"HALLOWED BY HISTORY, BUT NOT BY REASON": JUDGE RAKOFF'S CRITIQUE OF THE SECURITIES AND EXCHANGE COMMISSION'S CONSENT JUDGMENT PRACTICE

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Introduction

Over the past several years, in a trilogy of opinions,[1] Judge Jed S. Rakoff of the United States District Court of the Southern District of New York has established himself as a minor cult hero for daring to question the wisdom of the long-running consent judgment practice of the Securities and Exchange Commission ("SEC" or "Commission").[2] At its core, each opinion addresses issues of affinity for settlement, judicial deference to the judgments of administrative agencies, and the general theory of damages in cases

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1 *See* Sec. Exch. Comm'n. v. Bank of Am. Corp. (*Bank of America Opinion I*), 653 F. Supp. 2d 507 (S.D.N.Y. 2009); Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304 (S.D.N.Y. 2011); Sec. Exch. Comm'n. v. Citigroup Global Markets Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

2 *See, e.g.*, Matthew Farrell, Note, *A Role for the Judiciary in Reforming Executive Compensation: The Implications of Securities and Exchange Commission v. Bank of America*, 96 Cornell L. Rev. 169, 189 (2010) (describing Judge Rakoff as a "maverick"); Ed Koch, *Judge Jed Rakoff—A Light Unto His Fellow Jurists,* Huffington Post (Dec. 6, 2011, 12:05 PM), http://www.huffingtonpost.com/ed-koch/judge-jed-rakoff-a-light-_b_1130133.html (characterizing the Judge as "a light unto his fellow jurists"); Steven Pearlstein, *What Kind of Judge Stands Up for Truth and Justice?*, Wash. Post, Sept. 16, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/09/15/AR2009091503498.html (calling Judge Rakoff "the kind of activist judge we need more of"); John Cassidy, *Why Judge Rakoff Was Right to Block the Citigroup Settlement,* The New Yorker Rational Irrationality Blog (Nov. 29, 2011), http://www.newyorker.com/online/blogs/johncassidy/2011/11/why-judge-rakoff-was-right-to-block-the-citigroup-settlement.html (commenting that Judge Rakoff "did the American public a great service."); Jordan Weissmann, *Why Populist Hero Judge Rakoff Could Help Wall Street Win,* The Atlantic, Dec. 1, 2011, 4:23 PM, http://www.theatlantic.com/business/archive/2011/12/why-populist-hero-judge-rakoff-could-help-wall-street-win/249366/ (observing that the Judge "has the makings of a perfect hero"); Frederick J. Sheehan, *The SEC's Day in Court,* Financial Sense (Dec. 1, 2011), http://www.financialsense.com/contributors/fred-sheehan/2011/12/01/the-sec-day-in-court (describing the judge as "fighting for the common man"); David Bario, *With Latest Ruling, Rakoff Cements Status as Populist Firebrand,* AmLaw Daily (Nov. 28, 2011, 4:12 PM), http://amlawdaily.typepad.com/amlawdaily/2011/11/rakoff-as-populist-firebrand.html (describing the Judge as a "populist firebrand").

of corporate malfeasance.[3] While commentators have focused ample attention on the high-profile nature, appealing facts, or colorful judicial language[4] of each of the controversies, the value of the Judge's opinions is found elsewhere—in the basic issues he dares to confront regarding the proper role of the courts in validating and enforcing the special kind of settlement known as the consent judgment.[5] The Judge's rumblings uncover a practice "hallowed by history, but not by reason"[6] and his work sheds light on a curious corner of the Commission's maneuvering too long unexamined and unquestioned out of deference, convenience, apathy, or some combination thereof. If sunlight indeed remains the best disinfectant, Judge Rakoff's series of opinions offers the industry and its primary regulator a refreshing opportunity for introspection, as each embarks on a proper cleansing.[7] There remains, however, a significant difference between a good wash and a whitewash.[8] And, as Judge Rakoff notes, "in any case . . . that touches on the transparency of financial markets whose gyrations have so depressed our economy and debilitated our lives, there is an overriding public

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3 M. Todd Henderson, *Impact of the Rakoff Ruling: Was the Judge's Scuttling of the SEC/BofA Settlement Legally Pointless or Incredibly Important—or Both?*, WALL STREET LAWYER, Nov. 2009, at 4.

4 *See, e.g.*, James F. Haggerty, *Judge Rakoff, Citigroup, and the Upside of Saying 'Sorry'*, CORPORATE COUNSEL (Dec. 7, 2011) (suggesting that "[c]ommentators have focused on the strong language of the opinion"); *see also* Alison Frankel, *Rakoff to SEC: Oh Yes, It is My Job to Consider Public Interest*, REUTERS, Nov. 28, 2011, http://newsandinsight.thomsonreuters.com/Legal/News/2011/11_-_November/Rakoff_to_SEC__Oh_yes,_it_is_my_job_to_consider_public_interest/ (describing the *Citigroup Global Markets, Inc.* opinion as an "eminently quotable exercise in rhetoric").

5 *See Rakoff Rakes the SEC*, WALL ST. J., Sept. 15, 2009, http://online.wsj.com/article/SB10001424052970203917304574413242609077958.html (observing that "Judge Rakoff has done a public service by exposing the political point-scoring that drives far too many regulatory actions"); *see also* Michael C. Macchiarola, *In Respect of Resistance to the "Rubber Stamp,"* ASU LAW BLOG (Apr. 19, 2012), http://asulawjournal.lawnews-asu.org/?p=422. Unless otherwise explained, the terms "consent decree" and "consent judgment" are used interchangeably throughout this Article.

6 Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 827 F. Supp. 2d at 328, 332 (S.D.N.Y. 2011).

7 *See generally* Louis Brandeis, *What Publicity Can Do,* HARPER'S WEEKLY, Dec. 20, 1913, at 10; *see also* Knut A. Rostad, *Rakoff's Bank of America Opinion: "The Tipping Point"* ADVISORONE (Sept. 16, 2009), http://www.advisorone.com/2009/09/16/rakoffs-bank-of-america-opinion-the-tipping-point (asserting that "Judge Rakoff's total rejection of the settlement frames, far more powerfully than any argument to date, the moral basis for reform in compelling terms that resonate with ordinary investors").

8 *See, e.g., A Financial Regulator Under Fire: Unsettling Wall Street,* THE ECONOMIST, Dec. 3, 2011, http://www.economist.com/node/21541055 [hereinafter THE ECONOMIST] (agreeing that "before a suitable punishment can be set, there must be a determination as to what occurred, and why it was wrong" and adding that "[o]f such sentiments are revolutions born").

interest in knowing the truth."[9]

This Article proceeds, in five parts, to examine each of the three relevant opinions. Part I summarizes each controversy and articulates Judge Rakoff's critique of the Commission's settlement practice. This part lays the predicate for the analysis that follows. Part II describes the history of the consent judgment practice at the Commission and examines the motivations and developments that have made it all too convenient for the Commission and defendants to routinely favor settlement. This part of the Article also surveys the surprisingly scant literature and precedent that exist on the subject and examines the indispensible role that the courts have come to play in the Commission's settlement practice. Part III examines the wisdom of a policy that favors settlements generally and investigates the proper deference that a court owes an administrative agency proposing a settlement. This part highlights the various issues raised by the Commission's current affinity for settlement and suggests that a more active role for courts is both necessary and responsible in cases where the Commission seeks judicial enforcement powers to assist in the monitoring of wrongdoers post-settlement. Also, this part explores the role that a "public interest" inquiry plays as an appropriate judicial check on the SEC's settlement practice. Part IV briefly explores the anticipated results of this issue's newfound attention and theorizes as to the likely effects on the Commission's ongoing practice of gaining settlements. Finally, Part V offers a short conclusion.

I. Three Controversies with a Common Thread

Judge Rakoff has been "publicly stewing over the SEC's approach to settlements with alleged Wall Street malefactors since 2009."[10] While each of the cases examined here has unique facts and circumstances, a common thread binds the three. Together, they shed light on a long running and unchecked practice.[11] More than the simple musings of a frustrated judge, the opinions are thoughtful and measured, and reveal deep inconsistencies and troubling assumptions in the Commission's use of the courts as enforcement partner.[12] In each case, the Judge objects to the Commission's taking the judiciary for granted—involving the court as

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9 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 335.

10 *See* Bario, *supra* note 2.

11 *See, e.g.*, The Economist, *supra* note 8 (describing the settlement practice as one of the SEC's "pet habits").

12 *See, e.g.*, Brief of Appointed Pro Bono Counsel for the United States District Court at 1, Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 673 F.3d 158 (2d

an ongoing monitor without providing a full accounting of the underlying facts triggering such a necessity.[13] The Judge's concerns are straightforward. Absent an adequate appraisal, it remains nearly impossible for a court to determine (i) its proper role in such an arrangement or (ii) whether the public interest is served by its ongoing involvement. And, "before a suitable punishment can be set, there must be a determination as to what occurred, and why it was wrong."[14] As one commentator has observed, the entire process takes on "an Alice-in-Wonderland aspect" when a company subjects itself to disgorgement or monetary penalty and "routinely says it won't in the future violate the regulations it did not admit to violating in the first place."[15]

At the same time, allowing the judiciary an unfettered role in rewriting or second-guessing each and every Commission settlement would be equally unsatisfactory. Such a regime would frustrate the Commission's work and impart a substantial burden on its efforts to calculate the costs and benefits of the various enforcement strategies at its disposal. Moreover, without clearly defining the scope of judicial inquiry, the Commission and its targets would be forced to bargain with the prospect of eventual judicial interference hanging in the air. Such a regime might also prove unsatisfactory for the judiciary itself, as additional hearings, testimony, and review processes of all proposed Commission settlements would clog already full federal judicial dockets.[16]

Cir. 2012) (Nos. 11-5227-CV(L), 11-5375-CV(CON), 11-5242-CV(XAP)), 2012 WL 3288769 [hereinafter SEC Brief]. The brief stated:

> The district court, asked to approve a problematic consent judgment that included a request for substantial injunctive relief enforced by the court's own contempt power, held that the proposed consent judgment could not meet the acknowledged standards of judicial review where the court had not been provided with any evidentiary basis upon which to exercise its independent judgment.

Id.

13 One particularly colorful description of this objection suggested that the Judge did not want to be treated as a "potted plant." *See* Roger Parloff, *The Judge Who Slapped Citi*, FORTUNE, Nov. 30, 2011, http://finance.fortune.cnn.com/2011/11/30/judge-jed-rakoff-citigroup-sec/.

14 *See* THE ECONOMIST, *supra* note 8.

15 Neal Lipschutz, *Hear Out the SEC Guy, Too,* WALL ST. J. LAW BLOG (Dec 5, 2011, 11:24 AM), http://blogs.wsj.com/law/2011/12/05/hear-out-the-sec-guy-too/; *see also* Matt Taibbi, *Federal Judge Pimp-Slaps the SEC Over Citigroup Settlement*, ROLLING STONE TAIBBLOG (Nov. 29, 2011, 10:10 AM), http://www.rollingstone.com/politics/blogs/taibblog/federal-judge-pimp-slaps-the-sec-over-citigroup-settlement-20111129 ("By accepting hundred-million-dollar fines without a full public venting of the facts, the SEC is leveling seemingly significant punishments without telling the public what the defendant is being punished for.").

16 Samantha Dreilinger, *Is Three a Crowd? The Role of the Courts in SEC Settlements,* 7

Judge Rakoff has drawn attention to a corner of the world where the roles of the judiciary and the Commission routinely intersect. And, his opinions have dared to ask some basic questions about the proper role of each in the process of negotiating and enforcing settlements with corporate wrongdoers. His opinions highlight that the judiciary has, for too long, offered little in the way of a meaningful check on the settlements of the SEC. Today, however, more work is required—to define more exactly the scope of the proper judicial inquiry into the Commission's arrangements and to ensure that judicial force is not employed in anything other than a highly deliberative and responsible manner.

The particular facts and histories of the three relevant cases follow.

A. *SEC v. Bank of America*

On August 3, 2009, the SEC filed a complaint against Bank of America Corporation ("BofA") in the United States District Court for the Southern District of New York.[17] The Commission alleged that BofA had made materially false and misleading statements in its proxy statement seeking shareholder approval of the $50 billion acquisition of Merrill Lynch ("Merrill").[18] Specifically, the Commission alleged that BofA violated Section 14 of the Securities Exchange Act of 1934 and the accompanying Rules 14a–3 and 14a–9, as a result of its failure to adequately disclose information about Merill's payment of year-end bonuses.[19] BofA's proxy claimed that Merrill had agreed not to pay year-end performance bonuses or other discretionary incentive compensation to its executives prior to the closing of the merger without BofA's consent.[20] In fact, BofA

(2010), http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=samantha_dreilinger.

17 *Bank of America Opinion I*, 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009). An amended complaint was filed on October 19, 2009. In addition, the Commission filed a complaint, on January 12, 2010, alleging that Bank of America failed to adequately disclose, in connection with the proxy solicitation for the Merrill acquisition, information concerning Merrill's losses for the fourth quarter of 2008.

18 *Id.* For a vivid description of the circumstances surrounding the Merrill Lynch acquisition, see Heidi N. Moore, *Bank of America-Merrill Lynch: A $50 Billion Deal from Hell*, WALL ST. J. DEAL JOURNAL BLOG (Jan. 22, 2009, 2:16 PM), http://blogs.wsj.com/deals/2009/01/22/bank-of-america-merrill-lynch-a-50-billion-deal-from-hell/; *see also* GREG FARRELL, CRASH OF THE TITANS (2010) (describing the events leading to Merrill's need for a takeover).

19 *Bank of America Opinion I*, 653 F. Supp. 2d at 508.

20 *See* Bank of America and Merrill Lynch, Notice of Special Meeting of Stockholders (Form 424(B)(3)) (Oct. 31, 2008), *available at* http://www.sec.gov/Archives/edgar/data/70858/000095012308014233/g15211b3e424b3.htm.

had already agreed that Merrill could pay up to $5.8 billion[21] in discretionary year-end and other bonuses to Merrill executives for 2008.[22] Under the terms of the consent judgment proposed to the court, BofA, while not admitting or denying the Commission's specific allegations, agreed to (i) pay a $33 million fine to the Commission and (ii) refrain from making false and misleading statements in future proxy solicitations.[23] On September 14, 2009, in a colorfully worded opinion, Judge Rakoff rejected a proposed consent judgment that would have settled the matter.[24]

Lest there be any doubt about the gravity with which Judge Rakoff would consider whether the proposed consent judgment was acceptable, his September 14th order framed the issue in no uncertain terms:

> In other words, the parties were proposing that the management of Bank of America—having allegedly hidden from the Bank's shareholders that as much as $5.8 billion of their money would be given as bonuses to the executives of Merrill who had run the company nearly into bankruptcy—would now settle the legal consequences of their lying by paying the S.E.C. $33 million more of their shareholder's money.[25]

After taking particular issue with the notion that "the victims of the violation pay an additional penalty for their own victimization," Judge Rakoff ordered written submissions and oral arguments on the subject.[26]

Of the three cases examined in this Article, the BofA situation seems to be the most egregious example of the consent decree gone wild. The underlying facts of the case make the proposed settlement almost indefensible. And, the court soundly rejected the

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21 Sec. Exch. Comm'n. v. Bank of Am. Corp., (*Bank of America Opinion II*) 09 CIV. 6829 (JSR), 2010 WL 624581 (S.D.N.Y. Feb. 22, 2010). This amount represented nearly 12% of the "approximately $50 billion" of total consideration exchanged in the merger. *See generally,* Final Consent Judgment as to Defendant Bank of America Corporation, Sec. Exch. Comm'n. v. Bank of America Corp., 677 F. Supp.2d 717 (S.D.N.Y. 2010) (Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR)), 2010 WL 430122.

22 *Bank of America Opinion I*, 653 F. Supp. 2d at 508.

23 *Id.*

24 *See id.*; *see also* Kara Scannell, Liz Rappaport & Jess Bravin, *Judge Tosses Out Bonus Deal*, WALL ST. J., Sept. 15, 2009, http://online.wsj.com/article/SB125294493976909051.html.

25 *Bank of America Opinion I*, 653 F. Supp. 2d at 508; *see also* Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J. L. & PUB. POL'Y 639, 654 (2010) (observing that "Judge Rakoff left no ambiguity about the SEC's self-interest in agreeing to settle with Bank of America").

26 *Bank of America Opinion I,* 653 F. Supp. 2d at 508. The court heard oral argument on August 10, 2009 and received written submissions from the parties on August 24, 2009 and September 9, 2009.

proposal on fairness, reasonableness, and adequacy grounds. With respect to the proposal's fairness, the court observed that "[i]t is not fair, first and foremost, because it does not comport with the most elementary notions of justice and morality, in that it proposes that the shareholders who were the victims of the Bank's alleged misconduct now pay the penalty for that misconduct."[27] The Commission made a feeble attempt to defend the corporate penalty as a worthy signaling device, reasoning that such a mechanism informed shareholders that unsatisfactory corporate conduct had occurred and allowed for a better assessment of management's quality and performance.[28] Such a desperate argument could not overcome the court's distaste for the fact that the BofA shareholder's would be paying for their own injury. In the court's word, such a construction would be "absurd."[29]

With respect to the reasonableness of the proposed settlement, Judge Rakoff could not resist commenting that "a proposal that asks the victims to pay a fine for their having been victimized is . . . as unreasonable as it is unfair."[30] The Judge's opinion went on to illustrate two additional unreasonable aspects of the proposed consent judgment.

First, contrary to existing Commission policy, the proposed settlement failed to adequately address the question of why the Commission did not "pursue charges against either Bank management or the lawyers who allegedly were responsible for the false and misleading proxy statements."[31] In fact, aside from drawing the ire of Judge Rakoff, the notion that the BofA victims would bear the cost of their own victimhood stood in direct contradiction to the Commission's own 2006 policy statement concerning the imposition of financial penalties.[32] The "Statement of the Securities and Exchange Commission Concerning Financial Penalties" (the "Statement") accompanied the filing of two settled actions with corporate defendants and was the Commission's attempt to "pro-

27 *Id.* at 509.

28 Reply Memorandum of Plaintiff Securities and Exchange Commission in Support of Entry of the Proposed Consent Judgment at 13, Sec. Exch. Comm'n. v. Bank of America Corp., 677 F. Supp. 2d 717 (S.D.N.Y. 2010) (No. 09-Civ.-6829 (JSR)), 2009 WL 2876664.

29 *Bank of America Opinion I*, 653 F. Supp. 2d at 509.

30 *Id.* at 510.

31 *Id.* These facts give rise to interesting issues of attorney-client relationships and privilege, addressed by the court, but beyond the scope of this Article.

32 *See* Press Release, Sec. Exch. Comm'n., Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), http://www.sec.gov/news/press/2006-4.htm.

vide the maximum possible degree of clarity, consistency, and predictability in explaining the way that its corporate penalty authority will be exercised."[33] In the Statement, the Commission offered quite directly that any such activity should "take into account whether the penalty would be paid by shareholders who had been the principal victims of the violation."[34] The Statement further instructed that "[w]here shareholders have been victimized by the violative conduct, or by the resulting negative effect on the entity following its discovery, the Commission is expected to seek penalties from culpable individual offenders acting for a corporation."[35] No such culpable individual offenders were fingered by the Commission in the BofA case. Instead, the instruction seems to have simply been ignored.

Judge Rakoff's second illustration of the settlement's unreasonableness took aim at the consent judgment's request for injunctive relief, describing the use of injunctive relief as "pointless" in the circumstance where its imposition lacks a factual predicate.[36] BofA's submissions to the court advanced a position that the proxy statement in issue "was totally in accordance with the law."[37] Maintaining such a position effectively hindered any proper imposition of injunctive relief by the court. As the court noted, "notwithstanding the injunctive relief here sought by the S.E.C., the Bank would feel free to issue exactly the same kind of proxy statement in the future."[38] It is well understood that the sanction of contempt "may only be imposed for violation of a particularized provision known and reasonably understood by the contemnor."[39]

Judge Rakoff's succinct description of the proposed settlement's inadequacy revealed his overall disapproval with the Commission's product:

> The proposed Consent Judgment is inadequate. The injunctive relief, as noted, is pointless. The fine, if looked at from the

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33 *Id.*

34 *Id.* The Commission also named (i) the need for effective deterrence, (ii) the presence of fraudulent intent, (iii) possible harm to innocent third parties, and the possibility of unjust enrichment for the wrongdoer as other factors to be considered. *Id.*

35 *See id. Accord Securities Law Enforcement: Hearings on H.R. 975 Before the Subcomm. On Telecommunications and Finance of the House Comm. On Energy and Commerce*, 101st Cong., 1 Sess. 47–48 (1989) (statement of David S. Ruder, Chairman, Sec. Exch. Comm'n., attaching Memorandum in Support of the Securities Law Enforcement Remedies Act of 1989).

36 *Bank of America Opinion I*, 653 F. Supp. 2d 507, 512 (S.D.N.Y. 2009).

37 *Id.* at 511.

38 *Id.*

39 *Id.*

> standpoint of the violation, is also inadequate, in that $33 million is a trivial penalty for a false statement that materially infected a multi-billion-dollar merger. But since the fine is imposed, not on the individuals putatively responsible, but on the shareholders, it is worse than pointless: it further victimizes the victims.[40]

Despite conceding that "in certain circumstances," the court's review should include an inquiry into whether the arrangement "serves the public interest," Judge Rakoff's opinion did not address the proper scope of a "public interest" inquiry any further.[41] And, while not couched explicitly in "public interest" language, the Judge objected to BofA's characterization of its decision to pay the fine as part of the settlement as a proper exercise of its business judgment. Instead, the Court wondered whether a proper business decision could be made by parties seemingly not disinterested:

> It is one thing for management to exercise its business judgment to determine how much of its shareholders' money should be used to settle a case brought by former shareholders or third parties. It is quite something else for the very management that is accused of having lied to its shareholders to determine how much of those victims' money should be used to make the case against the management go away. And even if this decision is arguably within their purview, it calls for greater scrutiny by the Court than would otherwise be the case.[42]

The court instructed the parties to prepare to litigate the action, and set a trial date of February 1, 2010.[43]

The Commission and BofA returned a few months later, new settlement in hand. The revised proposal incorporated some modest measures designed to ensure that BofA would not engage in similar misconduct in the future.[44] Toward that end, the revised

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40 *Id.* at 512.

41 *See id.*

42 *Bank of America Opinion I*, 653 F. Supp. 2d 507, 510 (S.D.N.Y. 2009).

43 *Id.* at 512.

44 *Bank of America Opinion II*, 09 CIV. 6829 (JSR), 2010 WL 624581, at *6 (S.D.N.Y. Feb. 22, 2010). Specifically, the Bank agreed to (i) engage an independent auditor to assess accounting controls and procedures and ensure adequate disclosure; (ii) engage a disclosure consul, in consultation with the Commission to report to the audit committee for three years; (iii) engage a compensation consultant to advise a fully independent compensation committee of the board; and (iv) submit executive compensation plans to shareholders for a non-binding vote for the next three years. With respect to penalties, the parties agreed to increase the amount of the fine imposed on Bank of America from the original $33 million rejected by Judge Rakoff to the new and improved $150 million. In addition, the $150 million would be distributed, pursuant to Sarbanes-Oxley "Fair Fund" provisions, to Bank of America shareholders who

settlement comprised two parts: (i) a package of prophylactic measures tailored to adequately prevent nondisclosures in the future and (ii) a penalty provision to better "serve the purpose of partially compensating victims."[45]

Judge Rakoff found the changes to be an improvement—however modest—over the first settlement.[46] Begrudgingly, he offered that "[n]o one can quarrel that these remedial steps are helpful, so far as they go, and may help to render less likely the kind of piecemeal and mincing approach to public disclosure that led to the Bank's problems in the instant cases."[47] But, as one observer noted, "the outcome hardly met the judge's view of an ideal result that should impose meaningful sanctions or lead Bank of America to implement real changes in its corporate governance to protect shareholders in the future."[48] According to the Judge, the new and improved $150 million fine remained "paltry" in light of the controversy's size.[49] Moreover, the proposed remedies were likely to have only a "very modest impact on corporate practices or victim compensation."[50] Finally, in the new construction, the wrongdoers still escaped unpunished.[51] Nonetheless, Judge Rakoff unenthusiastically approved the settlement, characterizing it as "better than nothing" but still "half-baked justice at best."[52]

Regardless of the specific outcome in the BofA dispute, Judge Rakoff's scathing opinions are noteworthy in two regards. First, despite creating a whole host of inconveniences for the Commission, the Judge showed great measure and restraint.[53] In the end, his tinkering reflects the reality that the authority to approve a settlement is not the same as the authority to craft one.[54] At the same time, the Judge's rigor signaled that potential settlements with the

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were harmed by the bank's nondisclosures and not former Merrill shareholders now holding Bank of America stock as a result of the merger. *See id.* at *5.

45 *Id.* at *3.

46 *See* Peter J. Henning, *Should the Perception of Corporate Punishment Matter?*, 19 J. L. & POL'Y 83, 89 (2010).

47 *Bank of America Opinion II*, 2010 WL 624581, at *4.

48 Henning, *supra* note 46, at 90.

49 *Bank of America Opinion II*, 2010 WL 624581, at *4.

50 *Id.* at *5.

51 *Id.* at *6.

52 *Id.* at *5.

53 *See id.* at *6 ("[T]he considerable power given federal judges to assure compliance with the law should never be confused with any power to impose their own preferences.").

54 *See* Alexandra N. Rothman, Note, *Bringing an End to the Trend: Cutting Judicial "Approval" and "Rejection" Out of Non-Class Mass Settlement*, 80 FORDHAM L. REV. 319, 332 (2011).

Commission would garner more scrutiny than had previously been the norm.[55]

And, it would not be long before another opportunity for review presented itself.

B. SEC v. Vitesse Semiconductor Corp.

On December 10, 2010, the SEC filed an enforcement proceeding against Vitesse Semiconductor Corporation ("Vitesse") and four of the company's officers and directors.[56] The complaint alleged that, for more than a decade, Vitesse "engaged in fraudulent revenue recognition practices and stock options backdatings[57] that were concealed from its shareholders and the public by innumerable material misstatements in Vitesse's filings with the S.E.C."[58] Simultaneous with the complaint, the SEC filed proposed consent judgments with the company and two of its officers. By all indications, the Commission anticipated that the court would simply approve the settlement as negotiated.[59]

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55 *See, e.g.*, David S. Hilzenrath, *Judge Jed Rakoff on Free Love, the Death Penalty, Defending Crooks and Wall Street Justice*, WASH. POST, Jan. 20, 2012, http://www.washingtonpost.com/business/economy/judge-rakoff-on-free-love-the-death-penalty-defending-crooks-and-wall-street-justice/2012/01/05/gIQAIGKrDQ_story.html (offering that "Jed S. Rakoff is driving regulators nuts by refusing to rubber-stamp the kind of deals that have long defined Securities and Exchange Commission justice").

56 Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 305–6 (S.D.N.Y. 2011).

57 *Id.* at 305. "Options backdating" describes generally the practice of strategically dating the issuance of stock options contracts awarded to corporate executives to correspond to a low stock price. The options backdating practice has been used by corporations to (i) enhance the value of options grants for employees and (ii) retain the tax benefits of having issued "at the money" contracts. While not per se illegal, the SEC has increasingly espoused the position that backdating might be considered fraudulent. For a thoughtful description of options backdating practices, incentives that drove corporations to the practice, and the Commission's thoughts on enforcement, see Linda Chatman Thomsen, Director, Div. of Enforcement, Sec. Exch. Comm'n., Options Backdating: The Enforcement Perspective (Oct. 30, 2006), http://www.sec.gov/news/speech/2006/spch103006lct.htm ("Too many companies seem to have succumbed to the temptation to make in the money grants that appeared—for all corporate intents and purposes—to be at the money grants."). In the *Vitesse* case, the Commission alleged that the backdating occurred between 1995 and 2006 and included the re-pricing of forty stock option grants without proper accounting, resulting in the company's failure to record appropriately $184 million in compensation expenses. *See Vitesse Semiconductor Corp.*, 771 F. Supp. 2d 304, 306.

58 *Vitesse Semiconductor Corp.*, 771 F. Supp. at 305. The complaint alleges that the fraudulent practices were orchestrated by the four individual defendants: CEO Louis Tomasetta, CFO Eugene Hovanec, Controller Yatin Mody, and Director of Finance Nicole Kaplan. *Id.* at 306.

59 *Id.* at 306 (describing the SEC as "confident that the courts in this judicial district were no more than rubber stamps"); *see also* Maurice Pesso, *Guest Post: Judge Rakoff Again Criticizes SEC Settlements, How Will D&O Insurers Respond?*, WHITE AND WIL-

Again, Judge Rakoff charged that the consent judgments lacked information explaining why they should be approved and how they met the requisite legal standards for court approval.[60] In response to the Judge's request for additional clarity, the Commission submitted a December 21, 2010 brief and participated in a hearing the following day.

In its submission to the court, the Commission offered the standard that the court should apply to its approval determination, writing that it is "well established" that court approval of a proposed consent judgment required a determination that the agreement serve "the public interest."[61] The Commission further provided that, in making such a determination, the court "need not inquire into the precise legal rights of the parties nor reach and resolve the merits of the claims or controversy, but need only determine that the settlement is fair, adequate, reasonable and appropriate under the particular facts" and that there has been a valid consent by the parties.[62] Quoting Judge Rakoff's opinion from the earlier *Bank of America* decision, the Commission asserted that the court "has the obligation, within carefully prescribed limits, to determine whether the proposed Consent Judgment settling [a] case is fair, reasonable, adequate and in the public interest."[63] Finally, the SEC suggested that the scope of the court's inquiry is not unlimited, and must show "substantial deference to the SEC as the regulatory body having primary responsibility for policing the securities markets."[64]

The court offered its opinion on March 21, 2011.[65] While Judge Rakoff once again needled the Commission with his sharp critique, the *Vitesse* opinion is ultimately remarkable for its restraint. The Judge acknowledged that, at first glance, the terms of the proposed consent judgments might appear inadequate based

LIAMS LLP (Mar. 28, 2011), http://www.whiteandwilliams.com/resources-alerts-345.html.

60 *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 306 (commenting that the Commission filed the proposed Consent Judgments "without so much as a word of explanation as to why the Court should approve these Consent Judgments or how the Consent Judgments met the legal standards the Court is required to apply before granting such approval").

61 SEC Brief, *supra* note 12, at 32 (citing SEC v. Randolph, 736 F.2d 525, 529–30 (9th Cir. 1984)).

62 *Id.* at 35 (quoting Metro. House. Dev. Corp. v. Vill. of Arlington Heights, 616 F.2d 1006, 1014 (7th Cir. 1980)).

63 *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 304, 306–7 (referencing SEC Letter Brief dated Dec. 21, 2010).

64 *Id.* at 307 (referencing SEC Letter Brief dated Dec. 21, 2010).

65 *Id.* at 304.

on the relatively small size of the monetary penalties and the fact that the allegations of material misconduct by the defendants lasted over a decade.[66] Yet, despite the fact that the three defendants neither admitted nor denied liability, Judge Rakoff found the terms of the settlement to be "fair, reasonable, adequate, and in the public interest."[67]

The carefully crafted decision reveals a balance of purposeful deliberation and practical concern. In arriving at his conclusion, Judge Rakoff considered several factors beyond the terms of the actual settlement. First, the fact that the two corporate officers had pled guilty to parallel criminal charges and were cooperating with the government in its criminal case against two other Vitesse officers was compelling.[68] In real terms, the guilty pleas meant that the "public is not left to speculate about the truth of the essential charges" alleged in the Commission's complaint.[69] With respect to the company, the Judge was impressed that Vitesse had let "its money do the talking" by contributing substantial funds to a class action settlement pool despite its troubled financial condition.[70] In the Judge's estimation, "[n]o reasonable observer of these events could doubt that the company has effectively admitted the allegations of the complaint."[71]

Despite approving the settlement, Judge Rakoff again registered his displeasure with the Commission's longstanding practice of seeking court approval for settlements in which serious allegations of fraud are asserted against defendants without requiring an express admission or denial.[72] While the effects of such a policy were somewhat minimized in the *Vitesse* matter where two of the defendants had already pled guilty to related criminal charges, nonetheless, the Judge again took the opportunity to question whether a practice of non-admission/non-denial might ultimately render a proposed consent judgment "so unreasonable or contrary to the public interest as to warrant its disapproval."[73]

At the time of the *Vitesse* disposition, however, neither the Judge nor the Commission could have anticipated that yet another

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66 *Id.* at 307.
67 *Id.* at 308.
68 *Id.* at 307 ("These terms are very much colored by the fact that Mody and Kaplan have pleaded guilty to parallel criminal charges and are now cooperating with the Government.").
69 *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 310.
70 *Id.*
71 *Id.*
72 *Id.*
73 *Id.*

showdown over that very issue would again embroil the two a little more than half a year later.

C. SEC v. Citigroup Global Markets, Inc.

In a third strongly worded opinion, on November 28, 2011, Judge Rakoff emphatically rejected a proposed $285 million settlement of an enforcement action that the SEC had brought against Citigroup Global Markets, Inc.[74]

On October 19, 2011, the SEC had filed a civil enforcement action accusing Citigroup of a substantial securities fraud.[75] In familiar style, the Commission simultaneously filed a proposed consent judgment.[76] Pursuant to the terms of the consent judgment, Citigroup would pay a total of $285 million, consisting of a disgorgement of profits of $160 million, $30 million in interest, and a civil penalty of $95 million.[77] Specifically, the Commission charged Citigroup with violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 for misleading investors about the quality of securities underlying a $1 billion synthetic collateralized debt obligation.[78] The complaint related to a fund known as "Class V Funding III" and alleged that Citigroup employed the fund "to dump some dubious assets on misinformed investors."[79] While Class V Funding III was marketed as consisting of attractive assets, the Commission asserted that the fund was, in fact, arranged to include a "substantial percentage of negatively projected assets" and that Citigroup had taken a substantial short position in the same assets.[80] Citigroup realized profits of $160 million, while investors lost more than $700 million.[81]

Largely because Citigroup had agreed to the proposed settlement and consent judgment absent an admission or denial of the allegations, Judge Rakoff had, in an order dated October 27, 2011, "put some questions to the parties" concerning the proposed settlement.[82]

Among the questions posed by the court were the following:

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74 Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 827 F. Supp. 2d 328, 334–35 (S.D.N.Y. 2011).

75 *See* Complaint, Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387), 2011 WL 4965843.

76 *See Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 330.

77 *Id.*

78 *See* Complaint, *supra* note 75.

79 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 329.

80 *Id.*

81 *Id.*

82 *Id.* at 330.

> Given the S.E.C.'s statutory mandate to ensure transparency in the financial marketplace, is there an overriding public interest in determining whether the S.E.C.'s charges are true? Is the interest even stronger when there is no parallel criminal case?[83]

The court's inquiries were aimed at defining the proper scope of the "public interest" prong of its review. And, the question calls attention to at least two problems with a proposed settlement that disposes of the controversy without an appropriate level of detail as to the underlying conduct. First, by approving a final judgment without making available the evidence developed in the course of the Commission's investigation, interested parties are left to "draw their own conclusions about the evidence underlying the allegations in the SEC Complaint."[84] As the Judge's question hints, such a result might seem particularly displeasing given the Commission's responsibilities. Moreover, the Commission's decision to charge Citigroup with only a negligence-based offense could lend credence to a subsequent Citigroup assertion, in related proceedings, that the judgment resulted from a lack of scienter.[85] Such a result would seem to frustrate the Commission's own policy of barring subsequent public denials on the part of defendants.[86]

On November 28, 2011, the court issued its opinion in the matter. Despite "the substantial deference due the S.E.C. in matters of this kind," the court refused to approve the consent judgment.[87] After an in-depth discussion concerning the appropriate scope of review,[88] Judge Rakoff emphatically rejected the Commis-

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83 Sec. Exch. Comm'n.'s Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement at 15, Sec. Exch. Comm'n. v. Citigroup Global Markets Inc., 827 F. Supp. 2d 336 (S.D.N.Y. 2011) supplemented (Dec. 29, 2011) (No. 11-07387), 2011 WL 5307417.

84 Brief of Union Central Life Ins. Co. et al. as Amici Curiae Responding to the Court's October 27, 2011 Order at 6, Sec. Exch. Comm'n. v. Citigroup Global Markets Inc., 827 F. Supp. 2d 336 (S.D.N.Y. 2011) (No. 11-CV-07387), *available at* http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/2011/11_-_November/SECvCiti—proposedamicus.pdf. The brief also commented that "despite the fact that any proposed settlement must serve 'the public interest,' the SEC is advocating for a proposed Final Judgment that does not directly address the harm reaped upon investors by CGMI's alleged sale of over $1 billion in RMBS that it allegedly designed to fail." *Id.* at 7.

85 *Id.* at 8–9.

86 *See* 17 C.F.R. § 10 app.A (providing that the defendant agree not to "take any action or make any public statement, denying, directly or indirectly, any allegation in the complaint or finding or conclusions in the order, or creating, or tending to create, the impression that the complaint or the order is without a factual basis").

87 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 330.

88 *See generally* discussion of "The Likely Effects of the Newfound Attention," part IV, *infra.*

sion's contention that the public interest was not an appropriate consideration in assessing the proposed settlement, and "regretfully" concluded that "the proposed Consent Judgment is neither fair, nor reasonable, nor adequate, nor in the public interest."[89] The Judge's toughest objection concerned the casual nature by which the Commission requested the application of judicial power. In short, the Judge simply could not abide that the Commission asked the court to "employ its power and assert its authority when it does not know the facts."[90]

Turning to the economic effects of the proposed settlement, the Judge first noted that the settlement amount was "pocket change" to an entity as large as Citigroup.[91] Moreover, in his view, the arrangement would leave the defrauded investors "substantially short-changed," dealing "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 the non-admission/non-denial nature of the arrangement ameliorates any collateral estoppel assistance.[92] The court was also "troubled" when it compared the $95 million penalty sought with the $535 million penalty imposed in the consent judgment entered into a year earlier between the SEC and Goldman Sachs "involving remarkably similar alleged conduct in the same time period."[93]

The opinion concluded by consolidating the case with a parallel action against the Citigroup official responsible for the Class V Funding III fund and scheduling a trial for July 16, 2012.[94] The

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89 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 332.

90 *Id.* at 335 (noting that "[a]n application of judicial power that does not rest on the facts is worse than mindless, it is inherently dangerous").

91 *Id.* at 333–34. For the court, this was particularly distasteful in light of the fact that Citigroup was a "recidivist." In fact, the SEC has accused Citigroup of fraud five times since 2003, settling in each case. *See* Tim Fernholz, *Why the SEC Will Soon Be Prosecuting More Cases Against Big Banks—And Losing*, THE NEW REPUBLIC, Dec. 1, 2011, http://www.tnr.com/article/97963/SEC-banks-settlement#. Repeat offenders seem to be not all that rare. A recent New York *Times* analysis of SEC enforcement actions over the last fifteen years, for example, found "at least 51 cases in which 19 Wall Street firms had broken antifraud laws they had agreed never to breach." *See* Edward Wyatt, *Promises Made, and Remade, by Firms in S.E.C. Fraud Cases*, N.Y. TIMES, Nov. 7, 2011, http://www.nytimes.com/2011/11/08/business/in-sec-fraud-cases-banks-make-and-break-promises.html?pagewanted=all. These results might not be all that surprising in light of Professor Baynard's assertion that "the civil sanctions available to the SEC—inconveniences, really—are unlikely to deter committed recidivists." *See* Jayne W. Barnard, *Securities Fraud, Recidivism, and Deterrence*, 113 PENN. ST. L. REV. 189, 221 (2008).

92 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 334.

93 *See* SEC Brief, *supra* note 12, at 19.

94 *See Citigroup Global Markets, Inc.,* 827 F. Supp. 2d at 335; Sec. Exch. Comm'n. v. Stoker, 873 F. Supp. 2d 605 (S.D.N.Y. 2012). On July 31, 2012, a federal trial jury

Commission found itself scrambling to craft a response.[95]

On March 15, 2012, a panel of three Second Circuit judges stayed the *Citigroup* proceedings pending resolution of Citigroup's appeal of Judge Rakoff's rejection of the proposed settlement.[96] In granting the stay, the panel was persuaded that Citigroup presented a "strong showing of likelihood of success" in having the Judge's rejection set aside.[97] The full appeal has moved to a separate Second Circuit panel that remains "free to resolve all issues without preclusive effect"[98] after having heard the arguments in February 2013.

II. The Commission's Consent Judgment Practice and the Affinity for Settlement

In civil litigation, it is well established that a dispute can be resolved by contract between the parties, and courts remain "nearly powerless to shape their private bargain."[99] In fact, "[p]urely private parties can settle a case without ever agreeing on the facts, for all that is required is that a plaintiff dismiss his complaint."[100] This policy choice embraces the fact that private resolution is highly desirable, resulting in savings for the parties in terms of the time and money typically expended in protracted litigation.[101] In fact, settle-

found that the SEC had failed to prove Mr. Stoker liable for the alleged securities fraud. *See* Sec. Exch. Comm'n. v. Stoker, No. 11 –cv-7388 (JSR) (S.D.N.Y. July 31, 2012).

95 Jean Eaglesham & Suzanne Kapner, *SEC Cops Want to Fight U.S. Judge*, WALL ST. J., Dec. 16, 2011, http://online.wsj.com/article/SB10001424052970204844504577098833058976236.html (observing that the "settlement's rejection is proving to be a nightmare for the SEC" and commenting SEC staff is likely to suggest that the commission appeal the *Citigroup Global Markets, Inc.* decision). For a more thorough description of the procedural history of the *Citigroup Global Markets, Inc.* matter, see SEC Brief, *supra* note 12, at 7–10.

96 Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 673 F.3d 158 (2d Cir. 2012).

97 *Id.* at 169.

98 *Id.* at 161.

99 Henderson, *supra* note 3 at 4; *see also* Hester Indus., Inc. v. Tyson Foods, Inc., 160 F.3d 911, 916 (2d Cir. 1998) (holding that a settlement and dismissal was accomplished by "mutual agreement of the parties, and did not require any judicial action"); *Bank of America Opinion I*, 653 F. Supp. 2d 507, 508 (S.D.N.Y. 2009) ("Society greatly benefits when lawsuits are amicably resolved, and, for that reason, an ordinary civil settlement that includes dismissal of the underlying action is close to unreviewable.").

100 *Citigroup Global Markets Inc.*, 827 F. Supp. 2d at 332. A plaintiff need only file a notice of dismissal with the court. FED. R. CIV. P. 41(a)(1)(A)(i). If the case has moved beyond the preliminary stage, a stipulation of dismissal signed by all parties must be filed. *Id.*(a)(1)(A)(ii).

101 Danné L. Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM

ments routinely bring relief to injured parties more expeditiously than "a long wait for a judicial finding of wrongdoing."[102] A strong and established public policy in favor of settlement also reduces the number of trials, and is consistent with the civil justice system's primary objective to ensure "the just, speedy, and inexpensive determination of every action."[103] Moreover, leaving it to the parties to resolve their own dispute is generally supported on economic efficiency grounds.[104]

Today, the vast majority of Commission proceedings (over 90%) are settled—not litigated on the merits.[105] And, the Commission, by its own admission, has a "longstanding policy of settling cases on the basis of neither requiring an admission nor permitting a denial by the defendant."[106] At least one court has signaled that a federal policy in favor of settlements "has particular force where . . . a government actor committed to the protection of the public interest has pulled the laboring oar in constructing the proposed settlement."[107] And, the overwhelming majority of courts have agreed—approving SEC settlements rather routinely, and "without scrutinizing their factual bases or requiring substantive

J. CORP. & FIN. L. 627, 651 (2007) (noting that "[i]n most civil cases, equal parties enter into good faith negotiation motivated to arrive at a compromise agreement, thus avoiding the time, cost, emotional toll, and risk of trial"); *see also* Henderson, *supra* note 3, at 4.

102 Samuel Issacharoff & Robert H. Klonoff, *The Public Value of Settlement*, 78 FORDHAM L. REV. 1177, 1196–97 (2009).

103 *See* Johnson, *supra* note 101, at 651 (quoting Civil Justice Reform Act of 1990, 28 U.S.C. § 471 (1995)).

104 *See, e.g.*, Ronald H. Coase, *The Problem of Social Cost,* J. L. & ECON. Oct. 1960 (positing that, in a world without transaction costs, efficient outcomes could be best achieved by individual negotiation, and further providing that government is best to simply determine how rights would be assigned in a negotiation between firms and individuals absent such frictions). *But cf.* Owen M. Fiss, Comment, *Against Settlement,* 93 YALE L.J. 1073 (1984) (asserting that private settlement comes at a public price since the point of adjudication is not merely to resolve private disputes, but to bring reality closer to our ideals through the decision making of public officials).

105 *See* David M. Weiss, *Reexamining the SEC's Use of Obey-The-Law Injunctions*, 7 U.C. DAVIS BUS. L.J. 6 (2006); Johnson, *supra* note 101, at 647 ("The SEC settles most enforcement actions by consent."); Parloff, *supra* note 13 (observing that "about 90% of SEC cases are currently concluded by consent decree, and the lynchpin for virtually every one of those is that the defendant doesn't admit wrongdoing"); *see also* Eaglesham & Kapner, *supra* note 95 ("In the past year, the SEC went to trial in 19 cases, while filing a record-high 735 enforcement actions.").

106 Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011) (referencing SEC Letter Brief of Dec. 21, 2010).

107 United States v. Cannons Eng'g Corp., 899 F.2d 79, 84 (1st Cir. 1990); *see also* Sec. Exch. Comm'n. v. Wang, 944 F.2d 80, 85 (2d Cir. 1991) (observing a "strong federal policy favoring the approval and enforcement of consent decrees").

modifications."[108]

Some have warned, however, that the public's affinity for private settlement should not be embraced reflexively in the context of the settlements of a public agency.[109] Indeed, closer scrutiny seems a wise policy, as public agency settlements routinely lack at least three hallmarks of the best private settlements.[110] Notably, public agency settlements, in general, and Commission settlements, in particular, can be distinguished from the best private settlements because they (i) regularly impact third parties, (ii) often lack good faith negotiations between two equal parties, and (iii) generally derive from less noble motivations.[111]

Significant judicial scrutiny of settlements is not uncommon. In fact, several types of settlements expressly require judicial approval. Class actions,[112] shareholder derivative settlements,[113] bankruptcy proceedings,[114] and cases involving minors or incompetents[115] all require judicial approval. In addition, criminal plea agreements[116] require judicial consent. While the specific rationale for requiring a judicial approval or consent varies according to context, in each case, the court is employed in an effort to protect claimants and ensure a "fair shake" for all involved.[117]

A. *The History of SEC Settlements*

In a footnote to its letter brief to the court in the *Vitesse* matter, the Commission suggested that its practice of settling enforcement actions in which defendants neither admit nor deny the allegations

108 *See* Scott B. Schreiber et al., *SEC Announces New Policy Regarding "Neither Admit Nor Deny" Language in Settlements*, ADVISORY (Arnold & Porter LLP, Washington, D.C.), Jan. 2012, at 2, *available at* http://www.arnoldporter.com/resources/documents/Advisory%20SEC_Announces_New_Policy_Regarding_Neither_Admit_Nor_Deny_Language_Settlements.pdf.

109 *See* Johnson, *supra* note 101, at 652 (suggesting that "[t]he framework used to examine public policy interests in governmental settlements should be distinct and separate from the framework used to examine private settlements").

110 *Id.*

111 *Id.*

112 Federal Rule 23(e) provides that "the claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval." FED. R. CIV. P. 23(e).

113 *Id.* 23.1(c).

114 FED. R. BANKR. P. 9019(a).

115 *See, e.g.*, N.Y. C.P.L.R. 1207 (MCKINNEY 2011).

116 FED. R. CRIM. P. 11(c).

117 *See* Rothman, *supra* note 54, at 331, 352; *see also* SEC Brief, *supra* note 12, at 25 (arguing that "[t]he law is clear that a federal judge has a responsibility to independently determine whether a proposed consent judgment satisfies well-established standards of being fair, adequate, reasonable, and in the public interest").

of a complaint dates back to at least 1972, when the Commission provided its express approval for the policy in a release entitled "Consent Decrees in Judicial or Administrative Proceedings."[118] In essence, "neither admit nor deny" represents a crude construction resulting from a desire to adopt a policy satisfying both the Commission's "insistence that its allegations not be disavowed and also defendants' desire to argue in subsequent litigation that they are not bound by admissions."[119]

In a history lesson, no doubt embarrassing for the Commission, Judge Rakoff describes a more robust version of a practice "a bit more complicated than the S.E.C.'s footnote suggests."[120] It seems that the Commission's "non-admission/non-denial" practice started long before 1972 and by the time of the Commission's release, had grown to be strongly desired by defendants eager to deny wrongdoing and strategically employ the collateral estoppel advantages of a Commission settlement in parallel private civil actions.[121] By 1972, as Judge Rakoff describes,

> [I]t had become obvious that as soon as courts had signed off on such settlements, the defendants would start public campaigns denying that they had ever done what the S.E.C. had accused them of doing and claiming, instead, that they had simply entered into the settlements to avoid protracted litigation with a powerful administrative agency.[122]

Against this backdrop, the Commission's 1972 Release can be seen as little more than a minor improvement or refinement, aimed at keeping the settling defendant from subsequently denying in public the complaint's original allegations.[123] Today's proposed settlements support this interpretation, routinely including

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118 Consent Decrees in Judicial or Administrative Proceedings, Securities Act Release No. 352, Exchange Act Release No. 5337, 1972 WL 125351 (Nov. 28, 1972) (codified as amended 17 C.F.R. § 202.5(e)).

119 William O. Reckler & Blake T. Denton, *Understanding Recent Changes to the SEC's "Neither Admit Nor Deny" Settlement Policy*, Client Alert (Latham & Watkins, New York, N.Y.), Jan. 12, 2012, at 2; *see also* Fernholz, *supra* note 91 ("[S]uch settlements are flawed as instruments of justice."); Parloff, *supra* note 13 ("[S]ince 1972, the SEC has required corporations in the consent decree to promise not to deny the allegations of the complaint *in public*.").

120 Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011).

121 *Id.*

122 *Id.*

123 *See* Consent Decrees in Judicial or Administrative Proceedings, *supra* note 118. Today, defendants routinely agree not to "take any action or make any public statement, denying, directly or indirectly, any allegation in the complaint or findings or conclusions in the order, or creating, or tending to create, the impression that the complaint or the order is without a factual basis." 17 C.F.R. § 10 app.A.

boilerplate language prohibiting the settling party from engaging in similar securities law violations in the future, and from making or sponsoring any public statement denying any allegations in the government's complaint.[124]

Despite the minor improvement that a "non-admission/non-denial" regime might represent over a system in which a public denial was often pronounced before the ink on the settlement was dry, it remains difficult to uncover the proper respect being afforded the truth in today's practice of routinely embracing a "non-admission/non-denial" posture in settlement.[125] In fact, fostering such a policy typically disfavors the truthful facts of a particular situation, instead resorting to a comfortable contrivance that each party can live with. Such a posture seems hostile to both the Commission's charge to protect the integrity of the nation's securities markets and the duty of courts to defend and ensure the public interest.[126] The irony of truth taking a back seat to convenience in the federal securities realm cannot be overstated. In particular, such a convenience is at least unbecoming within an overarching regulatory structure that regularly calls upon registrants to abide by full, fair, and accurate disclosure of the kind that a prudent investor would like to know before making an investment decision. Certainly, the truth must also play an integral role in a court's fulfilllment of its public interest duties.

While not required, the court's approval has increasingly become a convenient imprimatur to each Commission settlement. Since 1972, and largely unchallenged, the Commission has regularly employed the courts as its enforcement partner—expected to

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124 *See* Richard J. Morvillo et al., *To Neither Admit Nor Deny: SEC Litigation Position Reiterates Need to Examine Standard Provisions in SEC Settlements* (Crowell & Moring LLP, Washington, D.C.), April 2001, at 1, *available at* http://www.crowell.com/pdf/Consents.pdf.

125 *See, e.g.*, *Vitesse Semiconductor Corp.,* 771 F. Supp. 2d at 309 (bemoaning the resulting "stew of confusion and hypocrisy unworthy of such a proud agency as the S.E.C.").

126 Perhaps even more troubling is the practice discussed by SEC Commissioner Luis Aguilar in a recent speech (and highlighted by Judge Rakoff in *Vitesse*):

> I hope that 2011 brings an end to the press release issued by a defendant after a settlement explaining how the conduct was really not that bad or that the regulator over-reacted. I hope that this revisionist history in press releases will be a relic of the past. If not, it may be worth revisiting the Commission's practice of routinely accepting settlements from defendants who agree to sanctions 'without admitting or denying' the misconduct.

See Commissioner Luis A. Aguilar, Sec. Exch. Comm'n., Speech by SEC Commissioner: Setting Forth Aspirations for 2011, Address to Practicing Law Institute's SEC Speaks in 2011 Program (Feb. 4, 2011), http://www.sec.gov/news/speech/2011/spch020411laa.htm.

stand by, ready to impose contempt charges or injunctive relief in the event that the settling party subsequently violates the agreement's terms.[127]

B. *The Insatiable Desire to Involve the Courts*

In each of the cases that are the subject of this Article, the Commission sought more than simple settlement and dismissal. Instead, the Commission opted to seek a consent decree—a judgment or order reflecting the settlement terms agreed to by the parties, and containing an injunction.[128] Unlike simple dismissal, settlement through consent decree or consent judgment requires judicial approval,[129] as a judge "must be confident that the settlement achieved through the consent decree or consent judgment is in the public interest."[130]

C. *Comparing Simple Settlement with Consent Judgments*

The distinctions between simple dismissal and consent judgment are significant. While both represent an arrangement between the Commission and the alleged wrongdoer, the consent decree emboldens the Commission—retaining the court as its ongoing enforcement partner.[131] In fact, in a recent article, Professor DiSarro highlighted several key distinctions between consent decrees and settlement agreements.[132] Among these, the mode of enforcement remains the most significant.[133] In effect, the pres-

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127 *Cf.* Reckler & Denton, *supra* note 119, at 2 (observing that "[w]hile the SEC can settle administrative actions brought internally without review by an administrative law judge, it must obtain a federal judge's approval to settle an action brought in district court").

128 *See In re* Masters Mates & Pilots Pension Plan & IRAP Litig., 957 F.2d 1020, 1025 (2d Cir. 1992) (describing a consent decree as "no more than a settlement that contains an injunction"); Gates v. Shinn, 98 F.3d 463, 468 (9th Cir. 1996) ("When a decree commands or prohibits conduct, it is called an injunction."); *see also* Rothman, *supra* note 54, at 332 (describing a consent judgment as a "court decree that all parties agree to").

129 *See* Buckhannon Bd. & Care Home, Inc. v. W. Va. Dep't of Health & Human Res., 532 U.S. 598, 604 n.7 (2001) ("Private settlements do not entail the judicial approval and oversight involved in consent decrees.").

130 Rothman, *supra* note 54, at 332; *see also* United States v. Ketchikan Pulp Co., 430 F. Supp. 83, 85–86 (D. Alaska 1977).

131 *See generally* Anthony DiSarro, *Six Decrees of Separation: Settlement Agreements and Consent Orders in Federal Civil Litigation*, 60 AM. U. L. REV. 275, 276–79 (2010).

132 *Id.* at 276.

133 *Id.* at 277. The DiSarro article also points to five other differences, most beyond the scope or concern of this Article. The other differences include: (i) the consent decree is a public document subject to public access and inspection; (ii) the court ordering the consent decree has inherent enforcement powers; (iii) the injunctive

ence of an injunction in the consent decree makes non-compliance with the settlement terms contempt of court.[134] By contrast, failure to abide by a simple settlement agreement would represent breach of contract.[135] This difference goes a long way to explaining the Commission's embrace of a policy that routinely involves the courts in its settlements with defendants.

A second difference between the consent decree and the simple settlement concerns the ability of the parties to keep the terms of their agreement beyond the eyes of others. The consent decree is a public document subject to inspection.[136] By comparison, a settlement agreement remains the private document of the parties to the controversy, and its terms are routinely kept confidential.[137]

A third difference between the consent decree and the simple settlement concerns the subsequent enforcement of the agreement's provisions. Because a consent decree is a court order, the issuing federal court retains the inherent power to enforce its terms. The enforcement of settlement agreements, by contrast, is generally the province of the state courts and the parties enjoy no routine access to the federal courts absent party diversity and a federal court filing.[138] When private parties ask a court to retain jurisdiction to enforce a settlement, however, the court has absolute discretion whether or not to do so.[139]

The particularity of a settlement may also change when it is embodied in a consent decree. While the injunctive provisions of a consent decree "must be stated in reasonable detail and cannot incorporate other documents by reference," settlement agreements are "not held to any requisite level of particularity."[140]

Finally, as a court document, the consent decree remains sub-

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provisions of the consent decree "must be stated in reasonable detail and cannot incorporate other documents by reference"; (iv) a court can insist on subsequent changes to a court issued consent decree; and (v) consent decrees can form the basis for the award of attorney's fees where a federal statute permits such an award. *Id.* at 276–79.

134 *Id.* at 277. *See* Local No. 93, Int'l Ass'n of Firefighters v. City of Cleveland, 478 U.S. 501, 518 (1986) ("Noncompliance with a consent decree is enforceable by citation for contempt of court.").

135 DiSarro, *supra* note 131, at 277.

136 *Id.*

137 *Id.*

138 *Id.* at 278 (adding that "[s]ome courts have concluded that parties stipulating to the jurisdiction of a federal court to resolve settlement disputes is the functional equivalent of a consent decree. This reasoning is flawed.").

139 *See generally* Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 381–82 (1994).

140 DiSarro, *supra* note 131, at 278.

ject to change at the wishes of the issuing court, and "consent decrees can subsequently be modified or terminated by the court, even over the objections of one of the parties."[141] Any change to a settlement agreement, on the other hand, can only be accomplished through mutual consent of the parties.[142]

Proposed settlements with the Commission are routinely accompanied by boilerplate language regularly included in settlement documents for both administrative proceedings and injunctive actions.[143] The language typically provides that the settling party refrain from (i) similar securities law violations in the future and (ii) making or permitting any public statement denying any allegations in the government's underlying complaint.[144] Today, the Commission routinely opts for the consent judgment instead of simple settlement. Presumably, by employing the consent judgment, the Commission reduces its enforcement costs. In fact, with respect to the Commission's consent judgment practice, the Commission has displayed an insatiable appetite for involving the court in its ongoing enforcement efforts. In the event of non-compliance, the consent judgment ensures that the government need not file a lawsuit to effect enforcement.[145] The Commission expects the court to stand by, ready to (i) accept a petition to set aside the agreement, (ii) provide injunctive relief, or (iii) enforce a contempt charge, as each might be required following a settler's breach. Moreover, while the Commission has routinely sought judicial authority in reaching a settlement, it has very rarely called upon a court to employ its enforcement powers.

D. *Subsequent Enforcement Efforts: Injunction and Contempt*

While the Commission has increasingly sought the judiciary's imprimatur in its settlement efforts, it has very rarely called upon a court to enforce an injunction or issue a contempt order following the non-compliance of one of its settlements. The Commission has shown some willingness to respond to subsequent defendant denials by threatening to invoke a settlement's contractual right to petition the court to vacate a consent judgment.[146] And, the Commission has actually moved to vacate consent judgments based upon the defendant's denial of culpability. In at least one case, for

141 *Id.*
142 *Id.*
143 Morvillo et al., *supra* note 124, at 1.
144 For a discussion of the typical SEC boilerplate see *id.*
145 Henderson, *supra* note 3, at 4.
146 Morvillo et al., *supra* note 124, at 1–2.

example, the Commission withdrew its motion only after the defendant withdrew his denial.[147]

There is ample evidence that the injunctive remedy has been seen as a "cornerstone" of the Commission's enforcement toolkit since its founding.[148] As one commentator describes: "[l]ike other special types of government settlements . . . a consent decree is a judicial Sword of Damocles intended to increase performance of the defendant under the terms of the settlement."[149] As the Commission is fast recognizing, however, this "sword"—like most—is double-edged. As the three cases examined in this Article highlight, the Commission's choice to employ the court as its enforcement partner reduces the Commission's own monitoring and enforcement costs. Such an advantage brings costs all its own, however. Most notably, such a strategy means that the court might ask questions that cause a certain amount of discomfort for the Commission.[150] In light of Judge Rakoff's recent predilection (and the copycats that are likely to follow) and the infrequency with which the Commission has actually called upon a court to enjoin a settling party from subsequent violations, it is high time for the Commission to reconsider whether seeking court approved consent judgments as a matter of course continues to represent a wise policy.

Injunctions allow the Commission to sanction repeat offenders with contempt of court.[151] The civil contempt remedy remains available to the Commission in the event that either (i) a defendant is engaging in an ongoing violation of an injunction or (ii) compensation is due the Commission as a result of a defendant's violation of an injunction.[152] Criminal contempt charges may also be brought against defendants who disobey previous injunctions.[153]

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147 Sec. Exch. Comm'n. v. Angelos, C.A. No. B96-834 (D. Md., Mar. 20, 1996), Lit. Rel. No. 14886 (Apr. 22, 1996), http://www.sec.gov/litigation/litreleases/lr14886.txt.

148 Russell Ryan, *Rethinking SEC Injunctions After Appeals Court Reprimand,* 37 Sec. Reg. & L. Rep. (BNA) No. 36, at 1488 (Sept. 5, 2005) (noting that injunctions have "been the cornerstone of the SEC's enforcement program for more than 70 years"); *see also* Weiss, *supra* note 105, at 6 (commenting that "[s]ince the founding of the Commission more than seventy years ago, the injunction has served as the SEC's most reliable enforcement tool").

149 Henderson, *supra* note 3, at 4; *see also* Morvillo et al., *supra* note 124, at 1 (commenting that "[t]his provision stems from the Commission's desire to use its police (and public relations) powers to promote deterrence").

150 *See* sources cited *supra* note 149.

151 Weiss, *supra* note 105.

152 *See* Universal City Studios, Inc. v. N.Y. Broadway Int'l Corp., 705 F.2d 94, 96 (2d Cir. 1983).

153 Weiss, *supra* note 105.

There is no disputing that it is among the "most formidable weapons" in the court's arsenal, and "one with significant potential for harm if it is wielded imprudently."[154] It follows, therefore, that courts should make that remedy available to an administrative agency deliberately, and only after a satisfactory showing that the underlying facts are serious enough to warrant its necessity.[155] In the words of Judge Rakoff:

> [W]hen a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, enforced by the formidable judicial power of contempt, the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts, while the public is deprived of ever knowing the truth in a matter of obvious public importance.[156]

Despite the formidable nature of the contempt remedy, by its own admission, the Commission "has not frequently pursued civil contempt proceedings and does not appear to have initiated such proceedings against a 'large financial entity' in the last ten years."[157] Before asking a court to play a significant role in the ongoing monitoring of the defendant's behavior, the Commission must explain to the court exactly what it has bargained for. Aside from satisfying the requirement of independent judicial power, such a requirement is made all the more necessary by the cynical nature of the routine settlement bargain described below.

E. The Cynical Nature of the Consent Judgment Bargain

It remains difficult to refute that, as a practical matter, the practice of routine settlement, absent an express admission or denial, offers a convenience for the Commission and defendants alike.[158] From a subject's perspective, settlement invariably offers a desirable alternative to the expensive and unwanted publicity of a trial.[159] In addition, settling defendants will often seek concessions

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154 United States v. Local 1804-1, Int'l Longshoremen's Ass'n, AFL-CIO, 44 F.3d 1091, 1095–96 (2d Cir. 1995).

155 *See e.g.*, Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011) (noting that the injunctive power "is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated").

156 *Id.* at 332.

157 SEC's Memorandum of Law, *supra* note 83, at 23.

158 Pesso, *supra* note 59, at 1.

159 *See* Weiss, *supra* note 105 (citing to James D. Cox et al., SECURITIES REGULATION: CASES AND MATERIALS 773 (4th ed. 2004)).

concerning the violations alleged in the Commission's complaint and may negotiate with the Commission with respect to the language of the complaint and the collateral and administrative consequences of the consent judgment.[160] By contrast, a loss at trial may result "not only in immediate sanctions but also in the defendant being collaterally estopped from relitigating related issues in subsequent private actions."[161] In addition, a cooperative and sophisticated defendant might be able to negotiate with the Commission about the shape and frequency of publicity surrounding a settlement.[162] For the Commission, its staff is simply too small to try more than the smallest fraction of the cases it investigates.[163] By allowing defendants to settle without admitting liability, the Commission benefits from a willingness of defendants to enter into settlements at an earlier time—all without requiring the Commission to devote substantial resources to taking enforcement actions to trial.[164] Accordingly, settlements offer the Commission a convenient combination of discernable victory without the corresponding expense in time and treasure.[165]

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160 *See* Sec. Exch. Comm'n. v. Clifton 700 F.2d 744, 748 (D.C. Cir. 1983).

161 Weiss, *supra* note 105; *see also* Pesso, *supra* note 59 ("By entering into the consent judgments without admitting liability, the defendants are not collaterally estopped from asserting their innocence in parallel civil actions.").

162 Dreilinger, *supra* note 16, at 13 (offering that "[a] defendant may therefore be able to shape the public's perception of the SEC's allegations by negotiating for the inclusion of mitigating factors, eliminating some or all of a corporate defendant's employees from the charges, or softening the typically harsh language in the litigation releases").

163 *See, e.g.*, Macey, *supra* note 25, at 646 ("Because investigations take time, the SEC focuses on bringing cases that do not require much, if any, investigative effort."). In fiscal year 2011, the SEC filed 735 enforcement actions, representing an 8.6% increase over 2010; *see* SEC. & EXCH. COMM'N., FY 2011 PERFORMANCE AND ACCOUNTABILITY REPORT, 2 (2011), http://sec.gov/about/secpar/secpar2011.pdf.

164 Pesso, *supra* note 59; *see also* Robert Khuzami, Former Director, Div. of Enforcement, Sec. Exch. Comm'n., Remarks Before the Consumer Federation of America's Financial Services Conference (Dec. 1, 2011), http://www.sec.gov/news/speech/2011/spch120111rk.htm (suggesting that, absent the arrangement, there "would be longer delays before victims get compensated, the expenditure of SEC resources that could be spent stopping the next fraud, and—quite possibly—less money in the pockets of wronged investors. And we'd lose the certainty that the victims would actually get compensation."). *Cf.* Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 310 (S.D.N.Y. 2011) ("For now, however, the S.E.C.'s practice of permitting defendants to neither admit nor deny the charges against them remains pervasive, presumably for no better reason than that it makes the settling of cases easier.").

165 *See, e.g.*, Joshua A. Naftalis, Note, *"Wells Submissions" to the SEC as Offers of Settlement Under Federal Rule of Evidence 408 and Their Protection From Third-Party Discovery*, 102 COLUM. L. REV. 1912, 1922 (2002) (noting the importance of settlements to the Commission); THE ECONOMIST, *supra* note 8 ("By settling, the SEC guarantees a good-enough result. It collects money. . . The regulators can claim victory in press releases and self-congratulatory reports to Congress."); *see also* S.E.C. FY 2011 REPORT, *supra*

In the BofA matter, Judge Rakoff seized on the "cynical" nature of the bargain between the Commission and an investigative target, characterizing that arrangement as one in which the Commission can claim that it is exposing wrongdoing in a high-profile merger, while the target simultaneously claims coercion.[166] "And all this is done at the expense, not only of the shareholders, but also of the truth."[167] Many have echoed this cynical view.[168] Commenting on the BofA case, one commentator observed that, in light of the recent spate of scandals, "the inference is unavoidable that the commission wanted to announce a seemingly tough settlement in a high-profile case, as part of its understandable campaign to re-establish itself as the tough cop of Wall Street."[169] The wisdom of a policy encouraging these bargains becomes more suspect in the case where the corporate management negotiating a potential settlement is composed of the same managers involved in the alleged wrongdoing.[170]

SEC civil enforcement actions follow a predictable rhythm. In the normal case, if the Commission approves the recommendation of its staff to file a civil action, the staff drafts and files a complaint with a U.S. District Court.[171] Typically, pleadings are followed by "discovery, including interrogatories, depositions, documentary discovery, and motion practice," culminating in a hearing or trial.[172] Settlements can be reached at any time in this process and are initiated and negotiated in an opaque process beyond the public record.[173] Undoubtedly, "[a]ll settlements are negotiated reso-

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note 163, at 2 ("Despite funding constraints, SEC staff worked diligently to build an agency whose ability to support capital markets and protect investors large and small continued to improve.").

166 Lawrence Chu & David J. Berger, *Federal District Court Rejects Proposed Consent Judgment between Bank of America and the SEC*, WSGR ALERT, (Wilson Sonsini Goodrich & Rosati, Palo Alto, C.A.) (Sept. 2009), *available at* http://www.wsgr.com/publications/pdfsearch/wsgralert_bank_of_america.pdf.

167 *See Bank of America Opinion I*, 653 F. Supp. 2d 507, 512 (S.D.N.Y. 2009).

168 *See, e.g.*, John C. Coffee, Jr., *The End of Phony Deterrence? 'SEC v. Bank of America'*, N.Y.L.J., Sept. 17, 2009; Sheehan, *supra* note 2; Cassidy, *supra* note 2.

169 Coffee, *supra* note 168.

170 *See, e.g.*, *Bank of America Opinion I*, 653 F. Supp. 2d at 510:

> It is one thing for management to exercise its business judgment to determine how much of its shareholders money should be used to settle a case brought by former shareholders or third parties. It is quite something else for the very management that is accused of having lied to its shareholders to determine how much of those victims' money should be used to make the case against the management go away.

171 Johnson, *supra* note 101, at 644.

172 Dreilinger, *supra* note 16, at 9.

173 *Id.*

lutions in which both parties agree to a compromise outcome instead of obtaining every element of relief or sanction that may have been sought."[174]

In a recent speech, the Commission's former Director of Enforcement, Robert Khuzami, defended the Commission's work and outlined the specific process by which decisions are made to strike a compromise with a defendant:

> When the Division of Enforcement recommends that the Commission settle a case, it is because our informed judgment tells us that what we are obtaining in settlement is within the range of outcomes we reasonably can expect to get after we prevail at trial, taking into account the strength of the case as well as the delay and resources required for a trial and the benefits of returning money to harmed investors quickly—not to mention the chances that we might lose at trial, or win but be awarded less than what the settlement achieves.[175]

While individual settlements are, no doubt, the work of a dedicated group of skilled, honest and professional personnel at the SEC and the result of a deliberative process, the reality remains that the Commission has ample motivation to settle the large majority of its cases. The fact that, today, settlements represent the preferred SEC enforcement method only serves to enhance the need for careful examination of the legitimacy of individual SEC settlements.[176]

The primary factors weighing in favor of the routine settlement of cases come in two main flavors. First, the reality of the Commission's economics dictates that the conservation of its resources plays an integral role in its decision making.[177] Second, the threat of reputational harm that can result from a loss at trial is a significant motivator in favor of settlements.[178] Invariably, the Commission's support and bargaining strength are enhanced through aggressive and successful settlement activity.[179] Very crudely, the Commission would most likely prefer settlements with many to full-fledged trials with a few.[180]

Chief among the many pressures that the Commission must

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174 Khuzami, *supra* note 164.
175 *Id.*
176 Johnson, *supra* note 101, at 669.
177 *See generally id.* at 671.
178 *See generally id.*
179 *See generally id.*
180 *Cf.* Coffee, *supra* note 168 ("[T]he SEC has to be prepared to litigate (and not reflexively settle). Ultimately, this dilemma may require that the SEC bring fewer cases in order to be able to litigate more intensively those that it does bring.").

navigate is the economic reality that the Commission faces in carrying out its mission. Simply put, the Commission's task is massive. Today, the Commission employs approximately 3,844 people and has responsibility for the regulation of over 35,000 individual entities.[181] And, as many have observed, the Commission has neither the staff nor the funding to litigate every enforcement action.[182] In an effort to conserve resources, staff attorneys are routinely instructed to prioritize cases that have important public policy implications, or are necessary to send important signals to regulated industries and entities.[183] Factors unrelated to a case's strength, therefore, routinely affect the Commission's decision making process with regard to individual settlements.

Apart from economic concerns, the Commission's settlement decisions are also influenced by the agency's important reputational concerns.[184] Enforcement actions have traditionally defined the mission of the agency.[185] It is clear that the Commission is largely evaluated on the basis of how well its Division of Enforcement performs.[186] Today, the Commission's bargaining strength is founded, in part, on its successful history and the perception that it only pursues winnable cases resulting from effective investigations. Losing a high-profile case, therefore, may substantially compromise the entire enforcement program of the Commission.[187] And,

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181 *See* S.E.C. FY 2011 REPORT, *supra* note 163, at 9.

182 *See, e.g.*, Khuzami, *supra* note 164:

> [L]itigation requires resources, lots of resources. And we are an agency on a modest budget.
>
> Trials are time-consuming and the agency spends a great deal of money deposing witnesses, producing exhibits, and arguing motions.
>
> And our opponents are well-armed with teams of expensive lawyers – a single company could spend an amount on its defense equal to half or more of our Division's entire annual operating budget.
>
> A settlement conserves our resources and allows us to redirect them in productive ways.

Id.

183 Dreilinger, *supra* note 16, at 11.

184 *Id.*

185 John Sivolella, *Bureaucratic Decision Making—SEC Enforcement and the Federal Courts' Ideology* 29 (Apr. 2007) (unpublished), www.allacademic.com/meta/p196843_index.html; *see also* Macey, *supra* note 25, at 644 (arguing that the SEC "focuses on the raw number of cases that it brings and on the sheer size of the fines that it collects").

186 Macey, *supra* note 25, at 643.

187 *See, e.g.*, Khuzami, *supra* note 164:

> We also have to consider the risks associated with litigation, including that cases are won and lost on subtle concepts of materiality, intent, and the meaning of a single sentence in a 500-page offering document.
>
> Litigation also takes time. Some judges move their dockets along rap-

the cost of a Commission loss at trial is borne by both the Commission and the public at large. Successful defendants do not generally leave the trial process unscathed either, with significant damage often affecting reputation and purse, despite the ultimate victory on the merits.

In theory, the Commission's "public interest" mandate serves as a check on the types of settlements that the Commission can agree to, and, more generally, on the entire settlement negotiation process.[188] Reference to this public interest mission is noticeably absent, however, from many of the Commission's recent public statements regarding its consent judgment practice. Increasingly, the courts are taking up the public interest mantle, and the debate is shifting to just how deeply a court can investigate the public interest implications of an individual settlement proposed for its approval.

III. The Proper Deference to be Accorded the SEC

In approving settlements, courts are given wide judicial discretion, limited only by "notions of reasonableness and deference."[189] Confronted with a proposed consent judgment from a federal agency, however, courts are constrained in the scope of their inquiry.[190] In particular, the law requires that courts "give substantial deference to the SEC as the regulatory body having primary re-

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> idly, but in other cases—real cases that we have in fact litigated—it can take years before a case sees the inside of a courtroom, and more years before all appeals are exhausted.
>
> A settlement removes the uncertainty and puts money in the pockets of investors relatively quickly.

Id.

188 *See, e.g.*, Sec. Exch. Comm'n. v. Citigroup Global Markets Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011) (commenting that the SEC "of all agencies" has "a duty, inherent in its statutory mission to see that truth emerges"). The efficacy of the public interest mandate, however, is far from certain. As one commentator has observed:

> [T]heoretically, the SEC's settlement negotiations are guided by its mandate to enforce the federal securities laws in the public interest. Yet, what constitutes actions in the 'public interest' is largely undefined, leaving the Commission staff to engage in what one former SEC attorney describes as an 'arbitrary exercise' that may be influenced by internal and external pressures such as public policy concerns, the overall political climate, and agency self-interest.

Dreilinger, *supra* note 16, at 10.

189 Henderson, *supra* note 3, at 4.

190 *See, e.g.*, Sec. Exch. Comm'n. v. Wang, 944 F.2d 80, 85 (2d Cir. 1991) ("Unless a consent decree is unfair, inadequate, or unreasonable, it ought to be approved.").

sponsibility for policing the securities markets."[191] Such an approach is consistent with a philosophy that courts asked to pass on the judgment of executive agencies must do so with less information, expertise, and political oversight than the agencies.[192] As one author recently commented:

> In the case of settlements, a court asked to approve a consent decree is not privy to (i) the details of the alleged wrongdoing, (ii) the intricacies of the negotiation between the parties, (iii) the facts of how the settlement or the litigation will affect the parties, (iv) the costs and benefits of proceeding with the case, or (v) how the settlement will affect other parties.[193]

On the one hand, the court must satisfy its own judicial needs and should be reluctant to assert its authority absent a proper articulation of the underlying conduct. At the same time, however, proper deference should be afforded the administrative agency charged with carrying out the affairs over which it is expert. And, these issues might be best addressed separately. First, the ability to craft the specific terms of any settlement seems squarely within the Commission's bailiwick and principles of deference would require the court to grant the Commission significant latitude to tailor the arrangement with an individual investigative target. When the Commission desires to employ the court as its enforcer, however, it is equally appropriate that the bar be raised. In such a case, the Commission wishes to involve the court in an ongoing effort. Such an undertaking should not be engaged without a court's true understanding of the underlying facts that give rise to the need for its might. To ask a sentinel to stand post absent the proper knowledge of just what he is guarding seems as improper as it is illogical. Accordingly, a district court must retain the exercise of its "independent judgment in assessing whether the proposed consent judgment accords with the public interest, not least because concern for the public interest is not meaningfully severable from the required consideration of the consent judgment's fairness, reasonableness, and adequacy."[194]

While each of the cases examined in this Article has unique facts and circumstances, there is a clear theme to the objections

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191 *See Bank of America Opinion II*, 09 CIV. 6829 (JSR), 2010 WL 624581, at *6 (S.D.N.Y. Feb. 22, 2010).

192 Henderson, *supra* note 3, at 5 (noting that "[d]eference to the executive branch that negotiates the settlement on behalf of the public is consistent with judicial deference to executive agencies generally").

193 *Id.*

194 *See* SEC Brief, *supra* note 12, at 46.

that Judge Rakoff raises. In essence, a court's work must navigate the choppy waters of (i) a Constitutional issue of separation of powers and (ii) a question of the proper level of inquiry required to establish that a settlement it ratifies is fair, reasonable, adequate and in the public interest. Each such issue is examined in this Part.

A. *The Separation of Powers Concern*

A deferential role for courts in evaluating consent judgments negotiated by government agencies finds root in the United States Constitution.[195] The decision whether and what to prosecute is an exclusively executive function.[196] And, by settling a matter, the respective parties signal their assent to extinguish the ongoing case or controversy that is the very prerequisite for a district court's jurisdiction under the Constitution.[197]

Increasingly, the Commission has emphasized the need for its deliberate balancing of all of the many factors that affect its settlement decisions. In large measure, the Commission views itself as the expert charged with managing the public interest through the overall decision making involved in all of its many enforcement activities. With such a broad task, it is not sufficient for the Commission to come to a conclusion that a particular transgression was serious enough to warrant a suit. Instead, the agency must measure whether "the costs of pursuing the suit were greater than any benefits in terms of deterrence or compensation that might flow from pursuing it further."[198] And, how can the Commission's subjective and holistic decision be second-guessed by a court that lacks a window into all of the agency's activities? Only the Commission seems properly equipped to understand the requirements of a specific case within a complete portfolio of all of its endeavors and constraints.

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195 SEC Memorandum of Law, *supra* note 83, at 8; *see* United States v. Microsoft Corp., 56 F.3d 1448, 1459 (D.C. Cir. 1995) (noting the "constitutional difficulties that inhere" in judicial review of settlements for compliance with the "public interest"); Maryland v. United States, 460 U.S. 1001, 1005–06 (1983) (Rehnquist, J., dissenting from summary affirmance) (explaining the separation of powers problems created by a "public interest" judicial review of consent decrees).

196 Heckler v. Chaney, 470 U.S. 821, 831 (1985) ("[A]n agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion.").

197 SEC Memorandum of Law, *supra* note 83, at 8 (citing Matter of S.L.E., Inc., 674 F.2d 359, 364 (5th Cir. 1982) ("If a dispute has been settled or resolved . . . it is considered moot. With the designation of mootness comes the concomitant designation of non-justiciability.").

198 Henderson, *supra* note 3, at 6.

The benefits of allowing the Commission to control the consent decree process, including the decision of whether to enter into such arrangements on a "non-admission/non-denial" basis seem clear:

> While it gives up a number of advantages when it proceeds by injunction rather than by litigation, including the filing of findings of fact and court opinions clearly setting forth the reasons for the result in a particular case, the SEC is thus able to conserve its own and judicial resources; to obtain contempt remedies, including fines and prison terms, not available to it under its own statutory scheme; and to protect the public by informing potential investors that a certain person has violated SEC rules in the past and by reminding defendants that they must obey the law in the future. While the defendants in such cases give up the right to contest the need for an injunction, they receive significant benefits in return: they are permitted to settle the complaint against them without admitting or denying the SEC's allegations and they often seek and receive concessions concerning the violations to be alleged in the complaint, the language and factual allegations in the complaint, and the collateral, administrative consequences of the consent decree. We are reluctant to upset this balance of advantages and disadvantages.[199]

Accordingly, the Commission maintains that consent judgments resulting from arm's-length negotiations between sophisticated parties are entitled to a presumption of reasonableness by the reviewing court.[200] And, the presumption is heightened where the consent judgment is the result of an enforcement effort by a federal government agency responsible for ensuring the "maintenance of fair and honest markets."[201] The Commission maintains that its overall settlement strategies and its "neither admit nor deny" policy, in particular, are necessary to facilitate settlements that "preserve the breadth of its enforcement reach."[202] In essence, the Commission's view is that it must be free from judicial intrusion in the negotiation of its settlements with investigative targets. And, only in such a regime can the aims of the Commission be accomplished and more money returned to wronged investors more quickly.

In a public statement in response to a court's refusal to accept the *Citigroup* settlement, the Commission's former Director of En-

199 S.E.C. v. Clifton, 700 F.2d 744, 748 (D.C. Cir. 1983).
200 *See, e.g.*, SEC Memo of Law, *supra* note 83, at 1. *See also* Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96, 116 (2d Cir. 2005).
201 Necessity for Regulation, 15 U.S.C. § 78b (2010).
202 Reckler & Denton, *supra* note 119, at 4.

forcement, Robert Khuzami, echoed the sentiments of the *Clifton* court and emphasized the involved and thorough nature of the Commission's deliberations. Mr. Khuzami suggested that to turn down settlements simply because they lacked an admission would represent an unwise policy. He further stated:

> The court's criticism that the settlement does not require an 'admission' to wrongful conduct disregards the fact that obtaining disgorgement, monetary penalties, and mandatory business reforms may significantly outweigh the absence of an admission when that relief is obtained promptly and without the risks, delay, and resources required at trial. It also ignores decades of established practice throughout federal agencies and decisions of the federal courts. Refusing an otherwise advantageous settlement solely because of the absence of an admission also would divert resources away from the investigation of other frauds and the recovery of losses suffered by other investors not before the court.[203]

Understandably, Mr. Khuzami's public statement embellishes Judge Rakoff's position. In fact, in all three cases, the Judge is careful to establish that the lack of an admission is not the sole factor informing his agitation.[204] Moreover, he concedes that a reviewing court must tread lightly because deference is, indeed, due the work of the Commission. Instead, the Judge's objections concern the fact that the court's powers are requested, in each case, without a full and proper showing of the facts giving rise to such a need. Again, the argument is around the level of deference that a court must show the Commission and not whether a court's power is absolute. For Judge Rakoff, then, the issue is one of line drawing and not one of whether there exists a line.[205] And, ultimately, it is the "public interest" prong of the inquiry that affords the court its widest latitude to meddle.

Just as the Commission has an interest in protecting and defending its proper role within an independent executive branch, so too do the courts have ample reason to assert the constitutional

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203 Robert Khuzami, Former Director, Div. of Enforcement, U.S. Sec. Exch. Comm'n., Court's Refusal to Approve Settlement in Citigroup Case (Nov. 28, 2011), http://www.sec.gov/news/speech/2011/spch112811rk.htm.

204 *Bank of America Opinion I*, 653 F. Supp. 2d 507 (S.D.N.Y. 2009); Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304 (S.D.N.Y. 2011); Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

205 SEC Brief, *supra* note 12, at 54 ("As the district court stated over and over, it simply lacked any factual basis upon which to determine whether the settlement was fair, reasonable, adequate, or in the public interest.").

independence of the federal judiciary in these types of disputes. "[O]ur Constitution unambiguously enunciates a fundamental principle–that the 'judicial Power of the United States' must be reposed in an independent Judiciary."[206] As the pro bono counsel appointed to represent Judge Rakoff in the *Citigroup* appeal argued, "[d]epriving the district court of its capacity to reach a sound and reasoned judgment regarding the propriety of a proposed consent judgment and the imposition of injunctive relief would undermine the judiciary's independence and thereby threaten the constitutional balance of power."[207]

B. *The Public Interest Concern*

In large part, any proper "public interest" inquiry cannot be divorced from the question of the proper deference that need be afforded the Commission. Is the Commission the ultimate arbiter of public interest within its general charge to maintain the integrity of the federal securities markets? Or, is that task subject to the second-guessing of a court that lacks the full picture of the Commission's overall activities?[208] As a practical matter, a court's public interest review cannot be severable from the reasonable, fair and adequate prongs of a proper judicial inquiry. For, as Judge Rakoff reminds, it is the public and the parties to whom reasonableness, adequacy, and fairness are owed.[209]

Yet, of the attacks on the SEC's consent judgment practice offered by Judge Rakoff over the course of the three cases, the "public interest" concern might be the most stinging. The issue comes to a head in the *Citigroup* dispute and, then, as a result of a substantial backpedalling on the part of the Commission. In fact, the Commission's inconsistent approach to the threshold required to establish "public interest" suggests a certain level of intellectual confusion as these cases have evolved. In the *Bank of America* case, for example, the court offered very little discussion of public interest.[210] In the initial rejection of the consent judgment, the court discredited the proposed settlement for its lack of fairness, reason-

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206 *See* N. Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 60 (1982).

207 SEC Brief, *supra* note 12, at 55; *see also* United States v. Rojas, 53 F.3d 1212, 1214 (11th Cir. 1995) ("[S]eparation of powers would be implicated when the actions of another Branch threaten an Article III court's independence and impartiality in the execution of its decisionmaking function.").

208 *See* Dreilinger, *supra* note 16, at 6 ("Allowing judges to embark on a searching public interest inquiry for every single SEC settlement could harm the SEC, defendants, and even the courts.").

209 *Citigroup Global Markets, Inc.*, 827 F. Supp. 2d at 335.

210 *See supra* text accompanying notes 41–42.

ableness and adequacy "even upon applying the most deferential standard of review."[211] As a result, any public interest inquiry remained extraneous, and the court did not have to involve itself in such an inquiry to find the proposal objectionable.

In the *Vitesse* case, the Commission's brief articulated the proper standard for the court to apply in determining whether to approve consent judgments in SEC enforcement actions. In fact, Judge Rakoff's opinion quoted liberally from the Commission's submission.[212] Characterizing the scope of the court's review as "well established", the Commission wrote that "[b]ecause actions brought by the Commission seek to enforce the federal securities laws, they should serve the 'public interest.'"[213] The Commission further elaborated that, to ensure that the public interest is served, the court:

> [N]eed not inquire into the precise legal rights of the parties nor reach and resolve the merits of the claims or controversy, but need only determine that the settlement is fair, adequate, reasonable and appropriate under the particular facts and that there has been a valid consent by the parties.[214]

The Commission's brief quoted from the language of the earlier *Bank of America* opinion, providing that the *Vitesse* court had "the obligation, within carefully prescribed limits, to determine whether the proposed Consent Judgment settling [a] case is fair, reasonable, adequate, and in the public interest."[215] Finally, the standard of review suggested by the Commission and adopted by the *Vitesse* court provided that the court "give substantial deference to the SEC as the regulatory body having primary responsibility for policing the securities markets, especially with respect to matters of transparency."[216]

In the *Citigroup* matter, however, the SEC tried another standard on for size. While retaining the "fair, adequate, and reasonable" language articulated in *Bank of America* and *Vitesse*, the Commission's memorandum reversed course from its filings in the

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211 *Bank of America Opinion I*, 653 F. Supp. 2d 507, 509 (S.D.N.Y. 2009).

212 Sec. Exch. Comm'n. v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304 (S.D.N.Y. 2011).

213 *Id.* at 306 (referencing SEC Letter Brief dated Dec. 21, 2010, which cites Sec. Exch. Comm'n. v. Randolph, 736 F.2d 525, 529 (9th Cir. 1984)).

214 *See id.* (citing Citizens for a Better Env't v. Gorsuch, 718 F.2d 1117, 1126 (D.C. Cir. 1983)).

215 *See id.* at 307 (quoting *Bank of America Opinion II*, No. 09-CV-6829 (JSR), 2009 WL 2842940, at *1 (S.D.N.Y. Aug. 25, 2009)).

216 *See id.* (quoting *Bank of America Opinion II*, No. 09-CV-6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 5624581, at *6 (S.D.N.Y. Feb. 22, 2010)).

prior cases, and suggested that "the public interest . . . is not part of [the] applicable standard of review."[217] Ultimately, the question of whether the court possesses the ability to inquire into whether a settlement placed before it is in the public interest is barely worthy of a discussion. And, the Commission's efforts to walk back from its own articulation of such a standard only serves to hurt the credibility of its efforts to define the scope of such an inquiry.

The more interesting question than whether there exists a public interest inquiry within the proper scope of judicial review is just how robust such a review should be and where its boundaries should be drawn. In essence, where a public interest inquiry ends and proper deference for the Commission begins becomes the question of the day in these cases. For, as one commentator has observed, "government agencies with missions, policies, and enforcement tools similar to the SEC have utilized a public interest inquiry to facilitate—and even improve—the settlement process."[218]

Any position in favor of enhanced judicial review for securities settlements suffers mightily from the absence of statutory guidance on what constitutes a settlement consistent with the public interest.[219] The courts, too, have not yet developed a consistent test or set of factors to support a meaningful public interest inquiry.[220] As a result, judges are left to navigate a vague mandate in favor of consent judgments.[221]

Over time, ad hoc judicial inquiries for individual settlements could do more harm than good. It is not difficult to imagine that a commission that relies on the settlement process to resolve more than 90% of its enforcement actions might strain under an additional burden if defendants are discouraged from undergoing the intense, lengthy, and costly bargaining process with the Commission only to have judges enforce their own requirements or reject a proposed settlement altogether.[222] Of course, in an effort to save time and resources, the Commission might choose to avoid the courts altogether.[223]

217 Opinion and Order at 5, Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., No. 11 Civ. 7387 (JSR) (S.D.N.Y. Nov. 28, 2011).
218 Dreilinger, *supra* note 16, at 29.
219 *Id.* at 6.
220 *Id.*
221 *Id.*
222 *Id.* at 6–7.
223 *Id.* at 7 (noting that this option "is especially attractive given the Commission's recently acquired power to impose civil monetary penalties 'against any person' in administrative proceedings").

In the coming days and years, the courts, the Commission, and individual defendants will be left to define the scope of the proper inquiry for the court. In that regard, Judge Rakoff has done a real service to begin a process of defining these roles that should have started long ago.

IV. The Likely Effects of the Newfound Attention

A few years removed from the *Bank of America* matter, some effects of Judge Rakoff's crusade are already taking hold. First, and predictably, the Commission has responded aggressively to charges leveled at the way that it does its business. Most notably, the merits of the defense of its practices are likely to be considered in the Commission's appeal of the *Citigroup* decision. Second, if imitation remains the greatest form of flattery, Judge Rakoff has enjoyed his share of adulation. The Judge's fans are not limited to the press, academics, and commentators. Other judges have shown various degrees of support for this line of thought, as the Commission is being asked to satisfy specific court-directed inquiries like no time in recent memory.[224] A position in favor of enhanced judicial scrutiny, however, today remains vacuous because the "public interest" standard remains relatively undefined. And, the success of any such policy will depend on a careful weighing of the costs and benefits of such an approach. Finally, once these matters become better settled, and the appellate courts have more clearly articulated the appropriate standards of review, there is likely to be an effect in the market for directors and officers insurance. Some of the likely effects of the newfound attention that Judge Rakoff has brought to these issues are briefly explored below.

A. *The* Citigroup *Appeal*

On December 15, 2011, the Commission filed a Notice of Appeal with the United States Court of Appeals for the Second Circuit

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[224] *See, e.g.,* Letter from Hon. Rudolph T. Randa, U.S. District Judge, to Andrea R. Wood & James A. Davidson, Counsel for SEC (Dec. 20, 2011), *available at* www.wlrk.com/docs/kossletter.pdf (refusing to approve a proposed settlement between the SEC and Koss Corporation and directing the Commission to show that the settlement is fair, reasonable, and in the public interest); *see also* Fed. Trade Comm'n. v. Circa Direct, No. 11-civ-2172, 2012 WL 589560 (D.N.J. Feb. 22, 2012) (challenging a settlement of alleged violations of the Federal Trade Commission Act and ordering the parties to submit briefs responding to whether the settlement is fair, adequate, and in the public interest); Sec. Exch. Comm'n. v. Merendon Mining (Nevada) Inc., No. C10-955RAJ (W.D. Wash. Mar. 5, 2012) (rejecting a proposed settlement between the SEC and three alleged Ponzi scheme defendants and taking issue with the SEC request for injunctive relief while reserving decisions on monetary relief for the future).

seeking review of Judge Rakoff's November 28th Order in the *Citigroup* matter. In addition, on December 16, 2011, the bank filed a motion in the district court seeking to stay the proceedings pending the appeal.[225] In support of the appeal, former Enforcement Director Khuzami again took the opportunity to defend the Commission's proposed settlement as "reasonably reflect[ing]the relief the SEC would likely have obtained if it prevailed at trial."[226] He also characterized Judge Rakoff's approach as contrary to legal authority and "at odds with decades of court decisions that have upheld similar settlements by federal and state agencies across the country."[227] With the appeal moving to the Second Circuit, there remained an interesting question of whether Judge Rakoff's position would be represented (aside from the record in the District Court) in a proceeding that amounted to "basically an appeal without an adversary."[228] That question was answered in the affirmative when the Second Circuit allowed for the appointment of pro bono counsel to represent and brief Judge Rakoff's position.[229] The case was heard by the Second Circuit on February 8, 2013.[230]

B. *The Copycat Effect*

Several recent cases suggest that the importance of Judge Rakoff's decisions will be found less in the resolution of any particular matter than with the change in the approach that the judiciary might take to pre-packaged SEC settlements.[231] On several occasions since Judge Rakoff first expressed his reservations, individual

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225 Citigroup subsequently filed its own Notice of Appeal and Memorandum in Support of the Stay Motion.

226 *SEC Enforcement Director's Statement on the Citigroup Case*, SEC News Digest, Issue 2011-241 (Dec. 15, 2011), http://www.sec.gov/news/digest/2011/dig121511.htm.

227 *Id.*

228 For an interesting description of this unlikely situation and some possible outcomes see Carolyn Kolker, *Analysis: In Citi Appeal, Who Will Speak for Rakoff?,* REUTERS (Jan. 17, 2012, 5:20 PM), http://www.reuters.com/article/2012/01/17/us-frankel-rakoff-idUSTRE80G28Q20120117.

229 *See* Sec. Exch. Comm'n. v. Citigroup Global Markets, Inc., 673 F.3d 158, 161 (2d Cir. 2012).

230 See Peter Lattman, *Court Hears Arguments on Judge's Rejection of S.E.C.-Citigroup Deal*, DEALBOOK BLOG (Feb. 8, 2013, 4:56 PM), http://dealbook.nytimes.com/2013/02/08/appeals-court-hears-arguments-over-judge-rakoffs-rejection-of-citigroup-settlement/.

231 *See, e.g.*, Edward Wyatt, *In Challenging S.E.C. Settlement, a Judge in Wisconsin Cites a Court in New York,* N.Y. TIMES, Dec. 28, 2011, http://www.nytimes.com/2011/12/29/business/judge-in-wisconsin-challenges-sec-settlement.html?_r=0 ("The fact that a federal judge halfway across the country cited the [*Citigroup*] case less than a month later means that other judges have noticed the ruling—which is significant because most S.E.C. enforcement cases rely on similar, negotiated settlements.").

judges have agreed that the settlement practice should require more than a judicial rubber stamp.

One commentator has summarized the effects of the Bank of America case and its progeny succinctly:

> By echoing the concerns that arose in *Bank of America*, these judges gave credence to Judge Rakoff's over-arching criticisms of the SEC settlement process and showed that Judge Rakoff was more than a publicity-hungry gadfly. In fact, as more judges 'pull a Rakoff' and break with the long-entrenched tradition of judicial deference, *Bank of America* becomes more interesting—and important. Judge Rakoff's decision will not be remembered for the outcome of the case, but rather how it sparked a new trend of judicial scrutiny for securities settlements.[232]

The newfound judicial scrutiny has come from several corners. In March 2010, for example, Judge William Pauley, of the Southern District of New York, rejected a Commission proposal to amend the historic global settlement that brokerage firms agreed to following the much celebrated conflicts of interest inquiries in 2003.[233] Labeling the proposed amendment "counterintuitive," Judge Pauley found it to be contrary to the public interest, despite the Commission's endorsement.[234] In August 2010, Judge Ellen S. Huvelle, of the D.C. Circuit, refused to "rubber-stamp" the Commission's proposed settlement with Citigroup over the bank's failure to fully disclose its exposure to subprime mortgages during the recent financial crisis.[235] Judge Huvelle raised significant questions about the proposed $75 million settlement and her concerns "mirrored Judge Rakoff's."[236]

Judge Rakoff's most recent kindred spirit seems to be Judge Rudolph T. Randa of the District Court of the Eastern District of Wisconsin. Upon being presented with a proposed settlement of fraud charges against Koss Corporation, a maker of stereo head-

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232 Dreilinger, *supra* note 16, at 5–6.

233 *See* Ashby Jones, *In Rejecting SEC Settlement, Has Pauley Pulled a Rakoff?*, WALL ST. J. LAW BLOG (Mar. 18, 2010, 12:58 PM), http://blogs.wsj.com/law/2010/03/18/in-rejecting-sec-settlement-has-pauley-pulled-a-rakoff/.

234 *See generally* Peter J. Henning, *When Judges Refuse to Be Rubber Stamps*, DEALBOOK BLOG (Mar. 22, 2010, 12:33 PM), http://dealbook.blogs.nytimes.com/2010/03/22/when-judges-refuse-to-be-rubber-stamps/.

235 *See* Peter J. Henning, *Can the S.E.C. Avoid Scrutiny of its Settlements?*, DEALBOOK BLOG (Aug. 17, 2010, 5:18 PM), http://dealbook.blogs.nytimes.com/2010/08/17/can-the-s-e-c-avoid-scrutiny-of-its-settlements/ (noting that one day later, albeit in a criminal case brought by the Department of Justice, another federal judge asked tough questions about what he viewed as a "sweetheart deal" with Barclays Capital, before he reluctantly approved the settlement).

236 *See* Schreiber et al., *supra* note 108, at 2, n.3.

phones, the Judge cited Judge Rakoff's *Citigroup* opinion and asked the Commission to provide a "written factual predicate for why it believes the court should find that the proposed final judgments are fair, reasonable, adequate and in the public interest."[237]

C. Costs and Benefits

At least one commentator has suggested a more practical lens through which the Commission's actions in these cases might be viewed. Describing the *Bank of America* case in particular, Professor Henderson offered the following assessment:

> Imagine that the SEC believed that the disclosures in the proxy statement were faulty and misleading, but that the circumstances of the deal were such that the mistakes were not worthy of aggressive punishment. (Perhaps because the executives at Bank of America were pressured into doing the deal as a public service to "save" the economy from collapse.) Accordingly, we can think of the suit and the settlement as telling shareholders that they were paying for the mistakes their agents made, perhaps hoping that shareholders would, either through lawsuit or otherwise, try to discipline those agents. Seen in this way, the apparent accommodation that the SEC made could instead be viewed as a rational calculation of the costs and benefits of the litigation and a pursuit of something approximating optimal deterrence of future proxy violations.[238]

Under such an interpretation, Judge Rakoff's efforts can be seen as "piling on to some extent," as, in a sense, they uproot the delicate balance of the Commission's value judgments.[239] By rejecting the settlements, Judge Rakoff suggests that "the SEC was systematically making errors about the tradeoffs in the deterrence calculation."[240] While we can hold out hope that Judge Rakoff's decisions will cause the SEC to be more thoughtful and deliberative in its efforts, it adds to the uncertainty of the entire settlement process. A less optimistic view is that the Judge's efforts will simply raise the costs of entering consent judgments.[241]

> Presumably the SEC prefers to use consent decrees in cases like this because they are the most efficient way to enforce the terms

[237] *See* Letter from Hon. Rudolph T. Randa, U.S. District Judge, to Andrea R. Wood & James A. Davidson, Counsel for SEC, Sec. Exch. Comm'n. v. Koss Corp., No. 2:11-CV-00991 (E.D. Wisc. Dec. 20, 2011), *available at* www.wlrk.com/docs/file/kossletter.pdf; *see also* Wyatt, *supra* note 231.

[238] Henderson, *supra* note 3.

[239] *Id.*

[240] *Id.*

[241] *Id.*

> of the agreement. By raising the costs of this alternative to pure settlements, which definitely do not require judicial approval, the options for the government and the parties are reduced. This in turn reduces the range of mutually beneficial bargains that can be struck, and may result in much higher costs for all other parties.[242]

D. *The Effect on the Insurance Market*

Few would argue that the added opacity surrounding SEC enforcement proceedings in the wake of Judge Rakoff's efforts "will affect the costs of defense for SEC enforcement proceedings and impact defense and settlement costs for related shareholder class actions and derivative litigation."[243] In particular, the underwriters of directors and officers ("D&O") insurance have undoubtedly taken notice of the evolving landscape, and will be anxiously monitoring the ongoing controversy surrounding the Commission's settlement policy.

Typically, SEC settlements themselves are uninsurable under D&O policies because they usually include fines, disgorgement, and equitable relief.[244] The costs of defending an SEC investigation, however, are generally recoverable under a D&O policy.[245] Some observers who follow the insurance market have suggested that if Judge Rakoff's criticisms ultimately result in a change in SEC policy where the Commission will only enter into settlements with defendants who admit liability, there will be a corresponding change in the insurance market. "If defendants cannot settle with the SEC without admitting liability, there likely will be fewer settlements and some defendants may decide to litigate until a final judgment—all resulting in increased costs of defense."[246] Accordingly, those in the insurance field are monitoring these issues closely.

E. *Changes to Criminal Cases at the Commission*

One measurable effect of Judge Rakoff's critique is found in a recently announced change to Commission policy.[247] On January 6, 2012, the Commission, through its Director of Enforcement, an-

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242 *Id.*
243 Pesso, *supra* note 59.
244 *Id.*
245 *Id.*
246 *Id.* (noting that "[i]n recent years, defense costs for even a single SEC defendant have run into the millions of dollars").
247 *See generally* Aruna Viswanatha & Sarah N. Lynch, *SEC Changes Settlement Lan-*

nounced that defendants are now prohibited from settling civil cases using the "neither admit nor deny" language if they have already admitted to wrongdoing in a parallel criminal case.[248] Under the new policy, where a defendant is the subject of a parallel criminal conviction, non-prosecution agreement ("NPA") or deferred prosecution agreement ("DPA") that contains admissions or acknowledgements of criminal conduct, the SEC will no longer permit that defendant to enter into a "non-admission/non-denial" style settlement. Instead of the traditional charging language, Commission settlement orders will now include language citing the fact and nature of the criminal disposition.[249] In addition, the Commission's staff will have the discretion to incorporate into the settlement order any relevant facts admitted during the defendant's plea allocution, in a jury verdict form, or in the NPA or DPA.[250]

The Commission, through its Director of Enforcement, has expressly denied that there is a connection between Judge Rakoff's opinions and the policy change. While the new policy represents an additional consideration for a prospective settling party, the practical impact of the change is likely to be modest for several reasons. First, the new policy does not apply to the vast majority of settling parties.[251] In this regard, it is limited to situations where the defendant has (i) pled guilty, (ii) been convicted, or (iii) made substantive admissions in an NPA or DPA.[252] Second, the new policy is somewhat limited in that settling parties are not required to make admissions beyond the scope of what they had already made in a criminal proceeding. The policy merely calls for the inclusion of language that "the defendant has admitted the parallel criminal action."[253]

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guage for Some Cases, REUTERS (Jan. 7, 2012, 5:15 PM), http://www.reuters.com/article/2012/01/07/us-sec-policychange-idUSTRE8051VB20120107.

248 *See* Steve Schaefer, *SEC Rule Change Doesn't Mean Much for Wall Street Settlements*, FORBES, Jan. 6, 2012, http://www.forbes.com/sites/steveschaefer/2012/01/06/sec-rule-change-wont-have-wall-street-admitting-guilt/ (quoting the full statement by SEC Director of Enforcement Robert Khuzami outlining the new policy).

249 *See* Schreiber et al., *supra* note 108, at 1.

250 *See* Posting of DavisPolk Client Newsflash, *SEC Changes "Neither Admit Nor Deny" Practice for Criminal Conviction Cases*, to dpwmail@davispolk.com (Jan. 9, 2012), http://www.davispolk.com/files/Publication/2202fc41-1395-49a8-b40f-fa8022c05ac9/Presentation/PublicationAttachment/38595d57-62a0-44f6-ba26-0b7f9da97fc0/01.09.12.lit.html (offering that "[t]he SEC's newly announced approach is likely to arise most notably in cases involving the Foreign Corrupt Practices Act or insider trading, where SEC enforcement actions often run parallel to criminal proceedings").

251 *See* Reckler & Denton, *supra* note 119, at 1 (noting that "[t]he vast majority of SEC cases fit into that unchanged category").

252 *See* Schreiber et al., *supra* note 108, at 2.

253 *Id.* at 3.

In the end, despite the Commission's denials, it is difficult to maintain a position that this policy change would have happened absent Judge Rakoff's more general criticisms.[254] Moreover, it remains unclear whether the change will be the beginning of a broader shift to more aggressive enforcement policies.[255]

Conclusion

The role of the federal judiciary in approving Commission settlements is an important one. Ultimately, defining the scope of that involvement has significant ramifications for the courts, the Commission, investigation targets, and the public at large. And adopting a reliable standard for the proper judicial public interest inquiry can preserve the utility and efficiency of the Commission's settlement process and, at the same time, satisfy the courts' burden that its enforcement mechanisms are warranted.

In the meantime, the level of skepticism will continue to filter into the individual consent judgments that the Commission presents routinely to the courts. Judge Rakoff's trilogy has already changed the equation for the Commission and its targets. Undoubtedly, the three cases examined in this Article have shed light on the cynical nature of a settlement process that, for too long, has offered a comfortable bargain for the Commission and defendant alike.[256] If the Judge's handiwork makes the Commission more deliberate and thoughtful in its work, that will be a benefit. The cost, however, must be measured in the increased uncertainty of outcomes. It remains to be seen just how much a more inquisitive bench will add to the cost of entering into consent judgments. In the end, all must guard against these cases amounting to little more than judicial meddling. Such a limited outcome would be unfortunate, and would simply push parties "towards less efficient means of resolving their disputes."[257]

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254 *See, e.g.*, *id.*; David Dayen, *Rakoff Gets Results: SEC Dropping No-Fault Settlement Language in Some Cases*, FIREDOGLAKE (Jan. 6, 2012, 12:15 PM), http://news.firedoglake.com/2012/01/06/rakoff-gets-results-sec-dropping-no-fault-settlement-language-in-some-cases/ (observing that "[t]his is a first step to stopping this travesty of allowing companies to get off the hook and pay their way out of fraud violations without even admitting they did anything wrong," and further asserting that "this never happens without the work of Jed Rakoff").

255 Schreiber et al., *supra* note 108, at 3.

256 *See, e.g.* Neal Lipschutz, *Rakoff Decision May Be 'Unprecedented,' But He's Still Right,* WALL ST. J LAW BLOG (Dec. 16, 2011, 1:50 PM), http://blogs.wsj.com/law/2011/12/16/if-rakoff-decision-is-unprecedented-hes-still-right/ (suggesting that Judge Rakoff was "calling 'stop' to a long-standing practice that took expediency too far").

257 Henderson, *supra* note 3; *see also* DavisPolk Client Newsflash, *supra* note 250

In the meantime, there can be no denying the observations made by Judge Rakoff's diligence and recently echoed by Professor Coffee:

> Too often, the goal of the SEC has been to achieve a settlement with a defendant that affirms its authority, but makes no sense. This may be the product of logistical constraints and caseload pressure, and a partial answer may be to allocate more resources to the SEC. But the SEC has to be prepared to litigate (and not reflexively settle). Ultimately, this dilemma may require that the SEC bring fewer cases in order to be able to litigate more intensively those that it does bring.[258]

And, the alarmist claims that more rigorous judicial inquiry somehow equates to the SEC's enforcement program being hamstrung by the inability to negotiate future settlements rings hollow in light of the responsible and deliberative consideration regularly afforded these matters by district courts and the multiple enforcement options still available to the Commission.[259]

In the end, no settlement is worth the public's interest in knowing the truth.

("[T]o the extent this and other changes to settlement policies at the SEC and other federal agencies make matters harder to settle, the number of litigated matters might increase and parties might begin to experiment with alternate ways to resolve cases.").

258 Coffee, *supra* note 168, at 4.

259 *See generally* SEC Brief, *supra* note 12, at 53–4.