STATEMENT OF SENATOR PETE V. DOMENICI

INTRODUCTION OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

January 18, 1995

Mr. President, I rise today to introduce a bill on behalf of Senator Dodd, myself and 15 other Senators on both sides of the aisle which will return some fairness and common sense to our broken securities class action litigation system. The system as it currently operates encourages the quick filing of frivolous complaints by entrepreneurial class action attorneys, and costs businesses countless amounts of time and money to defend against and settle these "strike suits". In cases of real fraud, the system often leaves injured investors with pennies on the dollar for their losses, while plaintiffs' lawyers take a substantial amount of the settlement. In short, the current securities litigation system rarely benefits anyone except for plaintiffs' attorneys, and victimizes innocent companies and investors.

The list of companies that have been hit with frivolous securities suits reads like the who's who of high growth, high-technology businesses. In fact, 19 of the 30 largest companies in Silicon Valley have been sued since 1988. They are the backbone of our economy and the foundation of our ability to compete in the new global marketplace. During two days of hearings on securities litigation conducted by Senator Dodd back in 1993, we heard from CEOs who had been involved in frivolous securities class actions first hand. Their testimony indicated that:

- Companies get sued when their stock price drops
- Companies also get sued by shareholders for settling securities suits.
- Frivolous litigation is time consuming and distracts CEOs and other corporate officers from economically productive activity.
- Defending a securities lawsuit often is as costly as starting up a new product line.
- The general counsel for the Intel Corporation testified that if Intel had been sued when it was a start-up company, that such a suit probably would have bankrupted the company before it invented the microchip. We cannot afford to allow the current system to snuff out this sort of innovation.

Frivolous litigation also adversely affects investors by drawing scarce resources away from productive activity, which is then reflected in a company's stock price. Arthur Levitt, Chairman of the Securities and Exchange Commission stated in testimony before the House in August of 1994, that "when issuers and others pay substantial sums to deal with frivolous lawsuits, significant costs are imposed on the process of capital-raising and on business, costs that ultimately will be borne by all shareholders".

Instead we must put a stop to the "race-to-the-courthouse" game played by plaintiffs' class action attorneys, in which they file lawsuits within hours of news that a company came up short on an earnings projection or will be forced to delay the introduction of a new product line. Information provided to the Senate Securities Subcommittee by the National Association of Securities and Commercial Law Attorneys (NASCAT) suggests that fifty-six percent of the class actions that they hand-picked to provide to the subcommittee were filed within 30 days of a "triggering event", like a missed earnings projection. Twenty-one percent of the cases were filed within 48 hours of the triggering. The stock price drops and class action suits are filed quickly with little due diligence done to investigate each of the elements necessary for a successful 10b-5 case.

Many academics and those familiar with our securities class action system also agree that the securities litigation system encourages the filing of frivolous suits. Jonathan Macey, a law professor at Cornell University believes that most securities class actions are frivolous. "The facts show that every time a firm's share price drops by enough that it's profitable for plaintiffs' lawyers to bring a lawsuit, they do", he said recently. Janet Cooper Alexander at Stanford University has proven that most class actions are settled without regard to whether the case has merit. Chairman Levitt has acknowledged that "virtually all securities class actions are settled for some fraction of the claimed damages, and some allege that settlements often fail to reflect the underlying merits of the cases. If true, this means that weak claims are overcompensated and strong claims are undercompensated."

In case you don't believe that class action attorneys are filing frivolous suits, take a look at the article the Wall Street Journal ran last week on January 11th. It provides an excellent example of the "cookie-cutter complaints" which often form the basis of these million dollar law suits. It documents a case against Philip Morris filed within 48 hours of the company's announcement of a price cut on one of its brands of cigarettes.

The case was dismissed after the judge noticed that the plaintiffs' attorneys had filed two separate suits which alleged that Philip Morris had engaged in fraud to create and prolong the illusion of their success in the toy industry As you might well know, Philip Morris doesn't make toys.

But this is how the current system works. Plaintiffs' lawyers race to the courthouse, file frivolous suits without any research into their validity, and companies normally must pay something to make them go away. Because usually, plaintiffs' lawyers don't make the glaring mistake they made in the Philip Morris case and forget to delete the word "toy" from their complaint. Judges rarely dismiss these cases without such a blunder. Companies continue to get sued and are forced to settle frivolous cases. Our bill will eliminate these poorly researched, "kitchen sink" complaints

Plaintiffs' lawyers often sue not only the issuer company, but their officers and directors, accountants, lawyers and underwriters. These cases are brought under joint and severable liability, which means that any one defendant could be made to pay the entire judgment even if he or she was only marginally responsible. This increases the pressure to settle even the most frivolous cases.

Our bill adopts the state law trend of imposing proportionate liability, liability according to relative fault. Our bill retains joint and severable liability for the really bad actors, but provides proportionate liability for those parties only incidentally involved. However, our bill contains a provision which deals with the problem of insolvent defendants and small investors. We believe that this provision strikes the correct balance and returns fairness to the system.

Our bill also allows for alternative dispute resolution as an alternative to costly and time consuming litigation. One reason these cases settle regardless of the merits is that it costs so much to get through what lawyers call "discovery", the process of exchanging information before a trial. By allowing for ADR, we hope to reduce those costs. Our bill also requires specificity in pleading securities fraud, a requirement imposed on every other fraud action under Rule 9(b) of the Federal Rules. This provision will reduce the number of "fishing expedition" lawsuits, like the one in the Philip Morris case.

Even in cases of real fraud, the current system allows investors to recover on average about six cents on the dollar, while plaintiffs' lawyers take on average between 30 and 33 percent of the settlement fund. One plaintiffs class action lawyer boasted in Forbes magazine that securities class action cases are a great practice because "there are no clients". Yet these clientless lawyers claim to be acting in the best interests of the class.

Once a settlement is reached, the entrepreneurial lawyer with no clients becomes an adversary of the plaintiffs class. The lawyers' interest shifts to protecting the settlement. "At its worst, the settlement process may amount to a covert exchange of a cheap settlement for a high award of attorneys' fees", according to John Coffee of Columbia University. Professor Coffee also has noted that plaintiffs attorneys in many securities class actions appear to "sell out their clients in return for an overly generous fee award".

Under our bill, plaintiffs' lawyers will no longer be able to sell out their clients for huge fee awards. Our bill allows judges to appoint a plaintiff steering committee or guardian ad litem at the request of the class to ensure that the attorneys act in the best interests of their clients. Clients, not lawyers will be in charge of the litigation, and will be able to make the important decisions like when to settle, when to dismiss their attorneys or when to proceed to trial.

Our bill also eliminates "pet plaintiff fees", bonus awards plaintiffs' attorneys pay to individuals to act as class representatives, regardless of the number of shares they own or the amount of their actual losses. These fees reduce the amount of recovery available to the class as a whole and serve no purpose but to give attorneys an available stable of plaintiffs willing to sue at a moment's notice in exchange for a big payoff. This practice undermines the fairness of the system and should be eliminated.

Our current securities class action system obviously is broken and needs the type of reforms Senator Dodd and I have proposed in this bill. Too many cases are pursued for the purpose of extracting settlements from corporations and other parties without regard to their merits. The business community is powerless to deal with these suits, and companies settle rather than "bet the company". These settlements yield large fees for plaintiffs' lawyers but compensate investors only for a fraction of their actual losses.

We reject the notion that stock price volatility is fraud. Plaintiffs' lawyers must be made to stop, think, investigate and research before they file these potentially devastating suits. Truly defrauded investors must have greater control over their litigation and receive a greater share of the settlement fund.

The spirit motivating this bill is the obligation that Chairman Levitt has identified: "to make sure the current system operates in the best interest of all investors. This means focusing not just on the interests of those who happen to be aggrieved in a particular case, but also on the interests of issuers and the markets as a whole".

I would like to commend Senator Dodd for tackling this difficult issue. Under his leadership in the last Congress, we developped a substantial hearing record in the Securities Subcommittee and collected as many facts and opinions as we could. This bill is the product of a great deal of work and deliberation, and I want to express my gratitude for the way he and his staff went about developing this legislation.

I ask unanimous consent that a copy of the Wall Street Journal article I mentioned earlier be printed in the record following my remarks. I also ask that a section-by-section description of the bill and the bill text itself also be printed in the Record. Thank you, Mr. President.