Seligman testifies before Senate

Legislative reform to limit frivolous private securities fraud suits is unnecessary, Professor Joel Seligman testified before a Senate subcommittee in June.

Seligman told the Senate Banking Securities Subcommittee that the judiciary and current disclosure laws both work to prevent fraud and abuse. He was among a dozen witnesses who testified at the hearing about proposals to limit securities class action lawsuits. Corporate executives have sought legislative relief from these lawsuits, alleging that they are prepared in advance with blanks to fill in the corporate defendant’s name, dates and stock values.

Seligman argued that the strong performance of the securities market showed that corporations don’t need more protection from stockholder suits. Despite a general economic downturn, "the total dollar amount of securities filed for registration with the Securities and Exchange Commission during 1992 reached a record of more than $700 billion — a 40 percent increase from the last year. The number of issuers accessing the public markets for the first time soared, with initial public offerings increasing 53 percent from 1991 to 1992," he testified.

Furthermore, the public isn’t shy about investing in securities. As of 1990, more than 51 million United States citizens directly owned corporate stock and tens of millions more owned stock indirectly through institutional investors. "One reason that the United States has achieved its current success in capital formation and breadth of securities ownership is the federal securities laws’ mandatory disclosure system, as enforced by the government and private litigation. The mandatory disclosure system has performed a significant role in maintaining investor confidence in the securities markets and deterring securities fraud," Seligman said.

Private litigation, which accounts for 90 percent of securities cases, is effectively enforcing the mandatory disclosure system. "To be sure, the private litigation system is not perfect, but I want to highlight that the judiciary has been effective in addressing perceived problems," he noted. For example, in the past few years, lower federal courts appear to have dismissed more federal securities law claims for failure to plead fraud with sufficient particularity. Courts also are more willing to sanction plaintiffs’ attorneys for frivolous litigation.

One investor who lost money because of alleged corporate fraud told the subcommittee that in her experience, "securities class action lawsuits exist for the benefit of stockholders’ lawyers, while the victims of fraud recover virtually none of their losses." Seligman said this common criticism fails to take into account that the primary purpose of both governmental and private securities litigation is to deter fraud.

The accounting industry has been a major proponent of securities reform that would lessen its share of liability in these lawsuits. Accountants favor a shift from joint and several liability to proportional liability, and claim they can’t continue to serve some clients without this protection. Seligman and SEC Enforcement Director William McLucas cautioned senators that this change would offer accountants too much protection. "I think it is worth noting that some of the litigation “crisis” accountants seek to correct can be attributed to failures in auditing and accounting practices. Of 60 §15(c)(4) proceedings filed against issuers between 1976 and June, 1985, 46 concerned accounting and financial disclosures.

"Given this background, certain recent proposals for reform appear to be little more than special pleading by a profession which recently has been successfully sued often," Seligman concluded.

Although he opposed changes, Seligman suggested that other problems in securities litigation deserve thoughtful review and possible reform. "The most significant problem has been the apparent substantial increase in discovery costs in recent years," he stated. "My recent experience as a court-appointed disinterested person in a shareholder derivative action suggests to me that this may be the most promising area in which the transaction costs of private securities litigation might be reduced without jeopardizing the ability of plaintiffs to litigate meritorious claims."