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Senator Amy Klobuchar
Committee on the Judiciary
United States Senate

Re: Response to Question Regarding Hearing, "Barriers to Justice and Accountability: How the Supreme Court's Recent Rulings Will Affect Corporate Behavior' on June 29, 2011

Dear Senator Klobuchar;

Please consider this my response to your thoughtful question "How important are the enforcement mechanisms implicated in the recent Supreme court decisions . . . in controlling how businesses behave." This is a profound question and the ultimate policy question when considering such issues that the Supreme Court has recently addressed: the contours of class actions in the face of an apparent nationwide employment discrimination against women by Wall Mart, the ability to business to eviscerate private remedies by disallowing class actions through coercive agreements to arbitrate, and narrowly defining who "makes" a false statement so that the only actors in the design and execution of a fraudulent scheme escape responsibility. These were the areas that were the subject of the June 29, 2011 hearing.

Unfortunately, the answer to your question is not something that can be easily observed and measured. That is, while I and my coauthors have published about ten empirical studies of securities class action litigation, it is not possible to link the ease or difficulty of private or SEC recoveries for fraud with the impact on business or individual behavior. What I can certify as accurate is that private suits provide the major means for addressing fraudulent reporting and providing relief to investors who are defrauded. Let me explain this statement. In one of our most recent studies, this one involving 773 securities class action settlements (1990-2004), we found that there is a report of SEC involvement in these cases of about 17 percent. In fact, this likely overstates the SEC involvement as we included within this group any news report of a complaint being filed with the SEC or the SEC making inquiry about as practice; thus, the actual instances in which the SEC launched a "formal" investigation is much smaller and smaller still would be the instances in which the SEC successfully concluded an enforcement action. *See* James D. Cox, Randall S. Thomas & Lynn Bai, There Are Plaintiffs and . . . There are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements, 61 Vand. L. Rev. 355 (2008). Thus, in 83 percent, or more, of the securities fraud class action settlements there is no evidence of any SEC action, or for that matter SEC interest, in the claims giving rise to the significant settlement.

Thus, private remedies, not governmental enforcement, action is the medium by which investors hold wrongdoers accountable for false financial reporting. Moreover, our work also reports that much larger cases are pursued in private suits, with larger investor recoveries, than when the SEC proceeds. *See* James D. Cox, Randall S. Thomas & Donna Kiku, SEC Enforcement Heuristics: An Empirical Inquiry, 53 Duke L. J. 737 (2003).

As my testimony emphasized, holding wrongdoers accountable to those harmed by their misconduct is basic to western civilization. Recent Supreme Court decisions provide great insulation to those who by design, and with full knowledge execute, illegal conduct that harms others. While we cannot measure whether this insulation encourages misconduct, the well-informed intuition that you and I share should tell us that giving wrongdoers a pass can only encourage more wrongdoing. If so, then we can expect another well-recognized principle to apply, the principle captured in Gresham's Law. That is, just as bad money drives out good currency, so it will be that fraudulent practices will drive from the marketplace good practices. This can hardly advance the public interest or be good for the U.S. economy.

Sincerely,

James D. Cox
Brainerd Currie Professor of Law