

Second Circuit's Citigroup Decision Protects SEC's Discretion in Settling Enforcement Cases

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Wednesday's decision by the U.S. Court of Appeals for the Second Circuit in the *Citigroup* case is significant because it clarifies the standards for judicial review of consent decrees in SEC enforcement proceedings and protects the discretion of the SEC to settle cases without requiring defendants to admit wrongdoing. The decision has garnered considerable attention because it vacates a 2011 order by federal district court judge Jed Rakoff, in which he rejected a proposed settlement and consent decree between the SEC and Citigroup Global Markets in a case involving marketing of mortgage-backed securities. See *SEC v. Citigroup Global Mkts Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

The Second Circuit opinion makes it clear that district courts cannot simply second-guess the SEC's choices on discretionary matters of policy, such as deciding to settle a case without requiring an admission of wrongdoing. The court held that the proper standard for reviewing a proposed consent judgment involving an enforcement agency is whether the decree is fair and reasonable and does not disserve the public interest. Judges must approve consent decrees proposed by the SEC absent a substantial basis in the record for concluding that the proposed decree does not meet these requirements. They should not assess a decree's "adequacy," and they must give significant deference to the SEC's determination that a decree serves the public interest.

Although the SEC has begun to apply a new policy in the last year, requiring defendants to admit misconduct as a condition of settlement in egregious cases ([as our colleague Nancy Adams discussed in her post earlier this week](#)), for many years the SEC has permitted defendants to settle enforcement proceedings without admitting wrongdoing. Where the SEC sues in federal court and seeks to resolve the case through a consent decree, as in the *Citigroup* case, judicial review of such a settlement is required.

In rejecting the *Citigroup* consent decree, Judge Rakoff criticized "the S.E.C.'s long-standing policy – hallowed by history, but not by reason – of allowing defendants to enter into Consent Judgments without admitting or denying the underlying allegations," because it "deprives the Court of even the most minimal assurance that the substantial injunctive relief it is being asked to impose has any basis in fact." On the one hand, he expressed concern that "a consent judgment that does not involve any admissions and that results in only very modest penalties" is viewed as merely "a cost of doing business" (although in *Citigroup* the "cost of doing business" was \$285 million in disgorged profits, penalties, and interest). On the other hand, he observed that "the potential for abuse in imposing penalties on the basis of facts that are neither proven nor acknowledged is patent."

But the Second Circuit took the view that Judge Rakoff's concern with establishing the facts was misplaced in this context: "Trials are primarily about the truth. Consent decrees are primarily about pragmatism," the Second Circuit observed, noting that in settlements each party seeks compromise in an effort to manage risk. Therefore "[i]t is an abuse of discretion to require, as the district court did here, that the S.E.C. establish the 'truth' of the allegations against a settling party as a condition for approving consent decrees."

Courts must of course review SEC consent decrees. The Second Circuit said that in determining whether a decree is fair and reasonable, a court should assess the decree's legality; whether its terms and enforcement mechanism are clear; whether it reflects resolution of the actual claims in the complaint; and whether it is tainted by improper collusion or corruption. But the primary focus of any additional inquiry should be on whether the decree is procedurally proper.

Notwithstanding its new "get tough" policy in some cases, the SEC has welcomed the Second Circuit decision, because settlements in which a defendant neither admits nor denies wrongdoing enable the agency to take action without the delay, uncertainty, and resources involved in extended litigation, [as Director of Enforcement Andrew Ceresney noted in a statement](#). And the decision also provides reassurance to defense counsel that they can negotiate a settlement of a court case with the SEC with less concern that it may be potentially rejected by the court.

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