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Litigation: The expanded role of courts in settling government investigations

A growing number of federal judges are closely scrutinizing—and sometimes rejecting—proposed settlements

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Government investigations of companies typically end in settlements. These may be civil in nature, in which companies commonly agree to pay money and take remedial measures to deter and prevent the misconduct that the government alleges occurred. Settlements may also be criminal in nature—either agreements not to prosecute the company (deferred or non-prosecution agreements), or a guilty plea pursuant to an agreement negotiated with the prosecutor. Even when company leaders believe the government's contentions are wrong, the costs and risks of a fight with the government, particularly for a public company, usually lead to a resolution short of litigation, and certainly short of trial.

Traditionally, the role of a judge in reviewing an agreement to resolve civil or criminal charges has been very limited. Although the rules vary in the civil and criminal contexts, the essence is the same: Courts are obliged to consider the reasonableness and fairness of such an agreement in light of the public interest. In practice, courts have largely deferred to the views of the parties, particularly the government, and generally accepted the settlement without much difficulty.

This state of affairs is changing. In a growing number of cases, particularly those involving financial institutions, federal judges have started to scrutinize settlements much more closely than in the past, making a once very predictable and commonplace process a good deal more doubtful and complicated.

The trend began in the fall of 2009 in a highly publicized case before Judge Jed Rakoff of the U.S. District Court for the Southern District of New York. In August 2009, the Securities and Exchange Commission announced a $33 million settlement with Bank of America for alleged fraud in connection with its acquisition of Merrill Lynch. Judge Rakoff rejected the settlement in a lengthy and pointed opinion, calling the monetary fine "trivial" and coming at the "expense, not only of the shareholders, but also of the truth." At the time, Judge Rakoff's opinion came as a surprising criticism of the SEC and its settlement policies. Several months later, the judge grudgingly approved a revised settlement of $150 million, saying that, although the revised settlement was "better than nothing," it was "half-baked justice at best."

In 2011 Judge Rakoff rejected another SEC settlement—a proposed $285 million agreement with Citigroup to resolve allegations of misleading investors in transactions related to collateralized debt obligations. Like most SEC settlements, the resolution did not include an admission or denial of liability by Citigroup, despite the significant civil monetary penalty imposed. As with the Bank of America settlement, Judge Rakoff

believed the proposed settlement was “neither fair, nor reasonable, nor adequate, nor in the public interest,” especially because it did not include any acceptance of responsibility for company wrongdoing, refused to accept it and set a trial date. The decision is currently being challenged in the 2nd Circuit. In March 2012, a panel of judges on the appeals court granted a stay of the district court’s order, pending the outcome of the appeal. In its decision, the appeals court was skeptical of Judge Rakoff’s ruling, stating that “[a] settlement is by definition a compromise” and expressing doubt that it is “within a court’s proper discretion to reject a settlement on the basis that liability has not been conclusively determined.” A different panel of the 2nd Circuit heard oral arguments in February and has yet to issue a ruling.

Other federal judges have followed Judge Rakoff in scrutinizing settlements closely. In December 2012, Judge Richard Leon, a federal judge in Washington D.C., refused to accept a settlement between the SEC and IBM in which the company did not admit or deny fault relating to allegations that it bribed Chinese and South Korean government officials. Several months later, Judge Leon also rejected a settlement between the SEC and Tyco, based on similar allegations of bribery in Saudi Arabia.

In January, Judge John L. Kane, a federal judge in Colorado, rejected a settlement between the SEC and two individuals who allegedly operated a Ponzi scheme. In his decision, Judge Kane wrote that he “refuse[d] to approve penalties against a defendant who remains defiantly mute as to the veracity of the allegations against him.”

In criminal cases, deferred prosecution agreements—in which the government files charges but defers prosecution while a company implements remedial measures in anticipation of the charges being dismissed—have been questioned. In December 2012, Judge John Gleeson, a federal judge in Brooklyn, following criticisms of other settlements with banks by judges and elected officials, refused to accept, at least at the outset, the Department of Justice’s $1.92 billion settlement with HSBC to resolve allegations that the bank laundered money for Mexican drug gangs, rogue states and terrorist organizations. Judge Gleeson asked the parties to submit further filings as to why the agreement is appropriate and as of June, has not yet accepted the settlement.

The trend toward increased judicial scrutiny of settlements of government enforcement actions may have a significant impact, for several reasons, on companies seeking to resolve government investigations. First, standard conditions such as a “neither admit, nor deny” clause, which is commonplace in SEC settlements, may continue to come under scrutiny, both from federal judges and from legislators. This June, following criticism on Capitol Hill, SEC Chairwoman, Mary Jo White wrote in a letter to Senator Elizabeth Warren that the SEC will “actively review” its use of the provision. Shortly thereafter, Chairwoman White stated publicly that the SEC will begin to seek admissions of guilt in some civil settlements.

Second, a company can no longer take for granted that a deal with the government will pass muster with a judge. Going forward, a company will need to negotiate a settlement with an eye toward defending it and may, as a result, consider agreeing to certain terms that it would otherwise choose not to. Although, historically, settlements have been treated as contracts between the parties deserving of great deference, some judges, such as Judge Rakoff, have concluded, at least in government enforcement actions, that this sort of deference “effectively reduce[s] [the courts] to potted plants” and “undermine[s] the independence of the federal judiciary.” In light of increased judicial activity in the realm of settlements, companies should be prepared to defend the merits and appropriateness of an agreement based on the underlying facts and circumstances.

Finally, companies that are “repeat violators” may face harsher scrutiny than others. The rejected settlements over foreign bribery violations in the case of IBM and Tyco both involved companies that had settled foreign bribery cases earlier—in 2000 and 2006, respectively—in which both agreed not to violate the foreign bribery law in the future. For a company with admitted violations, or even settled charges without

admissions, securing judicial approval of another settlement involving new facts may be a hurdle it would not have faced in the past.

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