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Bank of America Settlement and JPMorgan Case Highlight SEC's Tepid Response

By Susan Beck

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BLB&G served as Co-Lead Counsel for the investor Class in *In re Bank of America Securities Litigation.*

In the last week we've seen some flashy headlines about lawsuits stemming from the financial crisis. On Friday, Bank of America Corp. announced that it had agreed to pay $2.43 billion to settle a shareholder suit over allegedly inadequate disclosures it made when it acquired Merrill Lynch & Co. in 2009. Then on Tuesday New York Attorney General Eric Schneiderman brought a sweeping lawsuit accusing J.P. Morgan Chase Bank of deceiving investors in mortgage-backed securities before the financial crisis. (The suit focuses on the activities of Bear Stearns & Co. Inc., which JPMorgan acquired.)

Sounds like good news for those concerned about tough enforcement of our securities laws, right?

Wrong.

The problem is that both of these events highlight the weak, tepid response of the federal agency that should stand at the front lines of enforcing those laws. I'm talking about the Securities and Exchange Commission.

In the BofA case, don't forget that the SEC was initially willing to settle its case against BofA for a measly $33 million. That case — which alleged that the bank improperly failed to disclose that Merrill executives would be paid up to $5.8 billion in bonuses — was famously upended when Manhattan U.S. District Judge Jed Rakoff refused to approve the settlement, calling $33 million a "trivial penalty" in this September 2009 ruling. The SEC and the bank later came back with a $150 million deal, which included the settlement of charges that BofA concealed the full extent of Merrill's losses before the shareholder vote on the merger. An exasperated Rakoff called that penalty "modest"— especially in light of the expanded charges —- and queried why no individuals were charged. But he reluctantly signed off on the pact in February 2010, writing: "While better than nothing, this is half-baked justice at best."

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Now it's true that the SEC, unlike the shareholder plaintiffs, can't recoup investor losses, so it's unfair to compare the two settlements side-by-side. Instead, the agency is limited to seeking disgorgement of ill-gotten gains and statutory financial penalties. (SEC Chairman Mary Shapiro last year asked Congress to give her agency the power to impose bigger penalties. Legislation has been introduced, but not yet voted on.) Measuring ill-gotten gains in the context of a disclosure case is a tricky matter. But by settling for $150 million, the SEC may have underestimated the strength of this case. After all, in the shareholder litigation, Manhattan U.S. District Judge P. Kevin Castel brusquely rejected most of BofA's defenses in pretrial rulings. And he also refused to dismiss BofA's top officers and directors, who were never even sued by the SEC.

The SEC declined to comment.

The JPMorgan matter raises a slightly different question. Why was this case brought by the New York AG, and not by the SEC or Justice Department under our federal securities laws? Investor deception should be right down the SEC's alley. Instead, the charges were filed under New York's nebulous Martin Act. Although this lawsuit was the product of an effort by the Residential Mortgage-Backed Securities Working Group, a newly-formed state and federal task force that includes the SEC and the DOJ, the SEC is standing far in the background here.

I do wonder if the SEC feels its hands are tied by assurances that it gave JPMorgan in 2008 when it acquired Bear Stearns. As I reported in an article for *The American Lawyer*, JPMorgan's general counsel Stephen Cutler reached out to then-enforcement director Linda Thomsen with a bold request before that deal. Cutler, a former SEC director of enforcement who had been Thomsen's boss, tried to get her to ensure that JPMorgan wouldn't be sued for Bear Stearns's misdeeds. Although Thomsen, who is now a partner at Davis Polk & Wardwell, didn't give Cutler exactly what he wanted, she did take the unusual step of giving some vague assurances in writing, which upset some of her staff who were investigating Bear Stearns. (Cutler declined to comment for that article and Thomsen did not respond to requests for comment.)

Unfortunately the New York AG doesn't have the greatest track record when it comes to aggressively litigating another hallmark financial crisis case. As I noted in an earlier column, "Whatever Happened to the NY AG's Case Against BofA?," the AG's case against Bank of America and former CEO Ken Lewis and former CFO Joe Price has all but stalled in state court since it was filed with great fanfare in February 2010.

Let's hope this case is pursued with more urgency.

Susan Beck is a Senior Writer for The American Lawyer *magazine and its online publications. She contributes regularly to* AMLAW's Litigation Daily *website, offering an inside perspective on important developments in commercial and corporate litigation. She also writes a regular opinion column for the* Litigation Daily *called* Summary Judgment *where this essay appeared.*