FORM VS. FUNCTION IN RULE 10B-5 CLASS ACTIONS

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INTRODUCTION

The Supreme Court's widely anticipated decision last term in *Halliburton Co. v. Erica P. John Fund, Inc.*[1] did little to change the fundamental landscape of securities fraud litigation in the United States. Rule 10b-5[2] class actions premised on the "fraud-on-the-market" presumption of reliance may still be brought, although it is now clear that defendants may present evidence of lack of price distortion to rebut that presumption at the class certification stage. *Halliburton* does, however, raise a variety of new questions that will keep plaintiffs' lawyers and defense counsel fighting for years to come. Determining the answers to these questions will be expensive, but ultimately of little social value. This contribution to the *Duke Journal of Constitutional Law and Public Policy*'s symposium "Fraud on the Market after *Halliburton II*" explains why.

The problem stems from a mismatch between the form and function of Rule 10b-5 class actions, a mismatch created by the Supreme Court's seminal decision in *Basic v. Levinson*, which first recognized the fraud-on-the-market presumption of reliance.[3] Part I describes how this doctrinal innovation served to untether the Rule 10b-5 private right of action from its moorings in the common law of fraud, with the effect that Rule 10b-5 class actions today achieve none of the social benefits that flow from the common law fraud cause of action. Part II posits that Rule 10b-5 class actions might nevertheless serve a desirable social function, to the extent they produce new information about managerial misbehavior that is valuable to shareholders and regulators, and the value of that information

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1. Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014).
2. 17 C.F.R. § 240.10b-5 (1951).
3. Basic Inc. v. Levinson, 485 U.S. 224 (1988).

exceeds the costs of its production. Part III explains that the questions raised by *Halliburton*, as well some of the most common issues that litigants fight over in Rule 10b-5 class actions, serve merely to increase litigation costs without producing any offsetting informational benefits. Part IV concludes by suggesting that Rule 10b-5 class actions be replaced with an alternative—and likely more efficient—information-production mechanism, namely the SEC's new Whistleblower Bounty Program.

I. THE BREAK WITH THE COMMON LAW

Consider a simple fact pattern for a common law fraud action, one involving the sale of securities: Promoter A induces Couple B to invest in a company he owns by misrepresenting material facts about the company. The common law fraud cause of action would allow Couple B to sue Promoter A to recover any out-of-pocket losses sustained that are causally related to the fraud, assuming the couple could prove that they actually relied on the promoter's misstatements when they entered into the transaction.[4]

The fact that this cause of action is available to fraud victims like Couple B does important work to promote voluntary exchange in a market economy. First, the threat of having to pay damages in such a suit encourages would-be fraudsters to internalize the costs (or at least some of the costs) of their contemplated fraud, making it less profitable on an expected-value basis and therefore less likely to be committed. Second, by promising relief ex post, the common law fraud cause of action discourages potential victims from spending inefficiently on precautions ex ante, including by foregoing wealth-creating transactions altogether. Finally, by requiring culpable defendants to compensate injured plaintiffs, the common law fraud cause of action also provides a mechanism for righting wrongs.

Rule 10b-5 renders it unlawful 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 . . . not misleading . . . in connection with the purchase or sale of securities,"[5] but it does not explicitly lay out the elements a plaintiff must establish to recover in a private suit. This

4. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 525 (1977) ("One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.").

5. 17 C.F.R. § 240.10b-5(b) (1951).

is because the Securities and Exchange Commission (SEC), when it promulgated the rule, never anticipated that the federal courts would recognize a private right to sue under it.[6] To give shape to the judicially-recognized Rule 10b-5 private right of action, federal courts initially looked to the common law fraud cause of action for guidance, interpreting the elements of the implied right so as to track those of the storied tort—presumably with the hope and expectation that it would produce similar social benefits.[7] In some simple cases of securities fraud, like the one described above, the analogy between common law fraud and Rule 10b-5 does in fact work well. In such cases, the only real difference between a common law fraud and a Rule 10b-5 cause of action is the latter's broader jurisdictional reach.[8] In so-called fraud-on-the-market scenarios, however, the analogy fails.

Whereas classic common law fraud cases involve privity of dealing and actual reliance by the plaintiff on the misstatements of the defendant, the typical fraud-on-the-market scenario involves agents of a publicly traded corporation releasing falsely positive information about their firm, either in SEC filings or in other public statements. That misleading information, in turn, influences the trading activity of a set of investors who actually read and rely on it (and who thus may be able to state a common law fraud claim). The trading activity of these "informed traders" then operates to inflate the price at which millions of passive investors, who neither read nor rely on the misstatements, buy shares in the company on the secondary market. When the truth is revealed, the stock held by these passive investors will decrease in value, but they will be unable to bring a common law fraud claim due to their lack of actual reliance on the misstatements.

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6. *See* Milton Freeman, Remarks at Conference on Codification of the Federal Securities Laws (Nov. 18, 1966), *in* Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 922 (1967) (stating that, as originally created, Rule 10b-5 "had no relation in the Commission's contemplation to private proceedings").

7. *See* Bailes v. Colonial Press, Inc., 444 F.2d 1241, 1245 (5th Cir. 1971) ("[M]any of the principles applicable to common law suits apply by analogy to [a Rule 10b-5 suit]."). The elements of a private Rule 10b-5 claim are "(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." Stoneridge Inv. Partners, LLC, v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008) (citing Dura Pharm., Inc., v. Broudo, 544 U.S. 336, 341–42 (2005)).

8. Indeed, in *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946), the seminal case that first recognized a private right to sue under Rule 10b-5, the plaintiffs could have proceeded under either the common law or Rule 10b-5; Rule 10b-5 was preferred because of the 1934 Act's provision for nationwide service of process. *Id.* at 514.

When first presented with private Rule 10b-5 claims based on this type of fact pattern, federal courts could have responded in a variety of ways. For example, they might have stuck by their commitment to the common law fraud analogy, holding that passive investors can find no relief under Rule 10b-5 for fraud on the market due to their lack of actual reliance. Alternatively, the courts might have recognized that these sorts of cases are fundamentally different from common law fraud cases and, in light of that, crafted a new and coherent set of elements for stating such claims. They did neither. Instead, in *Basic v. Levinson*, the Supreme Court choose to modify the common law reliance requirement to facilitate fraud-on-the-market class actions, while keeping the other elements of the Rule 10b-5 "fraud tort" intact.[9]

According to *Basic*, plaintiffs are entitled to a presumption of reliance if they can show that: (1) the alleged misrepresentations were publicly known, (2) they were material, (3) the stock traded in an efficient market, and (4) the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed.[10] Although presumptions are not foreign to the common law generally, or to the common law of fraud specifically, *Basic* did more than recognize a presumption. It transformed the very meaning of reliance. Under *Basic*, plaintiffs are not presumed to have relied *on the misstatement*, but rather on the integrity of the stock's market price, which is itself presumed to have been distorted by the fraud. The reliance presumed by *Basic* is therefore "fundamentally different" from the reliance that has traditionally been required in common law fraud cases.[11]

The Supreme Court's decision in *Basic* might seem to the casual observer to have been a rather minor tweak to the common law. But

9. Basic Inc. v. Levinson, 485 U.S. 224 (1988).

10. *Id.* at 241–49. As the *Basic* court explained, the so-called "fraud-on-the market" presumption of reliance

> is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.

Id. at 241–42 (quoting Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986)) (internal quotation marks omitted).

11. *See, e.g.*, Merritt B. Fox, *Demystifying Causation in Fraud-on-the-Market Actions*, 60 BUS. LAW. 507, 507–08 (2005).

in fact it had major ramifications. Most notably, it created a form of Rule 10b-5 litigation that shares none of the social virtues of common law fraud, raising the question of its purpose.

Consider first the threat of damages. Unlike in a common law fraud case, the threat of paying damages in a Rule 10b-5 class action does not force would-be fraudsters to internalize the costs of their contemplated fraud, thereby assisting in deterrence. Why? The simple answer is that the individuals actually responsible for the fraud are essentially never forced to pay in these suits; instead, the corporation itself or its insurer—and, indirectly, the corporation's innocent shareholders—foot the bill.[12]

The harder question is why individuals are never forced to pay. The answer to that question takes us back to the *Basic* decision. By recognizing a new type of reliance that investors who admittedly did not read or rely on the alleged misstatements can establish based on common proof, *Basic* dramatically increased the number of plaintiffs who can sue to recover out-of-pocket damages under Rule 10b-5. At the same time, it facilitated the aggregation of these plaintiffs' claims through the class action device.[13] *Basic* thus had the effect of radically increasing the size of the potential damage awards in these suits.[14] Enormous potential damage awards, combined with the possibility of legal error, makes it rational for even innocent defendants to settle marginal cases. Against this backdrop, a corporate board's decision to settle a Rule 10b-5 class action while shielding its officers from liability is both legal and plausibly defensible.[15]

12. *See, e.g.*, Michael Klausner et al., *How Protective is D&O Insurance in Securities Class Actions? An Update*, 26 PROF. LIAB. UNDERWRITING SOC'Y J. 1, 1, 4 (2013) (empirical study of securities class actions filed between 2006 and 2010, finding that the insurer paid the full settlement in 58% of settled cases and partially funded the settlement in another 28%; outside directors contributed in none of the settled cases, and officers contributed in only 2%).

13. *See* Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1193 (2013) ("Absent the fraud-on-the-market theory [adopted in *Basic*], the requirement that Rule 10b-5 plaintiffs establish reliance would ordinarily preclude certification of a class action seeking money damages because individual reliance issues would overwhelm questions common to the class.").

14. *See* A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 928 (1999) (noting that damages in Rule 10b-5 class actions can amount to a substantial percentage of a corporation's total capitalization).

15. Agency costs may explain a board's decision to shield individual defendants from liability, but so too may a genuine belief in the individuals' innocence, or a fear that demanding payment might lead to over-deterrence in the future, as honest managers take steps to avoid the specter of liability.

One might respond that the threat of damages in Rule 10b-5 class actions still has some deterrent benefit insofar as corporations are forced to pay settlements, because at least this ensures that corporations will internalize some of the costs of fraud and perhaps respond by taking steps to reduce its likelihood by better monitoring corporate agents. The reality, however, is that when a solvent corporation pays, its shareholders pay, and shareholders already have good incentives to do what they can to prevent securities fraud, because they are its primary victims.[16] Moreover, in addition to paying the settlements in Rule 10b-5 class actions, shareholders also recover as members of the plaintiff class, so over time, diversified shareholders will be on the receiving end of fraud-on-the-market class actions roughly as often as they are on the paying end. As a result, fraud-on-the-market settlement payments will be unlikely to affect the behavior of diversified investors in any case.

Just as the empty threat of paying damages in a Rule 10b-5 class action does not cause would-be fraudsters to internalize the costs of securities fraud, the promise of receiving a damage award in a Rule 10b-5 class action does not discourage would-be victims from investing in precautions. Again, because diversified investors stand on both sides of the "v" in Rule 10b-5 class actions (as owners of the corporations that pay the settlements as well as members of the plaintiff class), settlement payments are, in the grand scheme, a wash to them and thus unlikely to affect their behavior.[17]

Finally, and for the same reasons, Rule 10b-5 class actions can hardly be said to "right wrongs" in the way that common law fraud suits do. Instead, non-culpable parties compensate, essentially, themselves, for wrongs done by third parties who escape any direct punishment in the litigation.

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16. *See* Amanda M. Rose, *Better Bounty Hunting; How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1252–1255 (2014) (explaining the traditional deterrence justification for corporate liability and why it fails in the context of Rule 10b-5 class actions).

17. Moreover, as Frank Easterbook and Daniel Fischel observed long ago, diversified shareholders stand to profit from secondary market fraud nearly as often as they lose, so they have little incentive to invest in precautions even in the absence of legal relief. *See* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611 (1985). *Cf.* Amanda M. Rose & Richard Squire, *Intraportfolio Litigation*, 105 NW. U. L. REV. 1679, 1688 n.29 (2011) (noting some challenges to this argument). For a discussion of why Rule 10b-5 class actions cannot be defended as a mechanism for compensating non-diversified information traders, see Rose, *supra* note 16 at 1244 n.38, and references cited therein.

II. A MODERN RATIONALE FOR FRAUD-ON-THE-MARKET SUITS

Just because fraud-on-the-market class actions do not produce the same social benefits as common law fraud suits does not necessarily mean that they are worthless. As I have argued elsewhere, fraud-on-the-market class actions might nevertheless be defended because they have the capacity to produce information that is valuable to shareholders and regulators.[18]

This argument begins with the recognition that, although diversified shareholders have natural incentives to cause firms in their portfolio to take reasonable steps to deter fraud-on-the-market, it is ultimately the board of directors that controls a corporation's operations, and the board is differently positioned:

> Whereas diversified shareholders are likely to lose as often as they win from secondary market fraud, and thus do not stand to profit from its distributional consequences, directors—and the officers to whom they may feel beholden—are positioned differently. They have considerable wealth tied up in the particular firms they serve, including stock, expected salary, and reputational capital. If left unpunished, fraud-on-the-market could help to enhance that wealth.[19]

A threat of sanction may therefore be necessary to prompt directors to invest the level of firm resources in fraud deterrence that shareholders would prefer. It may also be necessary "to overcome behavioral biases that lead directors to underestimate the likelihood that their CEO or other top officers would engage in fraud."[20] Although shareholders have numerous weapons at their disposal for sanctioning directors who fail to advance their interests,[21] those weapons cannot be deployed unless the infidelity is detected, and passive shareholders are poorly positioned to monitor directors' efforts at fraud deterrence.

Fraud-on-the-market class actions might be conceptualized as a way for shareholders to *outsource* this monitoring function to the class action bar. If, lured by the prospect of a large fee award, plaintiffs' attorneys ferret out and publicize frauds that would

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18. *See generally*, Rose & Squire, *supra* note 17; Rose, *supra* note 16; Amanda M. Rose, *Fraud on the Market: An Action Without a Cause*, 160 U. PA. L. REV. 87 (2011).

19. Rose, *supra* note 16, at 1255.

20. *Id.* at 1256.

21. For example, shareholders can "vote directors out of office, sue them for breach of fiduciary duty, or (most promising) take the so-called Wall Street Walk." *Id.*

otherwise go undetected, Rule 10b-5 class actions may in fact produce valuable deterrence benefits. After all, when fraud is exposed, shareholders take notice and punishment swiftly follows. Individuals are fired, others suffer reputational damage, and a share sell-off is typically triggered, leading to a large drop in the firm's stock price (which in turn impacts incentive compensation and increases the company's vulnerability to a takeover). The threat of such punishment may, in turn, improve directors' and officers' ex ante incentives to invest in fraud deterrence. To the extent fraud-on-the-market class actions increase the likelihood of fraud detection, they should also help to deter would-be fraudsters in a more direct fashion. As I have previously argued, "[e]ven though [fraud-on-the-market] suits do not result in the imposition of monetary sanctions on culpable officers, to the extent they help detect frauds, they increase the likelihood that culpable officers will be sanctioned by both the government (perhaps even criminally) and by the firm itself."[22]

Importantly, it is the market-based, firm-based, and regulatory punishment that follows from the exposure of fraud that really does the deterrence work—not the monetary settlements that are ultimately paid in fraud-on-the-market class actions, which are basically just circular transfer payments.[23] But the settlement payment is necessary because it creates the pool of funds from which the attorneys may be rewarded for their fraud detection efforts.

To be sure, this theory of the social purpose of fraud-on-the-market class actions raises some very important questions—namely, how well do class action attorneys actually do at exposing frauds, and are the costs associated with fraud-on-the-market class actions worth the informational benefits they produce? Before turning to these questions, however, let us first reconsider *Halliburton*'s impact on Rule 10b-5 class actions in light of their informational function.

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22. *Id.* at 1257.

23. To be sure, if settlement payments are not covered by insurance,

> they, too, may impart punishment on the board through their impact on the value of directors' shareholdings. But studies show that the bulk of the decline in a firm's stock price upon the revelation of fraud is attributable to reputational loss rather than anticipated legal penalties. Thus, the deterrence value of [fraud-on-the-market] suits lies more in the information they produce about the underlying fraud than in the legal remedies they impose.

Id. at 1256–57.

III. THE FORM-DRIVEN INEFFICIENCIES OF FRAUD-ON-THE-MARKET SUITS

In *Halliburton Co. v. Erica P. John Fund, Inc.*, the Supreme Court had the opportunity to reverse the course it took a quarter century ago by overruling *Basic v. Levinson*. It chose allegiance to the doctrine of stare decisis, reaffirming the *Basic* presumption of reliance while also making clear that defendants should have an opportunity to rebut it at the class certification stage by presenting evidence that the alleged misrepresentation did not actually impact the stock price.[24]

The decision creates a host of new issues for lawyers to battle over. For example, what is the level of proof required to rebut the *Basic* presumption through evidence of lack of price impact?[25] And what procedurally would the effect of such a rebuttal be?[26] How should courts react when the evidence presented to rebut the presumption is relevant both to price impact and to the issue of materiality (which the Supreme Court held just two years before *Halliburton* may not be litigated at class certification[27])? Should courts demand less from plaintiffs seeking to establish the *Basic* prerequisite of market efficiency, in light of statements in *Halliburton* that markets can be "generally efficient" while at the same time inefficiently processing certain types of information?[28]

These questions will take much time and consume significant resources to resolve. And yet they are wholly unrelated to what actually matters in fraud-on-the-market litigation, once its true information-producing function is recognized. Shareholders and regulators are eager to learn whether corporate agents intentionally lied to the marketplace, so that they may dole out punishment as necessary. They do not care whether the prerequisites to class certification have been satisfied or if reliance or loss causation can been established. Yet these are the issues that consume a great deal of the judicial docket in fraud-on-the-market class actions.

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24. *See* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014).

25. *See, e.g.*, Merrit B. Fox, *Halliburton II: It All Depends on What Defendants Need to Show to Establish No Impact on Price*, BUS. LAW. (forthcoming), *available at* http://ssrn.com/abstract=2488055.

26. *See, e.g.*, Wendy Gerwick Couture, *Answering Halliburton II's Unanswered Question: Burdens of Production and Persuasion on Price Impact at Class Certification*, SEC. REG. L.J. (forthcoming), *available at* http://ssrn.com/abstract=2540348.

27. *See* Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013).

28. *See* Mark I. Gross, *Class Certification in a Post-Halliburton World*, LAW360 (July 21, 2014, 10:47 AM), http://www.law360.com/articles/558536/class-certification-in-a-post-halliburton-ii-world.

The disconnect between the legal form and practical function of fraud-on-the-market class actions thus leads to considerable inefficiency, raising the question whether they ought to be replaced with an alternative information-production mechanism better suited to the task.

IV. AN ALTERNATIVE APPROACH

Whether, on the whole, the informational benefits produced by fraud-on-the-market class actions outweigh their costs is a difficult empirical question to answer. But at least two things can be stated with confidence. First, a significant percentage of fraud-on-the-market class actions produce no informational benefits because they come only *after* other sources have publicly exposed the fraud and do not otherwise enrich the public's understanding of what occurred.[29] These "follow-on" suits represent a pure deadweight cost to society. Second, even the small percentage of fraud-on-the-market class actions that do reveal new and valuable information produce deadweight social costs to the extent the litigation focuses on the sort of irrelevant side-issues discussed above.[30] In light of this, it is worth considering whether a better mechanism for fraud detection might be devised.

A full consideration of this issue would take us far beyond the scope of this symposium contribution. But let me conclude by briefly suggesting one possibility. As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC created the Whistleblower Bounty Program in 2011.[31] This program requires the SEC to pay significant financial rewards to eligible individuals who voluntarily provide the agency with original information about securities law violations if that information leads to an enforcement action resulting in $1 million or more in sanctions.[32] It is thus designed to provide financial incentives for individuals with knowledge of securities law violations to come forward to report it to the SEC. The program further seeks to encourage reporting by promising

29. According to one academic study, private litigation uncovered only 3% of the incidents of financial fraud exposed between 1996 and 2004 in companies with more than $750 million in assets. *See* Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2230 (2010).

30. *See supra* Part III.

31. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of U.S.C.A. (West 2015)).

32. For an in depth description of the program's requirements, *see* Rose, *supra* note 16 at 1260–1272.

whistleblowers confidential treatment and providing them with a cause of action for employer retaliation.[33]

In *Better Bounty Hunting: How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*,[34] I argue that the program is much better designed to elicit new information about corporate fraud than fraud-on-the-market class actions, and might serve as a template for the latter's replacement. For example, unlike fraud-on-the-market class actions, the bounty program targets its rewards at individuals who actually produce new information about managerial malfeasance, and award determinations require consideration of none of the irrelevant issues commonly fought about in fraud-on-the-market suits. I further argue that the program is likely to reduce the informational benefits produced by fraud-on-the-market class actions, whatever they may have been in the past. This is easy to see once one considers how class action attorneys—who are really outsiders to corporations with no special informational advantages—likely go about trying to detect frauds.

There are two main possibilities. First, it may be that class action attorneys are effective at getting corporate insiders with knowledge to reveal information to them.[35] But in the wake of the bounty program, those same insiders now have much more powerful incentives to report to the SEC. They have the promise of a large bounty payment, and also enjoy confidential treatment and legal protection against employer retaliation—benefits that do not flow from helping a class action lawyer. So the informants to class action attorneys of yesterday are very likely to become the SEC tipsters of today.

Second, it is possible that class action attorneys have developed some expertise in examining and analyzing publicly available information to discover suspicious disclosure practices. But the bounty program rewards people who can do this, too—company outsiders who see things in publicly available information that others do not. This type of knowledge fits within the program's definition of

33. *See id.*

34. *Id.*

35. The heightened pleading requirements and discovery stay imposed on plaintiffs by the Private Securities Litigation Reform Act has led to heavy reliance by plaintiffs' lawyers on confidential informants. *See* Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554 (2011) ("Allegations based on [information provided by confidential informants] often are the *only* specific allegations in a complaint supporting a claim of securities fraud.").

"original information."[36] So class action attorneys can recover personally through the program, as can other market participants, if they share this sort of special fraud-detection capability. Again this means there will be less of this sort of fraud left for fraud-on-the-market class action attorneys to expose.

The one potential downside of the program is that, to function well, it requires that the SEC follow through on the tips it receives, and pay out bounties in a way that will encourage tips going forward. So far, the SEC's administration of the program has been encouraging. Tips continue to pour in (over 3,600 in the 2014 fiscal year), and the SEC has handed out some impressive bounty awards (including a $30 million and $14 million award).[37] But one might worry that this will change, and in the future ineffective administration of the program will operate to undermine its informational benefits. This concern does not, however, counsel in favor of retaining fraud-on-the-market suits. Rather, as detailed in *Better Bounty Hunting*, adding a *qui tam* provision to a dysfunctional bounty program would be a superior alternative to retaining fraud-on-the-market suits.[38] Such a provision would allow qualifying whistleblowers to bring suit on behalf of the government when the SEC fails to investigate a tip, and thus would maintain a private check on agency under-enforcement, but without the considerable inefficiencies associated with fraud-on-the-market suits.

CONCLUSION

When the Supreme Court recognized the fraud-on-the-market presumption of reliance in *Basic v. Levinson*, it created something quite distinct from the common law fraud cause of action that private Rule 10b-5 litigation had originally been modeled on. Indeed, fraud-on-the-market class actions brought under Rule 10b-5 share none of the social virtues of common law fraud cases. If they are to be defended, it is because they help bring information about the wrongdoing of corporate agents to the attention of shareholders and regulators. But this information-production function is compromised by the outdated form of fraud-on-the-market class actions, a form that

36. *See* Rose, *supra* note 16, at 1262.

37. *See* SEC. EXCH. COMM'N, 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM, *available at* http://www.sec.gov/about/offices/owb/annual-report-2014.pdf.

38. *See* Rose, *supra* note 16, at 1290–1300.

rewards lawyers regardless of whether their cases bring new information to light and which requires expensive litigation over pointless issues. The Supreme Court's recent decision in *Halliburton Co. v. Erica P. John Fund, Inc.* renders this situation worse, making more urgent the need to look for superior alternatives. One such alternative already exists—the SEC's new Whistleblower Bounty Program. Unlike fraud-on-the-market class actions, the bounty program rewards only those individuals who actually bring forth new information about securities law violations, and requires resolution of none of the irrelevant issues that clog the judicial docket in fraud-on-the-market cases. It thus has the distinct advantage of reconciling legal form with social function.