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Second Circuit Grants SEC's Motion for Stay and Sharply Criticizes District Court's Rejection of Settlement in Case Against Citigroup

By James A. Meyers, Lori Lynn Phillips and Alison K. Roffi

On Thursday, March 15, the United States Court of Appeals for the Second Circuit issued a *per curiam* stay order strongly criticizing Judge Jed S. Rakoff's order rejecting a proposed consent judgment between the Securities and Exchange Commission and Citigroup Global Markets Inc. The Second Circuit granted the Commission's motion for a stay of the district court proceedings in *SEC v. Citigroup Global Markets Inc.*, No. 11 Civ. 7387 (S.D.N.Y.), pending resolution of the appeals. While the Second Circuit has yet to rule on the merits whether the district court's opinion should be overturned, it was highly critical of that decision, finding that the SEC and Citigroup had "made a strong showing of likelihood of success in setting aside the district court's rejection of their settlement" and that they had "shown serious, perhaps irreparable, harm sufficient to justify grant of a stay." Op. at 17. The order appears to call for practically complete deference to an agency's decision to settle. The court acknowledged that, because the parties were united in seeking the stay, it had not received the benefit of adversarial briefing and stated that it would appoint counsel to argue in support of the views expressed in the district court's opinion.

By way of background, the SEC sued Citigroup in October 2011, alleging that Citigroup had made various misrepresentations in connection with its role in structuring and marketing a largely synthetic billion-dollar collateralized debt obligation fund. The SEC alleged that Citigroup had informed investors that the Fund's assets, which consisted primarily of subprime residential mortgage-backed securities, were selected by an independent investment adviser. According to the SEC, however, Citigroup in reality had arranged to include a substantial percentage of poorly performing subprime RMBS in the Fund and established short positions on those

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For news & updates, visit www.orrick.com/securities very assets. Citigroup allegedly realized net profits of around $160 million from this arrangement while investors in the Fund claimed that they lost more than $700 million. The SEC brought non-scienter based charges under Sections 17(a)(2) and (3) of the Securities Act of 1933, and Citigroup agreed to settle the case for $285 million in disgorgement and civil penalties. The SEC submitted a consent judgment to the court in which, consistent with the SEC's regular practice, Citigroup did not admit or deny any of the SEC's allegations.

Judge Rakoff rejected the settlement, criticizing the fact that it did not require an admission of liability from Citigroup. The district court concluded that the proposed consent judgment was not fair, reasonable, adequate, or in the public interest.

The Second Circuit took a much more deferential approach, expressing its view that the judiciary should not second-guess the decision of an agency as to what is in the public interest. It held that: "While we are not certain we would go so far as to hold that under no circumstances may courts review an agency decision to settle, the scope of a court's authority to second-guess an agency's discretionary and policy-based decision to settle is at best minimal." Op. at 8. The only circumstance suggested in the order in which a court should reject a proposed settlement is where the injunctive relief provisions affirmatively *harm* the public interest in some way. *See* Op. at 7 n.1 & 12 n.5.

With respect to the deference to be given to the agency's judgment to settle, the Second Circuit concluded that Judge Rakoff did "not appear to have considered the agency's discretionary assessment of its prospects of doing better or worse, or of the optimal allocation of its limited resources." Op. at 9. Regarding Judge Rakoff's stated position that the settlement was unfair to Citigroup because it imposed substantial relief without a finding of liability, the Second Circuit found that the "more important concern is whether it is a proper part of the court's legitimate concern to protect a private, sophisticated, counseled litigant from a settlement to which it freely consents. We doubt that a court's discretion extends to refusing to allow such a litigant to reach a voluntary settlement in which it gives up things of value without admitting liability." Op. at 10.

More fundamentally, this decision, while preliminary and not a final ruling on the merits, shows that the Second Circuit is inclined to affirm the Commission's current practice of not requiring defendants to admit liability when settling cases (though the Commission's standard practice is also to prohibit defendants from denying the Commission's allegations). The Second Circuit "question[ed] the district court's apparent view that the public interest is disserved by an agency settlement that does not require the defendant's admission of liability. Requiring such an admission would in most cases undermine any chance for compromise." Op. at 10. According to the Court of Appeals, Judge Rakoff's order was "tantamount to ruling that . . . a court will not approve a settlement that represents a compromise. It is commonplace for settlements to include no binding admission of liability. A settlement is by definition a compromise. We 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." Op. at 12.

With the district court proceedings now stayed, the next step in the process is the Second Circuit's decision on the merits regarding the SEC's and Citigroup's interlocutory appeals and mandamus petition.

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