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SEC v. Bank of America: Where to Go From Here?

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October 1, 2009

The Securities and Exchange Commission and Bank of America are confronting the same question: Where to go from here? The SEC thought it had completed an investigation, brought an enforcement action and then settled it. The bank thought it had made a deal to resolve a Commission enforcement action and was prepared to move on. Then the unexpected happened. The federal court rejected the settlement, stating it is a "contrivance" and "cannot remotely be called fair." In addition, the SEC's Inspector- General announced a probe of the proposed deal following a congressional inquiry about the use of taxpayer funds in the settlement.

In SEC v. Bank of America Corporation, Case No. 09 cv 6829 (S.D.N.Y. Filed Aug. 3, 2009), the Commission alleges that shareholders were misled when voting on the acquisition of Merrill Lynch by the bank.

According to the SEC, proxy materials furnished to the voting shareholders were misleading because they suggested that no bonuses would be paid to Merrill employees without approval from the bank. Those materials failed to tell shareholders that, in fact, bonuses had already been approved.

The merger agreement provided that Merrill executives could not be paid bonuses without approval by the bank. But, a schedule of what are, in effect, exceptions appended to the agreement provided that up to $5.8 billion in bonuses had been approved by the board of each company for Merrill executives.

The merger agreement was attached to the proxies. The schedule was not.

The SEC and Bank of America agreed to settle. The bank, without admitting or denying the allegations in the complaint, as is customary, consented to the entry of a permanent injunction prohibiting future violations of the proxy provisions of the federal securities laws. The settlement also called for the bank to pay a $33 million civil fine.

Questions from the Court

The court eventually had questions about the proposed settlement. Both parties were directed to file briefs explaining the terms of the deal. Subsequently, the SEC stated that the settlement was appropriate and should be approved, arguing that the shareholders had been deceived and a fine should be imposed. The SEC also claimed it could not determine who was responsible for the improper conduct because outside counsel made the decision not to disclose the key schedule and the bank asserted privilege. In contrast, the bank claimed it had done nothing wrong, but agreed to settle to avoid a dispute with one of its primary regulators.

The court was not satisfied. The court wanted an explanation of the privilege issue from the SEC. If the bank has asserted the advice of counsel as a defense, then by law it has waived privilege. In any event, it is unacceptable for corporate officers to escape liability through the assertion of privilege, the court noted. At the same time, the court wanted an explanation of the proposed $33 million fine which would be paid by the same shareholders-and perhaps in part by federal taxpayers-who were, according to the SEC, defrauded. The court wanted the bank to explain the reason it is willing to pay $33 million of shareholder money to settle a case when it steadfastly maintains it has done nothing wrong.

Subsequently, the SEC and Bank of America filed additional briefs. Each brief largely reiterated the previously stated positions. Each urged the court to accept the settlement.

The court rejected the proposed settlement, concluding it was not fair to effectively require the defrauded shareholders to pay the settlement. The SEC never seriously tried to resolve the privilege issue to identify those responsible, while the bank never answered its questions, the court noted. Overall, the court found the settlement a "contrivance," designed to provide the SEC with "the facade of enforcement," and the bank with a quick resolution of an embarrassing situation. The court ordered the case to proceed to trial.

At this point, the parties are moving toward a trial that neither wants. For the SEC, the stakes are high. The agency has recently been battered for its investigative failures in the Madoff debacle. Now, it is faced with another high profile failure under a new chairman and enforcement director.

The bank also faces difficult choices. Having taken a hard line position that it has not done anything wrong, rather than an intermediate posture recognizing the SEC's contentions while maintaining that it has a defense, it has been accused of using shareholder money to cover an embarrassing situation.

A better option than trial may be for the parties to renegotiate the settlement under the supervision of the court with a view toward preventing a reoccurrence of the kind of misconduct alleged by the SEC. Eliminating the fine and installing procedures to ensure that any bonuses paid in the future are appropriate is not the same as telling shareholders at the time of the vote about the matter. But, it is a reasonable substitute under the circumstances. At the same time, there may be other remedial measures which could help ensure that, in the future, shareholders are adequately informed in the voting process. As part of the process, the bank will, in probability, be required to explain its disclosure decision and identify the people involved. Whether enforcement actions against those individuals would be appropriate will depend on the facts, although given the difficulty of securities law disclosure decisions, it seems unlikely.

A settlement of this type could resolve a difficult situation in a favorable manner for all. It would protect shareholders who are the harmed party. It would be consistent with the SEC's traditional shareholder protection role in these matters. The settlement would also resolve the matter for the bank which wants to avoid a dispute with the SEC. In addition, this type of resolution would be consistent with the supervisory role of the court in these matters and the issues raised in its order rejecting the initial settlement.

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