JUDICIAL REVIEW OF SEC CONSENT JUDGMENTS

Three years ago, Federal District Court Judge Jed Rakoff famously refused to approve a $285 million consent judgment between the SEC and Citigroup. Last summer, however, the Second Circuit overturned that ruling and clarified the standard that district courts are to use in considering approval of such settlements. The author explores the criticisms leveled at the SEC’s settlement practices by Judge Rakoff and others, the standards dictated by the Second Circuit, and the fallout from the case.

By Brent J. McIntosh *

“Trials are primarily about the truth. Consent decrees are primarily about pragmatism.” — Second Circuit Judge Rosemary Pooler, writing for the panel in SEC v. Citigroup Global Markets, Inc. 1

With that pronouncement this past summer, the Second Circuit cut off a nascent bid to invest trial courts with increased authority to conduct searching reviews of the substantive terms of consent judgments that the SEC and private defendants offer up for judicial approval. The tension over the proper level of judicial deference to proposed consent decrees is longstanding and structural. It arises from the interplay between the federal courts’ obligation to superintend the use of the judicial power in the public interest and regulatory agencies’ necessary institutional authority to make judgments about resolving claims short of trial and shepherding scarce agency resources. Trial courts have increasingly chafed at being asked to approve sweeping consent judgments while being provided little concrete information about the underlying facts, while the SEC and its regulatory cohorts have not taken kindly to what they view as unwarranted second-guessing of their informed judgments as to what compromises best serve the public interest. And various parties — commentators, private litigants, Members of Congress, and others — have objected to regulators’ routine use of consent judgments in which defendants neither admit nor deny the truth of the allegations against them.

This tension came to a head over the past three years in litigation in which Judge Jed Rakoff, of the U.S. District Court for the Southern District of New York, refused to sign off on an SEC consent judgment because, the judge said, the settlement amount was “pocket change” for the defendant and the truth of the allegations underlying the SEC’s complaint had not been established. 2 In a much-anticipated decision issued this past summer, the Court of Appeals for the Second

1 752 F.3d 285, 295 (2d Cir. 2014).

Circuit rejected the trial court’s ruling, expounding a highly deferential standard for judicial approval of such consent judgments. The circuit court rejected as impermissible the district court’s insistence on knowing the fundamental truth of the SEC’s allegations — securing for the SEC and other regulators broad authority to calibrate settlements to subjective factors, such as the perceived strength of their case and the need to allocate enforcement resources efficiently.

Yet all is not gloomy for opponents of deferential review. The circuit court’s decision does not provide regulators carte blanche to evade review of consent judgments while still securing judicial sanction. In any event, the trial court’s decision and others like it have focused attention on regulators’ use of no-admit/no-deny settlements, giving rise to increased scrutiny of settlement practices and prompting modifications of the SEC’s policies regarding requiring admissions of wrongdoing.

STRUCTURAL TENSION

The SEC and other regulatory agencies regularly settle civil claims against private actors by entering into and seeking judicial approval of consent judgments. In addition to monetary payments, such consent judgments often involve injunctions prohibiting further offenses, backed by the judiciary’s power to enforce such injunctions. Another regular feature of such settlements is that the private defendant often neither admits nor denies the conduct alleged — so-called “no-admit/no-deny” settlements — freeing the defendant to defend more effectively against civil lawsuits arising from the conduct alleged. Defendants — even those who think they’ve done nothing wrong — often prefer the quick certainty of a negotiated settlement to the burden and uncertainty of a trial, especially with a no-admit/no-deny settlement. Such settlements have the additional benefit of quickly bringing to a close the period of regulator-versus-defendant adversity that private entities dread.

From the regulators’ perspective, such settlements have a number of advantages: They eliminate the burden and inherent uncertainty of taking the underlying civil claims to trial, freeing enforcement staff to handle more matters more quickly with greater certainty than would be possible in a system in which many such matters were litigated through trial and possible appeal. This dynamic multiplies the reach of a given cadre of enforcement staff. Regulators generally view the calculus as to which cases to settle and on what terms to be within both their particular expertise and their allocated authority. After all, they are best positioned to judge the strengths and weaknesses of their case and other factors relevant to the probability and burden of securing a favorable verdict, and to measure those factors against the resource constraints their agencies face and the relative importance of the various matters they are pursuing. More fundamentally, in our constitutional system, it is the executive branch that must “take Care that the Laws be faithfully executed”; in practice, it is regulatory agencies that are charged with carrying out that mandate.

Such settlements have drawn criticism, though, on two different fronts. First, various critics — including many plaintiffs’ lawyers — argue that allowing defendants to settle regulators’ civil claims without admitting the underlying conduct diserves the truth-seeking function the federal judiciary is intended to perform. While this criticism is founded on nobly conceived principles about what the judiciary’s role ought to be — see, for example, Yale Law professor Owen Fiss’s prominent 1984 article Against Settlement — its most vociferous advocates are generally those who stand to benefit monetarily from defendants’ admissions of wrongdoing.

Second, some federal judges have leveled a variety of criticisms at the settlement practices the SEC and other

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3 U.S. Const. art. II, § 3. For discussions of this grant of authority, see Baltimore Gas & Electric Co. v. FERC, 252 F.3d 456, 459 (D.C. Cir. 2001), and Hotel & Restaurant Employees Union, Local 25 v. Smith, 846 F.2d 1499, 1519 (D.C. Cir. 1988) (en banc) (Silberman, J., separate opinion).

4 93 YALE L.J. 1073 (1984). Professor Fiss argues that “[c]ivil litigation is an institutional arrangement for using state power to bring a recalcitrant reality closer to our chosen ideals,” which is misused if parties “settle while leaving justice undone.” Id. at 1085, 1089.
regulators have employed. These reproaches fall into a handful of broad categories:

- The settlement amount is insufficient in light of the conduct alleged. Often this criticism is expressed in terms of allowing defendants to view the payment as merely a cost of doing business. For example, in reluctantly approving a 2010 settlement of claims against Citigroup, Judge Ellen Segal Huvelle of the U.S. District Court for the District of Columbia said, “$75 million would not deter anyone from doing anything.”

- The settlement does not involve any admission of wrongdoing, thus preventing the public (to say nothing of private litigants) from ascertaining the “truth” about the defendants’ wrongdoing. A variant of this point is that the agency gave the court scant information to demonstrate that the defendant actually did what the agency alleged — a criticism sometimes portrayed as protecting the defendant from an overzealous regulator’s demanding payment as a cost of doing business even where the defendant regards itself as blameless.

- The settlement’s financial incidence actually falls on the defendant company’s shareholders, not its management, even in cases in which the shareholders were the ones harmed by the company’s alleged malfeasance.

- The agency secured a settlement from the company, but the government failed to pursue criminal charges or civil claims against any individual responsible for the wrongdoing, allowing the actual perpetrators to get off scot-free.

- The agency’s determination to settle, and thus the alleged facts presented to the court, were based on an investigation conducted by agents — generally a law firm — that the defendant itself hired.

These criticisms find special traction in consent judgments that feature injunctive relief, an equitable remedy over which the federal judiciary wields special control. Where defendants and regulators agree to injunctive relief, courts have traditionally considered it their obligation to ensure that the injunction — and the courts’ imposition of it — does not disserve the public interest. As Judge Rakoff said, the “injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated”; on the contrary, “a court cannot grant the extraordinary remedy of injunctive relief without considering the public interest.” It is based on this obligation — coupled with the perception that agencies were increasingly taking judicial approval for granted and magnified by the natural human desire to understand the basis for actions one is asked to approve — that judges have increasingly questioned, and even resisted, the terms of consent judgments offered up for their approval.

**SEC v. CITIGROUP**

By far the most prominent such objection was Judge Rakoff’s 2011 rejection of the *SEC v. Citigroup* consent judgment. That settlement arose from the SEC’s allegation that Citigroup violated certain provisions of the ’33 Act. Under the settlement’s terms, Citigroup neither admitted nor denied the allegations, but it agreed to injunctive relief barring future violations and to a payment of $285 million: a $95 million civil penalty, disgorgement of $160 million, and $30 million of prejudgment interest.

**The District Court**

Recognizing “the substantial deference due the SEC in matters of this kind,” Judge Rakoff said he “spent long hours” evaluating the proposed settlement and ultimately concluded he could not approve it. The court’s objections to the settlement ran the gamut, from the amount of the payment to the SEC’s failure to provide “cold, hard, solid facts” on which the court could evaluate the settlement. There runs through the decision an implicit tension between the court’s frustration at having “not been provided with any proven or admitted facts upon which to exercise even a modest

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6 As discussed below, in rejecting the proposed *SEC v. Citigroup* settlement, the district court appeared to embrace both variants of this criticism: The settlement’s lack of admissions both precluded private plaintiffs from using it in suing Citigroup and failed to protect Citigroup by ensuring that it only settled upon believing it had done something wrong. 827 F. Supp. 2d at 334-35.

7 For example, Judge Rakoff said a previous SEC consent judgment involving Bank of America “does not comport with the most elementary notions of justice and morality,” because “it proposes that the shareholders who were the victims of the Bank’s alleged misconduct now pay the penalty for that misconduct.” *SEC v. Bank of America Corp.*, 653 F. Supp. 2d 507, 509 (S.D.N.Y. 2009).

degree of independent judgment” on the one hand, and, on the other hand, the court’s wide-ranging, forceful, undoubtedly independent judgment that the settlement’s terms were substantively objectionable.

Ultimately, applying the factors the Second Circuit had dictated for evaluating proposed consent judgments, Judge Rakoff refused to approve the consent judgment, saying it was “neither fair, nor reasonable, nor adequate, nor in the public interest” because the SEC and Citigroup failed to “provide the Court with a sufficient evidentiary basis to know whether the requested relief is justified under any of these standards.” In reaching this conclusion, Judge Rakoff emphasized that regulators’ settlements — especially those featuring injunctive relief — face greater scrutiny than typical civil settlements:

Purely private parties can settle a case without ever agreeing on the facts, for all that is required is that a plaintiff dismiss his complaint. But when a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, enforced by the formidable judicial power of contempt, the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts, while the public is deprived of ever knowing the truth in a matter of obvious public importance.9

Judge Rakoff based his decision, at least in part, on his belief that a consent judgment of the sort presented to him, which “does not involve any admissions” and “results in only very modest penalties,” will not deter corporate misbehavior but instead is “frequently viewed, particularly in the business community, as a cost of doing business imposed by having to maintain a working relationship with a regulatory agency.” He objected, moreover, that because Citigroup did not admit wrongdoing, private investors who sue Citigroup “cannot derive any collateral estoppel assistance from Citigroup’s non-admission/non-denial of the SEC’s allegations.”

Judge Rakoff also expressed concern that the lack of any factual demonstration of wrongdoing had the potential to disserve both the general public and Citigroup. As to the former, he objected that a settlement not backed with demonstrated facts served as an intolerable barrier to dissemination of much-needed truth about current events, comparing the proposed settlement’s lack of admissions to the propaganda rampant in totalitarian states:

> [I]n any case like this that touches on the transparency of financial markets whose gyrations have so depressed our economy and debilitated our lives, there is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the SEC, of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges; and if it fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement to the agency’s contrivances.10

Notably, while the public-interest test applies only to consent judgments that feature injunctive relief and the logical focus of that test is whether the injunctive relief itself disserves the public interest, Judge Rakoff’s objection to the consent judgment’s effect on the public interest had little to do with its injunctive relief and instead focused on other, non-injunctive terms of the settlement, such as the amount of Citigroup’s payment and the lack of admissions.

Shifting to an evaluation of Citigroup’s position, Judge Rakoff objected that a settlement not based on admitted or demonstrated facts could hamper the court’s efforts to ensure that the settlement resulted not from overbearing and unjustified regulatory pressure, but from Citigroup’s belief that it had engaged in bad behavior. Judge Rakoff said he harbored “little real doubt that Citigroup contests the factual allegations of the Complaint,” rendering the consent judgment “not fair, because, despite Citigroup’s nominal consent, the potential for abuse in imposing penalties on the basis of facts that are neither proven nor acknowledged is patent.” This expression of concern for Citigroup — a powerful and sophisticated party represented by experienced counsel — may strike some as misplaced. But it reflects well-informed realism about the enormous power regulators wield in today’s regulatory environment: Judge Rakoff appears concerned that aggressive regulators can exact settlements even from sophisticated parties that believe they have done nothing wrong, because a certain settlement now is preferable to

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9 Id. (footnote omitted).

10 Id. at 335.
an uncertain verdict in the future — and tense relations with powerful regulators in the interim.  

Judge Rakoff’s reaction was no surprise: He had rejected a similar consent judgment involving Bank of America only two years before, and he had written an article criticizing regulatory consent judgments earlier in 2011. Still, it sent shock waves through the financial community and the securities bar, in part for characterizing a $285 million payment as “pocket change,” and in part for the consequences that could flow from it: more regulatory complaints going to trial, with attendant uncertainty and delay; more admissions of wrongdoing, with real benefits to the plaintiffs’ bar; greater judicial scrutiny of the substantive terms of the compromises struck between regulators and companies; and possibly more onerous settlement terms.

The Second Circuit

Having rejected the consent judgment, Judge Rakoff ordered the parties to prepare for trial. The parties jointly sought immediate relief from the court of appeals. The Second Circuit quickly stayed the order pending appeal, then took more than two years to decide the appeal. What resulted was a forceful rejection this past June of the searching review of substantive settlement terms Judge Rakoff had employed, and a reaffirmation of the authority of the SEC and other regulators to compromise claims against private parties on terms they believe appropriate.

In vacating Judge Rakoff’s decision, the Second Circuit first agreed with him that in evaluating a proposed consent judgment, a district court is not a “rubber stamp” and instead must ensure the consent decree is “fair and reasonable.” The court then spelled out four factors that a district court must “at a minimum” consider in evaluating whether a proposed consent judgment is indeed fair and reasonable:

- the basic legality of the decree;
- whether the terms of the decree, including its enforcement mechanism, are clear;
- whether the consent decree reflects a resolution of the actual claims in the complaint; and
- whether the consent decree is tainted by improper collusion or corruption of some kind.

While noting that district courts may need to undertake additional inquiry to ensure fairness and reasonableness, the court of appeals specified that “[t]he primary focus of the inquiry . . . should be on ensuring the consent decree is procedurally proper, using objective measures similar to the factors set out above, taking care not to infringe on the SEC’s discretionary authority to settle on a particular set of terms.” The court of appeals did not include among the relevant considerations any substantive evaluation of the terms on which the SEC agreed to settle.

As to the truth of the underlying factual allegations, the Second Circuit said that “[a]s part of its review, the district court will necessarily establish that a factual basis exists for the proposed decree.” This determination may arise from the SEC’s factual averments alone, or the trial court may need to undertake a more searching review if “the record raises a suspicion that the consent decree was entered into as a result of improper collusion between the SEC and the settling party.” But the appeals court declined to “delineate the precise contours of the factual basis required to obtain approval for each consent decree.”

The Second Circuit also confirmed that when a proposed consent judgment involves injunctive relief, the district court must ensure that the grant of injunctive relief does not disserve the public interest. It is noteworthy that the object of this public-interest inquiry is not the settlement as a whole, but “the issuance of a permanent injunction.” This contrasts with Judge Rakoff’s evaluation, which focused on whether “the parties’ successful resolution of their competing interests” — in all its aspects — served the public interest. That is, under the Second Circuit’s standard, a consent judgment’s inclusion of an injunctive term does not thereby subject all of its terms — injunctive and non-injunctive — to the public-interest test. Rather, the procedurally focused standard described above continues to govern scrutiny of the settlement as a whole, and the district court’s public-interest inquiry should focus on whether the injunctive relief in particular serves the

11 For a discussion of this dynamic in the criminal context, see Matthew E. Fishbein, Why Individuals Aren’t Prosecuted for Conduct Companies Admit, N.Y. L.J., Sept. 19, 2014.
14 752 F.3d at 295.
administered.\(^{16}\) While he approved the proposed consent judgment, he did so only because, as he said, “[t]hey who must be obeyed have spoken, and this court’s duty is to faithfully fulfill their mandate.” His short opinion approving the settlement questions the Second Circuit’s reasoning and expresses concern about far-reaching consequences arising from the deferential standard the appeals court expounded. In particular, he said he fears that “the settlements reached by governmental regulatory bodies and enforced by the judiciary’s contempt powers will in practice be subject to no meaningful oversight whatsoever.” That concern notwithstanding, Judge Rakoff suggested the Second Circuit’s decision foreordained approval of the proposed consent judgment: “[I]t would be a dereliction of duty for this court to seek to evade the dictates of the court of appeals. That court has now fixed the menu, leaving this court with nothing but sour grapes.”

**RAMIFICATIONS**

Though Judge Rakoff’s decision has been vacated, its legacy lives on. The Second Circuit may have restored the standard for evaluating proposed SEC consent judgments to the deferential, procedure-oriented review that prevailed prior to the recent upheaval — and may even have carved it back by eliminating any review of adequacy — but all the attention focused on the SEC’s settlement practices has nonetheless had real consequences.

To begin with, the SEC has announced changes to its settlement practices. In June 2013, SEC Chair Mary Jo White announced that the SEC “intends to make companies and individuals admit wrongdoing as a condition of settling civil charges in certain cases.”\(^{17}\) This was a change in tone, at least: Former SEC enforcement chief Rob Khuzami had strongly defended no-admit/no-deny settlements the prior year. While the Chair left her reference to “certain cases” undefined, the SEC has suggested these will include instances of egregious intentional misconduct, obstruction of SEC investigations, extensive harm to investors, or


17 Jane Eaglesham & Andrew Ackerman, SEC Seeks Admissions of Fault, WALL ST. J., June 18, 2013. This development and others relevant to the SEC’s enforcement efforts are discussed in more depth in Herbert F. Janick III & John Lupton, The SEC’s Policies on Civil Settlements and Admissions in Settlements, 47 REV. SEC. & COMMODS. REG. 85 (2014), and Richard M. Phillips et al., The SEC’s New Enforcement Program, 47 REV. SEC. & COMMODS. REG. 79 (2014).
convictions or admissions of guilt in parallel criminal proceedings. That said, Ms. White also defended no-admit/no-deny settlements as a “major, major tool in the arsenal” that would still be used in a “majority” of cases. And the SEC welcomed the court of appeals’ confirmation of the SEC’s authority to use no-admit/no-deny settlements. Director of Enforcement Andrew Ceresney released a statement that said:

We are pleased with today’s ruling by the Second Circuit Court of Appeals reaffirming the significant deference accorded to the SEC in determining whether to settle with parties and on what terms. While the SEC has and will continue to seek admissions in appropriate cases, settlements without admissions also enable regulatory agencies to serve the public interest by returning money to harmed investors more quickly, without the uncertainty and delay from litigation, and without the need to expend additional agency resources.

In addition, the SEC may be taking the Second Circuit up on its invitation to “eschew the involvement of the courts and employ its own arsenal of remedies instead.” Just this year, the SEC has resolved more than one prominent matter through administrative settlements, which do not require judicial approval.

As a result of all these developments, the standard for approval of proposed SEC consent judgments is now clearer than ever, and the SEC is solidly in possession of substantial authority to negotiate compromises along terms it deems appropriate. But it is unlikely that the last chapter in this saga has been written. Recent developments in this area have focused public, media, and congressional attention on the SEC’s settlement practices. Senator Elizabeth Warren has been a vocal critic of the use of no-admit/no-deny consent judgments, and further congressional attention — possibly including new proposals for legislation — is surely in the offing. This spotlight will at the very least ensure that the SEC is circumspect in its settlement decisions and could result in further changes to SEC settlement policy, whether through public pressure or legislative action. Interested parties should expect some continued uncertainty, and possibly some further adjustments to the status quo, as regulatory agencies, the courts, the securities bar, the Hill, and the business community contend with future SEC consent judgments and judicial review thereof. ■