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## Second Circuit Affirms SEC Settlement Policy

The Second Circuit recently affirmed the Securities and Exchange Commission's ability to negotiate settlements without requiring an admission of wrongdoing, thus vacating and remanding a decision to the contrary by Judge Jed S. Rakoff of the Southern District of New York in *SEC v. Citigroup Global Mkts., Inc.*, No. 11-5227-cv(L); 11-5375-cv(con), 11-5242-cv(xap) (2d Cir. June 4, 2014). Judge Rakoff's decision was controversial from the outset and the Second Circuit's reversal came as no surprise.

### BACKGROUND

In 2011, the SEC filed a complaint against Citigroup alleging that it had negligently misrepresented its role in a \$1 billion fund related to subprime securities associated with the housing market, thereby violating sections 17(a)(2) and (3) of the Securities Act of 1933. Based on these allegations, the SEC proposed a consent judgment under which Citigroup would be enjoined from violating certain sections of the Securities Act, disgorge the profits gained from the alleged conduct, and pay prejudgment interest and a civil penalty. Citigroup agreed to the consent judgment, neither admitting nor denying the allegations contained in the complaint. Judge Rakoff rejected the consent judgment, however, under the premise that proven or acknowledged facts are necessary to protect the public interest in "knowing the truth," stating that if an injunction is not based on "cold, hard, solid facts," it "serves no lawful purpose and is simply an engine of oppression."

### HOLDING

Following an appeal by both the SEC and Citigroup, the Second Circuit vacated and remanded the case, holding that "[i]t is an abuse of discretion to require" that the Securities and Exchange Commission "establish the 'truth' of the allegations against a settling party as a condition for approving the consent decrees." According to the court, "[t]rials are primarily about the truth [while] [c]onsent decrees are primarily about pragmatism." In rejecting the district court's adequacy test, the Second Circuit reiterated its standard that a consent decree should be fair, reasonable, and not a disservice to the public, emphasizing that district courts should focus on evaluating objective factors so as to avoid assessing policy decisions, which rest solely with public branches of government.

### IMPACT

The Second Circuit affirmed the SEC's ability to negotiate settlements without requiring an admission of wrongdoing, allowing the SEC to maintain broad control over its settlement negotiations. The district court's ruling represented an unprecedented attempt to restrict the SEC's longstanding negotiation process; as the Second Circuit noted, settlement decisions allow the SEC to avoid the expense of trial and provide both litigants with a "means to manage risk."

Yet, the district court's decision shaped – or at least anticipated -- the SEC's agenda. During the pendency of the Second Circuit appeal of Judge Rakoff's decision, SEC

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Chairwoman Mary Jo White declared that the agency was abandoning its decades-old policy of allowing all defendants to settle cases without admitting or denying wrongdoing. The agency now requires an acknowledgment of wrongdoing for settlements of cases it considers particularly egregious, such as in its \$920 million settlement with JPMorgan Chase in September 2013. Chairwoman White also has indicated that the SEC will continue to pursue an evolving standard of admissions of wrongdoing through cases it brings and public discussion. Thus, while the Second Circuit has recognized the SEC's broad latitude in defining and implementing its own policy, the SEC itself has responded to calls for admission of wrongdoing in settlements by adopting admission policies of its own accord.

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