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NYT: S.E.C. Has a Message for Firms Not Used to Admitting Guilt.

The days of cop-out settlements in big securities cases may be waning.

In a departure from long-established practice, the recently confirmed chairwoman of the Securities and Exchange Commission, Mary Jo White, said this week that defendants would no longer be allowed to settle some cases while "neither admitting nor denying" wrongdoing.

"In the interest of public accountability, you need admissions" in some cases, Ms. White told me. "Defendants are going to have to own up to their conduct on the public record," she said. "This will help with deterrence, and it's a matter of strengthening our hand in terms of enforcement."

In a memo to the S.E.C. enforcement staff announcing the new policy on Monday, the agency's co-leaders of enforcement, Andrew Ceresney and George Canellos, said there might be cases that "justify requiring the defendant's admission of allegations in our complaint or other acknowledgment of the alleged misconduct as part of any settlement."

They added, "Should we determine that admissions or other acknowledgment of misconduct are critical, we would require such admissions or acknowledgment, or, if the defendants refuse, litigate the case."

Ms. White said that most cases would still be settled under the prevailing "neither admit nor deny" standard, which, she said, has been effective at encouraging defendants to settle and speeding relief to victims.

The policy change follows years of criticism that the S.E.C. has been too lenient, especially with the large institutions that were at the center of the financial crisis. Bank of America, Goldman Sachs, Citigroup and JPMorgan Chase were among the defendants that settled charges related to the financial crisis while neither admitting nor denying guilt, although Goldman was required to admit that its marketing materials were incomplete.

That this approach became such a heated public issue is in large part because of the provocative efforts of Judge Jed S. Rakoff of Federal District Court, who has twice threatened to derail settlements with large financial institutions that neither admitted nor denied the government's allegations.

In late 2011, he ruled that he couldn't assess the fairness of the agency's settlement with Citigroup in a complex mortgage case without knowing what, if anything, Citigroup had actually done. In his ruling, he said that settling with defendants who neither admit nor deny the allegations is a policy "hallowed by history but not by reason."

He described the settlement, which was for $285 million, as "pocket change" for a giant bank like Citigroup. Other judges have followed Judge Rakoff's lead, and an appeal of his Citigroup ruling is pending before the Court of Appeals for the Second Circuit.

The new policy would seem to vindicate Judge Rakoff, at least in spirit, but Ms. White said the decision was rooted in her experience as United States attorney in New York, where defendants in criminal cases are almost always required either to enter a guilty plea or go to trial.

“Judge Rakoff and other judges put this issue more in the public eye, but it wasn’t his comments that precipitated the change,” she said. “I’ve lived with this issue for a very long time, and I decided it was something that we should review, and that could strengthen the S.E.C.’s enforcement hand.” (Judge Rakoff, who is presiding over a trial in Fresno, Calif., said he couldn’t comment, citing the appeal of his Citigroup ruling.)

Those concerned that Ms. White, who before her confirmation as chairwoman of the S.E.C. was head of the litigation department at the prominent corporate law firm Debevoise & Plimpton, might be too cozy with the big banks and corporations that were formerly her clients, can breathe easier. Even some of the S.E.C.’s harshest critics were at least somewhat mollified.

“It’s an important step in the right direction,” said John Coffee, a professor at Columbia Law School and a vocal critic of S.E.C. settlements he deems too lenient. “There’s clearly a public hunger for accountability. Mary Jo White has shown she is sensitive to this.”

Ms. White agreed. “There’s no question I share the desire for more accountability in cases where that is warranted,” she said. “I do think there are situations where public accountability is particularly important, and that will be our focus. I don’t want to overstate this — no admit, no deny will still be the way most cases are resolved — but I think it’s an important change.”

There’s little doubt that extracting admissions of wrongdoing gives the S.E.C. enormous new leverage, and not just because defendants want to avoid the damage to their reputation that comes with admitting misconduct. Any admission is likely to be seized upon by private litigants in civil lawsuits, including class actions, with potentially devastating financial consequences.

“If they admit culpability to the S.E.C., plaintiffs will cite that in their cases, and that could mean hundred of millions or billions in damages,” Professor Coffee said. “It’s not just the stigma they’re worried about.”

Those concerned that the S.E.C. already has too much power, including many corporate defense lawyers, were critical.

“I don’t like this at all,” said Brad Karp, a litigator and chairman of Paul, Weiss, Rifkind, Wharton & Garrison who represented Citigroup in its settlement talks with the S.E.C. “It gives them enormous leverage. A financial institution cannot fight a primary regulator and win. They have you. They have complete leverage over you. Even if you fight and win over a year, the damage will outweigh any litigation result.”

But Ms. White’s emphasis on public accountability suggests that she sees admissions of guilt as far more than a bargaining chip to extract bigger settlements. In the type of prominent cases cited by the enforcement staff, the S.E.C. may be unwilling to negotiate over an admission of wrongdoing and will force defendants to go to trial.

That could cut two ways. Some corporate defendants have settled cases, even when they believed they were innocent, to avoid the cloud of litigation, and treated any fines simply as a cost of doing business. Now, if the S.E.C. takes a case to trial, it will be forced to prove its case.

“If they take a hard line where admissions are an inevitable cost of resolving the case, it will force defendants to trial,” Mr. Karp said. Defendants will “try to find every way possible to avoid that outcome. If they can negotiate around it, there will be early settlements. But if not, they'll go to trial."

Citigroup has said that if Judge Rakoff's ruling is upheld and its settlement is overturned, it will go to trial rather than admit wrongdoing.

Ms. White said that "our aim is to apply this policy in appropriate cases, and we'll do this in the public interest." She continued: "Will this lead to more cases going to trial? It's hard to say going in, but it might. We have to be prepared to go to trial, and we have to make people believe we're prepared."

That may be a tall order. Defense lawyers and judges have raised questions about the S.E.C.'s trial competence in complex cases. The S.E.C. responded that of its last 11 cases that went to trial, it prevailed in eight.

An important test of that litigation capacity is likely to come next month, when Fabrice Tourre, a former Goldman Sachs trader who is accused of misleading clients in a complex mortgage deal, is scheduled to go on trial.

Exactly which cases, and how many, will result in admissions of wrongdoing remain to be seen.

"It will be very interesting to see how this plays out in six months or a year," Mr. Karp said.

The S.E.C. memo cites three criteria: "misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm"; "egregious intentional misconduct"; or "when the defendant engaged in unlawful obstruction of the commission's investigative processes."

Relatively few of the financial crisis cases, including the big mortgage fraud cases settled by Citigroup, JPMorgan and Goldman Sachs, would seem to meet those criteria, because the purported misconduct wasn't that egregious, the evidence in some cases was ambiguous and the victims were limited to a few sophisticated financial institutions rather than large numbers of the investing public.

Ms. White declined to comment on any specific cases, but said: "No one case precipitated this. From this point forward, we'll be looking for appropriate cases in which to apply the policy. Most will still be resolved on a no admit, no deny basis. But we'll be scrutinizing this."

Professor Coffee said the agency should go even further, by identifying and holding more individuals responsible.

Still, he said, "You have to give Mary Jo credit: She has shown she is less tone deaf" to public demands for accountability. "The S.E.C. may have to bring fewer cases and pursue them harder," he added. "But that could be a good thing."