GATEKEEPING IN THE DARK: SEC CONTROL OVER PRIVATE SECURITIES LITIGATION REVISITED

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COMMENTS WELCOME

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ABSTRACT

Companies targeted by SEC enforcement actions often face parallel private class actions under the federal securities laws based on the same underlying conduct. But when the SEC selects enforcement targets, negotiates settlements, and assesses its own performance, it is unclear whether or how the agency considers this potential "piggybacking" effect. Although the agency's enforcement activities can and do have significant impacts on the flow of private litigation, the agency denies that it systematically accounts for those potential impacts in formulating enforcement policy.

The SEC is not idiosyncratic in this respect. Its practice reflects a gap in our understanding of how public agencies channel private litigation. While scholars have analyzed various deliberate and overt forms of agency "litigation gatekeeping," and have debated the social utility of "piggyback" litigation, the capacity and incentives of agencies to deliberately channel the flow of piggyback litigation have not been carefully examined.

This paper fills that gap. I argue that agencies like the SEC should consider the potential private litigation consequences of their enforcement activities. And I propose adjustments to the enforcement regime to implement this consideration in a transparent and systematic manner.

For thirty years, securities regulation scholars have proposed expanding the SEC's authority to control the flow of private securities class actions. But these proposals face significant conceptual and practical challenges and have not gained traction. This paper offers a new path forward: the SEC should make better use of its existing, inchoate authority to channel private litigation by incorporating the "piggyback" effect into its enforcement decisionmaking.

*Climenko Fellow and Lecturer on Law. J.D. Yale Law School. Selected for the "New Voices in Administrative Law" panel at the 2020 AALS Annual Meeting. For helpful comments on this project, I thank Lucian Bebchuk, Allen Ferrell, Howell Jackson, James Park, Shalev Roisman, James Spindler, Kara Stein, Matthew Stephenson, Urska Velikonja, and David Zaring.

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INTRODUCTION

For thirty years, leading securities regulation scholars have called for expanding the Securities and Exchange Commission's (SEC) authority over private securities litigation—by empowering the agency to pre-screen all putative class action complaints for merit, to decide which cases may be filed and which not, to take over the prosecution of meritorious cases, or to set the level of damages recoverable in private actions.[1] These proposals grow out of profound doubts about the private securities class action regime, frustration with the decentralized "multi-enforcer" approach to securities enforcement, and faith in the capacity of public agencies to act as effective "gatekeepers"[2] of private litigation.[3]

But putting the SEC in charge of private litigation also poses some serious risks. The SEC's decisionmaking is subject to its own distortions[4] and giving the agency "gatekeeping" authority risks importing these distortions onto the private litigation regime. Research suggests that private securities litigation does provide some deterrence and other social benefits which might be reduced or eliminated by subjecting private litigation to bureaucratic control.[5] And centralizing enforcement authority might sacrifice

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[1] *See, e.g.*, Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1514–17 (1996); Jill E. Fisch, *Class Action Reform*, Qui Tam, *and the Role of the Plaintiff*, L. & CONTEMP. PROBS., Autumn 1997 at 200 (1997); Alicia Davis Evans, *Investor Compensation Fund*, 33 J. CORP. L. 223, 241–47 (2007); Jennifer Arlen, *Public Versus Private Enforcement of Securities Fraud* 44–47 (2007), *available at* https://weblaw.usc.edu/assets/docs/Arlen.pdf; Amanda Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1357 (2008); *infra* Part I.A.3.

[2] The term "gatekeeping" refers to all forms of agency influence over the flow of private litigation, including both *catalyzing* and *restricting* private litigation. *See* David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 YALE L.J. 616, 616 (2013).

[3] *Infra* Part I.A.3.

[4] *See, e.g.*, Urska Velikonja, *Politics in Securities Enforcement*, 50 GA. L. REV. 17, 18 (2015); Jonathan R. Macey, *The Distortions Facing the U.S. Securities and Exchange Commission*, 33 HARV. J.L. & PUB. POL'Y 639, 639–41 (2010); Alexander I. Platt, *Unstacking The Deck: Administrative Summary Judgment and Political Control*, 34 YALE J. ON REG. 439, 441 (2017); *see also infra* Part I.A.3.

[5] *Infra* Part I.A.2 (collecting research showing deterrent and other benefits of securities class actions).

some of the benefits provided by the current system of multiple independent enforcers with diverse incentives and capabilities.[6]

This Article proposes a new way to harness the SEC's power to improve the private litigation regime—one that minimizes these risks. Rather than expanding SEC authority over private litigation, I argue that the SEC should make better use of its existing authority in this domain.

As the SEC noted in a recent Amicus Brief, "private plaintiffs ***routinely*** bring their own actions alleging fraud against defendants who are also subject to Commission administrative proceedings."[7] In fact, about twenty percent of class action settlements arise from cases targeting the same conduct as a parallel SEC enforcement action.[8] Research confirms that such "piggybacking" actions are more likely to survive a motion to dismiss and result in larger settlements.[9]

Yet, in formulating enforcement policy, the SEC appears to not systematically account for this significant "piggybacking" effect. When the SEC selects enforcement targets, frames comment letters to companies flagging material errors with their financial disclosures, negotiates settlements, and summarizes its performance in annual reports to Congress, it evidently does so without explicitly accounting for the potential impact its activities may have in catalyzing private litigation.[10] But these impacts still occur. Either they are falling in a random, haphazard way, or (more likely) they are being skewed by unseen forces. In either case, the agency is litigation gatekeeping "in the dark."

The SEC's failure to transparently and systematically integrate downstream private litigation consequences into its enforcement calculus is not idiosyncratic. Rather, it reflects a gap in our understanding of how public agencies can and should shape private enforcement. Administrative law scholars have carefully analyzed the capacity and incentives of administrative agencies to act as

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[6] *E.g.*, James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Law*, 100 CALIF. L. REV. 115, 121 (2012).

[7] Brief of SEC as Amicus Curiae at 20, *City of Providence v. Bats Global Markets, Inc.*, No. 15-3057, 2016 WL 7030327 (2d Cir. Nov. 28, 2016) (emphasis added).

[8] *Infra* Part I.B.2.

[9] *Id*.

[10] *Infra* Part I.B–C.

private litigation "gatekeepers," channeling the flow of private litigation through mechanisms like implying (and disimplying) rights of actions, filing amicus briefs, and *qui tam* regimes.[11] And civil procedure scholars have debated the social utility of "piggyback" cases.[12] But to date scholars have failed to apply the methodology or insights from the "gatekeeping" literature to the "piggyback" phenomenon.[13]

This Article corrects this oversight. I show that agencies like the SEC can and should consider the potential private litigation consequences of their enforcement activities. For instance, in deciding whether or when to file a case, what facts to include in a complaint or settlement, and whether to seek an "admission" from the target, the agency should consider what impact its choice will have on potential or ongoing private securities litigation against the same target for the same underlying misconduct. Factoring this "piggyback" effect into these enforcement decisions should lead the agency to do more to catalyze socially beneficial private litigation and to avoid catalyzing socially harmful private litigation.

A good place to start implementing this proposal would be the annual reports that agencies file with Congress reporting their enforcement performance. Every year, the SEC (like most enforcement agencies) provides Congress a set of statistics and anecdotes tracking the impacts of its enforcement program.[14] But these reports are devoid of any mention of the substantial piggyback effects of the agency's activities. Accordingly they present a woefully incomplete and misleading portrait of the agency's

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[11] *See, e.g.*, Engstrom, *supra* note 2, at 616; Matthew Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 VA. L. REV. 93, 95, 96 (2005); *see also* Part II.A.1.

[12] *See, e.g.*, Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285, 286 (2016); Myriam Gilles & Gary Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 PA. L. REV. 103, 157–58 (2006); Howard M. Erichson, *Coattail Class Actions: Reflections on Microsoft, Tobacco, and the Mixing of Public and Private Lawyering in Mass Litigation*, 34 U.C. DAVIS L. REV. 1, 5 (2000); *see also* Part II.A.2.

[13] *Infra* Part II.A.3.

[14] *See* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 909 (2016); U.S. Government Accountability Office, *Report to Congressional Requesters: Securities and Exchange Commission Division of Enforcement Should Document Its Procedures For Generating Public Reports*, GAO-20-47 (Oct. 2019).

enforcement footprint. If the agency began systematically tracking and including these impacts in its reports to Congress, that could kickstart a productive cycle of accountability, as stakeholders and overseers react to the agency's piggybacking policies (as revealed through their impacts).[15]

This paper makes several contributions.

First, it contributes to the ongoing debate over the securities class action reform. I respond to longstanding proposals by securities regulation scholars to centralize SEC control over private securities class actions by calling on SEC to make better and more explicit use of its existing authority and capacity to perform this function.[16]

Second, it brings together two important streams of literature—administrative law scholarship on agencies as litigation "gatekeepers"[17] and civil procedure scholarship on "piggyback" litigation[18]—to show that agencies exercise "gatekeeping" authority through enforcement activities that catalyze private litigation, and that they should treat this activity with the same deliberation and transparency as other forms of "gatekeeping."

Third, it contributes to the literature on the "accountability deficit" in public enforcement.[19] The proposal here is for public enforcers to take responsibility for the impact of their activities on private litigation arising under the same laws and regulations, so that "We the People" can better hold them accountable for their total

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[15] *Infra* Part III.A.

[16] *See e.g.*, Alexander, *supra* note 1, at 1514–17; Fisch, *Qui Tam*, *supra* note 1, at 200; Evans, *supra* note 1, at 241–47; Arlen, *supra* note 1, at 44; Rose, *supra* note 1, at 1356; *infra* Part I.A.3.

[17] *See e.g.*, Engstrom, *supra* note 2, at 616; Stephenson, *supra* note 11, at 94; *infra* Part II.A.1.

[18] *See e.g.*, Clopton, *supra* note 12, at 285, 286; Gilles & Friedman, *supra* note 12, at 107.

[19] *See, e.g.*, Margaret H. Lemos, *Democratic Enforcement: Accountability and Independence for the Litigation State*, 102 CORNELL L. REV. 929, 929 (2017); Mila Sohoni, *Crackdowns*, 103 VA. L. REV. 31, 33–34 (2017); Kate Andrias, *The President's Enforcement Power*, 88 N.Y.U. L. REV. 1031, 1031, 1035 (2013); Urska Velikonja, *Accountability for Nonenforcement*, 93 NOTRE DAME L. REV. 1549, 1550 (2018). *But see* Blake Emerson, *The Claims of Official Reason*, 128 YALE L.J. 2122 (2019) (arguing that enforcement guidance can create legally cognizable reliance interests that can give rise to a justiciable cause of action when the guidance is altered).

impact. Improving agency data-keeping and reporting on its own enforcement impact is an important part of this project.[20]

Fourth, although the piggyback effect is well-known in the context of SEC Enforcement Division, scholars have overlooked it entirely in the context of the SEC's Division of Corporation Finance.[21] As I show below, the "comment letters" issued by this division to companies regarding deficiencies in their periodic disclosures have become an important resource for plaintiffs in private litigation. This paper presents the first look at how the activities of this Division can and do catalyze private litigation.[22]

This Paper proceeds in three parts. Part I presents the phenomenon of "gatekeeping in the dark" through a case study of the SEC. While the agency has consistently provided high-level support for private securities class actions as a necessary supplement to the agency's own enforcement efforts, it has failed to systematically and transparently consider the downstream impacts of private litigation in formulating its enforcement policy. This Part closely examines the practices of two SEC divisions (Enforcement and Corporation Finance) and shows the failure to adopt a systematic policy to consider the downstream piggybacking effects. Part II looks beyond the SEC to ask whether agency enforcers like the SEC *should* consider the private litigation consequences of their enforcement activities in formulating enforcement policy. The question has not been answered by prior scholarship on "gatekeeping" and "piggyback" litigation. I make the case that such explicit consideration would improve both public and private enforcement, and sketch how agencies can go about implementing this proposal. Part III proposes reforms to bring the SEC, and agencies in general, in line with their responsibility to consider private litigation consequences.

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[20] *Infra* Part III.A.

[21] *Cf.* Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 923–24 (1998) (analyzing judicial reliance on a different SEC regulatory technique—"no-action" letters).

[22] *Infra* Part I.C.

I. THE SEC FAILS TO SYSTEMATICALLY AND TRANSPARENTLY CONSIDER THE PRIVATE LITIGATION CONSEQUENCES OF ITS ENFORCEMENT ACTIVITIES

Several prominent securities regulation scholars have called for legislative expansions of the Securities and Exchange Commission's (SEC's) authority over private securities fraud litigation.[23] But these proposals ignore that the agency *already* has significant authority to channel private litigation that it does not use. This Part examines the "piggyback" litigation generated by the activities of the SEC's Divisions of Enforcement and Corporation Finance, respectively, and how each Division fails to factor this private litigation into their enforcement activities. Section A reviews the general framework of public and private securities enforcement, debates about the merits of private securities class actions, and the long run of scholarly proposals to centralize control over securities class actions in the SEC. Sections B and C examine how the SEC's Enforcement Division and Division of Corporation Finance (respectively) fail to exercise their existing authority over the flow of private litigation by ignoring the "piggyback" effect of their enforcement activities. Section D considers some possible explanations for these findings.

A. Background

1. The Impacts of Public and Private Securities Enforcement

SEC Enforcement and private securities class actions (SCAs) each comprise a significant part of the securities enforcement landscape. The value of settlements produced in SCAs is comparable to the penalty and disgorgement orders obtained by the SEC.[24] Between 2010 and 2018, SCA settlements totaled $31 billion,[25] only $1 billion less than the penalties and disgorgement

[23] *See* Alexander, *supra* note 1, at 1514–17; Fisch, *Qui Tam*, *supra* note 1, at 200; Evans, *supra* note 1, at 241–47; Arlen, *supra* note 1, at 44–47; Rose, *supra* note 1, at 1357; *see also infra* Part I.A.3.

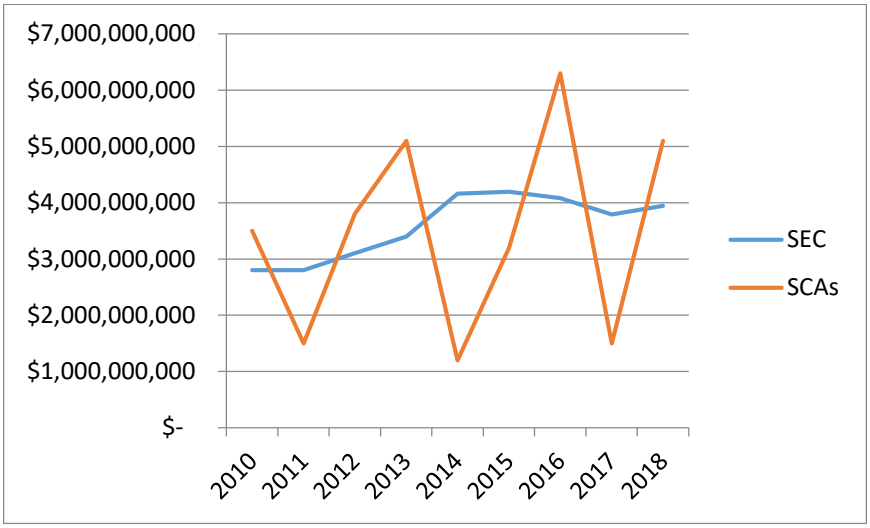
[24] SEC Commissioner Robert J. Jackson Jr., *Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration* (Feb. 26, 2018) ("roughly sixty cents of every dollar returned to investors in corporate-fraud cases [in 2016] came through private rather than SEC settlements.").

[25] Laarni T. Bulan et al., *Securities Class Action Settlements 2018 Review and Analysis 3*, CORNERSTONE RESEARCH (2018).

that the SEC won during the same period.[26] Figure 1 maps the annual SCA settlements against annual SEC penalties/disgorgement orders.[27]

Figure 1

SCA Settlement Value Compared To SEC Penalty And Disgorgement Orders[28]



Approximately one out of every twelve public companies listed on a major U.S. exchange is targeted by an SCA each year.[29] As Figure 2 shows, the volume of class action filings is comparable to the number of SEC standalone enforcement actions.

[26] This figure comes from the SEC's Annual Reports, available at https://www.sec.gov/reports.

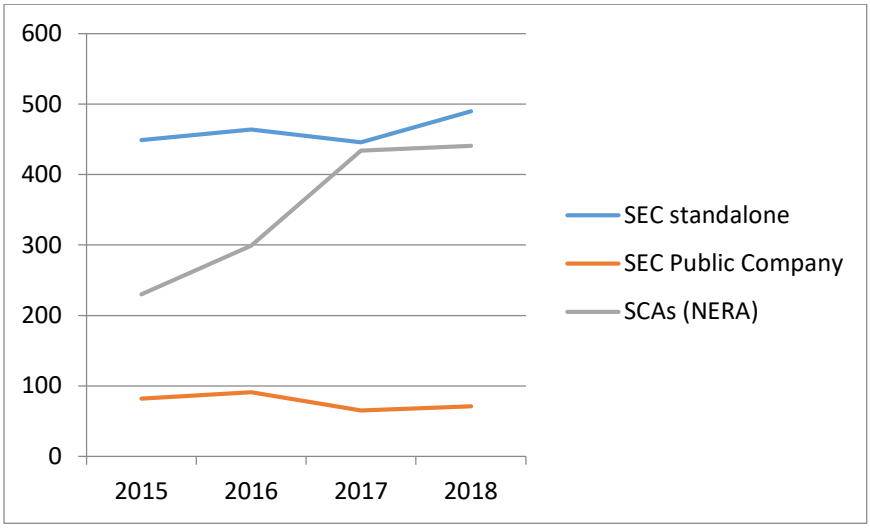
[27] Concededly, this does not capture the full scope of SEC enforcement, which also includes non-monetary penalties like industry bars, registration suspensions, etc.

[28] SEC Annual Reports; Bulan et al., *2018 Report*, *supra* note 25, at 3; Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review*, NERA ECONOMIC CONSULTING 28–29 (Jan. 2018).

[29] Boettrich & Starykh, *supra* note 28, at 3.

Figure 2

The Volume Of Filings[30]



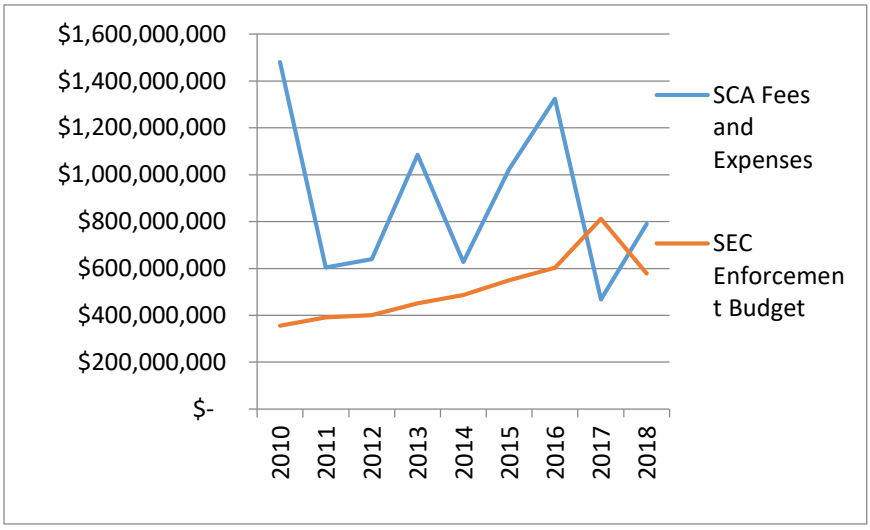
SCAs impose substantial transaction costs. The attorneys' fees and expenses for SCAs average about 24% of the total award in each case.[31] Figure 3 shows that the attorneys' fees awarded in SCAs is comparable (and typically exceeds) the SEC's total enforcement budget.

[30] SEC Annual Reports; Boettrich & Starykh, *supra* note 28, at 2–3, 5.

[31] *See* Theodore Eisenberg et al., *Attorneys' Fees in Class Actions: 2009-2013*, 92 N.Y.U. L. REV. 937, 952 Table 4 (2017); Lynn A. Baker at al., *Is The Price Right? An Empirical Study of Fee Setting in Securities Class Actions*, 115 COLUM. L. REV. 1371, 1372 (2015).

Figure 3

SCA Plaintiffs' Attorneys' Fees & Expenses Compared To SEC Enforcement Budget[32]



2. The Uncertain Benefits of Private Securities Class Actions

Many securities regulation scholars have questioned the social value of SCAs.[33] Critics argue that these actions fail to deter because the individuals actually culpable for the misconduct almost never make out-of-pocket contributions to settlements, which are instead paid for by company itself and its insurer.[34] These

[32] Boettrich & Starykh, *supra* note 28, at 42; SEC Annual Filings.

[33] *E.g.*, Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 159, 209 (2009) (endorsing the "conventional legal academic view" that securities litigation is "seriously compromised"); James C. Spindler, *We Have a Consensus on Fraud on the Market—And It's Wrong*, 7 HARV. BUS. L REV. 67, 67 (2017) (challenging the "broad consensus" view that securities class actions neither deter fraud nor compensate injured investors); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1302, 1321 (2008) (suggesting that "most commentators" agree that the FOTM SCA "cannot be defended on compensatory grounds" and does not provide optimal deterrence).

[34] Scholars agree that individual accountability is key to prevent securities fraud. *E.g.*, Donald C. Langevoort, *On Leaving Corporate Executives "Naked Homeless and Without Wheels": Corporate Fraud Equitable Remedies, and the Debate over Entity Versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 629 (2007) ("scholars from across the ideological spectrum have now joined the doubters of enterprise liability, at least with respect to private securities litigation."). But, although private securities class actions frequently name one or more corporate

settlements, critics charge, amount to one group of innocent shareholders (those currently invested in the company) subsidizing a payment to another group of innocent shareholders (those who bought or sold securities in reliance on the company's material misstatements).[35] At the same time, critics also allege that SCAs force issuers to *overinvest* in precaution costs of various forms[36]—including paying more for accountants and lawyers,[37] disclosing too much,[38] disclosing too little,[39] avoiding the regime by staying private longer or by reincorporating in foreign jurisdictions.[40] And critics also argue that these actions do not provide meaningful compensation for shareholders injured by fraud, because the cases typically settle for a tiny fraction of actual estimated losses.[41]

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director or officer in addition to the company itself, these individuals are almost never ultimately forced to make direct, out-of-pocket contribute to resulting settlements in these cases. Michael Klausner, *Personal Liability of Officers in US Securities Class Actions*, 9 J. CORP. L. STUDS. 349, 357, 359, 365 (2009); Bernard Black et al., *Outside Director Liability*, 58 STAN. L. REV. 1055, 1057, 1057 (2006); Amanda M. Rose, *Form vs. Function in Rule 10b-5 Class Action*, 102 DUKE J. CONST'L L. & PUB. POL'Y 57, 61 (2015).

[35] *E.g.*, Jackson & Roe, *supra* note 33, at 236 ("In diffusely owned firms, innocent shareholders often effectively bear the financial burden of such lawsuits, insiders can often shift payment of any of their own liability to the corporation itself, and lawyers can often direct the lawsuits to their own advantage but not to the best advantage of shareholders and financial markets."); Donald Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 648–50 (1996); John C. Coffee, Jr., *Reforming the Securities Class Action: On Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1557–60 (2006) (suggesting that "buy and hold" index investors come out the worst in this scenario).

[36] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 US 308, 313 (2007) ("Private securities fraud actions, however, if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law.").

[37] Langevoort, *Capping*, *supra* note 35, at 652.

[38] *Id.*

[39] *Id.*

[40] Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc., 552 U.S. 148, 164 (2008) (warning that FOTM SCAs "[m]ay raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets."); Rose, *Restructuring*, *supra* note 1, at 1331–37; CHUCK SCHUMER & MICHAEL BLOOMBERG, SUSTAINING NEW YORK'S AND THE US'S GLOBAL FINANCIAL SERVICES LEADERSHIP ii (2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf.

[41] *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 84 (2011); Coffee, *Reforming*, *supra* note 35, at 1545 ; Langevoort, *Capping*, *supra* note 35, at 651 ("[T]he compensatory system has relatively few informed, non-self serving defenders.");

Further, because many shareholders in the class will also be current shareholders of the company, critics say they are in effect shifting money from one pocket to the other, which does not serve any compensatory purpose.[42] Some critics say that diversified shareholders have no *need* to be compensated for the losses from fraud because they have already insulated themselves from such losses,[43] and actively trading investors are just as likely to be on the winning side of a fraudulent transaction—when they unwittingly sell shares before a corrective disclosure—as the losing side, such that their winnings and losings should balance out over time.[44]

On the other hand, recent research has shown that individual officers and directors of firms targeted by class actions actually *do* suffer meaningful career penalties including removal, diminished

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Rose, *Restructuring*, *supra* note 1, at 1312–14; Boettrich & Starykh, *supra* note 28, at 3635 (estimating that the median ration of settlement to investor losses has hovered at around 2% for the last decade). *But see* Jessica Erickson, *Automating Securities Class Action Settlements*, 72 VAND. L. REV. 1817 (2019) (arguing for reforming the claims administration process for securities class action settlements to "revolutionize" how investors recover the money they lost to corporate fraud).

[42] *See* Bratton & Wachter, *supra* note 41, at 93–94; Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 MD. L. REV. 348, 374–75 (2007); Coffee, *Reforming*, *supra* note 35, at 1558; Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 313 (2014); Rose, *Restructuring*, *supra* note 1, at 1313–14. Worse, these current shareholders also bear the cost of litigation (e.g., attorneys' fees), the higher D&O insurance premiums, and various reputational harms the company suffers through the suit. Coffee, *Reforming*, *supra* note 1, at 1546; *see also* Jonathan M. Karpoff et al., *The Legal Penalties for Financial Misrepresentation* 2 (May 1, 2007) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=933333) Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1796–97 (2006).

[43] *E.g.*, Richard A. Booth, *Class Conflict in Securities Fraud Litigation*, 14 U. PA. J. BUS. L. 701, 766 (2012) ("Diversified investors are protected against securities fraud by virtue of being diversified and ***have no need*** for a remedy that effectively reduces their returns.") (emphasis added); Bratton & Wachter, *supra* note 41, at 95 (concluding "diversified portfolio investors emerge undamaged . . . ."); Amanda M. Rose, *Better Bounty Hunting: How The SEC's New Whistleblower Program Changes The Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1283 (2014) ("[d]iversified shareholders . . . naturally internalize the social costs of secondary market fraud . . . ").

[44] *See* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 641 (1985); Grundfest, *Damages*, *supra* note 42, at 372–73 ; Langevoort, *Capping*, *supra* note 35, at 646; Rose, *Restructuring*, *supra* note 1, at 1313.

pay and responsibilities, and fewer board appointments.[45] This suggests that private securities litigation *does* contribute to deterrence. And researchers have also found that the firms targeted by class actions are more likely to adopt governance improvements including some that may prevent the reoccurrence of fraud.[46] The claim by critics that investors are equally likely to be on the "winning" side as the "losing" side of a fraud has been called into question,[47] as has the argument that victims of fraud cannot be compensated because the settlement comes from their own pockets.[48]

In sum, notwithstanding some of the broadest pronouncements of the SCA's detractors, there is some evidence that at least some of these cases do produce some social value. Whether these benefits outweigh the costs imposed remains subject to debate. Whether an

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[45] *See* Christopher F. Baum et al., *Securities Fraud and Corporate Board Turnover: New Evidence From Lawsuit Outcomes*, 48 INT'L REV. L & ECON. 14, 24 (2016) (finding that officers and directors of firms targeted by SCAs are more likely to be removed); Francois Brochet & Suraj Srinivasan, *Accountability of Independent Directors: Evidence From Firms Subject to Securities Litigation*, 111 J. FIN. ECON. 430, 447 (2014) (finding that officers and directors of firms targeted by SCAs are more likely to be removed, have fewer opportunities at other firms, and receive negative ISS voting recommendations); Mark L. Humphery-Jenner, *Internal and External Discipline Following Securities Class Actions*, 21 J. FIN. INTERMEDIATION 151 (2012) (finding that officers and directors of firms targeted by SCAs are more likely to be removed, to be paid less, and to have fewer opportunities at other firms); *see also* Alexander I. Platt, *Index Fund Enforcement*, 53 U.C. DAVIS L. REV. 19–20 (forthcoming 2020) (surveying this literature).

[46] *See* C.S. Agnes Cheng et al., *Institutional Monitoring Through Shareholder Litigation*, 95 J. FIN. ECON. 356, 358 (2010) (finding that firms targeted by SCAs develop more independent boards); Claire E. Crutchley et al., *When Governance Fails: Naming Directors In Class Actions*, 35 J. CORP. FIN. 81, 94 (2015) (finding that the boards of firms recently targeted by class actions have directors sitting on fewer other boards, and have CEO pay tied more to incentives); Justin Hopkins, *Do Securities Class Actions Deter Misreporting?*, 35 CONTEMP. ACCOUNTING RES. 2030 (2018) (finding that the threat of securities class actions improves firm disclosure); *see also* Platt, *Index Fund Enforcement*, *supra* note 45, at 61–63 (surveying this literature).

[47] *See* Thomas A. Dubbs, *A Scotch Verdict on "Circularity" and Other Issues*, 2009 WISC. L. REV. 455, 458–60 (2009); Spindler, *supra* note 33, at 111–12; Alicia J. Davis, *Are Investors' Gains and Losses from Securities Fraud Equal Over Time? Theory And Evidence* 4 (U. Mich. L. & Econ. Olin Working Paper No. 09-002, 2015), https://ssrn.com/abstract=1121198.

[48] James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323, 323 (2009) ; Spindler, *supra* note 33, at 101–02.

alternative system would be an improvement is the subject of the next section.

3. Scholarly Proposals to Expand SEC Control Over Securities Class Actions

For decades, leading securities regulation scholars have called for granting the SEC broad supervisory authority over private litigation.[49]

Janet Cooper Alexander proposed that Congress[50] replace the SCA system with a new "regulatory remedy" that puts the SEC in an "oversight" role over private enforcement.[51] Under Alexander's system, private parties seeking to initiate litigation would have "[t]o give notice of the action to the SEC, which would have the option to take over the action and, in any event, to appear at any settlement hearing."[52] Successful plaintiffs in this system would be entitled to recover attorneys' fees and costs.[53] The recoveries in such actions would be limited to (a) a statutory penalty, tied to "relevant circumstances" including whether the fraud was "intentional," the size of the firm, and whether the defendant was an individual; and (b) disgorgement of ill-gotten gains.[54]

Jill Fisch contemplated a regime in which putative SCA plaintiffs would be obligated to "submit a securities fraud complaint to the SEC . . . prior to filing."[55] A plaintiff who successfully persuaded the SEC to initiate action would be entitled to a "substantial financial reward" (in order to preserve the incentive to bring such matters).[56] Fisch's regime would allow the putative plaintiff to retain the right to proceed if the Commission declined to

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[49] Engstrom describes this stream of literature as "[r]ecurrent, but largely unanalyzed, calls to vest the Securities and Exchange Commission (SEC) with gatekeeper power over securities class actions." Engstrom, *supra* note 2, at 621–22.

[50] *See* Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1514 (1996) ("Replacing the compensatory damages rule with a regulatory sanction would require legislation.").

[51] *Id.* at 1514, 1517 & n.133.

[52] *Id.* at 1517.

[53] *Id*.

[54] *Id.* at 1515.

[55] Fisch, *Qui Tam*, *supra* note 1, at 200.

[56] *Id.*

intervene.[57] Although Fisch recognized that the plaintiffs' bar would likely "balk" at such a prospect, she suggested that it might prove to be "less onerous" than other proposed doctrinal or procedural restrictions on the class action regime. [58]

Alicia Davis Evans proposed that the SEC take over the adjudication of liability and damages awards in private securities enforcement.[59] In her scheme, an investor with at least 1% equity ownership could file an administrative petition for compensation based on alleged securities fraud.[60] The SEC would investigate the allegations, and, if appropriate, determine the level of damages to be awarded.[61] These damages would be paid to the shareholder from a new "investor compensation fund," funded by a tax on securities transactions.[62] The tax would be variable—set by the SEC to correspond to the "fraud risk rating" assigned to the firm by private rating agencies designated by the SEC.[63] According to Evans, because higher fraud risk rating will increase the per-transaction tax, and therefore decrease the value of the firm's share price, firms will be motivated to prevent fraud. [64]

Jennifer Arlen proposed that the SEC should be given authority to "preclude" any and all private actions against firms if the agency determines that there was no fraud or that firm satisfied its duty to "police" fraud.[65] This power would cover only private actions against firms; private parties would still have unilateral authority to proceed against individuals for securities fraud. Under Arlen's proposal, the SEC would wield "ultimate control" for corporate liability for securities fraud.[66]

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[57] *Id.*

[58] *Id.*

[59] *See generally* Alicia Davis Evans, *Investor Compensation Fund*, 33 J. CORP. L. 223 (2007).

[60] *Id.* at 246.

[61] *Id.* at 246–47.

[62] *Id.* at 241–42.

[63] *Id.* at 242–43.

[64] *See id.* at 244.

[65] Jennifer Arlen, *Public Versus Private Enforcement of Securities Fraud* 44–47 (2007), *available at* https://weblaw.usc.edu/assets/docs/Arlen.pdf.

[66] *Id.* at 47.

Amanda Rose proposed that Congress[67] grant SEC an "oversight" function over private litigation. Under her proposal, the SEC would be authorized to "prescreen" all Rule 10b-5 class action complaints for merit.[68] The SEC would deny the right to sue based either on a determination to pursue the matter itself, or because it does not view the litigation "as necessary or appropriate in the public interest," and would grant the right based on a determination that allowing suit is consistent with the public interest.[69] Such oversight could either apply to all SCAs, or to a more limited subset,[70] and, Rose argues, would give SEC "full control over, and thus ultimate responsibility for, Rule 10b-5 enforcement policy."[71] She also suggests that this process might provide some image-repair for class actions, and restore their moral force.[72] In order to retain the incentive for putative private enforcers to bring claims, where the SEC chooses to take over a matter, Rose suggests that the private party who brought the case to the SEC's attention should receive "reasonable recompense."[73] And Rose suggests the SEC "promulgate factors for determining when class action litigation is necessary or appropriate in the public interest" to guide decisionmaking and ensure transparency, non-arbitrariness.[74]

These proposals rest (to varying degrees) on three key principles: (1) the belief that the current regime of private securities class actions are *fundamentally* flawed and socially harmful[75]; (2)

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[67] Rose, *Restructuring*, *supra* note 1, at 1355 n. 241 (suggesting that legislation would "likely" be required for her proposal).

[68] *Id.* at 1306.

[69] *Id.* at 1354.

[70] *See id.* at 1354 n.240.

[71] *Id.* at 1354.

[72] *Id.* at 1357 (noting that if SCAs "bore the imprimatur of the Commission . . . it would be much more difficult for officers to dismiss them as mere nuisance filings.").

[73] *Id.*

[74] *Id.* at 1358.

[75] *E.g.*, Rose, *Restructuring*, *supra* note 1, at 1301 (noting the "academic consensus" that private class actions "cannot be defended on compensatory grounds" and arguing that it is "highly debatable" whether they can be defended on deterrence grounds); Alexander, *supra* note 50, at 1493–1507 (arguing that the current method for calculating damages in securities class actions will not achieve compensation or deterrence); *see also* Amanda M. Rose, *Fraud on the Market: An Action Without A Cause,* 160 U. PA. L. REV. PENNUMBRA 87, 96 (2011).

frustration regarding the coordination costs imposed by the decentralized, multi-enforcer approach to securities enforcement[76]; and (3) faith in the SEC's capacity and incentive to improve upon the current regime.[77]

But, as discussed above, recent empirical research has shown that the private class action litigation system is not *completely* devoid of social value but provides some deterrence and other social benefits.[78] Abolishing the current regime would mean sacrificing these real benefits in exchange for the prospect of a superior, but untested new regime. This trade may be worth it—or not.[79] But proponents of the shift have the difficult burden of showing that the new system would provide more benefits (and/or fewer costs) than the current regime.

Further, as James Park has shown, the current decentralized, multi-enforcer system of securities enforcement provides some distinct benefits that might be lost in a system of centralized, unilateral authority.[80] Again, the "gatekeeping" proponents may be

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[76] *E.g.*, Fisch, *Qui Tam*, *supra* note 1, at 198–99 ("Under the existing system, private enforcement litigation, such as class actions and citizen suits, often duplicates government enforcement efforts. Multiple investigations and lawsuits based on the same conduct waste resources. Private litigation may undercut government compliance efforts by threatening the defendant's ability to negotiate with government prosecutors. . . . Duplicative civil and government enforcement proceedings also risk overdeterrence. . . . The absence of coordination between the government and the private bar also leads to confusion . . . [and] reduces the transparency of the system."); Rose, *Restructuring*, *supra* note 1, at 1347 (noting the "coordination" problems of the current system in which "Private plaintiffs can and do bring actions that the Commission would not want litigated by private enforcers, either because the Commission believes it has already adequately penalized the defendant or because, in the exercise of its discretion, it would choose not to sanction the defendant."); *id.* at 1351 (describing the virtue of her proposal as ensuring private enforcement "truly 'supplement' the Commission's efforts rather than duplicate or frustrate them.").

[77] To be sure, some proponents of these "Gatekeeping" reforms acknowledge that the SEC is subject to various limitations and distortions. *E.g.*, Rose, *Restructuring*, *supra* note 1, at 1357 (noting that her proposal poses the risk that "inadequate enforcement resources, bureaucratic inefficiency, and/or regulatory capture might lead to greater deviations from optimal deterrence than unrestricted private enforcement").

[78] *See supra* Part II.A.2.

[79] *See* Rose, *Restructuring*, *supra* note 1, at 1305 (conceding that "it is unclear" how the "relative advantages and disadvantages of private Rule 10b-5 enforcement versus exclusive Commission enforcement 'balance out.'").

[80] *See* Park, *supra* note 48; *see also* James J. Park & Howard H. Park, *Regulation by Selective Enforcement: The SEC and Initial Coin Offerings*, WASH. J. L. &

correct that the benefits of decentralization are not worth it, but they have the difficult burden of challenging the status quo.

And the actor that would be at the center of the new proposed regime—the SEC—is subject to its own distortions. For instance, the agency has incentives to set enforcement policy in a manner that will please certain constituencies—namely its Congressional overseers and the broader public—which leads the agency to skew its priorities.[81] And there are also concerns about "agency capture,"[82] inadequate resources, and "bureaucratic slack" —all of which might send the agency's "gatekeeping" function off course, carrying private litigation with it.

More practically, the proposals would require a significant legislative transformation of a very well-entrenched securities enforcement regime—a big ask in even the most favorable legislative climate. For the most part, these proposals have failed to gain traction outside of the academic sphere.[83]

POL'Y (describing how the SEC's "selective enforcement" approach to ICOs was enabled, in part, by the fact that private parties have their own "powerful remedies" which allowed the SEC to "Devote its limited enforcement resources to the most important cases while allowing most investors to exercise self-help").

[81] *E.g.*, Macey, *supra* note 4, at 639 (showing that this incentive leads the SEC to pursue "high profile matters, to change its priorities frequently in accordance with public opinion, and perhaps most significantly, to pursue readily observable objectives, often at the expense of more important but less observable objectives"); Velikonja, *Politics*, *supra* note 4, at 20 (showing that this incentive has led the SEC to target more "strict-liability violations and follow-on cases, obscured almost entirely by meaningless reporting of enforcement results"); Platt, *Unstacking*, *supra* note 4, at 439 (showing that this incentive has led the SEC to rely increasingly on motions for "summary disposition" to quickly resolve cases without the formal hearing required by the APA).

[82] *E.g.*, Ed deHaan et al., *The Revolving Door and the SEC's Enforcement Outcomes: Initial Evidence from Civil Litigation*, 60 J. ACCOUNTING & ECON. 65 (2015) (finding evidence that DC-based SEC lawyers go easier on targets to curry favor with potential employers at private law firms); James D. Cox & Randall S. Thomas, *Revolving Elites: The Unexplored Risk of Capturing the SEC*, 107 Geo. L. J. 845 (2018) (documenting the increasing number of SEC division heads who come from the private sector, and suggesting this raises distinct concerns of agency capture). *But see* David Zaring, *Against Being Against the Revolving Door*, 2014 U. ILL. L. REV. 507.

[83] Two enacted reforms have given the SEC a somewhat broader role in the arena of private enforcement. Dodd-Frank authorized the SEC to pay monetary bounties to individuals who come forward to the agency with information regarding securities law violations that lead to SEC enforcement action resulting in at least $1 million in sanctions. The bounty ranges from 10% to 30% of the amount collected. The Whistle Blower Program's effect on private litigation is

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For several decades, scholarly critics of the securities class action regime have proposed granting SEC broad "gatekeeping" authority over private litigation. However, these proposals face a variety of conceptual and practical obstacles, and generally have not gained traction outside of the academic realm. The next two Sections turn to consider a new way for the SEC to channel the flow of private litigation—one that is already within their authority and expertise.

B. Litigation Gatekeeping at the SEC's Enforcement Division

1. The Enforcement Process

The SEC's Division of Enforcement is "responsible for civil enforcement of the federal securities laws."[84] The Division is charged with investigating violations, filing and litigating enforcement actions, and negotiating settlements. Enforcement often begins by opening a Matter Under Inquiry (MUI).[85] The Division may be prompted to do this based on information from a variety of sources, including market surveillance, investor complaints, media reports, and referrals from other branches of the SEC, Self-Regulatory Organizations, state and federal regulatory

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limited. It might lure some tipsters who might have otherwise gone to plaintiffs' lawyers. But this was a very small pool to begin with. And in the wake of an SEC action prompted by a whistleblower, plaintiffs' lawyers are still free to file piggyback private class actions. *See* 15 U.S.C. § 78u-6; Rose, *Bounty*, *supra* note 43, at 1261–75, 1288, 1290.

The Sarbanes-Oxley Act authorized the SEC to establish "FAIR" funds to distribute the fines and disgorgements it collects from enforcement actions to injured investors. This program has the potential to crowd out some private enforcement. Courts may dismiss a pending piggyback suit where an SEC fair fund has already provided full compensation to injured investors.[83] Plaintiffs' attorneys may be less likely to file piggyback suits where the SEC has established a fair fund because of the reduced damages (and therefore reduced fees) that may be available. *See* Pub. L. No. 107-204, § 308, 116 Stat. 745, 784–85 (codified as amended at 15 U.S.C. § 7246 (2013)); Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331 339–43, 365 & n. 176.

[84] SEC, Division of Enforcement, Annual Report 2018, at 6.

[85] SEC, Division of Enforcement, *Enforcement Manual* § 2.3.1 (Nov. 28, 2017).

agencies, and international law enforcers.[86] Companies also self-report violations through various initiatives.[87]

Once the Division has gathered additional information, it may convert a MUI into a full-fledged "investigation."[88] (In other cases, the Division dispenses with the MUI stage and begins right away with an investigation.[89]) Investigations are confidential. During an investigation, the Division's staff work to gather information to decide whether to recommend the Commission authorize an enforcement action. Among other tools, staff have the authority to use subpoenas to compel witnesses to testify and produce records.[90]

At the end of the investigation, the Division typically notifies the target if it plans to recommend an enforcement action, informs the target what violations the staff has determined to include in this recommendation, and invites the target to make a submission to the Division and the Commission regarding the proposed action.[91] This "Wells" process—named after the chair of the advisory committee chaired by John Wells in the 1970s who recommended the practice—provides an opportunity for the target to provide additional facts or reasoning to convince the agency to drop the charges or alter them in some way.[92]

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[86] *Id.*; SEC, *How Investigations Work* (Jan. 27, 2017), https://www.sec.gov/enforce/how-investigations-work.html.

[87] *E.g.*, Press Release, SEC, *SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors* (Feb. 12, 2018), available at https://www.sec.gov/news/press-release/2018-15; SEC, Division of Enforcement, Municipalities Continuing Disclosure Cooperation Initiative, https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml.

[88] Enforcement Manual, *supra* note 85, at § 2.3.2.

[89] *Id*.

[90] SEC, *How Investigations Work*, *supra* note 85, at § 2.3.3–4.

[91] *Id.* § 2.4; 17 C.F.R. § 202.5(c).

[92] For a history of the Wells process, *see* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 375–83 (2008); *see also* Steven Peikin, *Keynote Address at the New York City Bar Association's 7th Annual White Collar Crime Institute* (May 9, 2018) ("In some instances, defense counsel will persuade us that we have gotten something wrong, leading us to abandon a charge, recommend different relief, or decline to pursue a matter entirely.").

Prior to commencing an enforcement action, the Division must receive authorization from the Commission itself. The Division presents a recommendation—in the form of an "action memo" setting forth the factual and legal basis for the proposed charges. The SEC then votes on whether or not to authorize the proceedings.[93] When this is completed, the SEC presents their findings along with a recommendation regarding whether or not to pursue charges to the Commission.

In reality, the vast majority of SEC enforcement actions are settled before trial, and as many as half of them are settled before they are even filed.[94] In these cases, the Enforcement Division negotiates the settlement during the investigation and Wells process, and then submits it to the Commission for approval.[95] The Division has authority to proceed in administrative proceedings or in civil court actions.[96] If the action is filed in federal court, the judge has to approve the settlement before it takes effect. If the action is filed in an administrative proceeding, the settlement takes immediate effect.[97]

While the Division does not have the authority to impose jail-time, it can seek a variety of other significant sanctions on individual and corporate defendants—including cease and desist orders, revocation or suspension of registrations (i.e., licenses to engage in various regulated activities), bars prohibiting certain employment, conduct, or association with specified categories of entities, civil

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[93] SEC Enforcement Manual, *supra* note 85, at § 2.5.2.1.

[94] Urška Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J. F. 124, 128 (2016) (reporting that "[f]rom FY 2007 to FY 2015, between a third and one half of all defendants in primary enforcement actions settled with the SEC before the enforcement action was filed").

[95] Velikonja, *Shadows*, *supra* note 94, at 126.

[96] SEC, How Investigations Work, *supra* note 85. In 2015, the agency issued some guidance setting forth considerations for choosing between a federal court or administrative forum. SEC, *Division of Enforcement Approach to Forum Selection in Contested Actions*, https://www.millerchevalier.com/sites/default/files/resources/FCPAReview/FCPAReviewSummer2015_SEC-Guidance_Division-of-Enforcement-Approach-to-Forum-Selection.pdf. However, that guidance has been rescinded. For discussion of the agency's turn away from civil enforcement in federal court, *see* Alexander I. Platt, SEC *Administrative Proceedings: Backlash and Reform*, 71 BUS. LAWYER 1, 6–9 (2016).

[97] Velikonja, *Shadows*, *supra* note 94, at 128.

penalties, and disgorgements.[98] In some cases, the Division returns funds obtained from targets to the injured investors through the mechanism of a Fair Fund.[99] In the context of settlements, the Division may negotiate for targets to adopt a host of enumerated compliance reforms and be subject to ongoing monitoring.[100] The Division also makes referrals for criminal prosecution to U.S. Department of Justice.[101]

The Division's jurisdiction is vast.[102] Legally, the Division has authority to investigate and bring enforcement actions under a very large range of statutes and regulations, including those governing securities offerings and public company reporting and disclosure, the regulation of broker dealers, mutual funds, and hedge funds, and municipal securities issuers, and the prohibition on bribery of foreign governments.[103] The magnitude of market activity for which the Division is responsible is similarly vast: "approximately $90 trillion in annual securities trading, the disclosures of approximately 4,300 exchange-listed public companies valued at approximately $32 trillion, and the activities of over 27,000 registered entities and self-regulatory organizations."[104]

In comparison with this broad mandate, the resources available for the Enforcement Division are very limited. The Division employs just about 1,400 attorneys, accountants, and other professionals.[105] The annual budget for 2018 was $578 million.[106]

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[98] For discussion of the expansion of the agency's penalty authority over time, *see* Platt, *Backlash and Reform*, *supra* note 96, at 7.

[99] Velikonja, *Public Compensation*, *supra* note 83, at 333, 341.

[100] *E.g.*, Jayne W. Barnard, *Corporate Therapeutics at the Securities and Exchange Commission*, 2008 COLUM. BUS. L. REV. 793, 816–820.

[101] SEC, How Investigations Work, *supra* note 85.

[102] Stephanie Avakian, *The SEC Enforcement Division's Initiatives Regarding Retail Investor Protection and Cybersecurity* (Oct. 26, 2017) ("Enforcement has a very broad mandate – we cover a lot of ground across the securities markets."); Steven Peikin, *The Salutary Effects of International Cooperation on SEC Enforcement* (Dec. 3, 2018) ("In the Enforcement Division, the scope of our responsibility is extremely broad.").

[103] *E.g.*, Annual Report 2018, *supra* note 84, at 10 (listing types of cases brought).

[104] Annual Report 2018, *supra* note 84, at 6.

[105] Annual Report 2018, *supra* note 84, at 14; Avakian, *Measuring*, *supra* note 86, at 3.

[106] SEC, *Agency Financial Report Fiscal Year 2018*, at 59.

Given the resources shortfall, the Division has to make many difficult triage decisions—what types of violations should it emphasize? Which groups of investors should it be trying to protect? How should it allocate scarce enforcement resources to various matters?[107] These enforcement policies and priorities form a critical part of the regulatory landscape. Many groups have a strong interest in understanding these priorities: the regulated industry wants to know how to stay out of trouble; investors want to know whether and when they will be protected; Commissioners, other executive branch officials, Congressional overseers, and the public at large all may have an interest in monitoring the agency to ensure that its performance is in line with policy priorities. The next section turns to evaluate the impact of these discretionary enforcement choices on the flow of private litigation.

2. Piggybacking on the Enforcement Division

The Enforcement Division's decisions can have significant impacts on the flow of "piggyback" private litigation. Between 2009-2018, about 20% of SCA settlements had parallel SEC enforcement actions.[108] And research has shown that SCAs are less likely to be dismissed,[109] settle faster[110] and for more money,[111] and

[107] Avakian, *Measuring*, *supra* note 86, at 3 ("This wide gulf between our resources and our responsibilities translates into a need to think very carefully about how we allocate resources to carry out our investor protection mandate.").

[108] Bulan et al., *2018 Review*, *supra* note 25, at 12; *see also* Rose, *Restructuring*, *supra* note 1, at 1345 (reporting figures of 15% and 32% for 2007 and 2006).

[109] Stephen J. Choi, Karen K. Nelson & A.C. Pritchard, *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. EMPIRICAL LEGAL STUDS. 35, 61–64 (2009); John C. Coffee, Jr., *'Neither Admit Nor Deny': Practical Implications of SEC's New Policy*, CLS Blue Sky Blog (Jul. 22, 2013), http://clsbluesky.law.columbia.edu/2013/07/22/neither-admit-nor-deny-practical-implications-of-secs-new-policy/.

[110] James D. Cox & Randall S. Thomas with Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 767 (2003).

[111] James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 376–77 (2008); Cox & Thomas, with Kiku, *supra* note 110, at 763–64, 770; James D. Cox & Randall S. Thomas with Dana Kiku, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893, 898–900, 904 (2005); Coffee, *'Neither Admit Nor Deny'*, *supra* note 109; Laarni T. Bulan et al., *Securities Class Action Settlements 2017 Review and Analysis*, (CORNERSTONE RESEARCH) at 14; Bulan et al., *2018 Review*, *supra* note 25, at 12; Boettrich & Starykh, *supra* note 28, at 37.

are more likely to have an institutional lead plaintiff,[112] when there is a parallel SEC enforcement action.[113]

There are good reasons to believe that the relationship is causal. SEC enforcement can catalyze private litigation in at least four ways:

First, the Enforcement Division's *decision to initiate* an investigation or enforcement action itself may catalyze private litigation. Plaintiffs' attorneys may regard the filing of an SEC complaint as an indication that there is an actionable misconduct and, thus, a winnable case.[114]

Second, the Enforcement Division's decisions regarding *what legal charges* to include in a complaint or settlement also have important downstream impacts. For instance, the SEC has statutory authority to pursue charges based on negligence and failure to supervise, but many forms of private litigation (including under 10b-5) require proof of scienter. Thus, the Agency's choice to pursue charges of negligence, rather than scienter, will provide relatively less support for private litigation.[115]

Third, the Enforcement Division's decisions regarding *what facts* to include in a complaint or settlement similarly impact private litigation.[116] The SEC gathers substantial information during its investigation, but only includes some of what it has learned in the charging documents or settlement. The plaintiffs' attorneys may rely on the facts included in the SEC complaints or consent orders

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[112] Cox, Thomas & Bai, *supra* note 111, at 377.

[113] The SEC's practice of pursuing monetary penalties against corporate defendants began in earnest with the 2002 Xerox case. *E.g.*, Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 Fordham J. Corp. & Fin. L. 367, 394 (2008).

[114] *See* Arlen, *supra* note 1, at 18 (noting that SEC enforcement can "encourage[e] effective private litigation" by "helping to identify instances of fraud").

[115] *See* SEC v. Citigroup Global Mkts., Inc., 827 F. Supp. 2d. 328, 334 (S.D.N.Y. 2011) (criticizing SEC's decision to charge Citigroup "only with negligence" and not scienter "since private investors . . . cannot bring securities claims based on negligence" (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976))), *vacated*, 752 F.3d 285 (2d Cir. 2014).

[116] *See* Brandon L. Garrett, *The Public Interest in Corporate Settlements*, 58 B.C. L. REV. 1483, 1536 (2017) (explaining that "detailed factual statements" in SEC settlements help private litigation); Author F. Greenbaum, *Government Participation in Private Litigation*, 21 ARIZ. ST. L. J. 853, 981 (1989) ("The SEC at times shares the fruits of its investigation with the public at large, which may use the information in private enforcement efforts.") (footnote omitted).

to survive motions to dismiss,[117] and may try to have the complaints or consent orders admitted as evidence at trial or in a summary judgment.[118] As further discussed below, collateral estoppel is not available for SEC complaints or consent decrees, except in the case of admissions.[119]

Fourth, the Enforcement Division has the discretion to require the company to ***admit*** liability or specific facts as a part of its settlement. Such admissions may be used by plaintiffs' attorneys in

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[117] *See* Kevin Levenberg, Comment, *Read My* Lipsky: *Reliance on Consent Orders in Pleadings*, 162 U. PA. L. REV. 421, 450 (2014) (concluding that reliance on SEC complaints and settlements is appropriate at the pleadings stage); *see, e.g.*, Loreley Fin. (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC, 797 F.3d 160, 180 (2d Cir. 2015) (denying motion to dismiss complaint relying on SEC findings); Puddu v. 6D Glob. Techs., Inc., 742 F. App'x 553, 557 (2d Cir. 2018) (vacating dismissal of complaint based on allegations incorporated from SEC complaint); Berke v. Presstek, Inc., 188 F.R.D. 179, 181 (D.N.H. 1998) (denying motion to strike allegations from complaint referring to SEC consent decree); Tobia v. United Grp. of Companies, Inc., No. 1:15-cv-1208 (BKS/DEP), 2016 WL 5417824, at *3 (N.D.N.Y. Sept. 22, 2016) (same); *In re* Fannie Mae 2008 Sec. Litig., 891 F. Supp. 2d 458, 471 (S.D.N.Y. 2012) (same); Wenzel v. Knight, No. 3:15-cv-432, 2015 WL 222182, at *3 (E.D. Va. Jan. 14, 2015) (same); Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC, 376 F. Supp. 2d 385, 395 (S.D.N.Y. 2005); *In re* Bear Stearns Mortg. Pass-Through Certificates Litig. 851 F. Supp. 2d 746, 767–68 (S.D.N.Y. 2012). *But see In re* Merrill Lynch & Co. Research Reports Sec. Litig., 218 F.R.D. 76, 79 (S.D.N.Y. 2003) (striking allegations from complaint that rely on SEC complaint); Lipsky v. Commonwealth United Corp., 551 F.2d 887, 894 (2d Cir. 1976) (same); *In re* Morgan Stanley & Van Kampen Mut. Fund Sec. Litig., No. 03 Civ. 8208(RO), 2006 WL 1008138, at *5 (S.D.N.Y. Apr. 18, 2006) (dismissing complaint notwithstanding reliance on SEC complaint and noting "the position articulated in the SEC settlement agreement is not binding on this Court.") (citing *Lipsky*, 551 F.2d at 893–94)).

[118] *Compare* United States v. Gilbert, 668 F.2d 94, 97 (2d Cir. 1981) (explaining that a SEC consent decree is admissible for some purposes under FED. R. EVID. 408); *and* Option Res. Grp. v. Chambers Dev. Co., 967 F. Supp. 846, 849 (W.D. Pa. 1996) (same), *with* Carpenters Health & Welfare Fund v. Coca-Cola Co., No. 1:00-CV-2838-WBH, 2008 WL 9358563, at *4 (N.D. Ga. Apr. 23, 2008) (inadmissible); *Loreley Fin. (Jersey) No. 3 Ltd.*, 797 F.3d at 179 n.11 (2d Cir. 2015) (same); Paul Harris Stores, Inc. v. PricewaterhouseCoopers, LLP, No. 1:02-cv-1014-LJM-VSS, 2006 WL 2644935, at *6 (S.D. Ind. Sept. 14, 2006) (same); *and In re* Blech Sec. Litig., No. 94 Civ. 7696(RWS), 2003 WL 1610775, at *11 (S.D.N.Y. Mar. 26, 2003) (same).

[119] *Lipsky*, 551 F.2d at 893–94 ("Consent decrees . . . are not true adjudications of the underlying issues; a prior judgment can only be introduced in a later trial for collateral estoppel purposes if the issues sought to be precluded were actually adjudicated in a prior trial." (citing Buckeye Powder Co. v. E.I. Dupont, 248 U.S. 55, 63 (1918); Int'l Shoe Mach. Corp. v. United Shoe Mach. Corp., 315 F.2d 449 (1st Cir. 1963); Bronxville Palmer Ltd. v. State, 223 N.E.2d 887 (N.Y. 1966)); *In re* Cenco, Inc. Sec. Litig., 529 F. Supp. 411, 415–16 (N.D. Ill. 1982).

their complaints to help survive motions to dismiss,[120] (possibly) as evidence,[121] and maybe even for offensive collateral estoppel.[122]

3. Channeling Private Litigation at the Enforcement Division

So how does the Enforcement Division account for its downstream impact on private litigation in setting enforcement policy and priorities?

The agency's public statements indicate that it does not factor private litigation consequences into its enforcement decisionmaking.

Consider the SEC Enforcement Manual. That document, available publicly since 2008 (with periodic updates), outlines "various general policies and procedures" and provides "guidance" to the staff of the Division in the investigation of potential violations of the securities laws.[123] Section after section of the enforcement manual outlines considerations for the staff to evaluate when making decisions regarding, for instance, opening a "Matter under Inquiry" (MUI),[124] converting an MUI into an "investigation,"[125]

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[120] Coffee, *supra* note 109; Matthew G. Neumann, Note, *Neither Admit nor Deny: Recent Changes to the Securities and Exchange Commission's Longstanding Settlement Policy*, 40 J. CORP. L. 793, 808 (2014); Peter R. Flynn, Note, *Admission of Wrongdoing: Increasing Public Accountability in SEC Settlements*, 8 BROOK. J. CORP. FIN & COM. L. 538, 549 (2014); Jason E. Siegel, Note, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Effects*, 103 GEO. L.J. 433, 454 (2015).

[121] *See* Priyah Kaul, Note, *Admit or Deny: A Call for Reform of the SEC's "Neither-Admit-or-Deny" Policy*, 48 U. MICH. J. L. REFORM 535, 546 (2015). *But see* Coffee, *supra* note 109; Flynn, *supra* note 120, at 548; Neumann, *supra* note 120, at 808.

[122] *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 333–34 (S.D.N.Y. 2011), *vacated*, 752 F.3d 285 (2d Cir. 2014); George L. Miles, Note, *Let Judges Judge: Advancing a Review Framework for Government Securities Settlements Where Defendants Neither Admit nor Deny Allegations*, 46 CONN. L. REV. 1111, 1146 (2014); Kaul, *supra* note 121, at 543; Danne *supra* note 121, at 543; Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM J. CORP. & FIN. L. 627, 668 (2007); Siegel, *supra* note 120, at 445–46; Brad Karp & Susanna Buergel, *For: Neither Admit nor Deny*, COMPLIANCE WK., (Sept. 6, 2017, 8:15 AM), https://www.complianceweek.com/for-neither-admit-nor-deny/2538.article. *But see* Coffee, *supra* note 109; Neumann, *supra* note 120, at 807–08.

[123] SEC Enforcement Manual § 1.1.

[124] *Id.* § 2.3.1.

[125] *Id.* § 2.3.2.

prioritizing one investigation over another,[126] whether to provide a wells notice,[127] and closing an investigation.[128] For each decision, the manual calls for consideration of various factors including the "egregiousness" of the misconduct,[129] the opportunity to send a strong deterrent message,[130] and the magnitude of harm to investors harm.[131] The manual also calls for careful consideration of overlapping jurisdiction with other law enforcement agencies at the state, federal, or international levels,[132] including consideration of whether such entities might be better suited to pursue the misconduct.[133] But, in all of these decisions, the manual ***conspicuously avoids any reference to private litigation***. That is, at each stage of an investigation or enforcement action, the SEC Enforcement Staff are instructed to weigh a large number of factors but NOT the impact of their contemplated action on private litigation against the same target for the same misconduct.

Or, consider the SEC's policy regarding when to require "admissions" in settlements. The policy, as stated by then-Chair Mary Jo White in 2013, articulates several considerations for the Enforcement Division to weigh when evaluating when to require an admission as part of a settlement. These considerations include the egregiousness of the harm and the risk to the market or investors, whether an admission would "aid investors deciding whether to deal with a particular party in the future," and whether requiring an admission would "send an important message to the market."[134] But the policy does not call for any consideration of the potential impact of an admission on private litigation—one way or the other.[135] It does not instruct SEC enforcement to push for an admission that

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[126] *Id.* § 2.1.1.

[127] *Id.* § 2.4.

[128] *Id.* § 2.6.1.

[129] *Id.* § 2.1.1; § 2.3.1; § 2.6.1.

[130] *Id.* § 2.1.1.

[131] *Id.* § 2.1.1; § 2.3.1; § 2.6.1.

[132] *Id.* § 5; § 2.1.1.

[133] *Id.* § 2.3.1.

[134] SEC Chair Mary Jo White, *Deploying the Full Enforcement Arsenal*, Council of Institutional Investors Fall Conference 1, 4 (Sept. 26, 2013) https://www.sec.gov/news/speech/spch092613mjw.

[135] *Cf.* Flynn, *supra* note 120, at 538 ("the SEC's goal in requiring admissions in certain cases is not to increase settling parties' collateral liability").

would meaningfully help valuable private litigation. It also does not instruct SEC enforcement to avoid forcing an admission that would catalyze counterproductive private litigation.

Another place to look for the SEC Enforcement Division's approach to piggybacking is the "back end" of the Enforcement process. Each year the SEC collects various statistics and anecdotes regarding its enforcement program and packages these together in its agency-wide report to Congress.[136] More recently, the Enforcement Division has filed its own, separate report with still more statistics and anecdotes.[137] These reports provide extensive information regarding the number of enforcement actions filed, the amount of penalties and disgorgement ordered, and details regarding coordination with foreign, state, criminal, and other U.S. regulatory authorities. But there is no indication in any of these reports that the agency has any effect on private litigation. The reports show the amount the agency has won in penalties and disgorgement during the prior calendar year, but not how much private parties have won from the same targets in lawsuits that relied on the SEC's own investigations and enforcement actions.

Finally, the statements of agency leaders also make it clear that the agency does *not* consider downstream litigation consequences in formulating enforcement policy. Commissioners and Enforcement Directors often provide important information regarding enforcement policy and priorities in speeches and Congressional testimony. Here, too, there is almost nothing that indicates the SEC has a systemic approach to the piggyback effect—and some evidence that it does not. For instance, in 2012, then Enforcement Director Robert Khuzami was asked by a Congressman whether "the fact that an investor cannot bring an additional action change[d] the decision-making process for determining whether it is appropriate or not to settle with the defendant?" Khuzami's answer: "No. In general, we are going to follow the same guidelines."[138] More generally, in public speeches, SEC leaders have often emphasized cooperation and coordination—with criminal

[136] *E.g.*, SEC Annual Reports.

[137] SEC Enforcement Report.

[138] *Examining the Settlemet Practices of U.S. Financial Regulators, Hearing Before the Comm. On Fin. Servs., U.S. House of Representatives* (May 17, 2012) at 37 Serial No. 112-128.

authorities,[139] other U.S. regulators,[140] and international regulators[141]—but do not mention any coordination or consideration of "piggyback" litigation. Even when SEC leaders discuss subjects like the SEC's imposition of monetary penalties on public companies that raise many of the same issues as private class actions, these leaders do not make any connection with the piggyback effect.[142]

So much for agency words. How about their deeds?

Some agency actions seems to reflect a desire to minimize piggybacking. Since Dodd-Frank, the SEC has been avoiding scienter-based charges in settlements[143]—*i.e.*, the kind of charges that would provide the strongest catalyzing effect for piggyback suits. Since 2013, the SEC has also avoided requiring admissions in settlements where such admissions would provide meaningful

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[139] *E.g.*, Andrew Ceresney, *The Impact of SEC Enforcement on Public Finance*, 1, 8 (Oct. 13, 2016) https://www.sec.gov/news/speech/speech-ceresney-10132016.html; Andrew Ceresney, *Keynote Speech, ACI's 33rd International Conference on the FCPA*, 1, 1–2 (Nov. 30, 2016) https://www.sec.gov/news/speech/speech-ceresney-113016.html; Andrew Ceresney, *Directors Forum 2016 Keynote Address*, 1, 6–7 (Jan. 25, 2016) https://www.sec.gov/news/speech/directors-forum-keynote-ceresney.html.

[140] Andrew Ceresney, *The SEC Enforcement Division's Focus on Auditors and Auditing*, 1, 1–2 (Sept. 22, 2016) (PCOAB) https://www.sec.gov/news/speech/ceresney-enforcement-focus-on-auditors-and-auditing.html; Andrew Ceresney, *Testimony on "Oversight of the SEC's Division of Enforcement,"* 1, 1–2, 4 (Mar. 19, 2015) https://www.sec.gov/news/testimony/031915-test.html.

[141] Peikin, *Salutary*, *supra* note 102, at 2; Andrew Ceresney, *Keynote Speech, ACI's 33rd International Conference on the FCPA*, 1, 5–6 (Nov. 30, 2016) https://www.sec.gov/news/speech/speech-ceresney-113016.html.

[142] SEC Commissioner Hester M. Pierce, *The Why Behind the No: Remarks at the 50th Annual Rocky Mountain Securities Conference* (May 11, 2018) https://www.sec.gov/news/speech/peirce-why-behind-no-051118. The closest thing comes in a 2011 speech by Commissioner Elisse Walter arguing that constraints on private enforcement put more pressure on the SEC and "arguably" meant that the SEC should "weigh more heavily the extent of monetary harm" in considering whether to file a case. Elisse Walter, *Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program* (Nov. 8, 2011) https://www.sec.gov/news/speech/2011/spch110811ebw.htm. The logical premise of this argument is that the extent of private enforcement should be a factor in setting enforcement priorities. But Walter did not suggest (as I do here) that the agency should systematically incorporate piggybacking effects into enforcement decisionmaking.

[143] Velikonja, *Shadows*, *supra* note 94, at 133.

assistance to private litigation.[144] And, in the first half year of Jay Clayton's tenure as head of the SEC, the agency brought fewer standalone actions against entities.[145]

At least some of these results are actually consistent with the hypothesis that the SEC is "gatekeeping in the dark." Even if the SEC is not paying attention to the private litigation consequences in setting enforcement policy, their targets are very likely to be paying close attention, and so the piggybacking effect might become involved in the decision through the lens of the defendants' preference, resulting in what, from the outside, looks like an effort to minimize piggybacking.

In sum, the agency's public statements show a lack of concern for the piggyback effect. The agency's actions are ambiguous, but do not provide an indication that the agency has a clear systematic approach to the issue. Further, the fact that the agency's reports to Congress do not include consideration for private litigation impacts means that, even if the agency is secretly accounting for these impacts, it is not being held accountable for these secret decisions.

C. Litigation Gatekeeping at the SEC's Division of Corporation Finance

Virtually all prior writing about the SEC's impact on downstream private litigation is focused on the Enforcement Division. But this is not the only Section of the SEC that has such an impact. This part analyzes how the SEC's Division of

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[144] David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution That Wasn't*, 103 IOWA L. REV. 113, 116, 150 (2017); Verity Winship & Jennifer K. Robbenolt, *An Empirical Study of Admissions in SEC Settlements*, 60 ARIZ. L. REV. 1, 40 (2018); *see also* John C. Coffee, Jr., *In the Wake of the Whale, What's Changed?*, 36 NAT'L L.J. 18 (Oct. 7, 2013) https://advance.lexis.com/api/permalink/343269f4-f536-4e06-9a00-4854f9dcace8/?context=100051 (finding that the admissions in the SEC's JPMorgan settlement were well crafted to minimize any collateral consequences and provide little benefit to the plaintiffs in pending class actions against JPMorgan."); Flynn, *supra* note 120, at 545, 552; Joshhua Gallu, *JPMorgan Guilty Admission a Win for SEC's Policy Shift*, BLOOMBERG (quoting Adam Pritchard that the settlement was a "show of admission" without consequences); Paul Radvany, *The SEC Adds a New Weapon: How Does The New Admission Requirement Change The Landscape?*, 15 CARDOZO J. CONFLICT RESOL. 665, 697–99 (2014); Rosenfeld, *supra* note 144, at 154.

[145] Urska Velikonja, *Behind the Annual SEC Enforcement Report: 2017 and Beyond* (Nov. 19, 2017) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3074073

Corporation Finance wields its power to channel the flow of private litigation.

1. The Comment Letter Process

The Division of Corporation Finance (CorpFin) are the "police" to the Enforcement Division's prosecutors.[146] CorpFin employs hundreds of attorneys and accountants to review the periodic disclosures and financial statements filed by public companies.[147] The division reviews the disclosures of *every* public company at least once every three years.[148] During FY 2017, CorpFin reviewed the annual reports and financial statements of nearly 4,200 public companies.[149]

In the course of a review, if CorpFin staff identifies instances where it believes a company can improve its disclosure or enhance its compliance with the applicable disclosure requirements, they send a comment letter to the issuer.[150] Some comments ask for additional information, others ask that the issuer provide additional disclosure—in existing or future filings. Where the staff determines that there has been a "material" error in the disclosures that have been filed, a comment letter may ask the issuer to "restate" its disclosures to correct the error. In response, the issuer may provide additional information, agree to amend its filings, or do nothing. CorpFin has authority to refer matters to the Enforcement Division.

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[146] Rory Van Loo, *Regulatory Monitors: Policing Firms in the Compliance Era*, 119 COLUM. L. REV. 369, 399 (2019) (describing the overlooked "police" function played by regulatory monitors).

[147] U.S. SECURITIES EXCHANGE COMMISSION, *Filing Review Process*, SEC, https://www.sec.gov/divisions/corpfin/cffilingreview.htm (last visited Oct. 10, 2019); 15 U.S.C. § 7266(a) (2012). CorpFin performs other important functions, including issuing no-action letters, promulgating regulations, and writing amicus briefs, but the vast majority of its staff is devoted to the disclosure review and comment letter program. *See* U.S. SECURITIES EXCHANGE COMMISSION, *Testimony on "Management and Structural Reforms at the SEC: A Progress Report"*, SEC (Nov. 16, 2011), https://www.sec.gov/news/testimony/2011/ts111611rk.htm (statement of SEC CorpFin Director Meredith Cross) ("Approximately 80 percent of the staff of the Division is assigned to the disclosure review program.").

[148] 15 U.S.C. § 7266(c).

[149] U.S. SECURITIES EXCHANGE COMMISSION, AGENCY FINANCIAL REPORT: FISCAL YEAR 2017, 20 (2017).

[150] U.S. SECURITIES EXCHANGE COMMISSION, *Filing Review Process*, *supra* note 147.

The SEC describes CorpFin's mission as helping investors gain access to "materially complete and accurate information," facilitating "capital formation," and deterring "fraud and misrepresentation."[151] The comment letter process is often described as a "dialogue"[152]—involving many rounds of letters going back and forth between the issuer and the agency before issues are resolved. However, the terms of this dialogue changed materially in 2005 when the SEC mandated that both SEC comment letters and issuer responses would be publicly disclosed as a matter of course.[153]

2. Piggybacking on CorpFin

CorpFin's review and comment process can impact private litigation in two ways.[154]

First, the comment letter process may lead a company to make a restatement that triggers private litigation. Research has shown that a significant portion of SCAs involve restatements,[155] and that

[151] U.S. SECURITIES EXCHANGE COMMISSION, AGENCY FINANCIAL REPORT: FISCAL YEAR 2018, 10 (2018).

[152] *Filing Review Process*, *supra* note 147. John W. White, Director, Division of Corporation Finance¸ U.S. Securities Exchange Commission, Keynote Address at the ABA Section of Business Law Fall Meeting: Don't Throw out the Baby with the Bathwater (Nov. 21, 2008); PLURIS VALUATION ADVISORS LLC, QUICK REFERENCE GUIDE: SEC REVIEW PROCESS, 3 (2011); Keith F. Higgins, Director, Division of Corporation Finance, Securities Exchange Commission, Remarks Before the American Bar Association Business Law Section Spring Meeting: Disclosure Effectiveness (Apr. 11, 2014).

[153] U.S. SECURITIES EXCHANGE COMMISSION, SEC Staff to Publicly Release Comment Letters and Responses, SEC, https://www.sec.gov/news/press/2004-89.htm (last visited Oct. 11, 2019).

[154] Brief for United States as Amicus Curiae Supporting Respondents at 32, *Leidos, Inc. v. In. Pub. Retirement Sys.*, No. 16-581 (U.S. 2017) (asserting that private litigation complements the SEC's comment-letter process in that "both aim to improve the quality of information available to the market."). *But see* Zahn Bozanic et al., *SEC Comment Letters And Firm Disclosure*, 36 J. ACCOUNT. & PUB. POL'Y 337, 353, 356 (2017) (finding that firms undergoing a comment letter review are *less* likely to be targeted by a SCA in the next year because they improve the quality of disclosures).

[155] About half of accounting related SCA settlements involve restatements. Cornerstone Research, *Accounting Class Action Filings and Settlements 2018 Review and Analysis*, 15 (2018). *But see* Kevin LaCroix, *Number of Restatements Continues to Decline*, D&O DIARY (June 26, 2018).

SCAs accompanied by restatements produce larger settlements.[156] Indeed, forty of the largest one hundred SCA settlements of all time involved a restatement.[157]

Second, SCA plaintiffs may rely on comment letters (which are public) to help establish various elements of a claim. The Defense Bar and CorpFin itself both recognized this,[158] but scholars have generally overlooked it.

For instance, an SEC comment letter suggesting that a company has made a "material" misstatement might be used by litigants to help demonstrate the materiality of the misstatement in question.[159] Many plaintiffs have indeed relied on SEC comment letters and company responses to show materiality.[160] Courts have split on

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[156] Boettrich & Starykh, *supra* note 28, at 37; Choi, Nelson & Pritchard, *The Screening Effect of the PSLRA*, *supra* note 109, at 63.

[157] ISS SECURITIES CLASS ACTION SERVICES, *The Top 100 U.S. Class Action Settlements of All Time as of December 2018*, 25 (Feb. 11, 2019). To be clear, the SEC is not the only source of restatements. Indeed, research has shown that they are responsible only for about one quarter—the others arising from Auditors, or other sources. Zoe-Vonna Palmrose et al., *Determinants of Market Reactions to Restatement Announcements*, 37 J. ACCOUNT. & ECON. 59 (2004) (24%); Baruch Lev, et al., *Rewriting Earnings History*, 13 REV. ACCOUNT. STUDS. 419 at Tbl 2 (2007) (24%). In addition, researchers have found that litigation following a restatement is not more or less likely where the SEC induced the restatement, or it came from another source. The likely explanation for this finding, however, is that the SEC sometimes uses the restatement process to alter generally accepted accounting practices that affect an entire industry. *Id.* at note 9.

[158] Yin Wilczek, *Official Warns Issuers, Lawyers to Take Care in Responding to SEC Staff Comment Letters*, 8 ACCOUNT. POL'Y & PRACTICE REP'T 1023–24 (Dec. 7, 2012) (discussing CorpFin's warning to companies to be "careful" in drafting responses because, once public, these letters become part of the "total mix" of information available about a company, a term that comes from the legal definition of materiality).

[159] *See id.*

[160] Second Amended Class Action Complaint at ¶ 58, I*n re Herbalife, Ltd. Sec. Litig.*, No. 2:14-CV-02850-DSF (JCGx), 2015 WL 4498323 (C.D. Cal. May 8, 2015); Complaint at ¶ 53, SRM Global Master Fund Ltd. P'ship v. Bear Stearns Comps. LLC, No. 13-CV-2692, 2013 WL 1758311 (S.D.N.Y. Apr. 24, 2013); Consolidated and Amended Class Action Complaint at ¶¶ 208–09, *In re Netbank, Inc. Sec. Litig.*, No. 1:07-cv-2298, 2008 WL 2773514 (N.D. Ga. July 3, 2008); Consolidated Amended Complaint at ¶¶ 93, 112–17, Shenwick v. Twitter, No. 3:16-cv-05314-JST, 2017 WL 836240 (N.D. Cal. Jul. 3, 2008); Amended Class Action Complaint at ¶¶ 58–70, Zamir v. Bridgepoint Ed., Inc., No. 15-CV-408 JLS (DHB), 2015 WL 6549884 (S.D. Cal. Sept. 18, 2015); Consolidated Class Action Complaint at ¶ 12, Reinschmidt v. Zillow, Inc., No. 2:12-cv-02084-RSM, 2013 WL 7487224 (W.D. Wash. June 24, 2013); First Amended Consolidated Class Action Complaint at ¶¶ 80-87, *In Re Netflix, Inc. Sec. Litig.*, No. 3:12-cv-

whether comment letters can provide good evidence of materiality.[161] Courts have also relied on the issuer's response to a comment letter to establish materiality.[162] On the other side, some courts have relied on the SEC's determination that a misstatement was *not* material registered by closing a comment letter process without requiring a restatement.[163]

00225-SC (N.D. Cal. Mar. 22, 2013); Brief for Plaintiff-Appellant at 14, Chang v. Accelerate Diagnostics, Inc., No. 16-15315, 2016 WL 3211274 (9th Cir. Jun. 6, 2016); Amended Complaint at ¶ 114, Local 703 v. Regions Fin. Corp., No. 2:10-cv-02847-IPJ, 2011 WL 2428919 (N.D. Ala. Feb. 28, 2011); Brief for Plaintiff-Appellant at 14, Chang v. Accelerate Diagnostics, Inc., No. 16-15315, 2016 WL 3211274 (9th Cir. Jun. 6, 2016) (claiming "strong support" of the material falsity of defendants' "by reference to the SEC's comment letter to the Company."); Brief of Appellants at 63, Broderick v. PWC LLP, No. 04-56057, 2004 WL 2846084 (9th Cir. Sept. 17, 2004) ("The SEC uncovered and forced disclosure of this material event."); Plaintiff's Memorandum in Opp'n to Defendant's Motion to Dismiss at 17-18, E*Trade Fin. Corp. Sec. Litig, No. 1:07-cv-08538-RWS, 2009 WL 3232861 (S.D.N.Y. Jul. 2, 2009) ("The SEC demands for greater disclosure by E*TRADE alone demonstrate the inadequacy of Defendants' public reports.").

[161] *Compare In re Netbank, Inc. Sec. Litig.*, No. 1:07-CV-2298-BBM, 2009 WL 2432359, at *10 (N.D. Ga. Jan. 29, 2009) (noting that plaintiffs met their burden on materiality, in part, by alleging that defendants "received a comment letter from the SEC questioning its application of FAS 133 and the methods the Company used."); Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 186, 188 (S.D.N.Y. 2010); United States v. Blankenship, No. 5:14-CR-00244, 2015 WL 8731688, at *8 (S.D.W. Va. Dec. 9, 2015); *and* United States v. Wilmington Tr. Corp., No. 15-23-RGA, 2017 WL 4416354, at *8 (D. Del. Oct. 5, 2017) (holding that SEC comment letters were admissible evidence in a criminal trial to "show the types of information and disclosures that the SEC considers to be material."), *with* Reinschmidt v. Zillow, Inc., No. C12-2084 RSM, 2014 WL 5343668, at *8 (W.D. Wash. Oct. 20, 2014) ("Because the SEC did not require Zillow to disclose ARPU, and because ARPU's eventual disclosure could not plausibly render Zillow's statements about higher subscription prices false or misleading, Zillow had no duty to disclose ARPU during the class period.").

[162] Sun v. Han, No. 15-703 (JLL), 2015 WL 9304542, at *9 (D.N.J. Dec. 21, 2015).

[163] Harris v. AmTrust Fin. Servs., Inc., 135 F. Supp. 3d 155, 177 (S.D.N.Y. 2015) ("The fact that AmTrust clarified and improved its disclosures [in response to SEC comment letters] . . . does not raise an inference of an intent to deceive shareholders. To the extent it raises any inference, the most compelling inference is of a nonfraudulent intent—the desire to satisfy the SEC regarding a difference of opinion about the appropriate level of disclosure . . . ."); *see also In re Elan Sec. Litig.*, 385 F. Supp. 2d 363, 370–71 (S.D.N.Y. 2005) (approving settlement where plaintiffs' faced litigation risk because SEC had not required a restatement).

Comment letters are a potentially valuable source for plaintiffs to establish materiality, even when there has been a restatement, because many courts have found that the restatement itself does not establish materiality. Some courts have held that a restatement does not provide any evidence of materiality,[164] while others have held that it may be "some" or even "strong" evidence of materiality.[165] Thus, plaintiffs need some additional evidence to establish materiality, and a comment letter from the SEC suggesting that there is a material misstatement may provide some help.

[164] *See In re Atlas Mining*, 670 F.Supp.2d 1128, 1133–34 (D. Idaho 2009); *See In re Metawave Comms. Corp. Sec. Litig.*, 298 F.Supp.2d 1056, 1079 (W.D. Wash. 2003); J&R Mtkg. v. Gen. Mtrs. Corp., 2007 WL 655291 at *38–39 (E.D. Mich. Feb 27, 2007).

[165] *In re Ramp Networks, Inc. Sec.*, 201 F. Supp. 2d 1051, 1062, 1065–66 (N.D. Cal. 2002) (holding that restatements constitute "some" evidence of materiality where plaintiff also alleges specific facts concerning GAAP violations).

Outside of materiality, courts have recognized that comment letters may also be used to establish other elements of securities claims, including scienter, [166] loss causation,[167] and more.[168]

3. Channeling Private Litigation at the Division of Corporation Finance

So how does CorpFin account for the potential downstream impact of its comment letters on private litigation?

Some actions appear to be designed to encourage piggybacking. CorpFin's 2004 decision to publicize these letters provided an

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[166] *See* Cohen v. Telsey, 2009 WL 3747059, at *21 (D.N.J. Nov. 2, 2009); *see also In re Am. Bus. Fin. Servs., Inc. Noteholders Litig.*, 2008 WL 3405580, at *8 (E.D. Pa. Aug. 11, 2008); *In re Victor Techs. Sec. Litig.*, 1987 WL 60284, at *6 (N.D. Cal. Jan. 8, 1987); United States v. Hill, 1969 WL 2837, at *11 (D. Conn. Apr. 10, 1969); Fresno Cty. Emps. Ret. Ass'n v. comScore, Inc., 268 F. Supp. 3d 526, 552 (S.D.N.Y. 2017); *In re Bear Stearns Comps., Inc. Sec., Derivative, & ERISA Litig.*, 763 F. Supp. 2d 423, 561 (S.D.N.Y. 2011); Comment Letter by ABA Section on Business Law to SEC re: Release of Comment Letters and Responses at 4 (Sept. 28, 2004) (explaining that comment letters could be used defensively by companies to show a lack of scienter). *But see In re Imergent Sec. Litig.*, 2009 WL 3731965, at *10 (D. Utah Nov. 2, 2009) (finding that comment letters were "perhaps the closest" evidence of scienter, but not sufficient to survive a motion to dismiss); N. Collier Fire Control & Rescue Dist. Firefighter Pension Plan & Plymouth Cty. Ret. Ass'n v. MDC Partners, Inc., 2016 WL 5794774, at *19 (S.D.N.Y. Sept. 30, 2016) (rejecting reliance on comment letter to establish scienter where the company had previously "[r]eceived and responded to" several similar comment letters, and the letter did not directly identify the same impropriety targeted in the suit); *In re Turquoise Hill Res. Ltd. Sec. Litig.*, 2014 WL 7176187, at *6 (S.D.N.Y. Dec. 16, 2014); Pa. Pub. Sch. Employees' Ret. Sys. v. Bank of Am. Corp., 939 F. Supp. 2d 445, 451–52 (S.D.N.Y. 2013); Reilly v. U.S. Physical Therapy, Inc., 2018 WL 3559089, at *14 (S.D.N.Y. July 23, 2018); Foss on Behalf of Quality Sys. Inc. v. Barbarosh, 2018 WL 5276292, at *7 (C.D. Cal. July 25, 2018) ("Nor does Plaintiff explain how the letters could have alerted the Board to systemic deficiencies in QSI's internal controls. The SEC letters do not claim that QSI violated the law or engaged in serious misconduct, but simply requested that QSI clarify certain financial guidance.").

[167] *See Bear Stearns Comps., Inc. Sec., Deriv. & ERISA Litig.*, 763 F. Supp. 2d 423, 488 (S.D.N.Y. 2011).

[168] *See In re Allergan, Inc. Proxy Violation Sec. Litig.*, 2018 WL 3912934, at *3 (C.D. Cal. Aug. 14, 2018) (approving settlement where plaintiffs might have had difficulty convincing a jury that there was a violation where the SEC had sent a comment letter asking if there was one, but never followed up); *see also* Chang v. Accelerate Diagnostics, Inc., 2016 WL 3640023, at *4, 8 (D. Ariz. Jan. 28, 2016) (rejecting plaintiff's attempt to rely on comment letter as establishing falsity, where the letter merely asked for information); Fait v. Regions Fin. Corp., 712 F. Supp. 2d 117, 123 (S.D.N.Y. 2010); Mostaed v. Crawford, 2012 WL 3947978, at *10 (E.D. Va. Sept. 10, 2012) (relying on comment letters as alternative source of corporate benefit to deny attorneys' fees).

important new tool to private enforcement to use in SCAs.[169] This gave plaintiffs access to important information that can help their cases.

However, the agency has never publicly invoked pro-piggyback reasoning for the disclosure policy, nor has it ever endorsed the use of comment letters in private litigation. Instead, the agency claimed the decision to disclose these comment letters was driven by a desire to enhance "transparency" and in response to increasing numbers of these comment letters that private companies had obtained through the FOIA process and were making available for paying clients.[170]

Other actions seem to indicate a desire to minimize the piggyback effect from comment letter disclosure. For instance, comment letters are typically not written in a manner that would be of the most use to a plaintiff. They ask questions rather than provide definitive opinions and analysis. In the context of materiality, the letters are much more likely to solicit the company's materiality analysis than to put the agency's own analysis on paper. If the SEC disagrees with the materiality analysis provided by the company, it is likely to respond by asking more questions. But courts have held that mere *questions* raised in a comment letter do not constitute evidence of the agency's opinions.[171] Further, the SEC sometimes conveys its bottom line positions—including its views of the issuer's "materiality" analysis—to a company over the phone,[172]

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[169] *See generally* Miguel Duro, Jonas Heese & Gaizka Ormazabal, *The Effect of Enforcement Transparency* 781 (Apr. 26, 2018).

[170] *SEC Staff to Publicly Release Comment Letters and Responses*, U.S. SEC. & EXCH. COMM'N (June 24, 2004), https://www.sec.gov/news/press/2004-89.htm.

[171] *E.g.*, Perrin v. SouthWest Water Co., 2011 WL 10756419, at *11 (C.D. Cal. June 30, 2011); *see also* Pa. Pub. Sch. Emps. Ret. Sys. v. Bank of Am. Corp., 939 F. Supp. 2d 445, 452 (S.D.N.Y. 2013) ("[A]llegations of accounting irregularities, standing alone, are insufficient to state a securities fraud claim."); *In re Turquoise Hill Res. Ltd. Sec. Litig.*, 2014 WL 7176187, at *6 (S.D.N.Y. Dec. 16, 2014) ("In short, although a restatement inherently acknowledges an error in a company's financial statements, the Complaint's allegations do not support an inference that this error was intentional or that Defendants furthered the error, condoned it or were even aware of it until steps to review and ultimately correct it began."); *N. Collier Fire*, 2016 WL 5794774, at *3.

[172] *E.g.*, Enter. Fin. Services Corp., Annual Report (8-k) (Mar. 8, 2010) ("On March 8, 2010, the Company was informed that the Staff disagreed with the Company's determination that the effect of the accounting error on the prior periods was immaterial."); Enter. Fin. Services Corp., (Comment Letter Response) (Mar. 11, 2010) ("The Company acknowledges the staff's position, indicated to us in recent telephone conversations, that the Company's financial information for periods affected by the correction of the loan participation

thereby avoiding a written record that could be used against the target in litigation. While CorpFin has a "longstanding practice" of providing companies with oral comments,[173] a recent SEC Office of Inspector General (OIG) Report criticized CorpFin's use of oral comments practice as haphazard and noted that the staff did not regularly document the oral comments they provided.[174] And, as Figure 4 shows, CorpFin's use of oral comments has been increasing.

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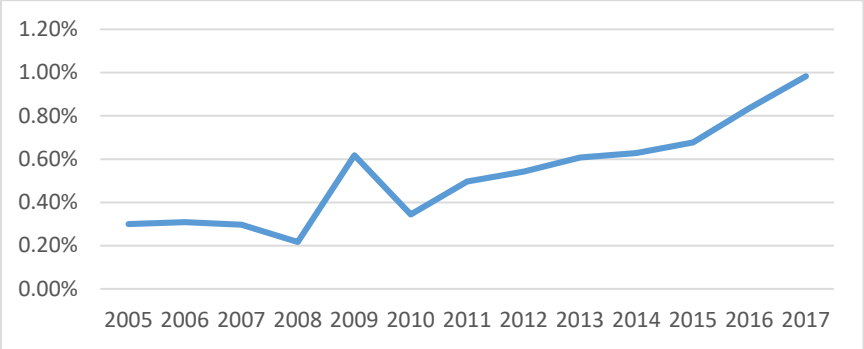
accounting error should be labeled as restated."); Hemispherx Biopharma, Inc, Annual Report (8-k) (Dec. 22, 2010); Novavax, Inc., Annual Report (8-k) (Mar. 17, 2011).

[173] U.S. SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., EVALUATION OF THE DIVISION OF CORPORATION FINANCE'S DISCLOSURE REVIEW AND COMMENT LETTER PROCESS 22, REPORT NO. 542 at 3 (Sept. 13, 2017); *see also* Baldwin B. Bane, *SEC's Work Defended as Liked By Investors and Registrants*, N.Y. TIMES (July 2, 1939) ("Often representatives of the registrant are in a position to confer personally and informally with our staff on registration problems. But for the benefit of those who cannot do this, and in order to make the registration procedure sensible and orderly, we have devised the deficiency letter."); SEC Speaks 1972 at 86–90 statement of Mary E.T. Beach (1972) ("We have found over the years that if we have more than one or two comments it is not practical to give them by phone."); *Concerning the Procedures of the Division of Corporation Finance in Reviewing Merger Filings: Hearing Before the Subcomm. On Energy & Power*, 106th Cong. 11 (Mar. 10, 1999) (statement of Michael R. McAlevey, Deputy Dir. of Div. of Corp. Fin.) ("The staff often also discusses any of the company's questions with the company and its legal, accounting, engineering and other advisors."); U.S. SEC. EXCH. COMM'N, COMMENT LETTER PROCESS, AUDIT REP. 259 at 7 ("Issuers and staff often discuss filing issues over the telephone throughout the review process."). CorpFin has also consistently invited companies to use telephone calls. *See* U.S. SEC. EXCH. COMM'N, FILING REVIEW PROCESS at 2 (Oct. 5, 2019) (inviting companies to call CorpFin with questions about comments and noting that the Division includes names and numbers of relevant staff members to facilitate such contact); Marie Leone, *How To Answer an SEC Comment Letter,* CFO (Sept. 23, 2009), https://www.cfo.com/accounting-tax/2009/09/how-to-answer-an-sec-comment-letter/ (quoting associate chief accountant at CorpFin urging targets to "pick up the phone" and call CorpFin).

[174] SEC 2017 OIG Report, U.S. SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., AUDIT OF THE DIVISION OF CORPORATION FINANCE'S MANAGEMENT OF REQUESTS FOR NO-ACTION AND INTERPRETIVE LETTERS, EXEMPTIONS, AND WAIVERS, REPORT NO. 540 at i, 4 (Mar. 27, 2017).

Figure 4 [175]

Percent of Issuer Responses Referencing "Oral Comments"



More broadly, CorpFin appears to be deliberately avoiding restatements.[176] A recent study of comment letters between 2009 and 2015 found that the SEC asked for the company's opinion on the materiality of a detected error less than 5% of the time—with a steady decline during that period.[177] And, in the 5% of cases where the company provided an explanation of why its error is non-material, the SEC challenged this explanation in comment letters just 15% of the time.[178]

But, here again, the evidence is ambiguous. It may be that CorpFin is trying to minimize piggybacking or that CorpFin itself is not considering the piggybacking effect at all but is simply internalizing (without scrutiny) the preferences of its targets to minimize this effect.

Again, it is informative to look at how CorpFin reports its performance to Congress. The SEC's annual reports and leaders in testimony invariably disclose the percentage of companies whose

[175] Source: Lexis Securities Mosaic.

[176] *E.g.*, Jean Eaglesham, *Shh! Companies are Fixing Accounting Errors Quietly*, WALL ST. J. (Dec. 5, 2019) (collecting research showing that companies have been increasingly avoiding "Big R" restatements and instead using "Little r" revisions, with the SEC's apparent approval).

[177] Andrew A. Acito et al., *The Materiality of Accounting Errors: Evidence from SEC Comment Letters*, 36 CONTEMP. ACCOUNT. RES. 839, 847 (2019).

[178] *Id.* at 859.

disclosures are reviewed by CorpFin each year,[179] but do not track any of the "piggybacking" consequences of these reviews—such as the number of resulting restatements, the litigation targeting restating companies, or the litigation relying on comment letters. Even if the agency is secretly accounting for these effects in setting policy (which is I think unlikely), it is hiding them from Congress and the public. More likely, the agency is not systematically tracking these effects, and therefore is not systematically designing its comment letter policies with them in mind.

D. "Gatekeeping in the Dark" at the SEC

The SEC has been a leading voice in defense of the private securities class action. It promulgates many of regulations that much private litigation arises under, including Rule 10b-5, and has resisted calls to "disimply" the private right of action under this rule that is the source of much private securities litigation.[180] The agency has long history of influencing courts through amicus briefs in support of preserving or expanding the private right of action,[181] and has also played a critical role in lobbying Congress to preserve private enforcement.[182] Most recently, SEC Chairman Jay Clayton has resisted calls (including calls from within the Trump

[179] *E.g.*, U.S. SEC. AND EXCH. COMM'N Agency Financial Report FISCAL YEAR 2017, 44 (2017); U.S. SEC. AND EXCH. COMM'N AGENCY FINANCIAL REPORT FISCAL YEAR 2016, 51 (2016).

[180] *Cf.* Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 747 (1995).

[181] *See* Brief for SEC as Amicus Curiae Supporting Respondent at 28, Halliburton v. Erica John Fund, 573 U.S. 238 (2014) (No. 13-371); Brief for SEC as Amicus Curiae Supporting Respondents at 31, Leidos Inc. v. Ind. Pub. Retirement Sys., 138 S. Ct. 2670, *cert. dismissed* (2018) (No. 16-581) (supporting SCA plaintiffs and noting that private enforcement of section 10(b) "complements" the SEC's comment-letter process); Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 WISC. L. REV. 151, 154 (discussing SEC Amicus role in *Basic*); David S. Ruder, *Development of Legal Doctrine Through Amicus Participation: The SEC Experience*, 1989 WISC. L. REV. 1167, 1168 (1989); Commissioner Elisse B. Walter, Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program (Nov. 8, 2011) (expounding on the SEC's role in filing amicus briefs).

[182] *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 133 (2011); Adam C. Pritchard, Halliburton II: *A Loser's History*, 10 DUKE J. CONST. L. & PUB. POL'Y 27, 40-41 (2015).

Administration[183]) to authorize companies to include mandatory arbitration provisions in their corporate charters—preserving shareholders' right to pursue securities class actions.[184]

But, as the preceding sections showed, the agency has apparently avoided adopting a policy providing for systematic consideration of the impact that its prosecutorial and policing activities have in catalyzing "piggyback" private litigation.[185] Thus, the agency's Enforcement Division and Division of Corporation Finance appear to go about their work, which may have intense consequences on downstream litigation, without systematically and transparently attending to those consequences. What explains this apparent inconsistency?

The highly collaborative nature of these enforcement activities may provide one explanation. As the current co-director of enforcement explains "An SEC investigation provides many opportunities for dialogue—from the time of the first contact with the staff through discussions about possible settlement or litigation."[186] Similarly, CorpFin's comment letter process was initially conceived, in the months following enactment of 1933 Securities Act, as a form of *assistance* to the regulated industry rather than a form of increased liability,[187] and this characterization holds sway today.[188] Such collaboration is undoubtedly an

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[183] *Cf.* U.S. DEPARTMENT DEP'T OF THE TREASURY, 2017-04856 (REV. 1), REPORT TO PRESIDENT DONALD J. TRUMP, A FINANCIAL SYSTEM THAT CREATES ECONOMY OPPORTUNITIES: CAPITAL MARKETS at 33-34 (Oct. 2017).

[184] Chairman Jay Clayton, *Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions* (Feb. 11, 2019).

[185] *Supra* Part I.B-C.

[186] Peikin, *Keynote supra* note 92, at 2.

[187] I explore this history in greater depth in a separate paper. *See* Alexander I. Platt, *Securities Enforcement in the Era of APA Originalism* (working paper).

[188] *See, e.g.*, *Testimony on "Oversight of the SEC's Division of Corporation Finance": Before the Subcomm. on Capital Mkts., Sec., and Inv. of the H. Comm on Fin. Servs. Investment* 115th Cong. 2 (2018) (CorpFin Director testifying that Staff "stands ready to *assist* companies in complying with the federal securities laws" and wants to be "as transparent and collaborative as possible"); *The Enron Collapse: Impact on Investors and Financial Markets Before the Subcomm. on Oversight and Investigations and the Subcomm. on Capital Mkts., Ins., and Gov. of the H. Comm. on Fin. Servs.* 107th Cong. 100 (2001) (CorpFin Director stating "the staff of the SEC wants to work together with the corporate community, the accounting profession, and private sector standard-setting bodies to advance, not just protect, the interests of investors by helping companies to get financial reporting right the first time."); Donna Gerson, *SEC Lawyer Talks Internships*, 38

important and valuable thing.[189] But one consequence may be that, in the absence of an express policy to do otherwise, the agency too readily accepts the target's own assessment of "piggyback" litigation.

Another possible factor may be the attitudes of SEC line attorneys and accountants toward plaintiffs' litigation. While there is famously a "revolving door" between the SEC's Enforcement Division and the private securities defense bar,[190] much less attention has been paid to the "door" between the SEC and the specialized plaintiffs' bar that litigates private securities lawsuits. Given the overlap between the missions of the two groups (*i.e.*, protecting investors, deterring fraud), and the consistent statements from SEC leaders that private class actions are an important "supplement" to SEC enforcement, one might assume there would be substantial personnel flow between these two institutions. In fact, there is not.[191] Unlike top-shelf defense firms, leading plaintiff's-side securities firms include almost no one with any SEC experience among their ranks. This "non-revolving door" might indicate that SEC enforcement attorneys do not actually view private securities class actions as a "supplement" to the SEC's work (as SEC leaders have maintained). If SEC line attorneys do view class actions as socially wasteful, this may skew the exercise of their "gatekeeping" power to selectively catalyze private litigation through decisions made in enforcement actions.

Another very important explanation is political. The debate over securities class actions is hotly contested and fundamentally politicized. The SEC may have made a savvy choice to avoid taking an explicit position for which it could be punished from either side. SEC enforcement policy is unavoidably shaped, in part, by political considerations—through the influence of Congressional overseers towards the Chair, who is appointed by the President.[192] By suppressing (and ignoring) its real influence over the incidence of

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STUDENT LAW. 28, 30 (2009) (quoting CorpFin reviewer explaining that "It's not an adversarial process. It's much more—but not necessarily always—collegial.").

[189] *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET, 111–12 (2003) (crediting SEC's use of informal, collaborative procedures as key to its success).

[190] *E.g.*, Ed deHaan et al., *The Revolving Door and the SEC's Enforcement Outcomes*, 60 J. ACCOUNT. & ECON. 65, 66 (2015).

[191] Alexander I. Platt, *The Non-Revolving Door* (working paper).

[192] *E.g.*, Urska Velikonja, *Politics in Securities Enforcement,* 50 GA. L. REV. 17, 18, 41 (2015).

"gatekeeping" litigation, the agency has avoided a highly politically charged debate. But even if this explains the SEC's policy of "gatekeeping in the dark," it cannot justify it. Good or bad, piggybacking is a part of the SEC's enforcement impact. It should begin acting that way and stop hiding its important impacts in this domain from public scrutiny.

Each of the foregoing explanations are important, but not sufficient. As the next part explains, the SEC's failure to consider private litigation consequences is not idiosyncratic. Rather, it is a product of a failure in our broader understanding of public control over private enforcement.

II. PUBLIC ENFORCERS LIKE THE SEC SHOULD CONSIDER THE PRIVATE LITIGATION CONSEQUENCES OF THEIR ACTIONS

The study of the SEC presented above illustrates what may be a broader phenomenon. Many enforcement agencies wield significant power to influence the flow of private litigation through ordinary enforcement activities. At least some of them may be like the SEC and fail to wield this power in a deliberate or transparent fashion.

Is this a problem?

As Section A shows, the prior literature on agency "gatekeeping" and "piggyback" litigation has failed to answer this question. In Section B, I make the case that administrative enforcers should incorporate the downstream private litigation consequences into their enforcement decisionmaking.

A. Prior Scholarship Has Failed To Address This Question

The federal bureaucracy wields enormous power to shape private litigation. Two separate streams of scholarship have examined this impact. First, as discussed in subsection 1 below, scholars have examined the phenomenon of litigation "gatekeeping"—the exercise of overt and deliberative public control over private litigation. Second, as discussed in subsection two below, scholars have examined the phenomenon of "piggyback" litigation, filed by private parties (often class actions) based on information disclosed in the course of administrative enforcement actions. But there is an unoccupied island between these two streams: Scholars have failed to examine the role or responsibility of administrative enforcers whose actions give rise to "piggyback" litigation as a byproduct. "Gatekeeping" scholars have a well-developed account of administrative decisionmaking for overt and

deliberative control over private litigation, but they generally ignore and provide no account for the duties of these same actors regarding the *incidental* impacts they have on the flow of private litigation. "Piggyback" scholars, on the other hand, attend closely to these incidental impacts, but generally provide little or no account for the role or responsibility of public enforcers in triggering this litigation.

This Part summarizes these two lines of scholarship and then shows how the "Gatekeeping" literature's careful focus on administrative decisionmaking and incentives has not yet been applied to the "piggybacking" phenomenon.

1. Litigation "Gatekeeping"

The U.S. enforcement ecosystem relies heavily on private enforcement of federal statutes.[193] In many regulatory domains, private actions are the primary enforcement mechanism. In others, private actions provide a significant supplement to the efforts of federal enforcers. But private enforcement—and especially the private class action—has been subject to relentless criticism.[194] Policymakers, courts, and scholars interested in reining in or otherwise recalibrating private enforcement have often looked to "litigation" reforms[195]—*i.e.*, adjusting pleading standards,[196] discovery barriers,[197] class certification requirements,[198] damages,[199] settlements,[200] and attorneys' fees.[201]

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[193] Engstrom, *supra* note 2, at 627–28.

[194] Engstrom, *supra* note 2, at 630-41.

[195] Engstrom, *supra* note 2, at 642-44.

[196] 15 U.S.C. § 78u–4(b)(2) (2012) (heightened scienter pleading requirement for securities class actions).

[197] 15 U.S.C. § 78u-4 (b)(3) (2012) (barring discovery in securities class actions pending a motion to dismiss).

[198] *E.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988) (allowing securities class action plaintiffs to rely on a "fraud on the market" presumption of reliance in order to facilitate securities class actions).

[199] *E.g.*, Donald Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 664 (1996).

[200] *E.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167, 167-70 (2009).

[201] *E.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1581–82 (2006).

For several decades, legal scholars from a wide range of specializations have been converging on an alternative avenue to bring private enforcement in line with social goals: public agencies as private litigation "gatekeepers."[202] Although the term "gatekeeping" seems to connote efforts designed to *reduce* the flow of private litigation, scholars have actually used the term to apply to various mechanisms by which administrative agencies may increase ***or*** decrease the flow of private litigation to bring it into line with social goals—including by implying (or disimplying) private causes of action by regulation,[203] screening, vetoing, and/or taking over the prosecution of individual private suits,[204] and/or prodding along socially beneficial private suits by filing amicus briefs or statements of interest.[205] Through these various mechanisms, gatekeepers have argued, public agencies may do more to catalyze socially beneficial private litigation and rein in socially harmful private litigation. These mechanisms also hold out some promise of improving *coordination* between these rival enforcement regimes, reducing costs that may arise, for example, when the threat of (uncontrolled) litigation chill potentially productive industry collaboration with agencies.[206] Furthermore, bringing private enforcement under the control of public enforcers can promote some greater degree public democratic accountability.[207]

But, of course, "gatekeeping" is not a panacea. The "gatekeeping" scholars have recognized that putting public officials in charge of private litigation also means subjecting the private enforcement regime to the distortions of public enforcement and giving up some of the unique benefits of decentralized private enforcement.[208] Accordingly, gatekeeping scholars have

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[202] For a review and synthesis, *see* Engstrom, *supra* note 2, at 711–12.

[203] Stephenson, *supra* note 11, at 94; Grundfest, *Why Disimply?*, *supra* note 180, at 728; *see also* Engstrom, *supra* note 2 n. 4 (collecting sources).

[204] *See supra* Part I.B.3; *see also* Engstrom, *supra* note 2 n. 5 (collecting sources).

[205] *See* Engstrom, *supra* note 11, at 647.

[206] *See* Stephenson, *supra* note 11, at 117–19; Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2204, 2221 (2010).

[207] *See* Stephenson, *supra* note 11, at 119-20. *But see* Lemos, *supra* note 19 at 1001 (suggesting that public enforcers are not accountable enough).

[208] *See discussion infra* Part II.B.1.

emphasized institutional design and context, rather than one-size-fits-all solutions.

2. "Piggyback" Litigation

A separate stream of scholarship has examined the subset of class actions that "piggyback" on enforcement actions by public agencies.[209] When a government agency announces an investigation, initiates, wins, or settles an enforcement action, one common byproduct of this activity is to catalyze private litigation. The government action may identify a potential target and subject matter for a lawsuit. It may produce information—in the complaint, the settlement, or consent decree, or other litigation documents—that a private party can incorporate into its complaint to survive a motion to dismiss, can rely on as evidence in a motion for summary judgment or at trial, or use as fodder for depositions. And, if the government action is "actually litigated," it may even give rise to collateral estoppel on some issues. [210]

The literature on piggybacking generally focuses on debating the social utility of this form of private litigation.[211] Critics argue that these types of actions serve no social purpose because they do not uncover any new misconduct and merely "run up the tab" on violations already uncovered by the government.[212] Defenders

[209] *See, e.g.*, John C. Coffee Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 221–22(1983); Erichson, *supra* note 12, at n.1; Bryant Garth et al., *The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation*, 61 S. CAL. L. REV. 353 (1988); Gilles & Friedman, *supra* note 12, at 127, 156.

[210] Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 326 (1979).

[211] There is very little empirical work on the subject. *See* Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries,* 36 YALE J. REG.165, 212 & 212 n.185 (2019).

[212] Coffee, *Rescuing*, *supra* note 209, at 228 (describing the "spectacle, one resembling the Oklahoma land rush, in which the filing of the public agency's action serves as the starting gun for a race between private attorneys, all seeking to claim the prize of lucrative class action settlements, which public law enforcement has gratuitously presented them"); William B. Rubenstein, *On What A "Private Attorney General" Is And Why It Matters*, 57 VAND. L. REV. 2129, 2151 (2004) (stating that piggyback counsel "simply piles on and runs up the tab").

argue that "piggybacking" can be a valuable corrective against under-deterrence by federal enforcers.[213]

3. The Hidden Gatekeepers of Piggyback Litigation

The "gatekeeping" literature has carefully examined the capacity and incentives of public agencies to channel private litigation. However, it focuses on *overt* and *deliberative* forms of administrative control over private litigation and says very little about the vast swath of public impact on private litigation that occurs incidentally as a byproduct of ordinary public enforcement activities.[214] For instance, David Engstrom's global synthesis and typology of gatekeeping mechanisms does not appear to include the "piggyback" effect.[215]

This exclusion is a mistake. When agencies catalyze private litigation through discretionary activity, they are acting as litigation gatekeepers *regardless* of whether the private litigation is an accidental or intentional product of their activities.

On the other hand, the "piggybacking" literature does examine these incidental impacts, but generally fails to attend to the agency's role in producing them. Some authors seem to assume that the government is acting deliberately when it catalyzes piggyback litigation. For instance, in defending the social utility of "piggyback" litigation, Myriam Gilles and Gary Friedman assert "government enforcement agencies act with knowledge of the claims of class action plaintiffs" and claim to have "strong evidence" to support this assertion.[216] But they do not identify any such evidence. Gilles and Friedman merely cite (1) SEC Chair Arthur Levitt stating that Class Actions are an important "supplement" to public enforcement; (2) two FTC officials acknowledging the same thing; and (3) the fact that the SEC website suggests investors check Stanford's clearing house for class

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[213] Clopton, *supra* note 12, at 287; Coffee, *Rescuing*, *supra* note 209, at 224–25; Gilles & Friedman, *supra* note 12, at 157–58.

[214] Engstrom, *supra* note 2, at 626.

[215] Engstrom, *supra* note 2, at 645–56. Engstrom acknowledges that "future work may reveal still other design dimensions that are salient to regulatory architects and should be included in any comprehensive survey." *Id.* at 655–56.

[216] Gilles & Friedman, *supra* note 12, at 157–58. Others have relied on them for this point. *See The Supreme Court – Leading Cases, Class Actions — Class Arbitration Waivers — American Express Co. v. Italian Colors Restaurant,* 127 HARV. L. REV. 278, 287 n.38 (2013).

actions.[217] But all these citations show is that some agency leaders are generally aware and supportive of piggybacking, not that agency enforcers actually have any reasonably sophisticated awareness of the likely piggybacking effects of their individual enforcement decisions at the retail level. Moreover, it certainly does not establish that agency enforcers reliably *internalize* the benefits and costs of such piggybacking in tailoring enforcement policy.

Other "piggyback" authors just exclude the government's catalyzing role from their analysis. For instance, Zachary Clopton provides a defense of the social utility of "redundant" private-public litigation, accounting for various "institutional" challenges,[218] but expressly excludes "agency gatekeeping" from his analysis and does not attempt to account for agency's capacity or responsibility to incorporate piggyback effect into its enforcement calculations.[219]

Even the scholars who are most attuned to litigation gatekeeping overlook the administrative role and responsibility when they discuss the piggyback effect. As mentioned above, Engstrom excludes the piggybacking effect from his typology of agency *gatekeeping*.[220] Similarly, Amanda Rose articulates and defends a proposal to expand SEC control over private securities class actions. But, while Rose criticizes "copycat" class actions filed in the wake of SEC Enforcement Actions against the same targets for the same underlying misconduct, she does not consider the SEC's role in producing these cases, or whether the SEC should be factoring this phenomenon into its enforcement decisions ex ante.[221]

The best analysis of the issue I have found is provided in the middle of Howard Erichson's 2000 study of the overlapping public and private actions against Microsoft and the Tobacco companies.[222] Erichson shows that public enforcement influences private litigation either through the "preclusive effect of a judgment" or "through the gathering and dissemination of

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[217] Gilles & Friedman, *supra* note 12, at 157–58 n.203.

[218] Clopton, *supra* note 12, at 306–07.

[219] *Id.* at 306.

[220] *See* Engstrom, *supra* note 2, at 635, 646 .

[221] Rose, *Restructuring*, *supra* note 1, at 1345; *see also* Fisch, *Qui Tam*, *supra* note 1, at 198 (noting that "private enforcement litigation . . . often duplicates government enforcement efforts" but not discussing whether the government should consider this in formulating enforcement priorities).

[222] Erichson, *supra* note 12, at 2–3.

documents and other information."[223] And he states that public enforcers "should think about" these preclusive and informational impacts in the course of their public enforcement duties.[224] But Erichson does not explain whether or not he thinks they are already doing so. My study of the SEC above suggests that at least some agencies may not be doing this. Erichson also does not defend, define, or support his suggestion that agencies "should think about" the preclusive and informational effects on private litigation, nor does he suggest how to implement this proposal. The next section fills this gap.

B. Why And How Public Enforcers Should Consider the "Piggyback" Effect

Administrative enforcers should consider the impact of their activities on "piggyback" litigation arising under the statutes and regulations they are responsible for enforcing against the same target for the same misconduct. Section 1 shows how doing so will improve public and private enforcement. Section 2 articulates <u>*how*</u> agencies can incorporate such consideration into their enforcement policy.

1. <u>Why Agency Enforcers Should Consider the "Piggyback" Effect</u>

i. Improving Public Enforcement

Rational Enforcement - An agency's failure to consider a major impact of its activities violates core principle against non-arbitrary administration.[225] In the landmark decision *Motor Vehicles Manufacturers' Association v. State Farm*, the Supreme Court explained that an agency that "entirely failed to consider an important aspect of the problem" violated the prohibition on "arbitrary and capricious" action.[226] Agency enforcers that fail to consider the "piggyback" effect of their activities violate this principle. Agency enforcers cannot avoid having some impact on private litigation. But, absent a systematic policy mandating

[223] *Id.* at 28.

[224] *Id.* at 27.

[225] JERRY L. MASHAW, REASONED ADMINISTRATION AND DEMOCRATIC LEGITIMACY (2018) (articulating the "many ways in which American administrative law demands administrative action based on reason").

[226] *See, e.g.*, Motor Vehicles Mfrs. Assn. v. State Farm Mut., 463 U.S. 29, 43 (1983).

consideration of this effect, the impact they have will be at best random, and more likely will be skewed by unseen forces. Bringing these impacts under the rubric of agency responsibility will promote a more rational administrative enforcement regime.

Accountable Enforcement **-** Decisions about enforcement policy are a critical part of the regulatory landscape. But, as compared to other regulatory actions like rulemaking, adjudications, and even guidance, enforcement decisions are relatively non-transparent insulated from public accountability.[227] Taking responsibility for the level of "piggyback" litigation generated by agency actions would promote accountability for public enforcement by allowing the public to better gauge and assess the agency's *true* enforcement impact. Put another way, the failure of agencies to account for the impact of their enforcement activities on piggyback litigation—including in reports to Congress—impedes the ability of the public, Congress, and the Executive to meaningfully assess the agencies' enforcement activities.

Such accountability may cut in either direction. When agencies begin to recognize their role in catalyzing private litigation, some voices will surely step out to criticize the agency for promoting "over-enforcement," while others will criticize the agency for failing to do more to catalyze private litigation. The critical point is that the agency's current significant impacts (and potential impacts) on piggybacking should not be artificially excluded from public debates over SEC enforcement priorities.

Reining in Administrative Drift—Embracing the proposal that agencies should consider the "piggyback" effect may also rein in some forms of administrative "drift." For instance, individual enforcers may have professional incentives to over-value results achieved directly through the prosecution of public enforcement actions even where the same results could be more efficiently produced through publicly catalyzed private litigation.[228] Enforcement leaders may understand that Congressional overseers

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[227] Lemos, *supra* note 19, at 954; Sohoni, *supra* note 19; Velikonja, *Accountability*, *supra* note 19.

[228] David Zaring, *Against Being Against The Revolving Door*, U. ILL. L. REV. 507, 517 (2013) (stating that scholars have posited that the "revolving door" may incentivize public enforcers to aggressively pursue wrongdoing while in the public sector. The same incentives may lead enforcers to artificially prefer public over private enforcement.).

are concerned exclusively with direct results of *public* enforcement, and therefore will not factor in results produced through publicly catalyzed piggyback litigation.[229] Enforcers may simply have a leisure preference such that they would prefer not to engage in the complicated work of calculating likely downstream litigation impacts. Enforcers also may have determined that avoiding direct express responsibility for "piggyback" litigation may be a way to avoid "picking sides" in the highly politically-charged debate regarding class actions.[230] And, given that many of the enforcement decisions that give rise to piggybacking are made in the course of a collaborative engagement between public enforcer and regulated party, the enforcers will be exposed to the *target*'s preferences regarding piggyback litigation and may be willing to trade away these consequences too cheaply.[231]

Bringing the "piggyback" effect under the rubric of agency responsibility should dampen the effect of these various distorting incentives. A public enforcer who has a formal charge to consider the social benefits provided by private litigation may be less likely to trade away those benefits too cheaply in a settlement. And Enforcement leaders who are evaluated by Congress for the combined impact on public and private enforcement will be less likely to artificially overweight the former.

ii. Improving Private Enforcement.

Law and economics 101 teaches that because private enforcers generally do not internalize the *social* costs or benefits of their enforcement actions,[232] but rather are generally motivated by the

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[229] *See infra* Part III.B-C (noting that SEC's annual reports to Congress regarding the impacts of its Enforcement and CorpFin programs omit the private litigation impacts of these divisions).

[230] *See* Part II.B.

[231] *Id.*

[232] Steven Shavell, *The Fundamental Divergence Between The Private and the Social Motive to Use The Legal System*, 26 J. LEGAL STUDS. 575, 578 (1997) (noting that private parties do not bear the legal costs incurred by defendants, or the court, and that the plaintiff's benefit from suit "does not bear a close connection to the social benefit associated with it and may bear almost no connection at all"); Stephenson, *supra* note 11, at 114–15 (private plaintiffs do not internalize defendant's litigation costs, the drain on judicial resources, the potential disruptive impact on effective communities); Rose, *Multienforcer*, *supra* note _ at 220 ("By definition, a private enforcer is incentivized to maximize her private welfare, which we can expect to diverge from social welfare in significant ways.").).

private benefits and costs of litigation,[233] they will fail to bring socially beneficial cases where the private benefits are too low, and may bring socially harmful cases as long as the private benefits are high enough.[234] Public enforcers, by contrast, have a public mandate to select enforcement priorities based on social value, and are not constrained by the pursuit of private benefits,[235] and therefore are free to pursue socially valuable cases even where the payout would not justify it, and may exercise discretion not to pursue socially harmful cases, even if there could be a large payout.[236]

As discussed above, some scholars have drawn on this basic insight to advocate for expanding public agency "gatekeeping" authority over private litigation.[237] Because agencies are in a better position than private enforcers to consider the *social* (rather than *private*) costs and benefits of any given action, agencies might play a valuable role in channeling private litigation through various "gatekeeping" tools like implying private rights of action, filing

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[233] Shavell, *supra* note 232, at 577–78; Stephenson, *supra* note 11, at 114–15 (private plaintiffs may derive private benefits including the prospect of a monetary recovery, the notoriety and increased membership that a group may gain from prosecuting high-profile case, or the benefits derived from harassing or damaging a competitor); *see* Engstrom, *supra* note at 2, at 632 (nothing that private enforcers tend to be motivated by private benefits).

[234] Shavell, *supra* note 232, at 581–84; Stephenson, *supra* note 11, at 114–15.

[235] *See* Park, *supra* note 6, at 122; *Cf.* NICHOLAS R. PARRILLO, AGAINST THE PROFIT MOTIVE: THE SALARY REVOLUTION IN AMERICAN GOVERNMENT, 1780-1940 (2013).

[236] *See* Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10B-5*, 108 COLUM. L. REV. 1301, 1329, 1347 (2008) ("Private plaintiffs can and do bring actions that the Commission would not want litigated by private enforcers, either because the commission believes that it has already adequately penalized the defendant or because, in the exercise of discretion, it would choose not to sanction the defendant."); Stephenson, *supra* note 11, at 116 ("government regulatory agencies (it is often claimed) are better at screening out enforcement actions that are either nonmeritorious or not worth the costs of precaution"); Park, *supra* note 6, at 122 (reasoning that public enforcers may be more likely to weigh social costs felt by themselves and others, and thus are less likely to act when social cost is great); Rose, *supra* note 206, at 2201–03 (articulating the advantages of public over private enforcers); Engstrom, *supra* note 2, at 630 (stating public enforcers exercise discretion to only take action where the social benefits outweigh the social costs of acting).

[237] Fisch, *supra* note 1, at 200.

amicus briefs, and deploying *qui tam* regimes.[238] Through a well-designed "gatekeeping" program, an agency might *improve* the social utility of private litigation by reining in wasteful private cases and catalyzing socially beneficial ones.

The same logic suggests that public enforcers can and should consider the social costs and benefits of private litigation not only when they exercise overt and deliberate control (as the "gatekeeping" literature has suggested), but also when they take any enforcement action that reasonably may catalyze private litigation. In either case, the agency has the capacity to channel the flow of private litigation. There is no good reason to distinguish the responsibilities of agencies in exercising overt control (gatekeeping) from incidental control (piggybacking).

Of course, the model of public and private behavior sketched above is vastly oversimplified. Although public enforcers have a public mandate to pursue socially beneficial litigation, they may be "captured" by some part of the industry they are supposed to be policing and therefore go too "easy" on these targets[239]; they may be pressured by Congressional overseers to pursue certain classes of cases and not others for political reasons[240]; they may suffer from "bureaucratic slack" a result of employees' desire to maximize leisure time[241]; or they may be overzealous enforcers or skew toward high-profile and aggressive cases because individual employees get career benefits (revolving door) from being involved in tough, high-profile cases.[242] Expanding agency control over private enforcement risks importing these various distortions onto the private litigation system. Private enforcement may provide a useful "check" against these failings of public enforcement, and

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[238] *Supra* Part II.A.1.

[239] *See* Rose, *Restructuring*, *supra* note 236, at 1361; Rose, *Multienforcer*, *supra* note 206, at 2215; William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 111 (2011).

[240] *E.g.*, Alexander I. Platt, *Unstacking The Deck: Administrative Summary Judgment and Political Control*, 34 YALE J. ON REG. 439 (2017).

[241] *See* Rose, *Multienforcer*, *supra* note 206, at 2216.

[242] *E.g.*, David Zaring, *Against Being Against The Revolving Door*, 2013 U. ILL. L. REV. 507, 520 (2013) ("The right way to signal worth to private prospective employers may be, among enforcement officials, at least, aggressive pursuit of wrongdoing while in the public sector.").

broadly expanding, agency control over private litigation may diminish the force of this check.[243]

As discussed above, the distorting incentives of public enforcers provide a good reason to hesitate before embracing some of the broader gatekeeping proposals. But my call for agencies to consider the "piggyback" effect does not propose *expanding* agency control over private litigation, but merely that agencies exercise their *existing* authority to channel the flow of private litigation with deliberation and transparency. Whether they recognize it or not, agency enforcers are already having profound impact on private litigation. In the current world, these impacts are hidden from public view and so may be easily skewed by unseen forces—including some of the distorting impacts surveyed above. For instance, as explained below, under the current regime, an agency negotiating a settlement with a target may internalize the *target's* preferences of avoiding piggyback litigation and agree to a settlement that trades away the "piggyback" effect too cheaply. Mandating agency consideration of private litigation impacts seems likely to *reduce* the impact of these types of distortions.

Also unlike some broader "gatekeeping" proposals, my proposal that agencies consider the "piggybacking" effect also does not eliminate the benefits of an autonomous private litigation regime. Private litigators would still retain the final say on whether to pursue a case, what facts to allege, and what claims to pursue. My proposal would merely change the level of assistance provided by public enforcement actions for private litigation. In some cases, there would be more assistance; in others, less. Accordingly, the unique benefits provided by private litigation or from a decentralized, multi-enforcer approach would not be lost.

Of course, it is true that my proposal is likely to have a relatively modest impact on the level of enforcement compared to some of the broader, system-transforming legislative proposals that have been advanced. But the effect of my proposal is hardly trivial. Piggybacking securities class actions produced something on the order of a billion dollars in 2018.[244] If greater consideration of

[243] Engstrom, *supra* note 2, at 621 ("Given that private enforcement is designed at least in part to counter agency capture, bringing agencies back into the picture risks returning the fox to the henhouse.").

[244] This is a back of the envelope calculation based on (1) the fact that about 20% of securities class actions have parallel SEC actions; and (2) in 2018, securities class action settlements totaled $5 billion dollars. *See* pages 6–9, 21.

"piggybacking" effect by the SEC affected just 25% of these cases, the proposal would be impacting the allocation of as much as $250 million in one year.

iii. Objections

John Coffee has argued that "it is not the SEC's job" to consider possible benefits to private litigation in negotiating settlements.[245] But, in other contexts, agencies frequently act as it *is* their job to facilitate private enforcement—filing amicus briefs, implying private rights of action, lobbying Congress, and more.[246] Moreover, agencies cannot really avoid catalyzing piggyback litigation through their enforcement activities; this proposal merely asks that they do so rationally and deliberately.

Some may object that this proposal improperly *subordinates* agencies to private parties by making public enforcement decisions contingent on patterns of private enforcement. In particular, some may object that this proposal calls for agencies to refrain from taking otherwise viable enforcement actions based on predictions about likely harmful private litigation that might result. Or, some might object that this proposal would call for agencies to *pursue* enforcement actions they would not have otherwise considered based on the fact that it might catalyze socially valuable private litigation.

But public enforcement is always dictated in some sense by private action. Obviously, enforcers respond to the law-breaking actions of the private party who is the target. But agency enforcers also factor third party private conduct into their enforcement calculations. For instance, the SEC's Enforcement Manual requires that, when enforcement staff are deciding whether to open an investigation, they consider whether the misconduct "affect[s] the fairness or liquidity of the U.S. securities markets," or "involve[s] a

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[245] John C. Coffee, Jr., *In the Wake of the Whale, What's Changed?*, THE CLS BLUE (Oct. 10, 2013), http://clsbluesky.law.columbia.edu/2013/10/10/in-the-wake-of-the-whale-whats-changed/; *see* Brian Lewis ET AL., *Securities Fraud*, 52 AM. CRIM. L. REV. 1567, 1640 (2015); *see also* Paul Radvany, *The SEC Adds a New Weapon: How Does The New Admission Requirement Change The Landscape?*, 15 CARDOZO J. CONFLICT RESOL. 665, 698 (2014) (former deputy chief of the SDNY Criminal Securities Fraud Unit explained that "it is not the SEC's role to attempt to obtain admissions solely to help private litigants in ongoing or subsequent actions").

[246] *See generally* Engstrom, *supra* note 2, at 647–48.

possibly widespread industry practice that should be addressed."[247] The manual also requires the Director of Enforcement to prioritize cases that, inter alia, involve misconduct "in connection with products, markets, transactions or practices that pose particularly significant risks for investors or a systemically important sector of the market."[248] The U.S. Justice Manual (f.k.a. the U.S. Attorneys' Manual) requires federal prosecutors considering charges against a corporation to consider "collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable."[249]

Similarly, my proposal is not unique in that it may lead agencies to decline to pursue certain winnable cases. Such decisions by enforcers to drop winnable cases are already ubiquitous. For many law enforcers, the number and scope of violations vastly outstrip the resources available to investigate and prosecute cases. Accordingly, these agencies are forced to set priorities—i.e., decisions about which cases to prosecute and which to ignore. As to the inverse criticism—the idea that agencies may pursue unsupported allegations based on the hopes of catalyzing profitable private litigation—this is already flatly prohibited by other internal and external constraints on enforcers.[250]

Some may object: why stop at calling for agencies to consider private litigation arising under the same statutes? Why not demand that agencies consider other forms of litigation—or other types of collateral consequences? The answer is: Unlike these other collateral consequences, the special subset of private enforcement is *part* of the regulatory regime that the agency is charged with administering. In some cases, the agency actually *promulgated* the regulations that private parties are relying on to bring private class actions. In other cases, the agency has been vested by Congress with the responsibility to enforce certain statutory regime that plaintiffs are also using. Either way, there is a stronger case for agency

[247] SEC DIVISION OF ENFORCEMENT: ENFORCEMENT MANUAL § 2.3.2 (U.S. Securities and Exchange Commission, 2017).

[248] Id. § 2.1.1.

[249] Justice Manual § 9-28.300 (U.S. Department of Justice, 2018) https://www.justice.gov/jm/title-9-criminal.

[250] Internal constraints include supervision, codes of conduct, and internal discipline. External constraints include the availability of judicial review for defendants facing unsupported charges, reputational costs for the individual and for the agency for pursuing frivolous, Congressional oversight, and legal ethics bodies.

responsibility over this subset of private enforcement actions than any other type of private litigation that the agency's actions happen to catalyze. There is also a cost/benefit justification for limiting consideration to piggyback litigation rather than other collateral consequences. In an ideal world, enforcers would have perfect information regarding the full scope of consequences of their actions. But there are costs associated with information collection, and the costs are likely to be substantially higher outside of the agency's area of expertise. An SEC enforcement official should be able to evaluate whether a securities class action helps or hinders the agency's core missions of investor protection and capital formation—but may have more difficulty doing so with regard to a consumer or antitrust class action. Certainly, there could be some value in tracking "piggybacking" across the federal government or across multiple governments. But that would require complex coordination across agencies and governments. One appeal of the argument here is that it would be very easy to implement.

2. How Agency Enforcers Can Consider The "Piggyback" Effect

Enforcement agencies whose activities regularly give rise to "piggyback" private litigation arising under the same statutes or regulations should consider these impacts in the course of formulating enforcement policy. Such consideration may be disaggregated into four steps. First, the agency must ***evaluate*** "piggyback" litigation to determine whether it furthers or hinders the agency's policy objectives. Second, the agency must ***predict*** the impact of its activities on "piggyback" litigation. Third, the agency must ***internalize*** the prospective benefits and harms of the coattails litigation. Fourth, and finally, the agency must ***implement*** the judgments and assessments developed into actual enforcement practice.

i. Evaluate

The agency must ***evaluate*** the "piggyback" litigation it might catalyze, determining whether this litigation promotes or undermines the agency's own policy agenda. In some cases, the evaluation may be categorical—i.e., the agency may adopt the view that all private litigation under its statutes and regulations is presumptively beneficial. But, more often, the evaluation will call for more nuanced determinations. Some types of private claims may be socially valuable, while others not—based on: the nature of the underlying misconduct, the remedies sought, the type of defendant,

number of victims, the nature of remedial efforts already undertaken, the likelihood of reoffending, the scope of the harm imposed, the existence of other parallel enforcement or regulatory actions, the likelihood that the action will result in compensating victims, and other factors.[251]

Sorting "good" and "bad" piggybacking is a complex task and these discretionary judgments will often be subject to debate. But these types of decisions are well within agencies' expertise and authority. Decisions about which cases to prioritize are ubiquitous in a world where the amount of potential violations vastly outstrips the resources available to prosecute these violations. For instance, pursuant to the SEC Enforcement Manual, when SEC attorneys have identified a possible serious violation of the federal securities, before opening a formal investigation into the matter, they must consider, inter alia, "the magnitude or nature of the violation," the "size of the victim group," "the amount of potential or actual losses to investors," whether the case involves a "recidivist," fulfills "a programmatic goal" of the agency, involves a "possibly widespread industry practice that should be addressed" or gives the agency "an opportunity to be visible in a community that might not otherwise be familiar with the SEC or the protections afforded by the securities laws."[252] Setting enforcement priorities is a complex business. Choosing which private actions (arising under the agency's own statutes and regulations) to catalyze and not catalyze is an extension of the same function.

As a matter of institutional design, the evaluation may be done at any level of the agency—or, likely, by some combination of multiple levels. For instance, agency leaders might decide to set out

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[251] For instance, in the realm of securities litigation, defense lawyers and allies have expressed skepticism regarding so-called "event-driven" securities class actions, as compared to financial-fraud-driven securities class actions. *E.g.*, Andrew J. Pincus, U.S. Chamber Institute for Legal Reform, A Rising Threat: The New Class Action Racket That Harms Investors and the Economy 1, 6 (Oct. 2018); *see* Michael S. Flynn ET Al., *Regulators Join in Event-Driven Securities Litigation*, HARVARD LAW FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Apr. 13, 2019), https://corpgov.law.harvard.edu/2019/04/13/regulators-join-in-event-driven-securities-litigation/. (defense lawyers critique of SEC's case against VW). *But see* Julie G. Reiser & Steven J. Toll, *Event-Driven Litigation Defense*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (May 23, 2019), https://corpgov.law.harvard.edu/2019/05/23/event-driven-litigation-defense/ (citing plaintiffs' lawyers challenge of the appellation and the critique).

[252] *See supra* note 247.

a policy or manual listing factors that line-attorneys should consider, along with other factors.

ii. Predict

To make informed decisions about the downstream impact of its enforcement actions, the agency must develop the capacity to ***reasonably predict*** this impact. One part of this is programmatically collecting relevant data on how the agency's activities have impacted private litigation. At a minimum, agencies should track the incidence and results of all "piggyback" litigation and the direct use of agency enforcement materials in such litigation by plaintiffs and courts. This is well within the agency's capacity. Agencies already compile and analyze various data on their enforcement activities. In some cases, agencies are required to report these data to Congress.[253] This proposal requires that agencies simply expand their data collection efforts to encompass a more complete picture of their enforcement impact.

Agencies may find it beneficial to collaborate with scholars and third-party research firms to help "match" the past public enforcement activity with private litigation. Agencies also may find it useful to engage with the plaintiffs' bar in the relevant area to learn about their practices—what plaintiffs look for, what will trigger their actions, etc.

In many cases, the data will yield some reasonably strong probabilistic guidance regarding what the downstream private litigation impact of certain enforcement activities will be, and the agencies should consider this information as part of their enforcement calculus. In some cases, the data may not be strong enough to support a reasonably certain prediction regarding the impact of an enforcement action on private litigation.[254] If so, then the agency may proceed without considering the impact. But the threshold for consideration is not complete certainty. In other contexts, enforcers are often forced to make decisions based on missing or incomplete information. For instance, the SEC generally considers the plans of other public enforcers (state, federal, foreign) when contemplating enforcement actions, but is sometimes forced to decide whether to proceed without a full picture of what these other actors will do.

[253] *See* Velikonja, *supra* note 14, at 906.

[254] Andrew C. Whitman, *Comment*, AM. CRIM. L. REV. (Mar. 4, 2015).

Regarding the challenge of collecting and processing information, consider the recent efforts of prosecutors across the country to study the scope of collateral consequences imposed on individuals subject to the criminal justice system. For instance, in Boston, District Attorney Rachel Rollins launched an effort (in coordination with Harvard Law School's Criminal Justice Policy Program) to "map some of the thousands of collateral consequences that flow from system involvement," in order to inform prosecutorial decisionmaking.[255] If prosecutors can do this with the sprawling extra-systemic collateral consequences, then surely agencies can be expected to track the incidence of "piggyback" litigation arising under their own statutes and regulations. Further, many agencies have dedicated departments for data analysis—for instance, the SEC's Division of Economic and Risk Analysis was created in 2009 to "integrate financial economics and rigorous data analytics into the core mission of the SEC."[256]

Many predictions regarding the impact of public enforcement decisions on private litigation can be made without sophisticated data collection or analysis. For instance, when the SEC considers requiring a defendant to *admit* to specific wrongdoing in a case where there is already a pending private class action based on the same alleged acts, it can be relatively confident that requiring such an admission will *boost* the private litigation. Similarly, when the SEC is considering whether to settle a case based on negligence-based or intent-based offenses, it can be confident that the latter option will provide stronger support for a private class action, which are only available for intent-based offenses.[257]

iii. Internalize

Finally, the agency must ***internalize*** the prospective impact its enforcement decisions may have on "piggyback" litigation. In deciding whether to take an enforcement action, the agency should evaluate the ***total*** impact, including both direct (public) and indirect (private).

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[255] THE RACHEL ROLLINS POLICY MEMO 1, 18 (Mar. 25, 2019), http://files.suffolkdistrictattorney.com/The-Rachael-Rollins-Policy-Memo.pdf.

[256] *See* U.S. Securities and Exchange Commission, https://www.sec.gov/dera. (last visited Oct. 11, 2019); J.W. Verret, *Economic Analysis in Securities Enforcement: The Next Frontier at the SEC,* 82 U. CIN. L. REV. 491, 491 (2013) (arguing DERA should run economic analysis of SEC enforcement decisions).

[257] *Infra* Part III.B.2.

Where the agency views the prospective private litigation as socially productive, and thus an "ally" of the public enforcement effort, it must think in terms of "marginal advantage" to determine what steps it should take to help that litigation along in order to reach optimal enforcement outcomes, and which steps it can leave to the private litigator to pursue in a more cost-effective manner to reallocate those scarce public enforcement resources toward other targets.

Where the agency views the prospective private litigation as socially harmful, it must decide whether the net social benefits that will be achieved by its own action is still worth pursuing.

The key is that the agency should be indifferent as to the source of the social benefit. If the agency determines that the optimal sanction in a case is $100, then (all else equal) it should be indifferent as to whether this sanction is imposed via public enforcement, private litigation, or some combination.[258]

The calculation may also include consideration for other factors, such as the amount of compensation received by victims or the transaction costs. The point is that, holding all else equal, the agency should not have an arbitrary preference for public enforcement (or vice versa).

Critically, incorporating the target's assessment of these consequences (as in the context of negotiating a settlement) is not a substitute.[259] A company facing a risk of "piggyback" litigation will factor that risk that into its settlement negotiations with an agency. But an agency that fails to internalize the social benefit provided by "piggyback" litigation is likely to under-value it in settlement negotiations and may be willing to trade away more valuable private

[258] Here and throughout, I am using "social benefit" in a capacious sense rather than an economically rigorous one, encompassing any value the agency may want to pursue. For instance, if the agency's goal is to maximize victim compensation, it should make decisions designed to maximize this compensation without regard to what source it is derived from. If the agency has certain distributive priorities, it could factor those priorities into the compensation. Similarly, the agency may also factor into its calculus any "corrective justice" benefits associated with remedies obtained through private rights of action.

[259] *Cf.* Eisha Jain, *Prosecuting Collateral Consequences*, 104 GEO. L.J. 1197, 1226 (2016) (discussing the "Counterbalancing" model of prosecuting collateral consequences, whereby the prosecutor leverages the defendant's preference to avoid a collateral consequence in order to extract a plea bargain); Erichson, *supra* note 12, at 29.

litigation effects in exchange for less valuable public enforcement effects.[260]

For instance, imagine a case in which the optimal sanction against the target is $100. Under Settlement A, the Public Enforcer obtains a penalty of $80, and no private litigation is expected to be catalyzed. Under Settlement B, the Public Enforcer obtains a penalty of $50, and private litigation is expected to be catalyzed against the same target with an expected settlement of $50.[261] The target will prefer Settlement A, since it will prefer to pay $80 rather than $100. A public enforcer that internalizes the preferences of the target and agrees to Settlement A has, in some sense, accounted for the private litigation consequences of the decision by incorporating the target's own preferences. But the public enforcer who chooses Settlement A has not complied with its responsibility to consider the effects of private litigation because it has not internalized the *social* benefits provided by private litigation.

Enforcers already internalize the benefits and costs of a range of collateral consequences. For instance, the U.S. Attorney's Manual instructs that, in investigating, charging, and negotiating settlements with corporate defendants, prosecutors "should" consider "collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution."[262] Boston District Attorney Rachel Rollins recently instructed her staff to "carefully consider, and factor into all case decisions, potential collateral consequences and harms that may arise at any point along the spectrum of system involvement."[263] These consequences are far more remote from the core mission of

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[260] *See* Samuel W. Buell, *Liability and Admissions of Wrongdoing in Public Enforcement of Law*, 82 U. CIN. L. REV. 505, 517–18 (2013) (suggesting it is "highly unlikely" that the SEC is "getting the cost benefit analysis right" with the "sometimes too clubby securities bar" regarding when to push for admissions in settlements).

[261] For example, under Scenario A, the SEC may obtain a higher penalty in exchange for dropping the charges to a negligence-based offense (which will not be helpful to private plaintiffs), while under Scenario B, the SEC obtains a smaller penalty but gets the defendant agree to settle the case on intent-based charges (which will be more helpful to these plaintiffs).

[262] Justice Manual § 9-28.300 (U.S. Department of Justice, 2018) https://www.justice.gov/jm/title-9-criminal; *see also* Justice Manual § 9-28.11000 (prosecutors "may" consider collateral consequences and laying out guidelines).

[263] *See* ROLLINS MEMO, *supra* note 255, at 18.

the agency/prosecutor than private litigation against the same target under the same statutes/regulations for the same conduct.

And the defense bar also increasingly thinks globally. The proliferation of "crisis management" practice groups among the upper echelons of litigation firms market themselves as providing global advice and litigation management services to companies following a corporate crisis or scandal—not just one enforcement action or case at a time.

iv. Implement

The fourth and final step is for the agency to translate the assessments and judgments reached through the preceding steps into actual enforcement practice. There are several ways an agency may direct its enforcement efforts to channel—i.e., increase or decrease—the flow of private litigation. The institutional context of each agency will vary, but the following represents a (non-exhaustive) list of some techniques available to enforcers to dial-up or dial-down the private litigation consequences of their enforcement activities.

Target Identification—Launching an investigation or enforcement action may provide an important signal to potential plaintiffs that there is a potentially profitable private case. Accordingly, public enforcers may influence private litigation by deciding who to target, when to launch the case, and whether to disclose and/or publicize the activity.[264]

Facts—Piggybacking suits rely on factual allegations included in complaints and settlements, as well as other factual evidence produced in the course of public enforcement efforts. Accordingly, public enforcers may influence private litigation by deciding what facts to include or not include and how broadly to disclose various evidence.[265]

For instance, in negotiating a settlement with a target who faces ongoing parallel private litigation, enforcers and targets often negotiate what specific factual allegations will be included in the

[264] *E.g.*, Erichson, *supra* note 12, at 6 ("a government lawsuit or investigation may simply give lawyers or litigants the idea for the private suit, or spur to action those who had been considering such a suit").

[265] *E.g.*, Erichson, *supra* note 12, at 6 ("Government litigation may generate documentary discovery or other information that private litigants use in their lawsuits.").

final, public settlement document. The target, fearing downstream "piggyback" effects, may resist efforts to include more inculpating allegations. The public enforcer faces a choice between including these allegations (and assisting the private litigation) and leaving them out in exchange for some other concessions from the target. [266]

Legal Claims—Similarly, agency enforcers may have a choice of what legal charges to pursue or settle—some of which may give rise to parallel private claims, some not.

For instance, in negotiating a settlement with a target who faces ongoing parallel private litigation, enforcers may face a choice between charging an offense that helps private litigants or excluding that charge and extracting an extra concession from the target.

Admissions—Agency enforcers may have a choice of whether to seek an admission from a target and what type of admission to seek. Some of these may be highly useful to private litigations—others not so much.

For instance, in negotiating a settlement with a target who faces ongoing parallel private litigation, enforcers may face a choice between demanding an admission on a key point that helps private litigants or dropping that admission and extracting an extra concession from the target.

Issue Preclusion—If a case is "actually" litigated, and the government prevails, the private parties may benefit from offensive collateral estoppel.[267]

III. How to Shine a Light on Litigation Gatekeeping by the SEC and Other Public Enforcers

When agencies like SEC fail to consider the piggyback litigation that their activities generate, they are failing in their duties as public enforcers. This part presents a few reforms to bring this important gatekeeping function into the light.

A. Reporting Agency Performance

[266] *But see* Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, 65 J. Fin. 2213 (2010) (showing that many of the key facts giving rise to fraud enforcement come from non-governmental sources like corporate employees, journalists, and others).

[267] *See* Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 330 (1979).

The single most important reform to improve agency practices with regard to piggyback litigation would be for agencies like SEC to begin including, in their reports to Congress, an account of the piggyback effect associated with their enforcement activities. [268] Indeed, even if one disagreed with the first 60 pages of this paper, one might still agree that this is a good idea. The agencies could do this voluntarily. Or Congress could demand it in oversight hearings, or (if necessary) by amending the relevant reporting statutes.[269] Currently, for instance, SEC reports on the number of Enforcement Actions commenced (and in what categories), the value of penalties and disgorgements obtained, and the number and percentage of companies reviewed by CorpFin; but provides no information regarding the impact of these activities on the flow of private litigation. The agency should begin systematically tracking and disclosing information relevant to assessing the piggyback effect, including the class action complaints that rely on comment letters, SEC Complaints or settlements, judicial decisions relying on the same, and the private settlements in cases against parties also facing a parallel SEC action. Once the SEC begins "owning" this piggyback effect as part of its enforcement footprint, this will kick off a productive debate regarding how SEC should calibrate its various programs and policies to produce the optimal level of piggyback litigation

B. SEC Enforcement

The Enforcement Division needs to develop the capacity to systematically predict and collect relevant data regarding "piggyback" consequences. It may work with existing databases or scholarly efforts already underway. This may also include ongoing consultations with the plaintiffs' bar to develop expertise in making these assessments. The Enforcement Manual, the admissions policy, and all other policies regarding the conduct of enforcement matters should be revised so that, among the various considerations to be weighed by Enforcement staff in considering whether to

[268] Other commentators have scrutinized SEC's enforcement statistics and called for different reforms. *E.g.*, Velikonja, *Reporting*, *supra* note _; Platt, *Unstacking*, *supra* note _; U.S. GAO, SEC Report (Oct. 2019).

[269] *See* 15 U.S.C. § 78w(b)(1) (2012) (requiring SEC, the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to report "whatever information, data, and recommendations for further legislation" that "it considers advisable with regard to matters within its respective jurisdiction"); *see also* Velikonja, *Reporting*, *supra* note 14, at 912–15 (discussing other statutory reporting requirements).

pursue an investigation, enforcement action or settlement, the "piggyback" consequences, are included. And, to aid in implementation of the foregoing, the Enforcement Director should promulgate guidance listing factors to help determine whether (a) a given enforcement action is likely to produce a "piggyback" effect; and (b) whether the "piggyback" effect is good or bad. This guidance is likely to generate substantial debate and should be formulated after broad consultation. It would be subject to change—just as the SEC's enforcement priorities are subject to change—particularly when leadership of the agency changes over. Having a policy in place, set by the agency's leadership, would give enforcement staff the guidance they need to begin to take into account the "piggyback" effects of their activities.

C. SEC CorpFin

CorpFin should adopt new guidance requiring written materiality determinations in every case where they reject the target corporation's (non)materiality determination. Phone is a valuable way for CorpFin and targets to communicate, and it is certainly wise for the agency to try to foster this type of open communication as a mechanism to improve the quality of firm disclosure. But when CorpFin has identified a material misstatement or omission in a prior disclosure, it should not use the phone as a mechanism to avoid a paper trail of materiality that is usable in private litigation. If the agency is going to adopt a position that an issuer's prior disclosures are materially misleading, it should document that position in writing. If the agency wants to minimize piggyback litigation, it should do so transparently—by adjusting downward the substantive standards for materiality—not by hiding its materiality determinations from the public.

Another possible reform that would promote *more* piggybacking would be to change the composition of CorpFin's staff. Currently, CorpFin is staffed exclusively by accountants and lawyers. But the "materiality" determinations they make are intended to be from the perspective of a "reasonable investor"—not a reasonable lawyer or accountant. Indeed, some courts have excluded non-investor "experts" who wanted to testify on materiality because only investors are eligible to testify on this subject. CorpFin could bring in some experienced investors to sit (alongside accountants and lawyers) on "materiality panels" to resolve contested issues at the end of the comment letter process. This would include assessing the nonmateriality determinations that are submitted by companies.

There is already a quasi "appeal" process for issuers dissatisfied with their initial examiner's views on various issues. The "materiality panel" would be part of this process.

CONCLUSION

Private litigation that "piggybacks" on the efforts of administrative enforcement is an important part of the enforcement landscape—in securities regulation and beyond. I have argued that, when agencies consider taking enforcement actions that may trigger piggyback litigation, they should recognize the potential piggyback effect as part of the regulatory regime they are charged with implementing and incorporate this effect into their enforcement decisionmaking. Agencies should be doing more to catalyze socially valuable private litigation, and to avoid catalyzing socially harmful private litigation. This proposal does not call for any expansion in agency power over private litigation, but rather for greater rationality and accountability in how agencies exercise their existing power. It is time for administrative enforcers to take responsibility for their effects on private enforcement.