

May 13, 2010

The Honorable Harry Reid
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Mitch McConnell
Republican Leader
United States Senate
Washington, DC 20510

Dear Majority Leader Reid and Republican Leader McConnell:

On behalf of the undersigned organizations, we write to express our strong opposition to the latest version of SA 3776, which seeks to overturn the Supreme Court's decisions in *Stoneridge v. Scientific-Atlanta*, 128 S. Ct. 761 (2008), and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), and create an entirely new species of securities class action liability. This revised amendment, sponsored by Senator Specter, would drastically expand the reach of private securities litigation and expose even wholly innocent parties to enormously expensive lawsuits based on a mere failure to discover the fraud of another party.

SA 3776, as modified, represents the third version of Senator Specter's attempt to expand private liability under the securities laws. This version of his amendment requires "actual knowledge of the improper conduct underlying the violation" and of "the role of the person in assisting in such conduct." But this formulation does not correct the flaws in his earlier versions. It continues to require that the defendant have actual knowledge only of the primary violator's conduct—the "improper conduct" in the words of the amendment—and does *not* require that the defendant know that this conduct was unlawful. This language continues to reflect a superficial change from the original Specter legislation, which was met with heavy criticism because it would have extended private liability even to those who provide such assistance "recklessly."

This latest version of SA 3776 would continue to subject defendants to liability whether or not they have any idea that the conduct they are assisting is wrongful. As in earlier versions of the amendment, a business that buys goods or services from a company that accounts for those sales improperly to inflate its revenues could be held liable for billions of dollars in damages so long as it is aware of the transactions—even if the buyer does not know about the fraudulent accounting. That would impose a lower standard on private plaintiffs than the one that the SEC must meet for its aiding-and-abetting actions under current law.

Furthermore, even a real "actual knowledge" standard would open the door to an onslaught of abusive and unjustified litigation. Because of the billions of dollars of potential liability and enormous litigation costs unique to securities class actions, virtually every complaint that is not dismissed at the pleadings stage results in a settlement. Current law properly prevents plaintiffs' lawyers from pursuing a "guilt by association" litigation strategy by requiring them to meet a bright-line test to avoid dismissal— identifying a statement made by each defendant to investors (or to the market) that was false or misleading. The Specter amendment would eliminate this clear standard and substitute the murky and uncertain question of whether the complaint adequately alleges "knowledge" and "substantial assistance." That

means any business that had any sort of relationship with an alleged fraud-doer could be subjected to discovery, trial, and possible liability in the billions of dollars based simply on artful pleading and tenuous connections.

Moreover, the legal standard courts apply at the motion-to-dismiss stage is not likely to be effective in eliminating unjustified claims. It requires only that “a reasonable person would deem the inference of” the defendant’s state of mind “to be cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007). (When the Supreme Court issued this decision, the standard was applauded by Milberg Weiss, at the time one of the leading plaintiffs’ law firms.) Even if the plaintiff’s allegations are just as consistent with negligence, recklessness, or innocence as they are with “knowledge,” the complaint will not be dismissed, and the company will become subject to potentially crippling discovery costs and a trial at which it may face joint and several liability for any damages awarded in the case—potentially billions of dollars, even when the company’s alleged involvement with the primary violator relates to only a tiny portion of the alleged fraud.

That most of these suits ultimately would fail if decided on the merits provides little solace for defendants forced to choose between a settlement and the enormous costs of defending against a potentially ruinous verdict. Senator Specter’s amendment would give profit-motivated trial lawyers—armed with a vague statutory standard and 20/20 hindsight—yet another potent weapon with which to extort businesses into paying enormous sums to settle even meritless lawsuits.

Finally, Congress should not even consider creating a whole new category of class action claims until it addresses the well-documented corruption and other abuses in the current system:

- Two leading securities class action plaintiffs’ lawyers were recently released from prison after serving sentences for illegal acts to obtain representation of securities class action plaintiffs, acts that netted the firm \$251 million in fees. One of these lawyers claims that this conduct was “industry practice”; the trial judge who sentenced him said this scheme “corrupted the law firm, and it corrupted it in the most evil way.”
- Dozens of newspaper articles have documented a pay-to-play scandal in which plaintiffs’ attorneys who make campaign contributions to state officials overseeing government pension funds are awarded lucrative assignments representing those pension funds in class action litigation. This practice has been condemned by the late Judge Edward Becker, among others.
- A study of attorneys’ fees in these class actions—fee awards that reduce the amount of money that investors receive—found that the average hourly rate paid to these lawyers nearly doubled between 1990 and 2003 (after adjusting for inflation) and averaged \$1370 per hour.

Truly culpable secondary actors must be held accountable for their misconduct. And the current securities laws provide multiple mechanisms for both deterring and prosecuting such fraud. Congress has empowered the SEC and the Department of Justice to bring both civil and

criminal prosecutions against culpable third parties. These government agencies can exercise their prosecutorial discretion to focus on real violations—unlike plaintiffs’ lawyers, they have no incentive to sue as many companies as possible in order to maximize their own compensation. Government enforcement actions also can target the actual wrongdoers in a company, rather than punishing the innocent shareholders who ultimately must foot the bill in a class action. And unlike plaintiffs’ attorneys, the government does not siphon off in fees as much as one-third of the recovery intended for injured investors.

Congress got it right in 1995 when it empowered only government enforcers to target aiding and abetting. SA 3776 should be rejected.

Sincerely,

American Bankers Association
American Financial Services Association
American Insurance Association
American Tort Reform Association
Business Roundtable
National Association of Manufacturers
National Venture Capital Association
NASDAQ OMX
NYSE Euronext
Securities Industry and Financial Markets Association
The American Institute of Certified Public Accountants
The Financial Services Roundtable
U.S. Chamber Institute for Legal Reform
U.S. Chamber of Commerce

Cc: The Members of the United States Senate