BETTER MARKETS

LEGAL FACT SHEET

Biased Courts Are Undermining the Rule of Law, Democracy, our Markets, Economy, and Capitalism Itself

May 20, 2024

Introduction

Independent and unbiased courts and judges are fundamental to our democracy, social compact, and financial and economic systems. They are supposed to uphold the rule of law and equal justice under law. However, our nation's laws are under assault. But the perpetrators are not private citizens. Instead, they are ideologically biased federal judges who are ignoring facts, law, and policy to rule in favor of the financial industry and against financial regulatory agencies. Because those agencies are run by Presidentially nominated and Senate confirmed officials, these unaccountable courts and judges are also undermining democracy. Well-regulated and policed markets are essential to our economy and capitalism, which are also threatened by these actions.

This is getting so bad that the outcome of a lawsuit is often predictable based upon where the lawsuit is filed. There are 12 circuit courts in the United States and 94 district courts, but the judges on the Fifth Circuit Court of Appeals and on federal district courts in Texas are the worst, consistently disregarding the law to strike down rules and regulations with which they disagree. These judges are aided and abetted by the practice of "forum shopping," where financial firms can manipulate the process and file suit in courts they have good reason to believe will rule in their favor.

Ironically, such conduct is a de facto admission that their cases lack merit and that they lack confidence in being able to win their case on the merits. After all, if it was a well-grounded case, they wouldn't need to manipulate the process to get before a court where their odds of winning are all but guaranteed before they even file their case much less before the merits of the case are considered.

Financial firms seeking to overturn even the most sensible and necessary rule have a political basis to engage in forum shopping to file their cases with the Fifth Circuit. Twelve of the Fifth Circuit's 17 judges were nominated by Republican presidents, and six of those 12 were nominated by President Trump. As a result, the court has become the "go-to circuit" for challenges to government policies.

Similarly, forum shopping incentivizes parties who wish to bring such challenges but who must do so in district court rather than appellate court to file their cases in the Northern District of Texas. The Northern District of Texas has seven divisions, but several divisions have only one or two judges. So parties that file their cases in the Amarillo division are usually guaranteed to have their case heard by the only judge in that division, an appointee of President Trump. Parties that file in the Fort Worth

Division will have their case heard by either an appointee of President Trump or President George W. Bush. The rulings of the judges in the Northern District of Texas may be appealed to the Fifth Circuit, which hears appeals from the district courts in Texas, Mississippi, and Louisiana. That is why 63% of all U.S. Chamber of Commerce lawsuits challenging federal regulations since 2017 have been filed in district courts within the Fifth Circuit's boundaries.

Although the Fifth Circuit's propensity for ruling against the government in cases involving issues such as abortion, immigration, and transgender rights garners most of the headlines, the court's reflexive opposition to government policies generally is just as pernicious in the sphere of financial regulation. Rule writing agencies such as the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), and Consumer Financial Protection Bureau (CFPB) have all taken critical steps recently to protect investors and consumers. But the Fifth Circuit threatens the ability of investors and consumers to receive these protections, because agency action can often be challenged in any of the federal circuit courts of appeals, which means that a rule "acceptable to eleven of the twelve circuits could easily by struck down by the twelfth, strategically chosen as the forum by a regulated entity." That is exactly what is happening with respect to financial regulation. And, because the Supreme Court hears so few cases, circuit court opinions often become the law of the land.

This Fact Sheet highlights some of the most egregious examples of litigants using forum shopping to bring recent challenges to financial regulations before the Fifth Circuit or the district courts within that circuit and the almost uniform rulings in favor of those litigants in response to those challenges.

The SEC

The Stock Buyback Rule and the Nasdaq Diversity Rule

Industry's decision to do everything possible to have the Fifth Circuit hear its challenges to SEC rules is not based simply on the court's conservative reputation. The Fifth Circuit's track record in cases involving the SEC support the view that the court will be unduly sympathetic to industry's claims. In November 2023, the Fifth Circuit held that the SEC acted arbitrarily and capriciously when it adopted a rule requiring greater transparency with respect to stock buybacks. The court invalidated the rule on the basis that the SEC failed to respond to suggestions from commenters regarding how it could attempt to quantify the rule's economic effects, despite the fact that the law imposes no requirement on agencies to conduct their own empirical or statistical studies and the fact that agencies receive hundreds if not thousands of comments on their significant rulemakings.

The Fifth Circuit is so biased that rule writing financial agencies like the SEC can't win even when all of the judges to hear the case initially agree with it. In 2021, the SEC approved Nasdaq rules requiring companies listed on the exchange to disclose the race, gender, and sexual orientation of their board members and have—or explain why they do not have—at least one female board member and one minority or LGBTQ+ board member. Opponents of the rules unsurprisingly filed a challenge in the Fifth Circuit, but a three-judge panel rejected those challenges in October 2023, in a well-reasoned, well-grounded decision. Nevertheless, the industry filed a petition for "en banc" review—an attempt to have all of the active judges on the Fifth Circuit decide the case instead of the three-judge panel.

En banc rehearings are very rarely granted. The federal circuit courts of appeals review only 0.19% of panel decisions en banc. Moreover, the odds of an en banc review when a panel of the circuit rules unanimously—as happened here—are significantly *less* than 0.19%. En banc review is seldom a route that should even be pursued unless one of the judges on the three-judge panel issued a dissent. The reason for the rarity of granting en banc review is the need for the federal judiciary to at least appear impartial and unbiased regardless of the ideological composition of the court:

> Partisan en bancs—by which we mean en banc decisions that are more than ideologically divided but exhibit my-party-versus-your-party warning signs—runs counter to the core notion of an independent judiciary. The federal courts of appeals make use of a randomly-assigned three-judge panel system precisely because any group of three (whatever their partisan affiliation) is seen as able to render justice in any case and therefore the equal of any other group of three. Partisan en bancs, however, present the possibility that cases are resolved not because of disagreements on the law or even diverging ideological priors, but because one side can out-muscle the other side. Judge Wilkinson's warning about "partisan warriors" is chilling. It starkly involves the fear that courts will become simple power brokers. It is very difficult to agree with Chief Justice Roberts that there are no "Trump judges" or "Obama judges" if appellate judges use en banc review as a weapon against each other when they have the numbers to do so.

Unfortunately, that is exactly what seems to be happening on the Fifth Circuit. In February 2024, the Fifth Circuit vacated the panel decision that ruled in favor of the SEC and agreed to have the case heard by the en banc court. It is virtually certain that this was done because the majority of judges on the circuit were appointed by Republican presidents—six by President Trump—and en banc review would allow them to overturn the decision of the three-judge panel favoring the SEC.

The Climate Rule

On March 6, 2024, the SEC adopted a rule requiring that public companies disclose certain climate-related information in their registration statements and annual reports. That same day, two companies sued the SEC over the rule in the Fifth Circuit. In the ensuing days, the Fifth Circuit received three additional lawsuits challenging the climate disclosure rule.

On March 15, 2024, the Fifth Circuit took the extraordinary step of issuing an emergency stay of the rule pending the outcome of the challenges to the rule on the merits. The Fifth Circuit's own rules say that parties should not file motions seeking emergency relief unless there is an emergency sufficient to justify disruption of the normal appellate process. The Fifth Circuit found that the petitioners' request for an emergency stay satisfied this standard despite the fact that the SEC's rule did not require companies to begin reporting any information pursuant to the rule until 2026.

After other parties filed challenges to the climate disclosure rule in different appellate courts and a lottery determined that all of the challenges to the rule would be heard by the Eighth Circuit Court of Appeals, the Fifth Circuit was forced to lift the emergency stay that it had granted because it no longer had jurisdiction over the cases. The fact that the lottery results could be considered a small win for the SEC shows just how hostile the Fifth Circuit has become to the government. Although of

the Eighth Circuit's 17 judges only one was appointed by a Democratic president, the Fifth Circuit is still considered the most conservative federal court of appeals in the United States.

The National Association of Private Fund Managers

The Fifth Circuit is now considered so antagonistic to the government that hedge funds have formed a trade association in Texas for the express purpose of enabling them to forum shop and file suit against the SEC in that circuit. In 2022, a group of hedge funds formed the National Association of Private Fund Managers in Texas after the SEC proposed a rule to bring greater transparency to the private fund industry. Despite the fact that the National Association of Private Fund Managers had no website and listed no individual's name or contact information in a comment letter to the SEC on the proposed rule, the group sued the SEC in the Fifth Circuit after the agency adopted the rule.

Although the case is still pending before the Fifth Circuit, so far it looks as though industry's decision to form a group in Texas for the express purpose of suing in the Fifth Circuit will pay off. At the February 5, 2024 oral argument in the case, the judges on the Fifth Circuit expressed skepticism about the SEC's claim that it had the authority to regulate the private funds industry.

Although the industry may have formed the National Association of Private Fund Managers for the purpose of challenging the SEC's private funds rule specifically, it appears that industry is going to use the group's location to its advantage in other cases too. The group has now also challenged rules that the SEC passed in 2023 to regulate short selling and securities loans, and although two other groups joined that suit, the location of the National Association of Private Fund Managers in Texas is what enabled the challengers to file their lawsuit in the Fifth Circuit. The National Association of Private Fund Managers also recently filed a lawsuit challenging the SEC's rule expanding the definition of a securities dealer in federal district court in Texas. So the National Association of Private Fund Managers has filed three lawsuits against the SEC all in the last year alone either in the Fifth Circuit or in a court whose decision would be reviewable by the Fifth Circuit.

It appears that other parts of the securities industry are now poised to emulate this forum shopping strategy: the Investment Company Institute has purposely formed a new affiliate called ICI Southwest, which is based in Texas and would therefore have standing to sue in the Fifth Circuit if the organization decides that it wants to sue over an SEC rule proposal regarding mutual fund pricing.

The CFTC

The Fifth Circuit's seeming inclination to go out of its way to rule against financial regulators is not limited to the SEC. In July 2023, the Fifth Circuit directed a federal district court in Texas to issue a preliminary injunction against the CFTC's decision to rescind a "no-action" letter it had granted to PredictIt, an online marketplace where people could bet on the outcome of political events. In 2014, the CFTC's staff had granted PredictIt the no-action letter, which meant the staff of one of the CFTC's five divisions would not recommend enforcement action based on PredictIt's failure to register under the Commodity Exchange Act, if the operators of the marketplace agreed to abide by certain terms. In 2022, the staff rescinded the letter on the ground that PredictIt's operators had not abided by those terms.

Certain users of the marketplace sought an injunction from a federal district court in Texas but then appealed to the Fifth Circuit because the district court had not ruled on its request for the injunction. The Fifth Circuit held in a 2-1 decision that the rescission of the no-action letter was likely arbitrary and capricious because, in its view, the CFTC had not provided sufficient reasons for the rescission, and it ordered a preliminary injunction while the district court fully considered the case on the merits.

In so ruling, the Fifth Circuit rejected the CFTC's argument that the no-action letter was not "final agency action" that could be challenged in court but rather simply the decision of the staff of one division regarding whether it might recommend an enforcement action. One judge who concurred in the judgement to order an injunction acknowledged that no other court of appeals "has held that a no-action letter or its withdrawal is sufficient to constitute 'final agency action' under the Administrative Procedure Act" and indeed that some of the other courts of appeals "have held the opposite." As a result, that judge recognized that the court's decision "conflicts with the precedents of our sister circuits."

The dissenting judge on the three-judge panel wrote an opinion that emphasized just how far the majority's decision strayed from established law. He could not find "any instance where a court has ruled that a 'no-action letter' constitutes a final action taken by the agency." He noted that the majority tellingly itself "cites no such case" and that to the contrary "no-action letters have been regularly found to be non-binding and devoid of legal authority, precluding their review." The judge concluded his dissent from the ruling to order an injunction by saying that in his view the Fifth Circuit should not be "the first court to draw the conclusion that a 'no-action letter' constitutes 'final agency action.'" In other words, the Fifth Circuit's decision was literally unprecedented.

Perhaps even more problematic about forum shopping in the Fifth Circuit is that the court appears to be a willing accomplice. After the Fifth Circuit's ruling regarding the no-action letter, the district court ordered that the case be transferred to Washington, D.C., because the Texas court was too "heavily congested" to rule on the case expeditiously. The statistics underlying that decision show just how pervasive forum shopping in Texas has become. The CFTC pointed out that there were 801 filings per judge in the Western District of Texas and 276 per judge in the federal district court in D.C. The Texas district court also noted that the CFTC and the two main plaintiffs in the case were all headquartered in D.C. For these reasons, the judge overseeing the case thought that the case could be resolved more quickly in the D.C. federal court and ordered the matter transferred to that venue.

Nonetheless, after the plaintiffs again appealed to the Fifth Circuit—the same court that had ruled in its favor on the no-action letter—the Fifth Circuit ordered that the case be returned to Texas. Despite all the evidence that Washington, D.C. was the proper forum for the matter, the Fifth Circuit held that there was a lack of "good cause" for the transfer. In a blatant invitation for parties to continue forum shopping, the Fifth Circuit said that congestion in the federal district courts in Texas could not justify the transfer because it "ignores the plaintiff's role as master of the complaint."

The CFPB

Unfortunately, the PredictIt case is not the only recent instance of the Fifth Circuit overruling the view of a district court judge that a case involving a financial regulator should be heard in Washington, D.C, and not Texas. Recently, industry filed a challenge to a CFPB rule limiting credit card late fees

to $8. It did so in the Fort Worth Division of the Northern District of Texas, which as noted above has only two judges, both of whom were appointed by Republican presidents, and which is recognized as a biased forum for challenges to government regulations. Nonetheless, in this particular case the judge ordered that the case be transferred to Washington, D.C., since no credit card issuer subject to the CFPB rule was based in Fort Worth and half of the groups challenging the rule were based in D.C. The judge's decision made it clear that he believed the challengers were engaging in forum shopping in a deliberate attempt to have their matter heard by a favorable court.

Despite the fact that the judge overseeing the case—in the district court considered one of the most favorable for challenges to government regulations—decided that his court was not the proper forum for the challenge to the rule, the Fifth Circuit reversed the decision and ordered the case back to Texas. In doing so, it ignored the dissenting view of one of the judges on the three-judge panel, who said that the Fifth Circuit's decision was "particularly worrisome not just as our usurpation of district courts' docket control, but also its implications for the judiciary's ability to prevent forum shopping." The fact that the Fifth Circuit would overrule a district court judge in its circuit who took the rare step of trying to combat such a flagrant instance of forum shopping is an indication of how out of control the Fifth Circuit has become in its zeal to de facto rubber stamp industry complaints against financial regulatory agencies regardless of the law, facts, or policy.

Conclusion

Forum shopping in the Fifth Circuit has become so pervasive and blatant that it has prompted efforts to stop it. Just last month, the Judicial Conference of the United States, which is the policymaking body for the federal courts, announced a policy that requires assigning judges at random in civil cases that have statewide or national implications, in an effort to curb "judge-shopping" in federal district courts that have only a single judge in a particular division. The purpose of the policy was to "promote[] the impartiality of proceedings and bolster[] public confidence in the federal judiciary."

Perhaps unsurprisingly, immediately after the Judicial Conference announced the new policy, two conservative Fifth Circuit judges criticized it. And the federal court in the Northern District of Texas, which as noted above has single-judge districts, announced that it would not follow the policy. Lawless, result-oriented judges and courts are incentivizing corporate lawsuits and delivering ideologically driven results.

Now, Senate leadership has taken notice. Recently, Senate Majority Leader Chuck Schumer introduced a bill that would make the guidance from the Judicial Conference law. The idea is that a law, rather than a policy statement, would better "advance the fairness and randomness of the distribution of" important cases and "ensure the perceived legitimacy of the courts." Otherwise, litigants will continue to "have the ability to effectively choose an actual judge," which, as demonstrated above, is effectively choosing an outcome. Whatever the mechanism, it is clear that forum shopping in the Fifth Circuit has become an epidemic that is undermining the rule of law, democracy, our markets, economy and capitalism and must be addressed.

BETTER MARKETS

Better Banks | Better Businesses

Better Jobs | Better Economic Growth

Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

For press inquiries, please contact us at press@bettermarkets.com or (202) 618-6430.

SUBSCRIBE to Our Monthly Newsletter

FOLLOW US ON SOCIAL

2000 Pennsylvania Avenue NW | Suite 4008 | Washington, DC 20006 | 202-618-6464 | www.bettermarkets.org