
The SEC's Longstanding "Neither Admit Nor Deny" Settlement Policy is Supported by Second Circuit Decision Granting Stay

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Overview

In the latest development involving the Securities and Exchange Commission's ("SEC") longstanding practice of settling enforcement cases on a "neither admit nor deny" basis, the Second Circuit issued an opinion on March 15, 2012 granting a stay in the case in which Judge Jed Rakoff had refused to approve the SEC's settlement with Citigroup. A three-judge panel of the United States Court of Appeals for the Second Circuit granted the SEC and Citigroup's motion for a stay of district court proceedings pending the Second Circuit's disposition of the parties' appeal and mandamus petitions.¹

This case has been closely watched because of Judge Rakoff's criticism of the "neither admit nor deny" policy, and his insistence on admissions on the basis of which the court could evaluate whether the proposed settlement is in the public interest. With this ruling, the Second Circuit seemed to accept the SEC's policy arguments, which may be a predictor of how the Second Circuit will rule on the merits. This development is important, as it removes some of the uncertainty created by Judge Rakoff's prior decisions, and is a significant step in validating the SEC's settlement practice.

Background of the Case

On October 19, 2011, the SEC filed a complaint alleging that Citigroup Global Markets Inc., the brokerage and securities arm of Citigroup Inc., negligently misrepresented key deal terms for a collateralized debt obligation it was marketing, along with Citigroup's consent and a proposed final judgment imposing an injunction, a \$285 million civil money penalty, and certain undertakings. On November 28, 2011, Judge Rakoff issued an order rejecting the settlement and ordering a prompt trial.² Judge Rakoff criticized the SEC settlement because it was "neither reasonable, nor fair, nor adequate, nor in the public interest," and because Citigroup did not admit to the SEC's allegations, stating that the lack of "any proven or admitted facts" deprived the district court of the facts necessary to determine, among other things, whether the punishment was adequate.³

The SEC and Citigroup both appealed that order on December 15, 2011, and the SEC alternatively petitioned to set aside that order on December 29, 2011. The SEC also filed an emergency motion for a stay of the district court proceedings.⁴ Citigroup joined with the SEC in all of its arguments.

Second Circuit Order

The appellate panel determined that the SEC and Citigroup had "made a strong showing of likelihood of success" that Judge Rakoff's ruling would be overturned and had shown "serious, perhaps irreparable, harm sufficient to justify grant of stay."⁵ The court also found that the SEC's "assessment of the importance of its settlement to the public interest was entitled due deference."⁶ Notably, the panel also defended the SEC's "neither admit nor deny" settlement policy as reasonable and practical.⁷

First, the panel emphasized the limited role of a district court in reviewing an executive branch agency's decision to settle a claim, including the SEC's "neither admit nor deny" policy. The panel found that it was "doubtful whether the court gave the obligatory deference" to the SEC on a "wholly discretionary" policy matter.⁸ Though Judge Rakoff thought that "it was bad policy, which disserved the public interest, for the SEC to allow Citigroup to settle on terms that did not establish its liability," the panel said it is not "the proper function of federal courts to dictate policy to executive administrative agencies. . . . While we are not certain we would go so far as to hold that under no circumstances may courts review an agency decision to settle, the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal."⁹ Additionally, the panel suggested that Judge Rakoff misinterpreted precedent regarding how to evaluate "public interest" and exceeded his judicial authority: "The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones."¹⁰ The panel also saw "no basis to doubt [] the SEC's decision" to settle or the SEC's consideration of the numerous factors that affect a decision of whether to litigate or settle the case, including the public interest, the risk of going to trial, and the likelihood of obtaining a settlement, which "are precisely the factors that the Supreme Court has recognized as making a discretionary agency decision unsuitable for judicial review."¹¹

The panel also took issue with Judge Rakoff's insistence on an admission of liability, which the panel said wrongly: (1) prejudged Citigroup's guilt in misleading investors, (2) assumed the SEC would succeed at trial, and (3) assumed that Citigroup would settle even if it had to admit liability.¹² The panel expressed "doubt whether it lies within a court's proper discretion to reject a settlement on the basis that liability has not been conclusively determined" and stated that settlements are "by definition a compromise" and commonly have no binding admission of liability, nor is an admission of liability necessary for a settlement to be in the public interest.¹³ The panel further suggested that practically, parties would have a disincentive to settle if one party had to admit liability, as "[r]equiring such an admission would in most cases undermine any chance of compromise."¹⁴

Finally, the panel questioned why the district court found the settlement to be unfair to Citigroup,

questioning "whether it is a proper part of the court's legitimate concern to protect a private, sophisticated, counseled litigant from a settlement to which it freely consents. We doubt that a court's discretion extends to refusing to allow such a litigant to reach a voluntary settlement in which it gives up things of value without admitting liability."¹⁵

The panel denied the SEC's motion to expedite its appeal on the merits, but directed the Clerk of Court to set a briefing schedule for counsel to submit briefs addressing the relevant issues. The panel took the unusual step of directing the Clerk of Court to appoint counsel to represent the district court's position, possibly because of the "important questions" raised by the case, including "the division of responsibilities [] between the executive and the judicial branches," "the deference a federal court must give to policy decisions of an executive administrative agency as to whether its actions serve the public interest," and "the question of a court's authority to reject a private party's decision to compromise its case" if the court does not think the party has incurred any liability.¹⁶

Response to the Citigroup Decisions

The SEC vigorously challenged Judge Rakoff's November decision, as "neither admit nor deny" settlements have been agency policy for years. After the decision, SEC Director of Enforcement Robert Khuzami stated that Judge Rakoff's decision "committed legal error by announcing a new and unprecedented standard that inadvertently harms investors by depriving them of substantial, certain and immediate benefits." In a speech on December 1, 2011, he said that turning down settlements because of a lack of admission would result in fewer settlements, longer delays before victims get compensated, expended SEC resources, and less money to investors.¹⁷

On December 16, 2011, the House Committee on Financial Services announced that it would "hold a hearing [in 2012] to examine the practice by the Securities and Exchange Commission of settling cases with defendants that neither admit nor deny complaints made by the SEC." The SEC made a small change in its "neither admit nor deny" policy in January 2012, when it announced that it will no longer allow companies to say they neither admit nor deny the Commission's civil charges when, at the same time, they admit to or have been convicted of criminal violations.

Other courts have cited Judge Rakoff's November 2011 decision questioning the factual premise of settlements. Judge Rudolph Randa in the Eastern District of Washington cited Judge Rakoff in questioning a "neither admit nor deny" settlement and requested that the SEC "provide a written factual predicate for why the agency believes the court should find that proposed final judgments in an enforcement action alleging that a company prepared materially inaccurate financial statements and lacked adequate financial controls are fair, reasonable, adequate, and in the public interest" before he decided whether to approve the settlement.¹⁸ Judge Randa also questioned the "adequacy of the SEC's proposed final judgment provision regarding disgorgement."¹⁹ The court ultimately approved the settlement in February 2012. Also in February 2012, Judge Renee Marie Bumb of the District of New Jersey cited Judge Rakoff's November 2011 decision when she blocked a proposed settlement between the Federal Trade Commission ("FTC") and a marketing company, arguing that the court had no facts to judge whether the proposed settlement was fair, adequate,

and in the public interest.²⁰ The court ordered the FTC and the company to present facts justifying the approval of a proposed \$11.5 million settlement when the company had not admitted any wrongdoing.²¹

After the Second Circuit panel issued its ruling on March 15, 2012, Director Khuzami issued the following statement: "We are pleased that the appeals court found 'no reason to doubt' the SEC's view that the settlement ordering Citigroup to return \$285 million to harmed investors and adopt business reforms is in the public interest." He further noted that "[a]s we have said consistently, we agree to settlements when the terms reflect what we reasonably believe we could obtain if we prevailed at trial, without the risk of delay and uncertainty that comes with litigation. Equally important, this settlement approach preserves resources that we can use to stop other frauds and protect other victims."

In sum, the Second Circuit's opinion last week was a significant positive development for the SEC's enforcement program. Although it was not a decision on the merits, the Second Circuit stated that the SEC's settlement policies, including the "neither admit nor deny" policy, were properly within the agency's discretion. Parties should take comfort in the fact that this decision strongly indicates that district courts should defer to the SEC's settlement decisions, thus likely removing the uncertainty that arose from Judge Rakoff's decision.

¹*U.S. Secs. and Exch. Comm'n v. Citigroup Global Mkts. Inc.*, No. 11-5227-cv, 11-5375-cv, 11-5242-cv, 2012 WL 851807, at *9 (2d Cir. Mar. 15, 2012).

²*U.S. Secs. and Exch. Comm'n v. Citigroup Global Mkts. Inc.*, No. 11 Civ. 7387, 2011 WL 5903733, at *6 (S.D.N.Y. Nov. 28, 2011).

³*Id.* at *6.

⁴The SEC also filed a motion to stay in district court, which Judge Rakoff denied without knowing of the SEC's motion to stay filed with the Second Circuit. This motion caused Judge Rakoff to write a supplemental order expressing displeasure with the SEC's conduct, stating that the SEC made "materially misleading" statements and disregarded professional responsibility in not citing to relevant authority; he also directed parties to fax him any filings before the Second Circuit immediately after filing. The SEC responded on December 29, 2011 that it had acted "in good faith."

⁵*Citigroup Global Mkts. Inc.*, 2012 WL 851807, at *9.

⁶*Id.*

⁷See, e.g., *id.* at *2.

⁸*Id.* at *4-5.

⁹*Id.* at *4.

¹⁰*Id.* at *4.

¹¹*Id.*

¹²*Id.* at *3.

¹³*Id.* at *6.

¹⁴*Id.* at *5.

¹⁵*Id.* at *5.

¹⁶*Id.* at *1.

¹⁷ Robert Khuzami, Remarks Before the Consumer Federation of America's Financial Services Conference (Dec. 1, 2011), available at www.sec.gov/news/speech/2011/spch120111rk.htm.

¹⁸*U.S. Secs. and Exch. Comm'n v. Koss Corp.*, No. 11-C-991-RTR, at *3 (E.D. Wis. Dec. 20, 2011).

¹⁹*Id.*

²⁰*Fed. Trade Comm'n v. Circa Direct LLC*, No. 11-2172 RMB/AND, 2012 WL 589670 (D.N.J. Feb. 22, 2012).

²¹*Id.* at *2.