Neither Admit Nor Deny: Recent Changes to the Securities and Exchange Commission's Longstanding Settlement Policy

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I. INTRODUCTION

On June 4, 2014, the Second Circuit Court of Appeals issued a long-awaited ruling in *SEC v. Citigroup Global Markets, Inc.* (*Citigroup III*).[1] The decision finally ended a

* I thank my wife Laura who, despite my frequent foolishness, has given me her unconditional love, undying affection and never-ending support. To my three sons—Travis, Zackary, and Joseph—you are my greatest affection; only through your success may I dare speak the words: "I have not lived in vain!"

1. SEC v. Citigroup Global Mkts., 752 F.3d 285, 298 (2d Cir. 2014) [hereinafter *Citigroup III*].

contentious line of cases[2] which pitted the tenacious Federal District Court Judge Jed S. Rakoff against the venerated Securities and Exchange Commission (SEC or Commission). Even though the SEC ostensibly prevailed in *Citigroup III*, in many ways Judge Rakoff had already won.[3] On June 17, 2013, prior to the Second Circuit's decision and largely in response to Judge Rakoff's criticisms, the SEC announced a change to its long-standing "neither admit nor deny" (NAND) settlement policy.[4] The change expanded the categories and circumstances of cases in which the SEC would demand admissions from defendants.[5] The change is the most significant since the SEC officially adopted NAND in 1972.[6]

The first signs of Judge Rakoff's displeasure with NAND settlements emerged in *SEC v. Bank of America (Bank of America I)*.[7] In August of 2009, the SEC filed a complaint alleging that Bank of America made false statements to garner investor support for a $50 billion merger with Merrill Lynch.[8] The SEC claimed that Bank of America issued a proxy statement reporting that Bank of America would not issue performance bonuses for Merrill Lynch executives prior to the closing of the merger without Bank of America approval.[9] In fact, Bank of America had already approved the payment of $5.8 billion in performance bonuses to Merrill Lynch executives.[10] The SEC's proposed NAND consent decree[11] called for Bank of America to pay a $33 million fine and refrain "from making future false statements in proxy [statements]."[12]

Judge Rakoff found the SEC's proposed NAND settlement unacceptable for at least three reasons. First, the victims—Bank of America's shareholders who had been misled to the tune of $5.8 billion—would pay a $33 million fine as a penalty for their own victimization.[13] He questioned why the SEC did not seek a penalty against the lawyers who drafted the proxy statements instead.[14]

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2. *See infra* Part III.A (discussing Judge Rakoff's scrutiny of NAND settlements).

3. *See* John C. Coffee, Jr., *'Neither Admit Nor Deny': Practical Implications of SEC's New Policy*, N.Y. L.J. (July 18, 2013), http://www.newyorklawjournal.com/PubArticleNY.jsp?id=1202611288235&slreturn=20130925154105 (noting that "[Judge] Rakoff has effectively won the war, even if he loses the . . . battle," because the SEC has already capitulated by changing its neither admit nor deny settlement policy).

4. *See* James B. Stewart, *S.E.C. Has a Message for Firms Not Used to Admitting Guilt*, N.Y. TIMES (June 21, 2013), http://www.nytimes.com/2013/06/22/business/secs-new-chief-promises-tougher-line-on-cases.html?_r=0 (describing the changes to the SEC's NAND policy).

5. *See id.* (discussing the particular circumstances in which the SEC may demand admissions under the Agency's revised policy).

6. Consent Decrees in Judicial or Administrative Proceedings, 37 Fed. Reg. 25,224 (Nov. 29, 1972) (codified at 17 C.F.R. § 202.5(e)) (entering the SEC's NAND policy change into the federal register).

7. SEC v. Bank of Am. Corp., 653 F. Supp. 2d 507, 507 (S.D.N.Y. 2009) [hereinafter *Bank of America I*].

8. *Id.* at 508.

9. *Id.*

10. *Id.*

11. The consent decree is an order in which the court "sanctions a *voluntary* agreement between . . . [the] parties." MERRIAM-WEBSTER DICTIONARY, http://www.merriam-webster.com/dictionary/consent%20decree (last visited Jan. 20, 2015) (emphasis added); *see also* Local No. 93, International Ass'n of Firefighters, etc. v. Cleveland, 478 U.S. 501, 519 (1986) (describing consent decrees as having the qualities of both private contracts and judicial orders).

12. *Bank of America I*, 653 F. Supp. 2d at 508.

13. *Id.* at 509.

14. *Id.*

Second, Judge Rakoff criticized one of the key elements of NAND settlements—the SEC's request for injunctive relief.[15] Bank of America submitted statements to the court claiming that the allegedly false proxy statement was "totally in accordance with the law."[16] Given Bank of America's position that the proxy statements were lawful, Judge Rakoff called injunctive relief "pointless."[17] If the defendant believed the statements were lawful, and if there were no finding of fact to the contrary, it made no sense to enjoin Bank of America from making similar lawful statements, which it would be free to make again in the future.[18]

Judge Rakoff concluded by pointing to what he called a "cynical relationship" between the SEC and Bank of America.[19] A relationship where the parties were willing to shift the burden of the defendant's alleged wrongdoing to the victim-shareholders, and where the SEC would claim a hollow victory (a NAND settlement) at the "expense . . . of the truth."[20] He then denied the consent decree, set a trial date, and told the parties to prepare to litigate the case.[21]

Later, in *SEC v. Bank of America* (*Bank of America II*),[22] Judge Rakoff begrudgingly approved a revised consent decree which addressed some of the concerns he expressed in *Bank of America I*,[23] but he called the final result "half-baked justice at best."[24] Judge Rakoff stated that if he were considering the case *de novo*, he "would reject the settlement as inadequate and misguided."[25] Although Judge Rakoff did not directly criticize NAND settlements in *Bank of America I* or *II*, these cases set the tone for a clash that would culminate in the SEC's changes to its NAND regime.

This Note explores the history and legacy of NAND settlements, the likely motives for the SEC's recent changes to its NAND policy, the potential short- and long-term effects of the changes, and recommends further policy measures that the SEC may adopt to alleviate public and judicial scrutiny of NAND. This Note has four parts. Part II examines the history and purpose of NAND settlements and the reasons the SEC adopted the regime. Part III describes the newly adopted changes to NAND and explores some of the criticisms of NAND, especially the strong rebukes the Commission has received from the courts. Part IV recommends three additional enforcement policy changes that the SEC should adopt to build on its recent changes to NAND. Finally, Part V looks at the possible ramifications of the SEC's changes to its NAND policy.

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15. *Id.* at 512; *see infra* Part II.B (discussing the composition of most NAND settlements).

16. *Bank of America I*, 653 F. Supp. 2d at 511.

17. *Id.*

18. *Id.*

19. *See id.* at 512 ("[The] S.E.C. gets to claim that it is exposing wrongdoing on the part of the Bank of America in a high-profile merger; the Bank's management 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.").

20. *Id.*

21. *Bank of America I*, 653 F. Supp. 2d at 512.

22. SEC v. Bank of Am. Corp., Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 624581 (S.D.N.Y. Feb. 22, 2010) [hereinafter *Bank of America II*].

23. Judge Rakoff's approval seemed to turn on the SEC's inclusion of a more robust and accurate statement of the stipulated facts, making it clear to the court what wrongdoing the SEC alleged Bank of America committed. *Id.* at *1.

24. *Id.* at *5.

25. *Id.* at *6.

II. BACKGROUND

The SEC has *officially*[26] used NAND settlements since the early 1970s when the Commission entered the practice into the Federal Register.[27] SEC NAND settlements, like many other civil settlements, typically require defendants to pay a penalty and return ill-gotten gains with interest.[28] However, unlike many other civil settlements,[29] NAND settlements allow the defendant to settle without admitting or denying the allegations of the complaint.[30]

NAND settlements yield valuable benefits to harmed investors, defendants and the SEC.[31] NAND settlements allow both the SEC and defendants to avoid costly, time-consuming, and unpredictable litigation.[32] NAND settlements also benefit defendants by minimizing their exposure to future class action suits and sparing them the public spectacle of a trial.[33] On the other hand, NAND settlements benefit investors by efficiently punishing wrongdoers and quickly returning investor funds.[34] Finally, NAND settlements benefit the SEC by allowing it to conserve limited resources and pursue a greater number of violations.[35]

A. Development of NAND

On November 29, 1972, the SEC announced a policy change that would form the foundation of its settlement regime for more than four decades.[36] The policy change stated that the Commission would no longer:

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26. The practice of NAND settlements predates the SEC's official adoption of the policy. *See, e.g.*, *Rye Man Barred From Trading in Cherry-Burrell, Other Stock*, N.Y. TIMES, Dec. 24, 1959, at 27 (describing a case in which the defendant had artificially inflated the share price of a company and settled without admitting or denying the allegations of the complaint); *see also* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011) (noting that the practice of entering consent decrees in which defendants neither admit nor deny wrongdoing started long before 1972).

27. Consent Decrees in Judicial or Administrative Proceedings, *supra* note 6.

28. *See infra* note 46 and accompanying text (describing the typical construction of an SEC NAND settlement).

29. *See infra* note 169 and accompanying text (discussing the Department of Justice's near complete rejection of NAND settlements).

30. *See Vitesse*, 771 F. Supp. 2d at 308 (discussing that purpose of NAND settlements).

31. *See infra* Part II (discussing the perceived benefits of NAND).

32. *See* SEC Enforcement Director's Statement on Citigroup Case, Release No. 2011-265 (Dec. 15, 2011), http://www.sec.gov/news/press/2011/2011-265.htm (discussing the risks associated with litigation); *see also* Ross MacDonald, Note, *Setting Examples, Not Settling: Toward a New SEC Enforcement Paradigm*, 91 TEX. L. REV. 419, 427–29 (2012) (describing the roughly equal damages that may be achieved through either settlement or litigation).

33. SEC v. Citigroup Global Markets, Inc., 752 F.3d 285, 295 (2d Cir. 2014) ("Consent decrees provide parties with a means to manage risk.").

34. *See* MacDonald, *supra* note 32, at 435 (explaining that the SEC has the power to recoup penalties on behalf of private parties) (citing David M. Becker, *What More Can be Done to Deter Violations of the Federal Securities Laws?*, 90 TEX. L. REV. 1849, 1852–53 (2012)).

35. SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 165 (2d Cir. 2012) [hereinafter *Citigroup II*] (criticizing the lower court for not considering "the [SEC]'s discretionary assessment of its prospects of doing better or worse, or of the optimal allocation of its limited resources").

36. Consent Decrees in Judicial or Administrative Proceedings, *supra* note 6; *see* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011) (recounting the history of the SEC's neither admit nor deny policy which was implemented in 1972).

> [P]ermit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint . . . . In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.[37]

The settlement regime became known generally as "neither admit nor deny."

The Commission had settled cases on the basis of NAND long before 1972.[38] However, the SEC's pre-1972 settlement regime did not bar defendants from publicly declaring that they were innocent and settled only to avoid costly litigation.[39] Such post-settlement declarations of innocence made a mockery of the judicial process and embarrassed the SEC.[40]

The SEC made a critical change to correct this discrepancy. Beginning in 1972, the SEC took advantage of the court's injunctive powers and incorporated language into its proposed consent decrees which enjoined defendants from *publicly* denying, directly or indirectly, the allegations of the complaint.[41] The Commission would no longer allow defendants to remain silent in court while loudly proclaiming their innocence in public.[42] Under this revised framework, the parties were able to maintain most of the positive aspects of NAND, and the SEC achieved the face-saving benefit of muted[43] post-settlement declarations of innocence from defendants.[44]

B. Composition of NAND Settlements

NAND settlements are the SEC's most commonly used enforcement tool by an overwhelming margin. The SEC settled approximately 97% of the cases it brought in Fiscal

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37. 17 C.F.R. § 202.5(e) (2008).

38. *See, e.g.*, *Rye Man Barred From Trading in Cherry-Burrell, Other Stock*, *supra* note 26 (describing a 1959 case in which the SEC settled with a defendant on the basis of NAND); *see also, e.g.*, Terry Robards, *Bank and Broker Accused by S.E.C.: National City and Merrill Lynch Agree to Put End to Investment Unit*, N.Y. TIMES, Feb. 7, 1970, at 52 (describing a 1970 case in which the SEC settled with a defendant on the basis of NAND).

39. *See Vitesse*, 771 F. Supp. 2d at 308 (describing the actions of defendants who settled with the SEC and then publicly deny any wrongdoing); *see, e.g.*, Robards, *supra* note 38 (reporting a case in which Merrill Lynch settled with the SEC without admitting or denying the allegations of the complaint and where the defendants issued a press release stating: "We believe the [C]ommission's claims have no validity and we have denied them. However, in order to avoid lengthy litigation, we have agreed [to the terms of the settlement]").

40. *See Vitesse*, 771 F. Supp. 2d at 308–09 (describing the SEC's attempt to stop defendants from settling on the basis of NAND and then publicly denying any wrongdoing).

41. *See id.* (describing the SEC's use of court authority to enjoin defendants from post-settlement declarations of innocence). The terms of SEC consent decrees contain "an express prohibition against making 'any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the Complaint is without factual basis.'" Joseph A. Grundfest Aff. ¶12, *SEC v. Bank of America Corp.*, 653 F. Supp. 2d 507 (S.D.N.Y. 2009) (No. 09-CV-6829 JSR), 2009 WL 2912392.

42. *See* 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 13 (describing the SEC's view of "silence" as an "implicit denial" of the allegations of the complaint).

43. *See Vitesse*, 771 F. Supp. 2d at 308 (noting that while defendants are enjoined from publicly denying the SEC's allegations, the defendant's "supporters" are under no such constraint).

44. *See* Robards, *supra* note 38 (describing a 1970 case where Merrill Lynch settled a case with the SEC and then publicly denied the allegations of the complaint).

Year 2012, compared to 91% in Fiscal Year 2011.[45] The typical NAND consent decree consists of three parts: (1) a permanent injunction from violations of securities laws; (2) disgorgement of any gains the defendant(s) received from the alleged violation(s), with interest; and (3) a civil penalty.[46] After 1972, the SEC also attached a "formal written 'Consent' of the defendant" not to deny the allegations of the complaint.[47]

In a typical scenario, the SEC and defendant privately negotiate the provisions of the proposed consent decree before the SEC files the complaint.[48] In fact, the SEC often files the complaint and proposed consent decree on the same day.[49] The SEC lays out the facts of the alleged misconduct in the complaint and then tells the court what the agency believes is an appropriate remedy in the proposed consent decree.

Judges normally give considerable deference to the SEC, and approve proposed consent decrees with little scrutiny.[50] However, when an agency asks for injunctive relief, the court must apply additional scrutiny.[51] The court reviews the proposed consent decree to determine whether it is fair, reasonable, and serves the public interest.[52]

C. Why Does the SEC Use NAND Settlements?

It is no accident that NAND settlements are the most popular tool the SEC uses to resolve enforcement actions.[53] While consent decrees are undoubtedly the product of

45. *See* U.S. SECURITIES & EXCHANGE COMMISSION, SELECT SEC AND MARKET DATA 2012, 3 (2012), *available at* http://www.sec.gov/about/secstats2012.pdf (reporting that the SEC brought 734 enforcement actions in FY 2012, compared to 735 in FY 2011); *see also* ELAINE BUCKBERG ET AL., NERA ECON. CONSULTING, SEC SETTLEMENT TRENDS: 2H12 UPDATE 1 (2013), *available at* http://www.nera.com/content/dam/nera/publications/archive2/PUB_SEC_Trends_Update_2H12_0113_final.pdf (reporting that the SEC settled 714 of the actions it brought in the fiscal year 2012, compared to 670 in in the fiscal year 2011).

46. *See, e.g.*, SEC v. Vitesse Semiconductor Corp., Litigation Release No. 22825 (Sept. 27, 2013), *available at* http://www.sec.gov/litigation/litreleases/2013/lr22825.htm (describing the consent decree in *Vitesse*); *see also* 15 U.S.C. § 77t(d) (2013) (outlining the SEC's three-tier system of civil penalties) [hereinafter *Vitesse* Litigation Release].

47. *See Vitesse*, 771 F. Supp. 2d at 309–10 (discussing the development of the SEC's policy disallowing defendants from publicly denying the allegations of the complaint). Depending on the nature of the alleged violation, the SEC's proposed consent decree may also temporarily or permanently bar the defendant from serving as an officer or director of a public company, or from practicing before the Commission as an attorney, accountant, stockbroker, or dealer. *See, e.g.*, *Vitesse* Litigation Release (describing the *Vitesse* consent decree).

48. *See infra* note 169 and accompanying text (describing Judge Rakoff's and other commentators' criticisms of the SEC's practice of negotiating consent decrees with defendants before the complaint is filed).

49. *See, e.g.*, SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 330 (S.D.N.Y. 2011) [hereinafter *Citigroup I*] (criticizing the SEC's practice of simultaneously filing the complaint and proposed consent decree); *see also* Coffee, *supra* note 3 ("Typically, on the same day, a complaint, an answer and a stipulation of settlement are filed in a federal district court . . . .").

50. *See* Reckler & Denton, *supra* note 42, at 13–14 (discussing the role of judges in approving consent judgments); *see also* Coffee, *supra* note 3 (stating that courts normally "grant[] the requested injunction after only a cursory review").

51. *See Bank of America I*, 653 F. Supp. 2d. at 508 (citing SEC v. Randolph, 736 F.2d 525, 529 (9th Cir. 1984) and SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991)) ("When . . . a federal agency . . . seeks to prospectively invoke the Court's own contempt power by having the Court impose injunctive prohibitions against the defendant . . . the Court is . . . obliged to review the proposal a little more closely . . . .").

52. *See* Citigroup III, 752 F.3d 285, 294 (2d Cir. 2014) (clarifying the standard of review for proposed consent judgments and rejecting the requirement that the consent decree be adequate).

53. *See supra* note 45 (examining the proportion of cases the SEC resolves through settlement).

lengthy investigations and tough negotiations, the mostly private nature of their creation makes them particularly attractive to both parties who are able to reach a relatively quick resolution to their dispute with little public scrutiny.[54] For the Commission, there are three overarching policy goals that form the foundation of NAND: (1) avoid litigation risk; (2) increase efficiency and conserve resources; and (3) deter future wrongdoing.[55]

1. NAND Settlements Reduce Litigation Risk

Litigation involves a considerable amount of risk. For the SEC, NAND's principal goals are to resolve enforcement actions without the risk of going to trial and losing, or winning at trial and receiving a smaller amount than the SEC could have obtained through settlement.[56] If the Commission can achieve a reasonable outcome without exposing itself to the risk of losing at trial, the choice to settle often boils down to a simple cost-benefit analysis[57]—the balance overwhelmingly favors settlement.[58] Furthermore, injunctions allow the SEC to gain quick relief for future securities laws violations by the same offender without the labor and expense of engaging in new litigation.[59]

2. NAND Increases Efficiency and Conserves Resources

Litigation is expensive. Defendants who see costly litigation as the "best alternative to a negotiated agreement"[60] have a powerful incentive to cooperate. The Commission, together with a cooperative defendant, can resolve cases more quickly through settlement than litigation. For this reason, NAND settlements enable the SEC to return funds to investors more quickly.[61] Furthermore, relatively low-cost NAND settlements allow the SEC to apply its finite resources to a greater number of enforcement actions.[62]

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54. Ghillaine A. Reid, *An Uncertain Future for "Neither Admit nor Deny" Settlements*, AMERICAN BAR ASSOCIATION (May 10, 2012), http://apps.americanbar.org/litigation/committees/securities/email/spring2012/spring2012-0512-uncertain-future-neither-admit-nor-deny-settlements.html.

55. *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. on Fin. Serv.*, 112th Cong. 75–76 (2012) (statement of Robert Khuzami, Director of the Division of Enforcement, U.S. Securities and Exchange Commission), *available at* http://financialservices.house.gov/uploadedfiles/112-128.pdf (describing NAND's policy goals).

56. SEC Enforcement Director's Statement on Citigroup Case, Release No. 2011-265 (Dec. 15, 2011), *available at* http://www.sec.gov/news/press/2011/2011-265.htm.

57. *See* David M. Becker, *What More can be Done to Deter Violations of the Federal Securities Laws?*, 90 TEX. L. REV. 1849, 1852–53 (2012) (describing the sanctions the SEC recommends in settlement as being roughly equal to or more than what it expects to receive at trial); *see also* MacDonald, *supra* note 32, at 427 (describing the "equal damages" that may be achieved through either settlement or litigation).

58. *See supra* note 45 (examining the percentage of cases the SEC resolves through settlement).

59. Howard Sklar, *I Cannot Tell a Lie: I Neither Admit nor Deny I Chopped Down the Cherry Tree*, FORBES (Jan. 4, 2012), http://www.forbes.com/sites/howardsklar/2012/01/04/i-cannot-tell-a-lie-i-neither-admit-nor-deny-i-chopped-down-the-cherry-tree.

60. "Best Alternative to a Negotiated Agreement or BATNA is the course of action that will be taken by a party if the current negotiations fail and an agreement cannot be reached." *Best Alternative to a Negotiated Agreement*, WIKIPEDIA, http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement (last visited Mar. 27, 2015).

61. Jaclyn Jaeger, *SEC's New 'Fess Up' Policy Comes with Legal Consequences*, COMPLIANCE WEEK (Sept. 2013)..

62. *Id.*

3. NAND Deters Future Wrongdoing

Deterrence is one of the primary objectives of SEC enforcement actions. The SEC uses NAND settlements to deter future misconduct in at least three ways: (1) by imposing "appropriate sanctions";[63] (2) by barring defendants from engaging in actions that "place investors at risk";[64] and (3) by "achieving corporate reform and other relief calculated to prevent future violations."[65] Deterrence of wrongdoing is an important goal for the SEC and one of the basic aims of NAND settlements.

III. ANALYSIS

Since its inception, many have criticized the SEC's NAND policy.[66] However, until recently, the critics were unable to garner enough public support to force a change.[67] The Financial Crisis, coupled with widespread scrutiny from courts, politicians, and the public, put pronounced pressure on the SEC to revise its NAND policy.[68]

A. Pressure to Change NAND

The Financial Crisis put great pressure on the SEC to reform its enforcement regime. Critics often cite deregulation,[69] Wall Street's focus on short-term gains,[70] and widespread fraud[71] as the root causes of the Financial Crisis. Ultimately, these explanations are too

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63. *Id.*

64. *Id.*

65. *Id.*; *see, e.g.*, *supra* note 47 (describing the SEC's use of NAND settlements to bar defendants from engaging in certain activities in the future).

66. *See* Michael C. Jensen, *Light Penalty for White-Collar Crime: Problem of Privilege Underlined in Four Seasons*, N.Y. TIMES, Jan. 22, 1973, at 37 (lamenting several cases where the SEC gave defendants very minimal punishment for securities violations on the basis of neither admit nor deny); *see also Examining Settlement Practices of U.S. Financial Regulators Before the H. Comm. on Fin. Serv.*, 112th Cong. 2 (2012) (testimony of Bill Galvin, Secretary of the Commonwealth and Chief Securities Regulator of Massachusetts), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-112-ba00-wstate-wgalvin-20120517.pdf (testifying that he warned Congress in 2003 that: "too often the guilty neither admit or deny any wrongdoing and routinely promise not to cheat again until they can come up with a more clever method to do what they just said they would not do again"; and stating that neither admit nor deny settlements allow wrongdoers to avoid "basic culpability").

67. *See* Stewart, *supra* note 4 (describing the changes to the SEC's NAND policy).

68. *Infra* Part III.A.

69. *See* Stephen Labaton, *S.E.C. Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES, Sept. 27, 2008, at A1 (describing comments made by then SEC Chairman Christopher Cox conceding that flawed oversight contributed the collapse of Bear Sterns and the Financial Crisis); s*ee also* John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 737 (2012) (describing the SEC's attempt to regulate the big investment banks through the CSE program as a way to compensate for Congress' efforts to deregulate).

70. *See* THE FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 64 (2011) *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf [hereinafter FINANCIAL CRISIS REPORT] ("The crisis has shown that most financial-institution compensation systems were not properly linked to risk management. Formula-driven compensation allows high short-term profits to be translated into generous bonus payments, without regard to any longer-term risks.").

71. *See* Suzanne McGee, *5 Years After the Crisis: Blame Washington or Wall Street?*, THE FISCAL TIMES (Sept. 16, 2013), http://www.thefiscaltimes.com/Columns/2013/09/16/5-Years-After-Crisis-Blame-Washington-

Wall Street-centric and fail to recognize the broad range of forces that contributed to the Financial Crisis—including lax mortgage lending standards and credit rating agency failures.[72] However, the fact that the collapse of Bear Sterns (an SEC-regulated entity) sparked the Financial Crisis[73] led many public officials,[74] as well as the media,[75] to blame the SEC.

One of the reasons for the sudden collapse of Bear Stearns was the SEC's flawed Consolidated Supervised Entity (CSE) Program.[76] The CSE Program was an effort by the Commission to better regulate large investment banks.[77] Unfortunately, an unintended consequence of the CSE Program was that it allowed the big investment banks to circumvent the SEC's longstanding "net capital rule," which sets fixed limits on debt-to-equity ratios of broker-dealers.[78] As a result, all five Wall Street investment banks—Bear Sterns, Goldman Sachs, Lehman Brothers, Morgan Stanley, and Merrill Lynch—sharply increased their debt-to-equity ratios after they entered the CSE Program.[79]

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or-Wall-Street#sthash.PfJHEAkG.dpuf (describing Wall Street's role in packaging sub-prime mortgages into collateralized debt obligations which were then sold as "investment grade securities" in hopes that when the truth was discovered and the investments collapsed, Wall Street would not be the one holding the bad paper); *see, e.g.*, SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 329–30 (S.D.N.Y. 2011) (describing the SEC's allegation that Citigroup had created a fund which was loaded with risky assets, took a short position in the fund's underlying assets, and then defrauded investors by misrepresenting that the fund contained high-quality assets).

72. *See* Coffee & Sale, *supra* note 69, at 731–49 (emphasizing the broad range of flawed regulations—or lack thereof—that led to the Financial Crisis); *see generally* FINANCIAL CRISIS REPORT, *supra* note 70 (surveying the range of problems that contributed to the Financial Crisis).

73. *See* Alan Greenspan, *Never Saw It Coming: Why the Financial Crisis Took Economists by Surprise*, FOREIGN AFFAIRS (Nov./Dec. 2013) *available at* http://www.foreignaffairs.com/articles/140161/alan-greenspan/never-saw-it-coming (describing the fall of Bear Sterns as the beginning of what became "possibly the greatest financial crisis in history").

74. *See* SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., REPORT NO. 446-A, SEC'S OVERSIGHT OF BEAR STERNS AND RELATED ENTITIES: THE CONSOLIDATED SUPERVISED ENTITY PROGRAM viii (2008), *available at* http://www.sec.gov/about/oig/Audit/2008/446-a.pdf [hereinafter SEC IG REPORT] ("[U]nder the Commission['s] . . . watch, Bear Stearns suffered significant financial weaknesses and the [Federal Bank of New York] needed to intervene during the week of March 10, 2008, to prevent significant harm to the broader financial system.").

75. *See* Joe Nocera, *Hoping a Hail Mary Pass Connects*, N.Y. TIMES, Sept. 19, 2008, at C1 (discussing the SEC's failure to take swift action to reign in the proliferation of junk mortgage backed securities following the demise of Bear Stearns and the SEC's possible complicity in the crisis in adopting regulations that allowed investment banks to be so highly leveraged); *see, e.g.*, Labaton, *supra* note 69 (describing the failed CSE program which allowed the large investment banks to escape the net capital rule and take on very high leverage).

76. *See* SEC. & EXCH. COMM'N, EXCHANGE ACT RELEASE NO. 34-49830, FINAL RULE: ALTERNATIVE NET CAPITAL REQUIREMENTS FOR BROKER-DEALERS THAT ARE PART OF CONSOLIDATED SUPERVISED ENTITIES (2004), http://www.sec.gov/rules/final/34-49830.htm (implementing Consolidated Supervised Entities (CSE), which allowed more lax capital requirements for certain broker-dealers).

77. *See* Coffee & Sale, *supra* note 69, at 737 (describing the SEC's attempt to regulate the big investment banks through the CSE program as a way to compensate for Congress's efforts to deregulate).

78. *See* 17 C.F.R. § 240.15c3-1 (2013) (placing fixed leverage limits on broker-dealers); *see also* Nicholas Lehmann, *Street Cop*, THE NEW YORKER (Nov. 11, 2013), http://www.newyorker.com/reporting/2013/11/11/131111fa_fact_lemann?currentPage=all (describing the SEC's lax regulatory conditions that allowed big banks to take on more debt).

79. *See* SEC IG REPORT, *supra* note 74, at 120 (providing a chart that shows the large increase in debt-to-equity ratios of the five big investment banks between 2006 and 2008).

High leverage, coupled with risky investments in complex securities, put the big banks in a precarious position, where even modest losses would put them in jeopardy.[80] Bear Sterns was leveraged at 33-to-1 when the markets began to decline in late 2007.[81] By March 2008, Bear Sterns faced a liquidity crisis and was on the verge of bankruptcy.[82] In May 2008, JPMorgan purchased Bear Sterns, and Bear Sterns ceased to exist.[83] The sudden collapse of Bear Sterns sent shockwaves through the markets, lending slowed to a crawl, asset prices rapidly declined, and the Financial Crisis began.[84]

NAND settlements added insult to injury. The consequences for many malefactors—if the SEC prosecuted them at all—were relatively small civil penalties,[85] disgorgement of ill-gotten gains, and an opaque settlement proceeding in which the wrongdoers neither admitted nor denied the SEC's allegations.[86] Furthermore, there was no guarantee the victims would receive the money the SEC recovered from defendants.[87]

The unsavory combination of economic distress, decreasing asset values, seemingly lax regulation, and poor accountability justifiably exposed the SEC and NAND to intense criticism. As noted, some of the most scathing criticism came from the courts—most notably from Judge Rakoff.[88] Many see Judge Rakoff's rejection of the SEC's proposed consent decree in *Citigroup I*[89] as the watershed moment for the Commission's most recent change to its NAND policy.[90]

1. Court Scrutiny of NAND Settlements

Among all of NAND's critics, court scrutiny has arguably played the most significant role in motivating the SEC to change its NAND policy. Judge Rakoff's denial of the SEC's proposed consent judgment in *Citigroup I*[91] has been the most influential. Although the

80. *See id.* at ix (describing the high leverage and heavy concentration of mortgage-backed securities at Bear Sterns as being strong factors to its collapse).

81. *Id.* at 19.

82. *Id.* at 10.

83. *Id.* at 6.

84. *See generally* FINANCIAL CRISIS REPORT, *supra* note 70 (describing the consequences of the Financial Crisis).

85. *See, e.g.*, Citigroup I, 827 F. Supp. 2d 328, 329–30 (S.D.N.Y. 2011) (noting that investors had been defrauded out of approximately $700 million, and the combined civil penalty and fines proposed by the SEC totaled only $285 million).

86. *See Citigroup I,* 827 F. Supp. 2d at 332 (noting the failure of the SEC to provide the public or the court with adequate information about the facts of the underlying dispute in its proposed consent decree).

87. *See id.* at 333–34 (noting that the language of the consent decree stated that the SEC "may" return investor funds to victims).

88. *See supra* Part I and *infra* Part III.A.1. (describing in greater detail Judge Rakoff's controversial decisions regarding SEC NAND settlements).

89. *Citigroup I*, 827 F. Supp. 2d at 332.

90. *See infra* Part III (describing the SEC's recent changes to its NAND settlement policy); *see also* Gregory J. Wallance, *The SEC's New 'Admit Liability' Policy Will Hurt Everyone Except Plaintiff Lawyers*, FORBES (July 3, 2013, 11:18 AM), http://www.forbes.com/sites/forbesleadershipforum/2013/07/03/the-secs-new-admit-liability-policy-will-hurt-everyone-except-plaintiff-lawyers/ (discussing the SEC's decision to change its NAND policy and how it was heavily influenced by Judge Rakoff's ruling in *Citigroup I*). *But see* Stewart, *supra* note 4 (describing Chairwoman White's claim that Judge Rakoff's comments did not precipitate the SEC's change to NAND).

91. *Citigroup I*, 827 F. Supp. 2d at 332.

Second Circuit thoroughly rebuked Judge Rakoff's *Citigroup I* decision,[92] Judge Rakoff's forceful critique of NAND settlements galvanized opposition to NAND, and many see it as the driving factor in the SEC's decision to change its NAND policy.[93]

a. SEC v. Vitesse[94]*—Rakoff Takes Direct Aim at NAND*

By the time Judge Rakoff issued his decision in *Vitesse*, he had already warned the SEC that he would not be a rubber stamp for its proposed consent decrees in *Bank of America I and II*.[95] In *Vitesse*, the SEC alleged that Vitesse Semiconductor Corporation (Vitesse) and four of its officers and directors[96] "engaged in fraudulent revenue recognition practices and stock options backdatings[97] that were concealed from its shareholders and the public."[98] The SEC's proposed consent judgment required Vitesse to pay a $3 million penalty and imposed an injunction on the defendants, barring them from future violations of various securities laws and regulations.[99]

Judge Rakoff reluctantly approved the SEC's proposed consent decree, but in dicta he expressed skepticism that the court would approve future NAND settlements.[100] The SEC's saving grace in *Vitesse* was the fact that two of the individual defendants pled guilty to charges of fraud in a parallel criminal proceeding and were cooperating with the government in criminal and civil actions against the remaining defendants.[101] Judge Rakoff recognized that an admission in *Vitesse* would be superfluous because the "public [was] not left to speculate about the truth of the essential charges."[102] Despite Judge Rakoff's approval, he questioned whether NAND settlements were "so unreasonable or contrary to the public interest as to warrant disapproval . . . ."[103] He again reproved the

92. Citigroup II, 673 F.3d 158, 163–66 (2d Cir. 2012); Citigroup III, 752 F.3d 285, 298 (2d Cir. 2014); *see* Thomas A. Zaccaro et al., *SEC's Guilt Admission Policy May Bring Pricey Trials*, LAW360 (July 3, 2013, 1:40 PM), www.law360.com/articles/454587/sec-s-guilt-admission-policy-may-bring-pricey-trials (access required) (noting that the Second Circuit expressed skepticism of Judge Rakoff's view that NAND settlements do not serve the public interest).

93. *See* Coffee, *supra* note 3 (noting that "[Judge] Rakoff has effectively won the war, even if he loses the . . . battle" because the SEC has capitulated by changing NAND). *But see* Stewart, *supra* note 4 (describing Chairwoman White's claim that Judge Rakoff's comments did not precipitate the SEC's change to NAND).

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

95. *See supra* Part I (discussing the *Bank of America I* and *II* cases).

96. *See Vitesse*, 771 F. Supp. 2d at 306 (naming the four individual defendants: co-founder and CEO, Louis Tomasetta; CFO and Executive Vice President, Eugene Hovanec; Controller and CFO, Yatin Mody; and Manager/Director of Finance, Nichol Kaplan).

97. *See generally* Jesse M. Fried, *Option Backdating and Its Implications*, 65 WASH. & LEE L. REV. 853 (2008) (providing a very good overview and discussion of stock options backdating and their implications).

98. *Vitesse*, 771 F. Supp. 2d at 305.

99. *Id.* at 307.

100. *See id.* at 310 ("Under these unusual circumstances—but reserving for the future substantial questions of whether the Court can approve other settlements that involve the practice of 'neither admitting nor denying'—the Court approves the proposed Consent Judgment.").

101. *Id.* at 307–08. Additionally, Vitesse had already given $2.4 million in stock to the California class action settlement fund. *Id.*

102. *Vitesse*, 771 F. Supp. 2d at 310.

103. *Id.*

SEC for its apparent view of the court as a "rubber stamp,"[104] and left the door open as to whether the court would approve future NAND settlements.[105]

b. SEC v. Citigroup[106]*—Rakoff Opens Fire on NAND*

Prior to Judge Rakoff's decision in *Citigroup I*, he had openly criticized the SEC's NAND policy but eventually approved the SEC's proposed consent decrees.[107] In this landmark decision, Judge Rakoff denied the SEC's proposed consent decree, primarily because he did not believe the settlement was in the public interest.[108] This case was a huge blow to the SEC, which was accustomed to minimal judicial scrutiny.

In *Citigroup I*, the SEC alleged that Citigroup Global Markets, Inc. (Citi) misled investors by marketing a synthetic collateralized debt obligation known as "Class V Funding III" (Fund) as an investment product comprised of one billion dollars in high quality assets.[109] The SEC alleged that Citi intentionally loaded the Fund with questionable assets, sold the Fund to "misinformed investors,"[110] and took a short position in the underlying assets.[111] The proposed consent decree required Citi to repay $160 million in ill-gotten gains, plus $30 million in interest, and imposed a civil penalty of $95 million.[112]

Judge Rakoff cited a number of specific reasons for his denial of the SEC's proposed consent decree. First, the SEC had only charged Citi with violations of Sections 17(a)(2) and (3) of the Securities Act,[113] which only require a showing of negligence. Additionally, violations of Sections 17(a)(2) and (3) do not grant a private right of action, making it more difficult for future private litigants to use the consent decree at trial.[114] Second, Judge Rakoff again criticized what he perceived as the SEC's use of the court as a rubber stamp for its NAND settlements.[115] Judge Rakoff opined that without sufficient knowledge of the facts to support the proposed settlement, the court is merely a "handmaiden," blindly carrying the SEC's water.[116]

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104. *See id.* at 306 (highlighting the fact that the SEC filed the complaint and proposed consent judgment on the same day and offered inadequate explanation as to why the court should grant approval).

105. *Id.* at 310.

106. Citigroup I,,827 F. Supp. 2d 328 (S.D.N.Y. 2011).

107. *See supra* Part I and Part III.A.1.a (discussing the Bank of America cases and *Vitesse*).

108. *Citigroup I*, 827 F. Supp. 2d at 331–33.

109. *See generally* Complaint at 3, U.S. Sec. Exch. Comm. v. Citigroup Global Mkts., Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387), 2011 WL 496843 [hereinafter Complaint] (describing the details of Citigroup Global Markets, Inc.'s alleged misconduct).

110. *Citigroup I*, 827 F. Supp. 2d at 329.

111. *See generally supra* note 109 (describing the details of Citigroup Global Market, Inc.'s alleged misconduct).

112. *Citigroup I*, 827 F. Supp. 2d at 330.

113. 15 U.S.C. § 77g(a)(2)(3) (2012).

114. *Citigroup I*, 827 F. Supp. 2d at 334; *see* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 (1976) (holding that the judicially created private right of action under rule 10b-5 of the Securities Exchange Act of 1934 cannot be extended to cases where wrongdoing is based on negligence); *see also* Finkel v. Stratton Corp., 962 F.2d 169, 174–75 (2d Cir. 1992) (holding that there is no implied private right of action under section 17 of the Securities Act of 1933).

115. *See Citigroup I*, 827 F. Supp. 2d at 332 (repeating the rubber stamp criticism Judge Rakoff had expressed in *Vitesse*); *see also supra* note 104 and accompanying text.

116. *Citigroup I*, 827 F. Supp. 2d at 332.

Third, Judge Rakoff highlighted the large imbalance between the harm Citi caused investors and the relatively small civil penalty levied by the Commission.[117] Investors lost approximately $700 million in the alleged fraud, the proposed civil penalty was just $95 million, and Citi would pay a total of just $285 million in fines, interest and penalties.[118] He pointed out that even if the SEC receives $285 million from Citi, the consent decree does not compel the SEC to return the money to investors.[119] Finally, he stated that corporate defendants view such settlements as a mere "cost of doing business imposed by having to maintain a working relationship with a regulatory agency."[120]

c. Other Courts Target NAND Settlements

Judge Rakoff's *Citigroup I* holding resonated with other courts. In *SEC v. Koss Corp.*, citing Judge Rakoff's decision in *Citigroup I*, the court refused to approve a proposed settlement because the court lacked sufficient information to establish a "factual predicate for why . . . the proposed final judgments are fair, reasonable, adequate, and in the public interest."[121] The court ultimately approved the settlement, but only after the SEC filed a brief explaining why the settlement was appropriate.[122]

In *CR Intrinsic Investors*,[123] the court conditionally approved a NAND settlement involving insider-trading.[124] The court held that approval would become final if the Second Circuit found that judges must accept consent decrees containing NAND clauses.[125] Other courts have also questioned NAND settlements,[126] including one non-SEC case involving the Federal Trade Commission.[127]

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117. *Id.* at 329–30.

118. *Id.*

119. *See id.* at 333–34 (citing the language of the consent decree that the SEC "may" return money to defrauded investors).

120. *See Id.* (describing the cozy relationship between big banks and the SEC).

121. Order in SEC v. Koss Corp., No. 11 Civ. 991 (E.D. Wis. Dec. 20, 2011), *available at* http://www.fedseclaw.com/files/2013/10/2011-12-20-Letter-Order-from-Court.pdf.

122. *Id.*

123. SEC v. CR Intrinsic Investors, LLC, No. 12 Civ. 8466 (VM), 203 U.S. Dist. LEXIS 55165, at *37–38 (S.D.N.Y. Apr. 15, 2013).

124. *Id.* The court found it peculiar that the defendant was willing to settle for $602 million when litigation would only cost approximately one million dollars. *Id.* at *13–14. The court suggested that the disparity in the amount of the consent decree and the cost of litigation was a signal that the defendants may be culpable, in which case a NAND settlement is inappropriate. *Id.*

125. *Id.* at *12.

126. *See, e.g.*, Order in SEC v. Bridge Premium Fin., LLC, 1:12-cv-02131-JLK-BNB (D. Colo. Jan. 17, 2013) (calling on the defendant to either "admit the allegation or go to trial," but finally approving the settlement after several of the defendants admitted allegations), *rev'd on recons.*, Civil Action No. 1:12-cv-02131-JLK-BNB (D. Colo. Mar. 11, 2013); *see also* SEC v. Citigroup, Inc., No. 10-cv-1277 (ESH) (D.D.C. Aug. 17, 2010), *available at* http://www.thecorporatecounsel.net/nonMember/08_10_CitiHuvelle.pdf (calling into question the substance of the proposed consent decree and ordering the SEC to answer a list of questions).

127. *See* FTC v. Circa Direct LLC, Civil No. 11–2172 RMB/AMD, 2012 WL 589560, at *3–7 (D.N.J. Feb. 22, 2012) (citing Judge Rakoff's decision in *Citigroup I*, the court denied a proposed settlement by the FTC because it did not have enough facts to determine if the settlement was fair, adequate and in the public interest and ordered the parties to present additional facts that would support a settlement if the defendant had not admitted any wrongdoing); *see also* FTC v. Circa Direct LLC, Civil No. 11–2172 RMB/AMD, 2012 WL 2178705, at *3–7 (D.N.J. June 13, 2012) (citing Judge Rakoff again, the court was not satisfied with the answers the FTC provided to the court's previous request in *Circa Direct*, 2012 WL 589560 and ordered the FTC to submit further information).

After *Citigroup I*, and with other judges applying a heightened level of scrutiny to proposed SEC consent decrees, the SEC was under intense pressure to revise its NAND policy.[128] Even though the Second Circuit has since walked back the heightened scrutiny Judge Rakoff and others applied to NAND settlements,[129] the courts had sent a clear signal to the SEC that the status quo was unacceptable. The SEC needed to make a change, if for no other reason than to give the judiciary an indication that it had received the message.

2. Increased Political Pressure

Political figures have also questioned the SEC's NAND settlement policy. In 2011, the Republican-led House of Representatives announced that it would hold a hearing to examine the SEC's NAND policy.[130] Representative Spencer Bachus, a Republican from Alabama and Chairman of the House Committee on Financial Services, said that NAND settlements have "raised concerns about accountability and transparency."[131] The House of Representatives held a hearing on the matter in May 2012.[132]

Additionally, in May 2013, just a few months before the SEC issued its most recent change to NAND, Senator Elizabeth Warren, a Democrat from Massachusetts, publicly questioned the SEC's NAND policy.[133] She asked SEC Chairwoman White to send "any internal research or analysis on the trade-offs . . . between settling an enforcement action without admission of guilt and going forward with litigation."[134] Political inquiry placed more pressure on the SEC to change its NAND policy.

3. Critics Claim that NAND Settlements Deprive Plaintiffs of Offensive Collateral Estoppel

Relying on *Parklane Hosiery v. Shore*,[135] some critics claim that NAND settlements block future litigants from asserting collateral estoppel to establish facts determined in an earlier SEC settlement.[136] In *Lipsky v. Commonwealth United Corp.*, the Second Circuit held that "a consent judgment between a federal agency and a private corporation which is

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128. *See* Wallance, *supra* note 90 (describing court pressure as the catalyst for recent changes to the SEC's NAND policy).

129. Citigroup III, 752 F.3d 285, 296 (2d Cir. 2014).

130. *See* Press Release, Staff of H.R. Comm. on Fin. Servs., 112th Cong., Leaders of Fin. Servs. Comm. Jointly Announce Hearing on SEC Settlement Practices (Dec. 16, 2011), http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=273033 (expressing the committee's intent to hold a hearing on the SEC's NAND policy).

131. *Id.*

132. *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the Comm. on Financial Servs*., 112th Cong. (2012) *available at* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=294796.

133. Letter from Senator Elizabeth Warren to SEC Chairman Mary Jo White (May 14, 2013), *available at* http://www.warren.senate.gov/documents/LtrtoRegulatorsre2-14-13hrg.pdf..

134. *Id.*

135. In *Parklane*, the Court held that the plaintiffs could assert offensive collateral estoppel in a class action lawsuit for fraud where the SEC had already tried the defendant for the same fraud and won a declaratory judgment. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 335 (1979). The *Parklane* Court held that a party may successfully assert collateral estoppel when "the party against whom estoppel is asserted has litigated questions of fact, and has had the facts determined against him in an earlier proceeding." *Id.*

136. *See* Coffee, *supra* note 3 (describing the impacts of NAND settlements on future plaintiffs' ability to assert offensive collateral estoppel).

not the result of an actual adjudication of any of the issues . . . cannot be used as evidence in subsequent litigation."[137] In other words, NAND settlements have "no evidentiary value and no collateral estoppel effect"[138] in future litigation. As a consequence, critics argue that NAND settlements make it less likely that future plaintiffs in class action lawsuits will win at trial.[139]

There is, however, a problem with the *Parklane* estoppel argument. Settlements *are not*, and never have been, the product of litigation[140]—they are intentionally designed to resolve disputes *without* litigation. Under the *Parklane* test, even if the SEC requires admissions of wrongdoing in its settlements, collateral estoppel will not be available to plaintiffs because no questions of fact have been determined against the defendant through litigation.[141] The *Lipsky*'s holding is also unhelpful; a consent decree, with or without an admission, is "not the result of an actual adjudication of any issues,"[142] and therefore inadmissible as evidence in subsequent litigation.

Although the critics' collateral estoppel arguments fall short, their argument that NAND settlements make trial success less likely for future plaintiffs has merit. Even if private litigants are unable to rely on *Parklane* to assert collateral estoppel, an admission in a previous SEC settlement may increase the likelihood of success at trial, or make it less likely that a judge will dismiss a lawsuit prior to adjudication.[143] Furthermore, a defendant's admission may increase settlement amounts because defendants have a strong incentive to settle rather than face the increased risk of losing at trial.[144]

B. Recent Changes to NAND

The SEC changed its NAND settlement policy twice following *Vitesse* and *Citigroup I*.[145] First, on January 7, 2012, after Judge Rakoff reluctantly approved the SEC's consent decree in *Vitesse*, the SEC announced that it would no longer offer NAND settlements in cases where there are: (1) parallel criminal convictions; or (2) non-prosecution agreements (NPA), or differed prosecution agreements (DPA) that include admissions or acknowledgments of criminal conduct.[146] The SEC conceded that NAND settlements made little sense in cases where the defendant(s) had already been criminally convicted or admitted wrongdoing for the same underlying misconduct.

Second, on June 17, 2013, the co-directors of the Commission's Enforcement Division, Andrew Ceresney and George Canellos, announced another change to the

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137. Lipsky v. Commonwealth United Corp., 551 F.2d 887, 893 (2d Cir. 1976).

138. *See* Citigroup I, 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011) ("[A]n allegation that is neither admitted or denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect.").

139. *Id.*

140. *See supra* note 135 (discussing the holding and test in *Parklane*).

141. *Id.*

142. *Lipsky*, 551 F.2d at 893.

143. *See* Coffee, *supra* note 3 (noting that if the SEC required admissions in its settlements, class action plaintiffs could "point to the admission in briefs and pleadings," decreasing the likelihood that the case would be dismissed and increasing potential settlement amounts).

144. *Id.*

145. *See infra* notes 146–47, and accompanying text (describing recent changes to the SEC's NAND policy).

146. Robert Khuzami, Public Statement by SEC Staff: Recent Policy Change (Jan. 7, 2012), http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171489600#.Uid28Rbqo_s.

Commission's NAND policy.[147] The change included categories and circumstances where the SEC would no longer offer NAND settlements to defendants.[148] Those categories and circumstances include: (1) when the defendant has admitted to the allegations in a parallel criminal proceeding (repeating the substance of the January 2012 change);[149] (2) where the misconduct "harmed large numbers of investors or placed investors or the market at risk of potentially serious harm"; (3) where there has been "egregious intentional misconduct"; or (4) "[w]hen the defendant engaged in unlawful obstruction of the [C]ommission's investigative process."[150]

In less than two years, the SEC had made two changes to its NAND policy—a policy which had stood almost untouched for over four decades. It remains to be seen if these changes will provide relief to investors or placate the SEC's critics, but the changes have already resulted in admissions.[151] Whatever the case, the SEC seems to have acknowledged that the status quo is no longer acceptable. The SEC's changes to NAND are modest but appropriate gestures to the judiciary and other critics that the Commission is willing to adjust its policies to correct real or perceived weaknesses in its enforcement regime.

C. Concern with Loss of SEC Independence

The loss of SEC independence is potentially a serious consequence of *Citigroup I*.[152] As this Note previously discussed, several courts took Judge Rakoff's cue and challenged the SEC's discretion to negotiate the terms of consent decrees.[153] Even though the Second Circuit rebuffed Judge Rakoff's *Citigroup I* decision,[154] Judge Rakoff has opened the door for courts to second-guess the Commission's discretion. Increased scrutiny will no doubt compromise the Commission's independence.

Despite harsh NAND criticism, there is near unanimous agreement that the SEC does not have the resources to litigate every case.[155] For this reason, NAND settlements will continue to be the SEC's most frequently used enforcement tool.[156] Despite elevated court scrutiny, even some of the SEC's toughest critics admit that it must retain independent

147. *See* Stewart, *supra* note 4, at B1 (describing changes to the SEC's NAND policy).

148. *Id.*

149. *See supra* note 146 and accompanying text (describing the SEC's change to its NAND policy following *Vitesse*).

150. *Id.*

151. *See* Mary P. Hansen, *"Neither Admit nor Deny" Settlements at the SEC*, NAT'L L. REV. (Apr. 3, 2014), http://securitieslawperspectives.com/neither-admit-deny-settlements-sec/ (noting that as of April 2014 the SEC had already demanded admissions in seven cases).

152. *See infra* note 157 (describing the importance of SEC independence).

153. *See supra* Part III.A.2 (describing cases in which judges have challenged SEC settlements post *Citigroup*).

154. *See generally* Citigroup II, 673 F.3d 158 (2d Cir. 2012) (picking apart Judge Rakoff's decision in *Citigroup I*); Citigroup III, 752 F.3d 285 (2d Cir. 2014)(same).

155. *See* Zaccaro et al., *supra* note 92 (describing the limited resources of the SEC and the possible negative implications of the SEC's policy change if it forces the SEC to litigate more cases, which in turn would result in the SEC bringing fewer enforcement actions, and could damage the SEC's enforcement program).

156. *See id.* (quoting SEC Chairwoman White as saying that NAND clauses will continue to be a "major, major tool in the [SEC's] arsenal").

discretion to determine which cases to litigate and which to settle[157]—a view the Second Circuit seemed to endorse when it stayed Judge Rakoff's order for prompt trial.[158] Even though the Second Circuit has dialed back court pressure, the SEC is likely to embrace a more cautious approach in determining which cases to litigate, which to settle, and the terms of its proposed consent decrees.

D. NAND Changes Have Had a Tangible Effect

The SEC's changes to NAND have already yielded positive results.[159] For example, a court recently approved a consent decree in which Mr. Phillip Falcone and Harbinger Capital Partners agreed to pay substantial civil penalties and disgorgement, and also admitted that they violated numerous securities laws and regulations.[160] In a much larger case, the SEC announced that it reached a settlement agreement with JPMorgan in which the bank agreed to pay over $800 million in penalties and also made an admission of wrongdoing.[161] Both of these cases seem to indicate that the SEC's NAND policy changes are more than cosmetic[162] and will have a tangible effect on future SEC enforcement decisions.

IV. RECOMMENDATIONS

This Note proposes three additional changes to the SEC's settlement regime. First, to the extent possible, the SEC should stop asking courts to impose injunctions on future violations of securities laws in its consent decrees. Second, the SEC should follow the DOJ's practice of filing a complaint prior to negotiating a settlement. Finally, the SEC should use administrative proceedings more often.

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157. In a 2012 Committee hearing, William F. Galvin, a vocal critic of the SEC's NAND policy, said: "The SEC must maintain its independence on these issues. Those who in this case champion this Judge's view of this settlement," speaking of Judge Rakoff's view in *Citigroup I*, "should remember that once SEC independence is compromised, a different Judge in another case could weaken SEC settlement terms. As an executive agency, in the absence of obvious error, the SEC must be able to decide which matters to investigate, which cases to litigate, which charges to bring, and the terms of any settlements." *Examining Settlement Practices of U.S. Financial Regulators Before the H. Comm. on Financial Services*, 112th Cong. 7 (2012) (testimony of William F. Galvin, Secretary of the Commonwealth of Massachusetts), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-112-ba00-wstate-wgalvin-20120517.pdf.

158. *See Citigroup II*, 673 F.3d at 163–64 (questioning whether Judge Rakoff had "given deference to the S.E.C's judgment on wholly discretionary matters of policy").

159. *See* Hansen, *supra* note 151 (noting that as of April 2014, the SEC had already settled seven cases in which it demanded admissions).

160. Philip Falcone and Harbinger Capital Agree to Settlement, SEC Press Release No. 2013-159 (Aug. 19, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539780222#.Uo7J6KXqo_v (describing the terms of the consent decree in *Falcone*); *see also* Steve Marcus, *Judge OKs SEC's Falcone Settlement with Admission of Wrongdoing*, REUTERS (Sept. 16, 2013, 7:06 PM), http://www.reuters.com/article/2013/09/16/us-sec-falcone-settlement-idUSBRE98F12R20130916 (stating that this case represents the "first big case to include an admission of wrongdoing since a recent policy change").

161. *See* Ben Protess & Jessica Silver-Greenberg, *Bank Is Said to Admit Fault in Settlement of Trade Loss*, N.Y. TIMES, Sept. 17, 2013, at B1 (breaking the news that JPMorgan had agreed to admit wrongdoing).

162. *See* Wallance, *supra* note 90 (referring to the SEC NAND policy changes as "cosmetically deft finesse").

A. The SEC Should Eliminate Injunctions From Consent Decrees

Courts have more rigorously scrutinized SEC consent decrees because the Commission asks the court to enjoin the defendant from future violations of securities laws.[163] As Judge Rakoff articulated in *Citigroup I*: to impose an injunction the court must find that the settlement is "fair, reasonable, adequate, and in the public interest."[164] While injunctions theoretically allow the SEC to obtain quick judgments in the event of defendant recidivism, the fact is that the SEC never uses them.[165] The SEC gains little by inviting elevated judicial scrutiny for injunctions that are not used and are practically unenforceable.[166]

Furthermore, as one commentator noted, the court frequently enjoins defendants from future violations of the same law(s) that the defendant never admitted to violating in the first place.[167] Essentially, the consent decree enjoins the defendant from violating the securities laws that he (and everyone else) has a legal duty to obey anyway and—as far as the court and the public knows—he never violated in the first place. As a practical matter, a court injunction barring future violations of laws which the defendant claims that the defendant has not violated, and that were never proved at trial, is the illusion of accountability masquerading as justice.[168] The SEC should stop asking the court for injunctions. This change would reduce court scrutiny and increase the speed and likelihood of court approval.

B. The SEC Should Stop Negotiating the Content of Its Complaints with Defendants

The SEC should change its NAND policy by filing complaints without negotiating them with defendants beforehand. Judge Rakoff and other critics have noted the differences between the SEC's settlement practices and those of the DOJ.[169] The DOJ does not

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163. *See* Citigroup I, 827 F. Supp. 2d 328, 331 (S.D.N.Y. 2011) (citing Winter v. Natural Res. Def. Council, Inc., 555 U.S. 7, 24 (2008) (citation omitted) ("In exercising their discretion courts . . . should pay particular regard for the public consequences in employing the extraordinary remedy of injunction.").

164. *Id.* at 330. *But see* Citigroup III, 752 F.3d 285, 294 (2d Cir. 2014) (altering the standard of review for government agency actions and removing the requirement of adequacy).

165. *See Wall Street's Repeat Violations, Despite Repeated Promises*, N.Y. TIMES (Nov. 7, 2011), http://www.nytimes.com/interactive/2011/11/08/business/Wall-Streets-Repeat-Violations-Despite-PromisesStsssss.html?_r=0 (reporting that between 1996 and 2011 there were at least 51 repeat violations of securities laws by big banks who had been enjoined from violating the securities laws in the future. None of the injunctions were ever enforced.); *see also* Sklar, *supra* note 59 (describing the fact that the SEC never uses injunctions, and that because of their boilerplate and vague wording they are practically unenforceable).

166. *See* Sklar, *supra* note 59 (stating that SEC injunctions are unenforceable).

167. *See* Neal Lipschutz, *Hear Out the SEC Guy, Too*, WALL ST. J. L. BLOG (Dec 5, 2011, 11:24 AM), http://blogs.wsj.com/law/2011/12/05/hear-out-the-sec-guy-too (discussing injunctions that bar the defendant from violating laws that it never violated in the first place, and describing them as having "an Alice-in-Wonderland aspect"); *see also Bank of America I*, 653 F. Supp. 2d. 508, 509 (S.D.N.Y 2009) (calling the SEC's proposed injunction "pointless" because the defendant claimed an allegedly fraudulent statement was lawful).

168. Lipschutz, *supra* note 167.

169. *See* SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 309 (S.D.N.Y. 2011) (citing the DOJ's near complete rejection of NAND settlements); *see also* Reckler & Denton, *supra* note 42, at 15–16 (describing the differences between the approaches of the SEC and DOJ); *see* Coffee, *supra* note 3 (stating that it is not the practice of the DOJ to "negotiate the contents of the indictment with the defendant").

normally negotiate the content of its indictments with defendants.[170] Conversely, it is the SEC's standard practice to negotiate the terms of civil complaints with defendants. This has the effect of watering down the contents of the complaint and makes it difficult for the court and the public to know what the SEC actually believes the defendant did wrong.

The SEC and the public would reap a number of benefits if the agency stopped engaging in pre-complaint negotiations with defendants. First, the change would increase transparency by giving the public a more complete understanding of the alleged wrongdoing. Second, it would give the court a more robust factual predicate to support the terms of the settlement. Third, the change would put the SEC in a stronger negotiating position when shaping the final terms of the consent decree with the defendant. These benefits suggest the SEC should stop negotiating the terms of its complaints with defendants.

C. The SEC Should Make Greater Use of Administrative Proceedings

An attractive alternative to a court proceeding is an administrative law proceeding. The Dodd–Frank Act greatly expanded the SEC's authority to prosecute cases in administrative proceedings.[171] The Dodd–Frank Act also increased the civil penalties available in such proceedings.[172]

Administrative proceedings have the advantage of being heard in front of an administrative law judge (ALJ) instead of a jury, which means that a more securities-savvy fact finder will hear SEC cases, likely leading to more predictable litigation outcomes.[173] Additionally, the normal rules of evidence do not apply to administrative proceedings,[174] which will reduce some of the procedural burdens on the parties. Furthermore, the SEC can schedule and complete administrative proceedings more expeditiously than court

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170. *See* Coffee, *supra* note 3 (describing the DOJ's practice of filing its indictment without negotiating its terms with the defendant).

171. The Dodd–Frank Act changed the Securities Act of 1933 allowing the SEC to impose monetary penalties against "a person" in administrative cease-and-desist proceedings. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929P, 124 Stat. 1376, 1862 (codified at 15 U.S.C. § 77h-1(g) (2012)). "Before Dodd–Frank, this remedy was available through administrative proceedings against only registered persons; to obtain civil monetary penalties against non-registered persons, the SEC was required to bring enforcement actions in federal district court." *Columbia Law School Symposium: The Past, Present, and Future of Insider Trading: A 50th Anniversary Re-Examination of Cady, Roberts and the Revolution It Began*, 2013 COLUM. BUS. L. REV. 492, 493 n.6 (citing Winston & Strawn LLP, *The Dodd-Frank Act: New Curbs on The Street?* 17 (2010), *available at* http://www.cdn2.winston.com/images/content/2/2/v2/225/8-6-2010-The-Dodd-Frank-Act-Webinar.pdf).

172. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No, 111-203, § 929P, 124 Stat. 1376, 1862 (codified at 15 U.S.C. § 77h-1(g)(2) (2012)) (authorizing money penalties of up to $150,000 for natural persons and $750,000 for other persons).

173. *See* Jordan Maglich, *SEC Sues Steven A. Cohen; Seeks Lifetime Ban From Managing Investor Funds*, FORBES (July 19, 2013, 2:38 PM), http://www.forbes.com/sites/jordanmaglich/2013/07/19/sec-sues-steven-a-cohen-seeks-lifetime-bar-from-managing-investor-funds/ (describing some of the advantages of bringing a case in an administrative proceeding rather than federal court).

174. *See* Administrative Procedure Act, 5 U.S.C. § 556(d) (2012) ("Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence."); *see also* U.S. SECURITIES AND EXCHANGE COMMISSION, RULES OF PRACTICE AND RULES ON FAIR FUND AND DISGORGEMENT PLANS, RULES 320–26, 53–56 (2006), *available at* http://www.sec.gov/about/rulesprac2006.pdf (describing the SEC's rules of practice regarding evidence in administrative proceedings).

proceedings.[175] The SEC, by litigating more cases in an administrative proceeding, can reduce the time it takes to litigate enforcement actions and increase the number of cases it takes to trial without requiring additional resources.

V. CONCLUSIONS

The SEC's changes to NAND are a net positive in light of the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[176] The SEC has struck a reasonable balance that offers better investor protection through increased transparency and greater deterrence value.[177] These changes should partially alleviate some of the pressure the agency endured following the Financial Crisis.[178]

A. Recent NAND Policy Changes Will Increase Investor Protection

Requiring admissions in limited circumstances protects investors in at least three ways. First, future litigants benefit from increased chances of success at trial.[179] Second, even if the SEC requires admissions in very few cases, the SEC will increase the overall deterrence value of its enforcement regime. Third, the threat of requiring admissions puts the SEC in a stronger bargaining position, which will likely increase settlement amounts.[180]

On the other hand, requiring admissions may have some negative effects on investor protection. First, requiring admissions will likely increase the number of cases the SEC will be forced to litigate. This will increase the possibility of the SEC losing cases at trial or winning at trial and receiving a lesser amount than could have been achieved through settlement. The effect will be to limit the amount of money the SEC can return to harmed investors. Second, given the SEC's limited resources, and because litigation is costly, the SEC may not be able to pursue as many enforcement actions, and therefore some securities violations may go unpunished. Third, more cases will be litigated and drawn out over a longer period, and therefore compensation to victims will be protracted. However, on balance, the SEC seems to have implemented reasonable changes that will increase investor protection.

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175. *See* Gretchen Morgenson, *At the S.E.C., a Question of Home- Court Edge*, N.Y. TIMES (Oct. 5, 2013), http://nyti.ms/1FUvM80 (noting that SEC cases are typically resolved more quickly by administrative hearings than district court proceedings).

176. *See The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml (last visited Mar. 28, 2015) (stating that "[t]he mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation").

177. *See* Stewart, *supra* note 4 (reporting SEC Chairwoman White's comment that: "most cases [will] still be settled under the prevailing 'neither admit nor deny' standard").

178. *See supra* Part III (describing the pressure the SEC was under following the Financial Crisis).

179. *See* Stewart, *supra* note 4 (quoting Professor John Coffee of Columbia Law School as stating: "If [defendants] admit culpability . . . plaintiffs will cite that in their cases, and that could mean hundreds of millions or billions in damages").

180. *See id.* (quoting Brad Karp, a lawyer at Paul, Weiss, Rifkind, Wharton & Garrison, who said the new policy "gives [the SEC] enormous leverage . . . even if you fight and win over a year, the damage will outweigh any litigation result").

B. The SEC's Changes to NAND Are a Good Start

The SEC has made positive and effective changes to its NAND settlement policy. The changes represent concrete and reasonable steps toward more substantial modifications to its enforcement regime. It is unfortunate that the Commission had to undergo such harsh scrutiny before making these changes. The SEC should take advantage of current public and political support for change by adopting additional common-sense measures. The three changes this Note proposes are practical measures that will further increase investor protection, without significantly decreasing the number of enforcement actions the SEC brings each year or significantly increasing the resources needed to enforce securities violations. If the SEC adopts these changes, the Agency may be able to avoid the kinds of court-clashes and public criticisms that forced it to change its NAND policy. The SEC's recent changes to its NAND policy, coupled with the changes this Note proposes, will place the SEC in a better position to protect investors, facilitate capital formation, and ensure the fairness and integrity of the marketplace.