New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
JUNE 30, 2021

Collateral Consequences of No-Admit-No-Deny SEC Settlements

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Parties settling with the SEC pursuant to an administrative order have always been mindful of the collateral consequences that such settlements can have on private litigation arising out of the same facts. The impact of SEC enforcement on private litigation in general is significant—civil cases arising out of the same facts as an SEC action typically settle for higher amounts than cases with no corresponding SEC action. Between 2010 and 2019, more than a quarter of securities class action settlements had a corresponding SEC action. Laarni T. Bulan and Laura E. Simmons, *Securities Class Action Settlements 2019 Review and Analysis*, Cornerstone Research 11 (2020).

When parties reach a settlement and the SEC's administrative order is publicly issued, private plaintiffs often seek to use the order's findings against the respondent in various ways. For this reason, respondents in SEC proceedings have often relied on the fact that most settlements expressly do not require the respondent to admit to any of the facts alleged in administrative order. Even after the SEC resolved in 2012 to require more respondents to admit facts in settlements, the vast majority of SEC settlements have not required admissions. Giovanni Patti and Peter Robau, *Admissions of Guilt to the SEC under Chair Jay Clayton*, NYU School of Law Program on Corp. Compliance and Enf't, Jan. 19, 2021.

The SEC's standard administrative orders expressly note that findings are "solely for the purpose of these [SEC] proceedings," a phrase intended to limit their effect in any other proceeding. These limitations make sense, as the SEC's "findings" do not follow any trial or other proceeding in which an unbiased factfinder actually made factual determinations based on all relevant and admissible evidence. Rather, they are the product of a settlement process in which the SEC has substantial leverage over a respondent, which can result in "findings" that are not necessarily supported by admissible evidence sufficient to prevail in contested litigation.

Although courts have been clear that the SEC's administrative findings do not constitute admissible evidence of liability, private plaintiffs

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have successfully used consent orders at the motion to dismiss stage to bolster their factual allegations. See, e.g., *In re OSG Sec. Litig.*, 12 F. Supp. 3d 619, 621-22 (S.D.N.Y. 2014) (noting that while settlements are "inadmissible as evidence of liability, they are admissible for other purposes, including proof of knowledge"). Some courts have expressed skepticism about the wholesale use of unadjudicated administrative allegations in securities complaints. However, others—including a recent decision in the District of Maryland in the *Under Armour* case—have given weight to the SEC's allegations when denying motions to dismiss. Indeed, it appears that the SEC's administrative order was outcome determinative in *Under Armour*.

After dismissing the plaintiffs' claims twice before, the judge in that case concluded that "findings" from an intervening SEC administrative order—which were not even incorporated into the plaintiffs' complaint—provided enough factual support to the previously-insufficient allegations to escape a third dismissal. *In re Under Armour Securities Litig.*, No. 1:17-cv-00388, 2021 WL 1985015 (D. Md. May 18, 2021).

Under Armour is not unique in its consideration of consent orders at the motion to dismiss stage, but the procedural history of *Under Armour* suggests that an administrative settlement with the SEC may cause private litigation to advance when it would not otherwise survive a motion to dismiss without the SEC order. If *Under Armour* is followed by other courts, practitioners may not be successful in limiting consideration of SEC administrative orders at the motion to dismiss phase and should therefore be prepared to support the motion with other legal grounds. This article offers several practical suggestions to minimize the collateral effects of entering into an administrative settlement with the SEC or a similar agency.

Use of Consent Orders To Bolster Civil Complaints

The use of consent orders and other types of unadjudicated claims to bolster civil complaints is not a new tactic. In some instances, plaintiffs copy and paste language from the settlement order into their civil complaints. In others, like *Under Armour*, the plaintiffs ask the court to take judicial notice of the settlement order. In the Second Circuit, defendants have had varying levels of success when attempting to dismiss such complaints, with courts splitting on the issue of whether unadjudicated findings lend enough support to otherwise insufficient allegations to survive a motion to dismiss.

The seminal case on this issue in the Second Circuit is *Lipsky v. Commonwealth United*, 551 F.2d 887 (2d Cir. 1976), which addressed the defendant's motion to strike allegations from a plaintiff's complaint derived from a separate SEC federal court complaint and consent judgment. The Second Circuit affirmed the district court's decision to strike the allegations, holding that "neither a complaint nor references to a complaint which results in a consent judgment may properly be cited in the pleadings." The court reasoned that the consent judgment had resulted from "private bargaining" between the SEC and the defendant, and not from any "hearing or ruling or any form of decision on the merits by the district court." The court equated the consent judgment to a nolo contedere plea, noting that neither results from "true adjudications of the underlying issues." Accordingly, the court ruled that the consent judgment could not "be used as evidence in subsequent litigation between that corporation and another party." Id. at 893-94.

Some courts that have confronted the issue after *Lipsky* have broadly interpreted its holding, striking any allegations in complaints that rely on other unadjudicated complaints or settlement orders. Other courts have taken a narrow view of *Lipsky*. Although there does not appear to be a clear majority view, the ruling in *Under Armour* may signal a trend toward the narrow view.

An example of the broader view is *In re Platinum and Palladium Commodities Litig.*, 828 F. Supp. 2d 588 (S.D.N.Y. 2011), in which plaintiffs alleged a scheme to manipulate the prices of platinum and palladium futures contracts. The plaintiffs sought to include references in the complaint to a CFTC consent order settling claims against defendants based on similar conduct. Id. at 591-92. Citing *Lipsky*, the court found that the "CFTC's findings are properly stricken" from the complaint, noting that the consent order and its factual findings "was the product of a settlement between the CFTC and the Respondents, not an adjudication of the underlying issues in the CFTC proceeding. Plaintiffs are therefore prohibited from relying on the CFTC Order to plead the 'underlying facts of liability.'" Id. at 593-94; see also *Johnson v. Niv*, CFTC No. 17-R010, 2020 WL 1934681 at * 5 (C.F.T.C. April 16, 2020) (citing *Lipsky* to strike allegations from a CFTC consent order where plaintiff provided no supporting evidence for his claims other than citing to the order).

Other courts have interpreted *Lipsky* more narrowly. For example, in *In re Fannie Mae 2008 Sec. Litig.*, 891 F. Supp. 2d 458 (S.D.N.Y. 2012), plaintiffs alleged that the defendant had made material misstatements in filings with the SEC and various securities offerings. In support of their allegations, the plaintiffs cited allegations from a previous SEC complaint against the defendant. The court denied the defendant's motion to strike

the allegations, stating that although the complaint itself was not admissible, factual information in the complaint was relevant to the plaintiffs' allegations. The court also noted that the plaintiffs' complaint already contained other documentary support, so it did not rely wholly on the SEC's complaint. See also *In re OSG Sec. Litig.*, 12 F. Supp. 3d 619, 621-22 (S.D.N.Y. 2014) (noting that although settlements are "inadmissible as evidence of liability, they are admissible for other purposes, including proof of knowledge"); *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*, No. 08 CIV 8093, 2012 WL 1076216, at *768 n. 24 (S.D.N.Y. March 30, 2012) (collecting cases).

Lipsky and its progeny dealt with motions to strike language from the complaint. Some plaintiffs do not include language from a settlement order within the complaint itself, choosing instead to ask the court to take judicial notice of the settlement order. In *In re Deutsche Bank Aktiengesellschaft Sec. Litig.*, for example, the plaintiffs asked the court to take judicial notice of an administrative cease and desist order issued by the Federal Reserve Board of Governors to bolster their allegations about "significant deficiencies" in the bank's anti-money laundering program. The court distinguished the case from *Lipsky* and granted the plaintiffs' motion to take judicial notice. *In re Deutsche Bank,* No. 16 Civ. 3495, 2017 WL 4049253, at *1-2 (S.D.N.Y. June 28, 2017).

The *Deutsche Bank* court read *Lipsky* extremely narrowly, almost as purely confined to its facts. The court pointed out that in *Lipsky*, the plaintiffs had copied passages from an SEC complaint that alleged mistakes in others' offering documents instead of their own. The court reasoned that the instant case was factually different from *Lipsky* because the plaintiffs were not offering the cease and desist order to "replace Plaintiffs' descriptions of [their own] offering documents alleged to contain material omissions or misrepresentations, but to support Plaintiffs' allegations of deficiencies in the Bank's AML systems." Id. This ruling completely sidestepped the point that the portions of the Federal Reserve Board's cease and desist order addressing that key issue were not the result of adjudicated factfinding.

Cases like *Deutsche Bank* and others demonstrate that there is no bright line defining limits on the use of unadjudicated settlement orders. The recent *Under Amour* decision suggests that wherever the line gets drawn, it is becoming more favorable to plaintiffs in private litigation.

'Under Armour'

The *Under Armour* case involves a securities class action in the District of Maryland alleging that Under Armour and its former CEO issued false and misleading statements about demand for Under Armour products and the company's financial condition. The court did not find the plaintiffs' claims sufficient, dismissing two versions of the complaint in succession. In the second dismissal, the court stated that the plaintiffs did not make a sufficient showing of scienter under Securities Exchange Act §10(b). The court concluded—somewhat remarkably, given its subsequent about face—that "further amendment of Plaintiffs' complaint asserting securities fraud claims … would be futile in light of the fundamental failure to plead scienter," and dismissed the second complaint with prejudice. *In re Under Armour Securities Litig.*, No. 1:17-cv-00388 (D. Md. Aug. 19, 2019), ECF No. 98 at 26.

After the second dismissal, however, reports in the Wall Street Journal surfaced that Under Armour was the subject of an SEC investigation. The court permitted plaintiffs to file another complaint based on what the court described as "this new evidence," even though its last dismissal was supposedly "with prejudice." After the plaintiffs filed yet a third compliant, and after the defendants filed a motion to dismiss that complaint, Under Armour reached a settlement with the SEC that appears to have involved some of the same issues as the allegations in the securities class action. As in most SEC settlements, Under Armour did not admit or deny the SEC's administrative findings. Nevertheless, even though the Court in *Under Armour* acknowledged that "the SEC's Order does not supply dispositive evidence," it denied the company's motion to dismiss based almost exclusively on the settlement order, quoting from it at length. The court found that "the SEC Order lends support" to the plaintiffs' allegations. But in the context of the court's two prior rulings finding that plaintiffs' allegations were insufficient, the court was really saying that the SEC order was the *only* "support" for the allegations. It is abundantly clear from the court's prior "with prejudice" rulings that the complaint would not have survived if the court

had not considered the recent SEC administrative order.

The court took judicial notice of the SEC administrative order based on a finding that, under Rule 201 of the Federal Rules of Evidence, the relevant facts are "not subject to reasonable dispute," a requirement of the evidentiary rule. But the court's finding that "there is no dispute with respect to the accuracy of the SEC Order" misses the critical point. The issue is not whether the SEC order contains errors. The issue is that the SEC's order does not purport to be an adjudication of facts, was agreed to by Under Armour solely for the purposes of the SEC enforcement action, and expressly states that Under Armour does not admit the findings in the order.

One of the drivers of the court's denial of Under Armour's latest dismissal motion was that the SEC's order included facts that could support a finding of scienter. But notably, the SEC order did not contain a finding of scienter because it involved a statute that permitted liability based on mere negligence. By contrast, the statutory allegations in *Under Armour* require proof of scienter, a heightened state of intent. In their letter to the court notifying it of the settlement, counsel for the company stressed this fact and also underscored that the SEC's investigation did not result in enforcement action against any individuals, unlike the class action which names the CEO.

Nonetheless, although the court acknowledged that the order did not include a finding of scienter, it used the factual findings in the order to justify a finding of scienter, noting that the order stated that "the company and its top officials, including then-CEO Defendant Plank, were aware of the potential misleading nature of the undisclosed pull forward sales practices." The court's ruling made clear that the findings in the SEC administrative order had revived the twice-dismissed allegations of scienter in the plaintiffs' complaint, even though the only new information was the SEC's order based on negligence.

Takeaways

As the *Under Armour* case shows, it will be challenging in the future for companies entering into administrative settlements with the SEC or similar agencies to eliminate courts' consideration of such settlements at the motion to dismiss phase of private litigation. However, there are some practical steps that defense counsel can take in the wake of *Under Armour* to minimize collateral consequences.

Although counsel should always be prudent when negotiating language of SEC orders, practitioners should assume that any language they agree to in the SEC order will be used by private plaintiffs to bolster their allegations, particularly as to scienter issues. Also, although the timing of SEC settlements is often out of the control of respondents, where possible, practitioners should attempt not to enter into SEC settlements until *after* a decision on a motion to dismiss in the private action, so the SEC order cannot be used to supplement plaintiffs' allegations. At the motion to dismiss stage, counsel should also consider taking the position that *Under Armour* was wrongly decided and that the broader view of *Lipsky* should govern, particularly given the split in case law in the Second Circuit on this issue.

Finally, companies should also consider the consequences of reaching an administrative settlement with the SEC as compared to the possibility of settling in federal court, if the SEC is open to that alternative. The administrative settlements include the SEC's "findings," which, as noted above, are the product of the SEC's substantial leverage to insist on including "facts" that may not be admissible or sufficient to satisfy a required statutory element in contested litigation. In contrast, some federal court consent settlements do not contain or require any "statement of facts" or admissions by the defendant. Settlements of that type should arguably be less outcome determinative even when presented to judges like the one in *Under Armour*, who appeared to rely exclusively on the "findings" of the SEC's administrative order to bolster the plaintiffs' otherwise insufficient pleading.

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