

SEC Announces New Policy Regarding “Neither Admit Nor Deny” Language in Settlements

I. Executive Summary

On January 6, 2012, Robert Khuzami, Director of the Division of Enforcement at the Securities and Exchange Commission (SEC), announced a change to the longstanding policy of allowing defendants to settle charges without admitting or denying allegations of wrongdoing in a civil injunctive complaint or administrative order.

Under the new policy, settlements will no longer include “neither admit nor deny” language where defendants (1) have been subject to parallel criminal convictions or (2) have signed Non-Prosecution Agreements (NPAs) or Deferred Prosecution Agreements (DPAs) that contain admissions or acknowledgments of criminal conduct. Instead of the traditional charging language, settlements will now include language that recites the “fact and nature” of a criminal conviction, NPA, or DPA. Settling defendants will continue to be prohibited from denying the factual allegations made by the SEC.

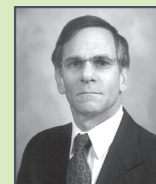
The change in policy represents an additional factor a settling party will need to consider when taking a plea or entering into an NPA or DPA with a criminal enforcement agency. At the same time, the import of the SEC’s new policy should not be overstated for several reasons. First, the SEC’s charging practice remains unaltered with respect to parties that do not face criminal exposure, which constitutes the overwhelming majority of SEC enforcement matters. Indeed, Mr. Khuzami emphasized that the SEC will continue its standard practice of charging on a “neither admit nor deny” basis. Second, where the new policy does apply, there is no requirement that settlements include “admissions or adjudications of fact beyond those already made in criminal cases.” Third, there is no requirement that settlements incorporate facts admitted in the plea allocution, NPA, or DPA. The inclusion of such language remains within the discretion of the Division of Enforcement, as always has been the case. Finally, although it is possible that the change represents a shift to more aggressive enforcement policies, it is unclear whether or to what extent this will be the case.

II. Background

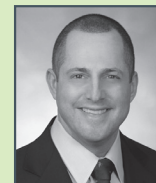
The SEC has long allowed defendants to settle without admitting to their allegations, even where they had made admissions of wrongdoing in parallel criminal or civil proceedings.¹ The use of “neither admit nor deny” language has become the SEC’s standard charging

¹ See Consent Decrees in Judicial or Administrative Proceedings, Securities Act Release No. 33-337 (Nov. 28, 1972) (formally permitting respondent to avoid admitting or denying the allegations).

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practice. Under well-settled law, courts are required to approve proposed civil settlements so long as they are fair, reasonable, adequate, and in the public interest.² Following this deferential standard, the overwhelming majority of courts have approved SEC settlements without scrutinizing their factual bases or requiring substantive modifications. Recently, however, Judge Jed Rakoff in the Southern District of New York and a number of other federal judges have questioned settlements where defendants neither admit nor deny the underlying allegations.

The latest change in policy comes on the heels of Judge Rakoff's most recent opinion in *SEC v. Citigroup*, issued less than two months ago. In *Citigroup*, Judge Rakoff rejected a US\$285 million settlement stemming from Citigroup's allegedly fraudulent marketing of collateralized debt obligation instruments. The SEC has appealed that decision, arguing it "ignores decades of established practice throughout federal agencies and decisions of the federal courts." While Mr. Khuzami expressly denied any connection between Judge Rakoff's *Citigroup* decision and the change in policy (and *Citigroup* did not involve a parallel criminal enforcement action where Citigroup admitted to criminal conduct), the new policy removes the narrow issue of allowing defendants who have made factual admissions in a criminal proceeding to settle an SEC civil action without admitting the same facts.

In *Citigroup*, Judge Rakoff denied the SEC's settlement largely because the "neither admit nor deny" language "deprive[d] the Court of even the most minimal assurance that the substantial injunctive relief it is being asked to impose has any basis in fact." While acknowledging the deferential standard of review, Judge Rakoff nevertheless held that he could not approve the settlement as fair, reasonable, adequate, and in the public interest because it did "not provide the Court with a sufficient evidentiary basis to know whether the requested relief is justified under any of these standards." Judge Rakoff also criticized the practice of neither admitting nor denying admissions on other grounds, specifically noting that (1) private investors would be unaided by such language

in civil litigation and (2) Citigroup would likely contest any of the allegations in the complaint in parallel civil litigation. Judge Rakoff had cited similar concerns in conjunction with two prior settlements.³

III. Implications

Although the SEC's new policy represents an additional consideration a party must take into account when entering into a settlement, the practical impact of the policy change is likely to be modest for several reasons.

First and foremost, the SEC's new policy will not apply to most settling parties. The policy is limited by its own terms to settlements where the defendant has (1) pled guilty, (2) been convicted, or (3) made substantive admissions in an NPA or DPA. As acknowledged in Mr. Khuzami's statement, "[t]he revision applies in the minority of our cases." Thus, the policy change does not affect the SEC's "traditional 'neither admit nor deny' approach in settlements that do not involve criminal convictions or admissions of criminal law violations." Accordingly, for the vast majority of cases, charging practices will remain unchanged.

In this regard, Mr. Khuzami indicated that the Division of Enforcement will continue to settle matters on a "neither admit nor deny basis." In a recent speech following *Citigroup*, Mr. Khuzami defended the SEC's "neither admit nor deny" policy.⁴ He noted that it is an "often unwise policy" to decline a settlement "due to the absence of an admission."

² See, e.g., *SEC v. Randolph*, 736 F.2d 525, 529 (9th Cir.1984).

³ See *SEC v. Vitesse Semiconductor*, 771 F. Supp. 2d 304 (S.D.N.Y. 2011); *SEC v. Bank of America Corp. (Bank of America II)*, Nos. 09-CV-6829, 10-CV-0215, 2010 WL 624581 (S.D.N.Y. Feb. 22, 2010); *SEC v. Bank of America Corp. (Bank of America I)*, 653 F. Supp. 2d 507 (S.D.N.Y. 2009). These concerns also have been echoed by at least two other federal judges. In August 2010, Judge Huvelle in the District Court of the District of Columbia raised significant questions about whether to approve a proposed US\$75 million SEC settlement. Her concerns mirrored Judge Rakoff's. See Hearing Transcript, *SEC v. Citigroup*, 1:10-cv-01277 (D.D.C. Aug. 20, 2010) (Dkt. No. 13). Similarly, in December 2011, Judge Randa requested from the SEC "written factual predicate for why it believes the Court should find that the proposed final judgment is fair, reasonable, adequate, and in the public interest." See Ltr. to Counsel, *SEC v. Koss Corp.*, No. 2:11-cv-00991 (E.D. Wis. Dec. 20, 2011) (Dkt. No. 5) (citing *Citigroup* and *Bank of America I*).

⁴ See Robert Khuzami, Remarks Before the Consumer Federation of America's Financial Services Conference, Dec. 1, 2011.

He emphasized that “the practical reality is that many companies would refuse to settle cases if they are required to admit unlawful conduct because that might expose them to additional lawsuits by litigants seeking damages,” and that taking a case to trial would not be worth its costs and risks, especially given that “a settlement ... reflects our best judgment of what we could get if successful at trial.” Elsewhere, Mr. Khuzami also has noted that settlements on a “neither admitting nor denying” basis were in the public interest because “obtaining disgorgement, monetary penalties, and mandatory business reforms may significantly outweigh the absence of an admission when that relief is obtained promptly and without the risks, delay, and resources required at trial.”⁵ Accordingly, “[r]efusing an otherwise advantageous settlement solely because of the absence of an admission also would divert resources away from the investigation of other frauds and the recovery of losses suffered by other investors not before the court.” These statements, along with the appeal of the *Citigroup* decision, indicate that the SEC will continue to craft settlements on a “neither admit nor deny basis” in resolving routine enforcement matters.

Second, where the new policy does apply, settling parties are not required to make admissions that they had not already made in criminal proceedings. In particular, the policy expressly states that the SEC is not required to include “admissions or adjudications of fact beyond those already made in criminal cases.” Rather, a settlement must merely include language noting that the defendant has admitted the parallel criminal action. Thus, the risk that a settling party will be forced to make new admissions of wrongdoing appears to be limited.

Third, the Division of Enforcement is not required to incorporate facts admitted in the plea allocution, NPA, or DPA. As was the case before the policy change, the decision to include this language remains discretionary. It remains to be seen how this discretion will be exercised.

Finally, the policy change does not—and is not intended to—address many of the systemic criticisms about SEC charging practice that Judge Rakoff has levied. For example,

Judge Rakoff has criticized settlements in which companies are charged with “negligently” violating the securities laws. In addition, Judge Rakoff has questioned the adequacy of the size of penalties in the *Citigroup* and other matters. None of these issues is addressed by the policy change—and it is not clear whether the change will be the beginning of a broader shift to more aggressive enforcement policies.

We hope that you have found this Advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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⁵ Robert Khuzami, Public Statement by SEC Staff, Nov. 28, 2011.