DRAFT: 10/30/91

The Honorable Christopher J. Dodd
Chairman
Securities Subcommittee
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Mr. Chairman:

I am pleased to respond to your October 2, 1991 letter to President Bush requesting the Administration's views on S. 1533, the "Securities Investor Protection Act of 1991." My letter also responds to the October 8, 1991 letter to President Bush from Senators Garn, Gramm, and Domenici concerning whether it is appropriate to address concerns about frivolous litigation in separate proposals considered in conjunction with S. 1533.

The version of S. 1533 approved by the Senate Banking Committee as section 1126 of the banking bill would establish a uniform statute of limitations for private rights of action under the Securities Exchange Act of 1934 of the earlier of two years from the date of discovery of a violation or five years from the date of the violation itself. The bill would supercede the Supreme Court's recent holding in Lampf v. Gilbertson that the applicable limitations period for private actions under the antifraud provisions of the Exchange Act is one year from discovery or three years from the violation. The legislation also would permit certain cases to be refiled if dismissed on the basis of Lampf.

The Administration would support legislation that extends that statute of limitations if certain additional provisions (outlined below) are added to minimize the potential for unnecessary or abusive litigation. We believe Lampf -- in particular the three-year outer limit -- unduly restricts the rights of victims of securities fraud to seek federal remedies. In addition to preventing some innocent victims from pursuing legitimate claims, Lampf limits the benefits of "private attorney general" lawsuits, thus reducing the level of deterrence and possibly leading to an expanded and more costly SEC enforcement program.

Chairman Breeden has testified that based on the Securities and Exchange Commission's experience, a three-year period will not provide many defrauded investors with a sufficient opportunity to bring actions for securities fraud. He pointed out that had a three-year statute of limitation been in effect for the Commission, approximately one-half of the case against Drexel Burnham, a large part of the Equity Funding case, and all of the case against E. F. Hutton for check-kiting would have been banned from the courthouse. We agree with Chairman Breeden that a longer limitations period is desirable, provided that steps are taken simultaneously to discourage unmeritorious claims.

The proposed five-year outer limit seems appropriate in that it would be consistent with the limitation period permitted for penalty actions brought by the Commission under the recent Securities Enforcement Remedies and Penny Stock Reform Act and for private actions under section 20A of the Exchange Act against persons who engage in insider trading.

We note that under similar legislation introduced in the House, there would be no outer limit on claims. We believe this would be unwise, as it would expose firms to litigation for a potentially indefinite period. The Administration would not support legislation which does not include an outer limit on claims.

Although S. 1533 initially included a provision commencing the two-year limitation period after the plaintiff discovered or <u>should have discovered</u> the violation <u>through the exercise of reasonable diligence</u>, the version included in the banking bill commences the two-year period only upon <u>actual</u> discovery.

We agree with the Commission's view that a reasonable diligence standard is not appropriate. In addition to raising complex, fact-based questions of reasonableness, which could prolong litigation, a reasonable diligence standard may even generate premature lawsuits filed only to protect against untimely filing defenses. Moreover, as Chairman Breeden's testimony points out, if an investor recklessly ignores clear evidence of fraud, the two-year period may be triggered on the basis of imputed knowledge.

Our greatest concern regarding this legislation is the opportunities it will make available for increased unmeritorious litigation. While we want to provide victims of securities fraud full opportunity to seek redress, we also realize that securities fraud claims have been a favorite tool of lawyers in filing frivolous or "shakedown" suits. An increase in the statute of limitations would almost certainly increase the number of such suits.

To ensure that this legislation does not lead to undue litigation, we believe it should be tied to targeted and limited litigation reforms. As cited in the October 8 letter, many such reforms were suggested in Chairman Breeden's testimony and in the recent report on civil justice reform by the Vice President's Council on Competitiveness.

We believe that many of these proposals can and should be adopted for securities fraud cases as part of this legislation. In particular, we believe that a proposal adopting the "loser pays" principle would screen out many unmeritorious claims. In addition, as suggested by Chairman Breeden, civil RICO claims should be barred where the predicate offense is based on violations of federal securities laws.

We would be happy to work with you in developing these proposals for reform in greater detail.

Sincerely,

Nicholas F. Brady