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CHAIRMAN LEVITT'S TESTIMONY ON PRIVATE LITIGATION UNDER THE FEDERAL SECURITIES LAWS

August 3, 1994 TO: BOARD OF GOVERNORS NO. 71-94 SEC RULES MEMBERS NO. 54-94 RE: CHAIRMAN LEVITT'S TESTIMONY ON PRIVATE LITIGATION UNDER THE FEDERAL SECURITIES LAWS _____ SEC Chairman Arthur Levitt recently testified on the need for meaningful improvements in the private litigation system under the federal securities laws before the House Subcommittee on Telecommunications and Finance. A copy of his testimony is attached. At the outset of his testimony, Chairman Levitt testified that "[p]reserving private actions as a source of deterrence and as the primary vehicle for compensating defrauded investors will be increasingly important as our securities markets continue to grow in size and complexity." He noted, however, that two recent Supreme Court decisions have narrowed the scope of private litigation under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. In the Central Bank of Denver case, the Court held that investors do not have a private right of action against persons who substantially assist a securities fraud. Three years ago, in the Lampf case, the Court held that an action under Rule 10b-5 must be brought within one year after discovery of a violation, and within three years after the violation occurred. Chairman Levitt stated that to address the Lampf decision, the Commission urged Congress to enact an express statute of limitations that would allow cases to be filed up to five years after a violation occurs, provided they are brought within two years after discovery of the violation. Shortly after the Central Bank of Denver decision, the Commission recommended that Congress also enact legislation to restore the previously well-established investor rights that were set aside by that decision. Chairman Levitt also testified in support of legislative proposals that would reform class action litigation, such as a measure that would prohibit the payment of additional compensation to a class representative, the payment of referral fees to a class counsel, service as class counsel by an attorney who has a beneficial interest in the securities that are the subject of litigation, and the payment of attorneys' fees from funds disgorged in a Commission action. In addition to legislative action, Chairman Levitt stated that active judicial case management could improve the current system. One particular idea that he discussed was the use of a competitive bidding process for law firms seeking to be selected as lead counsel in securities class actions. According to one court's analysis that utilized this process, substantial savings in terms of both fees and expenses were achieved for the class. Other proposals for which Chairman Levitt expressed support or recommended be subject to further study and consideration include (1) adoption by the courts of a consistent approach with respect to requiring that plaintiffs allege fraud, as well as the defendant's intent, with particularity; (2) the use of sanctions to deter frivolous claims, such as requiring a party to pay the opposing party's costs and reasonable

attorneys' fees; (3) elimination of the overlap between the private remedies under the Racketeer Influenced and Corrupt Organizations Act and under the federal securities laws because of the unfairness in exposing defendants in securities cases to the threat of treble damages and other extraordinary remedies provided by RICO; and (4) requiring that liability be apportioned on the basis of relative fault. Amy B.R. Lancellotta Associate Counsel Attachment

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