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SECOND CIRCUIT REVIEW

Expert Analysis

Second Circuit Limits Judicial Review of Regulatory Consent Judgments

By **Martin Flumenbaum** And **Brad S. Karp**

This month, we discuss *SEC v. Citigroup Global Markets*,[1] in which a panel of the U.S. Court of Appeals for the Second Circuit unanimously reversed a district court order refusing to approve a consent judgment between the Securities and Exchange Commission and Citigroup, concluding that the refusal constituted an abuse of discretion. Co-author Brad S. Karp represents Citigroup Global Markets in this matter.

The panel's decision, written by Second Circuit Judge Rosemary S. Pooler and joined by Judges Raymond Lohier, Jr. and Judge Susan L. Carney, vacated the order of the district court judge and remanded the case for further proceedings in accordance with the legal standard articulated by the Second Circuit. Lohier filed a brief concurring opinion, expressing the opinion that the factual record supported a reversal and direction to enter the consent decree without further proceedings.

Background and History

On Nov. 28, 2011, the district court judge rejected a proposed consent judgment between the SEC and Citigroup.[2] This consent judgment was rejected "because the Court has not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment."[3] Applying the standard of review set forth by the U.S. Court of Appeals for the Ninth Circuit in *SEC v. Randolph*,[4] the district court held "that the proposed Consent Judgment is neither fair, nor reasonable, nor adequate, nor in the public interest…because it does not provide the Court with a sufficient evidentiary basis to know whether the requested relief is justified under any of these standards."[5]

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The district court objected to the long-standing SEC practice of permitting defendants to enter into consent decrees without admitting or denying the allegations in the complaint (and so evading collateral estoppel effects and consequent civil liability in subsequent litigation by private plaintiffs),[6] as well as the lack of "cold, hard, solid facts, established either by admissions or by trials" that would satisfy the "overriding public interest in knowing the truth."[7]

'Motion' Decision

Both the SEC and Citigroup appealed this decision, and sought an immediate stay of the proceedings. Following the district court judge's denial of a stay,[8] the Second Circuit granted a stay of the proceedings on March 15, 2012.[9] In granting the stay, the Second Circuit panel, comprised of Judges John M. Walker Jr., Pierre N. Leval, and Rosemary S. Pooler, noted that "[w]e know of no precedent that supports the proposition that a settlement will not be found to be fair, adequate, reasonable or in the public interest unless liability has been conceded or proved and is embodied in the judgment."[10]

'Merits' Decision

In its decision, the Second Circuit clarified the standard for review of a proposed consent judgment involving a federal regulatory enforcement agency, which "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."[11] The court expressly excluded any inquiry of "adequacy" from the analysis as inapt in the context of a consent decree involving an enforcement agency, as opposed to in the context of a class action settlement.

The court identified four factors to be considered in evaluating "fairness and reasonableness": "(1) the basic legality of the decree, (2) whether the terms of the decree, including its enforcement mechanism, are clear, (3) whether the consent decree reflects a resolution of the actual claims in the complaint, and (4) whether the consent decree is tainted by improper collusion or corruption of some kind." In his concurring opinion, Lohier embraced limiting a district court's analysis to these four factors, and observed that "the perceived modesty of monetary penalties proposed in a consent decree is not a reason to reject the decree."

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Notably, the Second Circuit stated that "[t]he primary focus of the inquiry…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." In doing so, the court emphasized that a district court's review of a consent order should focus on procedural, rather than substantive, considerations.

The court further addressed what a district court may consider as part of its review of a consent decree. The Second Circuit stated that

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"there is no basis in the law for the district court to require an admission of liability as a condition for approving a settlement between the parties." The court held that "[i]t 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."[12] Although the Second Circuit did acknowledge that, "[a]s part of its review, the district court will necessarily establish that a factual basis exists for the proposed decree," it indicated that this could be satisfied by "factual averments by the S.E.C., neither admitted nor denied by the wrongdoer." In so stating, the circuit court placed its judicial imprimatur on the SEC's longstanding practice of no-admit/no-deny consent judgments.

The Second Circuit also addressed the standard for approving a consent judgment involving injunctive relief, holding that "the district court must assure itself the 'public interest would not be disserved' by the issuance of a permanent injunction." The court emphasized that "[t]he job of determining whether the proposed S.E.C. consent decree best serves the public interest, however, rests squarely with the S.E.C., and its decision merits significant deference."

The decision rejected the district court's concern for the "overriding public interest in knowing the truth," stating: "Trials are primarily about the truth. Consent decrees are primarily about pragmatism." Further, the Second Circuit noted that "provid[ing] collateral estoppel assistance to private litigants…is not the job of the courts."

Finally, the court briefly noted the SEC's ability to regulate without involvement of the courts, stating: "[T]o the extent that the S.E.C. does not wish to engage with the courts, it is free to eschew the involvement of the courts and employ its own arsenal of remedies instead.… [However,] if the S.E.C. prefers to call upon the power of the courts in ordering a consent decree and issuing an injunction, then the S.E.C. must be willing to assure the court that the settlement proposed is fair and reasonable."

Conclusion

The Second Circuit's decision limits the ability of district courts substantively to review regulatory consent judgments. The decision delineates the respective roles of regulatory agencies and courts, emphasizing that the SEC is charged with exercising discretionary judgment as to whether a settlement is in the public interest, and that courts are to defer to that assessment.

Significantly, the decision adopts a standard of judicial review that is unlikely to bar any regulatory settlements unless they are collusive or procedurally defective. The court's ruling effectively endorses the legitimacy of regulatory consent judgments in which the defendant neither admits nor denies the allegations. This decision will have wide-ranging and far-reaching implications for regulatory enforcement, particularly in industries subject to frequent enforcement via no-admit/no-deny consent judgments, which are a favored tool of not only the SEC, but also the Commodity Futures Trading Commission, Federal Trade Commission, Environmental Protection Agency, and certain civil resolutions by the Department of Justice.

Also, the Second Circuit's decision may slow the SEC's limited program of requiring admissions of wrongdoing in certain cases. Since the district court's rejection of the settlement in *SEC v. CGMI*, the SEC has re-evaluated its policy of allowing regulatory settlements without admissions or denials of liability. Thus, on Jan. 7, 2012, the SEC announced that it would no longer accept no-admit/no-deny settlements where the defendant has admitted guilt or been convicted in a parallel criminal prosecution. In recent months, the SEC has adopted a more aggressive policy that would permit the commission to seek admissions as a condition of settlement in certain cases.

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Specifically, on Sept. 26, 2013, SEC Chair Mary Jo White articulated a number of factors to be considered in evaluating whether admissions would be sought, including whether: (i) "a large number of investors have been harmed or the conduct was otherwise egregious," (ii) "the conduct posed a significant risk to the market or investors," (iii) "admissions would aid investors deciding whether to deal with a particular party in the future," or (iv) "reciting unambiguous facts would send an important message to the market."[13] Despite this new policy, the SEC has demanded admissions in only a handful of cases, and continues to employ no-admit/no-deny settlements on a regular basis.

In response to the Second Circuit's decision, SEC Director of Enforcement Andrew Ceresney announced that "the SEC has and will continue to seek admissions in appropriate cases," but added that "settlements without admissions also enable regulatory agencies to serve the public interest by returning money to harmed investors more quickly, without the uncertainty and delay from litigation and without the need to expend additional agency resources."[14] While the SEC is unlikely to abandon its policy of requiring admissions in certain cases, it may choose to do so even more sparingly in the aftermath of the Second Circuit's decision.

In addition, although recent administrative settlements by the SEC may reflect a preference to reach settlements that do not require federal court review,[15] this decision may increase the commission's willingness to avail itself of the courts for settlement approval.

Ultimately, the Second Circuit's decision brings much-needed clarity to the law, and confirms that regulatory consent judgments in which the defendant neither admits nor denies the allegations are an appropriate tool of enforcement agencies. This decision resolves the uncertainty in the law created by the district court's initial rejection of the regulatory consent judgment between the SEC and Citigroup, which had been echoed by various district courts since 2011.[16]

1. *SEC v. Citigroup Global Markets Inc.*, — F.3d —, 2014 WL 2486793 (June 4, 2014). Co-author Brad S. Karp represented Citigroup Global Markets in this matter before both the district court and the Second Circuit.
2. *SEC v. Citigroup Global Markets Inc.*, 827 F.Supp.2d 328 (S.D.N.Y. 2011).
3. Id. at 330.
4. *SEC v. Randolph*, 736 F.2d 525, 529 (9th Cir. 1984).
5. *SEC v. Citigroup Global Markets Inc.*, 827 F.Supp.2d 328, 332 (S.D.N.Y. 2011).
6. Id. at 334 ("[T]he combination of charging Citigroup only with negligence and then permitting Citigroup to settle without either admitting or denying the allegations deals a double blow to any assistance the defrauded investors might seek to derive from the S.E.C. litigation in attempting to recoup their losses through private litigation, since private investors not only cannot bring securities claims based on negligence, but also cannot derive any collateral estoppel assistance from Citigroup's non-admission/non-denial of the S.E.C.'s allegations." (internal citation omitted)).
7. Id. at 335.
8. *SEC v. Citigroup Global Markets Inc.*, 827 F.Supp.2d 336 (S.D.N.Y. 2011).
9. *SEC v. Citigroup Global Markets Inc.*, 673 F.3d 158 (2d Cir. 2012).
10. Id. at 166.
11. *SEC v. Citigroup Global Markets Inc.*, —F.3d—, 2014 WL 2486793 at *7 (June 4, 2014).
12. Id. at *8 (citing *SEC v. Citigroup*, 827 F.Supp.2d at 328, 335 (S.D.N.Y. 2011)).
13. Mary Jo White, Chair, Securities and Exchange Comm'n, Council of Institutional Investors Fall Conference in Chicago, Illinois: Deploying the Full Enforcement Arsenal (Sept. 26, 2013).
14. Public Statement, Andrew Ceresney, Director, SEC Division of Enforcement, Securities and Exchange Comm'n, Statement on Second Circuit Decision (June 4, 2014).
15. *In the Matter of Alcoa*, Exchange Act Release No. 71261 (Jan. 9, 2014); *In the Matter of Hewlett-Packard Company*, Exchange Act Release No. 71916 (April 9, 2014).
16. See *SEC v. Gilder*, Civil Action No. 12-cv-02839, 2014 WL 1628474 (D.Colo. April 24, 2014); *SEC v. Hohol*, No. 14-C-41, 2014 WL 461217 (E.D. Wis. Feb. 5, 2014); *SEC v. Petro-Suisse, Ltd.*, No. 12 Civ. 6221, 2013 WL 5348595 (S.D.N.Y. Sept. 25, 2013); *SEC v. CR Intrinsic Investors*, 939 F.Supp.2d 431 (S.D.N.Y. 2013); *SEC v. Bridge Premium Finance*, No. 12-cv-2131 (D.Colo. Jan. 17, 2013); *U.S. v. Wells Fargo*, 891 F.Supp.2d 143 (D.D.C. 2012); *FTC v. Circa Direct*, Civil No. 11-2172, 2012 WL 3987610 (D.N.J. Sept. 11, 2012); *SEC v. Cioffi*, 868 F.Supp.2d 65 (E.D.N.Y. 2012); *SEC v. Koss*, No. 11-cv-00991 (E.D. Wis. Feb. 23, 2012).

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