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Introduction

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SYMPOSIUM: SECURITIES LAW AFTER THE PRIVATE SECURITIES LITIGATION REFORM ACT—UNFINISHED BUSINESS

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It is a pleasure and indeed an honor to introduce colleagues, both old and new, in this collection of articles and essays. In many ways, this is somewhat of a repeat performance: a number of the authors contained in this volume joined me in a securities symposium for the *Maryland Law Review* in 1987 when I was a faculty member of that superb law

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My thanks to Brant Martin and Chris Olive for their significant contributions.

school.[1] Much has changed in the (nearly ten!) years since, and therefore we once again find ourselves together.

This Issue of the *SMU Law Review* begins and ends primarily with a major piece of legislation: the Private Securities Litigation Reform Act of 1995. But its scope extends further, as it usually must, to treat additional issues facing securities law scholars and practitioners today.

Prior to turning to the articles herein, this Article examines the key piece of federal securities legislation enacted in the 1990s: The Private Securities Litigation Reform Act of 1995.

I. THE PRIVATE SECURITIES LITIGATION REFORM ACT: REVIEW AND COMMENTARY

Reacting to perceived abuses by "strike suit" lawyers in the securities law arena and seeking to enhance private enterprise, the U.S. Congress overrode President Clinton's veto to enact the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act").[2] This legislation has major impact in several respects, including with respect to class action litigation, sanctions for abusive litigation, pleading requirements, proportionate liability, and forward-looking statements made by issuers as well as others.[3]

This Article reviews several key components of the Litigation Reform Act. In certain respects, the legislation will deter the initiation of private litigation under the federal securities laws.

A. Class Action Reform

The Litigation Reform Act amends both the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") to add new Sections 27(a) and 21D(a), respectively. These sections are intended to address the problem of "professional plaintiffs" and other abusive practices in private securities class actions. The content of these sections includes the following:

(1) A requirement that each plaintiff seeking to serve as a representative party on behalf of a class file with the complaint a sworn certification that: (i) the plaintiff reviewed the complaint and authorized its filing; (ii) the plaintiff did not purchase the securities in question at the direction of counsel or in order to participate in a private action; (iii) the plaintiff is willing to both serve as a representative party on behalf of the class and provide both deposition and trial testimony; (iv) sets forth all of such plaintiff's particular securities transactions that are the subject of the class action; (v) identifies any other action filed during the preceding three-year period in which the plaintiff sought to serve as a representative party

1. Symposium, *Affirmative Disclosure Obligations Under the Securities Laws*, 46 Md. L. Rev. 915 (1987).

2. *See Senate Overrides President's Veto; Securities Litigation Reform Bill Now Law*, 28 Sec. Reg. & L. Rep. (BNA) 3 (Jan. 5, 1996).

3. See generally the articles in this Issue that address the Litigation Reform Act.

on behalf of a class; and (vi) the plaintiff will not accept payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as approved by the court. The plaintiff's filed certification will not be deemed a waiver of the attorney-client privilege.

(2) Guidelines for early notice (not later than twenty days after the filing of the complaint) to class members pertaining to the appointment of the lead plaintiff. Such notice must appear "in a widely circulated national business-oriented publication or wire service." Within sixty days of such publication, any member of the purported class may seek to serve as lead plaintiff.

(3) Provisions requiring the court to consider any motion by a purported class member in response to the class notice to be appointed as the lead plaintiff. These provisions require the court to adopt a rebuttable presumption that the "most adequate plaintiff" is the person with the largest financial interest in the relief sought by the class, but allows for discovery on such motions in limited circumstances. However, these provisions also mandate restrictions on "professional plaintiffs" in declaring that, except as the court may otherwise permit (such as with respect to institutional investors), a person may be a lead plaintiff (or an officer, director, or fiduciary of a lead plaintiff) in no more than five securities class actions brought as plaintiff class actions during any three-year period.

(4) Provisions limiting the lead plaintiff's recovery to its proportionate share of any judgment or settlement, as well as reasonable costs and expenses, including lost wages.

(5) The prohibition of settlements under seal except in limited circumstances.

(6) Provisions limiting the award of attorneys' fees and expenses to a "reasonable percentage" of the amount of any damages and prejudgment interest "actually paid" to the class. These provisions do not address how attorneys' fees should be calculated in cases where the relief awarded or settlement does not include monetary damages.

(7) Specific and mandatory procedures for the disclosure of settlement terms to class members (including disclosure of the amount of plaintiff recovery, statement of attorneys' fees and costs sought, identification of lawyers' representatives for the plaintiff class to answer questions, and statement of the reasons for settlement).

(8) Provisions requiring the court to determine whether an interest on the part of plaintiff's counsel in the securities in question constitutes a conflict of interest sufficient to disqualify the attorney from representing the party.

In addition, the 1934 Act is amended to authorize the court to require security for payment of class action fees and expenses.

These sections taken together should reduce the abusive practices of plaintiffs' counsel in securities class actions. However, it is evident that the efficacy of these sections will depend on the extent to which institutional investors choose to "come forward" and utilize the new framework.

B. SANCTIONS FOR ABUSIVE LITIGATION

The Litigation Reform Act amends the 1933 and 1934 Acts to mandate court review, upon final adjudication of private securities actions thereunder, of the parties' or their attorneys' compliance with Rule 11(b) of the Federal Rules of Civil Procedure requirements for a good faith factual and legal basis as to any pleading or dispositive motion. If the court finds that there is a "substantial failure" of the parties or attorneys to comply with its provisions, the court is directed to impose mandatory sanctions in accordance with Rule 11.

The provisions set forth a rebuttable presumption in favor of the award being the reasonable attorneys' fees and costs incurred as a direct result of the violation. This presumption may be rebutted by the sanctioned party or attorney only upon proof that (i) the award will present an unreasonable burden or (ii) the violation was "de minimis."

C. STAY OF DISCOVERY AND PRESERVATION OF EVIDENCE

The Litigation Reform Act amends the 1933 and 1934 Acts to provide for (i) a stay of discovery during the pendency of any motion to dismiss unless the court finds that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to a party; and (ii) the preservation of the evidence that is relevant to the allegations of the complaint during the pendency of any stay of discovery. A party aggrieved by the willful failure of an opposing party to comply with the provisions requiring preservation of evidence may seek appropriate sanctions. These provisions will undoubtedly eliminate some of the burden of expenses incurred by defendants who succeed in having the complaint in question dismissed.

D. AUDITOR DISCLOSURE OF CORPORATE FRAUD

The Litigation Reform Act amends the 1934 Act by adding a new Section 10A thereto. New Section 10A sets forth requirements for audits conducted by an independent public accountant of an issuer's financial statements to include certain procedures to (i) detect illegal acts that would have a direct and material effect on the determination of financial statement amounts; (ii) identify related party transactions material to financial statements; and (iii) evaluate an issuer's ability to continue as a going concern. The statutory language makes clear that the above procedures are to be carried out in accordance with current generally accepted accounting principles, "as may be modified from time to time by the [SEC]." The existing auditing standards provide for all three types of procedures prescribed in the new section.

This section further specifies notification and reporting guidelines for a public accountant who becomes aware of information indicating possible illegal activities during the course of an audit. The provisions also appear to codify current generally accepted accounting principles. If, in the course of an audit the public accountant detects or otherwise becomes aware of information indicating that an illegal act has or may have occurred, notwithstanding such act's perceived materiality to the issuer's financial statements, the accountant must (i) determine the likelihood that an illegal act has occurred; (ii) determine the possible effect of the illegal act on the issuer's financial statements, including contingent effects such as fines, penalties, or damages; and (iii) inform appropriate management and assure that the issuer's audit committee or, if none, its board of directors, is adequately informed (unless such illegal act clearly is inconsequential).

The lone new requirement imposed on such accountants exists if such an accountant concludes that (i) the illegal act has a material effect on the issuer's financial statements; (ii) senior management has not taken "timely and appropriate remedial action" with respect to the illegal act; and (iii) the failure to take "remedial action" is likely to cause the accountant to depart from a standard report or to resign from its capacity as auditor. Under these conditions, the accountant must, "as soon as is practicable," report its conclusions to the board of directors. A board of directors receiving a report from such an accountant must inform the SEC within one business day of receipt of the report and must give the accountant a copy of the notice sent to the SEC. If, however, the accountant does not receive a copy of the notice within this time, it must resign from the engagement or furnish the SEC with a copy of its report (or documentation of its oral report) to the board of directors within one business day after the issuer fails to provide to the accountant the notice copy. Even if the accountant resigns, it must still furnish the SEC with a copy of its report within the same time period.

Fortunately, the new section further stipulates that an accountant that furnishes a report to the SEC under the new section will not be held liable in any private action for any findings, conclusions, or statements in the report. However, the willful failure to file a required report will subject the accountant "and any other person that the [SEC] finds was a cause of such violation" to cease-and-desist proceedings as well as the imposition of civil penalties.

E. Proportionate Liability & Related Issues

The Litigation Reform Act amends the 1934 Act to add new Section 21D(g) thereto. This new section (i) circumscribes the scope of the current joint and several liability scheme; (ii) creates a proportionate liability framework for actions brought against multiple defendants under the Exchange Act or against "outside directors" of the issuer whose securities are the subject of an action under Section 11 of the Securities Act; and

(iii) clarifies several issues relating to partial settlements in federal securities actions.

First, the statute limits the application of joint and several liability for damages to apply only if the trier of fact specifically determines that the defendant in question "knowingly committed" a violation of the federal securities laws. The section provides that the term "knowingly committed" requires actual knowledge as the scienter standard and specifically provides that recklessness cannot constitute a knowing violation. Further, the legislation codifies the right to contribution among such joint tortfeasors recognized by the Supreme Court in *Musick, Peeler & Garrett v. Employers Insurance*.[4] Under this framework, the legislation provides that the liability of such defendants is to be premised upon findings of percentage of responsibility as to each jointly and severally liable defendant.

Second, by implication, in all actions wherein the "knowingly committed" scienter standard cannot be proven by the plaintiff but the lesser standard of recklessness may be shown, the statute creates a proportionate liability scheme and (with certain exceptions)[5] restricts liability for damages solely to that portion of the judgment that corresponds to the percentage of each individual defendant's responsibility for plaintiffs' losses. In addition, if certain individually liable defendants' shares of liability are uncollectible due to insolvency or some other reason, the statute requires additional proportionate contributions either from the jointly and severally liable defendants or, if still uncollectible, from other proportionately liable defendants for those uncollectible shares in certain specified circumstances.

The statute further provides specific guidelines for determining the percentage of each individual defendant's responsibility for damages in the form of directing the court (i) to instruct the trier of fact to answer special interrogatories; or (ii) to itself make special findings with respect to multiple defendants on specific issues. Such issues are to include, among other things, the percentage of responsibility of each defendant and whether the defendant "knowingly committed" violations so as to properly place that defendant within the joint and several liability scheme.

Third, the statute evidently brings an end to the controversy generated by several recent decisions addressing issues of partial settlements in federal securities actions by providing for the discharge of all claims for contribution brought by any other persons, whether or not such persons have themselves settled with the plaintiff, against any defendant that has settled any private action at any time prior to judgment. Moreover, the sec-

4. 508 U.S. 286 (1993). *See* Barbara Moses & Ronit Setton, *Contribution Under Rule 10b-5*, 26 REV. SEC. & COMMODITIES REG. 159 (1993).

5. For example, a "reckless" violator may be jointly and severally liable in certain circumstances where the plaintiff is an individual whose recoverable damages exceed 10% of such plaintiff's net worth and such plaintiff's net worth is less than $200,000. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (amending the Securities Exchange Act of 1934 to add § 21D(g)).

tion requires the implementation of a settlement bar order by the court constituting the discharge of all obligations to the plaintiff of the settling defendant "arising out of the action." The legislation makes clear that such bar orders apply to contribution actions brought by and against the settling defendant.

In addition, the statute provides for a new judgment reduction method applicable in multidefendant partial settlement cases. This method serves to reduce the plaintiff's subsequent judgment against any nonsettling defendant by the greater amount of either (1) the proportionate responsibility of the settling defendant as determined by the court or jury, or (2) the amount that such a settling defendant has already paid to the plaintiff pursuant to the respective settlement agreement. This particular judgment reduction method evidently eliminates the controversy engendered by the Supreme Court's decision in *McDermott, Inc. v. AmClyde*,[6] which adopted the proportionate fault method as the proper judgment reduction method in admiralty cases and was extended to the federal securities context by several federal courts.

F. Safe Harbor for Certain Forward-Looking Statements

The Litigation Reform Act amends the 1933 Act by adding a new Section 27A and further amends the 1934 Act by adding a new Section 21E. The new sections generally provide 1934 Act reporting companies (as well as those acting on their behalf and underwriters with respect to information furnished by or derived from information provided by such companies) with a safe harbor from liability in private actions for certain forward-looking statements (for example, projections). The safe harbor is applicable to both forward-looking written and oral statements, so long as (1) the statement is identified as a forward-looking statement and is accompanied by meaningful cautionary statements, thus codifying the "bespeaks caution" doctrine; (2) the statement lacks materiality; or (3) the plaintiff fails to prove that the statement was made with actual knowledge of its falsity (irrespective of whether cautionary language is included). This safe harbor applies only to private actions and not to SEC enforcement actions.

The safe harbor also contains specific provisions for oral forward-looking statements made by an issuer or those acting on its behalf under situation (1) above. Such oral forward-looking statements are protected if such statements are accompanied by appropriate cautionary language and identify "readily available" documentation that sets forth important factors that could cause results to differ materially from those projected. The legislation provides that such documentation is to be deemed "readily available" if it is either filed with the SEC or otherwise generally disseminated (for example, a press release carried on the Dow Jones Broad

6. 511 U.S. 202 (1994). *See* Alan R. Friedman, *Contribution and Partial Settlements in Securities Fraud Actions in Light of* McDermott, Inc. v. AmClyde, 23 Sec. Reg. L.J. 143 (1995).

Tape). The applicability of the safe harbor provisions are subject to enumerated exclusions in the form of certain excluded issuers (for example, penny stock issuers) and certain statements in specific instances (for example, tender offers).

In addition, the safe harbor section specifies that its provisions do not impose a duty to update a forward-looking statement. It is unclear whether this language is meant to eliminate the "duty to update" any forward-looking statement or merely to clarify that no implied "duty to update" may be gleaned from this section. Hence, the breadth of this language will be developed by the courts.

In regard to this legislatively enacted safe harbor for forward-looking information, the Joint Explanatory Statement of the Conference Committee is useful:

> The first prong of the safe harbor protects a written or oral forward-looking statement that is: (i) identified as forward-looking, and (ii) accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement.
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> Under this first prong of the safe harbor, boilerplate warnings will not suffice as meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the statement. The cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement, such as, for example, information about the issuer's business.
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> The second prong of the safe harbor provides an alternative analysis. This safe harbor also applies to both written and oral forward-looking statements. Instead of examining the forward-looking and cautionary statements, this prong of the safe harbor focuses on the state of mind of the person making the forward-looking statement. A person or business entity will not be liable in a private lawsuit for a forward-looking statement unless a plaintiff proves that person or business entity made a false or misleading forward-looking statement with actual knowledge that it was false or misleading. The Conference Committee intends for this alternative prong of the safe harbor to apply if the plaintiff fails to prove the forward-looking statement (1) if made by a natural person, was made with the actual knowledge by that person that the statement was false or misleading; or (2) if made by a business entity, was made by or with the approval of an executive officer of the entity with actual knowledge by that officer that the statement was false or misleading.
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> This legislation permits covered issuers, or persons acting on the issuer's behalf, to make oral forward-looking statements within the safe harbor. The person making the forward-looking statement must identify the statement as a forward-looking statement and state that results may differ materially from those projected in the statement.

The person must also identify a "readily available" written document that contains factors that could cause results to differ materially. The written information identified by the person making the forward-looking statement must qualify as a "cautionary statement" under the first prong of the safe harbor (i.e., it must be a meaningful cautionary statement or statements that identify important factors that could cause actual results to differ materially from those projected in the forward-looking statement.) For purposes of this provision, "readily available" information refers to SEC filed documents, annual reports and other widely disseminated materials, such as press releases.[7]

G. Pleading Requirements

The Litigation Reform Act adds a new Section 21D(b) to the 1934 Act setting forth:

(1) A requirement that a plaintiff in the complaint in any private securities fraud action alleging material misstatements and/or omissions "specify each statement alleged to have been misleading; the reason or reasons why the statement is misleading; and if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."

(2) A requirement that in any private action under the 1934 Act in which the plaintiff "may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each such act or omission alleged to violate [the 1934 Act], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

As the Joint Explanatory Statement of the Conference Committee for this legislation recognized, the foregoing language derives "in part" from the Second Circuit's pleading requirement which is "[r]egarded as the most stringent pleading standard." Nonetheless, the Conference Committee apparently believed that this "stringent pleading standard" was too lax, stating "[b]ecause the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard." In view of the new statute and its accompanying legislative history, the pleading requirements in private securities fraud actions undoubtedly pose a difficult barrier for plaintiffs to hurdle.[8]

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7. Conference Report on HR 1058, with Joint Statement of Conference Committee, 27 Sec. Reg. & L. Rep. (BNA) 1881, 1894 (Dec. 1, 1995) (detailing the Private Securities Litigation Reform Act of 1995, Joint Explanatory Statement of the Committee of Conference) [hereinafter Joint Explanatory Statement]. *See* Harvey L. Pitt & Karl A. Groskaufmanis, *Securities Reform Act Offers Limited Safe Harbor*, NAT'L L.J., Jan. 15, 1996, at B4; Marc I. Steinberg, *Securities Litigation Developments: The Bespeaks Caution Doctrine and Related Defenses*, 23 SEC. REG. L.J. 447 (1996).

8. *See* Joint Explanatory Statement, *supra* note 7. *See also* Wexner v. First Manhattan Co., 902 F.2d 169 (2d Cir. 1990); Richard G. Himelrick, *Pleading Securities Fraud*, 43 MD. L. REV. 342 (1984).

H. Express Causation Requirement

The Litigation Reform Act adds a new Section 21(D)(b)(4) to the 1934 Act. This provision expressly provides that the plaintiff must prove loss causation in any private action arising under the 1934 Act.

I. Damages

The Litigation Reform Act adds a new Section 21D(e) to the 1934 Act. In general, this provision places a limitation on damages in 1934 Act actions where the plaintiff attempts to establish such damages by reference to the market price of a security. In this context, the award of damages is the difference between the purchase or sale price paid or received by the plaintiff, as applicable, and the mean trading price of the security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market. For these purposes, the "mean trading price" of a security is the average of the daily trading price of such security, determined as of the close of the market each day during the 90-day period referred to above.[9]

J. Section 12(b) of the 1933 Act

The Litigation Reform Act amends Section 12 of the 1933 Act by adding a new subsection (Section 12(b)) which provides that in actions brought under former Section 12(2) (now known as Section 12(a)(2)), a defendant may avoid all or part of the damages that otherwise would be incurred by proving that all or part of the depreciation in the value of the securities in question resulted from factors unrelated to such misstatement or omission.

K. SEC Aiding and Abetting Authority

The Litigation Reform Act amends Section 20 of the 1934 Act by adding a new subsection (f) to authorize the SEC to seek injunctive relief and/or certain money penalties against aiders and abettors for violations of the 1934 Act (or any rule or regulation thereunder). Specifically, the section provides that any person who "knowingly provides substantial assistance" to another person in violation of the Exchange Act (or any rule or regulation thereunder) shall be liable "to the same extent as the person to whom such assistance is provided." Hence, this section preserves aiding and abetting liability in certain SEC enforcement actions. Nonetheless, the mental culpability standard (although seemingly requiring actual knowledge) may require clarification.[10]

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9. If the plaintiff sells or repurchases the subject security during this time, then this period terminates on the date on which such plaintiff sells or repurchases the security.

10. The SEC also has cease and desist authority in these circumstances. *See* Marc I. Steinberg & Ralph C. Ferrara, 1 Securities Practice: Federal and State Enforcement §§ 5A:13-5A-17 (1985 & Supp. 1996).

L. RICO

The Litigation Reform Act amends Section 1964(c) of the Racketeer Influenced and Corrupt Organizations Act ("RICO") generally to eliminate securities fraud as a predicate act in a civil RICO action. According to the Joint Explanatory Statement of the Conference Committee for the legislation, the Committee also "intend[ed] that a plaintiff may not plead other specified offenses, such as mail or wire fraud, as predicate acts under civil RICO if such offenses are based on conduct that would have been actionable as securities fraud."[11] An exception is made, thereby permitting a civil RICO action to be initiated in this context, when any person has been criminally convicted in connection with the fraud, in which case the statute of limitations commences to run on the date the conviction becomes final.[12]

M. COMMENTARY

In the final analysis, is the Litigation Reform Act a significant measure? The answer clearly is "yes" for at least the following reasons:

1. Pleading requirements are strict, thereby establishing a difficult barrier for plaintiffs to hurdle. Discovery at this stage of the litigation generally is not permitted. Accordingly, fewer actions will be initiated and a larger number of cases will be dismissed due to the plaintiff's failure to meet the pleading requirements. The enhanced likelihood of a court ordering sanctions in such situations also will deter the bringing of these lawsuits.

2. The enactment of a proportionate liability framework for "deep pockets" shifts the balance of power in settlement negotiations. To hold, for example, an investment banker, broker, accountant, lawyer, or outside director jointly and severally liable, the plaintiff normally must show actual knowledge. Otherwise, liability based on proportionate fault prevails. Hence, an accounting firm that acts "recklessly" and is deemed 4% liable for the loss normally will pay 4% of the damages. Given the difficulty of pleading and proving actual knowledge along with the emergence of this proportionate liability framework, "deep pockets" no longer should feel besieged.

3. The safe harbor for certain forward-looking written and oral statements should induce greater flow of "soft" information to the financial markets. With sufficient cautionary language, certain forward-looking statements with respect to 1934 Act reporting companies will not be actionable in private proceedings, even if such statements are material and made with actual knowledge of their falsity. Coupled with the enhanced pleading requirements discussed above, a complainant has an onerous burden to bring a meritorious action. Of course, the safe harbor does not

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11. Joint Explanatory Statement, *supra* note 7, at 1895.

12. *See* Dennis J. Block & Jonathan M. Hoff, *Securities and Litigation Reform Law*, N.Y. L.J., Dec. 21, 1995, at 5.

apply to SEC actions and is not available for certain issuers, such as those which are privately-held, and for certain events (such as tender offers and going-private transactions).

4. Enactment of the Litigation Reform Act signifies that plaintiffs will resort to the states' securities laws to an even greater extent. In states such as Texas, which has a remedial securities statute, this increased reliance on state law already has emerged.[13]

5. The impact of the institutional investor in the class action setting remains to be seen. Will the institutions come forward and act as lead plaintiffs in class actions or will they view the action from the sidelines? Will the legislation, in fact, deter traditional plaintiff's counsel from instituting suits on behalf of their small investor clients? Moreover, will there emerge a legal services market in which "blue chip" law firms are retained by the institutional investor acting as representative party on behalf of the class to serve as lead counsel? If these uncertainties eventuate, the map of securities class actions will need to be redrawn.

II. ARTICLES IN THIS SYMPOSIUM

I am honored that an old friend, the Hon. Stanley Sporkin, leads off this collection. In his lecture "Lawsuits Against the Public Corporation," delivered in his keynote address at the 1996 SMU Law Review Corporate Counsel Symposium, Judge Sporkin suggests a three-pronged approach for public corporations. He offers a prospective guide for avoiding some lawsuits, handling the inevitable ones that arise, and preventing some down the road. His proposals, which include the establishment of a watchdog Business Practices Officer within the corporate structure, offer unique and creative perspectives on some of the very problems the PSLRA is designed to ameliorate.

Professor Douglas Abrams analyzes the Private Securities Litigation Reform Act in terms of its restriction on civil RICO claims in the securities arena. In *Crime Legislation and the Public Interest: Lessons from Civil RICO*, he reviews the unanticipated consequences that have flowed from private RICO actions, and the zealous nature of the "private attorneys general" that the Act unknowingly created. Professor Abrams provides a comprehensive legislative and social history of RICO, showing its evolution from a crime bill aimed at the Mafia, to the judicial headache that resulted from the explosion of RICO securities claims in the 1980s. He surveys the elements of a civil RICO claim, proves its "ready applicability" to securities transactions, and bemoans RICO's metamorphosis into a general federal antifraud remedy: something which the legislation was never intended to be. He notes the tremendous drain on judicial

13. *See* Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489 (1995); Marc I. Steinberg, *The Texas Securities Act: A Plaintiff's Preferred Route?*, 58 TEX. B.J. 1096 (1995). *See generally* MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 9.06 (1996).

resources that has followed, due especially to the complex nature of a claim brought under the statute.

Professor Abrams then observes the lessons available from the historical perspective of 25 years of RICO litigation: federalization of crimes is not always prudent, legislative and executive haste in enacting legislation often results in bad law, and, unfortunately evident in recent crime legislation, Congress has apparently let RICO's lessons go unheeded. Even the recent abrogation of RICO causes of action in the securities realm is less than comforting: other civil RICO actions which are equally burdensome still exist.

In *Chasing the Rogue Professional After the Private Securities Litigation Reform Act of 1995*, Professor Douglas Branson analyzes professional liability as it applies to the large number of "collateral participants" in a securities issuance. He points out, however, that under the federal securities regime as enacted and construed by the judiciary, pursuit of fraudulent conduct allegedly engaged in by securities-related professionals has become increasingly difficult.

With favored causes of action now seemingly closed, Professor Branson suggests bringing these rogues to justice through alternative means: primary liability, individual or group litigation instead of class actions, blue sky claims under state law, liability under state corporation laws, and common law theories such as negligent misrepresentation. He concludes that, because of the Reform Act and the recent federal case law, unless a smoking gun or direct involvement is found, remedies premised on state law may be the last refuge of allegedly victimized investors.

In *Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure*, Professor Charles Elson provides us with the first of two articles in this Symposium related to compensation of insiders. Professor Elson argues for an alternative system of director compensation, one that will more closely align directors' interests with those of the shareholders and which will encourage "active management oversight." His solution is relatively straightforward: compensate the directors with company stock in lieu of cash.

Professor Elson identifies the evils of a passive board of directors which rubber-stamps the insiders' decisions, and which fails to monitor and challenge management properly. He points out the abuses which necessarily flow from rewarding directors with pensions for length of service, large consulting contracts, and charitable contribution programs. He draws support from the recent report issued by the National Association of Corporate Directors' Commission on Director Compensation and "explain[s] why the current movement towards equity-based compensation will reunite ownership and control to create more active board oversight of management and a healthier, more competitive corporation."[14]

14. Charles Elson, *Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure*, 50 SMU L. REV. 127, 135 (1996).

Professor Janet Kerr joins us with Ralston *Redux: Determining Which Section 3 Offerings Are Public Under Section 12(2) After* Gustafson. Professor Kerr notes that in the wake of *Gustafson*,[15] the Supreme Court left questions unanswered as to which offerings, besides registered offerings, fall under Section 12(2) (now Section 12(a)(2)). She argues that the correct approach for these "other" offerings is to rely on the "fend for oneself" analysis promulgated by the Supreme Court almost a half-century ago in *Ralston Purina*.[16] She summarizes the two primary critiques of *Gustafson:* (1) that the Court used a narrower definition of "prospectus" culled from Section 10, rather than the wider and more appropriate definition found in Section 2(10); and (2) that the Court wrongly applied its Section 10 definition uniformly across the breadth of the Act, in clear violation of standard statutory interpretation.

Professor Kerr advocates classifying two groups as "self-fending" under the *Ralston Purina* analysis, for whom Section 3 offerings would be private and thus excluded from Section 12(2). These two groups, "insiders" on the one hand and "sophisticated" investors on the other, would provide a bright-line test for issuers, and would preclude the confusion inherent in the wake of *Gustafson.*

In *Reflections on Executive Compensation and a Modest Proposal for (Further) Reform*, Professor Mark Loewenstein examines the government's (and the public's) continuing fascination with executive compensation. He begins with a survey of the extant literature on the subject, and notes that, in spite of a relative paucity of sound empirical evidence on the subject, it is often the perception of overcompensation that needs to be addressed, whether or not overcompensation is actually present. He then analyzes recent judicial oversight of executive compensation, most notably through the Delaware *Aronson*[17] case and the Missouri *Saigh*[18] case. He argues that the procedural roadblocks set forth in such cases, based in the state corporation statutes, cause shareholder protections enunciated in *Rogers v. Hill*[19] to be nothing more than dead-letter law.

Professor Loewenstein then examines the SEC's attempts to regulate executive compensation, and Congress's attempts to do the same through the Internal Revenue Code. Neither of these approaches is satisfactory in his view, as they provide a cumbersome framework whose policy goals are undermined by their reliance on "performance-based" compensation. In short, linking a CEO's pay to the price of the stock may not always be a good idea from the investor's or the company's point of view. Professor Loewenstein's proposal is that shareholders be allowed a separate "ratification vote" on executive compensation. Such a vote would both allow

15. Gustafson v. Alloyd Co., 115 S. Ct. 1061 (1995).
16. SEC v. Ralston Purina Co., 346 U.S. 119 (1953).
17. Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
18. Saigh v. Busch, 396 S.W.2d 9 (Mo. Ct. App. 1965).
19. 289 U.S. 582 (1933).

shareholders a voice on this explosive issue, and would also serve to quiet the annual firestorm linked to the disclosure of CEO pay. Such a vote would also allow a Board to ascertain the opinions of shareholders from year to year and in the long-term adjust CEO compensation accordingly.

Professor Richard Painter and Ms. Jennifer Duggan in *Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation* observe that while the Act goes a long way towards remedying egregious conduct by accountants in an issuance of securities, it omits some key players from its scope: the lawyers. The courts and the SEC have held lawyers to some liability standard in securities transactions, but over the years that standard has undergone changes which make it difficult for counsel to plan and act accordingly.

Professor Painter and Ms. Duggan argue that by leaving lawyers out of the applicable liability provisions of the Act, Congress has placed securities attorneys in greater danger than before. In short, liability for counsel is now left up to the courts, foregoing the predictability that accountants now enjoy. While the two professions have always been treated differently, the authors' proposal for at least defining the standard of care of securities counsel may be a welcome addition to the Act. They conclude with several proposals that would help counsel define his or her role and thereby limit liability. Methods for detecting client fraud, notifying the Board of Directors, resigning from representation (and "waving the red flag"), and disclosure to the SEC (with attendant opt-in or opt-out default provisions) are among the proposals advocated.

In *Making Securities Arbitration Work*, Professor Norman Poser observes that "[t]he fact that parties who signed an agreement to arbitrate future disputes find themselves forced to litigate collateral issues tends to defeat the unique advantages of arbitration."[20] He details the history of securities arbitration and the litigation surrounding it, especially the federal courts' evolving willingness to enforce arbitration. He takes the reader through the different aspects and issues attendant to securities arbitration, including the collateral issues most often litigated: scope, eligibility, punitive damages, attorney's fees, and choice of forum and venue.

Professor Posner argues that two, and only two, questions should be left to the courts: arbitrability and limited judicial review of arbitration awards. All other issues should be decided by the applicable arbitration panel. For arbitrability, moreover, a four-part test should be used by the courts to help establish prospective predictability: (1) whether the parties have agreed to arbitrate; (2) the scope of the agreement; (3) whether Congress intended the claims to be arbitrable; and (4) whether the trial of any non-arbitrable claims should be stayed, pending the arbitration.

In *Contribution and Proportionate Liability Under the Federal Securities Laws in Multidefendant Securities Litigation After the Private Securi-*

20. Norman Poser, *Making Securities Arbitration Work*, 50 SMU L. REV. 277, 279 (1996).

ties Litigation Reform Act of 1995, Mr. Christopher Olive and I analyze Title II of that legislation.

Prior to the enactment of the Private Securities Litigation Reform Act, many issues with respect to partial settlements and contribution actions remained largely unresolved in multidefendant securities litigation. Partial settlements occur when at least one defendant settles with the plaintiffs or plaintiff-class, while other non-settling defendants remain in the litigation. The driving force behind partial settlements is the desire to avoid potential exposure for joint and several liability, particularly in securities fraud actions. Joint and several liability implies that defendants, regardless of their degree of culpability, could be potentially liable for all of the damages awarded to plaintiffs.

Two classic partial settlement scenarios normally arise with respect to settling defendants. First, so-called "deep pocket" professional defendants will settle, notwithstanding their relatively lesser culpability, in order to avoid being subject to enormous liability for the actions of more culpable defendants. Second, the more culpable defendants will settle with plaintiffs if their estimated settlement value is less than the projected costs in litigation and adjudication relative to their perceived degrees of culpability. In either situation, the settling defendants would almost certainly be subject to future litigation with non-settling defendants, in the form of contribution and related actions, so they successfully petition courts to implement settlement bar orders to eliminate such future litigation. The imposition of settlement bar orders, and the implementation of judgment reduction methods used to compensate non-settling defendants for the loss of these rights against the settling defendants, create complex partial settlement issues which have plagued courts and commentators for years.

In enacting Title II of the Private Securities Litigation Reform Act of 1995, Congress established significant limitations on joint and several liability and created a proportionate liability regime for certain less culpable defendants. Title II thus revolutionizes multidefendant securities litigation, and provides significant protection for marginally culpable defendants.

Importantly, pursuant to the 1995 legislation, Congress addressed many of the complex partial settlement issues and established a judgment reduction method for both settling and non-settling defendants in multidefendant securities litigation. Although the Title II provisions have been touted as a major success in litigation reform and necessary to ameliorate abusive class action securities fraud lawsuits, the impact of Title II extends far beyond securities fraud actions.

Professor Manning Warren in the Symposium's closing article authors *The Primary Liability of Securities Lawyers*. There, he analyzes the effect of the Supreme Court's decision in *Central Bank*.[21] Professor Warren ar-

21. Central Bank v. First Interstate Bank, 511 U.S. 164 (1994).

gues that a shift from "secondary" aiding and abetting liability for securities lawyers to "primary" Section 10(b) liability, in practical terms, may effect little change. He provides a comprehensive survey of a securities lawyer's duties in a securities offering, especially as they concern the disclosure process for which he or she may be held liable.

Professor Warren provides a detailed analysis of case law, asserting that a securities lawyer's role, since it is highly specialized, is sometimes little understood by jurists without a securities background. He concludes with a treatment of the applicable standards of care, and determines that not only is primary liability now the controlling law, but that it is appropriate as well.

In conclusion, I would like to thank the Board of Editors and Staff of the *SMU Law Review* for organizing this Symposium. I also thank the authors of this Symposium, many of whom have been my friends for years and others whom I have met more recently. This Symposium is a superb collection of articles and I am pleased to participate.