



May 11, 2007

The Honorable Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Christopher J. Dodd
Chairman
Senate Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Spencer Bachus
Ranking Member
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Richard C. Shelby
Ranking Member
Senate Committee on Banking, Housing,
and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairmen Frank and Dodd and Ranking Members Bachus and Shelby:

We write to you to, first, applaud Chairman Frank's decision to hold an oversight hearing in light of growing criticism that the Securities and Exchange Commission's policy is increasingly favoring companies over investors. Second, we urge Chairman Dodd and Ranking Members Bachus and Shelby to join Chairman Frank's efforts in addressing these concerns.

As you are all aware, we are only five years removed from the scandals of Enron and Worldcom and yet many have forgotten the lessons those cases have taught. There have been multiple reports and publications in the press recently, including the "Commission on the Regulation of U.S. Capital Markets in the 21st Century Report" released by the United States Chamber of Commerce in March, that propose regulatory and legislative reforms that would effect sweeping changes to basic investor protections existing in the United States since 1934. While the SEC has not endorsed all of those proposals (and SEC Chairman Christopher Cox has thus far rejected the reports' calls to affirmatively amend the Sarbanes-Oxley Act), the SEC's actions—and inactions—regarding the way that law and other securities laws are implemented is a cause for alarm. Just a few recent examples are set forth below.

First, we were quite dismayed to learn that the SEC had chosen to submit an amicus curiae brief in the United States Supreme Court case *Tellabs, Inc. v. Makor Issues & Rights Ltd.* that advanced an extremely narrow interpretation of the securities laws, signaling a shift away

from its years of advocacy on behalf of investors.¹ As a result, our two states plus twenty-two other states and territories were compelled to file their own amicus curiae brief in opposition. Eight other states joined a separate amicus brief likewise opposing the position of the Solicitor General and the SEC. It is unfortunate to see the SEC and the States so far apart when it comes to basic investor rights.

The SEC also chose to favor companies over investors on the issue of proxy access as evidenced by its opposition to the pro-investor position taken by the Second Circuit Court of Appeals in the case of *American Federation of State County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.* Similarly, rather than prosecuting investors' cause in response to recent backdating scandals, SEC commissioners have actually issued public remarks minimizing the illicit nature of this clearly fraudulent practice.

Another example of this shift from protecting investors to protecting companies is the SEC's delay in amending Reg SHO to protect investors from abusive short sales, fails to deliver, and voting abuses. Perhaps most startling is recent news of the SEC's interest in rules that would allow corporations to bypass litigation entirely by amending their bylaws to mandate arbitration of shareholder claims.² As for the SEC's own enforcement actions, their lawyers now must seek preapproval from all five commissioners for settlements and the amount of fines.³ Cumulatively, these actions (or inactions) by the SEC indicate a new direction that is obviously unsettling for investors.

In sum, the importance of protecting investors from fraud and providing them with suitable remedies cannot be overstated and serves as a foundation of our nation's financial system. Former SEC commissioners, Congress and the Supreme Court have all recognized, repeatedly, that private lawsuits are an important complement to the regulatory system. If institutional investors had not stepped forward and obtained billions of dollars in compensation for defrauded investors through private actions, the corporate scandals in recent memory would have gone unredressed. We urge both the House Financial Services Committee and Senate Banking, Housing, and Urban Affairs Committee to hold hearings so that investors may have a voice in this debate and that Congress may shed light on the SEC's new direction. As the Attorneys General of the States of Ohio and Utah, we are willing to testify regarding the impact the SEC's actions and inactions are having on the investors of our States and are willing to participate in any other way that would be of assistance to your committees in this cause.

¹ At oral argument, the Solicitor General defended the position taken by his office and the SEC that implies that the PSLRA should be interpreted as having raised the standard of proof at the pleading stage to a "high likelihood" standard that is more stringent than the traditional "preponderance of evidence" standard required at trial.

² Kara Scannell, "SEC Explores A Wider Role For Arbitration: Agency May Consider Letting Firms Head Off Lawsuits By Investors," *Wall Street Journal*, Apr. 16, 2007.

³ Broc Romanek, "SEC Enforcement Shift May Lead To Lower Penalties," *The CorporateCounsel.net Blog*, Apr. 16, 2007 (available at <http://www.thecorporatecounsel.net/blog/archive/001454.html>).

Sincerely,



Marc Dann
Attorney General
State of Ohio



Mark Shurtleff
Attorney General
State of Utah

cc: Honorable Christopher Cox, Chairman, Securities Exchange Commission
Honorable Melvin L. Watt, Chairman, House Subcommittee on Oversight and
Investigations
Honorable Paul Kanjorski, Chairman, House Subcommittee on Capital Markets,
Insurance, and Government-Sponsored Enterprises
Honorable Jack Reed, Chairman, Senate Subcommittee on Securities, Insurance and
Investment