



U. S. Securities and Exchange Commission
Washington, D. C. 20549 (202) 272-2650

**News
Release**

Address to

The Washington Bar Association

Washington, D.C.

April 17, 1985

SEC LITIGATION:
THOUGHTS ON WHEN TO SETTLE AND TRY CASES

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The views expressed herein are those of Commissioner Peters and do not necessarily represent those of the Commission, other Commissioners, or the staff.

SEC LITIGATION: THOUGHTS ON WHEN TO SETTLE AND TRY CASES

I am pleased to be here today and to have the chance to address a group that stays quite current on Commission developments and trends. As you are no doubt aware, Commissioners often try to send "messages" to the securities industry, the bar, and the accounting profession through different media, with varying degrees of success. Most "messages", however, are better delivered directly, and thus I welcome the opportunity to speak to you about a topic I consider very important. My remarks concern my perception of Commission litigation strategies, and more specifically, when and on what terms the Commission should settle enforcement actions. I should emphasize at the outset that the views I am about to express are mine and do not necessarily represent those of the Commission, other Commissioners or the staff. I have kept my remarks brief because I hope you will not only ask questions, but comment from your perspective as members of the private bar.

Let me start by comparing the perspectives of the Commission and private litigants when deciding whether to try or settle cases. As you know, several factors come into play when you are making this decision: What are the odds you will obtain the desired relief if you litigate? How far apart are the desired relief and the settlement offer? How much will it cost the client to try the case? Will trial publicity adversely

affect the client's interests? And finally, from a defense perspective, if the client settles, will similar lawsuits in the future be encouraged? These or similar issues confront the Commission when it decides whether to try or settle its enforcement actions.

When deciding whether to try or settle a case, I think that the Commission, like any litigator, compares the terms of the settlement offer with the relief desired, and analyzes the chances of obtaining that relief by prevailing at trial. When litigating an injunctive action, for example, the Commission considers (1) whether it has the evidence to prove unlawful conduct, and (2) whether there is reasonable likelihood of future violations. The Commission looks at the length of time that has passed since the unlawful conduct, and the respondent's present activities. (I am using the term "respondent" to refer to both defendants in civil actions and respondents in administrative proceedings). In deciding whether to settle a case involving disgorgement of ill-gotten gains, the Commission considers the respondent's financial status. As a result, even if the Commission believes it can prove unlawful conduct, but no equities exist for injunctive or ancillary relief, the Commission is more likely to settle. With respect to these factors, the Commission's reasoning process is quite similar to the private bar's.

Let's turn to an area where you might imagine that Commission litigation strategies differ greatly from private practice -- considering how much it will cost the client to try

the case. All of you know well, and I remember well, conversations with clients along these lines:

Attorney: If we decide to try this case, there's a 90% chance we'll win, but my fees to try the case will run you about \$25,000, and that's without complications. On the other hand, the plaintiff has said he'll settle for \$10,000, and I think we can talk him down to \$7,500.

Client: You mean to tell me that even if I win, which you won't guarantee, it will cost me \$25,000, and I can get out of this entire ridiculous mess for \$7,500?

Attorney: Yes, I think he'll accept \$7,500.

Client: Well, let's offer \$2,000 and see what happens.

It goes without saying that the Commission does not bill the taxpayer on an hourly basis for legal services rendered. And therefore, we don't have quite the same kind of conversations at 450 5th Street. Or, to put my point in terms an economist might use, there are no direct marginal costs when the Commission decides to try a case. The Commission does attempt to keep track of its lawyers' time, but its efforts do not compare to the tyranny of the time sheet under which most of you toil . . . thank God.

With that difference noted, though, the Commission's sensitivity to the "cost" of trying a case is more like private practice than you may imagine. I have come to recognize that the Commission has limited resources, which are not likely to increase in the present political environment. In order to discharge its statutory mandate, the Commission must maintain a presence across as broad a spectrum of issues as possible. The "cost" to the Commission of trying a case is that its lawyers who could be investigating other matters are "bogged down", if you will, on one case for a long period of time.

The Commission has taken steps to overcome its resource limitations. In the mid-1970's, the Commission negotiated consent decrees that shifted some of its policing activities to others. For example, these consent decrees required companies to create independent special review committees or to hire independent consultants to perform much of the fact-finding work that might normally fall on the Commission's staff. 1/ Also, the Division of Enforcement created a special trial unit, presently ably headed by Alexia Morrison, to improve the Commission's trial capabilities. It is very likely that this unit's mere existence has helped the Commission to negotiate settlements of enforcement actions because the alternative of trial is now a more viable one. Nevertheless, to be cost effective, the Commission still must settle the vast majority of its cases.

1/ See J. Seligman, The Transformation of Wall Street 541-45 (1982) (discussing the SEC's use of consent decrees in questionable-payments cases).

Settling cases, at least in the short run, may also be efficient. As you may know, the Commission places a great emphasis on efficiency. The Commission's 50th Annual Report notes with justifiable pride that the Commission brought 57% more enforcement actions in 1984 than in 1981, with 5% less personnel. Settling cases of course allows the Commission to bring an increasing number of enforcement actions without personnel increases. In sum, when the Commission decides whether to settle a case, the cost of trying the case is a major factor.

Trial publicity is another factor influencing settlement decisions from the respondent's point of view. Many respondents believe that they are guilty in the public's eyes as soon as they are charged by the SEC. Even if the respondent ultimately prevails, he thinks coverage of a public trial may exacerbate the perceived harm. This fear provides a strong incentive for private parties to settle Commission actions.

The impact of publicity is one factor that pushes private litigants and the Commission in different directions. The Commission actively seeks to publicize its cases in order to "get the message out". Thus, to the extent that trials are reported in the media, the Commission's enforcement program benefits because the "message" is being delivered. Private parties, naturally, are not so keen about having the "message" delivered at their expense.

Let's now discuss the "future litigation" factor. Litigators, especially defense lawyers representing large corporate clients, consider the effects of settling a case on future litiga-

tion. Will settlement of Case A today encourage potential plaintiffs with marginal claims to bring Cases B, C and D in hopes of a quick buck? If so, many litigators will advise their client to try Case A, even though settlement is less expensive and less risky in the short run.

In my experience, the Commissioners, as they should, consider the impact of a settlement on future litigation. In its case, however, the impact is magnified by the private bar's intense scrutiny of Commission actions. Thus, before settling cases on lenient terms, the Commission should consider whether every defendant will demand settlement on similar terms, and whether such demands will delay the resolution of future cases.

Let me describe one recent case to illustrate my point. Last November 27, the Commission settled a Rule 2(e) proceeding against a Big 8 accounting firm and one of its partners. 2/ The opinion and order set forth the Commission's views of the accounting issues in the case, and stated that the financial statements on which the firm rendered an unqualified opinion were not presented as the Commission thought they should have been. Nevertheless, there were neither findings entered, nor sanctions imposed against the respondents.

The Wall Street Journal reported the settlement on November 30. 3/ It quoted a statement by the firm's general

2/ In re Coopers & Lybrand and M. Bruce Cohen, Securities Exchange Act Release No. 34-21520 (November 27, 1984).

3/ Wall Street Journal, November 30, 1984, at 8 (Ingersoll, "Big Eight Firm and SEC Settle Digilog Dispute").

counsel that the firm was "gratified that this matter has been resolved in this unprecedented and unique manner." Noting that the Commission made no formal findings, the general counsel described the settlement as "basically a walkaway deal."

On December 14, a major Washington law firm wrote its clients and other friends of the firm, analyzing the settlement. 4/ After noting the lack of findings or sanctions, the author of the letter urged that "[a]ny person negotiating a settlement of an SEC administrative proceeding ... seek to include similar language in their Offer of Settlement and the SEC's Order." This statement demonstrates why the Commission must be careful when settling cases on novel or lenient terms. Lenient settlements may impede negotiations in subsequent cases, because every well informed lawyer will insist on similar terms. On the other hand, one must not be rigid, or inflexible. The Commission must be able to respond appropriately to unique situations without fear of setting a precedent that may prove bothersome in the future. So there is a fine line to be walked between knowing when to be innovative and responsive to particular circumstances and when not to, and knowing when to say "no" to persistent counsel demanding the same "soft" deal his friend Joe got.

4/ Letter dated December 14, 1984 from Theodore A. Levine of Wilmer, Cutler & Pickering to Clients and Other Friends of the Firm.

Before I leave this area, I feel obliged to warn you that this Commissioner, at least, is not of a mind to settle future 2(e) proceedings that are in any way factually distinguishable without findings or sanctions. Although I cannot speak for the Commission as a whole, or for the staff, it is my opinion that in the overwhelming majority of 2(e) cases it will be a waste of everyone's time and money to insist on settlements that include neither findings of improper professional conduct, nor sanctions.

Now I would like to say a few words about how the various factors I have mentioned boil down in the typical Commission enforcement action. As I said earlier, it is simply a fact that because of limited resources, and a desire to maintain a broad presence, the Commission settles the vast majority of its enforcement actions.

On the other side of the equation, most respondents in enforcement actions are also under strong pressure to settle. The cost of litigation and trial publicity are two of the principal reasons they do settle. In addition, because the Commission does not bring cases without a thorough investigation of the facts, there are relatively few cases in which the respondent has much to gain by trying the case. Thus, for several reasons, the usual respondent is at least as anxious as the Commission to settle an enforcement action. In most cases, therefore, I believe these simultaneous forces produce an appropriate balance of negotiating power between the Commission and the respondent.

There are noteworthy exceptions to this general rule, however. Certain types of respondents seem determined to litigate "tooth and nail" with the Commission. That, of course, is their right, but it is critical that the exercise of their right not stymie the Commission's enforcement program. These respondents tend to be well-heeled persons or entities for whom the stakes of litigation are high -- for example where a bar from association with a regulated entity or revocation of registration is a likely sanction, or where disgorgement of ill-gotten monies is requested. In such cases, the cost of trying the matter seems to be outweighed by the benefits of delaying adverse judgments. These respondents also tend not to be adversely affected, or so they think, by publicity. In fact, they usually engage in active publicity campaigns highlighting their litigation with the Commission as a crusade for private enterprise against the evil forces of the federal bureaucracy.

In my view, in such cases the Commission must be as prepared to litigate as the adversary. Unless the Commission demonstrates an unwaivering willingness to litigate, respondents may think they can wear the Commission down over time, and force it to abandon the case or settle on weak terms. In my opinion, these respondents threaten the integrity of the law enforcement process. Why do I feel that way?

For two reasons. First, it is my belief that, as a general rule, no private party should be able successfully to wage a war of attrition against any governmental agency. The

government cannot compromise law enforcement because a private litigant has greater resources. Therefore, in certain circumstances we should readjust our cost-benefit analysis to take into account the long-term benefits of sending out the message that there is some "bite" behind our "bark".

Second, like any good legal negotiator, the Commission must be willing and able to stop talking and move to the courtroom if it expects to be taken seriously in settlement negotiations. I, for one, am a firm believer in this context in the old saying that "you can't get a good deal unless you're willing to lose it." If respondents know that the Commission is willing to try any case where an inadequate settlement offer has been made, settlement negotiations will proceed more quickly and settlement offers will improve substantively. This, in turn, will lead to greater numbers of cases being brought, and a broader presence across all areas of the securities laws -- in short, it will lead to a more efficient and effective enforcement program.

Thank you for your attention.