JUDGE RAKOFF V. THE SECURITIES AND EXCHANGE COMMISSION: ARE "NEITHER ADMIT NOR DENY" SETTLEMENT AGREEMENTS IN SECURITIES CASES IN THE PUBLIC INTEREST?

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"But the ground is shaking. There are tremors."

- Judge Victor Marrero in questioning the Securities and Exchange Commission's settlement agreement with S.A.C. Capital Advisors[1]

"DPAs [(Deferred Prosecution Agreements)] have had a truly transformative effect on particular companies and, more generally, on corporate culture across the globe," declared Lanny Breuer, the head of the Criminal Division of the U.S. Department of Justice (DOJ) on September 13, 2012.[2] Deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) are settlement agreements between a prosecutor and a defendant in which the prosecutor agrees to either defer or forego prosecution in return for the defendant's cooperation in an ongoing investigation or prosecution, as well as an agreement to comply with the requirements of the settlement.[3] Rather than forcing prosecutors to face the "stark choice" of using the "sledgehammer" of criminal indictment or declining prosecution outright and simply "walking away," DPAs and NPAs provide a middle road where a corporation can avoid prosecution in return "for an admission of wrongdoing, cooperation with the government's investigation, . . . payment of monetary penalties, and concrete steps to improve the company's behavior."[4] As these agreements have become "a

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1 Peter Lattman, *Judge Is Skeptical of S.E.C. Deal with Hedge Fund*, N.Y. TIMES (Mar. 28, 2013), http://dealbook.nytimes.com/2013/03/28/judge-questions-s-e-c-settlement-with-steven-cohens-hedge-fund/?_php=true&_type=blogs&_r=0.

2 Lanny A. Breuer, Asst. Att'y Gen., U.S. Dep't of Justice Criminal Div., Speech to the New York City Bar Ass'n (Sept. 13, 2012) (transcript available at http://www.justice.gov/criminal/pr/speeches/2012/crm-speech-1209131.html).

3 *See* U.S. Sec. & Exch. Comm'n Div. of Enforcement, Enforcement Manual, §§ 6.2.3 & 6.2.4 (Nov. 1, 2012), available at http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

4 Breuer, *supra* note 2.

mainstay of white collar criminal law enforcement" over the last ten years, prosecutors now view DPAs and NPAs as having "the same punitive, deterrent, and rehabilitative effect as a guilty plea."[5]

> [W]hen a company enters into a DPA with the government, or an NPA for that matter, it almost always must acknowledge wrongdoing, agree to cooperate with the government's investigation, pay a fine, agree to improve its compliance program, and agree to face prosecution if it fails to satisfy the terms of the agreement. . . . [M]ost important[ly] . . . the company must virtually always publicly acknowledge its wrongdoing . . . in detail [and is prohibited from] continuing to deny that they did anything wrong.[6]

Taking a page from the DOJ handbook, on January 13, 2010, the SEC announced that it was authorizing the use of DPAs and NPAs by its Division of Enforcement (subject to Commission approval) to "encourage individuals and companies to report violations and provide assistance to the agency."[7] As of the end of 2012, the SEC had entered into five such agreements.[8] A notable difference between DOJ[9] and SEC[10] settlements, however, is the use of "neither

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[5] *Id.*

[6] *Id.*

[7] Press Release, U.S. Sec. & Exch. Comm'n., *SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations* (Jan. 13, 2010) (available at http://www.sec.gov/news/press/2010/2010-6.htm).

[8] Gibson Dunn, *2012 Year-End Update on Corporate Deferred Prosecution Agreements (DPAs) And Non-Prosecution Agreements (NPAs)*, 2 (Jan. 3, 2013), http://www.gibsondunn.com/publications/Documents/2012YearEndUpdate-CorporateDeferredProsecution-NonProsecutionAgreements.pdf.

[9] DOJ settlement options include a plea agreement, *nolo contendere*, and a DPA or NPA. *See, e.g.*, United States Attorneys Manual §§ 9-27.400, 9-27.500 & 9-27.600 (Oct. 2010) (hereinafter U.S.A.M.).

[10] The SEC can file a case in either federal court or bring an administrative action before an administrative law judge (ALJ). *About the SEC*, U.S. Sec. & Exch. Comm'n., (Feb. 26, 2013). http://www.sec.gov/about/whatwedo.shtml .The majority of the cases are settled without going to trial. *See id.* Settlement options include a consent judgment in federal court, a consent order in an ALJ proceeding, or a DPA or NPA. *Id. See also* Enforcement Manual, *supra* note 3 §§ 6.2.3 & 6.2.4. Throughout this article, a consent judgment in federal court and a consent order in an ALJ proceeding will be referred to as "consent judgments."

admit nor deny" language in SEC settlement agreements, where the corporation "neither admits nor denies" the statement of facts presented within the document.[11] "Neither admit nor deny" has been long used by the SEC within its settlement agreements, as corporations often seek to mitigate collateral consequences associated with admissions, such as the use of an admission against the corporation in a later shareholder derivative lawsuit.[12] Because this practice can at times lead to embarrassing results when there are parallel DOJ and SEC prosecutions,[13] the SEC announced in January 2012 that it would no longer use "neither admit nor deny" language in cases of parallel criminal prosecutions.[14] However, notwithstanding the January 2012 policy change and the relative infrequency of both DOJ and SEC parallel prosecutions, the use of "neither admit nor deny" language in SEC settlement agreements with corporations remains the subject of intense debate.[15]

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[11] *See* Edward Wyatt, *Settlement With Wachovia Points Up a Controversy*, N.Y. TIMES, Dec. 8, 2011, *available at* http://www.nytimes.com/2011/12/09/business/contrasting-settlements-in-wachovia-case.html?pagewanted=print (highlighting that in the DOJ settlement, Wachovia "admits, acknowledges and accepts responsibility" for its actions, whereas in the SEC settlement, Wachovia agreed to settle "without admitting or denying the allegations").

[12] *See* Edward Wyatt, *S.E.C. Changes Policy on Firms' Admission of Guilt*, N.Y. TIMES, Jan. 6, 2012, *available at* http://www.nytimes.com/2012/01/07/business/sec-to-change-policy-on-companies-admission-of-guilt.html.

[13] As an example, Bernard Madoff pled guilty to 11 counts of fraud, money laundering, perjury and theft in perpetrating a $50 billion Ponzi scheme, while settling the SEC's civil action without admitting or denying the allegations. *See* Diana B. Henriques & Jack Healy, *Madoff Goes to Jail After Guilty Pleas*, N.Y. TIMES, Mar. 13, 2009, *available at* http://www.nytimes.com/2009/03/13/business/13madoff.html?pagewanted=all. *See also* Press Release, U.S. Sec. & Exch. Comm'n., Defendant Bernard L. Madoff Consents to Partial Judgment Imposing Permanent Injunction and Continuing Other Relief (Feb. 9, 2009), *available at* http://www.sec.gov/litigation/litreleases/2009/lr20889.htm.

[14] *See* Robert Khuzami, Dir., Div. of Enforcement U.S. Sec. & Exch. Comm'n., *Public Statement By SEC Staff: Recent Policy Change* (Jan. 7, 2012), (transcript available at http://www.sec.gov/news/speech/2012/spch010712rsk.htm).

[15] *See* Robert Khuzami, Dir., Div. of Enforcement U.S. Sec. & Exch. Comm'n., Testimony on "Examining the Settlement Practices of U.S. Financial Regulators" (May 17, 2012), (transcript available at http://www.sec.gov/news/testimony/2012/ts051712rk.htm) ("This change will only affect a minority of cases . . . ."). *See also* William O. Reckler & Blake T. Denton, *Understanding Recent Changes to the SEC's "Neither Admit Nor Deny" Settlement Policy*, THE CORPORATE GOVERNANCE ADVISOR, Mar.–Apr. 2012, at 4 ("Because the new policy is limited to situations in

Most notably, the SEC's continued use of "neither admit nor deny" in proposed settlement agreements has come under increased scrutiny lately from Judge Jed S. Rakoff (Southern District of New York.) as well as other federal district judges.[16] While the use of settlement agreements has benefits to both the SEC and corporations,[17] these judges—who must approve a consent judgment or DPA[18]—have questioned whether the use of "neither admit nor deny" in these agreements serves the public interest at large.[19] This criticism has mainly focused on the value of disclosing the truth of the SEC's allegations of corporate misconduct "in matter[s] of obvious public importance."[20] However, where everyday people have lost their jobs, homes, and life savings as a result of corporate wrongdoing—such as the financial crisis of 2007–08 and the resulting Great Recession[21]—this debate poses an additional question: whether the use of "neither admit nor deny" deprives victims of the closure often found in the criminal justice system.[22] When public outcry for the guilty to be punished is

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which there have already been admissions in a criminal case, it is unlikely to have an impact on most defendants.").

[16] Peter Lattman, *Court Hears Arguments on Judge's Rejection of S.E.C.-Citigroup Deal*, N.Y. TIMES (Feb. 8, 2013), http://dealbook.nytimes.com/2013/02/08/appeals-court-hears-arguments-over-judge-rakoffs-rejection-of-citigroup-settlement/.

[17] *See generally* Gretchen Morgenson & Louise Story, *As Wall St. Polices Itself, Prosecutors use Softer Approach*, N.Y. TIMES, July 7, 2011, *available at* http://www.nytimes.com/2011/07/08/business/in-shift-federal-prosecutors-are-lenient-as-companies-break-the-law.html?pagewanted=all (noting that DPAs conserve "the government's limited investigative resources" and avoid "significant negative consequences to innocent parties who played no role in the criminal conduct").

[18] The main difference between a DPA and an NPA is that a DPA requires the government to file criminal charges with the court placing it under a judge's purview. An NPA is essentially a contract between the government and the corporation and thus no criminal charges are filed as long as the corporation completes the terms of the agreement. Memorandum from Craig S. Morford, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys, 1 n. 2 (Mar. 7, 2008) (available at http://www.justice.gov/dag/morford-useofmonitorsmemo-03072008.pdf (hereinafter Morford Memorandum).

[19] *See, e.g.,* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 332 (S.D.N.Y. 2011).

[20] *Id.*

[21] *See, e.g.,* Editorial, *Struggling in the Suburbs*, N.Y. TIMES, July 7, 2012, *available at* http://www.nytimes.com/2012/07/08/opinion/sunday/struggling-in-the-suburbs.html (noting the substantial rise in home foreclosures, unemployment and underemployment, as well as the drop in household wealth since the start of the Great Recession).

[22] *See, e.g.,* Susan Bandes, *When Victims Seek Closure: Forgiveness, Vengeance and the Role of Government*, 27 FORDHAM URB. L.J. 1599, 1601 (2000) (asking what is the legal system's "proper role" in

great, such as in the aftermath of the financial crisis,[23] "neither admit nor deny" may very well subvert the retributive catharsis settlement agreements are trying to satiate.

This article argues that in circumstances where the conduct of the corporation is particularly egregious, and the resulting impact on certain types of victims is both severe and far-reaching, the use of "neither admit nor deny" language within a settlement agreement may not be in the public interest. In Part I of this article, the rise of DPAs and NPAs as the new prosecutorial tool within the DOJ and SEC is discussed, creating a back-story as to why the use of "neither admit nor deny" is an issue of increasing public importance. Part II of this article examines the judicial and public criticism of the SEC's use of "neither admit nor deny" within their settlement agreements as well as the policy change by the SEC to no longer use the language where there are parallel civil and criminal proceedings. Finally, Part III of this article discusses how the use of "neither admit nor deny" language is not always in the public interest and evaluates different options that may better serve the public at large.

I. THE RISE OF DPAS, NPAS, AND SETTLEMENT AGREEMENTS WITHIN THE DOJ AND SEC

In November 2012, Robert Khuzami, then director of the SEC's Division of Enforcement, stated that although the SEC had used relatively few DPAs and NPAs since their adoption in 2010, the SEC's goal over time was to "dovetail" their use with DOJ agreements in such a way that there would be "uniformity of use" with more "consistency and clarity for the regulated community."[24] As the SEC has increasingly patterned its enforcement program after the DOJ,[25] any

helping victims achieve closure); Paul G. Cassell, *In Defense of Victim Impact Statements*, 6 OHIO ST. J. CRIM. L. 611, 619–26 (2009) (justifying the use of victim impact statements).

[23] *See* Ben Protess & Mark Scott, *U.S. Is Building Criminal Cases in Rate-Fixing,* N.Y. TIMES (July 14, 2012), http://dealbook.nytimes.com/2012/07/14/u-s-is-building-criminal-cases-in-rate-fixing/ ("[T]he public is still simmering over the dearth of prosecutions of prominent executives involved in the mortgage crisis . . . .").

[24] Dunn, *supra* note 8, at 5.

[25] In recent years, former DOJ prosecutors have taken prominent roles within the SEC, most recently Mary Jo White as head of the Commission. *See* Ben Protess & Benjamin Weiser, *A Signal to Wall Street in Obama's Pick for Regulators*, N.Y. TIMES (Jan. 24, 2013),http://dealbook.nytimes.com/2013/01/24/mary-jo-white-to-be-named-new-s-e-c-boss/.

discussion of the SEC's use of DPAs and NPAs must first begin with a brief history of the DOJ's adoption of these prosecutorial tools.

While corporate criminal liability has been black letter law since at least 1909,[26] the DOJ had no consistent policy on corporate prosecutions until the issuance of the so-called "Holder Memorandum" in June 1999.[27] Other than awarding credit to companies for cooperating in a criminal investigation[28]—and other general federal prosecution policies—prosecutors could consider whatever other factors they deemed relevant in deciding whether to pursue a criminal charge against a corporation.[29] While the Holder Memorandum did not require

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Robert Khuzami, the former director of the Enforcement Division, was also a star prosecutor within the DOJ; *see also* Ben Protess, *Khuzami, S.E.C. Enforcement Chief Who Reinvigorated Unit, to Step Down*, N.Y. TIMES (Jan. 9, 2013), http://dealbook.nytimes.com/2013/01/09/s-e-c-enforcement-chief-khuzami-steps-down/.

[26] Corporate criminal liability was first recognized by the U.S. Supreme Court in the seminal decision *N.Y. Central & Hudson River R.R. Co. v. United States*, 212 U.S. 481 (1909), where the Court held corporations could be criminally liable under the doctrine of *respondeat superior*. *Id.* at 494. This was recently upheld by the Second Circuit Court of Appeals in *United States v. Ionia Mgmt., S.A.*, 555 F.3d 303, 309 (2d Cir. 2009). Additionally, a corporation can be held criminally liable under the collective knowledge doctrine, which provides that even though no single employee could be convicted of the offense because no one person possessed the requisite knowledge, all knowledge possessed by the corporation's employees could be attributed to the corporation itself. *United States v. Bank of New England*, 821 F.2d 844, 856 (1st Cir. 1987). Following the *N.Y. Central* decision, the doctrine of corporate criminal liability has largely been formed by the federal judiciary. *See, e.g.,* Preet Bharara, *Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants*, 44 AM. CRIM. L. REV. 53, 61–71 (2007) (discussing the development of corporate criminal liability since 1909); John Hasnas, *The Centenary of a Mistake: One Hundred Years of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1329, 1337–38 (2007) (discussing *N.Y. Central*).

[27] *See* Memorandum from Eric Holder, Deputy Att'y Gen., U.S. Dep't of Justice, to All Component Heads and U.S. Att'ys (June 16, 1999) (available at http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.PDF) (hereinafter Holder Memorandum); Christopher A. Wray & Robert K. Hur, *The Power of the Corporate Charging Decision over Corporate Conduct*, 116 Yale L.J. POCKET PART 306, 308 (2007).

[28] In 1991, the U.S. Sentencing Commission published guidelines where an individual or organization could receive credit for having an effective compliance and ethics program in place at the time of the offense and where the individual or organization self-reported or cooperated in the investigation, as well as accepted responsibility for the criminal conduct. *See* 18 U.S.C. § 8C2.5(f) & (g) (2012). "An organization that qualified for the maximum 'discounts' could, in theory, obtain a ninety-five percent reduction in the fine that would otherwise be imposed." Harry First, *Branch Office of the Prosecutor: The New Role of the Corporation in Business Crime Prosecutions*, 89 N.C.L. Rev. 23, 37 (2010).

[29] Wray & Hur, *supra* note 27, at 308.

prosecutors to hold to its guidelines,[30] it did formulate eight factors an attorney should consider in prosecuting a corporation:

> 1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime [];
> 2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management [];
> 3. The corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it [];
> 4. The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of the corporate attorney-client and work product privileges [];
> 5. The existence and adequacy of the corporation's compliance program [];
> 6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies [];

[30] *See* Holder Memorandum, *supra* note 27, at 1 ("These factors are, however, not outcome-determinative and are only guidelines. Federal prosecutors are not required to reference these factors in a particular case, nor are they required to document the weight they accorded specific factors in reaching their decision.").

7. Collateral consequences, including disproportionate harm to shareholders and employees not proven personally culpable []; and

8. The adequacy of non-criminal remedies, such as civil or regulatory enforcement actions.[31]

Following the collapse of Enron and the indictment of Arthur Andersen,[32] Congress passed—and President Bush signed into law—the Sarbanes-Oxley Act of 2002 on July 30, 2002.[33] Just prior to enacting Sarbanes-Oxley, President Bush created, by executive order, the Corporate Fraud Task Force (CFTF) within the DOJ to investigate and prosecute financial crimes.[34] Less than six months after the creation of the CFTF, DOJ released the so-called "Thompson Memorandum" in January 2003, which made four significant revisions to the Holder Memorandum.[35] First, an additional factor was added to the Holder Memorandum's eight general factors to be weighed when prosecuting a corporation: "the adequacy of the prosecution of individuals responsible for the corporation's malfeasance . . . ."[36] Second, the Thompson Memorandum was binding on federal prosecutors.[37] Third, the memorandum stated that NPAs may be appropriate "in exchange for cooperation when a corporation's 'timely cooperation appears to be necessary to the public interest and other means of

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[31] *Id.* at 3.

[32] Enron Corporation was an energy conglomerate that achieved significant growth in the 1990's aided by aggressive accounting strategies executed by its auditor, Arthur Andersen. In 2000, Enron's financial performance began to suffer and eventually collapsed when these faulty accounting strategies were exposed. Arthur Andersen was indicted in March 2002 for destroying Enron-related documents prior to the SEC commencing an investigation. *Arthur Andersen LLP v. United States*, 544 U.S. 696, 698–702 (2005). *See supra* notes 46–56 and accompanying text.

[33] *See* Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. (2002) (enacted); First, *supra* note 29, at 40–41.

[34] First, *supra* note 28, at 43.

[35] Memorandum from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys (Jan. 20, 2003) (available at http://www.albany.edu/acc/courses/acc695spring2008/thompson%20memo.pdf) (hereinafter Thompson Memorandum). *See* First, *supra* note 29, at 44; Barry A. Bohrer & Barbara L. Trencher, *Prosecution Deferred: Exploring the Unintended Consequences and Future of Corporate Cooperation*, 44 AM. CRIM. L. REV. 1481, 1485 (2007).

[36] Thompson Memorandum, *supra* note 35.

[37] *Id.* ("In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed herein.").

obtaining the desired cooperation are unavailable or would not be effective.'"[38] Fourth, and most importantly, increased emphasis was placed on the "authenticity of a corporation's cooperation."[39] The main focus of the memorandum was clear: "[Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution."[40]

There are two additional items of note in regards to the Thompson Memorandum. First, the Thompson Memorandum represents the first time that the DOJ gave specific guidelines to prosecutors as to when an NPA is an appropriate tool for a corporate prosecution.[41] In weighing whether a corporation has sufficiently cooperated to warrant the use of an NPA, the prosecutor is instructed to consider the completeness of the corporation's disclosure (including possible waiver of attorney-client privilege and work product protections); whether the corporation is shielding its culpable employees, directors, and agents from individual prosecution; and whether the corporation is feigning cooperation while in actuality impeding the investigation.[42] Secondly, the memorandum references the existence of the SEC's voluntary disclosure program

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[38] *Id.*

[39] *See d.*

[40] *Id.*

[41] *Id.* The memorandum references the U.S. Attorney's Manual § 9-27.600–650, which provides principles governing non-prosecution agreements generally. *See infra* notes 81–84 and accompanying text. The first DOJ NPA was with Salomon Brothers in 1993, but up until the Thompson Memorandum, it was rarely used. *See also* Press Release, U.S. Dep't of Justice, DOJ, SEC Enter $290 Million Settlement with Salomon Brothers (May 20, 1992), (available at http://www.justice.gov/atr/public/press_releases/1992/211182.htm); James R. Copland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, CIVIL JUSTICE REPORT, May 2012, at 3 (reporting how from 1993 to 2003 the DOJ entered into only 17 NPAs and DPAs). For a discussion on the historical development of deferred prosecution agreements and its adaptation to the corporate defender, see Benjamin M. Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1866–80 (2005).

[42] Thompson Memorandum, *supra* note 35.

as an example of other regulatory agencies where cooperation may qualify the corporation for amnesty or reduced penalties.[43]

Following the publication of the Thompson Memorandum—and the prosecution of Arthur Andersen for obstruction of justice—the DOJ radically changed how corporate criminal misconduct was prosecuted.[44] The lesson of Arthur Andersen was a telling one for the DOJ.[45] Arthur Andersen was the accounting firm for Enron Corporation, and its Houston office, in reaction to a pending SEC investigation, destroyed more than two tons of documents relating to its work for Enron from August to November 2001.[46] Prior to the Enron scandal, Andersen had already settled two disputes with the SEC in July 2001 over alleged fraudulent accounting and auditing work for two other companies.[47] On March 7, 2002, the DOJ obtained a sealed indictment against the firm for obstruction of justice in the investigation of Enron.[48] Unaware that prosecutors had already taken the case to grand jury, on March 13, 2002, Andersen attorneys requested a DPA in which the firm would avoid indictment if it submitted itself to certain compliance measures.[49] DOJ attorneys never responded, and immediately following the unsealing of the indictment the next day, Andersen clients began departing en masse.[50] Deferral negotiations continued for the next month, culminating with Andersen receiving a formal DPA document on April 12, 2002 where the firm would avoid a guilty plea in exchange for admitting its

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[43] *See id.* *See also infra* note 101.

[44] In the five years after the Thompson Memo, the only corporation subject to a criminal trial was Arthur Andersen. First, *supra* note 28, at 49. Alternatively, over that same time period, DOJ's Corporate Fraud Task Force obtained 1,236 convictions all of which were individuals and not corporations. *Id.*; *see* Press Release, U.S. Dep't of Justice, *Fact Sheet: President's Corporate Fraud Task Force Marks Five Years of Ensuring Corporate Integrity* (July 17, 2007 (available at http://www.justice.gov/opa/pr/2007/July/07_odag_507.html.

[45] *See* Morgenson & Story, *supra* note 17 (noting that the reversal of Andersen's conviction by the Supreme Court signaled the end of "brass knuckle prosecutions" of white-collar crime by the DOJ).

[46] *See*, Elizabeth K. Ainslie, *Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution*, 43 AM. CRIM. L. REV. 107, 107-08 (2006).

[47] *Id.* at 107.

[48] Richard B. Schmitt, Devon Spurgeon & Jonathan Weil, *Andersen's Tug of War With Justice: How Firm's Plan to Settle Fell Apart*, WALL ST. J. (Apr. 19, 2002), *available at* http://online.wsj.com/article/0,,SB101917925342926792O,00.html.

[49] *Id.*

[50] *Id.*

misconduct and adopting certain compliance measures.[51] Andersen, however, rejected the final settlement offers, rationalizing that with its business already in shambles, facing trial was preferable to the "onerous" terms of the DPA.[52] The firm was convicted by jury in June 2002 and immediately began wrapping up its accounting business.[53] Three years later, Andersen's conviction was unanimously overturned by the U.S. Supreme Court, and the DOJ subsequently dropped the case.[54] However, the damage was done. Prior to its indictment, the firm was a $9.3 billion business with 85,000 employees worldwide.[55] By the time of the reversal of its conviction, the firm was all but non-existent.[56]

As the legal community watched the destruction of Andersen, heavy criticism mounted as to whether it was proper for prosecutors to hold a corporation criminally liable.[57] Notably, a corporate criminal indictment has

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[51] *Id.*

[52] *Id.*

[53] Kurt Eichenwald, *Andersen Guilty in Effort to Block Inquiry on Enron*, N.Y. TIMES, Jun. 16, 2002, *available at* http://www.nytimes.com/2002/06/16/business/andersen-guilty-in-effort-to-block-inquiry-on-enron.html?pagewanted=all&src=pm.

[54] *See* Carrie Johnson, *U.S. Ends Prosecution of Arthur Andersen*, WASH. POST, Nov. 23, 2005, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2005/11/22/AR2005112201852.html. The only individual criminally charged at Andersen, David Duncan, a former Houston office partner who had pled guilty to obstruction of justice in exchange for his testimony against the firm, withdrew his guilty plea in the wake of the Supreme Court's decision. *Id.*

[55] Gibson Dunn, *2008 Year-End Update on Corporate Deferred Prosecution Agreements and Non-Prosecution Agreements*, (Jan. 6, 2009), http://www.gibsondunn.com/publications/pages/2008year-endupdate-corporatedpas.aspx.

[56] *Id.*

[57] *See, e.g.*, Ainslie, *supra* note 46, at 110 (arguing that "[s]tringent civil violations can be imposed on renegade parts of business entities with far less collateral damage to innocent individuals than can criminal prosecutions of the business entity itself."); Hasnas, *supra* note 26, at 1329 (stating that "there is no theoretical justification for corporate criminal liability."); Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1367 (2009) ("The embarrassment of corporate criminal liability is that it punishes the innocent along with the guilty."); David A. Maas, *Policing the Ratings Agencies: The Case for Stronger Criminal Disincentives in the Credit Rating Market*, 101 J. CRIM. L. & CRIMINOLOGY 1005 (2011) (examining why there have been no criminal prosecutions against the ratings agencies' actors after the 2007–08 financial crisis); Jeff Izant, *Mens Rea and the Martin Act: A Weapon of Choice for Securities Fraud Prosecutions?*, 2012 COLUM. BUS. L. REV. 913 (2012) (arguing that state enforcement—such as New York State's

negative collateral consequences to innocent parties, in particular employees, investors, and creditors who had no role in or knowledge of the misconduct.[58] Partially in response to this criticism and partially due to incidences of high profile criminal misconduct by corporate executives at the time,[59] prosecutors began to increase the use of DPAs and NPAs in prosecuting corporations,[60] often exacting harsh concessions as the "price" of cooperation. Some examples of these harsh concessions included requiring the waiver of attorney-client and work product protection privileges,[61] coercing cooperation of individual employees within the government's investigation, and appointing independent directors or internal monitoring systems.[62]

However, the courts began to push back on these heavy handed techniques. In June and July of 2006—in two cases involving a settlement agreement with the firm KPMG—the federal bench found unconstitutional portions of the Thompson Memorandum that granted prosecutors the authority to require—as part of gauging corporate cooperation in considering a settlement

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"Martin Act"—may be a more effective means of criminal prosecution of securities fraud related to the financial crisis); Peter J. Henning, *Making Sure "The Buck Stops Here": Barring Executives from Corporate Violations*, 2012 U. CHI. LEGAL F. 91 (2012) (advising against expanding the criminal law in prosecuting corporate executives and rather giving the SEC the administrative power to exclude executives from holding a position of authority with public corporations).

[58] *See* Alschuler, *supra* note 57, at 1367 ([C]riminal punishment cannot really be borne by a fictional entity. . . . [It] is inflicted instead on human beings whose guilt remains unproven. Innocent shareholders pay the fines, and innocent employees, creditors, customers, and communities sometimes feel the pinch too. The embarrassment of corporate criminal liability is that it punishes the innocent along with the guilty.").

[59] *See* First, *supra* note 28, at 45. The period from 2001 to 2006, commencing with the collapse of Enron, has become known as the "Enron Era." Editorial, *Sizing up the Enron Era*, CHI. TRIBUNE, May 26, 2006, *available at* http://articles.chicagotribune.com/2006-05-26/news/0605260226_1_ceo-jeffrey-skilling-skilling-and-lay-worldcom-ceo-bernard-ebbers.

[60] A study by Gibson Dunn shows that the DOJ entered into two DPA and NPA agreements in 2002; six in 2003; eight in 2004; 14 in 2005; 24 in 2006; and 39 in 2007. Dunn, *supra* note 8, at 1.

[61] In 2005, the so-called "McCallum Memorandum" revised a portion of the Thompson Memorandum, requiring a review and approval process prior to seeking waiver of the attorney-client privilege or work product protection. Memorandum from Robert D. McCallum, Acting Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys (Oct. 21, 2005) (available at http://federalevidence.com/pdf/Corp_Prosec/McCallum_Memo_10_21_05.pdf).

[62] Bohrer & Trencher, *supra* note 35, at 1485–86. Other notorious provisions within these agreements included requiring the corporation to install slot machines at a state-franchised horse racing facility, endow a chair at the *alma mater* of the prosecutor who negotiated the agreement, and create 1,600 jobs in a state within ten years. *Id.* at 1486.

agreement—the mandatory availability of employees for questioning in a government investigation.[63] In both cases, the court held that KPMG's threats to withhold legal fees and fire employees unless the employees cooperated in an ongoing criminal investigation violated the employees' Fifth Amendment due process rights and Sixth Amendment right to counsel.[64]

In response to the *Stein* decisions—and mounting criticism over DOJ settlement agreements requiring the waiver of attorney-client privileges and work product protection—the Thompson Memorandum was revised in December 2006 by the so-called "McNulty Memorandum."[65] There, the nine factors prosecutors use to consider whether or not to prosecute a corporation remained largely unchanged.[66] While continuing to emphasize the necessity of corporate cooperation,[67] however, the McNulty Memorandum curtailed the instances in which a prosecutor may request a waiver of attorney-client privilege or work product protection.[68] In laying out a balancing test of considerations, as well as a step-by-step process for requesting attorney-client or work product material, the McNulty Memorandum instructs prosecutors to "seek the least intrusive waiver necessary to conduct a complete and thorough investigation."[69] The McNulty Memorandum also instructs prosecutors to "not take into account whether a

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[63] United States v. Stein (*Stein I*), 435 F. Supp. 2d 330, 382 (S.D.N.Y. 2006), *aff'd*, 541 F.3d 130 (2d Cir. 2008); United States v. Stein (*Stein II*), 440 F. Supp. 2d 315, 338 (S.D.N.Y. 2006).

[64] *See Stein I*, 435 F. Supp. 2d at 382 (holding that the Thompson Memorandum, coupled with DOJ conduct, violated the defendant-employees Fifth and Sixth Amendment rights); *Stein II*, 440 F. Supp. 2d at 337 (holding that defendant-employees' statements were coerced as "a product of intentional government action"). For a discussion of the DOJ's prosecution of KPMG, *see* First, *supra* note 28, at 50–53.

[65] First, *supra* note 28, at 53.

[66] Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Atty's (Dec. 12, 2006) (available at http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf) (hereinafter McNulty Memorandum).

[67] *Id.* at VII.B ("a corporation's cooperation may be critical in identifying the culprits and locating relevant evidence").

[68] *Id.* at VII.B.2 ("Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations.").

[69] *Id.*

corporation is advancing attorneys' fees to employees or agents under investigation and indictment" when evaluating the corporation's level of cooperation.[70] However, where the "totality of the circumstances show that it was intended to impede a criminal investigation," the advancement of attorneys' fees to employees may be considered.[71] Commentators agreed that despite the limitations placed on prosecutors within the McNulty Memorandum, corporations under investigation were still essentially at the mercy of the prosecutor and are often required to "offer and give complete and genuine cooperation . . . to escape an indictment."[72]

In August 2008, the DOJ released the latest iteration of the factors to consider in prosecuting a corporation.[73] Now incorporated within the U.S. Attorney's Manual in section 9-28.000, the so-called "Filip Memorandum" retains the nine factors found within the McNulty Memorandum as well as the prosecutor's discretion as to whether or not to prosecute a corporation.[74] Going further than the McNulty Memorandum, the Filip Memorandum restricts the prosecutor's ability to request a waiver of attorney-client and work product material.[75] Rather than predicating cooperation credit on the waiver of these protections, prosecutors are now instructed to seek "disclosure of the relevant facts" concerning the alleged misconduct.[76] Additionally, prosecutors are not to consider whether the corporation is advancing attorneys' fees to employees under investigation or indictment, unless the payment of fees is used to obstruct the investigation.[77] Enacted in response to criticisms that the DOJ had gone too far in requiring waivers of these legal protections, these restrictions signal a further

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[70] *Id.* at VII.B.3.

[71] *Id.* at VII.B.3 n. 3.

[72] Bohrer & Trencher, *supra* note 35, at 1488; *see* McNulty Memorandum, *supra* note 67, at III.B ("[T]he prosecutor generally has wide latitude in determining when, whom, how, and even whether to prosecute for violations of federal criminal law."). *See also* Thompson Memorandum, *supra* note 36, at II.B (quoting the same).

[73] *See* Memorandum from Mark Filip, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Atty's (Aug. 28, 2008) (available at http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf) (hereinafter Filip Memorandum). *See also* U.S.A.M. § 9-28.000.

[74] *See* Filip Memorandum, *supra* note 73; U.S.A.M. § 9-28.300(A) & (B).

[75] U.S.A.M. § 9-28.710 ("[P]rosecutors should not ask for such waivers and are directed not to do so.").

[76] U.S.A.M. § 9-28.720.

[77] U.S.A.M. § 9-28.730.

step back from the aggressive prosecutorial strategies seen during the Enron Era.[78] Most importantly, corporate cooperation remains the key factor:

> For these reasons and more, cooperation can be a favorable course for both the government and the corporation. Cooperation benefits the government – and ultimately shareholders, employees, and other often blameless victims – by allowing prosecutors and federal agents, for example, to avoid protracted delays, which compromise their ability to quickly uncover and address the full extent of widespread corporate crimes. With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation, and preserve assets for restitution. At the same time, cooperation may benefit the corporation by enabling the government to focus its investigative resources in a manner that will not unduly disrupt the corporation's legitimate business operations. *In addition, and critically, cooperation may benefit the corporation by presenting it with the opportunity to earn credit for its efforts.*[79]

Thus, with corporate cooperation remaining at the center of DOJ philosophy in prosecuting corporations, DPAs and NPAs—as currently used post-Filip Memorandum—are encouraged as "a middle ground that balances the collateral consequences of prosecuting corporations . . . against the likelihood of obtaining restitution, rehabilitating the corporation and engendering respect for the law and trust and confidence in enforcement authorities."[80]

Turning now to the substance of NPAs and DPAs, section 9-27.600 of the U.S. Attorneys Manual states that an NPA is an appropriate tool for obtaining

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[78] U.S.A.M. § 9-28.710 (discussing the legal community's criticism of DOJ policies that coerced corporations into waiving attorney-client privilege and work product protection).

[79] U.S.A.M. § 9-28.700 (emphasis added).

[80] Thomas F. O'Neill & Brendan T. Kennedy, *Answering to a Higher Authority: Sovereign-Mandated Oversight in the Board Room and the C-Suite*, 17 FORDHAM J. CORP. & FIN. L. 299, 321 (2012).

cooperation from a corporation where other means of obtaining cooperation are unavailable or ineffective and the necessity of the corporation's cooperation is in the public interest.[81] Prior to entering into an NPA, a prosecutor is required to consider whether obtaining the cooperation sought is of such a great public interest that it justifies foregoing prosecution of the corporation.[82] In making this determination, the prosecutor should weigh the significance of the investigation or prosecution, the value of the corporation's cooperation to the prosecutor's case, and the corporation's culpability in the misconduct and prior criminal history.[83] If the prosecutor decides that an NPA would be an appropriate tool to engender cooperation, the NPA should be limited in scope so as not to extend "blanket immunity" to the corporation.[84]

While the NPA surrenders the opportunity to prosecute a cooperating corporation, the DPA defers prosecution for a certain period of time, which is contingent upon the corporation's fulfillment of a number of obligations.[85] Unlike an NPA, with the DPA a charging document is filed with the courts as well as an uncontested Statement of Facts.[86] If the corporation has adhered to the obligations within the agreement throughout the deferral period, the prosecutor may drop the charges;[87] however, if the prosecutor determines that the corporation has breached the agreement, the corporation may be prosecuted with its admissions used against it.[88] Thus, both NPAs and DPAs serve as powerful tools—not only to secure the corporation's cooperation in an important investigation or prosecution—but also as a means to regulate corporate behavior without expending large amounts of prosecutorial resources.[89]

The reason why these settlement agreements are so attractive—and hence so powerful—lies in the collateral consequences to a corporation as a result of a

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[81] U.S.A.M. § 9-27.600(B).

[82] U.S.A.M. § 9-27.600(B)(3).

[83] U.S.A.M. § 9-27.620(A).

[84] U.S.A.M. § 9-27.630(B).

[85] Greenblum, *supra* note 41, at 1864.

[86] Morford Memorandum, *supra* note 18, at 1 n. 2.

[87] Greemblum, *supra* note 41, at 1864.

[88] *Id.*

[89] *See* Copland, *supra* note 41, at 12 ("[T]he expanded use of DPAs and NPAs . . . in effect has shifted power from regulators typically employing cost-benefit analysis to prosecutors charged with enforcing bright-line rules.").

criminal indictment.[90] Federal prosecutors are instructed to weigh the effects of a conviction or indictment in resolving a corporate criminal case.[91] Such consequences include the loss of jobs for employees, reduction in shareholder value, diminishment of retirement benefits for pensioners, and loss of customers—many of whom may have been innocent parties with no role or awareness of the criminal conduct.[92] Additionally, for those corporations engaged in regulated industries (such as public accountants), government contracts, or federally funded programs (such as health care programs), non-penal sanctions that may accompany a criminal indictment, such as a suspension or debarment, can have a crippling effect on a corporation.[93] As previously discussed, the specter of Arthur Andersen continues to loom large over corporate prosecutions.[94]

As a result, the use of DPAs and NPAs has surged since the downfall of Arthur Andersen.[95] According to records compiled by Gibson Dunn & Crutcher LLP, since 2000 there have been a total of 245 DPAs and NPAs entered into between corporations and the government.[96] The high water marks for these agreements were 2007 and 2010, with a total of 39 such agreements in each year.[97] Ranked second is 2012, with a total of 35 agreements, and since the SEC's announcement in 2010 to use DPAs and NPAs, the Commission has entered into 5 such agreements.[98] Thus, in exchange for avoiding a corporate death sentence,

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[90] *Id.* at 11.

[91] U.S.A.M. § 9-28.100.

[92] *Id.*. *See* Assaf Hamdani & Alon Klement, *Corporate Crime and Deterrence*, 61 STAN. L. REV. 271, 280 (2008) ("The perception that the reputational consequences of a conviction could exceed even the substantial monetary penalties in any parallel civil litigation can explain why firms under investigation for criminal violations are willing to do almost whatever it takes—including waiving attorney-client privilege, assisting the government's prosecution of their senior officers, and paying millions of dollars in civil fines—to avoid an indictment.").

[93] *See* Hamdani & Klement, *supra* note 92, at 278-79 (noting the effect of a criminal conviction to a corporation in a regulated industry); *see also* U.S.A.M. § 9-28.100.

[94] *See supra* notes 46–56 and accompanying text.

[95] Dunn, *supra* note 8, at 1.

[96] *Id.*

[97] *Id.*

[98] *Id.* at 1–2.

a corporation typically agrees to fully cooperate in the government investigation by disclosing all relevant facts; adhering to all provisions of the DPA or NPA and all statutes and regulations governing the corporation's business; paying a fine; creating or continuing a compliance program; adopting new policies and procedures to ensure corporate compliance; retaining a monitor; waiving any and all defenses; and in the case of a DPA, not denying the appended Statement of Facts.[99]

Given the fallout from the 2007–08 financial meltdown and the ever increasing complexity of frauds within the expanding regulatory environment, the SEC announced its adoption of these tools in January 2010.[100] While cooperation agreements have, in theory, been a part of the SEC's tool belt since the early 1970s,[101] and while formal guidelines were promulgated in 2001 pursuant to Section 21A of the 1934 Act,[102] it was not until the implementation of the "Cooperation Initiative" that the SEC fully adopted this approach.[103] Citing the

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[99] First, *supra* note 28, at 47.

[100] Press Release, *supra* note 7; *see also* Khuzami, *supra* note 15 (noting that since Fiscal Year 2009, numerous enforcement actions have involved "highly complex financial products, market practices, and transactions where the investor harm is great, the investigatory hurdles are significant, and the perpetrators most elusive").

[101] The birth of the SEC's "Voluntary Disclosure Program" was in the early 1970s investigation of illegal campaign contributions made by corporations during the 1972 presidential campaign. First, *supra* note 28, at 32. This investigation revealed that more than 450 American corporations had paid bribes to overseas and domestic political or commercial officials and led to the enactment of the 1977 Foreign Corrupt Practices Act. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITY AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 449 (Northeastern University Press 1995) (1982). During this investigation, the SEC began to encourage companies to perform internal reviews before SEC action and to disclose the results of the review to the Commission. First, *supra* note 28, at 33. This policy was later institutionalized in 1991 with the acceptance of the U.S. Sentencing Guidelines Manual. *Id.*, at 36-37; *see also* 18 U.S.C. § 8C2.5 (2012).

[102] The Seaboard Report, in which the SEC set forth four criteria in which it would consider how much credit to give to a corporation or individual for "self-policing, self-reporting, remediation and cooperation" was released in October 2001. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969 (Oct. 23, 2001) (hereinafter the Seaboard Report) (available at http://www.sec.gov/litigation/investreport/34-44969.htm). The criteria included the nature of the misconduct involved, the circumstances under which misconduct arose, where in the organization the misconduct occurred, and the duration of the misconduct. *See id.* The Seaboard Report was later incorporated into the SEC Enforcement Manual at § 6.1.2. Enforcement Manual, *supra* note 3, § 6.1.2.

[103] *See* Enforcement Manual, *supra* note 3, § 6.

"complexity of the markets and products [the SEC] patrol[s], the finite resources at [the SEC's] disposal, and . . . the consequences for investors," these incentives are designed to "secure cooperation of persons who saw, heard and witnessed securities fraud first-hand."[104] As reflected in the SEC's Division of Enforcement Manual, the enforcement staff is instructed to determine whether the public interest in securing cooperation justifies the credit given for cooperation.[105] In making this determination, the SEC is to assess the value and nature of the cooperation, the importance of the investigation, the societal interest in holding the individual or entity accountable for their misconduct, and the individual's or entity's history of misconduct and opportunity for future misconduct.[106] Under the principles formulated by the Seaboard Report in 2001, an entity's cooperation is best measured by its self-monitoring efforts leading up to the discovery of the misconduct, a prompt and complete public disclosure of the misconduct, remedial measures to rectify and prevent the misconduct, and cooperation with law enforcement in the investigation.[107] If the SEC determines that it is in its best interest to foster cooperation, there are a number of tools available to the enforcement staff, including proffer agreements, cooperation agreements, DPAs, NPAs, and immunity requests.[108]

According to the Enforcement Manual, a DPA is a written agreement between the SEC and a potential cooperating individual or corporation in which the SEC agrees to "forego an enforcement action" against the individual or corporation for a set period of time as long as the individual or corporation cooperates in the investigation, complies with the requirements of the DPA (including payment of a fine), and agrees to either admit or not deny the SEC's allegations.[109] Similar to a DOJ DPA, if the SEC determines that the agreement has been breached, an enforcement action may be brought against the individual

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[104] Robert Khuzami, Dir., Div. of Enforcement U.S. Sec. & Exch. Comm'n., Speech by SEC Staff: Remarks at News Conference Announcing Enforcement Cooperation Initiative and New Senior Leaders (Jan. 13, 2010), (available at http://www.sec.gov/news/speech/2010/spch011310rsk.htm).

[105] Enforcement Manual, *supra* note 3, § 6.1.1.

[106] *Id.*

[107] *Id.* at § 6.1.2.

[108] *Id.* at § 6.2.

[109] *Id.* at § 6.2.3.

or corporation, and any factual admissions may be used to file a summary judgment motion.[110] Notably, SEC staff is to consider any collateral consequences to the individual or corporation in drafting the relevant facts in which the individual or corporation will either admit or agree to not deny.[111]

An NPA, rather, is entered into only in "limited and appropriate circumstances" where the SEC declines to pursue an enforcement action against an individual or corporation, as long as the individual or corporation cooperates in the investigation and complies with the requirements of the NPA (including payment of a fine).[112] Unlike a DPA, there is no requirement for the individual or corporation to admit or not deny the SEC's allegations, and like the DOJ NPA, no statement of facts is required to be appended to the agreement.[113] In addition to the typical cooperation analysis for a settlement agreement, the SEC, in determining whether to use an NPA, should also consider the possibility of the individual or corporation entering into a criminal plea agreement that would

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[110] *Id.*

[111] *Id.* The SEC has entered into two DPAs, one with Tenaris, S.A. and the second with the Amish Helping Fund. In the Tenaris DPA, the corporation "without admitting or denying the allegations . . . offered to accept responsibility for its conduct and to not contest or contradict the factual statements" within the document. Deferred Prosecution Agreement—Tenaris, S.A., U.S. Sec. & Exch. Comm'n (May 17, 2011) (hereinafter Tenaris DPA). However, the DPA permits Tenaris to deny the factual statements within the agreement in later litigation in which the SEC is not a party. *See id.* In the Amish Helping Fund DPA, the corporation "offered to accept responsibility for its conduct and to not contest or contradict the factual statements" within the document. Deferred Prosecution Agreement—Amish Helping Fund, U.S. Sec. & Exch. Comm'n (July 17, 2010) (hereinafter Helping Fund DPA). "Neither admit nor deny" language was not present within the agreement. *See id.* Like the Tenaris DPA, the agreement permits the Amish Helping Fund to deny the factual statements within the agreement in later litigation in which the SEC is not a party. *See id.*

[112] Enforcement Manual, *supra* note 3, § 6.2.4.

[113] *Id.* The SEC's first NPA, with Carter's, Inc., did not contain a statement of facts, though Carter's did agree to not make any public statements denying the factual allegations of the agreement. *See* Non-Prosecution Agreement—Carter's, Inc., U.S. Sec. & Exch. Comm'n (Nov. 23, 2010) (hereinafter Carter's NPA). On the other hand, the NPAs with both the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) had an appended statement of facts in which the corporations "accepted responsibility for their conduct" and agreed to not make any public statements denying the factual allegations of the agreement. *See* Non-Prosecution Agreement—Federal Home Loan Mortgage Corporation, U.S. Sec. & Exch. Comm'n (Dec. 15, 2011) (hereinafter Freddie Mac NPA); Non-Prosecution Agreement— Federal National Mortgage Association (Fannie Mae), U.S. Sec. & Exch. Comm'n (Dec. 15, 2011) (hereinafter Fannie Mae NPA).

require future cooperation with the SEC and whether there are alternative timely and effective means to secure the cooperation.[114]

Given the SEC's history of resolving enforcement actions through consent judgments[115] and the relatively few DPAs and NPAs used by the SEC over the past three years, one must ask whether the adoption of these new tools means any marked change in SEC policy. Yet, there are two important considerations for using DPAs and NPAs, both relevant as to whether these tools are within the public interest. First, as noted previously, the Enforcement Manual only imposes two basic requirements on a corporation who enters into a DPA or NPA with the SEC: 1) cooperate fully and truthfully in the SEC's investigation and 2) comply with the settlement agreement.[116] Thus, if the DPA or NPA does not have a statement of facts, a corporation may very well be able to settle an enforcement action without the public having any knowledge as to what misconduct actually occurred.[117] Additionally, given the SEC's history with consent judgments and administrative law proceedings, where there is a statement of facts appended to the agreement, a corporation may very well be able to still settle the enforcement action without admitting the allegations.[118] Under this scenario, both the SEC's and the corporation's interests have been satisfied. The SEC has "won" a case while preserving its precious prosecutorial resources, and the corporation has put to rest a period of misconduct and minimized its exposure to harmful collateral consequences.[119] Unfortunately, the question that has until recently been oft forgotten is that while settlement agreements may be in the best interest of the SEC and the corporation, is a settlement agreement—in which the truth of the allegations are neither admitted nor denied—within the best interest of the public at large?[120]

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114 Enforcement Manual, *supra* note 3 § 6.2.4 (referring to the Seaboard Report).

115 *See* Wyatt, *supra* note 11.

116 Enforcement Manual, *supra* note 3, §§ 6.2.3 & 6.2.4 (stating that in some circumstances, a corporation may be required to admit or not deny an appended statement of facts).

117 The Enforcement Manual states that only a DPA will be made available to the public upon request, unless the SEC directs otherwise. *Id.* at § 6.2.3.

118 *See* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308–09 (S.D.N.Y. 2011) (discussing the SEC's historical use of "neither admit nor deny" within consent judgments).

119 Khuzami, *supra* note 15.

120 *See Vitesse Semiconductor*, 771 F. Supp. 2d at 309.

II. ASSESSING "NEITHER ADMIT NOR DENY"

To begin, the teeth of a DPA or a NPA is within the prosecutorial power the SEC may invoke if it finds the corporation to be in breach of the agreement.[121] Unlike a consent judgment where the SEC seeks to prospectively invoke the Court's contempt power,[122] DPAs and NPAs typically escape judicial review.[123] When DPAs do find themselves in court, federal judges generally review the documents under contract law and only for the purposes of enforcing the terms of the agreement.[124] Due to the federal court's limited role, there has been increased support over the years for greater judicial involvement within the DPA and NPA process.[125] While the McNulty and Filip Memorandums have sought to curb a number of the prosecutorial abuses found within these agreements,[126] practically speaking, the SEC and a corporation under investigation have been able to settle enforcement actions on their own terms and out of the purview of the public if they so desire. Given the court's recent responses to the absence of sufficient facts within SEC consent judgments, the risk is high that

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121 Enforcement Manual, *supra* note 3, §§ 6.2.3 & 6.2.4.

122 *See* SEC v. Bank of America Corp. (*Bank of America I*), 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009).

123 *See* U.S. Gov't Accountability Office, GAO-10-110, *DOJ Has Taken Steps to Better Track Its Use of Deferred and Non-Prosecution Agreements, but Should Evaluate Effectiveness*, 25 (2009), *available at* http://www.gao.gov/new.items/d10110.pdf (noting that, statutorily, NPAs are not required to receive judicial review because there are no court filings, and practically, judges are generally uninvolved in the DPA process).

124 *See* United States v. Kelly, 646 F. Supp. 2d 1249, 1253 (D. Kan. 2009) ("[A] diversion agreement is a contract between the prosecutor and the defendant."). S*ee generally* Candace Zierdt & Ellen S. Podgor, *Corporate Deferred Prosecutions Through the Looking Glass of Contract Policing*, 96 KY. L. J. 1 (2007) (discussing DPAs and NPAs through the lens of contract policing theory). Under administrative law principles, the federal courts "have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations . . . ." Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984). Most recently, the Second Circuit held, "[w]hile 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." SEC v. Citigroup *Global* Mkts. Inc., 673 F.3d 158, 164 (2d Cir. 2012).

125 *See* Greenblum, *supra* note 41, at 1896 (calling for judicial involvement to curb prosecutorial power and allow for "a more effective and accountable mechanism for reforming delinquent corporations"). *See al*so Copland, *supra* note 41, at 12–13 (recommending that judicial oversight will increase transparency, consistency, and effectiveness of DPAs).

126 *See supra* note 75.

greater use of DPAs and NPAs—as an alternative settlement agreement to consent judgments—will result in less public awareness of the misconduct of some corporations.[127]

Recent judicial criticism of SEC settlements is best explained through a series of opinions by Judge Jed S. Rakoff of the Southern District of New York from 2009 through 2011. In September 2009, Judge Rakoff rejected a settlement agreement between the SEC and Bank of America over allegations that Bank of America had misled its shareholders in seeking approval for its $50 billion acquisition of Merrill Lynch.[128] Judge Rakoff found that the $33 million settlement, in which Bank of America would neither admit nor deny the allegations, was not fair to the shareholders who were the innocent victims of a multi-billion-dollar lie.[129] In responding to the SEC's justification of the settlement, Judge Rakoff stated, "[it] makes no sense . . . that Bank of America shareholders, having been lied to blatantly in connection with the multi-billion-dollar purchase of a huge, nearly-bankrupt company, need to lose another $33

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[127] *See* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 309 (S.D.N.Y. 2011). This isn't the first time the SEC has run into difficulty with "neither admit nor deny." In September 2000, the SEC settled an enforcement action against Jonathon Lebed, a 15-year old high school student who had made $272,826 by buying penny-stocks and then artificially inflating their prices by relentlessly promoting them on the Internet and finally selling the stock high. Jonathan Lebed, Securities Act No. 7891, WL 1353040 (Sept. 20, 2000); *see also* Michael Lewis, *Jonathan Lebed: Stock Manipulator, S.E.C. Nemesis – and 15*, N.Y. TIMES (Feb. 25, 2001), *available at* http://www.nytimes.com/2001/02/25/magazine/25STOCK-TRADER.html. While agreeing to forfeit $285,000, Lebed also agreed to neither admit nor deny the SEC's allegations. *See id.* After settlement, Lebed stated on the 60 Minutes television program, "Yes, (I manipulated stocks), but I wasn't doing anything wrong. . . . I wasn't posting any kind of false information." *60 Minutes* (CBS television broadcast Oct. 22, 2000) (transcript available at http://www.cbsnews.com/8301-18560_162-242489.html). The SEC never sought to hold Lebed in breach of the settlement agreement. *See* Neil Roland, *Teen Sued Over Stock Fraud May Face Criminal Charges*, BLOOMBERG NEWS (Oct. 6, 2000), *available at* www.siliconinvestor.com/readmsg.aspx?msgid=14594776 (noting the SEC "is finished with Lebed").

[128] *See* SEC v. Bank of America Corp. (*Bank of America I*), 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009) (stating that the appropriate standard of judicial review for a settlement between the SEC and a corporation is whether the settlement is fair, reasonable, adequate, and in the public interest); *see also infra* notes 148–49 and accompanying text.

[129] In acquiring Merrill Lynch, Bank of America represented within its proxy statement seeking shareholder approval that Merrill would not pay year-end bonuses to its executives prior to the closing of the merger in 2008. *See Bank of America I*, 653 F. Supp. 2d at 508. In actuality, Bank of America had agreed that Merrill could pay $5.8 billion in bonuses to Merrill executives. *See id.*

million of their money in order to 'better assess the quality and performance of management' . . . ."[130] Further, Judge Rakoff characterized Bank of America's willingness to pay the penalty as a cost of doing business, which he considered to be even more shocking in light of the fact that Bank of America had received a $40 billion "bail out" in taxpayer funds—$20 billion of which had come after the merger.[131] The settlement was also deemed to be unreasonable because the facts surrounding the alleged misconduct were not described in sufficient detail so that the court could discern exactly what type of future misconduct it was granting an injunctive remedy against.[132] Lastly, Judge Rakoff concluded that a fine of $33 million—to be borne by innocent shareholders and not by the executives and attorneys who drafted the proxy statement—was grossly inadequate when compared to the "false statement that materially infected a multi-billion-dollar merger."[133] In concluding his decision, Judge Rakoff stated what has become a repeated refrain:

> [T]he S.E.C. gets to claim that it is exposing wrongdoing on the part of the [corporation] in a high-profile merger; the [corporation] gets to claim that they have been coerced into an onerous settlement by overzealous regulators. And all this is done at the expense, not only of the shareholders, but also of the truth.[134]

Five-months later, Judge Rakoff approved, albeit reluctantly, a revised settlement agreement between the SEC and Bank of America over the same allegations.[135] This time around, the settlement contained a series of prophylactic measures to prevent similar future misconduct as well as monetary penalties,

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130 *Id.* at 509. The $33 million represents the monetary fine imposed on the bank as part of the settlement. *Id.* at 508.

131 *See id.* at 510, n. 1.

132 *Id.* at 511. Bank of America, in its papers to the court, maintained that it never made false or misleading statements, and thus, Judge Rakoff assumed, absent the injunction sought by the SEC, the Bank would see nothing wrong with issuing the exact same kind of proxy statement in the future. *See id.*

133 *Id.* at 512.

134 *Id.*

135 *See* SEC v. Bank of America Corp. (*Bank of America II)*, 2010 WL 624581, at *6 (S.D.N.Y. 2010) ("In the exercise of that self-restraint, this Court, while shaking its head, grant's the S.E.C.'s motion and approves the proposed Consent Judgment . . . .").

some of which would partially compensate the victims.[136] This version of the agreement was notably different in that the parties had conducted extensive discovery, including a waiver of attorney-client privilege by Bank of America which resulted in a 35-page Statement of Facts and a 13-page Supplemental Statement of Facts, neither of which was challenged by Bank of America.[137] While finding that the prophylactic measures instituted by Bank of America and overseen by the SEC were "helpful," Judge Rakoff still took issue with the monetary penalty that had now risen to $150 million.[138] Though "not ideal," the penalty effectively transferred $150 million from all shareholders to those current Bank of America shareholders who were victims of the misconduct, thus renegotiating the price Bank of America paid for Merrill had the proxy statement not been misleading.[139] For Judge Rakoff, this result was palatable, but he still took umbrage to the fact that while those responsible for the misconduct—the Bank executives—could not receive any portion of the $150 million fine, they were also not meaningfully contributing to its payment.[140] In the end, Judge Rakoff was still tempted to reject the settlement but granted "substantial deference" to the SEC and approved the settlement citing "judicial restraint."[141] Ultimately for Judge Rakoff, the difference between the two proposed settlements was the hundreds of pages of testimony and other evidentiary material that fully disclosed the relevant facts of Bank of America's misconduct.[142]

In *SEC v. Vitesse Semiconductor Corp.*, while approving a settlement between the SEC and Vitesse Semiconductor for violations of certain securities regulations, Judge Rakoff provided a more detailed context as to why the use of

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136 *See id.* at *3.

137 See i*d.* at *1.

138 *Id.* at *4.

139 *Id.* at *5.

140 *Id.*

141 *Id.* at *6. Both in *Bank of America I* and *Bank of America II*, the SEC and Bank of America repeatedly reminded Judge Rakoff of the "considerable deference" the court should give to the SEC as a regulatory body. *See Bank of America I*, 653 F. Supp. 2d at 508; *Bank of America II*, 2010 WL 624581 at *6.

142 *See Bank of America II*, 2010 WL 624581 at *5 ("[The settlement's] greatest virtue is that it is premised on a much better developed statement of the underlying facts and inferences drawn therefrom . . . .").

"neither admit nor deny" should be placed under greater scrutiny.[143] In tracing the historic origins of "neither admit nor deny," Judge Rakoff laid out the rationale for the use of the language within these settlements:

> Long before 1972, the S.E.C. had already begun entering into consent decrees in which the defendants neither admitted nor denied the allegations. This was strongly desired by the defendants because it meant that their agreement to the S.E.C.'s settlements would not have collateral estoppel consequences for parallel private civil actions, in which the defendants frequently faced potential monetary judgments far greater than anything the S.E.C. was likely to impose. But there were benefits for the S.E.C. as well. First, the practice made it much easier for the S.E.C. to obtain settlements. And second, at a time (prior to 1972) when the S.E.C.'s enforcement powers were largely limited to obtaining injunctive relief, the S.E.C.'s focus was somewhat more centered on helping to curb future misconduct by obtaining access to the Court's contempt powers than on obtaining admissions prior to misconduct.[144]

However, by 1972, it was clear that in following the court's approval of a settlement, the defendant would often enter into public campaigns in which she denied wrongdoing and claimed she had settled with the SEC only to avoid extended litigation.[145] To steer clear of this result, the SEC began to include, in each settlement, a provision that expressly forbade the defendant from denying the allegations.[146] According to Judge Rakoff, the result has become "a stew of confusion and hypocrisy" leaving only one thing certain: "the public will never know whether the S.E.C.'s charges are true . . . ."[147]

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[143] SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011).

[144] *Id.*

[145] *See id.*

[146] *Id.* at 309.

[147] *Id.*

In approving an SEC consent judgment, the appropriate judicial standard of review is whether the agreement is fair, reasonable, adequate to the parties, and within the public interest.[148] While private civil settlements are generally near unreviewable, where a federal agency "seeks to prospectively invoke the Court's own contempt power by having the Court impose injunctive prohibitions against the defendant," a higher degree of scrutiny is warranted.[149] Based on his opinions within the *Bank of America I* and *II* decisions, and the *Vitesse Semiconductor* decision, the ultimate issue for Judge Rakoff is that while such agreements may serve the interests of the SEC and the corporation by making settling "easier," it does not serve the interest of the public at large, particularly when the corporation, after settling with the SEC, proceeds to rewrite history through "equivocal press releases."[150] Although Judge Rakoff approved the consent judgment with *Vitesse Semiconductor*,[151] and after full disclosure of the facts in *Bank of America II*,[152] the result was not the same with Citigroup.[153]

The SEC's action against Citigroup focused on a billion-dollar fund created by the corporation in 2007 to unload poorly rated mortgaged-backed securities on misinformed investors.[154] The basic scheme was to hand-select a number of assets that were projected to negatively perform and place them in a portfolio that would be marketed to investors as "attractive investments rigorously selected by an independent investment advisor."[155] At the same time, Citigroup took a "short position" on these very assets it had selected and realized a net profit of $160 million while the investors lost more than $700 million.[156] In

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148 *See* SEC v. Bank of America Corp. (*Bank of America I*), 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009).

149 *Id.*

150 *Vitesse Semiconductor*, 771 F. Supp. 2d at 309.

151 *Id.* at 310 (consent judgment approved because of admissions of guilt in parallel criminal proceedings, thus not leaving the public to speculate about the truth of the allegations).

152 SEC v. Bank of America Corp. (*Bank of America II)*, 2010 WL 624581, at *5 (S.D.N.Y. 2010).

153 *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

154 *See id.* at 329.

155 *Id.*

156 *Id.* For a full discussion of the Fund at issue, see *infra* notes 269–74 and accompanying text.

a parallel complaint against Brian Stoker—the Citigroup employee who oversaw the structuring of these funds—the SEC alleged that:

> Citigroup *knew* it would be difficult to place the liabilities of the Fund if it disclosed to investors its intention to use the vehicle to short a hand-picked set of poorly rated assets. By contrast, Citigroup *knew* that representing to investors that an experienced third-party investment adviser had selected the portfolio would facilitate the placement of the Fund's liabilities.[157]

However, this language was absent from the Citigroup complaint and therefore most disconcerting to Judge Rakoff.[158] Thus, while on the one hand, the SEC was alleging intent, or scienter, against Citigroup in the Stoker complaint, opening the corporation up to a host of collateral consequences discussed earlier in this paper, on the other hand, the SEC had only charged Citigroup with negligence in the Citigroup complaint.[159] Even more, Citigroup would be allowed to settle the charges "without admitting or denying the allegations" of the complaint.[160] This inconsistency between the two complaints, as well as the minimal facts made available by the SEC about Citigroup's misconduct, was simply too much for Judge Rakoff and he rejected the settlement.[161]

Interestingly, unlike in *Bank of America I* and *II* and *Vitesse Semiconductor*, the SEC argued that while the settlement must be fair, reasonable, and adequate, it did not necessarily need to be in the public interest.[162] The rationale for the SEC's strategy is a mystery, but some have theorized that given Judge Rakoff's oft-repeated criticisms of these agreements, the SEC felt the need to authoritatively establish its right to settle based on whatever terms it deems to be appropriate.[163] Judge Rakoff responded with a bold rebuke of the SEC, rooting his rationale within the injunctive remedy and the associated judicial power of

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[157] *Id.* at 330 (quotation omitted) (emphasis in original).

[158] *See id.*

[159] *See id.*

[160] *Id.* at 332.

[161] *See id.*

[162] *See id.* at 330–31.

[163] *See* John Coffee, *Collision Course: The SEC and Judge Rakoff*, N.Y. L.J., Jan. 19, 2012, *available at*http://www.newyorklawjournal.com/id=1202538773586/Collision-Course%3A-The-SEC-and-Judge-Rakoff .

contempt being sought from the Court.[164] For Judge Rakoff, the core consideration as to whether the court should exercise its powers to grant an injunctive remedy is if the remedy serves the public interest—and the ultimate arbiter of this determination lies within the independent judgment of the court.[165] As Judge Rakoff stated in *Bank of America II* and *Vitesse Semiconductor*, to be able to grant an injunctive remedy, there must be a sufficient evidentiary basis justifying the court to do so.[166]

> [W]hen a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, enforced by the formidable judicial power of contempt, the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts, while the public is deprived of ever knowing the truth in a matter of obvious public importance.[167]

In the eyes of Judge Rakoff, this absence of the facts is further exacerbated by the SEC permitting Citigroup to neither admit nor deny the underlying allegations.[168] While both parties seemingly were more concerned about collateral consequences to Citigroup than disclosing the facts,[169] Judge Rakoff dismissed those concerns, stating "a consent judgment between a federal agency and a private corporation which is not the result of an actual adjudication

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164 *See Citigroup*, 827 F. Supp. 2d at 332.

165 *Id.* at 331 ("[A] court, while giving substantial deference to the views of an administrative body vested with authority over a particular area, must still exercise a modicum of independent judgment in determining whether the requested deployment of its injunctive powers will serve, or disserve, the public interest.").

166 *See id.* at 332.

167 *Id.*

168 *See id.*

169 Judge Rakoff accused Citigroup that its intentions, while not to admit the allegations, were to deny them in the media and parallel litigation. *Id.* at 332–33. He also accused the SEC of being satisfied that by Citigroup agreeing to "not expressly deny the allegations," that somehow the truth had been sufficiently publicly exposed. *Id.* at 333.

of any of the issues [cannot] be used as evidence in subsequent litigation."[170] If anything, in Judge Rakoff's opinion, the settlement with the SEC was merely Citigroup's cost of doing business rather than "any indication of where the real truth" may lie.[171] Here, Citigroup—a recidivist offender—was able to settle a broad-ranging investigation without ever admitting to anything (thus mitigating collateral consequences) while also paying a modest fine and adopting certain relatively inexpensive prophylactic measures.[172] In Judge Rakoff's words, if the SEC's allegations were true, the settlement was "a very good deal for Citigroup," and even if they were false, it was "a mild and modest cost of doing business."[173]

Limiting Citigroup's collateral consequences was not the only party's interest Judge Rakoff criticized, however. Turning to the SEC, Judge Rakoff accused the regulator of seeking nothing more than a "quick headline" rather than acting in the investors' best interests.[174] By only charging Citigroup with negligence and then permitting them to settle without any admission or denial, the defrauded investors were dealt a "double blow," as they cannot bring a private securities action based on negligence[175] nor can they receive any evidentiary aid through collateral estoppel from Citigroup's non-admission or non-denial.[176]

Despite his criticism, the SEC's and Citigroup's interests do matter to Judge Rakoff, but resolving those interests does not automatically mean the

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[170] *Id.* at 333 (quoting Lipsky v. Commonwealth United Corp., 551 F.2d 887, 893 (2d Cir. 1976)).

[171] *Citigroup*, 827 F. Supp. 2d at 333. The fact that Citigroup was a recidivist offender and that the SEC had failed to enforce against any financial institution over the previous 10 years the very injunctive remedy it was seeking seemed to have made the settlement agreement particularly distasteful to Judge Rakoff. *See id.*

[172] *Id.*

[173] *Id.*

[174] *Id.* at 333–34. Judge Rakoff found the $285 million fine Citigroup was required to pay to be paltry in comparison to the total losses suffered by investors. *See id.* at 334. Additionally, the settlement left open whether any of the fine would be given to the defrauded investors to help cover their losses. *See id.*

[175] Under Delaware General Business Law § 102(b)(7), a corporation may exculpate monetary damages for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law." Del. Code Ann. tit. 8, § 102(b)(7)(ii) (2011). As such, if the corporation's articles of incorporation contain a § 102(b)(7) exculpatory clause, shareholders cannot base a derivative suit on gross negligence. *See* In re Walt Disney Co. Derivative Litigation, 906 A.2d 27, 67 (Del. 2006).

[176] *Citigroup*, 827 F. Supp. 2d at 334. *See also* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 332 (1979) (permitting offensive collateral estoppel where shareholders used declaratory judgment from SEC action against corporation in a later private action).

public interest has been served.[177] In what is probably the most important line from the opinion,[178] Judge Rakoff writes:

> Even after giving the fullest deference to the S.E.C.'s views—which have more than once persuaded this Court to approve an S.E.C. Consent Judgment it found dubious on the merits . . . , the Court is forced to conclude that a proposed Consent Judgment that asks the Court to impose substantial injunctive relief, enforced by the Court's own contempt power, *on the basis of allegations unsupported by any proven or acknowledged facts whatsoever*, is neither reasonable, nor fair, nor adequate, nor in the public interest.[179]

For Judge Rakoff, whether Citigroup actually stipulates to the allegations in the SEC's complaint is not as important as the SEC presenting sufficient evidence to justify the use of the court's injunctive power.[180] As in *Bank of America II* and *Vitesse Semiconductor*, it is much easier for the court to determine what future conduct the injunction prevents when the facts are made plain.[181] But where the truth is swept under the rug, it is not within the public interest to

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177 *See Citigroup*, 827 F. Supp. 2d at 335.

178 Coffee, *supra* note 163.

179 *Citigroup*, 827 F. Supp. 2d at 335 (emphasis added).

180 *See id.* ("An application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous. The injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression."); *see also* Coffee, *supra* note 164 ("[T]he court is here objecting that there are no 'acknowledged facts whatsoever'").

181 As earlier stated, after appending 48 pages in facts to the settlement agreement, Judge Rakoff approved the SEC's settlement with Bank of America. SEC v. Bank of America Corp. (*Bank of America II)*, 2010 WL 624581, at *5-6 (S.D.N.Y. 2010). In addition, the SEC's settlement with Vitesse Semiconductor was approved because of a parallel criminal proceeding in which the parties had admitted their guilt. *See* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 310 (S.D.N.Y. 2011).

"grant judicial enforcement to the agency's contrivances," even if it is "in the name of deference or convenience."[182]

Given the high-profile nature of the *Citigroup* decision, rather than retreating and revising the settlement agreement with Citigroup (similarly to *Bank of America I* and *II*), the SEC decided to appeal and motioned to stay the proceedings pending determination of the appeal.[183] Not surprisingly, Judge Rakoff rejected the stay, and the SEC and Citigroup then appealed to the Second Circuit where the stay was granted.[184] Focusing mainly on the administrative law issue of Judge Rakoff's alleged lack of deference for SEC discretion in constructing its settlements,[185] and the perception that Judge Rakoff would require some sort of admission by Citigroup to approve a settlement,[186] the Second Circuit stayed the proceedings and held that the SEC and Citigroup had a "strong likelihood of success" in their effort to overturn Judge Rakoff's ruling.[187]

On February 8, 2013, the SEC and Citigroup argued the merits of the settlement agreement against John Wing, the court appointed attorney for Judge Rakoff.[188] The essence of the SEC's argument on appeal was that Judge Rakoff's rejection of the settlement agreement conflicted with the "well-established judicial practice," under administrative law principles, of granting deference to the judgment of federal agencies in negotiating a settlement agreement.[189] According to the SEC, the staff weighed the risks and benefits of a trial versus a settlement and decided that a settlement, rather than litigation, "best served the public

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[182] *Citigroup,* 827 F. Supp. 2d at 335.

[183] SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 336, 337 (S.D.N.Y. 2011).

[184] SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 169 (2d Cir. 2012).

[185] *Id.* at 165 ("[I]t is 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.").

[186] *Id.* at 166 ("We know of no precedent that supports the proposition that a settlement will not be found to be fair, adequate, reasonable, or in the public interest unless liability has been conceded or proved and is embodied in the judgment.").

[187] *Id.* It should be noted that the Second Circuit only received papers from the SEC and Citigroup, and following the stay, counsel was appointed to represent Judge Rakoff. *See id.* at 160.

[188] *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 336, 336-37 (S.D.N.Y. 2011), *appeal docketed,* No. 11-5227 (2d Cir. 2013). Citigroup was represented by Paul, Weiss, Rifkind, Wharton & Garrison LLP while the SEC was represented by their Deputy General Counsel, Michael A. Conley, and Solicitor, Jacob H. Stillman. *See id.*

[189] Brief Comm'n.,for Petitioner at 18–19, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012) (No. 11-5227).

interest."[190] The SEC interpreted Judge Rakoff's rejection of the agreement as creating a "bright-line rule" that requires an admission of liability for any consent judgment seeking injunctive relief[191] as well as interfering with the ability of the SEC "to manage its enforcement program and allocate its resources."[192] In justifying its use of "neither admit nor deny" language within its settlement agreements, the SEC rationalized that "many . . . defendants will not admit to factual allegations because they are concerned about, among other things, the collateral estoppel effect of admissions on parallel private actions."[193] By requiring an admission, the SEC's ability to negotiate a compromise would be upset, thus forcing the SEC to limit the number of cases it pursues through district court enforcement actions.[194] As such, the SEC's enforcement program would not be driven by the staff's "ability to obtain the best outcome for investors in the greatest number of cases given [their] resources . . . , but rather by a judicial imperative requiring a factual adjudication in every instance."[195]

From Citigroup's perspective, the correct judicial standard of review to be applied is *only* whether the agreement was fair, reasonable and adequate, and any additional requirement that the facts upon which the settlement is based must be proven or acknowledged is inconsistent with federal judicial practice.[196] The court's role is not to second guess the federal agency on whether the settlement is ideal but only look to the fairness, reasonableness, and adequacy of the agreement.[197] By requiring an admission or proof of liability, Citigroup contends that Judge Rakoff overstepped his narrow judicial role in approving a negotiated agreement,[198] thus vitiating the very reason the SEC enters into these types of

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[190] *Id.* at 19.

[191] *Id.* at 21.

[192] *Id.* at 41.

[193] *Id.* at 47.

[194] *Id.* at 49. According to the SEC's brief, 87% of its district court cases are resolved by consent judgments each year. *Id.* at 23.

[195] *Id.* at 50.

[196] *See* Brief of Appellee, at 15–16, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012) (No. 11-5227).

[197] *See id.* at 29-30.

[198] *See id.* at 16.

agreements—mitigating collateral consequences to the corporation and conserving the precious prosecutorial resources of the SEC.[199] According to Citigroup, what best serves the public interest is solely determined by the federal agency and not by the judge reviewing the settlement agreement.[200] Rather than effecting an outcome the court would like to see, the role of the judge is only "to effect the terms negotiated by the parties."[201] Thus, in the eyes of Citigroup, the agreement with the SEC was fair, as "it reflect[ed] an agreement reached in arm's length negotiations between experienced, capable counsel after meaningful discovery," was reasonable and adequate because "it provide[d] for comprehensive relief, negotiated and agreed to by the parties after each weighed the significant litigation risk involved in proceeding to trial," and served the public interest, "as determined by the SEC, in the appropriate exercise of its authority to regulate the federal securities laws."[202]

According to Judge Rakoff, the SEC and Citigroup distorted his ruling, and no "bright-line rule" was created requiring an admission or proof of liability in approving a settlement agreement.[203] Rather, what Judge Rakoff was seeking was a full disclosure of the facts, which was not presented to him by either of the parties.[204] In referencing two prior consent judgments, Judge Rakoff provided

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[199] *See id.* at 17.

[200] *Id.* at 31–32. Citigroup, in making this argument, cited to the Second Circuit's decision granting a stay of the proceedings. "The S.E.C.'s decision to settle with Citigroup was driven by the considerations of governmental policy as to the public interest. The district court believed it was a bad policy, which disserved the public interest, for the S.E.C. to allow Citigroup to settle on terms that did not establish its liability. It is not, however, the proper function of federal courts to dictate policy to executive administrative agencies." SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012); *see also* Chevron, U.S.A., Inc. v. Natural Res. Defense Council, Inc., 467 U.S. 837, 866 (1984) ("[Federal judges – who have no constituency – have a duty to respect legitimate policy choices made by those who do. 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: Our Constitution vests such responsibilities in the public branches.") (internal quotations and citations omitted).

[201] Brief of Appellee, at 32–33 (internal quotations and citations omitted).

[202] *Id.* at 3–4. In making the argument that it is solely within the SEC's discretion to determine what best serves the public interest, Citigroup also stated that the court is only to evaluate whether a proposed injunction on the defendant would cause harm to the public interest, not if it best served the public interest. *Id.* at 48.

[203] *See* Brief of Appointed Pro Bono Counsel For The United States District Court, at 28, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012) (No. 11-5227).

[204] *See id.* at 30–31 ("Indeed, even though the SEC had conducted a four-year investigation of the matter, it chose not to present the court [either directly or even on an *ex parte* basis] with any

examples of what he was looking for from the SEC: a full recitation of the facts upon which the settlement agreement was based, similar to the 35-page Statement of Facts in *Bank of America,* or an express acknowledgment of key facts similar to the admission of a mistake in *Goldman Sachs*.[205] Here, Judge Rakoff received neither but found "puzzling anomalies" in the complaints filed against Citigroup and Brian Stoker and in the proposed consent judgment.[206] In Judge Rakoff's view, these inconsistencies, as well as the unique circumstances of the case, made the "need for injunctive relief doubtful."[207] Additionally, in light of the type of injunctive relief the SEC was seeking against Citigroup, a factual basis was needed to show that future misconduct could occur.[208] Taken together, Judge Rakoff had no "evidentiary basis upon which to exercise [his] independent judgment" in approving the consent judgment and granting injunctive relief.[209] It was this independent judgment upon which Judge Rakoff justified the district courts' role in determining if a settlement agreement serves the public interest.[210] Under Judge Rakoff's rationale, "[t]he public interest is measured in part by the settlement's ability to further the goals of the statute that the judgment is designed

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documents, deposition transcripts, or other evidence of any kind from the presumably extensive record collected during that investigation.").

[205] *Id.* at 30. Notably, both consent judgments contained "neither admit nor deny" language. *See* SEC v. Bank of America Corp. (*Bank of America II)*, 2010 WL 624581, at *1 (S.D.N.Y. 2010); SEC v. Goldman Sachs & Co., 2010 WL 2779309, at *2 (S.D.N.Y. 2010).

[206] *See* Brief of Appointed Pro Bono Counsel For The United States District Court, at 2, 24; *see also supra* notes 157–61 and accompanying text.

[207] *See id.* at 43. The unique circumstances include a limited claim of negligence against Citigroup which normally does not justify imposing injunctive relief, the fact that Citigroup had discontinued the misconduct five years prior and had already implemented a number of remedial measures, that an injunction prohibiting Citigroup from violating the same statute had already been imposed a year earlier, and the failure of the SEC to enforce any of its previously entered injunctions against Citigroup or any other major financial institution within the previous ten years. *See id.*

[208] *See id.* at 40 ("Here, the requirement was made even more acute by the fact that the proposed consent judgment sought not only an extremely broad ["obey-the-law"] prohibiting injunction but also a variety of mandatory injunctions in the form of prophylactic measures Citigroup was ordered to implement.").

[209] *Id.* at 27, 33.

[210] *Id.* at 46.

to enforce."[211] In his opinion, the proposed consent judgment had serious shortcomings in preventing securities fraud.[212] As such, Judge Rakoff's rejection of the agreement was not a case of him substituting his views for that of the SEC in what the settlement should have contained.[213] Contrary to the SEC's claims, trial was not the only option; the parties could also return to the table, similarly to *Bank of America I* and *II*, and renegotiate a deal that would pass judicial muster—namely the presentment of facts upon which the settlement was based.[214] Ultimately for Judge Rakoff, the district court's role in determining whether a settlement agreement is fair, reasonable and adequate is more than just serving as a "rubber stamp" or "potted plant."[215]

While the Second Circuit has not issued its decision yet, there have been two notable consequences as a result of the *Citigroup* settlement controversy. First, the SEC made a change in policy in which it would no longer allow defendants to neither admit nor deny allegations in a settlement agreement where there is a parallel criminal prosecution.[216] Second, public debate has increased about whether the SEC's use of "neither admit nor deny" language "allows defendants to avoid accepting responsibility for their conduct."[217]

On the heels of the Citigroup decision, Robert Khuzami stated that the SEC's change in policy regarding the use of "neither admit nor deny" language

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211 *Id.* at 47.

212 *Id.* Judge Rakoff took exception to the monetary penalty imposed on Citigroup, which he found to be inadequate due to how it was calculated by the SEC; the discrepancy between the Citigroup penalty of $95 million and an earlier Goldman Sachs penalty of $535 million for virtually identical conduct; and the lack of restitution to injured investors. *See id.* at 49–52.

213 *See id.* at 53.

214 *See id.*

215 *See id.* at 54–55. The Brief for the U.S. District Court goes to great lengths to address the SEC's and Citigroup's definition of judicial deference to a federal agency. In Judge Rakoff's view, "deference [does not] mean that courts mechanistically and mindlessly apply some formulaic standard. Rather, deference must be considered in the context of the particular demands of any given case . . . ." *Id.* at 56.

216 *See* Khuzami, *supra* note 14.

217 Reckler & Denton, *supra* note 15, at 2. *See* Edward Wyatt, *S.E.C. is Avoiding Tough Sanctions for Large Banks*, N.Y. TIMES, Feb. 3, 2012, *available at* http://www.nytimes.com/2012/02/03/business/sec-is-avoiding-tough-sanctions-for-large-banks.html?pagewanted=all (reporting that over the previous ten years the SEC had granted 350 waivers to financial institutions that had existing injunctions against them not to commit securities fraud again).

was unrelated to Judge Rakoff's ruling.[218] Nonetheless, the correlation is significant, though the actual number of instances in which there is a parallel criminal prosecution is relatively few.[219] In those cases, the SEC will delete the "neither admit nor deny" language from the settlement agreement, recite the "fact and nature" of the criminal conviction or DPA or NPA within the SEC settlement, and permit the staff the discretion to incorporate any relevant facts admitted to within the criminal conviction or DPA or NPA into the settlement documents.[220] Additionally, defendants will not be permitted to deny the allegations of the complaint or make statements suggesting the allegations are without a factual basis.[221]

Following this announcement, Khuzami was summoned to testify on the settlement practices of the SEC before the Committee on Financial Services of the U.S. House of Representatives on May 17, 2012.[222] In justifying the use of "neither admit nor deny" within SEC settlement agreements, Khuzami testified that the SEC weighs three considerations when contemplating a settlement: "(i) the strength of the evidence and the potential defenses, including the possibility that the Commission might not prevail at trial, or prevail but be awarded less than the proposed settlement achieves; (ii) the delay in returning funds to harmed investors caused by litigation; and (iii) the resources required for a trial, including, most importantly, the opportunity costs of litigating rather than devoting those resources to investigating other cases."[223] These considerations serve the important goals of settlements: accountability, deterrence, investor protection, and compensation to harmed investors.[224] Settlements hold defendants accountable by publically disseminating information about their misconduct, promote deterrence, protect investors by offering immediate sanctions that will prevent future misconduct, which minimizes the chance that other investors will be victimized, and return funds to harmed investors with greater speed and

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218 Khuzami, *supra* note 14.

219 *See id.*

220 *Id.*

221 *Id.*

222 Khuzami, *supra* note 15.

223 *Id.*

224 *See id.*

certainty than through a trial.[225] "Neither admit nor deny" language is often seen as the key to reaching these settlements:

> There is little dispute that if "neither-admit-nor-deny" settlements were eliminated, and cases could be resolved only if the defendant admitted the facts constituting the violation, or was found liable by a court or jury, there would be far fewer settlements, and much greater delay in resolving matters and bringing relief to harmed investors. *The reality is that many companies likely would refuse to settle cases if they were required to affirmatively admit unlawful conduct or facts related to that conduct.* This is 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 such lawsuits. This means that a defendant could, as a result of the admission in the SEC settlement, be precluded from challenging liability in the private civil litigation. In addition, and most significantly, such an admission can help to establish elements of criminal liability, since many federal securities laws provide for both civil and criminal liability for the same violation. At a minimum, the risks of increased civil and criminal liability that flow from an admission in an SEC action are sufficiently real that defendants are highly unlikely to settle, if at all, until those risks have passed or are quantified and deemed acceptable.[226]

In the SEC's view, requiring admissions as a condition of settlement would likely result in delays to victim compensation, postponement of sanctions, and significant expenditure of SEC resources that could be used to prevent future fraud.[227] While, admittedly, this approach means "some measure of . . . compromise . . . [it] is [intended] to redress wrongs committed by securities law violators, preclude wrongdoers from working with the investing public in the

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[225] *See id.*

[226] *Id.* (emphasis added).

[227] *See id.*

future, reform company practices, deter similar misconduct by others, and return funds directly to harmed investors in a timely manner."[228]

Public sentiment to this change in policy has been mixed.[229] Some see that the policy change will have little to no effect at all on how the SEC settles its cases.[230] In December 2011, just prior to the SEC's announcement, Khuzami publicly stated that he believed that the SEC rejecting a "reasonable settlement due to the absence of an admission" was an "unwise policy."[231] Luis A. Aguilar, an SEC commissioner, also publicly stated that the policy change "applies in so few situations, it needs to be revised to be more useful and effective."[232] Statements like these, as well as Khuzami's testimony before Congress, tend to show that there is little change expected. Others, however, see the policy change as having some ramifications for defendants in how settlements are negotiated with the SEC.[233] Obviously, a defendant facing a criminal charge has collateral estoppel concerns, but it is important to note that not all SEC cases overlap perfectly with the criminal case.[234] Accordingly, a criminal conviction or guilty plea may not necessarily provide a shareholder or investor with the relevant scienter needed to prove fraud in a private action.[235] Additionally, under Second

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[228] *Id.*

[229] *See* Wyatt, *supra* note 12 ("Securities law experts differed over the practical importance of the change, with some saying it is a notable acknowledgment by the agency of flaws in its system, and others suggesting that it will not affect most S.E.C. cases, which involve only civil charges.").

[230] *See* Reckler & Denton, *supra* note 15, at4-5 ("[U]ntil such time as more courts and critics join Judge Rakoff in questioning settlements that do not include admissions, the SEC can be expected to continue including 'neither admit nor deny' language in settlements that do not involve admissions in parallel criminal cases.").

[231] Robert Khuzami, Dir., Div. of Enforcement U.S. Sec. & Exch. Comm'n., Remarks Before the Consumer Federation of America's Financial Services Conference (Dec. 1, 2011).

[232] Edward Wyatt, *Settlements Without Admissions Get Scrutiny*, N.Y. TIMES, Feb. 24, 2012, *available at* http://www.nytimes.com/2012/02/25/business/neither-admit-nor-deny-settlements-draw-judges-scrutiny.html?_r=0.

[233] *See* Mei Lin Kwan-Gett, Alison Levine & Erin McLeod, *Assessing the SEC's New 'Neither Admit Nor Deny' Policy*, N.Y. L. J., Oct. 2012, at 1 (reporting that from January 2012 through August 2012, in 27 of 29 consent judgments where there was a parallel criminal case, the SEC omitted "neither admit nor deny" language from the settlement document).

[234] *See id.* at 3.

[235] *Id.*

Circuit case law, a settlement agreement does not have a collateral estoppel effect on subsequent private litigation because the issues were never actually litigated.[236] As such, it still behooves a defendant to negotiate expeditiously with the SEC—even when there is a parallel criminal proceeding—to limit their exposure to collateral consequences.[237]

Public criticism of "neither admit nor deny" has also been sharp from other federal district judges who have rejected or seriously questioned federal regulators' settlements containing such language.[238] In 2010, Judge Ellen Segal Huvelle of the Federal District Court for the District of Columbia rejected a proposed settlement agreement between the SEC and Citigroup only to later approve it after the parties brought sufficient evidence to show why the settlement was adequate and why the SEC had only charged two executives with wrongdoing.[239]

In December 2010, on the heels of the *Citigroup* decision, Judge Rudolph Randa of the Eastern District of Wisconsin, through a letter to the SEC, questioned whether the settlement agreement between the SEC and Koss Corporation was fair, reasonable, adequate, and in the public interest considering the lack of factual evidence justifying the injunctive and disgorgement remedies

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[236] *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011) ("As a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect."). *See also* Lipsky v. Commonwealth United Corp., 551 F.2d 887, 893 (2d Cir. 1976) ("[A] consent judgment between a federal agency and a private corporation which is not the result of an actual adjudication of any of the issues . . . can not be used as evidence in subsequent litigation.").

[237] *See* Kwan-Gett, *supra* note 233, at 4 (reporting that "cooperation with the government appears to yield gentler treatment" regarding admissions in a settlement agreement).

[238] Federal district judges are not the only ones critical of regulators' use of settlement agreements with financial institutions. In a recent Senate Banking Committee hearing, Senator Elizabeth Warren of Massachusetts grilled financial regulators for failing to prosecute Wall Street banks. After regulators failed to adequately respond to her question of when was the last time regulators had taken a Wall Street bank to trial, Sen. Warren stated, "I'm really concerned 'too big to fail' has become 'too big for trial.' That just seems wrong to me." David Uberti, *Senator Elizabeth Warren Grills Regulators, Ending Quiet First Month in Office*, BOSTON GLOBE, Feb. 14, 2013, *available at* http://www.boston.com/news/politics/2013/02/14/senator-elizabeth-warren-grills-regulators-ending-quiet-first-month-office/rEHdymDsEVcT5yW52LD93M/story.html.

[239] Edward Wyatt, *Judge Accepts Citigroup's Settlement with S.E.C.*, N.Y. TIMES, Sept. 24, 2010, *available at* http://www.nytimes.com/2010/09/25/business/25sec.html. In rejecting the initial settlement, Judge Huvelle stated to the parties, "I look at this and say, 'Why would I find this reasonable?' You expect the court to rubber stamp, but we can't." *See also* Kara Scannell, *Judge Won't Approve Citi-SEC Pact*, WALL ST. J. (Aug. 17, 2010), http://online.wsj.com/article/SB10001424052748704868604575433833841630548.html.

sought.[240] Judge Randa later approved the settlement after the parties provided sufficient evidence to justify the agreement.[241]

In September 2012, Judge Renee Marie Bumb of the District of New Jersey accepted a settlement agreement between the Federal Trade Commission (FTC) and Circa Direct LLC after initially rejecting it over concerns the corporation had not admitted liability and that there was not enough factual evidence to justify an injunctive remedy.[242] In considering the revised settlement, Judge Bumb took a moment to discuss whether the corporation's lack of admission should be considered within the public interest analysis.[243] In holding that it does, Judge Bumb repeated Judge Rakoff's justification for greater judicial scrutiny of these settlement agreements: "Because the consent decree does not merely validate a compromise but, by virtue of its injunctive provisions, reaches into the future and has continuing effect, its terms require more careful scrutiny."[244] For Judge Bumb, the core of the settlement was in airing the facts so that "the public [may] have some mechanism to evaluate the truth of the . . . claims."[245] While the final settlement agreement did not contain an admission of liability by Circa Direct, Judge Bumb conditioned her approval of the settlement on the FTC publishing the settlement and the alleged facts on the internet so that the truth would be made known.[246]

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[240] Letter from Hon. Rudolph T. Randa, U.S. District Judge, E.D. Wisc., to Ms. Andrea R. Wood & Mr. James A. Davidson, U.S. Sec. & Exch. Comm'n (Dec. 20, 2011), (available at http://www.fedseclaw.com/uploads/file/2011%2012%2020%20Letter%20Order%20from%20Court%281%29.pdf).

[241] *See* SEC v. Koss Corp., Litigation Release No. 22138, No. 2:11-cv-00991 (Oct. 24, 2011).

[242] *See* F.T.C. v. Circa Direct LLC, 2012 WL 3987610 (D. N.J. 2012).

[243] *See id.* at *4.

[244] *Id.* (quotation omitted)) *see* SEC v. Bank of America Corp. (*Bank of America I*), 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009) ("When, however, as in the case of a typical consent judgment, a federal agency such as the S.E.C. seeks to prospectively invoke the Court's own contempt power by having the Court impose injunctive prohibitions against the defendant, the resolution has aspects of a judicial decree and the Court is therefore obliged to review the proposal a little more closely . . . .").

[245] *Circa Direct*, 2012 WL 3987610, at *6, n. 3.

[246] *See id.* at *7.

In June 2012, Judge Frederic Block of the Eastern District of New York approved the SEC's settlement with two former Bear Stearns fund managers while refusing to extend Judge Rakoff's and Judge Bumb's public interest analysis of a settlement agreement.[247] Disagreeing with Judge Rakoff, Judge Block only inquired into whether the agreement was fair, reasonable, and adequate, relying on the fact that "the settlement is the product of arm's length negotiation between sophisticated parties with capable counsel and adequate knowledge of the facts adduced in discovery . . . ."[248] Further, Judge Block deferred to the SEC's judgment that the settlement was in the public interest, even though he had earlier characterized the monetary penalty the defendants were required to pay as "chump change."[249] Nonetheless, prior to approving the agreement, Judge Block expressed serious misgivings regarding the judge's role in approving the settlement, questioning the SEC as to whether he was expected to just "rubber stamp" the agreement.[250]

In January 2013, in a curt, one-paragraph opinion, Judge John L. Kane of the District of Colorado rejected the SEC's settlement with Bridge Premium Finance, stating two reasons: first, the defendants' defiant muteness as to the truth of the allegations against them, and second, the defendants' waiver of their right to the entry of a finding of fact and conclusion of law.[251]

Finally, in March 2013, Judge Victor Marrero of the Southern District of New York expressed skepticism over the SEC's proposed settlement agreement with SAC Capital Advisors (SAC) for insider trading allegations.[252] Focusing specifically on the SEC's use of "neither admit nor deny" language within the

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247 *See* SEC v. Cioffi, 868 F. Supp. 2d 65, 74 (E.D.N.Y. 2012).

248 *Id.* at 74.

249 *See id.* at 66, 74. The defendants in the case were required to pay the SEC $800,000 and $250,000, respectively, and investor losses due to their misconduct were $1.6 billion. *Id.* at 66.

250 *See* Alison Frankel, *Judge in SEC's Bear Stearns case catches Rakoff fever*, THOMPSON REUTERS NEWS & INSIGHT (Feb. 15, 2012), http://newsandinsight.thomsonreuters.com/Legal/News/2012/02_-_February/Judge_in_SEC_s_Bear_Stearns_case_catches_Rakoff_fever/ (quoting Judge Block, "Am I just a rubber stamp here or is there some inquiry I ought to be making about these provisions? About the fairness of it? Or the reasonableness of it? I'm not so sure I necessarily agree with everything Judge Rakoff wrote, but what should be the judge's role when the judge is being asked to consent to one of these types of things?").

251 SEC v. Bridge Premium Finance, LLC, No. 1:12-CV-02131-JLK-BNB, slip op. at 1 (D. Colo. Jan. 17, 2013) ("A defendant's options in this regard are binary: he may admit the allegation or he may go to trial.").

252 *See* Lattman, *supra* note 1.

settlement, Judge Marrero stated, "There is something counterintuitive and incongruous about settling for $600 million if [SAC] truly did nothing wrong."[253] When asked why SAC was willing to pay $600 million to settle the case rather than $1 million in legal fees to defend itself, SAC responded, "We're willing to pay $600 million because we have a business to run and don't want this hanging over our heads with litigation that could last for years."[254] Turning to the SEC, Judge Marrero expressed concerns about the inconsistencies between the DOJ's pending criminal case against a former SAC portfolio manager, Mathew Martoma—who had pleaded not guilty to related criminal charges—and the SEC's case against SAC.[255] "How would it look if in the settlement before it, the parties were allowed to say[,] 'We did nothing wrong?' [Judge] Marrero asked."[256] While Judge Marrero has not yet ruled on the settlement agreement, he hinted that he may condition approval on the outcome of the Second Circuit *Citigroup* appeal.[257] The SEC argued that the court is free to approve the agreement without considering the *Citigroup* appeal because "[the SEC] do[es] not see the no-admit, no-deny language as an unsettled question."[258] However, that is not the case for Judge Marrero, who sees himself in the same position as Judge Rakoff in the *Citigroup* settlement.[259] "The ground is shaking, let's admit that, said [Judge] Marrero." [260]

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253 *Id.*

254 *Id.* What is notable about SAC's response is that it echoes Judge Rakoff's accusation in *Citigroup* that Citigroup's settling of the SEC's case against it was merely one of the costs of doing business. *See supra* notes 168–73 and accompanying text.

255 *See* Lattman, *supra* note 1. Prosecutors allege that Mr. Martoma shared insider information with Steven A. Cohen, the head of SAC, regarding Alzheimer's drugs produced by Elan Corp. and Wyeth LLC. As a result, SAC was able to make $276 million in illegal profit and in losses avoided on shares of the two corporations. *See id.*

256 Bob Van Voris, *SAC Judge Questions Record $602 Million SEC Settlement*, BLOOMBERG (Mar. 28, 2013), http://www.bloomberg.com/news/2013-03-28/sac-judge-questions-record-602-million-sec-settlement.html.

257 *See* Lattman, *supra* note 1.

258 Van Voris, *supra* note 256.

259 *See id.*

260 *Id.*

How the Second Circuit will rule on the *Citigroup* appeal is yet to be determined. However, it appears that there are at least four ways the court could go.[261] First, the court could agree with Judge Rakoff's complaint that the SEC does not need to bring each and every settlement into federal district court, especially after considering the fact that the SEC never seems to invoke the injunctive power it consistently seeks as part of these settlements.[262] If this is the case, the SEC'suse of DPAs and NPAs will (likely) dramatically increase in situationswhere injunctive remedies are not typically part of the agreement and judicial review is limited or not at all required. Second, the court could agree with Judge Rakoff and Judge Bumb that the federal district courts are to exercise their independent judgment in approving a settlement agreement and that approval is not a mere "rubber stamp" to whatever the SEC can negotiate.[263] If this were to happen, Professor Coffee suggests that a consent judgment does not necessarily have to require a defendant to accept collateral estoppel by admitting to the enforcement agency's allegations.[264] However, if "neither admit nor deny" language is used, the district court should seek a full explanation as to the enforcement agency's rationale, and the court should have some factual understanding of the strength of the enforcement agency's case prior to imposing injunctive relief.[265] Additionally, a consent judgment should give the public some reliable information about what actually occurred.[266] If the Second Circuit ruled this way, use of DPAs and NPAs could dramatically increase as closer scrutiny by the courts could likely yield more exacting terms and/or admissions from defendants—and hence greater exposure to collateral consequences. Third, if the court does hold that it was proper for federal district judges to exercise their independent judgment in reviewing the settlement agreement, the court could then give some constructive guidelines as to how settlements should be reviewed.[267] Finally, the court could hold in favor of the SEC and rule that Judge

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[261] C. Evan Stewart, *A Tale of Two Judges*, 16 N.Y. BUS. L. J. 21, 23 (2012).

[262] *See id. See also* Brief of Appointed Pro Bono Counsel For The United States District Court, at 43, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012) (No. 11-5227).. *See also* Wyatt, *supra* note 215.

[263] Stewart, *supra* note 261, at 21. *See* Brief of Appointed Pro Bono Counsel For The United States District Court, at 54.

[264] Coffee, *supra* note 163.

[265] *See id.*

[266] *Id.*

[267] Stewart, *supra* note 261, at 21. An interesting proposition would be for the federal district court to exercise its own independent judgment in approving a settlement agreement, similarly to the

Rakoff overstepped his bounds by rejecting the agreement and not deferring to the SEC's judgment that the proposed settlement best served the public interest.[268] In this final scenario, status quo will likely be maintained, though the SEC will continue to have DPAs and NPAs available in those circumstances where deemed necessary.

Regardless of how the Second Circuit rules on the SEC/Citigroup appeal, the SEC will still maintain its ability to effectively settle the majority of these cases with the corporation "neither admitting nor denying" the allegations of misconduct. Precisely because DPAs and NPAs remain outside the scrutiny of the judiciary, any "reform" that may be seen via *Citigroup* is questionable. To advance real reform, a broader definition of "public interest" must be used by the courts to determine whether these settlement agreements are fair, reasonable, adequate, and serve the public interest.

III. EXPANDING THE DEFINITION OF "PUBLIC INTEREST"

Upon rejecting the *Citigroup* agreement, Judge Rakoff consolidated the SEC's case against Citigroup with the case against Brian Stoker and set the trial date for July 16, 2012.[269] Brian Stoker was a former mid-level executive at Citigroup and was the lead structurer (or "deal manager") of the synthetic collateralized debt obligation (CDO) called "Class V Funding III" (the Fund).[270]

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judicial inquiry of the independence and good faith of corporate special litigation committees under Delaware law. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 788–89 (Del. 1981). In those cases, the court applies a two step inquiry: first into the independence and good faith of the special litigation committee, and second, "applying its own independent business judgment," whether a motion to dismiss by the corporation should be granted. *Id.*

268 Stewart, *supra* note 261, at 21; *see also* Brief for Petitioner at 18–19, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 163 (2d Cir. 2012) (No. 11-5227).

269 SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

270 SEC v. Stoker, 873 F. Supp. 2d 605, 608 (S.D.N.Y. 2012). "CDOs are debt securities collateralized by fixed income obligations, such as residential mortgage-backed securities. A CDO collateralized by other CDOs is called a 'CDO squared.' One such CDO squared portfolio was a fund called 'Class V III' (the 'Fund'). Under the terms of the Fund and similar instruments, a 'protection buyer' makes periodic premium payments to a 'protection seller.' In return, the protection seller agrees to pay the protection buyer if the CDO experiences a default. Piercing through the jargon, the protection seller is effectively taking a long position on the CDO, while the protection buyer is effectively taking a short position." *Id.* at 607 (quotation omitted).

The Fund was structured to execute a proprietary trade[271] where Citigroup selected 25 CDOs—forecasted by Citigroup to default—to be included within the Fund[272] and then purchased $500 million[273] of default protection on those assets.[274] The SEC alleged that Stoker and Citigroup, either intentionally or negligently:

> design[ed] a Fund to take advantage of the potential for a falling housing market, chose assets for inclusion in the Fund based at least in part on the fact that some market participants thought they would fail, and took a $500 million naked short position on those assets, all without disclosing that Citigroup 1) had designed the Fund as a proprietary trade, 2) chose certain assets, and 3) took a $500 million naked short position on only those assets.[275]

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[271] "A proprietary trade is a trade undertaken for a firm's own account, rather than on behalf of the firm's customers." *Id.* at 608, n. 2 (quotation omitted).

[272] According to court records, Donald Quintin, the Managing Director of Citigroup's CDO secondary trading desk, sent Stoker a list of 21 assets on which he wished to purchase protection. Twelve of those assets were Constellations CDOs (named after constellations), a group of assets which had received significant interest from hedge funds who were seeking to purchase default protection on those assets (i.e. "short the asset"). Stoker forwarded the list of CDOs to Sohail Khan, the sales person at Citigroup, who then sent them to Credit Suisse Alternative Capital (CSAC), the collateral fund manager, who accepted all 25 assets into the Fund. Citigroup chose to engage CSAC as the collateral manager because it knew that it would be difficult to facilitate the transaction unless investors believed the assets in the Fund were selected by an experienced, third-party. *Id.* at 607–09.

[273] Citigroup initially took a $250 million short position on the 25 assets but later increased it to $500 million. *Id.* at 609-10.

[274] In addition to the 25 assets Citigroup had selected for the Fund, Citigroup also took a short position on an additional 24 assets, which it had not selected. Prior to the Fund closing, Citigroup sold its position in these 24 additional assets, as is common practice by the intermediary bank, but retained its short position on the 25 assets it had chosen for the Fund. *See id.* at 609.

[275] *Id.* at 615. A naked short position is one in which the investor has only purchased default protection on the asset and does not maintain an offsetting long position. By doing this, Citigroup positions itself to realize profits in the event that the CDOs in the Fund went into default. *See* Complaint, at 10, SEC v. Stoker, 2011 WL 4965844 (S.D.N.Y. 2011) (No. 11-CV-7388).

After a two-week jury trial, Stoker was found not guilty of the SEC's charges.[276] At trial, Stoker's attorney, John W. Keker, portrayed Stoker as a scapegoat for Citigroup's wrongdoings, merely doing the bidding of his bosses.[277] "It's not the bank or the transaction that's on trial here," Mr. Keker said in his closing argument, "It's Brian Stoker."[278] Mr. Keker succeeded in showing that there were multiple parties who were involved in structuring the Fund and marketing it to investors, including other Citigroup employees at the structuring desk, in-house and external counsel for Citigroup, CSAC employees, and in-house and external counsel for CSAC.[279] In casting Stoker as merely one of many in Citigroup's immense CDO universe, Mr. Keker argued that his client "shouldn't be blamed for the faults of banking any more than a person who works in a lawful casino should be blamed for the faults of gambling."[280] The jury was convinced by Mr. Keker's argument. After the verdict, Travis Dawson, one of the jurors, stated to reporters, "I'm not saying that Stoker was 100 percent innocent, but given the crazy environment back then it was hard to pin the blame on one person. . . . Stoker structured a deal that his bosses told him to structure, so why didn't they go after the higher-ups rather than a fall guy?"[281] Beau Brendler, the jury's foreman, also stated after trial, "I wanted to know why the bank's C.E.O. wasn't on trial. . . . Citigroup's behavior was appalling."[282]

The most fascinating aspect is what accompanied the jury verdict. Wrapped around the verdict form was a yellow sheet ripped from a legal pad that stated, "This verdict should not deter the S.E.C. from continuing to investigate the financial industry, review current regulations and modify existing regulations

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[276] Stoker, Litigation Release No. 22541, SEC v. Stoker, No. 11-CV-7388 (Nov. 12, 2012).

[277] *See* Peter Lattman, *Former Citigroup Manager Cleared in Mortgage Securities Case*, N.Y. TIMES (Jul. 31, 2012), http://dealbook.nytimes.com/2012/07/31/former-citigroup-manager-cleared-in-mortgage-securities-case/.

[278] *Id.* (quotation omitted).

[279] Memorandum of Points and Authorities in Support of Defendant Brian H. Stoker's Motion for Summary Judgment, at 8, SEC v. Stoker, 2012 WL 2126159 (S.D.N.Y. 2012) (No. 11-CV-7388).

[280] Peter Lattman, *S.E.C. Gets Encouragement from Jury That Ruled Against It,* N.Y. TIMES (Aug. 3, 2012), http://dealbook.nytimes.com/2012/08/03/s-e-c-gets-encouragement-from-jury-that-ruled-against-it/.

[281] *Id.*

[282] *Id.*

as necessary."[283] Mr. Brendler, who wrote the statement, explained the rationale behind it:

> We were afraid that we would send a message to Wall Street that a jury made up regular American folks could not understand their complicated transactions and so they could get away with their outrageous conduct. . . . We also did not want to discourage the government from investigating and prosecuting financial crimes.[284]

The jury verdict in the *Stoker* trial illustrates that there is more to the public interest that needs to be considered by the SEC than just the investors. The mission of the SEC is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[285] However, the financial crisis—of which the *Citigroup* case was a contributing factor—shows that there are more victims than just the sophisticated institutional investors who made bad investment decisions.[286] Perhaps Mr. Brendler best states the public's sentiments when he says, "Wall Street's actions hurt all of us and we badly need a watchdog who will rein them in."[287]

Certainly public outcry to punish corporations and their executives has been thunderous— particularly in light of the recent financial crisis[288]—and while the idea of punishing a legal fiction may seem appealing to most of the public,[289] one only has to look to the specter of *Arthur Andersen* to remember the consequences at stake. As mentioned earlier, legal scholarship has begun to question the efficacy of criminally prosecuting a corporation, and the increased use of DPAs and NPAs—with the requisite imposition of compliance and/or

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[283] *Id.* (quotation omitted).

[284] *Id.*

[285] *About The SEC*, U.S. Sec. & Exch. Comm'n., http://www.sec.gov/about/whatwedo.shtml (last visited Mar. 9, 2013).

[286] Two of the investors who suffered losses as a result of the Citigroup fund were bond insurer Ambec Financial Group and Koch Global Capital, an investment vehicle owned by the billionaire Koch brothers. *See* Lattman, *supra* note 277.

[287] *Id.* at 280. Mr. Brendler, who lives in Patterson, N.Y. was laid off in 2009 and at the time of the trial was still looking for full-time work. *Id.*

[288] *See* Protess & Scott, *supra* note 23 ("[T]he public is still simmering over the dearth of prosecutions of prominent executives involved in the mortgage crisis.").

[289] *See* Lattman, *supra* note 280 ("[Americans] still would be delighted to see the government hold these banks and some of their executives accountable for misconduct during the financial crisis.").

monitoring programs—has gone a long way to mitigate collateral consequences while ensuring "model" corporate conduct.[290] Despite these new tools—which, according to DOJ and SEC officials, have been effective in rooting out, punishing, and remediating corporate misconduct—the public outcry for retribution in the wake of scandal and economic crisis remains palpable.[291] Given the SEC's role in law enforcement is that of a regulator and not of a criminal prosecutor, there are inherent limitations on what the SEC can attain through its prosecutions.[292] As such, when it comes to holding corporations accountable for their wrongdoing, "the SEC will always be weaker than other punishers, regardless of how aggressive its enforcement agents sound in newspaper interviews."[293]

That does not by any means diminish the SEC's role, however. Unlike criminal prosecutors, some laws the SEC enforces do not require the element of scienter.[294] Thus, when financial institutions and/or their employees commit a wrongdoing where scienter cannot be proven, it is the SEC's responsibility to hold those entities responsible before the public. However, given the increasing use of settlements agreements and the comparatively few cases where a

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290 *See* Alschuler, *supra* note 57, at 1359 (arguing that imposing an appropriate compliance and internal monitoring program is a more appropriate means of corporate punishment than indictment and conviction); Hasnas, *supra* note 26, at 1356 (proposing a requirement that for a corporate conviction, prosecutors must establish that an effective compliance and monitoring program was not in place at the time of misconduct).

291 *See* Miriam H. Baer, *Choosing Punishment*, 92 B. U. L. REV. 577, 627 (2012) (noting that the general public has shown an increased desire to hold corporations accountable for the harms they have caused, and when corporate crises and losses arise, demands for punishment follow).

292 *See id.* at 623 (observing that even though the SEC has recently taken a "retributive turn. . . . [Its] punitive bite is limited substantially by its inability to initiate criminal charges").

293 *Id.*

294 *See* SEC v. Landberg, 836 F. Supp. 2d 148, 153 (S.D.N.Y. 2011) ("The same elements required to establish a section 10(b) violation and a Rule 10b–5 violation suffice to establish a violation under sections 17(a)(1)-(3) of the '33 Act, with the exception that scienter is not required for the SEC to enjoin violations under subsections (a)(2) or (a)(3). The statutory language of section 17(a) is broad and bars any person in the offer of sale of any securities from directly or indirectly employing any device, scheme or artifice to defraud.") (quoting 15 U.S.C. § 77q(a)(1)). *See also* Complaint, at 25, SEC v. Stoker, 2011 WL 4965844 (S.D.N.Y. 2011) (No. 11-CV-7388) (showing how the SEC's case against Brian Stoker was a charge of negligence under Sections 17(a)(2) and (3) of the Securities Act).).

corporation was taken to trial—as well as the corresponding use of "neither admit nor deny" within those agreements—the verdict statement in the *Stoker* trial shows the public sentiment for something, anything, to be done. While criminal remedies such as jail time may not be appropriate, public sentiment is that large corporations can easily pay a fine, install a monitoring system, and go on their merry way.[295] And while some see the imposition of a monitoring system to be particularly onerous,[296] the measures imposed on Citigroup did not seem to change Judge Rakoff's or the jurors' sentiments regarding the SEC's perceived failure to hold Citigroup responsible.[297] Extrapolating from Judge Rakoff's and the jurors' statements, sometimes, in the public eye, more than just a "slap on the wrist" is required for the SEC to effectively hold corporate wrongdoers accountable. When necessary, an "admission" or apology is appropriate.

Before discussing possible options for the SEC, it will help to first consider why an admission or apology may be appropriate when settling an enforcement action with a corporation. As a way to illustrate, the "admission" of Lance Armstrong serves as an example. Lance Armstrong was a seven-time Tour De France champion and an American icon.[298] A cancer survivor, Armstrong came back from the brink of death to dominate the sport of cycling for close to a decade and inspire hope in the hearts of cancer patients, survivors, and their families..[299] Despite Armstrong's incredible success, he was dogged by allegations

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295 *See* Scott Lemieux, *Justice, Deferred*, THE AMERICAN PROSPECT (Dec. 2, 2011), http://prospect.org/article/justice-deferred-0 ("DPAs often allow companies to get away with relatively light penalties, don't provide sufficient disincentives against future lawbreaking, and cause crucial facts to remain hidden from public sight.").

296 *See* Copland, *supra* note 41, at 12 ("[P]rosecutors—well versed in corporate compliance but less so in economics—may be imposing social costs, through DPAs and NPAs, that go well beyond the clear negative impact that such arrangements have on a company's shareholders and employees.").

297 *See* SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011) ("Citigroup was able, without admitting anything, to negotiate a settlement that (a) charges it only with negligence, (b) results in a very modest penalty, (c) imposes the kind of injunctive relief that Citigroup (a recidivist) knew that the S.E.C. had not sought to enforce against any financial institution for at least the last 10 years, . . . and (d) imposes relatively inexpensive prophylactic measures for the next three years.").

298 *See* Juliet Macur, *Armstrong Drops Fight Against Doping Charges*, N.Y. TIMES, Aug. 23, 2012, *available at* http://www.nytimes.com/2012/08/24/sports/cycling/lance-armstrong-ends-fight-against-doping-charges-losing-his-7-tour-de-france-titles.html?pagewanted=all.

299 *See* Richard Sandomir, *Backing, Not Backing Away From, Armstrong*, N.Y. TIMES, Aug. 24, 2012, *available at* http://www.nytimes.com/2012/08/25/sports/cycling/lance-armstrong-retains-support-of-nike-and-other-companies.html.

of blood doping and use of performance-enhancing drugs (PEDs).[300] Passing hundreds, if not thousands of drug tests, Armstrong vehemently maintained his innocence while some of his closest competitors were found to have used PEDs.[301] Seemingly indestructible, Armstrong aggressively pursued those who sought to legitimately question his reputation, at times suing them in private actions for libel or even abusively smearing their character in public.[302] One of these people was Betsy Andreu, the wife of Armstrong's former teammate and friend, Frankie Andreu.[303] Mrs. Andreu and her husband reportedly witnessed Armstrong, who at the time had just been diagnosed with cancer, admit to doctors at an Indiana hospital in 1996 that he had used a number of PEDs.[304] In the years that followed, as Armstrong maintained his innocence in the face of multiple doping allegations, Mrs. Andreu refused to take the code of silence Armstrong expected from his teammates and others associated with his cycling career.[305] Armstrong then launched a bitter attack against Mrs. Andreu, questioning both her sanity and assassinating her character.[306] As a result, Mr. and Mrs. Andreu experienced severe ostracizing from the cycling community, including Mr. Andreu's firing from Armstrong's team for refusing to dope.[307] In the years to come, it became increasingly apparent to Armstrong that he could not maintain his innocence forever, and Armstrong agreed to a "tell-all" interview with Oprah Winfrey in January 2013.[308] In the interview Ms. Winfrey specifically

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300 Macur, *supra* note 298.

301 *See id.*

302 Michael McCann, *Armstrong's Confession to Have Stark, Wide-Reaching Impact*, SPORTS ILLUSTRATED, Jan. 18, 2013,)*available at* http://sportsillustrated.cnn.com/more/news/20130118/lance-armstrong-legal-implications/.

303 *See* Austin Murphy, *Betsy Andreu Always Knew That Lance Armstrong Doped*, SPORTS ILLUSTRATED, Jan. 17, 2013, *available at*http://sportsillustrated.cnn.com/more/news/20130117/betsy-andreu-lance-armstrong/.

304 Juliet Macur, *Confession Falls Several Words Short of Closure*, N.Y. TIMES, Jan. 18, 2013, *available at*http://www.nytimes.com/2013/01/19/sports/cycling/in-armstrong-interview-no-closure-for-andreus.html?pagewanted=1.

305 Murphy, *supra* note 303.

306 *Id.*

307 *See id.*

308 Macur, *supra* note 304.

asked about Armstrong's relationship with Mr. and Mrs. Andreu and a recent phone call he had had with the couple.[309] Armstrong responded that he had not made peace with them, pausing before saying it's because "they've been hurt too badly."[310] Armstrong then elaborated on one part of the phone call with Mrs. Andreu, recalling, "I said listen, I called you crazy. I called you a bitch. I called you all these things. But I never called you fat."[311]

During Armstrong's interview with Ms. Winfrey, Mrs. Andreu was on the set of CNN.[312] Teary-eyed, her immediate response was:

> "If he can't say the hospital room happened, how are we to believe everything else he said?" . . . "I want to believe that Lance wants to come clean, but this is an indication that I can't" . . . "You owed it to me Lance, and you dropped the ball. After what you've done to me and what you've done to my family, and you couldn't own up to it? Now we're supposed to believe you? You had one chance at the truth, and this was it."[313]

Days later, Mrs. Andreu stated in an interview:

> "I was hopeful that he would come completely clean. . . . But when I saw the interview, I couldn't freakin' believe it. He was cherry-picking the truth. I really felt like calling him and saying, you are a moron, you had good intentions and you really screwed everything up. You didn't seem believable at all."[314]

Mr. Andreu added, "The one thing Betsy was waiting for in the interview was for Lance to clear her name, and he didn't do it. . . . It was so disappointing. . . . His apology was actually hollow and shallow without admitting the hospital room incident."[315]

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309 *Id.*

310 *Id.*

311 *Id.*

312 *Id.*

313 *Id.*

314 *Id.*

315 *Id.*

The Armstrong "admission" illustrates that for some victims, particularly where the misconduct is egregious and the damage both severe and far-reaching, an admission or apology goes much further than any monetary fine or compliance and monitoring system. Like the hollowness of Armstrong's apology to Betsy Andreu, settlement agreements without an admission or apology leave some victims particularly empty and angry. No amount of money can restore the years lost to Mrs. Andreu as her and her husband's reputations were destroyed. No injunction against Armstrong can give back to Mrs. Andreu the years she lost with her children as she worried about the decimation Armstrong caused to her family.[316]

Similarly, the losses due to the behavior of Wall Street financial institutions, such as Citigroup, are widespread throughout the global economy, and though the investors within the Citigroup Fund were all sophisticated, the collateral consequences of those losses as a result of Citigroup's misconduct went beyond just those investors. While the SEC and corporations seemingly worry about the collateral consequences to the corporation as a result of an admission of liability, it appears that Judge Rakoff—and certainly the *Stoker* jury—was concerned about the collateral consequences of Citigroup's misconduct on the public: the everyday people who lost jobs, homes, and livelihoods as a result of a decade's worth of speculation. It appears that these types of victims also have a "public interest" in a settlement agreement. Where, in some cases, lives have been ruined as a result of negligent corporate behavior, one must really ask if the public interest is served through "neither admit nor deny" language, particularly when there are "admission" options available that limit collateral consequences to the corporation.[317]

Returning to Judge Rakoff's opinion in the *Citigroup* case, it appears he had these third-party victims in mind when determining whether the settlement

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[316] *See* Murphy, *supra* note 303. In response to the question, "Do you have any sense of what your life might look like if not for the last decade," Mrs. Andreu responded, "Maybe I would've tried to invest my energies in something other than this crap while the kids were at school. I could've spent so much more time with them." *Id.*

[317] The question of the extent of closure the legal system ought to provide to victims is beyond the scope of this comment. At times, the legal system is able to provide a punishment that meets the victim's need for closure, but it is inappropriate for the legal system to attempt to meet a victim's need for closure on a case-by-case basis, particularly with the sheer number of cases handled and the limited budget available for regulators such as the SEC. *See* Bandes, *supra* note 22, at 1606.

agreement was fair, reasonable, and adequate.[318] Statutorily, the SEC is required only to consider the interests of the investor, the maintenance of fair, orderly and efficient markets, and capital formation in determining the public interest in an SEC action.[319] As mentioned earlier, the SEC argued in *Citigroup* that it was the "sole determiner of what is in the public interest in regard to Consent Judgments settling S.E.C. cases."[320] However, Judge Rakoff rejected that argument and made a case for expanding the scope of whom the SEC should consider in determining the public interest in a settlement agreement.[321]

> "As a practical matter . . . the requirement that a consent judgment be in the public interest is not meaningfully severable from the requirements . . . that the consent judgment be fair, reasonable, and adequate; for all these requirements inform each other. For example, before the Court determines whether the proposed Consent Judgment is adequate, it must answer a preliminary question: adequate for what purpose? The answer, at least in part, is that the settlement must be adequate to ensure that the public interest is protected . . . . The same analysis applies to the determination of the fairness of the settlement. Before the Court determines whether the settlement is fair, it must ask a preliminary question: *fair to whom*?[322]

Judge Rakoff then answered the question by stating that the agreement must be "fair to the parties *and* to the public."[323] Judge Rakoff clearly believed the settlement agreement was fair to the SEC and Citigroup, yet he expanded the scope of consideration by refusing to "equate" the "successful resolution" of the SEC's and Citigroup's "competing interests" with the resolution of the public

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[318] SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 331–32 (S.D.N.Y. 2011).

[319] According to Section 2(b) of the Securities Act of 1933, only the "protection of investors" and promotion of "efficiency, competition, and capital formation" are required considerations for the SEC in determining whether an action is "necessary or appropriate in the public interest." 15 U.S.C. § 77b(b) (2012).

[320] *Citigroup*, 827 F. Supp. 2d at 331.

[321] *Id.* at 331–32.

[322] *Id.* (emphasis added).

[323] *Id.* at 332.

interest.[324] In doing this, Judge Rakoff has made a strong case to broaden the standard of review of settlement agreements to include not just the investor's interests, but the interests of the public at large as well.

Absent Congressional expansion of what the SEC is required to consider in determining whether an action is within the public interest, there are several other options available to the SEC. John C. Coffee, Jr., of Columbia University Law School, recommends three of them.[325] First, the SEC could craft the language in such a way where there is an "admission" but not to the extent that would trigger collateral estoppel.[326]

> For example, the admissions made by the defendants in the *Bank of America* and *Goldman Sachs* cases neither conceded materiality nor scienter. Apologizing for a "mistake" (as in *Goldman Sachs*) does not imply that the mistake was made with scienter. Moreover, because the SEC typically and increasingly sues major defendants based on § 17(a)(2) and (3) of the Securities Act of 1933, which does not require proof of scienter, the settlement of such a negligence-based cause of action would not collaterally estop the defendant in resisting a scienter-based cause of action under Rule 10b-5. No private cause of action even exists under § 17(a), and hence a settlement based on it has no direct impact on the defendant's potential private liability (except to the extent material omissions are acknowledged, which might suffice for § 11 cases).[327]

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[324] *Id.* at 335.

[325] Coffee, *supra* note 163.

[326] *See Id.*

[327] *Id.*

Similarly to the "acknowledg[ing] . . . a mistake" admission in *Goldman Sachs*,[328] there are other examples of "admissions" the SEC has used within its settlement agreements. In *Bank of America*, the defendant "acknowledge[d] that there is an evidentiary basis for the statements in the Statement of Facts" while simultaneously maintaining the position that their acknowledgement was "not an admission as to the truth of any such statements or any inferences or legal conclusions based on such statements."[329] Additionally, the consent judgment stated that the defendant's "acknowledgement does not bind [it] to such statements or any inferences or legal conclusions based on such statements in any other litigation or proceeding."[330] As mentioned earlier in this article, in the Tenaris and Amish Helping Fund DPAs, both corporations "offered to accept responsibility for [their] conduct and to not contest or contradict the factual statements" while maintaining the ability to deny the factual statements within the agreement in later litigation in which the SEC is not a party.[331] What these four settlement agreements illustrate is that it is very well possible for the SEC to settle a corporate enforcement action with an "admission" while limiting collateral consequences to the company. This option strongly considers the public interest in a full disclosure of the facts within the document as well as an acknowledgment of or an apology for the misconduct that was done.

Professor Coffee's second option is exactly what the SEC has done with Judge Rakoff's ruling: either take the corporation to trial or appeal the judge's decision.[332] The result of that option is still unresolved as we wait for the Second Circuit's decision. The third option is for the SEC to settle with defendants for monetary damages and not seek injunctive relief from the courts.[333] In this line of thinking, the SEC could use DPAs and NPAs as settlement options, while possibly negotiating even higher monetary penalties, as many corporations would likely be willing to pay an additional amount so as not to be enjoined.[334] Given

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328 Consent Judgment, SEC v. Goldman Sachs & Co., No. 10-CV-3229 (BSJ), 2010 WL 2779309, at *2 (S.D.N.Y. 2010).

329 Consent Judgment, SEC v. Bank of America Corp., Nos. 09-CV-6829 (JSR), 10-CV-0215 (JSR), 2010 WL 430122, at *14 (S.D.N.Y. 2010).

330 *Id.*

331 Deferred Prosecution Agreement—Tenaris, S.A., U.S. Sec. & Exch. Comm'n (May 17, 2011); Deferred Prosecution Agreement—Amish Helping Fund, U.S. Sec. & Exch. Comm'n (July 17, 2010).

332 Coffee, *supra* note 163.

333 *Id.*

334 *Id.*

the SEC's unwillingness to pursue contempt actions against corporate defendants subject to injunctions, Professor Coffee questions whether injunctive relief is even all that important to the SEC.[335] However, while this option may very well settle the SEC's problem in getting federal district judges to approve their settlements, it still does not solve the "public interest" problem they face due to lack of "admissions."

A fourth option I would like to propose is requiring the use of victim impact statements, which are procedurally used at sentencing within the criminal court system as part of certain SEC settlement agreements. Under 18 U.S.C. § 3771(a)(4), a crime victim has the "right to be reasonably heard at any public proceeding in the district court involving release, plea, sentencing, or any parole proceeding."[336] While it is the prosecutor's duty to represent the people at trial, the prosecutor was not personally affected by the criminal conduct, and may not be fully aware of or able to represent the price the victim has paid.[337]

The justification for victim impact statements is fourfold. First, victim impact statements provide information about the full harm of the defendant's crime to the judge or jury—the sentencer—so that a proper sentence can be determined.[338] Second, victim impact statements provide a means of closure to the victim, as they are given the opportunity for participation and input within the legal proceeding.[339] Third, victim impact statements help a defendant understand and gain empathy toward the victim and thus may serve as the first step towards the defendant's rehabilitation.[340] Fourth, victim impact statements provide a sense of fairness in the overall process of sentencing.[341] At sentencing, while the prosecutor is heard, and the defendants and her supporting witnesses are heard, it seems only fair that the victim—the one who bore the brunt of the defendant's wrongdoing—should also be heard.[342]

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335 *Id.*

336 18 U.S.C. § 3771 (2009).

337 Cassell, *supra* note 22, at 613.

338 *Id.* at 620.

339 *Id.* at 622.

340 *Id.* at 623.

341 *Id.* at 624.

342 *Id.*

Granted, an SEC enforcement action is a civil action and not a criminal action, but given the reluctance to criminally prosecute a corporation since Arthur Andersen, and the adoption of DOJ tools by the SEC to aid in their enforcement actions, the SEC has become the main watchdog of a significant portion of corporate America with respect to misconduct in financial reporting and related issues. If this is truly a reality, and the SEC continues to settle the vast majority of their cases using settlement agreements, the question arises whether an entire swath of the public interest will ever be considered in an SEC enforcement action. Up until now, the SEC has made unambiguous that the public interest considered within their settlement agreements is solely that of the investor. But what the Great Recession has made apparent is that there are collateral consequences beyond the losses suffered by sophisticated institutional investors, particularly when those institutional investors are managing pension and retirement funds of everyday Americans.[343] Like a prosecutor in a criminal case, the enforcement staff has not personally experienced the consequences of the victims' losses, and thus, may not be fully aware of or even be able to represent the price the victims have paid. In those cases, permitting a corporation to settle an SEC enforcement action without considering third-party victims or the extent of harm caused by the corporation's misconduct beyond the monetary amount of the direct investors' losses would effectively turn a blind eye to those third-parties that may have lost the most.[344] This solution could be accomplished by either amending federal law requiring victim impact statements be a part of any SEC settlement agreement or on a case-by-case basis to be determined by the court. Granted, this option would mean more work for the SEC, as they would likely be the party required to solicit victim impact statements, and it may be infrequent as

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[343] *See* Press Release, *Pew Study Finds 61 Cities' Retirement Systems Face $217 Billion Gap*,, THE PEW CHARITABLE TRUSTS (Jan. 15, 2013),http://www.pewstates.org/news-room/press-releases/pew-study-finds-61-cities-retirement-systems-face-217-billion-gap-85899442677) (attributing some of the losses to pension funds to the Great Recession); Jill Schlesinger, *A Real Retirement Plan Crisis*, MONEYWATCH (May 15, 2012), http://www.cbsnews.com/8301-505146_162-57434873/a-real-retirement-plan-crisis/ (reporting that retirement accounts lost a third of their value due to the recession and market crash).

[344] In contemplation of Bernard Madoff's sentencing hearing in perpetrating a $50 billion Ponzi scheme, prosecutors submitted 113 victim impact statements to Federal District Judge Denny Chin. Of those victims, nine made oral statements at the hearing. Upon Judge Chin's sentencing of Mr. Madoff to 150 years in prison, the victims present at the hearing briefly applauded and cheered. *See* Letter from Lev. L. Dassin, Acting U.S. Attorney, S.D.N.Y., to Hon. Denny Chin, U.S. District Judge, S.D.N.Y. (Jun. 12, 2009), (available at http://graphics8.nytimes.com/images/blogs/dealbook/madoff_victims_impact.PDF); Diana B. Henriques, *Madoff Is Sentenced to 150 Years for Ponzi Scheme*, N.Y. TIMES, Jun. 29, 2009, *available at* http://www.nytimes.com/2009/06/30/business/30madoff.html?ref=bernardlmadoff&_r=0.

the harm done would have to be particularly egregious, severe and far-reaching. But where a corporation seeks to neither admit nor apologize in a settlement agreement for corporate wrongdoing that has had severe, far-reaching consequences, the public interest at large must also be considered prior to execution of the agreement. Perhaps this is what Judge Rakoff was alluding to when he wrote:

> [I]n any case like this that touches on the transparency of financial markets whose gyrations have so depressed our economy and debilitated our lives, there is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the S.E.C., of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerge; and if it fails to do so, this Court must not in the name of deference or convenience, grant judicial enforcement to the agency's contrivances.[345]

While the use of victim impact statements within a settlement agreement generates a number of procedural questions, from a policy perspective, it is another means to air the truth of the corporation's misconduct, provide closure to third-party victims, and ensure that the settlement agreement truly is within the public interest at large.

IV. CONCLUSION

In this comment, I have discussed the changing face of corporate prosecutions over the past 15 years as well as the SEC's recent adoption of new prosecutorial tools—namely DPAs and NPAs—that enhance their enforcement efforts. Given the SEC's intention to increase their use of these DPAs and NPAs, there is an increased probability that the truth of corporate misconduct may never be fully known, as these settlement agreements generally allow a defendant to "neither admit nor deny" the appended Statement of Facts. It is

[345] SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

exactly because the truth of the corporate misconduct may be swept under the rug that federal district court judges and the public at large have become so critical of recent SEC settlement agreements. Even with the SEC's policy change to no longer use "neither admit nor deny" language where there is a parallel criminal prosecution, reform is still needed. It is in circumstances where the conduct of the corporation is particularly egregious—and the resulting impact on certain types of victims is both severe and far-reaching—that the public interest, beyond the investors, must be considered within SEC settlement agreements. This article has posed two options which address this concern: acknowledge negligence and apologize within the document while simultaneously preserving the corporation's right to deny the allegations in later private actions, or use victim impact statements as a way to reveal the harm of the corporation's actions, determine whether an admission or apology is appropriate under the circumstances, and ensure that the settlement agreement is within the public interest at large. In those circumstances where victim impact statements are deemed appropriate, they not only aid in disclosing the full extent of the corporation's misconduct, but they also provide a means of closure to the public at large, something that is largely missing in the wake of the financial crisis and Great Recession.