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## Second Circuit Limits Scope of Judicial Review of SEC Settlement Agreements, Clearing the Way for SEC-Citigroup Consent Decree

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### **Appeals Court Vacates District Court's Refusal to Approve SEC-Citigroup Settlement and Articulates a Standard of Broad Deference to the SEC in Settling Charges**

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#### **SUMMARY**

In *SEC v. Citigroup Global Markets, Inc.*, a panel of the U.S. Court of Appeals for the Second Circuit ruled yesterday that a federal district court abused its discretion when it declined to approve a 2011 settlement agreement between the SEC and Citigroup. The appeals court held that it was impermissible for the district court to require the SEC to establish the “truth” of the SEC’s allegations as a condition of the proposed settlement. It also emphasized that the agency—rather than the district court—is the authority principally charged with ensuring that a consent decree best serves the public interest, and thus the SEC’s public-interest determination “merits significant deference.”<sup>1</sup> The decision grants the SEC, and likely other government regulatory agencies, broad discretion to decide how best to settle cases and limits federal courts’ authority to engage in significant fact-finding or to review the adequacy of the terms of settlement when analyzing consent decrees.

#### **BACKGROUND**

This case arises out of a proposed settlement of an SEC complaint against Citigroup for violation of sections 17(a)(2) and (3) of the Securities Act of 1933. The primary elements of the proposed settlement order included a permanent injunction barring future violations, disgorgement of the \$160 million in profits

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that Citigroup obtained as a result of the alleged conduct, \$30 million in prejudgment interest, and a civil penalty of \$95 million. No admission of guilt or responsibility was included in the agreement.<sup>2</sup>

In a widely publicized decision, Judge Rakoff of the U.S. District Court for the Southern District of New York declined to enter the consent decree. In the district court's view, the settlement agreement was "neither fair, nor reasonable, nor adequate, nor in the public interest" because the truth of the facts underlying the complaint had not been established for the court and the public.<sup>3</sup> Judge Rakoff did not require that Citigroup admit wrongdoing, but held that to ensure the consent decree was in the public interest, the parties were required to establish certain "cold, hard, solid facts" that were not present in the proposed order.<sup>4</sup>

Judge Rakoff's decision upended a longstanding tradition of "neither-admit-nor-deny" settlements entered into by the SEC and other regulatory agencies, and sparked a public debate about the appropriateness of such settlements. Among other things, the decision prompted congressional scrutiny of the settlement practices of U.S. financial regulators and spurred the SEC to modify its unofficial but time-honored practice of allowing companies to settle actions without admitting or denying wrongdoing.

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### THE SECOND CIRCUIT'S DECISION

The Second Circuit vacated the order declining to approve the settlement agreement on the ground that the district court had abused its discretion by applying an incorrect legal standard. In the process, the Second Circuit clarified the role of a district court in affirming or denying proposed settlements. The court of appeals recognized that, although there is a strong federal policy in favor of the approval and enforcement of consent decrees, district courts are not mere "rubber stamps" and must instead ensure that a proposed consent decree is "fair and reasonable," with the additional requirement that the decree not "disserve[] . . . the public interest" if the decree includes injunctive relief.<sup>5</sup> Absent a substantial basis in the record for finding that the proposed consent decree does not meet those requirements, however, the Second Circuit concluded that the proposed decree must be entered.

The Second Circuit further explained that determining whether a consent decree is fair and reasonable requires assessing at least four factors: (1) the basic legality of the decree; (2) the clarity of its terms; (3) its resolution of the actual claims in the complaint; and (4) the absence of any improper collusion or corruption.<sup>6</sup> But the focus remains on whether "the consent decree is procedurally proper, using objective measures . . . , taking care not to infringe the SEC's discretionary authority to settle on a particular set of terms."<sup>7</sup>

Importantly, the Second Circuit made clear that a district court may not assess the *adequacy* of a proposed settlement—a requirement that the Second Circuit observed had been imported from the class-action context but that the Second Circuit found not to apply in the context of SEC consent decrees.

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The Second Circuit also observed that that a district court may not insist upon admissions from parties to a consent decree. The SEC therefore could not be required to “establish the ‘truth’” of its allegations against Citigroup.<sup>8</sup> The Second Circuit acknowledged that a district court must satisfy itself that “a factual basis exists for the proposed decree,” but it concluded that there was likely a sufficient record in the case before it for determining that the proposed consent decree at issue was fair and reasonable.<sup>9</sup> The Second Circuit thus had no occasion to “delineate the precise contours of the factual basis required to obtain approval.”<sup>10</sup>

The Second Circuit also reasoned that a district court may not reject a consent decree because “it fails to provide collateral estoppel assistance to private litigants,” which the panel said “simply is not the job of the courts.”<sup>11</sup>

Finally, the Second Circuit explained that, to the extent a proposed decree provides for injunctive relief and a district court must evaluate whether the decree serves the public interest, in making those determinations courts should be highly deferential to the relevant regulatory agency. As the court of appeals explained, “the job of determining whether the proposed SEC consent decree best serves the public interest . . . rests squarely with the SEC, and its decision merits significant deference.”<sup>12</sup>

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## IMPLICATIONS

Yesterday’s decision has important implications for both regulatory agencies and regulated entities that enter into consent agreements to settle allegations of unlawful conduct. Judge Rakoff’s 2011 decision ignited a public debate as to the adequacy of government enforcement efforts in the wake of the financial crisis and in particular the longstanding practice of allowing parties to settle allegations of securities and other violations without admitting their conduct was unlawful. Some district judges began to engage in similar scrutiny of proposed settlements. In response, the SEC and some other agencies said they were modifying their policies of allowing neither-admit-nor-deny settlements. In the criminal context, the U.S. Department of Justice, in response to the related criticism that large financial institutions were viewed by the government as “too big to jail,” has recently begun to seek guilty pleas by financial institutions or their affiliates to resolve criminal charges. This development represents a break from the longstanding practice of allowing such entities to enter into deferred prosecution agreements, in part because of the serious collateral consequences of such convictions for innocent parties like customers, employees, shareholders, and local communities. Yesterday’s decision has no direct effect on settlements with the DOJ.

Yesterday’s decision reaffirms the primacy of the SEC and other enforcement agencies in deciding the appropriate means of settling allegations of unlawful conduct and will make settlements with regulated entities less subject to court scrutiny. Shortly after the decision was issued, Andrew Ceresney, Director of the SEC’s Division of Enforcement, announced that the agency was “pleased with [the] ruling . . .

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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.”<sup>13</sup>

The Second Circuit’s decision also mitigates what had promised to be a boon for private plaintiffs seeking to bring copycat suits against regulated entities. These plaintiffs would have benefited from the SEC’s putative obligation to prove unlawful conduct to justify consent decrees and from any collateral estoppel effect of court orders approving such decrees.

It is doubtful, however, that the decision, standing alone, will significantly change the current enforcement environment for financial institutions and other large companies. Judge Rakoff’s 2011 opinion was notable because it echoed the concerns of some in Congress and elsewhere about the adequacy of the government’s response to the financial crisis and its pursuit of financial crime. The Second Circuit’s decision will provide settling companies with greater certainty that their regulatory settlements in the Second Circuit will not be upended by reviewing courts. But it may not reverse the trend of requiring factual and legal admissions as part of regulatory and criminal settlements.

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### ENDNOTES

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- 1 *SEC v. Citigroup Global Markets, Inc.*, No. 11-5227-cv(L), slip op. at 25 (2d Cir., June 4, 2014).
- 2 *Id.* at 4-5.
- 3 827 F. Supp. 2d at 332.
- 4 *Id.* at 335.
- 5 *SEC v. Citigroup Global Markets, Inc.*, No. 11-5227-cv(L), slip op. at 17-19 (2d Cir., June 4, 2014).
- 6 *Id.* at 20.
- 7 *Id.* at 21.
- 8 *Id.* at 21.
- 9 *Id.* at 22.
- 10 *Id.* at 23.
- 11 *Id.* at 27.
- 12 *Id.* at 24-25.
- 13 Andrew Ceresny, Statement on 2nd Circuit Decision, U.S. SECURITIES AND EXCHANGE COMMISSION (June 4, 2014, 6:47 PM), <http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541993346>.

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