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An Evaluation of the SEC's Admissions Policy

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Since the establishment of the SEC's Division of Enforcement in the 1972, the SEC has routinely allowed defendants to settle enforcement actions without admitting fault. In the standard settlement language, a defendant neither admits nor denies wrongdoing, which means that the settlement cannot be used against the defendant in parallel proceedings, such as shareholder class action litigation and government contract debarment proceedings, but at the same time, the defendant may not publicly deny the SEC's charges. **The neither-admit-nor-deny concept grew out of the practical reality that the SEC's Enforcement Staff would be more likely to obtain a settlement and thus conserve SEC resources** that could be used to protect other investors if the Enforcement Staff did not insist that defendants admit wrongdoing, which itself could have damaging collateral consequences, particularly with respect to public companies and their shareholders.

With the greater emphasis in the last five years on punishing wrongdoers, the SEC announced in 2012 that it would **require defendants to admit liability in settlements where defendants also had pleaded guilty in related criminal actions.** The theory was that the defendant already had pleaded criminally guilty to essentially the same conduct at issue in the SEC's civil action, and thus the defendant would have few, if any, additional concerns with admitting fault in the SEC's settlement.

The SEC greatly expanded the admissions concept in 2013. On June 18, 2013, SEC Chair Mary Jo White announced that the SEC would seek more often admissions of wrongdoing from individual and corporate defendants as a condition of settling enforcement cases.[1] In a speech delivered on September 26, 2013, Chair White outlined the types of cases where the Commission, in its discretion, might seek an admission of wrongdoing, which include cases where:

- A large number of investors have been harmed or the conduct was otherwise egregious.
- The conduct posed a significant risk to the market or investors.
- Admissions would aid investors deciding whether to deal with a particular party in the future.

[1] http://www.bloomberg.com/news/articles/2013-06-18/sec-to-seek-guilt-admissions-in-more-cases-chairman-white-says

- Reciting unambiguous facts would send an important message to the market about a particular case.[2]

As this expanded admission policy was being implemented, the Director of Enforcement stated that the **SEC would *not* consider the collateral consequences to an individual or entity when determining whether to seek an admission.** That means, for example, that the SEC would not consider the impact to shareholders of additional payouts in costly plaintiff litigation and would not consider the increased potential for debarment of government contractors after admitting wrongdoing to the SEC. In contrast, the Department of Justice when seeking to impose corporate criminal liability *must* consider the collateral consequences to the company.

The SEC's expanded admission policy has created **three primary concerns**. **First, the admissions policy marks a fundamental shift in emphasis from protecting investors to punishing wrongdoers.** While this distinction may appear at first glance to be academic in nature, it has very real consequences. The SEC, as a regulatory agency, has as three-part mission: Protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. The admission policy may be at odds with the concept of protecting investors and facilitating capital formation. Indeed, protecting investors may mean that, under certain circumstances, alleged wrongdoers receive a *lesser* sanction from the SEC in an effort to ensure that shareholders and investors do not suffer additional, collateral consequences for alleged wrongdoing. For a public company, greater exposure to shareholder litigation and potential loss of valuable government contracts through admitting wrongdoing in a settlement with the SEC harms shareholders, who ultimately shoulder SEC corporate penalties, settlements with plaintiffs, and loss of shareholder equity in the case of debarment from lucrative government contracts. While those outcomes might be appropriate in some instances, would it be more appropriate for the Commission to *consider* those outcomes in determining whether to seek an admission?

The second concern with the SEC's admission policy is the lack of clear guidance and the disproportionate impact on some defendants. The admissions policy may allow for subjective application without considering the individualized conduct of the defendant. Although the admission policy is rooted in punishing the *wrongdoer*, the stated standards are not focused on evaluating the circumstances of the alleged wrongdoer. And while the SEC purports to be focused on protecting "investors" and the market as a whole, the collateral consequences to shareholders of the alleged wrongdoer company are not even considered.

[2] http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.VOoCDkpOmtU

Finally, the admissions policy is susceptible to being used directly or indirectly as a negotiating tool for greater penalties. This form of leverage could take the form of the SEC Enforcement Staff making overtures that, if a defendant were to agree to a higher penalty, the Enforcement Staff would not push for an admission. Or the Enforcement Staff might be less direct and instead say that they are still considering whether to seek an admission but would be open to a settlement offer. Regardless of the form it takes, leaving any discretion to the Enforcement Staff to seek an admission directly or indirectly increases the Enforcement Staff's leverage for higher penalties. The mere *threat* that the Enforcement Staff might seek the dreaded admission may result in defendants offering to settle for greater penalties than without that threat.

One possible solution may be to remove any discretion from the Enforcement Staff and place that discretion into the hands of the Trial Unit to evaluate whether the evidence is so strong that they would risk taking the matter to trial. Another possible solution may be for the Enforcement Staff to determine from the Commission at the start of settlement negotiations whether the Commission would insist on an admission of wrongdoing. That course would enable to the parties to negotiate under the same understanding of whether an admission is, in fact, likely to be sought.

One thing is clear. **The SEC's admission policy requires some rethinking.**