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Federal Appeals Court Issues a Preliminary Opinion Rebuffing District Court's Effort to Reshape SEC Consent Decrees

By Gregory G. Schwab and Nicholas C. Stewart

Four months ago, the January issue of the White Collar Watch ("WCW") reported that Judge Jed S. Rakoff of the United States District Court for the Southern District of New York issued an order, rejecting the proposed $285 million settlement between the Securities and Exchange Commission ("SEC") and Citigroup Global Markets, Inc. ("Citigroup"). Judge Rakoff was primarily concerned with the fact that the proposed settlement did not require Citigroup to admit any culpability. Without any proven or admitted facts, Judge Rakoff considered himself unable to review the judgment to ensure that it is "fair, reasonable, adequate, and in the public interest." After rejecting the proposed settlement and scheduling a July trial date, both the SEC and Citigroup filed appeals with the United States Court of Appeals for the Second Circuit.

After preliminarily staying Judge Rakoff's ruling, the Second Circuit asked the parties to submit briefs addressing whether the Court should continue the stay. Because both the SEC and Citigroup were united in seeking the stay, the district court's position went unrepresented. On March 15, 2012, the Second Circuit issued a per curiam opinion, explaining why it would continue the stay pending the outcome of the parties' appeal. *See S.E.C. v. Citigroup Global Markets Inc.*, — F. 3d —, 2012 WL 851807 (2d Cir. Mar. 15, 2012). Recognizing that it "ha[d] not had the benefit of adversarial briefing," the court was nevertheless fairly critical of the district court, concluding ultimately that the "S.E.C. and Citigroup have made a strong showing of likelihood of success in setting aside the district court's rejection of their settlement . . . ." In evaluating the "likelihood of success," the Second Circuit discussed the three grounds relied upon by Judge Rakoff.

First, the court analyzed the district court's determination that a settlement without an admission "is bad policy and fails to serve the public interest because defrauded investors cannot use the judgment to establish Citigroup's liability in civil suits to recover the investors' losses." The appellate panel had a "significant problem" with Judge Rakoff's apparent failure to "give[] deference to the S.E.C.'s judgment on wholly discretionary matters of policy." "'[F]ederal judges[,] who have no constituency," the Court reasoned

"have a duty to respect legitimate policy choices made by those who do.'" (quoting *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 866 (1984)). Even though the district court stated it was deferring to the SEC, its opinion overlooked the fact that the SEC had seemingly considered all appropriate factors and was also in the best position to make those determinations.

Second, the court expressed skepticism with Judge Rakoff's determination that the settlement was unfair to Citigroup because it imposed "'substantial relief on the basis of mere allegations . . . .'" The Second Circuit acknowledged the inconsistency between the district court's characterization of the settlement first as "pocket change" and subsequently as "substantial relief." However, it was more troubled by the district court's suggestion that a "private, sophisticated, counseled litigant" should be prevented from "reach[ing] a voluntary settlement in which it gives up things of value without admitting liability."

Finally, the court confronted Judge Rakoff's conclusion that he was unable to evaluate the fairness of the settlement without a conclusive set of facts. As an initial matter, the SEC presented the court with the findings of its lengthy investigation, as well as information regarding how those findings supported the agreement. However, as a legal matter, the Second Circuit "doubt[ed]" that a "court has authority to demand assurance that a voluntary settlement reached between an administrative agency and a private party somehow reflects the facts that would be demonstrated at a trial . . . ."

The Second Circuit's opinion highlights several considerations. First, the issue decided by the Second Circuit was limited to the question of whether to continue the stay. The Second Circuit did not have the benefit of argument in favor of Judge Rakoff's position. Before making a determination on the merits, the Second Circuit will hear from counsel appointed to represent the district court's position on appeal. At the time of this article, at least one financial reform watchdog group had asked for permission to participate in an "enhanced" amicus curiae role. The presence of these opposing viewpoints may impact the court's ultimate decision.

Second, regulated companies following the *Citibank* case should be cognizant of the differences among the federal circuits as to the standard of review for agreements that require judicial approval and enforcement. For example, the D.C. Circuit views such agreements as "committed to agency discretion by law" and, therefore, not subject to any judicial review. *See, e.g., Ass'n of Irritated Residents v. E.P.A.*, 494 F.3d 1027, 1031-33 (D.C. Cir. 2007). The Third Circuit expressed quite a different sentiment in *Pansy v. Stroudsburg*, 23 F.3d 772 (1994), which vacated a district court's decision to deny media access to a confidential settlement. There, the Third Circuit explained that the district court neglected to make any findings for the record or to independently balance the public interest before exercising its injunctive powers in granting a confidentiality order. The addition of the Second Circuit's upcoming opinion on the subject must be viewed in context – as a controlling statement of law for the Second Circuit, but not necessarily so for other jurisdictions.

Third, notwithstanding variations in the federal circuits, it nonetheless makes sense to offer any court a compelling reason to justify the exercise of injunctive relief. Saul Ewing recently hosted a panel discussion sponsored by the American Bar Association Criminal Justice Section on the status and future of SEC consent decrees. Among the valuable takeaways was the fact that – notwithstanding the recent developments in the *Citigroup* case – judges of most stripes will continue to treat seriously the decision of whether to lend their injunctive power to a settlement agreement. Thus, although many district courts are expected to accord some deference to administrative policy judgments, it is still important to present a persuasive case in favor of settlement. In this endeavor, parties may want to consult a policy statement – issued by the SEC on January 4, 2006 – which provides a helpful list of factors against which to measure the efficacy of a proposed agreement.