

## SEC Admissions Policy After Falcone — Proceed With Caution

*Law360, New York (September 19, 2013, 6:27 PM ET)* -- On June 18, 2013, U.S. Securities and Exchange Commission Chairwoman Mary Jo White announced a major shift in SEC enforcement policy. Specifically, she informed the legal community that the SEC would begin to require defendants to admit to liability for their conduct in a broader class of cases. In a subsequent internal memo, the SEC clarified that the circumstances that might warrant an admission include: “(1) misconduct that harmed large numbers of investors, or placed investors or the market at risk of potentially serious harm, (2) egregious intentional misconduct, or (3) when the defendant engaged in unlawful obstruction of the commission’s investigative processes.”

Since January 2012, the SEC has required admissions in cases where a defendant pleads guilty in a parallel criminal proceeding or enters a deferred prosecution or nonprosecution agreement. While the June 2013 announcement was clearly intended to expand on this policy, it left many in the enforcement community wondering where the new line would be drawn for the requirement of admissions. Some commentators speculated that the policy would be used sparingly, perhaps mostly in cases where the defendant was nearly bankrupt or had already been the subject of failed criminal proceedings.

However, the recent settlement between the SEC and the hedge fund Harbinger Capital Partners LLC and its founder Philip Falcone suggests a potentially broader application of the policy. In August 2013, Falcone and Harbinger paid more than \$18 million to settle two civil lawsuits with the SEC which alleged that Falcone used an improper loan from the fund to pay his personal taxes, and that Harbinger wrongly restricted investor redemptions and manipulated the market for certain distressed high-yield bonds issued by MAAX Holdings Inc. As part of the settlement, Falcone agreed to be excluded from the securities industry for at least five years and Falcone and Harbinger admitted to the factual allegations described and to liability. This settlement marked the first application of the SEC’s new policy.

Despite the SEC’s apparent belief that the Falcone case qualified as “egregious” or harmful enough to warrant the requirement of an admission, neither Falcone nor Harbinger was criminally charged prior to the agreement and it is not known whether the U.S. Department of Justice has an ongoing investigation of the matter. The Falcone settlement expressly left this possibility open, stating that “The Harbinger Defendants acknowledge that no promise or representation has been made by the [SEC] or any member, officer, employee, agent or representative of the Commission with regard to any criminal liability that may have arisen or may arise from the facts underlying this action or immunity from any such criminal liability.”

It seems unlikely that Falcone and Harbinger would have agreed to an admission if they thought criminal prosecution was likely. Nevertheless, risk of prosecution remains and only time will tell whether and how the DOJ will rely on admissions of liability as a shortcut in their own investigations.

## **Assess Everything Before Making Admissions**

Given the current uncertainty regarding how the DOJ will respond to admissions under the SEC's new policy in cases that have not already been prosecuted criminally, attorneys should carefully consider the implications an admission might have before entering into this type of agreement with the SEC. To the extent possible, attorneys should attempt to engage in a dialogue with the DOJ to better calculate the risk involved before admitting to facts that could form the basis of criminal liability.

In addition, defense attorneys are encouraged to conduct a thorough statute of limitations analysis when assessing the possible criminal ramifications of an SEC admission. Although the U.S. Supreme Court ruled in February 2013 that the SEC has five years from the date of any alleged misconduct to bring claims for civil penalties, this limitations period may not apply to SEC enforcement actions for injunctive relief or disgorgement. See *Gabelli v. SEC*, 133 S. Ct. 1216 (2013); see also Securities and Exchange Commission Division of Enforcement, *Enforcement Manual*, at 41 (2012). But see *SEC v. Bartek*, 484 Fed. Appx. 949 (5th Cir. 2012) (holding that permanent injunctions and officer and director bars were penal in nature and thus also subject to a five year limitations period).

Accordingly, some SEC enforcement actions may involve conduct for which the typical five year federal criminal statute of limitations has already expired. In these cases, an SEC admission would be relatively safe, at least in terms of potential criminal charges.

Further, in some cases a defendant might enter into a tolling agreement with the SEC, but not the DOJ. Under these circumstances, if the SEC tolling agreement leads to a settlement containing an admission, but the admission comes after the criminal statute of limitations has expired for all relevant claims, the risk of a DOJ follow-on action is minimized.

## **Other Considerations**

Each case will have its own unique facts. Attorneys should look carefully to see whether any aggravating or mitigating circumstances exist that might make criminal prosecution more or less likely. Attorneys should also be mindful of any press coverage regarding the case and whether public opinion might influence DOJ's thought process.

This is, of course, a double-edged sword. If the SEC views the conduct at issue as egregious enough to warrant an admission, then perhaps the DOJ will feel compelled to take action. On the other hand, the DOJ might be dissuaded by the possibility that the public would view a dual prosecution as overly harsh. This depends in part on how broadly the SEC casts its net in defining the conduct that requires an admission. While the Falcone settlement suggests a potentially broader application than some commentators initially suggested, only time will provide more guidance on the issue.

In sum, the Falcone settlement was the first case in which the SEC implemented its new policy and required a defendant who had not previously been convicted to admit wrongdoing. It remains to be seen how, if at all, the DOJ will respond to this admissions made in this case. It does seem likely, though, that the SEC will increase its use of this policy going forward. Assuming the SEC does so, defendants should proceed with caution.

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