Statement to the Senate Standing Committee on
Consumer Protection and Internet and Technology

Concerning Proposed New York Privacy Act

A Comment on "Private Law" Enforcement Mechanisms

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Personal Statement

I am a senior fellow with the Manhattan Institute for Policy Research, a nonprofit, nonpartisan think tank in New York City. Since 2003, I have directed the Institute's legal policy efforts. I have authored numerous studies on how civil and criminal law affects businesses and the broader economy. I have previously testified on litigation, legal enforcement, and various other law-and-economics concerns before other state legislative committees, including in the New York Senate, as well as committees in both house of Congress, the New York City Council and other municipal bodies, the OECD, and various federal administrative agencies and conferences.

Before joining the Manhattan Institute, I served as a consultant for McKinsey and Company in its New York office and clerked on the U.S. Court of Appeals for the Second Circuit. I studied economics and political economy at the University of North Carolina and the London School of Economics, and I have JD and MBA degrees from Yale.

Beyond the Center for Legal Policy's work, the Manhattan Institute has long concerned itself with the economic vitality of the city and state in which the Institute is housed. I want to emphasize that my comments today reflect my own views and do not necessarily reflect the views of any of my colleagues or of the Manhattan Institute for Policy Research.

Summary of Analysis

The issue of data privacy is one of critical import to citizens today. It lies squarely at the juncture of the committee's core foci: "consumer protection" and "internet and technology." It is important for the committee to tackle this issue.

That said, and without implying support for or opposition to any of the broader parts of the proposed legislation, S.B. 5642, the New York Privacy Act, I would like to advise the committee and the broader New York state legislature against creating a "private right of action" enforcement mechanism. Rather, any legislation with operative force should limit enforcement to the state attorney general's office and other appropriate executive branch and administrative actors. In general, and particularly in this field, private rights of action have shown a high propensity for abuse—largely functioning to enrich plaintiffs' lawyers and to give little to no compensation to plaintiffs alleging harms from privacy breaches.

Private Rights of Action: A Problematic Enforcement Mechanism

Private-enforcement actions generated under the New York Privacy Act—lawsuits for recovery—would almost inevitably be enforced through the class-action device, as privacy breaches usually involve thousands or millions of prospective claimants with common alleged injuries.

Class-action lawsuits are paradigmatic examples of the types of litigation that can become "abusive": suits that "have little legal merit, regardless of the magnitude of the recovery sought," but are nevertheless profitable to pursue.[1] As explained by my former colleague Marie Gryphon (Newhouse) in a 2008 Manhattan Institute report, "'Lottery suits' are defined by a combination of low legal merit and very high stakes."[2]

As a general rule, defendant corporations will settle low-merit cases whenever the expected cost of going to trial exceeds the proposed settlement cost.[3] Precisely because the costs of defending a class action lawsuit at trial are so large—both in terms of legal and discovery costs and because of the large expected payout even for low-probability claims—low-merit cases will regularly settle. Substantive liability rules are only germane to the extent they affect the probability of a pro-plaintiff verdict, and consumer cost or benefit does not enter into the defendant company's calculation except through that window.[4]

Such class settlements, by definition, tend to preclude *any* recovery by plaintiffs in the class who fail to opt out of the litigation. And because data-privacy classes tend to be extremely large, notice to class members is often suspect—in many cases only a website posting unlikely to be noticed by many affected class members.

There is a robust history of class-action litigation over alleged data-privacy breaches. Unfortunately, that history is not pretty. As Ted Frank of the Hamilton Lincoln Law Institute

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[1] Marie Gryphon, *Greater Justice, Lower Cost: How a "Loser Pays" Rule Would Improve the American Legal System* 4 (Manhattan Institute 2008), *available at* http://www.manhattan-institute.org/pdf/cjr_11.pdf. *See generally* Manhattan Institute, *Trial Lawyers, Inc.: Class Actions and Mass Torts* (2016), *available at* https://www.manhattan-institute.org/html/trial-lawyers-inc-class-actions-and-mass-torts-8462.html.

[2] Gryphon, *supra* note 1, at 4 & fig. 1.

[3] For the category of abusive lawsuits Gryphon characterizes as "nuisance suits," defendant companies who expect to face similar suits in the future—repeat players in a game-theoretic construct—may choose to fight such lawsuits even when settling would be the rational strategy for a "single-shot" game. *See* Gryphon, *id.*, at 6–7. This strategy would rarely apply, however, in class-action litigation, where the sheer size of potential recoveries generates a "lottery" scenario that drives settlement. In such cases, the size and uncertainty of pending litigation can impair company credit and stock prices until litigation is resolved. Moreover, even when litigating rather than settling may be in the interest of the average diversified corporate shareholder, agency costs would tend to make corporate managements and boards more likely to settle than to litigate in many instances, as managers and boards would bear more concentrated costs in the event of an unexpected negative verdict.

[4] Even given that settlement decisions are driven in part by substantive liability rules, this fact does not necessarily imply that such rules always, generally, or even usually comport with the public interest.

described in his brief to the U.S. Supreme Court in *Frank v. Gaos*, concerning a challenge to a class-action settlement of claims brought against Google:

> The vast majority of consumer and privacy class action settlements are for less than a dollar or two per class member. The settlement of a 2015 data breach of insurer Anthem was for a record $115 million—but after attorneys' fees and settlement administration costs, there would be only about $0.65 per class member for the 79-million member class.[5]

Indeed, the case against Google in the *Gaos* case itself remitted *zero* dollars to plaintiffs, distributing all pecuniary awards to class counsel and to third-party charities, many of which had ties to the class counsel, the defendant company, or both.[6]

Perverse incentives divide class counsel's interests from consumers'. Plaintiffs' lawyers face incentives to trade off both class monetary relief and consumer-aiding injunctive relief for counsel fees. As Mr. Frank observes in a 2013 Manhattan Institute paper, class-action suits "suffer from several structural deficiencies that can prevent class members from having their rights vindicated."[7] Frank observes that "in some cases, the problem of under-compensation [for the class] and self-dealing [by the class counsel] is so severe that class settlements unambiguously harm class members by putting them in a worse position than they were in before the litigation began."[8] As Frank explains:

> The problems arising from the class attorneys' conflict of interest are inevitable, but courts do not have any effective means to police all abusive class settlements. Although courts are tasked with ensuring that class attorneys act as fiduciaries for the class as a whole, they often do not have the information necessary to measure whether the class attorney and defendant have arrived at a fair settlement; accordingly, courts cannot easily act to prevent attorney self-dealing. Moreover, courts' incentives are poorly structured: approving an unfair settlement will rarely result in reversal, both because appellate review tends to be deferential and because objectors rarely have the financial incentive to follow through on an appeal. The incentive to follow through with an appeal is perversely muted when an appeal would have a high likelihood of success: class counsel will always have

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[5] *See* Frank v. Gaos, No. 17-961, 586 U.S. ___, 139 S. Ct. 1041 (2019). The quotation comes from page 50 of petitioner's opening brief, available here: https://hlli.org/wp-content/uploads/2018/04/Jul-09-2018-OPENING-BRIEF-for-Petitioners.pdf. The Manhattan Institute sponsored its own *amicus* brief in this case, available here: https://hlli.org/wp-content/uploads/2018/04/Jul-16-2018-BRIEF-of-Amicus-Curiae-Manhattan-Institute-for-Policy-Research.pdf. *See also* Editorial Board, *The Anthem Class-Action Con,* WALL ST. J. (Feb. 11, 2018).

[6] *See generally* Manhattan Institute, *Trial Lawyers, Inc.: Cy Pres* (2019), *available at* https://www.manhattan-institute.org/trial-lawyers-inc-cy-pres.

[7] Ted Frank, *Class Actions, Arbitration, and Consumer Rights: Why Concepcion is a Pro-Consumer Decision* (Manhattan Institute 2013), *available at* http://www.manhattan-institute.org/pdf/lpr_16.pdf, Executive Summary.

[8] *Id.* at 10.

> more at stake than an objector will, and a for-profit objector whose appeal might be successful can maximize his financial return by a *quid pro quo* with the class counsel—being paid to walk away—at the expense of the class. Indeed, for-profit objectors are usually better off if they lose objections at the district-court level and proceed with an appeal because that maximizes their chances that they will be paid to go away; such payments are substantially more lucrative than the possibility of fees for a successful objection. This all adds up to courts having little incentive to assess settlement proposals and little information with which to do so.[9]

Conclusion

In sum, the litigation we would expect to be generated by a private-litigation enforcement mechanism such as that in the proposed legislation, in the data breach context, would:

1. Be profitable for plaintiffs' attorneys *even if meritless*, for the reasons articulated in Ms. Gryphon Newhouse's paper;[10]

2. Involve settlements highly unlikely to protect actual consumers' rights—and foreclosing legal remedies for individual consumers genuinely harmed by a breach—owing to the inherent conflicts of interest between class counsel and class members, class-action lawsuits' preclusive effects, and the expected ineffective notice offered in these claims;[11]

3. Impose significant costs on businesses—to the New York state economy's detriment. According to a study by New York's NERA Economic Consulting, litigation costs depress economic growth, much in the manner of taxation.[12]

New York already faces a litigation climate among the worst in the nation, particularly with regard to the state's commercial tort liability costs relative to the size of the state economy. It can ill afford to exacerbate this trend—particularly when the proposed vehicle for consumer redress is likely to compromise actually harmed consumers' prospects for effective recovery.

I recommend that any ultimate New York privacy law eschew private rights of action, or at a minimum limit such actions to individual lawsuits alleging concrete injuries, rather than permitting a class vehicle for recovery. I am happy to speak with any legislators or staffers further on this issue.

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[9] *Id.* at 11.
[10] *See generally* Gryphon, *supra* note 1.
[11] *See generally* Frank, *supra* note 7.
[12] *See* NERA ECONOMIC CONSULTING, CREATING CONDITIONS FOR ECONOMIC GROWTH: THE ROLE OF THE LEGAL ENVIRONMENT 22, Oct. 26, 2011, *available at* http://www.instituteforlegalreform.com/sites/default/files/Economic_Growth_Working_Paper_Oct2011_0.pdf.