Supplemental Paper

THE PRIVATE SECURITIES REFORM ACT OF 1995

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The background of the Private Securities Reform Act of 1995 dates back at least to legislative events in 1993.[1] In June and July 1993, the Securities Subcommittee of the Senate Banking, Housing and Urban Affairs Committee held hearings concerning private class action litigation under the federal securities laws. Among other topics considered were (a) whether joint-and-several liability among defendants should be replaced with a system for allocation of liability among defendants, and (b) whether attorneys' fee shifting should be the norm.[2]

Subsequently Securities Exchange Commission ("SEC") Chairman Levitt endorsed two specific "reform" proposals: (1) a new provision in § 10(b) to permit fee-shifting when a case is brought without a substantial basis in law or in fact, and (2) measures to prevent law firms from using professional plaintiffs or otherwise maintaining an inventory of shareholders to serve as nominal plaintiffs.[3]

Early in 1994, Senator Dodd and four cosponsors introduced S. 1976[4] which, among other proposals would have (a) eliminated bonus payments to named plaintiffs; (b) limited attorneys' fees to a percentage of recovery; (c) required special verdicts; (d) limited named plaintiffs to those owning the lesser of one percent of the securities subject to the litigation or $10,000 (in market value) of these securities; (e) specified a variety of alternative dispute resolution mechanisms; (f) required the appointment of a guardian *ad litem* and plaintiff steering committee for the plaintiff class; (g) specified new pleading requirements for securities fraud actions; (h) eliminated civil liability for securities violations of the Racketeer Influenced and Corrupt Organization (RICO) Act; (i) specified new requirements for the SEC to consider regulatory

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1. Elsewhere I have discussed the question of whether there was a need for the new legislation. *See* Joel Seligman, *The Merits Do Matter*, 108 HARV. L. REV. 438 (1994).

2. *See, e.g.*, Susan Antilla, *A Battle over Securities-Fraud Cases*, N.Y. TIMES, July 4, 1993, at F–13; Christi Harlan, *Breeden Urges Accountants to Temper Bid for Limits on Auditors' Liability*, WALL ST. J., Mar. 8, 1993, at B6E; *Senate Panel Hears Views on Reducing Number of Frivolous Rule 10b–5 Actions*, 25 Sec. Reg. & L. Rep. (BNA) 847 (1993).

3. *Levitt Endorses Legislative Measures to Curb Private Securities Litigation*, 26 Sec. Reg. & L. Rep. (BNA) 113 (1994).

4. *See* 140 CONG. REC. S3685, S3696–3707 (daily ed., Mar. 24, 1994) (statement of Senator Dodd).

or legislative changes to provide safe harbors for forward-looking statements; and (j) substituted proportionate liability for joint and several liability.

After the Republican party gained control of both houses of Congress in the 1994 elections, the movement for private securities litigation reform took on a new urgency.

On January 4, 1995, H.R. 10, the "Common Sense Legal Reforms Act of 1995," was introduced in the House, with five sponsors and 115 cosponsors.[5] The original bill, drafted by California Congressman Christopher Cox, had its origins in one of the ten planks of the Republican party's 1994 election campaign Contract with America.

While there is always room for constructive improvement in the federal securities litigation process, in general, the initial H.R. 10 proposed to do substantially more harm than good. Its most troubling provisions would have:

(1) Adopted the English Rule for private securities actions, requiring a losing party to pay the prevailing party's reasonable attorneys' fees and other expenses.

(2) Required a plaintiff to plead and prove actual knowledge of a wrong and intent to deceive to prevail under § 10(b), rather than various forms of recklessness, as was then enforced in virtually all circuits.

(3) Established new pleading requirements for scienter which, in most cases, would be difficult if not impossible to meet (e.g., "allege specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred").

(4) Required that a plaintiff allege and prove actual reliance to establish either a material misrepresentation or material omission. Not only would this have reversed *Basic Inc. v. Levinson*[6] for material misrepresentations (where reliance normally is presumed by dint of the fraud-on-the-market doctrine), but it would have created the extraordinary burden for a plaintiff to prove that he or she actually relied on an omission.[7]

The initial bill inspired intense opposition. A petition circulated by the author and Columbia Law School Professor Harvey Goldschmid, for example, urging rejection of the initial H.R. 10 was signed through February 10, 1995, by seventy law professors who collectively concurred, "that the bill, in its current form, would effectively end most federal securities class actions, would generally threaten the viability of all private securities litigation, and would, therefore, threaten basic protections for investors and for our capital markets."[8]

Similarly SEC Chairman Arthur Levitt, on February 10, 1993, testified against the initial H.R. 10, stating in part:

> The Commission opposes a move to the more drastic measures that have been proposed, however, such as imposing automatic fee shifting under a strict "English Rule," eliminating antifraud liability based on reckless

5. *Hearings on H.R. 10, the Common Sense Legal Reforms Act, Before the Subcomm. on Telecommunications & Fin. of the House Comm. on Commerce*, 104th Cong., 1st Sess. (Feb. 10, 1995).

6. 485 U.S. 224 (1988).

7. *See Hearings, supra* note 5.

8. *Id.* at 294.

> conduct, and eliminating the fraud-on-the-market theory of liability. Proposals such as these, by severely limiting the private remedy against fraud and undermining the incentives for market participants to comply with the disclosure laws, could fundamentally damage the integrity and discipline of our capital markets, which are now the strongest and safest in the world.[9]

On February 10, 1995, Representative Jack Fields, Chairman of the House Subcommittee on Telecommunications and Finance, announced a bipartisan agreement, initially engineered with then Democratic Representative W. J. "Billy" Tauzin, which resulted in modification of the losers pay, culpability, and fraud on the market proposals in the original H.R. 10.[10]

After markup by the House Subcommittee on Telecommunications and Finance and the Committee on Commerce, Title II of H.R. 10, the "Securities Litigation Reform Act," was reported to the full House on February 24, 1995.[11] In this form, the bill would have amended the Securities Exchange Act principally to:

(1) Require class action steering committees.

(2) Eliminate bonus payments to named plaintiffs in class actions.

(3) Restrict professional plaintiffs ("Except as the court may otherwise permit for good cause, a person 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").

(4) Authorize fees and expenses upon motion by the prevailing party, if the court determines that "(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.... 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."

(5) Authorize 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...."

(6) Require disclosure of settlement terms to class members.

(7) Discharge any defendant who settles a private action from all claims of contribution and proportionately reduce any final verdict or judgment 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."

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9. *See id.* at 196 (prepared statement of Arthur Levitt, concerning litigation reform proposals).

10. *Id.* at 157–58 (statement of The Honorable Jack Fields); Martha M. Hamilton, *Shareholder Litigation Bill Modified*, WASH. POST, Feb. 10, 1995, at D1.

11. *See* Common Sense Legal Reforms Act of 1995, H.R. REP. NO. 104–50, Pt. I, 104th Cong., 1st Sess. (1995), 1995 Fed. Sec. L. Rep. (CCH) ¶ 85,605 (Feb. 24, 1995).

(8) Permit any defendant in a civil monetary action to submit to the jury a written interrogatory on each defendant's state of mind.

(9) Prohibit referral fees paid by attorneys to broker-dealers to obtain the representation of any customer in any private action.

(10) Define scienter to include either an intent to defraud or recklessness, but define recklessness to mean: "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."

(11) Require explicit pleading of scienter (e.g.: "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.").

(12) Require proof of reliance and causation (through both transaction causation and loss causation) for any misstatement or omission, but also allow reliance to be proven by the fraud on the market presumption if "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."

(13) Retain joint and several liability for knowing misconduct, but permit proportionate liability for reckless misconduct.

(14) Define damages in a fraud on the market case not to exceed the lesser of

(A) "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"

(B) "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."

(15) Create a safe harbor for the publication of any projection if

(A) "the basis for such protection 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"

(B) "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."

(16) Stay discovery during consideration of a motion to dismiss a complaint that may include statements within the safe harbor for forward looking statements.

(17) Direct the SEC to adopt rules that facilitate the safe harbor provisions of this bill.[12]

The House Committee on Commerce urged the case for these blunderbuss proposals by stating in part:

> 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.
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> Today, our litigation system allows, indeed encourages, abusive "strike suits"—class actions typically bought under the anti-fraud 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.
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> 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.[13]

The Commission acknowledged that this revision of H.R. 10 represented "an improvement over the bill as originally introduced,"[14] but continued to express reservations regarding the bill's fee shifting, scienter, pleading, reliance and fraud on the market, proportionate liability, calculation of damages, and safe harbor provisions.[15]

After debate on the House floor, the bill, now styled H.R. 1058, was enacted by the full House by a vote of 325 to 99 on March 8, 1995.[16]

There were four amendments to H.R. 10 as introduced in the House.

First, language was added to obviate civil RICO claims based upon securities law violations.[17]

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12. *See id.*
13. H.R. Rep. No. 104–50, 104th Cong., 1st Sess., pt. J, at 15 (1995).
14. *Id.* at 42 (Agency Views).
15. *Id.* at 43–46.
16. Securities Litigation Reform Act, 1995 Fed. Sec. L. Rep. (CCH) ¶ 85,608 (Mar. 8, 1995). *See* 141 CONG. REC. H2760–80 (daily ed., Mar. 7, 1995); 141 CONG. REC. H2818–64 (daily ed., Mar. 8, 1995); Neil A. Lewis, *House Passes Bill That Would Limit Suits of Investors*, N.Y. TIMES, Mar. 9, 1995, at A1; *House Amends and Passes Legislation to Reform Private Securities Litigation*, 27 Sec. Reg. & L. Rep. (BNA) 392 (1995); *Attorney Accountability Act Becomes First Tort Reform Measure to Pass House*, 27 Sec. Reg. & L. Rep. (BNA) 411 (1995).
17. *See* 141 CONG. REC. H2770–79 (daily ed., Mar. 7, 1995).

Second, the "I forgot" passage in the definition of recklessness was deleted. A new sentence was substituted that would provide: "Deliberately refraining from taking steps to discover whether one's statements are false or misleading constitutes recklessness, but if the failure to investigate was not deliberate, such conduct shall not be considered to be reckless."[18]

Third, the safe harbor provision was amended to insulate a projection from liability when it was accompanied by a statement disclosing "the risk that such projections, estimates, or descriptions may not be realized."[19]

Fourth, a proposal by Congressman Ron Wyden was included to add a new § 13A requiring each audit to include 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."[20]

In the Senate, a similar S. 240[21] would have amended the securities laws to:

(1) Prohibit referral fees to brokers, dealers, or other persons for assisting an attorney in obtaining the representation of any person under the 1933 Act.

(2) Amend both the 1933 and 1934 acts to require courts to determine whether attorneys with an interest in the securities that are the subject of litigation have a conflict of interest.

(3) Prohibit payment of attorneys' fees from Commission disgorgement funds.

(4) Require plaintiffs in class actions to sign a certificate that among other points requires the plaintiff to identify any other securities class action in which the plaintiff has served as a representative party, and states that the plaintiff will not accept any payment beyond a pro rata share of the class recovery except as ordered or approved by a court. Nothing in this provision, however, was meant to limit the award of reasonable costs and expenses (including lost wages) directly related to representation of a class.

(5) Restrict payment of attorneys' fees to a reasonable percentage of the amount of recovery.

(6) Require disclosure of settlement terms to class members.

(7) Add new procedures for appointment as lead plaintiff of the member or members most capable of adequately representing the plaintiff class. The statute would include a presumption that the most adequate plaintiff is the one who has the largest financial interest in the relief sought by the class.

(8) Require imposition of mandatory sanctions under the Federal Rules of Civil Procedure Rule 11 when the court makes a finding that Rule 11(b)(1) has been violated.

(9) Stay disclosure during the pendency of any motion to dismiss.

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18. *See* 141 CONG. REC. H2818–26 (daily ed., Mar. 8, 1995).
19. *Id.* at H2840–46.
20. *Id.* at H2846–48. *See* Barbara Moses & Rachael K. Jeck, *Securities Litigation Reform*, 28 REV. SEC. & COMMODITIES REG. 31 (1995).
21. S.240, 104th Cong., 1st Sess. (1995).

(10) Add new pleading requirements under the 1934 Act for claims alleging material misrepresentations or omissions—

"[T]he 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 plaintiff shall set forth all information on which that belief is formed."

(B) Required state of mind.

(1) In General. "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, specifically allege facts giving rise to a strong inference that the defendant acted with the required state of mind."

(2) Strong inference of fraudulent intent. For purposes of paragraph (1), a strong inference that the defendant acted with the required state of mind may be established.

(A) By alleging facts to show that the defendant had both motive and opportunity to commit fraud; or

(B) By alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness by the defendant.

(11) Add new safe harbors for forward looking statements to the 1933, 1934, and Investment Company acts. Specifically the acts would state:

> A person acting on behalf of [an] issuer, or an outside reviewer retained by such issuer, shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that the statement—
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> (A) projects, estimates, or describes future events; and
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> (B) refers clearly (and, except as otherwise provided by rule or regulation, proximately) to—
>
> (i) such projections, estimates, or descriptions as forward-looking statements; and
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> (ii) the risk that actual results may differ materially from such projections, estimates, or descriptions....

This safe harbor includes a begrudging exception for a forward looking statement when it is "knowingly made with the purpose and actual intent of misleading investors." There are other exceptions for issuers who during the previous three years were subject to conviction or subject to certain judicial or administrative decrees or who made forward looking statements in connection with blank check, penny stock, rollup, or going private transactions. There were still other exceptions to the safe harbor for forward looking statements:

> (A) Included in a financial statement prepared in accordance with generally accepted accounting principles;
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> (B) Contained in a registration statement of, or otherwise issued by, an investment company, as that term is defined in Section 3(a) of the Investment Company Act of 1940;
>
> (C) Made in connection with a tender offer;

> (D) Made by or in connection with an offering by a partnership, limited liability corporation, or a direct participation investment program, as those terms are defined by rule or regulation of the Commission; or
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> (E) 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.

The safe harbor would not apply to Commission actions, including disgorgement actions. Nor does the statutory language preclude the SEC from adopting other similar safe harbors by rule.

(12) Allow defendants the right to request that the court submit a written interrogatory to the jury on the issue of each defendant's state of mind.

(13) Delete securities fraud as a cause of action under RICO.

(14) Add a statutory basis for aiding and abetting liability for Commission—but not private—actions under the 1934 Act.

(15) Require the Commission to file a report on protections for senior citizens and qualified retirement plans.

(16) Adopt a new limit on damages. This usually will provide: "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 subject security and the value of that security, as measured by the median trading price of that security, during the 90-day period beginning on the date on which the information correcting the misstatement or omission is disseminated to the market."

(17) Create a new proportionate liability regime for private actions in which knowing securities fraud was not found. This regime includes a special procedure when there are uncollectible shares.

(18) Require auditors under specified circumstances to disclose discoveries or illegal acts.

The appointment of lead plaintiff procedure in S. 240 was inspired by a pathbreaking law review article by Arizona law professor Elliott Weiss and Professor John Beckerman.[22] To deter the problems associated with the current practice of usually appointing as lead counsel the lawyer who files the first complaint, Weiss and Beckerman instead proposed that the investors (normally institutional investors) with the largest stakes should normally serve as lead plaintiffs. As they explained:

> Institutional investor plaintiffs would not usurp the courts' functions, for judicial approval of settlements and attorney fee awards still would be required. But institutional investors, by acting as litigation monitors, should make it easier for courts to perform their tasks. Institutions with large stakes in class actions have much the same interests as the plaintiff class generally; thus, courts could be more confident that settlements negotiated under the supervision of institutional plaintiffs were "fair and reasonable" than is the case with settlements negotiated by unsupervised plaintiffs' attorneys. Similarly, a court might well feel confident in assuming that a fee arrangement an institutional investor had negotiated with its lawyers before initiating a class action maximized

22. Elliott J. Weiss & 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).

> those lawyers' incentives to represent diligently the class' interests, reflected the deal a fully informed client would negotiate, and thus presumptively was reasonable.[23]

Only in December 1995 was a conference committee appointed to reconcile the two versions of the Private Securities Reform Act.[24] Since this version of H.R. 1058 was enacted into law, two aspects of the Report are worth emphasizing. First, like many Conference Reports, this Report neither slavishly followed the House nor the Senate version, but often engaged in various forms of splitting the difference. Second, what was somewhat unique—and highly troubling—about this Conference Report was that much of the statutory language was negotiated with the SEC, but the accompanying Statement of the Managers was not. Much of the drafting of the ultimate Act involves a considerable improvement over the original version of the bill introduced in January 1995. The Managers Statement, in contrast, reflects the same fire-breathing mood as the original bill. Frustration with the Managers Statement may have lead to the odd denouement of the legislative process. After the House enacted H.R. 1058 by a vote of 320 to 102, and the Senate by a 65–30 vote,[25] President Clinton vetoed the bill[26] only to have the veto overridden by both houses of Congress, and H.R. 1058 became law.[27]

Be that as it may, H.R. 1058 provides:

> (1) Section 27 of the Securities Act and § 21D of the Securities Exchange Act were added to require in both the 1933 and 1934 acts:
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> (a) A sworn certification filed with the complaint, signed by the class action plaintiff, that:
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> (i) states that the plaintiff has reviewed the complaint and authorized its filing;
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> (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;
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> (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;
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> (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;
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> (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
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> (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

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23. *Id.* at 2105.

24. *See* H.R. REP. NO. 369, 104th Cong., 1st Sess., 1995–1996 Fed. Sec. L. Rep. (CCH) ¶ 85,710 (Dec. 1995) [hereinafter Conference Report].

25. *See Congress Overwhelmingly Passes Bill to Reform Private Securities Litigation*, 27 Sec. Reg. & L. Rep. (BNA) 1899 (1995).

26. *Presidential Veto Message on the Private Securities Litigation Reform Act*, 1995–1996 Fed. Sec. L. Rep. (CCH) ¶ 85,714 (Dec. 20, 1995).

27. Neil A. Lewis, *House Overturns Veto by President of Securities Bill*, N.Y. TIMES, Dec. 21, 1995, at A1.

> share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).[28]

(b) A procedure for appointment of lead plaintiffs in class actions.[29] Not more than 20 days after the complaint is filed, the plaintiff must "cause to be published in a widely circulated national business-oriented publication or wire service, a notice advising..." the plaintiff class regarding the claims asserted and that any member of the class may move within sixty days to serve as lead plaintiff.[30]

Not later than ninety days after this notice is filed, the court is required to appoint a lead plaintiff "the member or members that the court determines to be most capable of adequately representing the interests of class members (... 'the most adequate plaintiff')."[31] The criteria for selection are delineated in Securities Act § 27(a)(3)(B)(iii) and Securities Exchange Act § 21D(a)(3)(B)(iii):

> (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—
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> (aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);
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> (bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and
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> (cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.
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> (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—
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> (aa) will not fairly and adequately protect the interests of the class; or
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> (bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.[32]

Limited discovery is permitted if a plaintiff "demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class."[33]

The most adequate plaintiffs, subject to court approval, shall "select and retain counsel to represent the class."[34]

> 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

28. Private Securities Litigation Reform Act of 1995, Pub. L. 104–67, 109 Stat. 737 (1995) (to be codified at 15 U.S.C. §§ 77a et seq.); Sec. Act § 27(a)(2); Sec. Ex. Act § 21D(a)(2).

29. *See* Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Act § 27(a)(3); Sec. Ex. Act § 21D(a)(3)).

30. *Id.* (adding Sec. Act § 27(a)(3)(A)(i); Sec. Ex. Act § 21D(a)(3)(A)(i)).

31. *Id.* (adding Sec. Act § 27(a)(3)(B)(i); Sec. Ex. Act § 21D(a)(3)(B)(i)).

32. *Id.* (adding Sec. Act § 27(a)(3)(B)(iii); Sec. Ex. Act § 21D(a)(3)(B)(iii)).

33. *Id.* (adding Sec. Act § 27(a)(3)(B)(iv); Sec. Ex. Act § 21D(a)(3)(B)(iv)).

34. *Id.* (adding Sec. Act § 27(a)(3)(B)(v); Sec. Ex. Act § 21D(a)(3)(B)(v)).

> brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.[35]

Here, as in the Weiss and Beckermen article, the concern of the Conference Committee was to end the plaintiffs' lawyers race to the courthouse by substituting a system generally of institutional investor control.[36]

(c) Each representative party serving on behalf of a class shall only be entitled to a pro rata recovery, although he or she may also receive "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."[37]

> (d) 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.[38]

(e) Total attorneys' fees and expenses may not exceed a "reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."[39]

> 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 attorneys' fees. The provision focuses on the final amount of fees awarded, not the means by which such fees are calculated.[40]

(f) Any published or otherwise disseminated settlement agreement must include:

> (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.
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> (B) STATEMENT OF POTENTIAL OUTCOME OF CASE.—
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> (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.
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> (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.
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> (iii) INADMISSIBILITY FOR CERTAIN PURPOSES.—A statement made in accordance with clause (i) or (ii) concerning the amount of

35. *Id.* (adding Sec. Act § 27(a)(3)(B)(vi); Sec. Ex. Act § 21D(a)(3)(B)(vi)).
36. *See* Conference Report, *supra* note 24, at 87,201–02.
37. Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Act § 27(a)(3)(B)(4); Sec. Ex. Act § 21D(a)(3)(B)(4)).
38. *Id.* (adding Sec. Act § 27D(a)(3)(B)(5); Sec. Ex. Act § 21D(a)(3)(B)(5)).
39. *Id.* (adding Sec. Act § 27(a)(3)(B)(6); Sec. Ex. Act § 21D(a)(3)(B)(6)).
40. Conference Report, *supra* note 24, at 87,203.

> 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.
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> (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.
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> (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.
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> (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.[41]

(g) An attorney with a conflict of interest (direct ownership or beneficial ownership in the securities involved in the litigation) shall be subject to a judicial determination whether the ownership "constitutes a conflict of interest sufficient to disqualify the attorney from representing the plaintiff class."[42]

(h) In general, "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds...that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."[43]

Here the Conference Committee relied heavily on limited anecdotal evidence when its Report stated: "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.'"[44]

(iii) The legislation was perhaps most draconian in its creation of a novel version of Federal Rules of Civil Procedure Rule 11, which provides *in toto*:

> (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.

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41. Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Act § 27(a)(3)(B)(7); Sec. Ex. Act § 21D(a)(3)(B)(7)).

42. *Id.* (adding Sec. Act § 27(a)(3)(B)(8); Sec. Ex. Act § 21D(a)(3)(B)(9)).

43. *Id.* (adding Sec. Act § 27(b)(1); Sec. Ex. Act § 21D(b)(3)(B)).

44. Conference Report, *supra* note 24, at 87,203–04. *See Hearings Before the Securities Subcomm. of the Senate Comm. on Banking, Housing & Urban Affairs*, 104th Cong., 1st Sess. (Mar. 2, 1995) (testimony of former SEC Commissioner J. Carter Beese, Jr., Chairman of the Capital Markets Regulatory Reform Project Center for Strategic and International Studies) (citing testimony of Philip A. Lacovara at Hearings on H.R. 3185, Before the Telecommunications & Fin. Subcomm. of the House Comm. on Energy & Commerce).

> (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—
>
> (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.[45]

Here the Statement of the Managers blithely relied on a single witness to impugn the behavior of the judiciary when it stated: "Existing Rule 11 has not deterred abusive securities litigation. Courts often fail to impose Rule 11 sanctions even where such sanctions are warranted."[46]

(j) This substantive provision of the Reform Act closes with a section allowing a defendant

> 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...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.[47]

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45. Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Act § 27(c); Sec. Ex. Act § 21D(c)).

46. Conference Report, *supra* note 24, at 87,205.

47. Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Act § 27(d); Sec. Ex. Act § 21D(d)).

(2) Section 21D of the Securities Exchange Act alone was also amended to provide:

(a) A discretionary provision allowing the court to require security for payment of costs from either the attorneys for the plaintiff class or defendants.[48]

(b) A new and potentially far reaching pleading section that states *in toto*:

> (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;
>
> 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.
>
> (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.[49]

Here the Statement of Managers state clearly an intent to alter existing federal securities law pleading requirements:

> 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 interpreting this pleading standard. 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 complaint 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.[50]

(c) Securities Exchange Act § 21D(b)(4) which requires: "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."[51]

(d) There was also a limitation on damages that, in effect, repealed modern financial economics. The general provision, § 21D(e)(1), states in relevant part:

> 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, the

48. *Id.* (adding Sec. Ex. Act § 21D(a)(8)).
49. *Id.* (adding Sec. Ex. Act §§ 21D(b)(1)–(2)).
50. Conference Report, *supra* note 24, at 87,207.
51. Pub. L. 104–67, § 101, 109 Stat. 737 (1995) (adding Sec. Ex. Act § 21D(b)(4)).

> 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 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.[52]

This formula appears to be unwise both because the ninety-day period has no necessary relation to the period during which a corrective statement should affect a market price, and more importantly, because damages are not computed net of the market. For example, if a plaintiff buys stock at $50 when a relevant market index is 1000 and later sells at $50 when the index is 2000, the plaintiff would receive no damages while most economists would argue that the price of the stock had declined fifty percent net of market movements.

(3) The most hotly contested provision in the Reform Act was the new safe harbor for forward looking statements.[53]

This provision, like much of the Act is reticulate. The Section *only* applies 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.[54]

The safe harbor "[e]xcept to the extent otherwise specifically provided by rule..." is not available for 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;
>
> (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;

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52. *Id.* (adding Sec. Ex. Act § 21D(e)(1)).
53. *Id.* § 102 (adding Sec. Act § 27A; Sec. Ex. Act § 21E).
54. *Id.* (adding Sec. Act § 27A(a); Sec. Ex. Act § 21E(a)).

(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.[55]

The safe harbor itself is contained in Securities Act § 27A(c) and Securities Exchange Act § 21E(c). It appears to go far, for the first time in the history of federal securities laws, to immunize certain *deliberately* false statements. The Section provides:

(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 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—

55. *Id.* (adding Sec. Act § 27A(b); Sec. Ex. Act § 21E(b)).

(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;

(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).[56]

The safe harbor really involves three different types of safe harbors:

(1) Securities Act § 27A(c)(1)(A) and Securities Exchange Act § 21E(c)(1)(A) may immunize a deliberately false forward looking statement if the court concludes it was accompanied "by meaningful cautionary statements." How significant a change this will make in the bespeaks caution doctrine is an open question. If courts narrowly construe the term "meaningful cautionary statement" language when confronted with deliberate fraud, much mischief can be avoided.

(2) The defendant is given a second safe harbor in Securities Act § 27A(c)(1)(B) and Securities Exchange Act § 21E(c)(1)(B) if he or she cannot offer and prove sufficient meaningful cautionary statements because the plaintiff is still required to prove a higher culpability standard "actual knowledge" rather than the lower recklessness or negligence standard available today under the Securities Exchange Act § 10(b) and Rule 14a–9.

(3) There is then a novel safe harbor for oral forward looking statements when appropriate reference is made to a readily available written document.[57] It is unclear whether this will make any meaningful difference given the earlier judicial justifiable reliance doctrine.[58]

The safe harbors are buttressed by provisions that allow the Commission to further exempt forward looking statements[59] and that require the court to stay discovery during any motion for summary judgment concerning a covered forward looking statement.[60]

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56. *Id.* (adding Sec. Act. § 27A(c)(1)–(3); Sec. Ex. Act § 21E(c)(1)–(3)).
57. *Id.* (adding Sec. Act § 27A(c)(2); Sec. Ex. Act § 21E(c)(2)).
58. *See* 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4386–87 n.439 (1992).
59. *See* Pub. L. 104–67, § 102, 109 Stat. 737 (1995) (adding Sec. Act § 27A(c)(4); Sec. Ex. Act § 21E(c)(4)); *see also id.* (adding Sec. Act §§ 27A(g)–(h); Sec. Ex. Act §§ 21E(g)–(h)).
60. *Id.* (adding Sec. Act § 27A(f); Sec. Ex. Act § 21E(f)).

The term forward looking statement is defined in Securities Act § 27A(i)(1) and Securities Exchange Act 21E(i)(1) in terms similar to Securities Act Rule 175 and Securities Exchange Act Rule 3b-6,[61] but adds in Securities Act §§ 27A(i)(1)(E)–(F) and Securities Exchange Act §§ 21E(i)(1)(E)–(F):

> (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.[62]

Underlying the complex new safe harbors is a simple, but as yet unproven belief: "Fear that inaccurate projections will trigger the filing of securities class action lawsuit has muzzled corporate management."[63] Whether this belief is warranted—or whether corporate management is reluctant to publicly discuss projections for other reasons—is an empirical question that time will answer.

The Statement of Managers emphasized the significance of the bespeaks caution cases when it stated:

> 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 and must be of a nature that the factor or factors could actually affect whether the forward-looking statement is realized.[64]

The Managers, however, also encouraged the SEC to go further:

> 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.[65]

(4) Securities Exchange Act § 15(c)(8) was then amended to prohibit brokers, dealers, or associated persons from accepting or soliciting attorney reference fees.[66]

(5) Securities Act § 20(f) and Securities Exchange Act § 21(d)(4) were added to prohibit attorney's fees to be paid from Commission disgorgement funds.[67]

(6) The Commission won a victory when its power to prosecute persons for aiding and abetting was restored in Securities Exchange Act § 20(a) by the following section:

> 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

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61. *See* 2 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 622–36 (1990).
62. Pub. L. 104–67, § 102, 109 Stat. 737 (1995) (adding Sec. Act. § 27A(i)(1)(E)–(F); Sec. Ex. Act § 21E(i)(1)(E)–(F)).
63. Conference Report, *supra* note 24, at 87,208.
64. *Id.* at 87,209.
65. *Id.* at 87,210–11.
66. *Id.* § 103 (adding Sec. Ex. Act § 15(c)(8)).
67. *Id.* (adding Sec. Act § 20(f); Sec. Ex. Act § 21(d)(4)).

> 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.[68]

(7) Securities Act § 12 was amended by adding a new loss causation provision:

> If the person who offered or sold such security proves that any portion or all of the amount recoverable...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.[69]

(8) Not later than 180 days after enactment of the law, the Commission is required to report whether investors who are senior citizens or qualified retirement plans require greater protection against securities fraud.[70]

(9) Securities-related civil RICO claims,[71] are largely or totally obviated by an amendment to 18 U.S.C. § 1964(c):

> 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.[72]

The Statement of Managers further stated: "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."[73]

Nonetheless there may remain a small number of instances where securities related offenses might violate mail and wire fraud statutes but not federal securities laws and still be actionable under civil RICO.[74]

(10) A new § 21D(a) is added to the Securities Exchange Act to preserve joint and several liability for persons who knowingly commit securities fraud,[75] but otherwise to proportionately limit liability to the "portion of the judgment that corresponds to the percentage of responsibility of that covered person...."[76] The percentage of responsibility is to be determined by jury special interrogatories:[77]

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68. *Id.* § 104 (adding Sec. Ex. Act § 20(a)). This partially reverses the Supreme Court's 1994 decision in Central Bank of Denver v. First Interstate Bank of Denver, 114 S. Ct. 1439 (1994), which had held that there was no implied cause of action for aiding and abetting *private* § 10(b) claims. *See* James D. Cox, *Just Deserts for Accountants and Attorneys After* Bank of Denver, 38 ARIZ. L. REV. 519 (1996).

69. Pub. L. 104–67, § 105, 109 Stat. 737 (1995) (adding Sec. Act § 12).

70. *Id.* § 106.

71. *See* 10 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4456–66 (1993).

72. Pub. L. No. 104–67 § 107, 109 Stat. 737 (1995).

73. Conference Report, *supra* note 24, at 87,211.

74. *Cf.* Carpenter v. United States, 484 U.S. 19 (1987).

75. Pub. L. 104–67, § 201, 109 Stat. 737 (1995) (adding Sec. Ex. Act § 21D(g)(2)(A)).

76. *Id.* (adding Sec. Ex. Act § 21D(g)(2)(B)).

77. *Id.* (adding Sec. Ex. Act § 21D(g)(3)).

> 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.[78]

There is an elaborate provision for uncollectible shares limited to plaintiffs with a net worth of less than $200,000.[79]

Any covered person, essentially a defendant under § 11 of the 1933 Act or generally under the 1934 Act,[80] or any other person who could have been joined in the original action[81] is subject to contribution and to any continuing liability to the plaintiff on the judgment.[82]

There is a six-month statute of limitations for contribution claims,[83] and a settlement discharge procedure.[84]

Underlying the new proportionate liability rules was the belief on the part of the Managers of H.R. 1058:

> 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 invitation [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." This result has injured the entire U.S. economy.[85]

(11) The Commission is authorized to limit the liability of outside directors under § 11(f) of the Securities Act.[86]

(12) Finally a new § 10A(a) of the Securities Exchange Act authorizes the Commission to modify or supplement generally accepted auditing standards to establish:

> (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

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78. *Id.* (adding Sec. Ex. Act § 21D(g)(3)(C)).
79. *Id.* (adding Sec. Ex. Act § 21D(g)(4)).
80. *Id.* (adding Sec. Ex. Act § 21D(g)(10)(C)).
81. *Id.* (adding Sec. Ex. Act § 21D(g)(8)).
82. *Id.* (adding Sec. Ex. Act § 21D(g)(4)(C)–(5)).
83. *See id.* (adding Sec. Ex. Act § 21D(g)(5)).
84. *Id.* (adding Sec. Ex. Act § 21D(g)(7)).
85. Conference Report, *supra* note 24, at 87,204.
86. *See also* Sec. Ex. Act § 38.

> (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.[87]

If an independent public accountant detects or otherwise becomes aware of information indicating that an illegal act (whether or not material) has or may occur, the accountant must inform the appropriate level of management of the issuer and assure that the audit committee or board is adequately informed with respect to the illegal acts.[88] Failure to respond to a *material* illegal act will require the accountant to report its conclusions to the board,[89] or resign or furnish to the Commission a copy of its report.[90]

In general, according to the Statement of Managers:

> 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, 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 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.[91]

What was ultimately most troublesome about the 1995 Reform Act was that the complexity and unevenness of the evidence of these abuses was neither acknowledged nor examined. The Act itself may or may not prove to be mischievous—that ultimately is for the courts to decide. But the tone, particularly of the Statement of Managers, was regrettable for its stridence, if not its belligerence.

87. Pub. L. No. 104–67 § 301, 109 Stat. 737 (1995) (adding Sec. Ex. Act § 10A(a)).
88. *Id.* (adding Sec. Ex. Act § 10A(b)(1)).
89. *See id.* (adding Sec. Ex. Act § 10A(b)(2)).
90. *Id.* (adding Sec. Ex. Act § 10A(b)(3)).
91. Conference Report, *supra* note 24, at 87,200.