GEORGETOWN UNIVERSITY LAW CENTER

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The Honorable Christopher Cox
Chairman
United States Securities and Exchange Commission
100 F Street NE
Washington DC 20549

Dear Chairman Cox:

We write to you as law professors whose research has focused, in part, on private securities litigation in the United States. Our views and positions are diverse, and we have relationships with lawyers and interest groups on all sides of the litigation reform debate. Over the last year or so, at the invitation of the United States Chamber of Commerce, we have met a handful of times to discuss the state of knowledge and proposals for change on the question that should drive that debate: how well investors fare in private securities litigation. Because we have doubts that the current system is the best the United States can do, and believe the U.S. must do the best it can at investor protection, we urge the SEC to take a leadership role in studying this issue and making or recommending policy changes if and where appropriate. This letter does not endorse any particular set of changes because we do not necessarily agree among ourselves on the specifics of what should be done. But we do think the Commission can help shed light on some issues about which we know less than we should, and bring together the best serious thinking on issues that have been explored.

As you know, recent reports on the competitiveness of the U.S. capital markets have each made securities litigation reform a central recommendation. Without necessarily endorsing the specifics of any of those recommendations, we agree that the issue deserves careful attention and that, over time, the U.S. will lose ground if our litigation system is perceived as costing investors more than it benefits them. Given the world-wide perception in some quarters that this is so, it is important that the SEC respond. If that perception is well-founded, the Commission should seek reform. If it is not well-founded, the Commission should be a strong voice in countering the misperception. Either way, the Commission must become involved deeply enough to understand the reality, not just the politics and posturing.

To the extent that we agree on concerns about the current system, it is based on three related points. First, most private securities litigation is directed at corporations themselves as primary defendants, and those settlements are typically paid out of liability

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insurance, by the companies themselves or through a combination of both. To this extent, investors themselves fund the settlements, directly or indirectly, so that there is an immense amount of "pocket shifting" that occurs. While pocket shifting is not necessarily bad (that is the nature of insurance, after all) such compensation is unnecessary for most large, well-diversified investors, and likely overcompensates them over time. The second point is related: when the current system delivers this compensation to those who bought or sold during the class period, it does so at a relatively high cost in terms of plaintiffs' and defendants' attorneys fees and related expenses. There may well be ways of identifying those smaller victims of securities fraud who most need and deserve compensation and assuring their protection without incurring such high costs. We think it is also important to pay more attention to the burden imposed on smaller investors whose inactive trading makes it more likely that they will be funding the pay-outs than receiving them. Third, the current system does a bad job at deterrence, because -- putting aside a couple of noteworthy exceptions -- settlements almost never come out of the pockets of the managers who allegedly executed the fraud.

As you well know, the Commission faces many of the same issues in its own enforcement program -- when and how much to penalize an issuer for securities law violations poses many of these same questions. In the effort to distribute penalties and disgorgement amounts it collects as "fair funds," the Commission confronts the difficult questions of identifying who really has been harmed and who deserves how much compensation. This is another reason we believe that the Commission must become more engaged in discussions about the workings of private securities litigation: there is an inevitable and growing overlap between private recoveries and fair funds distributions, which has to be reconciled.

We have been around the issue of securities litigation reform long enough to know that it is emotionally charged, and that avoiding these questions may be politically astute. But it is very important that federal securities regulation get this right. Note that none of the concerns raised above assumes that a high percentage of securities class actions are low-merit or "vexatious;" they apply even if we assume that all cases are reasonably well-founded. Given the difficult nature of that particular debate, we would suggest putting it aside in order to focus on these deeper issues. To this end, we urge you to convene a series of roundtables on this subject at which thoughtful people on all sides of the issues can address, with evidence rather than rhetoric, how well investors fare under the current system, what if anything should be changed, and why. And we hope that you will devote staff resources to gaining a deeper knowledge of the current system, and seek answers to questions where there are gaps in our knowledge. To this end, we attach a list of questions that we believe worthy of discussion, consideration or further research, as well as a bibliography of writings that your staff might find helpful.

Please let us know if we can be of any help.

Sincerely,

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