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

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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 have significant impacts on the flow of private litigation, the agency denies that it 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 integrate consideration of the "piggyback" effect 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 systematically incorporating the "piggyback" effect into its enforcement decisionmaking.

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INTRODUCTION

For thirty years, leading securities regulation scholars have called for expanding the Securities and Exchange Commission's (SEC's) 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 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 centralized bureaucratic control.[5] Centralizing enforcement authority might sacrifice

1. 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*, 60 L. & CONTEMP. PROBS. 167, 200 (1997); Alicia Davis Evans, *The Investor Compensation Fund*, 33 J. CORP. L. 223, 241–47 (2007); Jennifer Arlen, *Public Versus Private Enforcement of Securities Fraud* 44–47 (2007), 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. *E.g.*, Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1 (2003); Jonathan R. Macey, *The Distorting Incentives 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); Urška Velikonja, *Politics in Securities Enforcement*, 50 GA. L. REV. 17, 18 (2015); *see also infra* Part I.A.3.

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

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 the SEC's 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 20% 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 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 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

6. 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.

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 infra* Part II.A.1.

12. *E.g.*, Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285,

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 "piggybacking" effects of the agency's activities. Accordingly, they present a woefully incomplete and misleading portrait of the agency's 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 the SEC to make better and more explicit use of its existing authority and capacity to perform this function.[16]

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286 (2016); 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); Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 157–58 (2006); *see also infra* Part II.A.2.

13. *See infra* Part II.A.3.

14. *See* Urška Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 909 (2016); U.S. GOV'T ACCOUNTABILITY OFF., GAO-20-47, REPORT TO CONGRESSIONAL REQUESTERS: SECURITIES AND EXCHANGE COMMISSION DIVISION OF ENFORCEMENT SHOULD DOCUMENT ITS PROCEDURES FOR GENERATING PUBLIC REPORTS (2019).

15. *Infra* Part III.A.

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

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

Fourth, although the "piggyback" effect is well-known in the context of the 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

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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 285–86; Gilles & Friedman, *supra* note 12, at 107.

19. *See, e.g.*, Kate Andrias, *The President's Enforcement Power*, 88 N.Y.U. L. REV. 1031, 1031, 1035 (2013); 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); Urška Velikonja, *Accountability for Nonenforcement*, 93 NOTRE DAME L. REV. 1549, 1550 (2018).

20. *See 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 Securities and Exchange Commission (SEC) regulatory technique—"no-action" letters).

22. *Infra* Part I.C.

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.

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 SEC's authority over private securities fraud litigation.[23] But 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 systematically factor this private litigation into their enforcement decisionmaking. 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 each 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

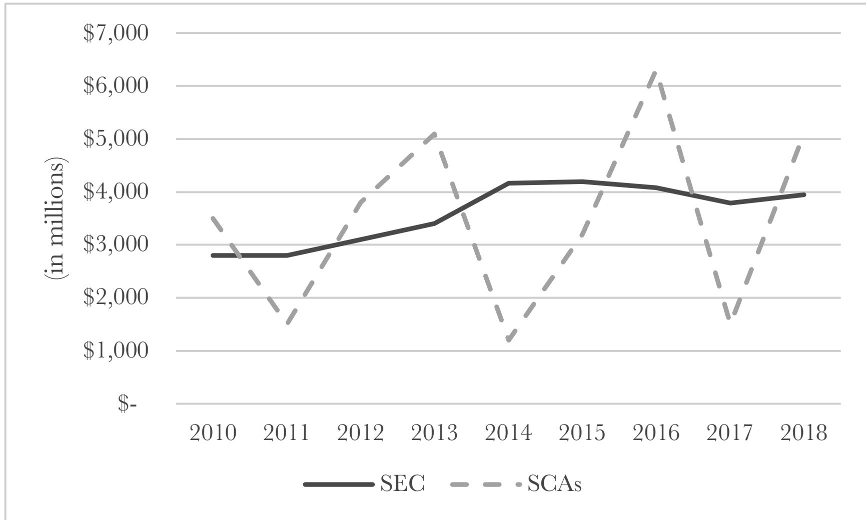
SEC Enforcement and private securities class actions (SCAs) each comprise a significant part of the securities enforcement landscape. The value of settlements produced in SCAs is comparable to the penalty and disgorgement orders obtained by the SEC.[24] Between 2010 and 2018, SCA settlements

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

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

totaled $31 billion,[25] only $1 billion less than the penalties and disgorgement that the SEC won during the same time period.[26] Figure 1 maps the annual SCA settlements against annual SEC penalties and disgorgement orders.[27]

Figure 1 - Recoveries[28]



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

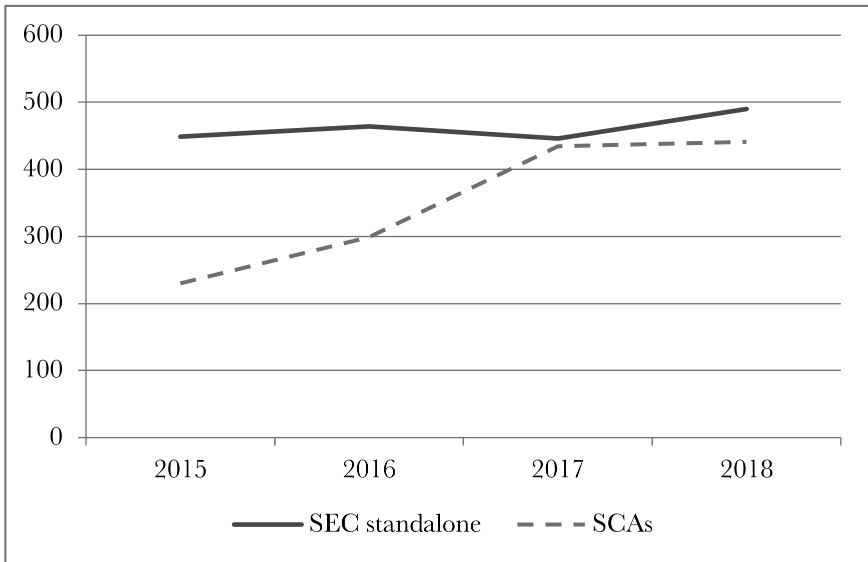
26. This figure comes from the SEC's Annual Reports, available at https://www.sec.gov/reports. The billions in penalties and disgorgement that the SEC recovered from 2010 and 2018 is approximately $32.06 billion. *See* SEC FY 2010 PERFORMANCE AND ACCOUNTABILITY REPORT 11 (2010); SEC FY 2011 PERFORMANCE AND ACCOUNTABILITY REPORT 13 (2011); SEC FISCAL YEAR 2012 AGENCY FINANCIAL REPORT 13 (2012); SEC FISCAL YEAR 2013 AGENCY FINANCIAL REPORT 2 (2013); SEC FISCAL YEAR 2014 FINANCIAL REPORT FISCAL YEAR 2014 19 (2014); SEC AGENCY FINANCIAL REPORT FISCAL YEAR 2015 2 (2015); SEC AGENCY FINANCIAL REPORT FISCAL YEAR 2016 ii (2016); SEC AGENCY FINANCIAL REPORT FISCAL YEAR 2017 3 (2017); SEC AGENCY FINANCIAL REPORT FISCAL YEAR 2018 5 (2018), *available at* https://www.sec.gov/reports?aId=edit-field-article-sub-type-secart-value&year=All &field_article_sub_type_secart_value=Reports+and+Publications-AnnualReports&tid=All (last visited Nov. 23, 2019) [hereinafter SEC Annual Reports 2010–2018].

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

28. Sources: 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. 2019); SEC Annual Reports 2010–2018, *supra* note 26, at 11 (2010), 13 (2011), 13 (2012), 2 (2013), 19 (2014), 2 (2015), ii (2016), 3 (2017), and 5 (2018).

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.

Figure 2 - Volume Of Filings[30]



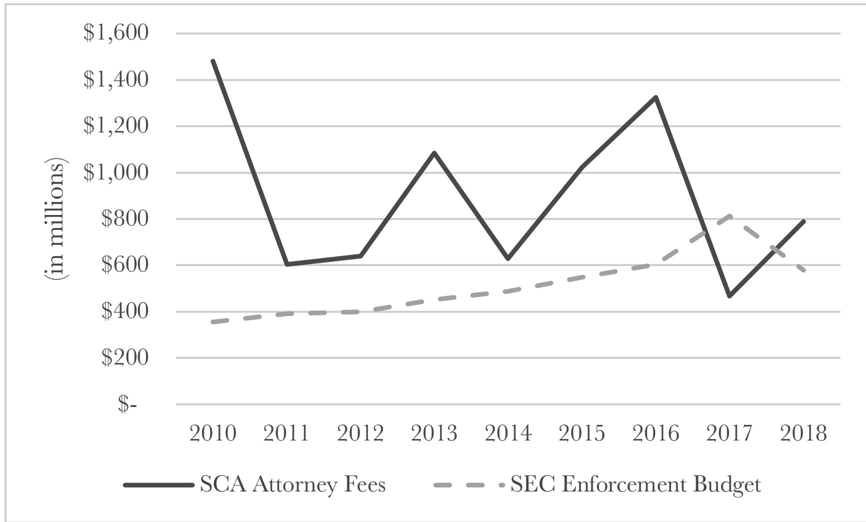
Both SCAs and SEC enforcement impose substantial litigation costs. The attorneys' fees and expenses for SCAs average about 24% of the total award in each case.[31] Figure 3 shows that the attorneys' fees awarded in SCAs is comparable to the SEC's enforcement budget.

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

30. Sources: Boettrich & Starykh, *supra* note 28, at 2–3, 5; SEC ANNUAL REPORTS: DIVISION OF ENFORCEMENT 9 (2018), *available at* www.sec.gov/reports (last visited Nov. 21, 2019).

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

Figure 3 – Litigation Costs[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 settlements, critics charge, amount to one group of innocent

32. Sources: Boettrich & Starykh, *supra* note 28, at 42; SEC Annual Reports 2010–2018, *supra* note 26, at 83 (2010), 125 (2011), 65 (2012), 65 (2013), 75 (2014), 69 (2015), 70 (2016), 65 (2017), and 59 (2018). This does not come close to capturing the full litigation costs associated with either form of enforcement. For instance, neither line includes the amount spent by defendants in defending or litigating the action, judges in adjudicating them, or firms on compliance costs in order to avoid liability.

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"); Rose, *Restructuring*, *supra* note 1, at 1302–03, 1321 (suggesting that "most commentators" agree that the fraud-on-the-market (FOTM) SCAs "cannot be defended on compensatory grounds" and does not provide optimal deterrence); 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 SCAs neither deter fraud nor compensate injured investors).

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

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] 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] Further, because many shareholders in the class

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FOREST L. REV. 627, 629 (2007) ("[S]cholars from across the ideological spectrum have now joined the doubters of enterprise liability, at least with respect to private securities litigation."). But, although private SCAs frequently name one or more corporate director or officer in addition to the company itself, these individuals are almost never ultimately forced to make direct, out-of-pocket contributions 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 (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.*, 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); 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).

36. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 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. Langevoort, *Capping*, *supra* note 35, at 652.

39. Langevoort, *Capping*, *supra* note 35, at 652.

40. Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc., 552 U.S. 148, 164 (2008) (warning that FOTM SCAs "may 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 (last visited Jan. 20, 2020).

41. *See* Boettrich & Starykh, *supra* note 28, at 35 (estimating that the median ration of settlement to investor losses has hovered at around 2% for the last decade); 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

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 pay and responsibilities, and fewer board appointments.[45] This suggests that private securities litigation *does* contribute to deterrence. Further, researchers have also found that the firms

("[T]he compensatory system has relatively few informed, non-self serving defenders."); Rose, *Restructuring*, *supra* note 1, at 1312–14. *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 (describing pocket shifting in Rule 10b-5 litigation). Worse, these current shareholders also bear the cost of litigation (e.g., attorneys' fees), the higher Directors & Officers (D&O) insurance premiums, and various reputational harms the company suffers through the suit. Coffee, *Reforming*, *supra* note 35, 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). *But see* 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 372–74; Langevoort, *Capping*, *supra* note 35, at 646; Rose, *Restructuring*, *supra* note 1, at 1313.

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 direc-

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

3. *Scholarly Proposals to Expand SEC Control Over SCAs*

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

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tors 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 Institutional Shareholder Services (ISS) voting recommendations); Mark L. Humphery-Jenner, *Internal and External Discipline Following Securities Class Actions*, 21 J. FIN. INTERMEDIATION 151, 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. 1453, 1475-76 (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. ACCT. RES. 2030, 2032 (2018) (finding that the threat of SCAs improves firm disclosure); *see also* Platt, *Index Fund Enforcement*, *supra* note 45, at 1476-78 (surveying this literature).

47. *See* Thomas A. Dubbs, *A Scotch Verdict on "Circularity" and Other Issues*, 2009 WISC. L. REV. 455, 457–60 (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* 4–7 (U. Mich. L. & Econ. Olin, Working Paper No. 09-002, 2015), https://ssrn.com/abstract=1121198.

48. *See* James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323, 324–27 (2009); Spindler, *supra* note 33, at 101.

49. *See* Engstrom, *supra* note 2, at 619–22 (discussing the "[r]ecurrent, but largely unanalyzed, calls to vest the Securities and Exchange Commission (SEC) with gatekeeper power over securities class actions").

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 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

50. *See* Alexander, *supra* note 1, at 1514 ("Replacing the compensatory damages rule with a regulatory sanction would require legislation.").

51. *See* Alexander, *supra* note 1, at 1489, 1515–17 & n.133.

52. *See* Alexander, *supra* note 1, at 1517.

53. *See* Alexander, *supra* note 1, at 1517.

54. *See* Alexander, *supra* note 1, at 1515.

55. Fisch, *supra* note 1, at 200.

56. Fisch, *supra* note 1, at 200.

57. Fisch, *supra* note 1, at 200.

58. Fisch, *supra* note 1, at 200.

59. *See* Evans, *supra* note 1, at 241, 247–48 (arguing that the current system undercompensates victims and does not deter fraud).

60. *See* Evans, *supra* note 1, at 246.

61. *See* Evans, *supra* note 1, at 246–47.

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]

Amanda Rose proposed that Congress grant the SEC an "oversight" function over private litigation.[67] 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 the 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] 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

62. *See* Evans, *supra* note 1, at 241–42.

63. *See* Evans, *supra* note 1, at 242–43.

64. *See* Evans, *supra* note 1, 242–44.

65. Arlen, *supra* note 1, at 44–47.

66. Arlen, *supra* note 1, at 47.

67. Rose, *Restructuring*, *supra* note 1, at 1354–55 n.241 (suggesting that legislation would "likely" be required for her proposal).

68. Rose, *Restructuring*, *supra* note 1, at 1306.

69. Rose, *Restructuring*, *supra* note 1, at 1354.

70. *See* Rose, *Restructuring*, *supra* note 1, at 1354 n.240.

71. Rose, *Restructuring*, *supra* note 1,at 1354.

72. Rose, *Restructuring*, *supra* note 1, at 1356–57 (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").

"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 and 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) 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

73. Rose, *Restructuring*, *supra* note 1, at 1357.

74. Rose, *Restructuring*, *supra* note 1, 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 SCAs 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. ONLINE 87, 96 (2011).

76. *E.g.*, Fisch, *Qui Tam*, *supra* note 1, at 198–99 ("piggyback" litigation can "waste resources . . . [,] undercut government compliance efforts . . . [,] risk overdeterrence . . . [,] lead[] to confusion . . . [, and] reduce[] the transparency of the system."); Rose, *Restructuring*, *supra* note 1, at 1347 (noting the "coordination" problems of the current system in which "[p]rivate 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"); Rose, *Restructuring*, *supra* note 1, at 1355 (describing the virtue of her proposal as ensuring private enforcement "truly 'supplement' the Commission's efforts rather than duplicate or frustrate them").

77. 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 infra* 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'").

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 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

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80. *See* Park, *supra* note 48, at 323–24; *see also* James J. Park & Howard H. Park, *Regulation by Selective Enforcement: The SEC and Initial Coin Offerings*, WASH. J.L. & POL'Y 3 (describing how the SEC's "selective enforcement" approach to Initial Coin Offerings (ICOs) was enabled, in part, by the fact that private parties have their own "powerful remedies" which allowed the SEC to "[d]evote 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"); 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 Administrative Procedure Act (APA)); 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").

82. *E.g.*, 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 some new concerns of agency capture); Ed deHaan et al., *The Revolving Door and the SEC's Enforcement Outcomes: Initial Evidence from Civil Litigation*, 60 J. ACCT. & ECON. 65 (2015) (finding evidence that DC-based SEC lawyers go easier on targets to curry favor with potential employers at private law firms); Alexander I. Platt, *The Non-Revolving Door: New Evidence of Capture at the SEC* (working paper) (finding that SEC attorneys almost never choose to enter the plaintiffs' bar following their government service and suggesting this may be evidence of "cultural capture"). *But see* David Zaring, *Against Being Against the Revolving Door*, 2014 U. ILL. L. REV. 507 (2013).

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]

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For several decades, scholarly critics of the SCA regime have proposed granting the 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 Enforcement Division 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,

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 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 (2012); 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. 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)); Urška Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 339–43, 365 & n.176 (2015).

84. U.S. SEC. & EXCH. COMM'N, DIVISION OF ENFORCEMENT, ANN. REP. 2018, at 6.

85. U.S. SEC. & EXCH. COMM'N, Division of Enforcement, *Enforcement Manual* § 2.3.1 (Nov. 28, 2017).

state and federal regulatory 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]

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 memorandum" setting forth the "factual and legal" basis for the proposed charges.[93] The SEC then votes on

86. *Id.*; *How Investigations Work*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/enforce/how-investigations-work.html (last modified Jan. 27, 2017).

87. *E.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors (Feb. 12, 2018), https://www.sec.gov/news/press-release/2018-15; *Municipalities Continuing Disclosure Cooperation Initiative*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

88. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.2.

89. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.2.

90. U.S. SEC. & EXCH. COMM'N, *How Investigations Work*, *supra* note 86.

91. U.S. SEC. & EXCH. COMM'N, *How Investigations Work*, *supra* note 86; 17 C.F.R. § 202.5(c) (2019).

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.").

93. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.5.1.

whether to authorize the proceedings.[94] When this is completed, the SEC presents their findings along with a recommendation regarding whether to pursue charges to the Commission.[95]

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.[96] In these cases, the Enforcement Division negotiates the settlement during the investigation and Wells process, and then submits it to the Commission for approval.[97] The Division has authority to proceed in administrative proceedings or in civil court actions.[98] 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.[99]

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 penalties; and disgorgements.[100] In some cases, the Division returns funds obtained from targets to the injured investors through the mechanism of a Fair Fund.[101] 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.[102] The

94. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.5.2.1.

95. U.S. SEC. & EXCH. COMM'N, *How Investigations Work*, supra note 86.

96. 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").

97. *Id.* at 126.

98. U.S. SEC. & EXCH. COMM'N, *How Investigations Work*, *supra* note 86. In 2015, the agency issued some guidance setting forth considerations for choosing between a federal court or administrative forum. U.S. SEC. & EXCH. COMM'N, *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. LAW. 1, 6–9 (2016).

99. Velikonja, *Shadows*, *supra* note 96, at 128.

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

101. Velikonja, *Public Compensation*, *supra* note 83, at 333, 341.

102. *E.g.*, Jayne W. Barnard, *Corporate Therapeutics at the Securities and Exchange Commission*,

Division also makes referrals for criminal prosecution to the U.S. Department of Justice (DOJ).[103]

The Division's jurisdiction is vast.[104] 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, hedge funds, and municipal securities issuers; and the prohibition on bribery of foreign governments.[105] The magnitude of market activity for which the Division is responsible is similarly vast: "[A]pproximately $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."[106]

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.[107] The annual budget for 2018 was $578 million.[108]

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?[109] 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

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COLUM. BUS. L. REV. 793, 816–20 (2008).

103. U.S. SEC. & EXCH. COMM'N, *How Investigations Work*, *supra* note 85.

104. Stephanie Avakian, Co-Director, U.S. Sec. & Exch. Comm'n, Division of Enforcement, 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, Co-Director, U.S. Sec. & Exch. Comm'n, Division of Enforcement, The Salutary Effects of International Cooperation on SEC Enforcement (Dec. 3, 2018) ("In the Enforcement Division, the scope of our responsibility is extremely broad.").

105. *E.g.*, ANNUAL REPORT 2018, *supra* note 84, at 10 (listing types of cases brought).

106. ANNUAL REPORT 2018, *supra* note 84, at 6.

107. ANNUAL REPORT 2018, *supra* note 84, at 14; Avakian, *Measuring*, *supra* note 86, at 3.

108. U.S. SEC. & EXCH. COMM'N, *Agency Financial Report Fiscal Year 2018*, at 59.

109. 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.").

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.[110] And research has shown that SCAs are less likely to be dismissed,[111] settle faster[112] and for more money,[113] and are more likely to have an institutional lead plaintiff,[114] when there is a parallel SEC enforcement action.[115]

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 <u>*decision to initiate*</u> 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 actionable misconduct and, thus, a winnable case.[116]

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110. 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).

111. *See* 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/.

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

113. 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 & Kiku, *supra* note 112, at 763–64, 770; James D. Cox, Randall S. Thomas & 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 111; Laarni T. Bulan et al., *Securities Class Action Settlements 2017 Review and Analysis*, CORNERSTONE RESEARCH 14 (2017); Bulan et al., *2018 Review*, *supra* note 25, at 12; Boettrich & Starykh, *supra* note 28, at 37.

114. Cox, Thomas & Bai, *supra* note 113, at 377.

115. 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).

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

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 Rule 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.[117]

Third, the Enforcement Division's decisions regarding *what facts* to include in a complaint or settlement similarly impact private litigation.[118] 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 decrees to survive motions to dismiss,[119] and may try to have the complaints or consent decrees admitted as evidence at trial or in a summary

117. *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).

118. *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); Arthur 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).

119. *See, e.g.*, 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); 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); Tobia v. United Grp. of Cos., Inc., No. 1:15-cv-1208 (BKS/DEP), 2016 WL 5417824, at *3 (N.D.N.Y. Sept. 22, 2016) (denying motion to strike allegations from complaint referring to SEC consent decree); Wenzel v. Knight, No. 3:15-cv-432, 2015 WL 222182, at *3 (E.D. Va. Jan. 14, 2015) (same); In re Fannie Mae 2008 Sec. Litig., 891 F. Supp. 2d 458, 471 (S.D.N.Y. 2012) (same); In re Bear Stearns Mortg. Pass-Through Certificates Litig. 851 F. Supp. 2d 746, 767–68 (S.D.N.Y. 2012) (same); Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC, 376 F. Supp. 2d 385, 395 (S.D.N.Y. 2005) (same); Berke v. Presstek, Inc., 188 F.R.D. 179, 181 (D.N.H. 1998) (same); *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). *But see* 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 v. Commonwealth United Corp., 551 F.2d 887, 893–94 (2d Cir. 1976)); 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*, 551 F.2d at 894 (same).

judgment.[120] Collateral estoppel is typically not available for SEC complaints or consent decrees.[121]

Fourth, the Enforcement Division has the discretion to require the company to <u>*admit*</u> liability or specific facts as a part of its settlement. Plaintiffs may use such admissions in complaints to help survive motions to dismiss,[122] as evidence,[123] and for offensive collateral estoppel.[124]

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?

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120. *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* Loreley Fin. (Jersey) No. 3 Ltd., 797 F.3d 160, 179 n.11 (2d Cir. 2015) (holding that an SEC order is inadmissible to prove the facts of liability); 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) (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).

121. *See 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 the prior trial."); In re Cenco Inc. Sec. Litig., 529 F. Supp. 411, 415–16 (N.D. Ill. 1982).

122. *See* Coffee, *'Neither Admit Nor Deny'*, supra note 111; *see also* Peter R. Flynn, *Admission of Wrongdoing: Increasing Public Accountability in SEC Settlements*, 8 BROOK. J. CORP. FIN & COM. L. 538, 549 (2014); Matthew G. Neumann, *Neither Admit nor Deny: Recent Changes to the Securities and Exchange Commission's Longstanding Settlement Policy*, 40 J. CORP. L. 793, 808 (2015); Jason E. Siegel, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 GEO. L.J. 433, 454 (2015).

123. *See* Priyah Kaul, *Admit or Deny: A Call for Reform of the SEC's "Neither-Admit-Nor-Deny" Policy*, 48 U. MICH. J. L. REFORM 535, 546 (2015). *But see* Coffee, *'Neither Admit Nor Deny'*, *supra* note 111; Flynn, *supra* note 122, at 548; Neumann, *supra* note 122, at 808.

124. *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 123, at 543; Danne L. Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM J. CORP. & FIN. L. 627, 668 (2007); Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM J. CORP. & FIN. L. 627, 668 (2007); Siegel, *supra* note 122, at 434–35; Brad Karp & Susanna Buergel, *For: Neither Admit nor Deny*, COMPLIANCE WK., (Sept. 6, 2017, 8:15 AM), available at https://www.complianceweek.com/for-neither-admit-nor-deny/2538.article. *But see* Coffee, *'Neither Admit Nor Deny'*, *supra* note 111; Neumann, *supra* note 122, at 807–08.

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

Consider the SEC Enforcement Manual. This document, which has been 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.[125] Section after section of the Enforcement Manual outlines considerations for making decisions regarding, for instance, opening a MUI,[126] converting an MUI into an "investigation,"[127] prioritizing one investigation over another,[128] whether to provide a Wells notice,[129] and closing an investigation.[130] For each decision, the manual calls for consideration of various factors including the "egregiousness" of the misconduct,[131] the opportunity to send a strong "message of deterrence,"[132] and the "widespread and extensive harm."[133] The manual also calls for careful consideration of overlapping jurisdiction with other law enforcement agencies at the state, federal, or international levels,[134] including consideration of whether such entities might be better suited to pursue the misconduct.[135] 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 Division 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.

Next, consider the SEC's policy requiring "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

125. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 1.1.

126. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.1.

127. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.2.

128. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.1.1.

129. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.4.

130. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.6.1.

131. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.1.

132. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.1.1.

133. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.1.

134. *See* U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at §§ 5, 2.1.1.

135. *See* U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.1. For a study of SEC coordination with other governmental enforcement authorities, see Verity Winship, *Enforcement Networks*, 37 YALE J. REG. 274 (2020).

"send an important message to the market."[136] But pursuing admissions does not call for consideration of the potential impact on private litigation of an admission.[137] It does not instruct SEC enforcement to push for an admission that 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 at 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 the SEC Annual Report to Congress.[138] The Enforcement Division now also files its own separate report with additional statistics and anecdotes.[139] 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.[140] But there is no indication in any of these reports that the agency has any effect on private litigation.[141] 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.[142]

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 nothing that indicates the SEC has a systemic approach to the "piggyback" effect. Indeed, the agency has gone on the record to actually *deny* that it considers potential "piggybacking" when making enforcement decisions. 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

136. Mary Jo White, Chairman, Sec. & Exch. Comm'n, Deploying the Full Enforcement Arsenal (Sept. 26, 2013).

137. *Cf.* Flynn, *supra* note 122, at 538–39 ("[T]he SEC's goal in requiring admissions in certain cases is not to increase settling parties' collateral liability . . . .").

138. *See* Sec. & Exch. Comm'n, FY 2018 ANNUAL PERFORMANCE REPORT (2018).

139. *See* Sec. & Exch. Comm'n, FY 2018 DIVISION OF ENFORCEMENT ANNUAL PERFORMANCE REPORT (2018).

140. *See id.*

141. *See generally id.* (offering no reference to the impact of enforcement on outside litigation throughout the report).

142. *See id.* at 16–17 (discussing the amount awarded to the agency).

settle with the defendant?"[143] Khuzami's answer was clear: "No. In general, we are going to follow the same guidelines."[144] Similarly, in 2013, an Assistant Director of the SEC office in charge of distributing settlement proceeds to injured investors confirmed that the SEC does not consider the existence of parallel private litigation when it investigates and settles enforcement actions.[145] More generally, in public speeches, SEC leaders have often emphasized cooperation and coordination with criminal authorities,[146] U.S. regulators,[147] and international regulators,[148] but do not mention any coordination or consideration of "piggyback" litigation. Even when SEC leaders discuss subjects such as 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 connect these actions to the "piggyback" effect.[149]

So much for agency words. How about their deeds?

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143. *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. On Fin. Servs.*, 112th Cong. 37 (May 17, 2012).

144. *Id.*

145. See Velikonja, *Public Compensation*, supra note 83, at 388 (citing Telephone Interview with Nichola Timmons, Assistant Dir., Office of Distributions, SEC (Dec. 24, 2013)).

146. *See* Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't., Keynote Address at Securities Enforcement Forum 2016: The Impact of SEC Enforcement on Public Finance (Oct. 13, 2016); Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't., Keynote Speech at ACI's 33rd International Conference on the FCPA (Nov. 30, 2016); Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't., Keynote Address at Directors Forum 2016 (Jan. 25, 2016).

147. *See* Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't., Keynote Address at American Law Institute Conference on Accountants' Liability 2016: Confronting Enforcement and Litigation Risks (Sept. 22, 2016); *Oversight of the SEC's Division of Enforcement: Hearing Before the H. Subcomm. On Capital Markets and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 114th Cong. (Jan. 2, 2017) (statement of Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't.).

148. *See* Peikin, *supra* note 104, at 2; Andrew J. Ceresney, Dir., Sec. & Exch. Comm'n, Div. of Enf't., Keynote Speech at ACI's 33rd International Conference on the FCPA (Nov. 30, 2016).

149. *See* Hester M. Pierce, Comm'r, Sec. & Exch. Comm'n,, The Why Behind the No: Remarks at the 50th Annual Rocky Mountain Securities Conference (May 11, 2018). *But see* Elisse Walter, Comm'r, Sec. & Exch. Comm'n, Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional (CRCP) Program (Nov. 8, 2011) (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). The logical premise of Walter's 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.

Some agency actions seems to reflect a desire to minimize "piggybacking." Since Dodd-Frank, the SEC has been avoiding scienter-based charges in settlements[150]—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 assistance to private litigation.[151] And, in the first half year of Jay Clayton's tenure as head of the SEC, the agency brought fewer standalone actions against entities.[152]

These trends are amenable to two alternative interpretations. It is possible that the SEC has adopted a negative view of "piggyback" litigation and has deliberately (but secretly) set out to calibrate its enforcement regime so as to minimize the amount of "piggybacking" that occurs. But it is also possible that the SEC has not adopted any view of "piggyback" litigation and instead regards it as entirely beyond its purview. Under this alternative interpretation, any shift away from "piggyback" catalyzing enforcement would not reflect the agency's hostility to "piggybacking," but rather the defendants' strong preference to minimize the incidence of "piggybacking." Defendants may be happy to pay the SEC more in settlements in order to reduce the likelihood or intensity of parallel private enforcement. If the SEC is, indeed, indifferent to "piggybacking," it will happily accept this tradeoff in every case.

The agency's own statements (surveyed above) provide a good deal of support for the latter interpretation—that the agency just does not see "piggybacking" as within its purview. However, both interpretations are possible—and, as I argue in the next part of this paper, both are troubling.

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150. Velikonja, *Shadows*, *supra* note 96, at 133.

151. 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 122, at 545, 552 (noting JPMorgan limited it's admission to reduce liability and when admissions are made the SEC limits company liability); Joshhua Gallu, *JPMorgan Guilty Admission a Win for SEC's Policy Shift*, BLOOMBERG (quoting Adam Pritchard that the settlement was a "show of an 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) (discussing the effects of an admission under SEC's new policy); Rosenfeld, *supra* note 151, at 154 (stating SEC is not requiring admissions "in the most egregious cases").

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

In sum, the agency's public statements show a lack of concern for the "piggyback" effect. The agency's actions are ambiguous and do not provide an indication that the agency has a 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 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.[153] CorpFin employs hundreds of attorneys and accountants to review the periodic disclosures and financial statements filed by public companies.[154] The Division reviews the disclosures of *every* public company at least once every three years.[155] During FY 2017, CorpFin reviewed the annual reports and financial statements of nearly 4,200 public companies.[156]

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, it sends a comment letter to

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153. Rory Van Loo, *Regulatory Monitors: Policing Firms in the Compliance Era*, 119 COLUM. L. REV. 369, 373–75 (2019) (describing the overlooked "police" function played by regulatory monitors).

154. *Filing Review Process*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/divisions/corpfin/cffilingreview.htm (last visited Oct. 10, 2019) [hereinafter *Filing Review Process*]; 15 U.S.C. § 7266(a) (2012). The Division of Corporation Finance (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 Testimony on "Management and Structural Reforms at the SEC: A Progress Report"*, U.S. SEC. & EXCH. COMM'N (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.").

155. 15 U.S.C. § 7266(c).

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

the issuer.[157] 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.

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."[158] The comment letter process is often described as a "dialogue"[159]—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 2004 when the SEC mandated that both SEC comment letters and issuer responses would be publicly disclosed as a matter of course.[160]

2. *"Piggybacking" on CorpFin*

CorpFin's review and comment process can impact private litigation in two ways:[161]

First, the comment letter process may lead a company to make a restatement that triggers private litigation. Research has shown that a significant

157. *Filing Review Process*, *supra* note 154.

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

159. *See Filing Review Process*, *supra* note 154; John W. White, Dir., Sec. & Exch. Comm'n, Div. of Corp. Fin., 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, 14 (2011); Keith F. Higgins, Dir., Sec. & Exch. Comm'n, Div. of Corp. Fin., Remarks Before the American Bar Association Business Law Section Spring Meeting: Disclosure Effectiveness (Apr. 11, 2014).

160. *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.

161. 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. ACCT. & PUB. POL'Y 337, 353–54 (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).

portion of SCAs involve restatements,[162] and that SCAs accompanied by restatements produce larger settlements.[163] Indeed, forty of the largest one hundred SCA settlements of all time involved a restatement.[164]

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,[165] 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.[166] Many plaintiffs have indeed relied on SEC comment letters and company responses to show materiality.[167]

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162. About half of accounting related SCA settlements involve restatements. *Accounting Class Action Filings and Settlements 2018 Review and Analysis*, CORNERSTONE RES. 15 (2018). *But see* Kevin LaCroix, *Number of Restatements Continues to Decline*, D&O DIARY (June 26, 2018), https:// www.dandodiary.com/2018/06/articles/financial-reporting/number-restatements-continues-decline/.

163. Boettrich & Starykh, *supra* note 28, at 37; Choi, Nelson & Pritchard, *The Screening Effect of the PSLRA*, *supra* note 111, at 63.

164. 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. ACCT. & ECON. 59, 72 (2004) (24%); Baruch Lev et al., *Rewriting Earnings History*, 13 REV. ACCT. STUDS. 419, 430 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. Lev et al., *supra*, at n.9.

165. Yin Wilczek, *Official Warns Issuers, Lawyers to Take Care in Responding to SEC Staff Comment Letters*, 8 ACCT. POL'Y & PRACTICE REP'T 1023, 1023 (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).

166. *See* Wilczek, *supra* note 165, at 1023.

167. Brief for Plaintiff-Appellant at 14, Chang v. Accelerate Diagnostics, Inc., No. 16-15315, 2016 WL 3211274 (9th Cir. June 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."); 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); Second Amended Class Action Complaint at ¶ 58, In re Herbalife, Ltd. Sec. Litig., No. 2:14-CV-02850-DSF (JCGx), 2015 WL 4498323 (C.D. Cal. May 8, 2015); 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); Plaintiff's Memorandum in Opp'n to

Courts have relied on comment letters, which can provide good evidence of materiality.[168] Courts have also relied on the issuer's response to a comment letter to establish materiality.[169] 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.[170]

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,[171] while others have held that it may be "some" or even "strong" evidence of materiality.[172] Thus, plaintiffs need some additional evidence to

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Defendant's Motion to Dismiss at 17–8, E*Trade Fin. Corp. Sec. Litig, No. 1:07-cv-08538-RWS, 2009 WL 3232861 (S.D.N.Y. July 2, 2009) ("The SEC demands for greater disclosure by E*TRADE alone demonstrate the inadequacy of Defendants' public reports."); Consolidated Amended Complaint at ¶¶ 93, 112–17, Shenwick v. Twitter, No. 3:16-cv-05314-JST, 2017 WL 836240 (N.D. Cal. July 3, 2008); 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).

168. *E.g.*, Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 186, 188 (S.D.N.Y. 2010) (relying on SEC comment letters to find that defendant had omitted material information); 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"); *see also* 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"); United States v. Blankenship, No. 5:14-CR-00244, 2015 WL 8731688, at *8 (S.D.W. Va. Dec. 9, 2015) .

169. Sun v. Han, No. 15-703 (JLL), 2015 WL 9304542, at *9–10, 14 (D.N.J. Dec. 21, 2015).

170. 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 . . . ."); 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."); *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).

171. In re Atlas Mining, 670 F. Supp. 2d 1128, 1133–34 (D. Idaho 2009); *see also* J&R Mtkg. v. Gen. Mtrs. Corp., No. 06-10201, 2007 WL 655291, at *12 (E.D. Mich. Feb 27, 2007); In re Metawave Comms. Corp. Sec. Litig., 298 F. Supp. 2d 1056, 1079 (W.D. Wash. 2003).

172. In re Ramp Networks, Inc. Sec., 201 F. Supp. 2d 1051, 1062, 1065–66 (N.D. Cal.

establish materiality, and a comment letter from the SEC suggesting that there is a material misstatement may provide some help.

Outside of materiality, courts have recognized that comment letters may also be used to establish other elements of securities claims, including scienter, [173] loss causation,[174] and more.[175]

2002) (holding that restatements constitute "some" evidence of materiality where plaintiff also alleges specific facts concerning GAAP violations).

173. *See* Cohen v. Telsey, Civ. No. 09-2033 (DRD), 2009 WL 3747059, at *21 (D.N.J. Nov. 2, 2009) (finding that the allegation regarding defendant's receipt of an "SEC letter describing the deficiencies in the disclosure," together with other evidence, provided sufficient evidence of knowledge); In re Am. Bus. Fin. Servs., Inc. Noteholders Litig., Master File No. 05-0232, No. 08-0784, 2008 WL 3405580, at *3, 8 (E.D. Pa. Aug. 11, 2008) (finding that allegations regarding defendant's receipt of "strong comment letters from the SEC," together with other evidence, provided sufficient evidence of knowledge); In re Victor Techs. Sec. Litig., No. C-83-3906A RFP, 1987 WL 60284, at *6 (N.D. Cal. Jan. 8, 1987) (finding that defendant's receipt of a "'comments letter' from the SEC objecting to its use of purchase accounting" provided evidence of scienter); United States v. Hill, No. 12,396, 1969 WL 2837, at *11 (D. Conn. Apr. 10, 1969); Fresno Cty. Emps. Ret. Ass'n v. comScore, Inc., 268 F. Supp. 3d 526, 540, 552 (S.D.N.Y. 2017) (discussing SEC comment letter and finding that defendant's "campaign . . . to placate the market in reaction to the inquiries by the . . . SEC regarding [its] accounting practices provides cogent support for the inference of scienter"); 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., Master File No. 2:05-CV-204, 2009 WL 3731965, at *10 (D. Utah Oct. 30, 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., No. 15 Civ. 6034 (RJS), 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., No. 13 Civ. 8846(LGS), 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., 17 Civ. 2347 (NRB), 2018 WL 3559089, at *14 (S.D.N.Y. July 23, 2018); Foss on Behalf of Quality Sys. Inc. v. Barbarosh, Case No.: SACV 14-00110-CJC(JPRx), 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.").

174. *See* In re Bear Stearns Comps., Inc. Sec., Deriv. & ERISA Litig., 763 F. Supp. 2d 423, 488 (S.D.N.Y. 2011) (finding that the plaintiffs sufficiently alleged loss causation based on, inter alia, the allegation that defendants had received an SEC comment letter).

175. *See* In re Allergan, Inc. Proxy Violation Sec. Litig., Case No.8:14-cv-02004-DOC-

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 important new tool to private enforcement to use in SCAs.[176] 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 Freedom of Information Act (FOIA) process and were making available for paying clients.[177]

Other actions by CorpFin 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.[178] Further, the SEC sometimes conveys

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KESx, 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., No. CV-15-00504-PHX-SPL, 2016 WL 3640023, at *4, *8 (D. Ariz. Jan. 28, 2016); Mostaed v. Crawford, Civil Action Nos. 3:11-cv-00079-JAG, 3:11-cv-00082-JAG, 2012 WL 3947978, at *10 (E.D. Va. Sept. 10, 2012) (relying on comment letters as alternative source of corporate benefit to deny attorney's fees); Fait v. Regions Fin. Corp., 712 F. Supp. 2d 117, 123 (S.D.N.Y. 2010) (rejecting the plaintiff's reliance on a letter from the SEC that questioned how the company's goodwill balance was not impaired as sufficient to alter the court's conclusion).

176. *See generally* Miguel Duro, Jonas Heese & Gaizka Ormazabal, *The Effect of Enforcement Transparency: Evidence from SEC Comment Letter Reviews*, 73 REV. ACCT. STUD. 780, 781 (Aug. 15, 2019).

177. *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.

178. *E.g.*, Perrin v. SouthWest Water Co., No. 2:08-cv-7844-JHN-AGRx, 2011 WL 10756419, at *11 (C.D. Cal. June 30, 2011) (receipt of comment letters from SEC did not "support a strong inference of scienter" where the letters merely "questioned the accounting"

its bottom line positions—including its views of the issuer's "materiality" analysis—to a company over the phone,[179] 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,[180] 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.[181] And CorpFin's reli-

methods of defendants); *Pa. Pub. Sch. Emps. Ret. Sys.*, 939 F. Supp. 2d at 452 (finding that receipt of an SEC comment letter making a "criticism" of defendant's accounting practice was merely an "allegations of accounting irregularit[y]" and this, standing alone, was insufficient to state a securities fraud claim).

179. *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. Servs. 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 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).

180. *See* U.S. SEC. & EXCH. COMM'N, OFF. 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); Baldwin B. Bane, *SEC's Work Defended as Liked By Investors and Registrants*, N.Y. TIMES, July 2, 1939, at 5 ("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."); *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."); *Audit Rep. 259*, U.S. SEC. EXCH. COMM'N, COMMENT LETTER PROCESS ("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*, *supra* note 154 (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).

181. SEC 2017 OIG Report, U.S. SEC. & EXCH. COMM'N, OFF. 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).

ance on oral comments appears to be increasing: issuer responses to comment letters in 2017 were about five times more likely to reference "oral comments" by CorpFin than they were in 2008.[182]

More broadly, CorpFin appears to be deliberately avoiding restatements.[183] 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.[184] 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.[185]

But, here again, the evidence is ambiguous. It may be that CorpFin is deliberately trying to minimize "piggybacking" or that CorpFin itself is indifferent to "piggybacking" and is simply internalizing (without scrutiny) the strong anti-"piggybacking" preferences of its targets.

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 disclosures are reviewed by CorpFin each year,[186] 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, it is hiding this consideration from Congress and the public.

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

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182. *See* Appendix A.

183. *E.g.*, Jean Eaglesham, *Shh! Companies are Fixing Accounting Errors Quietly*, WALL ST. J. (Dec. 5, 2019), https://www.wsj.com/articles/shh-companies-are-fixing-accounting-errors-quietly-11575541981 (collecting research showing that companies have been increasingly avoiding "Big R" restatements and instead using "Little r" revisions, with the SEC's apparent approval).

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

185. Acito et al., *supra* note 184, at 859.

186. *E.g.*, U.S. SEC. & EXCH. COMM'N AGENCY FINANCIAL REPORT FISCAL YEAR 2017, 44 (2017); U.S. SEC. & EXCH. COMM'N AGENCY FINANCIAL REPORT FISCAL YEAR 2016, 51 (2016).

litigation.[187] The agency has long history of influencing courts through amicus briefs in support of preserving or expanding the private right of action,[188] and has also played a critical role in lobbying Congress to preserve private enforcement.[189] Most recently, SEC Chairman Jay Clayton has resisted calls (including calls from within the Trump Administration)[190] to authorize companies to include mandatory arbitration provisions in their corporate charters—preserving shareholders' right to pursue securities class actions.[191]

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.[192] Thus, the agency's Enforcement Division and CorpFin 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."[193] Similarly, CorpFin's comment letter process was initially conceived, in the months following enactment of 1933 Securities Act,

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

188. *See* Brief for United States as Amicus Curiae Supporting Respondent at 28, Halliburton Co. v. Erica John Fund, 573 U.S. 258 (2014) (No. 13-317); *see also* 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); Elise B. Walter, Comm'r, 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).

189. *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).

190. *Cf.* U.S. DEP'T OF 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).

191. Jay Clayton, Chairman, Sec. & Exch. Comm'n, Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions (Feb. 11, 2019).

192. *Supra* Part I.B–C.

193. Peikin, *Keynote*, *supra* note 92, at 2.

as a form of *assistance* to the regulated industry rather than a form of increased liability,[194] and this characterization holds sway today.[195] Such collaboration is undoubtedly an important and valuable thing.[196] 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,[197] 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.[198] Unlike top-shelf defense firms, leading plaintiffs'-side securities litigation 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

194. I plan to explore this history in greater depth in future work.

195. *See, e.g.*, *Oversight of the SEC's Division of Corporation Finance*: *Hearing Before the Subcomm. on Capital Mkts., Sec., and Inv. of the H. Comm on Fin. Servs. Investment*, 115th Cong. 2 (Apr. 26, 2018) (statement of William Hinman, Director, CorpFin) (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 (Dec. 12, 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 STUDENT LAW. 28, 30 (2009) (quoting CorpFin reviewer explaining that "[i]t's not an adversarial process. It's much more—but not necessarily always—collegial").

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

197. *E.g.*, deHaan et al., *supra* note 82, at 66.

198. Alexander I. Platt, *The Non-Revolving Door: New Evidence of Capture at the SEC* (working paper).

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.[199] By suppressing (and ignoring) its real influence over the incidence of "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 one 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

199. *E.g.*, Velikonja, *Politics*, *supra* note 4, at 18, 41.

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.[200] 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.[201] Policymakers, courts, and scholars interested in reining in or otherwise recalibrating private enforcement have often looked to "litigation" reforms[202]—i.e., adjusting pleading standards,[203] discovery barriers,[204] class certification requirements,[205] damages,[206] settlements,[207] and attorneys' fees.[208]

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."[209] 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

200. Engstrom, *supra* note 2, at 627–28.

201. Engstrom, *supra* note 2, at 630–41.

202. Engstrom, *supra* note 2, at 642–44.

203. 15 U.S.C. § 78u-4(b)(2) (2012) (explaining heightened scienter pleading requirement for SCAs).

204. *Id.* § 78u-4 (b)(3) (barring discovery in SCAs pending a motion to dismiss).

205. *E.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988) (allowing SCAs plaintiffs to rely on a "fraud on the market" presumption of reliance in order to facilitate SCAs).

206. *E.g.*, Langevoort, *Capping*, *supra* note 35, at 664.

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

208. *E.g.*, Coffee, *Reforming*, *supra* note 35, at 1581–82.

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

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,[210] screening, vetoing, and/or taking over the prosecution of individual private suits,[211] and/or prodding along socially beneficial private suits by filing amicus briefs or statements of interest.[212] 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.[213] Furthermore, bringing private enforcement under the control of public enforcers can promote some greater degree of public democratic accountability.[214]

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.[215] Accordingly, "gatekeeping" scholars have 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.[216] 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

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210. Stephenson, *supra* note 11, at 94; Grundfest, *Why Disimply?*, *supra* note 187, at 728; *see also* Engstrom, *supra* note 2, at n.4 (showing additional sources).

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

212. *See* Engstrom, *supra* note 2, at 647.

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

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

215. *See discussion infra* Part II.B.1.

216. *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 2 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.

subject matter for a lawsuit. It may produce information—in the complaint, settlement, consent decree, or other litigation documents—that a private party can incorporate into its complaint to survive a motion to dismiss, can rely on it 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. [217]

The literature on "piggybacking" generally focuses on debating the social utility of this form of private litigation.[218] 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.[219] Defenders argue that "piggybacking" can be a valuable corrective against under-deterrence by federal enforcers.[220]

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.[221] For instance, David Engstrom's global synthesis and typology of "gatekeeping" mechanisms does not appear to include the "piggyback" effect.[222]

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.

217. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 n.5 (1979).

218. 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).

219. Coffee, *Rescuing*, *supra* note 216, 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").

220. Clopton, *supra* note 12, at 287; Coffee, *Rescuing*, *supra* note 216, at 224–25; Gilles & Friedman, *supra* note 12, at 157–58.

221. Engstrom, *supra* note 2, at 626.

222. 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." Engerstrom, *supra* at 655–56.

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.[223] 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 actions.[224] 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,[225] 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.[226]

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 "piggyback" effect from his typology of agency "*gatekeeping*."[227] 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

223. 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).

224. Gilles & Friedman, *supra* note 12, at 157–58 n.203.

225. Clopton, *supra* note 12, at 306–07.

226. Clopton, *supra* note 12, at 306.

227. *See* Engstrom, *supra* note 2, at 635, 646.

cases, or whether the SEC should be factoring this phenomenon into its enforcement decisions *ex ante*.[228]

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.[229] Erichson shows that public enforcement influences private litigation either through the "preclusive effect of a judgment" or "through the gathering and dissemination of documents and other information."[230] And he states that public enforcers "should think about" these preclusive and informational impacts in the course of their public enforcement duties.[231] But Erichson does not explain whether 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 *how* agencies can incorporate such consideration into their enforcement policy.

1. *Why Agency Enforcers Should Consider the "Piggyback" Effect*

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.[232] In the landmark decision *Motor Vehicles Manufacturers' Association v. State*

228. Rose, *Restructuring*, *supra* note 1, at 1345; *see* 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).

229. Erichson, *supra* note 12, at 2–3.

230. Erichson, *supra* note 12, at 28.

231. Erichson, *supra* note 12, at 27.

232. *See generally* JERRY L. MASHAW, REASONED ADMINISTRATION AND DEMOCRATIC LEGITIMACY viii (2018) (articulating the "many ways in which American administrative law demands administrative action based on reason").

Farm,[233] 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.[234] 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 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.[235] 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.[236] Enforcement leaders may understand that Congressional overseers are concerned

233. 463 U.S. 29 (1983).

234. *Id.* at 43.

235. Lemos, *supra* note 19, at 954; Sohoni, *supra* note 19, at 50; Velikonja, *Accountability*, *supra* note 19, at 1552.

236. Zaring, *supra* note 82, at 517 (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).

exclusively with direct results of *public* enforcement, and therefore will not factor in results produced through publicly catalyzed "piggyback" litigation.[237] 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.[238] 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.[239]

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,[240] but rather are generally motivated by the *private* benefits and costs of litigation,[241] 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

237. *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).

238. *See* Part II.B.

239. *Id.*

240. 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 (highlighting that 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 213, at 2200 ("By definition, a private enforcer is incentivized to maximize her private welfare, which we can expect to diverge from social welfare in significant ways.").

241. Shavell, *supra* note 240, at 577–78; *see* Stephenson, *supra* note 11, at 114–15 (noting

benefits are high enough.[242] 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,[243] 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.[244]

As discussed above, some scholars have drawn on this basic insight to advocate for expanding public agency "gatekeeping" authority over private litigation.[245] 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 amicus briefs, and deploying *Qui Tam* regimes.[246] 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

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that 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 also* Engstrom, *supra* note 2, at 631 (observing that private enforcers tend to be motivated by private benefits).

242. Shavell, *supra* note 240, at 581–84; Stephenson, *supra* note 11, at 114–15.

243. *See* Park, *supra* note 6, at 122; *Cf.* NICHOLAS R. PARRILLO, AGAINST THE PROFIT MOTIVE: THE SALARY REVOLUTION IN AMERICAN GOVERNMENT, 1780–940 (2013).

244. *See* 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); 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, *Multienforcer*, *supra* note 213, at 2201–03 (articulating the advantages of public over private enforcers); Rose, *Restructuring*, *supra* note 1, at 1329, 1347 ("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 ("[G]overnment regulatory agencies (it is often claimed) are better at screening out enforcement actions that are either nonmeritorious or not worth the costs of prosecution . . . .").

245. Fisch, *supra* note 1, at 200.

246. *Supra* Part II.A.1.

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;[247] they may be pressured by Congressional overseers to pursue certain classes of cases and not others for political reasons;[248] they may suffer from "bureaucratic slack" a result of employees' desire to maximize leisure time;[249] 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.[250] 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 broadly expanding, agency control over private litigation may diminish the force of this check.[251]

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

247. *See* William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 111 (2011); Rose, *Restructuring*, *supra* note 244, at 1361; Rose, *Multienforcer*, *supra* note 213, at 2215.

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

249. *See* Rose, *Multienforcer*, *supra* note 213, at 2216.

250. *E.g.*, Zaring, *supra* note 82, at 520 ("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.").

251. 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.").

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.[252] If greater consideration of "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.[253] 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.[254] 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

252. This is a back of the envelope calculation based on (1) the fact that about 20% of SCAs have parallel SEC actions; and (2) in 2018, SCAs settlements totaled $5 billion. *See supra* pages 7–10, 22.

253. Coffee, *What's Changed?*, *supra* note 151; *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) (quoting former deputy chief of the SDNY Criminal Securities Fraud Unit that "it is not the SEC's role to attempt to obtain admissions solely to help private litigants in ongoing or subsequent actions").

254. *See* Engstrom, *supra* note 2, at 647–48.

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 possibly widespread industry practice that should be addressed."[255] 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."[256] The U.S. Justice Manual (formerly known as 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."[257]

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.[258]

255. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.2.

256. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.1.1.

257. JUSTICE MANUAL § 9-28.300 (U.S. DEPARTMENT OF JUSTICE, 2018), https://www.justice.gov/jm/title-9-criminal.

258. 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.

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 *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.[259]

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

259. For instance, in the realm of securities litigation, defense lawyers and allies have expressed skepticism regarding so-called "event-driven" SCAs, as compared to financial-fraud-driven SCAs. *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*, HARV. L. F. ON CORP. GOVERNANCE & FIN. REG (Apr. 13, 2019), https://corpgov.law.harvard.edu/2019/04/13/regulators-join-in-event-driven-securities-litigation/ (referencing defense lawyers' critique of SEC's case against VW). *But see* Julie G. Reiser & Steven J. Toll, *Event-Driven Litigation Defense*, HARV. L. F. ON CORP. GOVERNANCE & FIN. REG (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).

260. U.S. SEC. & EXCH. COMM'N, *Enforcement Manual*, *supra* note 85, at § 2.3.2.

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.[261] 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.[262] 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.

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

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261. *See* Velikonja, *Reporting*, *supra* note 14, at 906.

262. *See* David Freeman Engstrom, *Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation Under the False Claims Act*, 107 NW. L. REV. 1689, 1657 (2013) (noting at least five different possibilities for the core tasks that an agency would perform if it took on private litigation).

from system involvement," to inform prosecutorial decisionmaking.[263] 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."[264]

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.[265]

iii. Internalize

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).

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.

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

264. *See* U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/dera. (last visited Jan. 20, 2020); 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).

265. *Supra* Part I.B.2.

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.[266]

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.[267] 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 litigation effects in exchange for less valuable public enforcement effects.[268]

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.[269] 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

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266. 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.

267. *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.

268. *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).

269. 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).

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."[270] 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."[271] These consequences are far more remote from the core mission of 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

270. 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).

271. *See* ROLLINS MEMO, *supra* note 263, at 18.

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.[272]

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.[273]

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 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.[274]

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.[275]

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272. *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.").

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

274. *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 nongovernmental sources like corporate employees, journalists, and others).

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

III. HOW TO SHINE A LIGHT ON LITIGATION "GATEKEEPING" BY THE SEC AND OTHER PUBLIC ENFORCERS

When agencies like the 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

The single most important reform to improve agency practices with regard to "piggyback" litigation would be for agencies like the SEC to begin including, in their reports to Congress, an account of the "piggyback" effect associated with their enforcement activities.[276] Indeed, even if one disagreed with the first sixty 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.[277] 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.[278] Once the SEC begins "owning" this "piggyback" effect as part of its enforcement footprint, this will kick off a productive debate regarding how the SEC should calibrate its various programs and policies to produce the optimal level of "piggyback" litigation.

276. Other commentators have scrutinized SEC's enforcement statistics and called for different reforms. *E.g.*, Platt, *Unstacking*, *supra* note 4; Velikonja, *Reporting*, *supra* note 14; U.S. GAO, SEC Report (Oct. 2019).

277. *See* 15 U.S.C. § 78w(b)(1) (2012) (requiring the 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).

278. *See* 15 U.S.C. § 78w(b)(1) (2012) (requiring the 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).

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 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. Using the 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

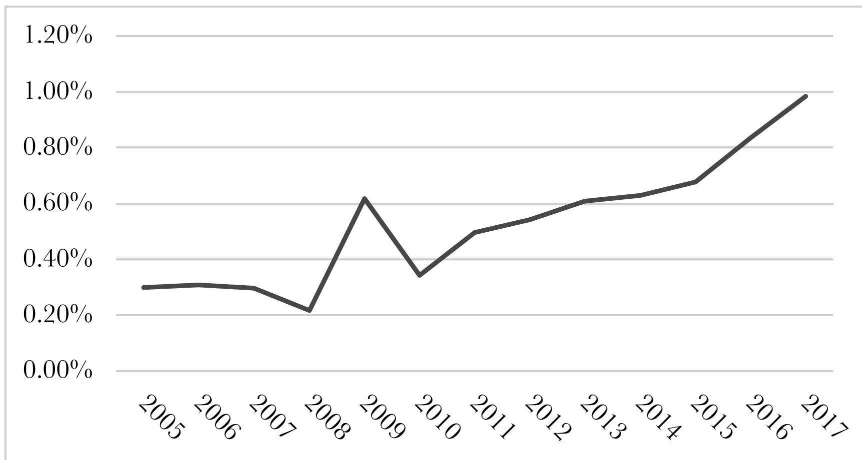
only investors are eligible to testify on this subject. CorpFin could bring in some experienced investors to sit (alongside accountants and lawyers) on "materiality panels" to resolve contested issues at the end of the comment letter process. This would include assessing the nonmateriality determinations 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.

APPENDIX A

Issuer Responses to SEC Comment Letters Referencing CorpFin's "Oral Comments"[279]



279. Source: Lexis Securities Mosaic.