SECURITIES LITIGATION UNIFORM STANDARDS ACT OF 1998

SPEECH OF

HON. EDWARD J. MARKEY

OF MASSACHUSETTS

IN THE HOUSE OF REPRESENTATIVES

Tuesday, July 21, 1998

Mr. MARKEY. Mr. Speaker, pursuant to the gentleman from Virginia's unanimous consent request of July 21, 1998 that all Members be given 5 legislative days within which to revise and extend their remarks on H.R. 1689 and to insert extraneous material, I wish to take the opportunity to extend upon my earlier remarks regarding this legislation and to respond to some rather incredible—and I believe inaccurate—remarks made by some of my distinguished colleagues regarding this legislation.

As I have indicated, I oppose this bill. If this bill is to become law, however, it is imperative that we clarify what the scienter requirement will be under the national standards created by H.R. 1689. My colleague from California—Representative Cox—seems to believe that standard should not include recklessness. I strongly disagree.

The federal courts have long recognized that recklessness satisfies the scienter requirement of Section 10(b) and Rule 10b-5—the principal antifraud provisions of the federal securities laws. It is true, as some of my colleagues have noted, that in Ernst & Ernst v. Hochfelder, the Supreme Court left open the question of whether recklessness could satisfy the scienter requirement of Section 10(b) and Rule 10b-5. My colleague from California, however, omits to state that the Court explicitly recognized that ''in certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act.'' My colleague from California also neglects to state that since Hochfelder was decided, every court of appeals that has considered the question — ten in number — has interpreted the text of Section 10(b) and Rule 10b–5 to impose liability for reckless misconduct.

And these courts had good reason to so hold. Recklessness is vital to protect investors and the integrity of the disclosure process. Without liability for reckless misstatements, injured investors would be able to recover only if they were able to prove that a defendant had intentionally lied. This would enable defendants who deliberately disregarded available information to avoid liability for investor losses, and would encourage corporate chieftains to bury their heads in the sand.

The recklessness standard promotes meaningful disclosure. Our securities laws are premised on disclosure. Issuers of securities must make full and fair disclosure of material facts to investors when offering their securities. If issuers of securities are liable for misstatements and omissions only when they consciously make false disclosures, they will have less incentive to conduct a probing inquiry into any potentially troublesome areas they discover in the course of preparing their disclosure documents. The recklessness standard helps ensure that disclosure is thorough and meaningful because it encourages issuers to know what is taking place in their own companies.

Finally, the recklessness standard helps bring deliberate securities violators to justice by preventing them from hiding behind evidentiary hurdles. Proving a defendant's actual knowledge of fraud in a securities case is often not possible. Defendants in securities fraud cases do not as a matter of course admit their fraudulent intent. Proving actual knowledge is particularly daunting when, as is often true in securities cases, the evidence relating to the defendant's state of mind is entirely circumstantial. As the U.S. Court of Appeals for the Second Circuit—one of the ten courts of appeals to have put their stamp of approval on recklessness—has noted: ''Proof of a defendant's knowledge or intent will often be inferential . . . and cases thus of necessity [are] cast in terms of recklessness. To require in all types of 10b–5 cases that a factfinder must find a specific intent to deceive or defraud would for all intents and purposes disembowel the private cause of action under § 10(b).''

I do agree with my colleague from the state of California that the 1995 Private Securities Litigation Reform Act did not change the scienter requirement for liability. I am deeply troubled, however, by his attempt to attribute to the Reform Act Conference Committee—of which I was a member—an intention to raise the pleading standard beyond that of the Second Circuit—which, at the time of the Reform Act was the strictest pleading standard in the nation. That clearly was not my understanding nor my intent. Indeed, not only is my colleague attempting to revise history, he is doing so in a manner that would create an illogical result. Because the antifraud provisions allow liability for reckless misconduct, it follows that plaintiffs must be allowed to plead that the defendants acted recklessly. To say that defrauded investors can recover for reckless misconduct, but that they must plead something more than reckless misconduct defies logic.

Likewise, I must take strong exception to the suggestion of my colleague from California about the Conference Committee's intentions regarding a footnote in the Statement of Managers. That footnote, inserted at the last minute without my knowledge and without any discussion of the matter by the Members during the Conference Committee meetings, states that the Committee chose ''not to include in the pleading standard certain language relating to motive, opportunity, or recklessness.'' Contrary to my colleague's statements, this footnote—and make no mistake about it, that's all it is, merely a footnote—does not mean that recklessness has been eliminated either as a basis for liability or as a pleading standard. Existence of this footnote in no way mandates that courts not follow the Second Circuit approach to pleading. The Conference Committee and the Congress that passed the Reform Act also chose not to expressly include conscious behavior in the pleading standard. Yet surely no one would suggest that in doing so, the Conference Committee and Congress intended to eliminate liability for conscious misconduct.

My colleague points to the fact that the President vetoed the bill because of his concerns that the conferees intended to adopt a pleading standard higher than the Second Circuit's. Members in both the House and the Senate following the veto made clear that we did no more than adopt the Second Circuit standard. In this regard, I strongly agree with my colleague from California, Congresswoman LOFGREN, who stated in the legislative history following President Clinton's veto: ''The President says he supports the second circuit standard for pleading. So do I. That is what is included in this bill.''

I would suggest that it is the gentleman from California, rather than myself and other opponents of this legislation, that are trying to rewrite history. I continue to feel that both the Reform Act of 1995 and the present legislation are bad for investors and bad for our financial markets. We do not need to compound the harm done by this legislation with revisionist histories that seek to surreptitiously eliminate liability for reckless behavior.

DISAPPROVAL OF MOST-FAVORED-NATION TREATMENT FOR CHINA

SPEECH OF

HON. TIM ROEMER

OF INDIANA

IN THE HOUSE OF REPRESENTATIVES

Wednesday, July 22, 1998

Mr. ROEMER. Mr. Speaker, I rise in strong opposition to H.J. Res. 121, disapproving Most Favored Nation trading status with China. I rise in strong support of normal trade relations and continued constructive engagement with China. I support constructive engagement with China as a method of improving our critically important bilateral relationship and pursuing our foreign policy goals to advance human rights and religious freedom. While progress is at times slow and painful, talks and diplomacy are key aspects of this bilateral relationship.

Last year's trip by President Jiang Zemin to the United States to participate in the first U.S.-China Summit in a decade was the first step in achieving our goals through constructive engagement. President Clinton's highly successful trip to China last month demonstrated that constructive engagement is the most effective way to advance our national interests and promote our values. The United States is committed to improving human rights conditions in China, and I strongly believe human rights should remain a firm pillar of U.S. foreign policy.

Under our policy of constructive engagement, China has acted forthrightly to address our differences, including human rights, both privately and publicly, advancing American values and principles of freedom and democracy. Within the past year, Chinese authorities released numerous political dissidents including Wei Jingsheng and Wan Dan as well as religious leaders like Bishop Zhou. China also signed the United Nations Covenant on Economic and Social Rights and has pledged to sign the UN Covenant on Civil and Political Rights in the fall. This has resulted in meaningful improvements in the lives of millions of Chinese.

Despite official restrictions, the number of religious adherents in China is growing rapidly, with tens of thousands of churches, both registered and unregistered, and with tens of millions of worshipers. I am pleased that Presidents Clinton and Jiang agreed to continued exchanges among officials and religious leaders to improve our mutual understanding of the role of religion in each country. The Chinese government has hosted several delegations of U.S. and foreign religious leaders and the UN Working Group on Arbitrary Detention.

These are positive steps and clearly demonstrate that China is working to expand cooperation with us. We must continue to press for more religious freedom in China. As Billy Graham has written, ''Do not treat China as an adversary but as a friend.'' Revoking normal trade relations and disengaging China will not help its people achieve religious freedom or improved human rights conditions.

Our policy of constructive engagement has also helped expand cooperation with China in critical areas important to our national security: improving financial stability in Asia, preventing the spread of chemical and biological agents on ballistic missiles, combating international crime and drug trafficking, protecting the environment and expanding free trade. China's resistance to devaluing its currency is a prime example of China's efforts to work with the international community to help slow the financial crisis in Asia. This is how the United States benefits from constructive engagement with China.

It is also important to recognize that revoking normal trade relations could actually increase our $15.7 trade deficit. At this time, China represents the fastest growing market for U.S. exports and accounts for more than $150 million of exports from my State of Indiana alone. Since every other major trading partner extends normal trade relations to China, revoking this status would give our competitors in Europe and Asia a competitive edge in developing markets from the ground up, thereby placing at risk more than 400,000 high-paying U.S. jobs and billions of dollars worth of future exports. The best way to reduce our trade deficit with China is to use our trade laws to our advantage in order to tear down China's tariff barriers and to help U.S. exporters to compete in China's markets. We must continue to support policies consistent with fair and free trade.

Mr. Speaker, I am confident that constructive engagement with China will lead to more positive results, advancing our trade interests and foreign policy goals regarding improved religious freedom and human rights conditions. I strongly encourage my colleagues to support constructive engagement and vote against this resolution to disapprove normal trade relations.

STRUCTURED SETTLEMENT PROTECTION ACT

HON. E. CLAY SHAW, JR.

OF FLORIDA

IN THE HOUSE OF REPRESENTATIVES

Friday, July 24, 1998

Mr. SHAW. Mr. Speaker, Mr. Speaker, today I rise along with my colleague Mr. STARK and a broad bipartisan group of our colleagues from the Ways and Means Committee to introduce the Structured Settlement Protection Act.

The Act addresses serious public policy concerns that are raised by transactions in which so-called factoring companies purchase recoveries under structured settlements from injured victims.

Recently there has been dramatic growth in these transactions in which injured victims are induced by factoring companies to sell off future structured settlement payments intended to cover ongoing living and medical needs in exchange for a sharply-discounted lump sum that then may be dissipated, placing the injured victim in the very predicament the structured settlement was intended to avoid.

As long-time supporters of structured settlements and the congressional policy underlying such settlements, we have grave concerns that these factoring transactions directly undermine the policy of the structured settlement tax rules. The Treasury Department shares these concerns.

Because the purchase of structured settlement payments by factoring companies so directly thwarts the congressional policy underlying the structured settlement tax rules and raises such serious concerns for structured settlements and injured victims, it is appropriate to deal with these concerns in the tax context.

Accordingly, we are proposing legislation to impose a substantial excise tax on the factoring company that purchases the structured settlement payments from the injured victim. The excise tax would be subject to an exception for genuine court-approved hardship cases to protect the limited instances of true hardship.

The following is a detailed discussion of the bill's provisions.

BACKGROUND

In acting to address the concerns over factoring companies that purchase structured settlement payments from injured victims the Treasury Department noted that: ''Congress enacted favorable tax rules intended to encourage the use of structured settlements—and conditioned such tax treatment on the injured person's inability to accelerate, defer, increase or decrease the periodic payments—because recipients of structured settlements are less likely than recipients of lump sum awards to consume their awards too quickly and require public assistance.'' (U.S. Department of the Treasury, General Explanations of the Administration's Revenue Proposals (Feb. 1998), p. 122).

Treasury then observed that by enticing injured victims to sell off their future structured settlement payments in exchange for a heavily discounted lump sum that may then be dissipated: ''These 'factoring transactions' directly undermine the Congressional objective to create an incentive for injured persons to receive periodic payments as settlements of personal injury claims.'' (*Id.*, at p. 122 [emphasis added].)

The Joint Tax Committee's analysis of the issue echoes these concerns: ''Transfer of the payment stream under a structured settlement arrangement arguably subverts the purpose of the Code to promote structured settlements for injured persons. (Joint Committee on Taxation, Description of Revenue Provisions Contained in the President's Fiscal Year 1999 Budget Proposal (JCS–4–98), (February 24, 1998), p. 223).

The Treasury Department in the Administration's FY 1999 Budget has proposed a 20-percent excise tax on factoring companies that purchase structured settlement payments from injured victims. Under the Administration's proposal, ''any person purchasing (or otherwise acquiring for consideration) a structured settlement payment stream would be subject to a 20 percent excise tax on the purchase price, unless such purchase is pursuant to a court order finding that the extraordinary and unanticipated needs of the original recipient render such a transaction desirable.'' (Treasury General Explanation, at p. 122). The proposal would apply to transfers of structured settlement payments made after date of enactment.

DESCRIPTION OF THE ACT

1. STRINGENT EXCISE TAX ON PERSONS WHO ACQUIRE STRUCTURED SETTLEMENT PAYMENTS IN FACTORING TRANSACTIONS

In its analysis of the Administration's proposal, the Joint Tax Committee notes the potential concern that in some cases the imposition of a 20-percent excise tax may result in the factoring company passing the tax along by reducing even further the already-heavily discounted lump sum paid to the injured victim for his or her structured settlement payments. The Joint Committee notes that ''[o]ne possible response to the concern relating to excessively discounted payments might be to raise the excise tax to a level that is certain to stop the transfers (perhaps 100 percent). . . .'' (Joint committee on Taxation, Description of Revenue Provisions Contained in the President's Fiscal Year 1999 Budget Proposal (JCS–4–98) (February 4, 1998), p. 223).

Factoring company purchases of structured settlement payments so directly subvert the Congressional policy underlying structured settlement and raise such serious concerns for structured settlement and the injured victims that it is appropriate to impose on the factoring company a more stringent excise tax rate applied against the amount of the discount reflected in the factoring transaction (subject to a limited exception described below for genuine court-approved hardships).

Accordingly, the Act would impose on the factoring company that acquires structured settlement payments directly or indirectly from the injured victim an excise tax equal to 50 percent of the difference between (I) the total amount of the structured settlement payments purchased by the factoring company, and (ii) the heavily-discounted lump sum paid the by the factoring company to the injured victim.

Similar to the stiff excise taxes imposed on prohibited transactions in the private foundation and pension context—which can range as high as 100 to 200 percent—this stringent excise tax is necessary to address the very serious public policy concerns raised by structured settlement factoring transactions.

Unlike the Administration's proposed tax imposed on the purchase price paid by the factoring company, the excise tax imposed on the factoring company under the Act would use a more stringent tax rate of 50 percent and would apply to the excess of the total amount of the structured settlement payments purchased by the factoring company over the heavily-discounted lump sum paid to the injured victim.

The excise tax under the Act would apply to the factoring of structured settlements in tort cases and in workers' compensation.

A structured settlement factoring transaction subject to the excise tax is broadly defined under the Act as a transfer of structured settlement payment rights (including portions of payments) made for consideration by means of sale, assignment, pledge, or other form of alienation or encumbrance for consideration.

2. EXCEPTION FROM EXCISE TAX FOR GENUINE, COURT-APPROVED HARDSHIP

The stringent excise tax would be coupled with a limited exception for genuine, court-approved financial hardship situations. Drawing upon the hardship standard enunciated in the Treasury proposal, the excise tax would apply to factoring companies in all structured settlement factoring transactions except those in which the transfer of structured settlement payment rights (1) is otherwise permissible under applicable Federal and State law and (2) is undertaken pursuant to the order of a court (or where applicable, an administrative authority) finding