#### 103D CONGRESS 1ST SESSION

# H. R. 417

To amend the Securities Exchange Act of 1934 in order to reform private enforcement of the Federal securities laws, and for other purposes.

### IN THE HOUSE OF REPRESENTATIVES

JANUARY 5, 1993

Mr. Tauzin (for himself, Mr. Parker, Mr. Hall of Texas Mr. Rowland, Mr. Montgomery, Mr. Shaw, Mr. Machtley, and Mr. Moran) introduced the following bill; which was read twice and referred to the Committee on Energy and Commerce

#### August 23, 1993

Additional sponsors: Mr. Peterson of Minnesota, Mr. Kyl, Mr. McMillan, Mr. Sundquist, Mr. Henry, Mr. Burton of Indiana, Mr. Porter, Mr. Linder, Mr. Paxon, Mr. Rush, Mr. Schaefer, Mr. Hastert, Mr. Upton, Mr. Pallone, Mr. Towns, Mr. McNulty, Mr. Neal of North Carolina, Mr. Moorhead, Mr. Gillmor, Mr. Gene Green of Texas, Mr. Michel, Mr. Zeliff, Mr. Ewing, Mrs. Johnson of Connecticut, Mr. Hyde, Ms. Long, Mr. Durbin, Mr. Baesler, Mr. Franks of Connecticut, Mr. Gutierrez, Mr. Crane, Mr. Quillen, Mr. Barcia of Michigan, and Mr. Baker of Louisiana

# A BILL

To amend the Securities Exchange Act of 1934 in order to reform private enforcement of the Federal securities laws, and for other purposes.

- 1 Be it enacted by the Senate and House of Representa-
- 2 tives of the United States of America in Congress assembled,

#### SECTION. 1. SHORT TITLE.

- 2 This Act may be cited as the "Securities Private En-
- 3 forcement Reform Act".
- 4 SEC. 2. FINDINGS.

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- 5 The Congress finds that—
- 6 (1) excessive securities litigation is a serious 7 burden on the national economy, diverting limited 8 capital resources to less productive areas;
  - (2) meritless lawsuits filed under Federal securities laws are making it harder for American companies to raise capital and attract experienced members to serve on their boards;
- (3) in the past 3 years, issuers of 1 out of every
  12 stocks traded on the New York Stock Exchange
  have been sued for securities fraud;
  - (4) in the securities fraud area, the civil justice system is being transformed into a nonmerit-based, unjust system, in which professional plaintiffs extract settlements from entrepreneurs, regardless of the merits of the cases filed;
  - (5) such securities lawsuits impose additional costs on publicly traded companies, often force them into bankruptcy, and create job losses within the economy;
- 25 (6) such securities fraud lawsuits stifle the de-26 velopment of future products by compelling invest-

- 1 ment bankers and accounting firms, whose assist-
- 2 ance is essential for accessing capital markets, to re-
- 3 sist working with new venture firms because of the
- 4 higher risk of litigation associated with them; and
- 5 (7) reform in the securities fraud laws are need-
- 6 ed to ensure that the courts can properly hear and
- 7 adjudicate securities fraud cases.

#### 8 SEC. 3. PRIVATE CIVIL ACTION PROCEDURES.

- 9 The Securities Exchange Act of 1934 is amended by
- 10 inserting after section 20A (15 U.S.C. 78u-1) the follow-
- 11 ing new section:
- 12 "PRIVATE CIVIL ACTION PROCEDURES
- 13 "Sec. 20B. (a) Requirement of Proportionate
- 14 Liability.—
- 15 "(1) Limitation on joint and several li-
- ABILITY.—A defendant who is found liable for dam-
- ages in an implied private action arising under a
- provision of this Act may be liable jointly and sever-
- ally only if the trier of fact specifically determines
- 20 that the defendant engaged in knowing securities
- 21 fraud, as defined in paragraph (3).
- 22 "(2) DETERMINATION OF LIABILITY.—If the
- trier of fact does not find, pursuant to paragraph
- 24 (1), that the defendant engaged in knowing securi-
- 25 ties fraud, the defendant's liability shall be deter-
- 26 mined 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 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 subsection shall have a right

- to recover from another defendant any portionof the judgment entered against him.
  - "(3) DEFINITION.—A defendant engages in 'knowing securities fraud' only if he (A) makes a material representation with actual knowledge that the representation is false or omits to make a statement with actual knowledge that, as a result of the omission, one of his material representations is false; and (B) knows that other persons are likely to rely on that misrepresentation or omission. Reckless conduct by the defendant shall not constitute 'knowing securities fraud'. The liability in damages, in any, of a defendant who acts in a reckless manner shall be determined in accordance with paragraph (3).
    - "(4) COVERAGE OF PROVISION.—This subsection relates only to the allocation of damages among defendants. Nothing herein shall affect the standards for liability under any implied private action arising under a provision of this Act.

## "(b) Awards of Attorney Fees.—

"(1) AUTHORITY TO AWARD FEES.—If the court in any implied private action arising under this Act 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, award the prevailing party reasonable fees and other expenses incurred by that party unless the court determines that the position of the losing party was substantially justified. If the court determines that the position of the losing party was substantially justified, it shall not award fees and other expenses to the prevailing party. The determination whether the position of the losing party was substantially justified shall be made on the basis of the record which is made in the civil action for which fees and other expenses are sought.

- "(2) 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.
- "(3) Allocation and size of award.—The court, in its discretion, may—

| 1  | "(A) determine whether the amount to be               |
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| 2  | awarded pursuant to this section shall be             |
| 3  | awarded against the unsuccessful party, its at-       |
| 4  | torney, or both; and                                  |
| 5  | "(B) reduce the amount to be awarded                  |
| 6  | pursuant to this section, or deny an award, to        |
| 7  | the extent that the prevailing party during the       |
| 8  | course of the proceedings engaged in conduct          |
| 9  | that unduly and unreasonably protracted the           |
| 10 | final resolution of the matter in controversy.        |
| 11 | "(4) Awards in discovery proceedings.—                |
| 12 | In adjudicating any motion for an order compelling    |
| 13 | discovery or any motion for a protective order made   |
| 14 | in any implied private action arising under this Act  |
| 15 | the court shall award the prevailing party reasonable |
| 16 | fees and other expenses incurred by the party in      |
| 17 | bringing or defending against the motion, including   |
| 18 | reasonable attorney fees, unless the court finds that |
| 19 | special circumstances make an award unjust.           |
| 20 | "(5) Definitions.—For purposes of this sub-           |
| 21 | section—  |
| 22 | "(A) The term 'fees and other expenses                |
| 23 | includes the reasonable expenses of expert wit-       |
| 24 | nesses, the reasonable cost of any study, analy-      |

sis, report, test, or project which is found by

the court to be necessary for the preparation of the party's case, and reasonable attorney 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.

## "(c) ABUSIVE PRACTICES..—

"(1) Shares of awards to representative plaintiffs.—In any implied private action arising under this Act that is certified as a plaintiff class action pursuant to the Federal rules of civil procedures, the share of any final judgment or of any settlement that is awarded to any party serving as a representative plaintiff shall be calculated in the same manner as the shares of the final judgment or settlement awarded to all other members of the plaintiff class.

"(2) REPRESENTATION OF CLASS ACTIONS.—

(A) In any implied private action arising under this Act that is certified as a plaintiff class action pursuant to the Federal rules of civil procedure, the plaintiff class may not be represented by (i) any attorney

who directly or indirectly owned or otherwise had a beneficial interest in the securities that are the subject of the litigation, or (ii) any attorney affiliated with such an attorney. An attorney who knowingly violates this prohibition shall be barred from representing any party in any action arising under this Act or under the Securities Act of 1933.

- "(B) In any implied private action arising under this Act that is certified as a plaintiff class action, an attorney may not represent the plaintiff class if the attorney has paid or is obligated to pay a fee to a third party who assisted him in obtaining the representation of any party to the action. An attorney who knowingly violates this prohibition shall be barred from representing any party in any action arising under this Act or under the Securities Act of 1933.
- "(3) DISGORGED FUNDS.—(A) Funds disgorged as a result of any action brought by the Commission in Federal court or of any Commission administrative action shall not be distributed as payment for attorney fees or expenses incurred by private parties seeking distribution of the disgorged funds.
- "(B) Any judgment awarded against any person in any implied private action arising under this Act

- shall be diminished by the amounts, if any, that
- 2 such person has been or may be required to dis-
- gorge, pursuant to a court order obtained at the in-
- 4 stance of the Commission in a proceeding brought
- 5 under section 21(d) of this Act, or in connection
- 6 with any Commission administrative action, relating
- 7 to the same alleged misconduct.
- 8 "(d) Burden of Proof.—In any implied cause of
- 9 action arising under this Act in which the plaintiff may
- 10 recover money damages only if it proves that the defend-
- 11 ant acted with scienter, the plaintiff must establish that
- 12 element of his claim by clear and convincing evidence in
- 13 order to establish a right to recover money damages.
- 14 "(e) Pleading Requirement.—In any implied
- 15 cause of action arising under this Act in which the plain-
- 16 tiff may recover money damages only if it proves that the
- 17 defendant acted with scienter, the plaintiff must allege in
- 18 its complaint facts suggesting that the defendant acted
- 19 with that state of mind.
- 20 "(f) AIDING AND ABETTING LIABILITY.—In any im-
- 21 plied cause of action arising under this Act in which the
- 22 plaintiff may recover damages only if it proves that the
- 23 defendant acted with scienter, a defendant may be held
- 24 liable as an aider and abettor only if the plaintiff proves
- 25 that the defendant knew that another party had violated

- 1 a provision of this Act and that the defendant, acting with
- 2 deliberate intent to deceive, manipulate, or defraud for the
- 3 defendant's own direct pecuniary benefit, provided sub-
- 4 stantial assistance to the other party's violation. Direct
- 5 pecuniary benefit shall not include ordinary compensation
- 6 for services provided.".

#### 7 SEC. 4. TIME LIMITATION ON PRIVATE RIGHTS OF ACTION.

- 8 The Securities Exchange Act of 1934 (15 U.S.C. 78a
- 9 et seq.) is amended by adding at the end the following
- 10 new section:

#### 11 "SEC. 36. LIMITATION ON PRIVATE RIGHTS OF ACTION.

- 12 "Except as otherwise provided in this Act, any pri-
- 13 vate right of action arising from a violation of this Act
- 14 shall be brought not later than the earlier of—
- 15 "(1) 5 years after the date on which such viola-
- tion occurred; or
- 17 "(2) one year after the date on which the viola-
- tion was discovered or should have been discovered
- through the exercise of reasonable diligence.".

#### 20 SEC. 5. EFFECTIVE DATE.

- The provisions of this Act shall apply to all actions
- 22 commenced on or after the date of the enactment of this
- 23 Act.