Events Surrounding Bank of America's Acquisition of Merrill Lynch

by Robert Khuzami
Director, Division of Enforcement
U.S. Securities and Exchange Commission

December 11, 2009

Chairman Towns, Ranking Member Issa, Members of the Committee:

Thank you for the opportunity to testify on behalf of the Securities and Exchange Commission regarding the events surrounding the Bank of America Corporation ("Bank of America") acquisition of Merrill Lynch & Co, Inc. ("Merrill") and the Commission's ongoing litigation against Bank of America.

Bank of America's Acquisition of Merrill

The Committee's invitation letter asks whether the SEC was consulted with regard to the January 16, 2009, bailout of Bank of America. I became Director of the Commission's Division of Enforcement on March 29, 2009, after the Merrill acquisition was negotiated and closed. Although I stand ready to assist the Committee in any way I can, I have no knowledge of what consultations, if any, occurred with the Commission, other than what I have read in the press or the testimony of previous Committee witnesses.

SEC's Litigation Against Bank of America

The Committee's invitation letter also asks about the SEC's ongoing litigation against Bank of America. On August 3, 2009, the Commission filed a complaint in the U.S. District Court for the Southern District of New York against Bank of America. The complaint concerns a November 2008 joint proxy statement that Bank of America and Merrill sent to their shareholders soliciting shareholder approval for the acquisition of Merrill by Bank of America. The complaint alleges that the joint proxy statement violated Section 14(a) of the Securities Exchange Act and Rule 14a-9 because it contained materially false and misleading statements.

Specifically, the complaint alleges that Bank of America represented in the proxy statement that Merrill had agreed not to pay year-end performance bonuses or other discretionary incentive compensation to its executives prior to the closing of the merger without Bank of America's consent. Bank of America, however, failed to disclose that it already had consented to Merrill's payment of up to $5.8 billion in discretionary year-end and other bonuses to Merrill executives for 2008. Bank of America's agreement to allow Merrill to pay these discretionary bonuses was set forth in a separate document that Bank of America omitted from the proxy statement. The substance of this separate agreement was never disclosed to shareholders prior to their vote on the merger. The complaint alleges Bank of America's omission of this information therefore rendered the proxy statement materially false and misleading.

At the time we filed our complaint, the Commission submitted a consent judgment for the court's consideration under which the case against Bank of America would be settled on terms that included the payment of a $33 million penalty by the company and the entry of a permanent injunction prohibiting it from further violations of the securities laws' proxy solicitation provisions. As you know, the Judge in the case declined to approve the consent judgment, and the litigation is thus ongoing.

The Judge's decision regarding the consent judgment does not affect the underlying case. We have continued to vigorously pursue the charges we filed against Bank of America, and have used the additional discovery available in the litigation to further pursue the facts and determine whether to seek additional charges. In determining how to proceed, we will, as always, be guided by what the facts warrant and the law permits. Trial of the case is scheduled to begin on March 1, 2010.

Because the enforcement action against Bank of America is ongoing, discussion of certain aspects of this litigation pose a risk of negatively affecting our case. Nevertheless, I am happy to discuss elements of the consent judgment or our publicly filed court papers that should not compromise our ability to bring this litigation to a successful conclusion.

With regard to the proposed settlement, we believe that it was reasonable, appropriate and in the public interest. The proposed settlement properly balanced all of the relevant factors that must be considered when assessing any settlement. Where a corporate issuer fails to meet its statutory obligations, the need for deterrence of similar misconduct is paramount. Among other things, the proposed $33 million penalty – which would have constituted the second largest penalty ever imposed in a proxy statement case – would have accomplished the following:

- The proposed penalty would have sent a clear message to corporations and those who advise them – and reinforced the previously articulated Commission pronouncement – that proxy statements must include the substance of a separate nonpublic document when the failure to do so results in a material misstatement or omission in the proxy statement. It also would have reiterated the principle that corporations are responsible for maintaining internal controls that prevent and detect misstatements contained in proxy statements. We believe that management at corporate issuers and their advisors would have received and understood this clear message.

- The proposed penalty also would have sent a strong message to shareholders that unlawful corporate conduct had occurred and that management failed to keep the company in compliance with the applicable laws. That message allows shareholders to better assess the quality and performance of management.

- The proposed settlement also would have undercut the position – now asserted by Bank of America – that there was no legal requirement to disclose such information.

Importantly, these objectives would have been achieved through a proper balance of imposing a significant monetary penalty that reflected the seriousness of the violations while not imposing undue financial burdens on shareholders. Although a $33 million penalty is a significant amount, it is unlikely to have a material adverse financial impact on individual innocent shareholders given the approximately 8 billion outstanding shares of Bank of America stock.

The actions in this proposed settlement do not reflect a change in the Commission's approach to pursuing charges against individuals that violate the federal securities laws. The Commission has been and will continue to be aggressive in bringing actions against individual wrongdoers that violate the securities laws. Moreover, the Commission will continue to vigorously pursue penalties from culpable individuals, including culpable corporate executives. Indeed, the Commission has a strong record of charging and seeking substantial penalties from individual executives in recent cases, and we will continue to do so in the future.[1]

Your letter of invitation also asked why our complaint charges only the corporation and not individual executives or lawyers for the companies. The SEC pursued all of the charges we believed were appropriate based on the investigative record and the applicable law. Section 14(a) of the Securities Exchange Act, which governs proxy statements, is directed to those who solicit proxies or in whose name proxies are solicited. In this case, it was the corporations – Bank of America and Merrill – that solicited the proxies and in whose name they were solicited. The corporation therefore had the legal obligation under Section 14(a), and we charged that the corporation failed to meet that obligation.

Conversely, in order to establish that individuals aided and abetted a Section 14(a) violation or committed fraud in violation of Section 10(b) of the Exchange Act, it would

---

[1] *See, e.g., SEC v. Brookstreet Securities Corp.*, No. SACV 09-01431 DOC (ANx) (C.D. Cal. 2009) Lit. Rel. No. 21328 (December 8, 2009) (charging company president/CEO for fraudulently selling risky, illiquid CMOs to retail customers); *SEC v. Morrice, et al.*, No. SACV09-01426 JVS (C.D. Cal. 2009) Lit. Rel. No. 21327 (December 7, 2009) (charging individuals for misleading investors about the company's subprime mortgage business); *SEC v. Greenberg, et al.*, No. 09-cv-6939, 2009 WL 2413951 (S.D.N.Y. Aug. 6, 2009) and *SEC v. American International Group, Inc.*, No. 06-cv-1000, 2006 WL 305791 (S.D.N.Y. Feb. 9, 2006) (corporate and individual charges for fraudulent accounting scheme); *SEC v. Mozilo, et al.*, No. 09-cv-03994, 2009 WL 2341660 (C.D. Cal. June 4, 2009) (charging individuals for knowingly misleading investors about company's condition); *SEC v. Strauss, et al.*, No. 09-cv-4150, 2009 WL 1138823 (S.D.N.Y. Apr. 28, 2009) (charging individuals for accounting fraud and for knowingly misleading investors about company's condition); *SEC v. Biovail Corp., et al.*, No. 08-cv-2979, 2008 WL 260474 (S.D.N.Y. Feb. 4, 2009) (same); *SEC v. Analog Devices, Inc. and Jerald Fishman,* Lit. Rel. No. 20604 (May 30, 2008) (charging corporation and CEO for stock options backdating); *Federal Home Loan Mortgage Corp., et al.,* Lit. Rel. No. 20304 (Sept. 27, 2007) (charging corporation and four executives with accounting fraud); *SEC v. Conagra Foods, Inc.,* Lit. Rel. No. 20206 (July 25, 2007) (charging corporation, subsidiary and eight individual executives with improper and fraudulent accounting practices).

have been necessary to prove individual scienter. To establish aiding and abetting, the statute requires that a person knowingly provide substantial assistance in support of a violation. The scienter element of a Section 10(b) violation similarly requires knowing or reckless misconduct. In contrast, scienter is not an element of a Section 14(a) violation. Based on the investigative record that existed at the time, we did not believe that we could fairly and properly assert scienter-based charges against individuals under the applicable legal standards. Of course, as I stated above, we have used the additional discovery available in the litigation to further pursue the facts and determine whether it is appropriate to seek additional charges in this case.

Another issue presented in the investigation was Bank of America's assertion of the attorney-client privilege during the investigation. As a matter of law, the Commission simply cannot compel parties to waive the attorney client privilege, a privilege that under the law serves important interests. Courts have held that parties' assertions of reliance on counsel made during the course of *an investigation* generally do not result in a waiver of the privilege. Court findings of privilege waivers generally have been limited to assertions of reliance on counsel made during the course of *judicial proceedings*. Commission staff therefore did not believe it had a sufficient legal basis to pierce the privilege. Once the case transitioned to contested litigation, we sought additional avenues for discovery that became potentially available. We ultimately reached agreement with Bank of America on the terms of a court order governing disclosure of information Bank of America previously had withheld on the basis of legal privileges. That order resulted in a broad waiver of the attorney-client privilege on matters relating to the Bank of America case.

Conclusion

In sum, we have vigorously pursued and will continue to vigorously pursue our charges against Bank of America and take all necessary steps in an effort to prove our case in court. Enforcement is one of our core responsibilities and a central part of our heritage as an agency. Now more than ever, it is critical that our Enforcement program help support investor confidence in the agency and in the marketplace.

Thank you for the opportunity to address these important issues. I look forward to answering your questions.