RESPONSE

SECURITIES CLASS ACTIONS AS PUBLIC LAW

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In response to William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69 (2011).

The Political Economy of Fraud on the Market[1] provides a wide-ranging criticism of and thoughtful reforms for securities class actions. In broad overview, Professors William Bratton and Michael Wachter would restrict securities class actions to nondiversified information traders and ramp up SEC enforcement efforts. However, both their critique of contemporary class actions and their model of the reforms they propose leave unexamined a good many matters relevant to both the criticism and reform of securities class actions.

For some time now, shareholder suits have been a whipping boy for what ails American capitalism. Bratton and Wachter earn high marks for being less passionate and much more thoughtful than others in the chorus calling for reform; indeed, their observations are among the most thoughtful to be found in this area. Nonetheless, their analysis is incomplete in many important areas, and in addition to the lacunae in their analysis, they commit an even more fundamental error by taking the narrow view that securities class actions have only a private and not a public mission.[2] To be sure, committing to both a larger enforcement budget for the SEC and a mission to re-

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1 William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69.

2 *Id.* at 133.

dress private losses caused by fraudulent financial reporting would make fraud enforcement more public than before. But this conjecture assumes such enforcement would be as robust and frequent as presently occurs with private suits. As will be seen, the checkered history of SEC enforcement of market frauds belies such a hopeful outcome.

Bratton and Wachter do not start their critique with a solid foundation of developing the purpose that we might wish to serve with private, or for that matter government, suits prosecuting fraudulent financial reporting. We might simply conclude that everyone is against fraud so that prosecution, either private or public, is desirable. But, had they made this inquiry, Bratton and Wachter might well have shortened their lengthy Article by omitting the titillating suggestion that public companies and their stockholders would benefit from a shareholder plebiscite on whether shareholders of that company can seek private relief for any damage they might have suffered.[3] Implicit in the suggestion of such a shareholder plebiscite is the view that the securities laws, and particularly their enforcement, are private and not public law. Thus, one must look beyond this Article for a study that begins with first principles and then progresses from there to a more refined and nuanced investigation of how we might advance those principles. Might we not just as easily defer to the shareholders on other matters, such as whether they are a reporting company, whether they will have an audit committee, and whether their annual reports should be accompanied by management's certification of the adequacy of internal controls and the auditor's attestation to management's assessment? Some may not appreciate these requirements (perhaps they are the same individuals who dislike seat belts or other mandated safety features that increase the costs of their cars), but they are laws that are public in the sense that they advance the view that perceived social benefits are larger than the individual's benefit derived from making her own choice.

The securities laws carry out several public objectives in addition to protecting the individual investor.[4] Thus, the quality of U.S. securities laws is directly linked to the cost of capital. To be sure, investors

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[3] *Id.* at 129.

[4] The commonly recognized objectives are: informing investors, enhancing allocational efficiency, reducing the frequency of fraudulent offerings of securities, heightening managerial responsiveness to owners, and reducing opportunistic behavior. *See* James D. Cox, *Coping in a Global Marketplace: Survival Strategies for a 75-Year Old SEC*, 95 VA. L. REV. 941, 961-72 (2009) (reviewing the likely impact on each of these objectives if differing disclosure standards apply in the same efficient market).

could self-insure by imposing a higher discount rate in pricing the shares of a firm opting out of the potential for fraud-on-the-market suits as a means to correct, and even deter, fraudulent financial reporting. But this applies at the average level so that when the fraud occurs, the shareholder—particularly one not well diversified—takes the hit for the above-average loss. Moreover, the higher discount rate would be systematic across all opting-out firms.[5] This poses issues for the United States generally, since one means of promoting U.S. capital markets has been the strength of our securities laws. To be sure, U.S. capital markets do not enjoy the dominance they had twenty-five years ago, but they still are attractive for domestic and foreign issuers at a level that makes U.S. markets competitive.[6] But the overall point here is that Bratton and Wachter assume, without analysis, that the securities laws are part of the private law and have no connection with more broadly based public welfare considerations.

Bratton and Wachter direct most of their complaints against securities class actions because they view this genre of suit as serving only a compensatory function.[7] For some time I have asserted that shareholder suits should not be so viewed. The point I first made nearly thirty years ago has not changed, and it comes into bold relief against the analysis of Bratton and Wachter: by characterizing the social calculus for evaluating the worth of all shareholder suits—whether derivative or securities fraud litigation—as compensatory, commentators and the courts have guaranteed that such suits will not measure up to their expected purpose.[8] Complaints such as those set forth by Bratton and Wachter—that the suits retrieve only a small portion of

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[5] *See* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628, 639-40 (reviewing why private ordering in the context of insider trading results in higher systemic risk, and hence greater costs of capital, for all securities).

[6] For a crisp assessment of the forces causing more foreign issuers to list closer to their principal places of business, see Jim O'Neill & Sandra Lawson, *Is Wall Street Doomed?*, *in* GOLDMAN SACHS, BRICS AND BEYOND 225 (2007), *available at* http://www2.goldmansachs.com/our-thinking/brics/brics-and-beyond-book-pdfs/brics-full-book.pdf.

[7] *See* Bratton & Wachter, *supra* note 1, at 84.

[8] *See generally* James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3 (1999) (identifying approaches courts should take to add a greater deterrence function to private suits, including viewing their objective as deterrence and not compensation); *see also* James D. Cox, *Compensation, Deterrence, and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745 (1984) (reviewing the impossibility of shareholder suits being understood to be compensatory).

the damage caused by the fraudulent reporting—document this fear.[9] The collective loss of investors in a large capitalization firm for fraudulent reporting over three or five financial quarters is generally immense. Because in most instances the corporation and the responsible employees did not gain any amount approaching the sums investors have lost, a judgment holding the corporation fully accountable would subject the corporation to debilitating liability. Instead of focusing on the investors' loss, we can focus on the purposes behind proscriptions of financial-reporting fraud, thus shifting our focus to the public objectives that can be served by the suit. Here we are aided by the reasoning in *J.I. Case Co. v. Borak*, which recognized that implied private rights of action advance a public norm by allowing the suit's plaintiff (i.e., class counsel) to serve as a private attorney general.[10]

With the compensatory orientation tightly under their belts, Bratton and Wachter take the predictable shot at securities class actions, namely that the compensatory benefits of such suits are suspect because of the twin effects of circularity and the absence of net loss to the well-diversified investor.[11] Circularity arises when the ultimate sum recovered flows from the corporate entity itself, such that, in the case of fraud-induced investors acquiring the entity's shares, the injured investors are indirectly paying their own recovery. And, over time, the well-diversified investors suffer no net loss because they will be winners as frequently as they are losers, where "winning" and "losing" reflect that the fraud's impact on the share price bestows something of a windfall to one side of the trade and a loss to the other side of the trade. While not developed in their Article, presumably Bratton and Wachter would allow recovery against the corporation if the corporation was itself trading with the investors, e.g., if it lied in the prospectus accompanying its public offering of securities or in the merger materials produced in the acquisition of another firm. So viewed, the authors remove well-diversified investors from the class of investors

[9] Judging whether suits recover a lot or a little vis-à-vis the class's damages is particularly problematic because so many variables can affect stock prices during the period between the telling of the lie and the revealing of the truth. Indeed, plaintiffs and defendants may begin their contest with wide-ranging estimates of the losses, but reality generally sets in for both as their settlement negotiations test their respective econometric models' assumptions. Thus, any assertion that the resulting settlement is larger or smaller in contrast to the investor losses is inherently whimsical.

[10] 377 U.S. 426, 432 (1964) ("Private enforcement of the proxy rules provides a necessary supplement to Commission action."), *abrogated by* Touche Ross & Co. v. Redington, 442 U.S. 560, 576-77 (1979) (finding that the private right of action under 14(a) did not extend to all provisions of the 1934 Act).

[11] *See* Bratton & Wachter, *supra* note 1, at 93-99.

entitled to sue for securities fraud. Instead, they accord standing to nondiversified investors deemed "information traders."[12] The informational traders are the opposite of the noise traders who just pile onto publicly traded shares without digesting any information, including the false information, about the firm. On these points, we might fault Bratton and Wachter for being too generous. They should have eliminated all the investor suits. Why should it matter if you have one trader flipping 100 quarters within one time period or one trader flipping 100 dimes over multiple time periods? In either case, the results would be expected to be the same: heads about 50% of the time. That is, if investors are repeat players in the market, over time they will have the experience of selling at a price inflated by fraud and buying at a price inflated by fraud. The well-diversified investor just gets to the average outcome more quickly. Should we base public policy on alacrity?

It is also not clear that we should penalize the noise trader or, for that matter, the well-diversified investor. Each is behaving presumably just as Bratton and Wachter would wish, namely according to the fundamental tenets of portfolio theory and the efficient market hypothesis. Noise traders neither read nor analyze. But they do trust the pricing of the market. Diversified investors understand that efficient markets calibrate risk and return, and invest according to the individual security's impact on the overall risk of the investor's portfolio. Thus, each places his trust in the market, but why should such trusting investors be deprived of a right of action when their trust was misplaced? And, is it not possible that the diversified investor might have invested less, or not at all, in that particular company if it had honestly reported its results? Finally, we might ask why would we wish to remove the benefit of class action suits from fully diversified investors. Might this just drive them to gerrymander their portfolio so as to qualify for class action treatment by narrowly falling out of the number of stocks needed to be deemed diversified?

In fact, Bratton and Wachter may well have gone the full nine yards and eliminated most securities class actions. To be sure, they would preserve a private suit for nondiversified information traders who can establish their reliance.[13] But wait, wasn't the whole point of *Basic Inc. v. Levinson* that if reliance were required to be so estab-

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[12] *Id.* at 97-99.
[13] *Id.* at 102.

lished, then the suit could not be certified as a class action?[14] When one must show reliance, individual questions, not common questions, predominate. It may well be that in any false reporting case the group of relying, nondiversified investors would be sufficiently small so that the burdens of probing the alleged reliance by each class member would not render class action status inefficient. Yet uncertainty abounds regarding how common questions would be resolved in individual cases since this could depend on how many such investors would qualify as informational nondiversified traders. Notwithstanding whether their claims can be aggregated, the question is really whether the suit promises enough "honey" to attract the class counsel bear. Thus, it may well be that limiting suits to only nondiversified information traders would ultimately mean that there would be few such suits because they could not be aggregated to make the suit efficient for the injured investors—or even if aggregated to that effect, the potential recovery may not be sufficient to attract counsel.

With regard to the circularity and portfolio arguments advanced against securities fraud suits, why not raise the same problem when there is a patent dispute between, for example, Advanced Micro Devices and Intel? Both of these large-cap firms enjoy a substantial institutional following. Why do we not just dismiss any private suit between two companies who are owned in some significant way by diversified investors on the ground that there is no gain to their institutional owners that can flow from the suit? After all, patent and copyright infringement suits are a way of doing business in the technology industries, and CalPERS is just as likely one day to own the shares of an infringer as to own the shares of the infringed. Today, there is indeed an epidemic of expensive IP litigation. It may well be a net loss to diversified investors. We do not cast these suits aside, regardless of the investor pool of the suit's combatants, because even though we view patents and copyrights as being private property in light of the rewards they confer on their owner, we also believe that these are rights that advance our general welfare. Simply put, we as a nation benefit from protecting investment in technology. Thus, there is a distinct public law aspect to our willingness to sustain such suits despite the netting-out effects among their owners.

Thus, we see a big hole in the reasoning that underlies the critical fulcrum of *The Political Economy of Fraud on the Market*'s reasoning that,

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[14] 485 U.S. 224, 242 (1988) (noting that requiring "proof of individualized reliance" would effectively prevent class actions, because "individual issues then would have overwhelmed the common ones").

in the case of the diversified investor, there is no value to the suit—a conclusion reached because the Article never views the securities laws, and particularly the proscription of fraudulent financial reporting, as embodying public law that advances public welfare. That is, by enhancing compliance with disclosure requirements, the underlying objectives of our disclosure laws are furthered.[15]

Bratton and Wachter favor SEC enforcement in place of private enforcement. They support their reasoning by first disputing that SEC enforcement resources are too limited[16] and strengthen their case by asserting that the differential in results achieved per dollar invested is one-third less for private suits than public suits.[17] The latter is a back-of-the-envelope calculation in which Bratton and Wachter divide the funds recovered by the SEC in its enforcement actions during the 1999–2009 period by the five-year (2004–2008) average enforcement budget, and then compare that ratio (4.35) with the quotient of private settlements during the same period divided by the assumed average 23% attorneys' fees, yielding a higher 6.20 ratio. There are multiple problems with this calculation. Their suggestions are open to two broad criticisms, each addressed below.

A. *Erroneous Accounting*

There is a serious likelihood that this back-of-the-envelope calculation omits many costs, such that the SEC enforcement costs are substantially greater than calculated. First, the SEC's enforcement efforts span a good many areas; only a small number of its enforcement suits in any year belong to the set out of which the type of violations for which class action securities suits arise. Thus, for a meaningful calculation, the denominator in the calculation for public enforcement needs to be slimmed considerably since only about one-half of the enforcement actions that the SEC initiates in any year are of the type that has the *potential* to become a private class action.[18] Also, the numerator should only include recoveries from enforcement actions of the type that lends itself to class action treatment. With the numera-

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[15] *See* Cox, *supra* note 4, at 966-67 (arguing that disclosure rules increase manager accountability).

[16] *See* Bratton & Wachter, *supra* note 1, at 148.

[17] *Id.* at 162.

[18] *See* James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 750 (2003) (basing this estimate on SEC data from 1997–2002).

tor and denominator so adjusted, it is likely that the comparative advantage first calculated disappears.

Second, it is likely that the expenses the government incurs to prosecute securities fraud are significantly greater than those reported for the SEC's enforcement budget standing alone. In fact, many of the frauds prosecuted by the SEC in 2002 and 2003 were the result of the efforts of many governmental bodies as well as self-regulatory organizations. For example, Enron and other large capitalization companies were the object of a strike force that included multiple government agencies.[19] Similarly, the massive $1.4 billion global settlement against ten investment banking firms was the product of the efforts of the New York Attorney General, the NASD and NYSE, and the SEC.[20] Thus, because it is common for enforcement agencies to work together, a calculation of the costs of government enforcement in any particular case needs to consider the costs borne by all government agencies that are involved in that matter. The Bratton and Wachter data does not do this.

Third, the only systematic study comparing the targets of SEC enforcement actions with the targets of private suits unaccompanied by parallel SEC enforcement action undermines the recommendation of Bratton and Wachter. The first such comparative study of this question, which I completed with Professors Randall Thomas and Dana Kiku, focused on settlements reached in the 1997–2002 period.[21] The data revealed that the SEC systematically targeted smaller firms, for which investors suffered smaller provable losses, and that the targeted firms were experiencing greater financial distress than were the firms that undertook settlements in private suits unaccompanied by parallel SEC action.[22] A follow-up study focused on an expanded time period, 1990–2003, and divided the study to examine settlements in the post-Enron period, 2002 and 2003.[23] In this study, financial distress is sta-

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[19] *See* Kristen Hays, *Task Force Prosecutors Prosper After Enron Case*, HOUS. CHRON., Nov. 2, 2006, at C1 (profiling the prosecutors involved in the strike force).

[20] *See* Press Release, Office of the N.Y. Attorney Gen., SEC, N.Y. Attorney Gen., NASD, NASAA, NYSE, and State Regulators Announce Historic Agreement to Reform Inv. Practices (Dec. 20, 2002), *available at* http://www.ag.ny.gov/media_center/2002/dec/dec20b_02.html (detailing the terms of the settlement).

[21] Cox, Thomas & Kiku, *supra* note 18, at 749.

[22] *Id.* at 776-77.

[23] *See* 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, 899 (2005).

tistically significant in identifying firms subject to SEC enforcement.[24] And for the 2002 and 2003 cases, the SEC appears to have shifted away from a bias toward suits against firms experiencing financial distress, preferring cases where investors suffered greater provable losses, albeit in firms that were smaller than those targeted in private suits without a parallel SEC action.[25] Moreover, our review of SEC enforcement releases and Lexis-Nexis public reports of any SEC inquiry—investigation or enforcement action, a more sweeping category than a formal enforcement action—finds such evidence in less than 19% of settled securities class actions.[26] We strongly suspect that enforcement suits would be a small subpart of that percentage. In sum, these data support the view that the SEC is an important, but only a supporting, player in redressing on behalf of investors the damages caused by fraudulent financial reporting.

Fourth, the above data support the view that the private suits without SEC action challenge larger capitalized firms that are not experiencing financial distress. The risks of these suits is greater; suits against such opponents mean that, because the firm is large and not experiencing financial distress, the defendant will be a stronger opponent throughout the litigation. Accordingly, we would expect greater rewards to the entrepreneurial lawyer. Thus, we should expect suits to entail a greater expense-to-benefit ratio when there is not a parallel SEC action than when the SEC is the litigant.

Fifth, the SEC cause of action faces none of the hurdles that increases the costs of prosecuting a private suit. The SEC in prosecuting its suits does not face a heightened pleading standard[27] or the bar to discovery[28] that the private plaintiff must address before initiating suit. Each of these innovations of the Private Securities Litigation Reform Act of 1995[29] requires a substantial investment of resources by plaintiffs' counsel that are not required when the SEC initiates suit. More-

[24] *Id.* at 905.

[25] *Id.* at 906.

[26] *See id.* at 895, 900-01 tbls. 2 & 3 (2005) (reviewing 389 settlements reached from 1990 to 2003, in which there were reports of SEC involvement in 73 cases).

[27] This requirement calls for the private plaintiff to allege scienter with particular facts, and those facts must give rise to a strong inference that the defendant acted with the requisite scienter. Securities Exchange Act of 1934 § 21D(b)(2), 15 U.S.C. § 78u-4(b)(2) (2006).

[28] *Id.* at § 21D(b)(3)(B), 15 U.S.C. § 78u-4(b)(3)(B) (staying discovery during any pending motion to dismiss).

[29] *See* Pub. L. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

over, to survive a motion to dismiss, the SEC is not required to allege loss causation to recover. Private litigants must allege loss causation,[30] and in a fraud-on-the-market case this customarily requires expensive econometric analysis to accompany the pleadings. Therefore, even accepting that the authors' back-of-the-envelope calculation was correctly made, we should not be surprised that private suits are more costly than SEC enforcement actions. They clearly do cost more, as the SEC and the private litigant face very different constraints in their pursuits of justice. One might argue that this makes the case that the SEC should be the plaintiff so as to circumvent the restrictions placed on private suits by the Supreme Court and Congress. This may well be the case, but we can ponder how long it would be the case if the SEC were increasingly stepping forward to bring damage actions on behalf of investors.

B. *Institutional Constraints*

Bratton and Wachter do not consider the institutional constraints that would confront the SEC were it to assume the role of recovering investor losses. The belief that an SEC enforcement action can provide all the relief that injured investors can expect from a class action damages suit ignores the statutory constraints that surround SEC sanctions. Simply stated, the SEC is *not* empowered to recover the sums investors lost because of the fraud. There is *no* statutory authority for such recovery, and SEC sanctions and settlements are not framed by the losses caused by a violation. With respect to monetary sanctions, the SEC has the express[31] and implied[32] authority to require disgorgement of any gains the defendant derived from his violation. The SEC also can extract fines, but there is a ceiling on the amount of the fine per violation.[33] Furthermore, any movement by the SEC toward

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[30] *See* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 346 (2005) (holding that fraud on the market requires not just allegations that the misrepresentation inflated the stock's price, but also evidence of loss causation once the untruthful statement became public).

[31] *See, e.g.*, § 21(d)(3), 15 U.S.C. § 78u(d)(3) (permitting civil penalties in securities cases).

[32] *See, e.g.*, SEC v. First City Fin. Corp., 890 F.2d 1215, 1229-32 (D.C. Cir. 1989) (awarding disgorgement remedy for violations of the early warning provisions of the Williams Act).

[33] *See, e.g.*, § 21(d)(3)(B)(iii), 15 U.S.C. § 78u(d)(3)(B)(iii) (setting the maximum fine per violation at $500,000 for an entity and at $100,000 for an individual). To be sure, SEC settlements frequently involve amounts greatly in excess of the issuer fine ceiling of $500,000. This occurs when the SEC takes the position that the issuer and

seeking "damages" suffered by the investor class would likely invite a range of legal developments, many beyond its rulemaking authority. At a minimum, any effort to recover investors' losses would need congressional action since, as stated before, the securities laws not only do not provide this authority, but also expressly provide that the monetary sanction is a fine or disgorgement.[34] Moreover, if damages are to be recovered, then we would expect the same issues that private litigants face bearing on causation, and particularly loss causation, to arise. The expected incorporation into such an SEC enforcement suit of such a burdensome requirement would not likely endear these suits to the staff at the SEC. If we believe—and it is not clear that Bratton and Wachter do believe—that the SEC enforcement efforts are understaffed, then the additional burden of seeking damages on behalf of injured investors raises doubts regarding just how eager the thin enforcement staff will be to characterize their suits as seeking damages as opposed to a fine and disgorgement, or less.

The above points at least qualify the optimism that Bratton and Wachter express for the SEC's ability to fill any void created by shareholders opting for SEC enforcement over private enforcement. These points also raise issues that may be dispositive for reasonable shareholders deciding whether to give up their private suit and to look to the SEC to seek recovery should they someday be defrauded.

Bratton and Wachter raise legitimate questions about the deterrent effects of securities class actions where the norm is that a settlement is paid solely by the corporation and not by the individuals who are responsible for the defalcation. Unfortunately, the authors appear to accept the status quo, i.e., entity recovery, and do not address how we can move toward holding individuals responsible. In failing to engage this issue, they tacitly reflect the reality of today's antifraud litigation: corporations pay and individual wrongdoers get a pass. This truism is now supported by three Supreme Court decisions.[35] In com-

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others have committed multiple violations. Nonetheless, the amount reached in such settlements is not anchored to the amount of investor losses suffered.

[34] Indeed, the natural implication of the "fair funds" provision of section 308(9)(a) of the Sarbanes-Oxley Act appears to bar implicitly any action for damages by the SEC. *See* Sarbanes-Oxley Act of 2002 § 308(a), 15 U.S.C. § 7246 ("[T]he amount of such civil penalty shall . . . become part of the disgorgement fund for the benefit of the victims of such violation."). This provision provides that the SEC can, whenever there is disgorgement recovered from a respondent in an enforcement action, dedicate the sum so recovered, plus any fine, to a fund to be returned to injured investors.

[35] *See* Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2305 (2011) (holding that an investment advisor who prepared a prospectus for a family fund was not responsible for misrepresentations appearing in the prospectus); Stone-

bination, they demand that the investor, at the time of trading, be able to attribute the false statement to the individual defendant. Thus we find the following is well engrained in the law: if the false statement is conceived and drafted by the defendant, but does not bear the defendant's name or otherwise identify the defendant *as its maker*, then the defendant is not a primary participant and, hence, has no responsibility to the defrauded investor.

Our own work, published in this journal, points to the perverse conundrum that the Supreme Court has created:

> [A]fter settlement [of a securities class action], defendant firms experience liquidity problems, as well as worsening Altman's Z-scores. Here, the distinction between causation and correlation is important. For example, do our findings regarding the deterioration of the Altman's Z-scores suggest that settlements drive firms toward financial distress (i.e., settlements are causally related to the worsening situation), or do they suggest that the financial deterioration in earlier time periods continues downward regardless of the settlement or its size (i.e., settlements are merely correlated with weakening financial performance), or do they represent some combination of both? . . .
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> . . . Although uncertainty persists about the precise connection between settlements and financial distress, there is no uncertainty that firms involved in securities class action litigation experience statistically greater

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ridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 166-67 (2008) (holding that a corporation's executives who knowingly prepared false documents to conceal from their customer's auditors that $17 million in the customer's revenues were fraudulent roundtrip transactions, and did so to retain the customer as a client, were not responsible to investors who purchased the customer's shares at prices inflated due to the fraudulent roundtrip transactions); Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (holding, broadly, that there is no aiding and abetting liability under § 10(b) of the 1934 Act); *see also* Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144, 149, 161 (2d Cir. 2010) (holding that an outside lawyer who on seventeen different occasions engineered on behalf of the client, Refco, fraudulent sham transactions for the purpose of concealing in various offering documents that Refco had massive trading losses and was unable to repay millions of dollars due on margin was not liable as a primary participant to investors who suffered significant losses upon the ultimate bankruptcy of Refco); Pugh v. Tribune Co., 521 F.3d 686, 698 (7th Cir. 2008) (holding that the president of a newspaper subsidiary who fraudulently overstated the number of subscribers and revenues for the subsidiary was not liable to those who purchased the parent company's shares at inflated prices even though the president's misstatements were incorporated into the consolidated financial statements issued by the parent); *In re* Nature's Sunshine Prods. Sec. Litig., 486 F. Supp. 2d 1301, 1311-12 (D. Utah 2008) (finding that plaintiffs failed to state a claim because defendant CEO, who had falsely represented company financial data to an auditor to obtain a "clean" audit, did not make statements publicly).

> risks of financial distress than their cohort firms. Since the burdens of ongoing embroilment in securities class action contribute to the firm experiencing value-decreasing pressures, our findings lend strong support for the view that such suits are better directed toward the officers, advisors, and other individuals who bear responsibility for the fraudulent representation(s) that spawned the suit. . . .
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> . . . The Supreme Court's narrow view of who is subject to primary liability under the SEC's antifraud provision has prompted the lower courts to repeatedly reach results at odds with imposing just deserts on violators. . . . In the wake of such decisions, the focus on entity liability is likely to continue, and just deserts are likely to remain an unfulfilled public policy objective . . . .[36]

In such a world, deterrence is not likely. If not, can justice be served by recoveries that reach only the corporation's treasury or insurance policy? This may be the ultimate point behind *The Political Economy of Fraud on the Market*. That is, without a legal process that will reach the assets of those responsible for the lie, cynicism for the entire process sets in and we lose interest in thinking about who, if anyone, was harmed and how we might best construct a process for compensating for any such harm. Thus, Bratton and Wachter are rightly cynical. But the answer to such cynicism is to focus on first principles: who should be financially responsible for false financial reporting. Perhaps, having stuck their toes in the water of securities litigation, they might next address this question, and in doing so, consider some of the lacunae identified above.

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[36] Lynn Bai, James D. Cox, & Randall S. Thomas, *Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Targeted Firms*, 158 U. PA. L. REV. 1877, 1912-14 (2010).