U.S. CHAMBER
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March 18, 2021

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Via Email: submissions@banking.senate.gov

Dear Senator Toomey:

I am writing on behalf of the U.S. Chamber Institute for Legal Reform as follow-up to your recent request for information regarding proposals to foster economic growth and capital formation. As more fully discussed below, we suggest that the Senate Banking Committee take action to abrogate the U.S. Supreme Court's *Cyan* decision as well as engage in oversight over any attempts by the SEC and/or CFPB to restrict the availability and use of pre-dispute arbitration clauses as a way to resolve disputes. Each of these areas are discussed in turn.

Advocate legislation to abrogate the Supreme Court's *Cyan* decision

Class actions under the federal securities laws typically involve mammoth claims seeking hundreds of millions or billions of dollars on behalf of thousands of investors. Congress should close a loophole—resulting from the Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*[1]—that permits a significant category of these cases (claims under the Securities Act of 1933) to be litigated in state courts rather than exclusively in federal court.

Plaintiffs' lawyers file these cases in state court to avoid key protections against abusive lawsuits that Congress enacted in the Private Securities Litigation Reform Act (PSLRA) and also to bring their claims in more plaintiff-friendly forums. But that means the same claim often is asserted in duplicate lawsuits by different lawyers in state and federal courts, which forces the company to defend the same claim in multiple courts—multiplying the cost, which ultimately is borne by shareholders.

The principal category of lawsuits falling within the *Cyan* loophole are claims under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, which is the cause of action for investors injured by misstatements and omissions in initial public offering documents. Although Congress in the Securities Exchange Act of 1934 specified that claims under the Act could be brought only in federal court, the Securities Act of 1933 allows claims under that statute to be brought in either state or federal court.

[1] 138 S. Ct. 1061 (2018).

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Prior to the enactment of the PSLRA, few 1933 Act claims were filed in state court. After Congress enacted the PSLRA, plaintiffs' lawyers focused on state law claims in an attempt to avoid the PSLRA's protections against abusive litigation. Congress closed that loophole when it enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

Then, plaintiffs' lawyers sought to bring 1933 Act claims in state court—with mixed results: some courts held that SLUSA barred the filing of such claims in state court, but other courts disagreed. The Supreme Court resolved the conflict in *Cyan*, holding that SLUSA neither barred the assertion of 1933 Act class action lawsuits in state court nor authorized removal of such claims to federal court. (The United States filed an amicus brief in *Cyan* urging the Court to hold that 1933 Act class actions were removable under SLUSA, but the Court rejected that argument.[2])

Following the *Cyan* ruling, there was a dramatic increase in the number of 1933 Act class actions filed in state courts:

- In 2018 (the year Cyan was decided), 35 class actions invoking the 1933 Act were filed in state court.[3]
- That number jumped to 52 in 2019—just about seven times the 2010- 2017 average.[4] Indeed, 2019 saw 50% more 1933 Act class actions filed in state court than in federal court.[5] And these state claims are large—the cases filed in 2019 involved claims twice as large as the cases filed in federal court.[6]
- State court claims dropped in 2020, but so did all securities class action filings, likely due to COVID-19.[7]

Importantly, the state court lawsuits have contributed to a dramatic increase in the likelihood that an initial public offering will be subject to a securities class action. IPOs issued between 2009 and 2019 were twice as likely to attract a lawsuit as those issued between 2001 and 2008.[8] That means that investors must factor in the cost of litigation—which runs into the millions of dollars—when determining whether to invest in a new business.

Those costs are multiplied dramatically by state court filings. That is because different groups of plaintiffs' lawyers file lawsuits asserting the same claim—some cases are filed in federal court and some in state courts. Thus, in 2019, 25 IPOs faced lawsuits in both state and federal court—

[2] Brief for the United States as Amicus Curiae, No. 15-1439, https://www.scotusblog.com/wp-content/uploads/2017/10/15-1439bsacUnitedStates.pdf.
[3] Cornerstone Research, *Securities Class Action Filings: 2020 Year in Review* 19 (2021), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review.
[4] *Id*.
[5] *Id*. at 21.
[6] *Id*. at 20.
[7] *Id*. at 19.
[8] *Id*. at 26.

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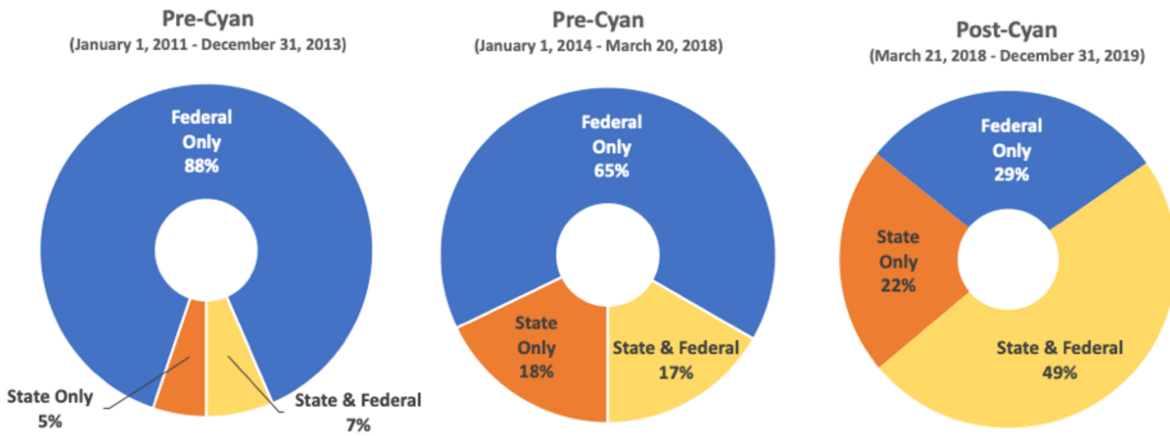
and some in multiple state courts.[9] Unlike multiple claims in federal courts (which can be consolidated even if filed in different parts of the country), these cases cannot be consolidated, so companies incur duplicative costs litigating the same case before different courts.

A recent Stanford analysis[10] of these lawsuits documents the dramatic change in litigation:



As one experienced observer of securities litigation put it, the *Cyan* loophole "increases the likelihood that a company defendant might have to fight a multi-front war" and "IPO companies now face a measurably more significant risk of getting hit with a securities lawsuit than may have been the case before *Cyan*."[11]

And, because state court judges lack broad experience with these types of cases, they dismiss a smaller percentage of cases than federal judges, forcing companies, and ultimately their shareholders, to incur discovery costs or pay unjustified settlements. Even more important, the essential procedural protections against abusive securities class actions enacted in the PSLRA do not apply to claims in state court. These include the lead plaintiff process, designed to ensure that litigation is controlled by shareholders, not lawyers; protections for class members, such as the requirement that recoveries be distributed on a per-share basis and prohibiting bounty payments to particular class members; limitations on attorneys' fees; and disclosure requirements applicable to proposed settlements.[12] That significantly increases the likelihood that unjustified, abusive claims will be brought in state court and force companies to pay unwarranted settlements, which hurts shareholders.

As the Stanford analysis concluded:

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[9] *Id*. at 21.
[10] Michael Klausner, Jason Hegland, Carin LeVine and Jessica Shin, *State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)* (June 22, 2020), https://clsbluesky.law.columbia.edu/2020/06/22/state-section-11-litigation-in-the-post-cyan-environment-despite-sciabacucchi/.
[11] Kevin LaCroix, *Multiplied and Parallel Litigation: The Mess that Cyan has Wrought* (Nov. 18, 2019), https://www.dandodiary.com/2019/11/articles/securities-litigation/multiplied-and-parallel-litigation-the-mess-that-cyan-has-wrought/.
[12] See 15 U.S.C. § 77z-1.

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> There are two concerns with litigating Section 11 cases in state court. First, state courts generally do not provide the same procedural protections that federal courts apply to Section 11 claims. Federal courts follow the relatively strict *Twombly–Iqbal* pleading standard, which governs motions to dismiss, and the mandatory stay of discovery provided for by the Private Securities Litigation Reform Act (PSLRA). Without these procedural protections, plaintiffs' attorneys may file weak cases in state court in the hope of pressuring defendants to settle. Second, if a plaintiffs' attorney can bring a suit in state court, there is nothing to stop another from bringing the same case in federal court, thereby imposing on defendants the burden of litigating parallel cases simultaneously.[13]

Most importantly, they found that "[t]he data support these two concerns: Relatively weak cases are filed in state court, and parallel litigation in state and federal court has become common and appears to pressure defendants to settle."[14]

Recognizing these risks, the Delaware Supreme Court recently held that companies incorporated in that State may include in their by-laws a provision requiring 1933 Act claims to be brought in federal court.[15] While this permits some companies to engage in self-help, it does not solve the problem for companies incorporated elsewhere, does not guarantee that non-Delaware state courts will enforce that restriction, and—because the court addressed only a facial challenge to such provisions—does not mean that Delaware courts will enforce such by-laws in all circumstances.

The Stanford analysis concluded that, given the harms resulting from 1933 Act class actions in state court, "[t]he appropriate response . . . is for Congress to do what it intended to do in SLUSA – simply withdraw state jurisdiction."[16]

Congress could fix this problem in either of two ways: (1) requiring that all 1933 Act claims be brought in federal court (and thereby eliminating the inconsistency between the 1933 Act and the 1934 Act); or (2) making 1933 Act class actions removable to federal court.

Those reforms do not deprive any plaintiff of his or her day in court—or change the substantive law governing their claims. They just will ensure that companies, and their shareholders, are not forced to bear unjustified and unfair multiple litigation costs.

In addition to the *Cyan* issue discussed above, we would also encourage an examination of the broader problems associated with securities litigation in general and working to reform how

[13] Michael Klausner, Jason Hegland, Carin LeVine and Jessica Shin, *supra* note 10.
[14] *Id*.
[15] *Salzberg v. Sciabacucchi,* 2020 WL 1280785 (Del. Mar. 18, 2020).
[16] Michael Klausner, Jason Hegland, Carin LeVine and Jessica Shin, *supra* note 10.

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securities litigation is currently handled. To that end, we would be happy to discuss additional reforms that would help slow the increasing amount of speculative securities litigation.[17]

Exercise oversight over any SEC or CFPB attempts to restrict the use of arbitration

Arbitration is an essential means of resolving disputes that is fair, quicker and cheaper than the expensive, overburdened, and complex court system. Today, hundreds of millions of employment and consumer contracts specify that any disputes will be resolved through arbitration.

The Federal Arbitration Act (FAA), adopted by Congress more than 95 years ago, was specifically intended to promote the use of arbitration. And the Supreme Court has consistently interpreted the FAA to invalidate restrictions on the enforceability of arbitration agreements that do not apply to contracts generally or that intrude on fundamental aspects of arbitration.

The organized plaintiffs' trial bar has embarked on a crusade against arbitration, convincing multiple agencies issuing rules purporting to restrict or ban arbitration. Courts invalidated all of the rules promulgated without specific congressional authorization, holding that they were precluded by the FAA. And Congress invoked the Congressional Review Act to invalidate the Consumer Financial Protection Bureau's anti-arbitration rule.

The trial bar is now renewing their push against arbitration, and as a result, agency attacks on arbitration are very likely to resume. Both the SEC and the CFPB have specific authority, granted in the Dodd-Frank Act, to regulate arbitration. At Gary Gensler's confirmation hearing, he was urged to have the SEC take action to restrict arbitration. And informed observers of the Consumer Financial Protection Bureau predict that, notwithstanding the restrictions on subsequent rulemaking imposed by the Congressional Review Act, the Bureau's new leadership is planning to promulgate a rule invalidating arbitration agreements.[18]

Oversight of these agencies will be extremely important in protecting arbitration against unjustified and unlawful attempts at regulation. (In addition, the plaintiffs' trial bar has made clear that it intends to seek enactment of the Forced Arbitration Injustice Repeal Act, which would effectively eliminate consumer and employment arbitration as well as several other categories of arbitration.)

To begin with, there are strong arguments in favor of arbitration:

- Empirical evidence demonstrates that employees and consumers do at least as well, and often better, in arbitration than in cases in court. A recently completed study found that the majority of consumer cases in each forum are settled (nearly 85% in court and nearly 57% in arbitration), but, for the cases that result in a decision, consumer-plaintiffs win substantially

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[17] *See* U.S. Chamber Institute for Legal Reform, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System* (February 2019), https://instituteforlegalreform.com/research/containing-the-contagion-proposals-to-reform-the-broken-securities-class-action-system/.

[18] Manatt, *CFPB News: How Warren Protégé Chopra Will Impact Consumer Financial Protection* (Jan. 25, 2021), https://www.jdsupra.com/legalnews/cfpb-news-how-warren-protege-chopra-4411377/.

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more frequently in arbitration—44% compared to 30%. Of cases decided in favor of a consumer, the median award in arbitration was $20,019 as compared to $6,565 in court; the mean award in arbitration was $68,198 as compared to $57,285 in litigation. [19] The same is true for employment disputes: an empirical study found that, for the cases that result in a decision by the arbitrator or court**,** employee-plaintiffs win three times as often in arbitration than in court—32% compared to 11%. For cases decided by the arbitrator or court in favor of the employee-plaintiff, the median award was $113,818 in arbitration compared to $51,866 in court; the mean award was $520,630 in arbitration compared to $269,885 in court.[20]

- <u>Arbitration providers and the courts ensure that arbitration provisions will be enforced only if they meet basic guarantees of fairness and due process</u>. The leading arbitration providers, the American Arbitration Association and JAMS, have stringent fairness rules that govern employment and consumer arbitrations.[21] In addition, courts consistently invalidate unfair arbitration clauses by declaring them unconscionable and unenforceable.

- <u>Arbitration is easy for individuals to navigate on their own, and they retain the option of using a lawyer to present their claims</u>. Litigation in court is extremely expensive, immensely time-consuming, and highly complicated. Arbitration is, as the Supreme Court has explained, "usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; [and] it is often more flexible in regard to scheduling of times and places of hearings and discovery devices."[22] Indeed, an arbitration claimant need not ever make a personal appearance to secure a judgment; claims can be adjudicated based solely on written submissions or on the basis of a telephone conference.[23]

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[19] NDP Analytics, *Fairer, Faster, Better II: An Empirical Assessment of Consumer Arbitration* 7-10 (November 2019), available at https://instituteforlegalreform.com/research/fairer-faster-better-ii-an-empirical-assessment-of-consumer-arbitration/. Other studies have found that consumers prevail more frequently in arbitration, including a 2010 study that found ***consumers won relief 53.3% of the time in arbitration, compared with a success rate of roughly 50% in court***. And just as in court, plaintiffs who win in arbitration are able to recover not only compensatory damages but also "other types of damages, including attorneys' fees, punitive damages, and interest." Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 896-904 (2010).

[20] NDP Analytics, *Fairer, Faster, Better: An Empirical Assessment of Employment Arbitration* 5-10 (May 2019), available at https://instituteforlegalreform.com/research/fairer-faster-better-ii-an-empirical-assessment-of-consumer-arbitration/.

[21] Am. Arbitration Ass'n, *Employment Due Process Protocol* (May 9, 1995), perma.cc/93NR-TXQP; Am. Arbitration Ass'n, *Consumer Due Process Protocol Statement of Principles* (Apr. 17, 1998), perma.cc/VPW4-KXUV; JAMS, *JAMS Policy on Employment Arbitration Minimum Standards of Procedural Fairness* (July 15, 2009), perma.cc/WC48-KP8G; JAMS, *JAMS Policy on Consumer Arbitrations Pursuant to Pre-Dispute Clauses Minimum Standards of Procedural Fairness* (July 15, 2009), https://perma.cc/NBA4-4U3N; Nat'l Arbitration and Mediation, *Employment Rules and Procedures* (2017), perma.cc/F2XD-TCHJ.

[22] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (quoting H.R. Rep. No. 97-542, at 13 (1982)); *see also*, *e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 345 (2011) ("[T]he informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.").

[23] *See, e.g.,* Am. Arbitration Ass'n, *Consumer Arbitration Rules* 22 (Sept. 1, 2014) ("A hearing may be by telephone or in person."), perma.cc/E8JN-FQE4.

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- Arbitration expands access to justice. Most harms suffered by employees and consumers are relatively small in economic value and individualized. Litigation in court, with its formality and intricate procedures, simply is not a realistic option for resolving many of these claims. As the Supreme Court put it: "[a]rbitration agreements allow parties to avoid the costs of litigation, *a benefit that may be of particular importance in employment litigation*, which often involves smaller sums of money than disputes concerning commercial contracts."[24] Without arbitration, as Justice Breyer explained in a Supreme Court opinion, "the typical consumer who has only a small damage claim (who seeks, say, the value of only a defective refrigerator or television set) [would be left] without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[25]

- Criticisms of arbitration by plaintiffs' lawyers are baseless. The principal opponents of arbitration are the plaintiffs' bar and its allies. Indeed, the American Association for Justice, which is the trade association for plaintiffs' lawyers (formerly known as the American Trial Lawyers Association), has made the elimination of arbitration its number one priority. That is because plaintiffs' lawyers cannot use arbitration proceedings to bring lawyer-driven class actions that provide millions in legal fees but often deliver no benefit to class members.

    - Arbitration does not impose a "gag rule": employees and consumers are free to discuss their claims with government authorities, the public, and other employees and consumers—and arbitration agreements that provide otherwise have been invalidated by the courts. As a leading law professor explained, "under U.S. law, the privacy of arbitration typically does ***not*** extend to precluding a party's disclosure of the existence of the arbitration or even its outcome. Instead, it means that non-parties can be excluded from the hearing and that the arbitrator and arbitration provider cannot disclose information about the proceeding."[26] These features protect the "privacy and confidentiality" of claimants who may not want their claims publicly known—features that are often unavailable in litigation and that empower claimants to maintain control over how much information to disclose about their claims.[27]

    - Arbitration's Individualized Process and Lack of Class Procedures Does Not Justify Banning Arbitration. Opponents of arbitration often complain that arbitration agreements require resolution of disputes on an individual basis and preclude class action lawsuits. While the features of class actions—aggregation of claims and spreading of litigation costs over many class members—may sound appealing in theory, in reality, these benefits are very rarely, if ever, realized. Most injuries that consumers and employees suffer are

[24] *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 123 (2001) (emphasis added).
[25] *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) (emphasis added).
[26] Christopher R. Drahozal, *FAA Preemption After* Concepcion, 35 Berkeley J. Emp. & Lab. L. 153, 167 (2014). The American Arbitration Association's rules provide that "[t]he arbitrator and the AAA shall maintain the privacy of the hearings unless the law provides to the contrary." Am. Arbitration Ass'n, *Commercial Arbitration Rules and Mediation Procedures* 31 (Apr. 1, 1999), perma.cc/5U92-5PQF. This rule applies only to the hearings themselves; nothing in the rules requires that the outcome be kept confidential.
[27] *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 686 (2010); *see also, e.g.*, *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1, 7 n.4 (1st Cir. 1999) (observing that both employers and employees may prefer the "confidentiality" of arbitration).

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> individualized, and therefore cannot be remedied through class actions. And when class actions are filed, they typically provide little or no benefit class members. The indisputable beneficiaries of class actions, rather, are the plaintiffs' attorneys who file them and receive large fees when the cases are settled. Finally, Justice Kagan (in an opinion for herself and Justices Ginsburg and Breyer) has recognized that groups of claimants can vindicate their rights in arbitration without class procedures—through "informal coordination among individual claimants, or amelioration of arbitral expenses,"[28] both of which are features of virtually all arbitration agreements.

The CFPB and SEC would face significant obstacles to promulgating anti-arbitration rules—in addition to the lack of any conceivable merit for the reasons just discussed.

With respect to the CFPB, there are at least two significant obstacles. First, the Congressional Review Act invalidation of the Bureau's prior anti-arbitration rule means that the rule "may not be reissued in substantially the same form, and a new rule that is substantially the same as such a rule may not be issued, unless the reissued or new rule is specifically authorized by a law enacted after the date of the joint resolution disapproving the original rule."[29] It is not clear how the Bureau would be able to issue an anti-arbitration rule that could avoid this restriction.

Second, the Dodd-Frank Act provision authorizing the Bureau to issue a rule governing consumer arbitration required the Bureau first to conduct a study regarding the use of arbitration in the consumer financial services context.[30] The Bureau could then issue a rule if it found "that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers"—with the proviso that "[t]he findings in such rule shall be consistent with the study."[31] To the extent the Bureau's new leadership plans to try to avoid the Congressional Review Act restriction by proposing a rule that is "different" from the prior rule, it would be obligated to conduct a new study to support the "new" findings underlying the "new" Rule.

The SEC also would face significant obstacles if it sought to eliminate arbitration. FINRA, and its predecessor, have long ***required*** the use of arbitration to resolve disputes between broker-dealers and their customers and employees.[32] The SEC has overseen FINRA's regulation and administration of the arbitration process through its oversight of FINRA rules—which have evolved over time. (For example, the rules prohibit the inclusion of class waivers in arbitration agreements.)

If the SEC changed position and proposed a rule banning the use of arbitration by broker-dealers, such a rule would be subjected to special scrutiny by the courts. When an administrative agency changes position, it "must also be cognizant that longstanding policies may have "engendered

[28] *Italian Colors Rest.*, 570 U.S. at 249 (Kagan, J., dissenting).
[29] 5 U.S.C. § 801(b)(2).
[30] 12 U.S.C. § 5518(a).
[31] *Id*. § 5518(b).
[32] *See* FINRA, Rules, Parts 12000 & 13000, https://www.finra.org/rules-guidance/rulebooks/finra-rules.

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serious reliance interests that must be taken into account."[33] "[A] reasoned explanation is needed for disregarding facts and circumstances that underlay or were engendered by the prior policy."[34] And the agency must explain why it rejected alternatives that would have had a lesser impact on those reliance interests.[35]

Given the strong policy arguments favoring arbitration, and the significant legal obstacles that would have to be overcome by both the CFPB and SEC, vigorous oversight of any effort to promulgate anti-arbitration rules is both justified and necessary.

* * *

Thank you for your consideration of these proposals. We are happy to answer any questions you may have on them and provide any additional information you may need as you consider them.

Sincerely,

Matthew D. Webb
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U.S. Chamber Institute for Legal Reform

[33] *FCC v. Fox Television Stations, Inc.*, 556 U. S. 502, 515 (2009).
[34] *Id*. at 515-16.
[35] *Department of Homeland Security v. Regents of the University of California*, 140 S. Ct. 1891 (2020).

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