



June 28, 2011

Honorable Patrick Leahy, Chair
Senate Judiciary Committee
224 Dirksen Senate Office Building
Washington, DC 20510

Honorable Charles Grassley, Ranking Member
Senate Judiciary Committee
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Leahy and Ranking Member Grassley:

We write to thank the Committee for holding a hearing to address the important issues raised by recent Supreme Court decisions that make it increasingly difficult for Americans to hold powerful corporations accountable for serious misconduct, including widespread discrimination and fraud. In a trio of cases this Term, a sharply divided Supreme Court issued rulings that limit access to justice, impinge upon American ideals of equality, and threaten the integrity of our markets and workplaces.

I. *Wal-Mart v. Dukes*: Too Big to Be Sued?

In a blow to group claims of gender discrimination and class actions more generally, the Supreme Court rejected a class-action lawsuit, *Wal-Mart v. Dukes*, brought by female employees of Wal-Mart who claim they suffered discriminatory pay and promotion practices resulting from the company's alleged corporate culture of discrimination. The massive lawsuit could have involved up to 1.6 million women, with Wal-Mart, the nation's largest private employer, facing potentially billions of dollars in damages. But a divided Court blocked the class action, ruling that the women of Wal-Mart did not have enough in common to band together in a class-action suit. This has led some critics of the ruling to suggest that it sets out a blueprint for discrimination: delegate nearly unfettered discretion to lower level managers and do it on a massive scale; the bigger the company, the more varied and decentralized its job practices, the less likely it will have to face a class-action claim.

While the central question of whether the women had enough in common to press a class-based claim was the subject of sharp disagreement between the conservative majority and more liberal dissenters, the Court was unanimous in holding that the lower courts should not have allowed the case to move forward under Federal Rule of Civil Procedure 23(b)(2).¹ This Rule

¹ *Wal-Mart Stores, Inc. v. Dukes et al.*, No. 10-277 (June 20, 2011), Slip Op. at 20-27.

allows litigants to proceed as a class when they are seeking primarily non-monetary relief, for example, an injunction against discriminatory hiring practices or a declaration from the court that a certain policy is discriminatory. Because the class action in *Wal-Mart* raised significant questions regarding backpay, all of the Justices agreed that it was not suited to Rule 23(b)(2).² Unfortunately, the majority, led by Justice Antonin Scalia, went further, shutting the courthouse doors to the women's class action altogether. Justice Ruth Bader Ginsburg, joined by Justices Stephen G. Breyer, Sonia Sotomayor and Elena Kagan, dissented from the majority's ruling on this point, arguing that the female employees should have been given the opportunity to try to make their case together under another part of the class-action rules (Fed. R. Civ. Pro. 23(b)(3)).

A fierce defender in the Supreme Court of the Constitution's guarantee of equal citizenship and equal treatment of the sexes, Justice Ginsburg noted in her *Wal-Mart* dissent substantial evidence that "gender bias suffused Wal-Mart's corporate culture."³ For example, Justice Ginsburg observed that women fill 70 percent of the hourly jobs but only 33 percent of management positions and that "senior management often refer to female associates as 'little Janie Qs.'"⁴ By leaving pay and promotion decisions in the hands of "a nearly all male managerial workforce" using "arbitrary and subjective criteria," the company, as Justice Ginsburg observed, arguably does little to prevent biases and stereotypes from tainting such decisions.⁵ For instance, the company requires, "as a condition of promotion to management jobs, that employees be willing to relocate."⁶ But as Justice Ginsburg noted in her opinion, citing a federal Labor Department report, "[a]bsent instruction otherwise, there is a risk that managers will act on the familiar assumption that women, because of their services to husband and children, are less mobile than men."⁷ "The practice of delegating to supervisors large discretion to make personnel decisions, uncontrolled by formal standards, has long been known to have the potential to produce disparate effects," Ginsburg wrote.⁸ "Managers, like all humankind, may be prey to biases of which they are unaware."⁹

These are pretty powerful claims of a widespread, discriminatory corporate culture that Justice Scalia and his fellow Justices in the majority brushed aside. But however strong this evidence of discrimination may or may not be, it is important to recognize that the Supreme Court's ruling was *not* about whether Wal-Mart was guilty of discriminating against its female employees. The ruling was solely about whether the courthouse doors would remain open to the class action filed by the plaintiffs, past and present female employees of Wal-Mart, who had banded together to seek a company-wide solution to an alleged company-wide problem. While Justice Ginsburg and the three other Justices who joined her opinion would have allowed the female employees an opportunity to show that their claims could proceed under a more

² *Id.*

³ *Wal-Mart Stores, Inc. v. Dukes et al.*, No. 10-277 (June 20, 2011) (Ginsburg, J., concurring in part and dissenting in part), Slip Op. at 5.

⁴ *Id.*

⁵ *Id.* at 3.

⁶ *Id.* at 3-4.

⁷ *Id.* at 4.

⁸ *Id.* at 6.

⁹ *Id.*

appropriate class-action rule, the five-Justice majority closed the courthouse door to the class altogether.

The majority's skepticism toward the Wal-Mart employees' ability to pursue their class action does not bode well for core American values of access to justice and equal employment opportunity. The Framers of the Equal Protection Clause and the very first civil rights statutes designed to enforce the guarantees of the Fourteenth Amendment recognized that they could not achieve their goal of rooting out discrimination without meaningful access to courts. Class actions are crucial for victims of discrimination who may not have the means to bring their own individual lawsuits—no doubt including many of the Wal-Mart employees who earn modest wages. The plaintiffs alleged that they and over a million-and-a-half other women of Wal-Mart experienced discrimination because of the corporate culture and practices of America's largest retailer. The experiences of these plaintiffs may be diverse in many ways, but as Justice Ginsburg explained, these female employees have in common their claims of pay and promotion discrimination. The majority failed to give a persuasive reason why these women should be prevented from banding together in court simply because Wal-Mart is a massive company and its corporate practices occur on a massive scale.

On Wall Street it might be all about "too big to fail," but with the *Wal-Mart* decision it appears that a majority on the Supreme Court believes that corporations can be too big to be held accountable.

II. *AT&T v. Concepcion*: Corporate Fraud a Few Dollars and One Consumer at a Time

The *Wal-Mart* case was merely the biggest-scale example of a disturbing trend in this year's Supreme Court Term. Justice Scalia, who wrote for the majority in *Wal-Mart*, also authored the pro-corporate, anti-consumer ruling in *AT&T v. Concepcion*. *Concepcion*, like *Wal-Mart*, will likely make it harder for Americans—consumers, injured people, employees, and those who have faced discrimination—to secure justice in the face of corporate misconduct.

In *Concepcion*, a sharply divided Supreme Court tossed out the lawsuit brought against AT&T by Vincent and Liza Concepcion on behalf of themselves and all others who were charged \$30.32 in sales tax for a supposedly free mobile phone.¹⁰ If successful, the class action could have yielded a remedy for all of AT&T's customers who allegedly had been improperly charged, and possibly served as a deterrent for the rest of corporate America. However, because Justice Scalia's majority opinion enforced an arbitration agreement containing a provision banning class actions, the Concepcions are now left with fighting just for their own \$30—an amount over which it hardly makes sense to spend the time and expense of pressing a legal claim against a corporate giant like AT&T.

Asserting that state law was preempted by the Federal Arbitration Act (FAA), the Supreme Court in *Concepcion* blessed a contract provision—contained in the lengthy, legalese-heavy, fine print that many of us never read in our cell phone contracts (or employment contracts, health insurance agreements, or other contracts that consumers are effectively forced to sign these days in order to obtain goods and services)—that basically allows corporations to

¹⁰ *AT&T Mobility LLC v. Concepcion*, No. 09-893 (April 27, 2011).

get away with wrongdoing so long as they do it on an individually small scale, making individual claims too small to pursue. The fine-print of the Concepcions' contract with AT&T required that all disputes be resolved through arbitration, not through the court system, while banning class actions. The five-Justice majority upheld the contract provision and reversed the court of appeals' application of California law, which holds a contractual ban on class actions unconscionable—and thus unenforceable—if it serves to insulate one party to the contract from liability for wrongdoing. The four dissenting Justices would have found this general principle of state contract law applicable to the class-action arbitration ban in AT&T's cell phone contract because the FAA, which prohibits states from discriminating against arbitration contracts, specifically preserves generally applicable state contract law.¹¹

Accordingly, not only does the ruling in *Concepcion* threaten access to justice, it also continues the Court's unfortunate line of precedent that attempts to re-write the Federal Arbitration Act to preempt state law. In enacting the FAA, Congress recognized that state courts are vital in protecting the rights of American consumers, and the federal law specifically preserves a critical role for state law. However, the Court's conservatives have been very aggressive in interpreting the Federal Arbitration Act to protect businesses from liability in both federal and state courts, reading a policy favoring arbitration into the Act. In *Concepcion*, the Court continued this trend, using the judicially-created pro-arbitration policy to trump the words of the Act itself, as well as the text and history of the Constitution.

The majority's opinion in *Concepcion* is blatant judicial policymaking. The Federal Arbitration Act is in no way hostile to class actions, and its text expressly preserves a critical role for state law. No plausible reading of the text and history of the Constitution's Supremacy Clause supports the Court's ruling in favor of broad preemption of state law in this case.¹²

III. *Janus Capital Group, Inc. v. First Derivative Traders*: Heads, Corporate Insiders Win, Tails, Consumers Lose

Continuing the Roberts Court's anti-access-to-justice rulings this Term, Justice Clarence Thomas wrote for a five-Justice majority to toss out a securities fraud lawsuit that sought to hold mutual fund managers liable for misleading shareholders. *Janus Capital Group v. First Derivative Traders*¹³ is particularly troubling because it deals with allegedly false statements and misleading practices that work to the benefit of insider hedge-fund investors, while placing the retirement accounts and long-term investments of hard-working Americans at risk. The Court's ruling in *Janus* will make it harder for private lawsuits to succeed in holding corporate America responsible for fraud on the market.

¹¹ *AT&T Mobility LLC v. Concepcion*, No. 09-893 (April 27, 2011) (Breyer, J., dissenting).

¹² See generally Brief of Constitutional Accountability Center as *Amicus Curiae* in Support of Respondents, available at <http://theusconstitution.org/blog.history/wp-content/uploads/2010/10/ATTCConcepcionBrief.pdf>

¹³ No. 09-525 (June 13, 2011).

While the Court’s ruling that the only entity that can be held liable in a private lawsuit under Securities and Exchange Commission (SEC) Rule 10b-5¹⁴ for “any untrue statement of a material fact” is the entity that has ultimate control of the contents of the statement may seem unsurprising, a closer look at the case shows the ruling to be out of step with securities law and common sense.

Janus Capital Group, Inc. is the publicly-traded parent company of the investment adviser Janus Capital Management, LLC. Janus Capital Management managed a mutual fund called Janus Investment Fund, a third, technically separate, legal entity. Janus Capital Management (the investment adviser) is tasked with day-to-day operations of the Investment Fund, including drafting prospectuses that are disseminated to investors and the market. The Fund has no employees of its own.

The prospectus for one of Janus Investment Fund’s mutual funds contained language giving the impression that Janus had adopted measures to curb “market-timing,” a practice that allows hedge funds and other special investors to trade rapidly into and out of funds, to the detriment of long-term investors (including Americans saving for retirement). The prospectus’s claims that the Fund would not be subject to market-timing made the fund more attractive to long-term investors, because market-timing dilutes the return on investment for long-term investors and can make a fund less stable.

In 2003, regulators uncovered several secret, rapid-trading deals between Janus and at least ten hedge funds, contrary to the prospectus’s claims that the fund would not countenance market-timing. In 2004, Janus Capital Group admitted wrongdoing and paid \$225 million to Fund investors to settle allegations made by New York Attorney General Eliot Spitzer, the SEC, and the Colorado Attorney General that Janus had failed to disclose the trading arrangements to long-term investors.¹⁵ But Janus Capital Group’s shareholders—who saw a precipitous drop in JCG’s stock price after the market-timing arrangements were made public—had to turn to a private action under Securities Exchange Act Section 10(b) and SEC Rule 10b-5, which prohibit “mak[ing] any untrue statement of fact” in connection with the purchase or sale of securities.

Despite the fact that Janus Capital Group and Janus Capital Management prepared the prospectuses, Justice Thomas held for the Court that they didn’t “make” the statements, so they can’t be held liable.¹⁶ Under the majority’s ruling, only the business trust set up to hold the funds could be held liable, even though it has no assets of its own to compensate the plaintiffs in the lawsuit. Through careful structuring of legal business entities, Janus was thus able to evade liability for securities fraud and shirk responsibility for harm to Janus Capital Group’s shareholders. Indeed, while the Fund investors, unlike JCG shareholders, were able to obtain some recovery because of the state and federal investigations, Justice Breyer’s dissent raises the

¹⁴ 17 CFR §240.10b-5 (2010).

¹⁵ Riva D. Atlas, *Janus Agrees to Lower Fees In \$225 Million Settlement*, N.Y. TIMES, April 28, 2004, available at <http://www.nytimes.com/2004/04/28/business/janus-agrees-to-lower-fees-in-225-million-settlement.html?scp=1&sq=Janus%20Agrees%20to%20Lower%20Fees%20April%2028,%202004&st=cse>.

¹⁶ *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525 (June 13, 2011), Slip Op. at 5.

possibility that, under the majority's new rule, even the SEC might not be able to hold JCG liable for misleading statements in the Fund's prospectus.¹⁷

As a result of the conservative majority's ruling in *Janus*, Janus Capital Group's shareholders will likely never be able to recover for the injury caused to them by the fraudulent prospectus statements. They cannot recover from the Fund, even though the Supreme Court identifies the Fund as the "maker" of the misleading statements, because the Fund has no assets of its own and is essentially a shell corporation. After the Court's ruling in *Janus*, they cannot recover from Janus Capital Management, even though Management employees ran the Fund and wrote the prospectuses, because any misleading statement can only be attributed to the legally distinct, but ultimately hollow, Fund itself. Heads, corporate insiders win, tails, consumers lose.

* * *

Keeping the courthouse doors open to legitimate claims of corporate misconduct is crucial to ensuring accountability and justice in our markets and workplaces. This is particularly true when individual Americans seek the protection of the courts against wealthy and powerful corporations. In the trio of rulings that are the focus of this Committee hearing—*Wal-Mart v. Dukes*, *AT&T v. Concepcion*, and *Janus Capital Group v. First Derivative Traders*—a sharply-divided Supreme Court closed the courthouse doors and took away important legal tools with which Americans have tried to hold corporations accountable for their actions. We thank the Committee for providing a forum to discuss these significant issues.

Sincerely,



Elizabeth B. Wydra
Chief Counsel



Douglas T. Kendall
President
CONSTITUTIONAL ACCOUNTABILITY CENTER

cc: Members of the Senate Judiciary Committee

¹⁷ Slip Op. at 10 (“[U]nder the majority’s rule it seems unlikely that the SEC itself in such circumstances could exercise the authority Congress has granted it to pursue primary violators who ‘make’ false statements or the authority that Congress has specifically provided to prosecute aiders and abettors to securities violations . . . because the managers, not having ‘ma[d]e’ the statement, would not be liable as principals and there would be no other primary violator they might have tried to ‘aid’ or ‘abet.’”)