Second Circuit Reverses District Court's Refusal to Approve Settlement Between Citigroup and the S.E.C.

On June 4, 2014, the United States Court of Appeals for the Second Circuit vacated a decision of the United States District Court for the Southern District of New York rejecting a proposed settlement consent decree agreed to by Citigroup Global Markets, Inc. ("Citigroup") and the United States Securities and Exchange Commission ("S.E.C."). In doing so, the Court of Appeals clarified the role of district courts in reviewing proposed consent decrees.[1]

I. Background and Procedural History

In October 2011, the S.E.C. sued Citigroup, alleging that Citigroup had negligently misrepresented its role and economic interest in structuring and marketing a large fund of mortgage-related assets, including making false statements as to the portfolio having been independently selected when it in fact contained "a substantial amount of negatively projected mortgage-backed assets in which Citigroup had taken a short position," leading to $160 million in profits for Citigroup and extensive losses for investors.[2] Citigroup agreed to a settlement by means of a consent judgment with the S.E.C. in which Citigroup agreed to: a permanent injunction against violations of certain sections of the Securities Act; forfeiture of the $160 million in profits; payment of $30 million in prejudgment interest; and a $95 million civil penalty fee.[3] Citigroup also agreed to make internal changes to prevent future violations. Consistent with past practice, there was no admission of guilt or liability in the consent decree.[4] Citigroup and the S.E.C. jointly presented the consent decree for approval by the district court.

In considering whether to approve the consent decree, District Judge Jed Rakoff gave both the S.E.C. and Citigroup a list of questions.[5] After holding a hearing, Judge Rakoff declined to approve the consent decree, observing that before approval, a 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."[6] Judge Rakoff determined the proposed decree was "neither fair, nor reasonable, nor adequate, nor in the public interest," and that if an "application of judicial power" to approve the decree "does not rest on facts . . . established by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression."[7] The parties were then ordered to prepare for trial.[8] Both the S.E.C. and Citigroup filed immediate appeals and the S.E.C. sought an emergency stay both in the district court and before the Second Circuit.[9] After the district court denied

[1] *United States Securities and Exchange Commission v. Citigroup Global Markets, Inc*., No. 11-5227-cv (L), 2014 WL 2486793, at *1 (2d Cir. June 4, 2014) (the "Opinion"), available at http://www.ca2.uscourts.gov/decisions/isysquery/f9d5ba99-7c41-4b34-b821-4a704a4dbecf/5/doc/11-5227_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/f9d5ba99-7c41-4b34-b821-4a704a4dbecf/5/hilite/.

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *See id.* at *2.

[6] S.E.C. v. Citigroup Global Mkts., Inc., 827 F. Supp. 2d 328, 332 (S.D.N.Y. 2011).

[7] *Id.* at 335.

[8] *Id.*

[9] *See* the Opinion at *3. Additionally, the S.E.C. sought a writ of mandamus to set aside the order. Because the Second Circuit decided to exercise jurisdiction, the petition became moot. *Id.* at *10.

the motion for a stay of its proceedings, the Second Circuit granted the motion before it, reasoning that the S.E.C. "demonstrated a strong likelihood of success on the merits, because the district court did not accord the S.E.C.'s judgment adequate deference."[10]

II. The Court of Appeals' Decision

The Court of Appeals found that it had jurisdiction to hear the appeal and reviewed the district court's decision under an abuse of discretion standard, stating that the district court abuses its discretion if it: " '(1) based its ruling on an erroneous view of the law,' (2) made a 'clearly erroneous assessment of the evidence,' or (3) 'rendered a decision that cannot be located within the range of permissible decisions.' "[11]

In addressing how much deference a federal agency should receive from a district court when seeking a consent decree, the court recognized there is a strong policy to approve and enforce such decrees, and also noted that the district judge "is not merely a 'rubber stamp.' "[12] Although Judge Rakoff invoked the "fair, reasonable, adequate, and in the public interest" standard, the Second Circuit clarified that:

> [T]he proper standard for review in a proposed consent judgment involving an enforcement agency 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.[13]

The Second Circuit omitted reference to adequacy, finding it "particularly inapt in the context of a proposed S.E.C. consent decree."[14] The court detailed four factors that the district court should assess, at a minimum:

(1) the legality of the decree;

(2) if the terms of the decree, specifically its enforcement mechanism, are clear;

(3) whether the decree shows a resolution of the complaint's claims; and

(4) if any kind of corruption or collusion has tainted the decree.[15]

"The primary focus of the inquiry, however, should be on ensuring the consent decree is procedurally proper, using objective measures similar to the factors set out above, taking care not to infringe on the S.E.C.'s discretionary authority to settle on a particular set of terms."[16]

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[10] S.E.C. v. Citigroup Global Mkts., Inc., 673 F.3d 158, 163–65 (2d Cir. 2012).

[11] The Opinion at *4 (quoting Lynch v. City of New York, 589 F.3d 94, 99 (2d Cir. 2009)).

[12] *Id.* at *6 (quoting S.E.C. v. Levine, 881 F.2d 1165, 1181 (2d Cir. 1989)).

[13] *Id*. at *7 (citation omitted).

[14] *Id.* The court noted, however, that the adequacy standard is perfectly constructed for class action settlements.

[15] *See id.*

[16] *Id.*

The Second Circuit found that the district court abused its discretion by requiring that the S.E.C. establish the veracity of the allegations against Citigroup before it would approve the decree.[17] Because consent decrees are primarily about pragmatism, while trials are primarily about the truth, "[i]t is not within the district court's purview to demand cold, hard, solid facts, established by admissions or by trials" as a precondition for approval of a decree.[18] On the other hand, the Second Circuit cautioned that it "need not, and do not, delineate the precise contours of the factual basis required to obtain approval for each consent decree."[19]

With respect to the public interest element that must be considered when there is a request for injunctive relief, the Second Circuit held that the S.E.C. alone determines whether the proposed decree best serves the public interest,[20] making clear that a district court may not find the public interest disserved merely because it disagrees with S.E.C. policy decisions.[21] Here, the court found that Judge Rakoff's analysis of the public interest as "an overriding interest in knowing the truth" constituted legal error.[22] The Court of Appeals emphasized, however, that in doing its job a district court cannot simply accept a proposed decree without review.[23]

III. Significance

The Court of Appeals decision clarifies the role of the district court in the review and approval of proposed consent decrees and provides a measure of certainty to both private litigants and the S.E.C. concerning the settlement process.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.

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[17] *See id.* at *8.

[18] *Id.* (internal quotations omitted) (citation omitted).

[19] *Id.*

[20] *See id.* at *9.

[21] *See id.* "[S]uch as deciding to settle without requiring an admission of liability," as is the case here. *Id.*

[22] *Id.*

[23] *See id.* at *10.

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