendant's state of mind at the time of the violation.

Section 107. Amendment to Racketeer Influenced and Corrupt Organizations Act

Section 107 amends Section 1964(c) of Title 18 of the U.S. Code to conduct that would have been actionable as fraud in the purchase or sale of a security as a predicate offense under civil RICO.

Section 108. Authority of Commission to prosecute aiding and abetting

Section 108 amends Section 20 of the 1934 Act by adding a new subsection (e), authorizing the SEC to bring an action seeking injunctive relief or money penalties against persons who knowingly “aid and abet” primary violators of the securities laws.

Section 109. Limitation on rescission

Section 109 amends Section 12 of the 1933 Act by adding a provision at the end of the section allowing a defendant to avoid the remedy of rescission under certain circumstances. In an action based on a misstatement or omission contained in a prospectus, a defendant may avoid rescissionary damages if the defendant proves that the depreciation in the value of the security resulted from factors unrelated to the alleged misstatement or omission. If the defendant shows there is no “loss causation” the purchaser may recover damages only for the remaining portion of the depreciation in the security's value.

Section 110. Applicability

The provisions included in Title I of this Act apply to any private action commenced after the date of enactment.

TITLE II–REDUCTION OF COERCIVE SETTLEMENTS

Section 201. Limitation on damages

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section 201 amends Section 36 of the 1934 Act by adding a new subsection (e), providing for a "look back" period in calculating damages in a private action involving a misstatement or omission under the 1934 Act. This provision is intended to limit damages to those losses caused by the fraud and not by other market conditions.

Plaintiff's damages will be calculated by taking into account the value of the security on the date plaintiff originally bought or sold the security and the value of the security during the 90-day period after dissemination of any information correcting the misleading statement or omission. If the plaintiff sells those securities or repurchases the subject securities during the 90-day period, damages will be calculated based on the price of that transaction and the value of the security immediately after the dissemination of corrective information.

****708 *29** Section 202. Proportionate liability

Section 202 amends the 1934 Act by adding a new Section 38, establishing a system for allocating damages in private actions brought under the 1934 Act. Under this section, a defendant who commits "knowing" securities fraud is jointly and severally liable for the full amount of the damages. To commit "knowing" securities fraud, a defendant must make a "material representation or omission with actual knowledge that the information is false," and "actually know that persons are likely to rely on" the false information. Reckless conduct would not constitute knowing securities fraud.

In cases involving multiple defendants, the court shall instruct the jury to determine (i) each defendant's percentage of responsibility, including any settling defendants, and (ii) whether each defendant committed knowing securities fraud. The defendants who did not commit knowing securities fraud will only be liable for the portion of damages attributable to their percentage of responsibility.

If there are uncollectible shares because the defendants who have committed knowing securities fraud are "judgment proof," the proportionally liable defendants may be liable for an additional amount of up to 50% of their total share of damages.

In addition, proportionally liable defendants will be liable for the uncollectible share if, within six months of entry of final judgment, the plaintiff establishes that (i) the damages are more than 10% of the plaintiff's net worth, and (ii) the plaintiff's net financial worth is less than $200,000.

Defendants who make an additional payment may, within six months of the date of the payment, seek contribution from other defendants in the action. A defendant who settles the action before verdict or judgment will not be subject to any claim of contribution. In determining the amount of the final judgment, the court will reduce the final judgment to take into account the settling

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

party's percentage of responsibility and the amount the settling defendant paid to the plaintiff. A person who is liable for damages under this section may seek, within six months of entry of the final judgment, contribution from persons who were not parties to the lawsuit.

Section 203. Applicability

The provisions included in Title II of this Act apply to any private action commenced after the date of enactment.

TITLE III–AUDITOR DISCLOSURE OF CORPORATE FRAUD

Section 301. Fraud detection and disclosure

This section amends the 1934 Act by adding a new Section 10A, requiring independent public accountants to institute certain procedures in connection with their activities. If an accountant learns of an illegal act that may be "consequential" to the company, the accountant must provide this information to the company's management. If management fails to act, and the accountant determines that the illegal act would have a material effect on the issuer's financial statements, the accountant must report the information to the board of directors. If the board fails to notify the Commission ****709 *30** within one day, the accountant must notify the Commission the following day. Failure to provide this notification will subject the accountant to civil penalties.

The provisions in this section apply to annual reports filed with the Commission after July 1, 1996 for registrants that file quarterly reports and January 1, 1997 for all other registrants.

REGULATORY IMPACT STATEMENT

This legislation seeks to reform private securities litigation and thus it has limited regulatory impact. Generally, there is little or no requirement for regulatory implementation of the provisions of the bill.

Some provisions, in fact, would reduce regulatory requirements. For example, the SEC is directed in Section 105 of the legislation to provide by regulation safe harbors for forward-looking statements comprehended by the Investment Company Act of 1940, and is authorized to provide for statutory safe harbors for forward-looking statements under the 1933 and 1934 Acts.

Two provisions would, however, have some regulatory impact. First, Section 105 of the legislation would broaden the SEC's authority to seek and to obtain disgorgement under the 1933 and 1934 Acts. This section authorizes the SEC to recover damages on behalf of investors

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

involving a forward-looking statement not protected by the statutory safe harbor. Under current law, SEC disgorgement is generally limited to any ill-gotten gains. It is not possible to estimate the number of persons to whom this provision would apply. Second, Title III of this legislation would impose new reporting obligations on public accountants. Although these obligations will increase the costs of conducting audits, it is not possible to estimate precisely the extent of these new costs.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF THE LEGISLATION

The Committee has requested a cost estimate of this legislation under the provisions of Section 403 of the Congressional Budget Act of 1974. The cost estimate of the Congressional Budget Office follows:

U.S. Congress,
Congressional Budget Office,
Washington, DC, June 19, 1995.

Hon. Alfonse M. D'Amato,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 240, the Private Securities Litigation Reform Act of 1995, as ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on May 25, 1995. CBO estimates that enacting S. 240 would cost the federal government between $125 million and ****710** ***31** $250 million over the next five years, assuming appropriation of the necessary amounts. Because enacting S. 240 would affect receipts, pay-as-you-go procedures would apply to the bill. Enacting S. 240 would not affect the budgets of state or local governments.

Bill purpose

Title I of S. 240 would require a court, when hearing class action litigation brought under the Securities Exchange Act of 1934, to appoint a lead plaintiff for the class under certain circumstances. The bill 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 bill 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

establishing such limited liability. The bill would amend the Racketeer Influenced and Corrupt Organizations statute to exclude from its purview an action involving fraud in the sale of securities. Title II of S. 240 would limit the amount of damages that could be awarded in certain securities litigation cases, and would limit the application of joint and several liability in those cases. Title III would include certain procedures to be followed during a required audit of a securities issuer, and would provide civil penalties for violations of those procedures.

Federal budgetary impact

CBO estimates that promulgating the rules required by the bill would result in increased costs to the federal government of approximately $300,000 in 1996, primarily for personnel costs, assuming appropriation of the necessary amounts.

By discouraging private litigation under the Securities Exchange Act of 1934, enacting S. 240 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 S. 240 is highly uncertain, CBO expects that financial fraud enforcement actions would number at least 100, and possibly up to 150. Therefore, CBO estimates that enactment of S. 240 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.

Pay-as-you-go impact

S. 240 would require civil penalties for violations of certain of its provisions. These civil penalties would count as governmental receipts, and thus would be subject to pay-as-you-go provisions. CBO estimates, however, that no significant additional amount of receipts would be collected.

Previous CBO estimate

On February 23, 1995, CBO provided an estimate for Title II of H.R. 10, the Securities Litigation Reform Act, as ordered reported ****711 *32** by the House Committee on the Judiciary, to that committee. S. 240 differs from that bill primarily in that S. 240 would require civil penalties for violations of the provisions of Title III, and it would require additional rulemakings by the SEC. In other respects the bills are substantially similar, and CBO's estimate of the SEC's enforcement costs under S. 240 is unchanged from our estimate for Title II of H.R. 10.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are John Webb and Melissa Sampson.

Sincerely,

June E. O'Neill, Director.

***33** ADDITIONAL VIEWS OF SENATORS GRAMM, MACK, FAIRCLOTH, BENNETT, GRAMS, AND FRIST

The Hippocratic Oath begins with the admonition to do no harm. The bill reported by the Committee follows that mandate. Unlike much of the legislation of past Congresses, this bill is not “two-steps-forward, one-step-back” legislation. The improvements that the bill makes over current law are not eroded by new legislative injuries.

While the bill provides significant incremental relief from abusive securities lawsuits, the costs of these lawsuits are so high that stronger reform is needed. Information presented to the Subcommittee on Securities indicates that approximately 300 securities litigation cases are filed each year. Few of these cases are brought to trial. Instead, the high costs of litigation normally induce settlements of the cases, at an average amounting to $8.6 million per case, for a combined total of nearly $2.5 billion per year. Even with settlements, the legal costs for defendants average an additional $700,000 per case.

Perhaps the most destructive aspect of securities strike suits is the disruption that they cause to company operations. For example, defendant companies devote an average of 1,000 management and employee hours to each case. This amounts to 37,500 workdays each year consumed by securities lawsuits.

Moreover, there seems to be a pattern of targeting high technology companies. A survey conducted by the American Electronics Association of their forty largest firms found that twenty-four had been sued for securities fraud, including nine out of the top ten. Either the securities litigation system is broken, or there is an enormous disrespect for the law in Silicon Valley. We believe that the problem lies with the system of litigation.

We therefore recommend that the bill's provisions be strengthened. Among such changes, particular attention should be given to (1) strengthening the proportionate liability provisions of section 202, (2) strengthening the sanctions for abusive litigation provision of section 103, (3) strengthening the safe harbor for forward-looking statements in section 105, and (4) delineate more clearly the standard of liability provisions of section 104.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

****712** PROPORTIONATE LIABILITY (SECTION 202)

No reform was more strongly supported by witnesses and members during subcommittee hearings than the concept of introducing proportionate liability for securities lawsuits. Currently, defendants have joint and several liability, which means that any person found to have any liability at all, regardless of how insignificant, can be liable for all of the damages awarded in these securities cases. The effect of this has been to add to the lawsuit "deep-pocket" plaintiffs who have at most a marginal involvement in the alleged wrongdoing, ***34** such as accounting firms, securities houses, banks, investment partners and others. Faced with (1) the risk of being jointly and severally liable for the entire settlement amount and (2) the high cost of litigation, such peripherally involved defendants frequently decide to settle the case rather than proceed to trial.

The concept of proportionate liability is that no one should be required to compensate for injuries for which they are not responsible. Unfortunately, the bill's proportionate liability provisions contain exceptions that leave deep-pocket parties still within reach of the strike-suit attorneys. Under the bill's provisions, if a clearly guilty defendant's share of a court's judgment is not collectible, every other peripherally involved defendant is jointly and severally liable for the uncollectible share if the financial net worth of the plaintiff is $200,000 or less, that is, most individual investors.

This exception to proportionate liability is open-ended, with no limitations on liability for defendants with minor fault, and no practical means of verifying the net worth or losses of those claiming to be such small investors. This is an exception with the potential for swallowing the rule and should be corrected.

ATTORNEY SANCTIONS FOR ABUSIVE LAWSUITS (SECTION 103)

The bill contains a very modest provision to penalize attorneys who promote abusive securities suits. Currently, strike suit attorneys face little cost or risk in filing lawsuits on flimsy pretexts. Rule 11 of the Federal Rules of Civil Procedure purportedly applies penalties against attorneys for abusive litigation. But investigation by the Congressional Research Service could find only three cases in history in which Rule 11 attorneys sanctions were ever actually applied in securities Rule 10b–5 cases. We advocated and support the directive in the bill that requires judges to review Rule 11 issues in every case and provide a written statement regarding compliance with Rule 11, with mandatory sanctions in the case of a violation. However, we fear that this provision by itself will not be enough to end the "winner pays" reality of securities suits and alter the imbalance in the economics of securities litigation. This is particularly true, since the provision still relies upon the action of judges who have so far demonstrated little interest in imposing such sanctions. Innocent

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

defendants will continue to be left in most cases to carry the expensive burden of proving their innocence.

****713** SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS (SECTION 105)

The safe-harbor provisions of the bill must be strengthened. Currently, there is impaired communication between investors and management regarding the forward-looking views and plans of corporations. Under the fear of costly abusive lawsuits filed when predictions of the future do not materialize, corporate representatives prefer to guard their silence or hide behind meaningless generic statements about the future. A statement from a recent securities filing by a financial services corporation is typical: “The amount of future provisions will continue to be a function of regular quarterly review of the reserve for credit losses, based upon management's assessment of risk at that time, and, as such, there can be no assurance as to the level of future provisions.” Investors and analysts are left wondering.

***35** While the provisions of the bill may allow for some degree of freer communication between corporate management and investors, we believe that the provisions have been so narrowly constrained and burdened with vague terms and standards that they are unlikely to provide in many cases adequate protection against abusive lawsuits. We are concerned that innocent corporations may still be subject to expensive and time-consuming litigation and detailed fact-finding over the terms and restrictions of the safe harbor provisions and the extent of their application. In order to be effective, a safe harbor must have a bright line that is unmistakable to all parties. Otherwise, the utility of a safe harbor for obtaining early dismissal of abusive securities suits, or discouraging them entirely, may be elusive.

STANDARD OF LIABILITY (SECTION 104)

Curiously, under current law, it is often not clear just what constitutes a violation of Rule 10b–5. The current ambiguity is one of the contributing factors allowing for the filing of abusive, meritless, strike suits. Without a clear line as to what is and what is not a violation, the issue is left to the trial process. That is to say, meritless claims are given too long of a ride, all the while imposing costs on innocent defendants. Moreover, different courts in different judicial circuits have applied different interpretations of the standard of liability. A clear standard of liability would give greater protection to the innocent while allowing courts to focus on genuine cases of securities fraud.

The legislation reported by the Committee would establish a single standard of liability. Unfortunately, it is still a vague standard that will require further judicial interpretation. Congress should provide clearer guidance to the courts than that provided in this bill. Otherwise, we will

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

continue to provide too much legal confusion and too much room for the pursuit of meritless lawsuits. All of that imposes an unnecessary cost on the innocent and on our economy.

**714 ROOM FOR IMPROVEMENT

While we support reporting this bill, we hope that in the remaining steps in the legislative process its provisions will be improved. At the same time, the legislation should remain free from provisions that take us backwards in the effort to eliminate abusive securities lawsuits.

Phil Gramm.
Connie Mack.
Lauch Faircloth.
Robert F. Bennett.
Rod Grams.
Bill Frist.

*36 ADDITIONAL VIEWS OF SENATORS SARBANES, BRYAN, AND BOXER

INTRODUCTION

We support the goal of deterring frivolous lawsuits and sanctioning appropriate parties when such lawsuits are filed. A number of the provisions in this bill are designed to achieve that goal. We support these provisions, and those that will improve class action procedures.

This legislation, however, will affect far more than frivolous suits:

The safe harbor provision will, for the first time, provide immunity under the Federal securities laws for fraudulent statements.

The proportionate liability provision will, for the first time, transfer responsibility from participants in a fraud to innocent victims of that fraud. These provisions will make it more difficult for investors to bring fraud actions, and will reduce recoveries in such actions.

The bill also fails to include provisions necessary to ensure that victims of securities fraud have adequate remedies:

The bill does not extend the statute of limitations for securities fraud actions imposed by the Supreme Court in 1991, which the SEC and the State securities regulators believe is too short.

Ignoring the recommendation of the securities regulators, the bill does not restore the ability of investors to sue individuals who aid and abet violations of the securities laws.

This legislation threatens the capital formation process by undermining the confidence on which our markets depend. We are not alone in this conclusion. In a June 8, 1995 letter, the Government Finance Officers Association ("GFOA") strongly agreed with this assessment. Consisting of more than 13,000 state and local government financial officials, the GFOA's members both issue securities and invest billions of dollars of public pension and taxpayer funds. In its letter, the GFOA opposed S. 240 as reported:

> We support efforts to deter frivolous securities lawsuits, but we believe that any legislation to accomplish this must also maintain an appropriate balance that ensures the ****715** rights of investors to seek recovery against those who engage in fraud in the securities markets. We believe that S. 240 does not achieve this balance, but rather erodes the ability of investors to seek recovery in cases of fraud.

Securities regulators, bar associations, consumer groups, and state and local government officials share this opinion, as discussed below. We reach the same conclusion, and accordingly voted against the legislation.

***37** STRENGTH OF U.S. CAPITAL MARKETS

By every measure, the United States capital markets are the largest and strongest in the world. In size, the U.S. markets remain preeminent: for 1993, U.S. equity market capitalization stood at $5.2 trillion, over one-third of the world total.[1] The U.S. markets continue to grow: the combined total of equity and debt filings for 1994, over $810 billion, was exceeded only by the record level set in 1993.[2] So attractive are the U.S. capital markets that more than 600 foreign companies from 41 different countries have tapped them, a level matched only in London, and more continue to come.[3]

The growth of trading on our exchanges is a sign of the strength of our markets. Average daily trading volume on the New York Stock Exchange increased from 44.9 million shares in 1980, to 156.8 million shares in 1990, to 291.4 million shares in 1994.[4] The NASDAQ and American Stock Exchanges have experienced similar gains in trading volume.[5]

Another sign of the strength of our markets is the rise of the mutual fund industry, one of the fastest-growing segments of the financial services industry. From 1980 to 1993, mutual fund assets increased by more than 10 times, to $1.9 trillion.[6] Approximately 38 million Americans, representing 27 percent of American households, own mutual funds.

Role of the Federal Securities Laws

Our securities markets have been operating under the Federal securities laws since those laws were enacted over 60 years ago. As discussed above, our markets today are the largest and most vibrant in the world. This is so not in spite of the Federal securities laws, but in part because of the Federal securities laws. The Federal securities laws generally provide for sensible regulation, and self-regulation, of exchanges, brokers, dealers and issuers.

Even more important to ensuring the success of our markets is investor confidence. That confidence is maintained because investors know they have effective remedies against persons who would defraud them. Both Republican and Democratic Chairmen of the Securities and Exchange Commission have stressed the integral role of the private right of action in maintaining investor confidence. In 1991, then-Chairman Richard Breeden testified before the Banking Committee:

> Private actions under Sections 10(b) and 14(a) of the Exchange Act have long been recognized as a "necessary supplement" to actions brought by the Commission and as an ****716** "essential tool" in the enforcement of the federal securities laws. Because the Commission does not have adequate resources to detect and prosecute all violations of the federal securities laws, private actions perform a critical role in preserving the integrity of our securities markets.

***38** Current Chairman Arthur Levitt reiterated that point in testimony before the House Subcommittee on Telecommunications and Finance on February 10, 1995:

> Besides serving as the primary vehicle for compensating defrauded investors, private actions also provide a "necessary supplement" to the Commission's own enforcement activities by serving to deter securities law violations. Private actions are crucial to the integrity of our disclosure system because they provide a direct incentive for issuers and other market participants to meet their obligations under the securities laws.

The importance of the private right of action is likely to increase, given the budgetary constraints on SEC resources. Testifying in 1993, the Director of the SEC's Division of Enforcement noted,

> Given the continued growth in the size and complexity of our securities markets, and the absolute certainty that persons seeking to perpetrate financial fraud will always be among us, private actions will continue to be essential to the maintenance of investor protection.

State of the Securities Litigation System

The Securities Subcommittee has held hearings over the past two years reviewing the health of the Federal securities litigation system. The Subcommittee received testimony from plaintiffs'

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

lawyers, from corporate defendants, from accountants, academics, securities regulators and investors. There was sharp disagreement among the witnesses over how well the securities litigation system is functioning, and over what policy responses are appropriate.

Some argue that American business, particularly younger companies in the high-tech area, face a rising tide of frivolous securities litigation. A number of corporate executives told the Securities Subcommittee of their experiences. The American Electronics Association decried what it described as the "current practice of filing off-the-shelf legal complaints when a company announces a downturn in performance [that] amounts to an uncontrolled 'tax on innovation.'"

Clearly some frivolous securities cases are filed, as indeed some frivolous cases of every sort are filed. However, frivolous securities litigation does not appear to be at the crisis levels which some assert. ****717** Presenting statistics obtained from the Administrative Office of the U.S. Courts, the Director of the SEC's Division of Enforcement testified in June 1993 that:

> the approximate aggregate number of securities cases (including Commission cases) filed in Federal district courts does not appear to have increased over the past two decades. Similarly, while the approximate number of securities class actions filed during the past three years is significantly higher than during the 1980's, the numbers do not reveal the type of increase that ordinarily would be characterized as an "explosion."

Professor Joel Seligman of the University of Michigan Law School, one of the leading experts on the Federal securities laws, testified ***39** at the same hearing, "there is little objective data at this time that suggests there is a need for significant reform of the federal securities laws, either to benefit plaintiffs or defendants."

The Committee Report states that it is easy to craft complaints alleging violations of the Federal securities laws. However, the Committee received evidence that it is difficult to bring even a meritorious securities action under the current system. Rule 9 of Federal Rules of Civil Procedure requires fraud to be pled with specificity. Joan Gallo, City Attorney for the City of San Jose, testified on March 22, 1995 about the successful securities fraud suit that San Jose brought against a number of brokers in the 1980's. She said, "[u]nder current law, despite the fact that the City had very experienced legal counsel, it was not until February 1986 that our third amended complaint was finally found sufficient by the Federal Court."

Some argue that securities fraud class actions are inhibiting the capital formation process. Marc Lackritz, President of the Securities Industry Association, testified on March 2, 1995 that "new or innovative ventures are fOregone because of the litigation risks involved in capital formation." James F. Morgan testified on behalf of the National Venture Capital Association that the big accounting firms are "winnowing out" growth companies because of their riskiness.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

In fact, initial public offerings have been setting records in recent years: the record $39 billion in initial public offerings in 1992 was in turn exceeded by a record $57 billion in IPO's in 1993.[7] The $34 billion in IPO's in 1994 was exceeded only by the records set in 1992 and 1993.[8] Less than one month ago, on May 22, 1995, the New York Times reported:

> One of the great booms in initial public offerings is now under way, providing hundreds of millions in new capital for high-tech companies, windfalls for those with good enough connections to get in on the offerings and millions in profit for the Wall Street firms underwriting the deals.

The Securities Industry Association's own publications describe the boom in initial public offerings:

> "After years of weakness in the late 1980s, investment in new securities and IPOs accelerated dramatically from ****718** 1990–1993. During that time, the securities industry raised a record $130 billion for small business through IPOs. Again, this was more than was raised in America's first two centuries!"[9]

PROVISIONS OF S.240

To be sure, frivolous litigation should be deterred and sanctioned. Some of the provisions in S.240 as reported appear to be directed toward this goal. The requirement that courts include specific findings in securities class actions regarding compliance by all parties and attorneys with Rule 11(b) of the Federal Rules of Civil Procedure ***40** should act as a powerful deterrent to frivolous cases. Should a court find a violation of Rule 11, the court is required to impose sanctions.

The bill also prohibits payments to lead plaintiffs in class actions of additional compensation, other than "reasonable costs and expenses." This will help ensure that class actions are brought by real parties in interest, rather than "professional plaintiffs." To the same end, the bill requires that the plaintiff file a sworn statement that he or she authorized the filing of the complaint and did not purchase the securities at the direction of counsel or to participate in a lawsuit. The bill also prohibits attorneys from paying brokers for referring clients.

The bill also seeks to improve the procedures governing class action lawsuits. The new procedures contained in the bill for selecting a lead plaintiff in class actions are designed to encourage participation by institutional investors. We are pleased that this provision contains safeguards intended to ensure that a lead plaintiff must continue to represent the class fairly and adequately, as required under the Federal Rules of Civil Procedure.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The bill also seeks to improve the quality of information provided to investors when a securities fraud action is settled. The bill requires that a notice of a proposed settlement provided to investors must include clear information to allow investors to make an informed decision on the settlement. The statement must include the reason for the proposed settlement, the average damages recoverable per share if the settling parties can agree, and the attorneys' fees and costs.

Provisions of S.240 will hurt investors

Other provisions in S.240, however, are not tailored to deterring or sanctioning frivolous litigation. Instead, they will make it more difficult to bring all securities fraud suits, including meritorious cases, and reduce recoveries across the board.

Safe harbor provision will undermine market confidence by protecting fraudulent statements

****719** Contrary to the advice of the SEC, the North American Securities Administrators Association, the Government Finance Officers Association and others, S.240 as reported creates a statutory exemption from liability for certain "forward looking statements." Not only will this provision immunize reckless statements, but Chairman Levitt has warned that as drafted it will immunize fraudulent statements as well. By undermining confidence in our markets, such a return to the pre-Federal securities laws days of "buyer beware" would not benefit investors or issuers.

"Forward looking statements" are broadly defined in the bill, to include projections of financial items such as revenues, income and dividends as well as statements of future economic performance required in documents filed with the SEC. As with any attempt to foresee the future, such statements always have an element of risk to them, and prudent investors must be careful in relying on them. In fact, until 1979 the SEC prohibited disclosure of forward looking information. The SEC believed that forward looking information ***41** was inherently unreliable, and that investors would place too much emphasis on such information in making investment decisions.

After reviewing the matter extensively in the 1970's, the SEC adopted a "safe harbor" regulation for forward looking statements.[10] The regulation (known as "Rule 175") generally offers protection for specified forward looking statements when made in documents filed with the SEC. To sustain a fraud suit, the investor must show that the forward looking information lacked a reasonable basis and was not made in good faith.

There is a wide body of opinion that the current regulatory safe harbor does not provide sufficient protection for good faith corporate projections. In a May 19, 1995 letter to the members of the Senate Banking Committee, Chairman Levitt acknowledged "a need for a stronger safe harbor

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

than currently exists.” Indeed, the SEC has been conducting a comprehensive review of its safe harbor regulation.[11] Testifying before the Securities Subcommittee in April, Chairman Levitt said:

> The Commission recently published a ‘concept’ release soliciting comments on current practices relating to disclosure of forward-looking information, with a view to developing a new safe harbor for projections that provides issuers with meaningful protection but continues to protect investors. The Commission has received approximately 150 comment letters in response to the release, and public hearings on the issue were conducted in Washington, DC and San Francisco during February.

As originally introduced by Senators Domenici and Dodd, S.240 would have allowed the SEC to continue this regulatory effort. The bill as introduced required that the SEC consider adopting rules or making legislative recommendations identifying criteria for exempting “forward-looking statements concerning * * * future economic performance” from antifraud liability under the Federal securities ****720** laws. S.240 provided that if the SEC adopted such a rule, a defendant could request a stay of discovery while the court considered a motion for summary judgment on the grounds that the forward looking statement was within the coverage of the rule.

Chairman Levitt endorsed this approach in his April 1995 testimony before the Securities Subcommittee:

> From the Commission's perspective, an appropriate legislative approach is contained in the Domenici/Dodd bill. This provision would allow the Commission to complete its rulemaking proceeding and take appropriate action after its evaluation of the extensive comments and testimony already received. Based on the Commission's experience with this issue to date, we believe that there is considerable value in proceeding with rulemaking, which can more efficiently be administered, interpreted and, if needed, modified, than can legislation.

***42** In a May 23, 1995 letter, the North American Securities Administrators Association, the Government Finance Officers Association, the National League of Cities and nine other groups expressed the same view (“we believe the more appropriate response is SEC rulemaking in this area”).

However, the Committee Print substitute to S.240, unlike the bill as introduced, abandoned this approach in favor of enacting a statutory safe harbor. Like the bill passed by the House, S.240 as reported will for the first time shield fraudulent statements from liability under the Federal securities laws. This provision constitutes an ill-advised break with 60 years experience under the Federal securities laws.

Under the original Committee Print, forward looking statements were immunized from antifraud liability under the Federal securities laws unless they were “knowingly made with the expectation,

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

purpose, and actual intent of misleading investors," and unless an investor could prove that he or she "had actual knowledge of and actually relied on" the statement.[12]

In a May 19, 1995 letter to the members of the Senate Banking Committee, SEC Chairman Levitt expressed his "personal views about a legislative approach to a safe harbor." He suggested that:

> [a] carefully crafted safe harbor protection from meritless private lawsuits should encourage public companies to make additional forward-looking disclosure that would benefit investors. At the same time, it should not compromise the integrity of such information which is vital to both investor protection and the efficiency of the capital markets–the two goals of the federal securities laws.

He stated, "[a] safe harbor must be thoughtful–so that it protects considered projections, but never fraudulent ones." He indicated he would support a safe harbor containing "a scienter standard other than recklessness."

****721** As explained above, the safe harbor provision in the original Committee Print did not adhere to Chairman Levitt's suggestions: the safe harbor in the original Committee Print would have protected fraudulent projections if an investor could not prove "actual knowledge" of and "actual reliance" on the projection. The substitute Committee Print offered at the Committee's May 25, 1995 mark up deleted the requirement that an investor prove he or she "had actual knowledge of and actually relied on" a fraudulent statement.

As amended, however, the substitute Committee Print continued to exclude from the safe harbor protection only statements "knowingly made with the expectation, purpose, and actual intent of misleading investors." The Committee Report states that "expectation," ***43** "purpose," and "actual intent" are separate elements, each of which must be proven by the investor. This language so troubled Chairman Levitt that he wrote to Committee members again, on May 25, 1995, the morning of the markup. He stressed that even the substitute Committee Print failed to adhere to his belief that a safe harbor should never protect fraudulent statements:

> I continue to have serious concerns about the safe harbor fraud exclusion as it relates to the stringent standard of proof that must be satisfied before a private plaintiff can prevail. As Chairman of the Securities and Exchange Commission, I cannot embrace proposals which allow willful fraud to receive the benefit of safe harbor protection. The scienter standard in the amendment may be so high as to preclude all but the most obvious frauds.

He warned that the bill's standard of "knowingly made with the expectation, purpose and actual intent of misleading investors" is a more stringent standard than currently used by the SEC and the courts. Given the broad definition of "forward looking statement" discussed above, it is crucial that the legislation not shield such statements from antifraud liability.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The Committee Report states that the safe harbor provision in the bill is based on current Rule 175, and a legal doctrine known as "bespeaks caution." Neither the SEC rule nor the court decisions cited, however, provide protection to fraudulent statements as the bill does.

As discussed above, the SEC's Rule 175 does not immunize fraudulent statements. It requires forward looking statements to be reasonable and made in good faith.

****722** The courts have imposed a similar requirement on forward looking statements. The Third Circuit case cited by the majority, In re Donald J. Trump Casino Securities Litigation, 7 F.3d 357 (3rd Cir. 1991), states:

> We have squarely held that opinions, predictions and other forward-looking statements are not per se inactionable under the securities laws. Rather, such statements *** may be actionable misrepresentations if the speaker does not genuinely and reasonably believe them.[13]

Rubenstein v. Collins, 20 F.3d 160 (5th Cir. 1994), also cited in the Committee Report, reaches the same conclusion. The Fifth Circuit held that a forward looking statement

> contains at least three factual assertions that may be actionable: (1) The speaker genuinely believes the statement is accurate; (2) there is a reasonable basis for that belief; and (3) the speaker is unaware of any undisclosed facts that would tend seriously to undermine the accuracy of the statement.[14]

The Third Circuit stated that to be immunized from liability the forward looking statements must be accompanied by cautionary statements "substantive and tailored to the specific future projections ***44** estimates or opinions ***"[15] The bill omits this requirement. Instead, it allows forward looking statements to be accompanied by general words of caution that will likely be boilerplate language, of little use to investors.

The Committee Report states that the safe harbor provision is intended to encourage disclosure of information by issuers. Encouraging companies to make fraudulent projections would hurt investors trying to make intelligent investment decisions and penalize companies trying to communicate honestly with their shareholders. We hope the majority of the Committee did not intend to achieve such a result. A safe harbor for fraudulent statements runs counter to the entire philosophy of the Federal securities laws, that fraud must be deterred and punished when it occurs. As described above, this philosophy has helped build the most vibrant securities markets in the world. While the majority of the Committee did not accept an amendment to this provision at the markup, we hope that the flaw in this provision identified by Chairman Levitt will be corrected.

Proportionate liability provision transfers losses from fraud perpetrators to fraud victims

Predating the Federal securities laws, courts have traditionally held parties who commit fraud to be "jointly and severally" liable. Under joint and several liability, each person who participates in a fraud is liable for the entire amount of the victim's damages. Mark Griffin, Securities Commissioner for the State of Utah, testified ****723** before the Securities Subcommittee on March 22, 1995 on behalf of the 50 State securities commissioners. He explained why the law currently holds all parties who participate in a securities fraud jointly and severally liable:

> Under current law, each defendant who conspires to commit a violation of the securities law is jointly and severally liable for all the damages resulting from the violation. The underlying rationale of this concept is that a fraud will fail if one of the participants reveals its existence and, as a result, all wrongdoers are held equally culpable if the fraud achieves its aims. (emphasis in original)

In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Supreme Court held that a defendant is liable under the Federal securities antifraud provision only if he or she possesses a state of mind known in the law as "scienter." Conduct intended to deceive or mislead investors satisfies the scienter requirement.

While the Supreme Court did not decide the question in Hochfelder, courts in every Federal circuit have held that reckless conduct also satisfies the scienter requirement. These courts have followed the guidance of hundreds of years of court decisions in fraud cases. As the Restatement of Torts, states, "The common law has long recognized recklessness as a form of scienter for purposes of proving fraud."[16]

***45** The most commonly accepted definition of reckless conduct that constitutes securities fraud was enunciated by the Seventh Circuit in Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir. 1977), cert. denied, 434 U.S. 875. This demanding standard defines reckless conduct as:

> Highly unreasonable [conduct], involving not merely simple, or even gross negligence, but an extreme departure from the standards of ordinary care, and which present 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.

Under current law, then, individuals who participate in a fraud through their reckless conduct are fully liable to the victims. Recklessness liability is generally applied to an issuer's professional advisers, such as accountants, attorneys and underwriters.

The bill limits joint and several liability under the Federal securities laws to persons who committed "knowing securities fraud." All other violators will generally be liable only for their

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

proportionate share of the fraud victim's losses. “Knowing securities fraud” is defined in the legislation specifically to exclude reckless conduct. S. 240 thus reduces the liability for reckless violators from joint and several liability to proportionate liability.

When investors' damages can be paid by a violator who is jointly and severally liable, this change will not affect the recovery available ****724** to investors. In cases where the architect of the fraud is bankrupt, has fled, or otherwise cannot pay the investors' damages, though, this change will harm investors. In those cases, innocent victims of fraud will be denied full recovery of their damages. Testifying before the Securities Subcommittee on April 6, 1995, Chairman Levitt said:

> Proportionate liability would inevitably have the greatest effect on investors in the most serious cases (e.g., where an issuer becomes bankrupt after a fraud is exposed). It is for this reason that the Commission has recommended that Congress focus on measures directly targeted at meritless litigation before considering any changes to the liability rules.

Perhaps recognizing this unfairness to investors, S. 240 would require violators who are proportionately liable to pay more than their proportionate share in two circumstances. Neither provision, however, goes very far toward making fraud victims whole. First, if part of the judgment is uncollectible, defendants who are proportionately liable would be jointly and severally liable to investors whose net worths are each under $200,000 and who each lost more than 10 percent of that net worth in the fraud. In our view, this will protect only a tiny number of investors. In many parts of the country, few investors who own their own homes will have net worths under $200,000. Further, very few such investors will invest 10 percent of their net worth in a single stock or bond issue. Second, if part of the judgment is uncollectible, defendants who are proportionately liable would also be liable for an additional amount, not to exceed 50 percent of their proportionate share. For ***46** example, a defendant found to be 10 percent responsible for the commission of a fraud would be liable for up to 15 percent of the investors' losses. This provision therefore will likely increase the recovery of defrauded victims only marginally, leaving the balance of losses uncollectible.

In a February 23, 1995 letter to House Commerce Committee Chairman Thomas J. Bliley, Jr., Chairman Levitt wrote, “[t]he Commission has consistently opposed proportionate liability.” The Association of the Bar of the City of New York agreed “it is critical that all defendants remain jointly and severally liable to the plaintiff when a wrongdoer is unable to pay his or her share of any judgment.” In their June 8, 1995 letter, the Government Finance Officers Association also identified the restriction of joint and several liability as a reason for their opposition to the bill.

Accountants are the class of defendants most likely to be affected by a change to proportionate liability. Dr. Abraham J. Briloff, CPA, the Emanuel Saxe Distinguished Professor Emeritus of Baruch College, City University of New York and a respected authority on accounting, testified

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

before the Banking Committee. He stressed the crucial role accountants play in preventing fraudulent financial statements from reaching the investing public. He stated that the accountant

> is presumed to stand as the ‘sentinel at the gates'; it is he who holds the passkey required for the history of the enterprise's ****725** management and accountability, its financial statements, to become acceptable for the purposes of the securities laws.
>
> If * * * he has permitted the passkey to be used irresponsibly, then he should be held fully liable for any resultant harm to those who relied on his professional undertaking.
>
> To the extent he may identify those who overtly created the underlying quagmire, well, then, the auditor should have the right of subrogation. But again, as in negotiable instruments law, if you cannot find the ‘maker’, you proceed against the ‘last endorser’–in the circumstances before us that ‘last endorser’ is presumed to be the certified public accountant who has undertaken the independent audit function.

The bill would undermine the independent auditor's role as the last line of defense against fraud.

The legislation reported provides that defendants who meet the Sundstrand definition of recklessness, that is, who know of a fraud but in an extreme departure from the standards of ordinary care do nothing about it, will no longer be responsible for the result of their conduct. Instead, innocent investors–individuals, pension funds, county governments–will have to make up the loss. This legislation would, for the first time in our legal history, transfer responsibility for bearing the results of a fraud from participants in the fraud to innocent victims of the fraud. Such a change would be neither fair to investors nor beneficial to our markets, and is opposed ***47** by a host of consumer groups, labor unions, and government officials.[17]

S.240 DOES NOT CONTAIN PROVISIONS NEEDED TO PROTECT INVESTORS

We are concerned about the provisions of S.240 described above, which in our view will harm investors bringing meritorious suits. We also are disappointed that S.240 as reported does not contain provisions that would aid investors bringing meritorious suits.

Failure to extend the statute of limitations

Chairman Levitt's May 25, 1995 letter to the members of the Banking Committee stated, “[i]n addition to my concerns about the safe harbor, there is not complete resolution of two important issues for the Commission. First, there is no extension of the statute of limitations for private fraud actions from three to five years.”

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

For over 40 years, courts held that the statute of limitations for private rights of action under Section 10(b) of the Securities Exchange Act of 1934, the principal antifraud provision of the Federal securities laws, was the statute of limitations determined by applicable State law. While these statutes varied, they generally afforded securities fraud victims sufficient time to discover and bring suit. Indeed, 13 States recognize the concept of equitable tolling, under which the statute of limitations does not begin to run until the fraud is discovered, for private securities fraud cases.[18]

****726** In Lampf v. Gilbertson, 501 U.S. 350 (1991), the Supreme Court significantly shortened the period of time in which investors may bring such securities fraud actions. By a five to four vote, the Court held that the applicable statute of limitations is one year after the plaintiff knew of the violation and in no event more than three years after the violation occurred. This is shorter than the statute of limitations for private securities actions under the law of 31 of the 50 States.[19]

Lampf's shorter period does not allow individual investors adequate time to discover and pursue violations of securities laws. Testifying before the Banking Committee in 1991, SEC Chairman Richard Breeden stated "the timeframes set forth in the [Supreme] Court's decision is unrealistically short and will do undue damage to the ability of private litigants to sue." Chairman Breeden pointed out that in many cases,

> Events only come to light years after the original distribution of securities and the Lampf cases could well mean that by the time investors discover they have a case, they are already barred from the courthouse.

***48** The FDIC and the State securities regulators joined the SEC in favor of overturning the Lampf decision.

On this basis, the Banking Committee in 1991 without opposition adopted an amendment to the bill later enacted as the FDIC Improvement Act ("FDICIA"). The amendment lengthened the statute of limitations for all Section 10(b) rights of action to two years after the plaintiff knew of the securities law violation, but in no event more than five years after the violation occurred. In a letter to Senator Bryan, Chairman Breeden stated that "[a]doption of these measures would give private litigants a more realistic time frame in which to discover that they have been defrauded, while also accommodating legitimate interests in providing finality to business transactions and avoiding stale claims."

When FDICIA reached the Senate floor in November 1991, some Senators indicated they would seek to attach additional provisions relating to securities litigation. They argued that the statute of limitations should not be lengthened without additional reform of the litigation system. No arguments were raised specifically against the extension of the statute of limitations. In order to expedite consideration of FDICIA, the extension of the statute of limitations was dropped. Senators

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Domenici and Dodd included the extended statute of limitations in their comprehensive securities litigation reform bill, introduced as S.1976 in the 103rd Congress and as S.240 in this Congress.

****727** Now that the Congress is acting on comprehensive changes to the securities litigation system, it should include the longer statute of limitations in keeping with the 1991 agreement. Chairman Levitt testified before the Securities Subcommittee in April 1995, "[e]xtending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud who successfully conceals its existence for more than three years."

We are deeply disappointed that the Committee did not include the extension of the statute of limitations in S. 240 as reported, and consider it imperative that the full Senate restore some balance to the legislation by voting to adopt the extension.

Failure to restore aiding and abetting liability

Chairman Levitt's May 25, 1995 letter to Banking Committee Members stated that, in addition to his concerns about the safe harbor, the Committee Print substitute did not resolve two important issues for the Commission. The first of these, discussed above, was the statute of limitations; the second was aiding and abetting liability. Chairman Levitt expressed his disappointment that "the draft bill does not fully restore the aiding and abetting liability eliminated in the Supreme Court's Central Bank of Denver opinion."

Prior to 1994, courts in every circuit in the country had recognized the ability of investors to sue aiders and abettors of securities frauds. The courts derived aiding and abetting liability from traditional principles of common law and criminal law. The notion attaches liability to those who provide assistance to the unlawful acts of others. To be held liable, most courts required that an investor show that a securities fraud was committed, that the aider and ***49** abettor gave substantial assistance to the fraud, and that the aider and abettor had some degree of scienter (intent to deceive or recklessness toward the fraud).[20]

In Central Bank of Denver v. First Interstate Bank of Denver, 114 S. Ct. 1439 (1994), the Supreme Court eliminated the right of investors to sue aiders and abettors of securities fraud. Writing for four dissenters, Justice Stevens criticized the five member majority for "reach[ing] out to overturn a most considerable body of precedent." While the issue was not directly before the Court, Justice Stevens warned that the decision would also eliminate the SEC's ability to pursue aiders and abettors of securities fraud.

As Senator Dodd stated at a May 12, 1994 Securities Subcommittee hearing, "aiding and abetting liability has been critically important in deterring individuals from assisting possible fraudulent

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

acts by others." Testifying at that hearing, Chairman Levitt stressed the importance of restoring aiding and abetting liability for private investors:

> Persons who knowingly or recklessly assist the perpetration of a fraud may be insulated from liability to private parties if they act behind the scenes and do not themselves make statements, directly or indirectly, that are relied ****728** upon by investors. Because this is conduct that should be deterred, Congress should enact legislation to restore aiding and abetting liability in private actions.

The North American Securities Administrators Association and the Association of the Bar of the City of New York also endorsed restoration of aiding and abetting liability in private actions.

The bill reported by the Committee restores, in part, the SEC's ability to sue parties who aid and abet violations of the securities laws. The provision in the bill is limited to violations of Section 10(b) of the Securities Exchange Act, and to individuals who act "knowingly." It ignores the recommendation made by the SEC, the State securities regulators and the bar association that aiding and abetting liability be fully restored for the SEC and private litigants as well. While the provision in the bill is of some help, the deterrent effect of the securities laws would be strengthened if aiding and abetting liability were restored in private actions as well.

CONCLUSION

Our capital markets depend on investor confidence. Individuals and institutions are motivated to place their funds in our markets, in part because they believe in the efficiency and fairness of those markets. Their confidence depends also on the existence of effective remedies against persons who commit securities fraud.

While we support the goal of deterring and sanctioning frivolous securities litigation, provisions in this bill will deter meritorious fraud actions as well. By protecting fraudulent forward looking statements, and by restricting the application of joint and several liability, this bill may undermine investor confidence. These changes are likely to fall hardest on the elderly, who often are targeted ***50** as fraud victims.[21] Further, it fails to include provisions that are needed to ensure that investors have adequate time and means to pursue securities fraud actions.

The securities markets are crucial to our economic performance as a nation; we should evaluate efforts to tamper with them very carefully. Because this legislation may reduce investor confidence in the capital formation process it seeks to promote, we oppose it and hope it will be improved by the full Senate.

Paul Sarbanes.
Barbara Boxer.

Richard Bryan.

****729 *51** ADDITIONAL VIEWS OF SENATOR DODD

I share the view of the Committee majority that this bill carefully addresses the flaws in the current securities litigation system, without limiting the rights of investors to bring actions to recover damages. Striking the balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless lawsuits was difficult, but on balance, I believe the Committee has succeeded.

The measure adopted by the Committee is based on a bill that Senator Domenici and I introduced in the past two Congresses. The bill, as reported, contains several substantial improvements to S. 240 as introduced this year in the Senate. However, there are several provisions of the original bill that I wish had also been included, although I understand the need to produce a consensus document.

Specifically, I have pressed for an extension of the current statute of limitations for private actions under the Securities Exchange Act of 1934. The Committee rejected an amendment to do that, and I expect this issue will be raised again when this bill is considered by the entire Senate.

Another issue of concern to me involves liability in private actions under 10b–5 for aiders and abettors of primary securities law violators. As chairman of the Subcommittee on Securities, I held a hearing on this issue in May 1994, after the Supreme Court ruled that private parties could not bring suit against alleged aiders and abettors. I am pleased that the Committee bill grants the Securities and Exchange Commission explicit authority to bring actions against those who knowingly aid and abet primary violators. However, I remain concerned about liability in private actions and will continue work with other Committee members on this issue as we move to floor consideration.

A final provision, which would have created a self-disciplinary organization for auditors, is also not part of the bill.

I favor all three of these provisions because of my belief that as we properly make it more difficult to bring meritless lawsuits, we must do all that we can to ensure that legitimate victims can continue to sue and can recover damages quickly. It is appropriate to “raise the bar,” but we must provide the careful balance that is needed to protect the rights of fraud victims.

Chris Dodd.

1 114 S. Ct. 1439 (1994).

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

2 Statement of Senator Pete Domenici, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, March 2, 1995.

3 Statement of Chairman Alfonse M. D'Amato, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

4 Statement of Senator Christopher J. Dodd, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

5 Arthur Levitt, "Between Caveat Emptor and Caveat Vendor: The Middle Ground of Litigation Reform," Remarks at the 22nd Annual Securities Regulation Institute, San Diego, California (January 25, 1995).

6 Safe Harbor for Forward-Looking Statements, Exchange Act Rel. No. 33-7107 (October 13, 1994).

7 "Majority Staff of the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, Report on Private Securities Litigation," 103d Congress, 2d Session (1994).

8 William P. Barrett, "I Have No Clients," Forbes, October 11, 1993.

9 Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 185, 739 (1975).

10 "Securities Litigation Reform: Hearings Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce," 103d Congress, 2d Session, 35–36 (1994).

11 Id. at 36.

12 D'Amato Statement, supra, note 3.

13 House hearings, note 10, supra, at 36.

14 Through the U.S. securities markets, corporate issuers raised $76 billion in 1992, $102 billion in 1993, and $130 billion in 1994. Small businesses making initial public offerings of stock raised $40 billion in 1992, $57 billion in 1993, and $34 billion in 1994. "Securities Industry Trends," Securities Industry Association Newsletter, April 5, 1995.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

15 Id. The $1 trillion figure includes private placements, underwriting and domestic medium-term note programs.

16 Testimony of James F. Morgan on behalf of the National Venture Capital Association, Hearings on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

17 Arthur Levitt, “Between Caveat Emptor and Caveat Vendor” supra, note 5.

18 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).

19 Janet Cooper Alexander, “Do the Merits Matter? A Study of Settlements in Securities Class Actions,” 43 Stan. L. Rev. 497, 511–13 (1991).

20 Many of these lawsuits are still pending. Testimony of James F. Morgan, supra, note 16.

21 Testimony of George H. Sollman on behalf of the American Electronics Association: Hearings on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

22 Testimony of Marc E. Lackritz, on behalf of the Securities Industry Association: Hearings on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995. Testimony of former SEC Commissioner J. Carter Beese, on behalf of the Center for Strategic and International Studies, Hearings on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

23 Testimony of Edward R. McCracken, President and Chief Executive Officer of Silicon Graphics, Inc. and Co-Chairman of the American Entrepreneurs for Economic Growth, Hearings on Private Litigation Under Federal Securities Laws: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993.

24 Testimony of George H. Sollman, supra, note 21.

25 “GOP Targets Shareholder Suits,” Investors Business Daily, February 26, 1995, p.A1.

26 Testimony of Patricia Reilly, “Hearing on Private Litigation Under Federal Securities Laws: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs,” June 17, 1993; See, Majority Staff Report, supra, note 7.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

27 Testimony of Maryellen Andersen, Council of Institutional Investors, Hearing on Private Litigation Under Federal Securities Laws: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, July 21, 1993.

28 See, Testimony of Arthur Levitt, Hearings on H.R. 10, the Common Sense Legal Reform Act of 1995, Subcommittee on Telecommunications and Finance, House Commerce Committee, February 10, 1995.

29 Testimony of Mark J. Griffin, Director of Utah Department of Commerce, Division of Securities, on behalf of the North American Securities Administrators Association, Hearings on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 22, 1995.

30 Testimony of Mark E. Lackritz, supra, note 22.

31 The Brancato Report on Institutional Investment, "Total Assets and Equity Holdings" Volume 2, Edition 1.

32 Elliott J. Weiss and John S. Beckerman, "Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions"" 104 The Yale Law Journal (1995). This article provided the basis for the "most adequate plaintiff" provision.

33 Testimony of Maryellen Andersen, supra, note 27.

34 "Let the Money Do the Monitoring," supra note 32.

35 Testimony of Patricia Reilly, supra, note 26.

36 See generally, Majority Staff Report, supra note 7, at 81 et seq.

37 NASCAT Analysis of Pending Legislation on Securities Fraud Litigation, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995.

38 Testimony of Patricia Reilly, supra, note 26.

39 Rule 11 governs all pleadings, written motions and other papers filed with the court. Under Rule 11(b), the attorney's signature on such papers certifies that:

(1) it is not being presented for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a non-frivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

40 See, response by Thomas Dunlap, Jr., General Counsel, Intel Corporation, to Written Questions of Senator Domenici, "Private Litigation Under the Federal Securities Laws: Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs," 103d Cong., 1st Session. S. Hrg. No. 103-431 (1993) (noting that "Rule 11 is rarely enforced in Federal Courts").

41 See, Majority Staff Report, 45–48, supra, note 7.

The original S. 240 contained a provision allowed for fee shifting in cases where a party unreasonably refused to enter into Alternative Dispute Resolution ("ADR"), if that party pursued a claim or defense later deemed "not substantially justified." Because the Committee has determined to retain the voluntary nature of ADR, it has not included the original S. 240's fee shifting mechanism in the final bill. The Committee, however, supports the increased use of ADR to reduce the time and expense associated with securities fraud litigation and encourages courts to explore new and innovative methods of ADR.

42 Rule 11(c)(2) limits sanctions to "what is sufficient to deter the repetition of such conduct or comparable conduct by others similarly situated."

43 Testimony of former SEC Commissioner J. Carter Beese, Jr., Chairman of the Capital Markets Regulatory Reform Project Center for Strategic and International Studies, before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, March 2, 1995 (citing testimony of Philip A. Lacovara, Hearing on H.R. 3185: Telecommunications and Finance Subcommittee of the House Committee on Energy and Commerce).

44 Testimony of Richard J. Egan, Chairman of the Board of EMC Corporation, Hearing on Private Litigation Under Federal Securities Laws: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993.

45 Testimony of Arthur Levitt, Chairman of the U.S. Securities and Exchange Commission: Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, April 6, 1995.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

46 In Re Time Warner Inc. Securities Litigation, 9 F.3d 259, 268 (2d Cir. 1993) (citations omitted.)

47 Testimony of Richard C. Breeden, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, April 6, 1995.

48 Testimony of James F. Morgan supra, note 16.

49 Testimony of J. Carter Beese, supra, note 43.

50 Testimony of John G. Adler, Hearing on Private Litigation Under Federal Securities Laws, Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, June 17, 1993.

51 February 14, 1995 letter from the California Public Employees' Retirement System to the SEC on SEC “safe harbor” proposal. See, note 6, supra.

52 The First, Second, Third, Sixth, and Ninth Circuits have adopted a version of the bespeaks caution doctrine. See e.g., In Re Worlds of Wonder Securities Litigation, 35 F.3d 1407 (9th Cir. 1994); Rubinstein v. Collins, 20 F.3d 160 (5th Cir. 1994); Kline v. First Western Government Securities, Inc., 24 F.3d 480 (3d Cir. 1994); Sinay v. Lamson & Sessions Company, 948 F.2d 1037 (6th Cir. 1991); I. Meyer Pincus & Associates v. Oppenheimer & Co., Inc., 936 F.2d 759 (2d Cir. 1991); Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991); Luce v. Edelstein, 802 F.2d 49 (2d Cir. 1986);

53 In Re Donald J. Trump Casino, 7 F.3d 357 (3d Cir. 1993).

54 Id. at 371.

55 Testimony of Arthur Levitt, February 10, 1995, supra, note 28.

56114 S. Ct. 1439 (1994).

57The percentages of damages as market losses in the analysis ranged from 7.9% to 100%. See Princeton Venture Research, Inc., “PVR Analysis, Securities Law Class Actions, Damages as a Percent of Market Losses,” June 15, 1993.

58 Lev and de Villiers, “Stock Price Crashes and 10b–5 Damages: A Legal, Economic and Policy Analysis,” Stanford Law Review, 7, 9–11 (1994).

59 Testimony of J. Carter Beese, Jr., supra, note 43.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

60 Id.

61 See, Testimony of Richard C. Breeden, supra, note 47; Testimony of David S. Ruder, Hearing on Securities Litigation: Impact of U.S. Supreme Court Decision: Central Bank of Denver v. First Interstate of Denver, Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, May 12, 1994. Testimony of Charles C. Cox, Hearing on Securities Litigation Reform Proposals: Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, April 6, 1995.

62 Testimony of David Ruder, see id.

63 Majority Report, supra. note 7.

64 Testimony of Marc E. Lackritz, supra, note 22.

65 Statement of Senator D'Amato supra, note 3.

66 Testimony of J. Carter Beese, Jr., supra, note 43.

67 Hearing Report, supra, note 40.

68 Hearing Report, supra, note 40 at 104. Testimony of J. Carter Beese, Jr., supra, note 43 (discussing surveys).

69 Statement of Arthur Levitt, April 6, 1995, supra, note 45.

70 See, Testimony of Marc E. Lackritz, supra, note 22. Nearly two-thirds of the companies responding in a 1994 survey reported substantial increases in D&O insurance premiums, with an average increase of 94%. Testimony of James Morgan, supra, note 16.

71 Testimony of James Morgan, supra, note 16.

72 Hearing Report, (statement of Jake L. Netterville) supra, note 40.

73 Id.

74 Id.

75 Testimony of Arthur Levitt, supra, note 45.

76 Testimony of Richard C. Breeden, supra, note 47. Testimony of David S. Ruder, supra, note 61.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

77 Testimony of J. Carter Beese, Jr., supra, note 43; Hearing Report (testimony of A.A. Sommer, Jr.), supra, note 40 at 353–4.

78 Hearing Report, supra, note 40 at 465.

79 Testimony of Marc Lackritz, supra, note 22.

80 See, e.g., Wilson v. Saintine Exploration & Drilling Corp., 872 F.2d 1124, 1126 (2d Cir. 1989).

1 U.S. Securities and Exchange Commission 1994 Annual Report, at 28.

2 Id. at 53.

3 Id.

4 Securities Industry TRENDS, Vol. XXI, No. 3, April 5, 1995.

5 Id.

6 See Testimony of Arthur Levitt before the Senate Securities Subcommittee, November 10, 1993.

7 "Securities Industry TRENDS," Vol. XXI, No. 3, April 5, 1995 (Source: Securities Data Company).

8 Id.

9 The Securities Industry Briefing Book, A Partnership with America (1994), at 11.

10 See Securities Act Release No. 6084 (June 25, 1979); 17 CFR 230.175 (1994), 17 CFR 240.3b–6 (1994).

11 See Securities Act Release No. 33–7101 (October 13, 1994).

12 In Basic, Inc. v. Levinson, 485 U.S. 224 (1988), the Supreme Court rejected this requirement of "actual knowledge of and actual reliance on" fraudulent statements in most circumstances. Instead, the Supreme Court recognized a doctrine called "fraud on the market" that had previously been adopted by a majority of Federal circuit courts. The Court held that:

> [a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in the market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a[n antifraud] action.

485 U.S. at 247.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

13 7 F.3d at 368.

14 20 F.3d at 166.

15 7 F.3d at 371-72.

16 See Restatement (Second) of Torts, Sec. 526(b), comment e; Prosser and Keeton, Law of Torts, Sec. 107.

17 See May 23, 1995 letter to Committee Members from American Council on Education, California Labor Federation–AFL–CIO, Congress of California Seniors–LA County, Consumer Federation of America, Consumers for Civil Justice, International Brotherhood of Teamsters, Government Finance Officers Association, Gray Panthers, National League of Cities, New York State Council of Senior Citizens, North American Securities Administrators Association, and U.S. Public Interest Research Group ("primary concerns with respect to the provisions of S. 240 * * * include * * * Limits on joint and several liability. * * *"); May 24, 1995 letter to Committee Members from Citizen Action, Consumer Federation of America, Consumers Union, Public Citizen, U.S. Public Interest Research Group, Violence Policy Center ("Abrogation of joint and several liability * * * would effectively immunize professional wrongdoers.")

18 See June 14, 1995 Letter from the North American Securities Administrators Association.

19 Id.

20 See, e.g., IIT v. Cornfeld, 619 F.2d 909, 992 (2nd Cir. 1980).

21 See "If the Hair is Gray, Con Artists See Green," The New York Times, May 21, 1995.

S. REP. 104-98, S. Rep. No. 98, 104TH Cong., 1ST Sess. 1995, 1995 U.S.C.C.A.N. 679, 1995 WL 372783 (Leg.Hist.)

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

PL 105–353, November 3, 1998, 112 Stat 3227

UNITED STATES PUBLIC LAWS

105th Congress - Second Session

Convening January 27, 1998

Additions and Deletions are not identified in this database.

Vetoed provisions within tabular material are not displayed.

PL 105–353 (S 1260)

November 3, 1998
SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998.

An Act to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to limit the conduct of securities class actions under State law, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

<< 15 USCA § 78a NOTE >>

SECTION 1. SHORT TITLE.

This Act may be cited as the "Securities Litigation Uniform Standards Act of 1998".

<< 15 USCA § 78a NOTE >>

SEC. 2. FINDINGS.

The Congress finds that—

<< 15 USCA § 78a NOTE >>

(1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;

<< 15 USCA § 78a NOTE >>

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;

<< 15 USCA § 78a NOTE >>

(3) this shift has prevented that Act from fully achieving its objectives;

<< 15 USCA § 78a NOTE >>

(4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and

<< 15 USCA § 78a NOTE >>

(5) in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.

TITLE I—SECURITIES LITIGATION UNIFORM STANDARDS

SEC. 101. LIMITATION ON REMEDIES.

(a) AMENDMENTS TO THE SECURITIES ACT OF 1933.—

<< 15 USCA § 77p >>

(1) AMENDMENT.—Section 16 of the Securities Act of 1933 (15 U.S.C. 77p) is amended to read as follows:

"SEC. 16. ADDITIONAL REMEDIES; LIMITATION ON REMEDIES.

"(a) REMEDIES ADDITIONAL.—Except as provided in subsection (b), the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity.

"(b) CLASS ACTION LIMITATIONS.—No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

"(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

"(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(c) REMOVAL OF COVERED CLASS ACTIONS.—Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

"(d) PRESERVATION OF CERTAIN ACTIONS.—

"(1) ACTIONS UNDER STATE LAW OF STATE OF INCORPORATION.—

"(A) ACTIONS PRESERVED.—Notwithstanding subsection (b) or (c), a covered class action described in subparagraph (B) of this paragraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

"(B) PERMISSIBLE ACTIONS.—A covered class action is described in this subparagraph if it involves—

"(i) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

"(ii) any recommendation, position, or other communication with respect to the sale of securities of the issuer that—

"(I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters" or appraisal rights.

"(2) STATE ACTIONS.—

"(A) IN GENERAL.—Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

"(B) STATE PENSION PLAN DEFINED.—For purposes of this paragraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of the State or political subdivision thereof, or by any agency or instrumentality thereof.

"(3) ACTIONS UNDER CONTRACTUAL AGREEMENTS BETWEEN ISSUERS AND INDENTURE TRUSTEES.—Notwithstanding subsection (b) or (c), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

"(4) REMAND OF REMOVED ACTIONS.—In an action that has been removed from a State court pursuant to subsection (c), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(e) PRESERVATION OF STATE JURISDICTION.—The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

"(f) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) AFFILIATE OF THE ISSUER.—The term 'affiliate of the issuer' means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

"(2) COVERED CLASS ACTION—

"(A) IN GENERAL.—The term 'covered class action' means—

"(i) any single lawsuit in which—

"(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

"(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

"(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—

"(I) damages are sought on behalf of more than 50 persons; and

"(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

"(B) EXCEPTION FOR DERIVATIVE ACTIONS.—Notwithstanding subparagraph (A), the term 'covered class action' does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

"(C) COUNTING OF CERTAIN CLASS MEMBERS.—For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

"(D) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.

"(3) COVERED SECURITY.—The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under this title pursuant to rules issued by the Commission under section 4(2).".

<< 15 USCA § 77z–1 >>

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) CIRCUMVENTION OF STAY OF DISCOVERY.—Section 27(b) of the Securities Act of 1933 (15 U.S.C. 77z–1(b)) is amended by inserting after paragraph (3) the following new paragraph:

"(4) CIRCUMVENTION OF STAY OF DISCOVERY.—Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.".

<< 15 USCA § 77v >>

(3) CONFORMING AMENDMENTS.—Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended—

(A) by inserting "except as provided in section 16 with respect to covered class actions," after "Territorial courts,"; and

(B) by striking "No case" and inserting"Except as provided in section 16(c), no case".

(b) AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934—

<< 15 USCA § 78bb >>

(1) AMENDMENT.—Section 28 of the Securities Exchange Act of 1934 (15 U.S.C. 78bb) is amended—

(A) in subsection (a), by striking "The rights and remedies" and inserting "Except as provided in subsection (f), the rights and remedies"; and

(B) by adding at the end the following new subsection:

"(f) LIMITATIONS ON REMEDIES.—

"(1) CLASS ACTION LIMITATIONS.—No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

"(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

"(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

"(2) REMOVAL OF COVERED CLASS ACTIONS.—Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

"(3) PRESERVATION OF CERTAIN ACTIONS—

"(A) ACTIONS UNDER STATE LAW OF STATE OF INCORPORATION.—

"(i) ACTIONS PRESERVED.—Notwithstanding paragraph (1) or (2), a covered class action described in clause (ii) of this subparagraph that is based upon the statutory or common law of

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

"(ii) PERMISSIBLE ACTIONS.—A covered class action is described in this clause if it involves—

"(I) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

"(II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that—

"(aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

"(B) STATE ACTIONS.—

"(i) IN GENERAL.—Notwithstanding any other provision of this subsection, nothing in this subsection may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

"(ii) STATE PENSION PLAN DEFINED.—For purposes of this subparagraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of a State or political subdivision thereof, or by any agency or instrumentality thereof.

"(C) ACTIONS UNDER CONTRACTUAL AGREEMENTS BETWEEN ISSUERS AND INDENTURE TRUSTEES.—Notwithstanding paragraph (1) or (2), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

"(D) REMAND OF REMOVED ACTIONS.—In an action that has been removed from a State court pursuant to paragraph (2), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

"(4) PRESERVATION OF STATE JURISDICTION.—The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

"(5) DEFINITIONS.—For purposes of this subsection, the following definitions shall apply:

"(A) AFFILIATE OF THE ISSUER.—The term 'affiliate of the issuer' means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

"(B) COVERED CLASS ACTION.—The term 'covered class action' means—

"(i) any single lawsuit in which—

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

"(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

"(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—

"(I) damages are sought on behalf of more than 50 persons; and

"(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

"(C) EXCEPTION FOR DERIVATIVE ACTIONS.—Notwithstanding subparagraph (B), the term 'covered class action' does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

"(D) COUNTING OF CERTAIN CLASS MEMBERS.—For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

"(E) COVERED SECURITY.—The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under the Securities Act of 1933 pursuant to rules issued by the Commission under section 4(2) of that Act.

"(F) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.".

<< 15 USCA § 78u–4 >>

(2) CIRCUMVENTION OF STAY OF DISCOVERY.—Section 21D(b)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–4(b)(3)) is amended by adding at the end the following new subparagraph:

"(D) CIRCUMVENTION OF STAY OF DISCOVERY.—Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.".

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

<< 15 USCA § 77p NOTE >>

(c) APPLICABILITY.—The amendments made by this section shall not affect or apply to any action commenced before and pending on the date of enactment of this Act.

<< 15 USCA § 78u NOTE >>

SEC. 102. PROMOTION OF RECIPROCAL SUBPOENA ENFORCEMENT.

<< 15 USCA § 78u NOTE >>

(a) COMMISSION ACTION.—The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

<< 15 USCA § 78u NOTE >>

(b) REPORT.—Not later than 24 months after the date of enactment of this Act, the Securities and Exchange Commission (hereafter in this section referred to as the “Commission”) shall submit a report to the Congress—

<< 15 USCA § 78u NOTE >>

(1) identifying the States that have adopted laws described in subsection (a);

<< 15 USCA § 78u NOTE >>

(2) describing the actions undertaken by the Commission and State securities commissions to promote the adoption of such laws; and

<< 15 USCA § 78u NOTE >>

(3) identifying any further actions that the Commission recommends for such purposes.

TITLE II—REAUTHORIZATION OF THE SECURITIES AND EXCHANGE COMMISSION

<< 15 USCA § 78kk >>

SEC. 201. AUTHORIZATION OF APPROPRIATIONS.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

“SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

“(a) IN GENERAL.—In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $351,280,000 for fiscal year 1999.

“(b) MISCELLANEOUS EXPENSES.—Funds appropriated pursuant to this section are authorized to be expended—

“(1) not to exceed $3,000 per fiscal year, for official reception and representation expenses;

“(2) not to exceed $10,000 per fiscal year, for funding a permanent secretariat for the International Organization of Securities Commissions; and

“(3) not to exceed $100,000 per fiscal year, for expenses for consultations and meetings hosted by the Commission with foreign governmental and other regulatory officials, members of their delegations, appropriate representatives, and staff to exchange views concerning developments relating to securities matters, for development and implementation of cooperation agreements concerning securities matters, and provision of technical assistance for the development of foreign securities markets, such expenses to include necessary logistic and administrative expenses and the expenses of Commission staff and foreign invitees in attendance at such consultations and meetings, including—

“(A) such incidental expenses as meals taken in the course of such attendance;

“(B) any travel or transportation to or from such meetings; and

“(C) any other related lodging or subsistence.”.

<< 15 USCA § 78***ll*** >>

SEC. 202. REQUIREMENTS FOR THE EDGAR SYSTEM.

Section 35A of the Securities Exchange Act of 1934 (15 U.S.C. 78***ll***) is amended—

<< 15 USCA § 78***ll*** >>

(1) by striking subsections (a), (b), (c), and (e); and

<< 15 USCA § 78***ll*** >>

(2) in subsection (d)—

(A) by striking “(d)”;

(B) in paragraph (2), by striking “; and” at the end and inserting a period; and

(C) by striking paragraph (3).

<< 15 USCA § 78d >>

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

SEC. 203. COMMISSION PROFESSIONAL ECONOMISTS.

Section 4(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78d(b)) is amended—

<< 15 USCA § 78d >>

(1) by redesignating paragraph (2) as paragraph (3); and

<< 15 USCA § 78d >>

(2) by inserting after paragraph (1) the following:
"(2) ECONOMISTS.—
"(A) COMMISSION AUTHORITY.—Notwithstanding the provisions of chapter 51 of title 5, United States Code, the Commission is authorized—
"(i) to establish its own criteria for the selection of such professional economists as the Commission deems necessary to carry out the work of the Commission;
"(ii) to appoint directly such professional economists as the Commission deems qualified; and
"(iii) to fix and adjust the compensation of any professional economist appointed under this paragraph, without regard to the provisions of chapter 54 of title 5, United States Code, or subchapters II, III, or VIII of chapter 53, of title 5, United States Code.
"(B) LIMITATION ON COMPENSATION.—No base compensation fixed for an economist under this paragraph may exceed the pay for Level IV of the Executive Schedule, and no payments to an economist appointed under this paragraph shall exceed the limitation on certain payments in section 5307 of title 5, United States Code.
"(C) OTHER BENEFITS.—All professional economists appointed under this paragraph shall remain within the existing civil service system with respect to employee benefits.".

TITLE III—CLERICAL AND TECHNICAL AMENDMENTS

SEC. 301. CLERICAL AND TECHNICAL AMENDMENTS.

(a) SECURITIES ACT OF 1933.—The Securities Act of 1933 (15 U.S.C. 77 et seq.) is amended as follows:

<< 15 USCA § 77b >>

(1) Section 2(a)(15)(i) (15 U.S.C. 77b(a)(15)(i)) is amended—
(A) by striking "3(a)(2) of the Act" and inserting "3(a)(2)"; and
(B) by striking "section 2(13) of the Act" and inserting "paragraph (13) of this subsection".

<< 15 USCA § 77k >>

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) Section 11(f)(2)(A) (15 U.S.C. 77k(f)(2)(A)) is amended by striking “section 38” and inserting “section 21D(f)”.

<< 15 USCA § 77m >>

(3) Section 13 (15 U.S.C. 77m) is amended—

(A) by striking “section 12(2)” each place it appears and inserting “section 12(a)(2)”; and

(B) by striking “section 12(1)” each place it appears and inserting “section 12(a)(1)”.

<< 15 USCA § 77r >>

(4) Section 18 (15 U.S.C. 77r) is amended—

(A) in subsection (b)(1)(A), by inserting “, or authorized for listing,” after “Exchange, or listed”;

(B) in subsection (c)(2)(B)(i), by striking “Capital Markets Efficiency Act of 1996” and inserting “National Securities Markets Improvement Act of 1996”;

(C) in subsection (c)(2)(C)(i), by striking “Market” and inserting “Markets”;

(D) in subsection (d)(1)(A)—

(i) by striking “section 2(10)” and inserting “section 2(a)(10)”; and

(ii) by striking “subparagraphs (A) and (B)” and inserting “subparagraphs (a) and (b)”;

(E) in subsection (d)(2), by striking “Securities Amendments Act of 1996” and inserting “National Securities Markets Improvement Act of 1996”; and

(F) in subsection (d)(4), by striking “For purposes of this paragraph, the” and inserting “The”.

<< 15 USCA § 77z–1 >>

<< 15 USCA § 77z–2 >>

<< 15 USCA § 77z–3 >>

(5) Sections 27, 27A, and 28 (15 U.S.C. 77z–1, 77z–2, 77z–3) are transferred to appear after section 26, in that order.

<< 15 USCA § 77aa >>

(6) Paragraph (28) of schedule A of such Act (15 U.S.C. 77aa(28)) is amended by striking “identic” and inserting “identical”.

(b) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.) is amended as follows:

<< 15 USCA § 78c >>

(1) Section 3(a)(10) (15 U.S.C. 78c(a)(10)) is amended by striking “deposit, for” and inserting “deposit for”.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

<< 15 USCA § 78c >>

(2) Section 3(a)(12)(A)(vi) (15 U.S.C. 78c(a)(12)(A)(vi)) is amended by moving the margin 2 em spaces to the left.

<< 15 USCA § 78c >>

(3) Section 3(a)(22)(A) (15 U.S.C. 78c(a)(22)(A)) is amended—
(A) by striking “section 3(h)” and inserting “section 3”; and
(B) by striking “section 3(t)” and inserting “section 3”.

<< 15 USCA § 78c >>

(4) Section 3(a)(39)(B)(i) (15 U.S.C. 78c(a)(39)(B)(i)) is amended by striking “an order to the Commission” and inserting “an order of the Commission”.

<< 15 USCA § 78g >>

<< 15 USCA § 78q >>

<< 15 USCA § 78z >>

(5) The following sections are each amended by striking “Federal Reserve Board” and inserting “Board of Governors of the Federal Reserve System”: subsections (a) and (b) of section 7 (15 U.S.C. 78g (a), (b)); section 17(g) (15 U.S.C. 78q(g)); and section 26 (15 U.S.C. 78z).

<< 15 USCA § 78g >>

(6) The heading of subsection (d) of section 7 (15 U.S.C. 78g(d)) is amended by striking “EXCEPTION” and inserting “EXCEPTIONS”.

<< 15 USCA § 78n >>

(7) Section 14(g)(4) (15 U.S.C. 78n(g)(4)) is amended by striking “consolidation sale,” and inserting “consolidation, sale,”.

<< 15 USCA § 78***o*** >>

(8) Section 15 (15 U.S.C. 78***o***) is amended—
(A) in subsection (c)(8), by moving the margin 2 em spaces to the left;
(B) in subsection (h)(2), by striking “affecting” and inserting “effecting”;
(C) in subsection (h)(3)(A)(i)(II)(bb), by inserting “or” after the semicolon;
(D) in subsection (h)(3)(A)(ii)(I), by striking “maintains” and inserting “maintained”;

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(E) in subsection (h)(3)(B)(ii), by striking “association” and inserting “associated”.

<< 15 USCA § 78***o***–4 >>

(9) Section 15B(c)(4) (15 U.S.C. 78***o***–4(c)(4)) is amended by striking “convicted by any offense” and inserting “convicted of any offense”.

<< 15 USCA § 78***o***–5 >>

(10) Section 15C(f)(5) (15 U.S.C. 78***o***–5(f)(5)) is amended by striking “any person or class or persons” and inserting “any person or class of persons”.

<< 15 USCA § 78s >>

(11) Section 19(c)(5) (15 U.S.C. 78s(c)(5)) is amended by moving the margin 2 em spaces to the right.

<< 15 USCA § 78t >>

(12) Section 20 (15 U.S.C. 78t) is amended by redesignating subsection (f) as subsection (e).

<< 15 USCA § 78u–4 >>

(13) Section 21D (15 U.S.C. 78u–4) is amended—

(A) in subsection (g)(2)(B)(i), by striking “paragraph (1)” and inserting “subparagraph (A)”.

(B) by redesignating subsection (g) as subsection (f); and

<< 15 USCA § 78ee >>

(14) Section 31(a) (15 U.S.C. 78ee(a)) is amended by striking “this subsection” and inserting “this section”.

(c) INVESTMENT COMPANY ACT OF 1940.—The Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) is amended as follows:

<< 15 USCA § 80a–2 >>

(1) Section 2(a)(8) (15 U.S.C. 80a–2(a)(8)) is amended by striking “Unitde” and inserting “United”.

<< 15 USCA § 80a–3 >>

(2) Section 3(b) (15 U.S.C. 80a–3(b)) is amended by striking “paragraph (3) of subsection (a)” and inserting “paragraph (1)(C) of subsection (a)”.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

<< 15 USCA § 80a–12 >>

(3) Section 12(d)(1)(G)(i)(III)(bb) (15 U.S.C. 80a–12(d)(1)(G)(i)(III)(bb)) is amended by striking “the acquired fund” and inserting “the acquired company”.

<< 15 USCA § 80a–18 >>

(4) Section 18(e)(2) (15 U.S.C. 80a–18(e)(2)) is amended by striking “subsection (e)(2)” and inserting “paragraph (1) of this subsection”.

<< 15 USCA § 80a–29 >>

(5) Section 30 (15 U.S.C. 80a–29) is amended—

(A) by inserting “and” after the semicolon at the end of subsection (b)(1);

(B) in subsection (e), by striking “semi-annually” and inserting “semiannually”; and

(C) by redesignating subsections (g) and (h), as added by section 508(g) of the National Securities Markets Improvement Act of 1996, as subsections (i) and (j), respectively.

<< 15 USCA § 80a–30 >>

(6) Section 31(f) (15 U.S.C. 80a–30(f)) is amended by striking “subsection (c)” and inserting “subsection (e)”.

(d) INVESTMENT ADVISERS ACT OF 1940.—The Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.) is amended as follows:

<< 15 USCA § 80b–3 >>

(1) Section 203(e)(8)(B) (15 U.S.C. 80b–3(e)(8)(B)) is amended by inserting “or” after the semicolon.

<< 15 USCA § 80b–18a >>

(2) Section 222(b)(2) (15 U.S.C. 80b–18a(b)(2)) is amended by striking “principle” and inserting “principal”.

(e) TRUST INDENTURE ACT OF 1939.—The Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) is amended as follows:

<< 15 USCA § 77ccc >>

(1) Section 303 (15 U.S.C. 77ccc) is amended by striking “section 2” each place it appears in paragraphs (2) and (3) and inserting “section 2(a)”.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

<< 15 USCA § 77ddd >>

(2) Section 304(a)(4)(A) (15 U.S.C. 77ddd(a)(4)(A)) is amended by striking "(14) of subsection" and inserting "(13) of section".

<< 15 USCA § 77mmm >>

(3) Section 313(a) (15 U.S.C. 77mmm(a)) is amended—

(A) by inserting "any change to" after the paragraph designation at the beginning of paragraph (4); and

(B) by striking "any change to" in paragraph (6).

<< 15 USCA § 77sss >>

(4) Section 319(b) (15 U.S.C. 77sss(b)) is amended by striking "the Federal Register Act" and inserting "chapter 15 of title 44, United States Code,".

<< 15 USCA § 77r >>

SEC. 302. EXEMPTION OF SECURITIES ISSUED IN CONNECTION WITH CERTAIN STATE HEARINGS.

Section 18(b)(4)(C) of the Securities Act of 1933 (15 U.S.C. 77r(b)(4)(C)) is amended by striking "paragraph (4) or (11)" and inserting "paragraph (4), (10), or (11)".

Approved November 3, 1998.

PL 105–353, 1998 S 1260

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

H.R. CONF. REP. 105-803, H.R. Conf. Rep. No. 803,
105TH Cong., 2ND Sess. 1998, 1998 WL 703964 (Leg.Hist.)
P.L. 105-353, ***1** SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

HOUSE CONFERENCE REPORT NO. 105-803

October 9, 1998

Mr. Bliley, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany S. 1260]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the House to the bill (S. 1260), to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to limit the conduct of securities class actions under State law, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its disagreement to the amendment of the House and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the House amendment, insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Securities Litigation Uniform Standards Act of 1998”.

SEC. 2. FINDINGS.

The Congress finds that–

(1) the Private Securities Litigation Reform Act of 1995 sought to prevent abuses in private securities fraud lawsuits;

(2) since enactment of that legislation, considerable evidence has been presented to Congress that a number of securities class action lawsuits have shifted from Federal to State courts;

(3) this shift has prevented that Act from fully achieving its objectives;

***2** (4) State securities regulation is of continuing importance, together with Federal regulation of securities, to protect investors and promote strong financial markets; and

(5) in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.

TITLE I–SECURITIES LITIGATION UNIFORM STANDARDS

SEC. 101. LIMITATION ON REMEDIES.

(a) Amendments to the Securities Act of 1933.–

(1) Amendment.–Section 16 of the Securities Act of 1933 (15 U.S.C. 77p) is amended to read as follows:

"SEC. 16. ADDITIONAL REMEDIES; LIMITATION ON REMEDIES.

"(a) Remedies Additional.–Except as provided in subsection (b), the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity.

"(b) Class Action Limitations.–No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging–

"(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

"(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

"(c) Removal of Covered Class Actions.–Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(d) Preservation of Certain Actions.–

"(1) Actions under state law of state of incorporation.–

"(A) Actions preserved.–Notwithstanding subsection (b) or (c), a covered class action described in subparagraph (B) of this paragraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

"(B) Permissible actions.–A covered class action is described in this subparagraph if it involves–

"(i) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

***3** "(ii) any recommendation, position, or other communication with respect to the sale of securities of the issuer that–

"(I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

"(2) State actions.–

"(A) In general.–Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

"(B) State pension plan defined.–For purposes of this paragraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of the State or political subdivision thereof, or by any agency or instrumentality thereof.

"(3) Actions under contractual agreements between issuers and indenture trustees.–Notwithstanding subsection (b) or (c), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

"(4) Remand of removed actions.–In an action that has been removed from a State court pursuant to subsection (c), if the Federal court determines that the action may be maintained in

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

State court pursuant to this subsection, the Federal court shall remand such action to such State court.

“(e) Preservation of State Jurisdiction.–The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

“(f) Definitions.–For purposes of this section, the following definitions shall apply:

“(1) Affiliate of the issuer.–The term ‘affiliate of the issuer’ means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

“(2) Covered class action.–

“(A) In general.–The term ‘covered class action’ means–

“(i) any single lawsuit in which–

“(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged ***4** misstatement or omission, predominate over any questions affecting only individual persons or members; or

“(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or

“(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which–

“(I) damages are sought on behalf of more than 50 persons; and

“(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

“(B) Exception for derivative actions.–Notwithstanding subparagraph (A), the term ‘covered class action’ does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

“(C) Counting of certain class members.–For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(D) Rule of construction.–Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.

"(3) Covered security.–The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under this title pursuant to rules issued by the Commission under section 4(2).".

(2) Circumvention of stay of discovery.–Section 27(b) of the Securities Act of 1933 (15 U.S.C. 77z–1(b)) is amended by inserting after paragraph (3) the following new paragraph:

"(4) Circumvention of stay of discovery.–Upon a proper showing, a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this subsection.".

(3) Conforming amendments.–Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended–

(A) by inserting "except as provided in section 16 with respect to covered class actions," after "Territorial courts,"; and

***5** (B) by striking "No case" and inserting "Except as provided in section 16(c), no case".

(b) Amendments to the Securities Exchange Act of 1934.–

(1) Amendment.–Section 28 of the Securities Exchange Act of 1934 (15 U.S.C. 78bb) is amended–

(A) in subsection (a), by striking "The rights and remedies" and inserting "Except as provided in subsection (f), the rights and remedies"; and

(B) by adding at the end the following new subsection:

"(f) Limitations on Remedies.–

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(1) Class action limitations.–No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging–

"(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or

"(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

"(2) Removal of covered class actions.–Any covered class action brought in any State court involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

"(3) Preservation of certain actions.–

"(A) Actions under state law of state of incorporation.–

"(i) Actions preserved.–Notwithstanding paragraph (1) or (2), a covered class action described in clause (ii) of this subparagraph that is based upon the statutory or common law of the State in which the issuer is incorporated (in the case of a corporation) or organized (in the case of any other entity) may be maintained in a State or Federal court by a private party.

"(ii) Permissible actions.–A covered class action is described in this clause if it involves–

"(I) the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or

"(II) any recommendation, position, or other communication with respect to the sale of securities of an issuer that–

"(aa) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and

"(bb) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

"(B) State actions.–

***6** "(i) In general.–Notwithstanding any other provision of this subsection, nothing in this subsection may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(ii) State pension plan defined.–For purposes of this subparagraph, the term 'State pension plan' means a pension plan established and maintained for its employees by the government of a State or political subdivision thereof, or by any agency or instrumentality thereof.

"(C) Actions under contractual agreements between issuers and indenture trustees.–Notwithstanding paragraph (1) or (2), a covered class action that seeks to enforce a contractual agreement between an issuer and an indenture trustee may be maintained in a State or Federal court by a party to the agreement or a successor to such party.

"(D) Remand of removed actions.–In an action that has been removed from a State court pursuant to paragraph (2), if the Federal court determines that the action may be maintained in State court pursuant to this subsection, the Federal court shall remand such action to such State court.

"(4) Preservation of state jurisdiction.–The securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions.

"(5) Definitions.–For purposes of this subsection, the following definitions shall apply:

"(A) Affiliate of the issuer.–The term 'affiliate of the issuer' means a person that directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with, the issuer.

"(B) Covered class action.–The term 'covered class action' means–

"(i) any single lawsuit in which–

"(I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or

"(II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class ***7** predominate over any questions affecting only individual persons or members; or

"(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which–

"(I) damages are sought on behalf of more than 50 persons; and

"(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(C) Exception for derivative actions.–Notwithstanding subparagraph (B), the term 'covered class action' does not include an exclusively derivative action brought by one or more shareholders on behalf of a corporation.

"(D) Counting of certain class members.–For purposes of this paragraph, a corporation, investment company, pension plan, partnership, or other entity, shall be treated as one person or prospective class member, but only if the entity is not established for the purpose of participating in the action.

"(E) Covered security.–The term 'covered security' means a security that satisfies the standards for a covered security specified in paragraph (1) or (2) of section 18(b) of the Securities Act of 1933, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred, except that such term shall not include any debt security that is exempt from registration under the Securities Act of 1933 pursuant to rules issued by the Commission under section 4(2) of that Act.

"(F) Rule of construction.–Nothing in this paragraph shall be construed to affect the discretion of a State court in determining whether actions filed in such court should be joined, consolidated, or otherwise allowed to proceed as a single action.".

(2) Circumvention of stay of discovery.–Section 21D(b)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–4(b)(3)) is amended by adding at the end the following new subparagraph:

"(D) Circumvention of stay of discovery.–Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.".

(c) Applicability.–The amendments made by this section shall not affect or apply to any action commenced before and pending on the date of enactment of this Act.

SEC. 102. PROMOTION OF RECIPROCAL SUBPOENA ENFORCEMENT.

(a) Commission Action.–The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify ***8** in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(b) Report.–Not later than 24 months after the date of enactment of this Act, the Securities and Exchange Commission (hereafter in this section referred to as the "Commission") shall submit a report to the Congress–

(1) identifying the States that have adopted laws described in subsection (a);

(2) describing the actions undertaken by the Commission and State securities commissions to promote the adoption of such laws; and

(3) identifying any further actions that the Commission recommends for such purposes.

TITLE II–REAUTHORIZATION OF THE SECURITIES AND EXCHANGE COMMISSION

SEC. 201. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"(a) In General.–In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $351,280,000 for fiscal year 1999.

"(b) Miscellaneous Expenses.–Funds appropriated pursuant to this section are authorized to be expended–

"(1) not to exceed $3,000 per fiscal year, for official reception and representation expenses;

"(2) not to exceed $10,000 per fiscal year, for funding a permanent secretariat for the International Organization of Securities Commissions; and

"(3) not to exceed $100,000 per fiscal year, for expenses for consultations and meetings hosted by the Commission with foreign governmental and other regulatory officials, members of their delegations, appropriate representatives, and staff to exchange views concerning developments relating to securities matters, for development and implementation of cooperation agreements concerning securities matters, and provision of technical assistance for the development of foreign securities markets, such expenses to include necessary logistic and administrative

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

expenses and the expenses of Commission staff and foreign invitees in attendance at such consultations and meetings, including–

"(A) such incidental expenses as meals taken in the course of such attendance;

"(B) any travel or transportation to or from such meetings; and

"(C) any other related lodging or subsistence.".

***9** SEC. 202. REQUIREMENTS FOR THE EDGAR SYSTEM.

Section 35A of the Securities Exchange Act of 1934 (15 U.S.C. 78*ll*) is amended–

(1) by striking subsections (a), (b), (c), and (e); and

(2) in subsection (d)–

(A) by striking "(d)";

(B) in paragraph (2), by striking "; and" at the end and inserting a period; and

(C) by striking paragraph (3).

SEC. 203. COMMISSION PROFESSIONAL ECONOMISTS.

Section 4(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78d(b)) is amended–

(1) by redesignating paragraph (2) as paragraph (3); and

(2) by inserting after paragraph (1) the following:

"(2) Economists.–

"(A) Commission authority.–Notwithstanding the provisions of chapter 51 of title 5, United States Code, the Commission is authorized–

"(i) to establish its own criteria for the selection of such professional economists as the Commission deems necessary to carry out the work of the Commission;
"(ii) to appoint directly such professional economists as the Commission deems qualified; and

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(iii) to fix and adjust the compensation of any professional economist appointed under this paragraph, without regard to the provisions of chapter 54 of title 5, United States Code, or subchapters II, III, or VIII of chapter 53, of title 5, United States Code.

"(B) Limitation on compensation.–No base compensation fixed for an economist under this paragraph may exceed the pay for Level IV of the Executive Schedule, and no payments to an economist appointed under this paragraph shall exceed the limitation on certain payments in section 5307 of title 5, United States Code.

"(C) Other benefits.–All professional economists appointed under this paragraph shall remain within the existing civil service system with respect to employee benefits.".

TITLE III–CLERICAL AND TECHNICAL AMENDMENTS

SEC. 301. CLERICAL AND TECHNICAL AMENDMENTS.

(a) Securities Act of 1933.–The Securities Act of 1933 (15 U.S.C. 77 et seq.) is amended as follows:

(1) Section 2(a)(15)(i) (15 U.S.C. 77b(a)(15)(i)) is amended–

(A) by striking "3(a)(2) of the Act" and inserting "3(a)(2)"; and

(B) by striking "section 2(13) of the Act" and inserting "paragraph (13) of this subsection".

(2) Section 11(f)(2)(A) (15 U.S.C. 77k(f)(2)(A)) is amended by striking "section 38" and inserting "section 21D(f)".

***10** (3) Section 13 (15 U.S.C. 77m) is amended–

(A) by striking "section 12(2)" each place it appears and inserting "section 12(a)(2)"; and

(B) by striking "section 12(1)" each place it appears and inserting "section 12(a)(1)".

(4) Section 18 (15 U.S.C. 77r) is amended–

(A) in subsection (b)(1)(A), by inserting ", or authorized for listing," after "Exchange, or listed";

(B) in subsection (c)(2)(B)(i), by striking "Capital Markets Efficiency Act of 1996" and inserting "National Securities Markets Improvement Act of 1996";

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(C) in subsection (c)(2)(C)(i), by striking “Market” and inserting “Markets”;

(D) in subsection (d)(1)(A)–

(i) by striking “section 2(10)” and inserting “section 2(a)(10)”; and
(ii) by striking “subparagraphs (A) and (B)” and inserting “subparagraphs (a) and (b)”;
(E) in subsection (d)(2), by striking “Securities Amendments Act of 1996” and inserting “National Securities Markets Improvement Act of 1996”; and

(F) in subsection (d)(4), by striking “For purposes of this paragraph, the” and inserting “The”.

(5) Sections 27, 27A, and 28 (15 U.S.C. 77z–1, 77z–2, 77z–3) are transferred to appear after section 26, in that order.

(6) Paragraph (28) of schedule A of such Act (15 U.S.C. 77aa(28)) is amended by striking “identic” and inserting “identical”.

(b) Securities Exchange Act of 1934.–The Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.) is amended as follows:

(1) Section 3(a)(10) (15 U.S.C. 78c(a)(10)) is amended by striking “deposit, for” and inserting “deposit for”.

(2) Section 3(a)(12)(A)(vi) (15 U.S.C. 78c(a)(12)(A)(vi)) is amended by moving the margin 2 em spaces to the left.

(3) Section 3(a)(22)(A) (15 U.S.C. 78c(a)(22)(A)) is amended–

(A) by striking “section 3(h)” and inserting “section 3”; and

(B) by striking “section 3(t)” and inserting “section 3”.

(4) Section 3(a)(39)(B)(i) (15 U.S.C. 78c(a)(39)(B)(i)) is amended by striking “an order to the Commission” and inserting “an order of the Commission”.

(5) The following sections are each amended by striking “Federal Reserve Board” and inserting “Board of Governors of the Federal Reserve System”: subsections (a) and (b) of section 7 (15 U.S.C. 78g(a), (b)); section 17(g) (15 U.S.C. 78q(g)); and section 26 (15 U.S.C. 78z).

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(6) The heading of subsection (d) of section 7 (15 U.S.C. 78g(d)) is amended by striking "Exception" and inserting "Exceptions".

(7) Section 14(g)(4) (15 U.S.C. 78n(g)(4)) is amended by striking "consolidation sale," and inserting "consolidation, sale,".

(8) Section 15 (15 U.S.C. 78***o***) is amended–

***11** (A) in subsection (c)(8), by moving the margin 2 em spaces to the left;

(B) in subsection (h)(2), by striking "affecting" and inserting "effecting";

(C) in subsection (h)(3)(A)(i)(II)(bb), by inserting "or" after the semicolon;

(D) in subsection (h)(3)(A)(ii)(I), by striking "maintains" and inserting "maintained";

(E) in subsection (h)(3)(B)(ii), by striking "association" and inserting "associated".

(9) Section 15B(c)(4) (15 U.S.C. 78***o***–4(c)(4)) is amended by striking "convicted by any offense" and inserting "convicted of any offense".

(10) Section 15C(f)(5) (15 U.S.C. 78***o***–5(f)(5)) is amended by striking "any person or class or persons" and inserting "any person or class of persons".

(11) Section 19(c)(5) (15 U.S.C. 78s(c)(5)) is amended by moving the margin 2 em spaces to the right.

(12) Section 20 (15 U.S.C. 78t) is amended by redesignating subsection (f) as subsection (e).

(13) Section 21D (15 U.S.C. 78u–4) is amended–

(A) in subsection (g)(2)(B)(i), by striking "paragraph (1)" and inserting "subparagraph (A)".

(B) by redesignating subsection (g) as subsection (f); and

(14) Section 31(a) (15 U.S.C. 78ee(a)) is amended by striking "this subsection" and inserting "this section".

(c) Investment Company Act of 1940.–The Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) is amended as follows:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(1) Section 2(a)(8) (15 U.S.C. 80a–2(a)(8)) is amended by striking “Unitde” and inserting “United”.

(2) Section 3(b) (15 U.S.C. 80a–3(b)) is amended by striking “paragraph (3) of subsection (a)” and inserting “paragraph (1)(C) of subsection (a)”.

(3) Section 12(d)(1)(G)(i)(III)(bb) (15 U.S.C. 80a–12(d)(1)(G)(i)(III)(bb)) is amended by striking “the acquired fund” and inserting “the acquired company”.

(4) Section 18(e)(2) (15 U.S.C. 80a–18(e)(2)) is amended by striking “subsection (e)(2)” and inserting “paragraph (1) of this subsection”.

(5) Section 30 (15 U.S.C. 80a–29) is amended–

(A) by inserting “and” after the semicolon at the end of subsection (b)(1);

(B) in subsection (e), by striking “semi-annually” and inserting “semiannually”; and

(C) by redesignating subsections (g) and (h), as added by section 508(g) of the National Securities Markets Improvement Act of 1996, as subsections (i) and (j), respectively.

(6) Section 31(f) (15 U.S.C. 80a–30(f)) is amended by striking “subsection (c)” and inserting “subsection (e)”.

(d) Investment Advisers Act of 1940.–The Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.) is amended as follows:

***12** (1) Section 203(e)(8)(B) (15 U.S.C. 80b–3(e)(8)(B)) is amended by inserting “or” after the semicolon.

(2) Section 222(b)(2) (15 U.S.C. 80b–18a(b)(2)) is amended by striking “principle” and inserting “principal”.

(e) Trust Indenture Act of 1939.–The Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) is amended as follows:

(1) Section 303 (15 U.S.C. 77ccc) is amended by striking “section 2” each place it appears in paragraphs (2) and (3) and inserting “section 2(a)”.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(2) Section 304(a)(4)(A) (15 U.S.C. 77ddd(a)(4)(A)) is amended by striking “(14) of subsection” and inserting “(13) of section”.

(3) Section 313(a) (15 U.S.C. 77mmm(a)) is amended–

(A) by inserting “any change to” after the paragraph designation at the beginning of paragraph (4); and

(B) by striking “any change to” in paragraph (6).

(4) Section 319(b) (15 U.S.C. 77sss(b)) is amended by striking “the Federal Register Act” and inserting “chapter 15 of title 44, United States Code,”.

SEC. 302. EXEMPTION OF SECURITIES ISSUED IN CONNECTION WITH CERTAIN STATE HEARINGS.

Section 18(b)(4)(C) of the Securities Act of 1933 (15 U.S.C. 77r(b)(4)(C)) is amended by striking “paragraph (4) or (11)” and inserting “paragraph (4), (10), or (11)”.

And the House agree to the same.

Tom Bliley,

M.G. Oxley,

Billy Tauzin,

Chris Cox,

Rick White,

Anna G. Eshoo,

Managers on the Part of the House.

Alfonse D'Amato,

Phil Gramm,

Chris Dodd,

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Managers on the Part of the Senate.

***13** JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the House to the bill (S. 1260) to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to limit the conduct of securities class actions under State law, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

UNIFORM STANDARDS

Title 1 of S. 1260, the Securities Litigation Uniform Standards Act of 1998, makes Federal court the exclusive venue for most securities class action lawsuits. The purpose of this title is to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court. The legislation is designed to protect the interests of shareholders and employees of public companies that are the target of meritless "strike" suits. The purpose of these strike suits is to extract a sizeable settlement from companies that are forced to settle, regardless of the lack of merits of the suit, simply to avoid the potentially bankrupting expense of litigating.

Additionally, consistent with the determination that Congress made in the National Securities Markets Improvement Act[1] (NSMIA), this legislation establishes uniform national rules for securities class action litigation involving our national capital markets. Under the legislation, class actions relating to a "covered security" (as defined by section 18(b) of the Securities Act of 1933, which was added to that Act by NSMIA) alleging fraud or manipulation must be maintained pursuant to the provisions of Federal securities law, in Federal court (subject to certain exceptions).

"Class actions" that the legislation bars from State court include actions brought on behalf of more than 50 persons, actions brought on behalf of one or more unnamed parties, and so-called "mass actions," in which a group of lawsuits filed in the same court are joined or otherwise proceed as a single action.

The legislation provides for certain exceptions for specific types of actions. The legislation preserves State jurisdiction over: (1) certain actions that are based upon the law of the State in which the ***14** issuer of the security in question is incorporated,[2] (2) actions brought by States and political subdivisions, and State pension plans, so long as the plaintiffs are named and have

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

authorized participation in the action; and (3) actions by a party to a contractual agreement (such as an indenture trustee) seeking to enforce provisions of the indenture.

Additionally, the legislation provides for an exception from the definition of "class action" for certain shareholder derivative actions.

Title II of the legislation reauthorizes the Securities and Exchange Commission (SEC or Commission) for Fiscal Year 1999. This title also includes authority for the SEC to pay economists above the general services scale.

Title III of the legislation provides for corrections to certain clerical and technical errors in the Federal securities laws arising from changes made by the Private Securities Litigation Reform Act of 1995[3] (the "Reform Act") and NSMIA.

The managers note that a report and statistical analysis of securities class actions lawsuits authored by Joseph A. Grundfest and Michael A. Perino reached the following conclusion:

> The evidence presented in this report suggests that the level of class action securities fraud litigation has declined by about a third in federal courts, but that there has been an almost equal increase in the level of state court activity, largely as a result of a "substitution effect" whereby plaintiffs resort to state court to avoid the new, more stringent requirements of federal cases. There has also been an increase in parallel litigation between state and federal courts in an apparent effort to avoid the federal discovery stay or other provisions of the Act. This increase in state activity has the potential not only to undermine the intent of the Act, but to increase the overall cost of litigation to the extent that the Act encourages the filing of parallel claims.[4]

Prior to the passage of the Reform Act, there was essentially no significant securities class action litigation brought in State court.[5] In its Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, the SEC called the shift of securities fraud cases from Federal to State court "potentially the most significant development in securities litigation" since passage of the Reform Act.[6]

The managers also determined that, since passage of the Reform Act, plaintiffs' lawyers have sought to circumvent the Act's provisions by exploiting differences between Federal and State laws ***15** by filing frivolous and speculative lawsuits in State court, where essentially none of the Reform Act's procedural or substantive protections against abusive suits are available.[7] In California, State securities class action filings in the first six months of 1996 went up roughly five-fold compared to the first six months of 1995, prior to passage of the Reform Act.[8] Furthermore, as a state securities commissioner has observed:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

It is important to note that companies can not control where their securities are traded after an initial public offering. * * * As a result, companies with publicly-traded securities can not choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its pecular litigation system on all national issuers.[9]

The solution to this problem is to make Federal court the exclusive venue for most securities fraud class action litigation involving nationally traded securities.

SCIENTER

It is the clear understanding of the managers that Congress did not, in adopting the Reform Act, intend to alter the standards of liability under the Exchange Act.

The managers understand, however, that certain Federal district courts have interpreted the Reform Act as having altered the scienter requirement. In that regard, the managers again emphasize that the clear intent in 1995 and our continuing intent in this legislation is that neither the Reform Act nor S. 1260 in any way alters the scienter standard in Federal securities fraud suits.

Additionally, it was the intent of Congress, as was expressly stated during the legislative debate on the Reform Act, and particularly during the debate on overriding the President's veto, that the Reform Act establish a heightened uniform Federal standard on pleading requirements based upon the pleading standard applied by the Second Circuit Court of Appeals. Indeed, the express language of the Reform Act itself carefully provides that plaintiffs must “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” The Managers emphasize that neither the Reform Act nor S. 1260 makes any attempt to define that state of mind.

The managers note that in Ernst and Ernst v. Hochfelder[10], the Supreme Court left open the question of whether conduct that was not intentional was sufficient for liability under the Federal securities laws. The Supreme Court has never answered that question. The Court expressly reserved the question of whether reckless behavior is sufficient for civil liability under section 10(b) and Rule ***16** 10b–5 in a subsequent case, Herman & Maclean v. Huddleston[11] , where it stated, “We have explicitly left open the question of whether recklessness satisfies the scienter requirement.”

The managers note that since the passage of the Reform Act, a data base containing many of the complaints, responses and judicial decisions on securities class actions since enactment of the Reform Act has been established on the Internet. This data base, the Securities Class Action Clearinghouse, is an extremely useful source of information on securities class actions. It can be

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

accessed on the world wide web at http://securities.stanford.edu. The managers urge other Federal courts to adopt rules, similar to those in effect in the Northern District of California, to facilitate maintenance of this and similar data bases.

Tom Bliley,

M.G. Oxley,

Billy Tauzin,

Chris Cox,

Rick White,

Anna G. Eshoo,

Managers on the Part of the House.

Alfonse D'Amato,

Phil Gramm,

Chris Dodd,

Managers on the Part of the Senate.

1 Public law 104–290 (October 11, 1996).

2 It is the intention of the managers that the suits under this exception be limited to the state in which issuer of the security is incorporated, in the case of a corporation, or state of organization, in the case of any other entity.

3 Public Law 104–67 (December 22, 1995).

4 Grundfest, Joseph A. & Perino, Michael A., Securities Litigation Reform: The First Year's Experience: A Statistical and Legal Analysis of Class Action Securities Fraud Litigation under the Private Securities Litigation Reform Act of 1995, Stanford Law School (February 27, 1997).

5 Id. n. 18.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

6 Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, U.S. Securities and Exchange Commission, Office of the General Counsel, April 1997 at 61.

7 Testimony of Mr. Jack G. Levin before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, House of Representatives, Serial No. 105-85, at 41–45 (May 19, 1998).

8 Id. at 4.

9 Written statement of Hon. Keith Paul Bishop, Commissioner, California Department of Corporations, submitted to the Senate Committee on Banking, Housing and Urban Affairs' Subcommittee on Securities" "Oversight Hearing on the Private Securities Litigation Reform Act of 1995," Serial No. 105-182, at 3 (July 27, 1998).

10 425 U.S. 185 (1976).

11 459 U.S. 375 (1983).

H.R. CONF. REP. 105-803, H.R. Conf. Rep. No. 803, 105TH Cong., 2ND Sess. 1998, 1998 WL 703964 (Leg.Hist.)

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

S. REP. 105-182, S. Rep. No. 182, 105TH Cong., 2ND Sess. 1998, 1998 WL 226714 (Leg.Hist.)
P.L. 105-353, ***1** THE SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

SENATE REPORT NO. 105–182

May 4, 1998

Mr. D'Amato, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 1260]

INTRODUCTION

The Committee on Banking, Housing and Urban Affairs, to which was referred the bill (S. 1260), to amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to limit the conduct of securities class actions under State law, having considered the same, reports favorably thereon with an amendment in the nature of a substitute, and recommends that the bill as amended do pass.

CONTENTS

	Page
Introduction	1
History of the Legislation	1
Purpose and Scope	3
Section-by-Section Analysis of S. 1260: "The Securities Litigation Uniform Standards Act of 1998"	8
Section 1. Short title	8
Section 2. Findings and purposes	8
Section 3. Limitation on remedies	9
Section 4. Applicability	9
Regulatory Impact Statement	9

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Cost of Legislation.. 9

Changes in Existing Law.. 10

Additional Views.. 11

HISTORY OF THE LEGISLATION

On July 24, 1997, the Subcommittee on Securities held an oversight hearing on the operation of the Private Securities Litigation Reform Act (hereinafter referred to as either the "PSLRA" or the "1995 Act") which was passed over presidential veto during the 104th Congress (PL–104–67). At this hearing testimony was received from: Arthur Levitt, Chairman of the Securities and Exchange Commission; Keith Paul Bishop, Commissioner, California Department of Corporations; Dr. Joseph A. Grundfest, Professor, Stanford Law School and former Commissioner, Securities and Exchange Commission; Mr. Michael A. Perino Lecturer, Stanford Law School; Mr. Joseph Polizotto, Managing Director, Office of the General Counsel, Lehman Brothers (on behalf of the Securities Industry Association); Mr. Kenneth Janke, Sr., President and Chief Executive Officer, National Association of Investors Corporation; Mr. Richard Miller, General Counsel, American Institute of Certified ***2** Public Accountants; Mr. Leonard Simon, Milberg Weiss Bershad Hynes and Lerach (on behalf of the National Association of Securities and Commercial Law Attorneys); Mr. Brian Dovey, President, National Venture Capital Association and; Mr. Robert C. Hinckley, Vice President, Strategic Plans and Programs, Xilinx (on behalf of the American Electronics Association).

As a result of the testimony received at the July 1997 hearing, Senators Gramm, Dodd, Boxer, Faircloth, Hagel and Moseley-Braun, together with seven other Senators who are not members of the Committee introduced on October 7, 1997, S. 1260, the "Securities Litigation Uniform Standards Act of 1997" (hereinafter referred to as either "Uniform Standards" or "S. 1260") Subsequently, a total of forty Senators cosponsored the legislation, including twelve from the Committee (Senators Gramm. Dodd, Boxer, Faircloth, Hagel, Moseley-Braun, Bennett, Grams, Kerry, Mack, Allard and Enzi).

On October 29, 1997 and on February 23, 1998, the Subcommittee on Securities held legislative hearings on S. 1260. Witnesses testifying on October 29, 1997 included: U.S. Representative Rick White; U.S. Representative Anna Eshoo; Arthur Levitt, Chairman, the Securities and Exchange Commission (SEC); Isaac C. Hunt, Jr., Commissioner, Securities and Exchange Commission; Robert C. Hinckley, Vice President, Strategic Plans and Programs, Xilinx, who testified on behalf of the American Electronics Association; Harry Smith, Mayor of Greenwood, Mississippi, who testified on behalf of the National League of Cities; Herbert Milstein of Cohen, Milstein, Hausfeld & Toll, who testified on behalf of the National Association of Securities and Commercial Law Attorneys; Professor Michael Perino, Stanford Law School; Thomas E. O'Hara, Chairman, Board of Trustees, the National Association of Investors Corporations and Daniel Cooperman, Senior

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Vice President, General Counsel, and Corporate Secretary, Oracle Corporation, who testified on behalf of the Software Publishers Association.

Witnesses testifying on February 23, 1998 included: Boris Feldman, Wilson, Sonsini, Goodrich & Rosati; Professor Richard W. Painter, Cornell Law School; Michael H. Morris, Vice President and General Counsel, Sun Microsystems; Mary Rouleau, Legislative Director, Consumer Federation of America; J. Harry Weatherly, Director of Finance, Mecklenburg County, North Carolina, on behalf of the Government Finance Officers Association; and John F. Olson, Gibson, Dunn & Crutcher.

On April 29, 1998, the Committee met in Executive Session to consider and adopt an amendment in the nature of a substitute that was offered by Chairman D'Amato and Senators Gramm and Dodd. The Committee also adopted an amendment, by voice vote, providing two findings to the bill. The amendment was offered by Chairman D'Amato and Senators Gramm and Dodd. The amendment makes clear the Committee's intention to enact this legislation in order to prevent state laws from being used to frustrate the operation and goals of the 1995 Reform Act. The legislation was ordered reported from Committee by a vote of 14–4. Senators Shelby, Sarbanes, Bryan and Johnson voted against this legislation.

***3** PURPOSE AND SCOPE OF LEGISLATION

The need for this legislation became apparent during a Securities Subcommittee hearing on July 24, 1997. This hearing was held to review the status of the implementation and impact of the "Private Securities Litigation Reform Act of 1995."[1] During the course of that hearing one disturbing trend became apparent; namely, that there was a noticeable shift in class action litigation from federal to state courts. At this hearing, one witness pointed out the dangers of maintaining differing federal and state standards of liability for nationally-traded securities:

> Disparate, and shifting, state litigation procedures may expose issuers to the potential for significant liability that cannot easily be evaluated in advance, or assessed when a statement is made. At a time when we are increasingly experiencing and encouraging national and international securities offerings and listings, and expending great effort to rationalize and streamline our securities markets, this fragmentation of investor remedies potentially imposes costs that outweigh the benefits. Rather than permit or foster fragmentation of our national system of securities litigation, we should give due consideration to the benefits flowing to investors from a uniform national approach.[2]

Former SEC Commissioner Joseph Grundfest summarized this post 1995 Act increase in state securities class actions in testimony co-authored with his fellow Stanford Law School faculty member Michael Perino:

> The relative stability of the aggregate litigation rate masks a significant shift of activity from federal to state court * * *. There is widespread agreement that these figures represent a substantial increase in state court litigation. Two phenomena seem to explain the bulk of this shift. First, there appears to be a "substitution effect" whereby plaintiff's counsel file state court complaints when the underlying facts appear not to satisfy new, more stringent federal pleading requirements, or otherwise seek to avoid the substantive or procedural provisions of the Act. Second plaintiffs appear to be resorting to increased parallel state and federal litigation in an effort to avoid federal discovery stays or to establish alternative state court venues for settlement of federal claims.[3]

While there was some disagreement as to the exact size of the increase in state class-action filings, the overall evidence received by the Committee is compelling.[4] As one witness testified "(t)he ***4** single fact is that state-court class actions involving nationally traded securities were virtually unknown prior to the [1995 Act]; they are brought with some frequency now."[5]

Further, the Committee has found that this state class-action trend has had an impact beyond the number of, and dollar amounts involved in, the class actions filed. This trend has created a ripple-effect that has inhibited small, high-growth companies in their efforts to raise capital, and has damaged the overall efficiency of our capital markets.[6] Specifically, the increased risk of state court class actions has had a chilling effect on the use of the "safe-harbor" and other important provisions of the 1995 Act.[7] The safe harbor was intended to help get valuable financial forecasts and forward-looking information to investors, so that these investors could make decisions with as much information as possible; as Thomas O'Hara of the National Association of Investors Corporation ("NAIC"), testified:

> The key to becoming successful with high-tech investments is a willingness to recognize–and tolerate–the inherent volatility of the business and access to crucial forward-looking information so an investor can make a wise decision.[8]

A number of witnesses at the July 1997 hearing advocated legislation to establish uniform standards for private securities class action litigation.[9] This legislation is an outgrowth of the July 1997 hearings and subsequent investigation and oversight by the Committee.

Some critics of establishing a uniform standard of liability have attacked such legislation as being an affront on Federalism and contrary to the recent trend towards reinforcing state rights.[10]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Proponents of the legislation have argued that we live in an information age in which we have truly national, if not international, securities markets and that uniform standards are entirely consistent with Congress's preeminent power over the regulation of interstate and foreign commerce. The Committee, while sensitive to both these considerations, found the interest in promoting efficient national markets to be the more convincing and compelling consideration in this context.

***5** We do have national markets for certain securities, and fraudulent and abusive securities class action litigation distorts the efficient operation of those markets and the optimal allocation of available capital. Commissioner Keith P. Bishop, then-California's primary state securities regulator, testified before the Subcommittee on Securities in July, 1997, that the preponderance of class action litigation in several states is irrelevant to the true national nature of the problem:

> It is important to note that companies can not control where their securities are traded after an initial public offering * * *. As a result, companies with publicly-traded securities can not choose to avoid jurisdictions which present unreasonable litigation costs. Thus, a single state can impose the risks and costs of its peculiar litigation system on all national issuers.[11]

The Committee emphasizes the important role that the local "cop on the beat," i.e., the state securities regulators, plays in a complementary state-federal securities regulatory system. In recognition of this dual system, this legislation uses the approach that the National Securities Markets Improvement Act of 1996 ("NSMIA") employed. The purpose of NSMIA was described by SEC Chairman Levitt in testimony regarding that legislation:

> The current system of dual federal-state regulation is not the system that Congress or the Commission would create today if we were designing a new system * * *. An appropriate balance can be attained in the federal-state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors. The bill's approach to the division of responsibilities in the investment adviser and investment company areas exemplifies such a balance.

As introduced, the legislation incorporated the conceptual framework of NSMIA (with respect to interplay of federal and state regulation), while complementing, and hopefully giving full force to the 1995 Act. The Committee strongly notes that this legislation only covers precisely those securities defined in the NSMIA, principally those securities that are traded on national exchanges. During the course of the two hearings held by the Subcommittee on Securities on this legislation, the Subcommittee received a great deal of constructive advice about how best to give effect to the 1995 Act.

Scienter

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

The Committee heard testimony from the Securities and Exchange Commission and others regarding the scienter requirement under a possible national standard of litigation for nationally traded securities. The Committee understands that this concern arises out of certain Federal district courts' interpretation of the Private Securities Litigation Reform Act of 1995 [PL 104–67]. In that regard, the Committee emphasizes that the clear intent in 1995 and ***6** our continuing intent in this legislation is that neither the PSLRA nor S. 1260 in any way alters the scienter standard in federal securities fraud suits. It was the intent of Congress, as was expressly stated during the legislative debate on the PSLRA, and particularly during the debate on overriding the President's veto, that the PSLRA establish a uniform federal standard on pleading requirements by adopting the pleading standard applied by the Second Circuit Court of Appeals. Indeed the express language of the PSLRA itself carefully provides that plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind" (emphasis added). The Committee emphasizes that neither the PSLRA nor S. 1260 makes any attempt to define that state of mind.

Certain exceptions

The SEC, as well as other commentators,[12] also noted the need to exempt from the legislation shareholder-initiated litigation based on breach of fiduciary duty of disclosure, in connection with certain corporate actions, that is found in the law of some states, most notably Delaware.

The Committee is keenly aware of the importance of state corporate law, specifically those states that have laws that establish a fiduciary duty of disclosure. It is not the intent of the Committee in adopting this legislation to interfere with state law regarding the duties and performance of an issuer's directors or officers in connection with a purchase or sale of securities by the issuer or an affiliate from current shareholders or communicating with existing shareholders with respect to voting their shares, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

In applying the uniform standards in this manner, the Committee expressly does not intend for suits excepted under this provision to be brought in venues other than in the issuer's state of incorporation, in the case of a corporation, or state of organization, in the case of an other entity.

Definition of "Class Action"

The Subcommittee on Securities heard testimony from the Securities and Exchange Commission and others that the definition of class action originally drafted as part of S. 1260 would inadvertently include cases that were beyond the intent of the legislation–such as certain types of individual state private securities actions.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

In response to these concerns, the Committee made several significant changes to the definition of class action. Because of the unique nature of the suits that the Committee has made subject to the legislation's provisions, this definition cannot simply track the exact language of Rule 23 of the Federal Rules of Civil Procedure.

In order to ensure that individual state actions would not be included as part of the bill's definitions, it was necessary for the Committee to create a standard of demarcation between individual actions appropriately brought in state court and those actions that ***7** should be subject to the bill's provisions. To address this goal, and to establish objective criteria in the application of the definition, the Committee specifically included a threshold number of fifty or more persons or prospective class members as part of the definition of a class action under this legislation.

Section 2(f)(1)(A)(i)(II) of the legislation provides a definition that closely tracks the relevant provisions of Rule 23 of the Federal Rules of Civil Procedure in which a suit is brought by representative plaintiffs on behalf of themselves and other unnamed parties. Section 2(f)(1)(A)(i)(I), however, provides that any single lawsuit is treated as a class action if it seeks damages on behalf of more than fifty persons and questions of law or fact common to the prospective class predominate, without regard to questions of individualized reliance. The predominance requirement, modeled on Rule 23, is included to assure that claims that are not closely related, but that are included in a single proceeding only for the purposes of convenience are not treated as a class action. The Committee is conscious, however, of the danger that the predominance requirement could be used as a loophole to bring a single suit that names many plaintiffs. If such a suit is brought under a state law that requires proof of each individual plaintiff's reliance on a defendant's alleged misstatement or omission, the necessity of proving reliance on an individual basis might mean that common questions would not predominate and the suit accordingly would not be treated as a class action.

Indeed the Supreme Court stated in Basic, Inc. v. Levinson [485 U.S. 224, 242, (1988)] that "requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would * * * prevent plaintiffs from proceeding with a class action, since individual issues would * * * overwhelm the common ones." To avoid this problem, the definition provides that the predominance inquiry must be undertaken without reference to issues of individualized reliance, so that the necessity of proving reliance on an individual basis would not defeat treatment of the suit as a class action.

Section 2(f)(1)(A)(ii) is a definition of class action that is intended to prevent evasion of the bill through the use of so-called "mass actions." These kinds of actions are now brought in product liability, environmental tort and similar cases. In practice, such suits may function very much like traditional class actions and, because they involve many plaintiffs, they may have a very high

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

settlement value. They accordingly may be abused by lawyers who seek to evade the provisions of this Act in order bring coercive strike suits.

Subpart (A)(ii) addresses the Committee's concern by including in the definition of class action any group of lawsuits that are filed or pending in the same court, that in the aggregate seek damages on behalf of more than fifty persons, that involve common questions of law or fact, and which are joined, consolidated, or otherwise proceed as a single action for any purpose. The Committee does not intend for the bill to prevent plaintiffs from bringing bona fide individual actions simply because more than fifty persons commence the actions in the same state court against a single defendant.

***8** However, the provisions of the bill would apply where the court orders that the suits be joined, consolidated, or otherwise proceed as a single action at the state level. The Committee also notes that when such suits proceed as a single action in state court, it is frequently at the request of the plaintiffs.

The class action definition has been changed from the original text of S. 1260 to ensure that the legislation does not cover instances in which a person or entity is duly authorized by law, other than a provision of state or federal law governing class action procedures, to seek damages on behalf of another person or entity. Thus, a trustee in bankruptcy, a guardian, a receiver, and other persons or entities duly authorized by law (other than by a provision of state or federal law governing class action procedures) to seek damages on behalf of another person or entity would not be covered by this provision.

Finally, while the Committee believes that it has effectively reached those actions that could be used to circumvent the reforms enacted by Congress in 1995 as part of the Private Securities Litigation Reform Act, it remains the Committee's intent that the bill be interpreted broadly to reach mass actions and all other procedural devices that might be used to circumvent the class action definition.

SECTION-BY-SECTION ANALYSIS

Section 1. Short title

The short title of the bill is the Securities Litigation Uniform Standards Act of 1998.

Section 2. Findings

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Congress finds that in order to avoid the thwarting of the purpose of the Private Securities Litigation Reform Act of 1995, national standards for nationally traded securities must be enacted, while preserving the appropriate enforcement powers of state regulators, and the right of individuals to bring suit.

Section 3. Limitation on remedies

Subsection 3(a) amends Section 16 of the Securities Act of 1933 as follows:

Subsection 16(a) is a savings clause.

Subsection 16(b) provides that no class action based on State law alleging fraud in connection with the purchase or sale of covered securities may be maintained in State or Federal court.

Subsection 16(c) provides that any class action described in Subsection (b) that is brought in a State court shall be removable to a Federal district court, and may be dismissed pursuant to the provisions of subsection (b).

Subsection 16(d) of the new section 16 provides for the preservation of certain law suits brought under State law affecting conduct of corporate officers with respect to certain corporate actions, including tender offers, exchange offers or the exercise of dissenter's or appraisal rights.

***9** Subsection 16(e) of the new section 16 reemphasizes that State securities commissions retain their jurisdiction to investigate and bring enforcement actions.

Subsection 16(f) of the new section 16 provides for definitions under the section, including definitions of “class action,” “covered security,” and “affiliate of the issuer.” “Class action” is defined so as to capture mass actions, but to exclude shareholder derivative actions and actions by a group of less than 50 individuals or entities. “Covered securities” includes securities satisfy the definition of that term given in subsection 18(b)(1) and 18(b)(2) of the Securities Act of 1933.

Subsection 3(b) amends Section 28 of the Securities Exchange Act of 1934 so as to effect the changes to that section substantially similar to, and consistent with, the amendments that subsection 3(a) makes to the Securities Act of 1933.

Section 4. Applicability

The changes in law made by the bill do not affect any court action commenced before and pending on the date of enactment of the legislation.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

REGULATORY IMPACT STATEMENT

This legislation is designed to address and unforeseen “loophole” in the 1995 Private Securities Litigation Act, that has blocked that law from accomplishing its stated goal of reforming private securities litigation. Because S.1260 seeks to achieve further reforms in the private securities litigation system, the Committee believes that this legislation will have little or no regulatory impact.

COST OF LEGISLATION

U.S. Congress,
Congressional Budget Office,
Washington, DC, May 1, 1998.

Hon. Alfonse M. D'Amato,
Chairman, Committee on Banking, Housing and Urban Affairs,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for S. 1260, the Securities Litigation Uniform Standards Act of 1998.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Kathleen Gramp (for federal costs), and Pepper Santalucia (for the state and local impact).

Sincerely,

June E. O'Neill, Director.

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 1260–Securities Litigation Uniform Standards Act of 1998

S. 1260 would amend existing law related to class actions involving certain types of securities fraud. Under this bill, certain class ***10** actions could not be based on state law and could only be maintained in federal courts.

CBO estimates that implementing S. 1260 would have no significant impact on the federal budget. Recent data on the number of securities-related class actions brought under state law suggest that fewer than 100 cases per year might shift to federal courts as a result of this bill.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Although class actions often involve complex and time-consuming issues, CBO estimates that the federal court system would not incur significant costs to process that number of new cases. Because S. 1260 would not affect direct spending or receipts, pay-as-you-go procedures would not apply.

S. 1260 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act of 1995 (UMRA) because it would preempt state securities laws. However, CBO estimates that the impact on state budgets would not be significant. The bill contains no private-sector mandates as defined in UMRA.

The CBO staff contacts for this estimate are Kathleen Gramp (for federal costs), who can be reached at 226–2860, and Pepper Santalucia (for the state and local impact), who can be reached at 225–3220. This estimate was approved by Robert A. Sunshine, Deputy Assistant Director for Budget Analysis.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of paragraph or subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

***11** ADDITIONAL VIEWS OF SENATORS SARBANES, BRYAN AND JOHNSON

I. INTRODUCTION

In reporting the Securities Litigation Uniform Standards Act ("Uniform Standards Bill'), the Senate Banking Committee once again sends to the Senate floor a solution in search of a problem. The Committee majority seeks to stem a supposed epidemic of frivolous securities fraud suits being filed in State court. The majority operates on the assumption that securities fraud class actions filed in State court are being used to evade the provisions of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). This assumption is supported neither by empirical studies of State court litigation nor by the record pace of securities offerings. Undeterred by the evidence, the majority would preempt securities fraud causes of action under State law. The Uniform Standards Bill would establish the provisions of the Litigation Reform Act as a uniform standard for litigation involving securities traded on the national stock exchanges.

In so doing, the majority turns a blind eye both to the shortcomings of the Litigation Reform Act and to the flaws of the Uniform Standards Bill. We opposed the Litigation Reform Act because we were concerned that it was not sufficiently protective of investors. Developments since its enactment heighten rather than lessen that concern. We oppose the Uniform Standards Bill both

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

because of its overly broad reach and because its sponsors fail to take this opportunity to correct the flaws of the Litigation Reform Act. Should the Uniform Standards Bill be enacted, investors will find their State court remedies eliminated. We fear that in too many cases, investors will be left without any effective remedies at all. Such a result can only harm innocent investors, undermine public confidence in the securities markets, and ultimately raise the cost of capital for deserving American businesses. For these reasons, a broad coalition of groups representing investors, public officials, workers and pension funds, including AARP, AFSCME, Consumer Federation of America, the Government Finance Officers Association, the National Association of State Retirement Administrators, the National League of Cities, the New York State Bar Association, the U.S. Conference of Mayors, and the United Mine Workers, opposes this Bill. Over two dozen law professors have expressed their opposition as well.[1]

***12** II. MYTH OF STATE COURT LOOPHOLE

The rationale for this legislation rests on a misconception of the facts. The sponsors of the Bill assert that securities fraud class actions have migrated from Federal court to State court in order to evade the provisions of the Litigation Reform Act. In particular, the Bill's supporters maintain that class actions are being brought in State court to avoid the Act's stay of discovery and safe harbor for forward looking statements. In fact, every empirical study of securities fraud class action filings reaches the same conclusion: while State court securities filings may have increased in 1996, they decreased in 1997.

For example, a study done by the National Economic Research Associates (NERA), a consulting firm, found that the number of securities class action suits filed in State courts during the first 10 months of 1996 increased to 79 from 48 filed during the same period in 1995.[2] In an update released in the summer of 1997, however, NERA found that the number of securities class actions filed in State courts during the first four months of 1997 declined to 19, down from 40 filed in the same period in 1996.[3] In July 1997, Professor Joseph Grundfest and Michael Perino of Stanford Law School testified that the number of issuers sued only in State class actions declined from 33 in 1996 to an annualized rate of 18 in 1997.[4] A “Price Waterhouse Securities Litigation Study” posted by that accounting firm on its Internet site corroborated NERA's findings. Using data compiled by Securities Class Action Alert based on the number of defendants sued, Price Waterhouse reported that the number of State court securities class actions increased from 52 in 1995 to 66 in 1996, but then declined to 44 in 1997. That was lower than the number of such actions in 1991 or 1993. The Study found “the total number of cases filed in 1997 shows little to no change from the average number of lawsuits filed in the period 1991 through 1995.” Data provided to the Committee by Price Waterhouse on February 20, 1998 also demonstrate that State court filings declined in 1997. Measured by the number of cases filed, the number of State securities class actions declined from 71 in 1996 to 39 in 1997. As the SEC testified in October 1997, “recent data * * * tends to show

that the migration of securities class actions from federal to state court may have been a transient phenomenon."

Not only do the Bill's supporters fail to address the decline in State court securities actions in 1997, they fail to recognize the geographic concentration of such actions. Many securities class actions are brought under the "fraud on the market" theory. Under this theory, each investor need not prove his or her individual reliance on the fraudulent statement.[5] Appellate courts in just four States have recognized the "fraud on the market" theory in securities ac ***13** tions.[6] The General Counsel of the SEC has suggested "eliminating the requirement of reliance makes possible a class action for securities suits."[7] Securities fraud class actions therefore may not be possible in the great majority of States. California is one of the few States that recognizes the "fraud on the market" theory.[8] Not surprisingly, the great majority of securities fraud class actions filed in State court are filed in California. According to the SEC, roughly 60% of State securities class actions brought since enactment of the 1995 Act were brought in California.[9] While we do not believe that any one State should set a "pro-plaintiff" national standard for securities fraud, we also do not believe that Congress need second-guess the judgments of California at balancing the interests of its local businesses versus those of its local investors. If California law makes it too easy to sue California businesses, then the California legislature should change the law.

The record volume of securities offerings is further evidence that investors feel they are receiving adequate information on which to base investment decisions. The $39 billion raised by initial public offerings in 1997 is a record second only to the nearly $50 billion raised in 1996.[10] Total underwriting of corporate equities and bonds in 1997 hit a record $1.3 trillion.[11] Market capitalization and trading volume on the national securities exchanges are also at record highs. By every measure, the nation's securities markets remain preeminent in the world. Whatever the cost of securities litigation, at either the Federal or State level, it does not interfere with the functioning of America's securities markets.

Unable to demonstrate a need for this legislation, supporters of preemption next argue that the mere threat of State litigation is a problem. In particular, they argue that the threat of State litigation is deterring companies from making the kind of "forward-looking statements" that would be protected from Federal litigation under the "safe harbor" contained in the 1995 Act. We were concerned that the safe harbor went too far and might very well protect fraudulent statements from liability. Regardless of one's views of the safe harbor, the evidence is that companies are in fact using it. A study of 547 high-tech firms by Professors at the University of Michigan and Stanford Business Schools found "a significant increase in both the frequency of firms issuing forecasts and the number of forecasts issued following enactment of the Reform Act."[12]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Proponents of preemption also cite the possibility that State actions may be used to circumvent the stay on discovery pending a motion to dismiss that was enacted by the Litigation Reform Act. We agree that State court filings should not be used by plaintiffs ***14** to "game the system," to enjoy the best of both the State and Federal securities laws. Discovery is an extensive, expensive proposition and should not be used to drive up the settlement value of weak cases. In fact, some State courts have voluntarily imposed stays on discovery in circumstances where the Federal courts would do so.[13] There is certainly no need to preempt State law causes of action generally in order to effectuate the discovery stay provisions of the Act.

A range of experts has concluded that the need for this legislation has not been demonstrated. SEC Commissioner Norman Johnson wrote on March 24, 1998:

> Consistent with the opinion the Commission and its staff have repeatedly taken, I believe there has been inadequate time to determine the overall effects of the Private Securities Litigation Reform Act of 1995, and that the proponents of further litigation reform have not demonstrated the need for preemption of state remedies or causes of action at this time.

> Perhaps the most telling debunking of the myth of an explosion in State court actions was provided by Boris Feldman, a partner in the Silicon Valley defendants' firm Wilson, Sonsini, Goodrich & Rosati. In a report on "Securities Litigation–Recent Developments" posted on his firm's Internet site, Mr. Feldman stated:

> In my opinion, plaintiffs' state court gambit has been a failure and is over. Others may disagree. I base that conclusion on three factors. First, plaintiffs' attempts to broaden dramatically state laws that have been on the books for years have not worked. Courts have consistently rejected plaintiffs' attempts to apply to shareholder disputes statutes that impose lower burdens, or greater penalties, than do the securities laws.

> Second, I believe that plaintiffs have come to realize that they will not be permitted to use courts in a particular state (i.e., California) to litigate the claims of shareholders around the country * * *

> Finally, plaintiffs have not had much success milking the state cases for discovery that they can then use to file a federal complaint.

III. SHORTCOMINGS OF THE LITIGATION REFORM ACT

The Uniform Standards Bill would preempt State law securities actions in favor of the provisions of the Litigation Reform Act. As we considered the provisions of the Litigation Reform Act insufficiently protective of investors to be an appropriate Federal securities antifraud standard, we

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

cannot support establishing that Act as the sole, “uniform” standard for nationally traded securities. At this juncture, it is necessary briefly to review the shortcomings of the Litigation Reform Act.

***15** Safe harbor protects fraudulent statements

The Litigation Reform Act created a “safe harbor” for forward looking statements, immunizing them from antifraud liability. Forward looking statements are broadly defined under the Act to include projections of financial items such as revenues, income and dividends as well as statements of future economic performance. Forward looking statements are thus precisely the sort of information of most interest to investors deciding whether to purchase or sell securities. Given this broad definition, it is crucial that such statements not be immunized when made with fraudulent intent. To do so is to provide fraud artists with an incentive to tailor their frauds to fit the statutory safe harbor and thereby defraud investors with impunity.

Prominent legal scholars have warned that the Litigation Reform Act's safe harbor did precisely that. A body of expert opinion suggests that the language of the safe harbor indeed protects deliberate falsehoods. Professor John Coffee of Columbia Law School wrote, “even if a knowingly false statement is made, the defendant escapes liability if meaningful cautionary statements are added to the forward-looking statement.”[14] (emphasis added) The Association of the Bar of the City of New York stated the safe harbor “could immunize artfully packaged and intentional misstatements and omissions of known facts.”[15] (emphasis added)

To date, no Federal circuit court has had an opportunity to address the Litigation Reform Act's safe harbor. The danger that the statutory language immunizes deliberate fraud remains strong.

Proportionate liability penalizes innocent investors

The Litigation Reform Act eliminated the rule of “joint and several” liability that has been applied in fraud cases for hundreds of years and that had been applied in Federal securities fraud cases. The Act substituted a system of “proportionate liability,” which transferred responsibility for bearing the results of a fraud from participants in the fraud to innocent victims of the fraud. This change was opposed and continues to be opposed by a host of consumer groups, labor unions, and government officials.[16]

Under joint and several liability, each person who participates in a fraud is liable for the entire amount of the victim's damages. Mark Griffin, Securities Commissioner for the State of Utah, testified before the Securities Subcommittee on March 22, 1995 on behalf of the 50 State securities commissioners. He explained why the law held all parties who participate in a securities fraud jointly and severally liable:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

> "Under current law, each defendant who conspires to commit a violation of the securities law is jointly and severally liable for all the damages resulting from the violation. ***16** The underlying rationale of this concept is that a fraud will fail if one of the participants reveals its existence and, as a result, all wrongdoers are held equally culpable if the fraud achieves its aims." (emphasis in original)

In practice, defendants bear the burden of proving their relative fault. Through a contribution action, a defendant in a securities fraud action can seek reimbursement from another party that he believes to be more at fault.

The Litigation Reform Act transferred this burden to investors. The Act limited joint and several liability under the Federal securities laws to persons who commit "knowing securities fraud." All other violators generally are liable only for their proportionate share of the fraud victim's losses. "Knowing securities fraud" is defined in the Act specifically to exclude reckless conduct. The Litigation Reform Act thus reduced the liability for reckless violators from joint and several liability to proportionate liability.

When investors' damages can be paid by a violator who is jointly and severally liable, this change will not affect the recovery available to investors. In many cases, though, the architect of the fraud is bankrupt, has fled, or otherwise cannot pay the investors' damages. In those cases, this change will harm investors: innocent victims of fraud will be denied full recovery of their damages. In a February 23, 1995 letter to House Commerce Committee Chairman Thomas J. Bliley, Jr., Chairman Levitt wrote, "[t]he Commission has consistently opposed proportionate liability." Testifying before the Securities Subcommittee on April 6, 1995, Chairman Levitt said

> "Proportionate liability would inevitably have the greatest effect on investors in the most serious cases (e.g., where an issuer becomes bankrupt after a fraud is exposed)."

The Litigation Reform Act thus transferred responsibility for bearing the results of a fraud from participants in the fraud to innocent victims of the fraud. It provided that those who commit fraud are no longer responsible for the results of their conduct. Instead, innocent investors must bear the losses if a portion of their damages are uncollectible. In so doing, the Litigation Reform Act seriously undermined the effectiveness of the Federal securities laws as a remedy for defrauded investors.

No extension of statute of limitations

We were concerned about the provisions of the Litigation Reform Act described above, which harm investors bringing meritorious fraud suits. We were also disappointed that the Act did not

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

contain provisions necessary to aid investors bringing meritorious suits. The first omission was the Act's failure to extend the statute of limitations for private rights of action under Section 10(b) of the Securities Exchange Act of 1934, the principal antifraud provision of the Federal securities laws.

In Lampf v. Gilbertson, 501 U.S. 350 (1991), the Supreme Court significantly shortened the period of time in which investors may bring such securities fraud actions. By a five to four vote, the Court held that the applicable statute of limitations is one year after the ***17** plaintiff knew of the violation and in no event more than three years after the violation occurred. This is shorter than the statute of limitations for private securities actions under the law of 33 of the 50 States.[17]

Testifying before the Banking Committee in 1991, SEC Chairman Richard Breeden stated "the timeframes set forth in the [Supreme] Court's decision is unrealistically short and will do undue damage to the ability of private litigants to sue." Chairman Breeden pointed out that in many cases,

> "events only come to light years after the original distribution of securities and the Lampf cases could well mean that by the time investors discover they have a case, they are already barred from the courthouse."
>
> The FDIC and the State securities regulators joined the SEC in 1991 in favor of overturning the Lampf decision. Chairman Levitt testified before the Securities Subcommittee in April 1995, "[e]xtending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud who successfully conceals its existence for more than three years." Chairman Levitt reaffirmed his support for a longer statute of limitations before the Committee as recently as March 25, 1998.[18]

This shorter period does not allow individual investors adequate time to discover and pursue violations of securities laws. Ignoring these recommendations, the Litigation Reform Act left intact the shorter statute of limitations adopted by Lampf.

No restoration of aiding and abetting

A final major shortcoming of the Litigation Reform Act was its failure to restore liability in private actions under the Federal securities laws for aiders and abettors of securities fraud. Prior to 1994, courts in every circuit in the country had recognized the ability of investors to sue aiders and abettors of securities frauds. The courts derived aiding and abetting liability from traditional principles of common law and criminal law. To be held liable, most courts required that an investor show that a securities fraud was committed, that the aider and abettor gave substantial assistance to the fraud, and that the aider and abettor had the intent to deceive or behaved recklessly.[19]

In Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994), again by a five to four vote, the Supreme Court eliminated the right of investors to sue aiders and abettors of securities fraud. Testifying at a May 12, 1994 Securities Subcommittee hearing, Chairman Levitt stressed the importance of restoring aiding and abetting liability for private investors:

> "persons who knowingly or recklessly assist the perpetration of a fraud may be insulated from liability to private parties if they act behind the scenes and do not themselves make statements, directly or indirectly, that are relied ***18** upon by investors. Because this is conduct that should be deterred, Congress should enact legislation to restore aiding and abetting liability in private actions."

> The North American Securities Administrators Association and the Association of the Bar of the City of New York also endorsed restoration of aiding and abetting liability in private actions. Chairman Levitt recently testified that he continues to support restoration of aiding and abetting liability.[20]

The Litigation Reform Act ignored the recommendation of the SEC, the State securities regulators and the bar association that aiding and abetting liability be restored for private litigants. The deterrent effect of the Federal securities laws thus remains weakened.

Pleading standard may have eliminated liability for reckless conduct

In addition to the concerns we identified at the time the Litigation Reform Act was passed, another concern has developed since its enactment: a number of Federal District Courts have interpreted the pleading standards enacted by the Act as eliminating liability for reckless conduct under the Federal securities antifraud provision. No Circuit Court has yet ruled on the issue and the majority of District Courts have ruled that the Act did not eliminate recklessness as a state of mind sufficient to satisfy the requirements for fraud. If, however, the view of the minority of District Courts should prevail, the effectiveness of the Federal securities laws as a deterrent to and remedy for fraud will be compromised.

The Litigation Reform Act enacted a strict pleading standards for Federal securities fraud suits. Following a standard applied by the U.S. Court of Appeals for the Second Circuit, the Act requires a complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." Federal District Courts have disagreed on how to interpret this provision, based primarily on different readings of the Act's legislative history. According to the SEC, 14 District Courts have interpreted this provision to allow plaintiffs to plead facts giving rise to a strong inference that the defendants acted either knowingly or recklessly, or that the

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

defendants had a motive and opportunity to commit the fraud.[21] However, a minority of District Courts have held that the Act eliminated recklessness as conduct sufficient to constitute fraud.[22]

This issue is currently pending in the Courts of Appeal for the Sixth and Ninth Circuits.[23] The Securities and Exchange Commission has filed an amicus brief in the Ninth Circuit case, urging the view that the Litigation Reform Act did not eliminate recklessness as the standard for antifraud liability. The Commission warned the Securities Subcommittee that elimination of liability for reckless conduct "would jeopardize the integrity of the securities markets, ***19** and would deal a crippling blow to defrauded investors with meritorious claims."[24] The Litigation Reform Act has thus unintentionally placed the effectiveness of the Federal securities laws at risk.

IV. FLAWS OF THE UNIFORM STANDARDS BILL

We oppose the Uniform Standards Bill firstly because of the shortcomings of the Litigation Reform Act described above. The Uniform Standards Bill would preempt securities fraud class actions brought under State law. Investors seeking to file class action lawsuits would be forced to file under the Federal securities laws. They would have to endure the objectionable provisions we have cited: the safe harbor and proportionate liability provisions enacted by the Litigation Reform Act and the shorter statute of limitations and the elimination of aiding and abetting liability left intact by the Litigation Reform Act. Because these provisions prevent investors from bringing meritorious securities fraud class actions, we cannot support the preemption of all State law provisions without which investors might have no remedies at all.

But the Uniform Standards Bill contains shortcomings of its own, apart from those already present in the Federal securities laws. These include a definition of "class action" that is overly broad; an unfair application of the statute of limitations; and a failure to codify liability for reckless conduct.

Definition of class action is too broad

Although narrowed by the Substitute Amendment adopted by the Committee, the Bill's definition of "class action" is still too broad. It may include State court actions brought by separate individual investors, or by groups of public investors such as school districts or local governments. They risk being dragged into Federal court against their will, potentially depriving them of more favorable State statutes of limitations, pleading standards, joint and several liability, and so on.

The term "class action" is commonly understood to refer to cases brought by one plaintiff on behalf of all other unnamed plaintiffs similarly situated. Under Rule 23 of the Federal Rules of

Civil Procedure, common questions of law and fact must predominate before a judge can certify a case as a class action. This is the type of case about which the proponents of the legislation complain: a case brought by an attorney with just one actual investor as lead plaintiff, in order to force a company to pay a large settlement.

The Bill, however, contains a definition of "class action" broad enough to pick up individual investors against their will. The Bill would amend Section 16 of the Securities Act of 1933 and 28 of the Securities Exchange Act of 1934 to define class action. New Sections 16(f)(1)(A)(ii) and 28(f)(5)(A)(ii) include as a class action any group of lawsuits in which damages are sought on behalf of more than 50 persons, if those lawsuits are pending in the same court, involve common questions of law or fact, and have been consolidated as a single action for any purpose. Even if the lawsuits are brought by separate lawyers, without coordination, and common ***20** questions do not predominate, they may qualify as a class action and thus be preempted. So, if an individual investor chooses to bring his own lawsuit in State court, to bear the expenses of litigation himself in order to avoid the provisions of the Litigation Reform Act, he can be forced into Federal court and made to abide by the Federal rules if 50 other investors each make the same decision. Indeed, the Bill provides an incentive for defendants to collude with parties to ensure that the preemption threshold is reached. Such a result does not merely end abuses associated with class action lawsuits, it deprives individual investors of their remedies.

The definition of "class action" in the Bill would preempt other types of lawsuits as well. New Sections 16(f)(1)(A)(i)(I) and 28(f)(5)(A)(i)(I) include as a class action any lawsuit in which damages are sought on behalf of more than 50 persons and common questions of law or fact predominate. The Bill specifies that the predomination inquiry be made "without reference to issues of individualized reliance on an alleged misstatement or omission * * *" This ensures that investors receive the worst of both worlds. While the investors could not bring a class action under State law because each investor must prove his or her reliance, they nonetheless constitute a "class action" under the Bill and their suit is preempted.

Suits brought by local government investors, such as cities or school districts, are likely to be preempted under this provision. For example, Mayor Harry Smith of Greenwood, Mississippi testified last October, "[i]n August, we learned that at least 22 cities and 12 counties might have been misled with regard to a series of investments."[25] Should 16 more cities and counties be found to have been victimized, these Mississippi local governments could not bring a suit under Mississippi law. There is no reason for such a suit to be shut out of State court. Such suits are not the vague, open-ended class actions about which the supporters of the Bill complain. Whatever the merits of preempting those cases, individual investors who forego filing such class actions should retain the right to bring a case in either Federal or State court.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Application of statute of limitations is unfair

The overly broad definition of “class action” leads directly to another of the bill's flaws. The Federal statute of limitations, which the SEC considers unduly short, will now apply in an unfair manner to State cases as well. Cases that were timely filed under State statutes of limitations may now be removed to Federal court and dismissed under the shorter Federal statute of limitations.

As described above, actions brought by individual investors in State court could constitute a “group” and be removable to Federal court. Similarly, an action brought by more than 50 identified investors, such as school districts or municipalities, could fall within the definition. The bill provides that in such instances the suits may be removed to Federal court. Once there, no action based upon State statutory or common law may be maintained. The investors ***21** must be able to maintain a suit under Federal law, including the Federal statute of limitations. Since most States have a statute of limitations longer than the Federal time period, it is likely that most investors will have to satisfy a shorter statute of limitations. In other words, investors who filed timely lawsuits under State law may find their lawsuits dismissed for failure to meet a shorter time requirement that they could not have known would be applied to them. Such a result goes far beyond discouraging frivolous suits. It can deprive defrauded investors of any opportunity to seek a remedy.

Failure to codify liability for recklessness

A final shortcoming of this Bill is its failure to codify liability under the Federal antifraud provisions for reckless conduct. Liability for reckless conduct is crucial to ensure that professionals such as accountants and underwriters perform the responsibilities assigned to them by the Federal securities laws. The SEC has stated, “a uniform standard for securities fraud class actions that did not permit investors to recover losses attributable to reckless misconduct would jeapordize the integrity of the securities markets.”[26] (emphasis added)

As described above, a minority of Federal district courts have interpreted the Litigation Reform Act and its legislative history as eliminating such liability. We recognize and support the statements made in the Committee Report that Congress did not and does not intend to eliminate such liability. We hope these statements are sufficient to preserve recklessness as the substantive standard for liability under the Federal antifraud provisions.

While such legislative history is helpful, however, is not a substitute for legislative language. Federal courts do not uniformly consider legislative history when deciding questions of statutory interpretation. Even those courts that do may not consider legislative history prepared in a succeeding Congress when interpreting a statute enacted in a preceding Congress. Chairman Levitt testified that he would prefer legislative language that explicitly codified liability for reckless

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

conduct.[27] Nonetheless, the Uniform Standards Bill fails to include such language. The Bill therefore would preempt State class actions in favor of a uniform Federal standard potentially containing a disastrous flaw, namely no imposition of liability for reckless conduct.

V. CONCLUSION

Requiring true class actions regarding securities traded on national exchanges to conform to an appropriate uniform standard is not without some intellectual appeal. But this bill fails on both counts. First, it would reach beyond true class actions to rob investors of their opportunity to bring individual actions in State court. Second, it would impose the current Federal standard as the uniform standard without rectifying its shortcomings.

The SEC testified before the Securities Subcommittee on October 29, 1997 that “the bill would deprive investors of important protections, ***22** such as aiding-and-abetting liability and longer statutes of limitations, that are only available under state law.” This concern remains valid. Thirty-three of 50 States provide longer statutes of limitations for securities fraud actions than do the Federal securities.[28] Forty-nine of 50 States provide liability for aiders and abetters of such fraud.[29] In too many instances, these provisions would no longer be available under the Uniform Standards Bill, leaving investors without remedies.

For these reasons, State and local government officials, unions, senior citizens, academics, consumer groups and others oppose the Uniform Standards Bill. The New York State Bar Association concluded in January 1998, “the proposed solution far exceeds any appropriate level of remedy for the perceived problem.” We urge the Senate carefully to consider the Bill's impact on individual investors before approving it in its current form.

Paul S. Sarbanes.
Richard H. Bryan.
Tim Johnson.

***23** ADDITIONAL VIEWS OF SENATOR JACK REED

S. 1260 SECURITIES LITIGATION UNIFORM STANDARDS ACT

INTRODUCTION

As a supporter of the Private Securities Litigation Reform Act of 1995 (hereafter “PSLRA” or “1995 Act”), I am pleased to support S.1260, the Securities Litigation Uniform Standards Act of 1998 (hereafter “1998 Act”). This legislation will create a uniform standard for securities class action lawsuits against corporations listed on the three largest national exchanges. While

class action suits are frequently the only financially feasible means for small investors to recover damages, such lawsuits have also been subject to abuse, draining resources from corporations while inadequately representing the interests of investor plaintiffs.

In 1995, I voted for the PSLRA in order to curtail this abusive litigation. At that time it was obvious that some class action suits were being filed after a precipitous drop in the value of a corporation's stock, without citing specific evidence of fraud. Such lawsuits frequently inflict substantial legal costs upon corporations, harming both the business and its shareholders. Unfortunately, since passage of federal litigation procedures protecting corporations from such suits there has been some attempt by class action plaintiffs to circumvent these safeguards by filing similar lawsuits in state courts.

The 1998 Act will preempt this circumvention, creating a national standard for class action suits involving nationally traded securities. I favor this legislation because it recognizes the national nature of our securities markets, provides for more efficient capital formation, and protects investors.

NEW RESPONSIBILITIES OF CONGRESS

Preemption marks a significant change concerning the obligations of Congress. When federal legislation was enacted to combat securities fraud (the Securities Act of 1933 and the Securities Exchange Act (SEA) of 1934, which included section 10(b), the antifraud provision upon which private actions are now based[1]), the federal law augmented existing state statutes. States were still free to provide greater protections to their citizens from fraud. Indeed, in 1995, the Chairman of the Securities and Exchange Commission provided testimony concerning the multifaceted system by which securities were regulated: through both public and private lawsuits in both state and federal courts.[2] Many of my colleagues voted for ***24** the 1995 legislation knowing that if federal standards failed to provide adequate investor protections, state suits would provide a necessary backup.[3]

With passage of this legislation, my colleagues and I have now accepted full and sole responsibility for securities traded on the three national exchanges to ensure that standards concerning fraud allow victimized, small investors to recoup lost funds through class action suits. A meaningful right of action against those that defraud guarantees the average investor confidence in our national markets. A uniform national standard concerning fraud provides no benefit to markets if issuers having listed securities can, with impunity, fail to ensure that consumers receive truthful, complete information on which to base investment decisions.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

My support for this legislation rests on the presumption that the scienter standard was not altered by either the 1995 Act or this legislation. I strongly endorse the Report which accompanies this legislation, which states clearly that nothing in the 1995 legislation changed the scienter standard[4] or the previous case law, established by the Second Circuit, concerning the means to successfully plead that state of mind.[5] The reason such standards were not changed in 1995 is that they are essential to providing adequate investor protection from fraud.

I have been deeply troubled by the ruling of several federal district courts[6] which, ignoring the clear legislative history of the 1995 Act, have invalidated the proper pleading standard for a 10b–5 action. With regard to 10(b) class action lawsuits, the PSLRA mandated stiffer pleading requirements concerning the defenddant(s)'s state of mind. See 15 U.S.C. S S 77z–1, 78u–4. The PSLRA requires plaintiffs to plead specific facts "giving rise to a strong inference" hat the defendants acted with the required state of mind. See 15 U.S.C. S 78u–4(b)(2). In contrast, some circuits allowed scienter to be averred generally prior to adoption of the PSLRA. (See In re Glenfed, Inc., 42 F.3d 1541, 1545–47 (9th Cir. 1994). However, the PSLRA's heightened standard was specifically linked to the most stringent pleading standard at the time, that of the Second Circuit. See The Conference Committee Report (Report), 141 Cong. Rec. 3702 (daily ed. Nov. 28, 1995).

***25** PRE-1995 STANDARDS

In Ernst & Ernst v. Hochfelder, the Court held that to establish liability under Section 10(b) and Rule 10b–5, a plaintiff must "establish scienter on the part of a defendant." 425 U.S. 185, 193 & n. 12 (1976). While in Hochfelder the Court failed to address whether recklessness satisfied the scienter requirement, subsequent decisions by virtually all the courts of appeals held that recklessness did meet the scienter requirement. Time Warner, supra. Sundstrand v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (defining reckless conduct as "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and 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.") (No Circuit Court has held otherwise.)

With regard to the standards necessary to establish scienter in a pleading, the Second Circuit developed the most stringent requirement. That court required plaintiffs to allege in the complaint "facts that give rise to a strong inference of fraudulent intent." Shields v. Citytrust Bancorp. Inc., 25 F.3d 1124, 1128 (2d Cir. 1994). Such a "strong inference" could be established in two ways: by "alleging facts to show that defendants had both the motive and opportunity to commit fraud, or by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

recklessness." Id. See also Beck v. Manufacturers Hanover Trust Company, 820 F.2d 46 at (2d Cir. 1987), and Ross v. A.H. Robins Co., 607 F.2d 545 (2nd Cir. 1979).

THE NEED TO PRESERVE THE RECKLESSNESS STANDARD

The court's reason for allowing a plaintiff to establish scienter through a pleading of motive and opportunity or recklessness is clear: "a plaintiff realistically cannot be expected to plead a defendant's actual state of mind." Cohen v. Koenig, 25 F.3d 1168, 1173 (2d Cir. 1994) (quoting Connecticut Nat'l. Bank v. Fluor Corp., 808 F.2d 957, 962 (2d Cir. 1987) (quoting Goldman v. Belden, 754 F.2d 1059, 1070 (2d Cir. 1985)). Since the 1995 Act allows for a stay of discovery pending a defendant's motion to dismiss, requiring a plaintiff to establish actual knowledge of fraud or an intent to defraud in a complaint raises the bar far higher than most legitimately defrauded investors can meet. The SEC has been clear on this point[7] and it has been well recognized by the supporters of both the 1995 and 1998 Acts that neither changed the preexisting scienter standard. Indeed, proponents of the 1995 Act were clear that the bill included recklessness. William H. Kuehnle, Comment, "On Scienter, Knowledge, and Recklessness Under the Federal Securities" Laws, 34 House. L. Rev. 121, n. 93, citing 141 Cong. Rec. S17934 (daily ed. Dec. 5, 1995) (statement of Senator D'Amato) ("The legislation creates a uniform standard for complaints that allege securities fraud. This standard is already the law in New ***26** York."). Even after passage of the Conference Report of the 1995 Act and the President's veto and message were complete, proponents of the legislation described the bill as retaining recklessness. See, e.g., 141 Cong. Rec. S19150 (daily ed. Dec. 22, 1995) (statement of Senator Domenici) ("[I]t is the Second Circuit's pleading standard."); 141 Cong. Rec. S19067 (Dec. 21, 1995) (statement of Sen. Dodd) ("[P]leading standard is faithful to the Second Circuit's test."); and 141 Cong. Rec. 5219 (daily ed. Dec. 20, 1995) (statement of Rep. Lofgren) ("The President says he supports the Second Circuit standard for pleading * * *. That is * * * included in this bill.")

Thus, the legislative history well establishes that the 1995 Act retained the standards, as established by the Second Circuit Court of Appeals, associated with pleading and establishing scienter in a 10(b) action. Not only are the standards clear, but it is clear that a weakening of such standards threatens the security of investors and the stability of our markets.

The views of the Majority, as outlined in this Report, make clear that interpretations which eviscerate a plaintiff's ability to plead motive and opportunity or recklessness, as defined by the Second Circuit prior to the 1995 Act, are both incorrect and a threat to the security of our markets. Such standards are under attack by both those who both misinterpret the standards of the 1995 Act and those who argue that recklessness fails to satisfy the scienter standard as established in the 1933 and 1934 Acts.[8] This later interpretation is particulary dangerous in that it could eliminate liability for recklessness in both private actions as well as regulatory enforcement actions by the SEC.[9]

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

CONCLUSION

With assurances of the Chair and sponsors of S. 1260 that proper protections for investors will remain in place, I supported the 1998 Act, thus moving toward an efficient, national, uniform standard for securities class action lawsuits. I trust that higher courts will adhere to current principles of legislative history and case law to rule that the pleading and scienter standards continue to protect investors. Additionally, as expressed in votes during the mark-up of this legislation, I am concerned that the definition of class action, as currently included in the bill, is too broad. Specifically, by defining a class as those whose claims have been consolidated by a state court judge, the bill infringes upon the rights of individual investors to bring suit; a situation sponsors have sought to avoid. I hope that this issue can be resolved before the bill reaches the Senate floor. Finally, I have appreciated the expert analysis that the Chairman, Commissioners, and staff of the Securities and Exchange Commission have provided on this issue. I thank them for their assistance.

Jack Reed.

***27** Office of the General Counsel,
U.S. Securities and Exchange Commission,
Washington, DC, April 20, 1998.

Ted Long,
Legislative Counsel, Offices of Senator Jack Reed,
Hart Senate Office Building, Washington, DC.

Dear Mr. Long: The attached responds to your request for staff technical assistance with respect to S. 1260, the “Securities Litigation Uniform Standards Act of 1997.” This technical assistance is the work of the staff of the Securities and Exchange Commission; the Securities and Exchange Commission itself expresses no views on this assistance.

I hope the attached is responsive to your request.

Sincerely,

Richard H. Walker,
General Counsel.

Attachment.

PLEADING STANDARD SCORECARD

I. CASES APPLYING THE SECOND CIRCUIT PLEADING STANDARD

1. City of Painesville v. First Montauk Financial Corp., 1998 WL 59358 (N.D. Ohio Feb. 8, 1998).

2. Epstein v. Itron, Inc., No. CS–97–214 (RHW), 1998 WL 54944 (E.D. Wash. Jan. 22, 1998).

3. In re Wellcare Mgmt. Group, Inc. Sec. Lit., 964 F. Supp. 632 (N.D.N.Y. 1997).

4. In re FAC Realty Sec. Lit., 1997 WL 810511 (E.D.N.C. Nov. 5, 1997).

5. Page v. Derrickson, No. 96–842–CIV–T–17C, 1997 U.S. Dist. LEXIS 3673 (M.D. Fla. Mar. 25, 1997).

6. Weikel v. Tower Semiconductor Ltd., No. 96-3711 (D.N.J. Oct. 2, 1997).

7. Gilford Ptnrs. L.P. v. Sensormatic Elec. Corp., 1997 WL 757495 (N.D. Ill. Nov. 24, 1997).

8. Galaxy Inv. Fund, Ltd. v. Fenchurch Capital Management, Ltd., 1997 U.S. Dist. LEXIS 13207 (N.D. Ill. Aug. 29, 1997).

9. Pilarczyk v. Morrison Knudsen Corp., 965 F. Supp. 311, 320 (N.D.N.Y. 1997).

10. OnBank & Trust Co. v. FDIC, 967 F. Supp. 81, 88 & n.4 (W.D.N.Y. 1997).

11. Fugman v. Aprogenex, Inc., 961 F. Supp. 1190, 1195 (N.D. Ill. 1997).

12. Shahzad v. H.J. Meyers & Co., Inc., No. 95 Civ. 6196 (DAB), 1997 U.S. Dist. LEXIS 1128 (S.D.N.Y. Feb. 6, 1997).

13. Rehm v. Eagle Fin. Corp., 954 F. Supp. 1246, 1252 (N.D. Ill. 1997).

14. In re Health Management Inc., 970 F. Supp. 192, 201 (E.D.N.Y. 1997).

15. Marksman Partners, L.P. v. Chantal Pharmaceutical Corp., 927 F. Supp. 1297, 1309–10, 1309 n.9 (C.D. Cal. 1996).

16. Fischler v. AmSouth Bancorporation, 1996 U.S. Dist. LEXIS 17670 (M.D. Fla. Nov. 14, 1996).

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

***28** 17. STI Classic Fund v. Bollinger Industries, Inc., No. CA 3:96–CV–0823–R, 1996 WL 866699 (N.D. Tex. Nov. 12, 1996).

18. Zeid v. Kimberley, 930 F. Supp. 431 (N.D. Cal. 1996).

II. CASES APPLYING A STRICTER PLEADING STANDARD THAN THE SECOND CIRCUIT

A. Cases holding that motive and opportunity and recklessness do not meet pleading standard

1. Mark v. Fleming Cos., Inc., No. CIV–96–0506–M (W.D. Okla. Mar. 27, 1998).

2. In re Silicon Graphics Sec. Lit., 970 F. Supp. 746 (N.D. Cal. 1997).

3. In re Comshare, Inc. Sec. Litig., Case No. 96–73711–DT, 1997 U.S. Dist. LEXIS 17262 (E.D. Mich. Sept. 18, 1997).

4. Voit v. Wonderware Corp., No. 96–CV. 7883, 1997 U.S. Dist. LEXIS 13856 (E.D. Pa. Sept. 8, 1997).

5. Powers v. Eichen, NO. 96–1431–B (AJB), 1997 U.S. Dist. LEXIS 11074 (S.D. Cal. Mar. 13, 1997).

6. Norwood Venture Corp. v. Converse Inc., 959 F. Supp. 205, 208 (S.D.N.Y. 1997).

7. Friedberg v. Discreet Logic, Inc., 959 F. Supp. 42, 48–49 (D. Mass. 1997).

8. In re Glenayre Technologies, Inc., 1997 WL 691425 (S.D.N.Y. Nov. 5, 1997).

9. Havenick v. Network Express, Inc., 1997 WL 626539 (E.D. Mich. Sep. 30, 1997).

10. Chan v. Orthologic Corp., et al., No. CIV–96–1514–PHX–RCB (D. Ariz. Feb. 5, 1998) (dicta).

B. Cases holding only that motive and opportunity do not meet Reform Act's pleading standard

1. Novak v. Kasaks, No. 96 Civ. 3073 (AGS), 1998 WL 107033 (S.D.N.Y. Mar. 10, 1998).

2. Myles v. MidCom Communications, Inc., No. C96–614D (W.D. Wash. Nov. 19, 1996).

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

3. In re Baesa Securities Litig., 969 F. Supp. 238 (S.D.N.Y. 1997).

4. Press v. Quick & Reilly Group, Inc., No. 96 Civ. 4278 (RPP), 1997 U.S. Dist. LEXIS 11609, at *5 (S.D.N.Y. Aug. 8, 1997).

III. EXAMPLES OF CASES WITH LANGUAGE QUESTIONING RECKLESSNESS AS A BASIS OF LIABILITY (ALL CASES PREVIOUSLY LISTED ABOVE)

1. In re Silicon Graphics Sec. Lit., 970 F. Supp. 746 (N.D. Cal. 1997).

2. Friedberg v. Discreet Logic, Inc., 959 F. Supp. 42, 49 n.2 (D. Mass. 1997).

3. Norwood Venture Corp. v. Converse Inc., 959 F. Supp. 205, 208 (S.D.N.Y. 1997).

1 Pub Law No. 104–67 (Dec. 22, 1995).

2 Testimony of Stephen M.H. Wallman, Commissioner, Securities and Exchange Commission; submitted to the Subcommittee on Securities' "Oversight Hearing on the Private Securities Litigation reform Act of 1995" (the "Reform Act Hearing"), July 24, 1997, p. 1.

3 Joint prepared statement of Joseph A. Grundfest and Michael A. Perino, "Reform Act Hearing," July 24, 1997, p. 6.

4 "* * * the apparent shift to state court may be the most significant development in securities litigation post-Reform Act." Securities and Exchange Commission, Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, p. 69 (1997); see also Statement of Senator Phil Gramm, Senate Subcommittee on Securities Hearing, February 23, 1998, entering into the record materials submitted by Price, Waterhouse, LLP documenting both the rise in state securities class action cases and the changing nature of those cases; see also Michael A. Perino, Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action, Stanford Law Review (forthcoming 1998), manuscript at 31, n. 127; see also Joseph A. Grundfest and Michael A. Perino; Securities Litigation Reform: The First Year's Experience (Release 97.1), Summary of Major Findings, p. ii–iii; Stanford Law School; February 27, 1997.

5 Written testimony of John F. Olson of Gibson, Dunn & Crutcher, "Hearing on S. 1260," February 23, 1998, p. 5.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

6 Joint prepared statement of Joseph A. Grundfest and Michael A. Perino, “Reform Act Hearing,” July 24, 1997, p. 6.

7 See, e.g., Prepared statement of Michael Morris, Vice President and General Counsel, Sun Microsystems, “Hearing on S. 1260,” February 23, 1998.

8 Written statement of Thomas E. O'Hara, Chairman, NAIC, “Hearing on S. 1260,” October 29, 1997.

9 See, e.g., Grundfest and Perino, supra, note 2; Written statement of Robert C. Hinckely, Vice President Strategic Plans and Programs, XILINX, on behalf of The American Electronics Association, the Reform Act Hearing, July 27, 1997, p. 17.

10 Written statement of Hon. Harry Smith, Mayor, Greenwood, Mississippi, on behalf of the National League of Cities, “Hearing on S. 1260,” October 29, 1997, p. 8.

11 Written statement of Hon. Keith Paul Bishop, Commissioner, California Department of Corporations, “Reform Act Hearing,” July 27, 1998, p. 3.

12 See, e.g., Prepared statement of John F. Olson, “Hearings on S. 1260,” Senate committee on Banking, Housing & Urban Affairs, Subcommittee on Securities, February 23, 1998, pp. 8–13.

1 See January 23, 1998 Letter to Senators and Members of Congress from Professors Ian Ayres, Stephen M. Bainbridge, Douglas M. Branson, William W. Bratton, John C. Coffee, Jr., James D. Cox, Charles M. Elson, Merritt B. Fox, Tamar Frankel, Theresa A. Gabaldon, Nicholas L. Georgakopoulos, James J. Hanks, Jr., Kimberly D. Krawiec, Fred S. McChesney, Lawrence E. Mitchell, Donna M. Nagy, Jennifer O'Hare, Richard W. Painter, William H. Painter, Margaret V. Sachs, Joel Seligman, D. Gordon Smith, Marc I. Steinberg, Celia R. Taylor, Robert B. Thompson, Manning G. Warren III, and Cynthia A. Williams.

2 See CRS Report for Congress, “Securities Litigation Reform: Unfinished Business?,” April 4, 1998, at 2.

3 Id. at 6.

4 Joint Written Testimony of Joseph A. Grundfest and Michael A. Perino before the Subcommittee on Securities, July 24, 1997, at Figure 1.

5 See Basic, Inc. v. Levinson, 485 U.S. 224 (1988), adopting the “fraud on the market” theory for Federal securities fraud actions.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

6 Richard H. Walker, “The New Securities Class Action: Federal Obstacles, State Detours,” 39 Ariz. L. Rev. 641, 678 & n.272 (Summer 1997).

7 Id. at 678.

8 Mirkin v. Wasserman, 858 P.2d 568, 580 (Cal. 1993).

9 Testimony of U.S. Securities and Exchange Commission before the Subcommittee on Securities, October 29, 1997, at 12.

10 “IPO Market Shows its Muscle for a Second-Straight Year,” Wall Street Journal, January 2, 1998.

11 “An Overview of the Capital Markets and Securities Industry in 1997,” Securities Industry Association, January 23, 1998, at 4.

12 Marilyn Johnson, Ron Kasznik and Karen K. Nelson, “The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms, January 5, 1998.

13 See, e.g., Milano v. Auhll, No. SB 213 476 (Cal. Super. Court, Santa Barbara County, Oct. 2, 1996; Sperber v. Bixby, No. 699812 (Cal. Super. Court, San Diego County, Oct. 25, 1996)

14 December 6, 1995 Letter to President Clinton.

15 November 15, 1995 Letter to President Clinton.

16 May 23, 1995 Letter to Senate Banking Committee Members from American Council on Education, California Labor Federation–AFL–CIO, Congress of California Seniors–LA County, Consumer Federation of America, Consumers for Civil Justice, International Brotherhood of Teamsters, Government Finance Officers Association, Gray Panthers, National League of Cities, New York State Council of Senior Citizens, North American Securities Administrators Association, and U.S. PIRG; May 24, 1995 Letter to Members from Citizen Action, Consumer Federation of America, Consumers Union, Public Citizen, U.S. PIRG, and Violence Policy Center.

17 Testimony of the U.S. Securities and Exchange Commission before the Subcommittee on Securities, October 29, 1997, at 20.

18 Senate Banking Committee Hearing, March 25, 1998, Transcript at 30.

19 See, e.g., IIT v. Cornfeld, 619 f.2d 909, 992 (2nd Cir. 1980).

20 Senate Banking Committee Hearing, March 25, 1998, Transcript at 30.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

21 See Testimony of the U.S. Securities and Exchange Commission before the Senate Securities Subcommittee, October 29, 1997, at 13.

22 See, e.g., "In re Silicon Graphics, Inc. Securities Litigation," C 96-0393, 1997 WL 337580 (N.D. Cal. June 5, 1997).

23 Hoffman v. Comshare, Inc., No. 97-2098 (6th Cir.); Zeid v. Kimberly, No. 97–16070 (9th Cir.).

24 Testimony of the U.S. Securities and Exchange Commission before the Senate Securities Subcommittee, October 29, 1997, at 13.

25 Testimony of Harry Smith, Mayor, City of Greenwood, Mississippi, on behalf of the National League of Cities before the Senate Securities Subcommittee, October 29, 1997, at 3.

26 Letter from Chairman Levitt and Commissioners Hunt and Unger to Senators D'Amato, Gramm and Dodd, March 24, 1998.

27 Senate Banking Committee Hearing, March 25, 1998, Transcript at 34.

28 Testimony of U.S. Securities and Exchange Commission before the Senate Securities Subcommittee, October 29, 1997, at 20.

29 Id. at 19.

1 15 U.S.C. S 77(l).

2 See Testimony of Securities and Exchange Commission, Hearings on Securities Litigation Uniform Standards Act. Subcommittee on Securities, United States Senate Committee on Banking, Housing and Urban Affairs, October 29, 1997. ("* * * the benefits of our dual system of federal and state law, which has served investors well for over 60 years.)

3 See Testimony of Professor Richard W. Painter, Hearings on Securities Litigation Uniform Standards Act. Subcommittee on Securities, United States Senate Committee on Banking, Housing and Urban Affairs, February 23, 1998, citing colloquy of Representative Christopher Cox with Professor Daniel Fischel, Hearings Concerning the Common Sense Legal Reform Act. Subcommittee on Telecommunications and Finance, House Committee on Commerce, January 19, 1995, at 110 (Mr. Cox. "So if you were a plaintiff, who like any plaintiff has a choice of forum, and if you were one of the investors who were defrauded in Orange County, for example, you might file your suit in State court or in Federal Court, depending on how you saw your advantage * * * " Mr. Fischel. "Yes, you would still have the same choice of forums.').

4 See Time Warner, Inc. v. Ross, 9 F3d 259, 268-69 (2d Cir. 1993).

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

5 A plaintiff can plead scienter, without direct knowledge of the plaintiff's state of mind, in two ways: “The first approach is to allege facts establishing a motive to commit fraud and an opportunity to do so. The second approach is to allege facts constituting circumstantial evidence of either reckless or conscious behavior.” Id.

6 See attached list of recent judicial adjudications of this standard, prepared at my request, by the staff of the Securities and Exchange Commission. The analysis indicates that of the thirty-two (32) federal district courts which have ruled on the issue, eighteen (18) have correctly upheld the previous Second Circuit Standard, whereas fourteen (14) have not.

7 See Testimony of Securities and Exchange Commission, Hearings on Securities Litigation Uniform Standards Act. Subcommittee on Securities, United States Senate Committee on Banking, Housing and Urban Affairs, October 29, 1997. (“The Commission strongly believe that recklessness must be preserved as the standard for liability because it is essential to investor protection.)

8 See Amicus Curiae brief of American Institute of Certified Public Accountants in the matter of Zeid v. Kimberely, (9th Cir. 1998)(No. 97–16070).

9 Four years after Hochfelder, in Aaron v. SEC, the Court, held that the SEC must meet the same scienter standards as private litigants, since the 1933 and 1934 Acts contained no distinctions in the standards of proof that either private or public litigants must meet. 446 U.S. 680 at 701 (1980).

S. REP. 105-182, S. Rep. No. 182, 105TH Cong., 2ND Sess. 1998, 1998 WL 226714 (Leg.Hist.)

End of Document © 2020 Thomson Reuters. No claim to original U.S. Government Works.

FEDERAL JUDICIAL CENTER
POCKET GUIDE SERIES

Securities Litigation

Jayme Herschkopf
U.S. Supreme Court Judicial Fellow
(August 2015–December 2016)

Federal Judicial Center
2017

This Federal Judicial Center publication was undertaken in furtherance of the Center's statutory mission to develop and conduct education programs for the judicial branch. While the Center regards the content as responsible and valuable, this publication does not reflect policy or recommendations of the Board of the Federal Judicial Center.

Contents

Acknowledgments, v

I. Introduction, 1

II. Sources of Securities Law, 2
- A. Statutes, 2
- B. SEC Rules and Regulations, 3
- C. Case Law, 4

III. What Is a Security?, 4

IV. Types of Securities Actions, 4
- A. Private Parties and Class Actions, 4
- B. SEC Civil Enforcement Actions, 5
- C. DOJ Criminal Enforcement Actions, 6
- D. Parallel Proceedings, 7

V. Preliminary Requirements and Procedures, 8
- A. Requests for Temporary Restraining Orders and Preliminary Injunctions, 8
- B. Class Action Management, 9
  1. Preliminary Case Management, 9
  2. Class Certification, 12
  3. Opt-out Plaintiffs, 12
  4. Third-Party Litigation Financing, 13
- C. Jurisdiction, 15
- D. Forum and Venue, 16
- E. Standing, 16

VI. General Pleading Requirements and Standards, and the Motion to Dismiss, 16

VII. Select Causes of Action Under the Securities Laws, 18
- A. Section 10(b) of the Exchange Act and SEC Rule 10b-5, 18
  1. Misrepresentations or Omissions, 19
  2. Materiality, 20
  3. Scienter, 21
  4. Reliance and Loss Causation, 22
- B. Insider Trading Actions, 23
- C. Other Specific Causes of Action, 25
  1. Section 11 of the Securities Act, 25
  2. Section 12(a)(1) of the Securities Act, 26
  3. Section 12(a)(2) of the Securities Act, 27
  4. Section 17(a) of the Securities Act, 28
  5. Proxy Litigation—Section 14(a) of the Exchange Act, 28
  6. The Williams Act—Sections 13–14 of the Exchange Act, 29

7. Section 16—Short Swing Profits, 31
8. Section 18—Liability for False Filings, 31

VIII. Secondary Liability, 31
A. Aiding and Abetting Liability, 32
B. Control Person Liability, 32
C. Respondeat Superior, 33

IX. Time Limitations Provisions, 33

X. Damages, 35

XI. Settlement, 35
A. Rulings Earlier in the Case, 36
B. Notice and Preliminary Approval, 36
C. Pending Cases, 36
D. Partial Settlements and Scope of Release, 37
E. Plan of Allocation and Fees, 37
F. Settlements with the SEC, 38

XII. Discovery, 39
A. Discovery Scheduling, 39
B. Discovery Disputes, 40
C. Parallel Proceedings, 40

XIII. Trial, 41

XIV. Conclusion, 41

Acknowledgments

This guide would not have been possible without the cooperation of numerous judges across the country who agreed to be interviewed and share their experiences in presiding over securities cases. The author thanks them for their time and contributions.

I. Introduction

The federal securities laws are vast and intricate. To complicate things further, congressional, regulatory, and judicial actions all combine to make this area of law prone to quick and dramatic change. Although securities litigation occurs most frequently in specific federal districts, cases are brought throughout the country, resulting in frequent case-law differences among the circuits.

The stakes of such cases can be quite high, and not only for the parties involved. Lawyers, compliance officers, traders, and other industry workers are very finely attuned to even small pronouncements on the nature of the securities laws. Judges should not be surprised if market participants well beyond their own districts pore over their decisions on issues of first impression.

That is not to say that securities cases are not without their rewards. Judges interviewed for this guide appreciate the intellectual challenge of such cases, and they agree that the lawyers involved tend to be experienced and smart, which makes the cases demanding, but structured.

This pocket guide is designed to offer judges an introduction to the law and practice of securities litigation. It provides an overview of the types of legal and practical issues judges may confront in litigation arising under the securities laws, and, where possible, offers suggestions. This guide also identifies the areas of securities law most prone to circuit splits or frequent change, so that judges know where to be particularly vigilant about looking at up-to-date case law and legislation.

Because of the sheer number and particularity of possible securities actions, this pocket guide cannot be exhaustive. Rather, it provides a lay of the land and highlights the issues that are most commonly litigated or most complex.[1] While the guide does provide descriptions of specific causes of action, details concerning each particular section are omitted in favor of common themes and parallels like pleading requirements and secondary liability assessments. The guide devotes particular attention to securities class actions because judges interviewed for the guide identified those cases as the ones that can be the most difficult to manage without prior experience, and for which it is possible to lay out helpful guidelines.

Finally, the guide points out the ways in which securities litigation is similar to or differs from other actions a judge may encounter. For example, the most common securities suits are those alleging fraud, which are usually brought under section 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder. Although these causes of action have specific elements and case law attached to them, in broad strokes, they are similar enough to suits brought under common-law fraud that judges can take some comfort applying their general knowledge from that area of law. In contrast, many suits brought under more obscure provisions of the securities laws are highly technical. For these cases, judges will not be able to rely on their general knowledge and must be

1. See Thomas Lee Hazen, Federal Securities Law (Federal Judicial Center, 3d ed. 2011) for a more thorough review of federal securities law issues litigated in the federal courts.

prepared to immerse themselves in the relevant statutes and rules to resolve the issues before them.

II. Sources of Securities Law

A. Statutes

The principal causes of action for securities suits, whether public or private, criminal or civil, are found in the Securities Act of 1933 ("the Securities Act") and the Securities and Exchange Act of 1934 ("the Exchange Act").[2] The Securities Act treats the distribution of securities, whether by issuers, underwriters, or sellers. The Exchange Act is broader: It regulates day-to-day trading and includes a number of requirements for securities markets, market professionals, and issuers. In other words, the Securities Act regulates sellers (broadly defined), whereas the Exchange Act regulates both sellers and purchasers. The Exchange Act also created the Securities and Exchange Commission (SEC), which administers the securities laws in three basic ways: (1) it promulgates rules and orders to regulate the securities industry; (2) it supervises an elaborate system of industry self-regulation; and (3) it brings enforcement actions, either as administrative proceedings or in federal court.

The past few decades have seen further developments in securities law in the passage of the Private Securities Litigation Reform Act of 1995 (PSLRA), the Securities Litigation Uniform Standards Act of 1998 (SLUSA), the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank").[3] While these statutes generally do not create new causes of action, they have had a profound effect on how securities actions are brought, particularly class actions. By and large, these acts amended the Securities Act and the Exchange Act, meaning that most of the relevant law remained in the same places in the U.S. Code.

The PSLRA included a wide array of reforms targeted at eliminating frivolous and unmeritorious securities class actions. It made substantial changes to pleading, discovery, liability, and fee provisions in the federal securities laws, and it placed additional requirements on those looking to serve as lead plaintiffs. The passage of the PSLRA caused many plaintiffs to flock to state courts in the hope of avoiding its terms. These lawsuits brought in state court were nominally predi-

---

2. 15 U.S.C. §§ 77a–77aa (2012); 15 U.S.C. §§ 78a–78pp (2012).

3. Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.); Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.); Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, and 28 U.S.C.); Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 7, 12, and 15 U.S.C.). Other statutes that govern the securities industry include the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb (2012); the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64 (2012); the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (2012); and the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa–78*lll* (2012). These last four statutes will not be treated in this guide.

cated on state law, but made the same sorts of arguments previously made under the federal securities laws.

Consequently, Congress passed SLUSA, which essentially provided that class actions that could be brought under the federal securities laws must be brought in federal court. However, it provided exemptions for certain actions brought by agents of the state and the like.

Sarbanes-Oxley was passed in the wake of fraud and corruption scandals that included companies like Enron and WorldCom. It included reforms in securities law to enhance the accountability of corporate officers, as well as requirements for more outside oversight and more detailed disclosure.[4]

Similarly, Dodd-Frank was passed in response to the financial crisis of 2008, and it contained an array of reforms in securities law as well as areas far beyond securities. Securities-related provisions included making certain disclosure requirements applicable to a broader range of organizations and instructing the SEC to conduct a host of studies and rule-making endeavors in areas like consumer protection, corporate governance, and credit ratings.

This quick overview of the more recent legislation offers a helpful window into congressional priorities. Amendments to the securities laws are generally designed to curb abusive private actions, to create accountability for corporate officers, and to render capital markets more efficient by encouraging voluntary disclosure of financial information.

B. SEC Rules and Regulations

In its role as regulator for the securities industry, the SEC has promulgated hundreds of rules, orders, policy statements, interpretive releases, and other materials that enforce or explicate the securities laws. The most well-known of these is Rule 10b-5, which was enacted in 1948 and is discussed at length later in this guide.[5]

In the past twenty years in particular, Congress has often passed securities legislation that contains broad objectives and then tasks the SEC with promulgating rules and regulations that fill in the details. This makes SEC materials increasingly important in litigation. Congress gave SEC rules and regulations statutory force, so they are among the most compelling laws the agency can generate. Other materials the SEC promulgates, including policy statements (clarifying the SEC's position on particular matters) and interpretive releases (providing guidance on topics of general interest to the business and investment communities), are advisory. Still, these materials can be extremely helpful in clarifying the agency's positions, particularly regarding the rules and regulations the agency itself has promulgated. Some judges, particularly court of appeals judges, have been successful in asking the SEC to submit briefings regarding the interpretation of particular regulations, including regulations cited in private litigation that might have a broader effect.

---

4. Some of Sarbanes-Oxley's requirements were lifted for small businesses in the Jumpstart Our Business Startups Act of 2012 (JOBS Act), Pub. L. No. 112-106, 126 Stat. 306 (codified as amended in scattered sections of 15 U.S.C.).

5. *See* Part VII.A, *infra*.

C. *Case Law*

Some areas of securities law are significantly shaped by judges' opinions. In particular, the law of securities fraud, which was promulgated under section 10(b) of the Exchange Act, SEC Rule 10b-5, and other provisions, is among the most heavily judicially shaped areas of federal law. Chief Justice Rehnquist called the law of Rule 10b-5 "a judicial oak which has grown from little more than a legislative acorn."[6]

Judges frequently analogize different provisions of the securities acts to one another when trying to determine the particular contours of whichever provision is under consideration. They do so based on provisions with similar language, structural roles, or purposes.

III. What Is a Security?

In many cases, there will be no question whether the instrument at issue is a security; the extremely broad statutory definition of *security* appears to encompass "virtually any instrument that might be sold as an investment."[7] Examples of securities include stocks, futures, bonds, and trust certificates.

In some cases, whether something qualifies as a security will be the *only* real issue to decide. The question of what qualifies as a security under the securities laws has been the subject of an extensive body of case law, and the challenge of providing a succinct definition is well-known. For example, one of the leading Supreme Court cases on this issue, *SEC v. W.J. Howey Co.*,[8] has a test for whether an investment contract falls under the securities laws. The test includes the existence of a "common enterprise" for investment. There have been numerous circuit splits regarding that case's definition of *enterprise* and its application to other investment instruments. This is an area of securities law that does not lend itself well to generalities; when the existence of a security is at issue, judges will most likely have to make an extremely particularized inquiry.

IV. Types of Securities Actions

There are several types of securities actions. In addition to securities actions brought by private parties, the SEC and Department of Justice (DOJ) can bring civil enforcement actions and criminal proceedings, respectively.

A. *Private Parties and Class Actions*

Many of the most complicated securities suits are filed as class actions. The Second Circuit and the Ninth Circuit have the largest number of securities class action filings. The Third Circuit and the Fifth Circuit have the third and fourth larg-

---

6. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

7. Reves v. Ernst & Young, 494 U.S. 56, 61 (1990). The definition is at 15 U.S.C. § 77b(a)(1) (2012).

8. 328 U.S. 293 (1946).

est number of these filings. Every circuit has had at least one potential securities class action filed in it yearly for the past five years.[9]

The vast majority of securities class actions allege violations of section 10(b) of the Exchange Act (and SEC Rule 10b-5) or section 11 or 12 of the Securities Act. In the past five years, there has also been a significant number of merger objection cases under sections 13 and 14 of the Exchange Act.[10] These sections are all discussed in further detail in Part VII, *infra*, and particular guidance for class action case management appears in Part V.B.

B. SEC Civil Enforcement Actions

SEC-brought actions often arise under the same sections of the securities laws as private actions, but have features particular to them. Sometimes the SEC needs to prove different elements than private parties do, or has alternative options available for proving those elements; some of these differences are discussed in Parts VII and VIII, *infra*. Judges interviewed for this guide also said that by and large, the cases brought by the SEC have more straightforward facts than private actions do. That is not to say, however, that these cases are easier to adjudicate. Judges caution that in SEC proceedings, there is sometimes a disconnect between the investigation and litigation of a case. For instance, investigative testimony, often used by the government to build its case, may constitute inadmissible hearsay and therefore cannot be relied on at summary judgment or trial. There may also be delays if SEC counsel needs to check with those higher up in the commission on certain policy implications.

A growing area of securities litigation in federal court is the set of cases challenging the SEC's use of administrative law judges (ALJs). The SEC has the option of using internal administrative proceedings, rather than the federal courts, to enforce the securities laws, and it frequently does so. Increasingly, defendants in those actions are challenging their constitutionality. Arguments are based on due process, equal protection, or separation-of-powers grounds, and recent cases have focused particular attention on jurisdictional and constitutional arguments relating to the setup of the regulatory system.

This area of law is fast moving and hard to predict. The Seventh Circuit recently rejected a set of jurisdictional arguments and held that the SEC's administrative review structure is constitutional.[11] The Second Circuit and D.C. Circuit have similarly held that federal courts lack jurisdiction to hear such claims until there is a final agency decision.[12] While it is difficult to offer judges guidance at this point, fortunately, these cases tend to be relatively isolated and should not affect the other types of cases discussed in this guide.

---

9. Svetlana Starykh & Stefan Boettrich, NERA, Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review 10 (2016).

10. *Id.* at 5.

11. *See* Bebo v. S.E.C., 799 F.3d 765 (7th Cir. 2015).

12. *See* Tilton v. S.E.C., 824 F.3d 276, 291 (2d Cir. 2016); Jarkesy v. S.E.C., 803 F.3d 9, 30 (D.C. Cir. 2015).

One noteworthy remedy available to the SEC under the securities laws is to seek a permanent or temporary injunction "whenever it shall appear to the Commission that any person is engaged or about to be engaged in acts or practices constituting a violation of any provision" of the securities laws or related rules.[13] These injunctions, popularly referred to as "obey-the-law" or "sin-no-more" injunctions, usually seek to prevent ongoing and future violations of the securities laws. One prime benefit is that violators may be held in contempt of court and assessed for related penalties.

Judges who encounter requests for such injunctions should scrutinize the proposed injunctions' specificity and scope. These injunctions "must be framed so that those enjoined know exactly what conduct the court has prohibited and what steps they must take to conform their conduct to the law" in order to be enforceable.[14] Judges should be wary of injunctions that are vague as to which laws and conduct are included as well as ones in which time frames of applicability do not seem commensurate with the conduct alleged.

C. DOJ Criminal Enforcement Actions

The government has the authority to bring criminal charges against a person who violates the securities laws willfully. Different courts of appeals define *willfully* in different ways, but they all generally agree that a defendant need not know of a particular rule or regulation in order to act willfully; rather, a defendant acting "with a bad purpose: either to disobey or disregard the law" is acting willfully.[15]

Although much of the same substantive law is used in criminal securities cases and civil securities cases, proceedings in the two types of cases tend to be quite different. Criminal securities cases are high stakes for both sides and are hard fought as a consequence. Criminal defendants also often need to pay their own lawyers, as opposed to being covered by the company that employs them.

Determining intent in a criminal case is usually the most difficult task facing a judge, and judges interviewed for this guide said issues concerning a finding of conscious avoidance can be particularly challenging. Conscious avoidance, also called "willful blindness" or "deliberate ignorance," provides that in situations in which a defendant's knowledge of a fact is required to prove guilt, that knowledge "may be found when the jury is persuaded that the defendant consciously avoided learning that fact while aware of a high probability of its existence."[16] In other words, defendants cannot escape culpability simply by burying their heads in the sand.

---

13. 15 U.S.C. § 78u(d)(1) (2012 & Supp. III 2015); *see also* 15 U.S.C. § 77t(b) (2012).

14. S.E.C. v. Smyth, 420 F.3d 1225, 1233 n.14 (11th Cir. 2005); *see also* S.E.C. v. Goble, 682 F.3d 934, 949–53 (11th Cir. 2012) (containing extended discussion of vagueness concerns in obey-the-law injunctions).

15. United States v. Peltz, 433 F.2d 48, 54 (2d Cir. 1970); *see also* 3B Fed. Jury Prac. & Instr. § 161:53 (6th ed.) (2013).

16. United States v. Svoboda, 347 F.3d 471, 477 (2d Cir. 2003) (internal quotation marks and citations omitted).

Judges must determine whether a factual predicate exists that makes a conscious avoidance jury instruction appropriate, as well as how to phrase such an instruction. Both of these issues have been addressed in circuit-specific case law, but have been most fully developed in the Second Circuit. A factual predicate exists when there is evidence that allows a rational juror to reach the conclusion, beyond a reasonable doubt, "that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact."[17] Several different phrasings of the instruction have been upheld by courts of appeals.[18]

Conviction under the securities laws can lead to fine, imprisonment, or both, but the maximum penalties under the Securities Act are much less severe than those under the Exchange Act.[19] In addition, section 32(a) of the Exchange Act prohibits imprisonment if the defendant "proves that he had no knowledge of [a] rule or regulation."[20] The Second Circuit has held that the statute's specific inclusion of the phrase "rule or regulation" means that the defense is unavailable for violations of a statute; the Eighth Circuit has disagreed.[21]

Under the federal sentencing guidelines, sentence length for securities-related crimes is heavily correlated with the amount of loss. Judges caution that dramatically different losses can be calculated using equally reasonable methods, particularly in situations involving the backdating of stocks. Judges should exercise care when reviewing loss calculations in any setting, but particularly when they are being used to determine a criminal sentence. There is a six-year statute of limitations on criminal securities fraud violations.[22]

D. Parallel Proceedings

When the SEC and the DOJ file parallel civil and criminal actions, most judges will stay the civil action until the criminal action is resolved. Oftentimes, the civil action will be withdrawn or settled before a judge needs to pick it back up. If the defendants in the two types of actions do not overlap exactly, however, stays can be a little more difficult. In such circumstances, judges often opt to stay only the cases of those civil defendants who also have criminal charges brought against them, and they schedule discovery such that these defendants are deposed at the end.

---

17. United States v. Ferrarini, 219 F.3d 145, 154 (2d Cir. 2000) (internal quotation marks and citation omitted); *see also* United States v. Heredia, 483 F.3d 913, 922 (9th Cir. 2007) (offering a different standard); United States v. Stone, 987 F.2d 469, 471 (7th Cir. 1993) (offering a similar test for an "ostrich instruction").

18. *See, e.g.*, U.S. S.E.C. v. Big Apple Consulting USA, Inc., 783 F.3d 786, 803–04 (11th Cir. 2015); United States v. Svoboda, 347 F.3d 471, 476 n.5 (2d Cir. 2003); United States v. Stone, 987 F.2d 469, 470 (7th Cir. 1993).

19. *See* section 24 of the Securities Act, 15 U.S.C. § 77x (2012); section 32(a) of the Exchange Act, 15 U.S.C. § 78ff(a) (2012).

20. 15 U.S.C. § 78ff(a) (2012).

21. *See* United States v. Eucker, 532 F.2d 249, 256 (2d Cir. 1976); United States v. Knueppel, 293 F. Supp. 2d 199, 204 (E.D.N.Y. 2003); *but see* United States v. Behrens, 644 F.3d 754, 756 (8th Cir. 2011).

22. 18 U.S.C. § 3301(b) (2012).

Judges may find themselves presiding over SEC or DOJ proceedings when a private suit has also been filed that is premised on the same facts. In such situations, judges need to be aware of the ways in which their decisions in either type of proceeding might affect the other. Some of these challenges are discussed in Part XII, *infra*.

V. Preliminary Requirements and Procedures

Preliminary procedures under the securities laws are not significantly different from those for other commercial suits, apart from the specific requirements under the PSLRA, discussed in Part V.B, *infra*. This part discusses a selection of issues that judges have frequently encountered in the preliminary stages of securities cases.

A. Requests for Temporary Restraining Orders and Preliminary Injunctions

Some types of securities actions begin with a request for a temporary restraining order (TRO) or preliminary injunction. Proxy litigation and Williams Act actions under sections 13–14 of the Exchange Act are common examples (discussed in Part VII.C.5 & 6, *infra*).

Motions for preliminary injunctions are reviewed under the traditional standard: Movants must demonstrate the prospect of irreparable harm and show that legal remedies are inadequate. Judges who receive a request for an injunction or TRO will have to move quickly, particularly when there is a melting asset involved or a corporate restructuring at stake. Judges interviewed for this guide were in agreement that there is no substitute for getting the parties talking, ideally in person, and that ex parte orders should be avoided whenever possible.[23]

Some judges suggest setting up a fast briefing schedule and instructing the parties to be ready with joint proposals as soon as possible. They also suggest that where possible, direct testimony be submitted by affidavit so that it can be sworn to and then tendered for cross-examination. Other judges call the parties into court the same day or the day after the TRO request is filed, arrange for a reporter, and set a schedule at that point. Judges also sometimes come to the hearing with a draft opinion so that they can decide the issue as soon as possible afterward.

When the SEC commences a case, it will sometimes seek an order to freeze or seize assets and to have a receiver appointed to help preserve the assets. In some such instances, the assets seized will be the only source of income a defendant has, so the defendant will petition the court not to stop the flow of funds entirely, but to provide enough to cover living expenses and legal fees. Judges confronting such situations should consider how to negotiate the request so as to be fair to both sides and preserve the assets at issue, while also acknowledging that no formal adjudication has yet occurred for the defendant.

---

23. Judges did say they are more likely to grant ex parte requests from the SEC, since these usually appear in cases in which assets are in immediate danger of disappearing.

B. Class Action Management

Federal Judicial Center publications have devoted considerable attention to class action management, particularly Chapter 31 of the *Manual for Complex Litigation, Fourth*,[24] and *Managing Class Action Litigation: A Pocket Guide for Judges*.[25] This section highlights aspects of class action management common in or particular to securities cases, but those other sources contain further details and suggestions.

1. Preliminary Case Management

Plaintiffs seeking to file class actions under the securities laws must satisfy not only the traditional requirements under Federal Rule of Civil Procedure 23, but also certain prerequisites under the PSLRA. Like many complex cases, securities class actions are usually best handled with immediate and assertive case management.[26] Judges should endeavor to create a structure in which issues are resolved quickly and, to the extent possible, once. Putting thought into case management at the start and continuing to pay attention to it as the action proceeds can help keep the case moving and narrow the issues under consideration.

Judges interviewed for this guide suggest setting up an initial conference under Federal Rule of Civil Procedure 16 quickly in order to get the parties talking to each other and to begin working through the requirements of the PSLRA. Chief among these requirements are notice procedures and the selection of lead plaintiff and lead counsel.

The PSLRA is designed in part to prevent lawyer-driven suits and expedite selection of a lead plaintiff. It includes a sixty-day deadline from the filing of a complaint for additional complaints from anyone seeking to serve as lead plaintiff. Prospective lead plaintiffs must file with their complaint a signed statement that confirms that the plaintiff did not purchase the security at issue at the direction of counsel or in order to participate in the suit. The statement must also identify any other actions in the previous three years in which that plaintiff served or sought to serve as a representative party. Additionally, such plaintiffs must provide notice to members of the purported class no later than twenty days after the filing of the initial complaint that an action is pending and that any member of the purported class may move to serve as lead plaintiff.[27]

At the initial conference, judges usually set a schedule for these proceedings as well as a conference at which to hear from candidates for lead plaintiff and render a decision. Other provisions of the PSLRA outline Congress's expectation about

---

24. Manual for Complex Litigation, Fourth ch. 31 (Federal Judicial Center 2004) [hereinafter MCL, Fourth].

25. Barbara J. Rothstein & Thomas E. Willging, Managing Class Action Litigation: A Pocket Guide for Judges (Federal Judicial Center, 3d ed. 2010).

26. Many courts have local rules that apply to securities class actions, and judges are encouraged to consult those rules along with the suggestions offered in this section and other FJC resources.

27. See 15 U.S.C. § 78u-4 (2012) for additional requirements.

how long certain steps of the litigation should take: for instance, that a lead plaintiff will be appointed within ninety days of the date the notice is published. Such time lines are often subject to revision, so judges should not feel constrained by them. There will be instances in which modifications to the periods set out in the statute will better suit the action, particularly when there are consolidation issues to consider.

Judges usually schedule the lead plaintiff conference between two and six weeks after all lead plaintiff petitions are due, and many wait until all petitions are received before reviewing the case. Judges report that frequently plaintiffs scramble to line up the lead plaintiff and lead counsel, and often, candidates fall by the wayside, leaving a shorter roster for a judge to consider closer to the conference date. The PSLRA mandates that the action be consolidated before a lead plaintiff is appointed.

The decision of which plaintiff is most appropriate for the role of lead plaintiff is left largely to the judge's discretion. The PSLRA states that the "most adequate plaintiff" should be appointed, and it offers a rebuttable presumption that this would be the plaintiff who (a) filed the complaint; (b) has the largest financial interest; and (c) otherwise satisfies Rule 23's requirements.[28] The PSRLA strives to help judges to be fair to parties in selecting a lead plaintiff, but also to pick one that has the interest and resources to pursue the case vigorously on behalf of the class.

Judges suggest setting aside about a week to get familiar with the complaint, class period, nature of the claims, and other factors that will help determine an appropriate lead plaintiff and lead counsel. Judges suggest that when reviewing the applications, a judge pay particular attention to how the class is defined, particularly the time period. A plaintiff will often define a class in such a way as to maximize the plaintiff's apparent loss, increasing the likelihood of him or her being appointed lead plaintiff. Judges caution that it can be extremely difficult to identify inappropriate manipulation at this early stage, so the judge should keep a watchful eye for parameters that are inappropriate. For instance, if a case involves alleged misstatements and a consequent stock drop and has a class period that extends well beyond such events, it may be worth questioning why.

Prospective lead plaintiffs almost always apply with attached counsel. However, a judge need not automatically select the lead plaintiff's originally chosen representative as lead counsel. The PSLRA directs that the lead plaintiff shall select counsel "subject to the approval of the court."[29] The judge may decide to examine how experienced the lead counsel candidate is in the subject and how many similar cases he or she has pending, to ensure the counsel has both the experience and time to adequately handle the case. Some judges, after appointing a lead plaintiff, require the plaintiff to conduct due diligence and reexamine potential lead counsel. These judges reason that the lead plaintiff has a fiduciary duty to the

---

28. *See* 15 U.S.C. § 78u-4 (a)(3)(B)(iii) (2012).
29. *Id.* § 78u-4(a)(3)(B)(v) (2012).

class and is in a position to negotiate better representation and more attractive fee proposals.

Having two or more firms as co-lead counsel is an option, though an unusual one. If one lead counsel is from a relatively small firm and would benefit from the resources of a second, for instance, judges have allowed a second to join. In extremely large cases, judges have also found it helpful to appoint a liaison counsel, who facilitates communication between the court and other counsel (for instance, if there are individual defendants with separate counsel).

One of the unintended effects of the PSLRA's notice provisions has been a tendency for attorneys to use them to increase their chances of being appointed lead counsel. For instance, as one court noted, some attorneys will file notices that solicit additional clients, and will file suit "not once but over and again, all in an effort to compile the largest portfolio of investor names."[30] Judges who encounter tactics like these need not give credence to an artificially created group, but can instead choose a lead plaintiff with a smaller financial stake but greater ability and incentive to manage the litigation effectively. This position is in line with guidance the SEC has offered on this point.[31]

Judges suggest that once the lead plaintiff has been selected, the judge set a motion schedule as early as possible. Under the PSLRA, discovery is stayed during the pendency of the motion to dismiss, but the judge will still need to set the schedule for a consolidated amended complaint and briefing for the motion to dismiss. Some judges set the schedule at the lead plaintiff conference. Other judges have the parties come to a second conference within a month after the lead plaintiff conference to set the schedule, and they have the parties provide a proposed schedule a week prior to this second conference. Reasonable extensions should be granted, but by and large, the case should be kept moving. Because the selected lead counsel often has experience in this area, judges report that the parties often have a good sense of a plan they want to follow and that things run smoothly.

Judges have different approaches to class action case management after the preliminary issues are taken care of. Some schedule regular conferences to keep parties on track and dispose of issues that arise. Others eschew such conferences, preferring instead to direct parties to meet and confer and draft short briefing papers before the parties meet before the judge. Judges who follow the latter course believe this prevents issues from festering longer than they need to and limits letter writing campaigns and other transaction costs.[32]

---

30. *In re* Network Assocs., Inc. Sec. Litig., 76 F. Supp. 2d 1017, 1021 (N.D. Cal. 1999).

31. *See, e.g., In re* Baan Co. Sec. Litig., 186 F.R.D 214, 218–35 (D.D.C. 1999) (appending an amicus brief from the SEC with its position on appointing lead counsel in such circumstances).

32. See Parts VI and XII, *infra*, on the motion to dismiss and discovery, for more information on class action management at these stages of litigation.

2. Class Certification

Federal Rule of Civil Procedure 23(c)(1) counsels that a judge should decide whether to certify an action as a class action "[a]t an early practicable time." Judges choose to schedule the motion for class certification at various points in litigation, but there has been a trend in recent years to make the decision earlier in securities cases. Most judges set this date at the Rule 26 discovery conference, and most set a time between the middle and end of fact discovery. This time line balances the need for sufficient discovery to draft a complete class certification motion against the desire for early clarity regarding the existence and scope of the class.

Class certification is usually the first point in the case where a judge can make factual findings, as well as take a preliminary position on the merits. Judges interviewed for this guide agree that the hardest questions they face at the certification stage usually involve issues of predominance, that is, Rule 23(b)(3)'s requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members." Looking at how a purported class intends to prove the merits of its case is often necessary for this determination. In addition, in *Halliburton Co. v. Erica P. John Fund, Inc.*, the Supreme Court clarified that defendants can present evidence at the class certification stage to rebut a presumption of reliance in a securities fraud case.[33] That decision means that this will be an area of heavy attention in the upcoming years.[34]

Parties have sometimes asked judges to bifurcate cases between common "liability" issues (e.g., falsity, materiality, scienter) and specialized "damages" issues (causation and damages). The request is for the class only to be certified with regard to the first set of issues, or for the case to be tried initially only on the first set of issues, or both. Judges will sometimes grant such requests in particularly complex cases in which the division can be done precisely in terms of the discovery sought. More frequently, judges deny such requests, because the judges find that they cause unnecessary complication of the class certification decision, as well as time delays, without providing much benefit in the way of procedural simplification or cost reduction.

The FJC has developed illustrative notices of proposed class action certification, which are available on its website.

3. Opt-out Plaintiffs

A regular feature in class action cases is the presence of opt-out plaintiffs: individual plaintiffs who choose not to participate in the class and who therefore have the option to pursue their own litigation. In the securities class action context, plain-

---

33. 134 S. Ct. 2398 (2014) ("*Halliburton II*")

34. *See, e.g.*, IBEW Local 98 Pension Fund v. Best Buy Co., 818 F.3d 775 (8th Cir. 2016) (applying *Halliburton II* and holding that defendant successfully rebutted the fraud-on-the-market presumption).

tiffs who opt out are often institutional investors represented by established law firms[35] and allege claims virtually identical to those of the class action.

Plaintiffs may opt out at various points in a litigation. Some opt out quite late, after a settlement has been announced, presumably because they hope to gain more money than they would have received as class members or because they otherwise object to the terms of the settlement. Some judges insist that fee petitions be filed prior to the opt-out deadline precisely so that potential opt-out plaintiffs can look to them as a factor in their decision. Plaintiffs may also opt out earlier in the litigation in the interest of retaining more control over the litigation of their claims.[36]

A judge who encounters opt-out plaintiffs must consider a few factors. First and most important, when opt-out plaintiffs want to pursue their own litigation, the judge must decide whether those cases should be coordinated with the main class action, and if so, how. Judges tend to put such cases on the same track, reasoning that it prevents prolonged and redundant litigation and is not significantly more expensive for the opt-out plaintiffs. Of course, there are exceptions to every rule, and plaintiffs who opt out late in the litigation may not be able to catch up. Opt-out plaintiffs may also resist being aligned with the class action calendar for other reasons. For example, courts traditionally have a broad reading of SLUSA's definition of a "covered class action," which includes actions "joined, consolidated, or otherwise proceed[ing] as a single action for any purpose."[37] An opt-out plaintiff who might otherwise not be subject to SLUSA preclusion, then, may become precluded because the plaintiff has the same calendar as the class action.[38]

Another point to consider is how statutes of limitations and repose (and relevant tolling) apply to opt-out plaintiffs. As discussed in Part IX, *infra*, case law on tolling is complex and quick to change, and this is equally true in the opt-out context. For instance, courts have grappled with whether plaintiffs who opt out of a class action after a statute of repose has run may nonetheless bring suit.[39]

4. Third-Party Litigation Financing

Litigation financing, in which third-party investors help finance a lawsuit in exchange for an interest in the proceeds, is a relatively recent phenomenon in the United States. It first rose to prominence in the personal injury context, but since 2010 it has expanded rapidly to other causes of action.

---

35. It has become increasingly common to see the same group of law firms representing both classes and opt-out plaintiffs in securities class actions.

36. *See* Jeffrey Paul Mahoney, *Navigating Alternatives to Securities Fraud Class Actions: State Law and Opt-Out Litigation,* 46 Loyola U. Chi. L.J. 459, 463–65 (Spring 2015).

37. 15 U.S.C. § 77p(f)(2)(A)(ii) (2012).

38. *See, e.g., In re* Fannie Mae 2008 Sec. Litig., 891 F. Supp. 2d 458, 480 (S.D.N.Y. 2012) (finding individuals' state law claims precluded under SLUSA because their suit was a covered class action).

39. *See, e.g.,* Franklin U.S. Rising Dividends Fund v. American Intern. Grp., 605 F. App'x 32 (2d Cir. 2015) (discussing such questions in the context of changed law and a transfer between circuits).

Litigation financing is controversial. In many instances, parties need not even disclose that they are being financed by third parties. The practice has been criticized for, among other things,

- increasing the volume of cases brought, particularly weak ones;
- prolonging litigation and discouraging settlement or alternative dispute resolution (ADR);
- undercutting plaintiff and lawyer control over litigation;
- directing money away from the injured;
- constituting champerty; and
- creating various ethical conflicts.[40]

Proponents of the practice point to its many benefits, including

- addressing the staggering costs of litigation that could bar even meritorious claimants from bringing suit;
- providing funding to improve the quality of litigation;
- off-loading risk because the litigation is non-recourse, meaning parties owe nothing for unfavorable outcomes;
- allowing companies to focus on their core business and leave the pursuit of their claim to others; and
- evening the playing field with resource-laden defendants.[41]

Both supporters and opponents of litigation financing have called for regulation and rule making to provide clarity to lawyers and investors and protection to claim holders.

The impact of litigation financing on individual securities suits is difficult to gauge. But as increasing numbers of securities class actions receive third-party funding the third-party players are becoming more visible, and judges are paying more attention to potential conflicts of interest. Judges report that in the lead plaintiff and lead counsel selection process, some parties have pointed to the fact that they secured the third-party funding as the reason why they must be selected as lead plaintiff and lead counsel. Funders may not agree to come through with the funding without their preferred counsel or plaintiff making the decisions. Judges also report that plaintiffs claim privilege over communications between them and their funders, or file motions to enforce collection. Some judges now ask

---

40. *See generally* U.S. Chamber Institute for Legal Reform, Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation 1–6 (Oct. 2012), *available at* http://web.archive.org/web/20160219202403/http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf; New York City Bar Association Formal Opinion 2011-2, *available at* http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02.

41. *See generally* David Lat, *6 Virtues of Litigation Finance*, Above the Law, Nov. 24, 2015, http://web.archive.org/web/20160606211438/http://abovethelaw.com/2015/11/6-virtues-of-litigation-finance/?rf=1; Sylvan Seidel & Sandra Sherman, *"Corporate Governance" Rules Are Coming to Third Party Financing of International Arbitration (and in General)*, *in* ICC, Doosier X: Third-Party Funding in International Arbitration 32–49; 35–36 (Bernardo M. Cremades & Antonias Dimolitsa eds., 2013).

parties if there is any outside financing so that proper fiduciary duties can be ascertained.[42]

C. Jurisdiction

Both the Securities Act and the Exchange Act confer subject-matter jurisdiction on federal courts for all cases brought under them.[43] This means that plaintiffs need not aver diversity of citizenship or amount in controversy to satisfy jurisdictional requirements, so long as they aver that some instrumentality of interstate commerce (such as the mail, telephone, or Internet) was used as part of the alleged violation. The type of instrumentality and degree of use required differ somewhat from circuit to circuit, though the general trend is toward broadening what satisfies this standard.

The law of extraterritorial jurisdiction in securities actions has been in flux in recent years. Dodd-Frank extended jurisdiction to actions brought by the government that involve "conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[44] Many commentators see this as a response to *Morrison v. National Australia Bank*,[45] a case in which the Supreme Court rejected a "conduct and effects" test that the Second Circuit had previously used to determine jurisdiction under the securities laws in favor of a "transactional" test that focused on the location of the transactions at issue. Whether the "conduct and effects" test of Dodd-Frank reinstates the one that existed before *Morrison* is a difficult question, and one that courts are still working through.[46]

The supplemental jurisdiction provisions in 28 U.S.C. § 1367 allow federal courts to adjudicate causes of action under state securities laws if they are brought alongside federal securities law actions. Although subject-matter jurisdiction under the Exchange Act is exclusive to the federal courts, jurisdiction under the Securities Act is not, so non–class actions brought under the Securities Act in state court usually may not be removed to federal court. Individual circuits do have certain exceptions to the rule of non-removal of Securities Act cases; notably, the Second Circuit allows removal for Securities Act cases brought in state court during a pending federal bankruptcy proceeding.[47] In addition, as mentioned earlier in the context of securities class actions, SLUSA preempts state courts from hearing most such cases, and the Supreme Court has given SLUSA preemption broad interpretation.[48]

---

42. *See generally* Bert I. Huang, *Litigation Finance: What Do Judges Need to Know?* 45 Colum. J.L. & Soc. Probs. 525 (2012).

43. 15 U.S.C. §§ 77v, 78aa (2012).

44. 15 U.S.C. §§ 77v(c), 78aa(b) (2012).

45. 561 U.S. 247 (2010).

46. *See, e.g.,* S.E.C. v. Chicago Convention Ctr., LLC, 961 F. Supp. 2d 905, 908 (N.D. Ill. 2013) (calling the issue "a complicated question" and determining that the court need not answer it "because the SEC has stated a claim under either inquiry").

47. *See* Cal. Pub. Employees' Ret. Sys. v. Worldcom, Inc., 368 F.3d 86, 104 (2d Cir. 2004).

48. *See* Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85–86 (2006).

Provided that subject-matter jurisdiction and venue are established, federal courts have personal jurisdiction over a defendant anywhere in the United States under the Securities Act and the Exchange Act, so process may be served nationwide. Personal jurisdiction over foreigners is subject to a minimum contacts test.[49]

D. Forum and Venue

The forum and venue provisions of the securities laws are extremely broad. The most likely disputes involving forum will be ones in which (a) plaintiffs contest the validity of a mandatory arbitration provision, or (b) the SEC opts to use administrative proceedings rather than a civil action, an option the SEC has exercised with increasing frequency since the passage of Dodd-Frank. The SEC has issued guidance explaining its choice of forum,[50] but judges will most likely still encounter suits from defendants who are unhappy with having their cases heard by an administrative law judge. See the discussion of SEC actions in Part IV.B, *supra*, for more information on the types of arguments found in these suits.

E. Standing

Standing under the securities laws varies widely depending on which section of the laws the suit is brought under. For instance, some actions, like those brought under section 12 of the Securities Act, require a showing of privity, that is, a specific relationship between the parties. Defendants will often probe the contours of the requisite relationship to show that it does not exist.

Standing issues can also arise in the class action context when the commonality of standing is disputed. For instance, defendants have argued that named plaintiffs who have purchased some tranches of a security, but not all, should not be allowed to pursue claims on behalf of purchasers of the other tranches; courts have disagreed on this issue.[51]

VI. General Pleading Requirements and Standards, and the Motion to Dismiss

Most securities lawsuits are resolved early in litigation, and the motion to dismiss in particular is a critical step. A case is often reconfigured or shut down entirely at this point. For instance, NERA Economic Consulting examined potential class action lawsuits brought under SEC Rule 10b-5 or section 11 of the Securities Act (which together constitute the vast majority of securities class actions), and it found that consistently over fifteen years, about half of them were dismissed completely at the motion-to-dismiss stage. In addition, less than 9% of such lawsuits

---

49. *See* Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 414 (1984).

50. SEC, Division of Enforcement Approach to Forum Selection in Contested Actions, *available at* http://web.archive.org/web/20160605002331/https://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf.

51. *See, e.g.,* NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co., 693 F.3d 145, 157–58 (2d Cir. 2012); *In re* Countrywide Fin. Corp. Mortgage-Backed Sec. Litig., 860 F. Supp. 2d 1062, 1068–69 (C.D. Cal. 2012).

had motions for summary judgment filed; this means that 91% of such suits were dismissed (by the court or the parties) or settled before then.[52] As a consequence, any changes to pleading requirements or to defenses allowed at the pleading stage (rather than at class certification, summary judgment, or trial) can have profound effects on caseloads and settlement amounts. Not surprisingly, then, the pleading stage is an area of intense focus for practitioners and policy makers alike.

The judges we interviewed suggested that when a judge is assessing motions to dismiss in a securities case, the judge use the opportunity to draw the boundaries of the case. They suggest paying particular attention to the subordinate components of the claims in order to see what can be done to narrow the case into something triable. Often, judges scrutinize the individual statements or omissions at issue, arguments relating to causation, and, in class actions, time periods. Given the specialized knowledge often needed by the judge and the sophistication of many of the lawyers involved in securities litigation, judges often find oral argument on the motion to dismiss helpful.

Some judges hold a pre-motion conference and instruct parties to draft a short summary of the arguments they plan to make in their motions. This process can sometimes help narrow or resolve certain open issues, and plaintiffs can address defendants' arguments in their initial brief rather than at reply. Judges will sometimes also allow plaintiffs to amend the complaint before they decide the motion based on arguments raised at the pre-motion conference. Note, however, that the Second Circuit has specifically held that the holding of such a conference cannot be grounds to deny leave to amend under Rule 15 if the motion is ultimately granted.[53] In the Second Circuit and throughout the country, liberal leave to amend means that judges usually dismiss these complaints without prejudice.

Elements of different causes of action under the securities laws have significant overlap. As a result, one difficulty judges frequently face is how to interpret case law addressing one cause of action when litigants argue that it should (or should not) apply to another. It may be helpful for the judge to consider securities suits as falling into two main groups: those that include allegations of fraud and those that do not. Issues like specificity of pleadings and mental element requirements tend to be more similar within these groups.

Cases brought under the securities laws that sound in fraud, for instance, must satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b). Courts have generally interpreted this rule to require that allegations be sufficiently particular as to put defendants on notice of the alleged wrong so that they can formulate an effective response. For example, courts have required that complaints specify the statements that the plaintiff contends were fraudulent, identify

---

52. Starykh & Boettrich, *supra* note 9, at 18.

53. *See* Loreley Financing (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC, 797 F.3d 160, 189–91 (2d Cir. 2015).

their speaker and where and when they were made, and explain why the statements were fraudulent.[54]

Other securities actions are premised on negligence, and therefore generally have the lower pleading standard of Rule 8. However, this division between fraud and non-fraud securities suits is complicated by two issues. First, some courts that have held that sections of the acts that do not *require* that fraud be pleaded to state an action (notably, sections 11 and 12 of the Securities Act) still need to satisfy Rule 9(b) if the claims are "grounded in fraud."[55] Many circuits have yet to consider this question in the wake of the Supreme Court's revisions to general pleading standards in *Bell Atlantic Corp. v. Twombly*[56] and *Ashcroft v. Iqbal*.[57] Second, the PSLRA has certain heightened pleading requirements for "securities fraud actions," and its definition of what qualifies as such an action appears to encompass claims brought under sections 11 and 12(a)(2) of the Securities Act.[58] So while these actions might otherwise need to satisfy Rule 8, in the class action context, the standard is higher.

If all or part of a case survives the motion to dismiss, the case proceeds to discovery (see Part XII, *infra*, for a discussion of discovery).

VII. Selected Causes of Action Under the Securities Laws

This part offers discussion of the elements and other noteworthy features of several specific causes of action brought under the securities laws. Many of the issues that arise under certain provisions also appear in others; this part points out such parallels as they appear. Because of the high proportion of securities actions that do not reach summary judgment, this part pays particular attention to issues arising during the pleading and earlier stages of litigation.

A. Section 10(b) of the Exchange Act and SEC Rule 10b-5

Section 10(b) of the Exchange Act and SEC Rule 10b-5 promulgated thereunder[59] are the most common bases for private securities litigation: in 2015, 84% of class actions filed in federal court included such claims.[60] One principal reason for these instruments' popularity is their breadth. Section 10(b) prohibits using "manipulative or deceptive" practices "in connection with" the purchase or sale of securities, and it applies to both secondary market trading and initial offerings.[61]

---

54. *See* ATSI Commc'ns, Inc. v. Saar Fund, Ltd., 493 F.3d 87, 99 (2d Cir. 2007) (citing Novak v. Kasaks, 216 F.3d 300, 306 (2d Cir. 2000)). In multidefendant cases, these criteria must be satisfied for each defendant. *See* Swartz v. KPMG LLP, 476 F.3d 756, 764–65 (9th Cir. 2007).

55. *See, e.g.*, *In re* NationsMart Corp. Sec. Litig., 130 F.3d 309, 315 (8th Cir. 1997); Lone Star Ladies Inv. Club v. Schlotzsky's Inc., 238 F.3d 363, 368 (5th Cir. 2001).

56. 550 U.S. 544 (2007).

57. 556 U.S. 662 (2009).

58. *See* 15 U.S.C. § 78u-4(b)(1) (2012).

59. 15 U.S.C. § 78j(b) (2012); 17 C.F.R. § 240.10b-5 (2012).

60. Cornerstone Research, Securities Class Action Filings: 2015 Year in Review 8 (2016).

61. It should be noted that there is another section of the Exchange Act, section 9(e), that establishes a cause of action against those who engage in manipulative practices with regard to trad-

SEC Rule 10b-5 is similarly broadly worded and far-reaching, and is often pleaded interchangeably. This guide refers to claims brought under either section 10(b) or SEC Rule 10b-5 as "10(b)" claims or actions. Even when plaintiffs base their allegations on other provisions in the securities laws, they will often include a 10(b) claim for good measure.

Because 10(b) claims are so common, because many of the issues they raise are also found in other securities suits, and because the case law itself often looks at other causes of action through a 10(b) lens, this guide offers an expanded treatment of 10(b) claims here, before discussing other causes of action.

Different circuits parse the elements of a 10(b) claim slightly differently, but essentially those bringing the suit must allege and prove that a defendant, in connection with the purchase or sale of securities,

1. made a misrepresentation or omission
2. of a material fact,
3. with scienter,
4. that the plaintiff relied on and
5. that caused injury to the plaintiff.

1. Misrepresentations or Omissions

A 10(b) claim must be premised on a false statement, often called a misstatement or misrepresentation in the case law, or an omission. Courts and the SEC have spent much time assessing the actionability of statements about the future, known as forward-looking statements. Frequently, if a company's prediction does not come true, a lawsuit follows. The law recognizes that a statement about the future implies that the speaker has a good-faith belief that it will be accurate, and if this is not true, 10(b) liability may attach. However, lawmakers are also sensitive to the fact that companies should not be held liable for a twist of fate they had no means of predicting and no duty to warn investors of.

The PSLRA partially addressed these concerns by providing a safe harbor for forward-looking statements when either (a) the statement is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement" or (b) the plaintiff fails to prove the statement "was made with actual knowledge by [the speaker] that the statement was false or misleading."[62] Courts have used the PSLRA safe harbor to find that certain forward-looking statements are not actionable as a matter of law, allowing for claims to be adjudicated at the motion to dismiss or summary judgment stage.

Most circuits have read the first prong of the PSLRA safe harbor provision to mean that forward-looking statements with the requisite cautionary language are not actionable regardless of the state of mind of the speaker, the Fifth Circuit be-

---

ing of exchange-listed securities. However, because manipulation is defined narrowly, and because a showing of willfulness is required, plaintiffs prefer to bring such claims under Rule 10b-5.

62. 15 U.S.C. § 78u-5(c) (2012).

ing the notable exception.[63] Congress's inclusion of the phrase "actual knowledge" in the second prong of the safe harbor provision has been understood to mean that forward-looking statements made recklessly are still included in the safe harbor, making the mental element required for forward-looking statements higher than the general scienter requirement for statements about current matters (discussed in Part VII.A.3, *infra*).[64]

The safe harbor developed in part from aspects of previously promulgated SEC rules that carved out exceptions for certain forward-looking statements so long as it was not shown that the statements were made lacking "a reasonable basis or w[ere] disclosed other than in good faith."[65] The safe harbor was also informed by the "bespeaks caution" doctrine first applied to the securities laws in *Luce v. Edelstein*.[66] The PSLRA safe harbor does not eliminate these other defenses, and courts still do look to them, particularly in non–class action cases. Judges should bear in mind, however, that the SEC rules require a deeper factual inquiry than the PSLRA safe harbor provision, making them difficult to apply before discovery. Additionally, judicial treatment of the "bespeaks caution" doctrine in particular varies widely between circuits, making the PSLRA safe harbor provision much easier to apply consistently.

As for omissions, a defendant cannot be found liable for omitting information unless there is a duty to disclose the information.[67] Judges interviewed for this guide stated that assessing what gives rise to a duty to disclose is often one of the most difficult issues they encounter. A duty can result from specific reporting requirements, as well as instances in which disclosure of certain facts is required to make a statement complete and not misleading. A disclosure duty can also arise after the fact: If a defendant later finds out that his or her statement was false or misleading, or subsequent events render it so, the defendant must correct or update the original statement if not doing so renders it materially misleading.

2. Materiality

Only misrepresentations and omissions of *material* facts are actionable under section 10(b) or SEC Rule 10b-5. A fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding" whether to purchase a security, or if inclusion of the omitted fact would have altered the "total mix" of information available to investors.[68] Materiality is an objective measure, not specific to the particular plaintiff, and is a mixed question of law and fact.

---

63. *See* Lormand v. US Unwired, Inc., 565 F.3d 228, 244 (5th Cir. 2009).

64. *See, e.g.,* Inst. Investors Grp. v. Avaya, Inc., 564 F.3d 242, 274 (3d Cir. 2009).

65. Two rules containing the same language offered the safe harbor under both the Securities Act and the Exchange Act: 17 C.F.R. § 230.175(a) (2011) and 17 C.F.R. § 240.3b-6(a) (2011).

66. 802 F.2d 49, 56 (2d Cir. 1986). The "bespeaks caution" doctrine provides that sufficient cautionary language renders alleged misrepresentations or omissions immaterial.

67. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988).

68. *See id.* at 231–32 (internal quotation marks and citations omitted).

At the motion to dismiss stage, judges have the option of deferring the issue of materiality, but they may also use it as grounds for dismissal, particularly for those classes of information that have been held to be immaterial as a matter of law. These classes include (a) puffing, or vague statements of optimism, and (b) opinions, if honestly held.[69] Furthermore, in assessing materiality, judges must consider not only the type of information being communicated, but also the degree; alleged misrepresentations or omissions that are relatively small quantitatively are probably not material.[70]

The materiality of a misrepresentation or omission often depends heavily on specific industry standards. Judges may need to acquire information in the relevant field through outside research or use of expert witnesses to resolve such issues.

3. Scienter

Section 10(b) claims require a showing that the defendant acted with scienter. Scienter connotes "intentional or willful conduct," a more serious mental element than mere negligence.[71]

While Federal Rule of Civil Procedure 9(b) allows conditions of a person's mind to be alleged generally, a showing of scienter is subject to heightened pleading requirements under the PSLRA; plaintiffs must plead "with particularity facts giving rise to a strong inference" of scienter.[72] The legislation does not define "strong inference," so in 2007 the Supreme Court clarified that in the face of competing possible inferences, "[a] complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[73] The Court advised lower courts to conduct a "holistic[]" assessment of all the relevant facts alleged, including those not necessarily in the complaint itself.[74]

Unfortunately, there is very little consistency between the circuits regarding precisely what scienter entails and what pleadings satisfy the required level of specificity. In particular, courts have grappled with to what extent reckless behavior constitutes scienter, a question renewed in the wake of the PSLRA's passage. Every court of appeals to consider the issue has concluded that recklessness can satisfy a scienter showing, but each one has also developed its own formulation. The Third Circuit, for instance, has held that recklessness "for purposes of a Rule 10b-5 claim . . . involve[es] . . . an extreme departure from the standards of ordinary care."[75] The Second Circuit has required "conscious recklessness—i.e., a

---

69. See the discussion of section 11 claims in Part VII.C.1, *infra*, for additional information on the actionability of opinions.

70. *See, e.g.,* Parnes v. Gateway 2000, Inc., 122 F.3d 539, 546–47 (8th Cir. 1997).

71. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

72. 15 U.S.C. § 78u-4(b)(2) (2012).

73. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007).

74. *Id.* at 326.

75. Belmont v. MB Inv. Partners, Inc., 708 F.3d 470, 493 (3d Cir. 2013) (internal quotation marks and citations omitted).

state of mind approximating actual intent."[76] The Ninth Circuit has held that "mere recklessness" is not sufficient, but "deliberate recklessness" that "reflects some degree of intentional or conscious misconduct" is.[77] Judges should therefore be cautious about looking beyond their own circuits for guidance when confronting issues of scienter and should pay particular attention to whether holdings within their circuit qualify the type of recklessness necessary to state a 10(b) claim.

The scienter requirement also raises some thorny issues when there are multiple defendants. Courts are currently divided on whether group pleading (the presumption that officers and directors are collectively responsible for certain types of alleged misstatements) is allowed in light of the PSLRA's heightened pleading standards, particularly its requirement that statements or omissions be pled "with particularity" against each defendant.[78] Courts also disagree on whether they will allow a "collective scienter" theory at the pleading stage. Under certain factual circumstances, courts have allowed a complaint to survive a motion to dismiss even when it does not identify a specific person with the requisite fraudulent intent, but only a corporate defendant.[79]

4. Reliance and Loss Causation

The final elements of a 10(b) claim are (a) a showing that plaintiffs relied on the material misrepresentation or omission and (b) a showing that they were damaged as a result. Reliance and loss causation are separate showings, but terminology in the case law can make this confusing. First, plaintiffs must show that the defendants' fraud caused them to buy or sell securities; this is referred to as *reliance* or *transaction causation*. Second, plaintiffs must show that the fraud (and not some other factor) caused their loss or damage; this is referred to as *causation* or *loss causation*.

a. Reliance

One extremely popular way to plead reliance is based on what is called the "fraud-on-the-market" theory. It is a presumption based on the idea that in an efficient market, a security's price accurately reflects all material information publicly available. Someone who purchases or sells a security relies on the accuracy of the security's price as reflecting all available material information. By extension, any public material misrepresentation or omission that may exist will affect the secu-

76. Novak v. Kasaks, 216 F.3d 300, 312 (2d Cir. 2000) (internal quotation marks and citations omitted).

77. WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc., 655 F.3d 1039, 1051 (9th Cir. 2011) (internal quotation marks and citations omitted).

78. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 326 n.6 (2007) (noting circuits' disagreement).

79. *See, e.g.,* Teamsters Local 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008).

rity's price; therefore, by trading in the security, the plaintiff has effectively relied on the fraud. The Supreme Court articulated the theory in *Basic Inc. v. Levinson.*[80]

The fraud-on-the-market theory is a rebuttable presumption. If a defendant can show that the security's price was not causally linked to the misrepresentation or omission, or that the plaintiffs were somehow aware of the truth and traded in the security anyway, the causal chain will be broken and the plaintiffs will not have proven their case.

The fraud-on-the-market theory has been the subject of some criticism in the economic community, particularly in the wake of the 2008 financial crisis. In 2014, the Supreme Court had the opportunity to revisit the theory in *Halliburton Co. v. Erica P. John Fund, Inc.*,[81] but did not significantly modify its precedent. The Court did hold, however, that in class action suits, defendants would be allowed to offer evidence against the presumption at the class certification stage, rather than waiting until summary judgment or trial.

b. Loss causation

Loss causation, the second causal element of a 10(b) claim that must be shown, is a simple concept: The harm plaintiffs suffer must have a causal connection to the defendant's culpable actions. Successfully pleading and proving loss causation, however, can be challenging. Judges interviewed for this guide stated that most 10(b) actions they encounter rise or fall on either scienter or loss causation.

Most courts of appeals have held that it is not sufficient for plaintiffs simply to allege a disparity between the price paid for a security and its true value. Instead, plaintiffs must plead and offer evidence showing that disclosure of the information the defendants allegedly omitted or misstated caused a drop in the security's value once disclosed.[82] This requirement ensures that 10(b) actions aren't used to help investors recover *any* decline in market value; instead, they compensate only those who suffered an actual loss as a result of fraud. Proving loss causation in the class action context almost always involves the plaintiffs enlisting an expert to conduct an event study, a statistical analysis assessing how the alleged misrepresentations and corrective disclosures affected price changes.

B. Insider Trading Actions

Insider trading actions are among the most prominent brought under the securities laws today. Consequently, they are likely to have more governmental focus and to receive more public scrutiny than other cases. Because they involve individuals rather than companies, they are also more likely to go to trial.

Insider trading is understood to be a type of securities fraud proscribed by section 10(b) and SEC Rule 10b-5. Insider trading liability in the securities laws is

80. 485 U.S. 224 (1988). The Supreme Court expressed a corollary presumption for omissions in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), which is known as the *Affiliated Ute* presumption.

81. 134 S. Ct. 2398 (2014).

82. *See* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 344–45 (2005).

premised on two main theories. The first is the traditional or "classical theory," which focuses on a "corporate insider [who] trades in the securities of his corporation on the basis of material, nonpublic information."[83] This theory is based on a fiduciary duty the insider has to the corporation's shareholders that information be used for the corporation's benefit, and not the individual's. Insiders with such information must either disclose it at the point of trade or abstain from trading.

The second theory, the "misappropriation theory" of insider trading, targets those outside the company who are provided with information in a position of trust and who then use it for personal gain. These outsiders owe a duty to the source of the information, and individuals in such a position are expected to either disclose the information at the point of trade or abstain from trading.[84] This theory, which is newer than the classical theory, has gained widespread acceptance in the last two decades.

One important developing area of law in the insider trading context is tipper/tippee liability. Courts are examining when someone who provides confidential nonpublic information (a "tipper") to someone else who then trades on it (a "tippee") can be found liable. In *United States v. Newman*,[85] the Second Circuit interpreted a series of Supreme Court cases to conclude that certain showings are necessary for tipper/tippee liability, including that tippees either must have known or should have known that the tipper received a consequential personal benefit from sharing the information. The Ninth Circuit, in the recent case *United States v. Salman*,[86] disagreed, holding instead that if the tippee was a close friend or family member of the insider, no proof of other personal benefit was necessary. The Supreme Court granted certiorari in *Salman* and heard the case in its October 2016 term.[87]

In addition to insider trading allegations brought as 10(b) claims, section 20A of the Exchange Act establishes a distinct private cause of action. Investors who traded contemporaneously with traders "in possession of material, nonpublic information," where the trades occurred in the opposite direction in the same class of securities (i.e., the insiders bought and the investors sold, or vice versa) can bring suit.[88] "Contemporaneous" is not defined, and the assessment is generally left to the district courts. Section 20A requires that a predicate violation of the Exchange Act be pleaded, and most often plaintiffs plead a section 10(b) violation as the predicate. Courts are in disagreement regarding whether plaintiffs may pursue section 10(b) and section 20A insider trading claims simultaneously; some have held that doing so would undermine section 20A's damages limitations.[89]

---

83. *See* United States v. O'Hagan, 521 U.S. 642, 651–52 (1997).

84. *See id.* at 652–53.

85. 773 F.3d 438 (2d Cir. 2014).

86. 792 F.3d 1087 (9th Cir. 2015).

87. Salman v. United States, 136 S. Ct. 899 (mem.) (Jan. 19, 2016). At the time of this publication, a decision is still pending.

88. 15 U.S.C. § 78t-1 (2012).

89. *See, e.g.*, Gordon v. Sonar Capital Mgmt. LLC, 962 F. Supp. 2d 525, 532 (S.D.N.Y. 2013) (allowing alternative pleading); T. Rowe Price New Horizon Fund, Inc. v. Preletz, 749 F. Supp. 705,

C. *Other Specific Causes of Action*

This section outlines other commonly used or otherwise noteworthy causes of action under the securities laws. Causes of action are referred to by their popular names and arranged in the order in which they appear in the securities laws. Like other sections of the guide, this section is not meant to be exhaustive. Its purpose, rather, is to provide a basic lay of the land of securities litigation, which can provide judges with context for whatever specific issues they may encounter.

1. Section 11 of the Securities Act

Section 5 of the Securities Act outlines registration requirements for securities.[90] Section 11 of the Securities Act establishes a private cause of action for registration statements that contain false or misleading information.[91] Registration statements actionable under section 11 must contain, at the time they became effective, (a) an untrue statement of a material fact or (b) an omission of a material fact required under law or necessary to make the statement not misleading. Section 11 does not include reliance or loss causation as elements; in this, it is broader than other so-called antifraud provisions of the securities laws. Scienter is not an element of a section 11 claim, though information about a defendant's mental state may be relevant for certain affirmative defenses, as discussed below.

The materiality standard for section 11 claims is essentially the same as that for 10(b) claims, and as they do in the 10(b) setting, judges have the option of deferring the question of materiality at the motion to dismiss stage or granting the motion if materiality is not present as a matter of law. For example, courts frequently have found that a statement was not material under the "bespeaks caution" doctrine. There is also a statutory good-faith defense, which is the most popular defense for such actions; if defendants can show they had reasonable grounds for believing, and did in fact believe, that there was no omission or material misstatement, they are not liable.[92] In addition, the SEC, in line with its policy to encourage broad disclosure about future plans, promulgated SEC Rule 175, which provides an additional safe harbor for forward-looking statements.[93]

There had been a circuit split on the question of what plaintiffs needed to allege in connection with statements of opinion in section 11 actions. In 2015, the Supreme Court shed some light on how statements of opinion might be actionable under section 11 in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*.[94] The Court held that if an opinion is stated and honestly held, if it contains no embedded facts that are shown to be false, and if it includes enough facts to prevent the opinion from being misleading, then there is probably

---

709–10 (D. Md. 1990) (prohibiting alternative pleading). Section 20A claim damages are statutorily capped at the defendant's gain (or avoided loss).

90. 15 U.S.C. § 77e (2012).

91. 15 U.S.C. § 77k (2012).

92. 15 U.S.C. § 77k(b)(3) (2012). SEC Rule 176, 17 C.F.R. § 230.176 (2011), offers some factors to consider.

93. 17 C.F.R. § 230.175 (2011).

94. 135 S. Ct. 1318 (2015).

no basis for liability, even if the opinion is later proved wrong. The Court left to the district court the task of analyzing these issues in the context of a motion to dismiss, making it likely that different approaches will continue to be used as case law develops.

As outlined in Part VI, *supra*, judges may also encounter some disagreement over whether section 11 claims sounding in fraud are subject to the heightened pleading standards of Federal Rule of Civil Procedure 9.

2. Section 12(a)(1) of the Securities Act

Section 12(a)(1) of the Securities Act creates a private cause of action for the offer or sale of unregistered securities.[95] "The registration requirements are the heart of the Act, and [section] 12[(a)](1) imposes strict liability for violating those requirements."[96] Unlike many other causes of action under the securities laws, section 12(a)(1) liability does not require a finding of materiality, nor of scienter, nor even of negligence. The purchaser can either recover damages or have the purchases rescinded, depending on whether the purchaser still owns the securities at issue. There are three elements that must be shown:

1. the defendant offered to sell or sold a security to the plaintiff;
2. the defendant used the mails or an instrument of interstate commerce; and
3. the defendant did not comply with the registration or prospectus requirements of section 5.

Once the prima facie case is shown by the plaintiff, the burden of proof shifts to the defendant to show that the elements of the violation do not exist or that an exemption or exception applies. These arguments will rely heavily on the statutory definitions of terms like *person*, *offer*, and *sold*, which appear in section 2 of the Securities Act, as well as on the safe harbor provisions and other statutory exemptions to section 5, which appear in sections 3 and 4.[97] Defendants may also point to the statute's privity requirements, which the Supreme Court addressed in *Pinter v. Dahl*,[98] or make an *in pari delicto* defense, that is, that the plaintiffs' wrongdoing outweighs their own.[99]

There is some case-law inconsistency concerning the limitations provisions that govern section 12(a)(1) claims. Actions under section 12(a)(1) must be brought within one year of the purported violation, and the Securities Act bars actions brought more than three years after the security is offered bona fide to the

---

95. 15 U.S.C. § 771(a)(1) (2012). This was originally section 12(1) of the Securities Act and will be so labeled in cases predating the PSLRA.

96. Pinter v. Dahl, 486 U.S. 622, 638 (1988).

97. Sections 2–5 of the Securities Act are codified at 15 U.S.C. §§ 77b-e (2012 & Supp. III 2015).

98. 486 U.S. 622 (1988).

99. While there once were courts that held that the *in pari delicto* defense was not available for section 12(a)(1) violations because of their strict liability nature, the Supreme Court has held that the defense is available for all private actions brought under the federal securities laws. *See Pinter*, 486 U.S. at 633–35. That being said, because of the restricted nature of the defense allowed under *Pinter*, it is not used frequently.

public. Courts have disagreed on whether equitable tolling can be applied to the limitations provisions, and if so, how, as well as when the bona fide offer occurs in the non-registration context. For more information on time limitations provisions, see Part IX, *infra*.

3. Section 12(a)(2) of the Securities Act

Section 12(a)(2) of the Securities Act creates a cause of action against those who have offered or sold securities by means of a prospectus or oral communication that contains material misrepresentations or omissions.[100] This cause of action is similar to a section 12(a)(1) claim, but more complicated because of the requirement to show materiality. The elements are as follows:

1. the defendant offered to sell or sold a security to the plaintiff;
2. the defendant used the mails or an instrument of interstate commerce;
3. the defendant used a prospectus or oral communication; and
4. the prospectus or oral communication contained an untrue statement or omission of material fact of which the purchaser was not aware.

The materiality element, absent from section 12(a)(1)'s elements, is similar to the section 11 requirement and involves similar issues regarding statutory scope. Although the Supreme Court has not weighed in on whether claims sounding in fraud are subject to the heightened pleading standards of Federal Rule of Civil Procedure 9, every court of appeals to address the issue in a section 12(a)(2) claim has held that Rule 9 applies.

As in section 12(a)(1) cases, in section 12(a)(2) cases, once the prima facie case is shown by the plaintiff, the burden of proof shifts to the defendant. And again, many of the available defenses focus on how various terms are defined by statute and interpreted by courts. In addition, section 12(a)(2) offers a defense for those who "did not know, and in the exercise of reasonable care could not have known, of [the] untruth or omission."[101] In other words, if defendants can prove an absence of negligence, they avoid liability.

Reliance and loss causation are not elements of a section 12(a)(2) claim; instead, they are statutory affirmative defenses. Courts have dismissed claims when defendants proved that the plaintiff knew of the misrepresentation or omission before the purchase. The statute also states that losses not caused by the misrepresentation or omission are not recoverable.[102] Some courts have taken this further, requiring that the pleading include some causal connection between the defective communication and the purchaser's loss. Finally, as with section 12(a)(1), with section 12(a)(2), there is some case-law inconsistency concerning the time limitations provisions that attach to the action.

---

100. 15 U.S.C. § 77l(a)(2) (2012). Again, this was originally section 12(2) of the Securities Act and will be so labeled in cases predating the PSLRA.

101. 15 U.S.C. § 77l(a)(2) (2012).

102. 15 U.S.C. § 77l(b) (2012).

4. Section 17(a) of the Securities Act

Section 17(a) of the Securities Act prohibits fraud, material misstatements, or omissions in connection with the offer or sale of securities.[103] In a sense, it is the Securities Act's equivalent of section 10(b), and similarly broad. Most courts have held that there is no private right of action under this section and the Supreme Court has reserved the issue several times, so judges will most likely see this section in actions brought by the SEC. The main advantage that section 17(a) has over section 10(b) from the SEC's perspective is that many section 17(a) claims can be premised on negligent conduct rather than requiring a showing of scienter.[104]

5. Proxy Litigation—Section 14(a) of the Exchange Act

Prior to an annual meeting, a corporation is required to provide shareholders with a proxy statement that contains information about the issues that will be voted on at the meeting. Corporations also frequently solicit proxies (essentially absentee votes) from shareholders on specific items on the agenda. Section 14(a) of the Exchange Act governs the form of the proxy statement, as well as solicitation of proxy votes from shareholders, so as to safeguard fair corporate suffrage.[105]

Proxy litigation has increasingly been used in struggles for control over publicly traded corporations, as well as to contest the elections of boards of directors and to recommend changes to articles of incorporation. Actions under section 14(a) often request not only damages, but also an injunction to bar further action using the proxies at issue. Since proxy litigation most often occurs in the context of mergers or change of control transactions, section 14(a) cases are the ones most likely to be time sensitive. See Part V.A, *supra*, on temporary restraining orders and preliminary injunctions, for suggestions on how to manage these cases when they are first filed.

Section 14(a) authorizes the SEC to adopt rules for the solicitation of proxies, consents, and authorizations. These rules detail the type of information shareholders can expect to receive and prohibit false or misleading statements in the solicitation of proxies. Rule 14a-9 prohibits the making of any false or misleading statement in the solicitation of proxies.[106] To state a claim, a plaintiff must allege

1. a misrepresentation or omission of a material fact;
2. that the misrepresentation was negligent or willful; and
3. that the proxy solicitation itself (not the specific representation) was an "essential link" in accomplishing the proposed corporate transaction.[107]

The pleading requirements concerning misrepresentation are similar to those for section 11 claims. However, proxy statements are essentially arguments in

---

103. 15 U.S.C. § 77q(a) (2012).
104. *See* Aaron v. SEC, 446 U.S. 680, 695–97 (1980).
105. 15 U.S.C. § 78n(a) (2012).
106. 17 C.F.R. § 240.14a-9 (2011).
107. Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 385 (1970).

furtherance of a specific position, and therefore, by nature, they have a complicated combination of facts, opinions, and conclusions. Judges will often be tasked with determining which statements are sufficiently factual to be actionable and whether they rise to the level of materiality.[108] Section 14(a)'s "essential link" requirement is unique among causes of action under the securities laws.

The law is somewhat muddy concerning the mental element of section 14(a) claims. For example, although there is nearly unanimous authority in lower courts that negligence is the standard of liability for section 14 claims, the Supreme Court has never ruled on the issue.[109] This leaves open the possibility that for certain types of proxy fraud claims, a higher standard is required. For instance, the Sixth and Eighth Circuits have held that scienter should be the standard of liability for section 14(a) defendants who are outside advisors to a company's board; the Third Circuit has disagreed.[110] Similarly, there is disagreement among the circuits regarding whether the PSLRA's particularity requirements apply to a negligence pleading.

Because the right to sue under section 14(a) is an implied right, there is no explicit statute of limitations. Courts have held that the time to sue under section 14(a) generally should be the same as that under section 10(b) before its modification by the Sarbanes-Oxley Act, that is, within one year of discovering the facts constituting the violation and no more than three years after the violation.

6. The Williams Act—Sections 13–14 of the Exchange Act

The Williams Act, passed by Congress in 1968, inserted additional subsections into sections 13 and 14 of the Exchange Act. The Williams Act was a response to the increasing use of cash tender offers—where an offeror publicly requests shares at a fixed price—to achieve control of unwilling companies. Before the Act, a cash tender offer was an effective way to avoid the Exchange Act's usual requirements for mergers, which included a shareholder vote.

The Williams Act is decidedly neutral on whether cash tender offers are "bad" or "good" as a policy matter, but it makes such offers subject to disclosure requirements. Because the Williams Act is not meant to benefit or protect incumbent management, suits are usually brought by the target company on behalf of its shareholders, purportedly asserting the shareholders' rights.[111]

---

108. *See, e.g.,* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090–91 (1991).

109. Some courts have read the Supreme Court's holding in *Aaron v. SEC*, 446 U.S. 680, 697–700 (1980), which discusses actions brought under section 17(a) of the Securities Act, to apply analogously to section 14.

110. *See* Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428–31 (6th Cir. 1980); SEC v. Shanahan, 646 F.3d 536, 546–47 (8th Cir. 2011); Herskowitz v. Nutri/Sys., Inc., 857 F.2d 179, 189–90 (3d Cir. 1988).

111. *See* Daniel J. Kramer et al., Federal Securities Litigation: A Deskbook for the Practitioner 7-1 to 7-2 (3d ed. 2014).

a. Section 13(d) litigation

There are two main types of litigation under the Williams Act. The first type is brought under section 13(d) of the Exchange Act,[112] which requires anyone acquiring beneficial ownership of more than 5% of certain securities to file with the SEC and send a schedule to the issuer with specified information. This requirement serves as an early warning to investors and company management that a takeover attempt may be under way. Section 13(d) suits allege that the disclosure information provided is false, misleading, or otherwise defective. There are no reliance or materiality requirements in such a claim. Though purportedly section 13(d) litigation is brought with shareholders' interests in mind, as a practical matter, managers often use section 13(d) to stall or block tender offers regardless of whether they would benefit shareholders.

It should be no surprise that most section 13(d) claims request injunctive relief to halt further tender offer activities. See Part V.A, *supra*, on temporary restraining orders and preliminary injunctions, for guidance on the initial management of such requests. The Supreme Court has made it clear that a technical violation of section 13(d) is not sufficient to justify an injunction,[113] so judges should be wary of arguments that point to the policy concerns of the Williams Act to justify findings of per se irreparable harm. Judges should also consider whether additional disclosure that brings the schedule in line with section 13's requirements and alerts shareholders to the nature of the dispute (for instance, by annexing the complaint) would be sufficient relief; Second Circuit courts have been particularly open to this option.[114]

b. Section 14(d) litigation

The second main type of Williams Act litigation comes under section 14(d) of the Exchange Act,[115] which prohibits anyone from making a tender offer that would result in their owning more than 5% of the issuer's shares without first filing the offer with the SEC, as well as a statement with information similar to that required under section 13(d). Section 14(d) also regulates the substance of tender offers and sets certain time limits for withdrawal.

"Tender offer" is not defined by statute or by the SEC, so one issue courts often confront in section 14(d) actions is whether a tender offer has occurred. *Wellman v. Dickinson*[116] lays out eight factors the SEC has listed as characteristic of a tender offer, but courts have consistently declined to declare those factors mandatory for finding that a tender offer has occurred.

Typically, section 14(d) actions are brought by the target company, which alleges that the raider (the company seeking to acquire the target, also referred to as a bidder) has made a tender offer without the requisite filings or that the filings

---

112. 15 U.S.C. § 78m(d) (2012).

113. *See* Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 60–61 (1975).

114. *See* Kramer et al., *supra* note 111, at 7-16 to 7-19.

115. 15 U.S.C. § 78n(d) (2012).

116. 475 F. Supp. 783, 823–24 (S.D.N.Y. 1979).

are faulty. Raiders have also been known to file suit under section 14(d) when there are competing tender offers, using the lawsuit to attack other bidders' statements as faulty or inadequate and insisting on additional disclosure. Suits by shareholders themselves are rare, but not unheard of. As with section 13(d) actions, with section 14(d) actions, injunctions are often the relief requested.

7. Section 16—Short Swing Profits

Section 16 of the Exchange Act includes a cause of action intended to prevent "short swing" trading, in which corporate insiders use access to nonpublic information to engage in short-term trading for profit.[117] The section enables issuers of securities to recover such profits from "insiders" (defined by statute) who both purchase and sell (or sell and purchase) equity securities within a six-month period. Unlike insider trading actions (discussed in Part VII.B, *supra*), which require an inquiry into the insider's knowledge or intent, section 16 is strict liability, with no mental element requirement.

Section 16 does not share many issues with other sections of the securities laws. Note also that there cannot be double recovery for the same transaction if a defendant is found liable under both section 16 and another provision of the securities laws. Finally, section 16's case law, like that of other sections, has been prone to frequent change with regard to the tolling of the applicable limitations provisions.

8. Section 18—Liability for False Filings

Section 18 of the Exchange Act establishes a cause of action for investors who are injured by false or misleading statements in documents filed with the SEC or another national securities exchange.[118] Section 18 claims are relatively rare compared with 10(b) claims, in part because unlike 10(b) claims, section 18 claims cannot be premised on a fraud-on-the-market theory, and therefore reliance must be pleaded with particularity.[119]

VIII. Secondary Liability

One of the fastest moving areas of law in securities litigation is secondary liability: whether and how individuals and corporations not principally or directly involved in the alleged violation can be held responsible. Private plaintiffs and government entities alike regularly conceive new theories of secondary liability, which are met with varying degrees of acceptance by different courts. In addition, congressional amendments to the securities laws frequently involve issues of secondary liability. This part offers an overview of how traditional theories of secondary liability have been used in securities litigation, with the caveat that judges should be sensitive to the current laws in their particular court.

---

117. 15 U.S.C. § 78p (2012).

118. 15 U.S.C. § 78r (2012).

119. *See* Kramer et al., *supra* note 111, at 9-1 to 9-2.

An important case that does not fall into a single theory of secondary liability is *Janus Capital Group, Inc. v. First Derivative Traders.*[120] In that case, the Supreme Court held that only "the person or entity with ultimate authority over [a] statement" could be held primarily liable for securities fraud based on that statement.[121] *Janus* has proven to be important in assessing not only individuals' liability (including that of corporate officers to whom statements are not implicitly attributed), but also liability in situations in which statements are issued by multiple entities.

A. Aiding and Abetting Liability

Congress authorized the use of aiding and abetting liability in SEC-brought actions under both the Securities Act and the Exchange Act. Dodd-Frank confirmed that the SEC has the power to bring claims against "any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision."[122] Courts generally agree that to establish aiding and abetting liability, there must be (a) a primary violation of the securities laws, (b) some general awareness on the part of the aider or abettor that his or her role was part of an overall plan of wrongdoing, and (c) knowing and substantial assistance.

The Supreme Court, in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, held that private parties cannot maintain an aiding and abetting lawsuit under section 10(b) of the Exchange Act.[123] Courts have read this decision as foreclosing aiding and abetting suits by private parties under other sections of the securities laws as well.

B. Control Person Liability

Both the Securities Act and the Exchange Act contain language providing for control person liability for violations of the federal securities laws.[124] Liability is derivative, meaning there must be a primary violation and a control relationship for liability to attach, but the primary violator need not be made a party to the action. The primary violator can be either a natural person or a legal entity (like a corporation). A control person defendant's liability is joint and several with the primary violator's. Depending on the underlying offense, a control person found liable might be able to sue for contribution even if the primary violator is not named in the suit.

Because *control* is not defined anywhere in the statutes,[125] there is a great deal of disagreement concerning the pleading and proof requirements for control person liability. Some courts, for instance, require proof that the control person was a

---

120. 1565 U.S. 135 (2011).

121. *Id.* at 142.

122. 15 U.S.C. § 77o(b) (2012); 15 U.S.C. § 78t(e) (2012).

123. 511 U.S. 164 (1994).

124. *See* 15 U.S.C. § 77o(a) (2012); 15 U.S.C. § 78t(a) (2012).

125. SEC Rule 405, 17 C.F.R. § 230.405 (2016), does offer a definition of *control* as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person."

"culpable participant" in the alleged illegal activity for liability to attach. Others hold that this showing is not part of a plaintiff's primary case, but that good faith is available to the defendant as an affirmative defense.[126] When construing the control person statutes, courts generally focus on both the actual exercise of control in the specific instance and the general power to control.

There are a number of statutory affirmative defenses offered for control person defendants, most significantly the Exchange Act's good faith defense.[127] The language of the good faith defense is absent from the Securities Act provision (which instead has a defense for lack of knowledge), making case law of each Act harder to analogize to that of the other. Other sections of the securities laws may also have relevant affirmative defenses in the control person setting. For instance, the Exchange Act precludes imposing liability for insider trading on someone solely because he or she employed an individual who engaged in it.[128]

C. Respondeat Superior

The common law doctrine of *respondeat superior* is similar, but not identical, to the control person liability appearing in the securities statutes. The courts of appeals are split on whether common law theories of vicarious liability can also be pleaded under the securities laws (and to which underlying offenses they might attach).

Proponents of concurrent liability point to the securities statutes' silence on being the exclusive means for finding vicarious liability and the presence of saving clauses in each statute providing that "[t]he rights and remedies provided by this [law] shall be in addition to any and all other rights and remedies that may exist at law or in equity."[129] Proponents of exclusive liability focus on statutory purpose, noting that the securities statutes generally impose liability only on persons who are to some degree culpable, an issue that common law *respondeat superior* does not address.

IX. Time Limitations Provisions

Time limitations provisions in the securities laws are usually two-fold: A shorter limitations period is linked to the violation or its discovery, and a longer one runs from the underlying transaction. These provisions are sometimes referred to as a "statute of limitations" and a "statute of repose," respectively, but that terminology remains a point of contention in many instances.

---

126. *See, e.g.,* Ganino v. Citizens Utils. Co., 228 F.3d 154, 170 (2d Cir. 2000) (requiring culpable participant as part of prima facie case); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1574–75 (9th Cir. 1990) (en banc) (once a plaintiff establishes control, burden shifts to the defendant to establish good faith).

127. 15 U.S.C. § 78t(a)(2012).

128. 15 U.S.C. § 78t-1(b)(3) (2012).

129. 15 U.S.C. § 77p (2012); 15 U.S.C. § 78bb(a) (2012).

The Securities Act's limitations provisions appear in section 13.[130] Actions under section 12(a)(1) must be brought within one year of the purported violation. Actions under sections 11 and 12(a)(2) must be brought within one year after the misstatement or omission was discovered or should have been discovered. Section 13 adds that "[i]n no event shall any such action be brought to enforce a liability" created under the Act more than three years after the security was bona fide offered to the public or sold. The Exchange Act does not contain a specific section devoted to limitations periods. Such provisions appear either next to specific causes of action or in other legislation, notably section 804 of the Sarbanes-Oxley Act, which provides limitations periods of two years from discovery or five years from violation for bringing "a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in [the Exchange Act]."[131]

Because the limitations provisions affect whether a suit can be brought, they are featured prominently in the case law. Particularly in recent years, this case law has changed quickly, so judges should be vigilant in ensuring that they base their decisions on up-to-date information. For instance, in 2010, the Supreme Court offered a new discovery rule for when the statute of limitations begins to run for section 10(b) claims.[132] Although most district courts that have addressed the issue have agreed that this ruling applies to section 11 claims as well, courts of appeals have yet to rule.[133]

Much of the recent case law regarding limitations provisions centers on class actions. Traditionally, courts have allowed the statutes of limitations for individual class members to be tolled during the pendency of a class action, under principles articulated in *American Pipe v. Utah*.[134] Courts have disagreed, however, over whether those who opt out of a class action can still have their limitations periods tolled.[135] In addition, the applicability of *American Pipe* tolling to securities laws' statutes of repose has been inconsistent in some circuits and unresolved in others. In 2014, the Supreme Court granted certiorari on the question whether the

130. 15 U.S.C. § 77m (2012).

131. 28 U.S.C. § 1658(b) (2012). By and large, courts have read this provision to apply only to private actions alleging fraud under the Exchange Act, and not as a replacement for section 13 of the Securities Act. *See* Thomas Lee Hazen, Federal Securities Law § 7.10 (Federal Judicial Center, 3d ed. 2011); *see also In re* Exxon Mobil Corp. Sec. Litig., 500 F.3d 189, 197 (3d Cir. 2007) (concluding that Congress intended that the provision only apply to fraud claims within the Exchange Act).

132. Merck & Co. v. Reynolds, 559 U.S. 633, 644–48 (2010).

133. *See, e.g.*, *In re* Bear Stearns Mortgage Pass-Through Certificates Litig., 851 F. Supp. 2d 746, 762 (S.D.N.Y. 2012) (collecting S.D.N.Y. cases); F.D.I.C. v. Countrywide Fin. Corp., No. 2:12-CV-4354 MRP, 2012 WL 5900973, at *3 (C.D. Cal. Nov. 21, 2012) (accepting S.D.N.Y. position). *But see In re* IndyMac Mortgage-Backed Sec. Litig., 793 F. Supp. 2d 637, 648 (S.D.N.Y. 2011) (rejecting the extension of *Merck* to Securities Act claims).

134. 414 U.S. 538 (1974).

135. *See* Renee Choy Ohlendorf, *Growing Divide over Class Action Tolling Under American Pipe*, ABA Litigation News, Feb. 4, 2015, http://web.archive.org/web/20151113162132/http://apps.americanbar.org/litigation/litigationnews/top_stories/020415-class-action-tolling.html.

section 13 three-year limitations period can be tolled under certain circumstances relating to class action filing,[136] but the Court ultimately concluded that certiorari was improvidently granted and dismissed the case.[137]

X. Damages

Generally, actions under the securities laws are limited to actual damages.[138] However, damages calculations can be quite complex, so they often require considerable judicial attention. In addition, limiting damages to actual damages does not preclude courts from imposing ancillary remedies, such as restitution, rescission, disgorgement, sanctions, and various forms of injunctive relief.

When possible, judges try to avoid nullifying large transactions that have already been completed and instead assign damages to make plaintiffs whole. For instance, if a merger were induced by material misrepresentations or omissions in the proxy materials, a judge might award plaintiff-sellers benefit-of-the-bargain damages rather than undoing the merger itself.

Joint and several liability traditionally governs damages awards, but the PSLRA introduced a rule of comparative fault as a way to counter the practice of plaintiffs including in securities class actions deep-pocketed defendants of questionable blameworthiness. Under this rule, a defendant is only liable according to his or her percentage of responsibility for the wrongdoing, unless "the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws."[139] This rule applies to contribution actions as well. Also, as explained in the next part, the PSLRA bars contribution claims against parties with whom plaintiffs have settled prior to final verdict or judgment.[140]

XI. Settlement

If a securities suit survives a motion to dismiss, there is a high likelihood that it will settle before summary judgment briefing. Parties face extraordinarily high discovery costs, and particularly in class actions, most litigants prefer the security of a settlement to the risk of protracted litigation and trial.

Settlements in securities suits follow patterns similar to those in other cases. As in other cases, when all litigants are present and involved in the litigation, the judge's role in approving a settlement agreement is relatively straightforward. Judges have a much greater responsibility when assessing settlement agreements for securities class actions, so it is on this set of cases that this part focuses. Part IV

136. Public Employees' Retirement Sys. of Miss. v. IndyMac MBS, Inc., 134 S. Ct. 1515 (mem.) (2014).

137. Public Employees' Retirement Sys. of Miss. v. IndyMac MBS, Inc., 135 S. Ct. 42 (mem.) (2014).

138. 15 U.S.C. § 78bb(a) (2012).

139. 15 U.S.C. § 78u-4(f)(2)(A) (2012). This rule is subject to some limited exceptions.

140. 15 U.S.C. § 78u-4(f)(7)(A) (2012).

of the FJC's pocket guide *Managing Class Action Litigation*[141] provides most of the fundamental information and guidance. This part is meant to supplement that source, highlighting some securities-specific issues and challenges judges may face.

A. Rulings Earlier in the Case

The knowledge that a case is likely to settle rather than go to trial may factor into certain decisions judges make in earlier phases of litigation. For instance, some judges suggest instructing the parties to discuss the possibility of settlement before the initial Rule 16 conference. Because some parties regard bringing up settlement as a show of weakness, having the judge step in eliminates this concern. Other judges feel strongly that the issue of settlement should not be raised by a judge until after a claim has survived a motion to dismiss. Until a judge has determined that a legal claim has been stated, there is no reason to suggest that parties should settle—though judges can encourage parties to make use of court mediation programs if appropriate or required under local rules.

As mentioned in Part V.B.2, *supra*, on class certification, judges are also sometimes confronted with requests to bifurcate liability and damages issues. If one party's damages case is significantly stronger than its liability case, agreeing to such a bifurcation may put that party into an inferior position for settlement negotiations later on.

B. Notice and Preliminary Approval

Whenever possible, judges suggest raising any potential concerns about the fairness of a settlement agreement before granting preliminary approval, as waiting until the fairness hearing can raise costs tremendously. Judges also suggest scrutinizing the proposed settlement notice that will go to class members. An effective notice should allow an individual with a high school education to read the notice and arrive at an informed decision on the next steps he or she wants to take.

Securities cases often have complicated facts, making a clear and comprehensible notice challenging but essential. The FJC has developed some illustrative notices of proposed class action settlement, which are available on its website.

C. Pending Cases

In assessing whether a settlement amount is reasonable, judges should be aware that pending Supreme Court or court of appeals decisions may affect the parties' calculations. For instance, in 2014, *Halliburton v. Erica P. John Fund*[142] (popularly referred to as "*Halliburton II*") was before the Supreme Court. The case addressed when and how a reliance presumption should be pleaded in section 10(b) class actions, and it had the potential to dramatically alter the class action landscape.

141. Barbara J. Rothstein & Thomas E. Willging, Managing Class Action Litigation: A Pocket Guide for Judges (Federal Judicial Center, 3d ed. 2010).

142. 134 S. Ct. 2398 (2014).

The opinion was issued in June 2014, and practitioners largely agree that it improved defendants' position in such cases.

The average settlement amount for section 10(b) class actions in the first half of 2014 was $40 million; the average in the second half was $29 million.[143] The change in settlement amounts might be due to a number of factors: to *Halliburton II*'s content, to the greater clarity, to both, or to other circumstances entirely. But it is reasonable to assume that parties that settled in early 2014 did so fully aware of the pendency of *Halliburton II*, and they opted to settle in the contemporaneous legal landscape rather than waiting for an unknown holding. And it would be reasonable for parties to take the case's pendency into account when agreeing to a settlement amount. Plaintiffs may have been willing to settle sooner and for less than they would have otherwise; in this instance, their gamble paid off, since the law turned somewhat against them. A judge looking to approve such a settlement might therefore decide that a settlement number that seems low would still be fair, given the precariousness of the law before a Supreme Court ruling. Because of the infrequency with which the Supreme Court steps in on such matters, cases at the court of appeals level (particularly in the Second and Ninth Circuits) can have a similar effect.

D. Partial Settlements and Scope of Release

The PSLRA has several provisions that affect distribution of damages between defendants and what damages are ultimately awarded. If a settlement only encompasses part of a group of defendants, it may have consequences when calculating damages later on. For example, 15 U.S.C. § 78u-4(f)(7) (2012), titled "Settlement discharge," bars contribution claims against parties with whom plaintiffs have settled prior to the final verdict or judgment, and it imposes a rule of comparative fault, whereby damages awards must be reduced with the settled party's amount in mind.

Judges should review the scope of release for class action settlement agreements to ensure that it is not unreasonably broad. Defendants may push for the incorporation of additional class members or for release from claims that do not necessarily correspond with the case brought, and at this point plaintiffs have less incentive to contest them.

E. Plan of Allocation and Fees

Judges often pay attention to the plan of allocation in private settlements. They check whether the plan is practicable, what happens to unallocated funds, and how attorneys' fees are calculated. Sometimes funds are distributed pro rata once all the claims are in, and sometimes claims are satisfied according to a rubric and anything left over is returned to defendants or donated to a designated charity.[144]

---

143. NERA, Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review (2015), at 26.

144. The settlement agreement will often make clear when funds should go to a charity, and which charity or charities. When that is not the case, judges tend to use the *cy pres* doctrine to

When assessing fees, some judges suggest asking for a breakdown of attorney charges by month and type of activity, so that the judge can see which stages of the litigation created the highest costs.

Judges should also be attuned to de minimis provisions or distribution thresholds, as these are often cause for objection. In many instances, the change in a security's price that is due to alleged liable conduct is a matter of pennies, so a de minimis provision of even $10.00 may invalidate the claims of a large number of smaller shareholders. What to do about such provisions is left to the discretion of the district judge, who must weigh the need to encourage the filing of class actions and "preserve the settlement fund from excessive and unnecessary expenses" against the interests of smaller shareholders.[145] In the face of objections, some judges have approved parties' removing the de minimis provision in favor of alternative cost-saving mechanisms; others have allowed the provision to remain.[146]

F. Settlements with the SEC

Traditionally, settlements with the SEC focused on cash payouts rather than admissions of culpability. Defendants were allowed to settle while "neither admitting nor denying" wrongdoing. Some district courts have questioned the appropriateness of such settlements, arguing that without an admission or denial, it is extremely difficult to gauge the fairness of the settlement amount.[147] Most judges still rely on the SEC's status as a public agency as justification for deferring to it to assess what is in the public interest. Judges have fewer reservations about asking that private settlement agreements include information on potential liability and relative merits to help them in their fairness assessment.

Shortly after Mary Jo White assumed her position as chair of the SEC in 2013, she announced that the SEC would demand more admissions of misconduct as part of settlements, particularly in instances of egregious conduct.[148] The policy is still in its early stages, so its effects are unclear. Some commentators have predicted that the policy change will lead to an increase in trials, since defendants will be unwilling to settle if it requires an admission of fault. Others predict that the SEC will turn increasingly to administrative orders (rather than court orders) for

---

determine the next best use of remaining funds. In many circuits there is case law that describes the scope of judges' discretion to make such distributions and that outlines what steps must be followed to make an appropriate *cy pres* determination. *See, e.g.*, Masters v. Wilhelmina Model Agency, Inc., 473 F.3d 423 (2d Cir. 2007); *In re* Airline Ticket Comm'n Antitrust Litig., 268 F.3d 619 (8th Cir. 2001).

145. *See In re* Global Crossing Sec. and ERISA Litig., 225 F.R.D. 436, 463 (S.D.N.Y. 2004).

146. *See, e.g.,* Union Asset Mgmt. Holding A.G. v. Dell, Inc., 669 F.3d 632, 640–41 (5th Cir. 2012); Sullivan v. DB Invs., Inc., 667 F.3d 273, 328–29 (3d Cir. 2011).

147. The best-known instance of such a ruling is *SEC v. Citigroup Global Markets, Inc.,* 827 F. Supp. 2d 328 (S.D.N.Y. 2011). The Second Circuit ultimately held that the district court had abused its discretion in withholding approval on the stated grounds. *See* SEC v. Citigroup Global Markets, Inc., 752 F.3d 285 (2d Cir. 2014).

148. James B. Stewart, *S.E.C. Has a Message for Firms Not Used to Admitting Guilt*, N.Y. Times, June 21, 2013, at B1.

settlement approval, which allow the SEC leeway to obtain admissions but to balance them against more concessions to defendants.[149]

SEC settlements may also include an injunction request (see the discussion in Part IV.B, *supra*).

XII. Discovery

For general guidance on discovery issues, judges should consult Chapter 4 of the FJC's *Manual for Complex Litigation, Fourth.*[150] In addition, the FJC has published two pocket guides that address e-discovery: *Managing Discovery of Electronic Information*[151] and *Criminal E-Discovery*.[152]

Under the PSLRA, all discovery in private class actions is supposed to be stayed "during the pendency of any motion to dismiss," absent showings of undue prejudice or a need for particularized discovery.[153] This is an unusual feature of securities class actions, and it covers attached cases as well. Judges frequently opt to extend such stays to earlier than the filing of a motion if a defendant states an intent to file, and through repleadings and reconsiderations of motions after an opinion has been issued.

A. Discovery Scheduling

Judges report that preparing early for discovery scheduling is extremely helpful; otherwise, the cost of discovery can quickly outweigh the value of a case. Many judges request proposed schedules from parties a week before the first discovery conference that list dates, either through to trial or else to summary judgment briefing. Judges often also request materials for any other issues the judge may need to rule on, including proposed confidentiality orders, production issues, and proposed deposition lists. While many judges will rule on all these issues at the initial conference, some judges wait to approve certain discovery requests, particularly the full list of proposed depositions. Judges who follow such practices believe they encourage parties to make better use of early depositions and avoid obstructionist tactics. Such an approach is also in line with the recent amendments to Federal Rule of Civil Procedure 26, which emphasize the need for proportionality in discovery.

Judges have some general recommendations for setting a discovery schedule, but they caution that schedules are very much the product of a case's needs. For

---

149. *See, e.g.,* James Edward Maloney, *Trends in Enforcement and Recent Developments in Securities Litigation*, *in* Inside the Minds: New Developments in Securities Litigation 19 (2014); Jason E. Siegel, Note, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 Geo. L.J. 433, 455–64 (2015); Gretchen Morgenson, *S.E.C. Wants the Sinners to Own Up*, N.Y. Times, Mar. 15, 2015, at BU1.

150. MCL, Fourth, *supra* note 24.

151. Barbara J. Rothstein, Ronald J. Hedges & Elizabeth C. Wiggins, Managing Discovery of Electronic Information: A Pocket Guide for Judges (Federal Judicial Center, 2d ed. 2012).

152. Sean Broderick et al., Criminal E-Discovery: A Pocket Guide for Judges (Federal Judicial Center 2015).

153. 15 U.S.C. § 77z-1(b)(1) (2012); 15 U.S.C. § 78u-4(b)(3)(B) (2012).

example, most securities cases will require expert discovery, and judges generally suggest setting the date for the end of expert discovery later than that for the end of fact discovery. In certain circumstances, judges have found extending expert discovery beyond summary judgment to be useful.

B. Discovery Disputes

Judges must also put a structure in place for resolving discovery disputes, bearing in mind whatever the local rules say on the matter. Judges interviewed for this guide varied widely in their treatment of discovery disputes, but they agreed that in general their procedures endeavor to create bright lines, promote common sense, and ensure speed where possible.

Judges are divided in their use of magistrate judges to oversee discovery in complex securities actions. Some judges favor using magistrate judges because they believe the magistrate judges give parties "breathing space" to work through disputes while not under the eyes of the trying judge. Others prefer to oversee discovery themselves to keep themselves educated and proceedings timely. Judges who don't use magistrate judges to assist in discovery also state that it tends to encourage parties to resolve disputes themselves rather than come to the judge; they think parties are more likely to "behave" in front of the judge who will try the case. Some point out that in certain districts, magistrate judges would not be available for a single judge's calendar for a case as complex as a securities class action.

Judges also have different approaches for how they instruct parties to raise discovery disputes. Some favor three-page briefing letters and mandatory meet-and-confers before parties approach the judge. Others prefer to get the parties on the phone more quickly so as to minimize briefing and delays. Still others insist on having a record for any discovery proceedings, often making phone calls untenable.

C. Parallel Proceedings

Parallel civil and criminal securities proceedings sometimes raise difficult questions for discovery. If a defendant decides to be cooperative with the government, the defendant risks any disclosures being discoverable by private civil plaintiffs. Courts of appeals have not wholly banned selective waiver arguments, but generally do not accept them under such circumstances (the notable exception is the Eighth Circuit, which does accept selective waiver arguments).[154] Conversely, defendants may also use a criminal proceeding to their advantage, invoking a Fifth Amendment right in a parallel civil proceeding, but waiving it once discovery is closed.[155]

---

154. *See In re* Steinhardt Partners, L.P., 9 F.3d 230, 235–36 (2d Cir. 1993) (collecting cases from other circuits); *but see* Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1977).

155. Lawrence J. Zweifach & Eric M. Creizman, *Defending Parallel Proceedings: Basic Principles & Tactical Considerations*, *in* Securities Litigation Report vol. 7.2 (2010), at 6–7, *available at* http://web.archive.org/save/_embed/http://www.gibsondunn.com/publications/Documents/DefendingParallelProceedings.pdf.

Federal Rule of Evidence 502(d) allows for court orders that limit the scope of a waiver of privilege, but such orders do not appear to be widely used in securities cases. More often, courts have exercised the option of granting a motion to stay civil proceedings or civil discovery during a pending criminal case, as described in Part IV.D, *supra*.

XIII. Trial

Securities trials that are not class actions have few if any noteworthy differences from other cases. For general information and guidance on trials in the complex commercial context, judges should consult Chapter 12 of the FJC's *Manual for Complex Litigation, Fourth*.[156]

Securities class action trials are exceedingly rare; since the passage of the PSLRA in 1994 only twenty-one federal securities class actions have gone to trial, and only fifteen have reached a verdict or judgment.[157] It is not surprising that the scarcity of such trials has led to an overreliance on those cases that *have* been tried. Jury instructions, verdict forms, and similar materials may be presented for approval with the simple justification that they were used in a previous case. It bears emphasizing that while a previous trial may serve as a valuable resource, in most instances it does not carry precedential weight. In cases in which the parties disagree over such matters, judges should be wary of choosing one side's proposal simply because it has been used before.

XIV. Conclusion

A pocket guide can only scratch the surface of an area of law as vast as securities litigation. Nevertheless, the author's hope is that reading this guide will leave judges with an improved sense of the securities litigation landscape and where the particular issues of cases they encounter may fit in. There is no doubt that handling a securities case for the first time may feel daunting, but understanding the broader context in which the action is brought can help a judge know where to look to render decisions with confidence.

---

156. MCL, Fourth, *supra* note 24.

157. Starykh & Boettrich, *supra* note 9, at 38.

The Federal Judicial Center

Board
The Chief Justice of the United States, *Chair*
Magistrate Judge Tim A. Baker, U.S. District Court for the Southern District of Indiana
Judge Curtis L. Collier, U.S. District Court for the Eastern District of Tennessee
Chief Judge Barbara J. Houser, U.S. Bankruptcy Court for the Northern District of Texas
Judge Kent A. Jordan, U.S. Court of Appeals for the Third Circuit
Judge Kimberly J. Mueller, U.S. District Court for the Eastern District of California
Judge George Z. Singal, U.S. District Court for the District of Maine
Judge David S. Tatel, U.S. Court of Appeals for the District of Columbia Circuit
James C. Duff, Director of the Administrative Office of the U.S. Courts

Director
Judge Jeremy D. Fogel

Deputy Director
John S. Cooke

About the Federal Judicial Center

The Federal Judicial Center is the research and education agency of the federal judicial system. It was established by Congress in 1967 (28 U.S.C. §§ 620–629), on the recommendation of the Judicial Conference of the United States.

By statute, the Chief Justice of the United States chairs the Center's Board, which also includes the director of the Administrative Office of the U.S. Courts and seven judges elected by the Judicial Conference.

The organization of the Center reflects its primary statutory mandates. The Education Division plans and produces education and training for judges and court staff, including in-person programs, video programs, publications, curriculum packages for in-district training, and Web-based programs and resources. The Research Division examines and evaluates current and alternative federal court practices and policies. This research assists Judicial Conference committees, who request most Center research, in developing policy recommendations. The Center's research also contributes substantially to its educational programs. The Federal Judicial History Office helps courts and others study and preserve federal judicial history. The International Judicial Relations Office provides information to judicial and legal officials from foreign countries and informs federal judicial personnel of developments in international law and other court systems that may affect their work. Two units of the Director's Office—the Information Technology Office and the Editorial & Information Services Office—support Center missions through technology, editorial and design assistance, and organization and dissemination of Center resources.

IN THE SUPREME COURT OF TEXAS

Misc. Docket No. 12-9191

**ADOPTION OF RULES FOR DISMISSALS
AND EXPEDITED ACTIONS**

ORDERED that:

1. In accordance with the Act of May 25, 2011, 82nd Leg., R.S., ch. 203, §§ 1.01, 2.01 (HB 274), amending section 22.004 of the Texas Government Code, Rules 91a and 169 of the Texas Rules of Civil Procedure and Rule 902(c) of the Texas Rules of Evidence are adopted as follows, and Rules 47 and 190 of the Texas Rules of Civil Procedure are amended as follows, effective March 1, 2013.

2. The Clerk is directed to:

   a. file a copy of this Order with the Secretary of State;

   b. cause a copy of this Order to be mailed to each registered member of the State Bar of Texas by publication in the *Texas Bar Journal*;

   c. send a copy of this Order to each elected member of the Legislature; and

   d. submit a copy of the Order for publication in the *Texas Register*.

3. These amendments may be changed in response to comments received on or before February 1, 2013. Any interested party may submit written comments directed to Marisa Secco, Rules Attorney, at P.O. Box 12248, Austin, TX 78711, or marisa.secco@txcourts.gov.

Dated: November 13, 2012

Wallace B. Jefferson, Chief Justice

Nathan L. Hecht, Justice

David M. Medina, Justice

Paul W. Green, Justice

Phil Johnson, Justice

Don R. Willett, Justice

Eva M. Guzman, Justice

Debra H. Lehrmann, Justice

PER CURIAM

In 2011, the 82nd Texas Legislature passed House Bill 274[1] (HB 274). HB 274 called upon the Court to promulgate four sets of procedural rule amendments in order to implement certain legislative policy initiatives. Two of those sets of rules — governing permissive appeals and offers of judgment — were completed by the Court last year.[2] This Order promulgates the remaining rules: a dismissal rule and a set of rules for expedited actions.

The Court is charged by the Texas Constitution with providing for "the efficient and uniform administration of justice".[3] The Legislature by enacting HB 274, and the Governor by signing it into law, have directed that a more determined effort be made to reduce the expense and delay of litigation, while maintaining fairness to litigants. Small measures cannot achieve that directive. These rules are a significant effort to improve the efficiency of the Texas court system while protecting the rights of litigants.

HB 274 added Government Code § 22.004(g), which calls for rules "for the dismissal of causes of action that have no basis in law or fact on motion and without evidence . . . [to be] granted or denied within 45 days of the filing of the motion to dismiss."[4] The Court referred the study of the

---

[1] Act of May 25, 2011, 82nd Leg., R.S., ch. 203, §§ 1.01, 2.01.

[2] *See* Misc. Docket Nos. 11-9182, 11-9183.

[3] TEX. CONST. art. V, § 31(b).

[4] Tex. Gov't Code § 22.004(g).

dismissal rule to the Supreme Court Advisory Committee. A ten-member subcommittee, chaired by Hon. David Peeples, worked on drafting the dismissal rule. The full Committee reviewed the subcommittee's proposal, a second proposal drafted by a voluntary Working Group of representatives from the Texas Chapters of the American Board of Trial Advocates, the Texas Association of Defense Counsel, and the Texas Trial Lawyers Association, and a third proposal drafted by the State Bar of Texas Court Rules Committee. The Supreme Court Advisory Committee debated the proposals on November 18, 2011, and again on December 9, 2011. Following the Committee's review, the Court revised the subcommittee proposal. This Order contains the final proposed rule, Texas Rule of Civil Procedure 91a, "Dismissal of Baseless Causes of Action".

HB 274 also added Government Code § 22.004(h), which calls for "rules to promote the prompt, efficient, and cost-effective resolution of civil actions . . . in which the amount in controversy, inclusive of all claims for damages of any kind, whether actual or exemplary, a penalty, attorney's fees, expenses, costs, interest, or any other type of damage of any kind, does not exceed $100,000."[5] The Court appointed a Task Force to propose rule changes for these "expedited actions."[6] The Task Force was chaired by Hon. Thomas R. Phillips, former Chief Justice of the Court. The other members of the Task Force were: David Chamberlain, Denis Dennis, Martha S. Dickie, Wayne Fisher, Jeffrey J. Hobbs, Lamont Jefferson, Hon. Scott Jenkins, Kennon Peterson,

---

[5] Tex. Gov't Code § 22.004(h).

[6] Misc. Docket No. 11-9193.

Bradley Parker, Ricardo Reyna, and Alan Waldrop. In drafting its proposal, the Task Force reviewed the expedited actions rules proposed by the Working Group following the passage of HB 274. Two members of the Working Group were also members of the Task Force. The Task Force also studied expedited trial rules implemented in other states.

The Task Force completed its work and sent a report, proposing new rules and rule amendments, to the Court. The Court again referred study of the rules to the Supreme Court Advisory Committee, which reviewed the proposals of the Task Force on January 27 and 28, 2012. The Court also received a proposal from the State Bar of Texas Court Rules Committee. The Court reviewed the various proposals and drafted a set of rules that implements a mandatory expedited actions process for cases under $100,000. The final proposed rules — including new Texas Rule of Civil Procedure 169 and amendments to Texas Rules of Civil Procedure 47 and 190 and Texas Rule of Evidence 902 — are contained in this Order.

An important issue in formulating rules for expedited actions has been whether the rules should have a compulsory element to them or merely encourage lawyers to agree to more expedited procedures in smaller cases. Having carefully weighed the arguments of the Working Group, the report of the Task Force, the deliberations of the Supreme Court Advisory Committee, and the experience of other jurisdictions, the Court has concluded that the objectives of HB 274 cannot be achieved, or the benefits to the administration of justice realized, without rules that compel expedited procedures in smaller cases.

DISMISSAL RULE

New Rule 91a, Texas Rules of Civil Procedure:

91a. Dismissal of Baseless Causes of Action

91a.1 Motion and Grounds. Except in a case brought under the Family Code or a case governed by Chapter 14 of the Texas Civil Practice and Remedies Code, a party may move to dismiss a cause of action on the grounds that it has no basis in law or fact. A cause of action has no basis in law if the allegations, taken as true, together with inferences reasonably drawn from them, do not entitle the claimant to the relief sought. A cause of action has no basis in fact if no reasonable person could believe the facts pleaded.

91a.2 Contents of Motion. A motion to dismiss must state that it is made pursuant to this rule, must identify each cause of action to which it is addressed, and must state specifically the reasons the cause of action has no basis in law, no basis in fact, or both.

91a.3 Time for Motion and Ruling. A motion to dismiss must be:

(a) filed within 60 days after the first pleading containing the challenged cause of action is served on the movant;

(b) filed at least 21 days before the motion is heard; and

(c) granted or denied within 45 days after the motion is filed.

91a.4 Time for Response. Any response to the motion must be filed no later than 7 days before the date of the hearing.

91a.5 Effect of Nonsuit or Amendment; Withdrawal of Motion.

(a) The court may not rule on a motion to dismiss if, at least 7 days before the date of the hearing, the respondent files a nonsuit of the challenged cause of action, or the movant files a withdrawal of the motion.

(b) If the respondent amends the challenged cause of action at least 7 days before the date of the hearing, the movant may, before the date of the hearing, file a withdrawal of the motion or an amended motion directed to the amended cause of action.

(c) Except by agreement of the parties, the court must rule on a motion unless it has been withdrawn or the cause of action has been nonsuited in accordance with (a) or (b). In ruling on the motion, the court must not consider a nonsuit or amendment not filed as permitted by paragraphs (a) or (b).

(d) An amended motion filed in accordance with (b) restarts the time periods in this rule.

91a.6 Hearing; No Evidence Considered. Each party is entitled to at least 14 days notice of the hearing on the motion to dismiss. The court may, but is not required to, conduct an oral hearing on the motion. The court may not consider evidence in ruling on the motion and must decide the motion based solely on the pleading of the cause of action, together with any pleading exhibits permitted by Rule 59.

91a.7 Award of Costs and Attorney Fees Required. Except in an action by or against a governmental entity or a public official acting in his or her official capacity or under color of law, the court must award the prevailing party on the motion all costs and reasonable and necessary attorney fees incurred with respect to the challenged cause of action in the trial court. The court must consider evidence regarding costs and fees in determining the award.

91a.8 Effect on Venue and Personal Jurisdiction. This rule is not an exception to the pleading requirements of Rules 86 and 120a, but a party does not, by filing a motion to dismiss pursuant to this rule or obtaining a ruling on it, waive a special appearance or a motion to transfer venue. By filing a motion to dismiss, a party submits to the court's jurisdiction in proceedings on the motion and is bound by the court's ruling, including an award of attorney fees and costs against the party.

91a.9 Dismissal Procedure Cumulative. This rule is in addition to, and does not supersede or affect, other procedures that authorize dismissal.

Comment to 2013 change: Rule 91a is a new rule implementing section 22.004(g) of the Texas Government Code, which was added in 2011 and calls for rules to provide for the dismissal of causes of action that have no basis in law or fact on motion and without evidence. A motion to dismiss filed under this rule must be ruled on by the court within 45 days unless the motion, pleading, or cause of action is withdrawn, amended, or nonsuited as specified in 91a.5. If an amended motion is filed in response to an amended cause of action in accordance with 91a.5(b), the court must rule on the motion within 45 days of the filing of the amended motion and the respondent must be given an opportunity to respond to the amended motion. The

term "hearing" in the rule includes both submission and an oral hearing. Attorney fees awarded under 91a.7 are limited to those associated with challenged cause of action, including fees for preparing or responding to the motion to dismiss.

RULES FOR EXPEDITED ACTIONS

Amendments to Rule 47, Texas Rules of Civil Procedure:

Rule 47. Claims for Relief

An original pleading which sets forth a claim for relief, whether an original petition, counterclaim, cross-claim, or third party claim, shall contain:

(a) a short statement of the cause of action sufficient to give fair notice of the claim involved~~;~~:

(b) ~~in all claims for unliquidated damages only the~~ a statement that the damages sought are within the jurisdictional limits of the court~~;~~:

(c) a statement that the party seeks:

(1) only monetary relief of $100,000 or less, including damages of any kind, penalties, costs, expenses, pre-judgment interest, and attorney fees; or

(2) monetary relief of $100,000 or less and non-monetary relief; or

(3) monetary relief over $100,000 but not more than $500,000; or

(4) monetary relief over $500,000 but not more than $1,000,000; or

(5) monetary relief over $1,000,000; and

(~~c~~d) a demand for judgment for all the other relief to which the party deems himself entitled.

Relief in the alternative or of several different types may be demanded; provided, further, that upon special exception the court shall require the pleader to amend so as to specify the maximum amount claimed. A party that fails to comply with (c) may not conduct discovery until the party's pleading is amended to comply.

Comment to 2013 change: Rule 47 is amended to require a more specific statement of the relief sought by a party. The amendment requires parties to plead into or out of the expedited actions process governed by Rule 169, added to implement section 22.004(h) of the Texas Government Code. A pleading other than a counterclaim that contains the statement in paragraph (c)(1) is governed by the expedited actions process. The further specificity in paragraphs (c)(2)-(5) is to provide information regarding the nature of cases filed and does not affect a party's substantive rights.

New Rule 169, Texas Rules of Civil Procedure:

Rule 169. Expedited Actions

(a) *Application.*

(1) The expedited actions process in this rule applies to a suit in which all claimants, other than counter-claimants, affirmatively plead that they seek only monetary relief aggregating $100,000 or less, including damages of any kind, penalties, costs, expenses, pre-judgment interest, and attorney fees.

(2) The expedited actions process does not apply to a suit in which a party has filed a claim governed by the Family Code, the Property Code, the Tax Code, or Chapter 74 of the Civil Practice & Remedies Code.

(b) *Recovery.* In no event may a party who prosecutes a suit under this rule recover a judgment in excess of $100,000, excluding post-judgment interest.

(c) *Removal from Process.*

(1) A court must remove a suit from the expedited actions process:

(A) on motion and a showing of good cause by any party; or

(B) if any claimant, other than a counter-claimant, files a pleading or an amended or supplemental pleading that seeks any relief other than the monetary relief allowed by (a)(l).

(2) A pleading, amended pleading, or supplemental pleading that removes a suit from the expedited actions process may not be filed without leave of court unless it is filed

before the earlier of 30 days after the discovery period is closed or 30 days before the date set for trial. Leave to amend may be granted only if good cause for filing the pleading outweighs any prejudice to an opposing party.

(3) If a suit is removed from the expedited actions process, then the court must continue the trial date and reopen discovery under Rule 190.2(c).

(d) *Expedited Actions Process.*

(1) Discovery. Discovery is governed by Rule 190.2.

(2) Trial Setting. On any party's request, the court must set the case for a trial date that is within 90 days after the discovery period in Rule 190.2(b)(1) ends.

(3) Time Limits for Trial. Each side is allowed five hours to complete jury selection, opening statements, presentation of evidence, examination and cross-examination of witnesses, and closing arguments.

(A) The term "side" has the same definition set out in Rule 233.

(B) Time spent on objections, bench conferences, and challenges for cause to a juror under Rule 228 are not included in the time limit.

(4) Alternative Dispute Resolution. Unless the parties have agreed to engage in alternative dispute resolution or are required to do so by contract, the court must not — by order or local rule — require the parties to engage in alternative dispute resolution.

(5) Expert Testimony. Unless requested by the party sponsoring the expert, a party may only challenge the admissibility of expert testimony as an objection to summary judgment evidence under Rule 166a or during the trial on the merits. This paragraph does not apply to a motion to strike for late designation.

Comments to 2013 change:

1. Rule 169 is a new rule implementing section 22.004(h) of the Texas Government Code, which was added in 2011 and calls for rules to promote the prompt, efficient, and cost-effective resolution of civil actions when the amount in controversy does not exceed $100,000.

2. The expedited actions process created by Rule 169 is mandatory; any suit that falls within the definition of 169(a)(1) is subject to the provisions of the rule. If multiple claimants each seek the monetary relief allowed under 169(a)(1) against the same defendant, the defendant may move to remove the case from the rule pursuant to 169(c)(1)(a).

3. Rule 169(b) specifies that a party who prosecutes a suit under this rule cannot recover a judgment in excess of $100,000. Thus, the rule in *Greenhalgh v. Service Lloyds Ins. Co.*, 787 S.W.2d 938 (Tex. 1990), does not apply.

4. The discovery limitations for expedited actions are set out in Rule 190.2, which is also amended to implement section 22.004(h) of the Texas Government Code.

Amendments to Rule 190, Texas Rules of Civil Procedure:

Rule 190. Discovery Limitations

. . .

190.2. Discovery Control Plan — ~~Suits Involving $50,000 or Less~~ Expedited Actions and Divorces Involving $50,000 or Less (Level 1)

(a) *Application.* This subdivision applies to:

(1) ~~any suit in which all plaintiffs affirmatively plead that they seek only monetary relief aggregating $50,000 or less, excluding costs, pre-judgment interest and attorneys' fees~~ any suit that is governed by the expedited actions process in Rule 169, and

(2) any suit for divorce not involving children in which a party pleads that the value of the marital estate is more than zero but not more than $50,000.

~~(b) Exceptions. This subdivision does not apply if:~~

~~(1) the parties agree that Rule 190.3 should apply;~~

~~(2) the court orders a discovery control plan under Rule 190.4; or~~

~~(3) any party files a pleading or an amended or supplemental pleading that seeks relief other than that to which this subdivision applies.~~

~~A pleading, amended pleading (including trial amendment), or supplemental pleading that renders this subdivision no longer applicable may not be filed without leave of court less than 45 days before the date set for trial. Leave may be granted only if good cause for filing the pleading outweighs any prejudice to an opposing party~~.

(~~c~~b) *Limitations.* Discovery is subject to the limitations provided elsewhere in these rules and to the following additional limitations:

(1) Discovery Period. All discovery must be conducted during the discovery period, which begins when the suit is filed and continues until ~~30 days before the date set for trial~~ 180 days after the date the first request for discovery of any kind is served on a party.

(2) Total Time for Oral Depositions. Each party may have no more than six hours in total to examine and cross-examine all witnesses in oral depositions. The parties may agree to expand this limit up to ten hours in total, but not more except by court order. The court may modify the deposition hours so that no party is given unfair advantage.

(3) Interrogatories. Any party may serve on any other party no more than ~~25~~ 15 written interrogatories, excluding interrogatories asking a party only to identify or authenticate specific documents. Each discrete subpart of an interrogatory is considered a separate interrogatory.

(4) Requests for Production. Any party may serve on any other party no more than 15 written requests for production. Each discrete subpart of a request for production is considered a separate request for production.

(5) Requests for Admissions. Any party may serve on any other party no more than 15 written requests for admissions. Each discrete subpart of a request for admission is considered a separate request for admission.

(6) Requests for Disclosure. In addition to the content subject to disclosure under Rule 194.2, a party may request disclosure of all documents, electronic information, and tangible items that the disclosing party has in its possession, custody, or control and may use to support its claims or defenses. A request for disclosure made pursuant to this paragraph is not considered a request for production.

(~~d~~c) Reopening Discovery. ~~When the filing of a pleading or an amended or supplemental pleading renders this subdivision no longer applicable,~~ If a suit is removed from the expedited actions process in Rule 169 or, in a divorce, the filing of a pleading renders this subdivision no longer applicable, the discovery period reopens, and discovery must be completed within the limitations provided in Rules 190.3 or 190.4, whichever is applicable. Any person previously deposed may be redeposed. On motion of any party, the court should continue the trial date if necessary to permit completion of discovery.

. . .

190.5. Modification of Discovery Control Plan

The court may modify a discovery control plan at any time and must do so when the interest of justice requires. Unless a suit is governed by the expedited actions process in Rule 169, t~~T~~he court must allow additional discovery:

(a) related to new, amended or supplemental pleadings, or new information disclosed in a discovery response or in an amended or supplemental response, if:

    (1) the pleadings or responses were made after the deadline for completion of discovery or so nearly before that deadline that an adverse party does not have an adequate opportunity to conduct discovery related to the new matters, and

    (2) the adverse party would be unfairly prejudiced without such additional discovery;

(b) regarding matters that have changed materially after the discovery cutoff if trial is set or postponed so that the trial date is more than three months after the discovery period ends.

Comment to 2013 change: Rule 190 is amended to implement section 22.004(h) of the Texas Government Code, which calls for rules to promote the prompt, efficient, and cost-effective resolution of civil actions when the amount in controversy does not exceed $100,000. Rule 190.2 now applies to expedited actions, as defined by Rule 169. Rule 190.2 continues to apply to divorces not involving children in which the value of the marital estate is not more than $50,000, which are otherwise exempt from the expedited actions process. Amended Rule 190.2(b) ends the discovery period 180 days after the date the first discovery request is served; imposes a fifteen limit maximum on interrogatories, requests for production, and requests for admission; and allows for additional disclosures. Although expedited actions are not

subject to mandatory additional discovery under amended Rule 190.5, the court may still allow additional discovery if the conditions of Rule 190.5(a) are met.

New Rule 902(c), Texas Rules of Evidence:

Rule 902. Self-Authentication

. . .

(c) *Medical expenses affidavit.* A party may make prima facie proof of medical expenses by affidavit that substantially complies with the following form:

Affidavit of Records Custodian of

____

STATE OF TEXAS	§
	§
COUNTY OF ____________	§

Before me, the undersigned authority, personally appeared __________, who, being by me duly sworn, deposed as follows:

Mv name is __________. I am of sound mind and capable of making this affidavit, and personally acquainted with the facts herein stated.

I am a custodian of records for __________. Attached to this affidavit are records that provide an itemized statement of the service and the charge for the service that __________ provided to __________ on _____. The attached records are a part of this affidavit.

The attached records are kept by __________ in the regular course of business, and it was the regular course of business of __________ for an employee or representative of __________, with knowledge of the service provided, to make the record or to transmit information to be included in the record. The records were made in the regular course of business at or near the time or reasonably soon after the time the service was provided. The records are the original or a duplicate of the original.

The services provided were necessary and the amount charged for the services was reasonable at the time and place that the services were provided.

The total amount paid for the services was $_____ and the amount currently unpaid but which __________ has a right to be paid after any adjustments or credits is $_____.

____
Affiant

SWORN TO AND SUBSCRIBED before me on the _____ day of _____, _____.

____
Notary Public, State of Texas

Notary's printed name: ___________ My commission expires: _______________

Comment to 2013 Change: Rule 902(c) is added to provide a form affidavit for proof of medical expenses. The affidavit is intended to comport with Section 41.0105 of the Civil Practice and Remedies Code, which allows evidence of only those medical expenses that have been paid or will be paid, after any required credits or adjustments. *See Haygood v. Escabedo*, 356 S.W.3d 390 (Tex. 2011).

SUBJECT: Revising certain remedies and procedures in civil actions

COMMITTEE: Judiciary and Civil Jurisprudence — committee substitute recommended

VOTE: (*After recommitted:*)
7 ayes — Jackson, Lewis, Bohac, S. Davis, Hartnett, Madden, Scott

1 nay — Raymond

3 absent — Castro, Thompson, Woolley

WITNESSES: For — Ryan Brannan, Texas Public Policy Foundation; Jeff Moseley, Greater Houston Partnership (GHP); Keith O'Connell, Texas Association of Defense Counsel (TADC); Lee Parsley, Texas Civil Justice League; Richard Trabulsi, Alan Waldrop, Texans for Lawsuit Reform; Joseph Nixon; (Registered, but did not testify: Kathy Barber, National Federation of Independent Business; Luke Bellsnyder, Texas Association of Manufacturers; Chrissy Borskey, General Electric; Brent Connett, Texas Conservative Coalition; Jon Fisher, Associated Builders and Contractors of Texas; Stephanie Gibson, Texas Retailers Association; Bill Hammond, Texas Association of Business; Bill Oswald, Koch Companies; Corbin Van Arsdale, AGC - Texas Building Branch; Julie Williams, Chevron U.S.A.; Wendy Wilson, Texas Apartment Association)

Against — Brad Parker, Texas Trial Lawyers Association; David Reagan, Texas Municipal League Intergovernmental Risk Pool, Texas Municipal League; Jerry Galow; (Registered, but did not testify: Rick Levy, Texas AFL-CIO; Bill Lewis, Mothers Against Drunk Driving; Dennis Speight, Texas Watch)

BACKGROUND: Civil Practice and Remedies Code, ch. 42 deals with settlements in the civil justice system. Sec. 42.004 contains provisions that award litigation costs. If a settlement offer is made and rejected and the judgment to be rendered is significantly less favorable to the rejecting party than was the settlement offer, the offering party recovers litigation costs from the rejecting party.

Litigation costs that may be awarded may not be greater than the sum of:

- 50 percent of the economic damages to be awarded to the claimant in the judgment;
- 100 percent of the noneconomic damages to be awarded to the claimant in the judgment; and
- 100 percent of the exemplary or additional damages to be awarded to the claimant in the judgment;

The amount of any statutory or contractual liens in connection with the occurrences or incidents giving rise to the claim is subtracted from this sum.

DIGEST: CSHB 274 would make several changes to the Texas civil justice system, including:

- allocation of litigation costs;
- early dismissal of actions;
- expedited civil actions;
- causes of action;
- appeals of controlling questions of law; and
- recovery of attorney's fees.

Allocation of litigation costs. CSHB 274 would limit litigation costs that could be recovered by a party offering a settlement. They would be limited to those litigation costs incurred by the offering party after the date the rejecting party rejected the earliest settlement offer that entitled the party to an award of litigation costs.

The bill would amend the settlement offer procedures to allow parties to make a settlement offer to settle all claims in the action between parties once the defendant had filed a declaration that settlements under this chapter were available in the action. The bill would state that parties were not required to file a settlement offer with the court.

The bill would repeal certain limits on litigation costs that could be recovered. The bill also would repeal a requirement that if litigation costs are awarded against a plaintiff that prevailed in the lawsuit that the litigation costs would be an offset against the plaintiff's recovery.

The bill would expand the definition of recoverable litigation costs to include reasonable deposition costs in settlement proceedings or in an award of litigation costs.

Recovery of attorney's fees. CSHB 274 would allow the prevailing party to recover attorney's fees in a lawsuit for a breach of an oral or written contract.

Early dismissal of actions. CSHB 274 would direct the Supreme Court of Texas to create rules for the dismissal of certain causes of action that the court determined should be disposed of as a matter of law.

The bill would allow trial courts to award attorney's fees to a prevailing party on the court's granting or denial, in whole or in part, of a motion to dismiss.

Expedited civil actions. CSHB 274 would direct the Supreme Court to adopt rules to promote the resolution of civil actions in which the amount in controversy was between $10,000 and $100,000. The rules would address the need for lowering discovery costs and for expeditious movement through the civil courts.

No implied cause of action. CSHB 274 would instruct the courts that a statute could not be construed to create a cause of action unless the statute clearly created a cause of action.

Appeal of controlling question of law. CSHB 274 would allow a trial court, on a party's motion or its own initiative, to permit an appeal from an order that was not otherwise appealable if:

- the order to be appealed involved a controlling question of law as to which there are grounds for difference of opinion; and
- an immediate appeal from the order could materially advance the ultimate termination of the litigation.

Such an appeal would not stay the proceedings unless the parties agreed to a stay or the trial or the appeals court ordered a stay pending an appeal. The appeal would be expedited if the appellate court accepted it.

Effective dates. Provisions in the bill dealing with appealing a controlling question of law, recovery of attorney's fees, and allocation of litigation

costs would take effect September 1, 2011. The provisions addressing early dismissal of actions, expedited civil actions, and implied causes of action would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, those provisions would take effect September 1, 2011.

SUPPORTERS SAY:

CSHB 274 would implement solid, fair, and necessary reforms to the Texas civil justice system to lower the cost of litigation. Since the 2003 tort reforms, Texas has made great strides in restoring balance to the courtroom between plaintiffs' access to civil lawsuits and defendants' right to not be subject to frivolous and costly lawsuits. However, time and experience have shown that further refinements are necessary to improve efficiency, lower costs, and improve access for litigants with smaller disputes. The governor, in his January state of the state speech, encouraged the Legislature to pass further civil justice reforms to strengthen the economy and ratchet up the fairness of the court system.

CSHB 274 would implement a combination of a modified loser-pays rule, an offer of settlement rule, and a procedure for early dismissal of meritless claims among other reforms. CSHB 274 would provide an ideal balance between lowering costs and improving fairness, while still protecting access to the civil-court system.

Allocation of litigation costs. The tort reforms passed in 2003 included an "offer of settlement" provision to encourage parties to settle early in order to avoid the uncertainty and costs of protracted litigation. That provision awarded attorney's costs if an offer was made and rejected and the ultimate judgment was significantly less favorable to the rejecting party.

The bill would level the playing field between plaintiffs and defendants by repealing certain limits on the recovery of costs. Under current law, if a plaintiff wins a case after rejecting a settlement offer and the ruling is substantially greater than the settlement offered, the plaintiff may collect the award and the costs of litigation. However, if a defendant wins the suit after the defendant's settlement offer was rejected, the defendant cannot collect litigation costs because current law requires that those costs be awarded as an offset against the plaintiff's recovery from that defendant. In other words, if the defendant owes the plaintiff nothing, there is nothing to offset with litigation costs. The bill would remove this inequity.

The bill also would include the cost of depositions as recoverable litigation costs. Current law under ch. 42 allows for the recovery of costs for the deposition of two experts, which is insufficient. Allowing the recovery of costs for all deposition expenses would be an important addition because depositions often are one of the largest costs of litigation.

Recovery of attorney's fees. CSHB 274 would help prevent frivolous lawsuits by allowing courts to award attorney's fees to the prevailing party if the claim was for breach of an oral or written contract. Only parties that knew they had a meritorious claim would bring them, and parties looking to extract a settlement out of defendants would be deterred from bringing meritless claims. This provision would do a great deal to improve business confidence in Texas and encourage investment.

Early dismissal of actions. CSHB 274 would instruct the Supreme Court of Texas to create rules for motions to dismiss frivolous lawsuits. The court would be free to adopt rules that fit best with Texas jurisprudence. The court would not have to adopt the federal standard.

The bill would allow trial courts to award attorney's fees to a prevailing party on the court's granting or denial, in whole or in part, of a motion to dismiss. This provision would help deter groundless lawsuits and inappropriate motions to dismiss.

CSHB 274 would not change the forms of pleadings in Texas. The bill would not require the Supreme Court to make a change in specificity of pleadings. If the court thought changes in pleadings were necessary because of the rule change, the court would make any necessary changes. The court would take its normal approach to changes in the rules and would implement them only after careful study and deliberation.

Expedited civil actions. The bill would improve access to civil courts by providing for expedited procedure and limited discovery for lawsuits with claims between $10,000 and $100,000.

While different levels of discovery already exist, the Level 1 discovery rule for smaller claims is not used often enough and is available only for claims below $50,000. Further, it contains no way to expedite the process. If the actions will take just as long to be resolved, they can easily cost just as much as standard actions.

No implied cause of action. CSHB 274 would add a new rule of statutory construction to require that if a statute intended a cause of action, it would have to be clear and unambiguous on its face that it did so. Causes of action should not be created by the courts by implication, but only when the intention to create such causes of action is expressly stated by the Legislature in the statute itself. This would provide courts and litigants clear guidance on causes of action, allowing for consistent application across the state.

Courts should not have to guess about the meaning of statutes. The bill would require the Legislature to clearly draft new causes of action in a statute when it intended to create one. Many statutes prohibit certain types of conduct, but the Legislature did not necessarily intend to create a private cause of action in each case. CSHB 274 simply would implement a rule of statutory construction common is most U.S. jurisdictions.

Appeal of controlling question of law. CSHB 274 would allow appellate courts, with permission of the trial court, to address and answer controlling questions of law in appropriate cases without the need for the parties to incur the expense of a full trial.

The bill would not cause a flood of new appeals. The bill provides for a two-tiered system of gate keeping to prevent inappropriate appeals. First, the trial court would have to agree to allow the appeal. Second, an appellate court would have to agree to accept it.

OPPONENTS SAY:

The premise of CSHB 274 that the courts are clogged with frivolous lawsuits is false. Plaintiff's attorneys work on commission. They have a strong incentive to take only cases they feel have merit in order to maximize their chances of winning the case and receiving their commission.

Current law already contains sufficient checks on frivolous lawsuits. These sanctions are found in the Texas Rules of Civil Procedure, rule 13 and the Texas Civil Practice and Remedies Code, secs. 9 and 10.

The changes CSHB 274 would make are not necessary. A 2005 *Baylor Law Review* article conducted a study of Texas trial court judges. The survey, which had a 78 percent response rate, found 86 percent of these judges said there was no need for additional tort law changes.

Allocation of litigation costs. CSHB 274 would remove important limits on the amount of attorney's fees that could be awarded. Limits in current law on the amount of attorney's fees that can be awarded to defendants allow poor and middle class plaintiff's to file lawsuits. Current law states that if a plaintiff wins a lawsuit but the defendant is awarded attorney's fees, the fees are to be an offset to the plaintiff's recovery. CSHB 274 would remove this important plaintiff protection and could allow the perverse result of a plaintiff owing a defendant when the defendant's attorney's fees are larger than the plaintiff's recovery. Removing these protections would unfairly limit access to the civil court system.

The bill also would allow for deposition costs to be recovered as part of recovered litigation costs. The bill is unclear as to whether this includes transcriptionist's fees, expert fees, or even travel costs.

Recovery of attorney's fees. The bill would implement a "loser pays" rule in contract cases in order to discourage lawsuits. Only parties with deep pockets or the judgment-proof poor would be able to file because they would be the only groups that could afford to risk paying both sides' attorney's fees if they did not prevail in a case.

Early dismissal of actions. The Supreme Court already is able to implement rules for an early dismissal of baseless actions. It is not at all clear that they are needed. If they were, the court likely already would have acted to create them. If the Legislature feels something must be done, it would be better to instruct the court to conduct a study to identify a problem, if one exists, and to suggest appropriate solutions.

CSHB 274 would fundamentally and inappropriately alter the way civil trials are conducted. If a motion to dismiss for failure to state a claim was created in Texas, it would move away from the general pleading system currently in use. Federal law contains such a motion and, as a result requires that pleadings be very specific in order to survive such a motion. This is only possible after extensive discovery. The bill would not take this into account. The bill's failure to address the consequences of the proposed change reinforces the need for a study before specific legislation is adopted.

Expedited civil actions. This change is unnecessary because the trial courts are not backed up. The Office of Court Administration, in a 2010 report on judicial case load, found that there was a 16 percent decrease in

the amount of new injury filings between 1991 and 2010. This occurred while the population of the state rose by 35 percent.

This change also is unnecessary because the Supreme Court of Texas already is able to adopt different rules for different types of civil actions. The Texas Rules of Civil Procedure already allow for different levels of cases, which limit the amount of discovery and dictate other terms in order to help expedite the resolution of different types of cases.

No implied cause of action. This change could result in massive reworkings of the court system and the common law. Under the common law system, courts may use statutes and prior case holdings to resolve current cases. An example is a plaintiff's attorney using existing laws against drunk driving to establish a basic duty – not to drive while intoxicated. The plaintiff's attorney could use this duty as the basis of a negligence claim against the defendant. However, the drunk driving statutes do not explicitly say they contain a cause of action. The uncertainty this change might bring about could lead to endless rulings by appellate courts on what does and does not constitute a cause of action. It would not clarify anything; indeed it would stir up calm jurisprudential waters.

Appeal of controlling question of law. These appeals could clog the appellate court system. Under the bill, every time a defendant lost a motion to dismiss a case, it could be appealed to the appellate courts.

NOTES:

CSHB 274 originally was set on the Major State Calendar for May 5 and was recommitted to committee after a point of order against the bill was sustained. The Judiciary and Civil Jurisprudence Committee reported the bill again on May 5.

INVESTED IN TEXAS

SIFMA is the voice of the nation's securities industry, advocating for effective and efficient capital markets. Together, we are Invested in America.

28,758 Financial Advisors
73,092 Securities Industry Employees
591,172 Finance & Insurance Industry Employees

TOP PUBLIC COMPANIES (MARKET CAP IN BILLIONS)

Company	Market Cap
EXXON MOBIL CORP	$295.2
AT&T INC	$285.5
TEXAS INSTRUMENTS INC	$119.9
CONOCOPHILLIPS	$71.4
SCHLUMBERGER LTD	$55.7

INDUSTRY IMPACT

205 Broker Dealer Main Offices

2,460 SEC- and State- Registered Investment Advisory Firms

2.20 Earnings Multiplier*

1.84 Employment Multiplier*

*These multipliers are used to calculate the contribution of the securities industry to the total employment and earnings numbers in the state.

BOND AND EQUITY ISSUANCE (MILLIONS)

MUNICIPAL	44,186.7 M/1504 ISSUES
Top Municipal Issuers (Millions)	
Texas PAB Surface Trans Corp	$1,856.7
Austin City-Texas	$1,392.9
Houston City-Texas	$1,370.6
San Antonio City-Texas	$1,305.1
Dallas & Fort Worth Cities-Texas	$1,167.1

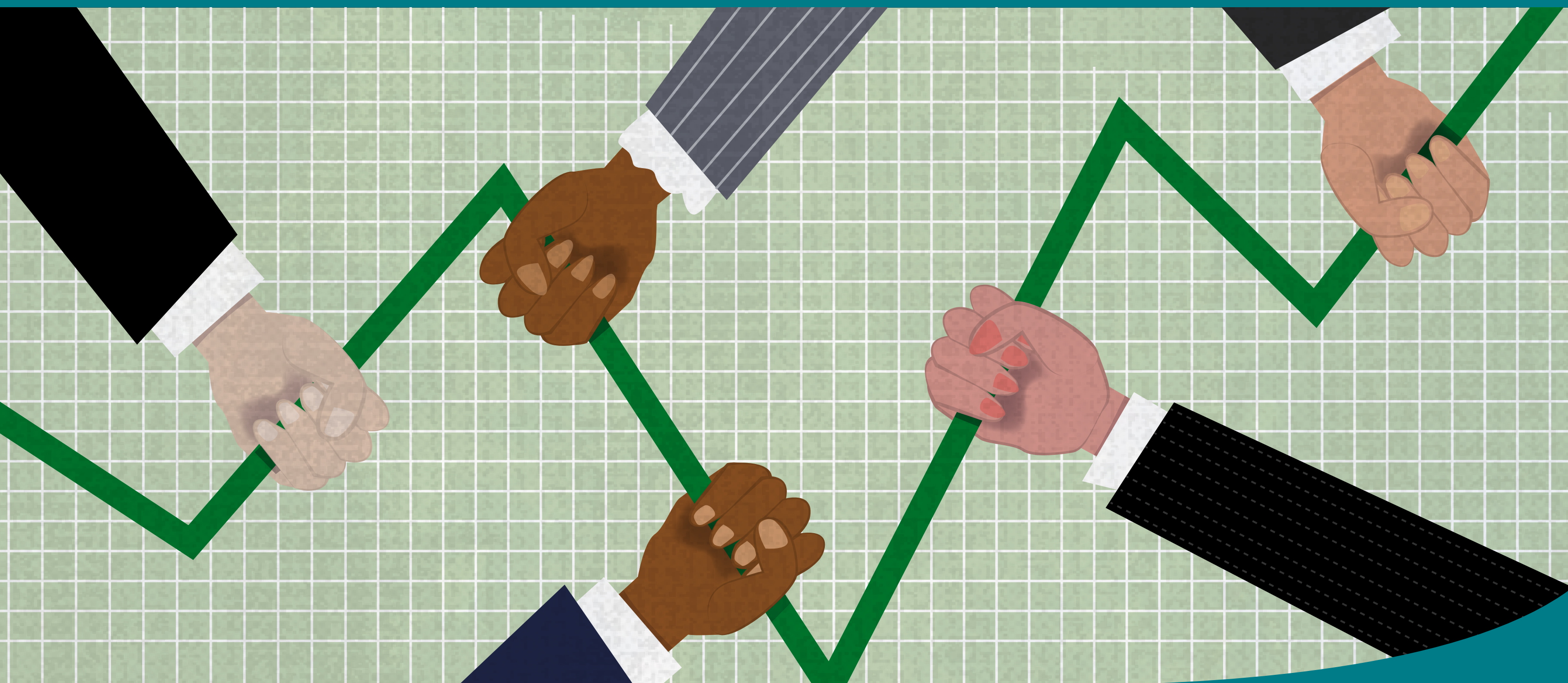
CORPORATE	102,818.0 M/90 ISSUES
Top Corporate Issuers (Millions)	
Occidental Petroleum Corp	$12,223.6
Exxon Mobil Corp	$7,000.0
AT&T Inc	$6,156.1
Tenet Healthcare Corp	$5,700.0
Vistra Operations Co LLC	$5,699.6

EQUITY	15,645.0 M/41 ISSUES
Top Equity Issuers (Millions)	
Occidental Petroleum Corp	$12,223.6
Exxon Mobil Corp	$7,000.0
AT&T Inc	$6,156.1
Tenet Healthcare Corp	$5,700.0
Vistra Operations Co LLC	$5,699.6

Sources: Bloomberg (2018), Bureau of Economic Analysis (2018)
Discovery Data (2018), FINRA (2018), Refinitiv (2018), SEC (2018)

www.states.sifma.org

ILR BRIEFLY



An Update on Securities Litigation

"New data confirms that the securities litigation crisis is continuing. Case filings remain at record highs for the third consecutive year. And we are seeing new evidence of the real-world adverse consequences for investors ..."

U.S. CHAMBER
Institute for Legal Reform

Broken Securities Class Action System Continues Out of Control†

The securities litigation system is in crisis. Two previous ILR reports[1] explain in detail the serious problems and how they can be addressed—in particular:

M&A Litigation

There is an increasing onslaught of cases challenging virtually every merger and acquisition deal valued at more than $100 million involving a public company. After a crackdown on abusive claims by the Delaware Court of Chancery, these cases migrated to federal court, where they are routinely settled with no benefits to investors and substantial payments to plaintiffs' lawyers, without any judicial oversight.

Event-Driven Claims

A new wave of "event-driven claims" continues, based on a company's failure to predict adverse events in its underlying business, such as a data breach or environmental disaster. Legal experts are skeptical about the merits of these claims, but they are powerful weapons for coercing quick settlements because of the reputational harm from ongoing litigation and the high cost of defense.

Parallel State-Federal Filings

The number of federal securities class actions filed in state court continues to grow as a result of the Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund,*[2] ruling that class actions under the federal Securities Act may be brought in state court. Among other things, this dynamic forces some companies to defend against the same claim simultaneously in actions in state and federal courts.

Policymaker Action Needed

Policymakers need to act, including the Securities and Exchange Commission (SEC) and, ultimately, Congress, to correct the serious imbalances in the securities litigation system.

New Data Confirms It: The Securities Litigation Crisis Continues

Case filings remain at record highs for the third consecutive year. And there is new evidence of the real-world adverse consequences for investors in the form of dramatic increases in rates and reduction in availability of directors and officers (D&O) insurance. That means higher costs are ultimately borne by investors. In addition, small and medium-sized companies that are not able to obtain appropriate levels of D&O insurance will have trouble attracting the high-quality directors that they need—again, harming the very investors that the securities laws are supposed to protect.

Record Filing Levels for the Third Consecutive Year

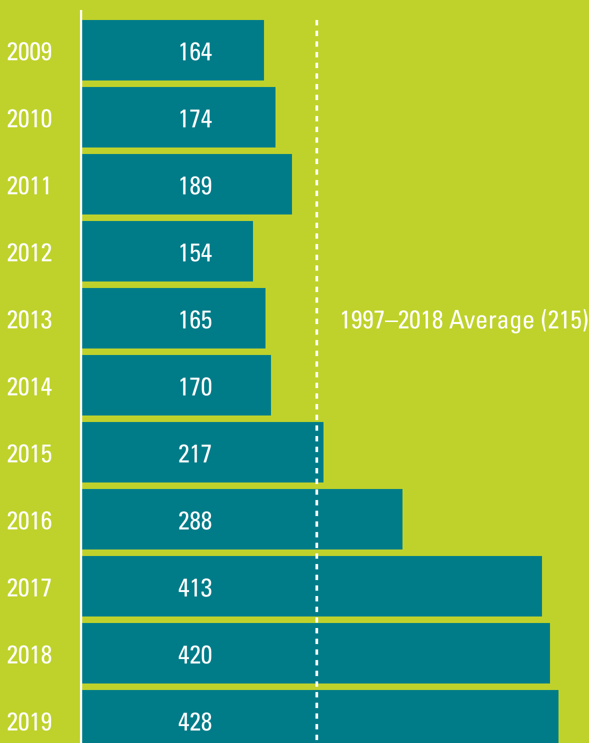
Each of the studies tracking securities litigation filings found that 2019 saw the same high level of litigation as 2017 and 2018—in the words of one analyst, "it is clear that the recent elevated levels of securities class action lawsuit filings represent the new normal."[3]

Cornerstone Research reported that "[p]laintiffs filed 428 new securities class actions across federal and state courts, the highest number on record and nearly double the 1997-2018 average."[4] "Filing activity in federal and state courts accelerated in 2019. Each of the last three years—2017 through 2019—has been more active than any previous year."[5] Other studies reported similar results—for example, NERA Economic Consulting found 433 new cases in 2019, "the third consecutive year with more than 400 cases filed."[6]

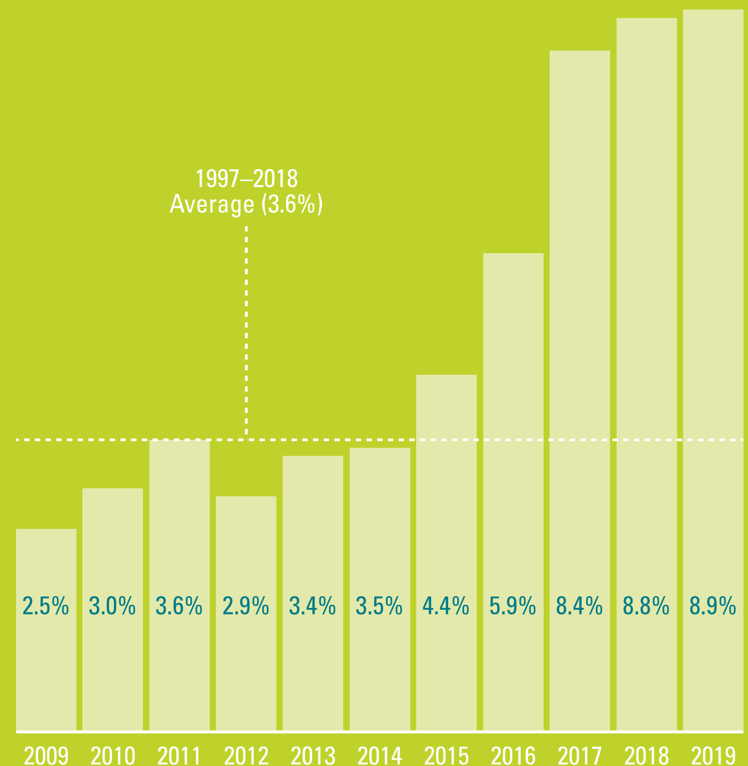
Even more important, "the likelihood of a U.S.-listed company getting hit with a securities suit is the highest it has ever been"—with one study finding "just under one out of every eleven U.S. listed companies was hit with a securities suit," a litigation rate of 8.66 percent.[7] Another study put the percentage higher at 8.9 percent—a record high and two and one-half times the 1997-2018 average.[8]

Finally, the size of the 2019 cases—although short of 2018's record—remains very large by historical standards. Analysts measure the relative size of a case by examining the dollar-value change in a defendant company's outstanding shares before and after the class period. The $285 billion calculated for 2019's cases is more than double the 1997-2018 average of $130 billion.[9]

Securities Class Action Filings 2009-2019



Likelihood of U.S. Listed Company to Face Securities Litigation 2009-2019



Dramatic Increases in State Court Filings—and Some Relief for Delaware Corporations

The consequences of the Supreme Court's *Cyan* decision are now being realized: 49 federal securities class actions were filed in state courts in 2019—more than four times the 2010-2018 average.[10] Indeed, 2019 saw more claims under the federal Securities Act filed in state court than in federal court.[11] And these state claims are large—the cases filed in 2019 involved claims three times as large as the 2010-2018 annual average.[12]

Moreover, plaintiffs' lawyers formerly focused these cases in New York and California state courts. But "[s]tate filings in states outside of New York and California almost tripled in 2019," with cases filed in Florida, Illinois, Massachusetts, Michigan, Nevada, New Jersey, Pennsylvania, Rhode Island, Tennessee, Texas, and Wisconsin.[13]

Nearly half of the state court cases—22—involved claims that also were asserted in parallel federal court cases.[14] One commentator observed that "the number of parallel state and federal lawsuits presents its own set of problems, as defense expenses are increased and as the claim management becomes complicated by duplicative and potentially conflicting case processing and claims resolution."[15]

Not surprisingly, state courts less familiar with securities class actions dismiss fewer claims—which means that plaintiffs' lawyers have a greater chance to force a settlement. The difference is significant: "[o]nly 26 percent of state Section 11 [of the federal Securities Act] filings were dismissed in 2010-2018 compared to 43 percent of Section 11-only federal filings."[16]

> *When parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court. The costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious. The possibility of inconsistent judgments and rulings on other matters, such as stays of discovery, also exists.*

Many Delaware corporations sought to protect themselves against abusive M&A litigation by including choice-of-forum provisions in their bylaws, requiring that the state-law causes of action invoked in M&A challenges be brought in Delaware state court (as opposed to federal court or other state courts). The Delaware courts upheld such provisions,[17] and they subsequently were expressly validated by an amendment to Delaware's corporate law.[18]

But the Delaware Court of Chancery held in 2018 that a Delaware corporation could not use a choice-of-forum provision in its articles of incorporation to protect itself against the consequences of *Cyan* by designating federal courts as

the forum for claims against the company under the federal Securities Act. In so doing, the court invalidated articles of incorporation provisions requiring such actions to be brought in federal court (and thereby avoiding the risk that the company would be subject to multiple claims in state and federal court, or in several state courts).[19] The Chancery Court held the provisions invalid on the ground that the "constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum when the claim does not involve rights or relationships that were established by or under Delaware's corporate law."[20]

On March 18, 2020, the Delaware Supreme Court unanimously reversed that determination, holding these forum selection provisions facially valid under Delaware law.[21] The court relied in large part on the harm inflicted on companies by multiple Securities Act lawsuits in different forums:

> When parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court. The costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious. The possibility of inconsistent judgments and rulings on other matters, such as stays of discovery, also exists. By directing 1933 Act claims to federal courts when coordination and consolidation are possible, [these forum-selection provisions] classically fit the definition of a provision 'for the management of the business and for the conduct of the affairs of the corporation.'[22]

The Delaware court further concluded that these provisions are consistent with federal law and policy and with federalism principles. It recognized that a facially-valid articles of incorporation provision "will not be enforced if adopted or used for an inequitable purpose"—such as when enforcement would be "unreasonable and unjust" or where there is "fraud or overreaching"—but that sister states otherwise should enforce these choice-of-forum provisions because they relate closely to a corporation's internal affairs and therefore "do not violate principles of horizontal sovereignty."[23]

"With the Delaware Supreme Court giving a green light to forum-selection provisions relating to federal Securities Act claims, Delaware corporations now can protect themselves against the burdens of defending such lawsuits in multiple forums."

With the Delaware Supreme Court giving a green light to forum-selection provisions relating to federal Securities Act claims, Delaware corporations now can protect themselves against the burdens of defending such lawsuits in multiple forums. Of course, that does not help companies incorporated in other states (unless those states also permit forum-selection provisions), or foreign corporations—which is why congressional action to address the *Cyan* problem remains an urgent priority.

Coronavirus Claims are the Newest Category of Event-Driven Lawsuits

It was probably inevitable that the growing number of "event-driven" securities lawsuits would include claims based on the Coronavirus pandemic—after all, plaintiffs' lawyers have already pointed to fires, a dam collapse, oil well explosions, and other disasters as the basis for securities claims.

Numerous legal experts, including Professor John Coffee of Columbia Law School, have expressed skepticism about these types of claims. As two litigators have explained, "[t]he inherent problem in all event-driven securities litigation is that just because something bad happened does not mean that the company or its directors and officers committed fraud. Because many of these events relate to business or operational risks that are known or already subject to a company's risk disclosures, many of the event-driven suits are based on the tenuous theory that the occurrence or the event upon which the case is based was the materialization of an under-disclosed or downplayed risk."[46]

Notwithstanding the legal obstacles, these claims continue to be brought—following a pattern in which the complaint is filed very quickly after the adverse business event—because they typically have a large settlement value: the costs of defense are high and few companies want to risk the reputational damage that could result from prolonging the litigation of such claims.

It therefore is not surprising that two Coronavirus securities claims have already been filed.[47] And they likely are the first in what will be a long line of virus-related securities lawsuits.

D&O Insurance Becomes More Costly—and Less Available

The securities litigation explosion has created, in the words of one expert, a "disrupted insurance market."

That means insurers "are seeking increased rates" and "many primary insurers are requiring increased retentions"—the "deductible" that a company must pay before insurance coverage is triggered.[24]

Markedly Increased Premiums

These higher costs are substantial: "insureds are seeing markedly increased premiums, in some cases double (or even higher) than previous premiums, even for those insureds whose risk profile has not changed."[25] And insurers "are increasing policy deductibles … . For example, a $2.5 million deductible for securities claims might be increased to $5 million or even higher. For companies going through the IPO process, deductibles may set at $10 million or higher."[26] Insurers are also lowering the amount of coverage offered, and "the current hardening market may mean that certain insurers simply decide not to renew their policies, or underwrite new ones, leading to a more limited pool of insurers for an insured to access."[27]

Little Relief in Sight

Another analyst expects "continuation of the high D&O insurance premium costs for public company issuers suffered in 2019. Given the limited underwriting capacity available in the D&O market today—after all, these levels of losses aren't exactly making the D&O insurance market attractive to carriers—there is a very low probability that companies will see any relief in their premium costs in the near future, and, certainly not in 2020."[28] Moreover, "rates for large-cap companies are increasing less than those of small-cap companies despite the significant losses being paid in the large-cap sector."[29]

Direct Impact on Investors

These higher costs directly impact investors—reducing companies' profits and, to the extent coverage is not available, exposing companies and their directors to personal liability. Because the burden is greatest for smaller companies, qualified individuals will be reluctant to serve on those companies' boards, which deprives investors of the experienced guidance that those companies need.

End of the *State Street* Saga—Plaintiffs' Lawyer Fees Cut, Conduct Referred to Bar Disciplinary Body

Prior ILR research explained how the *State Street* case made visible the abusive practices by some plaintiffs' law firms that frequently file securities class actions.[30]

A special master appointed by the federal district court to investigate alleged misstatements in the $75 million fee request (based on a $300 million settlement) found "a troubling disdain for candor and transparency that at times crossed the line into outright concealment of important material facts" as well as "a web of concealment and highly questionable ethical practices by experienced attorneys who should have known better."[31]

The district court rejected a proposed settlement that had been entered into between some of the law firms and the special master, reduced the attorneys' fee award by 20 percent, found that the plaintiffs' lawyers' submissions in support of the fee request "were replete with material false and misleading statements," and referred its findings of misconduct "to the Massachusetts Board of Bar Overseers for whatever action, if any, it deems appropriate."[32] The court's opinion contains disturbing findings regarding the actions of several of the law firms representing the plaintiff class.

Violated Ethical Rules

The court highlighted the discovery of a payment of $4.1 million to Damon Chargois, "a Texas lawyer who had done no work on these cases."[33] The court found that "in 2007, [one of the law firms] had asked Chargois to find institutional investors in the Southwest that could hire [the firm] as monitoring counsel and to influence them to do so"[34]—the term "monitoring counsel" refers to an arrangement under which a law firm monitors the institutional investor's investments and "recommend[s] that [the investor] initiate certain class actions and retain [the law firm] as lead counsel if [the investor] succeeded in being appointed lead plaintiff."[35]

As the district court explained, "[s]erving as monitoring counsel for an institutional investor is potentially very lucrative. The opportunity for monitoring counsel to profit greatly creates a risk that firms will engage in questionable conduct to obtain such assignments. … [I]t would be far more consistent with the purposes of [federal law] if such monitors, who could provide the service to many funds that would share the cost, were paid on a fee-for-service basis and did not have powerful financial incentives to recommend initiating a class action from which they would foreseeably benefit the most."[36]

The court found that "[n]either Chargois, nor his partner in Arkansas, Herron, had any relationship with any institutional investor. No institutional investor had ever asked either of them for advice generally or to find monitoring counsel particularly. However, Herron knew Steve Faris, an Arkansas State Senator on the Joint Committee on Public Retirement and Social Security Programs, which was responsible for oversight of [the Arkansas Teachers Retirement Fund (ATRS)]. Chargois arranged for [the law firm's] partners … to meet Faris."[37] Faris arranged for the law firm to be retained by the Fund, and Chargois wrote to the law firm:

> Our deal with [the law firm] is straightforward—we got you ATRS as a client (after considerable favors, political activity, money spent and time dedicated in Arkansas) and [the law firm] would use ATRS to seek lead counsel

> appointments in institutional investor fraud and misrepresentation cases. Where [the law firm] is successful in getting appointed lead counsel and obtains a settlement or judgment award, we split [the law firm's] attorney fee award 80/20. Period.[38]

This arrangement was not disclosed to ATRS, the plaintiff class, or to the court. The court found that the law firm "violated the Massachusetts ethical rules … in concealing its agreement to pay Chargois 20% of its fees in all ATRS cases in which [the other law firm] was Lead Counsel."[39]

Although neither the special master nor the court investigated the "favors" and "political activity" referred to by Chargois, they seem to involve what Professor John Coffee has called the "'rather sordid market of buying and selling plaintiffs'" in securities class actions through the use of political contributions, among other means.[40]

The court's opinion documents another example of political relationships being used to facilitate legal representations in class actions. One of the lawyers

> confirmed that he had served in the Massachusetts Legislature with [Thomas J.] O'Brien, the Plymouth County Treasurer who chaired the Plymouth County Retirement Board, and he was instrumental in obtaining the Board as a client for [two law firms]. [The lawyer] also confirmed that it was indeed his role to 'drum up business' for [the two firms]. More specifically, he testified that it was his job to get [a law firm] retained as a monitor for a fund and to represent it if the fund became a lead plaintiff in a class action. [His law firm] would then get up to 20% of the fees awarded to [that law firm] in a class action in which [it] represented a client obtained by [the lawyer who served in the legislature], even if [his law firm] did not file an appearance or do any work on the case.[41]

"[T]his case demonstrates that not all lawyers can be trusted when they are seeking millions of dollars in attorneys' fees and face no real risk that the usual adversary process will expose misrepresentations that they make."

In addition, lawyers from both firms made campaign contributions to O'Brien.[42]

Material False and Misleading Statements

The district court also described in detail the facts underlying its determination that "the submissions of [two of the plaintiffs' law firms] in support of the request for an award of $75,000,000 were replete with material false and misleading statements,"[43] some of which "led to the double-counting error that inflated their total [fee request] lodestar by over $4,000,000."[44]

The court concluded: "The United States has a proud history of honorable, trustworthy lawyers. However, this case demonstrates that not all lawyers can be trusted when they are seeking millions of dollars in attorneys' fees and face no real risk that the usual adversary process will expose misrepresentations that they make. Therefore, in making fee awards in class actions, it is important that judges be skeptical, and do the hard work necessary to protect the interests of the class and the integrity of the administration of justice."[45]

The district court's detailed explanation of the improper practices in *State Street* demonstrates the need for additional protections to prevent class members from being victimized by the attorneys designated to represent them.

Conclusion

Securities filings in 2019 continued the trends demonstrating that the system is out of control and in need of reform—and that investors are paying the price. Policymakers, particularly Congress and the SEC, should take action now.

Endnotes

† *ILR, Briefly: An Update on Securities Litigation* was prepared by Andrew J. Pincus, Mayer Brown LLP.

1 Andrew J. Pincus, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System*, U.S. Chamber Inst. For Legal Reform (Feb. 2019) ("Containing the Contagion"), https://www.instituteforlegalreform.com/uploads/sites-/1/Securites-Class-Action-System-Reform-Proposals.pdf; Andrew J. Pincus, *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy*, U.S. Chamber Inst. for Legal Reform (Oct. 2018), https://www.instituteforlegalreform.com/uploads/sites/1/A_Rising_Threat_Research_Paper-web_1.pdf.

2 *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

3 Kevin LaCroix, *Federal Court Securities Suit Filings Remain at Elevated Levels*, D&O Diary (Jan. 1, 2020), https://www.dandodiary.com/2020/01/articles/securities-litigation/federal-court-securities-suit-filings-remain-at-elevated-levels/.

4 Cornerstone Research, *Securities Class Action Filings – 2019 Year in Review* 5 (2020), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review.

5 *Id* at *3*.

6 NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2019 Full-Year Review* 2 (2020), https://www.nera.com/content/dam/nera/publications/2020/PUB_Year_End_Trends_012120_Final.pdf.

7 Kevin LaCroix, *Federal Court Filings*, *supra*.

8 Cornerstone Research, *supra*, at 11.

9 *Id*. at 7.

10 *Id*. at 4.

11 *Id*.

12 *Id*. at 20.

13 *Id*. at 19.

14 *Id*. at 4.

15 Kevin LaCroix, *Federal Court Filings*, *supra*.

16 Cornerstone Research, *supra*, at 26.

17 *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

18 *See* 8 Del. Code § 115.

19 *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

20 *Id*, at *3.

21 *Salzberg v. Sciabacucchi*, No. 346, 2019, 2020 WL 1280785 (Del. March 18, 2020).

22 *Id*. at *5.

23 *Id*. at *21, *23.

24 Kevin LaCroix, *Federal Court Filings*, *supra*.

25 Carl E. Metzger & Brian H. Mukherjee, *Challenging Times: The Hardening D&O Insurance Market*, Harvard Law School Forum on Corporate Governance (Jan. 29, 2020), https://corpgov.law.harvard.edu/2020/01/29/-challenging-times-the-hardening-do-insurance-market/.

26 *Id*.

27 *Id*.

28 Woodruff Sawyer, *D&O Databox: 2019 Year-End Summary* 10 (2020), https://woodruffsawyer.com/wp-content/uploads/2020/02/Databox-Year-End-Report-2019.pdf.

29 Jeff Hirsch, *D&O Insurance Pricing Trends*, D&O Diary (Feb. 13, 2020), https://www.dandodiary.com/2020/02/-articles/d-o-insurance/guest-post-do-insurance-pricing-trends/; *see also id*. ("[t]he 2019 take-home message is that premiums are up"; "D&O Rates Will Keep Climbing").

30 *Containing the Contagion*, *supra*, at 15.

31 *Id*.

32 *Arkansas Teacher Retirement System v. State Street Bank and Trust Co.*, No. 11-10230-MLW, 2020 WL 949885, at *6, *11 (D. Mass. Feb. 27, 2020).

33 *Id*. at *21.

34 *Id*.

35 *Id*. at *8.

36 *Id*. at *19 n.10.

37 *Id*. at *21-22.

38 *Id*. at *8 (alterations and emphasis omitted).

39 *Id*. at *40.

40 Matthew Goldstein, *Law Firm's Fee Settlement Could Shake Up Securities Class Actions*, N.Y. Times (Oct. 10, 2018), https://www.nytimes. com/2018/10/10/business/class-action-lawfirm-fees.html.

41 *Arkansas Teacher Retirement System*, 2020 WL 949885, at *18.

42 *Id*. at *19.

43 *Id*. at *6.

44 *Id*. at *7.

45 *Id*. at *11.

46 Jeffery A. Dailey & Neal Ross Marder, *The Rise in Event-Driven Securities Litigation: Why It Matters to Directors and Officers*, Willis Towers Watson (Nov. 12, 2018), https://www.willistowerswatson.com/en-US/insights/2018/11/ finex-observer-rise-in-event-driven-securitieslitigation.

47 Kevin LaCroix, *Pharma Company Hit with Securities Suit over COVID-19 Vaccine Claims*, D&O Diary (Mar. 15, 2020), https://www.dandodiary.com/2020/03/articles/securities-litigation/pharma-company-hit-with-securities-suit-over-covid-19-vaccine-claims/#more-19784; Kevin LaCroix, *Cruise Line Shareholder Files First Coronavirus-Related Securities Suit*, D&O Diary (Mar. 13, 2020), https://www.dandodiary.com/2020/03/articles/securities-litigation/cruise-line-shareholder-files-first-coronavirus-related-securities-suit/#more-19766.

U.S. CHAMBER
Institute for Legal Reform

202.463.5724 main
202.463.5302 fax

1615 H Street, NW
Washington, DC 20062

instituteforlegalreform.com

U.S. CHAMBER
Institute for Legal Reform

Containing the Contagion

Proposals to Reform the Broken Securities Class Action System

FEBRUARY 2019

U.S. CHAMBER
Institute for Legal Reform

An Affiliate of the U.S. Chamber of Commerce

© U.S. Chamber Institute for Legal Reform, February 2019. All rights reserved.

This publication, or part thereof, may not be reproduced in any form without the written permission of the U.S. Chamber Institute for Legal Reform. Forward requests for permission to reprint to: Reprint Permission Office, U.S. Chamber Institute for Legal Reform, 1615 H Street, N.W., Washington, D.C. 20062-2000 (202.463.5724).

Table of Contents

Executive Summary 1

The Litigation Explosion Continues 4

No Let-Up in Merger & Acquisition Claims 6

Event-Driven Claims Continue to Grow 9

The *Cyan* Effect 12

Abusive Conduct by Plaintiffs' Lawyers 14

Proposals for Reform 16

Conclusion 20

Prepared for the U.S. Chamber Institute for Legal Reform by

Andrew J. Pincus, Mayer Brown LLP

Executive Summary

The Institute for Legal Reform's October 2018 report, "A Rising Threat: The New Class Action Racket That Harms Investors and the Economy,"[1] explained in detail the serious problems plaguing the securities class action system:

- The number of cases has exploded, reaching levels not seen since before the enactment of the Private Securities Litigation Reform Act (PSLRA) in 1995.

- Federal courts have been hit by an avalanche of cases alleging misstatements in connection with a public company's merger or acquisition—virtually every deal valued at over $100 million is hit by a lawsuit. These cases formerly were brought in state courts under state law, but they moved *en masse* to federal court after the Delaware Court of Chancery and other state courts cracked down on abusive settlements that provide no benefits to investors and substantial payments to plaintiffs' lawyers. Those illegitimate settlements have resumed now that the cases are brought in federal court.

- A second wave of securities class actions rests on a different theory. These claims are triggered by adverse events in a company's underlying business, such as a product liability lawsuit, data breach, environmental disaster, or other similar negative occurrence. They assert that the company defrauded investors by failing to warn that the adverse event might occur, even though these events are—by definition—unexpected. (Harm from the underlying event is addressed through other types of lawsuits, not securities claims.) Legal experts are skeptical about the merits of these securities claims, but they are powerful weapons for coercing settlements because of the costs of defense and the reputational harm from ongoing litigation focused on such adverse events.

- Data confirm that these new waves of lawsuits are characterized by unjustified, abusive claims. Federal securities cases are being dismissed at a greater rate, and those cases not dismissed are settled, most for an amount less than or equal to the cost of defending the lawsuit. But the costs of litigation are significant and ultimately are borne by investors. And the principal beneficiaries are lawyers—both plaintiffs' and defense lawyers—who reap large fees. That is particularly true of merger and acquisition lawsuits, where lawyers get two-thirds of the payments.

> *Indeed, the number of filings in 2018 set a new record and public companies are more likely than ever before to be sued in a securities class action.*

- Congress enacted securities class action reform in 1995—the Private Securities Litigation Reform Act (PSLRA)—in large part because it found these cases were plagued by abusive practices and were principally driven by lawyers rather than investors. The very same abuses are recurring today. Plaintiffs' lawyers are again relying on "professional plaintiffs" to bring multiple cases. And in a number of instances the pension funds that are serving as plaintiffs have relationships with the lawyers they hire—often in the form of campaign contributions from lawyers to public officials. Despite the strong congressional intent to cure the problem of lawyer-controlled litigation, the 1995 reforms have not been fully successful—and the evidence shows that lawyer control is marked by higher fees and lower settlement payments to investors.

New information regarding these cases provides further confirmation of the urgency of the problem and the need for reform.

To begin with, data regarding 2018 securities class action filings show that the unprecedented rate of filings continued unabated. Indeed, the number of filings in 2018 set a new record, and public companies are more likely than ever before to be sued in a securities class action. Importantly, 2018's cases are larger than before and therefore threaten much higher litigation and settlement costs than cases filed in prior years—nearly three times larger than the average for 1997 to 2017.

Merger and acquisition cases continue to be filed in federal court at a breathtaking rate. But the federal courts—in contrast to the Delaware Chancery Court—have not yet identified effective tools for deterring the filing of unjustified claims leading to "settlements" that reward the plaintiffs' lawyers with fees but provide only meaningless disclosures to investors, who of course pay the bills for the plaintiffs' and defense lawyers and for wasted management time.

Event-driven claims—the second growth category of securities cases—also continue to be filed, notwithstanding skepticism about the legitimacy of a large number of these lawsuits. Again, courts do not appear to have recognized the differences between these suits and traditional securities fraud claims or to have developed tools for quickly weeding out unjustified claims.

Another new category of securities class action has emerged, resulting from the Supreme Court's holding in the *Cyan* case that class actions under the federal Securities Act—including claims under Section 11 of that Act, which is the principal basis for alleging misrepresentations or omissions in connection with initial public offerings—may be brought in state court. The first study quantifying the effect of that decision found a significant number of state court cases filed in 2018, which means that many companies will face securities class action claims in both state and federal court arising out of the same alleged misstatement or omission. That in turn increases the leverage of plaintiffs' lawyers to force settlements regardless of the merits, because of the increased cost of defending in two courts and the risk that state court judges unfamiliar with these complex cases will deny meritorious motions to dismiss.

Also in 2018 is evidence of continuing, significant abusive practices by some plaintiffs' lawyers in connection with these cases. In particular, the resurgence of actions brought only by individuals means that lawyers are able to assert the very control over these cases that the PSLRA was designed to prevent.

Action is urgently needed to stop the harm to investors and our capital markets resulting from our out-of-control securities litigation system. Multiple parts of our federal government—the Securities and Exchange Commission, the federal courts, and Congress—can and should take steps to correct today's serious imbalances, steps that are described in detail below.

“The first study quantifying the effect of that decision found a significant number of state court cases filed in 2018, which means that many companies will face securities class action claims in both state and federal court arising out of the same alleged misstatement or omission.”

The Litigation Explosion Continues

At the time, 2017 was a record year for securities class action filings. That trend continued in 2018—making clear that 2017's 50 percent increase in filings was not a one-off event but rather the new normal for securities class actions.

Several analysts issued reports on these filings. The numbers differ depending on the study, but the key points are clear.

Another Record Number of Filings

NERA Economic Consulting reported 441 new cases—"the highest [filing rate] since passage of" the Private Securities Litigation Reform Act in 1995 and "a near doubling of filings since 2015."[2]

Cornerstone reported 403 federal filings and an additional 17 new cases filed in state court asserting federal securities law claims.[3] The 420 total exceeds Cornerstone's combined state and federal total for 2017. That means, as one experienced observer put it, that "2018 arguably represents the most significant year of securities litigation filing activity since the end of the dot-com era."[4]

2018 is the second year in a row in which federal class action securities filings doubled the average annual filings over the prior 20 years.[5]

Public Companies are More Likely to be Sued Than Ever Before

"[A] record 8.4 percent of U.S. exchange-listed companies were subject to filings in 2018, slightly above the rate in 2017," Cornerstone found.[6] 2018 marks the sixth consecutive year in which the likelihood of securities litigation has increased.[7]

"That means, as one experienced observer put it, that '2018 arguably represents the most significant year of securities litigation filing activity since the end of the dot-com era.'"

The D&O Diary reached the same conclusion, finding a "litigation rate of 8.7%, which is not only higher than the rate in 2017 but is in fact the highest rate since at least 1996. In other words, the chances of a U.S.-listed company getting hit with a securities suit arguably were higher in 2018 than [they have] ever been."[8]

2018 Cases are Larger Than Ever

Estimating the size of securities class actions is difficult, but analysts have developed several measures for assessing cases' relative size. One is the dollar-value change in a defendant company's outstanding shares before and after the class period—and it reached a record $330 billion in 2018.[9] That is more than 2.5 times greater than the amount for 2017 and nearly triple the 1997 to 2017 average of $115 billion.[10]

In sum, there can be no doubt that, as Columbia Law School Professor John Coffee, Jr. recently put it, "[s]ecurities litigation is growing at a prodigious rate."[11]

The primary drivers behind this explosion continue to be two fundamental changes in the nature of federal securities lawsuits: M&A claims and event-driven litigation. Additionally, there is a new "*Cyan* Effect" at issue after the Supreme Court's 2018 ruling. These factors are described in the following sections.

No Let-Up in Merger & Acquisition Claims

While rare just a few years ago, suits challenging public company mergers and acquisitions (M&A) comprised approximately half of 2018's filings.[12] This was the case in 2017 as well. These M&A cases, which allege that disclosures to shareholders relating to the transaction were false and deceptive, largely migrated to federal court after some state courts—notably Delaware's Court of Chancery—cracked down on such cases.[13]

It is not clear whether federal courts can or will arrive at a similarly effective response. Professor Coffee recently explained the problem:

> The Delaware Chancery Court is a concentrated group of sophisticated judges who collectively bore the impact of a multitude of merger objection cases. Ultimately, they realized their time was being wasted—and they responded collectively. In contrast, federal judges are dispersed, and each federal district judge sees only a few such cases. Moreover, with all respect to federal judges, they can be characterized as "Lone Rangers" who do not typically act collectively. Hence, a joint response is less likely.[14]

And even if federal judges are willing, there are a number of significant obstacles.

"Plaintiffs may be able to choose where to file based on the court's willingness to process abusive M&A settlements."

First, generous venue rules may allow an M&A claim against a particular company to be brought in any of a number of different federal courts. Plaintiffs may be able to choose where to file based on the court's willingness to process abusive M&A settlements. Indeed, the adoption by the U.S. Court of Appeals for the Seventh Circuit of a tough standard similar to Delaware's Court of Chancery led to a more than 60 percent reduction in the proportion of merger objections filed in that Circuit.[15]

Second, plaintiffs seek to avoid any federal court oversight by using the tactic of an out-of-court settlement—in which the defendant agrees to insignificant additional disclosures, the plaintiffs' lawyers are paid a "mootness fee," and the case is dismissed. There is no clear answer to the question of whether courts may intervene to stop, or at least oversee the legitimacy of that practice.

One federal court stated that it "will exercise its inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—and require plaintiffs' counsel to demonstrate that the disclosures for which they claim credit" are "plainly material."[16] That is so, the court explained, because "disclosure suits like this are generally 'no better than a racket' that 'should be dismissed out of hand,'" absent a demonstration that the disclosures are "'plainly material.'"[17] It emphasized that "courts should not permit plaintiffs' counsel to file cases purely to exact attorneys' fees from corporate defendants under any circumstances."[18]

But another court found that it lacked the power to intervene.[19]

"...[P]laintiffs seek to avoid any federal court oversight by using the tactic of an out-of-court settlement—in which the defendant agrees to insignificant additional disclosures, the plaintiffs' lawyers are paid a 'mootness fee,' and the case is dismissed."

Professor Coffee suggests that federal courts use the tools set forth in the PSLRA, which include mandatory evaluation of dismissed cases to determine whether the claim was frivolous and standards for attorneys' fees.[20] It is not clear, however, whether courts will take those steps—and plaintiffs' lawyers might begin to bring M&A suits as individual cases rather than class actions in order to avoid that risk.

> *The fact is that the plaintiffs' lawyers are continuing to file federal court merger objection lawsuits.*

Another source of relief could be the U.S. Supreme Court, which will hear argument in mid-April 2019 in *Emulex Corp. v. Varjabedian*,[21] a case involving a claim under Section 14 of the Securities Exchange Act, which is the provision of federal law invoked in M&A cases. The question before the Court is whether the U.S. Court of Appeals for the Ninth Circuit was correct in holding that a negligent misstatement or omission is sufficient to establish liability, or whether the higher "scienter" standard—which requires intentional wrongdoing or a high degree of recklessness—is required. Adopting the tougher standard, and rejecting the Ninth Circuit's rule, will at least prevent the expansion of M&A lawsuits, but it is not likely to reduce them.

And in any event, plaintiffs' lawyers almost certainly would adapt by invoking other sections of the federal securities laws to justify their lawsuits.

The bottom line: M&A claims continue to plague the federal courts in record numbers.

> [F]ederal court merger objection lawsuits continued to be filed at significant levels, apparently unabated. To be sure, the way these suits are being resolved now may have changed (with plaintiffs' attorneys now agreeing to dismiss the suits in exchange for the defendants' agreement to pay a mootness fee), but that is a different issue. The fact is that the plaintiffs' lawyers are continuing to file federal court merger objection lawsuits.[22]

Unfortunately, there is no reason to believe this phenomenon will change without a focused effort to address the problem.

Event-Driven Claims Continue to Grow

The second dramatic change in securities lawsuits has been the growth in event-driven claims.

As Professor Coffee explains:

> Once, securities class actions were largely about financial disclosures (e.g., earnings, revenues, liabilities, etc.). In this world, the biggest disaster was an accounting restatement. Now, the biggest disaster may be a literal disaster: an airplane crash, a major fire, or a medical calamity that is attributed to your product… The expectation of major losses from the disaster sends the issuer's stock price down, which in turn triggers securities litigation that essentially alleges that the issuer failed to disclose its potential vulnerability to such a disaster.[23]

Event-driven litigation differs fundamentally from traditional securities cases, as "traditional securities litigation is not filed in the immediate wake of a stock drop; rather, plaintiff's counsel spends months interviewing potential witnesses and gathering evidence in order to be able to plead an intent to defraud with the degree of particularity that the Private Securities Litigation Reform Act (PSLRA) demands."[24]

But "[a] different pattern prevails…in the case of event-driven securities litigation, which regularly follows in the immediate wake of a stock drop"—and that may be because "some plaintiff's counsel are less concerned about surviving a motion to dismiss because they expect an early (and cheap) settlement."[25] As another experienced observer of securities class actions commented with respect to event-driven claims, "[f]irst comes the event, then comes the lawsuit."[26]

"[T]he inherent problem in all event-driven securities litigation is that just because something bad happened does not mean that the company or its directors and officers committed fraud."

The legitimacy of these lawsuits remains suspect. As two experienced securities litigators have explained:

> The inherent problem in all event-driven securities litigation is that just because something bad happened does not mean that the company or its directors

> and officers committed fraud. Because many of these events relate to business or operational risks that are known or already subject to a company's risk disclosures, many of the event-driven suits are based on the tenuous theory that the occurrence or the event upon which the case is based was the materialization of an under-disclosed or downplayed risk.[27]

It has been pointed out that "[w]hen the risk seemed remote at the time the corporate issuer made its disclosures, both the materiality of the issuer's omission and its alleged scienter"—key elements of the federal securities claim—"would seem open to serious challenge."[28] But obtaining dismissal on materiality grounds can be difficult under current precedent: "although many cases should and will be dismissed, this category of cases may remain viable because the potential damages are often very high."[29]

It is not surprising, therefore, that even in the past several months, new event-driven claims have continued to be filed—and have continued to meet the pattern of "file first, investigate later."

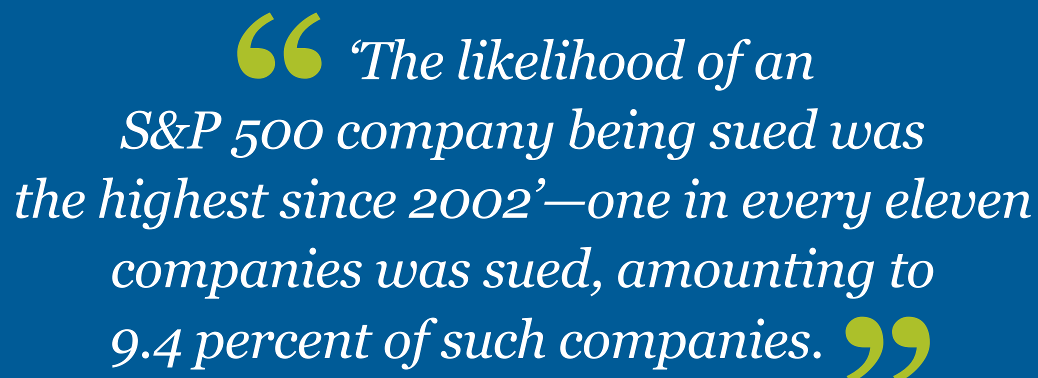
For example, on November 30, 2018, Marriott issued a press release informing customers of a breach of its guest reservation system.[30] The very next day, plaintiffs' lawyers filed a securities class action in the Eastern District of New York,[31] alleging that Marriott and its executives made false and misleading statements and failed to disclose the database's security issues.[32] The complaint devoted one paragraph to alleging that Marriott and its executives acted with scienter.[33] As *The D&O Diary*'s Kevin LaCroix put it, "the scienter allegations in the new Marriott lawsuit are not extensive (to say the least)."[34]

Another case followed a tragic plane crash, which killed everyone on board.[35] The crash marked the Boeing 737 Max 8's first accident.[36] The following month, a shareholder sued Boeing in a securities class action.[37] The complaint relied on press reports that the company withheld information about its new flight-control system from airlines or pilots.[38] But citing the information contained in those reports, of course, is "a different thing from saying the information was withheld from investors in violation of the federal securities laws."[39] According to Kevin LaCroix, "[t]he allegations of scienter in the complaint are not, shall we say, extensive."[40]

After wildfires in California, a utilities company shareholder filed a securities class action.[41] The complaint alleged that the company made false and misleading statements regarding its policies, which heightened the risk of wildfires in California.[42] But the complaint devoted little space to establishing how the defendants acted with scienter, especially in view of the defendants' prior disclosures stating that "wildfires…can disrupt the generation and transmission of electricity, and can seriously damage the infrastructure necessary to deliver power," which can lead to "lost revenues and increased expenses," "regulatory penalties and disallowances," and "damage [to] the business reputation" of the defendants.[43] The case was filed "[j]ust eight days after the fire started and while the embers were still smoldering."[44]

Other event-driven securities cases involve the collapse of a dam in Brazil,[45] alleged price-fixing of a company's products,[46] and alleged sexual misconduct by an executive[47]—among other claims.

These cases are only examples of what has become a significant trend. Fueled by event-driven claims, non-M&A securities suits are increasing over past levels. For example, one study of 2018 cases found that—after ignoring the M&A cases that constitute 50 percent of the total—"[t]he likelihood of an S&P 500 company being sued was the highest since 2002"—one in every eleven companies was sued, amounting to 9.4 percent of such companies.[48]



The *Cyan* Effect

The Supreme Court altered securities class action practices with its March 2018 ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund*.[49] That decision held that class actions under the federal Securities Act—including claims under Section 11 of that Act, which is the principal basis for alleging misrepresentations or omissions in connection with initial public offerings—may be brought in state court.

Prior to 2015, only a few such claims were filed. But since then, the numbers have grown with 33 cases filed in 2018.[50] Seventeen of those cases did not have parallel actions in federal court, but in the others there were parallel actions in federal court involving the same or very similar allegations.[51]

> *"The advent of a parallel track of securities class action litigation in state court creates a number of significant problems…"*

The advent of a parallel track of securities class action litigation in state court creates a number of significant problems, as securities litigation veteran Kevin LaCroix has explained:

- "[i]t increases the likelihood that a company defendant might have to fight a multi-front war, in the event of parallel state court and federal court lawsuits";[52]
- "state court securities class action lawsuits are less likely than federal court lawsuits to be dismissed"[53] —48 percent of federal court Section 11 claims are dismissed, compared to 33 percent of state court claims;[54] and
- "IPO companies now face a measurably more significant risk of getting hit with a securities lawsuit than may have been the case before *Cyan*."[55]

> *“Plaintiffs’ lawyers will be able to exploit these dual forums to pressure defendants to settle regardless of the merits of the cases...”*

Plaintiffs’ lawyers will be able to exploit these dual forums to pressure defendants to settle regardless of the merits of the cases—and to litigate complex claims before state court judges with little or no experience in applying the federal securities laws.

When Congress enacted the Securities Litigation Uniform Standards Act in 1998,[56] it recognized the adverse consequences of fragmenting claims regarding alleged misrepresentations or omissions by public companies. The Supreme Court held in *Cyan* that the text of the Act did not divest state courts of their pre-existing jurisdiction over 1933 Act claims, even if that result would serve Congress’s purpose. The initial data indicate that the precise harms Congress sought to prevent are likely to result from the *Cyan* decision.

Abusive Conduct by Plaintiffs' Lawyers

Recent developments also highlight the need to curb the plaintiffs' bar's ongoing abusive litigation practices.

Professional Plaintiffs

First, individual plaintiffs—rather than institutional investors—are increasingly being appointed as lead plaintiffs. That is exactly the opposite of Congress's goal in enacting the 1995 reforms, which sought to put institutional investors in control of these cases in order to check the power of the plaintiffs' bar.

Those reforms worked for the first 15 years following enactment of the PSLRA: although individuals initially were appointed lead plaintiff more often than institutional investors, by 2004, institutional investors were as likely or more likely to serve as lead plaintiffs—and that continued through 2010.[57] But starting in 2013, individuals more frequently served as lead plaintiffs—and they were named as the sole lead plaintiffs in 60 percent of the cases filed in 2017 and 2018.[58]

This change is strong additional evidence that claims brought in recent years are less meritorious than in the past. Institutional investors simply are not willing to endorse them. Plaintiffs' lawyers therefore are forced to turn to their pet "professional plaintiffs," which results in the very lawyer-driven litigation that the PSLRA sought to eliminate.

Frequent Filers

Second, one study found that three plaintiffs' law firms appear as counsel of record on more than half of the initially-filed complaints in non-M&A cases.[59] These firms' activity has coincided with an increase in the appointment of individuals, rather than institutional investors, as lead plaintiffs.[60] And the three firms' cases were dismissed at a rate of a staggering 51 percent, compared to the already-high 43 percent for all other firms.[61]

The concentration of so much litigation activity in a few firms—especially activity that has characteristics consistent with unjustified

> *"But starting in 2013, individuals more frequently served as lead plaintiffs—and they were named as the sole lead plaintiffs in 60 percent of the cases filed in 2017 and 2018."*

claims—raises serious questions. That is especially true because these firms' cases involve small damages exposure,[62] which means that the settlement that companies can be pressured to pay will likely be less than the costs of defending the lawsuit through trial. In that situation, what rational company would decide not to settle?

Excessive Fees

Third, the continuing saga of the *State Street Bank* case provides a window into abusive practices by plaintiffs' firms. (The case arises under a different federal statute, but the law firms involved frequently file securities class actions.)

The parties to the case, which involved alleged unfair and deceptive practices in conducting complex foreign exchange transactions, reached a $300 million settlement.[63] Plaintiffs' counsel were awarded more than $74 million in attorneys' fees, on top of another $1.25 million for expenses.[64]

Questions arose regarding some of the attorneys' fee requests, and the district court appointed a Special Master to investigate. After a 14-month investigation and a painstaking review of hundreds of thousands of pages of documents, the Special Master found that the fee award was undermined by serious mistakes that were only "compounded by a troubling disdain for candor and transparency that at times crossed the line into outright concealment of important material facts, including the payment of an enormous amount of money from class funds to a lawyer who never appeared in the case, did no work on the case, and whose identity was intentionally hidden from the clients, the class, co-counsel and the Court."[65] He determined that the plaintiffs' "lawyering… became tainted and entangled in a web of concealment and highly questionable ethical practices by experienced attorneys who should have known better."[66]

These questionable practices included payment to a lawyer in Texas of an undisclosed "finder's fee," amounting to a full "20 percent of the attorneys' fee it received in the litigation."[67] Professor John Coffee observed that the Special Master's report "shed an important light on the 'rather sordid market of buying and selling plaintiffs' in securities class actions"—an arrangement perceived as both "'under the table and dubious.'"[68]

Although the plaintiffs' firm initially objected to the Special Master's findings, it subsequently "acknowledge[d] that its conduct in [the] case did not meet emerging best practices of transparency, candor, and reliability."[69] The firm offered its "sincere acceptance of responsibility and expression of regret," and it agreed to undertake a multitude of remedial actions.[70] It "discontinued," for instance, "its practice of allowing another firm to pay for the costs of [its] staff attorneys working at [its] office, and of allowing its staff attorneys to be included on another Firm's lodestar petition"—which resulted in a fee award for the staff attorneys' work far in excess of their cost to the firm.[71] And the firm agreed to return $4.8 million in attorneys' fees to the class and to other law firms.[72]

This case study—in which a fee petition was subject to close review that virtually never occurs in securities litigation—provides a strong indication that there may be serious problems lurking beneath the surface in other cases.

Proposals for Reform

The securities class action system is plainly broken, harming investors and our capital markets. Reforms are urgently needed—and multiple parts of the federal government have important roles to play in remedying this serious problem.

The Securities and Exchange Commission

The Securities and Exchange Commission is responsible for protecting our nation's capital markets and enforcing the federal securities laws. It has the ability to collect relevant information and identify threats to the capital markets and investors. And it can promote appropriate solutions to eliminate those threats.

The Commission should therefore undertake a project to evaluate the current state of private securities class action litigation, with a focus on identifying abuses that are harming investors and suggesting practical ways to address those abuses. For example, M&A lawsuits are nothing less than a transaction tax diverting resources away from productive uses and into the pockets of lawyers.

The Commission should issue a policy paper describing the problem and then institute a program of amicus brief filings to inform federal courts of the pervasiveness of the M&A lawsuit problem and its adverse consequences, and urging them to intervene early to prevent the use of these cases to extort unjustified attorneys' fees. It could suggest that courts assert authority to review any out-of-court resolutions of these cases and order a Rule 11 proceeding to assess whether the complaint was sanctionable, particularly when—as is often the case—the same plaintiff has filed multiple M&A claims.

> *"The Commission should therefore undertake a project to evaluate the current state of private securities class action litigation, with a focus on identifying abuses that are harming investors and suggesting practical ways to address those abuses."*

> *Congress therefore should plug the loophole identified by the Supreme Court in* Cyan *and require all federal securities class actions to be brought in federal court.*

Another area appropriate for the Commission's attention is event-driven litigation. Numerous securities law experts have explained how difficult it can be for a plaintiff to plausibly allege the materiality, scienter, and loss causation elements of a federal securities claim. The Commission could issue a policy paper addressing those issues and use that analysis as the basis for submitting amicus briefs in appropriate cases to assist courts in analyzing these issues.

Federal Courts

Federal courts should take account of the successful approach adopted by the Delaware Chancery Court to address the M&A litigation avalanche. That means recognizing that the cases before them are not isolated one-off filings but instead part of a significant trend, and using available tools to detect and sanction abusive filings in order to deter future filings that will add to the flow of unjustified lawsuits.

Congress

Congress should enact targeted statutory changes that will eliminate the well-documented abuses of securities class actions.

OVERTURN *CYAN*

First, Congress should overturn the *Cyan* decision to ensure that federal securities class actions are heard in federal court. Allowing plaintiffs' lawyers to bring federal securities class actions in state and federal courts opens the door to multiple types of abuse. Companies can be forced to defend in two courts at the same time, multiplying litigation costs and creating added pressure to settle regardless of the merits. And state court judges are much less experienced in handling complex securities litigation. Congress therefore should plug the loophole identified by the Supreme Court in *Cyan* and require all federal securities class actions to be brought in federal court.

CENTRALIZE M&A LAWSUITS

Second, if courts are not unable to deter abusive M&A claims, Congress should take action. Hopefully, federal courts will be able to use existing tools to deter unjustified M&A lawsuits. But if they cannot, Congress should act to centralize these claims so that they will be filed in a limited number of federal courts that will be able to establish standards to deter the abusive claims that are now flooding the courts. Congress could accomplish this goal by requiring M&A lawsuits to be brought in the state of incorporation of the company whose disclosures are challenged in the lawsuit.

ENACT INVESTORS' BILL OF RIGHTS

Third, Congress should prohibit abusive practices used by plaintiffs' lawyers to exercise the very control over these lawsuits that the PSLRA sought to eliminate. Congress in 1995 recognized that the fundamental problem underlying the broken securities class action system was that cases were controlled by plaintiffs' lawyers rather than by investors. But the lead plaintiff system that Congress enacted has not solved the problem. Once again, the same "professional plaintiffs" are used by plaintiffs' lawyers to file dozens of lawsuits. Once again, financial connections between plaintiffs' lawyers and their clients enable the lawyers to control the litigation. Once again, fees for plaintiffs' lawyers do not bear a reasonable relationship to the benefit conferred on investors.

Congress should therefore enact a bill of rights for securities investors that gives courts the information they need to stop these abuses once and for all. It should:

- Require disclosure of all relationships between plaintiffs' lawyers and plaintiffs—personal, professional, economic (including campaign contributions), and otherwise (including any referral arrangements entered into with other lawyers with such relationships with the plaintiffs). And Congress should direct courts to assess these relationships in determining whether the case may continue.

- Presumptively bar any individual or entity from serving as a plaintiff in more than five cases in 36 months, requiring a reviewing court to find a compelling justification before allowing an additional case to proceed.

- Require federal courts to more closely scrutinize fee requests. This could include requiring the appointment of an independent monitor in all cases, or at least all cases involving fee requests over a specified threshold. Alternatively, Congress could specify a set of presumptive ceilings on fee awards, requiring the court to make findings that a case is unusual to exceed those ceilings. Finally, courts assessing fee applications should be required to take account of the extent to which the alleged fraud, and the factual contentions relied on by the plaintiff, were uncovered first by government investigators, journalists, or others and simply incorporated into the complaint by the plaintiffs' lawyers. Compensation should be reduced when the key information was not the product of the lawyers' work.

ELIMINATE ABUSIVE LITIGATION TACTICS

Congress should also eliminate abusive litigation tactics, especially those that circumvent protections enacted by Congress in 1995. Over the past 20 years, the plaintiffs' bar has been able to blunt the effect of several key reforms enacted in the PSLRA. Congress should amend the statute to prohibit these unjustified "work-arounds":

- The PSLRA assumed that securities fraud claims would be resolved in class actions, and its reforms therefore apply to that category of lawsuits. In response, some plaintiffs' lawyers have adopted the practice of urging large investors (individuals and entities such as funds) to file individual actions, either in federal court or in state court.

> *Congress should investigate the real-world economic consequences of these cases and adopt an appropriate cap on damages, taking account of any profits by culpable insiders.*

Those separate cases multiply the defendants' litigation costs and can be used to coerce the defendant into paying exorbitant settlements to avoid an adverse judgment in an individual case that could be used against the defendant in the class action. In some cases, these settlements can deplete available resources and leave investors in the class action (which will always include small investors) with only a limited chance of recovery. Congress should require that any such claims be stayed until after the class action is resolved.

- The district court's decision on the motion to dismiss is the critical event in securities class actions: if the motion to dismiss is denied, class certification and settlement virtually always follow—as the data demonstrate. Because this ruling is so critical, Congress should provide for interlocutory appeals of denials of motions to dismiss—either as of right or based on a discretionary standard, such as the one governing appeals of class certification decisions under Federal Rule of Civil Procedure 23(f).
- The PSLRA's pleading standard and its stay of discovery pending resolution of the motion to dismiss were two of its most critical reforms to prevent abusive tactics. Court interpretations have weakened both protections, and Congress should restore the Act's original meaning.

ADOPT A DAMAGES CAP

Congress should also consider adopting a cap on damages for non-IPO cases, with small investors given priority to collect damages. Numerous commentators have recognized that securities class actions cannot be justified on the theory that they effectively compensate injured investors. As the Institute for Legal Reform's October 2018 study explained,[73] these cases simply shift money from one group of innocent investors (the company's current shareholders) to another (the plaintiff class), with huge transaction costs paid to lawyers.

For that reason, scholars such as John Coffee have advocated a cap on this "pocket-shifting" exercise[74] that makes investors systemically worse off. Congress should investigate the real-world economic consequences of these cases and adopt an appropriate cap on damages, taking account of any profits by culpable insiders. Small investors should have priority in the distribution of such recoveries.

Conclusion

Recent data confirm what has been clear for some time: the securities class action system badly needs reform. Cases are at record high levels; the likelihood that a public company will be sued has never been greater; the system is plagued by M&A claims that exhibit every characteristic of classic litigation abuse; and event-driven claims are increasingly used to coerce unjustified settlements. Much of this illegitimate litigation is the product of abusive practices by plaintiffs' lawyers—precisely what led Congress to reform securities class actions 24 years ago.

Multiple parts of the federal government have important roles to play in reforming this broken system. The Securities and Exchange Commission, with its core responsibility of protecting the capital markets and investors, should analyze the current class action system, issue policy papers identifying abusive practices and ways to remedy them, and inform courts—through the filing of amicus briefs—of appropriate ways to curtail litigation abuse.

The federal courts should recognize that there has been a change in the nature of securities class actions, which warrants a judicial response that will curtail the systemic abuse now underway. And Congress should enact targeted reforms that will prohibit the abusive practices in use today and give courts the tools they need to stop unjustified lawsuits.

Endnotes

1 Andrew J. Pincus, *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy,* U.S. Chamber Inst. for Legal Reform (Oct. 2018), https://www.institutefor-legalreform.com/uploads/sites/1/A_Rising_Threat_Research_Paper-web_1.pdf.

2 Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, NERA Econ. Consulting, at 2 (Jan. 29, 2019), http://www.nera.com/content/dam/nera//2019/_Year_End_Trends_012819_Final.pdf. The one exception was 2001, in which there was a one-off jump in the filing of unique IPO-related cases. *Id.*

3 Cornerstone Research, *Securities Class Action Filings: 2018 Year in Review*, at 5, 19 (Jan. 2018), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review (drawing from Stanford Law School Securities Class Action Clearinghouse data).

4 Kevin LaCroix, *Cornerstone Research: Combined Federal and State Securities Suit Filings at Highest-Ever Levels in 2018* (Jan. 30, 2019), https://www.dandodiary.com/2019/01/articles/securities-litigation/cornerstone-research-combined-federal-state-securities-suit-filings-highest-ever-levels-2018/#more-17591.

5 *Securities Class Action Filings: 2018 Year in Review*, *supra* note 3, at 5.

6 *Id.* at 11.

7 *Id.*

8 Kevin LaCroix, *Securities Suit Filings Continued at Heightened Pace in 2018* (Jan. 6, 2019), https://www.dandodiary.com/2019/01/articles/securities-litigation/securities-suit-filings-continued-heightened-pace-2018/.

9 *Securities Class Action Filings: 2018 Year in Review, supra* note 3, at 7.

10 *Id.*

11 John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions* (Jan. 22, 2019), http://clsbluesky.law.columbia.edu/2019/01/22/the-changing-character-of-securities-litigation-in-2019-why-its-time-to-draw-some-distinctions/.

12 *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, *supra* note 2, at 5.

13 *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy, supra* note 1, at 7-12.

14 *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, *supra* note 11.

15 *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, *supra* note 2, at 5.

16 *House v. Akorn, Inc.*, No. 1:17-cv-05018, 2018 WL 4579781, at *3 (N.D. Ill. Sept. 25, 2018), *appeal docketed*, No. 18-3307 (7th Cir., Oct. 26, 2018).

17 *Id.* (quoting *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 724 (7th Cir. 2016).

18 *Id.*

19 *See Rosenfeld v. Time Inc.*, No. 17-cv-9886, 2018 WL 4177938 (S.D.N.Y. Aug. 30, 2018).

20 *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, *supra* note 11 (citing 15 U.S.C. § 78u-4(a)(6)).

21 No. 18-459.

22 *Securities Suit Filings Continued at Heightened Pace in 2018, supra* note 8.

23 *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, *supra* note 11.

24 *Id.*

25 *Id.*

26 Kevin LaCroix, *First, Wildfires. Then What? Securities Litigation, Of Course* (Nov. 18, 2018),

https://www.dandodiary.com/2018/11/articles/securities-litigation/first-wildfires-securities-litigation-course/.

27 Jeffery A. Dailey & Neal Ross Marder, *The Rise in Event-Driven Securities Litigation: Why It Matters to Directors and Officers*, Willis Towers Watson (Nov. 12, 2018), https://www.willis-towerswatson.com/en-US/insights/2018/11/finex-observer-rise-in-event-driven-securities-litigation.

28 *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, *supra* note 11.

29 *Id.*

30 Marriott Int'l, *Marriott Announces Starwood Guest Reservation Database Security Incident* (Nov. 30, 2018), http://news.marriott.com/2018/11/marriott-announces-starwood-guest-reservation-database-security-incident/.

31 Compl., *McGrath v. Marriott Int'l Inc.*, No. 1:18-cv-06845 (Dkt. No. 1) (E.D.N.Y. Dec. 1, 2018).

32 Id. ¶ 23.

33 See id. ¶ 40.

34 Kevin LaCroix, *Marriott Hit with Data Breach-Related Securities Lawsuit* (Dec. 3, 2018), https://www.dandodiary.com/2018/12/articles/securities-litigation/marriott-hit-data-breach-related-securities-lawsuit/.

35 Harry Suhartono et al., *Boeing Plane Goes Down With 189 People in 737 Max's First Crash*, Bloomberg (Oct. 28, 2018), https://www.bloomberg.com/news/articles/2018-10-29/indonesia-says-lion-air-jet-lost-contact-on-way-to-pangkalpinang.

36 *Id.*

37 Compl., *Ostroff v. Boeing Co.*, No 1:18-cv-07853 (Dkt. No. 1) (N.D. Ill. Nov. 28, 2018).

38 Kevin LaCroix, *First the Plane Crash, Then the Securities Lawsuit* (Nov. 29, 2018), https://www.dandodiary.com/2018/11/articles/securities-litigation/first-plane-crash-securities-lawsuit/.

39 *Id.*

40 *Id.*

41 Compl., *Barnes v. Edison Int'l*, No. 2:18-cv-09690 (Dkt. No. 1) (C.D. Cal. Nov. 16, 2018).

42 *Id.* ¶ 4.

43 *Id.* ¶ 29.

44 *First, Wildfires. Then What? Securities Litigation, Of Course*, *supra* note 27.

45 Kevin LaCroix, *Latest Brazilian Dam Disaster Leads to Event-Driven Securities Suit* (Jan. 29, 2019), https://www.dandodiary.com/2019/01/articles/securities-litigation/latest-brazilian-dam-disaster-leads-event-driven-securities-suit/.

46 Kevin LaCroix, *Securities Lawsuit Filing Follows Generic Drug Price Fixing Allegations* (Oct. 31, 2018), https://www.dandodiary.com/2018/10/articles/securities-litigation/securities-lawsuit-filing-follows-generic-drug-price-fixing-allegations/.

47 Kevin LaCroix, *Securities Lawsuit Filed Based on Reports of Alleged Inappropriate Office Relationship* (Dec. 13, 2018), https://www.dandodiary.com/2018/12/articles/securities-litigation/securities-lawsuit-filed-based-reports-alleged-inappropriate-office-relationship/.

48 *Securities Class Action Filings: 2018 Year in Review, supra* note 3, at 7.

49 138 S. Ct. 1061 (2018).

50 *Securities Class Action Filings: 2018 Year in Review, supra* note 3, at 19.

51 *Cornerstone Research: Combined Federal and State Securities Suit Filings at Highest-Ever Levels in 2018, supra* note 4.

52 *Id.*

53 *Id.*

54 *Securities Class Action Filings: 2018 Year in Review, supra* note 3, at 23.

55 *Cornerstone Research: Combined Federal and State Securities Suit Filings at Highest-Ever Levels in 2018, supra* note 4.

56 Pub. L. 105-353, 112 Stat. 3227.

57 *Securities Class Action Filings: 2018 Year in Review, supra* note 3, at 18.

58 *Id.*

59 *Id*. at 36.

60 *Id*.

61 *Id.* at 37

62 *Securities Class Action Filings: 2018 Year in Review*, *supra* note 3, at 36.

63 Special Master's R. & R. at 6, *Ark. Teacher Ret. Sys. v. State Street Bank & Tr. Co.*, No. 1:11-cv-10230 (Dkt. No. 357) (D. Mass. June 28, 2018).

64 *Id.*

65 *Id.* at 7.

66 *Id.* at 7-8.

67 Matthew Goldstein, *Law Firm's Fee Settlement Could Shake Up Securities Class Actions*, N.Y. Times (Oct. 10, 2018), https://www.nytimes.com/2018/10/10/business/class-action-law-firm-fees.html.

68 *Id.*

69 Special Master's Suppl. at 5, *Ark. Teacher Ret. Sys. v. State Street Bank & Tr. Co.*, No. 1:11-cv-10230 (Dkt. No. 485) (D. Mass. Oct. 10, 2018).

70 *Id.* at 11.

71 *Id.* at 4.

72 Debra Cassens Weiss, *Labaton Sucharow Agrees to Return $4.8M in Attorney Fees After Attorney Finder Fee Is Revealed*, ABA J. (Oct. 11, 2018), http://www.abajournal.com/news/labaton_sucharow_agrees_to_return_4.8m_in_attorney_fees_after_attorney_find.

73 *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy, supra* note 1, at 17-18.

74 *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534 (2006). A recent piece in the Harvard Law Review advocated eliminating private lawsuits and enhancing the Securities and Exchange Commission's enforcement role. *See Congress, the Supreme Court, and the Rise of Securities-Fraud Class Actions*, 132 Harv. L. Rev. 1067 (2019).

U.S. CHAMBER
Institute for Legal Reform

202.463.5724 main
202.463.5302 fax

1615 H Street, NW
Washington, DC 20062

instituteforlegalreform.com

H.R. REP. 104-50(I), H.R. REP. 104-50, H.R. Rep. No. 50(I), 104TH Cong., 1ST Sess. 1995, 1995 WL 78795 (Leg.Hist.)
***1** COMMON SENSE LEGAL REFORMS ACT OF 1995

HOUSE REPORT NO. 104-50(I)

February 24, 1995

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

REPORT

together with

MINORITY AND ADDITIONAL DISSENTING VIEWS

[To accompany H.R. 10]

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

	Page
The Amendment	2
Purpose and Summary	14
Background and Need for the Legislation	14
Subcommittee Hearings	20
Committee Consideration	21
Roll Call Votes	22
Committee Oversight Findings	34
Committee on Government Oversight and Reform	34
Committee Cost Estimate	34
Congressional Budget Office Estimate	34
Inflationary Impact Statement	36

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Section-by-Section Analysis.......... 36
Agency Views.......... 42
Changes In Existing Laws Made By the Bill.......... 46
Minority Views.......... 57
Additional Dissenting Views.......... 68

The amendment is as follows:

***2** 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:

TITLE II-REFORM OF PRIVATE SECURITIES LITIGATION

Sec. 201. Short title; table of contents.

Sec. 202. Prevention of lawyer-driven litigation.

(a) Plaintiff steering committees to ensure client control of lawsuits

"Sec. 36. Class action steering committee.

"(a) Class action steering committee.

"(b) Membership of plaintiff steering committee.

"(c) Functions of plaintiff steering committee.

"(d) Immunity from civil liability; removal.

"(e) Effect on other law."

(b) Prohibition on attorneys' fees paid from Commission disgorgement funds.

Sec. 203. Prevention of abusive practices that foment

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

litigation.

(a) Additional provisions applicable to private actions.

"Sec. 20B. Procedures applicable to private actions.

"(a) Elimination of bonus payments to named
plaintiffs in class actions.

"(b) Restrictions on professional plaintiffs.

"(c) Awards of fees and expenses.

"(d) Prevention of abusive conflicts of interest.

"(e) Disclosure of settlement terms to class members.

"(f) Encouragement of finality in settlement discharges.

"(g) Contribution from non-parties in interest of
fairness.

"(h) Defendant's right to written interrogatories
establishing scienter."

(b) Prohibition of referral fees that foment litigation.

Sec. 204. Prevention of "fishing expedition" lawsuits.

"Sec. 10A. Requirements for securities fraud actions.

"(a) Scienter.

"(b) Requirement for explicit pleading of scienter.

"(c) Dismissal for failure to meet pleading
requirements; stay of discovery; summary
judgment.

"(d) Reliance and causation.

"(e) Allocation of liability.

"(f) Damages."

Sec. 205. Establishment of "safe harbor" for predictive
Statements.

"Sec. 37. Application of safe harbor for
forward-looking Statements.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(a) Safe harbor defined.

"(b) Automatic protective order staying discovery;

expedited procedure.

"(c) Regulatory authority.

Sec. 206. Rule of construction.

Sec. 207. Effective date.

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:

***3** "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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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 ***4** 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:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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 ***5** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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 ***6** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***7** 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 ***8** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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:

***9** "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 ***10** 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-

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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 ***11** 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.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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 ***12** (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)).

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(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.".

***13** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"(3) provide that projections that are in compliance with such guidance and that concern the future economic performance of an issuer of securities registered ***14** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***15** 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:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

> 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 announcement-amount ***16** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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:

> ***17** 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]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

***18** 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 attorneys ***19** fees.[13] And an analysis by Professor Janet Cooper Alexander of Stanford

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 because ***20** 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]

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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. ***21** 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.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***22** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

***34** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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:

***35** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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).

***36** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***37** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***38** 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)).

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***39** 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."

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***40** 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.

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***41** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***42** Securities and Exchange Commission,
Washington, DC, February 23, 1995.

Hon. Thomas Bliley,
Chairman, Committee on Commerce, Rayburn House Office Building, Washington, DC.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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;"

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***43** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***44** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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. ***45** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***46** 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

* * * * * * *

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***47** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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;

***48** (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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.-

***49** (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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(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.

* * * * * * *

***50** REGISTRATION AND REGULATION OF BROKERS AND DEALERS

Sec. 15. (a)(1)***

* * * * * * *

(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.

* * * * * * *

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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***51** (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-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(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.

***52** (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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***53** (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.-

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(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)***

* * * * * * *

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(d)(1) Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting ***54** 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.

* * * * * * *

(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. 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.

***55** (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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***56** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

(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.

* * * * * * *

***57** 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 ***58** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

> 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 provisions ***59** 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:

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***60** 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.”

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***61** 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

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

"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]

***62** 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 successfully ***63** 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.

***64** 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 ***65** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***66** 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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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, ***67** 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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Bart Stupak.
Rick Boucher.
Ron Wyden.
Edolphus Towns.
Bart Gordon.

***68** 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?

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

***69** 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.

***70** 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

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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 ***71** 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.

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.

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.

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.

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).

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

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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).

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.

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

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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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.

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.

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,

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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. S 504 and 28 U.S.C. S 2412). Under the EAJA, the federal government can be required to pay a private party's attorneys' 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).

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).

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

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

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.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

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

H.R. REP. 104-50(I), H.R. REP. 104-50, H.R. Rep. No. 50(I), 104TH Cong., 1ST Sess. 1995, 1995 WL 78795 (Leg.Hist.)

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

Harvard Law School Forum on Corporate Governance

Saying So Long to State Court Securities Litigation

Posted by Laurie Smilan and Nicki Locker, Wilson Sonsini Goodrich & Rosati, on Monday, February 11, 2019

Tags: Class actions, Exchange Act, Federalism, IPOs, Jurisdiction, PSLRA, SEC, Section 10(b), Securities Act, Securities litigation, Securities regulation, State law
More from: Laurie Smilan, Nicki Locker, Wilson Sonsini Goodrich & Rosati

Editor's Note: Laurie Smilan is of counsel and **Nicki Locker** is partner at Wilson Sonsini Goodrich & Rosati. This post is based on their WSGR memorandum.

When Congress enacted the Securities Exchange Act of 1934, providing for federal regulation of securities traded on the public markets, it took the opportunity to consider conforming amendments to the sister statute regulating initial public offerings it had enacted the year before, the Securities Act of 1933. One such amendment would have done away with the ’33 Act’s concurrent jurisdiction and removal bar provisions, instead providing for exclusive federal jurisdiction like the new ’34 Act did. An ABA Special Committee had advocated for the change, which was included in the original Senate bill, out of concern that concurrent jurisdiction “will inevitably result in varied interpretations of the Act.” The Special Committee warned that “in view of the [‘33 Act’s] heavy liabilities,” “the resulting uncertainty” of “varied [and inconsistent] interpretations” by state and federal courts “will almost certainly operate as a detriment to legitimate business.” Unfortunately, the amendments were not adopted and the prophecy has proved prescient.

As senior SEC officials, the Treasury Department, and stock exchange leaders have recognized, the threat of protracted and often frivolous securities class action litigation has contributed to a decades-long decline in IPOs. Rather than risk becoming the target of vexatious securities litigation, companies increasingly choose private capital transactions or strategic combinations in lieu of going public, a phenomenon that has had significant detrimental effects on both the economy in general and small investors in particular. Congress attempted to stem the tide when it adopted the Private Securities Litigation Reform Act (“PSLRA”) in 1995. However, since that time, the number of public companies has been halved and the number of IPOs has declined from 949 in 1996 to an average of less than 150 per year.

In part, this is because the PSLRA was primarily focused on claims under the ’34 Act and thus did not squarely address the “heavy liabilities” and more lenient pleading standards under the ’33 Act, a combination that makes newly public companies uniquely vulnerable to securities claims. Typical securities fraud claims under Section 10(b) of the ’34 Act require proof of intentional or extremely reckless wrongdoing and must be brought in federal court where the PSLRA imposes stringent pleading requirements and a stay of discovery until plaintiffs’ claims are sustained. In contrast, IPO-related claims under Sections 11 and 12 of the ‘33 Act impose liability for innocent or merely negligent misstatements. Moreover, because the jurisdictional amendments to the ‘33 Act were not adopted, these IPO-related claims can be filed in either federal or state courts, the latter of which often lack familiarity with the complex federal securities laws and do not always adhere to the heightened scrutiny and protective procedures required by the PSLRA.

Plaintiffs’ lawyers took full advantage of the significant discrepancy between state and federal courts in adjudicating IPO-related claims. After the PSLRA was passed, they flocked to the state courts in an attempt to avoid the new law’s reforms, filing claims under state law challenging disclosures dictated by the federal securities laws for nationally traded securities. Three years later, Congress was forced to close that loophole by effectively pre-empting state law securities class actions in the Securities Litigation Uniform Standards Act (“SLUSA”).

However, in closing that loophole, Congress left another. In 2011, a California appeals court held that while SLUSA effectively pre-empted securities claims under state law, it did not divest the state courts of concurrent jurisdiction to hear

IPO-related claims under *federal* law. With the floodgates once again opened, an increasing number of plaintiffs filed stand-alone federal IPO claims in state courts. This tactic has had its desired effect: Securities class action plaintiffs have achieved a much higher rate of success in surviving threshold motions in IPO-related federal securities class actions litigated in state courts, extracting significant settlements out of proportion to results typically achieved in federal fora.

Several newly-public companies have tried different legal approaches meant to stem the tide of state court IPO-related securities litigation. Unfortunately, two decisions in 2018 have thwarted these efforts, not on policy grounds but because of the courts' narrow construction of existing law.

First, in *Cyan v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), the U.S. Supreme Court narrowly construed SLUSA, agreeing with the California appeals court that while SLUSA's less-than-clear language prevented plaintiffs from bringing securities class actions under *state* law, it did not strip state courts of jurisdiction to entertain *federal* IPO-related claims. The *Cyan* Court also rejected the argument—made *by the government*—that SLUSA overrode the "unusual" removal bar included in the '33 Act, thereby also closing that avenue to the federal courts for IPO-related claims.

Second, just last month in the *StitchFix/Roku* case, the Delaware Chancery Court struck down forum selection charter provisions meant to ensure that IPO-related claims under the '33 Act are filed in federal courts. The Chancery Court determined that these federal forum selection provisions were not permitted because they did not seek to regulate disputes governed by Delaware law or related to the corporation's internal affairs.

The only realistic "fix" after *StitchFix/Roku* and *Cyan*, then, would appear to be an amendment to the '33 Act itself—a fix the Special Committee suggested eighty-five years ago and the Supreme Court itself alluded to in *Cyan*. There is ample reason to require all federal securities class actions to be filed in federal court and little reason not to do so.

First, as noted above, securities litigation in non-expert state courts has resulted in a flood of cases being filed in state courts, often in parallel but with results inconsistent with nearly identical federal actions. These state court IPO cases allow plaintiffs to evade the PSLRA, impose burdensome and expensive discovery before allegations are tested, and result in fewer claims being resolved at early stages of litigation and increasing settlements being extracted. This state of affairs has provided even more disincentive for companies to consider going public, perpetuating the decline in IPOs that modern lawmakers and regulators have sought to reverse.

Second, as the Supreme Court recognized in *Cyan*, there is ample indication in the legislative history that SLUSA's supporters understood its purpose was "to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal, court." Unfortunately, the Court found that SLUSA's implementing language was more narrow than that purpose and prevented only state law, but not federal law, claims challenging IPO disclosures from being brought in state court.

Third, during the '33 Act's Congressional hearings, there was a significant emphasis on the need for expertise in interpreting and applying the Securities Act. Many felt that the D.C. Circuit Court of Appeals should have exclusive jurisdiction over disputes between securities regulators and issuers because the other *federal* courts lacked sufficient expertise and understanding of the markets to be trusted to adjudicate securities claims. State courts were not even considered as an option; it was universally agreed that failed state regulation had contributed to the abuses that resulted in the crash of 1929, the very cataclysm which led to the enactment of the federal Securities Act and its entirely new federal securities regulatory regime.

Finally, just one year later, the '34 Act unequivocally provided for exclusive federal jurisdiction. Conforming amendments to the '33 Act would have done the same for IPO claims but were not adopted. Why?

In *Cyan*, the Supreme Court observed: "We do not know why Congress [in enacting SLUSA] declined [explicitly] to require … that 1933 Act class actions be brought in federal court." The same observation could be made as to why Congress provided for concurrent jurisdiction in the first place. There is nothing in the legislative history of the '33 Act demonstrating that Congress gave any thought whatsoever to whether state courts ought to be permitted to adjudicate federal securities claims. Back in 1933, not a single mention was made concerning the fora in which private litigants could bring their claims in all of the Congressional debates, hearings and reconciliation processes surrounding the Securities Act. Somehow, both the concurrent jurisdiction and the "unusual" removal bar provisions of the Securities Act appeared late in the process in

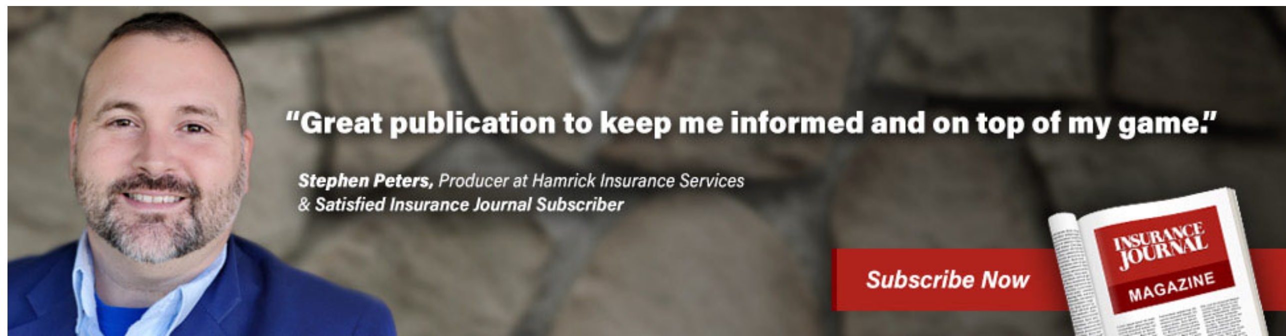
the House bill, were removed after reconciliation, and reappeared just days before the final vote—almost as if someone realized at the last minute that the jurisdictional issue had not been addressed and just put something in.

Some have speculated that the provision for state court jurisdiction was meant to address the burdens of travel for investors back in 1933. However, as far as the legislative history shows, that argument was first raised post-hoc in 1934 and even then was rejected by the Special Committee as “not valid.” That concern is certainly not valid today. Perhaps the best explanation for the differing jurisdictional provisions in the ’33 and ’34 Acts offered by legal scholars is that they are a “myster[y]” or mere “happenstance.”

Unfortunately, almost a century later, that “happenstance” is contributing to a shrinking IPO market. Given the absence of any apparent original purpose for granting concurrent jurisdiction over adjudication of IPO-related claims and Congress’ more recent intent to prevent plaintiffs from evading the protections of the PSLRA by filing suit in state courts, it is time for Congress to finally and definitively close the remaining state-court loophole for adjudication of federal securities claims. As the Supreme Court suggested in *Cyan*, “If Congress … want[s] to deprive state courts of jurisdiction over [Securities] Act class actions, it ha[s] an easy way to do so: just insert … an exclusive federal jurisdiction provision (like [that included in the Securities Exchange Act]) for such suits.” 138 S. Ct. at 1070. Eighty-five years after that very amendment was first proposed, it is time for Congress to do exactly that.

The complete publication, including footnotes, is available **here**.

Both comments and trackbacks are currently closed.



View this article online: https://www.insurancejournal.com/news/national/2019/06/18/529691.htm

D&O Insurance Costs Soar as Investors Run to Court Over IPOs

Companies going public in the United States face insurance costs that have increased as much as 200% in the last three years to cover their executives against lawsuits alleging they misled investors.

A rise in securities class-action cases involving initial public offerings is spurring IPO insurers to double and triple prices for directors and officers coverage, or "D&O" coverage, insurers and brokers told Reuters.

A $5 million policy that cost $200,000 in 2016 can now easily cost $500,000 to $600,000, said Paul Schiavone, head of North American Financial Lines for Allianz Global Corporate & Specialty, an Allianz SE unit.

"You want to be part of the market, but there are also lots of risks in IPOs," said Schiavone. "If things don't go well in a year, you have the investors saying, 'I want my money back.'"

The tightening insurance market follows a 2018 U.S. Supreme Court decision that allows some securities lawsuits to proceed in state court in addition to federal court.

"Since then, the market has gotten absolutely more challenging," said Jennifer Sharkey, President of the Northeast Management Liability Practice for insurance broker Arthur J. Gallagher & Co.

Investors who used to wait months to see how a new stock would perform now waste little time to see if promises made in offering documents come to fruition – and are swift to accuse the executives of misleading investors if they do not.

"You have a lot more aggressive lawyers and investors out there who are looking where the cash is," said Jeff Lubitz, who heads Securities Class Action Services for Institutional Shareholder Services. "And now, it looks like they will have multiple choices on how to jump on this."

The changes come amid a spate of mega-IPOs, including recent offerings by ride-sharing rivals Uber Technologies Inc and Lyft Inc. There were 205 IPOs in 2018, up 14% from 2017, according to accounting and consulting firm EY.

Many larger companies have ample funds to pay the premiums, but smaller companies that need the insurance in order to attract reputable board members may feel the strain, insurance brokers said.

There have been 25 lawsuits related to IPOs so far this year, against 19 companies. Six companies that launched IPOs face suits in both state and federal court, including Lyft, BrightView Holdings Inc, and US Xpress Enterprises .

Shareholders slapped Lyft with a lawsuit about three weeks after its stock began trading on March 28 and quickly tanked more than 20%. The suit alleges that Lyft misled investors by overstating its market share. A Lyft spokeswoman declined to comment.

As the pace quickens and litigation picks up in two court systems, insurers are on the line to pay tens of millions of dollars in defense costs and substantial settlements.

IPO-related settlements have totaled $929 million since 2017, including a $250 million settlement by Alibaba Group Holding Ltd in April, after an earlier $75 million state court settlement. Last year, LendingClub Corp settled a suit for $125 million, according to ISS.

About 25 insurers sell D&O coverage to companies going public, including American International Group Inc, Chubb Ltd, AXA XL, Beazley PLC, and Allianz SE. The insurers, collectively, can offer about $150 million coverage, according to broker Aon Plc.

Insurers are chopping coverage limits and requiring IPO clients to pick up more costs before a policy kicks in. And they are requiring companies to pay a percentage of the eventual loss, said Rachel Turk, D&O team leader for Beazley.

(Reporting by Suzanne Barlyn in New York, Editing by Neal Templin and Rosalba O'Brien)

Copyright 2020 Reuters. Click for restrictions.

More from Insurance Journal

Today's Insurance Headlines | Most Popular | National News

Automated Certificate of eService

This automated certificate of service was created by the efiling system.
The filer served this document via email generated by the efiling system on the date and to the persons listed below:

Judson Littleton
Bar No. 24065635
littletonj@sullcrom.com
Envelope ID: 48215803
Status as of 11/18/2020 2:47 PM CST

Case Contacts

Name	BarNumber	Email	TimestampSubmitted	Status
Warren W.Harris		warren.harris@bracewell.com	11/18/2020 2:09:55 PM	SENT
Mark Little		mark.little@bakerbotts.com	11/18/2020 2:09:55 PM	SENT
Thomas Phillips		tom.phillips@bakerbotts.com	11/18/2020 2:09:55 PM	SENT
Thomas E. Bilek	2313525	tbilek@bileklaw.com	11/18/2020 2:09:55 PM	SENT
Ellen Bush Sessions	796282	ellen.sessions@nortonrosefulbright.com	11/18/2020 2:09:55 PM	SENT
Noelle Marie Reed	24044211	noelle.reed@skadden.com	11/18/2020 2:09:55 PM	SENT
Mark Oakes	24062923	mark.oakes@nortonrosefulbright.com	11/18/2020 2:09:55 PM	SENT
Wallis Mizell Hampton	784199	wallis.hampton@skadden.com	11/18/2020 2:09:55 PM	SENT
Sheila Bickel		sheila.bickel@bakerbotts.com	11/18/2020 2:09:55 PM	SENT
Anthony Lucisano		anthony.lucisano@bakerbotts.com	11/18/2020 2:09:55 PM	SENT
Aaron Streett		aaron.streett@bakerbotts.com	11/18/2020 2:09:55 PM	SENT
Scott D.Musoff		scott.musoff@skadden.com	11/18/2020 2:09:55 PM	SENT
Rodney Acker		rodney.acker@nortonrosefullbright.com	11/18/2020 2:09:55 PM	SENT
Beth A.Kaswan		bkaswan@scott-scott.com	11/18/2020 2:09:55 PM	SENT
Walter ASimons		walter.simons@bracewell.com	11/18/2020 2:09:55 PM	SENT
Donald A.Broggi		dbroggi@scott-scott.com	11/18/2020 2:09:55 PM	SENT
Thomas L.Laughlin		tlaughlin@scott-scott.com	11/18/2020 2:09:55 PM	SENT
Randy L.Moonan		rmoonan@scott-scott.com	11/18/2020 2:09:55 PM	SENT
David R.Scott		david.scott@scott-scott.com	11/18/2020 2:09:55 PM	SENT
Amanda Lawrence		alawrence@scott-scott.com	11/18/2020 2:09:55 PM	SENT
John T.Jasnoch		jjasnoch@scott-scott.com	11/18/2020 2:09:55 PM	SENT
Fredericka Phillips		fredericka@frederickaphillips.com	11/18/2020 2:09:55 PM	SENT
Matthew A.Schwartz		schwartzmatthew@sullcrom.com	11/18/2020 2:09:55 PM	SENT
Joshua D.Tannen		tannenj@sullcrom.com	11/18/2020 2:09:55 PM	SENT