

**SECOND CIRCUIT SIGNALS SUPPORT FOR
THE SEC'S USE OF "NEITHER ADMIT NOR DENY"
LANGUAGE IN CONSENT SETTLEMENTS**

March 16, 2012

To Our Clients and Friends:

On March 15, 2012, the United States Court of Appeals for the Second Circuit granted a stay of district court proceedings in *SEC v. Citigroup Global Markets Inc.*, a case that has drawn much attention following Judge Rakoff's refusal to accept a proposed \$285 million settlement that did not require Citigroup to admit wrongdoing. In a per curiam ruling, a motions panel of the Second Circuit found that the SEC and Citigroup had made a "strong showing of likelihood of success in setting aside the district court's rejection of their settlement." In making this ruling, the panel indicated skepticism as to the reasoning in Judge Rakoff's opinion, which called into question the longstanding practice used by the SEC of allowing a settling party to neither admit nor deny the allegations made against it. Although these issues will now be the subject of full briefing, the panel's opinion appears to forecast likely Second Circuit support for the SEC's continued use of "neither admit nor deny" language in reaching settlements with defendants. The panel decision also articulated a more limited view of the District Court's role in reviewing SEC settlements than it found the court below to have applied.

JUDGE RAKOFF'S OPINION

In November 2011, Judge Rakoff of the United States District Court for the Southern District of New York rejected a proposed consent judgment between the SEC and Citigroup, raising serious questions about a longstanding practice used in SEC settlements. In order to resolve allegations of fraudulent marketing of collateralized debt obligation instruments, the SEC and Citigroup sought a court-approved \$285 million settlement in October 2011. Despite assurances that the court was giving "substantial deference" to the views of the SEC, Judge Rakoff rejected the settlement, holding that it was "neither fair, nor reasonable, nor adequate, nor in the public interest." In particular, the court stated that it doubted that the SEC's policy in consent judgments of permitting corporations to "neither admit nor deny" the charges served any interests other than those of the parties. Rather, the court noted, "a consent judgment that does not involve any admissions and that results in only very modest penalties is just as frequently viewed, particularly in the business community, as a cost of doing business imposed by having to maintain a working relationship with a regulatory agency, rather than as any indication of where the real truth lies."

In response, the SEC appealed to and alternatively sought a writ of mandamus from the Second Circuit to set aside Judge Rakoff's order. Citigroup joined with the SEC in all of its arguments.

THE SECOND CIRCUIT'S ANALYSIS

In analyzing whether the parties' request for a stay of the district court proceeding was warranted, the panel was required to evaluate whether the parties had "a strong likelihood of success" in overturning the district court's decision. In so doing, the panel examined — and rejected — each of the three arguments advanced by Judge Rakoff in refusing to approve the settlement.

First, the panel perceived "several problems" with Judge Rakoff's view that a consent judgment without an admission of liability by Citigroup failed to serve the public interest because defrauded investors could not use the judgment in civil suits seeking to recover investors' losses. As the panel observed, "the district court's logic appears to overlook the possibilities (i) that Citigroup might well not consent to settle on a basis that required it to admit liability, (ii) that the SEC might fail to win a judgment at trial and (iii) that Citigroup perhaps did not mislead investors." The panel further noted that Judge Rakoff's argument reflected the "still more significant problem" of failing to defer to an executive-branch agency's "wholly discretionary" policy judgment where the "SEC's decision to settle . . . was driven by considerations of government policy as to the public interest." Although the district court had "verbally acknowledged" its obligation to defer to the SEC's policy views, the panel found that the district court had effectively "imposed what it considered to be the best policy to enforce the securities laws," leading the panel to conclude that "it is doubtful whether the court gave the obligatory deference to the SEC's views in deciding that the settlement was not in the public interest."

Second, the panel noted its "difficulty reconciling" Judge Rakoff's view that the settlement was unfair to Citigroup — under the theory that the settlement imposed relief on Citigroup based on allegations not established by admissions or by trials — with the court's earlier observation that the size of the penalties amounted to a "mild and modest cost of doing business." Moreover, the panel expressed its "doubt that a court's discretion extends to refusing to allow a [freely consenting] litigant to reach a voluntary settlement in which it gives up things of value without admitting liability."

Finally, the panel rejected the district court's view that "it could not properly evaluate the fairness of the settlement unless the underlying facts were conclusively established either by a trial or by binding admission of liability." Not only did the panel find that the court had available to it a "substantial evidentiary record amassed by the SEC," the panel also rejected

the underlying premise of the argument, finding “no precedent that supports the proposition that a settlement will not be found to be fair...unless liability has been conceded or proved” and expressing “doubt whether it lies within a court’s proper discretion to reject a settlement on the basis that liability has not been conclusively determined.”

THE SECOND CIRCUIT OPINION SHOULD PROVIDE CLARITY TO DISTRICT COURTS CONSIDERING “NEITHER ADMIT NOR DENY” SETTLEMENTS

In the aftermath of Judge Rakoff’s November opinion, other district courts began to express doubts regarding the approval of SEC consent settlements that included the “neither admit nor deny” language, creating uncertainty for those considering a potential settlement with the SEC. While the motions panel noted that its opinion “does not address the ultimate question to be resolved by the merits panel,” its detailed analysis and outright rejection of many aspects of Judge Rakoff’s analysis appear to indicate a likely reversal of the district court order, and support for the SEC’s authority to continue to enter into “neither admit nor deny” consent settlements. In addition, the panel’s conclusions are likely to serve as a reminder to other courts of the deference that should be granted to settlements reflecting considered policy judgments of the SEC (and other executive agencies). To that end, the panel’s decision should also reassure private parties with current or forthcoming settlements with the SEC that the longstanding policy of settling without admitting or denying liability will most likely continue to be the standard practice, and that district courts will be less likely to second-guess the financial and other terms on which such settlements are premised.

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Please feel free to contact us with any questions.

Paul R. Berger
+1 202 383 8090
prberger@debevoise.com

Andrew J. Ceresney
+1 212 909 6947
ajceresney@debevoise.com

Edwin G. Schallert
+1 212 909 6295
egschallert@debevoise.com

Colby A. Smith
+ 1 202 383 8095
casmith@debevoise.com

Jonathan R. Tuttle
+1 202 383 8124
jrtuttle@debevoise.com

Mary Jo White
+1 212 909 6260
mjwhite@debevoise.com

Bruce E. Yannett
+1 212 909 6495
beyannett@debevoise.com