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FEDERAL SECURITIES FRAUD LITIGATION AS A LAWMAKING PARTNERSHIP

JILL E. FISCH*

ABSTRACT

In its most recent Halliburton II decision, the Supreme Court rejected an effort to overrule its prior decision in Basic Inc. v. Levinson. The Court reasoned that adherence to Basic was warranted by principles of stare decisis that operate with “special force” in the context of statutory interpretation. This Article offers an alternative justification for adhering to Basic—the collaboration between the Court and Congress that has led to the development of the private class action for federal securities fraud. The Article characterizes this collaboration as a lawmaking partnership and argues that such a partnership offers distinctive lawmaking advantages.

Halliburton II offered a compelling illustration of the lawmaking partnership, as Congress and the Court together used the Basic decision as a building block to enable and then refine private securities fraud class actions. Notably, Congress took affirmative steps through legislation—the Private Securities Litigation Reform Act and the Securities Litigation Uniform Standards Act—to balance the competing policy objectives of allowing effective enforcement while limiting the potential for abusive litigation. The process illustrates the three critical components of a lawmaking partnership: an open-textured statute, sequential adjustments to the statutory scheme by both the Court and Congress, and a set of common objectives to guide the lawmaking enterprise.

This Article argues that the existence of a lawmaking partnership offers the Court the freedom to engage in explicit policy analysis of a type that is inconsistent with a traditional textualist approach. Put differently, the partnership operates as a type of rule of construction allowing the Court to engage in its own analysis of the interpretation that will best further congressional objectives.

The lawmaking partnership also offers distinctive lawmaking advantages, including efficiency, political insulation, and comparative institutional competence. An exploration of these advantages can be used

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to identify the potential value of the lawmaking partnership beyond federal securities fraud.

I. INTRODUCTION

The lawmaking power is generally understood to reside primarily in the legislative branch.¹ In the case of federal law, that branch is Congress.² Yet it is well documented that Congress does not exercise exclusive federal lawmaking power.³ The federal courts play an important lawmaking role by interpreting federal statutes and creating interstitial law.⁴ Similarly, the growth of the administrative state has placed primary lawmaking authority for many substantive areas into the hands of unelected officials at administrative and independent agencies.⁵

Coordinating and balancing the exercise of lawmaking power among these three actors raises difficult questions. These questions include the extent of Congress’s power to delegate lawmaking authority,⁶ the weight to be given to interpretative material beyond the statutory text,⁷ and the legal significance of Congress’s failure to take action in response to a judicial or agency interpretation.⁸ At the constitutional level, the debate raises important separation-of-powers concerns.⁹ Separate from the constitutional questions, however, are broader policy questions about comparative institutional competence and the extent to which choices among lawmakers should reflect considerations of efficiency, expertise, and political accountability.¹⁰

¹ See Cass R. Sunstein, Is the Clean Air Act Unconstitutional?, 98 MICH. L. REV. 303, 331 (1999) (“Article I, Section 1, vests legislative power in the Congress.”).
² See U.S. CONST. art. 1, § 1 (vesting the “legislative” power in Congress).
³ Margaret H. Lemos, The Other Delegate: Judicially Administered Statutes and the Nondelegation Doctrine, 81 S. CAL. L. REV. 405, 407 (2008) (“It has long been recognized that some measure of lawmaking outside of Congress is permissible, even desirable.”).
⁵ See Harold J. Krent, Delegation and Its Discontents, 94 COLUM. L. REV. 710, 710 (1994) (reviewing DAVID SCHOPENBROD, POWER WITHOUT RESPONSIBILITY (1993)).
⁶ See generally Thomas W. Merrill, Rethinking Article I, Section 1: From Nondelegation to Exclusive Delegation, 104 COLUM. L. REV. 2097 (2004).
⁷ See Lemos, supra note 3, at 431 (considering debate over whether interpretation of an ambiguous statute allows courts to implement their policy judgments as opposed to those of Congress).
¹⁰ See generally NEIL K. KOMESAR, IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY (1994).
This Article does not attempt to resolve broad questions about the legitimacy or desirability of congressional delegations of the lawmaking function. Instead, this Article uses the Supreme Court’s recent decision in *Halliburton Co. v. Erica P. John Fund, Inc.* ("Halliburton II")\(^{11}\) to identify a new lawmaking model. This Article argues that Congress and the Supreme Court have developed the scope of federal securities fraud litigation through a collaborative process, a process that this Article terms a lawmaking partnership.\(^{12}\)

The partnership should operate as a rule of construction.\(^{13}\) Where the Court finds evidence of this type of collaborative process,\(^{14}\) the lawmaking partnership should authorize the Court to use policy analysis in its interpretation of the authorizing statute to determine how best to further Congress’s lawmaking objectives. In *Halliburton II*, this canon of construction provides independent support for adhering to the Basic decision.\(^{15}\)

The Article argues that not only is a lawmaking partnership an accurate description of the process used by the Court and Congress to develop the legal contours of private securities fraud litigation, but also that, in appropriate cases, it is a normatively desirable method of making securities law. In particular, the lawmaking partnership offers distinctive advantages over alternatives such as a narrow adherence to statutory text coupled with detailed statutory guidance, on the one hand, or a broad delegation to judicial or agency lawyering, on the other.

In *Halliburton II*, the Court considered the continued viability of a judicially-created doctrine—fraud on the market ("FOTM").\(^{16}\) The Court had previously created FOTM in *Basic Inc. v. Levinson*\(^ {17}\) as a tool to

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12. The partnership construct developed in this Article is conceptually similar to, but more bounded than, the manner in which Richard Fallon and Daniel Meltzer have used the term. See, e.g., Richard H. Fallon, Jr. & Daniel J. Meltzer, *Habeas Corpus Jurisdiction, Substantive Rights, and the War on Terror*, 120 Harv. L. Rev. 2029, 2041 (2007) (arguing that “[i]n the case of statutory interpretation, courts play the role of junior partners to Congress”).
14. See infra Part IV (describing the criteria for identifying a lawmaking partnership).
15. This Article does not take on the normative question of whether the Court should use policy analysis in a broader set of cases than those involving the lawmaking partnership as described herein. For greater attention to this issue, see, e.g., Daniel J. Meltzer, *The Supreme Court’s Judicial Passivity*, 2002 Sup. Ct. Rev. 343, 345 (calling for “a less passive attitude toward judicial lawmaking” in subconstitutional matters).
enable plaintiffs in impersonal public capital-markets transactions to address the reliance requirement in federal securities fraud class actions. 18

By enabling the class action, FOTM dramatically changed the nature of private securities fraud litigation and generated large-scale cases involving substantial potential damages. 19 In turn, these developments led to complaints about the resulting scope of litigation and the potential for litigation abuse. 20 Some commentators demanded that the Court reconsider its earlier decision. 21 Commentators also raised their concerns in Congress. 22

Although the Court did not revisit the validity of FOTM prior to Halliburton II, it responded to claims of abusive litigation by imposing various limitations on the private right of action. 23 Similarly, although Congress did not speak directly to the validity of FOTM, it responded by enacting statutory reforms, first in the Private Securities Litigation Reform Act of 1995 (“PSLRA”) 24 and then in the Securities Litigation Uniform Standards Act (“SLUSA”). 25 Both the Court’s decisions and Congress’s refinements to the statutory framework reflected a common goal of reducing the prospect of costly and frivolous litigation while maintaining the viability of private litigation as a means of enforcing the disclosure obligations of the federal securities laws.

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18. Id. at 246–48, 248 n.27.
The Court in *Halliburton II* did not discuss this cooperative enterprise in its opinion; instead, it based its decision on principles of stare decisis. Nonetheless, this Article argues that evidence of a lawmaking partnership supplies an independent justification for the Court’s decision. More significantly, the Article argues that the virtues of the lawmaking partnership extend beyond the issue of FOTM and should be considered by the Court in evaluating the scope of its lawmaking power with respect to federal securities fraud. Specifically, the lawmaking partnership should give rise to a canon of construction by which the Court determines how best to further congressional objectives, rather than limiting its inquiry to the contours of the statutory text.

The Article proceeds as follows. In Part II, the Article briefly recounts the traditional story positioning the federal lawmaking function in Congress and the debate over the relationship between that story and congressional delegations of lawmaking power to the courts and federal agencies. Part III describes the Supreme Court’s decision in *Halliburton II*. Part IV conceptualizes the lawmaking partnership and identifies its structural advantages with respect to the development of federal securities law. Finally, Part V extends the analysis beyond FOTM and, using the example of insider trading regulation, explains the potential value of the lawmaking partnership in enabling Congress, the courts, and the Securities & Exchange Commission (“SEC”) to collaborate on the development of federal securities law.

II. THE JUDICIAL OAK OF PRIVATE SECURITIES FRAUD

The starting point for understanding the federal lawmaking power is Article I of the US Constitution, which provides that “[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.” While this Constitutional text would appear to vest exclusive lawmaking power in Congress, the lawmaking function of the federal courts and government agencies is widely accepted. As Thomas Merrill explains: “the notion that Congress is the exclusive federal lawmaking body is an oversimplification of constitutional reality.”

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26. See *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2408 (2014) (holding that petitioners failed to provide “special justification” for overruling *Basic*).
Federal lawmaking occurs outside of Congress in two distinct fora. First, Congress delegates extensive lawmaking power to executive and independent agencies. Beginning at the end of the nineteenth century with the rise of the administrative state, federal agencies have exercised an increasing percentage of the federal lawmaking power. This development raised questions about the extent to which Congress could delegate lawmaking authority to agencies, questions that are addressed by the nondelegation doctrine. Broadly speaking, the nondelegation doctrine accepts the premise that Congress may permissibly delegate some degree of lawmaking power to agencies, but also that the Constitution imposes limits on the scope of that delegation, providing that a delegation may exceed constitutional limits if Congress does not retain for itself the role of making the critical policy choices that underlie legislation.

Courts also make federal law. At a minimum, the process of interpreting federal statutes requires courts to engage in interstitial lawmaking—addressing questions that the statute does not answer. In some substantive areas, however, Congress has gone further, enacting broad legislation and calling upon “the courts to give shape to the statute’s broad mandate by drawing on common-law tradition.” The Sherman Antitrust Act is commonly cited as an example of this type of legislation. As Margaret Lemos explains: “The Sherman Act is a clear-cut and self-conscious delegation of lawmaking power to courts.”

Although the Court has applied different doctrinal principles to judicial and agency lawmaking, some commentators question whether framing the distinction in binary terms is appropriate. Importantly, analyzing the appropriate scope of non-legislative lawmaking power entails a common question: to what extent should non-congressional lawmaking be driven by policy considerations not specifically identified by Congress?

30. See, e.g., Gary Lawson, The Rise and Rise of the Administrative State, 107 Harv. L. Rev. 1231, 1241 (1994) (explaining that “the demise of the nondelegation doctrine . . . allows the national government’s now-general legislative powers to be exercised by administrative agencies”).
31. Id. at 1237–41.
33. Lemos, supra note 3, at 429.
34. Id.
35. See id.; see also Frank H. Easterbrook, Judicial Discretion in Statutory Interpretation, 57 Okla. L. Rev. 1, 6 (2004) (explaining that “what judges have done is little different from what the FTC does”).
36. There are somewhat different reasons to defend a policy-oriented approach to agency lawmaking, in that Congress may seek to use the structural advantages of administrative agencies to
This question underlies, in part, a debate about the most appropriate methodology for statutory interpretation by the courts. Advocates of a textualist approach, such as Justice Antonin Scalia, ground their defense of textualism in the constitutional requirements for lawmaking. Textualists argue that only the legislative text itself—and not its intentions or purposes—passed “the constitutional requirements of bicameralism and presentment.” As such, they view departures from textualism as infringing upon Congress’s lawmaking power. Other commentators take a more purposivist approach, in which they consider the policy context in which Congress has acted in promulgating legislation and the purposes to which that legislation was addressed.

This debate has an important role in the development of the private right of action for federal securities fraud. The antifraud provision of the Securities Exchange Act of 1934 is frequently described as an open-ended statute that authorizes broad judicial lawmaking, although it contains no express private right of action. As the Supreme Court explained, “[w]hen we deal with private [securities fraud] actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.” As a result, the courts have taken primary responsibility for developing the scope of the private right of action and articulating the legal requirements for a successful claim.

42. In contrast, the federal securities laws contain a number of provisions that create an express private right of action, including sections 11 and 12 of the 1933 Act and sections 9(e) and 18 of the 1934 Act. 15 U.S.C. §§ 77k–l, 78i(e), 78r (2014); see also, e.g., Musick, Peeler & Garrett v. Emp’rs Ins. of Wausau, 508 U.S. 286, 296 (1993) (identifying “eight express liability provisions contained in the 1933 and 1934 Acts”).
The judicial development of private securities fraud litigation began in the lower courts, which recognized an implied private right of action under SEC Rule 10b-5 as early as 1946. Although the Supreme Court did not reject the private right of action, its early decisions largely articulated limitations on the scope of a 10b-5 claim. Thus, in Ernst & Ernst v. Hochfelder, the Court held that a 10b-5 claim could not be predicated upon a showing of mere negligence but required proof of scienter. In Blue Chip Stamps v. Manor Drug Stores, the Court limited standing in private litigation to plaintiffs who had purchased or sold securities in connection with the fraud. In Sante Fe Industries, Inc. v. Green, the Court rejected an attempt to address a breach of fiduciary duty through a 10b-5 claim.

Even before the rise of the new textualism, the Court grounded these holdings largely on textualist grounds. Policy considerations were not, however, absent from the Court’s analysis. Rather, throughout its development of private securities fraud litigation the Court sought to balance the two competing interests of protecting investors and limiting the potential for litigation abuse. In Blue Chip Stamps, for example, the Court justified its restriction on the class of potential plaintiffs in terms of “considerations of policy,” including a desire to limit the potential settlement value of lawsuits that could not easily be dismissed prior to trial. Similarly, in Sante Fe, the Court identified the concern that a more expansive interpretation of 10b-5 would create a “danger of vexatious litigation.”

The Court’s 1988 decision in Basic Inc. v. Levinson was different both in the Court’s extensive reliance on policy considerations and in the fact that the decision expanded the scope of 10b-5 litigation. In Basic, the Court concluded that private plaintiffs need not offer direct proof of reliance but can use the fraud-on-the-market theory to obtain a

47. 421 U.S. 723, 731 (1975).
49. See, e.g., id. at 477 (“The language of the statute is, we think, ‘sufficiently clear in its context’ to be dispositive here . . . .”) (quoting Ernst, 425 U.S. at 201).
50. Blue Chip Stamps, 421 U.S. at 742–44.
51. Sante Fe Indus., 430 U.S. at 478–79 (quoting Blue Chip Stamps, 421 U.S. at 740) (internal quotation mark omitted).
presumption of reliance for securities that traded in an efficient market tainted by public misrepresentations. Commentators have described the Basic decision as opening the floodgates. Yet, even in Basic, the Court’s role was one of reining in more expansive lower court lawmaking.

The Basic Court explicitly explained that it was necessary to adapt the common-law reliance requirement to the realities of the modern securities markets. Moreover, the Basic Court justified its acceptance of the FOTM presumption not in terms of the statutory text or even congressional intent, but on the basis of “considerations of fairness, public policy, and probability, as well as judicial economy.” These considerations were based, in part, on the need to “balance[e] the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Federal Rule of Civil Procedure] 23.”

Importantly, the Court did not act alone in developing the scope of private securities fraud litigation. Congress responded to the foregoing judicial interpretations through explicit statutory provisions that in some cases clarified and in other cases modified the judicially-created legal rules. In 1995, Congress adopted the PSLRA. The PSLRA, which grew out of the Common Sense Legal Reform Act, reflected both congressional acceptance of the judicially-created private right of action and a reassertion of congressional authority over the scope of that right of action. Included in the statutory provision were a heightened pleading standard, a discovery stay, an explicit loss-causation requirement, and refinements to the calculation of damages. In addition, Congress adopted a lead-plaintiff provision in an effort to respond to the argument that securities fraud class actions constituted “lawyer-driven litigation.”

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53. Id. at 247–48.
54. See Fisch, supra note 19, at 896 n.2 (citing commentary on the effect of Basic).
55. See id. at 910 (stating that “Basic is properly understood not as a revolution, but a retrenchment”).
56. Basic, 485 U.S. at 243–47.
57. Id. at 245.
58. Id. at 242 (1988) (quoting another source) (internal quotation marks omitted). “The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases . . . .” Id. at 243–44.
60. See Fisch, supra note 20, at 536–37 (describing provisions of the PSLRA).
61. See Jill E. Fisch, Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel Under the PSLRA, 64 LAW & CONTEMP. PROBS. 55, 60 (2001) (describing adoption of the lead-plaintiff provision).
Subsequently, in 1998, Congress enacted SLUSA. The statute preempted state-court litigation for “covered class actions” in order to ensure that those cases were subject to the provisions of the PSLRA. In 2002, Congress also extended the statute of limitations in private securities fraud litigation.

In legislating private securities fraud, Congress reaffirmed the critical policy considerations that had previously been identified by the Court. Congress explicitly recognized the importance of private litigation as a supplement to public enforcement efforts. Thus, the statement of managers accompanying the conference report for the PSLRA described private securities litigation as “an indispensable tool,” both for protecting investors and for “promot[ing] public and global confidence in our capital markets.” This policy judgment is consistent with the Court’s analysis. As the Court has repeatedly explained, “private securities litigation [i]s an indispensable tool with which defrauded investors can recover their losses—a matter crucial to the integrity of domestic capital markets.”

At the same time, Congress sought to structure private litigation so as to minimize the potential for vexatious litigation. In the PSLRA, Congress chose to retain the private securities fraud class action but to refine its use by implementing substantive and procedural safeguards against overuse and abuse. These safeguards serve similar policy objectives as the limitations imposed by the Court in cases like Ernst, Blue Chip Stamps, and Central Bank.

III. HALLIBURTON II

A. The Halliburton Decision

In Halliburton II, the Court considered the question of whether to overrule its prior decision in Basic, which had allowed plaintiffs to obtain

63. Id.
67. See Fisch, supra note 20, at 534–35 (explaining congressional objective of reducing abusive litigation).
68. See Barbara Black, Eliminating Securities Fraud Class Actions Under the Radar, 2009 COLUM. BUS. L. REV. 802, 810 (“Congress chose not to eliminate the securities fraud class action, but to cure it and thus confirmed its importance to the integrity of the U.S. capital markets.”).
class certification on the basis of the FOTM presumption of reliance. The decision followed several prior attempts by defendants to limit securities fraud class actions. The *Halliburton* case had previously been before the Supreme Court in a decision in which the Court held that plaintiffs were not required to establish loss causation in order to obtain class certification. The following term, in *Amgen*, the Court similarly held that proof of materiality was not required at the class-certification stage.

Four justices in *Amgen* raised questions, however, about the continued viability of FOTM. Justice Alito wrote, in a concurring opinion, that FOTM “may rest on a faulty economic premise.” Justice Thomas, joined in dissent by Justice Kennedy and in part by Justice Scalia, wrote that the *Basic* decision was “questionable” and observed that there was academic disagreement over the degree of market efficiency upon which *Basic* was premised.

Petitioners in *Halliburton II* seized upon these statements. They argued that academic consensus and new evidence about market efficiency had undermined the economic theory upon which *Basic* was based, and that the Court should therefore overrule *Basic*.

The Supreme Court disagreed. The Court explained that the petitioners had overstated the degree to which the *Basic* decision relied on strong claims of market efficiency. Instead, the Court stated that the presumption of reliance rested on the “modest premise” that “public information generally affects stock prices.” The Court thereby reasoned that the modern debate about the “degree” to which prices accurately reflect public information is “largely beside the point.” Similarly, the Court reaffirmed *Basic’s* determination that most investors rely on a

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72. *Id.* at 1204–16.
73. *Id.* at 1204. He therefore reasoned that “reconsideration of the *Basic* presumption may be appropriate.” *Id.*
74. *Id.* at 1208 n.4.
77. *Id.* at 2409.
78. *Id.* at 2410.
79. *Id.*
security’s market price “as an unbiased assessment of the security’s value in light of all public information.”80

More importantly, the Court observed that Basic’s presumption of reliance, as a substantive doctrine of federal securities law, was entitled to stare decisis principles.81 It reasoned that principles of stare decisis apply with “special force” in the area of statutory interpretation.82 The Court stated that absent special justification, which the Court found lacking, it was inappropriate to overrule Basic.83

B. An Alternative Theory for Retaining Basic

In ruling on the request to overrule Basic, the Halliburton II Court focused the bulk of its attention on the Basic decision itself. The Court considered the issues that the Basic Court had decided, explicitly and implicitly, in that decision.84 The Court also reflected upon whether it was appropriate to look to developments in economics as a basis for reconsidering the reasoning in Basic.85

Yet, it is possible to uphold FOTM on a different theory. As explained in Part II above, a key feature of federal securities fraud litigation is that it has been the focus of a collaborative lawmaking partnership between Congress and the Court. This collaboration is entitled to special weight and distinguishes Congress’s role from standard legislative inaction. Accordingly, this Article makes the novel claim that the Court should view the existence of the collaborative process as an independent justification for adhering to Basic. More broadly, the collaboration enables the Court to evaluate FOTM in the context of the policy considerations that justify retaining private securities fraud class actions.

As explained above, the Court and Congress have both contributed to the development of the private right of action for federal securities fraud.

80. Id. at 2411 (citing Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1192 (2013)).
81. Id. at 2411–12.
82. Id. at 2411 (internal quotation marks omitted).
83. Id. at 2407–13. The Court went on to consider a second argument by petitioners concerning evidence of price distortion. Id. at 2409–11. It concluded that the defendants in an FOTM case should be allowed, at class certification, to introduce evidence of lack of price distortion to rebut the presumption of reliance. Id. at 2414–17. I address this aspect of Halliburton II elsewhere. See Jill E. Fisch, The Future of Price Distortion in Federal Securities Fraud Litigation, 10 DUKE J. CONST’L. L. & PUB. POL’Y 87, 95–96 (2015).
84. See, e.g., Halliburton II, 134 S. Ct. at 2409 (refusing to reconsider an argument previously rejected by the Basic majority).
85. See id. (analyzing petitioner’s argument that the two premises upon which Basic was based “can no longer withstand scrutiny”).
In understanding *Halliburton II*, however, it is important to recognize that a major focus of this collaboration has been the securities fraud class action. The Supreme Court’s acceptance of FOTM in *Basic* was motivated by an effort to enable securities fraud class actions to conform to the commonality requirement of Federal Rule of Civil Procedure 23.86 Similarly, the PSLRA responded to concerns about abusive litigation with a range of procedural reforms expressly targeted to the class action.87 SLUSA, in turn, confirmed the focus of the PSLRA by preventing litigants from using state court litigation to avoid these reforms.88

*Basic* was clearly premised on the need to reconcile securities fraud litigation with Rule 23’s class action requirements. The *Basic* Court explained: “Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.”89 The Court went on to note with approval the District Court’s conclusion that FOTM offered “a practical resolution to the problem of balancing the substantive requirement of proof of reliance in securities cases against the procedural requisites of [Federal Rule of Civil Procedure] 23.”90 This focus was consistent with the intent of the Federal Civil Rules Advisory Committee, which drafted Rule 23, in 1966, with securities fraud as a model for class litigation.91 As the Committee recognized, the class action device was also an important tool for ensuring effective enforcement of the federal securities laws, explicitly recognizing this function in developing the rule.92 By accepting FOTM, *Basic* empowered private securities fraud litigation to serve as a tool for effective enforcement and created the opportunity for the development of the modern securities fraud class action.

Congress specifically focused in the PSLRA on the development of class action litigation. Section 21D(a) of the PSLRA is explicitly entitled

87. See *Fisch*, supra note 20, at 536-37.
90. *Id.* (quoting District Court) (internal quotation marks omitted).
92. *Id.*
“Private Class Actions” and introduces a range of reforms that apply exclusively to securities fraud class actions. These reforms placed additional burdens on investors seeking to bring class actions, in an effort to reduce abusive litigation. By tailoring the structure of the class action rather than eliminating it, the PSLRA reflected an implicit congressional decision to retain the class action mechanism and the FOTM theory that made it possible. Importantly, the adoption of these reforms made little sense absent a desire to retain the class action mechanism.

More broadly, the PSLRA can be understood as a legislative compromise in an effort to achieve two competing goals: reducing burdensome and potentially frivolous litigation while preserving the ability of investors to pursue meritorious claims. Empirical evidence suggests that Congress was successful in achieving both goals. Studies show that the adoption of the PSLRA’s heightened pleading standard facilitated the ability of courts to dismiss weak cases. A further effect is that, according to some studies, plaintiffs’ lawyers screen more diligently for case quality and do not even file weak cases. Moreover, because of the PSLRA’s discovery stay, these cases do not impose burdensome litigation costs upon defendants.

At the same time, the lead-plaintiff provision of the PSLRA has dramatically increased the involvement of large institutional investors in securities fraud class actions. In turn, this has had the effect of increasing

93. 15 U.S.C. § 78u-4(a) (2014); see also Fisch, supra note 20, at 536 (explaining that PSLRA reforms “targeted the class action structure in particular”).
94. “Congress chose not to eliminate the securities fraud class action, but to cure it and thus confirmed its importance to the integrity of the U.S. capital markets.” Black, supra note 68, at 810.
95. See, e.g., Donald C. Langevoort, Judgment Day for Fraud-on-the-Market: Reflections on Amgen and the Second Coming of Halliburton, 57 ARIZ. L. REV. 37, 42 (2015) (“[T]he structure of the PSLRA makes no sense unless read as a political compromise that preserves the foundation of the fraud-on-the-market class action while making it harder for plaintiffs to bring, plead, and prove a successful claim through a variety of reforms.”).
settlement amounts in meritorious cases and reducing the fees paid to class counsel. 100

Congress’s adoption of SLUSA reflected similar objectives and enhanced the effectiveness of the PSLRA reforms. SLUSA was adopted in response to efforts by plaintiffs to avoid the procedural requirements of the PSLRA by litigating securities fraud class actions in state court. 101 SLUSA eliminated these efforts by preempting state court litigation. 102 Significantly, SLUSA, by its terms, applies to “covered class actions,” demonstrating both an effort to retain the class action mechanism and to ensure that this litigation takes place in federal court under the provisions of the PSLRA. 103 In addition, Congress defined the term “covered class action” explicitly to incorporate the FOTM presumption. 104

The foregoing process can be understood as sequential collaboration between the Court and Congress. First, the Court acted in Basic to identify the need for the fledgling class action mechanism to enable the cost-effective litigation of private securities fraud claims in order to ensure the litigation served as a viable means of enhancing enforcement. The SEC evaluated the role of private litigation and defended the class action—to the Court and Congress—as a necessary supplement to public enforcement. Congress, after observing the development of the class action mechanism, adopted various procedures to refine its operation in securities fraud cases. These adjustments offered the potential for securities fraud class actions to offer more effective deterrence by increasing case quality and limiting the potential for frivolous litigation.

The iterative adjustments to the securities fraud class action can be understood as a type of lawmaking partnership in which both the Court and Congress have recognized the objective of structuring a procedural device that facilitates effective enforcement of the disclosure obligations of the federal securities laws and affirmatively acted to further that

103. A “covered class action” is defined as a class action where “damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate.” Id. § 78bb(f)(5)(B)(i)(I).
104. See id.
Because of Congress’s role in responding to Basic and revising the nature of the securities fraud class action in important ways, Basic and its progeny are not properly understood simply as judicial interpretations of section 10(b) of the 1934 Act. In the PSLRA and SLUSA, Congress did more than silently acquiesce in judicial lawmaking; Congress embraced and sought to improve upon the Court’s work.

This lawmaking partnership puts FOTM on a different legal footing than the standard interpretation of a federal statute. The Court has struggled with the question of whether to give weight to congressional inaction. Some commentators have argued that congressional silence or failure to overturn judicial interpretation of a statute, at least in some cases, should be understood as acquiescence in that interpretation.

Others have identified the problems with relying on legislative silence as indicative of congressional intent, including the fact that multiple inferences can be drawn from Congress’s failure to act. The claim asserted in this Article is different in a critical respect. With respect to securities fraud class actions, Congress has taken affirmative action to refine and reinforce the class action mechanism. Put differently, Congress has expanded upon the “building block” of Basic. This expansion reinforces the Basic decision as presumptively correct.

Importantly, this Article reads congressional lawmaking with respect to the securities fraud class action as an implicit endorsement of Basic. Concededly, this is different from an explicit congressional statement codifying the judge-made law, and, in the case of the PSLRA, Congress expressly stated that it was neither codifying nor rejecting any implied

105. Donald Langevoort has questioned my characterization of this collaboration as a partnership, observing that Congress has the upper hand in that it has the power to override judicial lawmaking. While the point is well taken, equal decisionmaking authority among all partners is merely a default rule that the parties are free to modify. See REvised Unif. P’Ship Act §§ 103, 404 (1997). Alternatively, the Court’s role might be characterized as that of a junior partner, rather than Congress’ co-equal. See, e.g., Richard H. Fallon, Jr., On Viewing the Courts as Junior Partners of Congress in Statutory Interpretation Cases: An Essay Celebrating the Scholarship of Daniel Meltzer 4 (unpublished manuscript) (arguing that “characterization of courts as junior partners rather than mere agents implies that they should regard themselves as trusted rather than distrusted agents, with some latitude to look beyond the letter of statutory language, especially when confronting cases of a kind that Congress likely did not foresee at the time of a statute’s enactment”).

106. See, e.g., Eskridge, supra note 8, at 71–78.


108. See generally Eskridge, supra note 8.
private right of action.\textsuperscript{109} As will be developed further below, Congress might have a variety of reasons for failing to codify such a right of action expressly, including political constraints and a reluctance to constrain the scope of future judicial interpretation. These considerations, as will be discussed, are fundamental reasons for the use of a lawmaking partnership in preference to constraining judicial lawmaking through a more restrictive statute.

The implications of the lawmaking partnership constitute more than a reason for the Court not to overrule a prior interpretive decision, however. The collaboration reflected in the partnership context suggests that the Court should understand congressional interventions such as the PSLRA as refinements rather than rejections of its approach.

IV. CONCEPTUALIZING THE LAWMAKING PARTNERSHIP

\textit{Halliburton II}'s decision to reaffirm \textit{Basic} is supported by the lawmaking partnership that has led to the development of the securities fraud class action. The existence of a lawmaking partnership is not unique to securities fraud litigation, however. A similar analysis should apply in other areas in which Congress and the Court have engaged in collaborative lawmaking. Simply put, judge-made law in the form of a statutory interpretation that has been developed or reinforced through a lawmaking partnership should be viewed by the courts as presumptively correct absent clear congressional action overruling it.

Three distinctive features of a lawmaking partnership warrant this presumption. First, the original statute, as with section 10(b), must be the type of open-textured statute that permits judicial lawmaking through the process of statutory interpretation. Second, Congress and the Court must engage in sequential adjustments, in each case cognizant of and responding to concerns that are raised in the other forum. Third, Congress and the Court must make these adjustments in furtherance of a common objective.

Each of these features is a necessary component of a lawmaking partnership. The first, an open-textured statute, has received considerable attention in the academic literature.\textsuperscript{110} Commentators argue that Congress uses this type of legislation purposefully to enable a common-law

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process. Although this Article does not take a normative position on whether such congressional delegations are desirable, it is reasonable to conclude that Congress chooses to use an open-textured statute in cases in which it contemplates a more expansive interpretive role for the courts. Reasons for this more expansive role might include limited congressional knowledge of the consequences of specific regulatory choices and a desire to encourage the type of evolutionary approach that characterizes common-law lawmaking.

The second feature, sequential adjustments by both the Court and Congress, distinguishes the lawmaking partnership from mere congressional inaction. By taking affirmative steps in response to judicial lawmaking, Congress demonstrates that its failure to reject features of the judge-made law is not the result of political gridlock or inattention. By definition, congressional responsiveness to the Court’s interpretation reflects awareness of the Court’s actions. Similarly, the responsive legislation constitutes action rather than inaction, thereby belying arguments that Congress was unable to react to an erroneous interpretation because of gridlock, other policy priorities, or inertia.

Finally, a lawmaking partnership is characterized by a common set of policy objectives. This distinguishes the lawmaking partnership as a common enterprise rather than two actors that are competing or working at cross-purposes. Specifically, congressional responses to the Court’s interpretation should reflect a consistency rather than a replacement of the policy objectives identified by the Court. Similarly, congressional action that seeks to correct errors in the Court’s approach or to update policies that have become obsolete would not qualify.

In the context of private securities fraud litigation, the partnership structure offers distinctive lawmaking advantages. One advantage is that it enables Congress to achieve a level of political insulation with respect to its enforcement policy. Private securities fraud litigation is a political hot potato and, as a result, an area in which interest-group politics is a particular concern. Corporate issuers and their executives face
substantial liability risk in private litigation and incur considerable costs in both insurance and litigation defense. These defendants pressure Congress to reduce the scope of their liability risk by restricting private litigation. On the other hand, the plaintiffs’ bar is a formidable political force as well. One study reports that the amount donated by lawyers, primarily plaintiffs’ lawyers, to federal political candidates since 1990 is more than $1 billion.115 Putting aside the extent to which political donations and lobbying influence congressional policymaking, it is easier for Congress to delegate determination of the scope of private litigation to the federal judiciary, which enjoys life tenure. Judicial lawmaking also provides a mechanism to overcome the gridlock that might result from high levels of interest-group engagement.

The lawmaking partnership also exploits the differential institutional competencies of the Court and Congress. The evaluation of the scope and quality of private litigation is a subject that is peculiarly within the competence of the judiciary. The courts can readily observe the quality of private lawsuits and the extent to which litigation filings are correlated with serious misconduct. The courts can also determine the effect of various reforms such as a heightened pleading standard on litigation volume and case quality. At the same time, Congress has the capacity to consider evidence that the courts cannot observe. This evidence might include the effect of litigation costs on issuers’ decisions to go public or to list their securities in the United States, or the effect of private enforcement on the capital markets.116 Thus, even with a common objective, the Courts and Congress can bring distinct issues of competence to the question of how best to achieve that objective.

By delegating the development of private enforcement to the courts, Congress creates a potential check on the possibility of agency capture.117 The antifraud provision, like most of the federal securities laws, can be enforced by the SEC as well as private litigants.118 Some commentators have advocated for the elimination of private securities fraud litigation, capture is “particularly pronounced in financial services” because of the substantial industry clout effected through political donations and lobbying).


116. Congress may also be in a better position than the courts to evaluate effects outside the litigation context, such as effects on the provision of financial products or the depth of the capital markets.


arguing for the superiority of public enforcement.\textsuperscript{119} Yet the effectiveness of public enforcement depends critically on the SEC’s exercise of its enforcement authority.\textsuperscript{120} An important constraint on public enforcement is the availability of resources—the SEC depends on Congress for funding, and Congress can limit enforcement activity just by closing the purse-strings.\textsuperscript{121} In addition, the broad scope of regulation and actors subject to federal securities regulation requires the SEC to make policy choices. SEC officials and staff may make such choices for a variety of reasons—such as a desire to appeal to the media, to further personal career objectives, or to assuage congressional critics.\textsuperscript{122} The courts are particularly well positioned to observe the areas in which SEC enforcement operates effectively. Although the courts cannot address deficiencies in public enforcement directly,\textsuperscript{123} they can identify those areas in which private enforcement is serving as a useful supplement by targeting conduct or defendants that are not the focus of the regulators.\textsuperscript{124}

Finally, the lawmaking partnership offers a dynamic process. Common-law adjudication has long been defended on the basis of its ability to operate incrementally and to evolve in response to changing circumstances.\textsuperscript{125} These features prevent the type of obsolescence that can occur in both congressional and agency lawmaking. In the context of financial regulation, this flexibility and responsiveness are particularly valuable because of the speed at which the market changes, creating new


\textsuperscript{123} Cf. SEC v. Citigroup Global Mkts., Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (raising concerns about the SEC’s enforcement policy choices and, as a result, refusing to approve proposed settlement of SEC enforcement action), vacated, 752 F.3d 285 (2d Cir. 2014).


regulatory demands. Again, the case of federal securities fraud offers an illustration. The public capital markets have shifted, over the past sixty years, from retail to largely institutional markets, with an ever-diminishing share of US equities held by retail investors. A Both institutional and retail money has moved, to an increasing degree, into indexed investments that are not made on the basis of information disclosure or issuer fundamentals. New types of traders have entered the market, such as hedge funds and high-frequency traders. Market information has shifted from paper-based disclosure documents to the internet and is conveyed through an ever-growing range of intermediaries. As the nature of the market changes, so do the nature of securities fraud and the scope of litigation necessary to deter such fraud effectively, as well as the costs and benefits of an enforcement regime.

A lawmaking partnership offers two different mechanisms for identifying and responding to these developments, reflecting the different expertise and informational access of the courts and Congress. Thus, for example, Basic responded to the impersonal nature of the public capital markets by recognizing the difficulty for investors of proving reliance directly. The PSLRA responded to the emergence of institutional investors by harnessing their larger stakes and greater sophistication in the form of the lead plaintiff as a way of controlling litigation decisions. SLUSA responded to an effort by the plaintiffs’ bar to shift litigation into state court in order to avoid provisions such as the discovery stay. The Court interpreted the heightened pleading standard of the PSLRA in a manner that effectively implemented Congress’s gatekeeping objective in

127. See, e.g., RUSSELL INVESTMENTS, INDEX INDUSTRY INNOVATION LEADS TO GROWING ADOPTION OF ETFS AMONG INSTITUTIONAL INVESTORS I (2014) (reporting that “assets in index-based strategies reached more than $7 trillion worldwide in 2013”).
light of its observations about the challenges of pleading the required state of mind.\textsuperscript{133}

V. THE LAWMAKING PARTNERSHIP BEYOND \textit{HALLIBURTON II}

A. Other Applications of the Partnership Framework

The analysis in this Article is broadly applicable outside the area of federal securities fraud. Although consideration of the lawmaking partnership in the context of other statutory schemes is beyond the scope of this Article, securities regulation alone offers numerous instances in which the collaborative interplay of congressional and judicial lawmaking suggests that the Court should apply a more flexible and goal-oriented approach to interpreting the applicable statute.\textsuperscript{134} Within federal securities fraud litigation, evidence of a lawmaking partnership might inform the Court’s analysis of a variety of issues.

One such issue is the extraterritorial scope of the antifraud provision. For many years, the courts applied section 10(b) to fraud involving conduct or effects within the United States.\textsuperscript{135} Congress did not interfere with these decisions for decades, allowing the courts to act in a “quasi-legislative role.”\textsuperscript{136} In \textit{Morrison v. National Australia Bank Ltd.}, the Court overturned these decisions and concluded that section 10(b) did not extend outside the United States.\textsuperscript{137} Congress subsequently responded to \textit{Morrison} in Dodd-Frank, both by reinstating the conduct and effects tests for SEC enforcement actions,\textsuperscript{138} and by ordering the SEC to “solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities and Exchange Act of 1934 . . . should be extended.”\textsuperscript{139}

\textsuperscript{133} See \textit{Tellabs, Inc. v. Makor Issues & Rights, Ltd.}, 551 U.S. 308 (2007).


\textsuperscript{137} 561 U.S. 247, 273 (2010).


\textsuperscript{139} \textit{Id.} § 929Y(a).
A second issue that has involved collaboration between the Court and Congress is determining the appropriate scope of liability exposure for secondary defendants. As with Morrison, the lower courts had applied the concept of aiding and abetting from the common law to private claims for federal securities fraud. In Central Bank, the Supreme Court rejected that approach, holding that section 10(b) does not create a cause of action for aiding and abetting. Congress subsequently responded to the concerns about the potential adverse effects of liability for secondary defendants in the PSLRA. Nonetheless, in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., the Court concluded that section 10(b) did not provide a private right of action against defendants who did not make fraudulent statements to the investing public. Most recently, Congress responded in Dodd-Frank with modifications to the liability exposure of secondary defendants—expanding the SEC’s authority to bring aiding and abetting claims and lowering the required state of mind for such liability from knowledge to recklessness. In addition, Dodd-Frank required the US Government Accountability Office to conduct a study on the impact of a private right of action for aiding and abetting.

The partnership analysis also offers insights with respect to the determination of the required mental state for fraud liability. The Court rejected negligence based liability in Ernst and held that scienter was the necessary state of mind, but it declined to define scienter or to determine whether proof of recklessness was sufficient. Congress did not specify the required state of mind when it adopted the PSLRA. Instead, it crafted the heightened pleading requirement to incorporate the judicially-created ambiguity—providing that the plaintiff “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” In turn, the Court took on the task of interpreting this

142. See Fisch, supra note 140, at 1293–94.
144. Id. at 154–67.
146. Id. § 929Z(a).
provision in *Tellabs*, and it concluded that, because Congress did not “throw much light” on what was meant by a “strong inference,” its task was to “prescribe a workable construction . . . geared to the PSLRA’s twin goals: to curb frivolous, lawyer-driven litigation, while preserving investors’ ability to recover on meritorious claims.”

**B. The Lawmaking Partnership and Insider Trading**

Perhaps the most compelling example of the lawmaking partnership is the development of the legal prohibition on insider trading. Because the scope of insider trading regulation and the appropriate role for the judiciary in developing insider trading law are currently the subject of some debate after the Second Circuit’s recent *Newman* decision, this Article will briefly consider the implications of the lawmaking partnership framework for that debate.

Federal insider trading liability is based on section 10(b), the same general antifraud provision discussed earlier in this Article in the context of private securities fraud. The statute itself contains no reference to insider trading or nonpublic information. Instead, insider trading liability has been developed through the joint actions of the Court and Congress.

The Court moved first. In *Chiarella v. United States*, the Court accepted the premise that trading on material inside information could

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150. *Id.* at 321–22 (internal quotation marks omitted).
151. See Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 S.M.U. L. REV. 1589, 1628 (1999) (arguing that “the Supreme Court should treat the insider trading prohibition as though it were a species of federal common law”).
152. See, e.g., Tanya Dmitronow et al., *After Newman, Congress Seeks to Define Insider Trading*, PROSKAUER ROSE LLP CORPORATE DEFENSE AND DISPUTES BLOG (Mar. 16, 2015), http://www.corporatedefensedisputes.com/2015/03/after-newman-congress-seeks-to-define-insider-trading/ (“Ever since the U.S. Court of Appeals for the Second Circuit issued its landmark decision in *United States v. Newman*, debate has raged about whether the court has sanctioned insider trading or has appropriately restrained the Government’s efforts to prosecute innocent market conduct—and whether the judiciary, rather than Congress, should be defining and outlawing insider trading in the first place.”).
155. The actions of the SEC and the Department of Justice in bringing insider trading cases before the Court obviously play a critical role as well. This Article will address the SEC’s role below. See infra notes 188–211 and accompanying text.
constitute securities fraud. The Court’s holding was a restrictive one, however. It concluded that insider trading liability was premised on the fiduciary duties owed by corporate insiders to the corporation. Corporate insiders who possessed no such duties could not be liable under this classical theory because their failure to disclose material nonpublic information did not constitute actionable fraud. Importantly, the Court observed that its conclusion was not grounded in the statutory text or a finding of congressional intent, noting that “neither the legislative history nor the statute itself affords specific guidance” as to the circumstances in which “silence may constitute a manipulative or deceptive device.”

Chiarella did not address situations in which insiders, rather than trading themselves, disclose inside information to others who subsequently trade. In 1983, the Court addressed this so-called “tipping” in Dirks v. SEC. Importantly, Dirks reinforced the Court’s holding in Chiarella that insider trading required a predicate breach of fiduciary duty. In Dirks, the Court concluded that tippees could only be liable if the tipper breached a fiduciary duty in disclosing the inside information and if the tippee knew of the breach. Dirks further explained that a tipper breached his or her duty by receiving a personal benefit in exchange for the tip or if he or she intended to bestow a gift on the recipient.

Many commentators were dissatisfied with the limitations on insider trading liability imposed by the Chiarella and Dirks decisions. Commentators also raised objections to the regulatory ambiguity. As Senator Alfonse D’Amato observed: “the present state of uncertainty about the law is simply not acceptable.”

Between 1986 and 1988,

156. 445 U.S. 222, 230 (1980) (“Application of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder’s welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information.”).
157. Id. at 224–30.
158. Id. at 231–35.
159. Id. at 226.
161. Id. at 660.
162. Id.
163. Id. at 663–64.
Congress held four separate sets of hearings devoted specifically to insider trading regulation.\textsuperscript{167}

In 1984, Congress adopted its first response to the \textit{Chiarella} and \textit{Dirks} decisions. The Insider Trading Sanctions Act of 1984\textsuperscript{168} did not revise the judicial approach to insider trading liability or expand the scope of the prohibition but merely made minor modifications to insider trading liability, including a prohibition on the trading of options and other derivatives in circumstances in which it would be illegal to trade stock and a provision providing for treble damages.\textsuperscript{169} The adoption of the 1984 statute suggested that Congress was aware of the scope of insider trading liability reflected in the \textit{Dirks} and \textit{Chiarella} decisions and chose not to alter this scope. Despite the urging of several witnesses, Congress did not adopt a formal definition of insider trading in the statute.\textsuperscript{170}

In 1987, in response to a request from the Senate Securities Subcommittee, the SEC drafted proposed legislation that would have provided a definition of insider trading and modified several aspects of the Supreme Court’s decisions.\textsuperscript{171} A specific issue that had divided lower courts was the extent to which insider trading liability could be premised on an alternative theory: the misappropriation theory.\textsuperscript{172} The SEC’s draft legislation sought to codify the misappropriation theory and to specify the circumstances and relationships that might give rise to a predicate duty.\textsuperscript{173} Congress chose again, however, not to adopt the misappropriation theory or any type of statutory definition.\textsuperscript{174} Instead, in the Insider Trading and Securities Fraud Enforcement Act of 1988 (“ITSFEA”), Congress

\begin{quote}
\textsuperscript{169} Id.
\textsuperscript{174} Painter et al., supra note 165, at 201–02.
\end{quote}
increased the penalties for insider trading and also added a private remedy for contemporaneous traders.\textsuperscript{175}

Notably, however, Congress did not codify the misappropriation theory, which was enjoying general acceptance in the lower courts.\textsuperscript{176} Indeed, ITSFEA contained explicit findings that the SEC’s rules regarding insider trading were “necessary and appropriate,” and that it had “enforced such rules and regulations vigorously, effectively, and fairly.”\textsuperscript{177} As Steve Thel argues, these findings can be read as a congressional endorsement of the misappropriation theory.\textsuperscript{178}

The Supreme Court accepted the misappropriation theory in \textit{O’Hagan}.\textsuperscript{179} Importantly, the \textit{O’Hagan} decision departed from the narrow approach to insider trading liability reflected in \textit{Chiarella} and \textit{Dirks}, relying instead on policy considerations to support its characterization of misappropriation as informational fraud.\textsuperscript{180} As Justice Ginsberg explained, the misappropriation theory is “tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence.”\textsuperscript{181}

The \textit{O’Hagan} decision did not eliminate all confusion over the scope of insider trading liability exposure.\textsuperscript{182} The Court’s acceptance of the misappropriation theory, however, reduced the pressure on Congress to adopt insider trading legislation.\textsuperscript{183} This outcome was viewed as less than optimal by some commentators who had argued that the scope of insider trading liability should be definitively resolved through legislation.\textsuperscript{184}


\textsuperscript{176} See Weiss, supra note 172, at 398–422.

\textsuperscript{177} Insider Trading and Securities Fraud Enforcement Act of 1988 § 2.


\textsuperscript{180} See Weiss, supra note 172, at 398 (explaining that the Court “explicitly relied on considerations of public policy to explain its support for the misappropriation theory”); \textit{see also} \textit{O’Hagan}, 521 U.S. at 638–59 (justifying Court’s holding in terms of the investor’s “informational disadvantage” relative to the insider).

\textsuperscript{181} \textit{O’Hagan}, 521 U.S. at 658.

\textsuperscript{182} See Painter et al., supra note 165, at 202 (identifying continuing issues of ambiguity and concern); \textit{cf.} Weiss, supra note 172, at 438 (concluding that, although \textit{O’Hagan} leaves “a few loose ends,” it “comes close to completing the development of a sensible, comprehensive regulatory framework”).

\textsuperscript{183} \textit{See}, \textit{e.g.}, Carol B. Swanson, \textit{Reinventing Insider Trading: The Supreme Court Misappropriates the Misappropriation Theory}, 32 WAKE FOREST L. REV. 1157, 1212 (1997) (“[W]ith the misappropriation theory firmly in place, Congress lacks the impetus to define through legislation the parameters of insider trading liability.”).

Congress adopted additional insider trading legislation in 2012 when it passed the Stop Trading on Congressional Knowledge Act (“STOCK Act”). The STOCK Act prohibits members of Congress from trading on inside information. Two aspects of the STOCK Act reinforce the characterization of the development of insider trading regulation as a collaborative process. First, Congress again declined to provide a statutory definition of insider trading. Second, in extending the prohibition, Congress incorporated the fiduciary duty approach reflected in the Court’s decisions. Specifically, the Act provides that members of Congress owe a duty of trust and confidence to Congress, the federal government, and US citizens “solely for purposes of the insider trading prohibitions.”

C. A Third Partner—The SEC

The example of insider trading introduces an additional dynamic into the lawmaking process—the SEC. As discussed in Part II of this Article, commentators have devoted considerable energy to debating the appropriate extent to which Congress should delegate lawmaking authority to federal agencies. Much of that debate focuses on the appropriate scope of agency rulemaking. Courts exercise oversight over agency rulemaking through application of the nondelegation doctrine, although the Supreme Court’s application of this doctrine has been extremely limited. Courts have also scrutinized agency rulemaking to ensure that it falls within Congress’s delegation of authority and is exercised in a manner that is not arbitrary and capricious.

The SEC’s role with respect to insider trading, at least initially, was not legislative in nature. Rather than formulating the scope of liability through formal rulemaking, the SEC fashioned the liability standard by bringing enforcement actions that were, in some cases, supplemented by

186. Id.
187. Id. § 4(g)(1); see also Sung Hui Kim, The Last Temptation of Congress: Legislator Insider Trading and the Fiduciary Norm Against Corruption, 98 CORNELL L. REV. 845, 849–50 (2013) (explaining how structure of the STOCK Act incorporated the Court’s fiduciary approach).
188. See supra Part II.
Department of Justice criminal prosecutions. It was the SEC—not Congress or the courts—that made the initial decision to use the general antifraud provision as a basis for imposing insider trading liability. Subsequently, the SEC’s enforcement actions have repeatedly tested the boundaries of existing law and offered new theories of liability.

Although enforcement has been the agency’s primary lawmaking role, the SEC has also responded to restrictive judicial decisions through formal rulemaking. For example, the SEC responded to the narrow scope of the Chiarella decision by promulgating Rule 14e-3, which prohibits insider trading in connection with a tender offer and does not require a fiduciary duty. The SEC responded to the information asymmetries authorized by the Dirks decision by adopting Regulation FD. The SEC also “extend[ed] the boundaries of Rule 10b-5 through the promulgation of Rules 10b5-1 and 10b5-2.” Rule 10b5-1 attempts to resolve a debate over whether mere possession of material nonpublic information is enough for liability by prohibiting trading if the defendant is “aware of the material, nonpublic information” when making the trade. Rule 10b5-2 provides a non-exclusive definition of circumstances in which a person will be deemed to have a relationship of trust and confidence for purposes of the misappropriation theory.

The inclusion of the SEC in the lawmaking partnership adds an additional dimension to the lawmaking process. In many cases, Congress

192. Commentators have termed this approach “regulation by enforcement,” and some have been highly critical. See, e.g., Harvey L. Pitt & Karen L. Shapiro, Securities Regulation by Enforcement: A Look Ahead at the Next Decade, 7 YALE J. ON REG. 149, 155 (1990); see also John Van De Weert & Maria Earley, CFPB Blurs Line Between Enforcement, Regulation, Nat’l J. (May 25, 2015), http://www.nationallawjournal.com/id=1202727293268/CFPB-Blurs-Line-Between-Enforcement-Regulation?slreturn=20151012160901 (describing similar approach by the Consumer Financial Protection Bureau).


194. See, e.g., James J. Park, Rules, Principles, and the Competition to Enforce the Securities Laws, 100 CALIF. L. REV. 115, 151 (2012) (“Throughout the years, the SEC has consistently pushed the boundaries of insider trading law.”).


and the Court have embraced the SEC’s lawmaking initiatives, agreeing that the SEC’s approach furthered their common policy objectives. Thus, for example, Congress explicitly found, in section 2 of the ITSFEA, that the SEC’s rules and regulations governing insider trading were “necessary and appropriate,” and that the Commission had “enforced such rules and regulations vigorously, effectively, and fairly.” Similarly in O’Hagan, the Court both accepted the misappropriation theory proffered by the government as encompassing the necessary deception required by its earlier decisions and upheld the SEC’s adoption of Rule 14e-3.

In other cases, however, the Court has restrained the SEC’s enforcement zeal. As noted above, even as the Court accepted insider trading liability in Chiarella, and extended that liability to tippees in Dirks, it held that the SEC’s desired scope of liability was too broad. In particular, the Court has rejected the SEC’s desired parity-of-information standard. Similarly, in Dirks, the Court insisted that tippee liability be premised both upon a breach of fiduciary duty and the tippee’s awareness of that breach, finding support for this approach in the scienter requirement.

Recent enforcements by the SEC have raised similar concerns in the lower courts. Mark Cuban fought a five-year battle with the SEC and won. Cuban also raised questions about the validity of Rule 10b5-2, questions that the District Court took seriously but were mooted by

202. United States v. O’Hagan, 521 U.S. 642, 655 (1997) (“The misappropriation theory advanced by the Government is consistent with Santa Fe Industries, Inc. v. Green, 430 U.S. 462 ... (1977), a decision underscoring that § 10(b) is not an all-purpose breach of fiduciary duty ban; rather, it trains on conduct involving manipulation or deception.”). Importantly, the Court observed that the scope of its acceptance of the misappropriation theory was limited by “two sturdy safeguards” provided by Congress regarding scienter. Id. at 665.
203. Id. at 667.
206. Dirks, 463 U.S. at 654–64.
208. See SEC v. Cuban, 634 F. Supp. 2d 713, 730–31 (N.D. Tex. 2009) (holding that SEC could not use Rule 10b5-2 to predicate misappropriation liability on the basis of a mere confidentiality agreement), vacated, 620 F.3d 551 (5th Cir. 2010). At trial, the Court instructed the jury that “the SEC had to prove that Cuban agreed (a) to keep the information confidential, and (b) not to trade on it or use it for his own benefit.” John Sylvia & Chip Phinney, Insider Trading: Lessons from the Mark Cuban Jury Verdict, SECURITIES MATTERS (Oct. 18, 2013), https://www.securitiesmatters.com/2013/10/insider-trading-lessons-from-the-mark-cuban-jury-verdict/.
changes in the SEC’s theory of liability.\textsuperscript{209} In \textit{United States v. Newman}, the Second Circuit overturned the convictions of two hedge fund managers, third- and fourth-degree “remote tippees.”\textsuperscript{210} Citing \textit{Dirks}, the court stated that the defendants’ liability required the tipper to obtain a personal benefit from tipping, and that there was insufficient evidence even that the insiders had received a personal benefit, and “absolutely no . . . evidence” that the defendants had any knowledge about a personal benefit.\textsuperscript{211}

\textbf{D. Implications of the Lawmaking Partnership for Insider Trading}

Existing insider trading law is the product of a lawmaking partnership, as conceptualized by this Article. Insider trading liability is premised on section 10(b), an open-textured statute—indeed, the statute is so open-textured that it does not even mention insider trading explicitly. The Court, Congress, and the SEC have made multiple adjustments and refinements to the regulation of insider trading. In each case, these adjustments have been cognizant of and responsive to the efforts of other lawmaking partners. Finally, as with private securities fraud litigation, the lawmaking enterprise seeks to appear to share the common objectives of addressing information disparities in the securities markets and maintaining public confidence\textsuperscript{212} while providing sufficient limiting principles to allow the necessary information flow to preserve healthy and efficient markets.\textsuperscript{213}

Insider trading also demonstrates the advantages of the lawmaking partnership as a tool to develop financial regulation. Congress, and to some degree the SEC, have been responsive to politically based concerns such as the public demand for greater enforcement penalties in the wake of Wall Street scandals. The Court, with its greater degree of political insulation, is able to provide a constraint on excess enforcement zeal, balancing these demands with concerns over predictability, information

\begin{itemize}
  \item \textsuperscript{209} The Court of Appeals expressly refrained from considering the validity of Rule 10b5-2. \textit{See Cuban}, 620 F.3d at 558 n.40.
  \item \textsuperscript{210} \textit{United States v. Newman}, 773 F.3d 438, 443, 448 (2d Cir. 2014) (explaining that defendants “were several steps removed from the corporate insiders”).
  \item \textsuperscript{211} \textit{Id.} at 453–54.
  \item \textsuperscript{212} For a more nuanced view of congressional objectives in regulating insider trading, see Joo, \textit{supra} note 167.
  \item \textsuperscript{213} \textit{See}, e.g., \textit{Dirks v. SEC}, 463 U.S. 646, 658 (1983) (expressing concern about liability rules that “could have an inhibiting influence on the role of market analysts, which . . . is necessary to the preservation of a healthy market”); Michelle N. Comeau, Comment, \textit{The Hidden Contradiction Within Insider Trading Regulation}, 53 UCLA L. REV. 1275, 1276–77 (2006) (“Congress, the SEC, and the judiciary have each stated that the goal of insider trading regulation is to promote investor confidence—the certitude of investors at large that the market is fair.”).
\end{itemize}
flow, and market efficiency. Judicial oversight can also check headline-driven lawmakers agendas, pushing particularly the SEC to justify its regulatory choices better.\textsuperscript{214} Thus, for example, the Court’s decision in \textit{Dirks} led the SEC to focus its efforts to reduce information asymmetries on issuer disclosure rather than recipient use of material nonpublic information through the adoption of Regulation FD.\textsuperscript{215} The Second Circuit’s decision in \textit{Newman} may similarly encourage the SEC to direct greater attention to tippers/sources rather than remote tippees.\textsuperscript{216} Congress also weighed in to readjust the SEC’s enforcement priorities with the adoption of the STOCK Act.\textsuperscript{217} Notably, prior to the legislation, no member of Congress had been the subject of an insider trading enforcement action\textsuperscript{218} despite evidence suggesting widespread use of material nonpublic information.\textsuperscript{219}

Finally, the lawmakers partnership is well positioned to respond to the dynamic structure of the securities markets and the evolution of information flow due to changes in technology and market participants. Since the \textit{Chiarella} decision, the markets have seen the emergence of many new types of traders and trading strategies—hedge funds, high-frequency traders, algorithmic trading, and index funds are all examples.\textsuperscript{220} Competition has led to new demands for information, which are met by innovations such as web crawlers, expert network firms, electronic road shows, and more.\textsuperscript{221}

\begin{footnotes}
\textsuperscript{214}. To the extent that the SEC has, in recent years, become increasingly politicized, especially with respect to its enforcement policy, this judicial constraint can be viewed as balancing both the SEC, directly, and Congress, indirectly. \textit{See, e.g.}, Ackerman & Viswanatha, supra note 122 (describing politicization of SEC enforcement decisionmaking).
\textsuperscript{215}. \textit{See supra} note 197 and accompanying text.
\textsuperscript{217}. \textit{See supra} notes 185–187 and accompanying text.
\textsuperscript{218}. Brachman, supra note 154, at 264.
\textsuperscript{219}. \textit{See, e.g.}, Joshua Michael Brick, \textit{The Stock Act: Is it Necessary and If So Is It a Sufficient Solution?}, 15 DUQ. BUS. L.J. 179, 193 (2013) (citing “the lack of cases prosecuting insider trading by members of Congress, combined with Congress’ consistently high portfolio returns”).
\end{footnotes}
These developments offer new challenges—both in defining material nonpublic information and in identifying the manners of acquiring that information that should be characterized as improper. While the financial incentives for acquiring an informational advantage are higher than ever, the value of maintaining a rich information environment offers reasons to be cautious about expansive liability provisions. A lawmaking partnership is well suited to maintaining the necessary balance.

These insights are of particular value in the aftermath of the Newman decision. The Newman decision renewed the long-dormant efforts to have Congress adopt a definition of insider trading. Some commentators have pointed to the decision as demonstrating the need for legislation to ensure that courts do not interpret the law too narrowly. Properly understanding insider trading regulation as the product of a lawmaking partnership, however, rebuts that claim and demonstrates that judicial oversight has provided a valuable counterbalance to regulatory excess while retaining flexibility to address market innovation.

As SEC Chair Mary Jo White explained: “I think it’s challenging to codify [insider trading law] clearly in a way that is both not too broad and retains the strength of common law.”

VI. CONCLUSION

Commentators have identified a variety of structural and political pressures that constrain the effectiveness of the lawmaking process with...
respect to financial regulation. The lawmaking partnership offers one possible response. Through a judicial-congressional collaboration, the lawmaking partnership enables the courts and Congress to temper their own institutional shortcomings. This has led, in the context of private securities litigation, to a balance that serves the dual objectives of investor protection and limiting the potential for litigation abuse. The structural advantages of the lawmaking partnership support both deference to this balance and a broader endorsement of the lawmaking partnership.

In the case of Halliburton II, the implications of this analysis suggest that the Court reached the correct result in declining to overrule Basic, although perhaps for the wrong reasons. More broadly, the analysis suggests that the Court should give greater weight to congressional action in considering the scope of private litigation under section 10(b), and, where Congress has participated in a collaborative process with objectives common to those of the Court, that the Court should view that participation as authorization to engage in its own policy analysis in furtherance of those objectives. Judicial lawmaking in this context should be understood not as unprincipled activism, but as consistent with a congressional choice of a lawmaking approach that offers distinctive advantages.

228. See Levitin, supra note 114, at 2068 (calling for a reform to “the politics of financial regulation”).