

Securities Regulation Daily Wrap Up, TOP STORY—2d Cir.: Court defers to SEC in vacating Rakoff’s refusal to approve Citigroup settlement, (Jun. 4, 2014)

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By Jim Hamilton, J.D., LL.M.

A Second Circuit panel ruled that it was an abuse of discretion for a federal district court to require that the SEC establish the “truth” of the allegations against a settling party as a condition for approving a consent decree settling an SEC enforcement action against Citigroup. Trials are primarily about the truth said the panel, while consent decrees are primarily about pragmatism. Thus, the panel vacated the district court’s decision and remanded for consideration based on the panel’s ruling. The job of determining whether a proposed SEC consent decree best serves the public interest rests squarely with the Commission, emphasized the panel, and its decision merits significant deference (*SEC v. Citigroup Global Markets, Inc.*, June 4, 2014, Pooler, R.).

Parenthetically, the appeals court pointed out that the SEC’s resources are limited, and that is why it often uses consent decrees as a means of enforcement. While district judges presented with consent decrees are not rubber stamps said the panel, federal courts recognize a strong federal policy favoring the approval and enforcement of agency consent decrees.

Public interest. The district court wrongly defined the public interest as an overriding interest in knowing the truth. On remand, the appeals panel said that the district court should consider whether the public interest would be disserved by entry of the consent decree. For example, a consent decree may disserve the public interest if it barred private litigants from pursuing their own claims independent of the relief obtained under the consent decree. What the district court may not do, instructed the panel, is find the public interest disserved based on its disagreement with the SEC’s decisions on discretionary matters of policy, such as deciding to settle without requiring an admission of liability.

Consent decrees. Consent decrees are normally compromises in which the parties give up something they might have won in litigation and waive their rights to litigation. Thus, a consent decree must be construed as written, said the panel, and not as it might have been written had the plaintiff established his or her factual claims and legal theories in litigation. Basically, said the court, consent decrees provide parties with a means to manage risk.

Noting that these assessments are uniquely for the litigants to make, the panel said it is not within the district court’s purview to demand cold, hard, solid facts, established either by admissions or by trials, as to the truth of the allegations in the complaint as a condition for approving a consent decree.

The district court used the fair, reasonable, adequate and in the public interest standard in considering the settlement. The appeals court panel clarified that the proper standard for reviewing a proposed consent judgment settling an SEC enforcement action requires that the district court determine whether the proposed consent decree is fair and reasonable, with the additional requirement that the public interest would not be disserved in the event that the consent decree includes injunctive relief. Absent a substantial basis in the record for concluding that the proposed consent decree does not meet these requirements, the district court is required to enter the order.

The panel omitted adequacy from the clarified standard. Scrutinizing a proposed consent decree for adequacy appears borrowed from the review applied to class action settlements, the panel reasoned, and is particularly inapt in the context of a proposed SEC consent decree.

While the adequacy requirement makes perfect sense in the context of a class action settlement, a consent decree does not pose the same concerns regarding adequacy. Plaintiffs with a private right of action are free to bring their own actions. If there is no private right of action, then the SEC is the entity charged with representing the victims, and is politically liable if it fails to adequately perform its duties.

Consent decrees vary, acknowledged the panel, and depending on the decree a district court may need to make additional inquiry to ensure that the consent decree is fair and reasonable. The primary focus of the inquiry, however, should be on ensuring the consent decree is procedurally proper, using objective measures, taking care not to infringe on the SEC's discretionary authority to settle on a particular set of terms.

Finally, the appeals court noted that if the SEC does not wish to engage with the federal courts, it is free to eschew the involvement of the courts and employ its own arsenal of remedies, such as the disgorgement of profits. Admittedly, these remedies are not on par with the relief afforded by federal court injunctions, but if the SEC prefers to call upon the power of the courts in ordering a consent decree and issuing an injunction, then the Commission must be willing to assure the court that the settlement proposed is fair and reasonable.

Concurring opinion. The opinion on the main points was unanimous on the three-judge panel. But in a concurring opinion, Judge Lohier would be inclined to reverse on the factual record before the panel and direct the district court to enter the consent decree. In Judge Lohier's view, it does not appear that any additional facts are needed to determine that the proposed decree is fair and reasonable and does not disserve the public interest. But Judge Lohier saw no harm in vacating and remanding to permit the very able and distinguished district judge to make that determination in the first instance.

The case is No. 11-5227-cv (L).

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