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Expert Analysis

Government Reliance on Private Litigants Diverges With Court Trends

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The Dodd-Frank Wall Street Reform and Consumer Protection Act underscores the legislature's increasing reliance on private litigants to fill a policing role traditionally occupied by federal regulators. In the face of a spate of Supreme Court decisions narrowing access to the courts, this safety net for the markets is becoming very precarious.

For nearly a century, Congress has looked to private litigants to enforce federal laws intended to protect the public. This reliance was born of necessity: As the markets expanded exponentially over the last century without corresponding growth in the federal regulatory apparatus, they quickly outstripped the government's ability to police them. As a result, as early as 1946, federal courts began to entertain the existence of a judicially implied private civil action for deceptive and manipulative securities practices that violated the Securities Exchange Act of 1934. Congress ultimately codified decades of this jurisprudence in the Private Securities Litigation Reform Act of 1995 (PSLRA).[1]

The government's reliance on private litigation to protect public interests extends far beyond securities law. In 1990, Congress created a private right of action to enforce the Americans with Disabilities Act.[2] Similarly, the Sherman Act—which provides trebled damages and attorney's fees—was drafted to encourage private causes of action. As noted by a prominent antitrust scholar, "[p]rivate rights of action both supplement and substitute for government enforcement" and have helped foster a more stable competition system in the United States than in other countries with more centralized systems of competition.[3]

> The U.S. government's increasing dependence on a quasi-private enforcement model is not easily reconciled with recent trends in the courts to restrict private litigants' access to the courts.

The policing power of private litigation is the result, in part, of the fact that private actions by necessity operate to determine the extent of protections codified in statutes. A distinguished scholar of employment law has noted that, because the government is disinclined to take on challenging cases, "cutting edge [civil rights] issues" have largely been enforced by the private bar, which has also "been principally responsible for whatever social change has resulted from legal challenges."[4]

Strained Budgets

Moreover, the fact that private enforcement of statutes is essentially self-funding is becoming a crucial advantage in an era of strained public budgets. As the budget crisis has ballooned following the global economic recession, regulators have raised the alarm that they simply lack the resources and infrastructure to effectively protect the public. These concerns have grown particularly acute as regulatory reforms following the financial crisis have added to rulemaking and oversight responsibilities.

Indeed, given its current funding restrictions, the Securities and Exchange Commission has little chance to protect the public from the next Bernie Madoff. As SEC Chairwoman Mary L. Schapiro recently stated before Congress while making the case for her agency's need for additional funding, "Dodd-Frank will require significant additional resources

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or a substantial reduction in the performance of our core duties."

The Commodity Futures Trading Commission is in an even worse position. The Dodd-Frank Act requires the CFTC to oversee the $583 trillion over-the-counter derivatives market. A funding increase is critical if the commission is to carry out its vastly expanded duties. As CFTC Commissioner Bart Chilton recently stated in the press, "We can't do the job Congress asked us to do when the regulatory reform bill was passed last year without increased funding—period."

It seems inevitable, given these shrinking resources, that litigation in the private sector will play an even larger role in protecting public interests. Indeed, many new reforms explicitly contemplate strengthening public-private partnerships in enforcing federal rules.

Dodd-Frank Act

One signal of this increase in public-private collaboration is the whistleblower protections and bounty afforded by the Dodd-Frank Act. Section 922 of the Dodd-Frank Act specifies that a person who provides "original information" to the SEC of fraud within a company that leads to an enforcement penalty of $1 million or more may be entitled to collect between 10 and 30 percent of the penalties of $1 million or more. The provision also provides substantial retaliation protections for whistleblowers.

Provisions aimed at strengthening private litigation are also found in the Dodd-Frank Act's expansion of the scope of liability for credit rating agencies, a category of entities previously exempt from private rights of action under the Exchange Act. Section 933 of the Dodd-Frank Act provides that credit rating agencies will be liable for their statements under the Exchange Act in the same manner as registered public accounting firms and securities analysts are liable for their statements. The act also requires that credit rating agencies disclose information about their processes and methodologies. With this additional information, private litigants may be able to more easily meet the scienter standard for suing credit rating agencies under the federal securities laws.

The U.S. government's increasing dependence on a quasi-private enforcement model is not easily reconciled with recent trends in the courts to restrict private litigants' access to the courts. For example, in *Stoneridge Investment Partners v. Scientific Atlanta Inc.*,[5] the U.S. Supreme Court rejected "scheme liability" and held that third parties who contract with companies that commit securities fraud are not liable to shareholders of those companies as primary violators of SEC Rule 10b-5 absent a showing that the plaintiff investors relied on the third party's conduct or statements.

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Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,[6] was no more favorable to advocates of private enforcement. In that case, the Supreme Court held that "private civil liability under Rule 10b-5 does not extend to those who do not engage in a manipulative or deceptive practice but who aid and abet such a violation of 10(b)."

A most recent example of circumscription of the important role of private litigants is the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion.*[7] The Court ruled that a "national policy favoring arbitration" preempted a California law intended to protect consumers from widespread fraud, and that class actions inherently conflicted with the speed and efficiency goals of arbitration. The prospect of this ruling prompted Vanderbilt law professor Brian Fitzpatrick to opine: "It could be the end of class action litigation."[8]

Ultimately, these conflicting trends will have to be reconciled, and legislative and regulatory solutions may prove to be the most effective way to accomplish this. The last year has seen increasing legislative interest in reversing *Stoneridge*, and the newly formed Consumer Financial Protection Bureau is charged with scrutinizing class action waiver clauses.

There can be little doubt that our current fiscal crisis has resulted in severe constraints on regulators' ability to protect consumers and the markets. Whether the courts will give private litigants the ability to fill this vacuum remains to be seen.

1. 15 U.S.C.A. §78u-4 (2010).
2. 42 U.S.C.A. §12101 et seq. (2008).
3. Spencer Weber Waller, "The Future of Private Rights of Action in Antitrust: A Conference Introduction," 16 Loy. Consumer L. Rev. 295 (2004).
4. Michael Selmi, "Public vs. Private Enforcement of Civil Rights: The Case of Housing and Employment," 45 UCLA L. Rev. 1401, 1403-1404, UCLA Law Rev. (June 1998).
5. 552 U.S. 148 (2008).
6. 511 U.S. 164 (1994).
7. 131 S. Ct. 1740 (2011).
8. "After AT&T Ruling, Should We Say Goodbye to Consumer Class Actions?" Wall St.J., April 27, 2011.

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