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To Plea or Not to Plea: That Is Not the Question

by Jeffrey E. McFadden and Samantha Kats

In June 2013, the U.S. Securities and Exchange Commission (SEC) announced that it would begin demanding additional accountability in its settlements by requiring settlement agreement language that includes admissions of wrongdoing, in contrast to the traditional "no admit, no deny" language, in certain types of cases. In large part, the SEC was motivated by the decisions of Senior Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York, who in September 2009 refused to approve a $33 million settlement between the SEC and Bank of America.[1] Two years later, Judge Rakoff again refused to accept a proposed settlement, this time between the SEC and Citigroup.[2] Although the 2nd Circuit promptly slapped down Judge Rakoff's 2011 ruling – observing that the SEC, as a federal agency, had virtually unlimited discretion to determine the terms on which it would settle[3] – the SEC nonetheless got religion and decided that part of that unlimited discretion would henceforth require, in certain circumstances, admissions of wrongdoing by the settling parties. Former SEC chair Mary Jo White instituted the admissions policy in the hope that such confessions of guilt would substantively alter the meaning and impact of SEC settlements. Among the types of cases justifying admissions are those in which 1) a large number of investors were harmed or the case otherwise involved egregious circumstances, 2) the conduct posed significant risk to the market and/or investors, 3) admissions would aid investors in deciding whether to invest in or do business with the offending party in the future, and 4) there was a need to send an important message to the market.[4]

While it remains unclear, some nine months into a new administration, whether the SEC will adhere to or scale back its situational admissions policy, what is clear is that the agency's new chairman, Jay Clayton, has publicly stated that the agency can achieve greater deterrence through its policing of capital markets by pursuing individuals rather than seeking large payments from corporate violators.[5] And the Jeff Sessions Department of Justice has stated that it intends to release its own version of the 2015 "Yates Memo" in the near future.[6] Thus, two points require renewed emphasis.

First, there will continue to be real ramifications and real tensions created by the SEC's admissions policy given the huge, detrimental impact such admissions would have on potential criminal liability of individuals. Second, and perhaps more compelling, whether the SEC succeeds in extracting admissions from a corporation or an individual is beside the point. Why? Because long before the SEC adopted its admissions policy, the agency has consistently treated the factual allegations

contained in its administrative and civil complaints and orders as if they were admissions, and prohibits settling counterparties from publicly stating otherwise. The collateral consequences of those practices in the markets are both real and profoundly damaging. Thus, given how unbalanced the playing field has long been, and further given that the only remaining bulwark against these practices and their consequences is the due process and evidentiary protections afforded in criminal prosecutions, there is scant public policy justification for the SEC's admissions policy, and defense practitioners would do well to avoid such admissions if downstream criminal exposure is even a remote possibility. We will unpack all these practices – and their collateral consequences – in the discussion that follows.

Settlements With the SEC Already Carry Enough Collateral Consequences to Obviate the Need for Admissions Overkill and the Attendant Increase in Criminal Exposure Risk

Roughly 98 percent of all SEC cases settle.[7] Although there are myriad reasons behind that sizable percentage, suffice it to say that the competing incentives on both sides often have little to do with the merits of the case. For example, on the SEC side, and as noted above, senior Enforcement Division staff are fond of talking about "message cases."[8] (Members of the defense bar often refer to such cases as "Rule interpretation through enforcement.") As far as the staff is concerned, a healthy settlement sends just as much of a message as a win in front of a judge or an administrative law judge. Numbers are also a big driver. As in so many other contemporary societal endeavors, metrics have become the singular measure of success, with a concomitant emphasis on quantity over quality. On the respondents' side, two of the biggest drivers are business disruption and the staggering costs of mounting a defense, irrespective of the strengths and weaknesses of the SEC's legal theories and evidence. And perhaps the biggest driver of all: Settle, or we won't let you raise money in the capital markets.

In theory, it was these competing, non-merits incentives that underpinned and justified the use of the "neither admit nor deny" language long contained in settlement agreements with the SEC. But as far as the SEC is concerned, such language does not prevent the agency from declaring, publicly and repeatedly, that the particular respondents at issue were, in fact, engaged in substantial wrongdoing.

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1. **SEC Press Releases**

   The SEC is far from bashful in its press releases highlighting large, fruitful settlements and the wrongdoing underpinning them, even when respondents "neither admit nor deny" the allegations. For example, in one of its settlements, although the respondents did not admit or deny the allegations, the SEC nonetheless highlighted its findings as if they were facts adjudicated on the merits, stating, among other things, that the respondent company "engaged in a panoply of accounting tricks to artificially meet its financial targets."[9] Such press releases can be just as damaging as those involving companies that are forced to admit wrongdoing as part of the settlement.[10] The SEC wastes no time in issuing a press release following a settlement, and, in the negotiation of such settlements, respondents have little, if any, input regarding the content of settlement agreements or the SEC's public statements characterizing them.

   The notion that one of the "rewards" of cooperation is increased input into the SEC's press release is largely a fiction. At most, the SEC may merely publicly acknowledge the company's or individual's cooperation in a settlement order and related public announcements, but it does not stop the SEC from highlighting its findings of wrongdoing.[11]

   As if such shout-outs of wrongdoing in a press release are not damaging enough, the SEC often takes its unilateral conclusions of wrongdoing on the road, presenting settled cases at various professional

conferences, section meetings for bar associations, and other public presentations and appearances, uniformly treating its allegations as if they were adjudicated facts. For example, senior members of the Enforcement Division of the SEC meet annually at the Practicing Law Institute's annual "SEC Speaks" conference in Washington, D.C., to reflect on the division's performance over the prior year, to highlight significant SEC settlements and findings of wrongdoing, and to discuss enforcement priorities for the following year.

2. **The SEC "Gag Rule"**
While the SEC gets to ignore the "neither admit nor deny" language of settlements through its press releases and public appearances, the affected respondent, who may well have settled for reasons having nothing to do with the merits, is precluded by regulation from saying so. Under the SEC Rules of Practice and Conduct, 17 C.F.R. § 202.5(e), the SEC enforces "its policy not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings." This language is express, standard boilerplate in any SEC settlement agreement and is non-negotiable. The purported justification is "to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur." 17 C.F.R. § 202.5(e). Any effort by a settling respondent to plead its case publicly is viewed by the staff as a material violation of the settlement agreement.[12] Remarkably, the SEC's policy does not appear to have been the subject of any First Amendment challenges. The net result is that the SEC publicly proclaims a respondent's guilt while the respondent is forced to bear the public disparagement and is legally precluded from defending its name and reputation, irrespective of the real reasons behind the settlement. In other words, the public policy behind the gag rule is to deem the SEC's allegations to be adjudicated admissions of wrongdoing. This is often a bitter pill for settling respondents to swallow, particularly individual respondents, who may disproportionately suffer reputational and career consequences from SEC settlements.

2. **Collateral Consequences**
There have long been substantial collateral consequences flowing from "neither admit nor deny" settlements. Such consequences include, but are not limited to, statutory disqualification, Rule 102(e) proceedings[13] and other professional licensing consequences, denial of coverage under D&O liability insurance policies, D&O bars, exposure to further civil litigation by investors or third parties, disclosure on job applications, and long-lasting reputational harm. Agreeing to admissions serves only to exacerbate these consequences. Perhaps one of the few saving graces of a "neither admit nor deny" settlement versus one containing admissions is that the former raises little risk of collateral estoppel in a follow-on criminal case[14] while the latter virtually guarantees it. Even more troublesome is the notion that the admission may be used in a criminal setting to establish elements of liability against the defendant.

Conclusion

As the discussion above makes clear, there are already profound consequences associated with the "neither admit nor deny" language in settlement agreements with the SEC, combined with a respondent's complete inability to profess innocence. Thus, any defense practitioner, especially one representing an individual potentially facing both SEC and criminal exposure, should scrupulously avoid adding to those consequences by agreeing to the inclusion of any "admissions" as part of a settlement with the SEC.

[1] *See SEC v. Bank of Am. Corp.*, 653 F. Supp. 2d 507, 510 (S.D.N.Y. 2009) (criticizing proposed consent judgment as "neither fair, nor reasonable, nor adequate" and stating it "was a contrivance designed to provide the S.E.C. with the facade of enforcement and the management of the Bank with a quick resolution of an embarrassing inquiry – all at the expense of the sole alleged victims, the shareholders.").

[2] *See U.S. SEC v. Citigroup Global Mks. Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (holding that approval of proposed consent judgment was not warranted), vacated and remanded, 752 F.3d 285 (2d Cir. 2014).

[3] *See U.S. SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285 (2d Cir. 2014) (finding requirement that SEC establish the "truth" of the allegations against firm as a condition for approving consent decrees was abuse of discretion).

[4] See Chair Mary Jo White, "Deploying the Full Enforcement Arsenal" (Council of Institutional Investors fall conference, Sept. 26, 2013), *available at* https://www.sec.gov/news/speech/spch092613mjw.

[5] *See* Peter Henning, "What the Future of S.E.C. Enforcement Holds Under Jay Clayton," *The New York Times*, March 27, 2017, *available at* https://www.nytimes.com/2017/03/27/business/dealbook/sec-chairman-jay-clayton.html.

[6] *See, e.g.*, Sarah N. Lynch, "UPDATE 1-U.S. Justice Dept. Mulls Changing Corporate Prosecution Policy," *Reuters*, Sept. 14, 2017, *available at* https://www.cnbc.com/2017/09/14/reuters-america-update-1-u-s-justice-dept-mulls-changing-corporate-prosecution-policy.html, and Jody Godoy, "Sessions Hints Yates Memo, Fraud to Stay on DOJ Radar," *Law360*, Jan. 11, 2017, *available at* https://www.law360.com/articles/879816/sessions-hints-yates-memo-fraud-to-stay-on-doj-radar.

[7] *See* Commissioner Luis A. Aguilar, "A Stronger Enforcement Program to Enhance Investor Protection" (20th Annual Securities and Regulatory Enforcement Seminar, Oct. 25, 2013), *available at* https://www.sec.gov/news/speech/2013-spch102513laa (noting that SEC settles approximately 98 percent of its enforcement cases).

[8] *See, e.g.*, Chair Mary Jo White, "Deploying the Full Enforcement Arsenal" (Council of Institutional Investors fall conference, Sept. 26, 2013), *available at* https://www.sec.gov/news/speech/spch092613mjw (stating "we need to be certain our settlements have teeth, and send a strong message of deterrence" and "make aggressive use of our existing penalty authority, recognizing that meaningful monetary penalties – whether against companies or individuals – play a very important role in a strong enforcement program"); Andrew Ceresney, Director, Division of Enforcement, "Securities Enforcement Forum West 2016 Keynote Address: Private Equity Enforcement" (Securities Enforcement Forum West, May 12, 2016), *available at* https://www.sec.gov/news/speech/private-equity-enforcement.html ("highlight[ing] certain problematic conduct and practices [the SEC] ha[s] uncovered through [its] private equity enforcement actions").

[9] *See* Press Release 2017-88, "Semiconductor Company and Former CFO Settle Accounting Fraud Charges" (May 1, 2017), *available at* https://www.sec.gov/news/press-release/2017-88.

[10] *See, e.g.*, Press Release 2014-263, "Wedbush Securities and Two Officials Agree to Settle SEC Case; L.A.-Based Broker-Dealer Admits Wrongdoing and Will Pay Financial Penalty for Market Access Violations" (Nov. 20, 2014), *available at* https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543504806.

[11] *See, e.g., In the Matter of Johnson Controls, Inc.*, Rel. No. 78287 (July 11, 2016), *available at* https://www.sec.gov/litigation/admin/2016/34-78287.pdf (recognizing the company's "timely self-report as well as the thorough productions"). *See also* SEC Press Release 2015-13, "SEC Charges Former Executive at Tampa-Based Engineering Firm with FCPA Violations" (Jan. 22, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-13.html (recognizing the company for self-reporting potential FCPA violations and cooperating substantially).

[12] *See, e.g.*, Floyd Norris, "Morgan Stanley Draws SEC's Ire," *The New York Times*, May 2, 2003, Section A., Col. 1, Business/Financial Desk p. 1, *available at* http://www.nytimes.com/2003/05/02/business/morgan-stanley-draws-sec-s-ire.html (quoting then-SEC chairman, William H. Donaldson, stating that "the [C]omission would regard a violation [of the duty not to deny the Commission's findings] as seriously as a failure to comply with any other term of the settlement" and warning the respondent that it "could face further legal action if it continued to deny having acted badly in the research scandal, which was the subject of a $1.4 billion industry settlement.").

[13] *See* SEC Rules of Practice, 17 C.F.R. § 201.102(e) (permitting SEC to censure, suspend or bar persons who appear or practice before it).

[14] Indeed, there is a carve-out in the Gag Rule that permits the respondent to fight the allegations contained in the settlement agreement in any subsequent litigation. *See* 17 C.F.R. § 202.5(f) (explaining "that the disposition of any such matter may not, expressly or impliedly, extend to any criminal charges that have been, or may be, brought against any such person or any recommendation with respect thereto. Accordingly, any person involved in an enforcement matter before the Commission who consents, or agrees to consent, to any judgment or order does so solely for the purpose of resolving the claims against him in that investigative, civil, or administrative matter and not for the purpose of resolving any criminal charges that have been, or might be, brought against him.")