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Assessing the SEC's New 'Neither Admit Nor Deny' Policy

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On Jan. 6, 2012, the U.S. Securities and Exchange Commission announced that it was changing its longstanding policy of allowing defendants to settle civil enforcement actions without admitting or denying the SEC's allegations. Now, where there is a parallel criminal case, the SEC will no longer allow the traditional "neither admit nor deny" language in its federal court consent judgments or its settled administrative orders. Given the frequency of parallel SEC and criminal proceedings, practitioners should pay careful attention to how this abrupt shift in a decades-old practice might affect their clients.[1] This article discusses the implementation of this policy change through its fledgling months and considers the ramifications for individuals and corporations.

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Changing the Policy After 40 Years

The SEC's policy change came on the heels of a much-ballyhooed critique by Judge Jed S. Rakoff and a subsequent promise by Congress to take a hard look at the SEC's "neither admit nor deny" policy.

On Nov. 28, 2011, Rakoff rejected a proposed settlement between the SEC and Citigroup Global Markets, which sought to resolve securities fraud charges related to the structuring and marketing of a collateralized debt obligation.[2] There was no parallel criminal action. The proposed SEC consent judgment contained the usual set-

tlement language whereby—"without admitting or denying the allegations of the complaint"—Citigroup "consent[ed] to the entry of a Final Judgment" pursuant to which it agreed to a permanent injunction from future securities law violations, to pay $285 million, and to establish certain remedial measures. Rakoff found that the proposed settlement was "neither fair, nor reasonable, nor adequate, nor in the public interest," principally because it lacked an admission of wrongdoing by Citigroup. He argued that:

> the S.E.C.'s long-standing policy—hallowed by history, but not by reason—of allowing defendants to enter into Consent Judgments without admitting or denying the underlying allegations…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.[3]

In response, the SEC issued several public statements defending its policy and also filed an appeal.[4] A day after the SEC appealed, the House Financial Services Committee announced that it would hold a hearing to discuss whether the SEC should be allowed to enter into settlements without forcing an admission or denial of wrongdoing.[5] At the hearing in May 2012, the SEC's Director of Enforcement, Robert Khuzami, vigorously defended the SEC's "neither admit nor deny" policy, arguing that:

> requiring admissions as a condition of settlement would likely result in longer delays before victims are compensated, dilution of the deterrent impact of sanctions imposed because of the passage of time, and the expenditure of significant SEC resources that could instead be spent stopping the next fraud.[6]

The SEC garnered some support from the U.S. Court of Appeals for the Second Circuit. In a per curiam opinion staying the district court proceeding, the Second Circuit found that the SEC and Citigroup, which shared the SEC's position, had "a strong likelihood of success" in their appeal to set aside the district court's rejection of their settlement.[7] Although not a final decision on the merits, the court pointed out the "significant problem" of a district court's failing to give "deference to the S.E.C.'s judgment on wholly discretionary matters of policy" and found that it was "doubtful whether the court gave the obligatory deference to the S.E.C.'s views in deciding that the settlement was not in the public interest."[8]

Despite its ardent defense of its policy, however, the SEC still decided to change how it treated defendants who made admissions in parallel criminal proceedings.

How the Policy Has Been Implemented

In announcing that it would no longer allow defendants to "neither admit nor deny" the SEC's allegations of misconduct where there was parallel criminal action, the SEC noted that it would henceforth: (1) abandon the "neither admit nor deny" language; (2) recite the fact and nature of the criminal conviction, Non-Prosecution Agreement (NPA) or Deferred Prosecution Agreement (DPA); (3) at the staff's discretion, incorporate any relevant facts admitted during the criminal plea allocution, set out in a jury verdict form, or included in the criminal NPA or DPA; and (4) retain the existing prohibition on denying the allegations of the SEC's complaint.[9] Significantly, the new policy does not necessarily require the defendant to admit anything. Khuzami explained that, even prior to the *Citigroup* opinion, the SEC had been considering whether the policy should be changed.[10]

Since Jan. 6, 2012, the SEC has implemented this new policy fairly consistently. *How* the SEC has executed the change, however, and *which* facts are included or referenced in its papers differs from case to case, defendant to defendant, and individual to corporation.

Injunctive Actions Settled on Consent

Since announcing the policy change, the SEC has settled at least 43 injunctive actions—36 individuals and seven corporations—for which there were parallel criminal proceedings.[11] Of those 43 settlements, 29 defendants signed SEC consent judgments—23 individuals and six corporations—after the policy change. In 27 of those 29 consent judgments, the SEC omitted the "without admitting or denying the allegations of the complaint" language that previously was standard within the opening paragraphs of the consent judgment.

Beyond removing the "neither admit nor deny language," *which* facts were incorporated into the SEC's papers and *how* they were incorporated varied from case to case. The nature of the criminal resolution—by guilty plea, DPA or NPA—and whether the defendant cooperated with the government likely were factors that impacted those decisions.

Individual Defendants: When an individual defendant resolved his criminal charges by pleading guilty and had a parallel SEC case affected by the policy change—which occurred at least 21 times—the SEC's consent judgment typically noted that the defendant has "pleaded guilty to criminal conduct relating to certain matters alleged in the complaint in this action," cited to the parallel criminal case, and listed the specific crimes to which the defendant pled guilty.[12] In at least 13 out of those 21 cases, the consent judgment also either (1) attached a statement of facts or a transcript of the plea colloquy, or (2) described specific facts to which the defendant has "admitted," or both.[13]

In three of the cases against individual defendants, the consent judgments simply omitted the "neither admit nor deny" language. Interestingly, in two out of these three instances, the defendants were convicted after going to trial.[14]

Corporate Defendants: To date, we have located six corporate SEC consent judgments affected by the policy change. The parallel criminal proceedings included four DPAs, one NPA, and one guilty plea.

In all of the SEC settlements involving a corporation that had entered into a DPA, the defendants were charged with Foreign Corrupt Practices Act (FCPA) or FCPA-like violations. The relevant portions of the consent judgments in three of the cases are identical, stating that the company entered into a DPA "in which it admits, and accepts and acknowledges responsibility for conduct relating to certain matters alleged in the complaint in this action."[15] However, the consent judgments neither provide the criminal case citation, describe the charges resolved therein, nor attach the "Statement of Facts" for which the company explicitly admitted responsibility when it settled the related criminal charges. Notably, the DPAs state that all three companies self-reported their FCPA violations and agreed to continue to cooperate with government agencies.

In settling the fourth DPA case, however, the SEC was more demanding. In the FalconStor consent judgment, the SEC required an explicit acknowledgement of responsibility for specific criminal misconduct, and stated that FalconStor accepted and acknowledged as true the facts and allegations in the Department of Justice's (DOJ) criminal complaint.[16] Perhaps one explanation for the harsher treatment of FalconStor was that it may not have self-reported its misconduct.

The SEC required further admissions in an insider trading case against Diamondback Capital Management.[17] In that case, Diamondback had previously entered into an NPA with the DOJ whereby it admitted to a "Statement of Facts" setting forth the wrongful conduct of two employ-

ees.[18] The SEC consent judgment attached that same Statement of Facts and also stated that Diamondback "admits the facts set forth in the [attached] Statement of Facts."

The lone corporate guilty plea case involved Provident Capital Indemnity. In April 2012, PCI pled guilty to criminal fraud charges relating to the issuance of bonds.[19] In connection with that plea, PCI admitted to a "Statement of Facts" detailing its misconduct. In PCI's subsequent consent judgment with the SEC, it acknowledged that the company had pled guilty to specific criminal charges contained in an indictment and admitted as true the same "Statement of Facts," which was attached.[20]

Exceptions: Although the SEC has fairly consistently removed the "neither admit nor deny" language from settlement agreements entered into after Jan. 6, 2012 where there were parallel criminal proceedings, there are at least two exceptions.[21] In both instances, the defendant signed a consent judgment after the policy change "without admitting or denying the allegations of the Complaint." Notably, however, both of those defendants were cooperating with the government.

Administrative Proceedings

Since Jan. 6, 2012, the SEC has settled at least 12 cases pursuant to administrative orders that omit the previously standard "neither admit nor deny" language and, as a result, the defendant explicitly admits to the factual findings therein.[22] In those cases, the respondents had previously pled guilty in parallel criminal proceedings. In another case, the SEC settled with Goldman Sachs in an administrative order where Goldman admitted the limited factual findings that were part of a parallel *civil* action by the Massachusetts Securities Division, while otherwise neither admitting nor denying the SEC's findings.[23] This resolution is interesting on two fronts. First, although the parallel case was a civil regulatory proceeding, the SEC insisted on equivalent factual admissions. Second, Goldman was allowed to parse the SEC's facts—admitting some while not admitting others.

Collateral Consequences

It is not yet clear how courts presiding over private civil litigation will treat the omission of the "neither admit nor deny" language from settlement documents and the concomitant admissions or acknowledgements made therein. Although one would expect the fact that a defendant had already made admissions in the criminal proceeding to render the duplication of those admissions in the SEC proceeding a mere redundancy, that is not always the case. It is important to note that the SEC's cases, while parallel to the criminal cases, often do not overlap perfectly. They may involve a different combination of defendants, a different time period, or, most importantly, different charges. For that reason, defendants must carefully weigh the possible ramifications of this new policy and any admissions made—explicitly or implicitly—when settling parallel criminal and SEC charges.

Admissibility of Settlement Documents: Although Federal Rule of Evidence 408(a) prohibits the admission of settlement documents to prove liability in subsequent litigation, some courts have held that settlement agreements are admissible for other purposes—such as to show intent and knowledge under Rule 404(b). The Second Circuit upheld a district court's decision to admit as Rule 404(b) evidence a prior SEC consent judgment to show that the defendant had knowledge of the SEC's reporting requirements involved in the judgment.[24] Similarly, the Tenth Circuit held that a district court had properly admitted a CFTC (U.S. Commodity Futures Trading Commission) consent judgment for the limited purpose of showing intent to defraud and knowledge of false misrepresentations, noting that "[t]he admissibility of such evidence is within the sound discretion of the trial judge."[25] Findings of fact made in administrative orders have also been found admissible in arbitrations.[26]

However, other cases have held that consent judgments including the "neither admit nor deny" language are not admissible even as Rule 404(b) evidence. For example, the Fifth Circuit found that the trial court had erred in admitting a consent judgment under Rule 404(b) where the decree "specifically neither admitt[ed] nor den[ied] any act of any kind" and was "evidence solely [of] the fact that [the defendants] consented to entry of the injunctions."[27]

The effect of admissions made in settlement papers with the SEC is particularly relevant in the FCPA context, where private plaintiffs may allege that a company's directors failed to ensure that the company had adequate internal controls to prevent illegal payments. Thus, a plaintiff in a securities action might use an admission to an internal controls charge in a SEC consent judgment to argue that a corporation and its officers or directors had an "intent to defraud" plaintiffs or that defendants had "knowledge" of alleged fraud, inferable from the absence of sufficient internal controls. Or a plaintiff might file a derivative action arguing that the corporation's officers and directors breached their fiduciary duties.

A recent shareholder derivative suit provides an interesting backdrop. On Nov. 4, 2010, the SEC and the DOJ simultaneously filed charges against and settled with Tidewater and its subsidiary for alleged FCPA violations. The DOJ charged Tidewater's subsidiary with violating the anti-bribery and books and records provisions of the FCPA.[28] The SEC charged Tidewater with violating the FCPA's anti-bribery, books and records, and internal controls provisions.[29] Tidewater "neither admitted nor denied" the SEC's allegations in the consent judgment. Subsequently, shareholders filed a derivative suit against Tidewater's officers and board members.[30] The district court dismissed the complaint in its entirety, finding no evidence that the officers and directors had breached their fiduciary duties to the company. Notably, the parties in the derivative suit heavily cited the criminal DPA, which attached the "Statement of Facts" to which Tidewater admitted, but did not rely on the consent judgment, perhaps because of its "neither admit nor deny" language.

Collateral Estoppel Effect of Admissions in Settlement Documents: In defending the SEC's "neither admit nor deny" policy, Khuzami noted that "many companies likely would refuse to settle cases if they were required to affirmatively admit unlawful conduct or facts related to that conduct" because "such admissions would not only expose them to additional lawsuits by private litigants seeking damages, but would also risk a 'collateral estoppel' effect" in subsequent lawsuits resulting from such admissions.[31] The general rule is that a settlement agreement does not have collateral estoppel effect on subsequent litigation brought by a third party because the issues were not "actually litigated."[32] A consent judgment or administrative order may be "conclusive, however, with respect to one or more issues, if the parties have entered an agreement manifesting such an intention."[33] Thus, parties' intentions as set forth in the settlement agreement are key

to determining whether a consent judgment collaterally estops a party from relitigating a factual issue resolved therein.[34]

Where SEC consent judgments expressly contain "neither admit nor deny" language, the parties' intent is clear that the decree should not have preclusive effect because there are no admissions. As explained by Rakoff in *Citigroup*, "[a]s a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation."[35] Indeed, where there is no admission and no evidence of intent to be bound collaterally, courts will not give preclusive effect to consent judgments.[36]

Conclusion

After several months under the SEC's new "neither admit nor deny" policy, the SEC has been fairly consistent about removing the language from its settlement papers when there is a parallel criminal action, but has dealt with the corresponding "admission" of facts in myriad ways. Sometimes there is nary a mention of the facts or charges covered by the criminal case, while at others there is a lengthy description of both facts and charges. Not surprisingly, cooperation with the government appears to yield gentler treatment. It is too soon to tell whether the SEC's policy change will dampen settlement rates or whether the "new" consent judgments will be given preclusive effect in collateral litigation. But the SEC's policy shift certainly gives defendants caught up in parallel proceedings reason to negotiate the precise language of their settlements with care.

1. See "Policy Re Consent Orders Announced," SEC NEWS DIGEST, Issue No. 72-227, at 2 (Nov. 28, 1972); 17 C.F.R. §202.5(e) (2012).

2. *SEC v. Citigroup Global Mkts.*, 827 F. Supp. 2d 328, 329-30 (S.D.N.Y. 2011) (JSR); (Oct. 14, 2011 Consent of Citigroup, found at 11-CV-7387).

3. Id. at 332.

4. See Robert Khuzami, Dir. Div. of Enforcement, SEC, Public Statement by SEC Staff: Court's Refusal to Approve Settlement in Citigroup Case (Nov. 28, 2011); Press Release, SEC, No. 2011-265, SEC Enforcement Director's Statement on Citigroup Case (Dec. 15, 2011); *SEC v. Citigroup Global Mkts.*, 673 F.3d 158 (2d Cir. 2012).

5. Press Release, The Comm'n on Fin. Servs., Leaders of Financial Services Committee Jointly Announce Hearing on SEC Settlement Practices (Dec. 16, 2011).

6. Robert Khuzami, Dir. Div. of Enforcement, SEC, Testimony on "Examining the Settlement Practices of U.S. Financial Regulators," at 5 (May 17, 2012).

7. *Citigroup*, 673 F.3d at 166.

8. Id. at 163, 165.

9. Robert Khuzami, Dir. Div. of Enforcement, SEC, Public Statement by SEC Staff: Recent Policy Change (Jan. 7, 2012).

10. Khuzami, supra note 6, at 6-7. See, e.g., *SEC v. Galleon Mgmt.*, 09-CV-8811-JSR (S.D.N.Y.) (Consents of Kumar and Shankar); *SEC v. Longoria*, 11-CV-0753-JSR (S.D.N.Y.); *SEC v. Cutillo*, 09-CV-0208-RJS (S.D.N.Y.); *SEC v. Lanexa Mgmt.*, 10-CV-8599-JSR (S.D.N.Y.).

11. These statistics represent the number of settlements that we were able to locate as of Aug. 8, 2012.

12. See, e.g., *SEC v. Mityas*, 12-cr-00133-CBA (E.D.N.Y.); *SEC v. Ashbury Capital Partners*, 00-CV-7898 (S.D.N.Y.).

13. See, e.g., *SEC v. Eshbach*, 12-CV-00244 (C.D. Cal.); *SEC v. Kluger*, 11-CV-01936 (D.N.J.); *SEC v. Fraser*, 09-CV-00443 (D. Ariz.).

14. *SEC v. Longoria*, 11-CV-0753-JSR (S.D.N.Y.) (Consents of Fleishman, Jiau and Pfaum).

15. See *SEC v. Biomet*, 12-CV-00454 (D.D.C); *SEC v. Orthofix Int'l*, NV, 12-CV-00419 (E.D. Tex.); *SEC v. Pfizer*, 12-CV-1303 (D.D.C.).

16. See *SEC v. FalconStor Software*, 12-CV-3200 (E.D.N.Y).

17. *SEC v. Diamondback Capital Mgmt.*, 12-CV-00409 (S.D.N.Y.).

18. Press Release, U.S. Attorney's Office, Manhattan U.S. Attorney Announces Agreement with Diamondback Capital Management, LLC to Pay $6 Million to Resolve Insider Trading Investigation (Jan. 23, 2012).

19. *United States v. Provident Capital Indemnity*, 11-CR-14 (E.D. Va.).

20. *SEC v. Provident Capital Indemnity*, 11-CV-045 (E.D. Va.).

21. See id. (Consent of Castillo); *SEC v. Fraser*, 09-CV-00443 (D. Ariz.) (Consent of O'Brien).

22. See, e.g., *In re Peter Madoff*, Admin. Proc. File No. 3-14963 (July 26, 2012).

23. *In re Goldman, Sachs*, Admin. Proc. File No. 3-14845 (April 12, 2012).

24. See *United States v. Gilbert*, 668 F.2d 94, 97 (2d Cir. 1981).

25. *Wegerer v. First Commodity of Boston*, 744 F.2d 719, 724 (10th Cir. 1984).

26. See, e.g., *Bear Stearns v. 1109580 Ontario*, 318 F. Supp. 2d 199, 201 (S.D.N.Y. 2004).

27. *United States v. Cook*, 557 F.2d 1149, 1152, 1155 (5th Cir. 1977).

28. *United States v. Tidewater Marine Int'l*, 10-CR-770 (S.D. Tex).

29. *SEC v. Tidewater*, 2:10-CV-04180 (E.D. La).

30. *Strong v. Taylor*, 11-CV-329, 2012 U.S. Dist. LEXIS 91097 (E.D. La. July 2, 2012).

31. Khuzami, supra note 6, at 5.

32. See Restatement (Second) of Judgments §27 Cmt. E (1982).

33. See id.

34. See *In re Chinnery*, 181 B.R. 954, 960-61 (Bankr. W.D. Mo. 1995).

35. *Citigroup*, 827 F. Supp. at 333.

36 See, e.g., *In re Cenco Sec. Litig.*, 529 F. Supp. 411, 415-16 (N.D. Ill. 1982).