PRIVATE CITIZENS POLICING CORPORATE BEHAVIOR: USING A *QUI TAM* MODEL TO CATCH FINANCIAL FRAUD

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INTRODUCTION

In 2008, Wall Street's reckless behavior plunged America's economy into a deep recession.[1] The 2008 Financial Crisis had long-lasting effects on the global economy and on American society.[2] While everyday Americans suffered, financial executives walked away from the Financial Crisis with multimillion-dollar bonuses.[3]

Since the 2008 Financial Crisis, public outrage over "corporate greed"[4] and the favorable treatment of executives has become a popular narrative in the American ethos.[5] Fringe candidates emerged in the 2016 presidential primaries with populist messages, disparaging the bankers of Wall Street.[6] Senator Bernie Sanders, a populist candidate leading what he dubbed a

1. *See The Origins of the Financial Crisis: Crash Course*, ECONOMIST (Sept. 7, 2013), https://www.economist.com/schools-brief/2013/09/07/crash-course [hereinafter *Crash Course*] (explaining the central role of investment banks and financiers in the 2008 recession).

2. *See, e.g.*, Laurence M. Ball, *Long-Term Damage from the Great Recession in OECD Countries* 8 (Nat'l Bureau of Econ. Research, Working Paper No. 20,185, 2014), http://www.nber.org/papers/w20185.pdf (finding that the temporal length of economic damage to a country is relative to the depth of its recession); *see also* Annabelle Timsit, *The Stress Caused by the 2008 Financial Crisis Had a Lasting Impact on Kids and Families*, QUARTZ (Sept. 14, 2018), https://qz.com/1387610/financial-crisis-anniversary-the-impact-of-the-crash-on-kids/ (expounding on some of the collateral consequences of the 2008 Financial Crisis).

3. *See Big Bank Bonuses, Despite Taxpayer Help*, N.Y. TIMES (July 31, 2009), https://archive.nytimes.com/www.nytimes.com/imagepages/2009/07/31/business/31paygrfx.ready.html (showing multimillion-dollar bonuses from nine large U.S. banks).

4. *See* Bernie Sanders, *Corporate Greed Must End*, HUFFINGTON POST: THE BLOG (June 24, 2015, 9:29 AM), https://www.huffingtonpost.com/rep-bernie-sanders/corporate-greed-must-end_b_7653442.html ("It is time to say loudly and clearly that corporate greed and the war against the American middle class must end. Enough is enough!").

5. *See* Letter from Elizabeth Warren, U.S. Senator, Mass., to the Honorable Michael E. Horowitz, Inspector Gen., Dep't of Justice (Sept. 15, 2016), https://www.scribd.com/document/324064523/Elizabeth-Warren-DoJ [hereinafter Warren Letter] ("Nine individuals were implicated in these [FCIC] referrals . . . . Not one of the nine has gone to prison or been convicted of a criminal offense. Not a single one has even been indicted or brought to trial.").

6. *See* Darrell Delamaide, '*Loose Cannon' Trump May Take Aim at Wall Street*, USA TODAY (May 17, 2016), https://www.usatoday.com/story/money/2016/05/17/trump-wall-street-clinton-presidential-election-money/84487440/ (explaining how both Trump and Sanders tapped into public resentment of Wall Street executives).

"political revolution,"[7] came surprisingly close to edging out former Secretary of State Hillary Clinton for the Democratic Party's nomination—the last states to vote decided the race.[8] In the Republican Primary, Donald Trump—running an unconventional campaign with a populist message—emerged the victor, outlasting 16 Republican candidates.[9] Perhaps the most shocking and significant ripple effect of the 2008 Financial Crisis was Donald Trump's surprise victory over Hillary Clinton in the 2016 presidential election.[10] Riding a wave of anger and frustration at corporate America, Trump promised to "drain the swamp" of Washington insiders and lobbyists with ties to Wall Street.[11] By 2016, the Financial Crisis was almost a decade gone, but the scars it left were clearly still fresh in the minds of many Americans.[12]

A more direct result of the 2008 Financial Crisis was Congress passing the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank).[13] The bill's sponsors designed the law to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail[,]' . . . [and] to protect consumers from abusive financial services practices . . . ."[14] In ushering in the most comprehensive set of new financial regulations since the Great

7. Tim Dickinson, *Bernie Sanders' Political Revolution*, ROLLING STONE (Nov. 18, 2015), http://www.rollingstone.com/politics/news/bernie-sanders-political-revolution-20151118.

8. *See* Byron Tau, *Hillary Clinton Takes Decisive Lead Over Bernie Sanders in Delegate Count, Popular Vote*, WALL ST. J. (June 8, 2016), http://www.wsj.com/articles/hillary-clinton-takes-decisive-lead-over-bernie-sanders-in-delegate-count-popular-vote-1465389182 (detailing how Clinton took a 2755 to 1852 delegate lead in the Democratic primary after winning California, all but ensuring her nomination).

9. Stephen Collinson, *Donald Trump: Presumptive GOP Nominee; Sanders Takes Indiana*, CNN, http://www.cnn.com/2016/05/03/politics/indiana-primary-highlights/ (last updated May 4, 2016); *see also Who Is Running for President*, N.Y. TIMES, https://www.nytimes.com/interactive/2016/us/elections/2016-presidential-candidates.html (last updated July 26, 2016) (listing the Democratic and Republican candidates for the 2016 presidential election).

10. *See* George Packer, *Ten Years After the Crash*, NEW YORKER (Aug. 27, 2018), https://www.newyorker.com/magazine/2018/08/27/ten-years-after-the-crash (tracing the 2016 Presidential Election and the rise of anti-establishment political movements to the unsatisfactory resolution of the 2008 Financial Crisis).

11. *Campaign's Slogan 'Drain the Swamp' May Be Easier Said Than Done*, NPR (Nov. 16, 2016), http://www.npr.org/2016/11/16/502274832/campaigns-slogan-drain-the-swamp-may-be-easier-said-than-done.

12. *See, e.g.*, Ben Casselman et al., *The Great Recession Knocked Them Down. Only Some Got Up Again*, N.Y. TIMES (Sept. 12, 2018), https://www.nytimes.com/2018/09/12/business/great-recession-2008-anniversary.html (profiling the lives of five individuals in the decade since the Financial Crisis).

13. Mark Koba, *Dodd–Frank Act: CNBC Explains*, CNBC (May 11, 2012), https://www.cnbc.com/id/47075854; *see also* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C.) [hereinafter Dodd–Frank Act].

14. Dodd–Frank Act, 124 Stat. at 1376.

Depression, Dodd–Frank drastically changed how the Securities and Exchange Commission (SEC) regulates financial products.[15]

A well-known section of Dodd–Frank is the Whistleblower Provision.[16] Within the Whistleblower Provision, § 922(d)(1)(G) directed the SEC's Office of the Inspector General (OIG) to consider:

> [W]hether, in the interest of protecting investors and identifying and preventing fraud, it would be useful for Congress to consider empowering whistleblowers or other individuals, who have already attempted to pursue the case through the Commission [SEC], to have a private right of action to bring suit based on the facts of the same case, on behalf of the Government and themselves, against persons who have committee [sic] securities fraud.[17]

The concept of citizens bringing a private right of action on behalf of the government is not new. The False Claims Act (FCA)[18] of 1863 employs this same technique, to great success.[19] The FCA includes what is known as a *qui tam* provision,[20] which allows individuals to act as "private Attorney[s] General[]"[21] and to bring suits against both corporations and citizens that defraud the U.S. government.[22] The purpose of these *qui tam* suits is to "encourag[e] private individuals to come forward with information about fraud that might otherwise remain hidden."[23]

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15. *See* Koba, *supra* note 13 ("In simple terms, Dodd–Frank is a law that places major regulations on the financial industry. It grew out of the Great Recession with the intention of preventing another collapse of a major financial institution like Lehman Brothers . . . . Dodd–Frank requires that the riskiest derivatives—like credit default swaps—be regulated by the SEC or the Commodity Futures Trading Commission (CFTC).").

16. Dodd–Frank Act § 922, 124 Stat. at 1841–49 (Whistleblower Provision).

17. Dodd–Frank Act § 922(d)(1)(G), 124 Stat. at 1849.

18. 31 U.S.C. §§ 3729–33 (2012).

19. *See* Pamela H. Bucy, *Private Justice*, 76 S. CAL. L. REV. 1, 54 (2002) ("The number of suits filed and monetary judgments obtained . . . shows that the qui tam FCA private justice model is successful.").

20. The term *qui tam* is borrowed from the Latin phrase "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which translates to "who pursues this action on our Lord the King's behalf as well as his own." Vt. Agency of Nat. Res. v. United States *ex rel.* Stevens, 529 U.S. 765, 768 n.1 (2000); *see also* 31 U.S.C. § 3730(b) (outlining the FCA's *qui tam* provision).

21. *See* Associated Indus. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943) (using the term "private Attorney General[]" to refer to a private individual in whom the government has vested "authority to bring a suit . . . [whose] sole purpose is to vindicate the public interest").

22. *See* Bucy, *supra* note 19, at 44–45.

23. United States *ex rel.* Barajas v. United States, 258 F.3d 1004, 1012 (9th Cir. 2001); *see also* S. REP. NO. 99–345, at 2 (1986) ("The proposed legislation seeks not only to provide the Government's

This Article argues that the SEC should recommend to Congress that it add a *qui tam* private right of action to Dodd–Frank to combat fraud in the securities sector and to re-instill public confidence in Wall Street. This Article also examines the viability of adding a private right of action to the Whistleblower Provision of Dodd–Frank. Part I explores the root causes of the Financial Crisis. Part II discusses the Department of Justice's (DOJ's) failure to successfully prosecute a single high-ranking executive for financial crimes after the crisis. Part III examines the inadequacy of current civil suit options available to individuals looking to recover money for securities violations. Next, Part IV explores the FCA's *qui tam* model and its underlying theory. Part V discusses adapting the FCA's model to suit securities' regulation. Finally, Part VI provides an in-depth recommendation for how to structure a *qui tam* private right of action under Dodd–Frank's Whistleblower Provision and addresses possible concerns about this proposal.

I. THE 2008 FINANCIAL CRISIS

A. The Aftermath of the Crisis

While the acts and policies that created the Financial Crisis occurred over the course of decades, the actual crisis unfolded over a matter of days. On September 15, 2008, the Wall Street banking firm Lehmann Brothers filed for Chapter 11 bankruptcy.[24] That same day, Bank of America agreed to purchase faltering Merrill Lynch—Wall Street's third largest bank at the time.[25] The next day, the U.S. government announced an $85 billion bailout of AIG.[26] The 2008 Financial Crisis was in full swing.[27]

On October 3, 2008, President George W. Bush signed the Troubled Asset Relief Program (TARP) in an effort to halt a full economic

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law enforcers with more effective tools, but to encourage any individual knowing of Government fraud to bring that information forward.").

24. The bankruptcy was the largest corporate bankruptcy in U.S. history. *See Top 10 Bankruptcies*, TIME, http://content.time.com/time/specials/packages/article/0,28804,1841334_1841431_1841342,00.html (last visited Dec. 4, 2018) (listing the top 10 bankruptcies in U.S. history).

25. Jonathan Stempel & Elinor Comlay, *Bank of America Takeover to End Independent Merrill*, REUTERS (Sept. 14, 2008), http://www.reuters.com/article/us-merrill-bankofamerica-idUSN1445019920080915.

26. Matthew Karnitschnig et al., *U.S. to Take Over AIG in $85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up*, WALL ST. J., http://www.wsj.com/articles/SB122165238916347677 (last updated Sept. 17, 2008).

27. *See generally Crash Course*, *supra* note 1 (explaining the root causes of the Financial Crisis).

depression.[28] This Act authorized the federal government to spend up to $700 billion on troubled assets to restore liquidity to the financial markets.[29] The week after President Bush signed TARP into law, the stock market continued to spiral downwards: the Dow Jones Industrial Average closed below 10,000 for the first time in over four years—an 18% decrease from the market's all-time high in October 2007.[30]

A deep freeze in the U.S. economy followed, lasting over two years.[31] Unemployment ballooned to over 10% in October 2009.[32] Americans lost $17 trillion in net wealth.[33] Thirteen million families lost their homes.[34] The Financial Crisis touched almost every American, as well as individuals, families, and companies worldwide.[35]

B. A Brief Review of the Crisis's Root Causes

The 2008 Financial Crisis was a product of decades of economic policies and practices. After the Great Depression, the federal government passed a series of securities and banking laws that were designed to protect the public from banks taking too many risks with consumers' savings and investments.[36] Congress passed a set of sweeping laws in the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act).[37] Congress also passed the Banking Act of 1933,

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28. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 372 (2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf [hereinafter FCIC REPORT] (explaining that TARP provided "authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system" (internal quotation marks omitted)).

29. *Id.* at 371 (describing how the government made "collateralized loans to provide liquidity support" and purchased "toxic mortgage-related assets that were weighing down many banks' balance sheets").

30. *Id.* at 372–73.

31. *See id.* at 391 (describing how the household net worth drop began in 2007 and carried into 2010).

32. *Id.* at 389. For context, in 2001, the unemployment rate in the U.S. was at a "30-year low of 4%." *Id.* at 84.

33. *Id.* at 391.

34. *Cf. id.* at 402 (providing that at the time when the report was published in 2011, various estimates predicted that "[w]hen the economic damage finally abates, foreclosures may total between 8 million and more than 13 million").

35. *See id.* at 393 ("[S]tock prices worldwide plummeted more than 40% in 2008 . . . .").

36. Julia Maues, *Banking Act of 1933 (Glass–Steagall)*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/glass_steagall_act.

37. Congress passed the Securities Act to provide investors with material information about securities offerings and to prohibit fraud in securities. In passing the Exchange Act, Congress created the SEC. *See The Laws That Govern the Securities Industry*, SEC, https://www.sec.gov/answers/about-

frequently referred to as Glass–Steagall, to separate commercial banking activities from investment banking activities.[38] In the 1950s, as more and more banks began to merge and form conglomerates, the federal government stepped in to regulate these new "[b]ank holding" companies.[39] The Bank Holding Company Act of 1956 effectively restricted bank-holding companies from engaging in "nonbanking" activities, such as investment and insurance activities.[40] In response to the Great Depression and its lasting effects, the federal government increasingly regulated the financial sector.[41]

In the 1980s, however, politicians and industry insiders began to push for deregulation of the U.S. banking and investment sectors.[42] In November 1999, after years of persistent lobbying from the financial industry, President Clinton signed the Gramm–Leach–Bliley (GLB) Act, removing Glass–Steagall's and the Bank Holding Company Act's barriers that had separated commercial banks from engaging in investment and insurance activities.[43] The GLB Act was both the climax of financial deregulation in the 1990s and a precursor to the deregulation of the early 2000s.[44]

With banks allowed to engage in commercial activities as well as make investments and issue insurance, the financial sector aggressively pushed to

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lawsshtml.html#secact1933 (last modified Oct. 1, 2013) (highlighting these Acts' significance in regulating securities).

38. Banking (Glass–Steagall) Act of 1933, Pub. L. No. 73–66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.); *see also* Maues, *supra* note 36 (explaining the impetus behind the Banking Act of 1933).

39. *See* Joe Mahon, *Bank Holding Company Act of 1956*, FED. RES. HIST., https://www.federalreservehistory.org/essays/bank_holding_company_act_of_1956 (last updated Nov. 22, 2013) (describing the lead-up to the passage of the Bank Holding Company Act of 1956).

40. *See generally* 12 U.S.C. § 1843 (1958) (establishing strict limits on bank-holding companies' interests in nonbanking organizations).

41. WILLIAM E. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL 59 (Henry Steele Commager & Richard B. Morris eds., 1965).

42. *See* FCIC REPORT, *supra* note 28, at xviii ("More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe.").

43. *See Glass–Steagall Act (1933)*, N.Y. TIMES, https://www.nytimes.com/topic/subject/glasssteagall-act-1933 (last visited Dec. 4, 2018) (describing how the GLB Act "repealed the Glass–Steagall Act's restrictions on bank and securities-firm affiliations").

44. *See* FCIC REPORT, *supra* note 28, at xviii ("From 1999 to 2008, the financial sector expended $2.7 billion in reported federal lobbying expenses; individuals and political action committees in the sector made more than $1 billion in campaign contributions.").

consolidate and offer a "one-stop shop" to consumers.[45] This rush started with the Citicorp-Travelers merger,[46] and included other high-profile mergers, such as Chase Manhattan Corporation with JPMorgan & Co. (forming JPMorgan Chase) in 2000,[47] and Bank of America with FleetBoston Financial Corporation in 2004.[48] With these mergers, commercial banks—which for years had been confined to managing checking and savings accounts—could now encourage people to invest their savings in securities and investment products.[49] Deregulation also opened the door for banks to securitize their own assets to create new investment offerings.[50]

As banks became increasingly creative at diversifying risk, the federal government continued to deregulate securities. In 2000, Congress passed the Commodity Futures Modernization Act (CFMA), a bill pushed by finance-industry lobbyists and the Federal Reserve Chairman, Alan Greenspan.[51] The CFMA prevented the federal government and the states from regulating new financial products created during the housing market boom.[52] The CFMA strictly prohibited the SEC, or any other agency—state or federal—from regulating Collateral Debt Obligations (CDOs)[53] or Credit

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45. *See Mr. Weill Goes to Washington*, PBS FRONTLINE (May 8, 2003), https://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/weill/ (describing banks' new "powerful" strategy after the repeal of Glass–Steagall as "a one-stop shop strategy").

46. *See* Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Press Release (Sept. 23, 1998), https://www.federalreserve.gov/boarddocs/press/bhc/1998/19980923/19980923.pdf (discussing the Federal Reserve Board's approval of the Citicorp-Travelers merger).

47. Chris Isidore, *Chase Buying J.P. Morgan*, CNN MONEY (Sept. 13, 2000), https://money.cnn.com/2000/09/13/deals/chase_morgan/. Currently, JPMorgan Chase is the largest bank in the U.S., with assets totaling $2.6 trillion. *About Us*, JPMORGAN CHASE & CO., https://www.jpmorganchase.com/corporate/About-JPMC/about-us.htm (last visited Dec. 4, 2018).

48. *BofA Nabs Fleet for $47B*, CNN MONEY (Oct. 27, 2003), https://money.cnn.com/2003/10/27/news/companies/ba_fleet/.

49. FCIC REPORT, *supra* note 28, at 55.

50. Banks began to securitize their own and other loan originators' loans to create revenue streams. *Id.* at 42. In a basic securitization system, banks first structured the "principal and interest payments from a group of mortgages to flow into a single pool." *Id.* at 70. The payments were then tranched (split into different risk levels) "to protect some investors from losses. Investors in the tranches received different streams of principal and interest" based on the risk associated with each tranche. *Id.*

51. MATT TAIBBI, GRIFTOPIA: A STORY OF BANKERS, POLITICIANS, AND THE MOST AUDACIOUS POWER GRAB IN AMERICAN HISTORY 67 (2011).

52. *See* FCIC REPORT, *supra* note 28, at 48 ("The CFMA effectively shielded OTC derivatives from virtually all regulation or oversight.").

53. CDOs are "package[s]" of loans that have been securitized. LINDA O. SMIDDY & LAWRENCE A. CUNNINGHAM, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 273 (LexisNexis, 8th ed. 2014). A mortgage secures a house loan by assigning the house as collateral in the case of a default. Franklin A. Gevurtz, *The Role of Corporate Law in Preventing a Financial Crisis: Reflections on* In re Citigroup Inc. Shareholder Derivative Litigation, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 113, 117 (2010). Banks pooled housing loans into CDOs. *Id.* CDOs are attractive to investors

Default Swaps (CDSs).[54] The abundance of these "over-the-counter (OTC)"[55] derivatives grew exponentially after Congress passed the CMFA.[56] In 2000, OTC products' gross-market value globally was $3.2 trillion—by Spring 2008, that figure had grown to more than $20 trillion.[57]

The mechanisms that led to the Financial Crisis were extremely complex and complicated, so much so that many of the bankers and investors that traded in these new OTCs did not realize what they were doing until it was too late.[58] Asset Backed Commercial Paper (ABCP), CDOs, CDSs—financial institutions created all of these OTC products to extract profit from the housing market in the early 2000s.[59] When the housing bubble burst in 2007, the market for financial products that relied on the housing market collapsed too, leading to widespread economic distress.[60] Furthermore, banks, loan originators, and even auditors contributed to the Financial Crisis by engaging in fraud—in the mortgage market and the rating systems for these new financial products.[61] The securitization of risky mortgages, the rampant fraud in the industry, and the federal government's aggressive deregulation policies of the 1980s and 1990s all compounded and ultimately led to the stock market tumbling in 2008.[62]

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because they diversify an investor's risk—instead of an investor's money put into just one individual asset, the risk is spread across all the assets in the pool. *Id.* In addition, CDOs are split into different "classes"—called tranches—and the different tranches are assigned a rating based on their level of risk (for example, a high-quality, low-risk tranche would have a rating of AAA). *Id.*

54. *See* FCIC REPORT, *supra* note 28, at 50 ("The purchaser of a CDS transferred to the seller the default risk of an underlying debt. The debt security could be any bond or loan obligation. The CDS buyer made periodic payments to the seller during the life of the swap. In return, the seller offered protection against default or specified 'credit events' such as a partial default. If a credit event such as a default occurred, the CDS seller would typically pay the buyer the face value of the debt.").

55. *Id.* at 46.

56. *See id.* at 48 ("The OTC derivatives market boomed.").

57. *Id.* For context, the U.S. GDP in 2008 was roughly $14.7 trillion. Kimberly Amadeo, *2008 GDP, Growth, and Updates by Quarter: The Financial Crisis Bludgeons the Economy*, BALANCE, https://www.thebalance.com/2008-gdp-growth-updates-by-quarter-3305542 (last updated Nov. 9, 2018). Thus, the value of the OTC market, just one type of investment vehicle, outgrew the annual production of the U.S. economy by a wide margin. *See* FCIC REPORT, *supra* note 28, at 48 (noting that the OTC market value was $20.3 trillion in 2008).

58. *See* FCIC REPORT, *supra* note 28, at 188 (describing how executives at some of the country's largest banks did not understand the risks inherent in their new investment instruments, such as CDOs).

59. *See id.* at xxiv ("[E]ach step in the mortgage securitization pipeline depended on the next step to keep demand going.").

60. *See id.* ("When borrowers stopped making mortgage payments, the losses—amplified by derivatives—rushed through the pipeline.").

61. *See id.* at xxv (labeling the credit rating agencies "key enablers" for their role in the 2008 Financial Crisis).

62. *See Crash Course*, *supra* note 1 (summarizing the causes of 2008 Financial Crisis).

II. REGULATORY SHORTCOMINGS AT THE DOJ

A. A Lack of Criminal Prosecutions

In the wake of the Financial Crisis, Congress established the Financial Crisis Inquiry Commission (FCIC) to "examine the causes, domestic and global, of the current financial and economic crisis in the United States."[63] Beginning in May 2009, the independent commission spent over a year combing through millions of pages of documents and held over 700 interviews.[64] The FCIC's January 2011 report to Congress concluded that the Financial Crisis was the result of human error and that it could have been avoided: "The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the American public."[65] The FCIC detailed evidence of reckless executive behavior and "stunning instances of [corporate] governance breakdowns and irresponsibility."[66] The FCIC also referred nine individuals to the DOJ for violating certain sections of the Exchange Act and the Sarbanes–Oxley Act (SOX).[67] None of these individuals, however, were ever even *charged* with a crime.[68]

The U.S. government failed to successfully prosecute a single high-ranking corporate executive in the aftermath of the Financial Crisis.[69] In 2009, a jury acquitted Bear Sterns's managers Ralph Cioffi and Matthew Tannin of charges that they had illegally inflated the value of their hedge fund.[70] Cioffi and Tannin were the only high-ranking corporate executives

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63. *History of the Commission*, STANFORD UNIV. ROCK CTR. FOR CORP. GOVERNANCE (internal quotation marks omitted), https://fcic.law.stanford.edu/about/history (last visited Dec. 4, 2018).

64. *Work of the Commission*, STANFORD UNIV. ROCK CTR. FOR CORP. GOVERNANCE, https://fcic.law.stanford.edu/about/work (last visited Dec. 4, 2018).

65. FCIC REPORT, *supra* note 28, at xvii.

66. *See id.* at xix (describing institutions' reckless behavior).

67. *See* Warren Letter, *supra* note 5 ("Nine individuals were implicated in these [FCIC] referrals . . . .").

68. *See id.* ("Not one of the nine has gone to prison or been convicted of a criminal offense. Not a single one has even been indicted or brought to trial.").

69. *See* Michael Winston, *Why Have No CEOs Been Punished for the Financial Crisis?*, HILL (Dec. 8, 2016), http://thehill.com/blogs/pundits-blog/finance/309544-why-have-no-ceos-been-punished-for-the-financial-crisis ("Nearly a decade after the fraud and irresponsible actions at Wall Street banks, Countrywide Financial, and other companies brought the nation to the brink of total economic collapse, there have been no prosecutions against their key executives.").

70. The hedge fund, which was loaded with risky mortgage-backed securities, collapsed in 2007, losing investors $1.6 billion. David Goldman, *Former Bear Stearns Execs Not Guilty*, CNN MONEY, http://money.cnn.com/2009/11/10/news/companies/bear_stearns_case/ (last updated Nov. 11, 2009). Cioffi and Tannin later agreed to a $1.05 million settlement with the SEC for their role in the hedge fund's collapse. Patricia Hurtado, *Cioffi, Tannin Settlement with SEC Approved by U.S. Judge*,

brought to trial in the wake of the Financial Crisis.[71] The closest the government ever came to bringing a criminal case against a corporate CEO to trial was when it charged Angelo Mozilo, Countrywide's CEO, with insider trading and securities fraud.[72] The government dropped the charges against Mozilo after he paid $67 million in civil fines to the SEC.[73] Unsurprisingly, the government's success against mid-to-low level corporate officials is nearly as dismal.[74]

The DOJ has often repeated that its lawyers struggled to file criminal charges against corporate executives because they lacked sufficient evidence for the *mens rea* element of securities crimes.[75] Attorney General Eric Holder claimed that the DOJ had diligently investigated the FCIC referrals—at a 2015 National Press Club event, Holder explained: "The inability to make [prosecutions], at least to this point, has not been as a result of a lack of effort."[76] Lanny Breuer, the head of the DOJ's Criminal Justice Division (2009–2013), told PBS Frontline in 2012 that, "when we [the DOJ] cannot prove beyond a reasonable doubt that there was criminal

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BLOOMBERG (June 18, 2012), https://www.bloomberg.com/news/articles/2012-06-18/cioffi-tannin-settlement-with-sec-approved-by-u-s-judge-1-.

71. *See Former Bear Stearns Executives on Trial*, NPR (Oct. 27, 2009), https://www.npr.org/templates/story/story.php?storyId=114215626?storyId=114215626 (discussing criminal charges against former Bear Stearns executives Ralph Cioffi and Matthew Tannin).

72. *See* Gretchen Morgenson, *Countrywide Mortgage Devastation Lingers as Ex-Chief Moves On*, N.Y. TIMES (June 24, 2016), https://www.nytimes.com/2016/06/26/business/countrywide-mortgage-devastation-lingers-as-ex-chief-moves-on.html (documenting Mozilo's legal troubles in the wake of the Financial Crisis).

73. *Id.*

74. In 2013, a federal court sentenced Kareem Serageldin, a senior trader at Credit Suisse, to 30 months in prison for inflating the value of mortgage bonds. William D. Cohan, *A Clue to the Scarcity of Financial Crisis Prosecutions*, N.Y. TIMES (July 21, 2016), https://www.nytimes.com/2016/07/22/business/dealbook/a-clue-to-the-scarcity-of-financial-crisis-prosecutions.html. In 2010, the SEC filed a suit against Goldman Sachs and one of its traders, 28-year-old Fabrice Tourre, for misleading investors in setting up the infamous ABACUS deal, a synthetic CDO that later became the subject of Michael Lewis's famous book *The Big Short*. JESSE EISINGER, THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES 263–68 (Simon & Schuster 2017). In 2014, a federal district court in New York ordered Tourre to pay the SEC more than $850,000 in *civil* fines for his role in the ABACUS deal; Goldman later settled with the SEC. *Id.* at 268.

75. *See* Joe Pinsker, *Why Aren't Any Bankers in Prison for Causing the Financial Crisis?*, ATLANTIC (Aug. 17, 2016), https://www.theatlantic.com/business/archive/2016/08/why-arent-any-bankers-in-prison-for-causing-the-financial-crisis/496232/ (explaining the difficulty with proving criminal intent in financial fraud cases).

76. William D. Cohan, *How Wall Street's Bankers Stayed Out of Jail*, ATLANTIC (Sept. 2015), https://www.theatlantic.com/magazine/archive/2015/09/how-wall-streets-bankers-stayed-out-of-jail/399368/.

intent, then we have a constitutional duty not to bring those cases."[77] Breuer elaborated that the Criminal Division within the DOJ in fact had tried to prosecute the FCIC referrals: "[W]e looked hard at every one of the referrals that we had [from the FCIC]."[78] But Breuer and Holder ultimately concluded it would be too hard to prove the *mens rea* element of these crimes.[79] According to Breuer, "federal criminal cases are hard to bring—I have to prove that you had the specific intent to defraud. I have to prove that the counterparty, the other side of the transaction, relied on your misrepresentation. If we cannot establish that, then we can't bring a criminal case."[80] According to Breuer, proving a securities violation hinged on the alleged wrongdoer's intent and whether the counterparty actually relied on the misinformation.[81]

High-profile legal scholars disagree with the DOJ's interpretation of the law. Jed S. Rakoff, a Senior Judge on the U.S. District Court for the Southern District of New York, has said the DOJ misconstrued the law: "In actuality, in a criminal fraud case the government is never required to prove—ever—that one party to a transaction relied on the word of another."[82] In other words, "[t]he SEC need not plead or prove reliance, that is, it need not show that it (or any actual investor) relied on a misstatement in making an investment decision."[83] According to Judge Rakoff and others, the DOJ mistakenly believed that it needed to prove reliance in prosecuting securities violations.[84]

Others accuse the DOJ of being timid and scared to lose at trial.[85] After several embarrassing mishaps at the DOJ in the early 2000s related to white-collar prosecutions, government lawyers seemed to fear how a trial

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77. Interview by Frontline with Lanny Breuer, former Assistant Att'y Gen., Criminal Div., U.S. Dep't of Justice, in PBS Studios (Nov. 30, 2012), http://www.pbs.org/wgbh/frontline/article/lanny-breuer-financial-fraud-has-not-gone-unpunished (providing an edited transcript of the interview).

78. *Id.*

79. *See id.* (documenting Breuer's position that the government could not prove the necessary intent to secure criminal prosecutions after the Financial Crisis).

80. *Id.*

81. *Id.*

82. *See* Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/ (explaining that Lanny Breuer's interpretation of the law "totally misstates the law"). Judge Rakoff concluded, "[t]he law, however, says that society is harmed when a seller purposely lies about a material fact . . . because such misrepresentations create problems for the market as a whole." *Id.*

83. STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION 265 (4th ed. 2015).

84. Only "private plaintiffs must both plead and prove reliance" in securities fraud civil suits. *Id.*

85. *See* EISINGER, *supra* note 74, at 230 (explaining how the DOJ during the Holder era preferred easier-to-prove insider trading cases to securities fraud cases).

loss would affect their reputation.[86] U.S. Attorneys frequently try to land associate positions at prestigious private firms after stints at the DOJ; ambitious federal prosecutors consider a less-than-sterling trial record in their government work a career liability.[87] In 2014, the DOJ brought 29% fewer cases against corporations than in 2004. In 2016, the DOJ brought 40% fewer white-collar criminal cases against individuals than in 1996.[88] While there are several potential explanations for this drop in prosecutions,[89] many see it as a failure by the DOJ to pursue difficult cases.[90]

B. The Rise of the Deferred Prosecution Agreement

The Deferred Prosecution Agreement (DPA) has become the favored tool of the government in financial misconduct cases (along with its sister agreement, the Non-Prosecution Agreement (NPA)).[91] Preferred over more difficult, costly, and time-consuming criminal prosecutions, DPAs and NPAs are now "mainstay[s]" at the DOJ.[92] Why would the government or any federal prosecutor choose to go up against a billion-dollar company with a high-powered defense team when, in lieu of bringing a trial, the government could opt for an easy settlement that grabs national headlines? Herein lies the trap of DPAs: they are easy on both the government and on corporations, but DPAs rarely result in compensation for victims of financial crimes.[93] With DPAs, the government receives "eye-popping

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86. *See id.* at 57 ("The [Arthur] Anderson case ushered in an era of prosecutorial timidity when it came to taking on the largest corporations in America.").

87. *See id.* at 191 ("[M]ost white-collar criminal law partners were former government officials, especially federal prosecutors."); *see also id.* at 230 (describing how easy wins are the way to further a federal prosecutor's career).

88. *See id.* at xviii–xx (noting the drop in the number of cases that the DOJ brought against corporations in 2014 and then again in 2016).

89. *See infra* Part II.B (explaining how the SEC favors using certain types of settlement agreements in lieu of criminally prosecuting white collar crimes).

90. *See* EISINGER, *supra* note 74, at 231 ("'The government failed,' says a former top prosecutor in the Southern District [of N.Y.], in a sentiment echoed by several former assistant US attorneys in the office. 'We didn't do what we needed to do.'").

91. *See* Anne M. Chapman & Kathleen E. Brody, *Deferred Prosecution Agreements in the Financial Services Industry: Trends and Tips*, CHAMPION, June 2013, at 42, http://www.omlaw.com/uploads/publications/Champion_June_2013_Feature.pdf (quoting former DOJ Criminal Division head Lanny A. Breuer, who explained that DPAs have become a "mainstay of white collar criminal law enforcement" during his speech to the New York City Bar Association on September 13, 2012).

92. *Id.*; *see also* EISINGER, *supra* note 74, at 93 (explaining the rise of the DPA).

93. *See* Russell Mokhiber, Editor, Corp. Crime Reporter, Address at the National Press Club: Crime Without Conviction: The Rise of Deferred and Non Prosecution Agreements (Dec. 28, 2005), www.corporatecrimereporter.com/deferredreport.htm ("[T]he rise of these agreements has undermined

dollar amounts" and the federal prosecutors "set themselves up for lucrative careers in the private sector."[94] Corporations favor DPAs because they can halt SEC investigations in the early stages without admitting any wrongdoing (to limit the corporation's liability in civil suits).[95] Furthermore, shareholders—not the corporation's executives—pay for the settlements.[96] These incentives for both the government and the corporations accused of financial crimes have led to a "[s]ettlement culture."[97]

As of 2017, 49 separate financial corporations had doled out a combined $190 billion in fines and settlements for their conduct in regards to the Financial Crisis (DPAs and NPAs).[98] For the DOJ, some of the highlights include a $16.65 billion settlement with Bank of America for its marketing and structuring of mortgage-backed securities and CDOs;[99] a $13 billion settlement with JPMorgan Chase, the nation's largest bank, for its mortgage-lending practices;[100] and a $7 billion settlement with Citigroup for its mortgage-backed securities practices.[101] At the SEC, prosecutors also secured several eye-popping settlements, albeit not in the league of the DOJ.[102] Although the DOJ's and the SEC's settlements are large and hard

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the general deterrent and adverse publicity impact that results from corporate crime prosecutions and convictions. . . . It could very well be that the rise of these deferred and non prosecution agreement deals represents a victory for the forces of big business who for decades have been seeking to weaken or eliminate corporate criminal liability.").

94. EISINGER, *supra* note 74, at xix.

95. *See id.* at 93, 100 (discussing the first DPA and its effect on corporate prosecution); *see also* Mokhiber, *supra* note 93 (highlighting a number of cases where prominent corporations, such as Arthur Anderson and Aetna, entered into DPAs and NPAs and were not required to admit wrongdoing); *see also infra* notes 103–05 and accompanying text (further discussing the benefits corporations gain from entering into DPAs and NPAs).

96. EISINGER, *supra* note 74, at xix.

97. *See id.* at xx (describing the corrosive effects of "[s]ettlement culture").

98. *Id.* at 317.

99. Press Release, U.S. Dep't of Justice, Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (Aug. 21, 2014), https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

100. Press Release, U.S. Dep't of Justice, Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-13-billion-global-settlement.

101. Press Release, U.S. Dep't of Justice, Justice Department, Federal and State Partners Secure Record $7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages (July 14, 2014), https://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement.

102. This includes a $550 million settlement with Goldman Sachs for misleading investors into the notorious ABACUS deal; a $285 million settlement with Citigroup for misleading investors and betting against one of its own CDO funds, and a $153.6 million settlement with JPMorgan Chase for the company's role in misleading investors in a mortgage-backed securities transaction. *SEC Enforcement*

for everyday Americans to comprehend, the settlements represent just a fraction of these corporations' assets,[103] are usually much less than reported due to tax write-offs available to corporations,[104] and are ultimately paid for by the companies' shareholders.[105]

C. The Difficulties of Proving the Mens Rea *Element in Securities Crimes*

Proving the *mens rea* element—the alleged bad actor's intent—is incredibly difficult in a securities fraud case.[106] The world of financial products is complex and in many ways like the Wild West; financial institutions are continuously creating new products at a pace far ahead of the government's ability to successfully regulate them.[107] Thus, prosecutors are left to apply outdated laws to complex transactions.[108] Furthermore, prosecutors are rarely well versed in the inner workings of financial products, such as derivatives and default swaps.[109] Executives and financial

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Actions: Addressing Misconduct That Led to or Arose from the Financial Crisis, SEC, https://www.sec.gov/spotlight/enf-actions-fc.shtml (last modified Feb. 22, 2017); *Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO*, SEC, https://www.sec.gov/news/press/2010/2010-123.htm (last modified July 15, 2010).

103. In 2014, when Bank of America reached a $16.65 billion settlement with the DOJ, the corporation's total assets were $2.1 trillion at the end of the fiscal year. BANK OF AM. CORP., 2014 ANNUAL REPORT 24 (2015), http://media.corporate-ir.net/media_files/IROL/71/71595/AR2014.pdf. In 2013, when JPMorgan Chase reached a $13 billion settlement with the DOJ, the corporation's total assets were $2.4 trillion at the end of the fiscal year. JPMORGAN CHASE & CO., ANNUAL REPORT 2013, Financial Highlights (2014), https://www.jpmorganchase.com/corporate/investor-relations/document/01-2013AR_FULL_09.pdf. And in 2014, when Citigroup reached a $7 billion settlement with the DOJ, the corporation's total assets were $1.8 trillion at the end of the fiscal year. CITIGROUP INC., 2014 ANNUAL REPORT 1 (2015), http://www.citigroup.com/citi/investor/quarterly/2015/ar14c_en.pdf?ieNocache=157.

104. This is only true for DOJ settlements; the SEC "has barred companies from deducting settlement costs as a business expense." Gretchen Morgenson, *Paying the Price, but Often Deducting It*, N.Y. TIMES (Jan. 12, 2013), http://www.nytimes.com/2013/01/13/business/paying-the-price-in-settlements-but-often-deducting-it.html?mtrref=www.google.com.

105. *See* Sonia A. Steinway, Comment, *SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical Analysis of the SEC's New Enforcement Approach*, 124 YALE L.J. 209, 222 (2014) (explaining that corporate settlements are "effectively split among shareholders").

106. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007) (describing *scienter* as "a mental state embracing intent to deceive, manipulate, or defraud" and discussing generally the high burden of proof plaintiffs must allege in bringing a securities action (citation omitted)).

107. *See* FCIC REPORT, *supra* note 28, at 6 ("Investors around the world clamored to purchase securities built on American real estate, seemingly one of the safest bets in the world. Wall Street labored mightily to meet that demand. Bond salesmen earned multi-million-dollar bonuses packaging and selling new kinds of loans, offered by new kinds of lenders, into new kinds of investment products that were deemed safe but possessed complex and hidden risks.").

108. *See* Bucy, *supra* note 19, at 55 n.309, 56 (discussing the difficulty of applying economic and securities statutes to economic wrongdoing).

109. *See id.* at 55–56, 58 (explaining how many attorneys are ill-prepared to prosecute complex economic crimes because of a lack of technical training and investigatory resources).

traders, on the other hand, possess intimate knowledge of these products and can hide their intent to defraud or deceive behind a product's complexities.[110] Alternatively, executives rely on a common refrain: risks are inherent in any investment, especially those traded in financial markets.[111] Executives also claim it is impossible to monitor every act of every employee in the corporation—especially when the corporation is a trillion-dollar institution with thousands of employees across the globe.[112]

This confluence of factors makes the prosecutor's task of proving an executive's intent to mislead or defraud particularly arduous.[113] Additionally, corporations have deep pockets and can afford the best white-collar defense lawyers.[114] Further complicating matters, the federal courts have become more business friendly in the last 20 years.[115] Because of the many factors stacked against prosecutors in white-collar cases, the government is bringing fewer charges against corporate misfeasors.[116] This trend is troubling and achieves neither justice nor accountability.

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110. *See id.* at 55 ("[Economic wrongdoing] [o]ften . . . is hidden within a large organization, buried in paper trails and electronic messages, concealed by false documentation, [and] involves complex and intricate transactions . . . .").

111. *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE 130 (Am. Law Inst. Publishers 1994) (1992) ("The basic policy underpinning of the business judgment rule is that corporate law should encourage, and afford broad protection to, informed business judgments . . . in order to stimulate risk taking . . . .").

112. *See* EISINGER, *supra* note 74, at 242 (examining Ian Lowitt's—Lehman Brothers's last C.F.O.—defense when SEC regulators began investigating him for securities violations in the lead up to Lehman's bankruptcy).

113. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319, 321 (2007) (explaining what a prosecutor must demonstrate to prove an executive's intent to mislead or defraud); *see also* Bucy, *supra* note 19, at 3–4 (highlighting how difficult it is to prove *mens rea* for economic crimes); *see also* EISINGER, *supra* note 74, at 324 (discussing the Heritage Foundation's advocacy for *mens rea* reform).

114. *See* EISINGER, *supra* note 74, at 186–89 (describing the important role that white-shoe defense firms play in corporate America).

115. Nick Wells & Mark Fahey, *The US Supreme Court Is More Friendly to Businesses Than Any Time Since World War II*, CNBC (Mar. 1, 2017), https://www.cnbc.com/2017/03/01/supreme-court-very-business-friendly-data-show.html (explaining that, according to a recently released study, "[t]he current [C]ourt led by Chief Justice John Roberts, a George W. Bush appointee, has decided in favor of business litigants over 60 percent of the time . . . . That's a big leap from the 44 percent pro-business cases the [C]ourt decided when led by . . . William Rehnquist").

116. *See* EISINGER, *supra* note 74, at 230 (providing some reasons why prosecutors do not charge financial institutions with securities violations).

III. CIVIL SUIT DEAD ENDS

A. Section 10b of the Exchange Act and the SEC's Rule 10b–5

The most frequently used statutory tools for enforcing securities violations are SEC Rule 10b–5 and § 10b of the Exchange Act of 1934.[117] Section 10b is the main antifraud provision of the Exchange Act and provides the statutory authority for the government to bring civil enforcement actions and criminal prosecutions against violators.[118] The SEC promulgated Rule 10b–5 in 1948 pursuant to § 10b of the Exchange Act.[119] Rule 10b–5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[120]

The Supreme Court has recognized an implied "private cause of action from the text and purpose of § 10(b)."[121] Thus, under Rule 10b–5, private investors can bring a civil suit against a corporation that defrauds them.[122] The SEC has stated that this private cause of action is "an essential tool for

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117. *See* CHOI & PRITCHARD, *supra* note 83, at 34 ("By far the most important antifraud provision is Rule 10b–5 . . . .").

118. *See* 15 U.S.C. § 78j(b) (2012) ("It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.").

119. *See* CHOI & PRITCHARD, *supra* note 83, at 34 (stating that the SEC promulgated Rule 10b–5 pursuant to § 10(b) of the Exchange Act); Cecilia A. Glass, Note, *Sword or Shield? Setting Limits on SLUSA's Ever-Growing Reach*, 63 DUKE L.J. 1337, 1340 (2014) ("The SEC promulgated Rule 10b–5 in 1948 . . . .").

120. 17 C.F.R. § 240.10b–5 (2018).

121. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 37 (2011); *see also* CHOI & PRITCHARD, *supra* note 83, at 34 (explaining that courts read into Rule 10b–5 a private right of action with regularity).

122. *See Matrixx Initiatives*, 563 U.S. at 37 (implying "a private cause of action" under § 10(b)).

enforcement of the [Exchange] Act's requirements."[123] There are six elements to a private 10b–5 claim: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[124]

B. Limits on Private Suits Against Corporations for Securities Fraud: Rule 9(b), the Private Securities Litigation Reform Act, and the Securities Litigation Uniform Standards Act

Rule 9(b) of the Federal Rules of Civil Procedure (FRCP) establishes the baseline pleading requirement for securities fraud claims.[125] The first part of Rule 9(b) states: "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake."[126] The Second Circuit has interpreted the "particularity" requirement to mean a plaintiff must: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."[127] The second part of Rule 9(b) states: "Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."[128] Based on this language, it appears that a plaintiff only needs to generally plead the intent element of a securities fraud claim.[129]

The second part of Rule 9(b)—the Rule's *scienter* requirement—has been a source of considerable confusion and disagreement amongst the federal circuit courts in the past several years.[130] Three main interpretations have emerged. The Fourth, Eleventh, and D.C. Circuits maintain the original meaning of Rule 9(b) and do not require a heightened pleading

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123. Basic Inc. v. Levinson, 485 U.S. 224, 230–31 (1988).

124. *Matrixx Initiatives*, 563 U.S. at 37–38 (citations omitted).

125. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007) (describing how FRCP Rule 9(b) governs securities pleadings).

126. FED. R. CIV. P. 9(b).

127. Rombach v. Chang, 355 F.3d 164, 170 (2d Cir. 2004) (quoting Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d Cir. 1993)).

128. FED. R. CIV. P. 9(b).

129. *Id.*

130. Hannah Ruth Roberts, *Anything but General: Pleading Scienter in Rule 9(b) Claims*, AM. B. ASS'N (May 23, 2017), https://www.americanbar.org/groups/litigation/committees/business-torts-unfair-competition/practice/2017/pleading-scienter-in-rule-9b-claims.html (outlining the three different interpretations of FRCP 9(b)'s *scienter* requirement that exist amongst the Circuit Courts of Appeals).

standard for *scienter* in fraud suits.[131] The First, Third, Fifth, Sixth, Seventh, and Eighth Circuits apply *Twombly*'s plausibility standard to Rule 9(b)'s *scienter* requirement;[132] thus, a plaintiff cannot allege intent generally but must allege it in such a way that makes her claim of fraud "plausible on its face."[133] The First Circuit explained that, under this plausibility requirement, plaintiffs must describe "enough facts from which malice might reasonably be inferred."[134] Rounding out the circuit split is the Second Circuit, which has perhaps the most stringent pleading requirements for fraud, requiring plaintiffs to allege "facts that give rise to a strong inference of fraudulent intent."[135] "A plaintiff can satisfy this requirement by '(1) alleging facts to show that defendant had both motive and opportunity to commit fraud, or by (2) alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.'"[136]

In the context of securities litigation, Congress did not believe that Rule 9(b)'s heightened pleading standard for fraud was high enough.[137] After years of lobbying by the defense bar and corporate America, Congress enacted the Private Securities Litigation Reform Act (PSLRA) in 1995 to deter "frivolous" securities lawsuits.[138] Taking aim at nuisance filings, "targeting of deep pocket defendants," vexatious discovery requests, and "the manipulation by class action lawyers,"[139] the PSLRA created a pleading standard even more strenuous than that required by Rule 9(b):[140]

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131. *See id.* ("The Fourth, Eleventh, and D.C. Circuits have yet to require heightened pleading for scienter in fraud."); *see also* Urquilla-Diaz v. Kaplan Univ., 780 F.3d 1039, 1051 (11th Cir. 2015) (holding that plaintiffs may allege *scienter* generally under 9(b)).

132. *See* Ashcroft v. Iqbal, 556 U.S. 662, 696 (2009) ("Under *Twombly*, the relevant question is whether, assuming the factual allegations are true, the plaintiff has stated a ground for relief that is plausible. That is, in *Twombly*'s words, a plaintiff must 'allege facts' that, taken as true, are 'suggestive of illegal conduct.'" (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 564 n.8 (2007))).

133. *Twombly*, 550 U.S. at 570; *see* Roberts, *supra* note 130 ("The First, Third, Fifth, Sixth, Seventh, and Eighth Circuits have all interpreted Rule 9(b)'s scienter standard as a plausibility standard in the post-*Iqbal* era.").

134. Schatz v. Republican State Leadership Comm., 669 F.3d 50, 58 (1st Cir. 2012).

135. First Capital Asset Mgmt. v. Satinwood, Inc., 385 F.3d 159, 179 (2d Cir. 2004) (emphasis omitted) (citations omitted).

136. PetEdge, Inc. v. Garg, 234 F. Supp. 3d 477, 491 (S.D.N.Y. 2017) (quoting S.Q.K.F.C., Inc. v. Bell Atl. Tricon Leasing Corp., 84 F.3d 629, 634 (2d Cir. 1996)).

137. Congress wished to "return the securities litigation system to [a] high standard. Congress ha[d] been prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets." H.R. REP. NO. 104–369, at 31–32 (1995) (Conf. Rep.).

138. *See id.* at 32 ("This legislation implements needed procedural protections to discourage frivolous litigation.").

139. *Id.* at 31.

140. Rule 9(b) is a heightened pleading standard in and of itself—more is required for a complaint in fraud actions than in other suits, which are subject to the *Twombly* plausibility standard.

> Under the PSLRA's heightened pleading instructions, any private securities complaint alleging that the defendant made a false or misleading statement must: (1) "specify each statement alleged to have been misleading and the reason or reasons why the statement is misleading," . . . and (2) "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind[.]"[141]

The Supreme Court further clarified what it meant by "strong inference," stating such inferences must be "cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[142]

The PSLRA's heightened pleading standard makes surviving a defendant's motion to dismiss more difficult for plaintiffs with legitimate securities claims.[143] Members of the public rarely have insight into the specific mental state of a company or its executives, and thus it is difficult to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind" for each instance of fraud.[144]

The PSLRA included several other important changes to securities laws, including adding a "safe harbor" provision for "forward-looking statements"[145] and limiting who can serve as the lead plaintiff in class-action securities suits.[146] The safe harbor provision requires any fraud claim based on a "forward-looking statement," such as a projection of profit, to plead with particularity "actual knowledge" that the defendant intended to defraud or mislead consumers.[147] Congress enacted the "lead plaintiff"

Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)).

141. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 321 (2007) (quoting 15 U.S.C. § 78u-4(b)(1)–(2) (2006)).

142. *Id.* at 324.

143. *See* Jonathan D. Glater, *Hurdles of Different Heights for Securities Fraud Litigants of Different Types*, 2014 COLUM. BUS. L. REV. 47, 82–83 (detailing the hurdles plaintiffs face after Congress passed the PSLRA).

144. *Id.* at 71 (quoting 15 U.S.C. § 78u-4(b)(2)(A) (2006)).

145. *See* 15 U.S.C. § 77z-2 (2012) ("Application of safe harbor for forward-looking statements").

146. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb) (2012) (stating that only investors with "the largest financial interest in the relief sought by the class" may serve as lead plaintiffs in a class action securities suit).

147. *See* Glater, *supra* note 143, at 71 ("The plaintiff must prove that the forward-looking statement was made 'with actual knowledge . . . that the statement was false or misleading.'" (quoting 15 U.S.C. § 77z-2(c)(1)(B)(i))).

provision to limit plaintiffs' lawyers' ability to churn out strike suits.[148] This provision, however, has made bringing class actions much more difficult for investors.[149] Generally, class actions are the only way for individual investors to bring their claims against multibillion-dollar corporations.[150] While the PSLRA only covers claims brought in federal courts, Congress passed the Securities Litigation Uniform Standards Act (SLUSA)[151] in 1998, which applied the PSLRA and its requirements to claims brought in state courts.[152]

The heightened pleading standard for securities lawsuits makes it extremely difficult for individual investors to bring civil suits in state and federal courts.[153] In the wake of the 2008 Financial Crisis, individuals hoping to recover their investments frequently had their claims dismissed on FRCP Rule 12(b)(6) due to their inability to meet PSLRA's heightened pleading requirements.[154] Adding a private right of action to Dodd–Frank's Whistleblower Provision that is similar to the *qui tam* model of the FCA would enable the SEC and private citizens to effectively plead securities violations against both individual and corporate wrongdoers.[155]

IV. THE FALSE CLAIMS ACT'S *QUI TAM* PROVISION

A. Introduction to the False Claims Act

Congress passed the FCA in 1863 to combat fraudulent acts against the federal government.[156] Since its inception, the FCA has been the federal

148. 15 U.S.C. § 78u-4(a)(3)(B); *see* Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966) (explaining that "strike suits" are suits brought by "people who might be interested in getting quick dollars by making charges without regard to their truth so as to coerce corporate managers to settle worthless claims in order to get rid of them").

149. *See* Glater, *supra* note 143, at 79–83 (discussing the effects of the lead-plaintiff provision).

150. *See, e.g.*, Deutschman v. Beneficial Corp., 132 F.R.D. 359, 378 (D. Del. 1990) ("The class action device is especially appropriate in securities fraud cases, such as this one, wherein there are many individual plaintiffs who suffer damages too small to justify a suit against a large corporate defendant.").

151. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105–353, 112 Stat. 3227 (codified at 15 U.S.C. § 78bb (2012)).

152. *See* Glater, *supra* note 143, at 66 n.64 ("SLUSA bars shareholders from filing securities fraud class action suits in state court or under state law in federal court and thereby sidestepping the requirements of the PSLRA.").

153. *See id.* at 82–83 (describing the effect of the PSLRA's high standard as intentionally favoring corporate defendants over individual investors).

154. *See id.* at 90–92 (illustrating how in one case involving Wachovia Bank, "[t]he stumbling block for the plaintiffs was establishing scienter to satisfy the PSLRA's high standard").

155. *See* 31 U.S.C. § 3730(b) (2012) (outlining the FCA's *qui tam* provision).

156. *See The False Claims Act: A Primer*, U.S. DEP'T OF JUSTICE, https://www.justice.gov/sites/default/files/civil/legacy/2011/04/22/C-FRAUDS_FCA_Primer.pdf (last visited Dec. 4, 2018) [hereinafter *FCA Primer*] (explaining how Congress at the time of enactment was

government's main statutory weapon for bringing individuals who file fraudulent claims against the U.S. to justice.[157] While the FCA has gone through many revisions, including a serious makeover in 1986,[158] one constant of the Act has been its *qui tam* provision.[159] The FCA's *qui tam* provision allows private citizens with inside knowledge of fraud to bring private actions on behalf of themselves and the federal government.[160] The purpose of these *qui tam* suits is to "encourag[e] private individuals to come forward with information about fraud that might otherwise remain hidden."[161] These whistleblowers are known as "relators" in the context of the FCA, and they are entitled to a share in "the proceeds of the action or settlement of the claim."[162] The relator has standing to sue on the theory that the federal government has assigned its right to claim damages to a private citizen via the FCA.[163]

The FCA's *qui tam* provision sets out a detailed and unique procedure by which an individual whistleblower can bring a private action against an individual or company that submitted fraudulent claims to the U.S. A relator with inside information of fraud files a *qui tam* action in federal court.[164] Once filed, the court then seals the action for at least 60 days while the DOJ reviews the action's merits.[165] If the government believes the claim has merit,[166] and believes the relator is the "original source" of the inside

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"concerned that suppliers of goods to the Union Army during the Civil War were defrauding the Army").

157. Thomas L. Harris, Note, *Alternate Remedies & the False Claims Act: Protecting Qui Tam Relators in Light of Government Intervention and Criminal Prosecution Decisions*, 94 CORNELL L. REV. 1293, 1294 (2009) (describing the FCA as the "principal federal antifraud statute").

158. These changes included "increasing damages from double damages to treble damages and raising the penalties from $2,000 to a range of $5,000 to $10,000." *FCA Primer*, *supra* note 156.

159. *See* Bucy, *supra* note 19, at 45–46 (comparing the different eras of the *qui tam* provision throughout the FCA's history).

160. *Id.* at 44 ("Private parties who allege and prove fraud against the government bring qui tam lawsuits.").

161. United States *ex rel.* Barajas v. United States, 258 F.3d 1004, 1012 (9th Cir. 2001); *see also* S. REP. NO. 99–345, at 2 (1986) ("The proposed legislation seeks not only to provide the Government's law enforcers with more effective tools, but to encourage any individual knowing of Government fraud to bring that information forward.").

162. Bucy, *supra* note 19, at 44; 31 U.S.C. § 3730(d)(1) (2012).

163. The "adequate basis for the relator's suit . . . is to be found in the doctrine that the assignee of a claim has standing to assert the injury in fact suffered by the assignor. The FCA can reasonably be regarded as effecting a partial assignment of the Government's damages claim." Vt. Agency of Nat. Res. v. United States *ex rel.* Stevens, 529 U.S. 765, 773 (2000).

164. 31 U.S.C. § 3730(b); *see also id.* § 3732(a) (stating where a relator may file an action).

165. *See* Bucy, *supra* note 19, at 49–50 (describing the DOJ evaluation process); *see also* 31 U.S.C. § 3730(b)(2) ("The complaint shall . . . remain under seal for at least 60 days . . . .").

166. If the DOJ initially believes there is no merit to the claim, it will move to dismiss the suit pursuant to FCA procedure. *See* 31 U.S.C. § 3730(c)(2)(A) ("The Government may dismiss the action notwithstanding the objections of the person initiating the action if the person has been notified by the

information,[167] the government can do one of two things: (1) the DOJ can decide to intervene, which occurs when the government believes there is a high chance for success in the case, or (2) the DOJ can decide not to intervene and allow the relator to proceed with a civil claim of her own.[168] Historically, *qui tam* cases in which the DOJ intervenes have much higher success rates than cases when the DOJ chooses not to intervene; thus, relators and their lawyers work extremely hard on the initial complaint to entice the government to intervene.[169]

If the government chooses to intervene, it retains "primary responsibility"[170] for the lawsuit; the complaint is unsealed and then served on the defendant.[171] At this point, the suit continues as is "typical of other lawsuits."[172] However, the relator still remains a plaintiff to the suit, creating a "dual-plaintiff" system in which both the relator and the federal government retain specific rights detailed in the statute.[173] If the action is successful, the relator is awarded 15–25% of the damages as a reward for their useful inside information.[174]

If, on the other hand, the government does not intervene, the relator can proceed with a private suit of her own.[175] If successful, the government awards the relator a significant share of the damages, anywhere between

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Government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion."). The complaint remains sealed throughout this process, and thus the reputation of the accused wrongdoer is spared harm from a meritless fraud accusation. *Id.* § 3730(b)(2).

167. *See id.* § 3730(e)(4)(B) (defining "original source" as "an individual who either (i) prior to a public disclosure under subsection (e)(4)(a), has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based, or (2) [sic] who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action under this section").

168. *See* Bucy, *supra* note 19, at 51–52 (detailing situations when the government decides to intervene in the *qui tam* process).

169. *See id.* at 51 ("The litigational advantages to private plaintiffs of obtaining DOJ intervention are so substantial that the acknowledged goal of any experienced relators' attorney is to obtain the government's intervention. Such intervention is obtained by preparing a thorough, complete, and convincing written statement for the government.").

170. 31 U.S.C. § 3730(c)(1).

171. *Id.* § 3730(b)(3).

172. Shauna Itri, *An Introduction to Whistleblower/Qui Tam Claims*, ABA, https://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/an_introduction_to_whistleblower_qui_tam_claims.html (last visited Dec. 4, 2018).

173. *See* Bucy, *supra* note 19, at 50 ("The relator retains certain rights if the government intervenes, including the right to object and be heard on a motion to limit the relator's role, or to dismiss or settle the case."); *see also* 31 U.S.C. § 3730(c)(3)–(4) (explaining that the government retains the right to dismiss the case or move to have the plaintiff's role diminished for good cause).

174. 31 U.S.C. § 3730(d)(1); *see* Bucy, *supra* note 19, at 50 (describing the calculation for *qui tam* awards).

175. 31 U.S.C. § 3730(c)(3).

25% and 30%.[176] The government, while not a party to the suit, recovers the remainder of the award. In these actions, individual citizens with inside knowledge of wrongdoing become "private Attorney[s] General[],"[177] uncovering wrongs that may otherwise have gone unnoticed and unpunished.[178] Even though the relator is the sole plaintiff in these suits where the government chooses not to intervene, the DOJ retains the ability to review the relator's suit and can move to dismiss if it believes the claim is frivolous.[179] Thus, the government possesses an important quality control measure over FCA *qui tam* suits, regardless of whether the government is a party.

B. The Theory Behind a Qui Tam *Approach to Regulation*

In her influential article "Private Justice," University of Alabama Law School Professor Pamela (Pierson) Bucy describes the different theories that underlie the concept of private justice.[180] Bucy defines the concept of private justice as "when private persons initiate lawsuits to detect, prove, and deter public harms."[181] According to Bucy, the FCA's *qui tam* model is a "common good" action.[182] Common good actions are those "brought by plaintiffs who have suffered no personal injury but who have been given authority to sue malfeasors because their lawsuits, which bring additional resources to law enforcement's efforts, are viewed as helpful to the common community."[183] In her article, which examines other "private justice" models,[184] Bucy argues the FCA's *qui tam* model is the most

176. *Id.* § 3730(d)(2).

177. *See* Associated Indus. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943) (using the term "private Attorney General[]" to refer to a private individual in whom the government has vested "authority to bring a suit . . . the sole purpose [of which] is to vindicate the public interest").

178. *See* 145 CONG. REC. 16,032 (1999) (statement of Rep. Howard L. Berman) (detailing what would happen if changes were made to the FCA's *qui tam* model).

179. *See* 31 U.S.C. § 3730(c)(3)–(4) (detailing the government's options when it decides not to intervene).

180. *See* Bucy, *supra* note 19, at 13 ("There are three basic types of private justice actions.").

181. *Id.* at 4.

182. *See id.* at 13 ("Examples [of 'common good' actions] include citizen suits, generally available in environmental laws and in some consumer protection statutes, and the civil False Claims Act's qui tam provisions.").

183. *Id.*

184. Bucy examines several private justice models, including those in environmental statutes (Clean Water Act, Resource Conservation & Recovery Act, etc.) and also those found in the Sarbanes–Oxley. *Id.* at 11 n.36, 31–32, 32 n.167.

effective model at eliciting helpful information that leads to the successful regulation of bad actors.[185]

Between 1987 and 2015, the DOJ collected over $33.2 billion in settlements and judgments through FCA *qui tam* actions.[186] During that same period, the courts awarded relators over $5 billion from successful FCA suits.[187] In 2015, the relators' awards in cases with no DOJ intervention surpassed the amount of relators' awards in cases with DOJ intervention.[188] This suggests that relators and their lawyers are continuing to pursue FCA claims even when the government declines to intervene and may be evidence that relators' attorneys are becoming more adept at bringing these single-plaintiff suits.[189] It may also hint at the possibility that the DOJ lacks resources—or perhaps the will—to intervene in FCA suits.[190]

The government uses the FCA to police bad actors within the financial industry, albeit in limited situations. For example, the government has used the FCA in cases of Financial Assistance Fraud,[191] Mortgage Fraud,[192] Loan Fraud,[193] Securities Pricing Fraud,[194] and Emergency Fund Fraud.[195]

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185. "Enlisting the resource of inside information: knowledgeable insiders who are willing to alert regulators to malfeasance before or as it is occurring, is the only effective and efficient way to police wrongdoing motivated by economic gain. An effective private justice institutional design can provide this resource," and "[o]nly one model, the qui tam provisions of the civil False Claims Act ('FCA'), explicitly seeks to elicit inside information about public harms." *Id.* at 11–12. "[T]he 'common good' private justice actions, especially the qui tam FCA actions, are capable of producing beneficial resources for public regulators, namely, legal and investigative talent and inside information." *Id.* at 54–55. "The qui tam private justice model. . . has proven to be highly effective in recruiting legal talent who have the skill and resources to handle complex, expensive cases." *Id.* at 58. "[T]he qui tam FCA 'common good' private justice action is extremely successful in bringing forth helpful inside information." *Id.* at 61.

186. *See* U.S. DEP'T OF JUSTICE, FRAUD STATISTICS—OVERVIEW (2015), https://www.justice.gov/opa/file/796866/download (documenting that a majority of the $33.2 billion, approximately $31 billion, came from *qui tam* suits where the DOJ intervened).

187. *Id.*

188. This was the first year that this occurred. *Id.*

189. Daniel Wilson and Jeff Overley, *More Relators Push FCA Cases to the End in 2017*, LAW360 (Jan. 4, 2018), https://www.crowell.com/files/20180104-More-Relators-Push-FCA-Cases-To-The-End-In-2017.pdf.

190. *See* EISINGER, *supra* note 74, at 156, 183–84 (detailing the DOJ's loss of resources over the years).

191. Financial Assistance Fraud occurs when a company submits a fraudulent request for financial assistance to the government under the Troubled Asset Relief Program. Itri, *supra* note 172.

192. Mortgage Fraud occurs when a company submits "fraudulent or falsified information in conjunction with securing Federal Housing Administration (FHA) or Housing and Urban Development (HUD) funds, loan guarantees, or mortgage insurance" *Id.*

193. An example of Loan Fraud is when a hedge fund illegally uses an off-shore account. *Id.*

194. Securities Pricing Fraud occurs when a company "fraudulent[ly] pric[es] . . . securities or financial products purchased by public pension funds or government entities." *Id.*

195. Emergency Fund Fraud occurs when a company fails to provide promised services to the Federal Emergency Management Agency (FEMA). *Id.*

Between 2009 and 2016, the DOJ collected billions of dollars in FCA judgments and settlements stemming from instances of housing and financial fraud.[196] This included a $25 billion settlement that the DOJ and 49 states' Attorneys General reached with America's five largest private-mortgage servicers.[197] In this record-breaking settlement, five *qui tam* relators shared a reward of $47 million for their inside information related to the companies' fraudulent loan-servicing and foreclosure practices.[198] Other significant financial-industry settlements reached in FCA *qui tam* actions include the DOJ's $16.65 billion settlement with Bank of America in 2014 for the company's illegal mortgage practices leading up to the Financial Crisis,[199] as well as a recent $1.2 billion settlement with Wells Fargo for its practice of endorsing residential-home mortgages that did not meet the Federal Housing Administration standards.[200]

All of these FCA claims filed against financial corporations share a common limitation—they deal with fraud perpetrated against the government and do not cover a corporation's fraudulent acts that harm individual members of the public.[201] While over half of the states in America now have their own *qui tam* fraud statutes, these state laws, like the federal law, only cover fraud against the state.[202] This limitation, in addition to the inadequacies of civil litigation for securities violations[203] and the recent failure of the DOJ to prosecute corporate executives in the wake of the Financial Crisis,[204] all make it necessary for Congress to add a *qui tam* private right of action to § 922 of Dodd–Frank.

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196. Press Release, Dep't of Justice, Office of Pub. Affairs, Fact Sheet: Significant False Claims Act Settlements & Judgments, Fiscal Years 2009–2016, https://www.justice.gov/opa/press-release/file/918366/download (last visited Dec. 4, 2018) [hereinafter DOJ Fact Sheet].

197. The five largest private-mortgage servicers were, at the time, Bank of America Corporation, JPMorgan Chase, Wells Fargo, Citigroup, and Ally Financial. *See id.* (announcing the record settlement).

198. *See id.* ("The 2012 settlement included $911.7 million in civil False Claims Act recoveries on behalf of federal mortgage-insurance programs . . . .").

199. *Id.*

200. *Id.*

201. *Id.*

202. *See* Lori L. Pines, *State* Qui Tam *Statutes: Incentives, Differences, & Challenges*, ABA, https://www.americanbar.org/content/dam/aba/administrative/state_local_government/StateFalseClaims43015.authcheckdam.pdf (last visited Dec. 4, 2018) (explaining that close to 40 states have their own *qui tam* laws that mimic the FCA).

203. *See supra* Part III.B (detailing the inadequacies of civil-litigation pathways currently available to individuals).

204. *See supra* Part II.A (outlining the failure of the DOJ to secure a single conviction of a high-ranking corporate executive in the aftermath of the 2008 Financial Crisis).

V. THE POTENTIAL FOR A *QUI TAM* PRIVATE RIGHT OF ACTION UNDER SECTION 922 OF DODD–FRANK

A. Introduction to Section 922 of Dodd–Frank

Dodd–Frank, passed in response to the institutional failures that precipitated the 2008 Financial Crisis,[205] provides a unique avenue through which the SEC can make a recommendation to Congress encouraging the creation of a *qui tam* private right of action in the securities context. Section 922(d)(1)(G) of Dodd–Frank reads:

> The Inspector General of the Commission shall conduct a study of the whistleblower protections established under the amendments made by this section, including . . . whether, in the interest of protecting investors and identifying and preventing fraud, it would be useful for Congress to consider empowering whistleblowers or other individuals, who have already attempted to pursue the case through the Commission, to have a *private right of action* to bring suit based on the facts of the same case, on behalf of the Government and themselves, against persons who have committee [sic] securities fraud.[206]

In January of 2013, the SEC's OIG released, in a report to Congress and the public, the findings of its study.[207] The report concluded:

> [I]t is premature to introduce a private right of action into the SEC's whistleblower program at this time, since the program is still relatively new and has only been in place since August 2011. . . . Upon collecting additional data and assessing the effectiveness of the program after a reasonable amount of time, the OIG will be in a better position to opine on the usefulness of adding a private right of action to the SEC's whistleblower program.[208]

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205. *See generally* Dodd–Frank Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) ("An Act [t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail[,]' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.").

206. Dodd–Frank Act § 922(d)(1)(G), 124 Stat. at 1848–49 (emphasis added).

207. *See generally* SEC, OFFICE OF AUDITS, EVALUATION OF THE SEC'S WHISTLEBLOWER PROGRAM (2013), https://www.sec.gov/files/511.pdf (providing a thorough evaluation of the SEC's Whistleblower Program to date).

208. *Id.* at 28.

It has been six years since the OIG concluded that it would be wise to delay any recommendation to Congress for a securities *qui tam* private right of action—in the hope that the additional time would allow for a better perspective on the issue.[209] The failure of the federal government to prosecute white-collar crimes, the limitations placed on private suits by the PSLRA, and the worrying trend of deregulation over the past several decades make the creation of a *qui tam* private right of action for securities violations all the more timely.[210] Thus, the SEC should, pursuant to § 922(d)(1)(G) of Dodd–Frank, recommend to Congress a private right of action under Dodd–Frank's Whistleblower Provision similar to the *qui tam* model in the FCA.[211] A *qui tam* private right of action for whistleblowers in the securities-fraud context would serve to deter the illegal acts that precipitated the Financial Crisis and would provide a remedy to those aggrieved by such acts.[212]

B. This Article's Proposed Legislation: An Introduction

As a preliminary matter, it is important to note that § 922 of Dodd–Frank already contains a so-called "private right of action" for whistleblowers, albeit in a different form than the proposal contained in this Article.[213] The current private right of action now available in § 922 only applies to retaliation claims and is different from the *qui tam* private right of action under the FCA.[214] Under Dodd–Frank, a whistleblower who is fired for providing information to the SEC may file a retaliation complaint

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209. *Id.* at 30.

210. *See supra* Part I.B (discussing the causes and consequences of decades of financial deregulation); *see also supra* Part II.A (highlighting the lack of criminal prosecutions related to the Financial Crisis); *see also supra* Part III.B (demonstrating the limits of private suits under the PSLRA).

211. *See* Dodd–Frank Act § 922(d)(1)(G), 124 Stat. at 1848–49 (providing the best means to implement *qui tam* actions under Dodd–Frank).

212. *See supra* Part IV.B (illustrating how *qui tam* actions have led to the effective regulation of bad actors in other financial contexts).

213. *See Protections Against Retaliation*, SEC, https://www.sec.gov/whistleblower/retaliation (last modified July 25, 2018) ("Dodd–Frank . . . created a private right of action that gives whistleblowers the right to file a retaliation complaint in federal court."). It is also important to note that Dodd–Frank established a process through which whistleblowers, who voluntarily provide original information to the SEC that results in a successful sanction that exceeds $1,000,000, can obtain an award, Dodd–Frank, however, did not create a public right of action under this subsection. Dodd–Frank Act §§ 23(a)–(b), 124 Stat. at 1740–41.

214. Douglas W. Baruch & Nancy N. Barr, *The SEC's Whistleblower Program: What the SEC Has Learned from the False Claims Act About Avoiding Whistleblower Abuses*, 2 HARV. BUS. L. REV. 28, 29 (2011), http://www.hblr.org/2011/07/the-secs-whistleblower-program-what-the-sec-has-learned-from-the-false-claims-act-about-avoiding-whistleblower-abuses/.

in federal court.[215] The whistleblower, under the current law, does not have the right to act as a "private [A]ttorney [G]eneral[]."[216] The proposed legislation in this Article, however, would allow whistleblowers to do just that—to act as private Attorneys General under § 922 of Dodd–Frank.[217]

As a second preliminary matter, this Article expands upon the work of Professor Pamela Bucy.[218] Professor Bucy, in her seminal article "Private Justice," called on Congress to enact a *qui tam* private right of action for financial and environmental regulation, generally.[219] Many of her recommendations were incorporated into Dodd–Frank, a testament to both her ingenuity and detailed proposal.[220] This Article aims to build upon Bucy's work—it suggests that § 922(d)(1)(G) of Dodd–Frank provides a timely opening for the SEC to recommend to Congress a *qui tam* private right of action for financial regulatory purposes.[221] In doing so, this Article applies lessons learned from the 2008 Financial Crisis to a possible *qui tam* private right of action under Dodd–Frank.[222]

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215. *See Protections Against Retaliation*, *supra* note 213 ("[E]mployers may not discharge, demote, suspend, harass, or in any way discriminate against an employee in the terms and conditions of employment because the employee reported conduct that the employee reasonably believed violated the federal securities laws."); *see also* Dig. Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 770 (2018) (holding that Dodd–Frank's anti-retaliation provision only extends to an individual who has reported a violation of the securities laws to the SEC).

216. *Cf.* Itri, *supra* note 172 (describing the role of the private right of action in FCA, which is less significant in Dodd–Frank).

217. *See infra* Part VI (proposing a *qui tam* private right of action).

218. *See infra* Part VI (suggesting an expansion of the private right of action under Dodd–Frank).

219. *See* Bucy, *supra* note 19, at 8 ("Part III discusses how and why an optimally designed private justice model should be expanded into two areas: protection of the environment and protection of national financial markets.").

220. *See* Baruch & Barr, *supra* note 214, at 28 ("The concept behind the SEC's whistleblower program [was] initially proposed by University of Alabama Law School Professor Pamela (Bucy) Pierson . . . .").

221. *See infra* Part VI.B (advocating for a *qui tam* provision that provides whistleblowers with incentives and legal tools to deter fraud in financial markets); *see infra* notes 254, 299–301 and accompanying text (describing the importance of whisteblowers in the effective enforcement of securities law); *see infra* Appendix 1 (outlining the implication of this Article's proposed *qui tam* provision).

222. Bucy's article was written in 2002 and therefore did not incorporate the lessons learned from the 2008 Financial Crisis. Bucy, *supra* note 19.

VI. A PROPOSAL ON HOW TO STRUCTURE A *QUI TAM* SECURITIES STATUTE

A. Key Components of the FCA's Qui Tam *Model That Should Be Retained in a* Qui Tam *Securities Statute*

1. Original Source Jurisdiction

Under the False Claims Act, a relator may bring a claim in federal court only if he or she is the "original source" of the inside information.[223] The FCA defines "original source" as:

> [A]n individual who either (i) prior to a public disclosure under subsection (e)(4)(a), has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based, or (2) [sic] who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action under this section.[224]

The "original source" provision, a result of the 1986 amendments to the FCA, is a safeguard against suits from individuals who are not whistleblowers but instead received information through public channels.[225] This prohibits professional plaintiffs' attorneys from churning out strike suits and is an important safeguard included in the FCA.[226] The "original source" jurisdictional requirement should be included in any *qui tam* securities statute in order to protect against frivolous lawsuits.

2. Standing to Bring an Action on Behalf of the Government

The power assigned to private individuals to act as "private [A]ttorney[s] [G]eneral[]" and bring a civil suit on behalf of the federal government is found in § 3730(b) of the FCA.[227] That provision states, "[a]

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223. 31 U.S.C. § 3730(e)(4)(A)–(B) (2012).

224. *Id.* § 3730(e)(4)(B).

225. *See* Bucy, *supra* note 19, at 47 (explaining how the 1986 amendments to the FCA changed the "jurisdictional bar" on *qui tam* suits, allowing whistleblowers to continue with a suit "even if government officials are aware of the fraud at issue, [so long as] the relator is an 'original source' of the information concerning the fraud").

226. *See* Carolyn V. Metnick, *The Jurisdictional Bar Provision: Who Is an Appropriate Relator?*, 17 ANNALS OF HEALTH L. 101, 108 (2008) (laying out the goals of the jurisdictional bar provision).

227. 31 U.S.C. § 3730(b); *see* Itri, *supra* note 172 ("The state and federal FCAs place power within the hands of private citizens, allowing them to become 'private attorney generals' . . . ."); Associated Indus. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943).

person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government."[228] Thus, a private plaintiff is granted the authority to sue, standing in the shoes of the government. As mentioned previously, this theory of standing is based on the principle that Congress can assign, by way of statute, its right to sue to a private citizen.[229] Any securities *qui tam* legislation must contain a similar provision in order to give standing to individual whistleblowers. Instead of the FCA's language, the new securities statute should read:

> A person may bring a civil action for a violation of '[1] Sections 11, 12(a) and (b), 15, 17 of the Securities Act of 1933[;] [2] Sections 6, 9, 10, 14, 15, 16(b), 18(a), 20, 29(b) of the Exchange Act of 1934[;] [3] Title 18, United States Code, Section 1344';[230] and [4] Title 15 United States Code Section 7241(a).[231]

Under this language, a whistleblower who is reporting securities fraud could bring her suit under several securities-violation theories.[232]

3. The Dual-Plaintiff Model: Its Benefits to Plaintiffs and the Government and Its Check on Frivolous Suits

Under the FCA's dual-plaintiff model, if the federal government chooses to intervene in a relator's suit, the litigation proceeds with both the DOJ and whistleblower acting as plaintiffs, each with a set of rights.[233] A *qui tam* securities statute should maintain the dual-plaintiff approach. However, in a *qui tam* securities statute the governmental party to the suit should be the SEC, not the DOJ. The SEC is well positioned to do this, as they have an enforcement division and are responsible for securing judgments and settlements against corporate wrongdoers.[234] Thus, the

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228. 31 U.S.C. § 3730(b)(1).

229. *See supra* text accompanying note 163 ("The relator has standing to sue on the theory that the federal government has assigned its right to claim damages to a private citizen via the FCA.").

230. Bucy, *supra* note 19, at 105.

231. *See* 15 U.S.C. § 7241(a) (2012) ("Corporate responsibility for financial reports.").

232. *See supra* notes 230–31 and accompanying text (listing several securities-violation theories under which a whistleblower may report securities fraud).

233. *See* 31 U.S.C. § 3730(c) (establishing the parties' rights in a *qui tam* suit).

234. *About the Division of Enforcement*, SEC, https://www.sec.gov/enforce/Article/enforce-about.html (last modified Aug. 2, 2007) (describing the responsibilities and objectives of the SEC's Division of Enforcement).

proposed *qui tam* securities statute could simply replace any mention of the DOJ with the SEC.

The dual-plaintiff model used in the FCA should be retained for several reasons. First, the model promotes efficient public-private partnerships. With both the government and the whistleblower as plaintiffs, the parties are able to combine their resources and expertise to put together a formidable plaintiff team.[235] Plaintiffs could use these additional resources when going up against a large corporation's high-powered defense team.[236] Second, the dual-plaintiff model provides an important "quality-control" check on the litigation.[237] Reckless plaintiffs' attorneys risk setting bad precedent and raising the ire of Congress when filing frivolous lawsuits.[238] When the SEC intervenes in a *qui tam* securities action and takes "primary responsibility,"[239] the government retains the authority to dismiss a case at any time if it discovers the claim has no merit.[240] Thus, a dual-plaintiff approach—one where the SEC represents the interests of the government and works alongside the individual whistleblower—is an important piece of any future *qui tam* securities statute.

4. Further Checks on Frivolous Suits: Instances When the Government Can Dismiss a *Qui Tam* Action Even When Not a Party to the Suit

Under the *qui tam* provision of the FCA, the government has the power to dismiss a fraud claim—even if the government is not a party to the suit.[241] This occurs in two situations. First, the government may dismiss a claim brought by a whistleblower if, during its initial 60-day review of the sealed complaint, it believes that the whistleblower's claim has no merit.[242] The government can dismiss a meritless claim so long as "the court has

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235. *See* Bucy, *supra* note 19, at 51–52 (describing how the dual-plaintiff model achieves legal efficiency).

236. *See id.* at 52 ("This dual-plaintiff design provides an efficient way for private litigants to supplement the DOJ's resources throughout the duration of a case.").

237. *Id.* at 52–53.

238. Indeed, this is exactly one of the reasons Congress enacted the PSLRA. *See* H.R. REP. NO. 104–369, at 32 (1995) (Conf. Rep.) ("This legislation implements needed procedural protections to discourage frivolous litigation.").

239. 31 U.S.C. § 3730(c)(1) (2012).

240. *See id.* § 3730(c)(2)(A) ("The Government may dismiss the action notwithstanding the objections of the person initiating the action if the person has been notified by the Government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion.").

241. *Id.* § 3730(c)(3)–(4).

242. *See id.* § 3730(b)(2) ("The Government may elect to intervene and proceed with the action within 60 days . . . .").

provided the [whistleblower] with an opportunity for a hearing on the motion."[243] Meritless claims dismissed before the 60-day review period are never made public, and thus the FCA provides an important protection against frivolous claims that may damage a company's or individual's reputation.[244] A *qui tam* securities statute should contain the same protections against meritless suits, including a 60-day *in camera* waiting period during which time the government may move to dismiss any complaint it deems meritless.[245]

The second situation in which the FCA's *qui tam* model provides protection against frivolous suits is in actions when the government decides not to intervene initially, but after having reviewed evidence uncovered during discovery, it decides the case is meritless.[246] Under § 3730(c)(2)(B)(3) of the FCA, the government may request evidence and discovery materials from the private plaintiff (the whistleblower).[247] If at any point the government believes the private plaintiff no longer has a legitimate claim, it can move to dismiss.[248] The FCA therefore provides two legitimate procedural checks on frivolous suits—one before discovery and one during and after discovery. This feature should be retained in any *qui tam* securities statute.

B. Differences Between the FCA's Qui Tam *Model and This Article's Proposal*

1. Damages and Whistleblower Awards

One area in which this Article diverges substantially from the FCA (and Bucy's proposed legislation) is with respect to the calculation of

243. This holds true at any stage of the litigation. *Id.* § 3730(c)(2)(A).

244. *See id.* § 3730(b)(2) ("The complaint shall be filed in camera, shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders.").

245. *See In Camera*, BLACK'S LAW DICTIONARY (10th ed. 2014) (defining *in camera* as "[i]n the judge's private chambers"). Here, *in camera* essentially means sealed and only viewed by the judge.

246. 31 U.S.C. § 3730(c)(2)(A); *see* Bucy, *supra* note 19, at 70 (describing the government's statutory authority under the FCA to prevent frivolous suits by dismissing *qui tam* actions regardless of whether it has intervened).

247. *See* 31 U.S.C. § 3730(c)(3) ("If the Government so requests, it shall be served with copies of all pleadings filed in the action and shall be supplied with copies of all deposition transcripts (at the Government's expense).").

248. Alternatively, the government may also choose to intervene and thus become a party to the suit—joining the whistleblower—if it deems there is a substantial likelihood of the suit succeeding. *See id.* ("[T]he court . . . may nevertheless permit the Government to intervene at a later date upon a showing of good cause.").

damages and the whistleblower's award.[249] Under the current version of the FCA, the alleged wrongdoer pays three times—or "treble"—"the amount of damages which the Government sustains," plus a $5,000–10,000 penalty per false claim.[250] Under the FCA, the relator's share is between 15% and 25% of the damages in a successful action if the government intervenes.[251] If the government does not intervene, the relator receives 25–30% of the total damages.[252] In either scenario, the specific amount awarded "depend[s] upon the extent to which the person substantially contributed to the prosecution of the action."[253] Courts, in making their relator-award determinations, use several factors to calculate the appropriate percentage from the statutory range.[254]

This Article proposes changing the process for determining damages and the whistleblower's award in the securities context, so as to make any new statutory scheme more effective at regulating securities.[255] Actual damages in securities cases range from small sums to eye-popping amounts.[256] The current FCA relator's award calculations would provide little financial incentive for whistleblowers when securities fraud occurs on a small scale—their award would be meager.[257] Thus, for *qui tam* securities claims under $1 million,[258] the whistleblower's award should be three times the amount of damages in intervener actions and five times the amount of

249. *See id.* § 3730(d) (explaining *qui tam* plaintiff awards); *see also* Bucy, *supra* note 19, at 81–82 app. (outlining Professor Bucy's proposed *qui tam* awards for plaintiffs pursuant to the FCA).

250. 31 U.S.C. § 3729(a)(1).

251. *See id.* § 3730(d)(1)–(2) (explaining the different calculations for *qui tam* awards).

252. *Id.*

253. *Id.* § 3730(d)(1).

254. Factors that courts consider in determining the whistleblower's *qui tam* award include: "(A) the significance of the information provided to the Government [by the *qui tam* plaintiff]; (B) the contribution of the [*qui tam* plaintiff] to the result obtained; and (C) whether the information which formed the basis for the suit was [previously] known to the Government." S. REP. NO. 99–345, at 28 (1986).

255. *See infra* notes 264–73 and accompanying text (outlining the policy rationales for potential changes to the damages scheme in securities' whistleblower suits).

256. *Compare* Margarida Correia, *Fifth Third Securities to Pay $100K to Settle Customer Complaint*, BANK INVESTMENT CONSULTANT (Jan. 20, 2015), https://bic.financial-planning.com/news/fifth-third-securities-to-pay-100k-to-settle-customer-complaint (announcing a $100,000 settlement between a securities broker and the Financial Industry Regulatory Authority (FINRA)), *with* Press Release, SEC, Goldman Sachs to Pay Record $550 Million to Settle SEC Charges Related to Subprime Mortgage CDO (July 15, 2010), https://www.sec.gov/news/press/2010/2010-123.htm (announcing the SEC's record $550 million settlement with Goldman Sachs).

257. *See* Bucy, *supra* note 19, at 61–62 (describing the extreme consequences that can follow from "blow[ing] the whistle" on one's own employer).

258. *See* 15 U.S.C. § 78u-6(a)(1) (demonstrating that the proposed cut off shares similarities with the current whistleblower provision under § 922 of Dodd–Frank, not for any other reason except to maintain uniformity).

damages where the government declines to intervene.[259] Furthermore, damages—here the actual amount lost in the fraud—should be paid out by the corporate or individual wrongdoer to the SEC.[260] The SEC would take this damage amount and facilitate a payout to individuals or companies harmed by the fraud.[261] Finally, the government should impose a fine against the wrongdoer—the fine should be the same amount as actual damages.[262] Costs and attorney's fees should also be awarded to the winning party.[263]

To elucidate the proposal, take this example: a whistleblower uncovers that her company has been making fraudulent misrepresentations to shareholders that later costs the shareholders $100,000. The whistleblower files a *qui tam* complaint in federal court, alleging a Rule 10b–5 violation. If the government intervenes and the suit is successful, the wrongdoer—here, the whistleblower's company—would pay a total of $500,000 to the SEC, plus any attorney's fees.[264] The $500,000 is comprised of three different "awards": (1) $100,000 in actual damages, given to the harmed shareholders; (2) a $100,000 fine (same amount as actual damages); and (3)

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259. The increased *qui tam* award amount also takes into account the risks a whistleblower faces when coming to the government with inside information of fraud. *See* Paul Sullivan, *The Price Whistle-Blowers Pay for Secrets*, N.Y. TIMES (Sept. 21, 2012), https://www.nytimes.com/2012/09/22/your-money/for-whistle-blowers-consider-the-risks-wealth-matters.html (describing the general risks to whistleblowers: financial, professional, and emotional); Bucy, *supra* note 19, at 61 (relaying the agonizing feelings that whistleblowers experience when they share inside information). Many executives make seven figures a year, so the award must be enough, when dealing with small sums, to entice those at the top of the corporation, who are, in some instances, the individuals who possess the most complete knowledge of the fraud. *See* Louise Story & Eric Dash, *Banks Prepare for Big Bonuses, and Public Wrath*, N.Y. TIMES (Jan. 9, 2010), https://www.nytimes.com/2010/01/10/business/10pay.html (describing the discussions surrounding paying "six-, seven- and even eight-figure sums for some chief executives and top producers.").

260. *See infra* text accompanying notes 274–75 ("The SEC must have sufficient resources to fund its investigations as an intervener, and thus the fines provide an important source of funding to sustain the success of the program.").

261. MICHAEL L. ROBERTS ET AL., 6 LITIGATING TORT CASES § 68:35, Westlaw (database updated June 2017), https://www.westlaw.com/Document/I8cb0b3b6fe1111d9ba3bbf2d1c593219/View/FullText.html?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0 ("Victims of fraud are entitled to compensation for wrongs which result directly, naturally and proximately from the fraud.").

262. The actual amount of money lost in the fraud. *See Actual Damages*, BLACK'S LAW DICTIONARY (10th ed. 2014) ("An amount awarded to a complainant to compensate for a proven injury or loss; damages that repay actual losses.").

263. *Cf.* Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 327 (2013) (explaining the English rule for attorney fees, in which the winning party receives reasonable attorney fees from the losing party).

264. If the SEC declines to intervene, the wrongdoer would pay $700,000 to the SEC in this example: a $500,000 award that would go to the whistleblower, $100,000 in actual damages, and a $100,000 fine (mirrors actual damages).

a $300,000 award to the whistleblower for her inside information that led to the successful resolution of the action (three times the actual damages). This proposal for *qui tam* securities claims under $1 million takes into account the importance of providing a legitimate financial incentive to entice whistleblowers to come forward when the fraud, *i.e.*, the actual damage amount, is relatively small. It also seeks to provide the government with a financial incentive, through the fine, to intervene in legitimate, albeit low-paying, *qui tam* suits. The penalty paid to the SEC would be reinvested into the agency's Office of the Whistleblower for future *qui tam* investigations.[265] Most importantly, under this proposal, the full amount of actual damages would be collected and returned to the victims to make them whole again.[266]

Critics will likely argue that such severe damage amounts for relatively small instances of fraud will weaken the economy.[267] However, this ignores several external costs associated with widespread securities fraud. When there is fraud in the marketplace, investors lose confidence in the market and thus will invest less money in the economy.[268] Financial fraud undermines the free-market rationale, which is one of the theoretical bases of the U.S.'s economy.[269] In a free market, individuals and businesses possess the freedom "to choose from between an array of goods and

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265. Securities investigations are expensive; thus, a fine leveled against a wrongdoer would be retained by the SEC and would go toward future *qui tam* investigations. Press Release, SEC, Former Company Insider Earns More Than $4.1 Million for Whistleblower Tip (Dec. 5, 2017), https://www.sec.gov/news/press-release/2017-222. The Office of the Whistleblower already administers the "investor protection fund" for whistleblowers under § 922 of Dodd–Frank. *Id.* It would be up to the SEC whether to establish a separate fund for just the *qui tam* investigations, or the SEC may elect to incorporate the *qui tam* fines into the existing "investor protection fund." *Id.*

266. In the FCA's payout model, the relator's award comes out of the total amount paid by the defendant. 31 U.S.C. § 3730(d) (2012). Thus, the whistleblower's award is subtracted from the actual damages amount. *Id.* In contrast, this Article proposes the following: the relator's award would be paid by the defendant, in addition to any amount of actual damages owed to those who were aggrieved by the defendant's fraud.

267. A common refrain heard from Wall Street and its lobby is that any regulations or fines imposed on the financial industry hamper the growth of the free market. *See* Peter A. French, *Enforced Corporate Responsive Adjustment*, 13 LEGAL STUD. F. 115, 127 (1989) ("Fines, however, have serious limitations and can be passed on to undeserving populations in the form of higher prices, layoffs, etc.").

268. *See* Geoffrey Christopher Rapp, *Proving Markets Inefficient: The Variability of Federal Court Decisions on Market Efficiency in* Cammer v. Bloom *and Its Progeny*, 10 U. MIAMI BUS. L. REV. 303, 327 (2002) ("Fraud arguably makes markets less efficient, by reducing investors' willingness to trade based on information.").

269. *See generally* Thomas G. West, *The Economic Principles of America's Founders: Property Rights, Free Markets, and Sound Money*, *in* FIRST PRINCIPLES SERIES NO. 32, at 9–13 (2010), http://thf_media.s3.amazonaws.com/2010/pdf/fp0032.pdf (discussing the Founders' commitment to free-market principles and how they intended a free-market economy to be protected from instability, including fraud).

services according to their tastes and preferences."[270] When there is fraud in the marketplace, individuals and businesses cannot make informed decisions about where to allocate their resources, and thus the free market becomes inefficient.[271] Total damages that are sometimes much greater than actual damages are therefore necessary to deter corporate malfeasance and, when compared to the external costs of fraud in the marketplace, these large damage amounts are appropriate.[272]

For fraudulent acts that lead to damages over $1 million, the calculations for awards would be similar to the proposal above, save for one difference—the SEC's fine should be calculated based on a graduated scale that takes into account several factors.[273] The SEC should be charged with promulgating rules defining these factors, but possibilities include the severity of the wrongdoing (was it widespread or only within one department), whether the company is a repeat offender, and whether the company has demonstrated a noticeable and legitimate effort to improve its behavior.[274] Fines collected here, like those in the under-one-million-dollar category, would be reinvested into the SEC for future *qui tam* securities investigations. The SEC must have sufficient resources to fund its investigations as an intervener, and thus the fines provide an important source of funding to sustain the success of the program.

Finally, any *qui tam* securities statute must address who will pay the fine, settlement, and award to the SEC. Under the current system, shareholders pay for most SEC fines and settlements levied against a corporation.[275] Thus, these fines or settlements present "a classic example of the agency problem: managers who violate securities laws may gain

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270. *US Market Economy*, ECON. WATCH (Oct. 13, 2010), http://www.economywatch.com/market-economy/us-market-economy.html.

271. *See* Rapp, *supra* note 268, at 327 (explaining how fraud makes markets more inefficient).

272. *See id.* ("Private suits—because of the threat of large damages—arguably deter fraud . . . .").

273. This proposal is designed to limit excessive fines in cases of widespread financial fraud where fraud damages can reach into the millions and billions of dollars. *See, e.g.*, DOJ Fact Sheet, *supra* note 196 (discussing settlements of millions and billions of dollars against the nation's largest mortgage servicers). If the fines were to mirror the actual damages of the fraud—as proposed in the under-one-million-dollar cases—the resulting fine would be unrealistically large.

274. The SEC has been criticized for not cracking down on repeat offenders of securities laws. Edward Wyatt, *Promises Made, and Remade, by Firms in S.E.C. Fraud Cases*, N.Y. TIMES (Nov. 7, 2011), http://www.nytimes.com/2011/11/08/business/in-sec-fraud-cases-banks-make-and-break-promises.html.

275. Former SEC Commissioner Cynthia Glassman summed up the current system nicely: "When the boards and management are agreeing to these [SEC] penalties, they're agreeing to pay with other peoples' money." Deborah Solomon, *As Corporate Fines Grow, SEC Debates How Much Good They Do*, WALL ST. J., https://www.wsj.com/articles/SB110021198122471832 (last updated Nov. 12, 2004).

from misconduct, especially in the short-term, while long-term losses from fines are spread across shareholders."[276] If the corporation can shift the costs associated with its fraud onto its shareholders, there is no deterrent effect.[277] In order for this proposal to effectively regulate the behavior of corporate America, any *qui tam* securities statute must contain a provision that states that any fine, settlement, or award against a corporation must *not* be passed on to the corporation's shareholders or result in layoffs of low-level employees. Instead, the corporation, internally, must do one or several things to pay for the total cost of the judgment or settlement: (1) reduce executive compensation; (2) eliminate bonuses; (3) reduce corporate perks (such as food and travel expenses for executives); or (4) do an internal audit to find the bad actor(s) and force the bad actors to pay for the damages.[278]

2. Any New Statute Must Explicitly State That *Qui Tam* Actions May Be Brought Against Individual Wrongdoers

The FCA does not contain explicit language stating that a whistleblower may file a *qui tam* civil suit against an individual.[279] Section 3730(a) states: "If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person."[280] However, the *qui tam* provision of the FCA—§ 3730(b)—does not specify that a private citizen acting on behalf of the government has the authority to bring a suit against an individual wrongdoer.[281] Section 3730(b) simply says that "[a] person may bring a civil action for a violation of section 3729."[282] Courts, however, have interpreted § 3730(b) to include violations of § 3729 perpetrated not just by a corporation but by individuals as well.[283]

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276. Steinway, *supra* note 105; *see also* EISINGER, *supra* note 74, at 204 ("[T]he SEC alleged that Bank of America lied to its shareholders, but the agency was making shareholders pay the bank's fine. The victims of the scheme had to pay the penalty. The shareholders were getting screwed twice.").

277. Steinway, *supra* note 105 ("There is ample evidence that *individuals* can be deterred by the threat of financial penalties when they pay the cost themselves. However, if their employer (or its shareholders) pays, the deterrent effect is undermined.").

278. These are just some suggestions for ways a corporation could possibly pay for the damages. The SEC would be allowed to promulgate other ways in which a corporation could pay—so long as the shareholders and low-level employees are not affected.

279. *See* 31 U.S.C. § 3730(b) (2012) (providing that a private person may bring a civil action for violations of the FCA but not explicitly stating that a private person may bring such actions against an *individual*).

280. *Id.* § 3730(a).

281. *Id.* § 3730(b).

282. *Id.*

283. *See* Press Release, U.S. Dep't of Justice, Justice Department Recovers over $4.7 Billion from False Claims Act Cases in Fiscal Year 2016 (Dec. 14, 2016),

In drafting a *qui tam* securities statute, Congress should incorporate explicit language that states a whistleblower can bring a *qui tam* civil action against an individual wrongdoer. In the eyes of the American public, one of the biggest frustrations of the 2008 Financial Crisis was the government's failure to hold individual actors responsible.[284] Including explicit language in the new statute would not only preserve that right, but also ensure that the statute functions in the same way as the FCA.[285] As discussed above, a fine or settlement against a company hits the shareholders, not the corporate executives who oversaw the misdeeds.[286] A law that makes individual wrongdoers (bank and investment executives) personally liable for harm to others is an important step toward accountability and deterrence of future bad acts.[287] For these reasons, the *qui tam* securities statute should explicitly state that a whistleblower has the authority to pursue action against individuals who violate federal securities laws. Thus, courts are not left to interpret any vague language in the statute, as they were forced to do in the case of the FCA's *qui tam* provision, § 3730(b).[288]

3. The Possibility for Criminal Charges in Intervener Suits

After the 2008 Financial Crisis, the public and elected officials expressed outrage that not a single high-ranking executive at any of the

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https://www.justice.gov/opa/pr/justice-department-recovers-over-47-billion-false-claims-act-cases-fiscal-year-2016 ("[E]xamples of individuals held personally liable for alleged false claims include George Hepburn ($10.3 million), founder and president of Dynasplint Systems Inc.; Dr. Jonathan Oppenheimer ($9.35 million), former owner and chief executive officer of a Nashville drug testing laboratory; Gottfried and Mieke Kellermann ($8.5 million), founders of Pharmasan Labs Inc. and NeuroScience Inc.; Jacob (Jake) J. Kilgore ($4 million), former co-owner, vice president, and later president of Orbit Medical Inc.; Dr. David G. Bostwick ($3.75 million), founder and former owner and chief executive officer of Bostwick Laboratories Inc.; Mark T. Conklin ($1.75 million), former owner, operator, and sole shareholder of Recovery Home Care Inc. and Recovery Home Care Services Inc.; Dr. David Spellberg ($1.05 million) and Robert A. Scappa, D.O. ($250,000), urologists with 21st Century Oncology LLC; and Ralph J. Cox III ($1 million), former chief executive officer of Tuomey Healthcare System.").

284. *See* Michael Erman, *Five Years After Lehman, Americans Still Angry at Wall Street: Reuters/Ipsos Poll*, REUTERS (Sept. 15, 2013), https://www.reuters.com/article/us-wallstreet-crisis-idUSBRE98E06Q20130915 ("More than half [of those polled] . . . want the government to do more to punish those responsible for the crisis.").

285. 31 U.S.C. § 3730(a)–(b)(1) (enabling private citizens to bring a *qui tam* civil action against an individual wrongdoer under the FCA).

286. *See supra* notes 105, 275–76 and accompanying text (explaining how company executives pass the cost of fines and penalties onto shareholders).

287. *See* Warren Letter, *supra* note 5 (criticizing the lack of DOJ prosecutions brought against individuals for corporate wrongdoing after "serious indications of violations" were found).

288. *See* Joel Deuth, Comment, *The False Claims Act's First-to-File Bar: How the Particularity Requirement of Civil Procedure Militates Against Combating Fraud*, 62 CATH. U. L. REV. 795, 795–97, 802 (2013) (discussing courts' struggle to interpret § 3730(b)(5)).

nation's major financial institutions went to prison.[289] *Qui tam* securities actions have the potential to provide the government with the ever-elusive *mens rea* element needed for criminal prosecutions of financial crimes.[290] Any new *qui tam* securities statute must clearly detail a procedure by which the SEC may make criminal referrals to the DOJ, thus allowing the government to use the inside information gathered from whistleblowers to bring criminal suits.

This addition to a future securities law would make sense and be efficient.[291] Under a securities *qui tam* suit in which the government is an intervener, the SEC would already have invested the time and resources into vetting and interviewing the whistleblower.[292] If the inside information uncovered points to criminal violations of securities statutes, there should be a set procedure included in the new *qui tam* law that would mandate the SEC to make a referral to the DOJ for further criminal investigation. Then, the DOJ could use this insider knowledge to help crack the *mens rea* barrier that has all too often kept the agency from bringing meaningful white-collar criminal charges.[293] This provision would also signal to the American people that the government is serious about holding individuals accountable for white-collar crimes.[294] Also, the possibility of criminal action against

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289. *See* Warren Letter, *supra* note 5 ("[K]ey companies and individuals that were responsible for the financial crisis and were the cause of substantial hardship for millions of Americans faced no criminal charges. This failure is outrageous and baffling . . . .").

290. *See supra* Part II.C (explaining how difficult it is to prove the *mens rea* element of a securities claim); *see also supra* note 113 and accompanying text (outlining the problems a prosecutor may face in attempting to prove intent in a fraud case).

291. It also would be similar to the FCA. Under the FCA, the DOJ's Criminal Division can opt to bring charges during the 60-day sealed review period of the whistleblower's complaint. *See* U.S. DEP'T OF JUSTICE, OFF. OF THE U.S. ATTORNEYS, JUSTICE MANUAL: CRIMINAL RESOURCE MANUAL 932 (2018) ("Based on the information . . . a decision whether to enter the case and take it over or to decline to do so will be made. After that decision is made, the Commercial Litigation Branch will coordinate as necessary with the USAO to ensure proper handling of the qui tam litigation . . . ."). The only difference here would be that the SEC—the governmental agency involved in a *qui tam* securities action—would make a referral to the DOJ, as opposed to the DOJ's Criminal Division that initially reviews the complaint. *Id.*

292. Only suits in which the SEC decides to intervene are eligible for referral to the DOJ for criminal prosecution. *See infra* Appendix 1 ("Criminal charges are available only in actions in which the SEC has chosen to intervene."). Individual whistleblowers filing civil *qui tam* securities actions could not refer their case to the DOJ. *See infra* Appendix 1 (displaying when criminal charges are an option).

293. *See* Warren Letter, *supra* note 5 (detailing the lack of corporate-executive prosecutions).

294. This message would build off of the "Yates Memo" in which then-Deputy Attorney General Sally Yates wrote: "Fighting corporate fraud and other misconduct is a top priority of the Department of Justice. . . . One of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing." *See* Memorandum from Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, to U.S. Attorneys (Sept. 9, 2015), https://www.justice.gov/archives/dag/file/769036/download.

companies and individuals will further serve as a deterrent against bad acts.[295]

CONCLUSION

To this day, Americans' dismay over the lack of corporate accountability in the aftermath of the 2008 Financial Crisis continues to reverberate throughout the country.[296] An average American tends to distrust corporate executives—in large part due to corporate America's role in facilitating the 2008 Financial Crisis.[297] This distrust is not only worrisome for the economic stability of the U.S., but it wears at the very fabric of the country's social and political order.[298]

Section 922 of Dodd–Frank—the Whistleblower Provision—presents a promising pathway for creating a regulatory framework that has the potential to re-instill trust in corporate America.[299] To effectively regulate securities fraud, Congress should borrow the FCA's *qui tam* private right of action model.[300] With individual whistleblowers acting as private Attorneys General, the corporate malfeasors in America will be put on notice that those inside their own companies—those with insider knowledge—are watching for fraud. This Article proposes a creative new solution to securities regulation. The proposed legislation in this Article "seeks not only to provide the Government's law enforcers with more effective tools, but to encourage any individual knowing of [securities] fraud to bring that information forward."[301] With the right tools, the federal government,

295. *See Five Things About Deterrence*, NAT'L INST. JUST., https://nij.gov/five-things/pages/deterrence.aspx (last modified June 6, 2016) (explaining how the certainty of punishment serves as a deterrent to criminal activity).

296. *See Mistrust in America Could Sink the Economy*, ECONOMIST (Aug. 10, 2017), https://www.economist.com/business/2017/08/10/mistrust-in-america-could-sink-the-economy (disussing the continued mistrust that Americans have toward corporations and banks).

297. *See id.* (attributing Americans' decreasing trust in corporations to the 2008 Financial Crisis).

298. *See* Andrew Ross Sorkin, *From Trump to Trade, the Financial Crisis Still Resonates 10 Years Later*, N.Y. TIMES (Sept. 10, 2018), https://www.nytimes.com/2018/09/10/business/dealbook/financial-crisis-trump.html (describing the impact of 2008 Financial Crisis on the economy and politics).

299. *See* Aimee Picchi, *5 Ways Dodd–Frank Has Benefitted You*, CBS NEWS (Feb. 3, 2017), https://www.cbsnews.com/news/5-ways-dodd-frank-has-benefited-you/ (noting that through August 2016, whistleblowers, under the current statutory framework, had received $100 million and triggered enforcement actions resulting in close to $600 million in sanctions).

300. *See supra* Part VI (explicating this Article's proposal).

301. *See* S. REP. NO. 99–345, at 2 (1986) (quoting from the Senate Judiciary Committee's report recommending the FCA's 1986 amendment).

private citizens, and the judicial system can work together to ensure a fair and healthy securities market.

APPENDIX 1

Party Bringing the Action	Defendant: Corporation	Defendant: Individual Executive
SEC & Whistleblower (SEC Intervenes)	Civil or Criminal	Civil or Criminal
Whistleblower (Private Right of Action)	Civil	Civil

Figure 1. Displaying the possible scenarios that may result from this Article's proposed *qui tam* securities statute. Criminal charges are available only in actions in which the SEC has chosen to intervene. The SEC will determine whether a violation rises to a criminal level, and if it does, the SEC will refer the criminal case to the DOJ for prosecution.[302] If the DOJ brings criminal charges, civil charges may still be brought by the SEC and the Whistleblower together, or only by the Whistleblower under a private right of action. Actions against corporations and individual executives at those corporations may be brought simultaneously.

302. The proposed criminal-referral process follows the current system in place at the SEC. *See* LINDA CHATMAN THOMSEN, SEC, INTERNATIONAL INSTITUTE FOR SECURITIES MARKET DEVELOPMENT 1 (2005), https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf ("Criminal enforcement of the federal securities laws is done through the U.S. Department of Justice and the individual U.S. Attorney's offices throughout the country.").