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Senator Herb Kohl
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 Kohl;

Please consider this my response to your thoughtful question "What can Congress do to restore the balance that the Class Action Fairness Act achieved between individual plaintiffs and businesses, and maintain a viable path for class actions?" This is a profound question and the ultimate policy question when considering the issue the Supreme Court addressed in *AT&T Mobility v. Concepion.*

Unfortunately, the answer to your question is not clearly within my field of research and teaching. But I can shed some light on the question from my own field of expertise. I do feel that much has been achieved in rationalizing and introducing discipline to securities class actions by the enactment of the Private Securities Litigation Reform Act of 1995. This legislation is the securities law analog to the Class Action Fairness Act. It sought, much as the Class Action Fairness Act, to introduce uniform and fair treatment for all parties embroiled I securities litigation. On this topic I and my co-investigators have done a good deal of work that tangentially bears on your excellent question. Our work documents that private suits provide <u>the</u> 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).

Thus, addressing directly any fears of abuse that flows from allowing small claims to be aggregated into a class action is a wise course. This was the course taken with the Class Action Fairness Act and before that the Private Securities Litigation Reform Act. Decisions such as *Concepcion,* you wisely conclude, eviscerate the consumer's rights by forcing them into a process where the expected benefits of asserting their right, individually, are dwarfed by the costs, real and imputed, of asserting their rights. A simple solution would be a neutral gatekeeper who could review the complaints and as a threshold matter determine that the individual claims not only appear non-spurious but also merit aggregation before an appropriate court of law. This mechanism would provide an escape from the harmful effects of *Concepcion* while preserving arbitration in other areas. That is, one resort to restoring the balance, without placing business at risk all individual claims being asserted as a class is through the introduction of a gatekeeper procedure.

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. The Class Action Fairness Act was enacted in part by the belief that balancing the interests of business and consumer, business and investor, and business and worker is the correct approach to a strong and fair economy. That approach should be taken as well toward modifying *Concepcion*.

Sincerely,

James D. Cox
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