No-Contest Settlements and the SEC's Recent Experience: Implications for Ontario

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by

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1. Introduction

On October 21, 2011 the Ontario Securities Commission (the "Commission") published Staff Notice 15-704 (the "Staff Notice"),[1] requesting comments on proposed enforcement initiatives intended to enhance the efficiency of Commission enforcement proceedings. One of these initiatives is a change in current Commission practice that would permit no-contest settlements, that is, settlements in which a respondent is not required to admit facts alleged by enforcement staff ("Staff"), a contravention of the Act or that the alleged conduct is contrary to the public interest. The Staff Notice describes a "no-contest settlement program" that would adopt, in limited circumstances, the practice followed by the U.S. Securities and Exchange Commission ("SEC") for settlement of enforcement proceedings brought by it in U.S. federal courts.[2]

Shortly after publication of the Staff Notice, a U.S. district court judge brought the SEC's no-contest settlement practice into question. On November 28, 2011, Judge Jed S. Rakoff rejected a consent judgment proposed by the SEC to settle a proceeding against Citigroup Global Markets Inc., in large part because it was not supported by an admission or acknowledgement of the truth of the SEC's allegations.[3] This paper has been prepared to assist the Commission by outlining Judge Rakoff's decision, the response to it in the United States, and its implications for the issues raised by the Staff Notice with respect to the Commission's settlement process.

2. SEC Settlement Practice and the *Citigroup* Rejection

(a) SEC No-Contest Settlements

The SEC's original enforcement authority was limited to seeking injunctions to prohibit conduct that contravened the U.S. federal securities laws.[4] Until the 1950s, the SEC generally required admission of a violation or an agreement that the court could find a violation on the basis of the record filed in an injunction proceeding, treating settlements without an admission as exceptional.[5] The SEC reversed this practice in the 1960s, and admissions became the exception.[6] In 1972, to prevent defendants from denying its allegations after a settlement was approved, the SEC adopted a rule declaring its policy against a defendant being allowed to suggest that the conduct alleged in a consent proceeding did not occur and stating that the SEC will treat a refusal to admit the allegations as equivalent to a denial, unless the defendant states

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[1] *OSC Staff Notice 15-704: Request for Comments on Proposed Enforcement Initiatives*, (2011) 34 O.S.C.B. 10720 (October 21). The Commission has scheduled a public hearing to be held on June 17, 2013 to receive oral submissions on the Staff Notice; see *Ontario Securities Commission Policy Hearings on Proposed Enforcement Initiatives: OSC Staff Notice 15-704*, (2013) 36 O.S.C.B. 4755 (May 9).
[2] See *SEC Rules of Practice and Conduct*, s. 202(5)(e), 17 C.F.R. s. 202.5(e) (defendant cannot refuse to admit allegations, unless states "that he neither admits nor denies" them).
[3] See *SEC v. Citigroup Global Markets Inc.*, 827 F. Supp.2d 328 (S.D.N.Y. 2011).
[4] See, e.g., *SEC v. Cioffi*, 868 F. Supp.2d 65 (E.D.N.Y. 2012) at 69-70 (summarizing SEC's remedial authority).
[5] See L. Loss, J. Seligman and T. Paredes, 10 *Securities Regulation* (4th ed. 2013) at 407 n. 54.
[6] *Ibid*.

that it "neither admits nor denies" them.[7] Since then and until last year, the SEC's enforcement settlements have invariably included this no-contest language, even in circumstances in which a defendant admitted the allegations in other proceedings. The SEC addressed the inconsistency of not admitting facts admitted elsewhere only in 2012, after Judge Rakoff's decision, in an announcement by its Director of Enforcement declaring a policy change under which a defendant who has entered a guilty plea or been convicted in a parallel criminal proceeding will not be allowed to "neither admit nor deny" the facts so admitted or found.[8]

(b) The *Citigroup* Decision

Prior to 2011, Judge Rakoff had demonstrated an inclination to review SEC consent judgments carefully. In 2009, he rejected a proposed consent judgment against Bank of America Corporation on the basis of the terms of the settlement.[9] In a subsequent case, he had criticized the SEC's Rule 202.5(e), describing it as resulting in a "stew of confusion and hypocrisy unworthy of such a proud agency" as the SEC, although approving the settlement because the individual defendants had admitted guilt in a parallel criminal proceeding.[10]

These two elements came together in the settlement proceeding against Citigroup, in which the SEC filed its complaint and the proposed consent judgment, without supporting evidence, as appears to be its common practice. Judge Rakoff then required a hearing and ordered that the parties answer nine probing questions relating to approval of the settlement, the first of which was why the Court should order a judgment based on allegations of "serious securities fraud," when the defendant "neither admits nor denies wrongdoing?"[11] The parties responded to these questions without providing additional evidence. Rather, the SEC took the position that the settlement was reasonable in light of the allegations in its complaint, which resulted from its investigation, while counsel for Citigroup "expressly confirmed" that Citigroup did not admit these allegations and was entitled to and would contest them in any parallel civil litigation, leading Judge Rakoff to conclude there was "little real doubt that Citigroup contests"

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[7] See *Consent Decrees in Judicial or Administrative Proceedings*, Securities Act Rel. No. 33-5337, November 28, 1972, announcing adoption of s. 202.5(e), note 2 above; see also *SEC v. Vitesse Semiconductor Corp*., 771 F. Supp.2d 304 (S.D.N.Y. 2011) at 308-09 (rule adopted because some defendants publicly denied the SEC's allegations after courts approved settlement, stating they entered into the settlement to avoid litigating with the SEC).

The Commission has a similar policy with respect to settlements of its regulatory proceedings, and it has brought proceedings to enforce it; see, e.g., *In the Matter of David Singh*, (1999) 22 O.S.C.B. 1493 (March 5) and 22 O.S.C.B. 2985 (May 14).

[8] See R. Khuzami, "*Public Statement by SEC Staff: Recent Policy Change*," http://www.sec.gov/news/speech/2012/spch010712rsk.htm. The policy also applies to defendants who enter a non-prosecution or deferred prosecution agreement that includes admissions or acknowledgments of criminal conduct. This change will only apply to a minority of the SEC's cases.

[9] *SEC v. Bank of America Corp*., 653 F. Supp.2d 507 (S.D.N.Y. 2009). This settlement was subsequently approved by Judge Rakoff, albeit "reluctantly," after the SEC presented a 35 page statement of facts and a 13 page supplementary statement, both based on extensive discovery that followed the initial rejection, and the Bank of America informed the judge that it did not contest the accuracy of the facts contained in the two statements. Counsel for the Bank of America also affirmed, at Judge Rakoff's request, that it had no material quarrel with these facts and agreed that they could be considered with respect to approval of the settlement; *SEC v. Bank of America Corp*., 09 Civ. 6829; 10 Civ. 0215 (S.D.N.Y. February 22, 2010).

[10] *SEC v. Vitesse Semiconductor Corp.*, 771 F. Supp.2d 304 (S.D.N.Y. 2011) at 309-10.

[11] Order, *SEC v. Citigroup Global Markets Inc.*, 11 Civ. 7387 (S.D.N.Y. October 27, 2011).

the SEC's factual allegations.[12] The SEC also argued that the court should not consider the public interest, which was within the SEC's exclusive purview.[13]

Judge Rakoff rejected the settlement on the basis that the parties had not provided the Court with sufficient facts to support an order granting the requested injunction and on the merits of the settlement, including the amount to be paid under it by Citigroup.[14] The standard of review applied to the settlement was that the Court had to be satisfied that the settlement was fair, reasonable and adequate and in the public interest. Judge Rakoff found that he was unable to make this determination without evidence of the alleged facts and also addressed other issues relating both to the terms of the proposed consent judgment and to Citigroup's failure to admit or acknowledge the SEC's allegations. In particular, he said that a no-contest settlement deprives investors who are harmed of an ability to use the admissions to prove their case in parallel civil litigation on the basis of collateral estoppel, suggested that the settlement was too soft and may have been influenced by the SEC's desire for a quick headline, and declared that the public had "an overriding public interest in knowing the truth" of the facts on which a consent judgment is based.[15] While recognizing that the SEC's decision to settle was entitled to deference, he emphasized the Court's independence, its role in reviewing a settlement and its responsibilities when issuing an injunction[16] and ordered that the parties proceed to trial in conjunction with the proceeding against Stoker.[17]

The SEC and Citigroup both appealed to the Court of Appeals for the Second Circuit and applied for a stay of Judge Rakoff's decision. A panel of the Court of Appeals granted the stay on the basis that the SEC and Citigroup had demonstrated a likelihood of success on the merits. It found, in effect, that Judge Rakoff had not given adequate deference to the SEC's decision to settle, substituting his own decision for the SEC's, and that requiring an admission of liability would virtually preclude the possibility of the compromise needed for settlements.[18] Underlying its decision was an acceptance of the potential harm to the regulatory process if the SEC were required to take all of its enforcement proceedings to trial.[19] (It is generally accepted that in view of the SEC's limited resources, requiring admissions in all settlements would significantly impede its enforcement capability.[20]) The appeal was heard on February 8, 2013, and is currently under reserve.

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[12] *SEC v. Citigroup Global Markets Inc.*, 827 F. Supp.2d 328 (S.D.N.Y. 2011) at 332-33.
[13] *Ibid*. at 330-31.
[14] The decision on the merits was also based on a failure to explain a seemingly inconsistent pleading with respect to Citigroup's knowledge contained in the complaint in a parallel proceeding against a Citigroup officer; see *SEC v. Stoker*, 865 F. Supp.2d 457 (S.D.N.Y. June 6, 2012) (motion to dismiss rejected); 873 F. Supp.2d 605 (S.D.N.Y. July 9, 2012) (motion for summary judgment rejected). The proceeding against Mr. Stoker was subsequently dismissed following a jury verdict; see G. McCool, "SEC loses civil fraud case against ex-Citigroup manager," Thompson Reuters News and Insight, July 31, 2012.
[15] *SEC v. Citigroup Global Markets Inc.*, note 12, above.
[16] A similar conclusion has been reached in a recent Australian decision concerning monetary penalties to be imposed by the Court, following a settlement between a defendant and the Australian Securities and Investments Commission, on the basis of an agreed statement of admitted facts; see *ASIC v. Ingleby*, [2013] VSCA 49 (March 19, 2013).
[17] *SEC v. Citigroup Global Markets Inc.*, note 12 above, at 335 (consolidating the two cases).
[18] *SEC v. Citigroup Global Markets Inc.*, 673 F.3d 158 (2d Cir. 2012).
[19] It has been estimated that approximately 90 per cent of the proceedings brought by the SEC and by other U.S. federal agencies are settled without going to trial.
[20] See, e.g., L. Loss, J. Seligman and T. Paredes, note 5 above, at 723 n. 82 (SEC "does not have adequate resources to fully investigate and litigate all potential matters").

(c) The Aftermath

Judge Rakoff's decision has been characterized by the leading text on securities regulation in the United States as "deeply concerning."[21] Not surprisingly, the decision has received public and judicial attention in view of the fact that all U.S. federal agencies usually enter no-consent settlements. [22] (In fact, while all such agencies agree to settlements without admissions, not all of them prohibit subsequent denial of the allegations by a defendant or respondent.[23]) As a result, the Financial Services Committee of the U.S. House of Representatives held a hearing on May 17, 2012 to consider Judge Rakoff's *Citigroup* decision.

The Committee received testimony from the SEC's Director of Enforcement, senior officials of three other federal financial agencies, a senior state securities regulator and two securities law academics. [24] Six of these witnesses agreed that settling on a no-contest basis is desirable, that requiring admissions of liability or wrongdoing would adversely affect the enforcement capabilities of federal regulators and that the courts should not intensively review settlement decisions made by the SEC. These were also generally the views of the seventh witness, William F. Galvin, the securities regulator in Massachusetts, who objected to no-contest settlements as a matter of principle, but viewed admissions as a negotiable term that might be used to achieve desirable outcomes like the payment of restitution to harmed investors.[25] The majority of the members of the Committee agreed that courts should defer to the decisions of regulators not to require admissions.

While Judge Rakoff's *Citigroup* decision appears to have had some influence on judicial practice, its influence appears not to have been significant and it has not generally impeded the SEC's enforcement activity, presumably in light of the Court of Appeals' stay decision and its impending decision on the appeal.[26] After the District Court's decision, the SEC continued to follow its prior practice with respect to consent judgments filed with a complaint.[27] A few courts

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[21] *Ibid*.; see also *ibid.* at 806 n. 4 (consent decrees " by far the SEC's most important enforcement device").

[22] See, e.g., Statement of Robert Khuzami, SEC Director of Enforcement, in Committee on Financial Services, U.S. House of Representatives, *Hearing: Examining the Settlement Practices of U.S. Financial Regulators*, May 17, 2012, at 80-82 (summarizing practices of securities, antitrust, environmental, consumer protection, public health and civil rights enforcement).

[23] See, e.g., *Federal Trade Commission v. Circa Direct LLC*, 2012 WL 3987610 (D.N.J.) at 6 n. 3 (FTC suggested it will no longer permit denials, but may follow SEC practice).

[24] See *Hearing*, note 22 above.

[25] Statement of the Honorable William F. Galvin, Secretary, Commonwealth of Massachusetts, *ibid*. at 66-73 (written statement) (of 52 settlements since 2002, over 40 per cent involved admissions; almost 50 per cent where no restitution, at 71); see also *ibid*. at 44-46 and 53.

[26] See, e.g., SEC, *Fiscal Year 2012 Agency Financial Report* (November 2012) at 13 (SEC brought 734 enforcement actions in year ending September 30, 2012, down from 735 in 2011); and see *ibid*., at 125-44 (major enforcement cases), http://www.sec.gov/about/secafr2012.shtml. In fiscal year 2012, the percentage of enforcement actions that were resolved on consent and otherwise fell from 93 per cent in the preceding year to 89 per cent; SEC, *FY 2014 Congressional Budget Justification, FY 2014 Annual Performance Plan and FY 2012 Annual Performance Report* at 31, http://www.sec.gov/about/reports/secfy14congbudgjust.pdf. The number of settlements rose from 670 in 2011 to 714 in 2012, the highest number since 2007, and the Citigroup settlement had the highest value of all settlements in the year; E. Buckberg, J. Overdahl and J. Baez, *SEC Settlement Trends: 2H12 Update* (NERA January 14, 2013) at 1-2.

[27] See, e.g., Letter, *SEC v. Koss Corp., 2*:11-cv-00991(E.D. Wisc. December 20, 2011) (SEC filed complaint, consent documents of defendants and proposed final judgments without supporting evidence); *SEC v. Cioffi*, 868 F. Supp.2d 65 (S.D.N.Y. 2012) at 66 (terms of settlement presented for Court's approval in open court before trial).

have requested additional information in written submissions and approved the settlement after receiving them.[28] One judge has rejected a proposed settlement on the grounds that the defendants made no admissions, stating that he refuses "to approve penalties against a defendant who remains defiantly mute as to the veracity of the allegations against him" and that "a defendant's options in this regard are binary: he may admit the allegations or he may go to trial."[29] Another has approved a settlement requiring the defendants, together, to pay approximately $600,000,000, but conditioned his approval on the decision of the Court of Appeals in *Citigroup*, holding that the settlement satisfied the standard in Judge Rakoff's earlier decisions, except for the fact that the defendants neither admitted nor denied the allegations[30] and emphasizing the importance of this issue, the value of admissions to plaintiffs in a parallel civil action, and the public's interest in knowing the truth.[31] In one case involving allegations of the payment of bribes to foreign government officials, the Court, after raising objections to the settlement, rescheduled the proceeding to a date to be determined.[32]

Citigroup has also not prevented approval of settlements in false advertising and antitrust proceedings. It has, however, resulted in more intensive review in light of the failure by the federal agencies to require admissions. In a proceeding by the Federal Trade Commission ("FTC"), the Court applied the standard of review in *Citigroup* and requested additional legal and factual submissions from the FTC.[33] In approving the settlement after receiving responses to some of its questions, the Court noted that a private right of action is not available for a breach of federal trade legislation. Addressing concerns about the public's access to true facts concerning the defendants' conduct, the Court conditioned its approval on the FTC creating a web page and publishing detailed summaries of its allegations, the evidence submitted to the Court, with links to documentary and expert evidence, and a notice from the Court stating that the Court has approved a settlement and that while the defendants do not admit to the allegations, they submitted no evidence to the contrary.[34]

Finally, in approving the settlement of an antitrust claim, one Court referred to the Court of Appeals' stay decision and the fact the applicable legislation did not create a private right of action and precluded use of consent judgments not based on testimony against a defendant in private litigation, while expressing concern about the amount of disgorgement and the risk that the defendant viewed the settlement merely as a cost of doing business. [35]

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[28] See *SEC v. Cioffi*, *ibid*.; *SEC v. Koss*, note 27 above (letter submissions); see also Letter, *ibid.*, February 1, 2012.
[29] Order Denying Entry of Final Judgments, *SEC v. Bridge Premium Finance, LLC*, Civil Action No. 1:12-cv-02131 (D. Colo. January 17, 2013).
[30] *SEC v. CR Intrinsic Investors, LLC*, 2013 WL 1614999 (S.D.N.Y. April 16, 2013).
[31] *Ibid*. at 10-12. The Court referred to a companion case, *SEC v. Sigma Capital Management, LLC*, 13 Civ. 1740 (S.D.N.Y. March 15, 2013) in which a settlement involving an affiliate of CR Intrinsic and some of the other defendants for approximately $14,000,000 was approved without comment.
[32] See Docket, *SEC v. International Business Machines Corp*., 1:11-cv-00563 (D. D.C. February 17, 2013); T. Schoenberg and A. Zajac, "IBM Judge Questions SEC on Foreign Bribe Settlement," Bloomberg.com, December 21, 2012.
[33] See *Federal Trade Commission v. Circa Direct LLC*, 2012 WL 2178705 (D.N.J.). The Court also received a letter from one FTC Commissioner arguing that that the settlement should not be approved without an admission or demonstration of the FTC's likelihood to succeed in litigation; *ibid.* at 3.
[34] See *Federal Trade Commission v. Circa Direct LLC*, 2012 WL 3987610 (D.N.J.) at 7. The FTC invited the Court to rely on documentary and expert evidence, presented to it on an earlier motion for a preliminary injunction, for the truth of the allegations in its complaint, when considering the public interest; *ibid.* at 3.
[35] See *U.S. v. Morgan Stanley*, 881 F. Supp.2d 563 (S.D.N.Y. 2012) at 568-69.

3. Implications for Commission Settlements

While the experience with no-contest settlements in the United States highlights some issues that are relevant to the Commission's consideration of the Staff Notice, it must be viewed carefully to take into account institutional, legal and cultural differences between the U.S. and Canada. Much of the debate about the *Citigroup* decision relates to the role of U.S. courts in approving settlements and granting injunctions. As a result, much of the discussion, particularly in the briefs in the Citigroup appeal, is premised on the dichotomy between the courts acting as a "rubber stamp" in performing a judicial review function on the one hand and the appropriate degree of deference to the expertise and regulatory policy role of, in this case, the SEC on the other. These issues, framed in terms of the independence of courts, their constitutional position as against executive agencies, their jurisdiction to review agency policy decisions and the intensity of any such review may be important for a resolution of the SEC's settlement practice, but they are not relevant to the Commission's determination of how to treat no-contest settlements.

A number of issues raised by the *Citigroup* decision are relevant to the Staff's proposal to allow no-contest settlements, for example, whether and how settlements that do not contain an admission by a respondent can satisfy public interest standards, but in the Canadian context, these issues are exclusively regulatory. They are closer to decisions made by the SEC when it determines to adopt a rule of practice like Rule 202.5(e) or to approve the settlement of a court proceeding.[36] In fact, it has been suggested that the issues raised by the *Citigroup* decision can be overcome if the SEC brings its enforcement actions as administrative proceedings.[37] This suggestion, if adopted, would bring SEC enforcement practice closer to the Commission's.

Under the Commission's Rules of Procedure, a settlement agreement between Staff and a respondent must be approved by the Commission in a public hearing.[38] This hearing follows a confidential settlement conference with a Commission hearing panel to provide "guidance on

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[36] It should be noted that all of the settlements discussed above, and considered by U.S. courts, had to be approved by the SEC, as the initiation and settlement of every enforcement proceeding is approved by the full Commission. The SEC's settlement approval practice is described more fully in the *amicus* brief filed on behalf of Harvey Pitt, a former General Counsel and Chairman of the SEC; see *Brief of Amicus Curiae Former Securities and Exchange Commission General Counsel and Chairman, Harvey Pitt in Support of Affirmance of District Court's Ruling*, August 21, 2012, filed in *SEC v. Citigroup Global Markets Inc*., 11-5227-cv, U.S.C.A., 2d Cir., at 9-14.

[37] See, e.g., *Brief of Amici Curiae Securities Law Scholars for Affirmance in Support of the District Court's Order and Against Appellant and Appellee*, August 16, 2012, filed in *SEC v. Citigroup Global Markets Inc.*, 11-5227-cv, U.S.C.A., 2d Cir., at 22.

Prior to 2010, the SEC had authority to seek a cease and desist order and an accounting and disgorgement in an administrative proceeding against a person who contravened securities laws; see, e.g., *Securities Exchange Act of 1934*, ss. 21C(a) and (e), 15 USC ss. 78u-3(a) and (e). It could also bring an administrative proceeding for a limited monetary penalty against a registrant; *ibid.*, s. 21B, 15 USC s. 78u-2. In July, 2010, the *Dodd–Frank Wall Street Reform and Consumer Protection Act* granted it authority to seek such monetary penalties in administrative cease and desist proceedings against other persons; *ibid.*, s. 21B(a)(2), 15 USC s. 78u-2(a)(2). Although the SEC has made little use of these provisions, it has been suggested that this is likely to change; see J. McKown, "Administrative Proceeding against Rajat Gupta Marks a Turning Point in SEC Enforcement Actions," (2011) 5 *Bloomberg Law Reports – Securities Law*, No. 3. On November 28, 2011, the same day as the *Citigroup* decision, the Chair of the SEC requested amendments to U.S. securities laws that would increase the monetary penalties available in both court and SEC proceedings; see Letter from Mary L. Schapiro to the Honorable Jack Reed, November 28, 2011, reproduced in *Hearing*, note 22 above, at 127. See also L. Skinner, "In Rakoff's wake, SEC may settle matters out of court," Investment News, December 1, 2011.

[38] See *OSC Rules of Procedure*, Rule 12.

whether the terms of" a proposed settlement would be in the public interest.[39] As a result, there is no relevant issue of deference. The matters to be addressed in connection with the Staff Notice and no-contest settlements thus relate only to the Commission's determination of the public interest with respect to its own regulatory proceedings.[40]

(a) Commission Settlement Practice

As settlement agreements must be approved by the Commission and must provide for a Commission order, their acceptability requires a determination by the Commission that a settlement and the orders it contemplates are in the public interest.[41] The Commission currently takes the position that a determination that an order is in the public interest must be based on admitted facts or findings of fact and, accordingly, requires a respondent who enters a settlement agreement to admit the allegations of fact and a contravention of Ontario securities law or conduct contrary to the public interest. The Commission has, however, occasionally approved settlements without such admissions.

In 1990, for example, the Commission approved a settlement with Price Waterhouse and one of its audit partners relating to their audit of financial statements of National Business Systems Inc. ("NBS"), which Staff alleged contravened the Act and regulations under it.[42] The settlement agreement did not contain admissions of wrongdoing by the respondents. It provided that Staff would recommend the resolution of the proceedings and that Staff's position was that the facts set out in the settlement agreement were accurate based on its investigation of NBS and expert advice from an independent outside accounting firm. The settlement agreement stated that Staff's position, based on its work and its adviser's report, was that "the conclusions set out herein are reasonable, and supported by the evidence therein."[43]

The settlement agreement provided that the respondents "neither admit nor deny the accuracy of the facts, allegations or conclusions of the Staff" set out in it and that they entered into the agreement "solely for the purpose of resolving the outstanding issues" described in it.[44] In fact, the respondents denied culpability; in describing the respondents' positions, the settlement agreement provided that they, as well as the public, were deliberately deceived and misled by NBS, its senior officers and others.[45] The settlement agreement also provided that in giving effect to the settlement, the respondents agreed to "neither oppose nor consent to the disposition of this proceeding in the manner requested by the Staff" and to comply with the order sought by Staff and made on that basis.[46]

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[39] *Ibid*., Rules 12.1-12.5. The hearing panel that considers approval of the settlement in a public hearing is comprised of the same panel members who presided at the preceding settlement conference.
[40] Additional considerations may arise with respect to settlements entered into by the Commission's Executive Director which although also involving only regulatory determinations are, as a matter of law, subject to review by the Commission; *Securities Act*, R.S.O. 1990, c. S.5, s. 8(1), as amended (hereinafter the "Act").
[41] See Act, s. 127(1); see also *OSC Rules of Procedure*, Rule 12.7(2)(a).
[42] *In the Matter of Price Waterhouse and Owen F. Smith*, (1990) 13 O.S.C.B. 1473 (April 20).
[43] Settlement Agreement, *ibid*., (1990) 13 O.S.C.B. 1475, paras. 3 and 4.
[44] *Ibid*., paras. 5 and 34.
[45] *Ibid*., paras. 18-21. Staff's position was that Staff did "not necessarily accept the position of" the respondents and had concluded that the respondents failed to carry out an audit in accordance with generally accepted auditing standards and that the respondents' conduct resulted in breaches of the Act and regulations under it, described in some detail in the agreement; *ibid*., paras. 22-33.
[46] *Ibid*., para. 34.

The Commission concluded that it was in the public interest to approve the settlement agreement. In making the agreed orders, it expressly recognized that the respondents had "neither opposed nor consented to the issuance of this Order."[47]

The Commission again approved a no-contest settlement in 1993.[48] In this proceeding, the settlement agreement provided that the respondents agreed to a settlement to resolve the allegations and the proceedings and consented to the making of the agreed orders against them.[49] This settlement agreement also contained the positions of Staff and the respondents. Staff's position was, in effect, that the respondents engaged in insider trading and other contraventions of the Act and regulations.[50] The respondents' position was that not all of them were aware of all of the facts set out in the settlement agreement, and each of them denied having material undisclosed information at any relevant time, that is, denied having engaged in insider trading or otherwise acting contrary to Ontario securities law.[51] The Commission's order recited the fact of the agreement and the respondents' consent to the order and declared that approval of agreement and the orders contemplated in it was in the public interest.[52]

(b) No-Contest Settlements

(i) Commission Jurisdiction

The issue before the Commission with respect to the Staff Notice is whether these decisions should continue to be treated as anomalies and not accepted as within Commission practice or whether no-contest settlements may be in the public interest, either generally or in specific circumstances. As this is a regulatory question, like other questions of the public interest, it should be viewed within the framework of the Act and the Commission's public interest jurisdiction with respect to enforcement matters.

It is trite, but useful, to repeat that the purpose of Commission enforcement proceedings, and sanctions imposed by the Commission, is to protect the securities market's integrity and to prevent repetition of undesirable conduct by specifically deterring respondents and generally deterring others who may be inclined to engage in similar conduct.[53] Determinations of such matters are intended to implement the purposes of the Act, namely, to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in them.[54] These purposes are to be implemented with regard to six fundamental principles, the most relevant of which for current purposes is that effective and responsive securities regulation "requires timely, open and efficient administration and

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[47] *Ibid*., Order, 13 O.S.C.B. at 1473.
[48] See *In the Matter of Seakist Overseas Limited*, (1993) 16 O.S.C.B. 1959 (April 30).
[49] *Ibid*., Settlement Agreement, paras. 2-3.
[50] *Ibid*., paras. 25-27.
[51] *Ibid*., paras 24 and 28-31.
[52] *Ibid*., Order, at 1960. See also *Re Ryckman*, (1996) 5 ASCS 519 (February 16) (approving settlement in which the respondents acknowledged the allegations and neither admitted nor denied them, but did not contest them for purposes of the Alberta Commission's proceeding).
[53] See, e.g., *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario Securities Commission*, [2001] 2 S.C.R. 132; *Re Cartaway Resources Corp*., [2004] 1 S.C.R. 672.
[54] Act, s. 1.1.

enforcement" of the Act.[55] These purposes and principles provide a basis on which the Commission may determine the relevance of the issues raised by the *Citigroup* decision in the U.S. for its determination of the public interest with respect to settlement of enforcement proceedings under the Act.

The arguments of the SEC and others with respect to the benefits of no-contest settlements in permitting an efficient resolution of proceedings, resulting in more effective allocation of its resources to other investigations and proceedings and immediate benefits to investors, are obviously relevant to the protection of investors and the efficient administration and enforcement of the Act. But a determination of the potential benefits from permitting no-contest settlements must be based primarily on the Commission's own experience with enforcement matters in light of its enforcement and other priorities.[56] Suffice it to say, in light of the Act's purposes and principles, it is open to the Commission to consider the advantages of no-contest settlements as being relevant to its public interest determinations, both with respect to the principle of no-contest settlements and the approval of any settlements brought before it.

Section 127 of the Act does not preclude such settlements. It authorizes the Commission to make orders, if in the Commission's opinion it is in the public interest to do so. Apart from an order imposing an administrative penalty or requiring disgorgement, for which a contravention of Ontario securities law is a prerequisite, admissions by a respondent are not necessary for an order agreed to in a settlement agreement to be made. The only requirement is that the Commission be of the opinion that the settlement and an order approving it and the orders it contemplates are in the public interest. It may so conclude, without an admission from a respondent, on the basis of facts in a settlement agreement that are declared by Staff to be true and not denied by the respondent, the respondent's acceptance of the settlement agreement as a basis for resolving the proceeding, the agreed sanctions in light of the conduct described in the settlement agreement, and the other factors that the Commission currently considers on settlement approval hearings.[57] With respect to the principle of no-contest settlements, the Commission might also consider the potential for Staff to negotiate restitution or compensation for harmed investors or a stronger sanction by accepting a proposed settlement agreement without admissions.[58]

(ii) Civil Actions by Investors

In the U.S. these factors have been balanced, by Judge Rakoff and others, against two dominant countervailing considerations. The first relates to the ability of investors to utilize

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[55] Act, s. 2.1(3). A complementary principle is that restricting fraudulent and unfair market practices and procedures is a primary means to achieve the Act's purposes; see s. 2.1(2)(ii).

[56] See *Notice 11-768 – Statement of Priorities: Request for Comments regarding 2013-2014 Statement of Priorities*, (2013) 36 O.S.C.B. 3423 (April 4) (Draft for Comment at 12-13).

[57] See, e.g., *In the Matter of Price Waterhouse and Owen F. Smith*, (1990) 13 O.S.C.B. 1473 (April 20); *cf.* note 9 above. This would not prevent a respondent from agreeing to disgorge funds or pay funds to the Commission, as a settlement agreement may provide for a "sanction" that the Commission lacks authority to impose; see, e.g., *In the Matter of Research in Motion Ltd.*, (2009) 32 O.S.C.B. 1421 (February 13) at 1428 (Settlement Agreement, paras. 61-62) (undertaking to compensate corporation); 32 O.S.C.B. 4434 (May 29) at 4436 (Reasons, para. 23); *In the Matter of HSBC Bank Canada*, (2010) 33 O.S.C.B. 63 (January 8); *In the Matter of Canadian Imperial Bank of Commerce and CIBC World Markets Inc.*, (2010) 33 O.S.C.B. 73 (January 8) (funds paid to Commission); see also *In the Matter of Coventree Inc.*, (2012) 35 O.S.C.B. 119 (January 6) at 130 (para. 79).

[58] See above, text accompanying note 25 (testimony of William F. Galvin).

admissions in a settlement to prove their case in a civil proceeding seeking compensation from the defendants, as the defendants will be estopped from denying these admissions in a collateral proceeding; a settlement without admissions enables the defendants to deny the alleged facts in a parallel civil action.[59] As the same legal principles apply to admissions made in settlements with the Commission, this is a relevant consideration.[60]

Compensation of investors, however, must be viewed in the context of the Act, rather than the legislation considered by U.S. courts. Although Commission settlements have frequently required a respondent to compensate or otherwise remediate harm to investors,[61] and the Commission has on occasion distributed settlement funds to harmed investors,[62] the primary focus of Commission enforcement is not compensation but protection of the integrity of capital markets and investors generally, as was recently held by the Ontario Court of Appeal.[63] In other words, Commission enforcement proceedings are first and foremost regulatory.[64]

The secondary market liability regimes under which investors bring civil actions based on disclosure violations by issuers may also be relevant to this issue. In the U.S., investors must prove not only a misrepresentation made by a defendant, but knowledge, intent or recklessness on the defendant's part, and must pass a high pleading threshold implemented by the *Private Securities Litigation Reform Act of 1995*.[65] The burden on plaintiff investors under the secondary market liability regime in the Act is not as stringent, as they need only prove a misrepresentation, after which the burden shifts to the defendant to demonstrate due diligence.[66] In addition, although leave of a court to bring an action is required by the Act, it is arguable that a settlement agreement may, even without admissions, assist a plaintiff-investor in obtaining leave to bring such an action.[67] This is not to suggest that consideration of potential benefit to investors seeking compensation is not relevant to the Commission's consideration of the public interest, but only that it is not determinative.

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[59] See, e.g., *SEC v. Citigroup Global Markets Inc*., 827 F. Supp.2d 328 (S.D.N.Y. 2011) at 333-34 (collateral estoppel).

[60] Admissions in a securities regulatory settlement agreement have generally been held to be admissible against the settling parties in subsequent civil actions by investors; see, e.g., *Hill v. Gordon-Daly Grenadier Securities*, (2001) 56 O.R. (3d) 379 (S.C.J.), affirmed (2001) 56 O.R. (3d) 388 (Div. Ct.); *BDO Dunwoody Ltd. v. Miller Bernstein*, (2008) 91 O.R. (3d) 207 (S.C.J.); *National Bank Financial Ltd. v. Potter*, 2012 NSSC 76 (CanLII).

[61] See, e.g., *In the Matter of AGF Funds Inc.*, (2005) 28 O.S.C.B. 73 (January 7); 28 O.S.C.B. 881 (January 21); *In the Matter of Franklin Templeton Investments Corp.*, (2005) 28 O.S.C.B. 2408 (March 11) (compensation); *In the Matter of Fulcrum Financial Group Inc.*, (2006) 29 O.S.C.B. 2068, 2069, 2096 and 2103 (March 10) (rescission offer).

[62] See, e.g., *ibid*.; and see *News Release: OSC and IIROC Announce Distribution Plans for ABCP Settlement Funds*, (2012) 35 O.S.C.B. 3901 (April 20).

[63] See *Fischer v. IG Investment Management Ltd.,* 2012 ONCA 47. An appeal of this decision to the Supreme Court of Canada was heard on April 18, 2013 and judgment was reserved.

[64] *Ibid*., paras. 46, 52 and 80. The Court of Appeal held that a Commission proceeding in which compensation was obtained for investors under a settlement agreement was not a "preferable procedure" for resolution of their claims, and did not warrant a refusal to certify a parallel class action based on the facts admitted in the settlement, because Commission proceedings under section 127 serve a "purely regulatory function" and are not intended to provide compensation or other relief to investors, and investors are not entitled to participate in them.

[65] See, e.g., *Tellabs, Inc. v. Makor Issues & Rights, Ltd*.. 551 U.S. 308 (2007); and see generally J. Coffee and H. Sale, *Securities Regulation: Cases and Materials* (12th ed. 2012) at 1042-48 and 1057-59.

[66] See Act, ss. 138.3-138.4.

[67] See Act, s. 138.8.

(iii) Public's Right to Know

The second major countervailing factor in the U.S. decisions is the concept that the public is entitled to and will benefit from an admission or finding that provides them with the truth of the SEC's allegations.[68] This issue arises most dramatically when the SEC, or another agency, files only a complaint and a consent order. This is not the practice before the Commission. Settlement agreements entered into by Staff almost always contain facts that Staff obtained in an investigation and declare to be true. This was the case with the two settlements outlined above, which the commission approved even though the respondents did not make admissions.[69] As long as the respondents are not permitted to deny the facts asserted as true by Staff in a settlement agreement to which the respondents are parties, accompanied by an appropriate sanction, this objection may be, in large part, addressed.[70]

(iv) Deterrence

The U.S. discussion of the *Citigroup* decision recognizes that both requiring an acknowledgement of wrongdoing through admissions and quicker resolution of proceedings involving serious sanctions may deter improper market conduct. These considerations are relevant to the Commission's ability to accomplish its protective and preventive goals through no-contest settlements. The considerations to be balanced relate to the deterrence obtained by requiring an admission as against the general deterrence that is likely to result from achieving more frequent enforcement results more quickly.

4. Conclusion

As stated above, these considerations are relevant to the Commission's determination of the acceptability of no-contest settlements as a matter of principle and of specific settlements that may be brought before a Commission hearing panel. As the Staff Notice does not propose an all-or-nothing policy, if no-contest settlements are permitted, the lack of an admission would be one element of a settlement to be weighed in light of other relevant factors with respect to the respondent, the likelihood of success, potential outcomes and the timing and cost of proceeding to a hearing, on the basis of the standards that the Commission currently applies when considering approval of proposed settlements.[71]

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[68] See, e.g., *SEC v. Vitesse Semiconductor Corp*., 771 F. Supp.2d 304 (S.D.N.Y.) at 309-10; *SEC v. Citigroup Global Markets Inc.*, 827 F. Supp.2d 328 (S.D.N.Y. 2011) at 335; *Federal Trade Commission v. Circa Direct LLC*, 2012 WL 3987610 (D.N.J.) at 6-7.

[69] See, e.g., Settlement Agreement, *In the Matter of Price Waterhouse*, (1990) 13 O.S.C.B. 1473 at 1476 and 1484-94 (paras. 4 and 22-33).

[70] See, e.g., *SEC v. CR Intrinsic Investors, LLC*, 2013 WL 1614999 (S.D.N.Y.) at 8 (settlement for over $600 million; incongruous not to admit allegations); see also *In the Matter of Seakist Overseas Limited*, (1993) 16 O.S.C.B. 1959 (payment of $23 million by respondents).

[71] See, e.g., *In the Matter of Koonar*, (2002) 25 O.S.C.B. 2691 (May 10) at 2692; *In the Matter of M.C.J.C. Holdings and Michael Cowpland*, (2003) 26 O.S.C.B. 8206 (December 19); *In the Matter of Rankin*, (2008) 31 O.S.C.B. 3303 (March 21) at 18-22; *In the Matter of Mega-C Power Corp*., (2011) 34 O.S.C.B. 1279 (February 4), para. 31.