ARTICLES

STING VICTIMS: THIRD-PARTY HARMS IN UNDERCOVER POLICE OPERATIONS

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ABSTRACT

While undercover operations by the police are familiar, the harm they can impose on third parties is not. When government agents impersonate criminals, they can impose personal, physical, financial, and reputational harms on victims wholly unrelated to their criminal investigation. A sham drug deal can lead to gunfire and an injured bystander. The mere existence of a government-run fencing operation can lead to increased property theft.

In a number of recent financial fraud investigations, FBI agents have conducted stings that they knew could harm unwitting investors. These stings targeted fraudulent price manipulation of "penny stocks": low-priced stocks marketed and sold directly to the public rather than through stock exchanges. Typically, an undercover FBI agent offers to help a suspect inflate the price of a penny stock by purchasing a large number of shares for manipulative purposes in exchange for a kickback. Not only does the tactic result in an arrest, it can also harm innocent investors who purchase stock at a price that was misleadingly inflated—by the

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government itself.

How should the law address third-party harms attributable to such undercover operations? Surprisingly, this question receives little attention in scholarship or in legal doctrine. These third parties—sting victims—experience government-created harm that is little discussed, under-theorized, and lacks a meaningful regulatory framework. Both doctrinal and academic attention to undercover operations focus only on the bilateral relationship between the government and the target of the investigation. Relying on a variety of examples, but with a special emphasis on penny-stock fraud, we argue that the analysis of stings should recognize potential harms to third parties. Law-enforcement agencies should require explicit consideration of these harms before conducting covert operations. We also identify ways in which stings may be structured and regulated to minimize these harms.

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INTRODUCTION

Government agents often participate in undercover operations to catch criminals in the act. Vice squad officers pose as drug addicts, gang task

force members infiltrate gangs, and FBI agents offer phony bribes to root out corrupt politicians. In recent years, the federal government has significantly increased its use of undercover operations.[1] Not only FBI agents, but also over 1100 federal employees in forty agencies, including the Department of Education, Department of Agriculture, Internal Revenue Service ("IRS"), and U.S. Securities and Exchange Commission ("SEC"), have engaged in undercover tactics since 2001.[2] In some undercover operations, the government's deceptive participation is not marginal, but central: in stings, the criminal activity is "bogus."[3] Law enforcement agencies can structure undercover operations to control for potential harms, but not all harms can be prevented. Innocent third parties may be inadvertently victimized. For example, a street "buy and bust" gone wrong might lead to an exchange of gunfire and an injured innocent bystander.

In other cases, the harm to third parties is not inadvertent, but inherent in the design of the sting itself. For example, it was recently revealed that the FBI impersonated the media in investigating a series of bomb threats made to a high school in Washington State in 2007.[4] The FBI contacted a suspect online with a link to a fake news story about the threats, purportedly by the Associated Press.[5] The link contained hidden spyware that enabled the FBI to locate and eventually arrest fifteen-year-old Josh Glazebrook.[6] The President and CEO of the Associated Press argued that in "stealing our identity," the FBI "corrode[d] the most fundamental tenet of a free press—our independence from government control."[7]

Other foreseeable harm is financial. In a number of recent financial fraud investigations, the SEC and FBI have jointly conducted stings that they knew could harm unwitting investors. These stings targeted securities

1. Eric Lichtblau & William M. Arkin, *More Federal Agencies Are Using Undercover Operations*, N.Y. TIMES, Nov. 15, 2014, http://nyti.ms/1q4cuai.

2. *Id.* With respect to SEC operations, see *infra* Part II.B.

3. *See* FBI UNDERCOVER OPERATIONS, H.R. REP. NO. 98-267, at 1 (1984) [hereinafter 1984 HOUSE REPORT]. Although we focus primarily on stings, we also draw upon other examples of covert policing that help illustrate the types of harms that arise in undercover operations.

4. *Endpoint Surveillance Tools (CIPAV)*, ELECTRONIC FRONTIER FOUND., https://www.eff.org/document/fbicipav-08pdf. *See also* Christopher Soghoian, TWITTER (Oct. 27, 2014, 12:18 PM), https://twitter.com/csoghoian/status/526815317390266368.

5. James B. Comey, Director of the FBI, *To Catch a Crook: The F.B.I.'s Use of Deception,* N.Y. TIMES (Nov. 6, 2014), http://nyti.ms/1wAYxku (confirming specifics of the ruse).

6. Kevin Poulsen, *FBI's Secret Spyware Tracks Down Teen Who Made Bomb Threats*, WIRED (July 18, 2007), http://archive.wired.com/politics/law/news/2007/07/fbi_spyware.

7. Letter from Gary Pruitt, President and CEO of the Associated Press, to Eric Holder, U.S. Attorney General, and James Comey, Director of the FBI (Nov. 10, 2014), https://corpcommap.files.wordpress.com/2014/11/holdercomeyletter.pdf.

fraud involving volatile, low-priced "penny stocks."[8] In some stings, an undercover agent would offer to help the suspect inflate the price of a stock by purchasing a large number of shares in exchange for a kickback. The FBI actually completed some of these manipulative purchases, which could have artificially inflated the market price of the stock and harmed innocent investors.

Fraudulent penny-stock scams have existed for a long time, but the use of concerted, long-term undercover operations against them appears to be new.[9] The SEC's involvement in the penny-stock stings also demonstrates how undercover operations have spread beyond the FBI to other agencies. The large number of such stings in the past few years (including long-term undercover operations in Boston and in Florida[10]) shows that federal law enforcement agencies have taken an aggressive stance toward financial crimes[11] and relied on techniques "more commonly associated with the investigation of organized and violent crime."[12] In addition to covert investigations, these tactics include wiretaps[13] and the "flipping" of potential defendants into informants.[14]

8. *See infra* Part II.B.

9. When then-SEC Commissioner Mary Shapiro discussed "stepped-up" enforcement methods against penny-stock fraud in 1990, she did not mention undercover techniques. Mary L. Shapiro, Seeking New Sanctions: Comments on Developments in the Commission's Enforcement Program, Speech at 10th Annual Northwest Securities Institute 6 (March 9, 1990), http://www.sec.gov/news/speech/1990/030990schapiro.pdf.

10. *See infra* Part II.B.

11. *See, e.g.*, Jason Ryan, *FBI Going Undercover at Financial Firms*, ABC NEWS (Mar. 20, 2009), http://abcnews.go.com/TheLaw/LawPolitics/story?id=7134443&page=1 (quoting FBI Deputy Director John Pistole as saying, "We have several ongoing undercover operations . . . in the corporate fraud and financial fraud area . . . .").

12. Lanny A. Breuer, Assistant Attorney General, Financial Crisis Fallout 2010: Emergent Enforcement Trends, Address at the Practising Law Institute (Nov. 4, 2010), http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101104.html. *Cf.* Marshall L. Miller, Principal Deputy Assistant Attorney General for the Criminal Division, Remarks at the Global Investigation Review Program (Sept. 17, 2014), http://www.justice.gov/opa/speech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller ("And in today's Criminal Division, we are vigorously employing proactive investigative tools that may not have been used frequently enough in white collar cases in past years: tools like wiretaps, body wires, physical surveillance, and border searches, to name just a few.").

13. *See* United States v. Rajaratnam, 719 F.3d 139, 157 (2d Cir. 2013) (upholding the admission of wiretap evidence in an insider-trading prosecution). In the *Rajaratnam* case, prosecutors and the FBI obtained a wiretap warrant for the purpose of investigating wire fraud. *See also* United States v. Rajaratnam, 2010 U.S. Dist. LEXIS 143175, at *5–6, *9–19 (S.D.N.Y. 2010) (holding that this evidence could be used in Rajaratnam's trial on insider trading charges, even though he was never charged with wire fraud and the relevant statute did not authorize the use of wiretaps to investigate securities fraud).

14. *See* Christopher Matthews et al., *"Flipped" Bankers Aid U.S. in Foreign-Exchange Probe*, WALL ST. J. (Sept. 14, 2014), http://www.wsj.com/articles/flipped-bankers-aid-u-s-in-foreign-

The aggressive approach to penny-stock fraud may represent a broader shift in enforcement policy. SEC Chair Mary Jo White has explicitly referred to the agency's recent strategy toward financial fraud as a kind of "broken windows" policing.[15] This term refers to the aggressive enforcement of minor criminal offenses on the street so as to diminish opportunities for more serious crimes.[16] In a 2013 speech, White praised the approach and stated that the SEC was "casting [its] nets wider, and using nets with smaller spaces, paying attention to violations and violators regardless of size."[17] Attention to penny-stock fraud may increase with the rollout of the Jumpstart Our Business Startups (JOBS) Act,[18] which makes it easier for small companies to solicit investment directly from the public.[19] The adoption of aggressive enforcement tools against financial crimes, however, has not been accompanied by serious consideration of their potential harms to innocent parties.[20]

How should the law address third-party harm from undercover operations? This question receives little attention either in scholarship or legal doctrine. The rules of criminal procedure, which govern law-enforcement conduct, largely ignore third-party harms. A defendant caught in a sting may allege entrapment or outrageous government conduct. But these defenses are unhelpful in addressing third-party harm. They focus on the potential harm to the *targets* of the investigation and give no explicit

exchange-probe-1410733662 ("The use of secret informants in the currency probe comes amid a growing push by U.S. prosecutors to bring criminal charges against individuals accused of wrongdoing at large financial institutions."); *Rajaratnam*, 2010 U.S. Dist. LEXIS 143175, at *76–77 (stating that Roomy Khan, a suspect under FBI investigation, "flipped" and gave evidence leading to the conviction of insider trader Raj Rajaratnam); Katie Benner, *The Strong Case Against Raj Rajaratnam*, FORTUNE (Oct. 23, 2009), http://archive.fortune.com/2009/10/22/magazines/fortune/raj_rajaratnam_case.fortune/index.htm.

15. Mary Jo White, Chair of the SEC, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.VD2BihawSUs.

16. *See* James Q. Wilson & George L. Kelling, *Broken Windows: The Police and Neighborhood Safety*, ATLANTIC MONTHLY 29 (Mar. 1982), http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/; GEORGE L. KELLING & CATHERINE M. COLES, FIXING BROKEN WINDOWS: RESTORING ORDER AND REDUCING CRIME IN OUR COMMUNITIES 8–9 (1996).

17. White, *supra* note 15. Recently, however, SEC Commissioner Mike Piwowar criticized this approach, arguing that "if every rule is a priority, then no rule is a priority." Sarah Lynch, *U.S. SEC Piwowar Takes a Swing at "Broken Windows" Enforcement Policy,"* REUTERS (Oct. 14, 2014, 9:55 AM), http://www.reuters.com/article/2014/10/14/sec-enforcement-piwowar-idUSL2N0S90PW20141014.

18. Jumpstart Our Business Startups Act, Pub. L. No. 112–106, 126 Stat. 306 (2012).

19. Peter J. Henning, *Greed Continues to Fuel Penny Stock Frauds*, N.Y. TIMES DEALBOOK (Sept. 15, 2014, 12:03 PM), http://nyti.ms/1uACcCl.

20. In October 2014, several prominent white-collar defense attorneys heavily criticized the SEC for applying the broken windows approach to corporate crime. Jesse Eisinger, *In Turnabout, Former Regulators Assail Wall St. Watchdogs*, N.Y. TIMES (Oct. 22, 2014), http://nyti.ms/1FD2qcK.

consideration to actual or potential third-party harms. In any event, although these defenses are recognized in theory, they rarely succeed.[21]

Criminal liability for government agents is similarly unlikely to curb third-party harms.[22] As a practical matter, prosecutors rarely bring criminal charges against government agents in legitimate stings. In fact, larger sting operations are typically coordinated with prosecutors in advance. Furthermore, otherwise illegal acts may lack the required criminal intent when committed by government agents in furtherance of an investigation.[23] The harm to third parties, however, remains the same regardless of intent.

Third-party harms have been undeservedly ignored. In the case of stock manipulation stings, innocent third parties can suffer direct financial harms as a result of the government's choice to rely upon this particular investigative approach. Such harms should not occur unless they are outweighed by the benefits of engaging in a sting.[24] In the case of impersonating the press, our First Amendment traditions suggest the benefits may never outweigh the costs. Third-party harms also have the potential to undermine the perceived legitimacy of law enforcement agencies.[25] When brought to light, these harms may lead to jury nullification or reduced sentences.[26]

Like legal doctrine, the scholarly commentary on undercover police investigations focuses nearly exclusively on the harms to those directly targeted by the police and the ethics of government-created temptations to commit crime.[27] Very little attention is paid to harms suffered by third parties.

In this Article, we discuss sting victims: innocent third parties harmed as a result of authorized conduct during an undercover operation.[28] Sting

21. *See infra* Part I.

22. For further discussion of the potential direct liability of law enforcement officials, see Elizabeth E. Joh, *Breaking the Law to Enforce It: Undercover Police Participation in Crime*, 62 STAN. L. REV. 155, 168–70 (2009).

23. *Id.* at 169.

24. *See infra* Part III.A.

25. *See, e.g.*, S. REP. 97-682, at 390 (1982) [hereinafter 1982 SENATE SELECT COMM. REPORT] (observing that "there is likely to be considerable public resentment of government, as well as significant opposition to the use of undercover law enforcement efforts, if law enforcement officials are permitted to inflict substantial harm on innocent individuals who have no legal recourse").

26. *See* 1 NATIONAL COMM'N ON REFORM OF FEDERAL CRIMINAL LAWS, WORKING PAPERS 324 (1970) (observing that a jury may acquit "because of the moral revulsion which the police conduct evokes in them, notwithstanding any amount of convincing evidence of the defendant's [criminal] predisposition").

27. *See infra* Part I.

28. A Senate Select Committee directed to study undercover policing described the harm as

victims constitute a government-created harm that is little discussed, under-theorized, and lacks a careful regulatory framework.[29] Both practical and academic attention to undercover operations focus on one particular relationship: the government and the intended target.[30] That focus is unduly narrow. Relying upon examples from many different contexts—but with a special emphasis on the investigations of penny-stock fraud—we introduce an analytical framework to help understand the importance of sting victims. In discussing the problem raised by third-party harms in undercover operations, we also identify ways in which stings may be structured and regulated to minimize these harms.

I. SECOND-PARTY HARMS

The usual analysis of undercover investigations focuses on "second-party" harms: those potential harms imposed on the target of a sting by the government's actions. The chief concern is the possibility that the government's actions in the undercover operation coerced or manufactured the target's criminal conduct.

That concern arises because of the way most stings are structured. While some stings may involve a covert agent who acts merely as a "fly on the wall," more typically, the agent not only disguises his or her true identity, but also encourages or facilitates the crime. That encouragement can be attributed to the nature of the offenses investigated. Undercover investigations often target consensual crimes between willing participants: drug deals, criminal rackets, political corruption, prostitution, and the like. These crimes are difficult to investigate without covert methods.[31] To be

"public injury . . . resulting from criminal acts committed by [government] agents or informants in furtherance of the operation's legitimate aims." 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 391. We thus exclude those cases of third-party harms where undercover officers "go rogue" and act beyond the bounds of their official authority. Because they are clearly criminal, these actions do not pose the same questions as collateral harms that are the result of authorized government activity. *See, e.g.*, Joh, *supra* note 22, at 168 (discussing phenomenon of rogue police officers). We also exclude those instances in which government informants in undercover operations commit criminal offenses in a way that is unrelated to the operation's purposes. *See, e.g.*, 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 391 (describing criminal offenses committed by informant Mel Weinberg in the Abscam operation of the 1980s). And finally, while any government investigation may have collateral effects on unrelated parties, we focus particularly on the direct effects of covert operations that are, in many cases, foreseeable.

29. While this Article pays particular attention to undercover operations run by the FBI and its use of administrative guidelines, our discussion of the harms posed to third parties by stings are applicable more generally in the law enforcement context.

30. *See infra* Part I.

31. *See, e.g.*, Robert E. Taylor, *FBI's Undercover Methods, as in Abscam, Staunchly Defended by Attorney General*, WALL ST. J., June 24, 1982 (quoting Attorney General William Rench Smith as

accepted as part of these enterprises often requires some willingness to participate, or at least to pretend to do so.[32] The question arises, then, of how far the government can go in facilitating the very crime for which it hopes to collect evidence. Too much active facilitation raises concerns that the government effectively created the crime. Yet in most jurisdictions, the government may participate in a crime when the targeted person already seems willing and able to commit the offense.[33]

Unlike in many other areas of police investigation, judges and legislatures have not established clear and precise guidelines on what the government may do in encouraging or facilitating crime.[34] Instead, covert policing is discussed in legal opinions in the context of two defenses available to criminal defendants: entrapment and "outrageous government conduct."[35] The body of scholarly commentary on undercover policing likewise focuses on second-party harms.[36]

saying that a "fundamental tenet" of the Justice Department was that "an enforcement program can never succeed without the effective use of undercover investigations").

32. *See, e.g.*, United States v. Russell, 411 U.S. 423, 432 (1973) ("Thus in drug-related offenses law enforcement personnel have turned to one of the only practicable means of detection: the infiltration of drug rings and a limited participation in their unlawful present practices.").

33. Former DOJ Assistant Attorney General of the National Security Division Kenneth L. Wainstein stated in 2010 that: "So long as [the defendant] has expressed an interest in committing a crime, it's appropriate for the government to respond by providing the purposed means of carrying out that crime so as to make a criminal case against him." Eric Schmitt & Charlie Savage, *In U.S. Sting Operations, Questions of Entrapment* (Nov. 29, 2010), http://www.nytimes.com/2010/11/30/us/politics/30fbi.html.

34. WAYNE R. LAFAVE, 2 SUBSTANTIVE CRIMINAL LAW § 9.8(a) (2d ed. 2014).

35. A third possibility is the direct criminal liability of the government agents involved, but such prosecutions are rare because (1) as a practical matter, few, if any, agents ever face prosecution; and (2) even if they did, they would likely be able to raise some version of a public authority defense, which justifies otherwise criminal conduct committed by a law enforcement official in the course of official conduct. Joh, *supra* note 22, at 169–71.

36. *See, e.g.*, Jacqueline Ross, *The Place of Covert Policing in Democratic Societies: A Comparative Study of the United States and Germany*, 55 AM. J. COMP. L. 493, 498–99 (2007) (examining undercover policing); Bruce Hay, *Sting Operations, Undercover Agents, and Entrapment*, 70 MO. L. REV. 387, 387 (2005) (performing a "systematic economic analysis of undercover police sting operations, their role in the legal system, and the courts' use of the entrapment defense to regulate their use"); Richard H. McAdams, *The Political Economy of Entrapment*, 96 J. CRIM. L. & CRIMINOLOGY 107, 108–09 (2005) (describing the entrapment defense, critiquing possible justifications for the defense and offering new rationales for the defense); Anthony M. Dillof, *Unraveling Unlawful Entrapment*, 94 J. CRIM. L. & CRIMINOLOGY 827, 832–33 (2004) (examining the relevancy of the entrapper's governmental status); Jacqueline E. Ross, *Valuing Inside Knowledge: Police Infiltration as a Problem for the Law of Evidence*, 79 CHI.-KENT L. REV. 1111, 1115–19 (2004) (examining the problem of shortcuts to conviction); Ronald J. Allen et al., *Clarifying Entrapment*, 89 J. CRIM. L. & CRIMINOLOGY 407, 408–09 (1999) (clarifying the nature of entrapment); Roger Park, *The Entrapment Controversy*, 60 MINN. L. REV. 163, 170 (1976) ("[T]he federal defense, with some modifications, is preferable to the hypothetical-person defense."). *Cf.* George E. Dix, *Undercover Investigations and Police Rulemaking*, 53 TEX. L. REV. 203, 229 (1975) (discussing the possibility of administrative rulemaking in covert

A. ENTRAPMENT

The entrapment defense,[37] judicially created or sometimes adopted by statute, permits a defendant targeted by an undercover operation to argue that the government has crossed the line from creating an opportunity for crime to manufacturing the crime itself.[38] The majority of American jurisdictions have adopted the so-called "subjective" version of entrapment,[39] which involves a two-step inquiry: first, whether the offense was induced by the government; and second, whether the defendant was already predisposed to commit the offense.[40] In most jurisdictions, inducement must be more than an ordinary opportunity to commit a crime.[41] Impermissible government inducement might include a criminal opportunity plus "persuasion, fraudulent representations, threats, coercive tactics, harassment, promises of reward, or pleas based on need, sympathy or friendship."[42] If the criminal defendant is shown to have been predisposed, then the defense is unavailable.[43] That is, if the defendant is the sort of person who would have committed the offense whether or not the government had been involved, the entrapment defense is unavailable, no matter the extent of government misconduct.[44] For instance, in *Jacobson*

policing).

37. Joh, *supra* note 22, at 172–73. *See also* Dru Stevenson, *Entrapment and the Problem of Deterring Police Misconduct*, 37 CONN. L. REV. 67, 103 (2004) ("[E]ntrapment almost definitionally involves sting operations.").

38. *See* Lopez v. United States, 373 U.S. 427, 434 (1963) ("The conduct with which the defense of entrapment is concerned is the manufacturing of crime by law enforcement officials and their agents."). A successful entrapment defense immunizes the defendant from criminal prosecution. LAFAVE, *supra* note 34.

39. This defense was first adopted by the Supreme Court in *Sorrells v. United States*, 287 U.S. 435 (1932), although not as a matter of constitutional law. The *Sorrells* decision recognized that federal criminal laws should be interpreted to recognize the defense: "We are unable to conclude that it was the intention of the Congress in enacting this statute that its processes of detection and enforcement should be abused by the instigation by government officials of an act on the part of persons otherwise innocent in order to lure them to its commission and to punish them." Sorrells v. United States, 287 U.S. 435, 438 (1932). More recently, the Court discussed the subjective approach in *Jacobson v. United States*, 503 U.S. 540 (1992): "In their zeal to enforce the law . . . Government agents may not originate a criminal design, implant in an innocent person's mind the disposition to commit a criminal act, and then induce commission of the crime so that the Government may prosecute." Jacobson v. United States, 503 U.S. 540, 548 (1992).

40. LAFAVE, *supra* note 34, § 9.8(b).

41. United States v. Mayfield, 771 F.3d 417, 431 (7th Cir. 2014).

42. United States v. Burkley, 591 F.2d 903, 913–14 (D.C. Cir. 1978).

43. LAFAVE, *supra* note 34, § 9.8(b).

44. There is, as the Seventh Circuit has recently observed, "some conceptual overlap" between the government's inducement and the defendant's predisposition, since the "character and degree of the inducement—and the defendant's reaction to it—may affect the jury's assessment of predisposition." *Mayfield*, 771 F.3d at 437.

v. United States, the Supreme Court held that the government had entrapped the defendant as a matter of law in a child pornography case because he ordered the sexually explicit materials "only after the Government had devoted 2 1/2 years" to convince him to do so.[45]

A minority of jurisdictions employ an "objective" version of entrapment, which focuses primarily on the government's inducement and whether that temptation "creates a substantial risk that such an offense will be committed by persons other than those who are ready to commit it."[46] Predisposition is not a separate element of the defense.[47] The application of the objective version of entrapment is necessarily a fact-intensive and case-specific inquiry that might consider a number of factors, including the nature and intensity of the government's offers or inducements.[48] The objective inquiry—whether the government conduct would induce an otherwise innocent person—necessitates some review of the defendant's conduct.

The defense of entrapment is available to defendants in every jurisdiction, but it is a defense of last resort[49] for at least two reasons. First, merely raising the defense creates some serious risks for the defendant's case.[50] Perhaps most hazardous for the defendant is that the usual rules of evidence that minimize unduly prejudicial evidence are no longer applicable in most jurisdictions applying the subjective approach.[51] Thus, when a defendant claims entrapment, the prosecution may be allowed to

45. Jacobson v. United States, 503 U.S. 540, 553 (1992).

46. MODEL PENAL CODE § 2.13. While this may at first seem like a defense friendly to defendants, the objective test also means that, at least in some jurisdictions, a conviction may be obtained without any evidence that the defendant might have been inclined (or predisposed) to commit the offense. *See, e.g.*, State v. Reed, 881 P.2d 1218, 1228 (Haw. 1994).

47. LAFAVE, *supra* note 34, § 9.8(e).

48. *Id.* § 9.8(c).

49. *See* Dru Stevenson, *Entrapment and Terrorism*, 49 B.C. L. REV. 125, 150 (observing that entrapment is "likely to come up in cases where the defense is most desperate").

50. Ben A. Hardy, *The Traps of Entrapment*, 3 AM. J. CRIM. L. 165, 165 (1974) (noting that entrapment is a "dangerous and judicially unpopular defense that should only be used in a few cases with ideal fact situations or in desperate circumstances where no other defense is possible."); Neil A. Lewis, *Experts Doubt Entrapment Plea by Barry*, N.Y. TIMES (Jan. 22, 1990), http://www.nytimes.com/1990/01/22/us/experts-doubt-entrapment-plea-by-barry.html?smid=pl-share (quoting Law Professor Gerald Caplan as saying: "The defendant who asserts an entrapment defense takes enormous risks.").

51. *See* LAFAVE, *supra*, note 34, § 9.8(f)(1); United States v. Russell, 411 U.S. 423, 443 (1973) (Douglas, J., dissenting) (noting that the defense "permits the introduction into evidence of all kinds of hearsay, suspicion, and rumor—all of which would be inadmissible in any other context—in order to prove the defendant's disposition"); Roger Park, *The Entrapment Controversy*, 60 MINN. L. REV. 163, 272 (1973) (noting that the "greatest fault" of the subjective approach "lies in the permissiveness of its ancillary rules of evidence").

introduce evidence of the defendant's prior convictions, prior arrests, and even information about his reputation or any suspicious conduct.[52] Equally problematic for defendants is the traditional view that a person who denies having committed the offense cannot simultaneously claim entrapment.[53]

The second reason why entrapment is a defense of last resort is that it is extremely unlikely to succeed. Most defendants are likely to be considered predisposed to have committed the offense.[54] This is especially true in jurisdictions in which the defense is decided upon by the jury, which may have a particularly difficult time ignoring the prejudicial effect of conduct evidence.[55]

So while many may have heard of the entrapment defense, in reality, the defense is a loser. In case after case, government agents have persuaded and encouraged defendants into participating in crimes—sometimes *entirely* run by the government—even after sometimes balking at the government's temptations. In most entrapment cases, judges and juries see a defendant with a prior criminal history taking advantage of yet another criminal opportunity, even if it is one that is financed, supplied, encouraged, and organized by the government.

B. OUTRAGEOUS GOVERNMENT CONDUCT

Apart from entrapment, defendants caught by stings may also raise an outrageous government conduct claim, a defense based on the due process clauses of the Fifth and Fourteenth Amendments.[56] The defense amounts to

52. LAFAVE, *supra* note 34, § 9.8(f)(1). *See, e.g.*, United States v. Barger, 931 F.2d 359, 366 (6th Cir. 1991) (stating that factors relevant in finding defendant's disposition include assessing "the character or reputation of the defendant, including any prior criminal record").

53. Roger D. Groot, *The Serpent Beguiled Me and I (Without Scienter) Did Eat—Denial of Crime and the Entrapment Defense*, 1973 U. ILL. L.F. 254, 254 (1973). In the federal courts, such inconsistent defenses are permitted after *Matthews v. United States*, 485 U.S. 58 (1988). However, because *Matthews* was not decided on constitutional grounds, state courts are free to decide otherwise. *See* Eaglin v. Welborn, 57 F.3d 496, 502 (7th Cir. 1995) (rejecting due process and self-incrimination challenges to Illinois rule applying inconsistency bar to entrapment claims).

54. In 2010, the Center on Law and Security at the New York University School of Law reported that as of September of that year, the entrapment defense had "never been used successfully in a post-9/11 federal terrorism trial." CENTER ON LAW AND SECURITY, NEW YORK UNIVERSITY SCHOOL OF LAW, TERRORIST TRIAL REPORT CARD: SEPTEMBER 11, 2001-SEPTEMBER 11, 2010 20 (2010). Of the 156 federal prosecutions implicated in the "top 50 plots," 62% involved government informants. *Id.* The Center on Law and Security tracks all federal criminal prosecutions that the government considers terrorism-related. *Id.*

55. *See* Sherman v. United States, 356 U.S. 369, 377 (1958) ("[W]hether a defendant has been entrapped is for the jury as part of its function of determining the guilt or innocence of the accused."); LAFAVE, *supra* note 34, at § 9.8(f)(2).

56. Although a distinct defense, some courts regrettably use language from both the entrapment

an allegation that the government's tactics in the sting were so shocking or flagrant that criminal charges must be dismissed in the interests of justice.[57] In the Supreme Court's decision in *United States v. Russell*, for example, the defendant claimed that he would not have been able to manufacture methamphetamine without an indispensable chemical that a government agent had provided him.[58] The Court noted that police participation in illegal drug manufacturing is "one of the only practicable means of [its] detection."[59] Because it focuses only on the conduct of the government, a defendant may raise the outrageous government conduct defense even where the defendant's "predisposition" to commit the crime has rendered the entrapment defense unavailable.[60]

Like entrapment, however, the outrageous government conduct defense is more theoretical than practical.[61] Although the Supreme Court has twice recognized the possibility of this defense,[62] it failed in both cases.[63] The Sixth Circuit remarked that the defense has been rejected "with almost monotonous regularity."[64] Courts are reluctant to find that government involvement in a sting is so excessive that it violates due process.[65]

and the due process defenses together. *See, e.g.*, United States v. Lakhani, 480 F.3d 171, 180 (2007) (describing government conduct at issue as a "due process" challenge, although test reflected the objective entrapment defense).

57. United States v. Russell, 411 U.S. 423, 427 (1973). *See also* Joh, *supra* note 22, at 173–75 (discussing examples).

58. Russell, 411 U.S. at 431.

59. *Id.* at 432.

60. LAFAVE, *supra* note 34, § 9.8(g).

61. *See* United States. v. Mayer, 490 F.3d 1129, 1139 (9th Cir. 2007) ("We have only once dismissed an indictment because the government directed a criminal enterprise.").

62. LAFAVE, *supra* note 34, § 9.8(g)

63. Hampton v. United States, 425 U.S. 484, 490 (1976); United States v. Russell, 411 U.S. 423, 436 (1973).

64. United States v. Al-Cholan, 610 F.3d 945, 952 (6th Circ. 2010). *See also* United States v. Bagnariol, 665 F.2d 877, 883 (9th Cir. 1987) (noting outrageous government conduct claims are limited to "extreme cases," such as when government engaged in "dominant fomentation" or "aggressive solicitation" of criminal activity).

65. Of recent note, however, is a small group of cases in which the defense has been successful with respect to a controversial "reverse sting" technique by the Bureau of Alcohol, Tobacco, Firearms and Explosives ("ATF") officials. These cases involve the establishment of entirely fictitious cocaine stash houses that undercover agents then encourage the defendants to rob. Everything about the crime is simulated, except the defendant. An investigative report found that the technique disproportionately targeted racial minorities. *See* Brad Heath, *Investigation: ATF Drug Stings Targeted Minorities*, USA TODAY (July 20, 2014), http://www.usatoday.com/story/news/nation/2014/07/20/atf-stash-house-stings-racial-profiling/12800195/. One of the federal district court opinions even accused ATF agents of "trolling poor neighborhoods" for suspects. *Id.*

II. HARMS TO INNOCENT THIRD PARTIES

Unlike defendants, third-party sting victims receive little attention from scholars or courts. Most academic discussions of government-run stings conceptualize the dynamic as a binary one: a struggle between the government and the targeted person or persons. For example, the best-known sociological study of covert policing, Gary Marx's *Undercover,* pays overwhelming attention to the potential harms to the target; third parties receive only passing attention.[66]

To some extent, this focus on the targeted person or persons is sensible. After all, it is the target that faces criminal prosecution. And many stings involve no third parties. A successful street "buy and bust" results in a feigned illegal transaction, but little else. The results are similar when an undercover officer poses as a prostitute and ensnares an unsuspecting "john." Even more complicated stings may involve nothing more than an elaborate fictional world in which the target is the only non-law enforcement person affected.

Stings can unintentionally harm third parties, however. Some of these collateral consequences are unforeseen. A phony street-corner drug deal may go awry and lead to violence that injures third parties. Even when an operation goes as planned, it can cause harm to third parties. For example, whenever a sting identifies an offender without an arrest right away, the offender may commit further crimes, and the government may end up indirectly contributing to third-party harm.[67]

A. Examples of Third-Party Harms

Some stings injure third parties in ways that are immediate and obvious. Long-term undercover investigations sometimes require police to tolerate significant criminal wrongdoing, either to maintain the false identity of undercover agents or to gather evidence for more serious crimes.[68] This tolerance can harm wholly innocent third parties. Police may draw in suspected thieves by running a fictitious fencing operation. But they may also incentivize additional thefts or criminal victimization that

66. *See generally* GARY T. MARX, UNDERCOVER (1988) (examining the use of covert tactics).

67. *Cf.* Peter J. Henning, *Questions for the Government in an Insider Trading Case*, N.Y. TIMES DEALBOOK (Sept. 14, 2014, 1:14 PM), http://dealbook.nytimes.com/2014/09/02/questions-for-the-government-in-an-insider-trading-case/ (describing a case in which federal agents apparently obtained evidence that the defendant had engaged in insider trading but allowed him to do so again before arresting him).

68. *See* Joh, *supra* note 22, at 165 (describing how police often have to tolerate criminal behavior during undercover sting operations).

might not have otherwise occurred.[69] The infiltration of a close-knit criminal organization may even require an officer to directly participate in crimes in order to maintain his or her cover.[70] For example, a now-disbanded unit[71] of London's Metropolitan Police force (also known as Scotland Yard) was recently exposed for allegedly authorizing its undercover officers "'to engage in minor criminality' to maintain their cover."[72] The officers had, for instance, allegedly engaged in the arson of a department store in order to maintain their identities.[73] Whether supervisors knew of or approved these specific activities remains unknown.

Some stings may harm third parties in ways that are less obvious to the victims themselves. More specifically, when these individuals suffer a harm or unwanted consequence, they may not realize that the injury can be attributed to a government investigation.[74] The government may set up a proprietary business that harms a legitimate business through its mere existence, or the government may participate in criminal activity knowing that this involvement will harm innocent parties.[75] For instance, in Operation Recoup, the FBI targeted stolen car racketeering by setting up its own fictitious used car business. This fake business deliberately sold wrecked cars to "retaggers" who used the motor vehicle identification numbers from the junked cars to disguise the identity of stolen cars. During the course of Operation Recoup, FBI agents also sold several stolen and retagged cars to unwitting car dealers, even though the FBI knew the cars would be sold to unsuspecting purchasers who would lose title to the cars.[76]

While infiltrating animal rights and environmental activist groups,

69. *See* Brown v. State, 484 So. 2d 1324, 1325–26 (Fla. Dist. Ct. App. 1986) (describing the facts of a case where police may have encouraged illegal conduct that otherwise may not have occurred).

70. *See* Joh, *supra* note 22 (discussing examples).

71. The unit, known as the Special Demonstration Squad, was disbanded in 2008. Vikram Dodd & Rob Evans, *Police Chiefs Were Aware Six Years Ago that Undercover Unit "Had Lost Moral Compass,"* GUARDIAN (July 24, 2014), http://gu.com/p/4v8gq.

72. Robert Booth & Sandra Laville, *Scotland Yard Undercover Unit Condemned in Home Secretary's Report*, GUARDIAN (Mar. 6, 2014), http://gu.com/p/3nbtq (reporting that undercover officers in Scotland Yard's Special Demonstration Squad ("SDS") were authorized).

73. Rob Evans, *Secretive Review into Claim that Police Spy Set Fire to Debenhams*, GUARDIAN (June 25, 2012), http://gu.com/p/38hgp. Several investigations into the activities of the secretive SDS are now ongoing. *See, e.g.* Rob Evans, *Further Headaches for Undercover Police Chiefs as More Activists' Convictions Could Be Overturned*, GUARDIAN (June 27, 2014), http://gu.com/p/3qfgt.

74. *See, e.g.*, 1984 HOUSE REPORT, *supra* note 3, at 24 n.63 (quoting testimony of Floyd Clarke, Mar. 17, 1983, stating that victims of stings "may never realize their losses are the result of FBI activity, since it is not the practice of the Bureau to advise them of this fact, even after the operation is concluded").

75. 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 392.

76. *See* 1984 HOUSE REPORT, *supra* note 3, at 22 (discussing an example).

members of the aforementioned Scotland Yard undercover unit fathered at least two children with women from those groups.[77] At least one former member of the unit claimed that such sexual relationships were officially encouraged. In October 2014, Scotland Yard entered into a financial settlement of $680,000 with one of the women involved to forestall a lawsuit.[78]

In a few recent high-profile cases, government investigators harmed third-party persons or organizations by appropriating their identities without their consent. Such governmental "identity theft" occurred when a Drug Enforcement Administration ("DEA") agent opened a Facebook account in the name of a real woman who had been arrested on drug charges.[79] The DEA used the account to identify persons in a suspected drug ring.[80] Although it was created without her knowledge, the fake Facebook account included actual photos of the woman, Sondra Arquiett, with her young son, as well as one of her wearing only underwear.[81] A DEA agent posted the photos to Facebook from Arquiett's phone.[82] According to Arquiett, DEA agents had simply seized her phone after her arrest.[83] The government argued that she had "implicitly" given the government access to the information in her cellphone, although it conceded that she had given no explicit authorization.[84] U.S. Attorney Richard S. Hartunian acknowledged in a court filing that a DEA agent used

77. Rob Evans & Paul Lewis, *Undercover Police Had Children with Activists*, GUARDIAN (Jan. 20, 2012), http://gu.com/p/34m2x. There remains uncertainty as to whether these sexual relationships with targeted persons were authorized. *See, e.g.*, Rob Evans, *Police Chiefs Confused Over Whether They Have Authorized Their Spies to Sleep with Activists*, GUARDIAN (Oct. 18, 2013), http://gu.com/p/3jkty (describing this uncertainty). Indeed, in the revised Home Office code on undercover operations, there is an admonition about the possible intrusion into a person's "private or family life," and no explicit ban on sexual relationships with targets. Daniel Boffey, *Alleged Victims' Fury at Failure to Ban Undercover Police Seduction Tactics*, GUARDIAN (Mar. 15, 2014), http://gu.com/p/3nht2.

78. Alan Cowell, *Woman Who Had Child With British Undercover Officer Will Receive Settlement*, N.Y. TIMES (Oct. 24, 2014), http://nyti.ms/1rsBCCc.

79. This incident was first reported by Chris Hamby, *Government Set Up a Fake Facebook Page in This Woman's Name*, BUZZFEED (Oct. 6, 2014, 4:16 PM), http://www.buzzfeed.com/chrishamby/government-says-federal-agents-can-impersonate-woman-online.

80. *See* Sentencing Memorandum and Motion for a Non-Guidelines Sentence at 8, United States v. Arquiett, No. 5:11-CR-00033 (N.D.N.Y. Jan. 9, 2012) [hereinafter Arquiett Sentencing Memorandum].

81. *Id.*

82. Sari Horwitz, *Justice Dept. Will Review Practice of Creating Fake Facebook Profiles*, WASH. POST (Oct. 7, 2014), https://www.washingtonpost.com/world/national-security/justice-dept-will-review-practice-of-creating-fake-facebook-profiles/2014/10/07/3f9a2fe8-4e57-11e4-aa5e-7153e466a02d_story.html.

83. Arquiett Sentencing Memorandum, *supra* note 80, at 8.

84. Answer at 2–3, Arquiett v. United States, No. 13-CV-0752 (N.D.N.Y. Aug. 7, 2014).

the account to send a "friend request" to a wanted fugitive.[85] Arquiett sued the government, claiming she had suffered "fear and great emotional distress" from the appropriation of her identity.[86] Shortly after the story was reported, the Justice Department announced it would review its practices.[87]

In January 2015, the Justice Department settled the civil case for $143,000.[88] Hartunian said in a statement that the "settlement demonstrates that the government is mindful of its obligation to ensure the rights of third parties are not infringed upon in the course of its efforts to bring those who commit federal crimes to justice," although the settlement did not prohibit DEA agents from using the same tactic in the future.[89]

In another instance of governmental "identity theft," Scotland Yard created false identities for dozens of undercover officers by appropriating, without consent, the identities of real children who had died before they were fourteen years old.[90] Metropolitan Police Commissioner Bernard Hogan-Howe issued a general apology to the families affected but refused to disclose the identities of the officers involved.[91]

Perhaps even more troubling is the FBI's impersonation of the press in its investigation of bomb threats made to a high school in Washington State. FBI agents identified the fifteen-year-old suspect, Josh Glazebrook, by sending a message to his MySpace account. The message contained a link to a phony news story about the threats, purportedly written by the Associated Press, and asked if the story was accurate.[92] By clicking on the

85. Horwitz, *supra* note 82.

86. Complaint at 3, *Arquiett*, No. 13-CV-0752.

87. Horwitz, *supra* note 82.

88. Jacob Gershman, *U.S. to Pay Woman $134,000 for Impersonating Her on Facebook*, WALL ST. J. L. BLOG (Jan. 20, 2015, 8:02 PM), http://blogs.wsj.com/law/2015/01/20/u-s-to-pay-woman-134000-for-impersonating-her-on-facebook/.

89. Erick Tucker, *AP NewsBreak: U.S. Settles Case Over Fake Facebook Page*, ASSOCIATED PRESS (Jan. 20, 2015, 8:37 PM), http://bigstory.ap.org/article/1b16e349738f4495a61b8b4d8def63b6/apnewsbreak-us-settles-case-over-fake-facebook-page.

90. Paul Lewis & Rob Evans, *Police Spies Stole Identities of Dead Children*, GUARDIAN (Feb. 3, 2013), http://www.theguardian.com/uk/2013/feb/03/police-spies-identities-dead-children.

91. The agents involved were issued documents, such as passports and drivers' licenses with the names of the dead children, in case those targeted by the investigations should start to become suspicious. Rob Evans & Paul Lewise, *Met Chief Sorry for Police Spies Using Dead Children's Identities*, GUARDIAN (July 16, 2013), http://www.theguardian.com/uk-news/2013/jul/16/met-chief-spies-dead-children-identities.

92. Ellen Nakashima & Paul Farhi, *FBI Lured Suspect with Fake Web Page, But May Have Leveraged Media Credibility*, WASH. POST (Oct. 28, 2014), http://www.washingtonpost.com/world/national-security/fbi-lured-suspect-with-fake-web-page-but-may-have-leveraged-media-credibility/2014/10/28/e6a9ac94-5ed0-11e4-91f7-5d89b5e8c251_story.html.

link, Glazebrook actually downloaded computer spyware that permitted the FBI to identify his Internet Protocol address and geophysically locate his computer.[93] The principal technologist of the ACLU, Christopher Soghoian, discovered the relevant documents in the government's response to a Freedom of Information Act request by the Electronic Frontier Foundation.[94]

In a letter to Attorney General Eric Holder, the general counsel of the Associated Press called the impersonation "essentially a piece of government disinformation" and stated that it was "improper and inconsistent with a free press for government personnel to masquerade as The Associated Press or any other news organization."[95] The Reporters Committee for the Freedom of the Press, representing several major news outlets, stated that the FBI's impersonation of the Associated Press "endangers the media's credibility and creates the appearance that it is not independent of the government."[96] Citing both the Facebook and Associated Press cases, Senator Patrick Leahy, in a letter to Attorney General Eric Holder, urged a "review [of] all techniques involving federal law enforcement impersonating others without their consent."[97]

B. MARKET MANIPULATION AND PENNY-STOCK FRAUD

An extensive series of undercover operations in recent years demonstrates how third-party harm can take complex, subtle, and unexpected forms. The FBI, working jointly with the SEC, has conducted numerous stings in which undercover agents purchased large quantities of publicly traded stocks from defendants as part of stock-manipulation schemes. Such transactions falsely imply increased demand for a stock, which can distort stock prices and harm innocent third-party investors.

Securities law incorporates the notion that false information harms third parties in the market. The Supreme Court has endorsed the reasoning

93. Mike Carter, *FBI Created Fake Seattle Times Web Page to Nab Bomb-Threat Suspect*, SEATTLE TIMES (Oct. 27, 2014), http://seattletimes.com/html/localnews/2024888170_fbinewspaper1xml.html.

94. *Endpoint Surveillance Tools (CIPAV)*, ELECTRONIC FRONTIER FOUND., https://www.eff.org/document/fbicipav-08pdf. *See also* Christopher Soghoian, TWITTER (Oct. 27, 2014, 12:18 PM), https://twitter.com/csoghoian/status/526815317390266368.

95. Letter from Karen Kaiser, Associated Press General Counsel, to Eric Holder, U.S. Attorney General (Oct. 30, 2014), https://corpcommap.files.wordpress.com/2014/10/letter_103014.pdf.

96. Letter from Reporters Committee for Freedom of the Press, to Eric Holder, U.S. Attorney General (Nov. 6, 2014), http://www.rcfp.org/sites/default/files/2014-11-06-letter-to-doj-fbi-regarding-se.pdf.

97. Letter from Patrick Leahy, Senator of Vermont, to Eric Holder, U.S. Attorney General (Oct. 30, 2014), http://thehill.com/sites/default/files/10-30-14_leahy_to_holder_re_-_fbi_fake_ap_article.pdf.

of the "efficient capital markets hypothesis" (ECMH), the orthodox explanation of how securities markets set prices.[98] According to this theory, "the price of a company's stock is determined by the available material information regarding the company."[99] Negative information about a stock induces selling, and positive information induces buying; the law of supply and demand causes prices to move accordingly. This is, of course, basic market theory. What the ECMH adds is the notion that this pricing mechanism works particularly effectively in public securities markets. In a developed market, buying and selling activity is rapid, frequent, and transparent. Prices thus respond quickly and precisely to new information; this is referred to as the "efficiency" of the capital markets. Because information determines price, misleading information distorts price. Stock manipulation exploits this phenomenon: a manipulator disseminates misleading information about a security in order to move its price in a profitable direction.

Following the logic of the ECMH, the Supreme Court has adopted the so-called "fraud-on-the-market" doctrine. This doctrine presumes that misleading information, by distorting prices, can indirectly harm any investor trading in that security, including those who had never heard or read the information.[100] These investors, who may be scattered around the country or even around the world, pay unfairly inflated prices (or sell at deflated prices). They are invisible and unknowing victims of the manipulation. Thus, if the manipulative purchases are part of a government sting operation, as in several recent cases, purchasers of the stock may be third-party victims of the sting.

Misleading information can take many forms. Manipulators may disseminate false or misleading press releases or other forms of "hype."[101] Purchases and sales are themselves a kind of information. When a stock is publicly traded, investors can see records of the purchases and sales. This indicates the level of demand for a stock, which implies how the market

98. *See* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2409 (2014); Basic, Inc. v. Levinson, 485 U.S. 224, 241 (1988).

99. *Basic*, 485 U.S. at 241.

100. *Id.* ("Misleading statements . . . defraud purchasers of stock even if the purchasers do not directly rely on the misstatements."). This presumption can be rebutted by "appropriate evidence," such as evidence that the market price did not move in response to the information. *Id.* at 252.

101. *See* News Release, U.S. Attorney's Office, S.D. Cal., Rancho Santa Fe Consultant Pleads Guilty to Securities Fraud (June 18, 2013) http://www.justice.gov/usao/cas/press/2013/cas13-0618-Bahr.pdf [hereinafter U.S. Attorney, Bahr News Release] (stock manipulator "arranged for the dissemination of promotional material that overstated the likelihood of [the company's] success and future profits").

perceives its value. Thus, stock manipulators sometime arrange large stock purchases in order to push a stock price upward (or large sales to push it downward). If other investors notice the large purchases, so much the better for the manipulator: the investors may infer that someone has determined that the stock is worth buying. But even investors who are unaware of the purchases can be affected. According to the fraud-on-the market doctrine, any investors who purchased the stock during the period of its manipulation paid an unfairly inflated market price, even if they never communicated with or purchased from the manipulator, and even if they were unaware of the manipulator's large purchases.

In most of the FBI stock stings, an undercover agent offered to purchase stocks for manipulative purposes in exchange for kickbacks. These stings involved companies whose stocks were traded "over the counter" ("OTC")—meaning they could be widely bought and sold by the public, but only through broker-dealers and not through a centralized stock exchange.[102] Many, if not all, of the stock-manipulation stings appear to have involved "penny stocks,"[103] also known as "microcap" stocks[104]—very low-priced, speculative OTC stocks.[105] The typical reason a publicly traded stock trades OTC is that the company fails to meet the requirements to be listed on an exchange, such as the New York Stock Exchange or NASDAQ. For example, its overall size, per-share price, and/or overall trading activity may be below the minimum level required by the exchanges. OTC stocks need not comply with SEC reporting requirements—the core requirements of the federal securities regulation system.[106] Because they are not traded on stock exchanges, OTC stocks are

102. Press Release, U.S. Attorney's Office, S.D. Fla., Undercover Operation Nabs Market Insiders and Promoter (Oct. 7, 2010), http://www.fbi.gov/miami/press-releases/2010/mm100710.htm [hereinafter Undercover Operation Nabs Market Insiders].

103. *See, e.g.*, Complaint at 3, SEC v. Balbirer, No. 0:13-cv-61761 (S.D. Fla. Aug. 14, 2013) [hereinafter Balbirer Complaint].

104. Press Release, U.S. Attorney's Office, D. Mass., FBI Undercover Operation Nets Seven Defendants in Securities Kickback Scheme (Feb, 27, 2014), http://www.fbi.gov/boston/press-releases/2014/fbi-undercover-operation-nets-seven-defendants-in-securities-kicback-scheme [hereinafter FBI Undercover Operation Nets Seven]; Undercover Operation Nabs Market Insiders, *supra* note 102.

105. SEC, *Penny Stock Rules*, https://www.sec.gov/answers/penny.htm (last visited July 10, 2015) ("The term 'penny stock' generally refers to a security issued by a very small company that trades at less than $5 per share. Penny stocks generally are quoted over-the-counter . . . ."). The SEC defines the term for regulatory purposes at 17 C.F.R. § 240.3a51-1, but the term is used loosely and colloquially (and often pejoratively) to refer generally to small, speculative stocks.

106. Securities traded in the "OTC Pink" marketplace, commonly referred to as the "Pink Sheets," are not subject to the SEC's reporting regulations, and OTC Pink subjects most of its companies to no disclosure requirements at all. *See* Dorsey & Whitney LLP, *"Going Dark"—Voluntary Delisting and Deregistration Under the Securities Act of 1934—the Attractions of the "Dark Side"* (Mar. 17, 2009),

also free from the regulations imposed by the exchanges.

In addition, the lack of centralized exchange trading and reduced trading activity reduces the consistency and transparency of the stock's price. As discussed above, stock price is determined by the available information, including the level of demand from other investors. Less trading activity means less information of this type, resulting in more volatile prices that can be strongly affected by a few large transactions.[107] All these factors make smaller stocks more easily susceptible to price manipulation. OTC markets are, in the economic parlance, relatively less "efficient" than the major stock exchanges for purposes of the ECMH: their prices do not reflect information as smoothly or accurately. But the basic mechanism still operates: information shapes price, and false information distorts price. Indeed, the fact that OTC markets have less trading activity means it is less likely that false information will be countered by accurate information. For example, if a manipulator inflates the price of a well-known exchange-traded stock, there are many knowledgeable professional investors who will see through the manipulation, bet against the stock, and push its price back down. That process is far less likely to occur in a thinly traded OTC stock that does not attract the attention of large numbers of professional and institutional investors.

So-called "pump and dump" schemes flourish in these circumstances. Penny-stock owners or promoters inflate ("pump") the price of these stocks through false or misleading practices or information.[108] Once the shares reach a targeted price, conspirators sell ("dump") the shares for a large profit and leave unwitting investors with the losses.[109]

Buying enough shares to manipulate a stock's market price costs a great deal of money; thus, the cost of inflating the price may outweigh the gains from selling at the increased price. In addition, purchases by persons with known connections to the company may be recognized as manipulative and ignored by the market. Therefore, stock manipulation schemes tend to involve purchasing stocks with someone else's money and/or identity. In the penny-stock stings, undercover agents purported to

http://www.dorsey.com/going_dark_voluntary_delisting_deregistration/; OTC MARKETS GROUP, *The Marketplaces*, http://www.otcmarkets.com/marketplaces/otc-pink (last visited July 10, 2015).

107. *The Lowdown on Penny Stocks*, NASDAQ, http://www.nasdaq.com/investing/lowdown-on-penny-stocks.stm (last visited July 10, 2015).

108. Kevin Perkins, Assistant Director of FBI Criminal Investigation Division, Statement Before the Senate Judiciary Committee (Dec. 9, 2009), http://www.fbi.gov/news/testimony/mortgage-fraud-securities-fraud-and-the-financial-meltdown-prosecuting-those-responsible.

109. *Id.*

offer such illicit services to defendants in exchange for kickbacks. Posing as corrupt members of the securities industry, FBI agents (or confidential informants) claimed to have access to the investment resources of others, which they agreed to misuse to make manipulative stock purchases. In reality, however, the agents would buy the stocks with FBI funds.[110]

An early example of this type of operation was a 2002 sting that came to be known as the "Bermuda Short."[111] The defendants were Paul Lemmon, the director of a financial services company located in Bermuda, and Mark Valentine, the chairman of a Canadian securities brokerage firm. Valentine owned a majority of the stock of three small companies. An undercover FBI agent posed as a securities trader for a fictitious mutual fund. Lemmon and Valentine agreed to pay the agent kickbacks if he would cause the fund to purchase $9 to $10 million worth of stock in each of the three companies.[112] Although these massive purchases never took place, the agent used FBI funds to complete a "test trade" of $25,000 worth of one of the stocks and $10,000 worth of another. In return, the agent received two kickback payments of $25,000. Lemmon pleaded guilty to one count of conspiracy, and Valentine pleaded guilty to a securities fraud charge.[113]

Since 2008, the FBI has used this tactic in at least two major long-term undercover operations, one in Massachusetts[114] and the other in Florida.[115] In "Operation Pennypincher," FBI agent John Keelan posed as a

110. Press Release, SEC, SEC Announces Charges Against Florida-Based Penny Stock Schemes (Aug. 14, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539776014 [hereinafter SEC Announces Charges] (describing stings in which FBI agents posed as pension fund and hedge fund managers); Press Release, SEC, SEC Charges Penny Stock Promoters in Series of Kickback Schemes (Oct. 7, 2010), http://www.sec.gov/news/press/2010/2010-187.htm [hereinafter SEC Charges Penny Stock Promoters]; Indictment at 2, United States. v. Lemmon, No. 02-80088CR (S.D. Fla. 2002) [hereinafter Lemmon Indictment]; Balbirer Complaint, *supra* note 103, at 4 (describing a sting in which an FBI agent posed as a hedge fund manager).

111. Lemmon Indictment, *supra* note 110.

112. *Id.* The defendants also agreed to give the agent money to bribe the mutual fund's (nonexistent) due diligence officers to approve the fund's purchase of the stocks. *Id.*

113. Order Instituting Administrative Proceedings at 2, In re Lemmon, No. 3-12153 (Jan. 20, 2006).

114. Press Release, U.S. Attorney's Office, D. Mass., Canadian Man Charged in Securities Kickback Scheme (Nov. 30, 2012), http://www.fbi.gov/boston/press-releases/2012/canadian-man-charged-in-securities-kickback-scheme [hereinafter Canadian Man Charged]; Jean Eaglesham, *Inside One of the U.S.'s Biggest Ever Investment-Fraud Stings*, WALL ST. J. (July 6, 2014), http://www.wsj.com/articles/inside-one-of-the-u-s-s-biggest-ever-investment-fraud-stings-1404700281.

115. South Florida has long been a hub of fraudulent penny-stock activity. *See* Tom Stieghorst, *Penny Stock Fraud Infects South Florida*, SUN-SENTINEL (Dec. 1, 1988), http://articles.sun-sentinel.com/1988-12-01/business/8803090976_1_stock-firms-penny-stock-stock-fraud (quoting then-SEC Chair David Ruder as saying: "It is my belief that South Florida is an area where the problem is greater than virtually any other area in the country."). In addition to the Massachusetts and Florida

corrupt fund manager of the fictional hedge fund SeaFin Capital in suburban Boston.[116] Keelan, as "John Kelly," sought out promoters who would bring in penny-stock executives willing to pay kickbacks; in return, "Kelly" promised to buy their stock using funds from the fictional SeaFin.[117] In one case, an FBI agent (presumably Keelan) posing as "a representative of a major investment fund" used $40,000 supposedly belonging to his fund to purchase stock in Safetek International, Inc.[118] The president and CEO of Safetek allegedly paid the agent $20,000 in kickbacks.[119] As of July 2014, criminal charges had been filed against twenty-two people caught in the sting; eighteen have already pleaded guilty or have been found guilty.[120]

The Florida stings led to civil securities fraud and related charges against forty individuals and twenty-four companies between 2010 and 2013.[121] Many of these defendants were also charged criminally,[122] and several pleaded guilty.[123] In one of the Florida sting cases, an FBI agent subscribed to an initial public offering of stock and wired $50,000 to the defendant, allegedly in return for a $15,000 kickback.[124] Another involved Larry Wilcox, a former actor best known for playing a police officer on

operations, a similar recent sting in Southern California resulted in at least one conviction. *See* Complaint ¶ 11, SEC v. David F. Bahr, No. 13CV1423 GPC KSC (S.D. Cal. June 18, 2013), https://www.sec.gov/litigation/complaints/2013/comp-pr2013-114.pdf [hereinafter Bahr Complaint]. *See also* U.S. Attorney, Bahr News Release, *supra* note 101(reciting the same factual allegations as the basis of a parallel criminal case). The defendant waived indictment and pleaded guilty on the same day. *See* U.S. Attorney, Bahr News Release, *supra* note 101. It is unclear whether the California sting was part of a larger operation, as well as whether other operations have occurred or are ongoing.

116. Eaglesham, *supra* note 114.

117. *Id.*

118. Grand Jury Indictment ¶¶ 11, 15, United States v. Shneibalg, No. 14-cr-10056 (D. Mass. 2014) [hereinafter Shneibalg Indictment].

119. *Id.* ¶¶ 12, 16.

120. Eaglesham, *supra* note 114; Press Release, U.S. Attorney's Office, D. Mass., FBI Undercover Operation Nets Seven Defendants in Securities Kickback Scheme (Feb, 27, 2014), http://www.fbi.gov/boston/press-releases/2014/fbi-undercover-operation-nets-seven-defendants-in-securities-kicback-scheme; Press Release, U.S. Attorney's Office, D. Mass., Businessman Convicted in Fraud Scheme (Nov. 4, 2013), http://www.justice.gov/usao-ma/pr/businessman-convicted-fraud-scheme; Press Release, U.S. Attorney's Office, D. Mass., Businessmen Convicted in Securities Fraud Scheme (May 3, 2013), http://www.fbi.gov/boston/press-releases/2013/businessmen-convicted-in-securities-fraud-scheme; Canadian Man Charged, *supra* note 114.

121. SEC Announces Charges, *supra* note 110.

122. Undercover Operation Nabs Market Insiders, *supra* note 102.

123. Press Release, U.S. Attorney's Office, S.D. Fla., U.S. Attorney Announces Regional Results of Operation Broken Trust, Targeting Investment Fraud (Dec. 06, 2010), http://www.fbi.gov/miami/press-releases/2010/mm120610.htm; Press Release, U.S. Attorney's Office, S.D. Fla., Larry Wilcox Pleads Guilty to Conspiracy to Commit Securities Fraud (Nov. 3, 2010), http://www.justice.gov/usao/fls/PressReleases/2010/101105-01.html.

124. Balbirer Complaint, *supra* note 103, at 5.

television.[125] Wilcox, the president and CEO of a company called UC Hub, allegedly paid an FBI agent an $8,000 kickback to purchase $20,000 worth of UC Hub stock.[126] As part of his plea deal, Wilcox agreed to work for prosecutors as an undercover informant.[127]

III. EVALUATING THIRD-PARTY HARMS

A. THIRD-PARTY HARMS AND COST-BENEFIT ANALYSIS

The fact that stings, such as the penny-stock stings, may harm an unknown number of third parties suggests a skewed or absent cost-benefit analysis by the government. The question is not simply "whether the undercover technique works, but whether and when it is worth the costs."[128] Every government action imposes at least some diffuse, invisible third-party costs by consuming public resources. Costs alone do not invalidate a sting; the question is whether an operation produces social benefits sufficient to *justify* its direct and indirect costs. A sting that results in arrest and conviction is not necessarily a "successful" one if its costs outweigh the public safety benefits of the conviction. A sting should not be undertaken if its reasonably foreseeable costs, such as third-party harms, are evident, and its public-safety benefits are limited.

1. Third-Party Harms as Foreseeable Costs of Stings

It would be impossible to account for all unforeseeable and low-probability consequences of any government operation. But law enforcement should take pains to identify and consider likely, foreseeable harms to third parties. Such foreseeable harms can be physical, emotional, or in the case of penny-stock stings, financial.

The FBI's penny-stock stings may have distorted stock prices, exposing innocent investors to economic harm. This risk may not be obvious to the layperson, but the potential harm should have been readily apparent to white-collar crime experts in the FBI and particularly the SEC.

125. Wilcox played Jon Baker, a California Highway Patrol officer, in the popular 1970s TV show *CHiPs.* SEC Charges Penny Stock Promoters, *supra* note 110.

126. Complaint at 8, SEC v. Mellone, No. 1:10-CV-23609-JAL (S.D. Fla. Oct. 7, 2010). Criminal charges were also filed against Wilcox. *See* Undercover Operation Nabs Market Insiders, *supra* note 102.

127. Thomas Kaplan, *Ex-TV Cop's New Role: Confidential Informant*, N.Y. TIMES DEALBOOK (Oct. 11, 2010, 12:19 PM), http://dealbook.nytimes.com/2010/10/11/ex-tv-cops-new-role-confidential-informant/?_r=0. It is unclear if Wilcox actually went undercover, but the fact that his plea deal was not announced until his co-defendants were indicted several months later suggests that he was cooperating with authorities at some level in the interim. *Id.*

128. 1984 HOUSE REPORT, *supra* note 3, at 10.

Yet the SEC and FBI sources have expressed the belief that these sting operations did *not* expose the public to harm. With respect to the South Florida stings, an SEC press release stated that "FBI undercover operations [were] conducted in such a way that no investors suffered harm."[129] Similarly, FBI sources told the press that in devising the Bermuda Short, "the challenge was to conduct the sting without further hurting investors, so there was no actual pump-and-dump scheme involved."[130]

But even though the transactions did not directly victimize investors, the ECMH and fraud-on-the-market doctrine hold that manipulative purchases can distort prices, and thereby harm innocent third-party investors.[131] Take, for example, one of the South Florida stings involving an OTC stock, Redfin Network, Inc. In July 2011, Jeffrey Schultz, the president and CEO of RedFin, allegedly concocted a manipulation scheme with an FBI cooperating witness. The witness promised to purchase $32,000 worth of RedFin stock on the open market in exchange for a 25% kickback.[132] The purchases were to be timed with favorable press releases by the company. Schultz allegedly said that he wanted the cooperating witness to "bring in the buying" that would attract "new players." He allegedly said "buying begets buying" and that his goal was to raise the share price "to that 10 cent mark."[133]

In a series of transactions between July 28 and August 1, 2011, the FBI purchased approximately 349,118 shares at a total cost of $26,290.[134] Schultz allegedly wanted to continue the scheme, but no further purchases were made.[135] Just as Schultz allegedly intended, these purchases appear to have encouraged other buyers and inflated the stock's price. Prior to the FBI purchases, RedFin's trading volume (the total number of shares bought

129. *See* SEC Charges Penny Stock Promoters, *supra* note 110.

130. John Saunders, *Greed Was the Bait for FBI Stock Sting*, GLOBE AND MAIL (Apr. 23, 2009, 11:09 AM). "Pump-and-dump" refers to driving up a stock's price through phony purchases or promotional hype, followed by a mass selloff to profit from the inflated price. *The Lowdown on Penny Stocks*, NASDAQ, http://www.nasdaq.com/investing/lowdown-on-penny-stocks.stm.

131. *See supra* Part II.B. Whether the FBI or SEC should be liable under the securities laws is beyond the scope of this Article. Moreover, such a consideration is irrelevant to this Article's primary concern: the potential harm to third-party victims. As Justice Blackmun observed, "an investor can be victimized just as much by negligent conduct as by positive deception." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 216 (1976) (Blackmun, J., dissenting).

132. Complaint at 5, SEC v. Schultz, No. 0:13-cv-61763 (S.D. Fla Aug. 14, 2013) [hereinafter, Schultz Complaint].

133. *Id.* at 4.

134. *See id.* at 5 (number of stocks bought and total price is derived from adding up the allegations in the complaint).

135. *Id.* at 6.

and sold) averaged around 40,000 per day in July 2011.[136] During that period, the price was stable at six to seven cents per share. The FBI purchased 25,605 shares of RedFin on July 28.[137] Volume jumped to over 204,000 that day, and reached 103,000, 231,000, and 233,000 on July 29, August 1, and August 2, respectively.[138] The FBI purchased the bulk of its shares—225,000—on August 1, accounting for the vast majority of trading volume that day.[139] On August 2, the stock reached a high of twelve cents per share. The following day, the price ranged from seven to eight cents, and volume fell dramatically to 24,884 shares. Volume did not reach triple digits again until September 9. The stock price was generally between seven and eight cents per share until August 24, when it settled at the five to six cent range.

In addition to such distortions of specific stock prices, price manipulation can add to the volatility and unreliability of penny-stock markets generally. Furthermore, had government agents in the penny-stock stings not offered a way to disguise and fund manipulative purchases, the defendants may have been unable to engage in manipulation at all, even assuming they were "predisposed" to do so. That is, the stings may create "surplus crime"—and surplus social harm via market distortion—that would not have occurred otherwise.[140] This resembles a sting in which an agent posing as a "fence" incentivizes targets to steal cars: the crimes and the resultant harm to victims may not have occurred but for the government operation.[141]

Even stings that do not target publicly traded stocks can cause third-party harms. The Boston penny-stock stings, for example, "typically" involved purchases of restricted shares that were not publicly traded.[142] Such shares have no developed market, so the ECMH analysis would not apply and transactions would have no manipulative effect on market prices. But they could nonetheless cause harm to investors or creditors. "Kelly" promised companies that he would cause SeaFin to buy up to $5 million of

136. Stock volume and price data in this paragraph are from a Google Finance search (www.google.com/finance/historical?cid=717707&startdate=Jun 1%2C 2011&enddate=Oct 1%2C 2011&num=30&ei=Ya-1U6CnJ-KsiQKfnoCQDA&start=30) (copy on file with authors).

137. Schultz Complaint, *supra* note 132.

138. July 30 and 31 were weekend days on which the markets were closed.

139. Schultz Complaint, *supra* note 132.

140. Even if the sting satisfies the legal requirement that the defendants were "predisposed" to engage in stock manipulation, that does not answer the policy question of whether society would have been better off had the sting not occurred.

141. This example can be found in 1984 HOUSE REPORT, *supra* note 3, at 23–24.

142. Eaglesham, *supra* note 114.

their stock and then began making purchases.[143] The promised and actual influx of capital from SeaFin would make it easier for the companies to attract investors or obtain credit, ultimately harming those investors or creditors.[144]

These third-party harms in penny-stock stings are foreseeable consequences of the stings. The FBI could have avoided distorting the prices of publicly traded stocks if it had stopped the sting after agents made an agreement with the targets, but before any test trades were made; a successful prosecution would not require any completed trades.[145] However, the government designed the penny-stock stings to involve actual trades, making price distortion and third-party harm the likely consequence of a successful operation. By contrast, while physical injury to third parties may be a foreseeable consequence of a drug buy-and-bust sting, it can be fairly seen as the unexpected and relatively improbable fallout of a *failed* operation.

2. Stings with Limited Benefits

Invisible, diffuse third-party harm from stings may be small, even in the aggregate. The potential third-party harm from the penny-stock stings, for example, is admittedly limited due to the small size of the companies involved. But as SEC Chair Mary Schapiro has observed, penny-stock scams often victimize "orphans and widows"[146]—that is, less wealthy, unsophisticated investors for whom even a relatively small financial loss can be devastating. Furthermore, when a sting's benefits are small, even small harms may be unjustified. The small size of the companies limits not only the potential aggregate harm, but also the benefits of incapacitating and punishing their owners and promoters.

143. *Id.*

144. *Cf.* 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 392 ("In [the 1980s Abscam sting], for example, a legitimate investor might have been led by one of the targets to believe that Arab sheiks were depositing hundreds of millions of dollars in the Chase Manhattan Bank and might have purchased Chase Manhattan stock in reliance on that information.").

145. A mail or wire fraud conviction would not require a completed securities transaction; the statutes merely require the use of mail or wires (such as interstate phone lines) "for the purpose of executing" a "scheme or artifice to defraud." 18 U.S.C. §§ 1341, 1343 (2012). The facts in most of the stings would probably also support a charge of conspiracy to commit securities fraud even without any completed transactions. *See* 18 U.S.C. § 371 (2012). In addition, 18 U.S.C. § 1349 specifically prohibits attempt or conspiracy to commit mail or wire fraud. 18 U.S.C. § 1349 (2012). One recent penny-stock sting concluded with the defendant, David Bahr, pleading guilty to a § 1349 charge. U.S. Attorney, Bahr News Release, *supra* note 101.

146. Mary L. Schapiro, SEC Commissioner, Seeking New Sanctions: Comments on the Developments in the Commission's Enforcement Program 2, Speech at 10th Annual Northwest Securities Institute (Mar. 9, 1990), http://www.sec.gov/news/speech/1990/030990schapiro.pdf.

A common criticism of stings is that they catch unwise, unlucky individuals who may be immoral or foolhardy, but are not particularly dangerous.[147] The penny-stock stings may fail a cost-benefit analysis for this reason. Consider again some of the Boston stings that involved the purchases of *non*-publicly traded stock. As discussed above, a company participating in such a scheme could publicize the influx of capital, fanning demand for its publicly traded stock and manipulating its price upward. But a company might have entered into this kind of arrangement for reasons other than stock manipulation or otherwise misleading investors or creditors. As noted above, most of the Boston cases did not involve publicly traded stock. Thus, the defendants were not manipulators, since the stocks in question had no market prices to manipulate. Rather, the defendants were trying to bribe a (phony) trader ("Kelly") to misappropriate funds from his nonexistent employer ("SeaFin") in order to bring investment capital into the defendants' companies. Apparently, this is what happened in the *Safetek* case.[148] These bribes do not appear to have been proposed by the defendant, but to have been expressly solicited by the "trader"—that is, the undercover FBI agent.[149] These circumstances call into question whether the sting generated any benefits in terms of protecting the public.

Unlike the manipulation schemes of some of the sting defendants, this scenario presents no significant risk to any third parties. Even the intended second-party "victims" are nonexistent. According to the Wall Street Journal, the undercover agent "stressed that his employer was to be kept in the dark about the backroom deals, which effectively involved stealing millions of dollars from the fund's investors." This "employer," the "millions of dollars," and the victimized "investors," however, were entirely fictional.[150]

147. *See, e.g.*, Trevor Aaronson, *The Informant*, MOTHER JONES (Sept./Oct. 2011), http://www.motherjones.com/politics/2011/08/fbi-terrorist-informants?page=5 ("The Portland [FBI sting of 18-year-old Mohamed Osman Mohamud] has been held up as an example of how FBI stings can make a terrorist where there might have been only an angry loser.").

148. Shneibalg Indictment, *supra* note 118, ¶ 7. The *Shneibalg* case involved Safetek International, Inc., whose stock was publicly (OTC) traded, *see id.* ¶ 2, but the Shneibalg Indictment contains no allegations of a manipulation scheme.

149. The Shneibalg Indictment does not state who first proposed a kickback in exchange for the investment. *Id.* ¶ 7 (stating only that Shneibalg "indicated that he was willing to enter into the kickback arrangement"). According to a subsequent investigative report, however, "Kelly" explicitly told defendants that he did not expect the investments to make a profit for "SeaFin" and that they would have to kick back 50% of the "SeaFin" investment amounts to him. Eaglesham, *supra* note 114.

150. Shmuel Shneibalg, the defendant in the *Safetek* case, was not charged with securities fraud, but with mail and wire fraud for "a scheme to defraud and obtain money . . . by secretly kicking back to [an undercover agent] fifty percent of Fund monies invested in Safetek International Inc." Shneibalg

Such a sting produces no immediate social benefit, even if it ultimately induces a clear violation of law. The defendants in the *Safetek* case, for example, were willing to break the law to raise capital for their businesses. As noted above, some defendants could use such capital infusions to mislead other investors or creditors. But some may have simply wanted to apply that capital to productive purposes. This is not to say the defendants' conduct was innocent; they did believe they were bribing someone to misappropriate investment money. Yet these "bribes" occurred only because the government decided to devote public resources to the stings.

A defendant convicted as a result of the Boston operation argued on appeal that offering to invest in "down and out companies in desperate need of capital" was analogous to making expensive drugs available to "poor, homeless drug addicts."[151] It seems unlikely that such defendants would have caused any harm in the absence of the sting.[152] The companies' inability to legitimately raise capital apparently arose from the fact that they were poor investments. The capital markets were not interested in them. Furthermore, the FBI used middlemen to actively recruit targets to participate in the SeaFin schemes.[153] Absent such recruitment, the defendants likely would not have had any opportunity—legal or illegal—to obtain such a large amount of capital. If not for the sting, many of the companies involved very likely would have simply gone out of business for want of capital. In this way, these investigations may be subject to the same criticism that has been directed at a number of post 9/11 anti-terrorism stings: that the government may be targeting hapless individuals who posed no real danger to the public.[154]

Many of the other penny-stock defendants were apparently trying to

Indictment, *supra* note 118, ¶ 5. As the Indictment points out, "the Fund [apparently SeaFin] never existed, except as part of an ongoing FBI undercover operation." *Id.* That is, under the government's own theory, Shneibalg's intended "victims" were the fictional investment fund and its nonexistent investors.

151. Eaglesham, *supra* note 114.

152. *Cf.* United States v. Manzella, 791 F.2d 1263, 1269 (1986) (in legitimate stings, "punishing the criminal will, or at least may, reduce the crime rate, by taking out of circulation a person who, had he not been caught, would have committed the same crime, only in different circumstances, making it harder to catch him").

153. The FBI agent in the operation "found middlemen who would help him reel in executives of penny-stock companies willing to pay a huge kickback in return for an investment of up to $5 million." Eaglesham, *supra* note 114.

154. TREVOR AARONSON, THE TERROR FACTORY: INSIDE THE FBI'S MANUFACTURED WAR ON TERRORISM 13 (2013).

manipulate prices.[155] However, absent the stings, these defendants may not have had the ability to actually manipulate prices; indeed, the manipulation stings like those in Florida were based on FBI-financed test trades and undercover agents' false promises of multimillion-dollar purchases. The FBI has not suggested that there is an actual rash of crooked fund managers taking kickbacks in exchange for diverting millions of their employers' investment dollars. If such criminals do exist, *they* would pose a greater threat to the public than the much smaller fish caught in the stings. The FBI would do better to pursue them rather than impersonate them.

Even assuming that sting targets pose a threat to the public, simply identifying and incapacitating offenders may not be worthwhile if they are easily replaced. If an incapacitated criminal is merely replaced by another criminal, there is no net gain in crime reduction. Aggressive enforcement of street drug sales makes the most sense if enforcement results in fewer instances of the same offense. Arresting the local drug dealers may, however, simply invite another group of dealers to take their place. The same may be true of white-collar scam artists: arresting one may simply open up more opportunities for others. For example, there may be a practically endless supply of entrepreneurs willing to enter into the deals offered by "SeaFin."

3. Localized Benefits, Externalized Costs

Why would a law enforcement agency execute stings that do not provide net benefits to the public? Agencies may derive localized benefits from stings without internalizing the costs. That is, in deciding whether to expend public funds on an action (such as a sting), members of a public agency (such as a police department or the FBI) are likely to consider not only the potential benefit to the public at large, but also the benefit to the agency and its agents.

In the 1990s, a group of Albuquerque police detectives wrote a how-to guide for "storefront" sting operations, or ersatz businesses created by law enforcement to attract criminals.[156] Their analysis illustrates the problem of externalized costs. While they recognized that storefronts could result in harm to third parties, their concern was not with third-party welfare, but how storefronts might translate into liability exposure for police departments. In other words, they considered whether harms from stings

155. Complaint ¶ 25, SEC v. Mellone, No. 1:10-CV-23609-JAL (S.D. Fla. Oct. 7, 2010) (alleging that defendant "actively sought partners for a market manipulation scheme").

156. JOHN F. SMITH ET AL., HOW TO SET UP AND RUN A SUCCESSFUL LAW ENFORCEMENT STING OPERATION 49–58 (1991).

might impose costs *on the department*, but not whether such harms might represent costs *to the public* that may outweigh the benefits of apprehending criminals.[157] For example, the authors stated that "[c]ivil suits have been filed alleging that a storefront [set up by police for sting purposes] conducting a similar business caused [plaintiff's genuine business] to lose customers and income . . . [and] resulted in the [genuine] business closing."[158] In these cases, the authors stated that the phony business, free from the need to turn a profit, set its prices too low and undercut the plaintiffs' genuine businesses.[159] The authors also noted that attracting a visible unsavory element could depress business at neighboring legitimate businesses. They argued that this could cause complaints or exposure of the sting and result in "premature closure of the operation."[160] Again, their focus was not on harm to third parties per se, but on the resultant costs to the police.

Given their experience as detectives rather than policymakers, this focus is understandable, even commendable. A responsible police agency should weigh the potential costs of its operations. Weighing the overall public costs and benefits from law enforcement policy, however, is not a job for police agencies alone. Sting operations need administrative, legislative, and judicial input to bring third-party and public interests into the analysis.

Any public agency will naturally seek to protect its own interests. This is not necessarily selfish or corrupt; an agency must maintain its own financial and political strength in order to protect the public. Civil asset forfeiture laws are a good example. Federal and state civil asset forfeiture laws often permit police to seize property suspected of being involved in crime in civil, rather than criminal, proceedings and to benefit from the sale or ownership of the seized assets.[161] Recently, civil asset forfeitures have drawn extensive criticism for two reasons. First, many civil forfeiture laws permit the seizure of assets even if the affected individual never faces criminal charges, and many states allow this under merely a "preponderance of the evidence" standard.[162] Second, in an age of

157. *Id.* at 49–51, 58 ("Possible liabilities should not deter the start of a storefront.").

158. *Id.* at 55.

159. *Id.*

160. *Id.* at 55–56.

161. JOHN L. WORRELL, OFFICE OF COMMUNITY ORIENTED POLICING SERVICES, DOJ, ASSET FORFEITURE 3–4 (2008), http://www.popcenter.org/Responses/pdfs/asset_forfeiture.pdf.

162. MARIAN R. WILLIAMS ET AL., INSTITUTE FOR JUSTICE, POLICING FOR PROFIT 13, http://www.ij.org/images/pdf_folder/other_pubs/assetforfeituretoemail.pdf; WORRELL, *supra* note 161, at 18–19.

shrinking public resources, law-enforcement agencies may come to depend on forfeitures to supplement their budgets.[163] Not only do some police departments use civil forfeitures as a "routine source of funding,"[164] but a *Washington Post* investigation reported a subculture of policing in which aggressive forfeiture tactics were taught and rewarded.[165]

Furthermore, while law enforcement and prosecutors presumably have the public interest in mind most of the time, public safety per se is difficult to define and measure. Rather, police, prosecutors, and regulatory enforcement agencies are evaluated by cruder, but more easily quantifiable measures, such as arrests, convictions, and civil judgments.[166] Success according to these metrics bears some relationship to public safety, but also yields political favor, better funding, and professional advancement for the agencies and their leaders. Thus, it seems plausible that even the most well-intentioned agencies would design stings to have a high probability of arrest and conviction.[167] Straightforward legal theories, starkly immoral behavior, simple factual situations, and unsophisticated defendants increase this probability. The penny-stock stings satisfy all these criteria.

Penny-stock stings, and white-collar stings generally, surely have political motivations as well. They may deflect the common complaint that "street crime" enforcement disproportionately targets minority and poor defendants. Resentment caused by the financial crisis and recession has given government additional political incentive to target white-collar criminals.[168] Few individuals or corporations implicated in the crisis have faced criminal charges.[169] The Justice Department's recent insider trading

163. WORRELL, *supra* note 161, at 16.

164. Robert O'Harrow, Jr., & Steven Rich, *Asset Seizures Fuel Police Spending*, WASH. POST (Oct. 11, 2014), http://www.washingtonpost.com/sf/investigative/2014/10/11/cash-seizures-fuel-police-spending/.

165. Michael Sallah et al., *Stop and Seize*, WASH. POST (Sept. 6, 2014), http://www.washingtonpost.com/sf/ investigative/2014/09/06/stop-and-seize/; Robert O'Harrow, Jr. & Michael Sallah, *They Fought the Law. Who Won?*, WASH. POST (Sept. 8, 2014), http://www.washingtonpost.com/sf/investigative/2014/09/08/they-fought-the-law-who-won/; Robert O'Harrow, Jr. & Michael Sallah, *Police Intelligence Targets Cash*, WASH. POST, (Sept. 7, 2014), http://www.washingtonpost.com/sf/investigative/2014/09/07/police-intelligence-targets-cash/; WORRELL, *supra* note 161, at 15–17.

166. Keith A. Findley & Michael S. Scott, *The Multiple Dimensions of Tunnel Vision in Criminal Cases*, WIS. L. REV. 291, 325–36. (2006).

167. *Cf.* 1984 HOUSE REPORT, *supra* note 3, at 81 ("The publicity and prestige accorded successful undercover operations provide powerful incentives for agents, their supervisors, and the superiors at headquarters to extend the technique into new areas and to continue to plan and recommend additional operations.").

168. *See supra* text accompanying notes 21–25.

169. Jesse Eisinger, *Why Only One Top Banker Went to Jail for the Financial Crisis*, N.Y. TIMES (Apr. 30, 2014), http://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-

prosecutions have been characterized as symbolic, though misplaced, retribution for Wall Street's role in the financial crisis.[170] The Justice Department's Criminal Division has been accused of an excessive fear of losing cases that has caused it to avoid complex prosecutions involving the financial crisis and to focus on more straightforward financial crimes such as insider trading.[171]

The most recent round of penny-stock stings, which seem to have begun as the recession took hold around 2008,[172] may be similarly motivated. Penny-stock prosecutions have no meaningful relationship to the financial crisis or the recession, but can be portrayed as part of a larger campaign against financial fraud.[173] The stings also provide an easy route to conviction. Stings produce clear evidence of criminal conduct, and the penny-stock defendants (and their lawyers) are likely to be less sophisticated than Wall Street executives.

Budgetary concerns may also explain why stings focus on relatively small targets. In the penny-stock stings, the FBI made payments in the tens of thousands of dollars. In the Boston stings, "John Kelly" promised defendants that he would make a series of "escalating payments" in order to slowly build trust, but in fact, the small payments were necessitated by the FBI's "limited finances."[174] Such small amounts could not manipulate the prices of large companies' stocks or otherwise be of interest to major financial criminals.

crisis.html.

170. *See* CHARLES GASPARINO, CIRCLE OF FRIENDS: THE MASSIVE FEDERAL CRACKDOWN ON INSIDER TRADING 17 (2013) (arguing that the Justice Department pursued insider traders "to satisfy the public's demand for Wall Street scalps, even though insider trading had nothing to do with the practices that led to the banking debacle"). *Cf.* Thomas W. Joo, *Legislation and Legitimation: Congress and Insider Trading in the 1980s*, 82 IND. L.J. 575, 578 (2007) (arguing that Congressional hearings on insider trading in the 1980s "symbolically reduced America's economic problems to one relatively simple issue").

171. Eisinger, *supra* note 169 (quoting a former Southern District of New York Prosecutor as saying, "Am I going to chase after crimes I don't know were committed and don't know who by, or do we go after crimes we do know were committed and by whom?").

172. Complaint ¶ 25, SEC v. Mellone, No. 1:10-CV-23609-JAL (S.D. Fla. Oct. 7, 2010) (stating that an undercover agent posed as a trustee of a pension fund in May 2008).

173. In a press release regarding the South Florida stings, U.S. Attorney Wifredo A. Ferrer stated, "The prosecution of white collar crime, including securities, health care, and mortgage fraud, is one of my top priorities." Undercover Operation Nabs Market Insiders, *supra* note 102. In a press release regarding the Boston stings, U.S. Attorney Carmen Ortiz stated, "Secret deals like the ones alleged today harm hard working Americans who invest their savings in the financial markets. Illegal kickbacks undermine fair competition and ultimately destabilize financial markets." FBI Undercover Operation Nets Seven, *supra* note 104.

174. Eaglesham, *supra* note 114.

Finally, law enforcement agencies undoubtedly take into consideration a different cost-benefit analysis as well: the Supreme Court's uneven development of Fourth Amendment restrictions on investigative techniques. While conventional searches and seizures have generated a considerable body of Fourth Amendment rules, undercover police work has not. Thus, the very fact that undercover operations are lightly regulated may exert "hydraulic pressure" on the police to rely upon them.[175] As a House of Representatives subcommittee once reported, law enforcement agencies may exhibit an "enthusiasm" for the sting "precisely from the fact that . . . the technique is relatively unencumbered by []constitutional and legislative constraints imposed on traditional methods of law enforcement."[176]

B. AN OLD PROBLEM NEEDING NEW ATTENTION

It is difficult to determine whether the FBI and SEC explicitly weighed the costs and benefits of engaging in the penny-stock stings. The FBI is not required to report regularly on its undercover operations.[177] Even if the agencies performed such a calculation, the cases discussed here raise the question of whether the analysis was adequate. The apparent lack of attention to third-party harms is surprising, since the problem is an old one. The collateral damage of government stings was one of the many ethical and legal concerns in the congressional investigation of the infamous "Abscam" sting of the 1980s. This Section will discuss the results of the hearings, the administrative FBI guidelines that were promulgated as a result, and their limits.

1. The Abscam Scandal and Third-Party Harms

The Abscam scandal began with an undercover FBI investigation that initially focused on the trafficking of stolen property, but eventually turned toward political corruption.[178] FBI agents posed as Arab sheiks and relied heavily on a confidential informant, Mel Weinberg, who pretended to be a business agent for the fictitious "Abdul Enterprises."[179] Weinberg

175. Gary Marx, *The Interweaving of Public and Private Police in Undercover Work*, *in* PRIVATE POLICING 172, 184–86 (Clifford D. Shearing & Phillip C. Stenning eds., 1987).

176. 1984 HOUSE REPORT, *supra* note 3, at 81.

177. *See infra* Part III.B.4.

178. *See* OFFICE OF INSPECTOR GENERAL, THE FEDERAL BUREAU OF INVESTIGATION'S COMPLIANCE WITH THE ATTORNEY GENERAL'S INVESTIGATIVE GUIDELINES 41–42 (2005) [hereinafter 2005 OIG REPORT]. For a detailed description of the techniques used in the Abscam investigation, see United States v. Kelly, 707 F.2d 1460 (D.C. Cir.) (per curiam), *cert. denied*, 464 U.S. 908 (1983).

179. 2005 OIG REPORT, *supra* note 178, at 41.

introduced undercover FBI agents to government officials, who were offered money in exchange for favors and political influence.[180] Evidence from the investigation eventually led to the convictions of a U.S. Senator, six members of the House of Representatives, the Mayor of Camden, New Jersey, members of the Philadelphia City Council, and an inspector for the Immigration and Naturalization Service.[181]

The Abscam investigation received widespread attention chiefly because of its targeting of public officials, its reliance on an informant of dubious motives, and the question of whether FBI agents had engaged in entrapment.[182] Following widespread press coverage, the House Subcommittee on Civil and Constitutional Rights held extensive hearings on FBI undercover operations and issued a final report in April 1984.[183] The hearings made clear that Abscam represented just one of many stings launched by the FBI in a variety of contexts, a technique that was shunned ten years earlier as too risky and costly.[184]

The 1984 House Report focused on the potential for government overreach and the harm to sting targets. Less well known is its conclusion that stings "have caused the innocent third parties to suffer substantial damages."[185] Several witnesses testified that Abscam had indirectly caused them considerable financial losses.[186] The House Report also considered other sting operations. In Operation Whitewash, for example, FBI agents established a painting contracting business with the intent of identifying corrupt union officials. The process of identifying potential targets involved the intentional completion of substandard work, which financially

180. *Id.* at 42.

181. *Id.*

182. *See* 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 15–19 (listing "principal deficiencies in Abscam").

183. *See* 1984 HOUSE REPORT, *supra* note 3.

184. *See, e.g.*, *id.* at 12 ("Prior to Abscam, the FBI utilized the undercover technique only sporadically, and almost entirely in the area of anti-fencing 'stings' and domestic intelligence and counterintelligence work. Today, the range of criminal activities under investigation by this technique is nearly coextensive with the FBI's jurisdiction."); Robert Ostrow, *Senate to Investigate Checks, Balances on FBI "Stings,"* L.A. TIMES, July 19, 1982.

185. 1984 HOUSE REPORT, *supra* note 3, at 75; 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 11 (finding that use of undercover techniques "cause innocent persons to suffer harm to their reputations or to their property").

186. 2005 OIG REPORT, *supra* note 178, at 43; *FBI Undercover Operations: Hearings Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary*, 97th Cong. 1–35 (1983). One witness, Brandy Troche, testified that she and her husband had lost their business after having being swindled by Mel Weinberg, the chief informant in the Abscam sting. Ronald J. Ostrow, *Victims Ask Congressional Panel to Aid Innocent Third Parties in FBI Operations*, L.A. TIMES, Apr. 2, 1982. Troche told the committee: "Please don't let this happen to other people." *Id.*

hurt a legitimate third-party company that had unknowingly contracted with the FBI.[187] No kickback schemes were ever found.[188]

The 1984 House Report criticized "the FBI's use of . . . deceptive practices and the need to avoid discovery," concerns which "have resulted in severe harm befalling totally innocent citizens . . . as a result of careless (even callous) neglect or conscious design on the part of the undercover agents."[189] These harms included physical or financial harms directly caused by government agents or confidential informants, or criminal victimization caused by the government's tolerance of crime in order to let the undercover investigation continue undisturbed.[190] In particular, the Report stressed that without the ability to determine the extent of third-party harm, there could be "no meaningful determination of whether the benefits of such operations outweigh the costs."[191]

The Senate was also concerned. In March 1982, the Senate established its own Senate Select Committee to Study Undercover Operations and also issued a report raising questions about the use of undercover operations.[192] Both the House Subcommittee and the Senate Select Committee concluded that existing internal controls at the FBI were inadequate.[193] The reports of both committees recommended new federal legislation, including a warrant requirement for undercover operations and the establishment of congressional oversight.[194]

2. FBI Undercover Guidelines

While none of the legislative recommendations proposed by the House or Senate as a result of the Abscam investigation were ever realized, one immediate response to the controversial sting did have a lasting consequence. Soon after details of the sting became public, in 1980, then-Attorney General Benjamin Civiletti issued the "Attorney General's Guidelines on FBI Undercover Operations."[195] These were the first internal

187. The FBI compounded matters by filing a meritless mechanic's lien against the third-party's projects. Moreover, the House Report noted that the front continued "solely to mislead the remaining creditors and mitigate the FBI's financial loss." 1984 HOUSE REPORT, *supra* note 3, at 22.

188. *Id.*

189. *Id.* at 5.

190. *Id. at* 19–22.

191. *Id.* at 87.

192. 1982 SENATE SELECT COMM. REPORT, *supra* note 25.

193. 2005 OIG REPORT, *supra* note 178, at 44.

194. *Id.* The Senate Committee rejected the House Subcommittee's warrant requirement. *Id.*

195. OFFICE OF ATTORNEY GENERAL, ATTORNEY GENERAL'S GUIDELINES ON FBI UNDERCOVER OPERATIONS (1980) http://vault.fbi.gov/FBI%20Undercover%20Operations%20/FBI%20Undercover%20Operations%20Part%201%20of%201 [hereinafter 1980 UNDERCOVER GUIDELINES].

administrative guidelines for the FBI that were specific to undercover operations.[196] These guidelines, which require FBI compliance,[197] have been updated occasionally over the years.[198] The current guidelines were last substantially revised in 2002.[199] The Undercover Guidelines are not only important in guiding the FBI, the chief law enforcement agency, but also other federal agencies that follow the guidelines as well.[200]

196. The first set of undercover guidelines were issued in 1976 by then-Attorney General Edward Levi. 2005 OIG REPORT, *supra* note 178, at 36. Levi's guidelines, however, purported only to reflect existing FBI practices, and not to direct or reform them. *See* Press Release, DOJ, Jan. 5, 1981 (on file with authors) ("[I]n large part, [the guidelines] reaffirm existing Bureau practices and procedures in this area.").

197. The FBI's 2011 Domestic Investigations and Operations Guide states that undercover operations that "do not concern threats to the national security or foreign intelligence" must conform to the Attorney General's Undercover Guidelines. FBI, DOMESTIC INVESTIGATIONS AND OPERATIONS GUIDE, § 18.6.13 (2011) [hereinafter 2011 DIOG] http://vault.fbi.gov/FBI%20Domestic%20Investigations%20and%20Operations%20Guide%20%28DIOG%29/fbi-domestic-investigations-and-operations-guide-diog-2011-version/fbi-domestic-investigations-and-operations-guide-diog-october-15-2011/view. In the unclassified version of the 2011 DIOG available on the FBI website, most of the section on undercover operations has been redacted.

198. Although the 2011 DIOG requires adherence to the Undercover Guidelines, it does not specify the date of the applicable version. The most recent version appears to date from 2002, as issued by Attorney General John Ashcroft, OFFICE OF THE ATTORNEY GENERAL, THE ATTORNEY GENERAL'S GUIDELINES ON FEDERAL BUREAU OF INVESTIGATION UNDERCOVER OPERATIONS (2002) [hereinafter 2002 UNDERCOVER GUIDELINES], http://www.justice.gov/sites/default/files/ag/legacy/2013/09/24/undercover-fbi-operations.pdf, and revised by Attorney General Michael Mukasey in 2008, Office of the Attorney General, Order No. 2955-2008, Changes to the Attorney General's Guidelines on FBI Undercover Operations (March 5, 2008) [hereinafter 2008 Changes to Undercover Guidelines], http://www.justice.gov/sites/default/files/ag/legacy/2013/09/24/change-atg-guidelines-fbi-undercover-operations.pdf; Order No. 3020-2008, Conforming the Attorney General's Guidelines on FBI Undercover Operations to the General's Guidelines for FBI Domestic Operations (Nov. 26, 2008) [hereinafter Conforming the Undercover Guidelines], http://www.justice.gov/sites/default/files/ag/legacy/2013/09/24/d9942790.pdf. The primary change made in 2008 was to exclude national security and foreign intelligence operations, which are subject to different sets of guidelines, from the Undercover Guidelines. *See* 2008 Changes to Undercover Guidelines, *supra*, at 1. Another significant change was to define an "undercover operation" as a series of undercover activities including more than five substantive contacts between an undercover agent and a target. *See id.* The Guidelines had previously said an operation "generally consists of more than three" such contacts. 2002 UNDERCOVER GUIDELINES, *supra*, at II.B.

199. This Article assumes the 2002 Undercover Guidelines, as revised in 2008, remain in effect. The authors have found no publicly available indication of new Guidelines or significant revisions since 2008. Attorney General Mukasey's 2008 revisions, 2008 Changes to Undercover Guidelines and Conforming the Undercover Guidelines, *supra* note 198, are not germane to the current discussion, but they indicate that the 2002 Undercover Guidelines were the latest version as of 2008. When Mukasey replaced several other sets of FBI guidelines in 2008, he expressly stated in an accompanying memo that the Undercover Guidelines (presumably the 2002 Guidelines, as revised in 2008) remained in effect. Memorandum from the Attorney General, to the Heads of Department Components 5 (Sept. 29, 2008), http://www.usdoj.gov/ag/readingroom/guidelines-memo.pdf.

200. Stevenson, *supra* note 49, at 163. *See, e.g.*, Pieniazek v. Gonzales, 449 F.3d 792, 794 (7th Cir. 2006) (immigration agency); United States v. Dion, 476 U.S. 736, 740–42 (8th Cir. 1985) (the

Under the Guidelines, every undercover operation[201] requires the approval of the Special Agent in Charge (SAC) of the relevant field office.[202] When the FBI engages in joint operations with another law enforcement agency, such as the SEC, the Guidelines presumptively apply.[203] If an operation involves certain enumerated "fiscal circumstances"—that is, if it is likely to require large expenditures or complex financial dealings—it must be further approved by the FBI Director, an Assistant Director, or a Deputy Assistant Director at FBI Headquarters.[204] Operations involving "sensitive circumstances" are subject to more scrutiny than those involving economic costs. If an operation is likely to involve certain "sensitive circumstances," it must be reviewed and recommended by "appropriate supervisory personnel" at FBI Headquarters and by an Undercover Review Committee[205] made up of FBI employees and DOJ attorneys.[206] Sensitive circumstances include investigating government officials, participating in felonies, establishing a commercial business, and notably, "significant risk of violence or physical injury to individuals or a significant risk of financial loss."[207] Although not expressly mentioned, the reference to possible harms suffered by individuals appears to bring third-party harm into consideration. Final approval must be obtained from the Director or an Assistant Director.

In a section entitled "General Approval Standards," an official approving an FBI undercover operation must "weigh the risks and benefits

Department of the Interior).

201. "Undercover operation" refers to any operation in which an FBI agent operates under a false identity. Thus, they include, but are not limited to, stings. 2002 UNDERCOVER GUIDELINES, *supra* note 198, at II.B. The 2002 Undercover Guidelines do not distinguish stings from undercover operations.

202. Undercover operations that involve confidential informants must conform to a separate set of guidelines. *See* OFFICE OF THE ATTORNEY GENERAL, THE ATTORNEY GENERAL'S GUIDELINES REGARDING THE USE OF FBI CONFIDENTIAL HUMAN SOURCES 3–7 (2006), http://www.justice.gov/sites/default/files/oip/legacy/2014/07/23/ag-guidelines-use-of-fbi-chs.pdf [hereinafter, CONFIDENTIAL HUMAN SOURCES GUIDELINES]; Conforming the Undercover Guidelines, *supra* note 198, at 2 (replacing language in the Undercover Guidelines that had referred to the superseded Attorney General's Guidelines Regarding the Use of Confidential Informants). These guidelines and their administration have come under criticism, given that the FBI is said to have authorized its confidential informants to commit 5600 crimes in 2011. Letter from Representative Stephen F. Lynch, Rep. Mass., to Eric H. Holder, Jr., U.S. Attorney General 2 (Aug. 22, 2013), http://lynch.house.gov/sites/lynch.house.gov/files/Letter%20to%20Attorney%20General%20Holder%20August%2022%202013_0.pdf.

203. *See* 2002 UNDERCOVER GUIDELINES, *supra* note 198, at III.

204. *Id.* at IV(C)(1). Under the Guidelines as revised in 2008, the FBI Director sets expenditure limits for undercover operations. 2008 Changes to Undercover Guidelines, *supra* note 198, at 1–2. Any operations that exceed those limits must be approved by FBI Headquarters. *Id.*

205. 2002 UNDERCOVER GUIDELINES, *supra* note 198, at IV(C)(2).

206. *Id.* at IV(D)(1).

207. *Id.* at IV(C)(2)(m).

of an operation."[208] Among the potential costs to be weighed include "the risk of personal injury to individuals, property damage, financial loss to persons or businesses, damage to reputation, or other harm to persons."[209] As with "sensitive circumstances," "harm to persons" would seem to include harm to third parties, although it is not expressly mentioned. Despite this instruction, however, the Guidelines do not require officials to put this "risk-benefit" analysis in writing.

The SAC must make a written determination of certain factors before approving an undercover operation.[210] Despite the general directive to "weigh the risks and benefits of an operation," the SAC is required only to provide a written determination that the undercover operation is "warranted" and "appears to be an effective method"—the SAC is not instructed to lay out a formal cost-benefit analysis. Furthermore, despite the general directive to consider "harm to persons," the Guidelines do not require the SAC to make a written determination regarding such harms.

A cost-benefit determination is expressly required only when FBI Headquarters considers an application for approval under "sensitive circumstances."[211] In that situation, a U.S. Attorney or a Section Chief in the DOJ Criminal Division must personally sign a letter stating that he or she has reviewed and approved the operation.[212] The letter must include the prosecutor's finding that the operation is justified by a broad-based cost-benefit analysis: *i.e.*, "that the potential benefits in detecting, preventing, or prosecuting criminal activity outweigh any direct costs or risks of other harm."[213] Even here, however, the Guideline only appears to require a conclusion that the benefits justify the costs; it does not explicitly mandate the prosecutor to provide a detailed analysis. In 2013, the DOJ reportedly issued "guidelines" to prosecutors that were meant to improve oversight of "sensitive" investigative methods, including undercover operations.[214] These guidelines have not been made public.

208. *Id.* at IV(A).

209. *Id.* at IV(A)(1).

210. *Id.* at IV(B)(1).

211. *Id.* at IV(F)(2)(b).

212. *Id.* at IV(F)(2)(b), as revised in 2008 Changes to Undercover Guidelines, *supra* note 198, at 2. Prior to March 2008, this paragraph required a letter "*from* the appropriate federal prosecutor"; the 2008 revision required the letter to be personally signed by that prosecutor. *Id.* "Appropriate federal prosecutor" is defined to mean a U.S. Attorney or Section Chief in the DOJ Criminal Division. 2002 UNDERCOVER GUIDELINES, *supra* note 198, at II(F).

213. 2002 UNDERCOVER GUIDELINES, *supra* note 198, at IV(F)(2)(b), as revised in 2008 Changes to Undercover Guidelines, *supra* note 198, at 2.

214. Lichtblau & Arkin, *supra* note 1.

The FBI's own administrative guidelines address the concerns raised here: that stings, even properly conducted ones, may harm innocent third parties to such a degree that the sting may not be worth initiating. The FBI is required to consider these possible harms in deciding whether to approve an undercover investigation. However, these guidelines leave open a number of questions.

First, the Undercover Guidelines lack transparency. Whether or not the FBI follows its own guidelines on undercover stings—and thus whether it thoroughly considers third-party harms—is nearly impossible to know. Indeed, because detailed written analyses do not appear to be required, the relevant documentation may not exist. While both the House and Senate Reports issued in the wake of the Abscam scandal called for Congressional oversight of FBI undercover operations,[215] no such requirements exist today. The 1984 House Subcommittee observed that while it was "deeply concerned" about third-party harms, "there [was] no way of determining [their] full extent," given the lack of publicly available information, "the Bureau's policy against notification to potential litigants, and the Justice Department's litigative stance of stonewalling."[216]

There are, consequently, only limited opportunities to ascertain whether the FBI is following its own guidelines. On limited occasions, nonpartisan agencies, such as the General Accountability Office ("GAO") and Office of Inspector General ("OIG"), have been asked to compile reports. For instance, in a 2005 report, the OIG[217] reviewed eighty-three undercover operations files pursuant to a broader review of four sets of Attorney General Guidelines.[218] The OIG opined that the FBI was largely in compliance with the Undercover Guidelines, despite finding violations of the Undercover Guidelines in ten of the eighty-three operations reviewed.[219] A majority of the violations involved failure to obtain proper authorization for operations, such as failure to seek renewal of an expired authorization or unauthorized participation in a multi-agency undercover

215. 2005 OIG REPORT, *supra* note 178, at 44.

216. 1984 HOUSE REPORT, *supra* note 3, at 87.

217. Under the Inspector General Act, the DOJ has an independent Office of Inspector General. The SEC does not. COUNCIL OF THE INSPECTORS GENERAL ON INTEGRITY AND EFFICIENCY, *The Inspectors General* 13 (July 14, 2014), https://www.ignet.gov/sites/default/files/files/IG_Authorities_Paper_-_Final_6-11-14.pdf (listing federal agencies with Offices of Inspector General).

218. 2005 OIG REPORT, *supra* note 178, at 151.

219. *Id.* In contrast, the OIG reviewed 120 files involving the use of confidential informants and found violations of the Attorney General's Guidelines Regarding the Use of Confidential Informants (the predecessor to the Confidential Human Sources Guidelines) in 87% of those files. *Id.* at 7.

task force.[220]

In addition, the OIG found six cases in which the letter submitted by the prosecutor[221] failed to include a cost-benefit determination.[222] Four of the six prosecutor's letters also omitted another element required by the Undercover Guidelines.[223] To address such failures of compliance documentation, the OIG suggested that the FBI establish procedures to "ensure[] greater consultation between agents and Undercover Coordinators and Division Counsel."[224] It is unclear whether the FBI has followed this recommendation.[225]

Detailed information about undercover operations is difficult to obtain. While the federal Freedom of Information Act[226] provides for a right of access to federal agency records, Exemption 7(E) permits non-disclosure of information in two circumstances: when it "would disclose techniques and procedures for law enforcement investigations or prosecutions, or would disclose guidelines for law enforcement investigations or prosecutions if such disclosure could reasonably be expected to risk circumventions of the law."[227] Courts have broadly interpreted the exemption's scope to permit withholding of information regarding numerous law enforcement procedures, policies, and records.[228] While the second circumstance in Exemption 7(E) requires an assessment of potential harm to law enforcement interests, the first circumstance does not.[229]

220. *Id.* at 151.

221. The report did not state how many of the eighty-three files reviewed required a prosecutor's letter; as noted above, only those involving "sensitive circumstances" require such a letter. *Id.* at 9.

222. *Id.* at 154. The 2005 OIG Report appears to have treated the letters' omission of a cost-benefit determination as a violation, even though the 2002 Undercover Guidelines in effect at the time stated only that such a determination "should" be included in the letter. *See* 2002 UNDERCOVER GUIDELINES, *supra* note 198, at IV(F)(2)(b).

223. 2005 OIG REPORT, *supra* note 178, at 154.

224. *Id.* at 158.

225. The only apparent response was a 2008 revision requiring that the prosecutor's letter "shall" include a cost-benefit determination. *Compare* 2008 Changes to Undercover Guidelines, *supra* note 198 ("shall"), *with* 2002 UNDERCOVER GUIDELINES, *supra* note 198, at IV(F)(2)(b) ("should"). It is, of course, unclear whether this change has made any difference in the prosecutors' letters.

226. 5 U.S.C. § 552 (2014), as amended by OPEN Government Act of 2007, Pub. L. No. 110-175, 121 Stat. 2524.

227. *Id.* § 552(b)(7).

228. *See* U.S. DEP'T OF JUSTICE, DOJ GUIDE TO THE FREEDOM OF INFORMATION ACT 645–46 (2009) [hereinafter FOIA GUIDE], http://www.justice.gov/sites/default/files/oip/legacy/2014/07/23/exemption7e_0.pdf. ("[C]ourts have construed Exemption 7(E) to encompass the withholding of a wide range of techniques and procedures . . . ."); Joh, *supra* note 22, at 183–92 (discussing exemption 7(E)).

229. Lower courts have not been in agreement as to whether the circumvention showing applies

With respect to undercover operations, courts appear to have interpreted Exemption 7(E) very expansively. Some courts have permitted use of the exemption to deny even very general descriptions of law enforcement techniques because doing so would disclose secret techniques.[230] While Exemption 7(E) does not protect techniques that are well known to the public, this does not mean stings are unprotected because they are a well-known technique. Rather, courts have held that Exemption 7(E) *does* protect covert operations whose *specifics* are little known, and thus should be exempt from disclosure precisely because "the method employed is meant to operate clandestinely."[231] To the extent that documents regarding FBI undercover operations are occasionally made public through FOIA requests, they are heavily redacted.

The Abscam investigations criticized the FBI for its lack of transparency about third-party harms. In the 1984 House Report on Abscam, the Subcommittee bluntly stated that the reassurances of then Assistant Attorney General Phillip Heymann and Associate Deputy Attorney General Paul Michel about the infrequency of third-party harms were "proven to be false."[232] Indeed, the House Report concluded that "significant financial losses to innocent third parties are all too often the legacy of undercover operations."[233]

The lack of transparency is not the only shortcoming of the FBI's Undercover Guidelines. Like other internal administrative agency standards, they are unenforceable. Section VII of the Guidelines states that they are "not intended to, do not, and may not be relied upon to create any

only to the second or to both clauses of the exemption. FOIA GUIDE, *supra* note 228, at 637–38.

230. *Id.* at 644–45. *See, e.g.*, Concepcion v. FBI, 606 F. Supp. 2d 14, 43–44 (D.D.C. 2009) (permitting nondisclosure of "certain techniques and procedures [used] in conducting criminal investigations and undercover operations" because doing so "could jeopardize any future criminal investigations and undercover operations conducted by the FBI"); Perrone v. FBI, 908 F. Supp. 24, 28 (D.D.C. 1995) (agreeing that "disclosure of this information would help plaintiff or potential criminals predict future investigative actions by the FBI and consequently employ countermeasures to neutralize these techniques"). Of note is that the courts have consistently upheld the non-disclosure of FBI form FD-515, which is used "at various stages in an investigation to report statistically important events such as indictments, arrests and convictions, or the recovery of stolen property," as well as "publicly known investigative techniques . . . used by personnel during the investigation," along with a "rating column which records a numerical rating from 1 to 4." Sellers v. DOJ, 684 F. Supp. 2d 149, 164 (D.D.C. 2010). *See also* Peay v. DOJ, No. 04-1859, 2007 WL 788871, at *6 (D.D.C. March 14, 2007) (concluding FBI properly withheld "entire rating column [of form FD-515] in order to protect . . . the specific techniques that were and were not used by the FBI during its investigation of plaintiff and others").

231. Maguire v. Mawn, No. 02 Civ. 2164, 2004 WL 1123673, at *7 (S.D.N.Y. 2004).

232. 1984 HOUSE REPORT, *supra* note 3, at 24.

233. *Id.*

rights, substantive or procedural, enforceable by law."[234] In *United States v. Caceres*, the Supreme Court held that exclusion of evidence was not a remedy for a violation of the IRS's internal guidelines, unless the violations implicated constitutional or federal rights.[235] The Court provided a broad justification for imposing no sanctions on agencies that violate their own guidelines: "[I]t is far better to have [internal guidelines] and to tolerate *occasional* erroneous administration of the kind displayed by this record, than either to have no rules except those mandated by statute, or to have them framed in a mere precatory form."[236] Thus, the existence of Guidelines provides little protection to the already weak due process protections accorded to sting targets.[237]

As noted above, a surprising range of federal agencies other than the FBI also engage in undercover operations. Those operations lack accountability and transparency as well. The Bureau of Alcohol, Tobacco and Firearms has a committee meant to supervise undercover operations, but it went almost seven years without holding a meeting.[238] A 2012 inspector general's report found the IRS to be lax in overseeing the funds spent in its undercover operations; for some operations, detailed accounting of expenditures took over four years.[239]

3. Limited Tort Recovery

Innocent third parties who discover that they have been injured as a result of an undercover operation have relied primarily on the Federal Tort Claims Act ("FTCA"),[240] which provides a cause of action

> for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would

234. 2002 UNDERCOVER GUIDELINES, *supra* note 198, at VII.

235. United States v. Caceres, 440 U.S. 741, 749–55 (1979).

236. *Id.* at 756. At least one district court has held that a violation of the Undercover Guidelines would not justify reversal; the court relied upon the reasoning of *Carceres* without citing it. *See* United States v. Abumayyaleh, 2006 WL 3690739, at *2 (D. Minn. 2006). *Cf.* United States v. Marbelt, 129 F. Supp. 2d 49, 56 (D. Mass. 2000) ("A showing that the Customs Service had not followed its internal guidelines is not a valid defense to the crime charged.").

237. *See* Stevenson, *supra* note 49, at 164 ("The lack of enforcement mechanism or sanctions makes the guidelines essentially advisory, a matter of internal processes, and a secondary device for regulating sting operations.").

238. Eric Lichtblau & William M. Arkin, *More Federal Agencies Are Using Undercover Operations*, N.Y. TIMES (Nov. 15, 2014), http://nyti.ms/1q4cuai.

239. *Id.*

240. 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 393.

> be liable to the claimant in accordance with the law of the place where the act or omission occurred.[241]

In practice, however, most plaintiffs lose FTCA suits because of the Act's so-called "discretionary function" exception.[242] The exemption bars lawsuits "based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused."[243] Government conduct falls under the exception when it "involves an element of judgment or choice."[244] If a court does find the government's conduct to involve discretionary judgment, then it must determine whether that judgment is meant to be "based on considerations of public policy."[245] The conclusion that the challenged conduct does involve such considerations means that the lawsuit is barred by the exception. Under this analysis, innocent third parties harmed in FBI stings generally cannot take advantage of the FTCA's limited waiver of federal immunity.[246]

A Fourth Circuit decision, *Suter v. United States*,[247] is illustrative. The plaintiffs in *Suter* were financial victims of a large scale Ponzi scheme.[248] These victims brought an action under the FTCA because they alleged that they were victimized not only by the defendant, but also by an undercover FBI agent's participation in the fraudulent scheme—an involvement that they alleged "drastically extended the scope of the injury inflicted and number of victims injured."[249]

The Fourth Circuit held that the FTCA's discretionary function exception barred the victims' suit. Citing the Undercover Guidelines' assumption that government agents may sometimes participate in the crime investigated and that innocent third parties may suffer financial losses, the Court decided that the FBI agent's participation in the Ponzi scheme was the kind of decision "which we would expect inherently to be grounded in considerations of policy."[250] In short, the *Suter* court concluded that

241. 28 U.S.C. § 1346(b) (2012).

242. 28 U.S.C. § 2680(a) (2012); 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 393 (noting that exception may shield government from liability).

243. 28 U.S.C. § 2680(a).

244. Berkovitz v. United States, 486 U.S. 531, 536 (1988).

245. *Id.* at 537.

246. 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 393.

247. Suter v. United States, 441 F.3d 306 (4th Cir. 2006).

248. *Id.* at 309.

249. *Id.*

250. *Id.* at 311 (quoting Baum v. United States, 986 F.2d 716, 720–21 (1988)).

"discretionary, policy-based decisions concerning undercover operations are protected from civil liability by the discretionary function exception, *even when those decisions result in harm to innocent third parties.*"[251]

4. Increased Transparency and Accountability

Whether the FBI engages in the "weighing" of costs and benefits as required by the Undercover Guidelines is difficult to ascertain. That lack of information makes it difficult to determine whether the costs of harms suffered by sting victims are outweighed by the benefits of government stings in any particular case.

A necessary first step was proposed thirty years ago, and we underscore it again here: increased transparency for FBI stings, specifically with regard to harms suffered by third parties. The 1984 House Report, published after four years of investigation, called for reporting "requirements by which the number of injured [third] parties" could be determined.[252] Without these details, it is impossible to evaluate claims of FBI efficacy in its pursuit of financial fraud, or of any other crimes, by relying upon undercover investigations.[253]

Very little information about third-party harms is available.[254] Courts

251. *Id.* at 312 (emphasis added). *See* Ga. Cas. & Sur. Co. v. United States, 823 F.2d 260, 263 (8th Cir. 1987) (holding FTCA suit against FBI for undercover investigation of car theft ring barred because "[t]he FBI's decision to maintain secrecy . . . involved the balancing of policy considerations protected by the discretionary function exception"); Frigard v. United States, 862 F.2d 201, 203 (9th Cir. 1988) (holding FTCA suit against CIA for creating fictitious investment company barred because "the alleged decisions by the CIA to use [the company] and to keep its use of the company secret are administrative decisions grounded in social and economic policy").

252. 1984 HOUSE REPORT, *supra* note 3, at 87.

253. Inserting congressional oversight into the FBI's use of stings echoes concerns raised about the agency's other techniques. In 2011, Rep. Stephen Lynch of Massachusetts proposed a bill, Confidential Informant Accountability Act of 2011, H.R. 3228, 112th Cong. (2011), to require the FBI and other agencies to list the number and types of crimes in which government informants participated. Mark Clayton, *Whitey Bulger Trial and the FBI: How Have Rules About Informants Changed?*, CHRISTIAN SCI. MONITOR (June 4, 2013), http://www.csmonitor.com/USA/Justice/2013/0604/Whitey-Bulger-trial-and-the-FBI-How-have-rules-about-informants-changed.

254. Beginning in 1984, Congress imposed a reporting requirement on the FBI regarding the "statistical and descriptive information regarding the utilization of the undercover technique." 1984 HOUSE REPORT, *supra* note 3, at 86. That reporting requirement still appears to exist, although the authors were unable to find any such publicly available reports produced by the FBI. In any case, any such report would not be required specifically to note third-party injuries. Pub. L. 102-395, 102(b), 106 Stat. 1838 (1992) (codified as amended at 28 U.S.C. § 530 (2012)) (requiring FBI to provide a "detailed financial audit of each undercover investigative operation"); Undercover Investigative Operations Conducted by Federal Bureau of Investigation or Drug Enforcement Administration, Annual Report to Congress; Financial Audit, Pub. L. 104-132, 110 Stat. 1315 (1996) (codified as amended at 28 U.S.C. § 533) ("Notwithstanding any other provision of law, section 102(b) of the Department of Justice and Related Agencies Appropriations Act, 1993 (Public Law 395), shall remain in effect until specifically

often uphold the denial of FOIA requests for information on FBI undercover operations of any sort.[255] Some third-party harms come to light when injured plaintiffs bring FTCA suits, but few injured parties are likely to litigate. Furthermore, plaintiffs are inherently limited to those who are able to determine that a government sting is responsible for their losses.[256] Some third-party victims, such as investors who pay inflated prices for manipulated stocks, may never realize that they were harmed by a sting.

Congressional oversight could help monitor compliance in a way that existing agency self-regulation does not. The FBI sometimes justifies the use of controversial sting techniques by referring to the fact that the operations involved complied with the Undercover Guidelines.[257] As the Abscam investigation reports noted, however, the FBI's compliance with its internal guidelines may be "construed bureaucratically, or 'ritualistically,' rather than in a manner designed to encourage compliance with the intent of the policymakers."[258]

There are good reasons for the FBI or any other law enforcement agency to keep secret some aspects of their undercover investigations. Divulging precise details about covert operations can expose them to discovery by targets and perhaps even danger to the agents involved. But basic information about undercover operations should be made publicly available, particularly regarding whether the FBI is unnecessarily risking harm to third parties. Estimated financial losses, as well as a report generated by the FBI on pending third-party lawsuits, would help determine whether adequate cost-benefit analyses existed. Unlike the existing provisions of the Undercover Guidelines, compliance with this requirement would actually be observable by the public and other branches of government.

Transparency alone sometimes prompts change. For instance, media scrutiny of controversial law enforcement practices has led agencies to stop, or at least review, their practices. There are numerous examples. When the *New York Times* reported in October 2014 that the IRS was using civil forfeiture laws to seize funds from small business owners on the

repealed.").

255. *See supra* Part III.B.2.

256. 1984 HOUSE REPORT, *supra* note 3, at 86.

257. *See, e.g.*, James B. Comey, Director of the FBI, *To Catch a Crook: The F.B.I.'s Use of Deception*, N.Y. TIMES (Nov. 6, 2014), http://nyti.ms/1wAYxku (defending a 2007 Associated Press impersonation case because the "technique was proper and appropriate under Justice Department and F.B.I. Guidelines at the time").

258. 1984 HOUSE REPORT, *supra* note 3, at 80.

presumption that they were structuring their bank deposits to avoid reporting requirements,[259] the agency responded by announcing it would suspend the practice.[260] After *Buzzfeed* first reported that a DEA agent had appropriated Sondra Arquiett's identity to create a Facebook page without her consent, the Justice Department announced it would review the practice.[261]

Some techniques that inherently cause third-party harms should be presumptively barred rather than subjected to a cost-benefit analysis, such as impersonating the press or real individuals without their consent. The current Undercover Guidelines have no such prohibition, and they indeed assume that in some cases, impersonations of the media are warranted.[262] Explicitly referring to such extreme investigative tactics in the Guidelines may have the perverse consequence of validating them, even though they would have previously been "unthinkable in federal criminal investigations."[263] Presumptive bans should also apply to situations involving romantic or sexual relationships of the sort that have been revealed about the Special Demonstration Squad of Scotland Yard.[264]

Finally, "given the inherent risks in undercover operations to third parties,"[265] Congress might consider indemnifying injured third parties. Demanding more careful balancing of costs and benefits before operations will not prevent all harms to third parties. Thus, in its 1982 Report on undercover operations, a Senate Select Committee recommended indemnification legislation, including a provision that permitted financial recovery for persons "injured in their person or property," when

259. Shaila Dewan, *Law Lets I.R.S. Seize Accounts on Suspicion, No Crime Required*, N.Y. TIMES (Oct. 25, 2014), http://nyti.ms/1toLyCH.

260. *Statement of Richard Weber, Chief of I.R.S. Criminal Investigation*, N.Y. TIMES (Oct. 25, 2014), http://nyti.ms/1toPbZj (noting that the IRS "will no longer pursue the seizure and forfeiture of funds associated solely with 'legal course' structuring cases unless there are exceptional circumstances justifying the seizure and forfeiture and the case has been approved at the director of field operations (D.F.O.) level").

261. Sari Horwitz, *Justice Dept. Will Review Practice of Creating Fake Facebook Profiles*, WASH. POST (Oct. 7, 2014), http://www.washingtonpost.com/world/national-security/justice-dept-will-review-practice-of-creating-fake-facebook-profiles/2014/10/07/3f9a2fe8-4e57-11e4-aa5e7153e466a02d_story.html.

262. *See* 2002 UNDERCOVER GUIDELINES, *supra* note 198, at IV(C)(2)(j) (noting sensitive operations include those with "a significant risk that a third party will enter into a professional or confidential relationship with a person participating in an undercover operation who is acting as an attorney, physician, clergyman, or member of the news media"); 2011 DIOG, *supra* note 197, at 18.5.6.4.8.2 (discussing the need for agents to "operate openly and consensually with members of the news media" under the "Use of Subterfuge" section).

263. 1984 HOUSE REPORT, *supra* note 3, at 89.

264. *See supra* Part II.A.2.

265. 1984 HOUSE REPORT, *supra* note 3, at 87.

> the injury was proximately caused by conduct, of a federal employee or of any other person acting at the direction of or with the prior acquiescence of federal law enforcement authorities, that violated a federal or state criminal statute during the course of and in furtherance of a Department of Justice undercover operation.[266]

Observing that harms to "innocent citizens" from stings were sometimes "inevitable," the Select Committee recommended indemnification to compensate third parties who "fortuitously happen to be in the wrong place at the wrong time to bear the foreseeable costs of law enforcement efforts."[267] Without the potential for such compensation—and given the bars posed in FTCA litigation—the Select Committee warned that there would "likely . . . be considerable public resentment of government."[268] The harms suffered by third parties in the penny-stock stings discussed here seem especially well suited to such financial compensation. To be sure, such an indemnification scheme is politically unlikely. In calculating costs and benefits of these harms, however, the "acceptability of these risks depends on how the system deals with those persons for whom the risk has become a reality."[269]

CONCLUSION

As James Comey, Director of the FBI, has recently pointed out, deception "has long been a critical tool in fighting crime."[270] When that deception harms innocent third parties, that broad justification falls short. When it is foreseeable that an investigation will create sting victims, law enforcement agencies should minimize these harms and in some cases forgo the sting altogether. As in the case of the recent penny-stock stings, the question should not simply be whether the operation will yield an arrest, but whether the overall benefits outweigh harms to innocent victims.

266. 1982 SENATE SELECT COMM. REPORT, *supra* note 25, at 390. The other two provisions addressed injuries caused by an "informant or cooperating private individual" and negligent FBI supervision of an undercover operation. *Id.*

267. *Id.*

268. *Id.*

269. 1984 HOUSE REPORT, *supra* note 3, at 87.

270. James B. Comey, Director of the FBI, *To Catch a Crook: The F.B.I.'s Use of Deception*, N.Y. TIMES (Nov. 6, 2014), http://nyti.ms/1wAYxku.