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(202) 272-2650



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"THE PETRIFIED FOREST: LITIGATION IN AMERICA"

Stephen J. Friedman, Commissioner

Washington is well-known as a city of lawyers, but it is also a city of economists. While there are surprising similarities between those professions that are often too little appreciated, there is also a friendly rivalry. In particular, my economist friends are sometimes heard to mutter, "There are too many lawyers -- and too much litigation." That is a not uncommon complaint, and it has some basis. As of the end of 1980, there were 574,810 lawyers in the U.S., 31 per twelve thousand people. In Japan there is only one lawyer per twelve thousand people.

But, in an 'unaccountable lapse, those same economists forget that lawyers, like everyone else, function in a labor market which responds to supply and demand, and that the flood of young men and women into the legal profession has met a swelling demand. We ought not to disregard their counsel, however, for economics has a useful perspective to offer in its focus on the overall effects of certain kinds of activity and in the trade-offs that attend the pursuit of any single set of values to the exclusion of others.

In that context, I would like to share with you some thoughts about our common responsibility to assure that the legal system continues to perform its vital social functions -- to help order human affairs, in both private and public law, and to provide a method for resolving disputes and declaring rights.

We have, of course, an extraordinarily rights-oriented and litigious society. For better or worse, Americans believe it is essential to have a forum to have their rights determined. We place great importance on an independent judicial check on the exercise of governmental power. In pursuit of that end, government agencies, like the SEC, are required to go to court to enforce their policies. I deeply fear that in many ways our litigation system is not performing its basic functions adequately. In particular, litigation has become so lengthy, expensive and burdensome that it no longer offers an effective forum for the determination of rights or the implementation of public policy. While the petrification of the legal system has received much attention in the context of criminal justice, its implications for the civil system are at least as important.

There is substantial evidence of this judicial gridlock. During the year ended June 30, 1980, almost 169,000 civil cases were filed in the U.S. district courts -- 327 per judge. This is an increase of over 93.3 percent since 1970; during that same decade, the economy grew by 36% in real terms and the population by 9%.

Even more important than the numbers are some trends that suggest strongly that the litigation system is no longer

doing its job. The most dramatic is the volume of settled cases. Civil cases in the Federal district courts that were terminated without court action reached an alltime high in 1980 of 44.4 percent (compared with 39.1 percent in 1970). Even more extraordinary is the fact that the percentage of cases reaching trial declined to 6.5 percent in 1980 from 10 percent in 1970. Consider the SEC enforcement program. Almost 90% of our enforcement actions are settled. This makes sense for the Commission as a matter of resource allocation. Private parties also think it makes sense for them -- as the large percentage of settlements proves. But it raises significant questions about the role of the courts in the process of resolving disputes over legal rights and principles.

Moreover, many settlements come on the eve of trial after the expenditure of significant resources in time and money for pre-trial discovery and pre-trial motions. Newspaper reports estimate that A.T.&T. spent \$250 million to prepare for its defense in the government's antitrust case and expected to call 400 witnesses. The government spent approximately \$10 million to ready the case for trial. Recently, the trial date was deferred to give the parties time to reach a settlement. The discovery period in the Justice Department's anti-trust action against IBM lasted 10 years.

Is this trend toward settlement positive or negative? Of course, it is far preferable for people to settle their disputes by agreement rather than through the coercive order of a court. But it strains the imagination to call a settlement after discovery -- after the expenditure of hundreds of thousands of dollars, or millions, in legal fees and countless hours of executive time in what has become a very formal discovery process -- as settlement by agreement rather than litigation. The discovery process has clearly become a weapon in modern litigation strategy. You are all well aware of the breadth of requests for documents, the endless pages of interrogatories and the extensive depositions that are commonplace, and the great burden of time and expense that they impose. There are many companies, and certainly many individuals, that simply do not have the resources to engage in that kind of exercise.

Moreover, we have to ask ourselves why parties settle at that stage when so much time and expense has already been consumed? The conventional wisdom holds that it is because discovery has enabled both sides to see the likely outcome. There are other possibilities: that, for example, the additional expense of a trial is not worth the satisfaction of vindication to the defendant when the same expenditure in settlement will buy immediate respite; or that, even with discovery completed, the legal principles are sufficiently

vague that the result is still highly uncertain for the parties.

Finally, in the case of administrative agencies and the Justice Department, I fear that the burden of discovery and litigation, and particularly the time involved, is a substantial impediment to the implementation of public policy. Whatever one thinks about the merits of the civil antitrust proceedings against IBM and A.T.&T. -- and I am certainly not expressing any opinion about them here -- I can't help feeling that the time and resources required to obtain a judgment make it very difficult for an antitrust policy to have the required effect on the structure of the economy or the amount of competition in our markets. Some cases take so long that they are overtaken by changes in the marketplace. The result is a pressure for settlement that may often blur the edge of the original policy objectives being sought. I have used the antitrust cases as examples because they are the most dramatic examples, but the same pattern is found in the administration of the securities laws.

The classic response to these problems has been to add more judges and employ more informal administrative procedures. That approach may only defer, rather than solve the problem. The number of judges has not kept pace with the volume of litigation, and the result has been increased pressure for settlement from judges with hopelessly overburdened calendars. Administrative agencies have turned to administrative law judges. That may result in some cost savings, but still creates substantial delays. The average time to try and complete the 11 most recent litigated SEC administrative proceedings was 35 months. The longest proceeding took 72 months (clearly an aberration), and the shortest 18 months.

The use of administrative law judges suggests another trend which is worthy of some note: the significant movement away from the judicial system as a method of resolving disputes in a contested forum. For example, in recent years, there have been many articles in the press about extrajudicial mini-trials, a variant on arbitration. In the securities industry, the use of voluntary arbitration to settle small claims disputes between securities firms and their customers has increased significantly. Between 1978 and 1980 the number of small claims arbitration filings grew from 75 to 229, largely as a result of securities industry educational efforts and SEC encouragement. The average time to resolve these claims is two to four months, and the majority are decided by a single arbitrator.

It is my impression that these are generally regarded as healthy developments. I do not necessarily agree. They are healthy for the judicial system, in the sense that they relieve some of the caseload. But they reflect a rejection of

that system as an effective way to resolve disputes. That is a clear indication of trouble.

I would like to speculate with you about the reason of this development, because I think they suggest some of the directions in which change might be useful. In an ironic twist, these problems arise from the very strength of our system. The genius of the common law, and the more elaborate legal system that grew out of it, has been its recognition of the importance of the factual context of each case in the search for justice. In turn, that central thrust requires flexible legal rules that are capable of accommodating varying fact patterns. Such rules have in fact been major forces in American law. For example,

- materiality in securities law
- fiduciary obligations in corporate law
- negligence in the law of civil wrongs.

These two attributes -- a commitment to the importance of factual differences in applying the coercive force of the law, and a set of legal concepts that accommodates the differences, have brought us many benefits. In the securities laws, for example, we have avoided a rigid set of rules divorced from an ever-shifting reality.

But we have also paid a price. Out of a desire for flexible rules, we have adopted concepts that are sometimes so uncertain that the possibly relevant facts often seem endless. Out of a desire to seek out all the facts in a search for truth, we have produced a civil discovery system that many believe is out of control.

One can see a microcosm of this development in the Freedom of Information Act. Adopted in 1974, it was intended to provide more access for citizens to information held by the government. Instead it has become a substitute for investigative efforts by the private sector and a way of obtaining information about competitors that was first secured by governmental compulsion, formal or informal. Moreover, it is probably the best example of the costs and burdens of overregulating the government. In 1975, the SEC processed 638 FOIA requests; in 1980 the number jumped to 1,317. In 1980 our estimated cost of compliance was \$451,900.

One of the best examples of the administrative problems created by the FOIA involves a request by reporters for the Wall Street Journal and the Washington Post for access to the Commission's files on approximately 550 corporations that made voluntary disclosure of questionable payments. The first

request was filed late in 1976. The Commission released a limited number of files before the Justice Department requested that we not turn over any more records until Justice had completed its investigations. Nevertheless, between 1976 and 1979, we estimate that the SEC spent approximately 5,000 person hours processing this one request. In 1979, the SEC was sued by Dow Jones -- the owner of the Wall Street Journal -- under the FOIA. The court ordered us to process the request in an expedited fashion. Since mid-1980, the SEC has spent approximately 5,000 additional hours on this matter -- committing the resources of a substantial number of personnel in the Divisions of Corporation Finance, Enforcement and the General Counsel's Office, including 5 full-time paralegals, 2 lawyers, and 2 part-time law students. The Division of Enforcement alone has \$20,000 in its budget for overtime work on this one matter.

That development, like the luxuriant growth of discovery in private litigation, is the result of single-minded attention to the benefits of "truth seeking" without recognizing the costs, burdens and potential for abuse on the other side. Moreover, in giving paramount weight to the desire to ascertain all of the facts and to administer flexible rules, we have neglected other values. The result has been a judicial system that grows more ponderous every year, in which the pressure for settlement, and the expense and burden of litigation all combine to impede the search for justice and exactitude.

The other leg of this analysis, the flexible standard, also deserves attention. Flexible standards, like materiality and fraud, serve an important purpose in the securities laws. They substitute for a far more rigid regulatory approach. They permit an enforcement program to adopt to the inventiveness of the markets. And they leave room in the law for an element of "I can't define it, but we all know it when we see it."

On the other hand, there are positive values in drawing tighter lines. When the law is clear, self-regulation is more meaningful, and the bar assumes a greater part of the policing function. When lines are drawn with clarity, the litigation process is simplified, a narrower range of facts is relevant, and the fact-finding process is less burdensome.

There are many indications of developments in response to this concern in various areas of the law. The appearance of no-fault automobile insurance and no-fault divorces represent a judgment that the system was not serving its ends in an effective way. They were both designed, among other things, to reduce the cost, delays and burdens of litigation. Note that they do so at some cost in the exploration of the "justice" of the claims. Indeed, the whole concept of "insurance" is somewhat at odds with questions of fault.

In antitrust, the development of merger guidelines is playing an important role in permitting firms to structure their affairs, although the guidelines probably have little direct impact on litigation.

Similar responses are discernible in the evolution of the securities laws. The elaborate folklore of the private placement exemption gave way, first to the regulatory laticework of Rule 146, and then to the far more simple -- and limited -- approaches of Rule 242 and new Section 4(6) of the Securities Act of 1933. For resales of restricted securities, the arcane lore about when a purchaser had proved his "investment intent" or had a "change in circumstances" was largely replaced by Rule 144. As our experience with Rule 144 grew, the regulatory aspects of that rule have been reshaped into a far more simple rule of wide applicability.

Just as we pay a price for flexibility, so we pay a price for bright lines. They can make performance of our essential enforcement function more difficult and less flexible. They require more frequent changes in the rules -- as in the case of the Internal Revenue Code -- as a host of smart people think up end runs around the bright lines. We have been trying to achieve a proper balance in the tender offer area, and the result has been a proliferation of rules. Is the flexible application of a broad antifraud standard preferable?

My basic concern, however, is addressed to a far broader set of problems than the administration of the securities laws. In my judgement, the pendulum has swung too far in the direction of elaborate fact-finding and the application of flexible rules. We must recognize, and accept, that redressing that balance involves introducing a greater degree of judicial and substantive arbitrariness. If judges are to control the discovery process more tightly, the standards of permissible inquiry must be narrowed somewhat and they must be given the power to impose discipline on the discovery process.

Everyone accepts the idea that there should be summary procedures for "small cases." There are also large cases in which a relatively small range of disputed facts are relevant, and more abbreviated procedures are appropriate. And finally, we should continue to experiment with substantive rules that provide relatively clear guides for conduct, testing our ability to tolerate the occasional arbitrary and inflexible result.