

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION— SDNY: Court Conditions Settlement Approval on Decision in Pending 2nd Circuit Case, (Apr. 17, 2013)

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By Rodney F. Tonkovic, J.D.

A district court approved a consent judgment in an enforcement action conditioned upon the disposition of the pending appeal in the Second Circuit in *S.B.C. v. Citigroup Global Markets, Inc.* The court was troubled by the “neither admit nor deny” provisions contained in the consent judgment but concluded that the most prudent course would be to approve the settlement subject to the condition that it become final upon the 2nd Circuit’s ruling (*SEC v. CR Intrinsic Investors, LLC*, April 16, 2013, Marrero, V.).

The Commission brought this action against CR Intrinsic Investors, LLC (CR Intrinsic), an unregistered investment adviser, alleging violations of the antifraud provisions of the securities laws. According to the Commission, CR Intrinsic participated in an insider trading scheme that resulted in hedge fund portfolios under its management generating approximately \$275 million in illegal profits or avoided losses. At the same time, the SEC submitted for the court’s approval a final judgment providing for consent to the judgment “without admitting or denying the allegations of the Complaint.” The judgment also provided for an injunction, disgorgement, and civil penalties.

Injunctive and monetary relief. The court concluded that the proposed settlement’s injunctive relief component was fair, adequate, reasonable, and in the public interest. The court noted that, as the injunction essentially prohibits CR Intrinsic from conduct that is already prohibited under the securities laws, it would not attach undue weight to this component. Next, the disgorgement amount, prejudgment interest, and civil penalty were found to be fair, adequate, reasonable, and in the public interest. The court saw no basis for questioning the adequacy of the monetary relief and observed that it was significant and proportional to the amounts at issue.

“Neither admit nor deny” provisions. The court then considered the appropriateness of the consent judgment’s “neither admit nor deny” provisions. The court was troubled by these provisions because they would permit CR Intrinsic to resolve the allegations of its involvement in a massive insider trading scheme without admitting or denying the allegations of the complaint. The court noted that the ability of a court to question the appropriateness of these types of provisions and to reject proposed settlements of that ground is an issue that will be decided soon by the Second Circuit.

Under the circumstances, the court determined that the best course of action available to it was to approve the settlement “subject to a condition that it would become final upon a definitive determination in the *Citigroup* appeal that district courts lack authority to reject such settlements on the basis of reservations about the ‘neither admit nor deny’ provision.”

Reasons for higher scrutiny. In the event that the *Citigroup* ruling allows district courts to accord higher scrutiny to “neither admit nor deny” provisions, the court went on to articulate its concerns and considerations. At the outset, the court noted that both parties urged that these provisions are part of a longstanding and commonplace practice and that settlements with these provisions have regularly been approved without the provisions being called into question. Moreover, courts must accord deference to an administrative agency’s decisions to commence and resolve administrative proceedings.

The court recognized that in the vast majority of cases, a “neither admit nor deny” provision is reasonable and likely to produce a balanced outcome. However, in some instances, courts should give such provisions a higher level of scrutiny. The court stated that the “uniquely harmful fact patterns emerging from modern financial and industrial market scandals” require scrutiny that reflects “the proportional seriousness of the alleged injurious acts and their substantial after-effects.”

In this case, “it is both counterintuitive and incongruous for defendants in this SEC enforcement action to agree to settle a case for over \$600 million that would cost a fraction of that amount, say \$1 million, to litigate, while simultaneously declining to admit the allegations asserted against it by the SEC,” the court said. It would look to an outside observer, the court continued, as if CR Intrinsic “essentially folded” in exchange for the ability to admit no wrongdoing.

The court also noted pending criminal proceedings against the tippee arising out of the same circumstances and entailing conduct implicating some or all of the defendants in this action. The court worried that a conviction in the criminal case would make a premature judicial seal of approval on the provisions at issue in this case “particularly pernicious,” and the judge felt that this was a compelling reason for the court not to simply “rubber stamp” the consent judgment.

A parallel private civil action is also unresolved. A final approval at this time, the court stated, would deny the allegedly defrauded investors a resolution that could ease the burden of proving their case and could diminish the amount of their recovery. The parties would also take longer to resolve the private litigation, which would impose a burden on the courts. Finally, the court cautioned that the public would be denied an adjudication of the truth of the allegations in a matter of major public concern.

The case is No. 12 Civ. 8466 (VM).

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Companies: CR Intrinsic Investors, L.L.C.

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