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1ST SESSION

H. R. 1058

IN THE SENATE OF THE UNITED STATES

MARCH 10 (legislative day, MARCH 6), 1995

Received; read twice and referred to the Committee on Banking, Housing, and
Urban Affairs

AN ACT

To reform Federal securities litigation, 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,*

3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Securities Litigation Reform Act”.

6 (b) TABLE OF CONTENTS.—The table of contents for
7 this Act is as follows:

- Sec. 1. Short title; table of contents.
- Sec. 2. Prevention of lawyer-driven litigation.
 - (a) Plaintiff steering committees to ensure client control of lawsuits.
 - “Sec. 36. Class action steering committees.
 - “(a) Class action steering committee.
 - “(b) Membership of plaintiff steering committee.
 - “(c) Functions of plaintiff steering committee.
 - “(d) Immunity from civil liability; removal.
 - “(e) Effect on other law.”
 - (b) Prohibition on attorneys’ fees paid from Commission disgorgement funds.
- Sec. 3. Prevention of abusive practices that foment litigation.
 - (a) Additional provisions applicable to private actions.
 - “Sec. 20B. Procedures applicable to private actions.
 - “(a) Elimination of bonus payments to named plaintiffs in class actions.
 - “(b) Restrictions on professional plaintiffs.
 - “(c) Awards of fees and expenses.
 - “(d) Prevention of abusive conflicts of interest.
 - “(e) Disclosure of settlement terms to class members.
 - “(f) Encouragement of finality in settlement discharges.
 - “(g) Contribution from non-parties in interests of fairness.
 - “(h) Defendant’s right to written interrogatories establishing scienter.”
 - (b) Prohibition of referral fees that foment litigation.
- Sec. 4. Prevention of “fishing expedition” lawsuits.
 - “Sec. 10A. Requirements for securities fraud actions.
 - “(a) Scienter.
 - “(b) Requirement for explicit pleading of scienter.
 - “(c) Dismissal for failure to meet pleading requirements; stay of discovery; summary judgment.
 - “(d) Reliance and causation.
 - “(e) Allocation of liability.
 - “(f) Damages.”
- Sec. 5. Establishment of “safe harbor” for predictive statements.
 - “Sec. 37. Application of safe harbor for forward-looking statements.
 - “(a) Safe harbor in general.
 - “(b) Definition of forward-looking statement.
 - “(c) No duty to make continuing projections.
 - “(d) Automatic procedure for staying discovery; expedited procedure for consideration of motion on applicability of safe harbor.
 - “(e) Regulatory authority.”
- Sec. 6. Amendment to Racketeer Influenced and Corrupt Organizations Act.
- Sec. 7. Financial fraud detection and disclosure.
 - “Sec. 13A. Fraud detection and disclosure.
 - “(a) Audit requirements.
 - “(b) Required response to audit discoveries.
 - “(c) Auditor liability limitation.
 - “(d) Civil penalties in cease-and-desist proceedings.
 - “(e) Preservation of existing authority.
 - “(f) Definitions.”
- Sec. 8. Rule of construction.
- Sec. 9. Effective date.

1 **SEC. 2. PREVENTION OF LAWYER-DRIVEN LITIGATION.**

2 (a) PLAINTIFF STEERING COMMITTEES TO ENSURE
3 CLIENT CONTROL OF LAWSUITS.—The Securities Ex-
4 change Act of 1934 (15 U.S.C. 78a et seq.) is amended
5 by adding at the end the following new section:

6 **“SEC. 36. CLASS ACTION STEERING COMMITTEES.**

7 “(a) CLASS ACTION STEERING COMMITTEE.—In any
8 private action arising under this title seeking to recover
9 damages on behalf of a class, the court shall, at the earli-
10 est practicable time, appoint a committee of class members
11 to direct counsel for the class (hereafter in this section
12 referred to as the ‘plaintiff steering committee’) and to
13 perform such other functions as the court may specify.
14 Court appointment of a plaintiff steering committee shall
15 not be subject to interlocutory review.

16 “(b) MEMBERSHIP OF PLAINTIFF STEERING COM-
17 MITTEE.—

18 “(1) QUALIFICATIONS.—

19 “(A) NUMBER.—A plaintiff steering com-
20 mittee shall consist of not fewer than 5 class
21 members, willing to serve, who the court be-
22 lieves will fairly represent the class.

23 “(B) OWNERSHIP INTERESTS.—Members
24 of the plaintiff steering committee shall have
25 cumulatively held during the class period not
26 less than—

1 “(i) the lesser of 5 percent of the se-
2 curities which are the subject matter of the
3 litigation or \$10,000,000 in market value
4 of the securities which are the subject mat-
5 ter of the litigation; or

6 “(ii) such smaller percentage or dollar
7 amount as the court finds appropriate
8 under the circumstances.

9 “(2) NAMED PLAINTIFFS.—Class plaintiffs
10 serving as the representative parties in the litigation
11 may serve on the plaintiff steering committee, but
12 shall not comprise a majority of the committee.

13 “(3) NONCOMPENSATION OF MEMBERS.—Mem-
14 bers of the plaintiff steering committee shall serve
15 without compensation, except that any member may
16 apply to the court for reimbursement of reasonable
17 out-of-pocket expenses from any common fund es-
18 tablished for the class.

19 “(4) MEETINGS.—The plaintiff steering com-
20 mittee shall conduct its business at one or more pre-
21 viously scheduled meetings of the committee, of
22 which prior notice shall have been given and at
23 which a majority of its members are present in per-
24 son or by electronic communication. The plaintiff
25 steering committee shall decide all matters within its

1 authority by a majority vote of all members, except
2 that the committee may determine that decisions
3 other than to accept or reject a settlement offer or
4 to employ or dismiss counsel for the class may be
5 delegated to one or more members of the committee,
6 or may be voted upon by committee members serially,
7 without a meeting.

8 “(5) RIGHT OF NONMEMBERS TO BE HEARD.—

9 A class member who is not a member of the plaintiff
10 steering committee may appear and be heard by the
11 court on any issue relating to the organization or ac-
12 tions of the plaintiff steering committee.

13 “(c) FUNCTIONS OF PLAINTIFF STEERING COMMIT-
14 TEE.—The authority of the plaintiff steering committee
15 to direct counsel for the class shall include all powers nor-
16 mally permitted to an attorney’s client in litigation, includ-
17 ing the authority to retain or dismiss counsel and to reject
18 offers of settlement, and the authority to accept an offer
19 of settlement subject to final approval by the court. Dis-
20 missal of counsel other than for cause shall not limit the
21 ability of counsel to enforce any contractual fee agreement
22 or to apply to the court for a fee award from any common
23 fund established for the class.

24 “(d) IMMUNITY FROM CIVIL LIABILITY; REMOVAL.—

25 Any person serving as a member of a plaintiff steering

1 committee shall be immune from any civil liability for any
2 negligence in performing such service, but shall not be im-
3 mune from liability for intentional misconduct or from the
4 assessment of costs pursuant to section 20B(c). The court
5 may remove a member of a plaintiff steering committee
6 for good cause shown.

7 “(e) EFFECT ON OTHER LAW.—This section does not
8 affect any other provision of law concerning class actions
9 or the authority of the court to give final approval to any
10 offer of settlement.”.

11 (b) PROHIBITION ON ATTORNEYS’ FEES PAID FROM
12 COMMISSION DISGORGEMENT FUNDS.—Section 21(d) of
13 the Securities Exchange Act of 1934 (15 U.S.C. 78u(d))
14 is amended by adding at the end the following new para-
15 graph:

16 “(4) PROHIBITION ON ATTORNEYS’ FEES PAID
17 FROM COMMISSION DISGORGEMENT FUNDS.—Except as
18 otherwise ordered by the court, funds disgorged as the re-
19 sult of an action brought by the Commission, or of any
20 Commission proceeding, shall not be distributed as pay-
21 ment for attorneys’ fees or expenses incurred by private
22 parties seeking distribution of the disgorged funds.”.

1 **SEC. 3. PREVENTION OF ABUSIVE PRACTICES THAT FO-**
2 **MENT LITIGATION.**

3 (a) **ADDITIONAL PROVISIONS APPLICABLE TO PRI-**
4 **VATE ACTIONS.**—The Securities Exchange Act of 1934 is
5 amended by inserting after section 20A (15 U.S.C. 78t–
6 1) the following new section:

7 “PROCEDURES APPLICABLE TO PRIVATE ACTIONS

8 “SEC. 20B. (a) **ELIMINATION OF BONUS PAYMENTS**
9 **TO NAMED PLAINTIFFS IN CLASS ACTIONS.**—In any pri-
10 vate action under this title that is certified as a class ac-
11 tion pursuant to the Federal Rules of Civil Procedure, the
12 portion of any final judgment or of any settlement that
13 is awarded to class plaintiffs serving as the representative
14 parties shall be equal, on a per share basis, to the portion
15 of the final judgment or settlement awarded to all other
16 members of the class. Nothing in this subsection shall be
17 construed to limit the award to any representative parties
18 of actual expenses (including lost wages) relating to the
19 representation of the class.

20 “(b) **RESTRICTIONS ON PROFESSIONAL PLAIN-**
21 **TIFFS.**—Except as the court may otherwise permit for
22 good cause, a person may be a named plaintiff, or an offi-
23 cer, director, or fiduciary of a named plaintiff, in no more
24 than 5 class actions filed during any 3-year period.

25 “(c) **AWARDS OF FEES AND EXPENSES.**—

1 “(1) AUTHORITY TO AWARD FEES AND EX-
2 PENSES.—If the court in any private action arising
3 under this title enters a final judgment against a
4 party litigant on the basis of a motion to dismiss,
5 motion for summary judgment, or a trial on the
6 merits, the court shall, upon motion by the prevail-
7 ing party, determine whether (A) the position of the
8 losing party was not substantially justified, (B) im-
9 posing fees and expenses on the losing party or the
10 losing party’s attorney would be just, and (C) the
11 cost of such fees and expenses to the prevailing
12 party is substantially burdensome or unjust. If the
13 court makes the determinations described in clauses
14 (A), (B), and (C), the court shall award the prevail-
15 ing party reasonable fees and other expenses in-
16 curred by that party. The determination of whether
17 the position of the losing party was substantially
18 justified shall be made on the basis of the record in
19 the action for which fees and other expenses are
20 sought, but the burden of persuasion shall be on the
21 prevailing party.

22 “(2) SECURITY FOR PAYMENT OF COSTS IN
23 CLASS ACTIONS.—In any private action arising
24 under this title that is certified as a class action pur-
25 suant to the Federal Rules of Civil Procedure, the

1 court shall require an undertaking from the attor-
2 neys for the plaintiff class, the plaintiff class, or
3 both, in such proportions and at such times as the
4 court determines are just and equitable, for the pay-
5 ment of the fees and expenses that may be awarded
6 under paragraph (1).

7 “(3) APPLICATION FOR FEES.—A party seeking
8 an award of fees and other expenses shall, within 30
9 days of a final, nonappealable judgment in the ac-
10 tion, submit to the court an application for fees and
11 other expenses that certifies that the party is enti-
12 tled to such an award under paragraph (1) and the
13 amount sought, including an itemized statement
14 from any attorney or expert witness representing or
15 appearing on behalf of the party stating the actual
16 time expended and the rate at which fees and other
17 expenses are computed.

18 “(4) ALLOCATION AND SIZE OF AWARD.—The
19 court, in its discretion, may—

20 “(A) determine whether the amount to be
21 awarded pursuant to this section shall be
22 awarded against the losing party, its attorney,
23 or both; and

24 “(B) reduce the amount to be awarded
25 pursuant to this section, or deny an award, to

1 the extent that the prevailing party during the
2 course of the proceedings engaged in conduct
3 that unduly and unreasonably protracted the
4 final resolution of the action.

5 “(5) AWARDS IN DISCOVERY PROCEEDINGS.—

6 In adjudicating any motion for an order compelling
7 discovery or any motion for a protective order made
8 in any private action arising under this title, the
9 court shall award the prevailing party reasonable
10 fees and other expenses incurred by the party in
11 bringing or defending against the motion, including
12 reasonable attorneys’ fees, unless the court finds
13 that special circumstances make an award unjust.

14 “(6) RULE OF CONSTRUCTION.—Nothing in
15 this subsection shall be construed to limit or impair
16 the discretion of the court to award costs pursuant
17 to other provisions of law.

18 “(7) PROTECTION AGAINST ABUSE OF PROC-
19 ESS.—In any action to which this subsection applies,
20 a court shall not permit a plaintiff to withdraw from
21 or voluntarily dismiss such action if the court deter-
22 mines that such withdrawal or dismissal is taken for
23 purposes of evasion of the requirements of this sub-
24 section.

1 “(8) DEFINITIONS.—For purposes of this sub-
2 section—

3 “(A) The term ‘fees and other expenses’
4 includes the reasonable expenses of expert wit-
5 nesses, the reasonable cost of any study, analy-
6 sis, report, test, or project which is found by
7 the court to be necessary for the preparation of
8 the party’s case, and reasonable attorneys’ fees
9 and expenses. The amount of fees awarded
10 under this section shall be based upon prevail-
11 ing market rates for the kind and quality of
12 services furnished.

13 “(B) The term ‘substantially justified’
14 shall have the same meaning as in section
15 2412(d)(1) of title 28, United States Code.

16 “(d) PREVENTION OF ABUSIVE CONFLICTS OF IN-
17 TEREST.—In any private action under this title pursuant
18 to a complaint seeking damages on behalf of a class, if
19 the class is represented by an attorney who directly owns
20 or otherwise has a beneficial interest in the securities that
21 are the subject of the litigation, the court shall, on motion
22 by any party, make a determination of whether such inter-
23 est constitutes a conflict of interest sufficient to disqualify
24 the attorney from representing the class.

1 “(e) DISCLOSURE OF SETTLEMENT TERMS TO CLASS
2 MEMBERS.—In any private action under this title that is
3 certified as a class action pursuant to the Federal Rules
4 of Civil Procedure, any proposed or final settlement agree-
5 ment that is published or otherwise disseminated to the
6 class shall include the following statements:

7 “(1) STATEMENT OF POTENTIAL OUTCOME OF
8 CASE.—

9 “(A) AGREEMENT ON AMOUNT OF DAM-
10 AGES AND LIKELIHOOD OF PREVAILING.—If the
11 settling parties agree on the amount of dam-
12 ages per share that would be recoverable if the
13 plaintiff prevailed on each claim alleged under
14 this title and the likelihood that the plaintiff
15 would prevail—

16 “(i) a statement concerning the
17 amount of such potential damages per
18 share; and

19 “(ii) a statement concerning the likeli-
20 hood that the plaintiff would prevail on the
21 claims alleged under this title and a brief
22 explanation of the reasons for that conclu-
23 sion.

24 “(B) DISAGREEMENT ON AMOUNT OF
25 DAMAGES OR LIKELIHOOD OF PREVAILING.—If

1 the parties do not agree on the amount of dam-
2 ages per share that would be recoverable if the
3 plaintiff prevailed on each claim alleged under
4 this title or on the likelihood that the plaintiff
5 would prevail on those claims, or both, a state-
6 ment from each settling party concerning the
7 issue or issues on which the parties disagree.

8 “(C) INADMISSIBILITY FOR CERTAIN PUR-
9 POSES.—Statements made in accordance with
10 subparagraphs (A) and (B) concerning the
11 amount of damages and the likelihood of pre-
12 vailing shall not be admissible for purposes of
13 any Federal or State judicial action or adminis-
14 trative proceeding.

15 “(2) STATEMENT OF ATTORNEYS’ FEES OR
16 COSTS SOUGHT.—If any of the settling parties or
17 their counsel intend to apply to the court for an
18 award of attorneys’ fees or costs from any fund es-
19 tablished as part of the settlement, a statement indi-
20 cating which parties or counsel intend to make such
21 an application, the amount of fees and costs that
22 will be sought (including the amount of such fees
23 and costs determined on a per-share basis, together
24 with the amount of the settlement proposed to be
25 distributed to the parties to suit, determined on a

1 per-share basis), and a brief explanation of the basis
2 for the application. Such information shall be clearly
3 summarized on the cover page of any notice to a
4 party of any proposed or final settlement agreement.

5 “(3) IDENTIFICATION OF LAWYERS’ REP-
6 RESENTATIVES.—The name and address of one or
7 more representatives of counsel for the class who
8 will be reasonably available to answer written ques-
9 tions from class members concerning any matter
10 contained in any notice of settlement published or
11 otherwise disseminated to the class.

12 “(4) OTHER INFORMATION.—Such other infor-
13 mation as may be required by the court, or by any
14 plaintiff steering committee appointed by the court
15 pursuant to section 36.

16 “(f) ENCOURAGEMENT OF FINALITY IN SETTLE-
17 MENT DISCHARGES.—

18 “(1) DISCHARGE.—A defendant who settles any
19 private action arising under this title at any time be-
20 fore verdict or judgment shall be discharged from all
21 claims for contribution brought by other persons
22 with respect to the matters that are the subject of
23 such action. Upon entry of the settlement by the
24 court, the court shall enter a bar order constituting
25 the final discharge of all obligations to the plaintiff

1 of the settling defendant arising out of the action.
2 The order shall bar all future claims for contribution
3 arising out of the action—

4 “(A) by any person against the settling de-
5 fendant; and

6 “(B) by the settling defendant against any
7 person other than a person whose liability has
8 been extinguished by the settling defendant’s
9 settlement.

10 “(2) REDUCTION.—If a person enters into a
11 settlement with the plaintiff prior to verdict or judg-
12 ment, the verdict or judgment shall be reduced by
13 the greater of—

14 “(A) an amount that corresponds to the
15 percentage of responsibility of that person; or

16 “(B) the amount paid to the plaintiff by
17 that person.

18 “(g) CONTRIBUTION FROM NON-PARTIES IN INTER-
19 ESTS OF FAIRNESS.—

20 “(1) RIGHT OF CONTRIBUTION.—A person who
21 becomes liable for damages in any private action
22 under this title (other than an action under section
23 9(e) or 18(a)) may recover contribution from any
24 other person who, if joined in the original suit,
25 would have been liable for the same damages.

1 “(2) STATUTE OF LIMITATIONS FOR CONTRIBU-
2 TION.—Once judgment has been entered in any such
3 private action determining liability, an action for
4 contribution must be brought not later than 6
5 months after the entry of a final, nonappealable
6 judgment in the action.

7 “(h) DEFENDANT’S RIGHT TO WRITTEN INTERROG-
8 ATORIES ESTABLISHING SCIENTER.—In any private ac-
9 tion under this title in which the plaintiff may recover
10 money damages, the court shall, when requested by a de-
11 fendant, submit to the jury a written interrogatory on the
12 issue of each such defendant’s state of mind at the time
13 the alleged violation occurred.”.

14 (b) PROHIBITION OF REFERRAL FEES THAT FO-
15 MENT LITIGATION.—Section 15(c) of the Securities Ex-
16 change Act of 1934 (15 U.S.C. 78o(c)) is amended by add-
17 ing at the end the following new paragraph:

18 “(8) RECEIPT OF REFERRAL FEES.—No broker or
19 dealer, or person associated with a broker or dealer, may
20 solicit or accept remuneration for assisting an attorney in
21 obtaining the representation of any customer in any pri-
22 vate action under this title.”.

1 **SEC. 4. PREVENTION OF “FISHING EXPEDITION” LAWSUITS.**

2 The Securities Exchange Act of 1934 (15 U.S.C. 78a
3 et seq.) is amended by inserting after section 10 the fol-
4 lowing new section:

5 **“SEC. 10A. REQUIREMENTS FOR SECURITIES FRAUD AC-**
6 **TIONS.**

7 “(a) SCIENTER.—

8 “(1) IN GENERAL.—In any private action aris-
9 ing under section 10(b) of this title based on a
10 fraudulent statement, liability may be established
11 only on proof that—

12 “(A) the defendant directly or indirectly
13 made a fraudulent statement;

14 “(B) the defendant possessed the intention
15 to deceive, manipulate, or defraud; and

16 “(C) the defendant made such fraudulent
17 statement knowingly or recklessly.

18 “(2) FRAUDULENT STATEMENT.—For purposes
19 of this section, a fraudulent statement is a state-
20 ment that contains an untrue statement of a mate-
21 rial fact, or omits to state a material fact necessary
22 in order to make the statements made, in the light
23 of the circumstances in which they were made, not
24 misleading.

25 “(3) KNOWINGLY.—For purposes of paragraph
26 (1), a defendant makes a fraudulent statement

1 knowingly if the defendant knew that the statement
2 of a material fact was untrue at the time it was
3 made, or knew that an omitted fact was necessary
4 in order to make the statements made, in the light
5 of the circumstances in which they were made, not
6 misleading.

7 “(4) RECKLESSNESS.—For purposes of para-
8 graph (1), a defendant makes a fraudulent state-
9 ment recklessly if the defendant, in making such
10 statement, is guilty of highly unreasonable conduct
11 that (A) involves not merely simple or even gross
12 negligence, but an extreme departure from standards
13 of ordinary care, and (B) presents a danger of mis-
14 leading buyers, sellers, or security holders that was
15 either known to the defendant or so obvious that the
16 defendant must have been aware of it. Deliberately
17 refraining from taking steps to discover whether
18 one’s statements are false or misleading constitutes
19 recklessness, but if the failure to investigate was not
20 deliberate, such conduct shall not be considered to
21 be reckless.

22 “(b) REQUIREMENT FOR EXPLICIT PLEADING OF
23 SCIENTER.—In any private action to which subsection (a)
24 applies, the complaint shall specify each statement or
25 omission alleged to have been misleading, and the reasons

1 the statement or omission was misleading. The complaint
2 shall also make specific allegations which, if true, would
3 be sufficient to establish scienter as to each defendant at
4 the time the alleged violation occurred. It shall not be suf-
5 ficient for this purpose to plead the mere presence of facts
6 inconsistent with a statement or omission alleged to have
7 been misleading. If an allegation is made on information
8 and belief, the complaint shall set forth with specificity
9 all information on which that belief is formed.

10 “(c) DISMISSAL FOR FAILURE TO MEET PLEADING
11 REQUIREMENTS; STAY OF DISCOVERY; SUMMARY JUDG-
12 MENT.—In any private action to which subsection (a) ap-
13 plies, the court shall, on the motion of any defendant, dis-
14 miss the complaint if the requirements of subsection (b)
15 are not met, except that the court may, in its discretion,
16 permit a single amended complaint to be filed. During the
17 pendency of any such motion to dismiss, all discovery and
18 other proceedings shall be stayed unless the court finds
19 upon the motion of any party that particularized discovery
20 is necessary to preserve evidence or to prevent undue prej-
21 udice to that party. If a complaint satisfies the require-
22 ments of subsection (b), the plaintiff shall be entitled to
23 conduct discovery limited to the facts concerning the alleg-
24 edly misleading statement or omission. Upon completion

1 of such discovery, the parties may move for summary
2 judgment.

3 “(d) RELIANCE AND CAUSATION.—

4 “(1) IN GENERAL.—In any private action to
5 which subsection (a) applies, the plaintiff shall prove
6 that—

7 “(A) he or she had knowledge of, and re-
8 lied (in connection with the purchase or sale of
9 a security) on, the statement that contained the
10 misstatement or omission described in sub-
11 section (a)(1); and

12 “(B) that the statement containing such
13 misstatement or omission proximately caused
14 (through both transaction causation and loss
15 causation) any loss incurred by the plaintiff.

16 “(2) FRAUD ON THE MARKET.—For purposes
17 of paragraph (1), knowledge and reliance may be
18 proven by establishing that the market as a whole
19 considered the fraudulent statement, that the price
20 at which the security was purchased or sold reflected
21 the market’s estimation of the fraudulent statement,
22 and that the plaintiff relied on that market price.
23 Proof that the market as a whole considered the
24 fraudulent statement may consist of evidence that
25 the statement—

1 “(A) was published in publicly available re-
2 search reports by analysts of such security;

3 “(B) was the subject of news articles;

4 “(C) was delivered orally at public meet-
5 ings by officers of the issuer, or its agents;

6 “(D) was specifically considered by rating
7 agencies in their published reports; or

8 “(E) was otherwise made publicly available
9 to the market in a manner that was likely to
10 bring it to the attention of, and to be consid-
11 ered as credible by, other active participants in
12 the market for such security.

13 Nonpublic information may not be used as proof
14 that the market as a whole considered the fraudu-
15 lent statement.

16 “(3) PRESUMPTION OF RELIANCE.—Upon proof
17 that the market as a whole considered the fraudu-
18 lent statement pursuant to paragraph (2), the plain-
19 tiff is entitled to a rebuttable presumption that the
20 price at which the security was purchased or sold re-
21 flected the market’s estimation of the fraudulent
22 statement and that the plaintiff relied on such mar-
23 ket price. This presumption may be rebutted by evi-
24 dence that—

1 “(A) the market as a whole considered
2 other information that corrected the allegedly
3 fraudulent statement; or

4 “(B) the plaintiff possessed such corrective
5 information prior to the purchase or sale of the
6 security.

7 “(4) REASONABLE EXPECTATION OF INTEGRITY
8 OF MARKET PRICE.—A plaintiff who buys or sells a
9 security for which it is unreasonable to rely on mar-
10 ket price to reflect all current information may not
11 establish reliance pursuant to paragraph (2). For
12 purposes of paragraph (2), the following factors
13 shall be considered in determining whether it was
14 reasonable for a party to expect the market price of
15 the security to reflect substantially all publicly avail-
16 able information regarding the issuer of the security:

17 “(A) The weekly trading volume of any
18 class of securities of the issuer of the security.

19 “(B) The existence of public reports by se-
20 curities analysts concerning any class of securi-
21 ties of the issuer of the security.

22 “(C) The eligibility of the issuer of the se-
23 curity, under the rules and regulations of the
24 Commission, to incorporate by reference its re-
25 ports made pursuant to section 13 of this title

1 in a registration statement filed under the Se-
2 curities Act of 1933 in connection with the sale
3 of equity securities.

4 “(D) A history of immediate movement of
5 the price of any class of securities of the issuer
6 of the security caused by the public dissemina-
7 tion of information regarding unexpected cor-
8 porate events or financial releases.

9 In no event shall it be considered reasonable for a
10 party to expect the market price of the security to
11 reflect substantially all publicly available information
12 regarding the issuer of the security unless the issuer
13 of the security has a class of securities listed and
14 registered on a national securities exchange or
15 quoted on the automated quotation system of a na-
16 tional securities association.

17 “(e) ALLOCATION OF LIABILITY.—

18 “(1) JOINT AND SEVERAL LIABILITY FOR
19 KNOWING FRAUD.—A defendant who is found liable
20 for damages in a private action to which subsection
21 (a) applies may be liable jointly and severally only
22 if the trier of fact specifically determines that the
23 defendant acted knowingly (as defined in subsection
24 (a)(3)).

1 “(2) PROPORTIONATE LIABILITY FOR RECK-
2 LESSNESS.—If the trier of fact does not make the
3 findings required by paragraph (1) for joint and sev-
4 eral liability, a defendant’s liability in a private ac-
5 tion to which subsection (a) applies shall be deter-
6 mined under paragraph (3) of this subsection only
7 if the trier of fact specifically determines that the
8 defendant acted recklessly (as defined in subsection
9 (a)(4)).

10 “(3) DETERMINATION OF PROPORTIONATE LI-
11 ABILITY.—If the trier of fact makes the findings re-
12 quired by paragraph (2), the defendant’s liability
13 shall be determined as follows:

14 “(A) The trier of fact shall determine the
15 percentage of responsibility of the plaintiff, of
16 each of the defendants, and of each of the other
17 persons or entities alleged by the parties to
18 have caused or contributed to the harm alleged
19 by the plaintiff. In determining the percentages
20 of responsibility, the trier of fact shall consider
21 both the nature of the conduct of each person
22 and the nature and extent of the causal rela-
23 tionship between that conduct and the damage
24 claimed by the plaintiff.

1 “(B) For each defendant, the trier of fact
2 shall then multiply the defendant’s percentage
3 of responsibility by the total amount of damage
4 suffered by the plaintiff that was caused in
5 whole or in part by that defendant and the
6 court shall enter a verdict or judgment against
7 the defendant in that amount. No defendant
8 whose liability is determined under this sub-
9 section shall be jointly liable on any judgment
10 entered against any other party to the action.

11 “(C) Except where contractual relationship
12 permits, no defendant whose liability is deter-
13 mined under this paragraph shall have a right
14 to recover any portion of the judgment entered
15 against such defendant from another defendant.

16 “(4) EFFECT OF PROVISION.—This subsection
17 relates only to the allocation of damages among de-
18 fendants. Nothing in this subsection shall affect the
19 standards for liability under any private action aris-
20 ing under this title.

21 “(f) DAMAGES.—In any private action to which sub-
22 section (a) applies, and in which the plaintiff claims to
23 have bought or sold the security based on a reasonable
24 belief that the market value of the security reflected all

1 publicly available information, the plaintiff's damages
2 shall not exceed the lesser of—

3 “(1) the difference between the price paid by
4 the plaintiff for the security and the market value of
5 the security immediately after dissemination to the
6 market of information which corrects the fraudulent
7 statement; and

8 “(2) the difference between the price paid by
9 the plaintiff for the security and the price at which
10 the plaintiff sold the security after dissemination of
11 information correcting the fraudulent statement.”.

12 **SEC. 5. ESTABLISHMENT OF “SAFE HARBOR” FOR PRE-**
13 **SCRIPTIVE STATEMENTS.**

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

17 **“SEC. 37. APPLICATION OF SAFE HARBOR FOR FORWARD-**
18 **LOOKING STATEMENTS.**

19 “(a) **SAFE HARBOR IN GENERAL.**—In any private ac-
20 tion arising under this title based on a fraudulent state-
21 ment (as defined in section 10A), a person shall not be
22 liable with respect to any forward-looking statement if and
23 to the extent that the statement—

24 “(1) contains a projection, estimate, or descrip-
25 tion of future events; and

1 “(2) refers clearly (or is understood by the re-
2 cipient to refer) to—

3 “(A) such projections, estimates, or de-
4 scriptions as forward-looking statements; and

5 “(B) the risk that such projections, esti-
6 mates, or descriptions may not be realized.

7 The safe harbor for forward-looking statements estab-
8 lished under this subsection shall be in addition to any
9 safe harbor the Commission may establish by rule or regu-
10 lation.

11 “(b) DEFINITION OF FORWARD-LOOKING STATE-
12 MENT.—For the purpose of this section, the term ‘for-
13 ward-looking statement’ shall include (but not be limited
14 to) projections, estimates, and descriptions of future
15 events, whether made orally or in writing, voluntarily or
16 otherwise.

17 “(c) NO DUTY TO MAKE CONTINUING PROJEC-
18 TIONS.—In any private action arising under this title, no
19 person shall be deemed to have any obligation to update
20 a forward-looking statement made by such person unless
21 such person has expressly and substantially contempora-
22 neously undertaken to update such statement.

23 “(d) AUTOMATIC PROCEDURE FOR STAYING DISCOV-
24 ERY; EXPEDITED PROCEDURE FOR CONSIDERATION OF
25 MOTION ON APPLICABILITY OF SAFE HARBOR.—

1 “(1) STAY PENDING DECISION ON MOTION.—

2 Upon motion by a defendant to dismiss on the
3 ground that the statement or omission upon which
4 the complaint is based is a forward-looking state-
5 ment within the meaning of this section and that the
6 safe harbor provisions of this section preclude a
7 claim for relief, the court shall stay discovery until
8 such motion is decided.

9 “(2) PROTECTIVE ORDERS.—If the court denies
10 a motion to dismiss to which paragraph (1) is appli-
11 cable, or if no such motion is made and a party
12 makes a motion for a protective order, at any time
13 beginning after the filing of the complaint and end-
14 ing 10 days after the filing of such party’s answer
15 to the complaint, asserting that the safe harbor pro-
16 visions of this section apply to the action, a protec-
17 tive order shall issue forthwith to stay all discovery
18 as to any party to whom the safe harbor provisions
19 of this section may apply, except that which is di-
20 rected to the specific issue of the applicability of the
21 safe harbor. A hearing on the applicability of the
22 safe harbor shall be conducted within 45 days of the
23 issuance of the protective order. At the conclusion of
24 the hearing, the court shall either dismiss the por-
25 tion of the action based upon the use of the forward-

1 looking information or determine that the safe har-
2 bor is unavailable in the circumstances.

3 “(e) REGULATORY AUTHORITY.—The Commission
4 shall exercise its authority to describe conduct with respect
5 to the making of forward-looking statements that will be
6 deemed not to provide a basis for liability in private ac-
7 tions under this title. Such rules and regulations shall—

8 “(1) include clear and objective guidance that
9 the Commission finds sufficient for the protection of
10 investors;

11 “(2) prescribe such guidance with sufficient
12 particularity that compliance shall be readily ascer-
13 tainable by issuers prior to issuance of securities;
14 and

15 “(3) provide that forward-looking statements
16 that are in compliance with such guidance and that
17 concern the future economic performance of an is-
18 suer of securities registered under section 12 of this
19 title will be deemed not to be in violation of this
20 title.

21 Nothing in this section shall be deemed to limit, either
22 expressly or by implication, the authority of the Commis-
23 sion to exercise similar authority or to adopt similar rules
24 and regulations with respect to forward-looking state-

1 ments under other statutes under which the Commission
2 exercises rulemaking authority.”.

3 **SEC. 6. AMENDMENT TO RACKETEER INFLUENCED AND**
4 **CORRUPT ORGANIZATIONS ACT.**

5 Section 1964(c) of title 18, United States Code, is
6 amended by inserting “, except that no person may bring
7 an action under this provision if the racketeering activity,
8 as defined in section 1961(1)(D), involves conduct action-
9 able as fraud in the purchase or sale of securities” before
10 the period.

11 **SEC. 7. FINANCIAL FRAUD DETECTION AND DISCLOSURE.**

12 (a) AMENDMENTS TO THE SECURITIES EXCHANGE
13 ACT OF 1934.—The Securities Exchange Act of 1934 is
14 amended by inserting after section 13 (15 U.S.C. 78m)
15 the following new section:

16 **“SEC. 13A. FRAUD DETECTION AND DISCLOSURE.**

17 “(a) AUDIT REQUIREMENTS.—Each audit required
18 pursuant to this title of an issuer’s financial statements
19 by an independent public accountant shall include, in ac-
20 cordance with generally accepted auditing standards, as
21 may be modified or supplemented from time to time by
22 the Commission, the following:

23 “(1) procedures designed to provide reasonable
24 assurance of detecting illegal acts that would have a

1 direct and material effect on the determination of fi-
2 nancial statement amounts;

3 “(2) procedures designed to identify related
4 party transactions which are material to the finan-
5 cial statements or otherwise require disclosure there-
6 in; and

7 “(3) an evaluation of whether there is substan-
8 tial doubt about the issuer’s ability to continue as a
9 going concern over the ensuing fiscal year.

10 “(b) REQUIRED RESPONSE TO AUDIT DISCOV-
11 ERIES.—

12 “(1) INVESTIGATION AND REPORT TO MANAGE-
13 MENT.—If, in the course of conducting any audit
14 pursuant to this title to which subsection (a) applies,
15 the independent public accountant detects or other-
16 wise becomes aware of information indicating that
17 an illegal act (whether or not perceived to have a
18 material effect on the issuer’s financial statements)
19 has or may have occurred, the accountant shall, in
20 accordance with generally accepted auditing stand-
21 ards, as may be modified or supplemented from time
22 to time by the Commission—

23 “(A)(i) determine whether it is likely that
24 an illegal act has occurred, and (ii) if so, deter-
25 mine and consider the possible effect of the ille-

1 gal act on the financial statements of the is-
2 suer, including any contingent monetary effects,
3 such as fines, penalties, and damages; and

4 “(B) as soon as practicable inform the ap-
5 propriate level of the issuer’s management and
6 assure that the issuer’s audit committee, or the
7 issuer’s board of directors in the absence of
8 such a committee, is adequately informed with
9 respect to illegal acts that have been detected or
10 otherwise come to the attention of such ac-
11 countant in the course of the audit, unless the
12 illegal act is clearly inconsequential.

13 “(2) RESPONSE TO FAILURE TO TAKE REME-
14 DIAL ACTION.—If, having first assured itself that
15 the audit committee of the board of directors of the
16 issuer or the board (in the absence of an audit com-
17 mittee) is adequately informed with respect to illegal
18 acts that have been detected or otherwise come to
19 the accountant’s attention in the course of such ac-
20 countant’s audit, the independent public accountant
21 concludes that—

22 “(A) any such illegal act has a material ef-
23 fect on the financial statements of the issuer,

24 “(B) senior management has not taken,
25 and the board of directors has not caused sen-

1 ior management to take, timely and appropriate
2 remedial actions with respect to such illegal act,
3 and

4 “(C) the failure to take remedial action is
5 reasonably expected to warrant departure from
6 a standard auditor’s report, when made, or
7 warrant resignation from the audit engagement,
8 the independent public accountant shall, as soon as
9 practicable, directly report its conclusions to the
10 board of directors.

11 “(3) NOTICE TO COMMISSION; RESPONSE TO
12 FAILURE TO NOTIFY.—An issuer whose board of di-
13 rectors has received a report pursuant to paragraph
14 (2) shall inform the Commission by notice within
15 one business day of receipt of such report and shall
16 furnish the independent public accountant making
17 such report with a copy of the notice furnished the
18 Commission. If the independent public accountant
19 making such report shall fail to receive a copy of
20 such notice within the required one-business-day pe-
21 riod, the independent public accountant shall—

22 “(A) resign from the engagement; or

23 “(B) furnish to the Commission a copy of
24 its report (or the documentation of any oral re-

1 port given) within the next business day follow-
2 ing such failure to receive notice.

3 “(4) REPORT AFTER RESIGNATION.—An inde-
4 pendent public accountant electing resignation shall,
5 within the one business day following a failure by an
6 issuer to notify the Commission under paragraph
7 (3), furnish to the Commission a copy of the ac-
8 countant’s report (or the documentation of any oral
9 report given).

10 “(c) AUDITOR LIABILITY LIMITATION.—No inde-
11 pendent public accountant shall be liable in a private ac-
12 tion for any finding, conclusion, or statement expressed
13 in a report made pursuant to paragraph (3) or (4) of sub-
14 section (b), including any rules promulgated pursuant
15 thereto.

16 “(d) CIVIL PENALTIES IN CEASE-AND-DESIST PRO-
17 CEEDINGS.—If the Commission finds, after notice and op-
18 portunity for hearing in a proceeding instituted pursuant
19 to section 21C of this title, that an independent public
20 accountant has willfully violated paragraph (3) or (4) of
21 subsection (b) of this section, then the Commission may,
22 in addition to entering an order under section 21C, impose
23 a civil penalty against the independent public accountant
24 and any other person that the Commission finds was a
25 cause of such violation. The determination whether to im-

1 pose a civil penalty, and the amount of any such penalty,
2 shall be governed by the standards set forth in section 21B
3 of this title.

4 “(e) PRESERVATION OF EXISTING AUTHORITY.—Ex-
5 cept for subsection (d), nothing in this section limits or
6 otherwise affects the authority of the Commission under
7 this title.

8 “(f) DEFINITIONS.—As used in this section, the term
9 ‘illegal act’ means any action or omission to act that vio-
10 lates any law, or any rule or regulation having the force
11 of law.”.

12 (b) EFFECTIVE DATES.—As to any registrant that
13 is required to file selected quarterly financial data pursu-
14 ant to item 302(a) of Regulation S-K (17 CFR
15 229.302(a)) of the Securities and Exchange Commission,
16 the amendments made by subsection (a) of this section
17 shall apply to any annual report for any period beginning
18 on or after January 1, 1996. As to any other registrant,
19 such amendment shall apply for any period beginning on
20 or after January 1, 1997.

21 **SEC. 8. RULE OF CONSTRUCTION.**

22 Nothing in the amendments made by this Act shall
23 be deemed to create or ratify any implied private right
24 of action, or to prevent the Commission by rule from re-

1 stricting or otherwise regulating private actions under the
2 Securities Exchange Act of 1934.

3 **SEC. 9. EFFECTIVE DATE.**

4 This Act and the amendments made by this Act are
5 effective on the date of enactment of this Act and shall
6 apply to cases commenced after such date of enactment.

 Passed the House of Representatives March 8,
1995.

Attest:

ROBIN H. CARLE,
Clerk.

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