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REGULATORY ENFORCEMENT UNDER NEW YORK'S MARTIN ACT: FROM FINANCIAL FRAUD TO GLOBAL WARMING

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INTRODUCTION

In this Article, I shall examine the uses and limitations of New York State's Martin Act, adopted in 1921,[1] as a means of combating various types of financial, business, and social misconduct both large and small. The major innovation of the Martin Act was that it stripped down the basic fraud action by eliminating the standard elements of knowledge, reliance, and damages. Potential liability under the Martin Act therefore is broader than that found under the common-law tort of deceit in both cases of civil and criminal liability. In addition, there are ways in which liability under the Martin Act is broader than that found under federal securities and exchange laws, passed in 1933 and 1934,[2] which themselves rely in modified form on the basic system of common-law actions.

In Part I, I shall outline the rising unease about the enforcement procedures that have taken place under the Martin Act. In Part II, I shall canvass anew the early history of the Martin Act and its relationship to the common law of fraud and both the federal securities laws and state "blue-sky" laws, with which it must be compared. In Part III, I shall examine the early historical application of the Martin Act in order to set the stage for a closer examination of two controversial contexts: the prosecution of alleged commercial frauds in the cases brought against Maurice "Hank" Greenberg of AIG, and global warming in connection with the now-halted investigation of ExxonMobil and the recent public nuisance cases against five oil companies in both California and New York. A

1. N.Y. GEN. BUS. LAW §§ 352-c, 353 (McKinney 1996).
2. Securities Act of 1933, 15 U.S.C. § 77a (2012); Securities Exchange Act of 1934, 15 U.S.C. § 78a (2012).

brief conclusion argues that the procedural changes that limit the discretion of the New York Attorney General are more important, especially in high profile cases, than any substantive reform of the Martin Act, which on most critical points tracks the federal securities laws.

I.
The Unleashing of the Martin Act

The Martin Act was passed in 1921, and has been continuously enforced for close to 100 years. But in the last 25 years, it has been transformed from a relatively modest operation into an 800-pound gorilla. The transformation started under now-disgraced former New York Attorney General (NYAG) Eliot Spitzer, who served as Attorney General between 1999 and 2006. Spitzer ratcheted up his powers under the Martin Act to cudgel favorable settlements from large firms doing business in New York. Spitzer's efforts were often directed against Wall Street firms that were subject to direct regulation by the Securities and Exchange Commission (SEC). But using his formidable investigative powers under the Martin Act, Spitzer extracted large settlements against brokerage houses for financial fraud. In many cases, the substantive results appear unexceptionable; he extracted, for example, a huge settlement from Merrill Lynch because it touted shares to the public that it had disparaged privately.[3] But the means he deployed under the Martin Act were troubling. Spitzer's operations depended on his ability to unilaterally conduct major investigations backed by his power of indictment. Once filed, an indictment could prove a death knell to financial firms. An indictment could cost these firms both their licenses and reputations. In an effort to stave off that threat, firms yielded to various demands, including oversight, that were far more onerous than the relatively modest fines that could be imposed after a conviction was obtained in a legal action, where the defendant had all the procedural protections of the criminal law. It was for circumventing of structural and procedural safeguards that Spitzer was strongly castigated by business groups such as the Chamber of Commerce, whose president, Thomas Donahue, denounced Spitzer for appointing himself "investigator, prose-

3. *See, e.g.*, Rebecca Leung, *The Sheriff of Wall Street*, CBS News (May 23, 2003), http://www.cbsnews.com/news/the-sheriff-of-wall-street/.

cutor, judge, jury and executioner" over all U.S. businesses.[4] "Spitzer's approach," he claimed, "is to walk in and say, 'we're going to make a deal, and you're going to pay $600 million to the state, and you're going to get rid of this person and that person, and if you don't do it by tonight, we're going to indict the company.' "[5]

Former NYAG Eric Schneiderman has brought the Martin Act back into the spotlight. His most notable endeavor was the climate-change investigation of Exxon Mobil, which involved activities going back decades on the energy and environment frontier.[6] The gist of the charges was that internal politics turned a company that had been a leader in the fight against global warming into one that consciously sought to obfuscate the work of the United Nation's Intergovernmental Panel on Climate Change (IPCC).[7] When these charges failed to pan out, Schneiderman shifted his investigation from Exxon Mobil's past conduct to its current efforts to influence the policy debate over the use of fossil fuels in the light of the risks of global warming, which in turn led the company to overvalue its reserves in ways that he claimed presented a false picture of the company's financial health.[8] Schneiderman sought extensive discovery, and changed his theory of the case multiple times, all within the broad confines of the Martin Act.[9] His campaign mirrored Spitzer's strong-arm tactics but extends

4. *U.S Group is Taking on Spitzer*, N.Y. TIMES (Jan. 6, 2005), http://www.nytimes.com/2005/01/06/business/worldbusiness/us-group-is-taking-on-spitzer.html.

5. *Id.*

6. *See* John Schwartz, *Exxon Mobil Climate Change Inquiry in New York Gains Allies*, N.Y. TIMES, Mar. 29, 2016, at B3 (listing the Martin Act as among Attorney General Schneiderman's New York-specific tools to investigate Exxon).

7. For a collection of posts attacking the overall pattern of Exxon's changing position, see Neela Banerjee, Lisa Song & David Hasemyer, *Exxon: The Road Not Taken*, INSIDE CLIMATE NEWS (Sept. 16, 2016) [hereinafter *The Road Not Taken*], https://insideclimatenews.org/content/Exxon-The-Road-Not-Taken.

8. John Schwartz, *Exxon Mobil Fraud Inquiry Said to Focus More on Future Than Past*, N.Y. TIMES, Aug. 19, 2016, at B1 (in which Schneiderman claims that, since burning even a fraction of declared oil reserves would heat the world to a dangerous level, Exxon is overvaluing its oil reserves because the company will have to leave much of the oil in the ground).

9. *See generally* People v. PricewaterhouseCoopers, 2016 NYLJ LEXIS 3688, at *2–7 (N.Y. Sup. Ct. 2016).

them beyond the traditional context of financial fraud. It makes some sense for a prosecutor to look at sales and promotions to identify fraud against customers to whom the sales pitches were directed, but it makes little sense to look to a company's position on global warming, where a host of other factors are at play.

At the outset, therefore, it is important to stress one similarity that links these two campaigns—namely, the inordinate power that it vested in one person, the NYAG, to launch major attacks against established businesses. In these cases, the *process* issues are as important as the substantive ones. It is possible to engage in prosecutorial abuses against firms that are guilty of some unrelated offense, since the public may too hastily conclude that these shortcuts were justified because they allowed virtuous prosecutors to attack bad commercial actors. But the hasty conclusion that the ends justify the means is wrong in this context, as in so many others, for three reasons. First, the same dubious means can be used against the innocent as well as the guilty, bludgeoning them into costly and unjust settlements. Second, bullying tactics undermine the public legitimacy of prosecutions against the guilty. Demoralization about the law-enforcement process leads to the loss of confidence in the overall system, leading to widespread dissatisfaction both within the business community and the public at large. Finally, aggressive prosecution leads firms that operate on the margins of the law to take excessive precautions, abstaining from sensible and desirable projects for fear of an unfortunate exposure to undeserved legal sanctions.

In dealing with both civil and criminal sanctions, there should be no free pass to the aggressive prosecutor. It is not just under-deterrence that causes serious social dislocations. Over-deterrence can, and does, bring about the same result. In this context it is good to recall the words of Justice Felix Frankfurter in *McNabb v. United States*[10]:

> A democratic society, in which respect for the dignity of all men is central, naturally guards against the misuse of the law enforcement process. Zeal in tracking down crime is not in itself an assurance of soberness of judgment. Disinterestedness in law enforcement does not alone prevent disregard of cherished liber-

10. McNabb v. United States, 318 U.S. 332 (1943).

> ties. Experience has therefore counseled that safeguards must be provided against the dangers of the overzealous, as well as the despotic. The awful instruments of the criminal law cannot be entrusted to a *single* functionary. The complicated process of criminal justice is therefore divided into different parts, responsibility for which is separately vested in the various participants upon whom the criminal law relies for its vindication.[11]

Frankfurter's anxiety about excessive reliance on a single functionary applies with even greater force to many modern regulatory schemes, of which the most notable is the Consumer Financial Protection Bureau (CFPB), which was created as part of the 2010 Dodd–Frank Act.[12] The distinctive features of CFPB are numerous. The CFPB has enormous powers that consolidate the enforcement of some 19 different consumer protection statutes that run the gamut: student loans, credit cards, home mortgages, and much more. Inside the CFPB, the complete oversight for its far-reaching operations is lodged in a single director whose decisions are subject at most to a highly limited review. There is no budgetary constraint by Congress, as the agency has by design a guaranteed source of funding through the Federal Reserve Bank, which cannot be checked by Congress or, indeed, even the Federal Reserve itself. Finally, Dodd–Frank provides that the CFPB Director serves for a five-year term—which necessarily allows one president to bind his successor, given that the Director is subject to presidential removal only limited grounds—namely for "inefficiency, neglect of duty, or malfeasance in office."[13]

The question of whether this unique statutory arrangement offends the basic constitutional structure dealing with separation of powers on the one side and checks and balances on the other came to a head in *PHH Corporation v. Consumer Financial Protection Bureau*,[14] under facts that could be scarcely more illustrative of the dangers of this top heavy organization.

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11. *Id.* at 343 (emphasis added).

12. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

13. 12 U.S.C. § 5491(c)(3) (2018).

14. PHH Corp. v. Consumer Fin. Prot. Bureau, 839 F.3d 1 (D.C. Cir. 2016), *vacated and reh'g en banc granted*, No. 15-1177 (D.C. Cir. 2017).

PHH specializes in home mortgage lending, and it also participates in a mortgage insurance market, through its "captive" subsidiary Atrium Insurance Corporation that supplied reinsurance to outside insurers that wrote coverage for mortgages issued by PHH. There was a complex question of whether PHH was, in accordance with historical practice, exempt from certain kickback or self-dealing provisions which had protected it under the Real Estate Settlement Procedures Act, passed in 1974, so long as the fees paid the mortgage insurers was reasonable. But once the enforcement functions were transferred to the CFPB, it ruled, without any change in the substantive law, that this long-standing interpretation no longer held. On appeal to the Director, the initial fine (for this dubious act of statutory interpretation) was increased from $6 million to $109 million[15]—a punitive fine after a unilateral reinterpretation of an established interpretation of a statute on which there was extensive industry reliance.

The imperial nature of this CFPB decision lay it open to the charge that this concentrated power violates the general requirements of separation of powers. In one sense the issue arises in a second-best world because it assumes that independent agencies, whose officers are immune from removal at the will of the President,[16] are consistent with the basic constitutional system, even though the Constitution itself contains no explicit authorization for their use. Thus the process of implication is necessarily invoked to both define the scope and limits of that exception.

In the initial round, Judge Brett Kavanaugh held for himself and Senior Judge Raymond Randolph that independent agencies, or those whose heads can only be removed for cause,[17] have too much power to be led by a single official.[18] Given that all administrative agencies "pose a significant threat to individual liberty and to the constitutional system of separation of powers and checks and balances," they "have historically been headed by *multiple* commissioners, directors, or

15. For a discussion of substantive issue, see Richard A. Epstein, *Tyranny Within the Administrative State*, HOOVER INST.: DEFINING IDEAS (May 31, 2016), https://www.hoover.org/research/tyranny-within-administrative-state.
16. Humphrey's Ex'r v. United States, 295 U.S. 602, 603 (1935).
17. *Id.*
18. *PHH Corp.*, 839 F.3d at 8–9.

board members who act as checks on one another."[19] Given the CFPB head's level of unilateral authority, Kavanaugh held that the constitution requires that the President can remove such an official at will.[20]

That initial decision was reversed en banc by a divided court that showed the deep progressive/classical liberal split on this issue.[21] The majority decision written by Judge Nina Pillard took a very different view of the overall matter. In its view, heading an agency with a sole director and not a multiple panel was its virtue because the streamlined structure was designed "to imbue the agency with the requisite initiative and decisiveness to do the job of monitoring and restraining abusive or excessively risky practices in the fast-changing world of consumer finance."[22] In response to the Kavanaugh view that the issue of removal could not be examined apart from the other structural provisions, Pillard concluded: "The relevance of 'internal checks' as a substitute for at-will removal by the President is no part of the removal-power doctrine, which focuses on executive control and accountability to the public, not the competing virtues of various internal agency design choices."[23] So long as removal could be properly limited for cause, in her view the other design features did not matter.

As a matter of recent historical decision, the Pillard position draws some support from the long history of deference to Congress in the design of administrative agencies. But as a matter of first principle, her entire approach is inconsistent with the basic conception of separation of powers that drove the initial constitutional design. These design decisions recognize the inherent trade-offs between going too fast and too slow. Of course, it is important to be zealous in the pursuit of wrongdoing. But that tendency that creates the risk of overzealous behavior, which was on ample display in *PHH*, makes the Kavanaugh approach preferable as a matter of principle. Indeed, it is just that principle of aggressive concentration of powers in the hands of a single executive, here the NYAG, that, even more than its substantive provisions, makes the cur-

19. *Id.* at 5.
20. *Id.* at 8.
21. PHH Corp. v. Consumer Fin. Prot. Bureau, 881 F.3d 75 (D.C. Cir. 2018).
22. *Id.* at 81.
23. *Id.* at 79.

rent operation of the Martin Act so dangerous. In the hands of cautious NYAGs, the risk of excess is subject to internal political constraints. But under NYAGs like Spitzer and Schneiderman, surely the opposite is true.

Speaking generally, a sound legal system has to contend with two kinds of error: both over and underenforcement. It is always hard to know whether it is socially preferable to trade away the upside of effective enforcement in order to minimize the downside of wrongful or excessive punishments. Any effort to beef up procedural protections will unfortunately trammel good public officials but simultaneously limit the harm from zealous overenforcement. In a perfect world, I would prefer that good leaders be unconstrained by procedural hurdles. But in our imperfect world, procedural protections are necessary, indeed urgent. The ultimate prudential calculation requires assessing which form of error is greater, and, as Justice Frankfurter's admonition reminds us, it is never wise to disregard the downside. But it is just that error that the Martin Act has committed—especially as it has been interpreted and applied by recent NYAGs.

Textually, there is nothing about the Martin Act that compelled Schneiderman's behavior any more than there is in the Federal Trade Commission Act of 1914, Section 5, which broadly prohibits "using unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce . . . ."[24] But it takes awareness of the dangers to control the excesses. Clearly there is wiggle room in each of these two key statutes, which has led to some highly controversial cases. Yet ironically, it took a one-page statement from the FTC—a multimember body—to announce that it would confine the application of this elastic provision to operate as an adjunct to the antitrust laws dealing with anticompetitive injury instead of a freewheeling statute that could be directed at any contract that displeased the FTC.[25] Given the

24. 15 U.S.C. § 45(a)(1) (2012).

25. FED. TRADE COMM'N, STATEMENT OF ENFORCEMENT PRINCIPLES REGARDING "UNFAIR METHODS OF COMPETITION" UNDER SECTION 5 OF THE FTC ACT (Aug. 13, 2015). For my account of the evolution, which was largely attributable to the work of Commissioner Joshua Wright, who has since returned to the George Mason Law School Faculty, see Richard A. Epstein, *When Bureaucrats Do Good*, HOOVER INST.: DEFINING IDEAS (Aug. 17, 2015), https://www.hoover.org/research/when-bureaucrats-do-good.

powers vested in the NYAG, some check on his unilateral powers could go a long way toward curbing prosecutorial excesses under the Martin Act. Such a procedural change could then be buttressed substantively by limiting the Martin Act to those cases that are akin to the common-law tort of deceit.

Unfortunately, all of the implicit safeguards built into the earlier common-law-inspired use of the Act have been eroded by unsupported extensions of its substantive reach, which in turn have increased the danger of invoking the extraordinary remedial provisions built into the Act in the first place. These provisions give huge investigative powers to the NYAG, acting solely on his own authority, long before any trial. For example, Section 352 of the Act enables the NYAG to undertake confidential investigations in which he can subpoena witnesses, compel attendance, and examine witnesses under oath, either in private or before a magistrate court of record.[26] Section 354 gives the NYAG the unilateral authority to order a public investigation by filing an application before a trial-court judge, who has no choice but to grant the application.[27] To paraphrase Chief Justice John Marshall, the power to investigate is the power to destroy,[28] especially with respect to those businesses whose reputation is critical to their ability to remain open. Reputation, of course, is, and should be, of great importance in the securities business. The decisions of individual and institutional investors to flee a firm that has committed a serious violation of industry norms takes its effect immediately and does so without the need for costly and prolonged litigation. It is for that reason that losses in share values routinely exceed any potential liability or fines for illegal behavior.[29] This bonding mechanism makes good sense when the bad news is accurate about a firm. But it should be a source of unease when the loss in stock value from a triggering event does not stem from any actual bad conduct by the firm in question. The risk of social harm from over-deterrence is exceedingly high whenever the simple announcement of an investigation can be

26. N.Y. GEN. BUS. LAW § 352(2) (2016).

27. *Id.* at § 354.

28. *See* McCulloch v. Maryland, 17 U.S. 316, 431 (1819) ("[T]he power to tax involves the power to destroy . . . .").

29. Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 547, 582 (2008).

enough to trigger a suspension of the licenses needed to do business—not to mention follow-on consequences in stock price. In those settings, there is intolerable pressure to settle a case short of the initiation of suit.

The federal government enjoys similar forms of leverage under the federal securities laws, which, to some extent, exhibit the same flaws as the Martin Act.[30] This excessive concentration of power is exemplified by the practice of the SEC to try its own cases before administrative law judges (ALJs) that the SEC appoints itself. Concentrating that power in the hands of a political commission whose membership is determined along party lines is asking for trouble. One recent decision on the topic, *Bandimere v. SEC*,[31] held that the ALJs appointed by the SEC wield sufficient power in individual cases to count as inferior officers under the Appointments Clause. Therefore, the *Bandimere* court held that the ALJs would need to be appointed, without Senate confirmation, either by the President, the Courts of Law, or the Head of Department. As the SEC was none of the above, its commissioners could not constitutionally appoint ALJs.[32] The District of Columbia Circuit in *Raymond J. Lucia Cos. v. SEC*[33] disagreed with this reading, and held that the ALJs should be treated only as government employees because the decision of the ALJ was not final, but ultimately depended for its validity on an enforcement decision by the Commission as a whole, which has the power to review every case. That decision let the SEC resort to deferred prosecution agreements, which allowed parties to retain their licenses only if they acceded to onerous behavioral and structural changes in the conduct of their business.[34]

30. For a discussion of the perverse incentives that arise when the costs of being indicted exceed the fines that could be imposed on conviction, see Richard A. Epstein, *Deferred Prosecution Agreements on Trial: Lessons from the Law of Unconstitutional Conditions, in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 38 (Anthony S. Barkow & Rachel E. Barkow eds., 2011).

31. Bandimere v. SEC, 844 F.3d 1168, 1179 (10th Cir. 2016), *reh'g en banc denied*, 855 F.3d 1128 (10th Cir. 2017).

32. *Id.*

33. Raymond J. Lucia Cos. v. SEC, 832 F.3d 277 (D.C. Cir. 2016).

34. *See, e.g.*, James R. Copland & Rafael Mangual, *The Shadow Regulatory State at the Crossroads: Federal Deferred Prosecution Agreements Face an Uncertain Future*, MANHATTAN INST. (June 27, 2017), http://www.manhattan-institute.org/html/shadow-regulatory-state-crossroads-federal-deferred-prosecution-a

For the moment at least, these abusive practices have come to a halt as Justice Elena Kagan upended the District Court decision by holding in *Lucia v. SEC* that the ALJs that were appointed by the Securities and Exchange Commission counted as inferior officers under the Appointments Clause. Thus, they could not be appointed by the Commission's staff, but had to be appointed by its head alone.[35] The court relied heavily on its earlier decision in *Freytag v. Commissioner*, which held that the special trial judges in the United States Tax Court were inferior offices because, even though they were not authorized under statute to issue final decisions, the extensive scope of their authority meant that they had sufficient power to shape the overall scope of the decision.[36]

The Appointments Clause issue is, however, only the tip of a larger due process iceberg.[37] The decision in *Lucia* spent no time at all discussing the particulars of the case, which were deeply troubling from a due process point of view. Raymond Lucia was permanently barred from practice as an investment advisor because the administrative law judge in the case, Cameron Elliot, found him guilty of serious violations of the securities laws for giving his "Buckets of Money" presentation to a general audience. Under the strategy presented by Lucia, an investment portfolio would contain both stocks and bonds. The low-risk investments would be sold first, while the high-risk investments would be allowed to appreciate. Lucia's large slide deck contained hypothetical examinations of how his method works, and these were deemed to be materially misleading and thus in violation of the anti-fraud provisions of the Investment Advisors Act of 1940[38] and applicable regulations.[39] This was despite the fact that the slides had passed

greements-face-uncertain. For my longstanding opposition to these agreements, see Richard A. Epstein, *The Dangerous Incentive Structures of Nonprosecution and Deferred Prosecution Agreements*, HERITAGE FOUND. (June 26, 2014), http://www.heritage.org/research/reports/2014/06/the-dangerous-incentive-structures-of-nonprosecution-and-deferred-prosecution-agreements.

35. Lucia v. SEC, No. 17-130, slip op. at 5 (U.S. June 21, 2018).

36. Freytag v. Comm'r, 501 U.S. 868, 891 (1991).

37. For my longer discussion of this issue, see Richard A. Epstein, *Miscarriage of Justice at the SEC*, HOOVER INST.: DEFINING IDEAS (Apr. 30, 2018), https://www.hoover.org/research/miscarriage-justice-sec.

38. 15 U.S.C. §§ 80b-1 to 80b-21 (1940).

39. *See* 17 C.F.R. § 275.206(4)-1(a)(5) (2012) (prohibiting misleading advertising).

muster before a private industry self-regulatory organization known as FINRA (The Financial Industry Regulatory Authority), on which the U.S. securities regulation regime relies heavily for enforcement.[40] In addition, the SEC itself raised no objections to the slides when it previewed the presentation. None of the 50,000 people who attended these presentations over the years filed any complaint against Lucia, let alone lost any money as a result. At these presentations, Lucia asked attendees to contact him directly if they wanted additional personal advice.

The case was then referred to ALJ Cameron, who had never previously ruled against the SEC's enforcement division in the approximately 50 or so cases he oversaw. According to Professor Ronald Mann, Elliot "adopted a bright-line rule of issuing lifetime bans on employment in the investment industry against any defendants who had the nerve to contest the proceedings against" the SEC.[41] This case followed true to form. Elliot presided over a full-scale trial, after which he concluded that Lucia should be suspended for life from the securities profession. This initial decision was not final; it had to be reviewed by the agency's five commissioners, who in 2015 followed Elliot's recommendation in a 3–2 decision.[42] In the Court's opinion, Justice Kagan simply prefaced her remarks by noting that the Dodd–Frank Act allows the Commission to preside over these cases, but also allows it to delegate that activity to an ALJ.[43] Her opinion never raised these due process issues despite the fact that the Commission's power to select individual judges on an ad hoc basis gives rise to the appearance of bias. Such risk is hardly cured even if the SEC mends its ways and now requires the head of the SEC to make those appointments. It should seem clear that the risk of bias is not con-

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40. *See generally* FINRA, https://www.finra.org (last visited Aug. 11, 2018).

41. Ronald Mann, *Argument Preview: Justices Turn to Constitutional Limits on Appointments of Administrative Law Judges*, SCOTUSBLOG (Apr. 16, 2018), http://www.scotusblog.com/2018/04/argument-preview-justices-turn-to-constitutional-limits-on-appointment-of-administrative-law-judges/.

42. For the opinion and order of the Commission, see Lucia, Exchange Act Release No. 34-75662, 2015 WL 5172953 (Aug. 11, 2015). An interim remand order is unreported. For the relevant initial decision of the administrative law judge, see Initial Decision Release No. 495, 2013 WL 3379719 (July 8, 2013) (ALJ).

43. Lucia v. SEC, No. 17-130, slip op. at 1 (U.S. June 21, 2018).

fined solely to the Martin Act, but also arises under the SEC generally, where delegation can result in the same kind of aggregation of power in the hands of a single public official. These issues will surely have to be vetted in future cases.

In addition to trusting plausibly unconstitutionally appointed ALJs with immense power, the SEC resorts to deferred prosecution agreements, whereby the defendant accedes to prosecutors' demands for structural and behavioral changes in exchange for deferring a prosecution that could, among other things, result in a loss of licenses to do business. These agreements can prove to be especially onerous on defendants, given that they can be imposed without offering defendants the benefit of any form of judicial oversight.[44] These two features of the SEC's enforcement regime show how easy it is for administrative agencies to centralize power and then abuse it to the detriment of private parties.

The Martin Act's scheme is still more perverse, inasmuch as it centralizes power in the hands of a single individual. The need for some judicial or institutional check against self-aggrandizement is as important with the SEC as in the Martin act context, and remains critical even if the substantive law remains relatively unchanged. The level of prosecutorial discretion in all such cases is sufficiently broad that the identity of the prosecutor really matters. Put in its simplest form, it is better to have an overbroad statute with a prudent prosecutor than a finely tuned statute with an overzealous prosecutor. After the fact remedies are notoriously ineffective in controlling abuses of prosecutorial discretion.[45] Ex ante schemes of control are more important. This point becomes even clearer after reviewing the substantive evolution under the Martin Act, in its relationship to both the common law and the SEC.

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44. *See, e.g.*, Copland & Mangual, *supra* note 34. For Epstein's opposition to these agreements, see Epstein, *supra* note 34.

45. Peter A. Joy, *The Relationship Between Prosecutorial Misconduct and Wrongful Convictions: Shaping Remedies for a Broken System*, 2006 WIS. L. REV 399, 427 n.139 (surveying literature to this effect).

II.
THE MARTIN ACT, THE COMMON-LAW ACTION FOR DECEIT, AND THE FEDERAL SECURITY AND EXCHANGE ACTS

A. *The Origins of the Martin Act*

To better understand the recent growth of the Martin Act, it is useful to look back to its origins and basic structure. When enacted in 1921, the Martin Act was among the last of the many "blue-sky" laws enacted in the early part of the twentieth century to deal with a spate of flagrantly dishonest marketing practices targeting "an enormous population with an unusually high per capita wealth suddenly made security conscious."[46] These blue-sky laws were intended to prevent unscrupulous promoters from bilking innocent investors out of their savings by offering them securities whose market value was no greater than the blue sky above.[47]

Early Supreme Court decisions showed no hesitation in sustaining the constitutionality of the blue-sky laws, chiefly on the ground that they fell squarely within the scope of the police power. Passed at the height of the so-called *Lochner* era, when the protection of economic liberties from government regulation was at its zenith,[48] these laws produced little constitutional doubt.[49] The worry that these laws might over-deter

46. Ambrose V. McCall, *Comments on the Martin Act*, 3 BROOK. L. REV. 190, 193 (1933).

47. *See* Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) ("The name that is given to the law indicates the evil at which it is aimed; that is, to use the language of a cited case, 'speculative schemes which have no more basis than so many feet of 'blue sky'; or, as stated by counsel in another case, 'to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations.' "). For discussion, see Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 331–34 (1988).

48. The era took its name, of course, from *Lochner v. New York,* 198 U.S. 45 (1905), which struck down a New York law that limited workers in certain classes of bakeries to 10 hours per day and 60 hours per week, as an unconstitutional "labor" statute that was directed more toward suppressing competition than protecting health and safety—which indeed was the case. *See, e.g.*, DAVID E. BERNSTEIN, REHABILITATING *LOCHNER* (2011).

49. *See Hall*, 242 U.S. at 552 (upholding Ohio's blue-sky law); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917) (upholding South Dakota's blue-sky law); Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917) (upholding Michigan's blue-sky law).

legitimate business behavior was a distant worry in the hectic years of the First World War, when crooked behavior was rampant.[50]

Since its original passage, the scope of the Martin Act has been expanded by legislative action. In 1955, Section 352-c authorized the Attorney General to institute criminal proceedings against parties engaged in fraudulent practices, even absent proof of scienter or intent.[51] In 1976, Section 353(3) authorized the NYAG to seek monetary restitution for persons defrauded by the defendant's activities.[52]

The major doctrinal innovation of the Martin Act was to soft-pedal the role of scienter, reliance, and damages—all essential elements of a common-law fraud claim. However, within the context that sparked passage of the Martin Act, these shortcuts were perfectly appropriate responses for dealing with blatant fraudsters, and the Martin Act preserved other common-law rules that kept liability from running rampant. For instance, its application extended to misrepresentation by omissions as well as by affirmative utterances, but was limited to material misrepresentations, ruling out mere statements of opinions and predictions. The Martin Act also respected the common-law privity limitations that grew up in connection with the tort of deceit, which blocked litigation for persons who suffered only from the indirect consequences of fraud. There is much that is distinctive about the Martin Act, but there is also much that it shares with both federal securities law and the older common law. As the New York Court of Appeals has recognized, "[a]lthough the Martin Act was enacted in 1921, its present form generally tracks the Federal securities acts of 1933 and 1934. Accordingly, we have looked to Federal

50. In those years, "[s]windlers stalked Gotham's streets, fleecing the people who were investing with solo speculators and putting money into the stock market for the first time in a burst of postwar patriotic fervor." Nicholas Thompson, *The Sword of Spitzer*, LEGAL AFF. (May/June 2004), https://www.legalaffairs.org/issues/May-June-2004/feature_thompson_mayjun04.msp.

51. *See* People v. Landes, 645 N.E.2d 716, 717–18 (N.Y. 1994) (outlining this history).

52. *See* Assured Guar. Ltd. v. J.P. Morgan Inv. Mgmt., Inc., 962 N.E.2d 765, 768 (N.Y. 2011) (describing this history); N.Y. GEN. BUS. LAW § 353(3) (McKinney 2014).

court decisions construing those statutes when interpreting our own."[53]

The original Martin Act gave a broad definition to the types of activities that fell within its scope. Section 352-c contains a list of activities prohibited by the statute:

> It shall be illegal and prohibited for any person, partnership, corporation, company, trust or association, or any agent or employee thereof, to use or employ any of the following acts or practices:
>
> > (a) Any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale;
> >
> > (b) Any promise or representation as to the future which is beyond reasonable expectation or unwarranted by existing circumstances;
> >
> > (c) Any representation or statement which is false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made;
>
> where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities, as defined in section three hundred fifty-two [giving extensive investigative powers to the Attorney General] of this article, regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted.[54]

The initial version of the law had a schizophrenic quality, being broad in scope but feeble in its application. Indeed, the statute has been described as "deliberately enfeebled" at birth.[55] As Nicholas Thompson explained in criticizing Spitzer's ramped-up enforcement efforts, the original Martin Act embodied a political compromise whereby the broad reaches of the law were directed to marginal players, both in-

53. *See Landes*, 645 N.E.2d. at 718.
54. N.Y. GEN. BUS. LAW § 352-c(1) (McKinney 1982).
55. *See* Thompson, *supra* note 50.

side and outside the financial industry, while the established players received something of a free pass.[56] For instance, Thompson noted that the New York law did not have a registration requirement of the sort found in many other blue-sky statutes, because for large institutions "a registration law was a bureaucratic burden to be avoided. A simple fraud statute seemed like a good way to swat down small-time sharks and keep the field open for themselves."[57] Enforcement in this early era was predictably light.[58] But the shifting tides of enforcement notwithstanding, a comparison with the common-law tort of fraud or deceit shows how wide a liability net the Martin Act has always cast.

B. *The Common Law of Deceit*

To put the Martin Act in context, it is useful to compare its provisions to common-law tort of deceit that awarded private parties money damages for the loss attributable to fraudulent conduct.[59] The elements of the common-law tort are embodied in Section 525 of the Restatement (Second) of Torts.

> 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.[60]

It is also instructive to note that the standard federal definition of securities fraud takes exactly the same tack. Under federal law, plaintiffs must prove "(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 misrepre-

56. *Id.*
57. *Id.*
58. Lydie N.C. Pierre-Louis, *Hedge Fund Fraud and the Public Good*, 15 FORDHAM J. CORP. & FIN. L. 21, 34 (2009) ("The original Martin Act was a weak law and no enforcement actions were commenced for years after its adoption.").
59. *See* Pasley v. Freeman (1789) 100 Eng. Rep. 450 (KB).
60. RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW. INST. 1965).

sentation or omission; (5) economic loss; and (6) loss causation."[61]

The tort and its constitutive elements necessarily give rise to all sorts of knotty doctrinal questions. What is the basis of liability? Does the tort cover fraud only, or does it extend further? How is the element of causation cashed out when the loss is financial, as opposed to the more familiar tort context of physical injury? Is there a materiality limitation? Does liability for false statements cover omissions, mere opinions, predictions, and statements of intention? The express text of the Martin Act answers some of these questions, but it remains silent on other key issues. It is therefore common for cases under the Martin Act to draw explicit comparisons to the federal security acts, which in turn rely on explicit comparisons to the various common-law rules. All of these interactions must be examined.

C. *Basis of Liability: Fraud, Recklessness, Negligence, and Beyond*

At common law, the basic instinct was to impose liability for deceit but not for innocent or even negligent misrepresentations.[62] There are good reasons for this distinction, even though the harm to the aggrieved party may be the same. Imperfect information—from whatever source—distorts any decision-making process, because it leads people to attach false weights to the goods and services they purchase or sell. Attach too high a value to some object, and you will pay too much for it. Attach too low a value, and you will part with it for too low a price.

Unfortunately, incomplete information is the normal state of human affairs, so any legal system must be picky about the shortfalls in information that it will target for attack. The basic presumption that all individuals should ordinarily bear the costs of their own mistakes provides a sensible point of departure for two reasons. First, it offers a strong incentive for individuals to ferret out good information to counteract the

61. Stoneridge Inv. Partners v. Scientific-Atlanta, 552 U.S. 148, 157 (2008). *See also* Pits, Ltd. v. Am. Express Bank Int'l, 911 F. Supp. 710, 719 (S.D.N.Y. 1996) (noting the exact parallel between the common-law action for deceit in New York and an action for federal securities fraud under Section 10(b) of the Exchange Act and SEC Rule 10b-5).

62. *See, e.g.,* Derry v. Peek [1889] 14 App. Cas. 337 (HL).

bad, so long as the incremental value of superior information outweighs the cost in time, effort, and money it would take to learn it. Second, this rule protects other parties by removing (in most cases) the obligation to correct the errors of their trading partners, some of which they may not know at all. The security of transactions is remarkably improved if everyone understands that his own mistakes are not a ground on which he can upset transactions made with others.

This rule holds best where there are unilateral mistakes for which no one else is to blame, let alone one's trading partner. Like all legal rules, however, this one is subject to exception. More specifically, fraud in the inducement (note the causal element) changes the calculation because now one person has invested in disinformation of another solely for his own advantage. In general, it is common to treat reckless disregard of the truth as though it were a specimen of fraud, on the ground that the parties who engage in these steps well know what they have done wrong.[63] This is a far cry from both innocent misrepresentation and even negligent misrepresentation,[64] neither of which involve conscious awareness of the likelihood of falsehood.

This carefully crafted definition of fraud makes sense functionally because the correct legal approach is to always start with the low-hanging fruit: the area where the minimum of legal intervention will generate the maximum of social improvement. Under this simple test, the primacy of fraud—which is the primary target of the common law, the federal securities laws, and New York's Martin Act—should be apparent. On the one hand, fraud constitutes the greatest peril to voluntary transactions, because fraudsters will work overtime to deceive the individuals from whom they wish to extract money or other forms of private benefit. On the other hand, fraud is far less common than simple mistake or ordinary negligence, so both civil and criminal enforcement may properly focus on the most egregious form of misconduct. The dangers of fraud are recognized in the common-law rules that govern its application, which, in virtually every jurisdiction, specifically

63. *See id.*

64. *See id.* at 375 ("Fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it is true or false.").

provide that contributory negligence is not a defense to a fraud action, precisely because we want people to be able to know that they are protected from deliberate fraud when they rely on information received from others.[65] To be sure, there remains some residual risk that people will make mistakes because of the innocent misrepresentations of others. But in most contexts, where there is a parity of access of information to both parties, the more prudent rule is to eliminate liability altogether, cautioning both sides to confirm the key assumptions on which they base their own decisions.

Negligent misrepresentations present a harder case, given that it is never clear on whom the burden of discovering the hidden truth of various assertions should fall. There has long been a reluctance to develop any generalized remedy of negligence that parallels the scope of fraud. The usual legislative efforts are to impose these duties of care only in those cases in which good institutional reasons make it clear that the parties on one side of a transaction (say, the issuer of a new class of securities) are likely to have better and cheaper access to information than those on the other (such as the multitude of investors interested in buying the securities). In Britain, one early law reflecting this compromise was the Director's Liability Act of 1890,[66] passed in the immediate aftermath of *Derry v. Peek*, which made directors and promoters liable to purchasers of stocks and bonds unless the director or promoter could show that "he had reasonable ground to believe," and at all material times did believe, his statements to be true.[67] Modern American law goes one step further and holds firms strictly liable for false statements made in a prospectus.[68]

Nonetheless, in most contexts other than the highly specialized one of securities sales, a party can bear the risk of ordi-

65. *See* Seeger v. Odell, 115 P.2d 977, 980 (Cal. 1941) ("Negligence on the part of the plaintiff in failing to discover the falsity of a statement is no defense when the misrepresentation was intentional rather than negligent.").

66. Director's Liability Act 1890, 53 & 54 Vict. c. 64 (Eng.).

67. *Id.* § 3(a).

68. 15 U.S.C. § 77k(a) states:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . [may] sue.

nary negligence by his trading partner, in no small part because the means of self-protection are readily available. One simple line of defense is to get independent information from two or more people, and then to push harder when there is a discrepancy between them. The great methodological mistake on this topic is to assume that the question of liability for negligence should be resolved as one of abstract theory, when in fact the more reliable method is to look at the explicit terms of liability in this context, as in so many others, where the risk of disproportionate loss is one that leads to routine exemptions from liability for negligence.[69] Thus, it is common for brokers and other suppliers of information to demand (and receive) explicit protection against liability for losses resulting from merely negligent counsel. The alternative position, treating the advice as an implicit guarantee, could lead to the breakdown of the industry, because it would allow the customer to keep the upside of successful trades while gaining the right of action against the broker in the event of poor outcomes. No party would pay for this kind of insurance in a voluntary market, which is why it is routinely not required as a matter of law. In other contexts, liability for a wholly innocent misrepresentation will sometimes be less important if the defendant who recommends an investment to the plaintiff has made that same investment himself. After all, it is very common for people who seek to recruit others into some risky venture to announce at the outset that they are putting their own money at risk as well, which acts as an implicit bond against poor advice. And once the promoter's own private investigations reveal the true state of affairs, we no longer deal with innocent misrepresentations but with ordinary fraud.

The plain text of the Martin Act does not compel grave departures from the common law's sensible distinctions. The Act imposes liability for any false statement connected with se-

69. *Hedley, Byrne & Co. v. Heller & Partners, Ltd.* contains a powerful denunciation of the various distinctions between paid and gratuitous transactions before switching gears and honoring the standard exemption clause put into the contract, by saying: "A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact that he is not." [1964] AC 465 (HL) 533. The same rejection of negligence applies in cases where there is an effort to hold someone responsible in ordinary negligence for some catastrophic loss that might have been prevented by an adequate inspection.

curities trading when the party making the statement "(i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made."[70] If the statute were meant to institute a strict-liability rule, there would be no need for this careful enumeration of mental states, and the text does not support a strict-liability reading. The first case described is a clear case of intent, and the second and third refer to negligence. The fourth mental state is the hardest to construe, and could admittedly be bent into a strict-liability shape, but the better reading is that it targets statements made by parties who know they lack the knowledge they pretend to have.

Judicial interpretation, however, has diverted the Act from this sensible reading, and it is now commonly said that the Martin Act requires no proof of scienter in civil actions.[71] In an early case interpreting the Act, the New York Court of Appeals urged: "The words 'fraud' and 'fraudulent practice,' in this connection, should therefore be given a wide meaning, so as to include all acts, although not originating in any actual evil design or contrivance to perpetrate fraud or injury upon others, which do by their tendency to deceive or mislead the purchasing public come within the purpose of the law."[72] More recently, in *People v. Sala*, a New York appellate court stated that "the People need only prove that the defendant committed an intentional act constituting fraud, which under the Martin Act 'includes all deceitful practices contrary to the plain rules of common honesty and all acts tending to deceive or mislead the public.'"[73] And in *State v. 7040 Colonial Road*

70. N.Y. GEN. BUS. LAW § 352-c(1)(c).

71. HAROLD K. GORDON, JONES DAY, ENFORCEMENT PROCEEDINGS UNDER NEW YORK'S MARTIN ACT 26 (2015), https://www.jonesday.com/files/Publication/cc6cfc9e-1517-4707-958d-8ea80d2042c2/Presentation/PublicationAttachment/9be275fc-e882-499c-9045-9a429519ab82/FebMar15_%20NYSupplement_MartinActFeature.pdf; John C. Coffee, Jr., *On Thin Ice: Climate Change, Exxon, the NYAG and the Martin Act*, CLS BLUE SKY BLOG (Nov. 23, 2015), http://clsbluesky.law.columbia.edu/2015/11/23/on-thin-ice-climate-change-exxon-the-nyag-and-the-martin-act/.

72. New York v. Federated Radio Corp., 154 N.E. 655, 657 (N.Y. 1926).

73. People v. Sala, 695 N.Y.S.2d 169, 177 (App. Div. 1999) (citing KAUFMAN, PRACTICE COMMENTARIES, MCKINNEY'S CONS LAWS OF N.Y., BOOK 19, GENERAL BUSINESS LAW ART 23-A, at 32-33); *see also* People v. Lexington Sixty-First Assocs., 345 N.E.2d 307, 311 (N.Y. 1976).

Associates Co., a New York trial court held that the term "fraud" as used in the Martin Act "includes all deceitful practices contrary to the plain rules of common honesty and all acts tending to deceive or mislead the public, whether or not the product of scienter or intent to defraud."[74]

These expansive definitions play fast and loose with the distinction between "deceive" and "mislead." In so doing, they create the risk of imposing ill-considered liability on innocent, but false, statements. But that perceived risk is often greater in theory than in practice, as the facts of many of the landmark Martin Act cases illustrate. The broad statement in *Sala* was made in connection with a criminal prosecution for a fraudulent plan to gain tenant approval for a conversion of rental units to condominiums under New York City's convoluted Rent Stabilization Law.[75] The landlord filled vacant units with family and friends in order to boost the number of unit holders who voted in favor of the conversion.[76] This elaborate scheme was plainly an intentional—indeed, a conspiratorial—deception. Similarly, *7040 Colonial Road* involved a successful suit to enjoin the conversion of residential premises into a cooperative arrangement, when the Attorney General determined that the defendants had not disclosed certain key facts relating to the financial condition of the premises, including its own failure to make good on the maintenance obligations for the retained units.[77] This case, too, looked like a culpable misrepresentation (albeit one by omission, a wrinkle discussed below). Neither of these real estate transactions involved a wholly innocent misrepresentation, and both were sensibly covered by Section 352-e(1) of the Martin Act.[78]

Thus, for the archetypal Martin Act case of yore, the elision of the scienter issue was more troubling in theory than in practice. Indeed, the New York courts' frequent invocation of "deceit" and the standard of "common honesty" could be char-

74. State v. 7040 Colonial Rd. Assocs. Co., 671 N.Y.S.2d 938, 941 (Sup. Ct. 1998) (citing KAUFMANN, INTRODUCTION AND COMMENTARY OVERVIEW MCKINNEY'S CONS. LAWS OF NEW YORK, BOOK 19, GENERAL BUSINESS LAW, ARTICLE 23-A, at 32–33).

75. *Sala*, 695 N.Y.S.2d at 177; N.Y.C. ADMIN. CODE §§ 26-501 to 26-520 (2017).

76. *Lexington Sixty-First Assocs.*, 345 N.E.2d at 311.

77. *7040 Colonial Rd. Assocs. Co.*, 671 N.Y.S.2d at 941–42.

78. N.Y. GEN. BUS. LAW § 352(1) (McKinney 2014).

itably read to parallel the common law's sensible hesitance to impose liability for innocent and negligent misstatements, the cases' no-less-frequent disclaimers of any scienter requirement notwithstanding. At the very least there is a stipulated element of the definition of fraud, given that Section 353(1) of the Martin Act authorizes actions by the Attorney General against "practices or transactions heretofore referred to as and declared to be fraudulent practices."[79] Moreover, the NYAG's effort to obtain only injunctive relief minimized the importance of the intent issue: it is perfectly proper to enjoin harmful behavior, regardless of the defendant's state of mind. A strict-liability rule works well for enjoining ordinary nuisance cases, and those rules can apply just as well in these financial situations. Indeed, once an injunction is sought, no one could claim, having been warned, that the activities in question remained unintentional, no matter how innocently they began.

D. *Statements of Fact: Materiality, Omissions, Opinions, and Predictions.*

In many ways, the single most important feature of the common-law action for deceit is that it covers only statement of facts. The term "facts" can obviously be read very broadly to cover all assertions that a given state of affairs corresponds to the description that the defendant has made of it. Indeed, in most fraud cases, the point passes by without dispute. If the defendant claims that he owns a well-oiled machine that turns out not to function at all, it does not take deep philosophical awareness to conclude that this statement of fact is false, and therefore imposing civil recovery and criminal punishment is so clear that no one gives the matter a second thought. In a hardcore fraud case, lying does not consist only in shaving corners. It also consists in making up matters out of whole cloth. Hence the term "blue sky" accurately reflects the proper state of affairs when the fraud goes to the sale of stock.

Nonetheless, just as the term "statement of fact" implicates some easy cases, it also gives rise to some hard ones. The use of language is often variable, and there are some statements that are regarded properly as weighty and consequential and others that are rightly dismissed as light and trivial. The law of fraud must take this complication into account, and in

79. *Id.*

response it develops an initial filter of "materiality" to indicate which statements are capable of supporting potential liability and which are too evanescent to matter. A statement's context matters as well as its content; sometimes a statement is made in relative isolation, while in other cases the identical statement may be just one of many statements, often made by many independent individuals, about a given issue. Clearly the statement is more likely to be material when it stands solo than when it is part of a symphony of statements concerning broad matters of public interest where other voices have weighed in.

Subject to that caveat, the overarching inquiry into materiality can conveniently be broken down into three separate issues, each of which forms a discrete piece of the whole. The first of these is the basic question of whether, and if so when, an omission should be regarded as a statement of fact covered under the common law of deceit, the federal securities laws, and the Martin Act. The answer, as will become clear, is that these omissions must be covered by the same contextual standards that are used with actual statements of fact. In this context, the correct impulse is to expand the basic liability for deceit, for there is no doubt that omissions can be as telling, or material, as statements of fact. The second issue relates to statements of opinion as distinct from statements of bald fact, and the third relates to predictions of future events, a subset of opinion. In both of these latter two contexts, it becomes critical to distinguish between "puffing," i.e., vague commendations of goods and services, and specific statements that are properly the source of liability in all three settings. I examine each of these subcases after addressing the general conception of materiality.

1. *Materiality*

The inquiry into statements of fact is framed by the legal inquiry into "materiality." Although Section 525 of the Second Restatement of Torts does not use the term, it is widely understood that any misrepresentation must involve some "material" or major fact to be actionable. Otherwise any minor or inconsequential remark could generate a large liability, which is why traditional writers on the topic spoke of *actionable* misrepresentations, as a subclass of the larger whole.[80] The exact formulation of materiality necessarily treats a question of degree as though it were a hard line. Nonetheless, since speech is ubiquitous in a way in which liability determinations cannot be, there needs to be some initial filter that keeps a large amount of small talk out of the legal system. How this is best done is subject to much dispute. There are always ample grounds, for example, to differ as to whether the determination of materiality turns on an independent judicial assessment of the importance of the statement, or whether materiality should be measured by reference to the specific persons to whom it is made, which raises extra difficulties for any statement made to that diverse group of individuals known as the public at large.

The definitive Supreme Court precedent on this matter is *TSC Industries, Inc. v. Northway*,[81] which involved charges that a proxy statement issued in connection with a proposed acquisition of TSC was "incomplete and materially misleading."[82] In addressing this question, the Supreme Court opted for the objective standard by explicitly rejecting the *broader* definition of materiality adopted by the Seventh Circuit, which had used the phrase "all facts which a reasonable shareholder *might* consider important."[83] The Supreme Court's narrower standard followed "the conventional tort test of materiality whether a reasonable man *would* attach importance to the fact misrepresented or omitted in determining his course of action."[84] That answer seems correct in the context of any public offering, for it is not possible for any offeror to take into account the multiple individual variations between different prospective sellers (or buyers, as the case may be). But the subjective standard could prove more acceptable in those cases where there is a one-on-one transaction in which the defendant is aware of the weakness and foibles of his trading partner. Clearly, for most

80. Hence the title of George Spencer Bower's book, *Actionable Misrepresentation* (1911), an early masterpiece on this topic. It is now in its fifth edition. SPENCER BOWER & KEN HANDLEY, ACTIONABLE MISREPRESENTATION (5th ed. 2014).

81. TSC Indus., Inc. v. Northway, 426 U.S. 438 (1976).

82. *Id.* at 441.

83. *Id.* at 445 (quoting Northway, Inc. v. TSC Indus., Inc., 512 F.2d. 324, 330 (7th Cir. 1975)).

84. *Id.* (citing RESTATEMENT (SECOND) OF TORTS § 538 (2)(a) (Tentative Draft No. 10, 1964)).

purposes, the public setting dominates. In that context, the Supreme Court in *TSC Industries* put the words "*would*" and "*might*" in italics to stress the difference between these two definitions. The Court then cashed out this view by insisting that, in the public context of investment decisions, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[85]

Although sensible in its basic outlook, this principle in application often overlooks some of the complexities of deciding what kinds of statements or omissions should create potential liability in dealing with acquisitions and mergers of publicly traded stock. The best illustration of the hybridization of statements and omissions is the 1988 Supreme Court decision in *Basic, Inc. v. Levinson*,[86] where the question before the Supreme Court was whether it was a material misrepresentation to say that a company's board was not in preliminary merger negotiations when in fact it was. Any release of this information is obviously very ticklish, for its disclosure could push stock prices upwards, which could make the deal less attractive for the acquiring party.[87] But if mum is the word, what should be done in response to a direct question about whether these negotiations took place? The district court took the position that these statements were not material because they were not "destined" to lead to an agreement in principle.[88] As a matter of simple economics, its broad contention must be wrong, because anyone thinking about buying shares in a company will vary his estimate of their value, up or down, given knowledge of the possible merger agreement, so that the price will move, either up or down, on the information in the short run no

85. *TSC Indus.*, 426 U.S. at 449.

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

87. The same risk arises when insiders, like lawyers or investment advisors, trade on information supplied by the acquirer on their own account, driving up the price of the stock. It is for this reason that the agent binds itself by contract not to trade on that information. *See* United States v. O'Hagan, 521 U.S. 642, 652–53 (1997) (applying the insider trading statute to these misappropriation cases). For a critical analysis of this issue, see Richard A. Epstein, *Returning to Common-law Principles of Insider Trading After* Newman v. United States, 125 YALE L.J. 1482 (2016).

88. *Basic*, 485 U.S. at 229.

matter what the ultimate outcome of the acquisition effort. What is evident about this situation is that the reason for keeping quiet is the same as the reason for making a misleading statement. Here is one class of disclosures that hurts shareholders as a group. So long, therefore, as management is not trading on its own account, the statements it made should be regarded as justified as the only effective means to preserve the needed secrecy in the negotiations.

Unfortunately, securities law does not have a well-developed category of *justified* falsehoods, so the hard question becomes how to determine the materiality of various noncommittal board responses over the life cycle of merger and acquisitions negotiations, many of which fail. The laundry list of factors offered in *Basic*[89] is so comprehensive that it is beyond useless, so that in practice the only way for firms to handle the question in practice is to adopt a blanket approach by which they always say "no comment" whenever asked about possible merger negotiations. That sphinxlike response conveys no information, but it is far from clear whether that private adaptation is more efficient than a legal regime that does allow for justified concealment. More specifically, there may well be cases in which it makes sense for the firm to let the market know that there is no pending merger so that they can better price the shares. But that option is precluded by *Basic*.

To make matters more difficult, the proof of reliance by individual traders—the causal link that will be discussed in detail later[90]—does not mesh well with the facts in *Basic* that led

89. *Id.* at 239, which states that:

> Whether merger discussions in any particular case are material therefore depends on the facts. Generally, in order to assess the probability that the event will occur, a factfinder will need to look to indicia of interest in the transaction at the highest corporate levels. Without attempting to catalog all such possible factors, we note by way of example that board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest. To assess the magnitude of the transaction to the issuer of the securities allegedly manipulated, a factfinder will need to consider such facts as the size of the two corporate entities and of the potential premiums over market value. No particular event or factor short of closing the transaction need be either necessary or sufficient by itself to render merger discussions material.

90. *See infra* Section II.E.

to the fraud-on-the-market theory and posits that the price of shares in the market reflects all "available material information regarding the company and its business," even if there are no acts of individual reliance.[91] Hence the fraud-on-the-market theory is introduced to fill that gap so as to provide a rough estimate of the price differential at the time of the false announcement. But the situation is ultimately unstable because those who sold improvidently recouped their losses, while those who purchased fortuitously get to keep their gains, so that shareholders at the time of the judgment suffer the diminution in value. It is no wonder that the all-silent approach dominates any potential remedy given, proving once again the difficulty in using these theories to establish liability. As will become evident, theories of liability that work reasonably well in direct negotiations do not always work as well in connection with public offerings with the diffuse distribution of information.

The complexities on the topic of materiality at common law, under the federal securities laws, and under the Martin Act, are compounded when the plaintiff's case involves not a single statement but an elaborate course of dealing in which multiple statements are made in multiple arenas. More specifically, many financial fraud cases do not result from a single statement by one party to another. Instead there is a constant stream of information that may be accurate in part, but inaccurate in some respects and incomplete in others. Any effort to control fraud that looks at the former but ignores the latter is woefully incomplete, so that any effective control of fraud yokes together the treatment of omissions and misrepresentations.

That interplay between material statements and omissions was very much in play in the important Supreme Court decision *Matrixx Initiatives, Inc. v. Siracusano*,[92] a spiritual sequel to *TSC Industries*. Matrixx was the defendant in a class action for securities fraud brought under Section 10(b) of the Exchange Act of 1934. The gist of the complaint was that the defendant had made a material omission when it had failed to disclose that it had received information from reliable physicians who

91. *Basic*, 485 U.S. at 241–42 (quoting Peil v. Speiser, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).
92. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011).

had detected a high level of anosmia, or loss of smell, among individuals who had used its main product, Zicam, a cold remedy. The previous controlled studies on the topic had not, as Matrixx had stressed, revealed any systematic connection between the two, even though other studies had noted that anosmia had occurred in individuals who had used other zinc-based products. The defendant's contention was that the complaint did not adequately allege that Matrixx made a material representation or omission or that it acted with scienter because the complaint did not allege that Matrixx "knew of a statistically significant number of adverse events requiring disclosure." A unanimous Supreme Court held that it was proper to let the case go to the jury because any analysis of "the materiality of adverse event reports cannot be reduced to a bright-line rule."[93]

Ironically, the Court's analysis seems wrong on both points. The evidence in this case did support a bright-line result, but for the plaintiff, not the defendant. While there are often situations for which bright line rules are hard to manage, this case was not one of them. Adverse events are *always* a big deal in medicine, wholly apart from their financial implications.[94] A single adverse event might give rise to a jury question of whether it is a powerful enough signal to warrant a directed verdict for the plaintiff. But usually reports of adverse events come in bunches, and the case is certainly *not* a jury question when an extended series of documented cases reveal the same adverse consequence, whose seriousness is not in doubt.

To give two points of reference in this case, it is clear beyond any doubt that a plaintiff in a medical-malpractice case would have slam-dunk proof that the omission of this information created a breach of the physician's duty to disclose possible material complications from the proposed treatment.[95] Worse still, as in *Matrixx*, the FDA had received multiple clinical reports on the side effects of the drug, on the strength

93. *Id.* at 30.

94. For a glimpse of how big the impact can be, see FDA ADVERSE EVENTS REPORTING SYSTEM (FAERS) PUBLIC DASHBOARD, https://www.fda.gov/drugs/guidancecomplianceregulatoryinformation/surveillance/adversedrugeffects/ucm070093.htm.

95. For the basic doctrine, see Canterbury v. Spence, 464 F.2d 772, 783 (D.C. Cir. 1972).

of which it launched its own investigation. Days later, the defendants issued a press release stating that the FDA had not found any connection between Zicam and anosmia, which knowingly gives a false impression about the impact that an FDA study would have on the marketability of the drug.[96] In this situation, moreover, the omission in question was manifestly material because the mere fact that drug is subject to FDA investigation is itself sufficient to drive down the share price even if the drug is ultimately exonerated. In cases where there are these obvious benchmarks keyed to the notion of materiality, there is no need for a jury determination. As is so often the case, the common strategy of courts in tort cases is to allow juries to decide cases when a cleaner appreciation of the underlying substantive law supports a partial summary judgment for the plaintiff.

2. *Omissions*

In light of the fact pattern in *Matrixx* and similar cases, it should come as no surprise that even though the term "omission" is not found in the Martin Act, the term has, by judicial decision, always been read into the definition.[97] Hence the overall analysis takes place in the same fashion as it does when the term "omission" is included, as in Section 11 of the Securities Act dealing with registration statements.[98] Section 11 covers strict liability in a registration statement that "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[99] Nonetheless, in practice, the actual language of the governing law takes a back seat to a functional analysis in ways that expand the operative scope of the Martin Act. Any isolated utterance resists classification un-

96. *See Matrixx,* 563 U.S. at 34–35.

97. *See, e.g.*, People *ex rel.* Vacco v. World Interactive Gaming Corp., 714 N.Y.S.2d 844, 864 (Sup. Ct. 1999) ("It is well settled that fraud exists not only where there has been an affirmative misstatement of a material fact, but also where there has been an omission of a material fact.").

98. 15 U.S.C. § 77k(a) ("In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may . . . sue.").

99. *Id.*

til the background context, whether specific to an individual case or socially generalizable, is understood. As in *Matrixx*, to say a good fact about X—the FDA had not found any negative correlation between Zicam and anosmia—only to omit a bad fact about X—the FDA was investigating recent reports of that connection—is to speak a half-truth, which is a lie if the omission is deliberate and is all the more insidious because the half-truth lends an aura of plausibility to the overall transaction. To turn a blind eye to these omissions would allow fraudsters to disarm their listeners en masse with impunity.

Doctrinally, therefore, it is no surprise that the Martin Act has always been construed in ways that bring it in line with the federal securities laws and the common law on the general issue of materiality and the specific problem of omissions.[100] Indeed, in *New York v. Rachmani Corp.*,[101] the New York Court of Appeals explicitly adopted the definition of materiality articulated in *TSC Industries*, and further noted that "[a]n omitted fact is material if there is a *substantial likelihood* that a reasonable shareholder would consider it important in deciding how to vote."[102] The statement was made in connection with individuals who voted in favor of a cooperative sale when they lacked full information about the transaction. As with all omissions, there is no obvious way to rely on what has *not* been said.[103]

The use of the term of "omitted fact" was essential to *Rachmani* because of the nature of the underlying dispute, namely the conversion of rental units to condominiums. The problem arose because of "the failure to mention an unsatisfied precondition to a cooperative conversion of an apartment house constituted fraud which justified the issuance of an injunction" under the Martin Act.[104] The New York Court of Appeals denied injunctive relief on the ground that there was no "actionable" fraud because the disputed condition was not sig-

100. For the industry view, see DECHERT LLP, THE MARTIN ACT: A PRIMER (Jan. 15, 2004), https://www.dechert.com/content/dam/dechert%20files/onpoint/2004/1/new-york-state-s-martin-act-a-primer/FS_2004-04.pdf.
101. New York v. Rachmani Corp., 525 N.E.2d 704, 726–27 (N.Y. 1988).
102. *Id.* at 726.
103. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1972).
104. *Rachmani Corp.*, 71 N.Y.2d at 721.

nificant and had, in any event, been disclosed in the original offering plan.[105]

The conceptual point, however, is that in all cases, the tort of deceit cannot be limited to false statements, but must also take into account omissions that when set against the background of what was discussed and mentioned, could have an impact on the course of conduct in a particular case.[106] But here too there is nothing in the architecture of the Martin Act which makes the common law or federal securities law analysis on this critical initial coverage issue obsolete, otiose, or irrelevant.

3. *Statements of Fact and Opinion*

The basic inquiry follows similar lines in drawing the distinction between statement of facts and statement of opinions. It is easy enough to conjure statements of the latter. The radio commercial on WFMT that states that the Goodman Theatre is the "foremost" theater in Chicago may sound like a statement of fact, but is, in fact, widely regarded as a statement of opinion, because of the drastic consequences that would flow from the opposite interpretation. There are many theaters in Chicago, and there are surely some rankings that hold that the Goodman is not the best theater, or perhaps even in the top ten. The same analysis applies to heaping praise on athletes, entertainers, CEOs, or just about anyone else. There is a strong and justified sense that the public at large, especially the universe of theater-goers who care about these matters, is context-sensitive, and will appropriately discount any claim of supposed preeminence that is made in such bald terms.

One common way to put the point is to note that the ubiquitous practice of "puffing" is not actionable even if literally false. One standard account of what falls into a safe haven is offered by Learned Hand in *Vulcan Metals Co. v. Simmons Mfg. Co.*[107]:

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105. *Id.*

106. It is common for a trial judge to instruct the that "the definition of a 'false statement' included both affirmative misrepresentations and any representation that 'effectively conceals or omits a material fact.'" *See* People v. Sala, 739 N.E.2d 727, 730 (N.Y. 2000).

107. Vulcan Metals Co. v. Simmons Mfg. Co., 248 F. 853 (2d Cir. 1918).

> There are some kinds of talk which no sensible man takes seriously, and if he does he suffers from his credulity. If we were all scrupulously honest, it would not be so; but, as it is, neither party usually believes what the seller says about his own opinions, and each knows it.[108]

A social code, universally accepted, vanquishes any hyperbolic literalism in thinking about ordinary discourse. Until the claims in question become more specific, the better approach by far is to let matters slide, so that self-correction takes place on the side of the listener, in light of public facts. But when the nature of the claim *is* specific, such as "*Good Housekeeping* has ranked our product as best in class," it is a false statement of fact if *Good Housekeeping* has done no such thing. The inevitable hard cases therefore arise when the implicit background understandings do not hold, precisely because one side has a hidden store of information that the other lacks.

One early case that shows a deep appreciation of this distinction and all it entails is *Smith v. Land and House Property Corp.*,[109] in which the plaintiff had offered a hotel for sale, stating that it was then let to "'Mr. Frederick Fleck (a most desirable tenant).'"[110] Before the contract of sale could be signed, Fleck made several late payments on the lease and then went into bankruptcy. When the defendant refused to complete the transaction on the ground that the plaintiff's statement about Fleck was a misrepresentation, the plaintiff sought specific performance, claiming that their gauzy remark was "a mere expression of opinion."[111] Lord Justice Bowen rejected that contention, hitting all the right notes:

> If the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best involves very often a statement of a material fact, for he impliedly states that he knows facts which justify his opinion. Now a landlord knows the relations between himself and his tenant, other persons either do not know them at all or do not know them equally well, and if the landlord says that he consid-

108. *Id.* at 856.
109. Smith v. Land & House Prop. Corp. (1884) LR 28 Ch D 7 (Eng.).
110. *Id.* at 8.
111. *Id.* at 10.

> ers that the relations between himself and his tenant are satisfactory, he really avers that the facts peculiarly within his knowledge are such as to render that opinion reasonable. Now are the statements here statements which involve such a representation of material facts? They are statements on a subject as to which *prima facie* the vendors know everything and the purchasers nothing. The vendors state that the property is let to a most desirable tenant, what does that mean? I agree that it is not a guarantee that the tenant will go on paying his rent, but it is to my mind a guarantee of a different sort, and amounts at least to an assertion that nothing has occurred in the relations between the landlords and the tenant which can be considered to make the tenant an unsatisfactory one. That is an assertion of a specific fact. . . . In my opinion a tenant who had paid his last quarter's rent by driblets under pressure must be regarded as an undesirable tenant.[112]

The fact/opinion distinction plays out the same way in defamation cases as in deceit cases. Thus, suppose some third party had made the same statement that Frederick Fleck was a most desirable tenant to another third party, who then purchased the property from his landlord who had said nothing, or that a third party had deliberately understated the size of the farm that the plaintiff purchased, likewise when the owner had said nothing. In both settings, the plaintiff took the risk as against the owner, but not against the third party, because a defendant in a defamation case could not defend on the ground that the basic statement was simply a matter of opinion if he knew as much as the defendant did in *Smith*. The still classic 1910 treatment of the issue by Van Vechten Veeder took just this view.[113] Let the underlying facts be stated before

112. *Id.* at 15–16.

113. *See* Van Vechten Veeder, *Freedom of Public Discussion*, 23 HARV. L. REV. 413, 419–20 (1910):

> The distinction is fundamental, then, between comment upon given facts and the direct assertion of facts. And the significance of the distinction is plain. If the facts are stated separately, and the comment appears as an inference drawn from those facts, any injustice that the imputation might occasion is practically negatived by reason of the fact that the reader has before him the grounds upon

the conclusion is reached, then third parties can make their own judgment whether the evidence presented supports the conclusion. Hence a detailed account of a transaction that is then branded a theft is not defamatory if the underlying factual statements are true. But if the charge of theft is made without that supporting context, the identical statement is now transformed from one of opinion based on known facts to a statement of fact that can support liability for either defamation or deceit. The one obvious exception is where the unstated facts are so widely known to the public from multiple sources that there is no reason to repeat them each time the topic arises, because the requisite symmetry of which Lord Justice Bowen spoke is again present. The bottom line is that it is the presence of asymmetrical information that controls the characterization of any given statement as one of fact or opinion.

This same limitation is carried over into securities law where again the question is whether a given statement escapes sanction because it counts as one of opinion, on the tests outlined above. This issue came to the fore in the recent Supreme Court decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*,[114] which is notable for how Justice Elena Kagan first relied on the Restatement (Second) of Torts § 539,[115] then on a brief excerpt from Bowen's opinion

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> which the unfavorable inference is based. When the facts are truthfully stated, comment thereon, if unjust, will fall harmless, for the former furnish a ready antidote for the latter. The reader is then in a position to judge whether the critic has not by his unfairness or prejudice libeled himself rather than the object of his animadversion. But if a bare statement is made in terms of a fact, or if facts and comment are so intermingled that it is not clear what purports to be inference and what is claimed to be fact, the reader will naturally assume that the injurious statements are based upon adequate grounds known to the writer. In one case, the insufficiency of the facts to support the inference will lead fair-minded men to reject it; in the other, there is little, if any, room for the supposition that the injurious statement is other than a direct change of the fact, based upon grounds known to the writer, although not disclosed by him.

114. Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 135 S. Ct. 1318 (2015).

115. RESTATEMENT (SECOND) OF TORTS § 539 (AM. LAW INST. 1977).

> (1) A statement of opinion as to facts not disclosed and not otherwise known to the recipient may, if it is reasonable to do so, be interpreted by him as an implied statement

in *Smith*, to the effect that when "the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best . . . impliedly states that [the speaker] knows facts which justify his opinion."[116]

Omnicare arose under Section 11 of the 1933 Securities Act, which, as mentioned previously, subjects the registration statement of an issuer to liability if that statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[117] In connection with a new public offering of common stock, Omnicare stated: "We believe our contract arrangements with other healthcare providers, our pharmaceutical suppliers and our pharmacy practices are in compliance with applicable federal and state laws."[118] It further averred: "We believe that our contracts with pharmaceutical manufacturers are legally and economically valid arrangements that bring value to the healthcare system and the patients that we serve."[119] Both statements were accompanied by caveats; Omnicare "mentioned several state-initiated 'enforcement actions against pharmaceutical manufacturers' for offering payments to pharmacies that dispensed their products."[120] It then cautioned that the laws relating to that practice might "be interpreted in the future in a manner inconsistent with our interpretation and application."[121]

The plaintiffs sued for violation of the strict-liability Section 11, claiming that defendant's representations were "materially false" because the federal government later investigated Omnicare for violation of its anti-kickback laws.[122] The pattern necessarily raises the much-mooted interconnection between statements of fact and opinion. Justice Kagan thought that the

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(a) that the facts known to the maker are not incompatible with his opinion; or

(b) that he knows facts sufficient to justify him in forming it.

(2) In determining whether a statement of opinion may reasonably be so interpreted, the recipient's belief as to whether the maker has an adverse interest is important.

116. *Omnicare,* 135 S. Ct. at 1330–31.

117. 15 U.S.C. § 77k(a) (1933).

118. *Omnicare,* 135 S. Ct. at 1323.

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.* at 1324.

last statement could be actionable given that it did not mention the possibility of the federal investigation, but only state-initiated actions. In my view, the gap between this statement and one treating Frederick Fleck as a desirable tenant when known to be in arrears on his rent and teetering on bankruptcy seems enormous because of the differences in the background knowledge of the two target audiences. The Omnicare investors, often represented by learned intermediaries, were not in the dark about the general structure of the securities laws and the extensive substantive overlap between state and federal laws regulating every aspect of the health care business. Nor did they lack the common knowledge that government investigations of billing standards and practices are a fixed and inescapable part of any ongoing health-care business. Therefore, it seems hard to believe that anyone who is apprised of the risk of investigation at the state level can somehow be blissfully ignorant of the parallel risk at the federal level, knowing that overlapping federal and state enforcement systems is the norm in virtually every regulatory area today.

It is possible to go further. Whenever a dispute arises about regulatory risk, the close case is one in which the prospectus says *nothing* about regulatory risk at any level. Even here, there is much to be said for the view that everyone knows that healthcare is a heavily regulated industry, so that the risk of an administrative investigation is too obvious to belabor. But even if, as seems the case, that somewhat jaded view is incorrect, the level of inference rightly expected from sophisticated buyers is so powerful that it becomes hard, even if this supposed omission is given weight, to credit the claim for its materiality in light of all the obvious inferences that can be drawn from the extensive set of stated and background information. And there is a heavy cost for flyspecking these registration statements, for the volume of offerings will diminish substantially if virtually every registration can be found with the benefit of hindsight to contain some material exaggeration or omission, under a strict liability regime no less. The oft-expressed fear of common-law judges was that expanding the class of false statements of fact could by degrees make every speaker a warrantor of the success of any deal that turns sour. Indeed, Justice Holmes said it well: "The rule of law [that "vague commendation" of wares is not actionable] is hardly to be regretted, when it is considered how easily and insensibly words of hope or expectation are converted by an interested memory into statements of quality and value, when the expectation has been disappointed."[123] In my view, a summary judgment for the defendant in *Omnicare* puts a clear limit on the scope of misrepresentations of fact that lines up well with the common-law theory that should animate this entire area.

4. *Predictions*

The same conceptual framework carries over to the line between statements of fact, which are actionable under the securities law, and "mere" predictions, which are not. Often the initial cut into the problem stems from the quotation from Learned Hand in *Vulcan* about the line between mere puff and an actionable misrepresentation.[124] The distinction resonates in this context, because predictions deal with the future, which is often highly uncertain, and not the past, whose events are fixed even if not always known with precision. In this context, it is well-nigh universally held that statements of "corporate optimism" of the sort which insist that sales are "going reasonably well," or that the company was "pursuing the right strategy," or that the firm will "start to grow revenue" in the second half of the year, are regarded as non-actionable puffery by modern judges,[125] and for the identical reason expressed by Lord Justice Bowen and Judge Hand:

> [N]ot every unfulfilled expression of corporate optimism, even if characterized as misstatement, can give rise to a genuine issue of materiality under the securities laws. . . . In particular, courts have demonstrated a willingness to find immaterial as a matter of law a certain kind of rosy affirmation commonly heard from corporate managers and numbingly familiar to the marketplace—loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no rea-

123. Deming v. Darling, 20 N.E. 107, 108–09 (N.Y. 1889).

124. *See* N.Y.C. ADMIN. CODE §§ 26-501 to 26-520, and *supra* text accompanying note 75.

125. Shaw v. Dig. Equip. Corp., 82 F.3d 1194, 1217–19 (1st Cir. 1996), *abrogated on other grounds by* 15 U.S.C. § 78u-4(b)(2) (1934).

sonable investor could find them important to the total mix of information available.[126]

Judicial pronouncements of this sort in the decided cases can be multiplied at will,[127] and the degree of unanimity of opinion over the question covers not only federal securities laws but also state securities laws.[128] The logic is again the same. It is not enough to look only at the statement as made; it is also necessary to take into account the general background knowledge of the audience, whose members are unlikely to be taken in by bland, commonplace predictions of future commercial success. All of these observations on facts, opinions, and predictions carry over to the Martin Act, where exactly the same dynamic takes place.

The moral is that on key points of doctrine, the differences between the common law, the federal law, and the Martin Act are overstated. It is easy to miss this point if one fails to appreciate that the common law is not just some arbitrary assemblage of rules but instead a coherent intellectual structure for which it is difficult (especially on short notice) to gin up a rival. Accordingly, the best cases from over a century ago survive undiminished today. Therefore, if it is impossible to enjoin these statements under the Martin Act, it would become indefensible to think that such statements should be the source of a damage suit, let alone a criminal prosecution. So much of the interpretation of the securities laws is sensible gloss that the lessons learned from common-law cases and federal securities laws should not be ignored in dealing with the Martin Act, and for the most part, judicial decisions respect the overlap in analysis on the points of commonality.

E. *Causation*

A good deal of attention must also be paid, moreover, to the *causal* issues implicit in any case of fraud, or even misrepresentation. As a matter of basic theory, causation is a key ele-

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126. *Id.* at 1217.

127. *See, e.g.*, Robert N. Kravitz, *Room for Optimism: The "Puffery" Defense under the Federal Securities Laws (Part 1 of 2)*, 19 A.B.A. SEC. LITIG. J., Winter 2009, at 23; Kravitz, *Room for Optimism: The "Puffery" Defense under the Federal Securities Laws (Part 2 of 2)*, 19 A.B.A. SEC. LITIG. J. Spring 2009, at 1. *See also* ECA v. J.P. Morgan Chase & Co., 553 F.3d 187 (2d Cir. 2009).

128. *See, e.g.*, Next Century Commc'ns Corp. v. Ellis, 318 F.3d 1023 (11th Cir. 2003) (applying Georgia law).

ment in all torts cases, whether for physical injury or financial losses, because it links up the act or omission of the defendant to the plight of the plaintiff. The simple assertion that the plaintiff has been hurt is consistent with the harm being self-inflicted, being the result of an act of God, or being inflicted by any third party unrelated to the defendant. To be sure, no-fault systems compensate injured persons regardless of the cause of injury. However, under that approach, the compensation always comes from a general fund raised by tax revenues or some insurance scheme like employer-based workers' compensation—not from a specific exaction collected from one isolated person among millions who is singled out for special treatment.

The same logic that applies to damages awards also applies to injunctive relief. Any particular person is entitled to an injunction only if she faces the prospect of some imminent harm, including the repetition of some past adverse event. But that injunction can only be directed to the person who caused the harm or created the risk. When these harms are global, either a class action or some direct government enforcement is appropriate, under the rules of public nuisance that have been well established for nearly 500 years.[129] The basic line is that special harms to a single person are remedied by a direct action, while those low-level harms that are broadly felt are remedied by an administrative action by some public body against the wrongdoer that could both fix the wrong and impose a fine for its occurrence. (In the latter case, the funds in question stay in the public treasury, typically to be spent on, say, the road or waterway that has been subject to damage.) The same general logic can apply to false public statements or omissions in which it is impossible to pinpoint the individuals who have suffered the damages. These basic rules apply to omissions as well as acts of commission, and the usual, and correct, approach is to first find some statutory or private law duty that requires some action, and then hold the failure to discharge that duty an actionable wrong. In some cases, these duties are strict, but in most they tend to require some level of care that can vary by circumstances. But causation remains an element in both kinds of cases.

129. Y.B. Mich. 27 Hen. 8, f. 27, pl. 10 (1536) (Eng.).

In dealing with physical harms, respecting the rules on remoteness of damage for both acts and omissions are essential to the overall integrity of the system. To be sure, the formal test of causation in the law of torts relies on an unhappy amalgam of "but for" causation, limited by some notion of proximate causation, based alternatively on foresight or directness.[130] But this two-part test makes matters more complicated than they really are, for in practice, most cases of causation work *backwards* from the injury to a particular defendant, and not forward from a distant act of some potential defendant to the injury of the plaintiff.[131] Thus, the paradigmatic case of causation is the direct application of force—hands, sticks, guns, and the like—covered by the common law rules of trespass. The complex variations on it are those cases of *indirect* harm where the defendant sets a dangerous condition that results in harm to the plaintiff by the application of some intermediate force.[132] In these situations, the damages are too remote for liability when the dangerous condition created by the defendant is corrected, as when a trap is filled before anyone can fall in it, or a bomb is defused before it explodes. If some other person resets the trap or rearms the bomb, responsibility for the harm should lie with the later actor. Only in very rare cases could one go back behind that action to the remote stranger on an expanded theory of causation.

A parallel form of analysis applies to the tort of misrepresentation at common law, and by extension to all actions that take place under the federal securities laws or the Martin Act and other blue-sky laws. In this context, the key element, as articulated in all the cases discussed above, is that of the plaintiff's *reliance* on the misstatement of the defendant. Omissions also are generally judged by a test that asks whether the provision of additional information would have altered the plaintiff's conduct in whole or in part in a way that would have re-

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130. *See* RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 26 (AM. LAW INST. 2010).

131. *See* Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973); RICHARD A. EPSTEIN & CATHERINE M. SHARKEY, CASES AND MATERIALS ON TORTS 341–43 (11th ed. 2016).

132. For the classic discussion, see Scott v. Shepherd (1773) 96 Eng. Rep. 525 (KB). In Roman law, the same distinction applies between killing (*occidere*) and furnishing a cause of death (*causam mortis praestare*). DIG. 9.2.7.1 (Ulpian, Ad Edictum 18); DIG. 9.2.51.pr.

duced or avoided the loss. There is no tighter test, and giving up on causation in omission cases is tantamount to a huge compromise of the entire system of public and private enforcement. Where that causal connection is established in particular cases, an award of damages is appropriate for harm suffered. Where it is threatened, or even imminent, in connection with speech directed to a specific person, private injunctions are not likely to play much of a role because any person who is smart enough to request a private injunction against being deceived or misled is smart enough not to need it. Armed with the truth, he should never be deceived by a falsehood. But public injunctions, such as those contemplated under both the federal securities laws and the Martin Act, remain fitting because it is perfectly appropriate to protect *unsuspecting* members of the public from systematic frauds which, if allowed to go forward, would result in substantial financial losses. Fraud on the public is thus an obvious analogue to the common-law public nuisance.

The role of reliance in these cases is made clear by this simple, but often overlooked, distinction. It is one thing to *lie to* another person, but it is quite another to *deceive* that person. In the former case, the target of the lie is not misled, or even if misled, did not take any steps that led to his own damage. The lie is an attempt at deceit, but, like the blow that does not land or the bomb that does not go off, it is not a completed tort. The point is evident from the grammar of both verbs. "I lied *to* you" is not an equivalent to "I deceived you." *Reliance* by the particular plaintiff on the false statement of the defendant is thus needed to complete the private wrong. As Judge Francis Buller said in the landmark 1789 case of *Pasley v. Freeman*,[133] "Fraud without damage, or damage without fraud, gives no cause of action; but where these two concur, an action lies."[134]

In *Pasley*, the defendant stated to the plaintiff that Falch was worthy of credit, but the defendant knew that he was in fact not creditworthy. The novel feature of the case was that the fraud in question appeared to be not for the plaintiff's direct benefit, so that one judge, Judge Grose, took the position that no liability should attach because there was no collusion

133. Pasley v. Freeman (1789) 100 Eng. Rep. 450 (KB). The decision to allow the action was 3 to 1.
134. *Id.* at 453.

between the defendant and Falch and there was no contractual privity between the plaintiff and the defendant, given that the loan was made to a third person.[135] But the three judges in the majority were not troubled by the want of a return benefit. Indeed, they regarded the defendant's action as being "more diabolical" because of the lack of an immediate self-interest.[136] But for present purposes, the key element is that the plaintiff relied explicitly and immediately on the defendant's statements about the creditworthiness of Falch. In causal terms, there was no possible intermediate action that could sever the connection in this discrete financial context. It was not as though the defendant had made this statement to some stranger who in turn had relayed the information to the plaintiff. That immediacy requirement is abundantly satisfied in cases like *Smith*, with the face-to-face interactions between buyer and seller.[137]

F. *Privity*

The discussion of causation in *Pasley* opens yet another complication in these situations, for the prospect of third-person interventions raises serious questions as to whether the defaults suffered should be attributable to the defendant. Indeed, the reference to privity obviously brings forward the early history of the actions for harms caused by defective products after they left the hands of the defendant and passed through intermediate hands. Thus, the early case of *Winterbottom v. Wright*[138] held that the driver of a defective coach could not recover from the defendant, who had supplied coaches to the Postmaster General, who in turned leased them to the plaintiff's employer, when the plaintiff was injured when the coach broke down because of a latent defect. The want of privity was held to defeat the action against the defendant who had supplied and maintained the coach, even though the plaintiff did not have an action against his employer unless he could prove, which seemed unlikely, the latter's improper maintenance or use of it.

135. *Id.* at 451–53.
136. *Id.* at 456.
137. *See supra* notes 109–112 and accompanying text.
138. Winterbottom v. Wright (1842) 152 Eng. Rep. 402.

This legal doctrine slowly reversed itself through case after case in which latent defects caused damage to innocent plaintiffs after going through the hands of one or more third parties, such as distributors or retailers.[139] The question was whether the use of that conduit, which severed privity of contract, also made any damage suffered by the plaintiff too remote. That rule applied to the full range of products, including the poison belladonna sold as a harmless dandelion extract in *Thomas v. Winchester*,[140] the broken wheel in *MacPherson v. Buick Motor Co.*,[141] or the alleged defective bottle of Coca-Cola in *Escola v. Coca-Cola Bottling Co.*[142] In each of these cases three conditions combined to limit liability. The defect in question was latent; it reached the plaintiff in its original condition; and the plaintiff made normal and proper use of the product.[143] The mischief of the privity requirement—its excessive restrictiveness—was well captured by Judge Cardozo when he said: "The dealer was indeed the one person of whom it might be said with some approach to certainty that by him the car would not be used. Yet the defendant would have us say that he was the one person whom it was under a legal duty to protect. The law does not lead us to so inconsequent a conclusion."[144]

Yet if the traditional privity rule was too restrictive, its abandonment opened the door too wide to liability, as all of the limitations initially built into the early formulations of product-liability law were consciously peeled away. Thus, under the new regime that began to emerge in the 1960s, upstream manufacturers were systematically held liable for losses from patent defects, downstream product modifications, or plain misuse, all of which are better controlled either by intermediate parties or by the plaintiff herself.[145] These shifts may

139. For my account of this early history, see RICHARD A. EPSTEIN, MODERN PRODUCTS LIABILITY LAW 9–24 (1980).

140. Thomas v. Winchester, 6 N.Y. 397 (1852).

141. MacPherson v. Buick Motor Co., 111 N.E. 1050 (N.Y. 1916).

142. Escola v. Coca-Cola Bottling Co., 150 P.2d 436, 468 (Cal. 1944) (Traynor, J., concurring) ("The manufacturer's liability should, of course, be defined in terms of the safety of the product in normal and proper use, and should not extend to injuries that cannot be traced to the product as it reached the market.").

143. EPSTEIN, *supra* note 139.

144. *MacPherson*, 111 N.E. at 1053, *quoted in Escola*, 150 P.2d at 465.

145. EPSTEIN, *supra* note 139, at 76–92.

seem small in the abstract, but they had huge practical consequences. The insurance needed to cover losses under the *Escola* strict-liability regime was a tiny fraction—less than one percent—of what the new regime demanded.[146]

Properly understood, the privity requirement served as a rough but clearly imperfect proxy for the causation requirement. But in dealing with *financial* losses in all sorts of contexts, the privity requirement retains a much more tenacious role. Information moves so quickly among persons that there remains to this day a genuine fear that liability can easily go too far. To put the point in its simplest form: no matter how many times a single product is transferred, it remains a single product—one drug tablet, one Coke bottle, one car. But every time information is transferred, there is a huge multiplicative effect. That information is retained by the original party and is now shared, time and time again, with a new round of individuals. In some of these iterations the information retains its original form, but in many it is mixed and combined with information from other sources, so that it is hard to know exactly how much of the original information remains.

These difficulties were apparent to Justice Cardozo in the most influential case dealing with financial losses, *Ultramares Corp. v. Touche*,[147] which he wrote fifteen years after his decision in *MacPherson* and which reveals a far different mindset toward the privity issue. The case involved the movement of information among three parties, in contrast to more public offerings or statements. The defendant accountant failed to detect the fraud of its client, Fred Stern & Co., which in turn was able to procure extensive loans, both secured and unsecured, from the plaintiffs. The complication arose because Stern subsequently went bankrupt. In a first-best world, the ac-

146. In August 1976, I was hired by the American Insurance Association (AIA), consisting of the major stock companies, to analyze the industry's large losses and premium hikes. At that time, the AIA had no systematic institutional understanding of the issue. Most people thought that the strict liability rule of the Restatement (Second) of Torts, Section 402A, was the major cause of the change, but that was in fact wrong. It was the three elements just mentioned—expanded definition of defect, no insulation from product modifications, and a broad foreseeable misuse standard—that drove the analysis. For my then-contemporary account of the problem, see Richard A. Epstein, *Products Liability: The Search for the Middle Ground*, 56 N.C. L. REV. 643 (1978), which summarized the results of my work for the AIA.

147. Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931).

countants would be out of the picture, as the plaintiff would have been able to recover with interest all the sums that it advanced to the bankrupt party. But the question of Touche's negligence liability arose precisely because Stern was insolvent, and thus the issue became whether the defendant accountant should be liable for its inability to detect a third-party fraud by exercising reasonable care in doing its audit. It was evident that the accountants and the plaintiffs were not in privity with each other, although it was perfectly evident that the audit statement was intended to be used, and would be used, to obtain loans from third parties like this plaintiff. Judge Cardozo nonetheless denied the action by drawing a distinction between fraud and negligence:

> To creditors and investors to whom the employer exhibited the certificate, the defendants owed a like duty to make it without fraud, since there was notice in the circumstances of its making that the employer did not intend to keep it to himself. A different question develops when we ask whether they owed a duty to these to make it without negligence. If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.[148]

This passage is notable for several key points. The first is that Cardozo thinks that the ambit for liability in fraud is always narrower than negligence. In both settings, he is prepared to go beyond the strict privity limitation found in *MacPherson*. He is willing to extend liability for fraud to those persons to whom the client exhibited the audit report, for it was well known that the document would be key in making a loan or a sale, and would typically be transmitted without alteration, although not necessarily without written or oral embellishment. The power of that privity limitation remains largely intact today, as efforts to expand the potential right of recovery to the public at large,[149] or even to those whom the defendant

148. *Id.* at 179 (citations omitted).

149. *See, e.g.*, White v. Guarente, 372 N.E.2d 315, 318 (N.Y. 1977) (confining liability to "a known group possessed of vested rights," and not "the extensive and indeterminable investing public-at-large").

might "reasonably foresee" might rely on the statement, have largely faltered, given that it would impose enormous liability upon parties, like accountants, who may receive but a modest financial reward for their services.[150]

The reason why courts are willing to go beyond privity in fraud cases is that the defendant has it wholly within its power to avoid making these wrongful statements. In cases like *Ultramares*, however, where only negligence is at issue, the potential liability could unintentionally ratchet up, rapidly extending far and wide. Cardozo himself was well aware of the difference. In *Ultramares*, citing *MacPherson*, he mused that

> [A] manufacturer who is negligent in the manufacture of a chattel in circumstances pointing to an unreasonable risk of serious bodily harm to those using it thereafter may be liable for negligence though privity is lacking between manufacturer and user. A force or instrument of harm having been launched with potentialities of danger manifest to the eye of prudence, the one who launches it is under a duty to keep it within bounds . . . . Even so, the question is still open whether the potentialities of danger that will charge with liability are confined to harm to the person, or include injury to property. . . . In either view, however, what is released or set in motion is a physical force. We are now asked to say that a like liability attaches to the circulation of a thought or a release of the explosive power resident in words.[151]

His answer to the question was no, and the explanation rests on the different characteristics of goods and information. As noted earlier, words can move with a rapidity that is not possible with respect to physical forces, which in most cases quickly come to rest. In ordinary physical-injury cases, the number of joint-causation situations tends to be very small, and so (for the most part) the extension of *MacPherson* from personal injuries to property damage seems relatively safe. Certainly, if the crash damaged the contents of the car, the

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150. For details of that view, see *Rosenblum v. Adler*, 461 A.2d 138, 147 (N.J. 1983), *superseded by statute*, N.J. STAT. ANN. § 2A:53A-25 (West 2017), which was in turn rejected in *Bily v. Arthur Young & Co.*, 834 P.2d 745, 767 (Cal. 1992).

151. *Ultramares*, 174 N.E. at 181 (citations omitted).

principle of liability would be about the same, and the extension to different types of personal property is little different from the extension of tort liability to multiple persons in the same car. It is also worth noting that, historically, *MacPherson*, like *Escola* afterwards, had *no* impact whatever on business activities given the remaining constraints on liability. It was only when tort law was applied to toxic releases that it encountered the hazards latent in seeking to impose damage remedies on countless individuals, each of whom has contributed at most a tiny fraction of loss to any one of countless other individuals.[152]

The flow of information, however, differs radically from the movement of goods, which helps explain the powerful economic rationale that lies behind the restrictive rules in *Ultramares*. In any face-to-face negotiations, the defendant must receive compensation sufficient to cover the risk of tort liability. Where negligence is the supposed norm, a principle like *res ipsa loquitur* could easily allow a jury to infer negligence from the fact of error, so that the system verges on strict liability,[153] which may be fine in cases involving physical injury to strangers, but is more dubious in medical malpractice cases, where the strict liability principle has long been regarded as too expansive for a sustainable market in medical or health-related services, given the inherent riskiness of medical procedures.[154] The market for medical services will shut down if the liability in question is disproportionate to the payment received to enter into the transaction in the first place, which is why Cardozo, for example, was acutely aware of the need to keep the total financial exposure proportionate to the consideration received for the services rendered.[155] As he observed, "A promisor will not be deemed to have had in mind the as-

152. *See* RESTATEMENT (THIRD) OF TORTS: APPORTIONMENT OF LIABILITY § 26 (AM. LAW INST. 2000); RESTATEMENT (SECOND) OF TORTS § 433A (AM. LAW INST. 1965) (dealing with the apportionment problem).

153. For its various formulations, see RESTATEMENT (SECOND) OF TORTS § 328D (AM. LAW INST. 1965); RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 17 (AM. LAW INST. 2010).

154. For an early statement of this rationale, see Clarence Morris, *Custom and Negligence*, 42 COLUM. L. REV. 1147, 1164–65 (1942).

155. *See* H.R. Moch Co. v. Rensselaer Water Co., 159 N.E. 896, 898–99 (N.Y. 1928) (dealing with the question of liability of a utility for the failure to supply water pressure), *cited in Ultramares*, 174 N.E. at 448.

sumption of a risk so overwhelming for any trivial reward."[156] Nor, it should be added, should the promisee labor under any such illusion that it can impose liability to remove or cushion its loss. The common thread that comes through all these cases is that a market system will break down if the liability imposed by courts for adverse events is disproportionate to any fee that the defendant had earned. So, the judgment in *Ultramares* (and similar cases) is best understood as insisting that the plaintiff could have hired its own auditor on terms that would have, for a healthy premium, allowed it to recover for any losses made on the advances, on whatever terms and conditions the two parties agree.[157] The principle of freedom of contract thus sneaks in through the back door to explain the use of the privity doctrine in these cases of financial loss.

The narrow approach to privity and remoteness of damage in *Ultramares* carried over to the instructive case of *Holmes v. Securities Investor Protection Corp.*,[158] which imposed a direct injury restriction for cases of financial loss, even when attributable to fraud. *Holmes* was a stock-manipulation case in which it was alleged that, between 1964 and 1981, the defendants made unduly optimistic statements about six companies in which they held stakes in order to drive their stock prices higher; they also engaged in a number of sham trades in order to make these shares appear more liquid than they were. On the strength of these activities, the broker-dealers purchased suffi-

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156. *Moch*, 159 N.E. at 898. For an endorsement of this view, see Charles O. Gregory, *Gratuitous Undertakings and the Duty of Care*, 1 DEPAUL L. REV. 30, 60 (1951) ("Cardozo thought the sum of $42.50 insufficient to warrant the conclusion that a negligent water company should be made to relieve a fire insurance company from bearing the ultimate risk of loss by fire . . . ."). The full explanation is a bit more complex, for it requires an explanation for why the first-party market works better. It does so because it is easier to tie coverage to the harm suffered by the plaintiff than it is to those harms brought about by a specific source, which may be difficult to identify in many cases. The contract law also provides greater flexibility on such key issues as deductibles and policy limits that cannot be introduced under a simple tort regime.

157. Victor P. Goldberg, *Accountable Accountants: Is Third-Party Liability Necessary?*, 17 J. LEGAL STUD. 295, 301 (1988) (urging that the best solution is for courts to "allow the parties to resolve the problem by contract."). The point has also been made in the early cases in this area. S*ee, e.g.*, Cabot v. Christie, 42 Vt. 121 (1869).

158. Holmes v. Sec. Inv'r Prot. Corp., 503 U.S. 258 (1992).

cient quantities of the shares to lead to their financial ruin.[159] The Securities Investor Protection Corporation (SIPC) was charged with protecting customers from financial loss when the broker-dealers who held their accounts went bankrupt. The SIPC made the appropriate payments to various customers, subrogated the customers' rights against the defendants, and then brought an action against Holmes and his co-conspirators. The SIPC alleged a pattern and practice of violations of the Securities Act, which gave rise to liability under the Racketeer Influenced and Corrupt Organizations Act (RICO)[160] for participation in a stock-manipulation scheme that was said to have "disabled" the broker-dealers from meeting their obligations to their customers.[161]

The basic substantive provision of RICO states:

> Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.[162]

In line with established case law, the Court held that "but for" causation (always a dubious account) was not sufficient, and that proximate cause had to be shown.[163] In this context, the reliance on that dual combination meant that the Court looked closely at the various decisions by other actors that intervened between what the defendant did and what losses were suffered by the broker-dealers, incorporating "common-law principles of proximate causation."[164] It then noted that even if subrogation was accepted, tort liability did not follow be-

159. *Id.* at 262–63.

160. 18 U.S.C.A. §§ 1962, 1961(1) & (5) (West 1988).

161. *Holmes*, 503 U.S. at 261.

162. 18 U.S.C.A. § 1964(c) (West 1995).

163. *Holmes*, 503 U.S. at 268.

164. *Id.*, with the Court's near-obligatory citation to W. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser and Keeton on Law of Torts § 41, at 264 (5th ed. 1984) ("Here we use 'proximate cause' to label generically the judicial tools used to limit a person's responsibility for the consequences of that person's own acts. At bottom, the notion of proximate cause reflects 'ideas of what justice demands, or of what is administratively possible and convenient.'"). In my view, the principles of proximate causation are a good deal more precise than this counsel of despair suggests. *See* Richard A. Epstein, Torts 258–73 (1999).

cause the many factors apart from trading in these shares could have led to the insolvency of the two broker-dealers. The Court stated:

> [T]he link is too remote between the stock manipulation alleged and the customers' harm, being purely contingent on the harm suffered by the broker-dealers. That is, the conspirators have allegedly injured these customers only insofar as the stock manipulation first injured the broker-dealers and left them without the wherewithal to pay customers' claims. Although the customers' claims are senior (in recourse to "customer property") to those of the broker-dealers' general creditors, the causes of their respective injuries are the same: The broker-dealers simply cannot pay their bills, and only that intervening insolvency connects the conspirators' acts to the losses suffered by the nonpurchasing customers and general creditors. As we said, however, in *Associated General Contractors* [*of California, Inc. v. Carpenters*],[165] quoting Justice Holmes, "The general tendency of the law, in regard to damages at least, is not to go beyond the first step."[166]

Justice Holmes's opinion just cited, in *Southern Pacific Co. v. Darnell-Taenzer Lumber Co.*,[167] only adds to the confusion. The difficulty is that Justice Holmes's proposition about ordinary tort law in physical injury cases was manifestly wrong. At the time he wrote it, there was still some support for the so-called "last wrongdoer" rule in physical injury cases,[168] but it had by and large given way to a rule that said that if the first defendant created a dangerous condition, which then resulted in harm because of the subsequent act of a second defendant, both could be held responsible for the harm, even if they had not coordinated the activities among them.[169] The number of

165. Associated Gen. Contractors of Cal., Inc. v. Carpenters, 459 U.S. 519, 534 (1983) (quoting S. Pac. Co. v. Darnell–Taenzer Lumber Co., 245 U.S. 531, 533 (1918)).

166. *Holmes*, 503 U.S. at 271 (1992).

167. S. Pac. Co. v. Darnell–Taenzer Lumber Co., 245 U.S. 531, 533 (1918).

168. For its leading defense, see THOMAS BEVEN, NEGLIGENCE IN LAW 45 (3d ed. 1908).

169. *See, e.g.*, Atherton v. Devine, 602 P.2d 634 (Okla. 1979). For the general statements about intervening acts, see RESTATEMENT (SECOND) OF TORTS

cases is small, and the dangerous condition in question—say an uncovered hole in the street—had to persist until the time of the injury. But *Darnell-Taenzer* was a rate-regulation case in which the plaintiff charged that he was hurt because he had to pay excessive amounts for a shipment, which in turn he could recover from his customers. Holmes thought that this question prompted the following answer:

> The answer is not difficult. The general tendency of the law, in regard to damages at least, is not to go beyond the first step. As it does not attribute remote consequences to a defendant so it holds him liable if proximately the plaintiff has suffered a loss. The plaintiffs suffered losses to the amount of the verdict when they paid. Their claim accrued at once in the theory of the law and it does not inquire into later events.[170]

The rule here is the soul of good sense, but only for administrative reasons that are orthogonal to the theory of proximate causation. The immediate plaintiff is in a good position to challenge the overpayment. But if there is a setoff for recovery that the ratepayer receives from other parties, then one of two things must happen. The first is that the next downstream party, and the one after that, each have determinate losses equal to a fraction of the overcharge. The second is that each party up and down the chain must have an action for its actual losses. In either case, the coordination problems among multiple claimants are acute; one way or the other, it becomes necessary to formulate estimates of the ultimate harm borne by each injured party, which would nearly always consume more resources, and involve more parties, than the whole case is worth. Channeling all the losses to the immediate purchaser eliminates these confusions while improving the incentives for the plaintiff to sue to recover the amount of the overcharge.[171] Historically, the rule announced is not limited only to rate

§§ 431, 448 & 449 (AM. LAW INST. 1965). The Third Restatement does not trouble itself with any of these refinements when it adopts broad tests in cases of intervening actions and supervening causes. RESTATEMENT (THIRD) OF TORTS § 34 (AM. LAW INST. 2013). For a comprehensive account, see EPSTEIN, *supra* note 164.

170. *Darnell-Taenzer*, 245 U.S. at 533–34.

171. On the importance of channeling, e.g., limiting the number of plaintiffs in torts cases, see William Bishop, *Economic Loss in Tort*, 2 OXFORD J.

cases. Indeed, it was explicitly carried over to treble-damage antitrust cases in *Illinois Brick Co. v. Illinois*, which treated *Darnell-Taenzer* as a "particularly apt precedent."[172] These administrative imperatives displace, rather than incorporate, a common-law proximate-cause analysis, although leading to a similar conclusion.

It is therefore easy to distinguish *Holmes* from its key precedent. Nonetheless, the decision makes perfectly good sense, because of the problem of deciding how the purchase of these inflated stocks mixed in with other management mistakes that the broker-dealers may well have made. The ultimate lesson thus remains the same. The complex patterns of interaction of various decisions made on information that comes from multiple sources tend to render the tort action difficult, but not impossible, to sustain. It is therefore an open question whether the action should apply if SIPC could prove that huge purchases made in explicit reliance on the fraud, with all other forms of mismanagement ruled out, caused the losses. But excluding other causes, which is a staple of *res ipsa loquitur* in physical injury cases, is much harder to accomplish as the class of potential causes rapidly increases.[173]

Holmes has therefore been followed repeatedly whenever it is hard to disentangle multiple influences on a given outcome. To give but one other RICO example from the Second Circuit, *Laborers Local 17 Health and Benefit Fund v. Philip Morris, Inc.* asked whether the plaintiff health and benefit fund could recover from Philip Morris for the additional costs that it had to bear in treating patients who had contracted additional illnesses from smoking.[174] Plaintiff alleged that Philip Morris engaged in fraudulent conduct that induced its union members to overconsume cigarettes. The RICO case followed closely on

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LEGAL STUD. 1 (1982); Mario J. Rizzo, *A Theory of Economic Loss in the Law of Torts*, 11 J. LEGAL STUD. 281, 305 (1982).

172. Ill. Brick Co. v. Illinois, 431 U.S. 720, 751 (1977).

173. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 328D (AM. LAW INST. 1965), which refers to "(b) other responsible causes, including the conduct of the plaintiff and third persons, are sufficiently eliminated by the evidence." The test in *Prosser & Keeton on Torts* requires that the accident "(2) must be caused by an agency or instrumentality within the exclusive control of the defendant." DOBBS, KEETON & OWEN, *supra* note 164, at 244.

174. Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc., 191 F.3d 229 (2d Cir. 1999).

the heels of *Holmes* and likewise foundered on the proximate-cause questions that made it impossible to disentangle various causes:

> [P]laintiffs' alleged damages might have derived from inefficiencies in the Funds' own management, as well as from non-smoking related health problems suffered by the smokers, and it would be the sheerest sort of speculation to determine how these damages might have been lessened had the Funds adopted the measures defendants allegedly induced them not to adopt. The complexity of these calculations makes the ultimate question of damages suffered by the Funds virtually impossible to determine.[175]

To this list can be added the question of how much each individual plaintiff knew about the risk at various times in his or her smoking career, and what other physical exposures could have contributed to their underlying condition. The causal chain is indeed filled with missing links, which explains why the relatively generous rules on causation followed in physical-injury cases are rejected in connection with financial losses. The analysis here is perfectly general and applies with equal force to common-law cases, securities-act cases, RICO cases, and, of course Martin Act cases. The same cautious attitude we saw in the privity context carries over to cases in which the fraud is made in connection with a public offering of securities, where the number of potential purchasers is far greater.

The logic of *Ultramares* proved highly influential in the important Supreme Court decision in *Blue Chip Stamps v. Manor Drug Stores.*[176] *Blue Chip* was not a common-law action, but relied instead on Section 10(b) of the Securities Act of 1934,[177] as interpreted under Rule 10b-5, first promulgated in 1948.[178]

175. *Id.* at 240.

176. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 747–48 (1975) (quoting *Ultramares*).

177. 15 U.S.C. § 78j(b) (2012).

178. 17 C.F.R. § 240.10b-5 (2017). The text of the regulation in full reads:

> § 240.10b-5 Employment of manipulative and deceptive devices.
>
> 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,

The case posed the simple question of whether a party who was neither a buyer nor seller of shares could maintain an action for damages by alleging that the defendant seller of the shares had "made the prospectus overly pessimistic in order to discourage respondent and other members of the allegedly large class whom it represents from accepting what was intended to be a bargain offer."[179] As a matter of basic incentives, the reliance associated with a decision not to purchase introduces the same distortion into the market as the converse situation in which an unwise purchase or sale is made on the strength of false statements. Therefore, if administrative concerns did not loom large in the overall equation, the rough economic equivalence between acting and not acting on either the buy or sell side should make both equally relevant.

There were, however, two instructive responses to this damage action, one statutory and the other administrative. First, liability for transactions that did not take place because of the defendant's misrepresentations is not covered by the key words in the federal statute, which limits coverage "in connection with the purchase or sale of any security."[180] As Justice Powell noted in his concurrence, the clause in question did *not* read "in connection with the purchase or sale of, or an offer to sell, any security."[181] That limitation is not relevant with respect to the Martin Act, which applies to these transactions "regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted."[182] As Justice Rehnquist's noted, twice before, in both 1957 and 1959, the SEC had requested that Congress amend Section 10(b) to read: "in connection with the purchase or sale of, *or any attempt to purchase or sell,* any security."[183]

(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.

179. *Blue Chip Stamps*, 421 U.S. at 726–27.

180. 15 U. S. C. § 78j(b) (2012). 17 C.F.R. § 240.10b-5 (2017).

181. *Blue Chip Stamps,* 421 U.S. at 756 (Powell, J., concurring).

182. N.Y. GEN. BUS. § 352-c(1)(c).

183. *Blue Chip Stamps,* 421 U.S. at 732.

Yet, when those words were put into the 1921 Martin Act, the sole remedy was injunctive relief, and it made perfect sense to allow the stoppage of these offerings before they could work harm on ordinary individuals if left uncorrected. Here, the governing principle in the fraud context is no different from that governing the various kinds of property damage attributable to common-law nuisances: It often makes sense to allow the state to enjoin a nuisance before it occurs, rather than to have to wait for the occurrence of the harm. But the same caveat applies in both cases as well. The definitions of fraud and nuisance should be appropriately cabined to ensure that prophylactic relief does not lead to some massive abuse that suppresses freedom of expression, in the one case, and freedom of action, including the use and development of real property, in the other.

Given these basic considerations, it should come as no surprise that the SEC also has statutory power to issue injunctive relief under Section 20(b) of the 1933 Securities Act for violations of Section 17(a)[184] of that same law, which applies only to sellers who engage in the use of fraud or other manipulative devices by sellers "in the offer or sale of any securities,"[185] authorizing both damages and injunctive relief.[186]

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184. Section 17(a) of the 1933 Act provides:

> It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Securities Act of 1933 § 17(a), 48 Stat. 84 (codified as amended at 15 U.S.C. § 77q(a) (2010)).

185. *Id.*

186. Section 20(b) of the 1933 Act provides:

> Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter [e. g., § 17 (a)], or of any rule or regulation prescribed under author-

Similarly, the SEC has the power under Section 21(d)[187] of the 1934 Act to seek injunctive relief against a person who is "engaged or is about to engage in acts or practices constituting a violation" of the Act, including Section 10(b),[188] and the regulations promulgated thereto under Rule 10b-5.[189] In dealing with this fourfold set of statutory provisions, Congress (at least as construed by the Supreme Court) divided the baby by finding that scienter was not required for violations of Section 17(a) of the 1933 Act, but was required for injunctive relief under Section 10(b) of the 1934 Act.[190] In *Aaron v. SEC*, the Supreme Court, relying largely on the legislative history, held that scienter was required for both injunctive relief and for damages under Section 10(b) and Rule 10b-5,[191] but it issued a divided verdict under Section 17(a) of the 1933 Act, finding that scienter was required in damage actions under Section 17(a)(1) but not under Section 17(a)(2).[192] The latter prohibits any person from obtaining money or property "by means of any untrue statement of a material fact or any omission to state a material fact"[193] and contains no scienter requirement at all. The Court also reached the same conclusion with respect to Section 17(a)(3),[194] which made it unlawful "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit,"[195] and was directed toward effects and not intentions. It seems quite clear that the differences between the Securities Acts and the Martin Act on injunctive relief are on the smaller side, especially since it is always easy to establish scienter for a defendant who continues

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> ity thereof, it may in its discretion, bring an action in any district court of the United States . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.

Securities Act of 1933 § 20(b), 48 Stat. 86 (codified as amended at 15 U.S.C. § 77t(b) (2010)).

187. Securities Exchange Act of 1934 § 21(d), 48 Stat. 900 (codified as amended at 15 U.S.C. § 78u(d) (2015)).

188. 15 U.S.C. § 78j(b).

189. 17 C.F.R. § 240.10b-5 (1975).

190. Aaron v. SEC, 446 U.S. 680 (1980).

191. *Id.* at 691.

192. *Id.* at 697.

193. *Id.* at 687.

194. *Id.* at 697.

195. *Id.* at 687.

to engage in certain practices after being warned of their illegality.

The central point of principle, however, is that it is generally unwise to authorize individual damage actions against potential buyers and sellers, which was the point raised in *Blue Chip*. On this point, the attitude taken in *Ultramares* invited the Court in *Blue Chip* to stress the key points of principled difference between the action given to defrauded buyers and sellers and that action which might be given to other persons who did not go forward with the purchase or sale. Of these differences, two are key. The first is the potential scope of the action. The requirement of an actual transaction limits the number of potential parties to the suit. An offering to the public that understates potential value could drive away countless numbers of individuals, when it is never clear whether they would have purchased or sold even if provided with full and adequate information. These potential plaintiffs have the benefit of hindsight so that the disappointed purchasers make their claims only for those stocks that have soared after the original offering. Otherwise, they remain silent. Second, the absence of a specific transaction and interaction makes it difficult to prove the fact of reliance, rendering it difficult to determine the applicable measure of damages.[196] Any current shareholder that neither buys nor sells is always a potential plaintiff once the class of putative plaintiffs is expanded to cover at least some parties who engage in no action.

It is therefore no wonder that the Supreme Court shrank from giving the normative theory of deceit full range in cases rich with institutional complications. In cases like these, it must be remembered that direct administrative oversight by the SEC can be imposed without the remedial complications involved in private rights of action, which makes it sensible to withhold private liability even when some form of government action is warranted. And what makes sense in connection with the common law and the federal securities law also makes sense in connection with the Martin Act. Indeed, the New York courts have worked an effective integration between regulatory relief and private rights of action. In *CPC International Inc. v. McKesson Corp.*, a divided New York Court of Appeals had held

196. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 735–39 (1975) (discussing these points).

that no private right of action could be implied under the Martin Act.[197] The result paralleled that under Section 17(a) of the Securities Act, which, the New York Court of Appeals again held, implied no private right of action.[198] Once again the parallels between the state and federal law are more significant than any differences on the same point. Yet by the same token, in *Assured Guaranty (UK) Ltd. v. J.P. Morgan Investment Management Inc.*, the New York Court of Appeals held that the Martin Act did not preempt private rights of action for breach of fiduciary duty and for gross negligence in the management of portfolio assets, both non-fraud claims, for which the plaintiff relied on a guarantee.[199] Again the result is exactly correct, because there is no reason why the regulatory oversight should block a garden-variety private action brought under a contract of guarantee.[200] Instructively, *Assured Guaranty* did not cite to *Ultramares*, because the case itself did not challenge any of the outer limits on common-law actions for fraud that were implicated in that case.

The same set of concerns about rapid information flow also appear in the law of insider trading when the information that comes from an unauthorized release by the insider travels through the hands of multiple parties and is combined with information that comes from other sources.[201] The point was of special urgency in the highly publicized decision in *United States v. Newman*,[202] where the alleged tippees were three or four steps removed from the insiders who first divulged the information. As that information passed through the hands of these intermediaries before being, at last, received by the defendants, it was combined with other information that made it

197. CPC Int'l Inc. v. McKesson Corp., 514 N.E.2d 116, 118 (N.Y. 1987).
198. *Id.* at 122.
199. Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc., 962 N.E.2d 765, 771 (2011).
200. *See id.* at 769 ("Here, the plain text of the Martin Act, while granting the Attorney General investigatory and enforcement powers and prescribing various penalties, does not expressly mention or otherwise contemplate the elimination of common-law claims . . . . Certainly the Martin Act, as it was originally conceived in 1921 with its limited [injunctive] relief, did not evince any intent to displace all common-law claims in the securities field.").
201. For my extensive treatment of these issues, see Epstein, *supra* note 87. Note that the use of the common-law reference point is as appropriate for insider trading cases as for misrepresentation cases. *Id.*
202. United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

unclear how much of the information came from improper inside sources and how much came from legitimate ones. In the absence of solid evidence on the flow of the information, the action foundered, as it should have. "[N]o rational jury would find that the tips were so overwhelmingly suspicious that Newman and Chiasson [a codefendant] either knew or consciously avoided knowing that the information came from corporate insiders or that those insiders received any personal benefit in exchange for the disclosure."[203]

Indeed, this issue is more complicated for another reason. The securities law is at its greatest strength when the parties who have given away or relied on information are acting in breach of a voluntarily assumed fiduciary duty. For instance, in *United States v. O'Hagan*,[204] a partner in a law firm used confidential information about their client's forthcoming tender offer to purchase stock and cash out when the offer became public, a clear breach of fiduciary duty to that client. But in the so called classical theory of insider trading endorsed in *O'Hagan*,[205] the basis of the duties that officers and directors owe to shareholders is much more obscure: the standard rests on positive law, not voluntary arrangement, and thus is far more likely to be inefficient relative to what private parties would desire in face-to-face negotiations. Indeed, one difficulty in the plaintiff's entire theory in *Newman* was that the insider information was released in gray-market transactions, where the managers of the firms wanted to get the information out quietly, even selectively, in order to stimulate interest in the stock. It was only the existence of a strong nondiscrimination rule imposed by the SEC in Fair Disclosure, Regulation FD[206] that made it possible to be completely above-board about those releases. But those cases stand in sharp contrast to

203. *Id.* at 455. Dirks v. SEC, 463 U.S. 646, 662 (1983) (The last clause refers to the misguided requirement that there be a return benefit to the tippee for the receipt of the information to count, I regard that so-called benefit requirement as wholly irrelevant). *See also* Epstein, *supra* note 87, at 1504–10 (the proper analogy is to the receipt of stolen goods, where the good-faith donee does not prevail over the true owner. It is as wrong to trade on donated information as purchased information).

204. U.S. v. O'Hagan, 521 U.S. 642 (1997).

205. *See id.* at 651–52.

206. Final Rule: Selective Disclosure and Insider Trading, SEC Release No. 33-7881, 17 C.F.R. §§ 240, 243, 249 (proposed Dec. 20, 1999), https://www.sec.gov/rules/final/33-7881.htm.

others in which the information that is passed on to third parties has been misappropriated from the company. In this last setting, the information should be treated as stolen property, which potentially makes everyone involved in the release, or in receipt of the information as a tippee, both civilly and criminally liable.[207]

As these materials show, the proper approach is sensitive to transaction-costs considerations. Thus when harms are widespread, enforcement of the basic rules is better left to direct government action than to individual suits. The key point, however, is that the shift from private to public enforcement should *only* be used to reduce the transaction cost of enforcement. It is not an open invitation for legislatures or courts to expand the definition of harm so as to create a decisive break between the public and private law, thereby generating the endless liability that Cardozo sought to avoid, especially in these financial negligence cases.[208] The sky is the limit on government action if administrative agencies can "redefine" property rights at will, without having to pay just compensation for the property interest taken. The constant cross-references between common-law rules, the federal securities acts, and the Martin Act rests on the simple fact that they all address the same fundamental problem of how best to deal with information breakdown. Therefore, to the extent the Martin Act eliminates the *scienter* problem, it contains the seeds of its own misapplication whenever, as is sometimes the case, it expands the potential scope of liability in ways that the traditional law of misrepresentation, including privity limitation, rightly rejects.

III.
THE MALLEABLE MARTIN ACT IN ACTION

The next task is to examine the notable cases that have been brought under the Martin Act. As the previous discussion indicates, this job cannot be undertaken in a vacuum, because

207. *See* Salman v. United States, 137 S. Ct. 420 (2016). For my commentary, see Richard A. Epstein, *Intellectual Myopia On Insider Trading*, HOOVER INST.: DEFINING IDEAS (Oct. 10, 2016), http://www.hoover.org/research/intellectual-myopia-insider-trading.

208. *See* Richard A. Epstein, *From Common Law to Environmental Protection: How the Modern Environmental Movement Has Lost Its Way*, 23 SUP. CT. ECON. REV. 141, 143 (2015).

it is critical to note the similarities and differences between Martin Act cases, on the one hand, and common-law actions for deceit and federal securities-fraud actions, on the other. I shall concentrate on three such situations here. The first is the original Martin Act prosecution of bogus financial schemes. The second is the Act's use in the more complicated financial transactions of AIG and its then-Chairman Maurice "Hank" Greenberg and then-CFO Howard Smith. The third involves the now fizzling campaign of former NYAG Schneiderman to use the Martin Act against ExxonMobil on charges of climate fraud. The overall verdict is that the early cases gave rise to little social concern, at least on the basic matters of liability. Indeed, the NYAG's case against Greenberg and Smith was sound, but only on the issue of liability, given their admissions of scienter. But—by the same token—the decision to force his resignation was on balance a classic example of government overreach, just as it would have been overreach under the federal securities law. At the same time, the ongoing case that Schneiderman brought against ExxonMobil for improper conduct was as unsound and ill-conceived under the Martin Act, both on questions of liability and damage, as it would have been under the federal securities law.

A. *Busting Bogus Financial Schemes.*

The initial use of the Martin Act was to attack routine fly-by-night schemes of financial fraud. Judges perceived the basic scope of the social problem, and in 1926 they consciously and unanimously opted for a broad reading of the statute in *New York v. Federated Radio Corp.*,[209] a case involving only injunctive relief. In opposing that decision, the defendants argued that a broad definition of fraud ran afoul of the Due Process Clause: "[The Martin Act] does not define the 'fraud' or the 'fraudulent practices' which it purports to restrain. No enlargement of the meaning of the act by implication being permissible, it must be held to be applicable only to cases involving so-called legal fraud according to the hitherto accepted definition."[210] There is, in fact, a long tradition arguing for the narrow construction of statutes passed in derogation of the common

209. People v. Federated Radio Corp., 244 N.Y. 33 (1926).
210. *Id.* at 33.

law.[211] Nonetheless, Judge Cuthbert Pound brushed this aside by reverting to the Supreme Court decision in *Hall v. Geiger-Jones Corp.*,[212] which espoused a far broader proposition:

> The purpose of the law is to prevent all kinds of fraud in connection with the sale of securities and commodities and to defeat all unsubstantial and visionary schemes in relation thereto whereby the public is fraudulently exploited. The words 'fraud' and 'fraudulent practice' in this connection should, therefore, be given a wide meaning so as to include all acts, although not originating in any actual evil design or contrivance to perpetrate fraud or injury upon others, which do by their tendency to deceive or mislead the purchasing public come within the purpose of the law.[213]

From our evaluative perspective, the key question is whether this broader definition creates risks that should have been guarded against in the context of this case. The answer is no. The object of the litigation in *Federated* was that "the advertising matter of the defendants, contained in a promoters' prospectus, unduly inflates the value of the stock and conceals certain facts in regard to such values which should in good faith be revealed."[214] Given the private preparation of these selling materials, it is highly doubtful that any one of the abundant misstatements of fact contained therein were not deliberately incorporated by the defendants as part of their sham selling scheme. It is also highly doubtful that they could have credibly contested their unique knowledge of the details of the venture when they had sole control over the preparation of the sales spiels from start to finish.

Moreover, the decision in *Federated Radio Corp.* puts no pressure on the distinction between matters of fact and matters of opinion. The willingness to hold defendants responsible for culpable omissions is also consistent with basic tort the-

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211. *See, e.g.*, Roscoe Pound, *The Common Law and Legislation,* 21 HARV. L. REV. 383, 386 (1908) ("We are told commonly that three classes of statutes are to be construed strictly: penal statutes; statutes in derogation of common right; and statutes in derogation of the common law.").

212. Hall v. Geiger-Jones Co., 242 U.S. 539 (1917).

213. *Federated Radio Corp.*, 244 N.Y. at 38–39.

214. *Id.* at 40 (internal citations omitted).

ory. Finally, the likelihood that some targets would rely on the prospectus, if circulated, should be taken as a given, as potential purchasers were the prospectus's sole intended audience. Aiming for an injunction prior to purchase prevents the need to sort out thorny questions of causation once the false information is unleashed to the defendant's target audience. The statement of Judge Pound also contains the words "in connection with the sale of securities"[215] and thus by implication expresses the need to limit the potential ambit of the case, even if under the Martin Act the context behind injunctive relief is arguably broader than it was construed in some part of *Blue Chip Stamps*.[216] Since the injunction prevents the sale, it removes the need to think about the refund, the purchase price or the loss of reliance damages when the deal goes south. Nor did the broad reading of the statute invite systematic abuse in enforcement, as long as it is confined to enjoining the phony stock schemes to which it was originally applied. The broad statute works well in this context, even if, as will become evident, it does not work equally well in all others. The same kind of analysis applies with equal force to most of the condominium conversion cases noted above.[217]

B. *The AIG–Greenberg Litigation*

As noted earlier in Section II.A,[218] there is nothing in the text of the Martin Act that limits its application to the blue-sky fraudulent offerings cases that spurred its adoption. Prior to Eric Schneiderman, the most aggressive use of the Martin Act was by then-NYAG Elliot Spitzer, who, it was said at the time, rejected the "unspoken gentleman's agreement" that exempted "the big boys" from the Martin Act, by limiting "acceptable targets" to the likes of "shady pharmacists, Ponzi schemes, and peddlers of fraudulent Salvador Dali lithographs."[219] Among the biggest targets that Spitzer attacked were AIG, its former CEO Maurice "Hank" Greenberg, and Howard Smith, its CFO during the critical years between 2001

215. *Id.* at 38.
216. *See* discussions *supra* Sections II.D.4, II.E.
217. *See supra* notes 73–77 and accompanying text.
218. *See supra* notes 53–54 and accompanying text.
219. Nicholas Thompson, *The Sword of Spitzer*, LEGAL AFF. (May–June 2004), https://www.legalaffairs.org/issues/May-June-2004/feature_thompson_mayjun04.msp.

and 2004. Thus, the original litigation covered a multitude of transactions, prosecuted under both common-law rules of deceit and the Martin Act.

Two transactions were key. The first of these, which took place between 2000 and 2004, was between AIG and General Re, a reinsurance carrier, while AIG was under the control of Greenberg and his codefendant, Smith.[220] The gist of New York's claim was that the transaction in question was a sham because it did not transfer any real risk to General Re, but was designed solely to improve AIG's balance sheet in ways that allowed it to increase the stated reserves on its financial statements.[221] That change was in turn alleged to have allowed AIG to present a stronger position to public markets and thus enter into more financial transactions.[222] The second of the disputed transactions was with CAPCO, a company financed by AIG, in which AIG is alleged to have used CAPCO to convert underwriting losses into investment losses and thus present a rosier financial picture to analysts. In the opening act of this drama, Spitzer had forced out Greenberg as Chairman and CEO of AIG and Smith as its CFO in 2005, about three years before the company experienced serious financial losses in the meltdown of 2008 under new financial management. Much of the litigation brought against Greenberg and Smith disappeared in the years after that initial encounter.[223] By 2006, with Greenberg and Smith out, new management quickly settled those claims for $1.6 billion. One can criticize the size of the settlement, but there is no dispute that AIG was, under standard principles of vicarious liability, responsible for the actions of its two top officials.

The litigation against Greenberg and Smith went on for another dozen years, as the defendants sought to derail the prosecution. During the litigation, the NYAG dismissed all common law fraud charges and dropped from his Martin Act account all the transactions except for two that will be described shortly. In *People v. Greenberg*,[224] Greenberg and Smith

220. *See* People v. Greenberg, 994 N.E.2d 838 (N.Y. 2013).
221. *See id.* at 840.
222. *See id.*
223. *See* Bethany McLean, *Hank Greenberg's Other AIG Trial: A Fight That Just Won't End*, FORTUNE (Aug. 27, 2015), http://fortune.com/2015/08/27/hank-greenbergs-other-aig-trial-a-fight-that-just-wont-end/.
224. People v. Greenberg, 946 N.Y.S.2d 1 (App. Div. 2012).

first sought to dismiss the charges on preemption grounds, invoking Title I of the Securities Litigation Uniform Standards Act of 1998 (SLUSA),[225] the Private Securities Litigation Reform Act of 1995,[226] and the National Securities Markets Improvement Act of 1996.[227] But whether the matter turned on express or implied preemption, there was no evidence whatsoever that these statutes, designed to recalibrate the operation of the federal securities laws, had an unspoken collateral intention to upend the long-established system of dual enforcement that had been in place from the initial adoption of state blue-sky laws, which predated the federal securities laws by fifteen years.[228] The court rebuffed Greenberg and Smith's summary judgment request on the underlying claim. In so doing, it did not rely on any of the strict liability strands of the Martin Act, but instead invoked the standard rule under which "officers and directors are liable for a corporation's fraud where they either personally participate in the fraud or have actual notice of its existence."[229] As Greenberg and Smith had jointly conducted both sets of negotiations, this participation standard was easily met.

The litigation continued for a further five years, but on February 10, 2017, the case finally settled short of trial in part due to the intercession of well-known mediator Kenneth Feinberg.[230] At the time of the settlement, Schneiderman issued a public statement announcing, "Greenberg and Smith agree to

225. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, § 101, 112 Stat. 3230 (codified as amended in scattered sections of 15 U.S.C. (2006)).

226. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C. (2006)).

227. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C. (2006)).

228. People v. Greenberg, 994 N.E.2d 838, 840 (N.Y. 2013). Greenberg and Smith sought certiorari in the preemption issue in *Greenberg v. New York*, No. 16-294, filed August 30, 2016. It was denied on December 12, 2016. People v. Greenberg, 54 N.E.3d 74 (N.Y. 2016), *cert. denied sub nom.* Greenberg v. New York, 137 S. Ct. 591 (2016). For relevant documents, see SCOTUSBLOG, http://www.scotusblog.com/case-files/cases/greenberg-v-new-york/ (last visited Aug. 16, 2018).

229. *Greenberg*, 946 N.Y.S.2d at 9.

230. Randall Smith, *Former A.I.G. Executives Reach Settlement in Accounting Fraud Case*, N.Y. TIMES, (Feb. 10, 2017), http://www.nytimes.com/2017/02/

return multi-million dollar bonuses they received while the frauds were on AIG's books."[231] The statement also noted that this settlement followed on the heels of an earlier settlement that Greenberg and Smith had made with the SEC resulting in the disgorgement of virtually all the payments made during the 2001 to 2004 period when the transactions remained on the books uncorrected. The wording of Schneiderman's announcement tip-toed around the question of whether Greenberg and Smith had personally committed fraud, even though they had orchestrated the challenged transactions. The following passage sums up the state of play:

> If, as the parties presently concede, there was no risk of loss in the [General Re] transaction, it should have been recorded on AIG's financials as a deposit. Instead, AIG recorded $250 million in loss reserves for the fourth quarter of 2000 based upon the [General Re] transaction and an additional $250 million in loss reserves for the first quarter of 2001, consistent with Greenberg's intent when he reached out to Ferguson, to shore up the reserves. Had these amounts not been credited in this manner, AIG would have had a $187 million decline in its loss reserves by the first-quarter of 2001.[232]

The history of the CAPCO transaction was similarly suspect: "After Greenberg and Smith left the company in 2005, AIG announced that CAPCO involved an improper accounting structure created to characterize underwriting losses relating to the auto warranty business as capital losses."[233] The terms of the settlement called for Greenberg to pay $9 million plus interest and for Smith to pay $900,000 with interest—part of the money that the two men had received as performance bonuses for the years between 2001 and 2004, when the alleged frauds had taken place. This settlement accompanied Greenberg and Smith's deals with the SEC, with the combined

10/business/dealbook/former-aig-executives-reach-settlement-in-account ing-fraud-case.html?mcubz=0.

231. Press Release, N.Y. St. Att'y Gen., A.G. Schneiderman Announces Settlement of Martin Act Case Against Former AIG CEO Maurice R. Greenberg and Former AIG CFO Howard I. Smith (Feb. 10, 2017).

232. *Greenberg*, 946 N.Y.S.2d at 3–4.

233. *Id.* at 5.

disgorgement equaling the bonuses the defendants collected during the 2001–2004 period. Schneiderman then proclaimed:

> Today's agreement settles the indisputable fact that Mr. Greenberg has denied for twelve years: that Mr. Greenberg orchestrated two transactions that fundamentally misrepresented AIG's finances. After over a decade of delays, deflections, and denials by Mr. Greenberg, we are pleased that Mr. Greenberg has finally admitted to his role in these fraudulent transactions and will personally pay $9 million to the State of New York.[234]

The simultaneous statement by Greenberg did not contain the word "fraud" but did contain the following statements:

> The General Re transaction was done for the purpose of increasing AIG's loss reserves, and the Capco transaction was done for the purpose of converting underwriting losses into investment losses. I knew these facts at the time that I initiated, participated in and approved these two transactions.
>
> For the years 2000 through 2002 (in the case of the Capco transaction) and 2000 through 2003 (in the case of the [General Re] transaction), I certified AIG's publicly-filed annual consolidated financial statements aware that the financial effects of these transactions were and continued to be reflected in those statements.
>
> As a result of these transactions, AIG's publicly-filed consolidated financial statements inaccurately portrayed the accounting, and thus the financial condition and performance for AIG's loss reserves and underwriting income. The accounting for the [General Re] transaction was correctly restated by AIG in AIG's 2005 Restatement of the Company's financial results for the years 2000 through 2003 and the first three quarters of 2004. The accounting for the Capco transaction was also restated by AIG in AIG's 2005 Restatement of the Company's financial results.[235]

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234. *See* Press Release, N.Y. St. Att'y Gen., *supra* note 231.

235. Statement, Maurice R. Greenberg (Feb. 10, 2017), https://ag.ny.gov/sites/default/files/2017_02_10_greenberg_statement_final_2.pdf. *See also*

The SEC and Martin Act suits against Greenberg and Smith were not the only lawsuits that arose out of these transactions. In addition, the SEC ran its own investigation of the transaction that yielded positive results: "In June 2005, two [General Re] executives pleaded guilty to participating in a conspiracy to commit securities fraud for their role in the [General Re] transaction. In February 2008, four other [General Re] executives were convicted on federal criminal charges with respect to the [General Re] transaction."[236] The latter convictions were reversed for a new trial on evidentiary grounds, as one of the key witnesses, Richard Napier, a senior General Re executive, "may well have testified falsely" on major issues in the earlier federal case,[237] which effectively sidelined him from any role in the prosecution under the Martin Act. The *Wall Street Journal* made much of the inconsistencies in his testimony, reflecting poorly on the NYAG.[238] But the point is a sideshow. One can look into the disputed transaction's structure on its face by assessing whether AIG transferred sufficient risk to turn it into a legal transaction. Given the admissions from Greenberg and Smith, it is apparent that no risk was transferred. They rightly entered into the settlement, in which they admitted scienter, because they knew that the case against them was strong regardless of the disputed and inconsistent Napier testimony.

On this score, it is worth noting that the original complaint by Spitzer included other counts, both at common law

Statement, Howard I. Smith (Feb.10, 2017), https://ag.ny.gov/sites/default/files/2017_02_10_smith_statement_final.pdf.

236. *Greenberg*, 946 N.Y.S.2d at 4.

237. United States v. Ferguson, 676 F.3d 260, 281 (2d Cir. 2011) (dealing with key questions of who attended what meetings that were thus critical to the question of conspiracy). On remand, the defendants entered into deferred-prosecution agreements in which they acknowledged that "aspects of the [General Re] transaction were fraudulent" and that they should have "attempted to stop [the transaction] from going forward, but instead continued to participate in it." Consent Motion for Deferred Prosecution Continuance, United States v. Ferguson, No. 06-cr-137 (D. Conn. June 22, 2012); Deferred Prosecution Order, United States v. Ferguson, No. 06-cr-137 (D. Conn. June 25, 2012).

238. For the *Wall Street Journal*'s continued attack against New York's case, see, for example, *The 'Risk-Free' Hank Greenberg Case*, WALL ST. J. (Feb. 19, 2015), http://www.wsj.com/articles/the-risk-free-hank-greenberg-case-1424390839.

and under the Martin Act. The pressure to remove Greenberg and Smith was undoubtedly heightened by the full array of charges, many of which were subsequently withdrawn. One possible interpretation of this maneuver is that the government dropped all of its common-law counts because it did not think that it could meet their distinctive scienter barrier. But that explanation does not cover the decision to drop *both* common law and all but two Martin Act counts. Nor is it consistent with the public admission of scienter in the two claims that Greenberg and Smith settled. It seems likely that these other claims were dropped for reasons that likewise apply to common-law and Martin Act claims, implicating the need to prove false and material statements of fact. Otherwise, the prosecution would have no reason not to keep all of the Martin Act counts.

The next point of interest is the resultant punishment, and its integration with the earlier decision. Prior to settlement, the question of remedy required special attention. Since the litigation arose only after the General Re and CAPCO transactions had been reversed, there was no need for an injunction once Greenberg and Smith were out of AIG. Similarly, it would have been difficult for any private investors to prove that they had lost money because they traded in reliance on the false information allegedly generated by these transactions, whose effect on the net earnings of AIG was uncertain. To avoid both of these traps, the prosecution requested, as authorized under the Martin Act amendments, equitable relief, more specifically, "including but not limited to a ban on [Greenberg's and Smith's] participation in the securities industry and a ban on serving as an officer or director of a public company."[239] The NYAG also sought disgorgement of cash bonuses the defendants had received from AIG. In its second decision on the case, the New York Court of Appeals held that the award of disgorgement from Greenberg and Smith did not depend on a showing of irreparable harm, but, after trial, could be tailored to the overall facts and circumstances of the case.[240] There is nothing exceptional about this approach: restitution for illicit gains is a long-established remedy the origins

239. *See* People v. Greenberg, 994 N.E.2d 838 (N.Y. 2013).
240. *See* People v. Greenberg, 54 N.E.3d 74 (N.Y. 2016).

of which lie at common law and not in modern courts of equity.[241]

The harder question is whether the appropriate remedy, if push had come to shove, would allow the NYAG to remove Greenberg and Smith from their positions at AIG. The NYAG has broad remedial discretion, but removal would be virtually impossible to justify if Greenberg and Smith's scienter were not established. No strict-liability offense could justify such draconian public intervention. Thus, once again, the issue of scienter—although formally irrelevant under the Martin Act—plays a role in the case. On this score, the initial question is whether the removal of a person from private (that is, non-governmental) office should be subject to a public official's oversight or reserved in the first instance to the discretion of the organization's governing body. There is of course no debate that, to the extent that a particular statute requires that an officer or director be barred from participation in the securities industry, the decision is neither that of the public enforcer nor that of the board of directors. The matter has been taken out of their hand by a clear statutory directive. Yet the situation is quite different in connection with civil actions where the finding of scienter still leaves open the choice of remedy, which depends on a variety of factors dealing with frequency, severity, and self-aggrandizement in the particular case.

The governmental imposition of restitution, or even fines, on individual defendants is perfectly appropriate to maintain deterrence against particular actions. The great advantage of using some combination of these two remedies is that they only impose a cash transfer penalty on the defendants, without imposing losses on innocent shareholders who played no part in the decision. In addition, these targeted measures do not distort the incentives or operation of the firm of which the defendants had long been an integral part. But banning defendants from work in a firm or an industry is necessarily far more intrusive on firm activities, because CEOs and CFOs are not fungible. Executive searches are so arduous and time-consuming precisely because the difference between the first- and

241. *See* Sinclair v. Brougham [1914] AC 398 (HL) 431 ("The case of a chattel is easy: A shopkeeper delivers an article at the house of B in mistake for the house of A. An action would lie against B for restitution.").

second-best candidate could be the difference between success and failure. Thus one key, if not the key, decision of any board is the selection of its CEO, just as the key decisions of that CEO involve the appointment of her chief subordinates.

In light of the critical relationship between executive selection and firm success, the first-line decision on these matters to rest with the Board itself, which can of course take into account the outcome of the civil prosecution under the Martin Act and its proof of scienter. Clearly, care must be taken to avoid conflicts of interest so that in this instance, neither Greenberg nor Smith should participate in any of the deliberations or vote on the outcome. If the Board, properly constituted, thinks, on the basis of its own internal deliberations, that it should replace the defendants, that should be the end of the matter, so long—and this is a critical qualification—as its action was *not* taken under an explicit or implicit threat of further investigations or litigation by any regulatory body, be it the NYAG or the SEC. It is impossible for an outsider to project how a board's deliberations whether to fire an executive in light of possible criminal sanctions will or should come out in any particular case; in a sense, that is precisely the point. The Board has better incentives than any insiders on the Board to make the correct trade-offs. It will, of necessity, have more complete knowledge of the circumstances surrounding the particular sanctions, and it will be able to place any one decision in the larger context of the overall performance of the corporate officers, like Greenberg and Smith, have provided to the corporation through their entire tenure.

On this score, it surely should matter to the Board that the historical success of the firm since Greenberg took over had been legendary. The Board is likely also to find it in Greenberg's and Smith's favor that they did not seek personal enrichment, and neither of their actions had any direct effect on the AIG's bottom line in either the short or long run. Their actions were undertaken to bolster the position of AIG in financial markets, for it was undisputed that Greenberg and Smith were deeply concerned about the underwriting profits that they considered to be a bellwether test of the firm's success and failure. Accordingly, the transaction was intended to change public perceptions of the firm's position in the marketplace, and to increase, at least in the short run, the ability of

AIG to expand its business. A mistake in judgment, but one subject to rectification.

In light of this record, if the Board, armed with full knowledge, favors retention, it is difficult to come up with any strong public-policy rationale for permitting the NYAG or the SEC to overrule that decision. This intervention would impose upon the firm the arduous duty to find a new management team that would be responsible for overall firm direction. In retrospect, the decision to remove Greenberg and Smith may have proved very costly because of the huge financial losses that were incurred in the financial meltdown of 2008. To be sure, it is always difficult to guess whether whether any CEO or CFO, old or new, could have unwound AIG's complex positions in time to fix the problem. But the ousted pair's large experience in handling complex transactions might have led them to reduce AIG's reliance on complex swaps, which put the firm at risk during the crisis of 2008.

Rather than resorting to the ultimate remedy of dismissal, a responsible board could have dealt with the matter by imposing lesser sanctions: internal fines, additional oversight, preclearance, and reporting requirements inside the firm; a redefinition of responsibilities; a change in contracting practices; and a strong warning of what would happen if the error were repeated, without forcing a precipitous change in top management. If the entire system does not meet with public approval, a decline in share value could offer a quick gauge of public response to the initiative that could easily lead to a change of firm direction. Indeed, in those cases where the Board does not sufficiently respond to egregious CEO and CFO behavior, shareholders have available private derivative suits against the Board of Directors for breach of its duties of care and loyalty. It is precisely because shareholders are *not* likely to want to bring those disruptive actions that the entire process of corporate governance should *not* be short-circuited by officious, unilateral threats by regulatory authorities. Spitzer's serious lapse in judgment imposed threats against the AIG board, which essentially forced their hand on a matter that was better left to their judgment.

Once scienter is introduced into the case, it is of course possible to pursue punitive action in these removal cases, but no more so under the Martin Act than under the federal securities laws, both of which go beyond the conventional common-law tort action's limit to compensation for discrete past harms. At this point, the strong equitable remedy of removal from office would be questionable if it rested solely on bad transaction outcomes without any proof of scienter, given the huge sanctions requested and the inevitability of some transactional failures under the best of circumstances. In complex transactional cases, moreover, it should be clear that some scienter requirement *has* to be read into the law, notwithstanding the Martin Act's apparent indifference to that element, because adopting some version of the business judgment rule is the only way to cabin both civil and criminal liability within reasonable bounds.

By way of background, publicly and privately traded companies book all sorts of transactions in ways in which the accounting methods do not perfectly track the underlying economics of the situation. In some cases, the rules they follow are dictated by either tax or securities authorities. In other cases, they are the result of business judgments by the firm on how best to account for certain complex transactions, given issues such as the timing of income or deductions, or the allocation of income or loss among various parties to myriad transactions. It would impose an impossible regulatory burden on all firms if any false public impression created by the choice of an accounting method could expose a company to potential civil or criminal liability without scienter.

The rule in practice, therefore, for both the federal securities acts and the Martin Act, has been that sanctions are imposed only where there is a known and deliberate flouting of standard accounting rules of the sort found in the AIG case.[242] As to the other difficult transactions, the usual rule requires firms to add notes to their financial statements to clarify certain balance sheet entries. Once that is done, the entire matter is left to potential purchasers of these securities to ferret out an accurate picture of the institutions' financial health for themselves. Ultimately, the question is who bears the risk of inaccurate information. The accommodation under both the securities acts and the Martin Act charges firms and their senior officers with responsibility for sham or bad-faith transactions, and nothing more. The rest of the risk rightly falls on individual investors. The admissions of both Greenberg and

242. *See supra* notes 233–235 and accompanying text.

Smith, like that of BMS, fall into the first class and thus break no new ground.

It is also worth noting that the NYAG did not seek to impose a deferred-prosecution agreement (DPA) on Greenberg, Smith, or AIG. DPAs are commonly imposed under the federal securities law, as illustrated in the federal prosecution in *Ferguson*.[243] The use of DPAs, however, has rightly given rise to serious condemnation because the warped prosecutorial incentives they create can lead to systematic abuse.[244] Bringing a lawsuit triggers huge collateral consequences in the form of lost licenses to do business, which can be far more serious than the penalties imposed upon conviction for the stated offense. Conviction requires proof beyond a reasonable doubt in a criminal case, yet the barriers to starting an investigation are almost nil. Deciding to investigate a case requires no proof at all, nor does a decision to file criminal charges. There is, accordingly, less protection against this serious charging practice than there is against conviction, and this structural defect allows prosecutors to push to get extensive settlements. Just this dynamic happened under the federal securities laws when J.P. Morgan Chase was bludgeoned into a $1.7 billion fine for its supposed role in not detecting the Bernard Madoff scandal, even though J.P. Morgan was not mentioned even once in the SEC's own exhaustive report on how the scandal had gone undetected for so long. That report first noticed that the SEC had all sorts of "red flags" in dealing with Madoff, but nonetheless managed to exonerate all SEC employees of "any financial or other inappropriate connection with Bernard Madoff or the Madoff family that influenced the conduct of their examination or investigatory work."[245] Nonetheless, the SEC

243. *See* Copland & Mangual, *supra* note 34.

244. *See, e.g.*, James Copland & Isaac Gorodetski, *The Shadow Lengthens: The Continuing Threat of Regulation by Prosecution*, MANHATTAN INST. (Feb. 25, 2015), https://www.manhattan-institute.org/html/shadow-lengthens-continuing-threat-regulation-prosecution-5898.html; Epstein, *The Dangerous Incentive Structures*, *supra* note 34; Epstein, *Deferred Prosecution Agreements on Trial*, *supra* note 30.

245. U.S. SEC. & EXCH. COMM'N, OFF. OF INVESTIGATIONS, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME—PUBLIC VERSION (2009), http://www.sec.gov/news/studies/2009/oig-509.pdf. For my critique, see Richard A. Epstein, *In Defense of JP Morgan*, HOOVER INST.: DEFINING IDEAS (Oct. 29, 2013), http://www.hoover.org/research/defense-jp-morgan. For the evolution of the case, see Christian Dem, *JPMorgan*

used its prosecutorial power against J.P. Morgan, whose sole responsibility was to make routine disbursements to Madoff's clients, from which it did not and could not infer any illegality.

Notably, those heavy-handed tactics were not employed against Greenberg or Smith. On the financial side, the only remedy was disgorgement of bonuses received during the 2001–2004 period when these transactions were still on the books. This was accompanied by an allowance for the disgorgement previously made to the federal government for the case brought and settled under the federal securities laws. This complementarity shows that the common elements between the two statutes were greater than any differences. There is little reason to think that the major dispute over the AIG transactions will result in unanimous agreement. But for these purposes at least, the potential dangers that are found under the Martin Act are also present under the federal securities laws, which give rise to dangers of dual enforcement and an abuse of the investigative process. But in this case at least, the admission on scienter dampens the charges with respect to liability, and the admitted liability therefore leaves us uncertain as to whether a court would have removed Greenberg and Smith had they not resigned under pressure.

C. *Global Warming: Fraud and Free Speech*

1. *The Litigation*

a. ExxonMobil

The most recent Martin Act situation involves the campaign started by NYAG Schneiderman to invoke the Martin Act to attack ExxonMobil for allegedly creating a false climate of public opinion that would allow the company to artificially raise the price of its stock. The supposed technique consisted of a decades-long effort by ExxonMobil to poo-poo the science on global warming, in order to dampen the incredible legal and social pressure to curtail or eliminate the use of fossil fuels that lie at the heart of its business. The simple argument put

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Chase Could Face Penalties Related to Madoff Scandal, DAILY KOS (Oct. 24, 2013), http://www.dailykos.com/story/2013/10/24/1250190/-JPMorgan-Chase-could-face-penalties-related-to-Madoff-scandal#; *see also* Jessica Silver-Greenberg & Ben Protess, *JPMorgan Chase Nears a $2 Billion Deal in a Case Tied to Madoff*, N.Y. TIMES (Jan. 5, 2014, 10:00 PM), https://dealbook.nytimes.com/2014/01/05/jpmorgan-chase-nears-a-2-billion-deal-in-a-case-tiedo-madoff/.

forward by Schneiderman was that the First Amendment does not protect against fraud, and a pervasive industry fraud is what ExxonMobil perpetuated. The baldness of his claim was made clear in his March 29, 2016 press conference that announced the legal assault, brought in part under the Martin Act[246]:

> [W]e are here for a very simple reason. We have heard the scientists. We know what's happening to the planet. There is no dispute but there is confusion, and confusion sowed by those with an interest in profiting from the confusion and creating misperceptions in the eyes of the American public that really need to be cleared up. The U.S. Defense Department, no radical agency, recently called climate change an urgent and growing threat to our national security. We know that last month, February, was the furthest above normal for any month in history since 1880 when they started keeping meteorological records. The facts are evident. This is not a problem ten years or twenty years in the future. . . .
>
> [ExxonMobil is] using the best climate models so that when they spend shareholder dollars to raise their oilrigs, which they are doing, they know how fast the sea level is rising. Then they are drilling in places in the Arctic where they couldn't drill 20 years ago because of the ice sheets. They know how fast the ice sheets are receding. And yet they have told the public for years that there were no "competent models," was the specific term used by an Exxon executive not so long ago, no competent models to project climate patterns, including those in the Arctic. And we know that they paid millions of dollars to support organizations that put out propaganda denying that we can predict or measure the effects of fossil fuel on

246. For this transcript, see Appendix in Support of Petition and Emergency Motion of Exxon Mobil Co. to Set Aside or Modify the Civil Investigative Demand or Issue a Protective Order at App. 002–021, *In re* Civil Investigative Demand No. 2016-EPD-36 (Mass. Sup. Ct. June 10, 2016) (No. 16-1888F) [hereinafter Massachusetts Superior Court Appendix], http://www.mass.gov/ago/docs/energy-utilities/exxon/appendix-in-support-of-petition-and-emergency-motion.pdf.

> our climate, or even denying that climate change was happening.
>
> There have been those who have raised the question: aren't you interfering with people's First Amendment rights? The First Amendment, ladies and gentlemen, does not give you the right to commit fraud. And we are law enforcement officers, all of us do work, every attorney general does work on fraud cases. And we are pursuing this as we would any other fraud matter. You have to tell the truth. You can't make misrepresentations of the kinds we've seen here.[247]

These statements are not unique to Schneiderman, for similar findings were part of a proposed California statute, the Climate Science Truth and Accountability Act of 2016, which would have allowed similar climate-related fraud prosecutions under the California unfair competition and consumer protection laws[248]:

> Sec. 2. (a) The legislature finds and declares all of the following:
>
> There is broad scientific consensus that anthropogenic global warming is occurring and changing the world's climate patterns, and that the primary cause is emission of greenhouse gases from the production and combustion of fossil fuels, such as coal, oil and natural gas.[249]

Outside the Martin Act, it is possible to find literally hundreds of statements that make the same proposition: the science on global warming is clear, and it is settled, so it is only the obstructionists and the deniers who block the path to social redemption. Thus, a group of prominent scientists have written: "Human-caused climate change is not a belief, a hoax, or a conspiracy. It is a physical reality. Fossil fuels powered the Industrial Revolution. But the burning of oil, coal, and gas also caused most of the historical increase in atmospheric levels of heat-trapping greenhouse gases. This increase in greenhouse

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247. *Id.* at App. 003–005.

248. S.B. 1161, 2015–2016 Reg. Sess. (Cal. 2016), https://leginfo.legislature.ca.gov/faces/billCompareClient.xhtml?bill_id=201520160SB1161.

249. *Id.*

gases is changing Earth's climate."[250] Note that this letter contains no specifics, but does assert that climate change is responsible for "sea level rise, altered rainfall patterns, retreat of Arctic sea ice, ocean acidification, and many other aspects of the climate system."[251]

More specifically, global warming has been advanced to explain the recent break off of a huge, trillion metric ton iceberg from the Larsen C ice shelf in Antarctica. According to David Remnick of the *New Yorker*, "[s]uch events now seem almost ordinary—and harbingers of far worse."[252] It is quite possible that, "should the much larger West Antarctic Ice Sheet thaw and slip into the ocean, sea levels across the globe could rise as much as seventeen feet."[253] In other writings, sober-minded writers working through the Climate Leadership Council,[254] including George Shultz, Jim Baker, and Martin Feldstein, have taken the position that "[m]ounting evidence of climate change is growing too strong to ignore. While the extent to which climate change is due to man-made causes can be questioned, the risks associated with future warming are too big and should be hedged. At least we need an insurance policy."[255]

Their recommendation was that the United States impose a $40 per ton tax on carbon dioxide (CO_2) emissions, subject to gradual increase, which will be then returned to the public in the form of a carbon dividend that they hope will exceed any additional energy costs that most Americans would have to bear. The tax will be protected against international arbitrage—i.e., selling goods made outside the US by companies

250. *An Open Letter Regarding Climate Change From Concerned Members of the U.S. National Academy of Sciences*, RESPONSIBLE SCIENTISTS (Sept. 20, 2016), http://www.responsiblescientists.org.

251. *Id.*

252. David Remnick, *Trump Family Values,* NEW YORKER (July 24, 2017), http://www.newyorker.com/magazine/2017/07/24/trump-family-values.

253. *Id.*

254. For a description of the organization, see *Founding Statement*, CLIMATE LEADERSHIP COUNCIL (June 20, 2017), https://www.clcouncil.org/founding-statement/.

255. JAMES A. BAKER, III, MARTIN FELDSTEIN, TED HALSTEAD, N. GREGORY MANKIW, HENRY M. PAULSON, JR. GEORGE P. SHULTZ, THOMAS STEPHENSON & ROB WALTON, CLIMATE LEADERSHIP COUNCIL, THE CONSERVATIVE CASE FOR CARBON DIVIDENDS 1 (2017), https://www.clcouncil.org/media/TheConservativeCaseforCarbonDividends.pdf.

that do not have to pay local carbon taxes—by imposing border carbon adjustments. These three elements in turn will allow for the removal or rollback of direct forms of regulation, including the Obama Clean Power Plan, and would also blunt any effort to use the tort system to impose liability on separate companies—which has long been regarded as a most unrealistic proposal given the impossible logistics of litigation.[256] Still other writers, most notably David Wallace-Wells, predict more dire consequences: an "Uninhabitable Earth," from which we can expect "[f]amine, economic collapse, [and] a sun that cooks us."[257]

There is little doubt that these are dire statements. But wholly apart from the question of their accuracy, there is the difficult question about the connection to the Martin Act itself. The first point to note is that the definition of fraud used by Schneiderman in his press conference is one of hardcore legal fraud, which posits that ExxonMobil knew all the relevant environmental impact information that is taken, without demonstration, as though it were a key fact. If his account were correct, he would have no need to rely on the expanded definition of fraud that dispenses with scienter, which in this context does raise serious First Amendment issues, given the suppression of debate that could follow if all statements of opinion that proved false were actionable. Indeed, an SEC composed of five Schneidermans could bring exactly the same case under the federal securities laws, using the same narrow definition of scienter. In both cases, any claim that ExxonMobil should be subject to sanction even if it were simply unaware of the truth when it issued its reports and made its statements would be dead-on-arrival as an approach to stimulate public outrage against the company. If Exxon is the only firm that did serious climate research, it would be ironic that it

256. For a rejection of this theory, at least for federal courts, see Am. Elec. Power Co. v. Connecticut, 564 U.S. 410 (2011). The proposal has been supported by Benjamin Ewing & Douglas A. Kysar, *Prods and Pleas: Limited Government in an Era of Unlimited Harm*, 121 YALE L.J. 350 (2011). For my response, see Richard A. Epstein, *Beware of Prods and Pleas: A Defense of the Conventional Views on Tort and Administrative Law in the Context of Global Warming*, 121 YALE L.J. ONLINE 317 (2011).

257. David Wallace-Wells, *The Uninhabitable Earth*, N.Y. MAG. (July 9, 2017), http://nymag.com/daily/intelligencer/2017/07/climate-change-earth-too-hot-for-humans.html.

alone should be held responsible for its foresight. But if other oil companies did the same, why exempt them from liability given that they could also be subject to suit under the current scienter theory?

The popular campaigns against ExxonMobil take the same form. None of these efforts rely on anything that remotely resembles a strict-liability theory under which proof of the defendant's negligence or intention to harm is irrelevant. Schneiderman was well aware that this theory could not support any kind of financial remedy or injunctive relief against ExxonMobil, without imposing potential liability on virtually everyone else who had made some erroneous climate forecast. The most that could be sought would be some requirement, similar to that imposed on AIG, for misstating reserves or other metrics used in the oil and gas business. Far from appealing to strict liability, the hashtag used by opponents of Exxon was, and remains, #ExxonKnew.[258] These opponents do not rely on the niceties of the Martin Act when they proclaim: "Exxon knew about climate change half a century ago" and "[t]hey deceived the public, misled their shareholders, and robbed humanity of a generation's worth of time to reverse climate change."[259] Each of these references speaks in terms of deception, duplicity, and worse.

One notable exposé in the *Los Angeles Times*, "What Exxon Knew About the Earth's Melting Arctic,"[260] claims Exxon downplayed the risks of global warming externally as its own scientists were "closely studying the impact of climate change on the company's operations."[261] The article noted that the change in Arctic conditions was both good and bad news for the company. On the one hand, it reduced the cost of exploration in the oil-rich Arctic; on the other hand, climate change

258. *See* #EXXONKNEW, http://exxonknew.org/ (last visited Nov. 19, 2017).

259. *Id. See also* Neela Banerjee et al., *CO_2's Role in Global Warming Has Been on the Oil Industry's Radar Since the 1960s*, INSIDE CLIMATE NEWS (Apr. 13, 2016), https://insideclimatenews.org/news/13042016/climate-change-global-warming-oil-industry-radar-1960s-exxon-api-co2-fossil-fuels; NAOMI ORESKES & ERIK CONWAY, MERCHANTS OF DOUBT: HOW A HANDFUL OF SCIENTIST OBSCURED THE TRUTH OF ISSUES FROM TOBACCO SMOKE TO GLOBAL WARMING (2010).

260. Sara Jerving et al., *What Exxon Knew About the Earth's Melting Arctic*, L.A. TIMES (Oct. 9, 2015), http://graphics.latimes.com/exxon-arctic/.

261. *Id.*

could create "higher sea levels and bigger waves," and potentially impede drilling operations. The claim was that Exxon wanted to tamp down claims of global warming to reduce pressure to keep fossil fuels in the ground. But at no point does the article explain in what way Exxon had or relied on any private information of value when the standard temperature measures were at all times in the public domain. Nor did it bother to mention that, at the time the *Los Angeles Times* wrote its article, the level of sea ice in the Arctic was in the process of recovery from its 2012 low, which was inconsistent with their doomsday view of the underlying science.[262]

The denunciations, moreover, quickly reached a fever pitch. One representative of this style of argumentation is a report entitled "The Climate Deception Dossiers: Internal Fossil Fuel Industry Memos Reveal Decades of Corporate Disinformation."[263] The exposé starts with the observation that half of all carbon emissions have taken place since 1988[264]—without noting the weak correlation between those higher emissions and the steady global temperatures over the same period.[265] It also claims that "[g]lobal warming is accelerating the rate of sea level rise and dramatically increasing flooding risks,"[266] without addressing any of the abundant evidence to the contrary. The study notes that some of these companies "continue to support groups that spread misinformation designed to deceive the public about climate science and climate policy,"[267] again without explaining why the work of such groups as the CO_2 Coalition is flawed, resting as it does on its interpretation of independently generated and publicly available data. Indeed, this critique does not systematically engage the views of any scientists on the other side of the debate, let alone address any of the particular points raised above. Instead, the constant trope is that the "deniers," a clear allusion

262. *Id.*
263. *See* KATHY MULVEY & SETH SHULMAN, UNION OF CONCERNED SCIENTISTS, THE CLIMATE DECEPTION DOSSIERS: INTERNAL FOSSIL FUEL INDUSTRY MEMOS REVEAL DECADES OF CORPORATE DISINFORMATION (2015), http://www.ucsusa.org/sites/default/files/attach/2015/07/The-Climate-Deception-Dossiers.pdf.
264. *Id.* at 3.
265. *See infra* text accompanying notes 320–322.
266. MULVEY & SHULMAN, *supra* note 263, at 2.
267. *Id.*

to Holocaust deniers, practice nonstop deceit in the effort to preserve their business.

Here is one final example. Inside Climate News published a series of exposés on the subject in the last half of 2015, which allowed no room for doubt. Some of the tenor comes through in the headlines of the separate studies: "Exxon's Own Research Confirmed Fossil Fuels' Role in Global Warming Decades Ago: Top executives were warned of possible catastrophe from greenhouse effect, then led efforts to block solutions."[268]

To give some sense as to the overstatement in these studies, it is useful to look at just one of the documents that Inside Climate News treats as a smoking gun. That document was a June 6, 1978 presentation by J.F. Black, a scientific advisor at Exxon, to high-ranking Exxon executives.[269] That presentation refers to an earlier oral presentation, the graphs from which are included at the end of the report, that he had made to the Exxon Corporate Management Committee the previous July. It is exceedingly difficult to distill the ultimate message from that report, given its constant diffidence on the soundness of the underlying theory or the available data. Thus it notes "[t]he CO_2 increase measured to date is not capable of producing an effect large enough to be distinguished from normal climate variations."[270] Shortly thereafter his report states: "There is considerable uncertainty regarding what controls the exchange of atmosphere CO_2 with the ocean and with carbonaceous materials on the continents," and, "[m]odels which predict the climatic effects of a CO_2 increase are in a primitive stage of development."[271] Black's report is replete with further references to the uncertainties in question. In one telling section, Black discusses the effect of the "doubling of carbon dioxide concentrations in the atmosphere," and con-

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268. Neela Banerjee, Lisa Song & David Hasemyer, *Exxon's Own Research Confirmed Fossil Fuels' Role in Global Warming Decades Ago*, INSIDE CLIMATE NEWS (Sept. 16, 2015), http://insideclimatenews.org/news/15092015/Exxons-own-research-confirmed-fossil-fuels-role-in-global-warming.

269. J.F. Black, Sci. Advisor, Exxon Res. & Eng'g Co. Prods. Res. Div., The Greenhouse Effect: Transcript of a Talk Delivered Before the PERCC Meeting (May 18, 1978), http://insideclimatenews.org/sites/default/files/documents/James%20Black%201977%20Presentation.pdf.

270. *Id.* at 1.

271. *Id.* at 2.

cludes "this will have a negligible effect on sea levels" and "probably no effect on the polar ice sheets."[272] At another place, his report says:

> A study of past climates suggests that if the earth does become warmer more rainfall should result. But an increase as large as 2°C would probably also affect the distribution of the rainfall. A possible result might be a shift of both the desert and the fertile areas of the globe toward higher latitudes. Some countries would benefit but others could have their agricultural output reduced or destroyed. The picture is too unclear to predict which countries might be affected favorably or unfavorably.[273]

The Inside Climate News report quotes only one sentence from this passage: "Some countries would benefit but others could have their agricultural output reduced or destroyed."[274] The lead-in to this quotation reads: "He warned Exxon scientists and managers that independent researchers estimated a doubling of the carbon dioxide (CO_2) concentration in the atmosphere would increase average global temperatures by 2 to 3 degrees Celsius (4 to 5 degrees Fahrenheit), and as much as 10 degrees Celsius (18 degrees Fahrenheit) at the poles."[275] Black's letter does not use the word "warning," and it also contains this sentence: "More research is needed, however, to establish the validity and significance of predictions with respect to the Greenhouse effect."[276]

This passage was presented in the final "Summary" of the report, but it offers no evidence for its most striking proposition—that any increase in the earth's temperature will generate a three-fold increase at the poles. The basic theory at most explains why some greater polar increase should occur, but gives no clue for what that number or effect would be. In addition, previous temperature changes, either up or down, did not show such an extreme reaction at the poles. Black's letter does not give any indication whether other scientists inside the company accepted his presentation. Indeed, the last sentence,

272. *Id.* at 7.
273. *Id.* at 1.
274. *Id.*
275. Banerjee, Song & Hasemyer, *supra* note 268.
276. Black, *supra* note 269, at 10.

which was an obvious call for further research, is inconsistent with the tenor of the rest of the report. And no one has offered any reason to think that there was a groundswell of professional opinion, inside or outside Exxon, agreeing with this prediction, which was after all, based largely on publicly available information.

It should go without saying that virtually all of the Exxon documents now available for public viewing are fair game for investigative journalists determined to cherry pick data in order to make a point. Yet ironically, the moderate level of the observed changes in global temperatures are perfectly consistent with the subsequent uncertainty expressed by Exxon on the impact of global warming. This insistent pillorying of ExxonMobil does not make sense if the critics themselves have, as seems to be the case, overstated their position on the impact of global warming. Yet Inside Climate News never noted that Black's dire prediction of 10°C changes in polar temperature had proved resoundingly false, given that the amount of Arctic sea ice had already rebounded from its 2012 low when its story came out in 2015. Indeed, the entire condemnation rests on the unexamined assumption that the harmful effects of global warming have been conclusively established. Such is the incomplete and inaccurate state of the evidence on which Schneiderman relied.

It is, of course, possible to amass evidence that undermines any skeptical account of global warming. But for the purposes of the Martin Act, the ultimate truth on the scientific question is not what matters. For these purposes, the key issue is whether the categorical statements made about the definitive science on global warming are defensible when made by the NYAG, without bothering to look at any of the theoretical and empirical evidence lined up on the other side of the debate. For the purposes of the Martin Act, it does not matter that lots of people, including many reputable scientists, agree with Schneiderman. What matters is whether any supposed consensus view on a matter of scientific concern should be allowed to shut down scientific debate. I have gone through a fraction of the evidence with some care in order to make clear that the proper object of public condemnation is less the Martin Act than the dogmatic insistence by Schneiderman and others that these tough issues of climatology are so cut-and-dried that only one view of them is acceptable in public discourse, and ultimately definitive of the boundaries of legal fraud.

In response to the pointed criticism, ExxonMobil has taken two lines of defense. The first is to announce, along with many other oil companies, its support of the carbon tax proposal advanced by Baker and Shultz.[277] Their support has been mocked as skin deep by environmental groups such as 350.org (which claims that any level of CO_2 that exceeds 350 number of parts per million is dangerous, including the current levels that are now over 400 ppm).[278] And it is always difficult to figure out dual-motive cases when it is clear that ExxonMobil fought back with uncommon vigor against the requests of Schneiderman to continue its investigation into its accounting practices. At this point in time, the entire unfortunate matter is bogged down in the details of pre-trial motions. ExxonMobil pleaded in vain with New York federal district judge Valerie E. Caproni, to take depositions of Schneiderman and Massachusetts Attorney General Maura Healey in an effort to establish their abuse of power.[279] At the same time, in New York State Court, ExxonMobil attacked Schneiderman's "frivolous" claims, which it insists are filled "with inflammatory, reckless and false allegations of an 'ongoing fraudulent scheme' and 'sham' business practices."[280] They added, "No further evidence is required to establish the political motivation of the attorney general's fruitless year-and-a-half long investigation pursuing his ever-shifting and unraveling investigative theories."[281] The first of these theories relates to the knowledge

277. John Schwartz, *Exxon Mobil Lends Its Support to a Carbon Tax Proposal*, N.Y. TIMES (June 20, 2017), http://www.nytimes.com/2017/06/20/science/exxon-carbon-tax.html.

278. *Id.*

279. David Hasemyer & Nicholas Kusnetz, *Exxon's Opposition to Climate Fraud Probes Gets Less Sympathy from NY Judge*, INSIDE CLIMATE NEWS (Apr. 21, 2017), https://insideclimatenews.org/news/21042017/exxon-mobil-climate-change-scandal-fraud-investigations-new-york-schneiderman.

280. Erik Larson, *Exxon Says N.Y. Attorney General Distorted Company's Climate Data,* BLOOMBERG (June 9, 2017, 4:12 PM), https://www.bloomberg.com/news/articles/2017-06-09/exxon-says-n-y-attorney-general-distorts-company-s-climate-data.

281. John Siciliano, *Exxon Mobil Blasts New York AG's 'Sham' Climate Investigation*, WASH. EXAM'R (June 9, 2017), http://www.washingtonexaminer.com/exxon-mobil-blasts-new-york-ags-sham-climate-investigation/article/2625545.

that Exxon (before it was ExxonMobil) had forty years ago. The second is a claim that ExxonMobil today has manipulated the evidence on the costs of regulatory compliance that should be expected in the light of anticipated climate control regulations.

The record on the historical claims is far more favorable to Exxon than Schneiderman's allegations suggested. Anyone who cares to look at the reams of information already in the public sphere would see that much of the research undertaken by ExxonMobil on the subject largely consisted of its own interpretation of publicly available studies. The Martin Act case against Exxon bore absolutely no relationship to the flagrantly false statements of private information contained in a business prospectus, targeted to a particular vulnerable population, which provoked the strong endorsement of the Martin Act back in 1926 in *Federated Radio Corp.*

Note the differences in the two scenarios. With global warming, it is impossible to link the research to any effort to influence the buying or selling of shares at all. The statements were made at odd times, and were never associated with the purchase or sale of any security or with any effort to buy or sell any securities, both of which are explicit limitations on the NYAG's authority under the Martin Act. In addition, given the wealth of information that forms the backdrop of all of Exxon's work, it seems clear that none of the asserted falsehoods would count as a false statement of fact, to which the Martin Act is restricted. These clearly would fall under the class of predictions, as to the future course of world climate change, or opinions about the same course of action. No person could possibly or properly rely on this information to make a decision to purchase shares, which means that, given the context, anyone would be hard pressed to say that the information produced by Exxon was material in the sense that this term is used in the securities law (as Columbia Law Professor Merritt Fox has noted in a public panel on the topic[282]). As discussed earlier, there is a proper distribution of responsibility for error in cases of this sort. The defendant companies are only held re-

282. *See* Chris White, *Law Expert Blasts NY Attorney General for Investigations Against Exxon*, DAILY CALLER (June 7, 2016, 4:22 PM), http://dailycaller.com/2016/06/07/law-expert-blasts-ny-attorney-general-for-investigations-against-exxon/.

sponsible for what are known to be sham transactions. For the rest, it is the duty of all investors to seek out information on their own to determine the extent, sources and effect of global warming on the use of fossil fuels. They are free to think that the prospects are dire, or that the entire matter may blow over.

The legal implications seem clear. No decided case of the Martin Act has ever applied the term "fraud" to transactions that are wholly unrelated to the buying and selling or the potential buying and selling of stock. Whether one accepts the narrower definition of "in connection with" that was used in *Blue Chip Stamps* to exclude statements which were not followed by a purchase or sale, or the broader views under the Martin Act, which allow for the injunctions of potential sales, the answer is the same. These statements have so many purposes that they could not fall into any class of false statement of facts. There are, of course, First Amendment issues in these cases, and that body of law does not offer any protection for false statements of facts made in pursuit of a sale. But it offers extensive protection for statements of opinion based on matters of public interest and concern, in which discourse regarding the future outcome of scientific events would surely fall.[283] Ultimately, Schneiderman was right that the First Amendment does not protect against fraud. But he is wrong to think that this case comes close to that general prescription. None of the proponents of serious global warming has a monopoly on the truth. As Oliver Wendell Holmes said a long time ago in *Abrams v. United States,* "the best test of truth is the power of the thought to get itself accepted in the competition of the market,"[284] which means that no one gets a pass against criticism.

The second Schneiderman charge switched from historical knowledge to the claim that ExxonMobil used different numbers for internal and external consumption in seeking to measure the costs, if any, of potential direct government taxes or regulation on CO_2 emissions. This claim has a more contemporary focus, but it is subject to the same general objec-

283. *See* Gertz v. Robert Welch, Inc., 418 U.S. 323 (1974) (strengthening First Amendment protection for speech dealing with a matter of public concern); Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc., 472 U.S. 749 (1985) (refusing to extend like protection to statements that do not have public interest and concern).

284. Abrams v. United States, 250 U.S. 616, 630 (1919).

tions. It is, of course, common to use different numbers for different purposes and in any event, even under the Martin Act, the proof of materiality would require some judgment that ordinary investors would be influenced by this one fact, among many, in their decision to buy stock.

Inquiries of this sort are unlikely to bear fruit for two reasons. First, there are many forms of public information available regarding the prospect of government regulation or taxation—investors could look to independent sources to make their own judgment as to the probability and severity of anticipated government regulation in the United States or elsewhere. They need not rely on information provided by ExxonMobil. As Professor Fox put the point in 2016: "the market was well supplied with information about climate change."[285] It also matters that the impact of any such regulation lies far into the future, and thus must be discounted down to present value to calculate its impact, if any, on share prices. As such, the business judgments of ExxonMobil bear no resemblance to the discrete sham transactions with immediate financial impact that led to the favorable Martin Act settlements against AIG, Greenberg, and Smith.

Second, a great number of issues influence movements in stock price for large publicly traded companies, so it is highly unlikely that projections about the cost of regulations that may be forthcoming ten or twenty years into the future would be accorded much weight by investors who know how rapidly the political landscape can move. The election of Donald Trump as president, the appointment of Scott Pruitt as head of the Environmental Protection Agency, and the decision to withdraw from the Paris Accords show just how quickly events can overtake predictions. In addition, the overall success of American firms in reducing their CO_2 footprint without further regulation cuts in the same direction. Any substantial reduction in CO_2 emissions largely depends on what China and India do in the next decade, again, independent variables for individuals to weigh on their own. It is hard to point to any uniquely private information that ExxonMobil had that could influence share prices. Schneiderman's campaign has all the looks of a vendetta.

285. White, *supra* note 282.

This analysis has been borne out by subsequent events. In February 2017, ExxonMobil's annual 10-K filing announced that the company had cut its estimate of recoverable reserves by about 3.3 billion barrels, out of a total of just more than 23 billion barrels.[286] The amount of barrels cut was not chosen at random, but represented the oil found in the costly to extract Canadian oil sands. The driver was not the prospect of future regulation intended to cope with global warming, but the more prosaic reality that at present the oil contained in these sands was too costly to extract economically under the prevailing low prices—the most material of all circumstances. The move was widely anticipated and, as even the pro-global warming website, Inside Climate News acknowledged, had nothing to do with climate change.[287] The lessons here are two-fold. First, the market does indeed know how to value stocks, rendering global warming regulation an exotic irrelevancy. Second, there are no substantive differences between the federal securities laws and the Martin Act. Both the SEC and the NYAG could investigate the changes, and both should back off in light of the changes that did occur. Let this be a lesson for future cases.

b. Global Warming and Public Nuisance

The question then becomes whether this initial foray against ExxonMobil contains any lessons for dealing with the more recent set of suits that have been filed by a number of municipalities in New York,[288] California and elsewhere on the question of whether global warming constitutes a public nuisance that has been created by ExxonMobil and other oil com-

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286. Geoffrey Smith, *Exxon's Big Oil Sands Write-Off Could Help It Dodge SEC Troubles*, FORTUNE (Feb. 23, 2017), http://fortune.com/2017/02/23/exxon-mobil-oil-sands-sec/.

287. Nicholas Kusnetz, *Exxon Relents, Wipes Oil Sands Reserves from Its Books,* INSIDE CLIMATE NEWS (Feb. 23, 2017), https://insideclimatenews.org/news/22022017/exxon-mobil-tar-sands-alberta-canada-climate-change-oil-prices ("Low prices force the oil giant to stop counting 3.5 billion barrels as an asset, a major turnaround in its accounting.").

288. Complaint, New York v. BP PLC (S.D.N.Y. 2018) (No. 18-cv-182) (footnote omitted), http://www1.nyc.gov/assets/home/downloads/pdf/press-releases/2018/complaint-filed-8031957-20180109.pdf.

panies, which make and distribute fossil fuels throughout the United States.[289]

Much abbreviated, the key allegations in the New York complaint read:

> Defendants' past and ongoing actions are harming New York City now: the City already has suffered damage from climate change, including inundation, erosion, and regular tidal flooding of its property. The City now faces further imminent threats to its property, its infrastructure, and the health and safety of its residents. . . .
>
> Global warming-induced sea level rise is expected to be higher in areas surrounding New York City than in many other parts of the world. According to the NPCC's [New York City's expert committee] "high end" projection, the sea level surrounding the City is expected to rise above the 2000-2004 baseline level (which already includes climate-change related sea level rise) by ten inches by the 2020s, by thirty inches by the 2050s, by fifty-eight inches by the 2080s, and by seventy-five inches—more than six feet—by 2100. Even the "middle range" projections are dire: four to eight inches by the 2020s, eleven to twenty-one inches by the 2050s, eighteen to thirty-nine inches by the 2080s, and twenty-two to fifty inches by 2100. Even without storms, this sea level rise threatens low-lying areas of the City—for example, by the 2050s approximately forty-three miles of the City's coastline (including many residential neighborhoods) could be at risk of daily or weekly tidal inundation, even during non-storm conditions. And a sea level rise of six feet would put parts of all five boroughs —including portions of the Financial District, Red Hook, and the vast majority of Coney Island and the Rockaways—under water.[290]

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289. For the record, I have worked as an advisor to the Manufacturer's Accountability Project on the legal issues that have stemmed out of these lawsuits.

290. Complaint, *supra* note 288, at ¶2.

The public nuisance claim here is novel in all its aspects.[291] Previously in the *American Electric Power Co. v. Connecticut*, the Supreme Court held that this cause of action was not viable under federal law but left open the prospect that it might be brought under state law, at least if the doctrines of federal preemption did not block the case.[292] But this public nuisance case is markedly different from *AEP* because it is not brought against the *emitters* of greenhouse gases, but the producers of fossil fuels for making and distributing these products.[293] The extra layer creates a major question of causation, given that the total amount of carbon dioxide emissions is dependent heavily on the way in which the crude oil is processed and used by downstream parties. For these purposes, I shall not discuss some of the nuisance law aspects of the case,[294] except to note that virtually all of these claims take the position that in light of global warming, the risk of sea level rise is far greater than it has ever been before so that it is appropriate to require these defendants to fund an abatement program that can stave off disaster before it arrives. One key difficulty with this claim is that it is uncertain how the rate of carbon dioxide increases translates itself into sea level rise. In fact, historical averages have been roughly in the order of 1/20th of an inch per year or five inches per century—a change that is not obviously driven by carbon dioxide increases,[295] and that rate has been constant over the past 20 years.

For these purposes, however, one question that arises under both the Martin Act and the federal securities law is whether the stark claims that are raised in these complaints are inconsistent with the representations that most local governments have made in their various bond offerings that take the position that denies that there are any serious environmental risks that will impair their ability to repay their debts. The covenant in the Oakland issue is perfectly typical:

> The City is unable to predict when seismic events, fires or other natural events, such as sea rise or other

291. *See* Richard A. Epstein, *Is Global Warming a Public Nuisance?*, HOOVER INST.: DEFINING IDEAS (January 15, 2018), https://www.hoover.org/research/global-warming-public-nuisance.

292. *See* Am. Elec. Power Co. v. Connecticut, 564 U.S. 410 (2011).

293. *See* Complaint, *supra* note 288, at ¶ 14.

294. *See* Epstein, *supra* note 256.

295. See *infra* Section III.C.2.

> impacts of climate change or flooding from a major storm, could occur, when they may occur, and, if any such events occur, whether they will have a material adverse effect on the business operations or financial condition of the City or the local economy.[296]

It takes no imagination to see the obvious inconsistency between the two different assertions. But it does raise the hard question of whether the decision to file the law suits makes the statements in the bond covenants material misrepresentations for the purposes of either the Martin Act or the federal securities law. It is worth noting that the exacting standards of the Martin Act seem to cover this case even if the truth lies somewhere between the two sets of statements, so that there is some risk, even if not one to the extent portrayed in these complaints. Given that damages and reliance are not normally required in Martin Act claims, it looks as though some sanction should be imposed on these local governments, although it is by no means clear what it should be: a fine, an upward interest adjustment, the immediate right to redeem bonds that have long maturity rates, or something else. It would be instructive to trace out the prices on these various bonds, but it appears that they have not moved much in response to the lawsuit. This suggests that the bond covenants are more accurate than the allegations in the lawsuits, at which point the other question is whether sanctions should be allowed against the plaintiffs because of the frivolous nature of their claims. The litigation is in its earliest stages, but ExxonMobil has already brought suit in Texas for an order authorizing it "to conduct depositions and obtain documents pertaining to potential claims of abuse of process, civil conspiracy, and violations of ExxonMobil's constitutional rights."[297] We can be confident that this is only the opening salvo in this case, which will go through many iterations before it reaches a final conclusion, both on the public nuisance claims and the securities law claims. But in principle there is no reason why the Martin Act

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296. Josh Rosner, *Have California Munis Misled Investors and Bond Insurers About Climate Risk?*, SEEKING ALPHA (Jan. 9, 2018), https://seekingalpha.com/article/4136231-california-munis-misled-investors-bond-insurers-climate-risk.

297. Verified Petition for Pre-Suit Depositions of Matthew F. Pawa et al. (N.D. Tex. 2018) (No. 096-297222-18), https://www.courthousenews.com/wp-content/uploads/2018/01/ExxonDepositions.pdf.

should not be a two-edged sword that can be applied with equal force against parties who understate their potential liabilities under the securities laws. Let us hope that the bond covenants are entirely accurate, which means that the public nuisance claims are necessarily incorrect.

Nevertheless, matters have progressed in these various lawsuits in what will surely be a long and arduous process. In the New York litigation, the most pointed question from the bench thus far involved the role of the plaintiffs in bearing any responsibility for climate change. If the distribution of fossil fuels with full knowledge of the claimed climate consequences is improper, then what about the extensive use of the same fuels by the City of New York in its own activities? Judge Keenan noted that the New York City police, fire and sanitation departments all have cars and trucks. As Judge Keenan asked plaintiff's attorney Matthew Pawa, "Aren't the plaintiffs using the product that's the subject of the lawsuit?" To which Pawa replied yes.[298] At this point the plaintiffs were *in pari delicto*—of equal blame—which could block the claim altogether under tort law principles. Given that concession, the defendant's lawyer, Theodore Boutrous, stressed that this problem did not need a piecemeal, but a global solution.

The litigation in California took a very different tack, as Judge William Alsup—who has an engineering background[299]—posted a list of eight questions that spoke to the full range of historical and technical issues raised by these cases.[300] These questions were followed by an extended de-

298. Saqib Rahim, *NYC tests climate 'nuisance' theory in federal court*, GOVERNOR'S WIND & SOLAR ENERGY COAL. (June 15, 2018), http://governorswindenergycoalition.org/nyc-tests-climate-nuisance-theory-in-federal-court/.

299. Judge Alsup earned a Bachelor of Science in mathematics from Mississippi State University in 1967 prior to obtaining a J.D. from Harvard Law School. *Alsup, William Haskell*, FED. JUD. CTR., www.fjc.gov/history/judges/alsup-william-haskell (last visited Aug. 16, 2018).

300. The questions are as follows:

1. What caused the various ice ages (including the "little ice age" and prolonged cool periods) and what caused the ice to melt? When they melted, by how much did sea level rise?
2. What is the molecular difference by which CO_2 absorbs infrared radiation but oxygen and nitrogen do not?
3. What is the mechanism by which infrared radiation trapped by CO_2 in the atmosphere is turned into heat and finds its way back to sea level?

bate on March 21, 2018.[301] The plaintiff's expert witness, Professor Myles Allen, got bogged down trying to explain the basic relationship between increases in CO_2 and temperature change under a logarithmic relationship known as Arrhenius's law. The defense did not use any expert witness, but followed the far cleverer strategy of having Chevron's lawyer Theodore Boutrous lay out his case with an effective dramatic twist. He began with the notion that Chevron accepts the consensus of the scientific community on climate change as announced in the IPCC,[302] and quickly concluded that "climate change is a global issue that requires global engagement and global action."[303] Thereafter he teased out many of the uncertainties in the various iterations of the IPCC's triennial reports.[304] He mentioned that the IPCC noted "economic and population growth" as drivers of these changes, which result also from "the cyclical patterns of climate changes over hundreds of thousands of years" and predated the current increase in CO_2

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4. Does CO_2 in the atmosphere reflect any sunlight back into space such that the reflected sunlight never penetrates the atmosphere in the first place?
5. Apart from CO_2, what happens to the collective heat from tail pipe exhausts, engine radiators, and all other heat from combustion of fossil fuels? How, if at all, does this collective heat contribute to warming of the atmosphere?
6. In grade school, many of us were taught that humans exhale CO_2 but plants absorb CO_2 and return oxygen to the air (keeping the carbon for fiber). Is this still valid? If so, why hasn't plant life turned the higher levels of CO_2 back into oxygen? Given the increase in human population on Earth (four billion), is human respiration a contributing factor to the buildup of CO_2?
7. What are the main sources of CO_2 that account for the incremental buildup of CO_2 in the atmosphere?
8. What are the main sources of heat that account for the incremental rise in temperature on Earth?

Some Questions for the Tutorial, California v. BP PLC, No. C 17-06011 WHA (N.D. Cal. Mar. 6, 2018), http://blogs2.law.columbia.edu/climate-change-litigation/wp-content/uploads/sites/16/case-documents/2018/20180306_docket-317-cv-06011_order.pdf.

301. *See* Transcript of Proceedings, California v. BP PLC, No. C 17-06011 WHA (Mar. 21, 2018), https://www.documentcloud.org/documents/4435400-SF-Oakland-Transcript-of-Alsup-Tutorial-032118.html.

302. *Id.* at 80.

303. *Id.* at 82.

304. *Id.* at 90–91.

attributable to human beings starting in about 1950.[305] It was these changes that contributed to the Little Ice Age, which the IPCC report attributes to such issues as lower solar activity and volcanic activities—neither of which involves changes in CO_2 concentrations.[306] In so doing he sketched out an argument that separated climate change from changes in carbon dioxide levels.

On June 25, 2018, Judge Alsup dismissed the California and Oakland litigation in a pointed sixteen-page opinion for failure to state a claim.[307] After a detailed review of the science presented at the March 21 proceedings, including finding Arrhenius was concerned with global cooling rather than warming,[308] the opinion treated the underlying science of global warming as a given: "This order fully accepts the vast scientific consensus that the combustion of fossil fuels has materially increased atmospheric carbon dioxide levels[.]"[309] Elsewhere, he acknowledged "other causes" were also at work.[310] Nevertheless, perhaps reflecting the wisdom of Chevron's litigation strategy, the issue in the case "is not over science" but was a "legal one."[311] Applying the basic tort law of public nuisance, Judge Alsup found the question came down to balancing the historical civilizational utility of extracting fossil fuels against the real harm incurred by plaintiffs to determine whether the defendants' conduct was reasonable.[312] His order held that the grand global nature of this policy question makes it a federal one, but because of its gargantuan economic and foreign relations implications, one for the political branches to determine, not the courts.[313] Judge Alsup's order thus refrained from weighing in on the substantive scientific

305. *Id.* at 94.
306. *Id.* at 98.
307. Order Granting Motion to Dismiss Amended Complaints, City of Oakland v. BP PLC, No. C 17-06011 WHA (N.D. Cal. June 25, 2018), http://blogs2.law.columbia.edu/climate-change-litigation/wp-content/uploads/sites/16/case-documents/2018/20180625_docket-317-cv-06011_order-1.pdf.
308. *Id.* at 3.
309. *Id.* at 12.
310. *Id.* at 4.
311. *Id.* at 6.
312. *Id.* at 7–8 (citing RESTATEMENT (SECOND) OF TORTS §§ 826–832 (AM. LAW INST. 1979)).
313. *Id.* at 14–16.

issues discussed above. But it does suggest a blow to activists who continue to press suits in New York and elsewhere.

It is still unclear whether these remaining cases will be set for trial or dismissed, perhaps on the grounds that the need for a comprehensive solution is inconsistent with the piecemeal relief that is requested. But for these purposes, what is most apparent is that the common law, the Martin Act, and the federal securities acts all give ample room to raise these issues—and to reject the claims once they are raised. What matters ultimately are the scientific issues about which Boutrous discussed in his exchange with Judge Alsup. It is to those that I turn next.

2. *The Science*

It is clear that the various actions against ExxonMobil under the Martin Act and against multiple oil companies under the law of public nuisance raise a common core of science issues that require some independent analysis. The Schneiderman position in March 2016 echoed a common theme in this literature, which is that the science is so settled that the only question that remains is to devise a sensible solution to the problem. In all these cases, it seems as though individual litigation is a poor way in which to proceed. But whether or not this matter is returned to the legislative arena, as suggested by Judge Alsup's opinion, it is important to ask whether the science is as solid in one direction as is commonly supposed.

The answer is that it is not. Right now, many climate scientists take issue with the question of whether global warming attributable to man-made CO_2 poses a substantial threat, backed by extensive evidence. Patrick Michaels and Paul Knappenberger articulate a view, hinted at by the title of their recent book, *Lukewarming,* that any increase in CO_2 levels could be expected, with other things held equal, to produce some modest increase in global temperatures which do not a present a significant environmental danger.[314] The CO_2 Coalition, which I have worked with from time to time, goes one step further and claims that the recent increases in CO_2 levels

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314. *See* PATRICK J. MICHAELS & PAUL C. KNAPPENBERGER, LUKEWARMING: THE NEW CLIMATE SCIENCE THAT CHANGES EVERYTHING 116–17 (2016).

result in a net benefit to humanity.[315] From literally hundreds of articles that I have reviewed on both sides of the debate, it becomes all too clear that there are few people taking a maybe-yes/maybe-no stance. On virtually every point, the global warming debate gives rise to fierce hand-to-hand combat that cannot easily be put to rest, and certainly not so by the collection of factoids that Schneiderman and Pawa strung together in rapid fashion. It is, therefore, worthwhile to step back from his charges of fraud to ask whether the evidence on the scope and extent of global warming is as unequivocal as he claims. In the context of the Martin Act, it is not necessary for these purposes to show that the many reputable scientists are correct in claiming that fears of global warming are overwrought. It is simply sufficient to show that there are two sides to the argument.

The first point is that one has to be careful of the common claim that 97% of scientists believe in global warming. There are good reasons to believe that this figure misstates the division of authority within the scientific community.[316] To see why this is the case, it is critical to isolate the key ambiguity inherent in this formulation. As commonly stated, the 97% consensus includes in its ranks *any* scientist who thinks that *some* increase in CO_2 concentrations will lead to *some* increase in temperature, a broad and undefined class which includes most people who are self-described climate skeptics. Indeed, this particular claim appears to be a necessary truth. But the harder questions ask how much of an increase in CO_2 poses a

315. See CO_2 COALITION, http://co2coalition.org (last visited Aug. 12, 2018). The organization has been attacked as a pawn of the fossil fuel industry. *See, e.g.*, *CO_2 Coalition*, DESMOG, http://www.desmogblog.com/co2-coalition (last visited Oct. 29, 2016); John Cook et al., *Quantifying the Consensus on Anthropogenic Global Warming in the Scientific Literature*, 8 ENVIRON. RES. LETTERS 1 (2013), http://iopscience.iop.org/article/10.1088/1748-9326/8/2/024024/pdf ("Our analysis indicates that the number of papers rejecting the consensus on AGW is a vanishingly small proportion of the published research."). The study was confined to an analysis of abstracts, without any effort to look into the merits of any of the 11,944 papers reviewed.

316. *See* Joseph Bast & Roy Spencer, *The Myth of the Climate Change '97%'*, WALL ST. J. (May 26, 2014, 7:13 PM), https://www.wsj.com/articles/joseph-bast-and-roy-spencer-the-myth-of-the-climate-change-97-1401145980; *see also* Judith Curry, *The 97% 'consensus'*, CLIMATE ETC. (July 26, 2013), https://judithcurry.com/2013/07/26/the-97-consensus/.

threat and why. That point has been repeatedly hammered home by others, including Matt Ridley, who has written:

> The supposed 97% consensus, based on a hilariously bogus study by John Cook, refers only to the proposition that climate change is real and partly man-made. Nobody has ever shown anything like a consensus among scientists for the proposition that climate change is going to be dangerous.
>
> Professor Daniel Sarewitz put it well recently: "Even the vaunted scientific consensus around climate change . . . applies only to a narrow claim about the discernible human impact on global warming. The minute you get into questions about the rate and severity of future impacts, or the costs of and best pathways for addressing them, no semblance of consensus among experts remains."[317]

These observations are not isolated. Recent surveys about the attitude of members of the American Meteorological Society "found that, while a majority of meteorologists surveyed are convinced humans have contributed to global warming [64%], this was a substantially smaller majority than that found among all Earth scientists (82%)."[318] It also found that "[s]ome members have expressed that their views, which question the view that human-caused global warming was occurring, are treated with hostility within the [American Meteorological Society]."[319]

It is pointless to dwell on political animosity, but it is critical to properly frame the conceptual issue discussed before

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317. Matt Ridley, *Global Warming Versus Global Greening*, GLOB. WARMING POL'Y FOUND. (Oct. 18, 2016), http://www.thegwpf.org/matt-ridley-global-warming-versus-global-greening/ (citing Cook et al., *supra* note 315). *See also* Daniel Sarewitz, *Saving Science*, THE NEW ATLANTIS (2016), http://www.thenewatlantis.com/publications/saving-science. Sarewitz rightly relies on Vannevar Bush's 1945 report to President Truman, which charted the course for post-war advances in scientific research. *See* VENNEVAR BUSH, SCIENCE THE ENDLESS FRONTIER: A REPORT TO THE PRESIDENT (1945), https://www.nsf.gov/od/lpa/nsf50/vbush1945.htm.

318. Neil Stenhouse et al., *Meteorologists' Views About Global Warming: A Survey of American Meteorological Society Professional Members*, 95 BULL. AM. METEOROLOGICAL SOC'Y 1029, 1029 (2014). Other surveys found a high fraction of scientists, often around 80 percent, believe that "induced climate change is occurring," without, apparently, determining its likely severity. *Id.*

319. *Id.* at 1030.

Judge Alsup. To do so, I rely on the clear exposition of the problem by the CO_2 Coalition. The standard formula for global warming rests on two key variables. The first of these is the rate of expected increase in CO_2 concentrations. The second is the size of a sensitivity coefficient, or "S." As to the first, the impact of temperature changes varies with the logarithmic change in concentration, which always rises more slowly than the percentage increase, such that a doubling of concentration leads to about a 31% increase in temperature. But an increase of what? On this last point, the sensitivity index measures the rate at which the higher concentrations translate into higher temperatures. The higher the level of sensitivity, the greater the response will be to any given increase (or decrease) in the level of concentration of CO_2. The setup, often called the Arrhenius equation, is as follows:

$$T = S \log_2 (C2/C1), \text{ where } T = T2 - T1.$$

The proposition that higher concentrations of CO_2 leads to some degree of global warming only requires that S, the doubling sensitivity number, be greater than zero for any increase in CO_2 concentration to increase global temperature. So long as any of that CO_2 is produced by human beings, the proposition that human action causes global warming is (trivially) true, but entirely consistent with the *Lukewarming* hypothesis and, indeed, the possibility that CO_2 produces net social benefits.

The key question, therefore, for the purposes of the global-warming debate, is just how much greater than zero is S. Where S is low, the temperature increases are small. Where S is large, the temperature increases are obviously greater. In all cases, the increases get smaller in percentage terms as the concentrations gets higher, given the logarithmic nature of the basic relationship. The key scientific dispute in this regard is about the magnitude of S. The conventional models, including those used by the Intergovernmental Panel on Climate Change (IPCC), a leading international, UN-sponsored body dedicated to measuring the effects of climate change, tend to place $S > 3$ or so, which is a high number. Others think that more recent evidence puts S far lower, perhaps at $S < 2$, at which point the increases in temperature are far slower.[320]

320. *See* Robert P. Murphy, Patrick J. Michaels & Paul C. Knappenberger, *The Case Against the Carbon Tax* (CATO Inst., Working Paper No. 33, 2015),

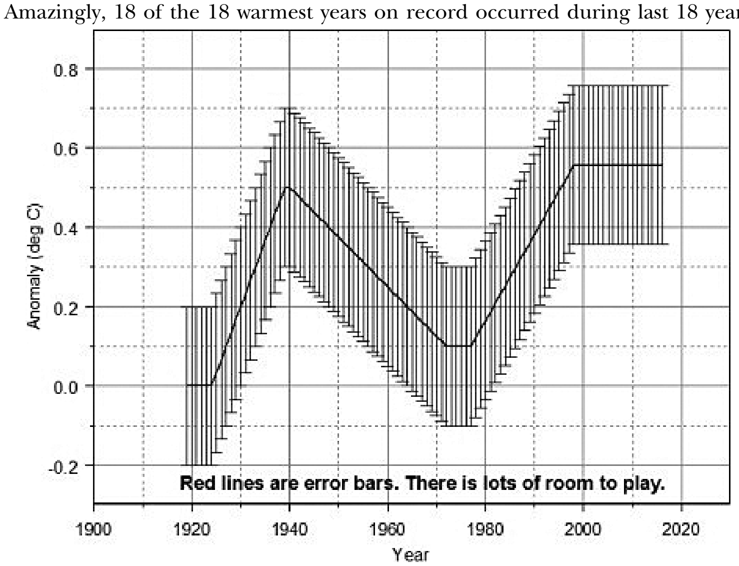
This factor has in turn been challenged as being too low.[321] One reason to incline toward the lower estimate is that water vapor, also a greenhouse gas, has at least some influence on temperature, which necessarily means that CO_2 should matter less proportionally. There is, moreover, no obvious monotonic relationship between water vapor and temperature, which means that shifts in its concentration over time and over different portions of the earth can explain some of the variability in regional responses that models based on CO_2 levels cannot, i.e., periods, such as that in the middle of the 1970s, where cooling rather than warming has been observed.

On this score, it is instructive to look at the graph that Professor Richard Lindzen offers of temperatures since 1920:

FIGURE 1

SCHEMATIC OF TEMPERATURE ANOMALY RECORD

Amazingly, 18 of the 18 warmest years on record occurred during last 18 years



http://object.cato.org/sites/cato.org/files/pubs/pdf/cato-working-paper-33.pdf.

321. *See* Joseph Majkut, *Is There a Divergence Between Climate Models and Temperature Data?*, NISKANEN CTR.: CLIMATE & ENERGY POL'Y (Dec. 1, 2015), http://niskanencenter.org/blog/is-there-a-divergence-between-climate-models-and-temperature-data/.

During the same period, CO_2 levels moved steadily upward from about 320 ppm in 1960 to somewhat over 400 ppm today. As Lindzen has observed, "the warming episode from about 1978 to 1998 appeared to have ceased and temperatures have remained almost constant since 1998."[322] As he then notes, it follows necessarily that all of the temperature reports in last 18 years have been close to the high point, given that there has been no decline in temperature. The monotonic increases in the level of CO_2, whether natural or man-made, cannot explain why temperatures first rose, then declined, and then rose again, only to remain flat thereafter. Any single driver for temperature thus has to be ruled out on this data. CO_2 levels surely play some role, but so must other factors. The approximately 13 percent increase in CO_2 levels over the last 18 years has generated at most only modest atmospheric temperature increases, which raises the claim, strongly denied by others, of a "pause" in global warming.[323] Indeed, there is scant evidence that even major reductions in the overall level of CO_2 are likely to have an appreciable effect on long-term global warming in light of the interplay of social forces.[324] Perhaps some insidious effects of CO_2 may be delayed, but at the very least those additional complications cast doubt on Schneiderman's categorical conclusions.

322. Richard Lindzen, *Thoughts on the Public Discourse over Climate Change*, MERION WEST (Apr. 25, 2017), http://merionwest.com/2017/04/25/richard-lindzen-thoughts-on-the-public-discourse-over-climate-change/.

323. For rival views, see Brian Kahn, *No Pause in Global Warming*, SCI. AM. (June 4, 2015), http://www.scientificamerican.com/article/no-pause-in-global-warming/ ("The global warming hiatus—a decade-plus slowdown in warming—could be chalked up to some buoys, a few extra years of data and a couple buckets of seawater."); John C. Fyfe et al., *Making Sense of the Early-2000s Warming Slowdown*, 6 NATURE CLIMATE CHANGE 224, 224 (2016) ("It has been claimed that the early-2000s global warming slowdown or hiatus, characterized by a reduced rate of global surface warming, has been overstated, lacks sound scientific basis, or is unsupported by observations. The evidence presented here contradicts these claims.").

324. The U.S. contribution to reduced global temperatures in 2100 would be about 0.03 of a degree, using the EPA's own climate model, under assumptions that exaggerate the effectiveness of the policies. Note that the standard deviation of the temperature record is about 0.1 of a degree, so that the U.S. effect would not be measurable against normal variation. *See* Benjamin Zycher, *The Carbon Tax is Not Just Political; It's Ineffective, Too*, THE HILL (Sept. 28, 2016, 2:01 PM), http://thehill.com/blogs/pundits-blog/energy-environment/298285-the-carbon-tax-is-not-just-political-its-ineffective.

The rise and fall of global temperatures is also confirmed by a comparison of the general patterns of increase for the years between 1895 and 1946 and between 1957 and 2008.[325] To be sure, the temperature range in the earlier period was slightly lower, but the up-and-down patterns of temperature changes were the same in the low-CO_2 environment for the early period and high-CO_2 environment for the latter one, again showing that multiple factors are necessarily in play. In this complex environment, it is not credible that a single driver could have the high level of influence attributable to CO_2. One countervailing force that tends to reduce temperature increase is the release of aerosols, whose presence in the atmosphere tends to counteract any influence of CO_2.[326] So long as those move independently of changes in CO_2 concentrations, their combined effect is difficult to determine no matter how long or short the time horizon. NYAG Schneiderman also pointed to the shrinking of Arctic Sea ice mass, an assertion commonly made in authoritative places.[327] But recent accounts point strongly in the opposite direction. One recent report recounts "[s]ince hitting its earliest minimum extent since 1997, Arctic sea ice has been expanding at a phenomenal rate,"[328] noting that Arctic Sea ice levels have increased by about 25% between 2012 and 2016.[329] Historically, moreover, Arctic Sea ice has sometimes been at much lower

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325. *See* CO_2 COALITION, A PRIMER ON CARBON DIOXIDE 6 (2016), http://co2coalition.org/wp-content/uploads/2016/08/Primer-on-CO2-and-Climate-1.pdf.

326. *Id.* at 7.

327. *See, e.g.*, *Arctic Sea Ice Minimum*, NASA: FACTS, https://climate.nasa.gov/vital-signs/arctic-sea-ice/ (last visited Aug. 12, 2018).

328. Paul Homewood, *Record Arctic Sea Ice Growth in September*, NOT A LOT OF PEOPLE KNOW THAT (Sept. 25, 2016), https://notalotofpeopleknowthat.wordpress.com/2016/09/25/record-arctic-sea-ice-growth-in-september/.

The charts are always capable of multiple interpretations, but one useful point is that the extent of the Arctic Sea ice today is about 33% higher than it was at the same date in 2012, which in turn was only about 75% of what it was at its 2001 peak. The movement over the last ten years has been roughly stable. *See also* Thomas Richard, *Arctic Sea Ice Rebounds as Polar Temperatures Start to Plunge*, BLASTING NEWS (Sept. 19, 2016), http://us.blastingnews.com/news/2016/09/arctic-sea-ice-rebounds-as-polar-temperatures-start-to-plunge-001129573.html?utm_source=CFACT+Updates&utm_campaign=4c96e5bd23-Call_off_the_death_spiral_9_19_2016&utm_medium=email&utm_term=0_a28eaedb56-4c96e5bd23-260145993.

329. Homewood, *supra* note 328.

levels, so that in the 1903–1908 period, famed Arctic explorer Roald Amundsen was able to navigate a northwest passage through the Arctic by boat.[330] The cyclical nature of Arctic Sea ice seems to be largely independent of CO_2 concentrations, so that the recent record increases in CO_2 concentrations have seen both ebbs and flows in Arctic Sea ice concentration.

Indeed, most of the alarmist predictions have been off base. Oftentimes this position is denied categorically, as in the open letter prepared by MIT President, L. Rafael Reif, protesting the decision of Donald Trump to withdraw from the Paris Accords on global warming. Reif led with this categorical statement: "As human activity emits more greenhouse gases into the atmosphere, the global average surface temperature will continue to rise, driving rising sea levels and extreme weather."[331] Reif's letter offered no evidence for this proposition and it prompted the following pointed response on these points from Willie Soon and Christopher Monckton:

> The average sea level rise since 1870 has been 1.3–1.5 mm (about a twentieth of an inch) per year, or five inches per century. Professor Nils-Axel Mörner, a renowned sea-level researcher who has published more than 500 peer-reviewed articles on this topic, has been unable to find observational evidence that supports the models' predictions of dramatically accelerating sea level rise.
>
> Observations over the last few decades indicate that extreme weather events, including tornadoes and hurricanes, have been *decreasing*, rather than increasing, both in number and in intensity. Moreover, total accumulated cyclonic energy has also been declining. As MIT Emeritus Professor Richard Lindzen has explained, the decline in storminess is a consequence of reduced temperature differentials between the tropics and exo-tropics that arise when global average temperatures are slightly warmer.

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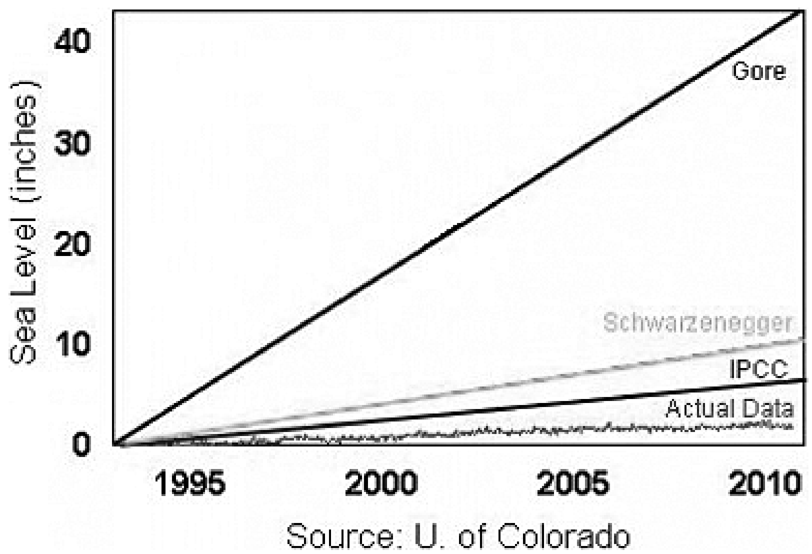
330. *Roald Amundsen*, 15 ENCYCLOPEDIA ARCTICA: BIOGRAPHIES 18–24 (1951), http://collections.dartmouth.edu/arctica-beta/html/EA15-05.html. Amundsen made the trip in a 46-ton fishing boat. The trip took three years, but clearly the Arctic ice had to melt during it. *Id.* at 19, 20–22.

331. Letter from L. Rafael Reif, President, Mass. Inst. Tech., to MIT Community (June 2, 2017), http://news.mit.edu/2017/letter-mit-community-us-withdrawal-paris-climate-agreement-0602.

> Looking at the United States, major hurricane activity is at a record low. As of June 1, 2017, it had been eleven years and seven months since a category 3 to 5 hurricane last struck the U.S. mainland. According to NOAA Hurricane Research Division data, the previous record was nine years, set in 1860–1869.[332]

Those general observations on sea level are borne out by comparing predictions of sea level change with the observed data since 1996—a period which has seen substantial increases in carbon dioxide levels.[333]

FIGURE 2
GLOBAL SEA LEVEL



332. Willie Soon & Christopher Monckton of Brenchley, *Response to MIT President: Paris Exit Scientifically Sound (Part II)*, MASTER RES. (July 6, 2017), http://www.masterresource.org/climate-science/mit-president-exit-paris-ii/. I supported the President's decision on scientific, not political grounds. *See* Richard A. Epstein, *Forget the Paris Accords*, HOOVER INST: DEFINING IDEAS (May 30, 2017), http://www.hoover.org/research/forget-paris-accords; Richard A. Epstein, *Containing Climate Change Hysteria*, HOOVER INST.: DEFINING IDEAS (June 5, 2017), http://www.hoover.org/research/containing-climate-change-hysteria.

333. This figure, and others of similar import are available through a simple Yahoo Images search for the term "ocean level rise chart."

Other studies report similar results, including a rejection of the claim that global warming increases general ecological instability, which in turn increases the number of extreme events, like hurricanes and cyclones. Instead the data tend to show that these events have been in a modest, but consistent, *decline* over the last century.[334] Indeed, between Hurricane Wilma in 2005 (just a few weeks after the far more devastating Hurricane Katrina) and Hurricane Harvey in 2017, the United States experienced a decade of relatively modest hurricane activity resulting in one of the quietest periods since the data has been collected,[335] shattered only by the devastating downpours from Hurricane Harvey in late August 2017.[336] But once again it would be a mistake to attribute this behavior to increase in CO_2 levels, for it is well established that the cycles between El Niño (which sends cold air west to the Atlantic) and La Niña (which does not) have much to do with the movement of hurricanes from the West Coast of Africa to the Caribbean and the Southern United States.[337] That phenomenon is driven by the so-called El Niño Southern Oscillation (ENSO), which involves the constant cycling of surface ocean temperatures in the Pacific equatorial region that drives climate patterns across both oceans.

The skeptical account of the role of CO_2 in global warming receives additional support from one finding that embarrasses the global-warming hypothesis. A compilation of about 100 estimates of global warming, when applied over the period

334. *See* CO_2 COALITION, *supra* note 325, at 17–19. Despite the late twentieth century warming period, the data show no upward trend in strong tornadoes; in fact, there appears to be a slight downward trend in the frequency of strong tornadoes. *See id.* at 19.

335. Without discounting the effects of other storms such as Superstorm Sandy in 2012 (which made landfall as a Category 2 storm), there were no Category 3 or above hurricanes to make landfall in the United States for nearly a decade until Hurricane Harvey. *See Complete List of Continental U.S. Landfalling Hurricanes*, NAT'L OCEANIC & ATMOSPHERIC ADMIN.: HURRICANE RES. DIV. (June 1, 2017), http://www.aoml.noaa.gov/hrd/tcfaq/E23.html.

336. Erin Ailworth, Dan Frosch & Christopher M. Matthews, *Harvey to Hit Flooded Houston Again*, WALL ST. J. (Aug. 28, 2017, 7:07 AM), https://www.wsj.com/articles/harvey-to-hit-houston-again-1503927231.

337. For a brief account, see Aylin Woodward, *La Niña Forecast May Mean Even Worse Atlantic Hurricanes in 2018*, NEW SCIENTIST (Oct. 25, 2017), https://www.newscientist.com/article/2151474-la-nina-forecast-may-mean-even-worse-atlantic-hurricanes-in-2018/.

between 1979 and 2013, predicted an increase of 1°C, when the actual result for this period is about 0.2°C to 0.25°C—a four- to five-fold disparity, depending on whether satellite or balloon measurements are used.[338] Surely a deviation between prediction and reality of that magnitude cries out for fresh thinking about the underlying problem. Since measures of CO_2 increase can be accurately observed, the key inquiry must surround the proper determination of S, which is not directly observable. But a better fit for the data comes from noting that S is on the lower side of the relevant estimates. Nothing that Schneiderman and other defenders of global warming have said addresses these difficulties. It cannot simply be assumed that the IPCC has made the best estimate of S.

Even if recent temperature increases are modest at best, the same is not true of the level of greenery on the earth's surface. Matt Ridley, in his lecture "Global Warming Versus Global Greening,"[339] offers powerful evidence that the main consequence of CO_2 has been an increased level of global greening, to the tune of 14% of land coverage over the last thirty years. That one number, if true, suggests that the so-called social cost of carbon may well be, at least for restricted ranges, negative and not positive.[340] A group of Australian scientists also published an earlier study that predicted "[u]sing gas exchange theory" that a "14% increase in atmospheric CO_2 (1982–2010) led to a 5 to 10% increase in green foliage cover in warm, arid environments. Satellite observations, analyzed to remove the effect of variations in precipitation, show that cover across these environments has increased by 11%."[341] In this instance, there is ample reason to believe that these large greening effects are attributable to increases in CO_2, given that in controlled experiments, plant growers

338. For the graph, see *Climate Science: Assumptions, Policy Implications, and the Scientific Method: Hearing Before the H. Comm. of Sci., Space & Tech.,* 115th Cong. 35–51 (2017) (Testimony of John R. Christy).

339. Matt Ridley, Lecture at the 2016 Global Warming Policy Forum: Global Warming versus Global Greening (Oct. 17, 2016), http://www.thegwpf.com/matt-ridley-global-warming-versus-global-greening/.

340. *Id.*

341. Randall Donohue et al., *Impact of CO_2 Fertilization on Maximum Foliage Cover Across the Globe's Warm, Arid Environments*, 40 GEOPHYSICAL RES. LETTERS 3031 (2013), https://openresearch-repository.anu.edu.au/bitstream /1885/73415/2/01_Donohue_Impact_of_CO_2__fertilization_2013.pdf.

pump in CO_2 to increase growth rates. Other correlated variables include temperature, precipitation and radiation.[342] Studies have also found that rising CO_2 levels can lead plants to use water more efficiently, increasing vegetation everywhere, in particular the dry areas.[343]

> To let CO_2 in, plants have to open up pores called stomata in their leaves, which in turn allows water to sneak out. Plants thus need to strike a balance between taking up carbon to build new leaves, stems and roots, while minimizing water loss in the process. This led to sophisticated adaptations that ha[ve] allowed many plant species to conquer a range of arid environments.[344]

To make this analysis even more comprehensive, it is critical to take into account the interplay of both global and local forces in any particular case. Thus, a claim that water levels are rising in Florida could be attributable to water rising or to land sinking, or some combination of both. Nor is it clear how much of the sea level increase can be attributed to global warming, when the rise has been relatively constant at seven inches per century for the last 3000 years.[345] Similarly, the large calving of an iceberg from the Antarctica cannot be attributable to tiny changes in global temperatures, especially

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342. Zaichun Zhu et al., *Greening of the Earth and Its Drivers*, NATURE, http://www.nature.com/articles/nclimate3004.pdf. *But see Carbon Dioxide Fertilization Greening Earth, Study Finds*, NASA, https://www.nasa.gov/feature/goddard/2016/carbon-dioxide-fertilization-greening-earth (noting that rising carbon dioxide concentrations is the chief culprit of global warming and its beneficial impact on plants may be limited).

343. *Rising Carbon Dioxide is Making the World's Plants More Water-Wise*, THE CONVERSATION, http://theconversation.com/rising-carbon-dioxide-is-making-the-worlds-plants-more-water-wise-79427 (last visited Apr. 13, 2018).

344. *Id.* (also pointing out that the water savings could lead to increased water runoff, and precipitation may not go through vegetation but through direct soil evaporation, which might not necessarily benefit humans in the end).

345. Larry Bell, *Is Climate Change Elevating Coastal Flooding Risk?*, CFACT (Sept. 26, 2016), https://www.cfact.org/2016/09/26/is-climate-change-elevating-coastal-flooding-risk/?utm_source=CFACT+Updates&utm_campaign=49124bbde3-Flood_of_disinformation9_28_2016&utm_medium=email&utm_term=0_a28eaedb56-49124bbde3-260145993. On this point, the Union of Concerned Scientists appears to overstate the case for attributing rising sea levels to global warming. *See An Open Letter Regarding Climate Change from Concerned Members of the U.S. National Academy of Sciences*, *supra* note 250.

when the size of the ice pack is increasing elsewhere on Antarctica. Rapid movements in ice are much more likely to be the result of localized volcanic activity beneath the surface.

In addition, many local losses can be mitigated by undoing key man-made adaptations. The Sierra Club has made just this point when it writes, "[w]hat we can and must do is to let nature resume control of water flow by removing barriers like the Tamiami Trail, the Miami Canal and the L-67 canals, while cleaning up Big Sugar's effluent to Everglades standards."[346] Much of the runoff in the Everglades comes from the construction of a network of oil exploration channels before World War II. The rapid flow of water through these channels disrupts the natural ecology. Filling them up should not be a huge problem, but it has never been undertaken. In addition, the runoff of phosphorus from nearby farms undermines the local environment.[347]

There is also an extensive empirical dispute over both long and short-term trends in global warming, wholly apart from the explanation of its sources. On this score, recent research suggests that we are now at the end of a global warming period extending close to 11,000 years—the Holocene epoch, during which time temperatures fell gradually as CO_2 levels increased, a finding that is in obvious tension with Schneiderman's claims in his March 2016 press conference. Once again there must be some natural force to explain a relationship that is the inverse of what is normally expected.[348] The more controversial portion of the long-term research swirls around a famous doomsday proposal in 2000 from Michael Mann and his coauthors. These authors posit a "hockey stick" version of human history that sees very stable temperatures over hundreds of years, followed by a sharp increase in temperatures around 1900, roughly corresponding to the major uptick in

346. Jon Ullman, *The Everglades and Sea Level Rise: The Clock Is Ticking*, SIERRA CLUB FLA. NEWS (Feb. 26, 2013), http://www.sierraclubfloridanews.org/2013/02/the-everglades-and-sea-level-rise-clock.html.

347. *Phosphorus: Challenges Part 3*, FRIENDS OF THE EVERGLADES, https://www.everglades.org/phosphorous (last visited Aug. 16, 2018) ("Phosphorus from agricultural runoff has impaired water quality in large portions of the Everglades and has been particularly problematic in Lake Okeechobee.").

348. *See* Andy May, *Lindzen, Soon and Spence Debunked?*, WATTS UP WITH THAT (May 3, 2017), https://wattsupwiththat.com/2017/05/03/lindzen-soon-and-spencer-debunked/.

the use of fossil fuels.[349] It is easy to extrapolate from that model ruinous temperature increases in the next century that could fully justify the most alarmist predictions possible.

But there is, however, the major question as to whether the model is true. On this score, Mann seems to think the best way to firm up his position is by bringing defamation suits against those who disagree. One such suit is against the writer Mark Steyn who claimed that Mann "has perverted the norms of science on an industrial scale"—a slight that Mann would have been well-advised to ignore.[350] More instructive is Mann's litigation in Canada against the Canadian climatologist Tim Ball claiming "Mann belongs in the state pen, not Penn. State," for fraudulent misstatement of data.[351] This case took an odd twist when Mann claimed that he did not have to release his raw data because it was his intellectual property—a claim that is clearly wrong for at least two reasons. First, the property comes from a government project for which data generally has to be made public wholly apart from litigation. Second, turning over the documents and data to the court does not imply that the recipient may publish them because they are first subject to judicial inspection to see if a more selective claim of privilege can be sustained, and then, if need be, turned over to the plaintiffs under some kind of protective order.[352]

Scientifically, however, the most striking point is the comparison of the historical account offered by Mann—which has low variability until the onset of the 20th century—and the Ball version, which has far higher variability in earlier periods and relatively modest level of temperature variability (wholly apart from any causation question) for the post-1800 period,

349. Michael E. Mann, Raymond S. Bradley & Malcolm K. Hughes, *Global-Scale Temperature Patterns and Climate Forcing Over the Past Six Centuries*, 392 NATURE 779 (Apr. 23, 1998). For a vigorous modern defense of Mann, see Chris Mooney, *The Hockey Stick: The Most Controversial Chart in Science, Explained*, THE ATLANTIC (May 13, 2013), http://www.theatlantic.com/technology/archive/2013/05/the-hockey-stick-the-most-controversial-chart-in-science-explained/275753/.

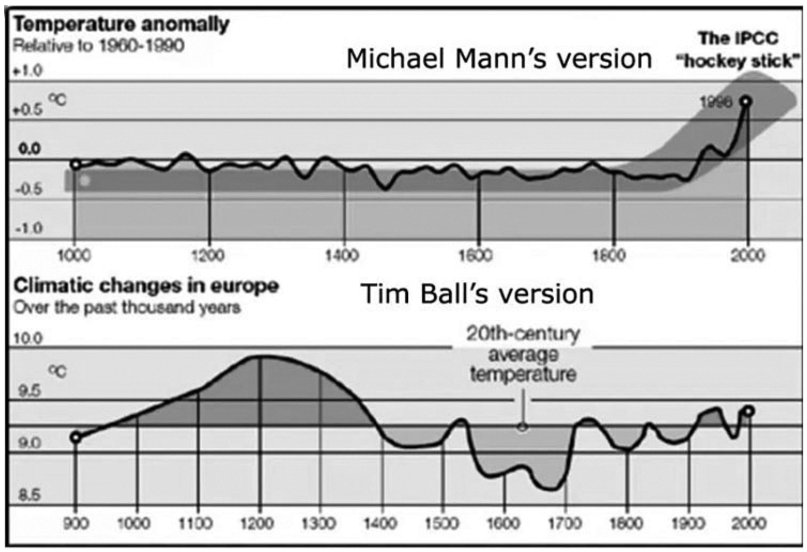
350. John O'Sullivan, *Breaking: Fatal Courtroom Act Ruins Michael 'Hockey Stick' Mann*, PRINCIPIA SCI. INT'L (July 4, 2017), http://principia-scientific.org/breaking-fatal-courtroom-act-ruins-michael-hockey-stick-mann/.

351. *Id.*

352. *See* FED. R. CIV. P. 26(b)(2)(B).

smaller than that for the 900 to 1200 A.D. period.[353] See for yourself:

FIGURE 3
BATTLE OF THE GRAPHS: MANN VERSUS BALL



Obviously, if Ball's graph is accurate, then Mann's is seriously misleading. There is evidence of a major amount of warming during the medieval period, which is best captured by the accurate historical evidence that both Greenland and Labrador had temperate climates in which grapes could grow. That fits in neatly with the Ball model, and in fact was previously adopted in the IPCC's 1990 Report.[354] But it is much more difficult to explain under the Mann model. It is of course possible that the temperature changes in the North Atlantic were not representative of overall global changes. This point is surely debatable. Nevertheless, there are at least two macro-level difficulties with the Mann model. First, the only way to preserve the model's low level of variability to postulate a simultaneous large decrease in temperatures elsewhere that

353. *See* Mann, Bradley & Hughes, *supra* note 349.
354. For the various maps, one can do a simple Google image search to see the variability. *See* GOOGLE IMAGES, https://www.google.com/images (search for "medieval warm period little ice age graph").

parallel the increase in temperatures in the North Atlantic. The second is that any such model of variability makes it highly unlikely that changes in CO_2 levels, whose impacts are worldwide, could produce both effects at the same time. The puzzle is even greater because the change in CO_2 levels during this period are too small to count as an effective driver. Hence, the data would require finding other explanations, which in turn, reduces the overall importance of CO_2. All readers should judge for themselves who has the better of the debate, a judgment that is always subject to revision. But neither the Martin Act nor the federal securities laws have anything useful to contribute to this debate.

Conclusion

In dealing with the issues under the Martin Act, it is critical to deal with both the procedural and substantive issues. In general, most of the dangers lie in the unique procedural features of the Martin Act, not its substantive provisions.

The chief vice of the Martin Act stems from the incredible discretion that it confers on the NYAG to conduct either public or private investigations of potential targets, without limitation. Similarly, broad investigative powers are also available to the SEC, which give it, like other federal agencies, the power to initiate lawsuits that can bankrupt major corporations and require them to forfeit their licenses when indicted for particular offenses. There are of course important differences in that the SEC has to act by majority vote of a five-member commission while the NYAG can move unilaterally. But even here, it is important to recall the SEC has three commissions from the President's party and two from the opposition, so that votes rigidly divided along partisan lines can often lead to investigations and indictments, which are exceedingly difficult to resist given that the sanctions for being indicted, including loss of licenses, are more devastating than any fine that might be imposed at the end of the ordeal. It was just this unfortunate state of affairs that drove Arthur Andersen over the brink. But it is critical to note that this was not by the SEC, which has no authority to bring *criminal* prosecutions, but by the Department of Justice, which could, like the NYAG, mount criminal prosecution on a set of dubious charges that lacked the critical element of scienter.[355] The parallel actions by the SEC are, at least in theory, cabined by its rulemaking. These actions are subject to the Administrative Procedure Act,[356] as well as limited by statutory language that requires the SEC rules to consider "whether the action will promote efficiency, competition, and capital formation."[357] Thus the lack of institutional safeguards makes civil and criminal prosecutions far easier in cases that stray far from the financial fraud cases to which the Martin Act was originally directed. That precise result seemed to be in formation with the ill-advised efforts of NYAG Eric Schneiderman to invoke the investigative powers of the Martin Act to challenge the activities of ExxonMobil over the past forty years, on evidence that turns out to be fatally weak.

If these procedural shortfalls require prompt correction, the picture with the substantive requirements is far more nuanced. The focus of the inquiry was whether the law's departure from the substantive common-law requirements of scienter, reliance, and damages had brought about a fatal imbalance in the enforcement of the law against major public companies and their officials. In general, I think that critique is overblown for at least two reasons, and that the greater danger by far lies in the excessive concentration of power lodged in the NYAG. Turning first to the substantive issues, the removal of these limitations did not, in practice, create a free-for-all that allowed the NYAG to sue any firm or executive for any reason. Even after the passage of the Martin Act, the additional requirements used to cabin potential liability for false words still remained in place, so that, substantively, the Martin Act on many key points bears a close resemblance to both common-law fraud and federal securities laws, which work in the same area. Thus, under the Martin Act, the state is not spared the burden of proving a false statement of fact, as opposed to a statement of opinion or the prediction of a future event. In addition, it is necessary for the state to prove that the

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355. *See* Arthur Andersen LLP v. United States, 544 U.S. 696 (2005) (overturning a charge of obstruction of justice for want of the proof of scienter). For discussion of the undue leverage of the government in these prosecutorial situations, see Epstein, *Deferred Prosecution Agreements on Trial*, *supra* note 30.

356. Administrative Procedure Act, 60 Stat. 237 (1946) (codified as amended at 5 U.S.C. §§ 701–708 (2012)).

357. 15 U.S.C. § 78c(f).

false statements were material, so that they were likely to exert a real influence on the behavior of the parties to whom they were directed. It was also incumbent to show that the statements were made incident to the purchase or sale of a security, or of an offering to buy or sell securities, which precluded its application to general public statements that might in some indirect fashion at some uncertain time influence the price at which stock is sold.

Under these rules, the law could function to allow injunctions against corrupt stock transactions before they occurred, which is why in its initial encounter with the law in *Federated* the New York Court of Appeals gave it such a full-throated endorsement. But the situation becomes more nuanced in those cases where the government seeks disgorgement of profits, and injunction against future conduct or prosecution of possible criminal conduct. In these cases, it turns out that, both for political and legal reasons, the question of scienter is injected, even if it is formally irrelevant under the basic liability test. It is therefore instructive to note that while Greenberg and Smith fought ferociously against the Martin Act counts, in the end they lost because they admitted to scienter even as they sought to deny fraud, which in most instances is established by proof of scienter. Similarly, the loud #ExxonKnew campaign floundered precisely because there was no scienter that has been established based on Exxon's early investigations into global warming or in the effort to prove that ExxonMobil issued false statements because they ignored the impact of potential climate regulation on future profits. ExxonMobil did revise its reserves, not because of anything to do with potential regulatory risks of global warming, but because of the huge downward pressure exerted on oil prices from the momentous technological innovations most intimately associated with advanced fracking techniques.

The most important lesson to learn from this account of the Martin Act is that the quality of its public administration depends not only on matters of institutional design, or on its detailed substantive provisions, but perhaps even more on the quality of the public officials who administer it. If they are overconfident in their judgments, they will be overzealous in their behavior, which will lead to overheated public rhetoric on the one side and misguided legal results on the other. There is in public life no set of procedural safeguards that can wholly protect against overly aggressive public officials—which is not to say that safeguards should be disregarded. The protection against abusive discovery, for example, could be critical in controlling excessive enforcement at either the state or federal level. Fortunately, the line seems to have held against Schneiderman's direct global warming charges against ExxonMobil. But we should not rejoice too much over his strategic retreat. The public nuisance cases remain. Next time we may not be so fortunate.