June 4, 2014

Second Circuit Reverses District Court's Rejection of Regulatory Consent Judgment in *SEC* v. *CGMI*

Today, the United States Court of Appeals for the Second Circuit issued a significant decision in *SEC* v. *Citigroup Global Markets Inc*., in which it concluded that the district court's refusal to approve a consent judgment between the SEC and Citigroup was an abuse of discretion.[1] On November 28, 2011, the district court rejected this consent judgment, in which Citigroup neither admitted nor denied the allegations, because of a lack of "cold, hard, solid facts, established by admissions or by trials." The Second Circuit's decision effectively rejects the proposition that district courts may substantively review regulatory consent judgments, and consequently endorses the ability of the SEC and other regulatory agencies to enter into "no admit, no deny" settlements.

This decision should undermine the increasing trend in the district courts to second-guess the remedies agreed to by regulators and defendants, and the concomitant media and political pressure to do so. The Second Circuit's decision sharply delineates the respective roles of regulatory agencies and the 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.

Summary of Decision

In its decision, the Second Circuit clarified the standard for the review of a proposed consent judgment involving an 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." (Op. 19 (internal citation omitted).). 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 four factors to be considered in evaluating "fairness and reasonableness" include: "(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." (Op. 20 (citations omitted).) In a two-page concurring opinion, Judge 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." (Concurring Op. 1.)

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[1] Paul, Weiss, Rifkind, Wharton & Garrison LLP represented Citigroup Global Markets Inc. in this matter both before the district court and the Second Circuit.

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." (Op. 21.) 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 require and consider as part of the approval of a consent decree. The Second Circuit stated that "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." (Op. 17.) 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." (Op. 22 (citing decision below).) 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." (Op. 22.) In effect, the Second Circuit 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." (Op. 24 (internal citation omitted).). The Second Circuit emphasized, though, 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." (Op. 24-25.)

The decision also emphatically rejected the district court's stated concern for the "overriding public interest in knowing the truth," stating: "Trials are primarily about the truth. Consent decrees are primarily about pragmatism." (Op. 21.) Further, the Second Circuit noted that "provid[ing] collateral estoppel assistance to private litigants . . . is not the job of the courts." (Op. 27.)

Finally, the Second Circuit briefly noted the ability of the SEC to regulate without the involvement of the courts. (Op. at 27 ("[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." (Op. 27.)

Implications

Today's decision adopts a standard of judicial review that is unlikely to bar any regulatory settlements unless they are collusive or procedurally defective, which is rarely, if ever, an issue in such settlements. By doing so, it effectively endorses the policy of entering into 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 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 Commodities Futures Trading Commission, Federal Trade Commission, Environmental Protection Agency, and civil resolutions by the Department of Justice.

Fundamentally, this decision preserves regulatory consent judgments as an enforcement tool for regulatory agencies. If consent judgments were required to be predicated on admissions of wrongdoing, private parties would be less likely to enter into consent judgments due to the potentially devastating collateral consequences posed by private litigation premised on such admissions. Further, enabling consent decrees where the defendant neither admits nor denies the allegations preserves a necessary flexibility, even where the collateral consequences are insignificant, as parties can "agree to disagree" about a set of ambiguous, uncertain, or highly contested facts.

Also, this decision may further reduce the SEC's already 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 whether to enter into regulatory settlements without admissions or denials of liability. On January 7, 2012, the SEC announced that it would no longer accept no-admit/no-deny settlements when the defendant had admitted guilt or been convicted in a parallel criminal prosecution. In recent months, the SEC adopted a more aggressive policy toward requiring admissions as a condition of settlement in certain cases. Specifically, on September 26, 2013, Chairman Mary Jo White articulated a number of factors concerning 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."[2] However, 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 decision, SEC Director of Enforcement Andrew Ceresney announced that "the SEC has and will continue to seek admissions in appropriate cases," but 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."[3] While the SEC is unlikely to abandon its policy of requiring admissions in certain

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2 Mary Jo White, Chairman, Securities & Exchange Comm'n, Council of Institutional Investors Fall Conference in Chicago, Illinois: Deploying the Full Enforcement Arsenal (Sept. 26, 2013).

3 Public Statement, Andrew Ceresney, Director, SEC Division of Enforcement, Securities and Exchange Comm'n, Statement on 2nd Circuit Decision (June 4, 2014).

cases, it may choose to do so even more infrequently in the aftermath of this decision. In addition, although recent administrative settlements by the SEC may reflect a preference to reach settlements that do not require federal court review,[4] this decision reduces the incentive to avoid resort to the courts for settlement approval.

Ultimately, the Second Circuit's decision brings 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 finally 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 has been echoed by a handful of other courts since 2011.[5]

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[4] In the Matter of Alcoa, Inc., Exchange Act Release No. 71261 (Jan. 9, 2014); In the Matter of Hewlett-Packard Company, Exchange Act Release No. 71916 (April 9, 2014).

[5] *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, LLC*, 939 F. Supp. 2d 431 (S.D.N.Y. 2013); *SEC* v. *Bridge Premium Finance, LLC*, 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 LLC*, 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).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Susanna M. Buergel (212) 373-3553 sbuergel@paulweiss.com	Charles E. Davidow (202) 223-7380 cdavidow@paulweiss.com	Brad S. Karp (212) 373-3316 bkarp@paulweiss.com
Daniel J. Kramer (212) 373-3020 dkramer@paulweiss.com	Jane B. O'Brien (202) 223-7327 jobrien@paulweiss.com	Walter G. Ricciardi (212) 373-3350 wricciardi@paulweiss.com
Richard A. Rosen (212) 373-3305 rrosen@paulweiss.com	Audra J. Soloway (212) 373-3289 asoloway@paulweiss.com	Jacob H. Hupart (212) 373-3381 jhupart@paulweiss.com