



## *The Second Circuit Vacates Citigroup Decision and Clarifies Standard of Review for SEC Consent Decrees*

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In 2011, in a widely-publicized decision, United States District Court Judge Jed Rakoff rejected a proposed consent judgment offered by the U.S. Securities and Exchange Commission (“SEC”) in connection with its financial crisis enforcement action against Citigroup Global Markets, Inc. (“Citigroup”). The consent decree allowed Citigroup to settle the action without admitting or denying liability. Judge Rakoff criticized the terms of the SEC’s proposed consent decree, noted that Citigroup was not required to admit liability, and held that the allegations underlying any decree must be supported by acknowledged or proven facts. Many have considered Judge Rakoff’s decision a catalyst for the SEC’s shift in settlement policy, which now requires certain defendants to admit liability.<sup>1</sup>

On Wednesday of this week, in *SEC v. Citigroup Global Markets, Inc.*, the United States Court of Appeals for the Second Circuit vacated Judge Rakoff’s decision and flatly rejected the notion that a district court may require admissions of liability as a condition of settlement.<sup>2</sup> It also clarified the standard by which a district court must review proposed consent decrees involving the SEC and other enforcement agencies. Specifically, it held that a district court must determine whether a proposed consent decree is “fair and reasonable,” and, if the proposed consent decree includes injunctive relief, the reviewing district court must also find that the “public interest would not be disserved” by its entry.<sup>3</sup> It further required that, unless there exists a “substantial basis in the record for concluding that the proposed consent decree does not meet these requirements,” a district court must order the consent decree.<sup>4</sup>

The Second Circuit’s opinion provides substantial deference to the SEC in settling enforcement actions, and it prohibits district courts from interfering with the SEC’s discretionary authority to determine the appropriateness of charges and the terms of settlement. The decision, however, will not likely affect the SEC’s shift in policy, which now requires admissions of liability by certain defendants.<sup>5</sup>

### **Background: Judge Rakoff’s Decision**

In 2011, the SEC filed a complaint against Citigroup, alleging that Citigroup negligently misrepresented to investors its role in selecting the assets of a fund and its interest in those assets. The SEC subsequently submitted a consent decree for Judge Rakoff’s review, which included a permanent injunction against future violations of Section 17(a)(2) and (3) of the Securities Act of

1933, disgorgement of Citigroup's net profits, prejudgment interest, and a civil penalty. As part of the settlement, Citigroup also agreed to change its internal controls to prevent similar acts from occurring in the future. Citigroup did not admit any of the conduct alleged in the SEC's complaint.<sup>6</sup>

Judge Rakoff declined to order the SEC's proposed consent decree, and instead, held a hearing to discuss a series of questions that he posed to the SEC and Citigroup, including:

- "Why should the Court impose a judgment in a case in which the S.E.C. alleges a serious securities fraud but the defendant neither admits nor denies wrongdoing?"
- "Given the S.E.C.'s statutory mandate to ensure transparency in the financial marketplace, is there an overriding public interest in determining whether the S.E.C.'s charges are true?"
- "How can a securities fraud of this nature and magnitude be the result simply of negligence?"<sup>7</sup>

After conducting the hearing and reviewing the parties' written responses to the questions posed, Judge Rakoff refused to enter the consent decree and directed the parties to prepare for trial. In declining to enter the decree, Judge Rakoff stated that the court must "be satisfied that it is not being used as a tool to enforce an agreement that is unfair, unreasonable, inadequate, or in contravention of the public interest,"<sup>8</sup> and he found that the proposed consent decree was "neither fair, nor reasonable, nor adequate, nor in the public interest."<sup>9</sup> Judge Rakoff further stated:

when a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, . . . 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.<sup>10</sup>

Judge Rakoff's opinion also criticized the terms of the proposed consent decree and indicated that the allegations underlying the consent decree must be supported by acknowledged or proven facts to be reasonable, fair, adequate, and in the public interest.<sup>11</sup> The opinion denying the entry of the consent decree received considerable attention.<sup>12</sup> The SEC sought immediate relief before the Second Circuit, which led to the appeal.

## The Second Circuit's Opinion

After analyzing the various standards by which courts have reviewed SEC consent decrees, the Second Circuit clarified the standard by which district courts in the Second Circuit must review SEC consent decrees. Specifically, it held that a district court must determine whether an SEC consent decree is "fair and reasonable," and that, if the decree included injunctive relief, the district court must also ensure that the "public interest would not be disserved."<sup>13</sup> Unless there exists a "substantial basis in the record for concluding that the proposed consent decree does not meet these requirements," a district court must order the consent decree.

To determine whether a decree is "fair and reasonable," the Second Circuit stated that a district court must, at a minimum, review the following:

- 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.”<sup>14</sup>

Although the Second Circuit noted that a district court might inquire beyond the areas identified above, it cautioned that the primary purpose of its review is to determine whether the consent decree is procedurally proper, and that a reviewing court must not interfere with the SEC’s “discretionary authority to settle” a particular case.<sup>15</sup>

The Second Circuit declined to include an element of “adequacy” in its standard for review, noting that such a requirement is more appropriate in the context of a class action settlement, which typically precludes future claims. In matters involving the SEC, however, the Second Circuit determined that a consent decree does not prohibit future claims, and thus does not pose the same concerns.<sup>16</sup>

If the consent decree involves injunctive relief, the Second Circuit held that a reviewing court must determine that the “public interest would not be disserved” by its entry. It cautioned, however, that it is the job of the SEC, not the court, to determine whether the decree best serves the public interest, and its determination is to be afforded significant deference.<sup>17</sup>

Turning to the district court’s opinion, the Second Circuit found that Judge Rakoff abused his discretion by requiring the SEC to establish the “truth” of its allegations as a condition of approving the consent decree. By requiring a party to establish “truth,” the Second Circuit reasoned, the district court interfered with the parties’ ability to manage risk associated with litigation. Thus, although a district court must establish a factual basis to a proposed consent decree, it need only rely on “colorable claims, supported by factual averments by the SEC.”<sup>18</sup> To require proof of the “truth” of the allegations, as the district court had required below, would be an abuse of discretion.

The Second Circuit also rejected the idea that a district court may require an admission of liability as a condition of approving a settlement. Thus, a district court cannot simply conclude that the public was disserved based on its disagreement with the SEC on “discretionary matters of policy, such as deciding to settle without requiring an admission of liability.”<sup>19</sup> The decision to require an admission of liability, according to the Second Circuit, “rests squarely with the S.E.C.”<sup>20</sup> Similarly, the Second Circuit noted, a district court also may not withhold approval of a consent decree based on a belief that the SEC brought improper charges, or that the consent decree should provide collateral estoppel for private litigants.

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- <sup>1</sup> "S.E.C. Has a Message for Firms Not Used to Admitting Guilt," *The New York Times*, June 21, 2013 (<http://www.nytimes.com/2013/06/22/business/secs-new-chief-promises-tougher-line-on-cases.html?>). Prior to its change in policy, the SEC generally allowed defendants to settle SEC actions without admitting or denying allegations.
- <sup>2</sup> No. 11-5227-cv (2nd Cir. June 4, 2014).
- <sup>3</sup> *Id.* at 19.
- <sup>4</sup> *Id.*
- <sup>5</sup> Within hours of the Second Circuit's opinion, the Director of Enforcement for the SEC released the following statement:  
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.  
Public Statement of Andrew Ceresney, Director, SEC Division of Enforcement (June 4, 2014) (<http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541993346>) (emphasis added).
- <sup>6</sup> No. 11-5227-cv at 5-6.
- <sup>7</sup> *Id.* at 6-7.
- <sup>8</sup> *Id.* at 8.
- <sup>9</sup> *Id.*
- <sup>10</sup> *Id.* at 9.
- <sup>11</sup> *Id.* at 8.
- <sup>12</sup> See, e.g., "Judge Blocks Citigroup Settlement With S.E.C.," *The New York Times*, Nov. 28, 2011 (<http://www.nytimes.com/2011/11/29/business/judge-rejects-sec-accord-with-citi.html?>).
- <sup>13</sup> No. 11-5227-cv at 19.
- <sup>14</sup> *Id.* at 20.
- <sup>15</sup> *Id.* at 21.
- <sup>16</sup> *Id.* at 19.
- <sup>17</sup> *Id.* at 24-25.
- <sup>18</sup> *Id.* at 22-23. The Second Circuit will allow further inquiry, however, if the court's initial review "raises a suspicion that the consent decree was entered into as a result of improper collusion." *Id.* at 23.
- <sup>19</sup> *Id.* at 26.
- <sup>20</sup> *Id.* at 17.

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