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Admit It! SEC May Seek Admissions of Wrongdoing in Settlements

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The U.S. Securities and Exchange Commission ("SEC") is poised to modify its "no-admit, no-deny" policy to seek more admissions of wrongdoing from defendants as a condition of settlement in enforcement cases. The change comes on the heels of recent criticism of the policy from two federal judges and a U.S. Senator and would result in potentially far-reaching consequences for companies, their directors, officers, and employees.

The Proposed Policy Change

At the Wall Street Journal CFO Network's Annual Meeting on Tuesday, June 18, SEC Chairman Mary Jo White announced her intention to require more admissions of wrongdoing from defendants in the settlement of enforcement actions. Prior to this announcement, the SEC only required such admissions in a narrow sub-set of cases in which parties admitted certain facts as part of a guilty plea or other criminal or regulatory agreement. Such an approach would represent a radical departure from the SEC's longstanding no-admit, no-deny policy, under which defendants settle cases without admitting or denying wrongdoing. Chairman White emphasized that the no-admit, no-deny policy will still be used in the "majority" of cases and that "having 'no-admit, no-deny' settlement protocols in your arsenal as a civil enforcement agency [is] critically important to maintain."[1]

Details are still forthcoming on the scope of the proposed changes to the SEC policy, which will require approval from a majority of the five SEC commissioners. However, Chairman White presumably would not have announced her intention to depart from tradition and require admissions of wrongdoing in certain settlements if such a change lacked majority support from the other Commissioners. In a memo written to the Enforcement Division staff, the Division's Co-Directors, George Canellos and Andrew Ceresney, have suggested that the SEC would only require admissions of wrongdoing where it would be in the public interest. According to the memo, this may include "misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm; where admissions might safeguard against risks posed by the defendant to the investing public, particularly when the defendant engaged in

[1] *See* http://blogs.reuters.com/alison-frankel/2013/06/19/should-defendants-fear-new-sec-policy-on-admissions-in-settlements/ (hereinafter Frankel, "Should Defendants Fear New SEC Policy").

egregious intentional misconduct; or when the defendant engaged in unlawful obstruction of the Commission's investigative processes."[2]

Judicial and Senate Criticism of "No Admit" Settlements

The proposed change comes on the heels of recent, well-publicized criticism. In 2011, U.S. District Judge Jed S. Rakoff of the Southern District of New York rejected a proposed $285 million settlement with Citigroup, calling the no-admit, no-deny policy an invitation to abuse and finding the process to be against public interest "because it asks the Court to employ its power and assert its authority when it does not know the facts." *SEC v. Citigroup Global Markets Inc.*, 827 F. Supp. 2d 328, 335 (2011). Judge Rakoff's 15-page order came as a swipe at the SEC, which had long used the no-admit, no-deny policy to secure settlement agreements.[3] Earlier this year, U.S. District Judge John Kane in the District of Colorado refused to approve a similar SEC settlement with Bridge Premium Finance where the defendant "remain[ed] defiantly mute as to the veracity of the allegations against him." *SEC v. Bridge Premium Finance*, No. 1:12-cv-02131-JLK-BNB (Jan. 17, 2013).

These jurists have been joined by Senator Elizabeth Warren of Massachusetts, who received national attention earlier this year for her questioning of regulators during her inaugural Banking Committee meeting, asking whether "too-big-to-fail" has "become too-big-for-trial."[4] In a March 2013 letter to Chairman White, Attorney General Eric Holder and Federal Reserve Chairman Ben Bernanke, Senator Warren asked whether their "institution[s] [had] evaluated the cost to the public of settling cases without requiring an admission of guilt rather than pursuing more aggressive actions."[5]

Potential Impacts of the Policy Change

The potential ramifications of the new policy, if approved by a majority of the Commissioners, could be wide-ranging, which may lead to more trials.

- **Shareholder Litigation:** Requiring admissions in an SEC settlement may have serious consequences for defendants also facing parallel private shareholder class action or derivative litigation. Such parallel actions are common in any case involving a public company or public company executives or directors that are targeted by the SEC. Securities plaintiff's lawyers, quoted in a recent news story on the SEC's proposed policy change, are apparently already enthusiastic supporters, saying of the new policy, "'[t]his could make a huge difference,'" and that "admissions of liability in SEC cases would strengthen" class actions, "even if the admissions weren't, on their own, considered irrefutable evidence of liability to shareholders." This is so because plaintiffs must overcome significant pleading and procedural hurdles in order to state a claim. For example, class actions are subject to the heightened pleading requirements of the Private Securities Litigation Reform Act ("PSLRA"), which has resulted in a high volume of dismissals of such suits prior to any discovery being conducted. As another example, derivative litigation often is dismissed for failure to make a demand on a Company's board of directors prior to filing suit, or for failure to allege adequately that such a demand should be excused due to futility. Plaintiff's counsel apparently expect that admissions of liability will assist them in meeting these high pleading and

[2] *See* http://www.ft.com/intl/cms/s/0/7a93d5dc-d882-11e2-b4a4-00144feab7de.html#axzz2X4uT09h8.

[3] Judge Rakoff's order is currently on appeal to the Second Circuit and was argued in February of this year. In March 2012 the Court of Appeals stayed the order pending appeal and found that the SEC and Citigroup had a strong likelihood of success that they would prevail on appeal. In doing so, the Court of Appeals observed that "[i]t is commonplace for settlements to include no binding admission of liability. A settlement is by definition a compromise. We know of no precedent that supports the proposition that a settlement will not be found to be fair, adequate, reasonable, or in the public interest unless liability has been conceded or proved and is embodied in the judgment." 673 F.3d 158, 166 (2d Cir. 2012).

[4] *See* http://go.bloomberg.com/political-capital/2013-02-14/elizabeth-warren-decries-too-big-for-trial-approach-to-banks/

[5] *See* http://lawprofessors.typepad.com/files/warren.ltrtoregulatorsre2-14-13hrg1.pdf.

procedural requirements. This could result in more actions surviving threshold motions to dismiss or settling for large amounts before plaintiff's counsel have invested a lot of resources in the litigation. Companies and their officers and directors, however, will strenuously resist admissions of intentional wrongdoing in order to avoid the impact of such admissions on the civil securities litigation. Such companies and their officers and directors may slow down or stop any settlement talks in which the SEC pushes for an admission of wrongdoing. This may result in more trials. In some cases, on the other hand, defendants may negotiate more aggressively earlier on with the SEC by offering higher monetary penalties and stronger injunctive remedies in return for the SEC taking admissions off the table.

- **Criminal Liability:** It is most likely that the SEC will invoke the new admission policy in cases where criminal charges are also brought. Frequently, the SEC investigates cases at the same time that the U.S. Department of Justice ("DOJ") is pursuing a criminal investigation. It is unlikely that any defendant would agree to a settlement with the SEC incorporating admissions pending the outcome of the criminal investigation. In cases where both civil and criminal proceedings are already underway, the SEC action will typically be stayed pending the outcome of the criminal proceeding, in which case the proposed policy change is unlikely to have a significant impact. Where the facts against a defendant in parallel proceedings are particularly strong, however, the defendant may choose to negotiate a global settlement of both matters, i.e., a guilty plea, along with an SEC settlement that includes an admission. But in the case of a defendant in an SEC enforcement action who is also being investigated by DOJ but has not yet been charged criminally, the DOJ could use an admission in the SEC case in prosecuting the defendant. Such an admission might encourage prosecutors who were previously unsure about whether the evidence was sufficient to bring a criminal case to go ahead and pursue charges. Fear of these consequences could encourage defendants to bypass settlement and go to trial against the SEC instead. Finally, in those cases where a defendant has been convicted, it is likely that the SEC will insist on an admission.

- **D&O Insurance and Indemnification:** Admissions of wrongdoing could cause director's and officer's liability insurers ("D&O insurers") to contend that no coverage is available to the company or individuals involved in the admissions and that any amounts previously advanced must be refunded to the carriers. Additionally, companies may contend that indemnification of directors, officers or employees involved in admissions may be terminated and that prior amounts advanced must be refunded to the company. While such positions would not be well taken, it may be costly to litigate against the D&O insurers and/or the indemnifying company, which may result in defendants attempting to avoid admissions either by settling higher and earlier (without an admission, if the SEC is willing to cut such a deal) or by going to trial.

- **Regulated Entities:** Finally, admissions of wrongdoing may have important impacts for defendant corporations as regulated entities. An admission of wrongdoing may lead to debarment or other adverse regulatory consequences not just with the SEC but also with other regulators (e.g., the FDIC) and, in the case of government contractors, with the government itself. Again, these consequences may lead to more trials.

Conclusion

Although the new policy is still being fleshed out and must be approved by a majority of the SEC's commissioners, such a policy could have a substantial impact on defendants in enforcement actions. The devil will be in the details and in the implementation. The SEC will have to invoke the policy in actual cases in order to make it a real weapon. It could instead become a mere "paper policy" – cited, but not followed. (By way of comparison, the SEC has been criticized for offering only two bounties to date in the Dodd-Frank-derived whistleblower program it put in place nearly two years ago, to much fanfare.) Even if the SEC does invoke the policy, it may ultimately buckle in actual cases where defendants are game for trial

and have the courage of their convictions. Concerned about the time, expense, and the risk of losing a high-profile trial, enforcement lawyers may end up caving in the end, content with a high-dollar settlement without an admission of liability. In any event, it could lead to new complexity in negotiations in SEC cases.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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