SIMPSON THACHER MEMORANDUM

As Judicial Scrutiny of the SEC's Settlement Practices Mounts, the SEC Adopts a Limited Change to Its 'Neither Admit Nor Deny' Policy

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Last Friday, the Securities and Exchange Commission ("SEC") reportedly adopted a limited modification to a longstanding settlement policy that has been under increasing fire in recent months. Under the change, as reported by *The New York Times* and *The Wall Street Journal*, companies that admit to or are convicted of criminal conduct in parallel cases with the Department of Justice ("DOJ") will no longer be permitted to simultaneously settle SEC charges without admitting or denying the charges. On the one hand, this reported change does not appear to negatively impact companies because it will merely require them to admit to wrongdoing as a condition of settling SEC allegations in the limited number of instances in which the companies are already admitting to or have been convicted of the same conduct in DOJ proceedings. At the same time, however, this development is noteworthy because it is a sign that, despite the growing criticism, the SEC is -- at least for the time being -- standing behind its policy of allowing companies and individuals in the vast majority of SEC matters to continue settling without having to admit or deny the SEC's allegations.

THE SEC'S LONGSTANDING POLICY AND THE RECENT CRITICISM

The SEC has long allowed companies and individuals that settle SEC charges to resolve the matters without admitting or denying the allegations. The primary benefit of this settlement policy has been that it enables defendants to avoid having admissions made in connection with SEC settlements used against them in shareholder class actions and other ancillary litigation. For its part, the SEC has defended this policy by arguing that allowing companies to enter into settlements without admitting or denying wrongdoing preserves the time and expense associated with prolonged court battles.

Until last Friday's policy change, the SEC routinely permitted companies to settle charges without admitting or denying liability in situations where DOJ simultaneously announced that the same companies had resolved parallel criminal charges through admissions of wrongdoing, including through deferred prosecution and non-prosecution agreements. Indeed, as recently as December 29, 2011, the SEC settled Foreign Corrupt Practices Act ("FCPA") charges with Magyar Telekom and Deutsche Telekom by permitting both companies to neither admit nor deny liability. *See SEC v. Magyar Telekom Plc. and Deutsche Telekom AG*, Litigation Release No. 22213, Case No. 11 CV 9646 (SDNY) (Dec. 29, 2011). That same day, DOJ announced that it had entered into a deferred prosecution agreement with Magyar Telekom and a non-prosecution agreement with Deutsche Telekom. *See SEC v. Magyar Telekom Plc.*, No. 11 CR 00597 (E.D. Va. Dec. 29, 2011). Both the DOJ deferred prosecution agreement and the DOJ non-prosecution agreement contained acknowledgements of wrongdoing by the companies.

Under the new policy, the SEC reportedly will no longer permit companies to settle allegations without admitting or denying liability if the companies at the same time have admitted to wrongdoing in parallel criminal settlements with DOJ or have been convicted of parallel criminal conduct.

This modest policy change, of course, comes in the midst of increasing judicial criticism of the SEC's entire 'neither admit nor deny' settlement policy. In 2009, Judge Jed Rakoff in the Southern District of New York generated widespread attention with an opinion criticizing the SEC's settlement practices in the context of the SEC's proposed $33 million settlement with Bank of America. *SEC v. Bank of America Corp.*, No. 09 Civ. 6829 (S.D.N.Y. Sep. 14, 2009). More recently, in November 2011, Judge Rakoff rejected a $285 million SEC settlement with Citigroup, again assailing the SEC's practice of allowing companies to settle without admitting the underlying allegations and calling the policy "hallowed by history, but not by reason." *SEC v. Citigroup Global Markets Inc.*, No. 11 Civ. 7387 (S.D.N.Y. Nov. 28, 2011). Judge Rakoff's criticism has not gone unnoticed -- as at least one other federal judge and Congress have begun confronting the SEC about its settlement policies. Last month, Judge Rudolph Randa of the Eastern District of Wisconsin, citing Judge Rakoff's Citigroup decision, rejected an SEC settlement with the Koss Corporation and requested "a written factual predicate" for the settlement. *SEC v. Koss Corporation*, No. 11-C-991 (E.D. Wis. Dec. 20, 2011). And members of the House Financial Services Committee have announced plans to hold a hearing early this year about the SEC's settlement policies.

LOOKING AHEAD

In light of the growing judicial and now Congressional scrutiny of its settlement policies, the SEC's announcement last Friday reflects only a modest change that will apparently have a minimal impact even in the limited number of cases in which it will apply. Only a small percent of SEC settlements are reached simultaneously with resolutions of criminal charges that involve admissions of wrongdoing. FCPA matters are one area where this new policy is likely to apply with some frequency because it is common for companies to resolve FCPA inquires by the SEC at the same time as admitting to FCPA wrongdoing in DOJ settlements. In these limited situations, companies will need to pay closer attention to the specific factual allegations made by the SEC that they will now need to admit, as SEC allegations are sometimes broader or different than DOJ's factual allegations. In short, last Friday's announcement could be viewed by companies as a positive development because it suggests that the SEC intends, at least for now, to continue defending its policy of permitting them to settle SEC charges without admitting or denying the allegations -- at least in instances where they are not acknowledging wrongdoing in a parallel criminal case.

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