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A BRIEF ANALYSIS OF POLICY AND LITIGATION

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The Supreme Court Allows Class Certification Based on Statistical Evidence

David D. Smith

EI Vice President David D. Smith has dealt with class certification in a wide range of industries. He is a co-author of an ABA book chapter on the use of econometrics in class certification.

The Supreme Court recently decided in *Tyson Foods, Inc. v. Bouaphakeo et al*. to uphold the certification of a class of employees at Tyson Foods, Inc. The employees worked in a pork processing plant in Iowa. Their work required them to wear protective gear. The exact gear each worker wore on any particular day depended on the specific tasks he or she did on that day. The suit alleged that because donning and doffing of the gear was "integral and indispensable" to their hazardous work, according to the Fair Labor Standards Act of 1938, the workers should be compensated for any overtime spent donning and doffing the gear. They sued to recover unpaid overtime.

The employees had to show that they worked more than 40 hours a week to be eligible for the overtime pay, but Tyson Foods had not kept records of their time. The employees hired an industrial relations expert who videotaped a sample of about 53 employees for each donning and doffing activity, and extrapolated the average time that it took each person in the 3,344 person class to perform these activities. The jury awarded the class about $2.9 million.

The Court wrote that the acceptability of statistical evidence, such as the study based on these samples, "depends on the purpose for which the evidence is being introduced and on the elements of the underlying cause of action.... Because a representative sample may be the only feasible way to establish liability, it cannot be deemed improper merely because the claim is brought on behalf of a class." Given that Tysons had not kept records of the employees' time, each class member could have relied on the expert's sample to establish liability if each had brought an individual action.

The statistical sample was allowed because respondents sought "to fill an evidentiary gap created by the employer's failure to keep adequate records." The Court also warned that this case does not present an opportunity to adopt "broad and categorical rules" on the use of statistical evidence in class actions. A dissenting opinion argued that whether a particular employee worked more than 40 hours a week without receiving overtime pay was "clearly individualized." The study done by the expert showed "significant variability in how much time employees spent on donning and doffing," and the District Court did not address whether the study was permissible common proof.

Different Competitive Effects in Financial Rate-Setting Cases

Stuart D. Gurrea and Jonathan A. Neuberger

In recent years, many of the largest banks have been accused of manipulating benchmark rates. Cases concern the LIBOR rate used to set adjustable mortgages and other financial products (*In re LIBOR-Based Fin. Instr. Antitrust Litig., 935 F. Supp. 2d 666* (S.D.N.Y. 2013)), foreign exchange market benchmark rates ("FX fixes") (*In re Foreign Ex. Benchmark Rates Antitrust Litig., 74 F. Supp. 3d 581* (S.D.N.Y. 2015)), and most recently reference rates for financial derivatives ("ISDAfix") (*Alaska Electrical Pension Fund, et al. v Bank of America Corporation et al.*).The complaints filed in these cases all include claims under Section One of the Sherman Act alleging anticompetitive conspiracies among defendant financial institutions. The district courts, however, originally reached a different conclusion in the LIBOR litigation than in the FX and ISDAfix litigations regarding whether the type of alleged rate manipulation would give rise to antitrust liability.

Stuart D. Gurrea has extensive experience in constructing and assessing economic models. His consulting experience includes calculating damages and performing financial analyses. Jonathan A. Neuberger specializes in financial economics, valuation, and damages analysis in complex commercial litigation across a broad range of industries.

LIBOR, which stands for the London Interbank Offered Rate, was designed to reflect the average rate that leading banks in London pay for short-term loans. LIBOR rates were set based on submissions by participating banks to the British Bankers Association. Several banks were accused of deliberately misreporting their LIBOR submissions and thereby tainting LIBOR rates. Allegedly false LIBOR submissions benefited defendant banks in several ways. Some were intended to improve trading positions held by bank trading desks. Artificially low submissions could lower payments on bank liabilities pegged to LIBOR and could present the banks to investors and regulators as financially healthier than they actually were.

> "The recent ruling by the court of appeals reopens the issue of cooperative rate-setting, with unknown consequences for antitrust claims."

The FX manipulation cases involve foreign exchange dealers allegedly colluding to move spot FX rates and affect the determination of key FX benchmarks (daily "fixes").Currency dealers allegedly took advantage of their knowledge of pending client orders, which referenced certain future benchmark rates, and traded to their own benefit ("front-running" of client orders).

In an effort to move FX rates to their advantage, dealers also allegedly colluded to concentrate trades from multiple institutions just before benchmark rates were set with the intent of manipulating spot FX benchmarks ("banging the close").

The ISDAfix is a benchmark rate referenced by many financial derivatives. Like LIBOR, the ISDAfix is computed based on data submitted by dealers regarding hypothetical transactions and not actual transaction data. ISDAfix submissions, however, are made in response to market-based actual rates offered in inter-dealer trades and executable inter-dealer bids at a particular time of the day. Dealers can accept the market rate, submit a different rate, or take no action. Plaintiffs' allegations in this case are similar to those in the FX case, namely that defendant banks conspired to manipulate the US Dollar ISDAfix by coordinating trading to generate a desired reference rate at a particular time of day, i.e., banging the close. Banks then allegedly adopted the reference rate for purposes of making ISDAfix submissions rather than determining submissions based on their own bid/ask spreads.

In all three cases, plaintiffs brought antitrust claims related to defendants' collaborative conduct. Courts, however, have not adopted a universal view of these antitrust claims. In the LIBOR case, the court found that plaintiffs' alleged conspiracy did not undermine competition or cause antitrust injury. Thus, the court dismissed the antitrust claims in this case.

In the FX and the ISDAfix cases, in contrast, the courts refused to dismiss plaintiffs' Sherman Act claims at the pleading stage. The root of such divergence can be

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New Fiduciary Rule for Investment Advisors: Questionable Benefits and Substantial Costs

Robert Litan and Hal J. Singer

The Department of Labor (DOL) recently adopted new fiduciary rules for securities brokers and others providing financial advice to savers managing their individual retirement accounts (IRAs). Previously, the only requirement the government imposed on those advisors was that their advice be "suitable" for investors, given the investors' income, assets, and willingness to assume risk. Under the new rule, advisors will have fiduciary obligations to the extent they receive transaction-specific direct commissions from the sponsors of investments they recommend. These rules likely will have costs that far exceed their benefits.

Payments from investment companies have been a major form of compensation for financial advisors. DOL believes that this system results in extra costs to investors because it causes advisors to give "conflicted advice" that favors investments with the highest commissions rather than those that are best for the investor. DOL estimates that by eliminating these extra costs, the rule will have annual benefits relative to the value of IRAs of 25 basis points (i.e., 25 one hundredths of a percent) or about $3.8 billion net of compliance costs.

Yet DOL has overestimated the costs of conflicted advice and thus the potential benefits of the new rule. DOL argues that funds sold by brokers receiving commissions had higher fees and thus inferior performance to other investments. Once brokers no longer have an incentive to steer customers to poorly performing funds, consumers will realize higher returns on their IRAs. The supposed finding that broker-sold funds perform poorly, however, disappears if the analysis considers foreign rather than domestic equities or is done for a different time period. Thus, there is no sufficient evidence that broker-sold funds consistently underperform other investments.

> "[T]he rule may cause many small investors to lose the services of financial advisors..."

Moreover, the fiduciary rule may result in serious harms to small investors. Without commissions, financial advisors will have no incentive to service such investors. Advisors may either withdraw from this segment of the market or begin to charge those investors a fee based on a percentage of their assets, a "wrap fee."

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Thus, the rule may cause many small investors to lose the services of financial advisors, services that have significant benefits. Two such benefits are coaching to stay invested during market downturns and assistance in rebalancing portfolios. The annual value of just those two benefits has been estimated to be 44.5 basis points, almost twice the DOL's estimate of the benefits of the fiduciary rules. This estimate ignores the value of other benefits that would also be lost, such as encouragement to increase savings and take greater advantage of employer matching plans.

Advocates of the proposed rule assume naively that "robo advisors" will eventually fill the gap, so small savers will continue to be advised. But emails and tweets from a robot will not prevent an investor from selling in a panic. The value of human interaction during periods of market stress will swamp anything else a small saver does with respect to outcomes and retirement security.

Alternatively, small investors may be able to continue to use a broker but have to pay a wrap fee. Fee-based advisory relationships, however, generally cost much more than commission-based relationships. Paying brokers a wrap fee is likely to result in added annual costs to small investors of 31 basis points. These costs are much greater than the supposed benefits of the fiduciary rule. For example, an investor with a portfolio of $100,000 would pay $310 in annual fees, whereas DOL estimates that investor's benefits from the rule would be only $250.

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Different Competitive Effects

traced back to the economic effects of the alleged conduct in each of the cases.

Construction of reference rates based on submissions of market participants is by definition a collaborative process. Without input from competing financial institutions, reference rates cannot be computed. The alleged collective actions of market participants, however, differ across cases and have different economic effects on competition. In the LIBOR litigation, the court viewed the collaboration of the participating banks as necessary for the existence of LIBOR rates. Thus that collaboration, by itself, was not deemed anticompetitive. The conduct at issue concerned a hypothetical market transaction and not an actual transaction, and banks' alleged concerted actions were found not to have reduced actual competition. On appeal, however, the Second Circuit determined that any process by which competing firms set a price or a component of price (like LIBOR) represents horizontal price-fixing and is thus a per se violation of antitrust law. This finding led the appeals court to remand the case for additional consideration by the trial court of issues related to antitrust standing and injury.

As with the LIBOR rate-setting process, the determination of ISDAfix and FX benchmark rates requires the collaboration of market participants through a process that by necessity is not competitive in nature. The determination of ISDAfix is similar to the LIBOR process in that participating institutions are queried about rates for hypothetical transactions and not actual market transactions. The ISDAfix and FX benchmark rates, however, also incorporate as key inputs to the reference rate-setting process market-based rates that defendants allegedly altered through coordinated efforts. In particular, plaintiffs allege that by coordinating to bang the close and achieve a desired rate, defendant dealers pushed actual rates away from competitive rates. As a result, plaintiffs have claimed that the alleged conduct in these cases disrupted the workings of otherwise competitive markets and caused them to suffer economic harm.

The FX and ISDAfix cases explicitly allege coordinated conduct among defendant banks to engage in actual transactions that altered the outcomes of otherwise competitive markets. This alleged conduct has enabled antitrust claims to move forward in these cases. In contrast, the court's ruling in the LIBOR case focused more on the rate-setting process itself, which the court deemed cooperative rather than competitive. The recent ruling by the court of appeals reopens the issue of cooperative rate-setting, with unknown consequences for antitrust claims.

New Fiduciary Rule for Advisors

A simple calculation indicates how much the rule is likely to cost investors. Assume conservatively that the only assets that are affected by the rule are the $1.487 trillion of IRA investments in mutual funds with a front- end load—that is with commissions and expenses deducted at the time of purchase. That figure is the estimated average annual value of those investments between 2017 and 2026. (In reality, the costs of the rule would also be felt by investors who rely on broker assistance without the use of a front end load.) Assume further that half of investors (on a dollar weighted basis) lose their brokers as a result of the rule, while the remaining half maintain their brokers but are forced to convert to a wrap fee compensation model. The rule's costs to investors, which as noted are a fraction of their affected assets, would be over $5.6 billion a year. Even assuming that DOL's estimate of the rule's benefits is correct, the costs net of benefit would be just under $1.9 billion a year.

DOL argues that its rule will not cause financial advisors to either abandon small savers or switch them to a wrap fee arrangement because it includes Best Interest Contract Exemptions ("BICE"). The BICE allow brokers and advisors who meet certain conditions to receive commissions and marketing and distribution fees from mutual funds. The requirements to qualify for BICE, however, are so onerous that advisors are more likely to forgo commissions than to use the exceptions. Moreover, DOL's whole argument for the benefits of the fiduciary rule is based on the contention that the rule would stop advisors from receiving commissions from investment companies. It cannot then turn around and say that because of BICE, the rule would not have that effect.

DOL has an alternative to the fiduciary rule that would reduce the costs of conflicted advice without imposing large costs on small investors. DOL could require brokers to make additional disclosures of the cost of broker compensation. DOL rejected enhanced disclosure rules with only the unsupported assertion that investors could not understand the additional information. Certainly DOL should have at least tried these rules before adopting the fiduciary rules with their questionable benefits and significant costs.

EI News and Notes

CertainTeed Summary Judgment

U.S. District Judge Michael Baylson granted CertainTeed's motion for summary judgment in a multi-district price-fixing litigation but ordered all other remaining drywall manufacturers to remain in the case. EI Chairman Barry C. Harris testified at deposition on behalf of CertainTeed. Plaintiffs alleged that beginning in 2011 the defendants conspired to raise prices by 35% and stop providing customers with job quotes. The opinion agreed with CertainTeed that it had independently followed pricing moves by its competitors. Dr. Harris' analysis considered whether CertainTeed's pricing actions were in its independent economic interest, which involved consideration of CertainTeed's cost structure and product mix. EI economists Stephanie Mirrow and Su Sun also worked on the case. CertainTeed was represented by White & Case.

Jury Rejects Wage-Hour Classes' Claims

EI President Jonathan L. Walker testified at trial on behalf of Taco Bell Corporation and Taco Bell of America, Inc. in *Medlock v. Taco Bell et al*. The matter involved alleged violations of California wage-hour laws. Dr. Walker's testimony concerned liability to members of two classes of present and former Taco Bell employees. Plaintiffs had sought over $169 million in damages and penalties on behalf of these classes. A federal jury rejected both classes' claims. The jury found in favor of a third class and awarded $496,000 in damages to its members. EI Senior Economists Erica Greulich and James Bono and Economist Anna Koyfman also worked on the case. Taco Bell was represented by Shephard, Mullin, Richter & Hamilton.

Study on Regulation of Business Broadband

EI Principal Hal J. Singer recently did a study for USTelecom of a proposal that the Federal Communications Commission begin to regulate the prices of business broadband services. He found no evidence of a lack of competition in the industry. To the contrary, business broadband prices have been declining, and the industry has been growing rapidly. Thus, there is no reason for regulation. Regulation is likely to slow the industry's growth. Dr. Singer estimated that regulation would eliminate 43,560 jobs, cut economic output by $3.4 billion over a five-year period, and prevent 67,000 buildings from getting access to fiber. The study can be found at www.EI.com/Publications/Reports.

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