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Second Circuit Vacates Judge Rakoff's Decision Refusing to Approve Citigroup's "Neither Admit nor Deny" Settlement with the SEC and Clarifies Standard for Evaluating Consent Decrees in Favor of Pragmatism

By Richard T. Sharp, Wayne M. Aaron, and Ian E. Browning*

In this article, the authors discuss the U.S. Court of Appeals for the Second Circuit's long-awaited decision in SEC v. Citigroup Global Markets, Inc., *which held that Judge Jed S. Rakoff of the Federal District Court for the Southern District of New York abused his discretion in refusing to approve a proposed consent decree between the U.S. Securities and Exchange Commission and Citigroup.*

Introduction

The U.S. Court of Appeals for the Second Circuit's long-awaited decision in *SEC v. Citigroup Global Markets, Inc.*,[1] released on June 4, 2014, held that Judge Jed S. Rakoff of the Federal District Court for the Southern District of New York abused his discretion in refusing to approve a proposed consent decree between the U.S. Securities and Exchange Commission ("SEC") and Citigroup.[2] The Second Circuit vacated the decision of the court below[3] and remanded, clarifying the appropriate standard of review to preclude judicial evaluation of the "adequacy" of a consent decree. The Circuit held that the standard for reviewing a consent decree is simply whether it is "fair and reasonable," thereby limiting the district court's substantive review of consent decrees to a significant extent. The Second Circuit also emphasized the discretionary power of the SEC in determining how to prosecute and settle enforcement actions, recognizing that the decision to settle a given case is a pragmatic one based on numerous factors. The Circuit held that the "exclusive right" to decide the charges to be asserted against a defendant rests with the SEC, and that the SEC's determination regarding whether a consent decree serves the public interest "merits significant deference."[4] This decision should allay defendants' concerns that they will be forced to provide a binding admission before a settlement will be approved in civil

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1 *SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285 (2d Cir. 2014).

2 Following Judge Rakoff's order setting a trial date, in March 2012 a Second Circuit motions panel stayed the lower court proceedings pending this appeal. *SEC v. Citigroup Global Mkts., Inc.*, 673 F.3d 158, 169 (2d Cir. 2012).

3 *SEC v. Citigroup Global Mkts., Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

4 *SEC v. Citigroup Global Mkts., Inc.,* 752 F.3d at 296.

district court proceedings, often a major issue in civil actions brought by regulators such as the SEC. It should not be viewed, however, as a signal that the SEC will abandon attempts to obtain such admissions when it deems appropriate, whether in the civil or administrative context.

Legal Background

When deciding whether to approve consent decrees between the SEC and private parties, certain courts within the Second Circuit (including the district court in this action) have evaluated whether the proposed settlement is "fair, reasonable and *adequate*."[5] Where injunctive relief is included in the proposed consent decree, courts also must conclude that the "public interest would not be disserved."[6] The Circuit observed that the "adequacy" requirement "appears borrowed from the review applied to class action settlements" where it makes "perfect sense" because such settlements may preclude future claims, and that this is not an issue with SEC consent decrees, where potential plaintiffs may bring their own actions.[7]

SEC v. Citigroup Global Markets, Inc.

Background

The SEC filed a complaint against *Citigroup* in October 2011 alleging that Citigroup negligently misrepresented its role and financial interest in a billion-dollar fund known as "Class V Funding III."[8] The SEC asserted that Citigroup influenced the selection of approximately half of the fund's assets, contrary to its statement to investors that the fund's portfolio would be selected by an independent investment advisor.[9] These securities were largely collateralized by subprime securities tied to the U.S. housing market.[10] The SEC further alleged that Citigroup selected for inclusion in the fund a significant amount of mortgage-backed securities in which Citigroup had taken a short position, resulting in a $160 million profit to Citigroup, while fund investors incurred significant losses.[11]

When filing the complaint, the SEC also filed a proposed consent decree with Citigroup in which Citigroup would:

(1) Consent to the entry of a permanent injunction prohibiting Citigroup from violating Sections 17(a)(2)-(3) of the Securities Act of 1933;

(2) Disgorge $160 million (Citigroup's alleged profits);

(3) Pay prejudgment interest of $30 million; and

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[5] *See, e.g., SEC v. Cioffi*, 868 F. Supp. 2d 65, 74 (E.D.N.Y. 2012) (emphasis added); *SEC v. CR Intrinsic Investors, LLC*, 939 F. Supp. 2d 431, 434 (S.D.N.Y. 2013).

[6] *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006).

[7] *See SEC v. Citigroup Global Mkts., Inc.,* 752 F.3d at 294.

[8] *Id.* at 289.

[9] *Id.*

[10] *Id.*

[11] *Id.*

(4) Pay a civil penalty of $95 million.[12]

Citigroup further would agree not to seek an offset against any compensatory damages awarded in any related investor action and consent to make internal changes, over a three-year span, to prevent similar acts from reoccurring.[13]

District Court Ruling

In the decision below, Judge Rakoff criticized the proposed consent decree, comparing it unfavorably with the civil penalty imposed by consent decrees approved in other SEC cases.[14] He commented that the proposed consent decree would transform the court into "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."[15] He then refused to approve the consent decree, consolidated the case with *SEC v. Stoker*,[16] a related case in which the SEC asserted claims against a Citigroup employee allegedly involved in the matter, and set a trial date.[17]

Second Circuit's Decision

As noted above, following the district court's ruling, the parties immediately filed for a stay pending interlocutory appeal, which was granted by the Second Circuit.[18] Both the SEC and Citigroup advocated for reversal. The Second Circuit reversed the district court's ruling, clarified the applicable standard of review, and remanded the case to Judge Rakoff for reconsideration of the proposed consent decree to "consider whether the public interest would be disserved by entry of the consent decree."[19]

The Circuit "quickly dispense[d]" with the argument that the district court had abused its discretion by requiring an admission of liability as a prerequisite to approving the proposed consent decree, as *pro bono* counsel appointed to represent the district court stated that the court had not conditioned its approval on an admission of liability. The Circuit expressly stated that "there is no basis in the law . . . to require an admission of liability as a condition for approving a settlement. . . . [That decision] rests squarely with the S.E.C."[20]

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[12] *Id.*

[13] *Id.*

[14] These cases were: *SEC. v. Bank of Am. Corp.*, 2010 U.S. Dist. LEXIS 15460 (S.D.N.Y. Feb. 22, 2010); *SEC v. Goldman, Sachs & Co.*, 2010 U.S. Dist. LEXIS 119802 (S.D.N.Y. July 20, 2010).

[15] *SEC v. Citigroup Global Mkts., Inc.*, No. 10 Civ. 3229 (BSJ), 827 F. Supp. 2d at 332.

[16] Docket No. 11 Civ. 7388 (JSR).

[17] *SEC v. Citigroup Global Mkts., Inc.,* 827 F. Supp. 2d at 335.

[18] *See supra* note 2.

[19] *SEC v. Citigroup Global Mkts., Inc.,* 752 F.3d at 297 (holding that the district court incorrectly defined the "public interest" as an overriding interest in the truth). The Circuit also noted that on remand, "if the district court finds it necessary," that it may ask the parties to provide additional information to alleviate any concerns regarding potential collusion between the parties. *Id.* at 296.

[20] *Id.* at 293.

The Circuit next addressed the scope of deference district courts should afford proposed consent decrees and noted the strong federal policy favoring their enforcement and approval. In furtherance of this policy, the Circuit clarified that the appropriate inquiry is whether proposed consent decrees are "fair and reasonable" and, in cases where injunctive relief is requested, ensuring that the public interest would not be disserved.[21] Notably, the Circuit explicitly rejected the concept of "adequacy" from the standard, observing that the concept appears to be borrowed from the review applied to class action settlements which "strikes us as particularly inapt in the context of a proposed S.E.C. consent decree."[22] The Circuit explained that while analyzing class actions for adequacy is logical because they preclude future civil claims, SEC consent decrees do not pose this problem.[23]

Detailing the requirements of the "fair and reasonable" standard, the Circuit held that a court analyzing proposed SEC consent decrees "should, at a minimum," assess:

(1) the basic legality of the decree;

(2) whether the terms of the decree, including its enforcement mechanism, are clear;

(3) whether the decree reflects a resolution of the claims asserted; and

(4) whether it is "tainted by improper collusion or corruption of some kind."[24]

The "primary focus of the inquiry . . . should be on ensuring the consent decree is procedurally proper, using objective measures . . ., taking care not to infringe on the S.E.C.'s discretionary authority to settle on a particular set of terms."[25]

The Circuit held that the district court had abused its discretion by requiring the SEC to establish the "truth" of the allegations against the settling party as a precondition for approving a consent decree.[26] The Circuit noted that while trials are "primarily about the truth," settlements like consent decrees are "*primarily about pragmatism*" and "provide parties with a means to manage risk."[27] The Circuit also noted that the SEC is tasked with assessing whether settling makes sense, and that such an assessment involves numerous factors including the likelihood of success and the costs and benefits of proceeding to trial.[28] As the Circuit conclusively held, "[i]t is not within the district court's purview to demand 'cold, hard, solid facts, established either by admissions or by trials'. . .."[29] The Circuit noted that "the district court here, with the benefit of copious submissions by the parties, likely had

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[21] *Id.* at 294.

[22] *Id.*

[23] *Id.*

[24] *Id.* at 294–95.

[25] *Id.* at 295.

[26] *Id.*

[27] *Id.* at 295 (emphasis added).

[28] *Id.*

[29] *Id.* (quoting *SEC v. Citigroup Global Mkts., Inc.,* 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

a sufficient record before it on which to determine if the proposed decree was fair and reasonable."[30]

Finally, the court addressed whether the "public interest would be disserved" by the consent decree because it included injunctive relief, but proceeded to hold that "[t]he job of determining whether the proposed S.E.C. consent decree best serves the public interest . . . rests squarely with the S.E.C., and its decision merits significant deference."[31] The Circuit noted that the district court "correctly recognized that it was required to consider the public interest," but held that its improper definition of the "public interest" as "'an overriding interest in knowing the truth'" constituted legal error.[32] The Circuit further held that it was an abuse of discretion "[t]o the extent the district court withheld approval of the consent decree on the ground that it believed the S.E.C. failed to bring the proper charges against Citigroup."[33] The Circuit also noted that a district court may not reject consent decrees because they fail to provide collateral estoppel assistance to private litigants because "that simply is not the job of the courts."[34]

Implications

The Second Circuit's decision in *Citigroup* has several important implications for litigants and subjects of regulatory investigations. First, it reaffirms the broad, discretionary powers of the SEC to manage its own cases and determine whether settlement is an appropriate course of action in a given case. Second, the clarified standard of judicial review for consent decrees significantly reduces the ability of district courts to reject such settlements, because the "adequacy" of the settlement is not a valid consideration. Finally, it should allay concerns of civil defendants (or entities under civil investigation) that they will be required to admit liability in order to settle. This is particularly important in light of the potential collateral estoppel effects such an admission in a civil matter may have in related civil litigation.[35] Although it is now clear that the SEC is not *required* to seek admissions to obtain approval of a consent decree, it still has free reign to seek them (whether in the civil or administrative context), and has signaled that it will continue to do so when appropriate.[36]

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[30] *SEC v. Citigroup Global Mkts., Inc.,* 752 F.3d at 296.

[31] *Id.* For example, the Circuit explained that if injunctive relief in a consent decree were to bar private litigants from "pursuing their own claims independent of the relief obtained under the consent decree," the public interest may be disserved. *Id.* at 297.

[32] *Id.* at 297 (quoting *SEC v. Citigroup Global Mkts., Inc.,* 827 F. Supp. 2d at 331).

[33] *Id.*

[34] *Id.*

[35] When not actually litigated, such admissions may not result in collateral estoppel, but may be considered evidentiary admissions.

[36] *See, e.g.*, Mary Jo White, Chair, SEC, Deploying the Full Enforcement Arsenal, Council of Institutional Investors Fall Conference (Sept. 26, 2013), *transcript available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.U-OMU_ldV8E.

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