THE NASDAQ STOCK MARKET
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NASDAQ

JOSEPH R. HARDIMAN
PRESIDENT

December 20, 1993

The Honorable Christopher J. Dodd
United States Senate
444 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Pete V. Domenici
United States Senate
427 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senators:

During the past year, we at the Nasdaq Stock Market have become increasingly concerned about the effect that abusive litigation is having on the flow of information to the market for the stock of Nasdaq companies. The Nasdaq Stock Market is a computer screen-based market that operates, unlike an exchange, without a trading floor. It lists the securities of 4,500 domestic and foreign companies, more than all other U.S. stock markets combined, and accounts for approximately 45% of all the equity share volume that takes place in the U.S. each day. The companies listing their securities on Nasdaq run the full spectrum of U.S. industries, from a substantial number of young innovative corporations that make up the new and emerging industries to many seasoned companies operating in well-established sectors of the economy.

Our concern is with the increasing number of lawsuits against public companies that are commenced merely because of a downward price movement in a company's stock. Many of these lawsuits are filed in cookie cutter fashion without stating particulars just to generate settlements. While we generally would not become involved in a litigation issue, we are very concerned about the chilling effect these suits are having on the quality of information that is being provided to the market. If forward looking information is released by a company and at some point in the future, for whatever

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reason, the market for that company's shares declines, the company today has an excellent chance of an expensive lawsuit alleging violations of the securities laws, whether or not there is any evidence of misconduct. In most cases, the complexity of the applicable statutes, the costs of defending litigation and the possibility of class action damages forces the company to make a business decision to settle.

This has brought about a very significant change in corporate exposure. As a result, many companies are striking a more defensive and restrictive posture and information relating to a company's projections of the future is increasingly not being made available to the public as it has in the past. Forward looking statements are critical to investors and securities analysts evaluation of a company's prospects. With less information the markets work less efficiently resulting in both a misallocation of and rise in the cost of capital.

We have been working with Nasdaq companies as well as a number of organizations and associations to develop a number of reforms which would discourage frivolous lawsuits by altering the economics and the procedures in these lawsuits. We strongly urge you to consider the following reform proposals for legislation on securities litigation. These reforms should also be applicable to pendant state claims.

- **Optional Alternative Dispute Resolution (ADR)**: Parties in a shareholder suit should have the option of requesting Early Neutral Evaluation (a form of voluntary, non-binding ADR used in several Federal courts) utilizing special securities experts. If a party refuses to submit to Early Neutral Evaluation and subsequently loses in court, that party would be required to pay the attorneys' fees of the prevailing party if its case is not "substantially justified." If a party does submit, but is not satisfied with the results of Early Neutral Evaluation, it could take the case to court. At an early stage of the court proceeding, the judge would evaluate the results of the Early Neutral Evaluation and any other information the parties want to submit. If the party that did not agree with the results of Early Neutral Evaluation does not have a case that is "substantially justified," that party will be put on notice that if it proceeds with its case and loses, it must pay the attorneys' fees of the prevailing party incurred from that point forward.

- **Arbitration** : Corporations could be allowed, with shareholder approval, to include provisions in their bylaws that would require shareholder claims under the securities laws to be handled by arbitration or ADR.

- **Named Plaintiff Thresholds:** The named plaintiffs should be required to hold, in the aggregate, at least a certain percentage of the securities at issue.

- **Plaintiff Steering Committees:** As in bankruptcy cases, the court would be authorized to appoint a committee of shareholders to include those with the largest claims at stake. The committee could supervise class counsel and take greater control of the litigation, with safeguards to ensure that the litigation would not be unduly delayed.

- **Prohibitions Against Litigation Abuses:** Practices such as payments of bounties to named plaintiffs and payments of referral fees to third parties should be barred. Doing so will help ensure that the named plaintiffs have a real stake in the litigation.

- **Offer and Settlement:** The securities laws should be amended to allow either party to offer a settlement, and to require the party declining the settlement (or that party's attorney) to pay the offerer's costs (including attorneys' fees) in the event the ultimate judgment is substantially less favorable to the party declining the offer. This approach is similar to state litigation reform statutes such as Florida's.

- **Pleading Reforms:** The securities laws should be amended to codify the practice, already adopted by several courts, that the facts allegedly establishing that the defendant acted with intent to defraud must be pleaded with particularity. In addition, certain other specific elements should be pleaded with particularity (such as the false or misleading statements at issue, and the information relied on in allegations based on information and belief).

- **Changes in Calculation of Damages:** The securities laws should be amended to incorporate certain principles that would improve the calculation of damages and prevent abusive tactics in litigation. A fundamental principle in all legal contexts is mitigation of damages. This principle should be applied by capping damages at the maximum price decline of the security immediately following the disclosure at issue. This principle should also be used to reduce damages for plaintiffs who continue to hold a security following the disclosure at issue, since the price often rebounds and makes up for the loss. In addition, a methodology should be established for courts to use in order to eliminate losses resulting from market volatility. Another important principle is that damages should be individualized. This concept can be implemented by making clear that, as a number of courts have held, damages must be calculated on a "per-share" basis.

- **Two-Tier Proportionate Liability** - Joint and several liability should continue to apply to those defendants found to have engaged in intentional fraud. Other defendants who are held liable, but found not to have engaged in intentional fraud, would be required to pay the amount of damages proportionate to the harm caused by their conduct.

We are hopeful that these proposals will reverse the disturbing trend of litigation abuse which has had a negative effect on the flow of necessary information to the marketplace with a resultant impact on the cost of capital to American companies. We offer to work with you to accomplish these needed reforms.

Sincerely,