11-5227-CV

United States Court of Appeals
For the
Second Circuit

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant-Cross-Appellee,

v.

CITIGROUP GLOBAL MARKETS INC.,

Defendant-Appellee-Cross-Appellant,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF *AMICI CURIAE* SECURITIES LAW SCHOLARS
FOR AFFIRMANCE IN SUPPORT OF THE DISTRICT COURT'S ORDER AND AGAINST APPELLANT AND APPELLEE

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INTEREST OF *AMICI CURIAE*

Amici are nineteen scholars at American law schools whose research and teaching focus on federal securities enforcement and the Securities and Exchange Commission (SEC).[1] A full list of *amici*, who join this brief as individuals and not as representatives of any institutions with which they are affiliated, is set forth in the Appendix.

We have a strong interest in the issues presented by the appeal of the district court's November 28, 2011 order refusing to approve the proposed consent judgment between the SEC and Citigroup Global Markets Inc. As scholars who study the SEC, we have concerns about the agency's practice of settling enforcement actions alleging serious fraud without *any* acknowledgement of facts, on the basis of a pro forma "obey the law" injunction, a commitment to undertake modest remedial measures and insubstantial financial penalties. The prevalence of this practice is precisely why federal district courts must have discretion, when reviewing consent judgments between a government agency and a private party that include an injunction, to take into account the public interest.

[1] Pursuant to Federal Rule of Appellate Procedure 29(c)(5), this brief was not authored in whole or in part by any party or its counsel, nor did any party or its counsel contribute money that was intended to fund preparing or submitting this brief. There is no person other than the *amici curiae* who contributed money that was intended to fund preparing or submitting this brief.

SUMMARY OF ARGUMENT

This appeal asks the Court to determine the proper role of a federal district court when the Securities and Exchange Commission (SEC) seeks the court's approval of a proposed judgment that includes an injunction against the defendant's future misconduct to which the defendant has consented. This question is "a matter of obvious public importance" (Opinion at 9): it involves allegations of securities fraud against Citigroup Global Markets (Citigroup), part of one of the largest financial institutions in the world, Citigroup Inc., which was the recipient of massive amounts of federal bailout money because the government deemed it "too big to fail."[2] The sales of collateralized debt obligations (CDOs), structured and distributed by Citigroup and others, played a major part in the 2007-2008 economic crisis, which imposed the most harm on the people of the United States since the crisis of the 1930s.[3] Simultaneously with the filing of its complaint, the SEC submitted for the district court's approval a proposed consent judgment that would (1) permanently enjoin Citigroup from future violations of Sections 17(a)(2)

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[2] The total amount of government bailout received by Citigroup Inc. was $346,000,000,000. See Report of Special Investigator General for the Troubled Asset Relief Program, SIGTARP 11-002 (U.S. Dept. Treasury) Summary at 2 (Jan. 13, 2011), *available at* http://www.sigtarp.gov/Audit%20Reports/Extraordinary%20Financial%20Assistance%20Provided%20to%20Citigroup,%20Inc.pdf

[3] The Financial Crisis Inquiry Commission identified over-the-counter derivatives, including CDOs, as significantly contributing to the financial crisis because they amplified the losses from the collapse of the housing bubble. Financial Crisis Inquiry Commission, THE FINANCIAL CRISIS INQUIRY REPORT 127-55 (Jan. 2011).

and (3) of the Securities Act, (2) require Citigroup to disgorge $160 million in profits, plus $30 million in prejudgment interest, and to pay a $95 million civil penalty, and (3) require Citigroup to undertake certain compliance measures for three years.

Injunctive relief backed by the court's contempt power is an extraordinary remedy that courts cannot issue without taking into account the public interest. The district court performed its responsibility in reviewing the proposed consent judgment and appropriately exercised its discretion in refusing to approve it because the parties did not provide information for the court to determine, in the exercise of its independent judgment, that the settlement was fair, reasonable, adequate and in the public interest.

As scholars who study securities enforcement and the SEC, we have concerns about the SEC's practice, exemplified in this case, of settling enforcement actions alleging serious fraud without *any* acknowledgement of facts, on the basis of a pro forma "obey the law" injunction, a commitment to undertake modest remedial measures, and insubstantial financial penalties. The prevalence of this practice is precisely why courts must have discretion, when reviewing consent judgments between a government agency and a private party that include an injunction, to take into account the public interest. The requirement of judicial review serves as an independent check on settlements that may meet the needs of

the settling parties, but do not serve the public interest because they neither inform the public of the truth of the allegations nor deter future violations.

Finally, the SEC warns that the district court's order, unless reversed, will have serious implications for SEC enforcement and allocation of its resources. This is a dilemma of the SEC's making because the agency has alternatives it could have pursued to avoid this confrontation with the district court.

ARGUMENT

I. THE DISTRICT COURT WAS CORRECT THAT JUDICIAL REVIEW OF A PROPOSED CONSENT JUDGMENT INCLUDES CONSIDERATION OF THE PUBLIC INTEREST.

The district court correctly stated the appropriate standard for judicial review when an administrative agency submits a proposed consent judgment that includes injunctive relief:

> whether, giving deference to the views of the agency, the proposed consent judgment is fair, reasonable, adequate and in the public interest. (Opinion at 4)

As the court further noted, "the parties' successful resolution of their competing interests cannot be automatically equated with the public interest…." (Opinion at 13)

Indeed, the SEC itself initially stated that "public interest" was the appropriate standard (Memorandum By Plaintiff SEC in Support of Proposed

Settlement at 5 (quoting with approval *SEC v. Bank of America Corp.*, No. 09-CV-6829 (JSR), 2009 WL 2842940, at *1 (S.D.N.Y. Aug. 25, 2009)). It was only after the court called for a hearing and sought information about the proposed settlement that the SEC attempted to circumscribe judicial discretion and asserted that public interest was not part of the applicable standard. (Memorandum of Law by Plaintiff SEC in Response to Questions Posed by the Court Regarding Proposed Settlement at note 1) Citigroup goes even further and asserts that there is no role at all for the courts except "to give effect to the terms negotiated by the parties." (Brief of Defendant-Appellee-Cross-Appellant Citigroup Global Markets, Inc. p.3)

The law, however, does not support the parties' positions. The SEC is seeking an extraordinary remedy that courts cannot grant without considering the public interest; *see, e.g., eBay, Inc. v. MercExchange,* 547 U.S. 388, 391 (2006); *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972). The proposed consent judgment includes injunctive relief, enforced by the court's contempt powers. Once a court enjoins a defendant from future violations, the SEC could move summarily to have the court hold the defendant in contempt if the agency has evidence of a subsequent violation. Because the contempt power is "among the most formidable weapons in the court's arsenal," *United States v. Local 1804-1, Int'l Longshoremen's Ass'n, AFL-CIO,* 44 F.3d 1091, 1095 (2d Cir. 1995), giving the court the power to regulate a party's subsequent out-of-court

behavior, it is incumbent on the court to consider the public interest before granting injunctive relief. Neither opinion cited by the SEC supports its position that the agency's determination of public interest is unreviewable. The principal case in this Circuit cited by the SEC, *SEC v. Wang,* 944 F.2d 80 (2d Cir. 1991), addresses the standard of review applicable to the distribution of proceeds in a proposed SEC disgorgement plan and does not address injunctive relief. *SEC v. Randolph,* 736 F.2d 525 (9th Cir. 1984), the other decision cited by the SEC, also does not support its position. *Randolph* merely states the uncontroverted principle that the SEC's determination of public interest is entitled to judicial deference. *Id.* at 530.

II. THE DISTRICT COURT ACTED WITHIN ITS DISCRETION WHEN IT REFUSED TO APPROVE THE PROPOSED CONSENT JUDGMENT BECAUSE THE PARTIES DID NOT PROVIDE INFORMATION FOR THE COURT TO DETERMINE THAT IT WAS FAIR, REASONABLE, ADEQUATE, AND IN THE PUBLIC INTEREST.

The question before this Court is whether a district court may refuse to approve a proposed consent judgment in an SEC enforcement action when the parties do not provide the court with information to assess the strength of the agency's allegations against the defendant. This information was necessary here so that the court could decide whether, after giving deference to the views of the agency, the proposed consent judgment is fair, reasonable, adequate and in the

public interest. The district court was fulfilling its obligations when it reviewed the proposed consent judgment, asked the parties questions, gave careful consideration to the SEC's explanations and, after giving due deference to the agency's views, concluded that it could not approve the proposed consent judgment "because the Court has not been provided with *any* proven or admitted facts with which to exercise even a modest degree of independent judgment." (Opinion at 4) (emphasis added)

The district court explained why it required more information to exercise its independent judgment.

- First, the SEC's complaint, if true, means that Citigroup engaged in serious and intentional fraud in disregard of the interests of its customers and for its own substantial gain. Yet, although the first sentence of paragraph one of the complaint labels this a "securities fraud action," the complaint charges Citigroup only with negligence.
- Second, the requested injunction is a general "obey-the-law" injunction that does not "describe in reasonable detail … the act or acts restrained," as required by Fed. R. Civ. P. 65(d), does not shed any light on the conduct that, according to the SEC, was illegal, and is unlikely to serve as an effective deterrent against future wrongdoing.

- Third, the prophylactic measures imposed for three years are relatively inexpensive measures that appear to be "window-dressing."
- Fourth, the penalties are modest, given the gravity of allegations, the investors' losses, the harm to the public and the fact that Citigroup is a recidivist.

Faced with the stark contrast between the serious allegations in the complaint and the modest relief requested, the district court acted appropriately in seeking factual information to understand this discrepancy. The court did not exceed its discretion in refusing to approve a settlement where there was such a disparity between the bare allegations and the proposed relief and where the factual information was deficient.

The district court correctly identified the potential for harm if a court approves a consent judgment without information to exercise its own independent judgment: the court would become a rubber stamp for the agency. As the Opinion states:

> before a court may employ its injunctive and contempt powers in support of an administrative settlement, it is required, even after giving substantial deference to the views of the administrative agency, to be sure that it is not being used as a tool to enforce an agreement that is unfair, unreasonable, inadequate, or in contravention of the public interest. (Opinion at 7-8)

Without information the court cannot determine whether the requested injunction is an appropriate remedial measure. The injunction may be (as it appears to be here) devoid of content and power. In other cases the requested relief may be an abuse of the agency's power. As the Opinion states, "in the absence of *any* facts, the Court lacks a framework for determining adequacy." (Opinion at 14) (emphasis added)

III. THE SEC'S PRACTICE OF SETTLING ALLEGATIONS OF SERIOUS SECURITIES FRAUD WITHOUT ANY ACKNOWLEDGEMENT OF FACTS IN EXCHANGE FOR MODEST SANCTIONS DOES NOT SERVE THE PUBLIC INTEREST.

The SEC's practice of allowing defendants to settle allegations of serious securities fraud without any acknowledgement of facts in exchange for modest sanctions, which the present case illustrates, does not serve the public interest. The public has an interest in knowing the facts about how major financial institutions like Citigroup Inc. conducted their business in the period leading up to the financial crisis, even if the parties prefer not to provide such facts.[4] Further, in the

[4] "Regulatory enforcement is pursued on behalf of the public, who for good reasons would very much like to be told whether the firm is a lawbreaker and, if so, exactly how and to what extent." Samuel W. Buell, *Potentially Perverse Effects of Corporate Civil Liability,* in Anthony S. Barkow & Rachel E. Barkow (eds.), USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (NYU Press 2011) at 97, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969836

absence of meaningful sanctions, it is doubtful whether the settlements serve to deter future violations, which is a principal purpose of SEC enforcement actions.[5]

As the district court recognized, in a case "that touches on the transparency of the financial markets whose gyrations have so depressed our economy and debilitated our lives," there is "an overriding public interest in knowing the truth." (Opinion at 15) Indeed, the events of the last few years bear a striking resemblance to the events that led to the enactment of the federal securities laws eighty years ago. Those laws were enacted because Congress recognized that investor confidence is essential to strong and efficient capital markets. In particular, Congress recognized the need to reform the securities sales practices of investment bankers that led to the 1929 Crash.[6] Similarly, the turmoil of the current financial crisis has had a detrimental impact on investor confidence that needs to be restored.[7] SEC Chairman Mary Schapiro has frequently stated that restoring investor confidence is a paramount goal of the agency under her

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[5] *See* James D. Cox & Randall S. Thomas, with assistance of Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 759 (2003) (describing "detection, enforcement and deterrence of financial frauds" as mission of SEC enforcement).

[6] Joel Seligman, THE TRANSFORMATION OF WALL STREET at 41-42 (3d ed. 2003).

[7] "If the fiscal crisis of 2008 has taught us anything, it is that the SEC's traditional objectives of investor protection and disclosure transparency are critically important in maintaining the health of the capital markets and reining in animal spirits that contribute to bubbles and fraud." Jill E. Fisch, *Top Cop or Regulatory Flop? The SEC at 75*, 95 VA. L. REV. 785, 788 (2009).

leadership.[8] Yet, nearly five years after the crisis, the public still seeks answers: who (if anyone), or what, was responsible for the financial crisis? Did our major financial institutions engage in fraud, self-dealing or overreaching conduct? Louis Brandeis's prescription – "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman" – is the first principle of federal securities regulation that is as true today as ever.[9]

A number of the SEC's practices in its settlement of securities fraud cases by means of consent judgments concern us, as scholars of the SEC and securities enforcement. First, the facts in this case illustrate a common practice: the SEC filed a complaint alleging serious securities fraud, while simultaneously filing a proposed consent judgment with modest financial penalties, a pro forma "obey the law" injunction against future violations,[10] an undertaking to implement inexpensive remedial measures that appear to be window-dressing[11] and no acknowledged facts. At the same time the SEC issued a press release touting its

[8] *See, e.g.*, Message from the Chairman, SEC 2009 PERFORMANCE AND ACCOUNTABILITY REPORT at 2.

[9] Joel Seligman, THE TRANSFORMATION OF WALL STREET at 41-42.

[10] Courts have stated that general "obey the law" injunctions are unenforceable. *See, e.g.*, SEC v. Lorin, 76 F.3d 458, 461 (2d Cir. 1996); SEC v. Smyth, 420 F.3d 1225, 1233 n. 14 (11th Cir. 2006).

[11] *See* Jayne W. Barnard, *Corporate Therapeutics*, 2008 COLUM. BUS. L. REV. 793, 833-34 (citing studies that question effectiveness of corporate compliance programs instituted via consent judgments).

supposed success: "Citigroup to Pay $285 Million to Settle SEC Charges for Misleading Investors About CDO Tied to Housing Market." The press release was accompanied by a chart ("SEC Charges Stemming From Financial Crisis") showing monetary recoveries against major financial institutions; the press release concluded by inviting readers to visit the SEC website for information about "dozens of other SEC enforcement actions related to the financial crisis." (SEC Press Rel. 2011-214 (Oct. 19, 2011), at http://www.sec.gov/news/press/2011/2011-214.htm). The prevalence of this practice invites cynicism.[12] Both parties get what they want. The SEC has an opportunity to promote its success, and Citigroup can put the matter behind it and treat the settlement as a "cost of doing business." The matter is swept under the carpet, and the public is left to wonder what really happened.

The SEC asserts that, because its complaint contains detailed allegations of wrongdoing which Citigroup cannot deny, that should conclude the district court's inquiry. According to Director of Enforcement Robert Khuzami, "these are not 'mere' allegations, but the reasoned conclusions of the federal agency responsible

[12] *See* Samuel W. Buell, *Potentially Perverse Effects of Corporate Civil Liability,* in Anthony S. Barkow & Rachel E. Barkow (eds.), USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (NYU Press 2011) at 97, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969836 (recommending that the SEC move away from its culture of "aiming toward a press conference at which the agency announces another large payment from a corporation" because it does not satisfy public's interest in truth and does not provide adequate deterrence).

for the enforcement of the securities laws after a thorough and careful investigation of the facts."[13] The SEC's position effectively leaves no place for judicial review. "Trust us!" says the SEC.

Similarly, during the hearing on the proposed consent judgment, the SEC's attorney stated that "we don't believe … that the public is left wondering what occurred in this case." (Transcript at 13) The district court reasonably found the SEC's assertion "unpersuasive as a matter of fact." (Opinion at 10) It noted that "there is little real doubt that Citigroup contests the factual allegations of the complaint." (Opinion at 9) When the court asked Citigroup's attorney whether his client admitted the allegations, he responded: "We do not admit the allegations, your Honor. *But if it's any consolation*, we do not deny them." (Transcript at 13) (emphasis added) In this appeal Citigroup makes it clear that it does dispute the SEC's allegations:

> Notwithstanding the extensive disclosures [Citigroup] made to these ultra-sophisticated investors in the Class V offering documents and marketing materials, the Complaint alleges that certain disclosures regarding the selection of assets for inclusion in Class V as well as [Citigroup's] or its

[13] Robert Khuzami, Public Statement by SEC Staff: Court's Refusal to Approve Settlement in Citigroup Case (Nov. 28, 2011), *available at* http://www.sec.gov/news/speech/2011/spch112811rk.htm.

affiliates' interests in the transaction were incomplete and misleading. (Citigroup Brief p. 8)

The SEC's willingness to settle, on the basis of Citigroup's flippant statement that "if it's any consolation, we do not deny them," suggests "a rather cynical relationship between the parties" that worried this same judge in a review of a previous SEC proposed consent judgment, *SEC v. Bank of America Corp.*, 653 F. Supp.2d 507, 512 (S.D.N.Y. 2009), and casts into serious doubt the SEC's assertion that the public somehow understands what happened in this case. In the face of the parties' united stance against providing information, the court acted within its discretion in refusing to approve the proposed consent judgment.

It also concerns us that the SEC measures success to a large extent by the number of actions brought. The SEC Chairman and the SEC Director of Enforcement frequently point with pride to the number of enforcement actions filed. For example, Director Khuzami recently testified before a Congressional committee: "… the SEC's enforcement program is achieving significant results. During FY 2011, the Commission filed 735 enforcement actions – more than the SEC has ever filed in a single year."[14] Statements like these bear an unfortunate resemblance to a sheriff's carving notches on his gun to prove his toughness. The

[14] Robert Khuzami, Testimony on "Examining the Settlement Practices of U.S. Financial Regulators" before the House Committee on Financial Services (May 17, 2012), *available at* http://www.sec.gov/news/testimony/2012/ts051712rk.htm.

agency's emphasis on numbers reinforces the concern that the agency has incentives to settle on terms that may not be consistent with the public interest.[15]

In particular, we doubt whether quick and easy settlements are likely to promote deterrence. Although the SEC frequently points with pride to the dollar amounts of settlements,[16] in fact overall settlement amounts have not increased significantly during the past decade and settlements in major "high-value" cases have declined in recent years.[17] In addition, the perception that the SEC's practices do not achieve effective deterrence and that the consent judgments are formulaic and rote is exacerbated because the SEC rarely seeks to hold a defendant in contempt for breach of an injunction against further securities violations.[18] Citigroup and its affiliates have been enjoined from violating securities laws four times since 2000, yet have not been the subject of a contempt proceeding. Indeed, the SEC informed the district court that the SEC "does not appear to have initiated

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[15] *See* Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 HARV. J. L. & PUB. POL'Y 639, 643-47 (2010) (explaining that the SEC's focus on number of cases brought and amount of fines collected is at the expense of more important, but less observable, objectives).

[16] Khuzami Testimony, *supra* note 14 (stating that "the SEC obtained orders in FY 2011 for $2.8 billion in penalties and disgorgement").

[17] John C. Coffee, Jr., *Is the SEC's Bark Worse Than Its Bite?,* NAT. L.J. (July 9, 2012) (reporting on a NERA Economic Consulting survey).

[18] 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 (reporting that an analysis of enforcement actions during the last fifteen years found at least 51 cases in which 19 Wall Street firms had broken antifraud laws they had agreed not to breach).

[civil contempt] proceedings against 'a large financial entity' in the last ten years." (SEC Response to Judge's Questions p. 23) It is difficult to see how the SEC's settlement practices serve to deter future violations, and they contribute to a jaundiced view of the relationship between the agency and the financial industry.[19]

Finally, federal district courts should not be precluded from asking the SEC tough questions because judicial review can lead to beneficial changes in the SEC's practices. For example, in *SEC v. Vitesse Semiconductor Corp.*, 771 F. Supp.2d 304 (S.D.N.Y. 2011), the federal district court pointed out the contradiction of allowing defendants in an SEC enforcement action to settle charges without admitting or denying the allegations after they had previously pleaded guilty in parallel criminal proceedings. Subsequently, the SEC's Division of Enforcement announced that it made a policy change to eliminate the "neither admit-nor-deny" language where defendants had already admitted to, or been criminally convicted of, conduct that formed the basis of the SEC enforcement action.[20] One SEC Commissioner has gone farther and suggested that it may be time to reconsider the agency's general policy of allowing defendant to "neither

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[19] Similarly, the SEC's practice of granting exemptions to major financial institutions from laws and regulations that act as a deterrent to securities fraud contributes to the perception that consent judgments lack real bite. Edward Wyatt, *S.E.C. Is Avoiding Tough Sanctions for Large Banks,* N.Y. TIMES, Feb. 3, 2012, http://www.nytimes.com/2012/02/03/business/sec-is-avoiding-tough-sanctions-for-large-banks.html?pagewanted=all.

[20] Robert Khuzami, Public Statement by SEC Staff: Recent Policy Change (Jan. 7, 2012), *available at* http://www.sec.gov/news/speech/2012/spch010712rsk.htm.

admit nor deny" the allegations in an SEC complaint.[21] If judicial discretion to review consent judgments critically is curtailed, an important impetus to encourage the agency to review and revise its policies is eliminated.

IV. THE DISTRICT COURT'S REFUSAL TO APPROVE THE PROPOSED CONSENT JUDGMENT WILL NOT FORCE THE SEC TO TRY MORE CASES.

The SEC asserts that unless the district court's order is reversed, the parties will be forced to go to trial, which would impose serious constraints on the agency's allocation of resources and "would divert resources away from the investigation of other frauds…."[22] Similarly, Citigroup argues that the district court's order "undermines the ability of private parties to resolve disputes with regulators." (Citigroup brief at 35) Implicit is a warning that the district court's order, if upheld, will impede the agency's "strategy of low cost enforcement."[23]

The parties are wrong on two counts. First, as discussed in Part II, the district court requested information from the parties to meet its judicial responsibility, and only when that information was not forthcoming did it refuse to

[21] SEC Commissioner Luis A. Aguilar, Shining a Light on Expenditures of Shareholder Money (Feb. 24, 2012) *available at* http://www.sec.gov/news/speech/2012/spch022412laa.htm.
[22] Khuzami statement, *supra* note 13.
[23] *See* John C. Coffee, Jr., *Collision Course: The SEC and Judge Rakoff*, N.Y.L.J. (Jan. 19, 2012) (describing the SEC's "strategy of low cost enforcement").

approve the proposed consent judgment in this case. The court did not establish a "bright-line" rule applicable to all proposed consent judgments.

For example, in *SEC v. Vitesse Semiconductor Corp.*, 771 F. Supp. 2d 304 (S.D.N.Y. 2011), the federal district court also expressed doubt initially about approving the proposed consent judgment, because the financial penalties appeared modest in light of the SEC's allegations of serious misconduct over an extended period of time and because the defendants neither admitted nor denied the SEC's allegations. After the SEC provided information that addressed its concerns, the court did approve the proposed consent judgment. With respect to the corporate defendant, the SEC provided information to show that, in fact, the amount of the penalty was substantial in light of the company's precarious financial state and its previous financial contributions to class action settlements. The court also viewed the company's commitment to make these payments, in light of its dire financial condition, as practically an admission of culpability. With respect to the two individual defendants, after the SEC explained that the individual defendants had pleaded guilty to parallel criminal charges, the court reasoned that the public would understand that the SEC allegations were true.

Second, the SEC has available alternatives short of proceeding to trial. In cases similar to the instant one, involving the conduct of major financial institutions during the financial crisis, federal district courts have approved

proposed consent judgments where defendants acknowledged that the SEC has developed probative evidence that supports certain legal conclusions.

For example, contrast what happened in *SEC v. Bank of America Corp.,* 653 F. Supp.2d 507 (S.D.N.Y. 2009), *subsequent opinion*, 2010 WL 624581 (Feb. 22, 2010), with this case. *Bank of America* involved allegations that the Bank made material misstatements of fact in the proxy statement that solicited shareholder approval for the merger with Merrill Lynch. Specifically, the SEC alleged that the proxy statement did not adequately disclose the defendant's agreement to let Merrill Lynch pay certain employees substantial bonuses and the defendant's knowledge of Merrill Lynch's great losses during the fourth quarter of 2008. After the court initially disapproved a proposed consent judgment because of the absence of established facts supporting the proposal, 653 F. Supp. 2d 507, 512, the SEC subsequently presented to the court a 35-page Statement of Facts and a 13-page Supplemental Statement of Facts. At the hearing on the proposed consent judgment, the court asked counsel for the Bank to affirm "that you have no material quarrel with the accuracy of the facts set forth in the SEC statement of facts and that the Court can consider these statements of fact as agreed to for the purposes of evaluating the settlement," to which the Bank counsel responded "That's correct, your Honor." (2010 WL 624581, note 2) After reviewing additional submissions, the court was satisfied that the SEC acted reasonably in

proposing a settlement premised on the assumption that the defendant's nondisclosures were the result of negligence. The court approved the proposed consent judgment because it acknowledged the substantial deference to the SEC that the law requires.[24]

Another example is *Securities and Exchange Commission v. Goldman, Sachs & Co.* (Civ. Action No. 10 Civ. 3229 (S.D.N.Y. filed Apr. 16, 2010), involving allegations similar to those in the instant case. The SEC alleged in its complaint that defendant failed to disclose to investors information about a CDO known as ABACUS 2007-AC1, particularly the role that a hedge fund played in the selection of the portfolio and the fact that the hedge fund had taken a short position against the CDO. In settling that matter, Goldman acknowledged that the marketing materials contained incomplete information and that "it was a mistake" for the marketing materials to state that the portfolio was "selected" by a third party without disclosing the hedge fund's role in the selection process and its adverse interests to the CDO investors.[25] (Goldman Sachs to Pay Record $550

[24] Subsequently, documents filed in private litigation revealed that Bank executives knew about Merrill's vast mortgage losses before its shareholders voted on the merger. Gretchen Morgenson, *Merrill's Losses Were Withheld Before Bank of America Deal,* N.Y. TIMES, June 3, 2012, *available at http://www.nytimes.com/2012/06/04/business/bank-of-america-withheld-loss-figures-ahead-of-merrill-vote.html?pagewanted=all*.

[25] The courts in these cases did not, as a condition of their approval, require defendants to concede that their conduct was intentional or reckless, which would

Million to Settle SEC Charges Related to Subprime Mortgage CDO: Firm Acknowledges CDO Marketing Materials Were Incomplete and Should Have Revealed Paulson's Role, SEC Litig. Rel. No. 21592 (July 15, 2010) at http://www.sec.gov/litigation/litreleases/2010/lr21592.htm)

In these cases, the district courts approved the proposed consent judgments because the parties provided information to enable the court to exercise its independent judgment about whether the proposed consent judgments were fair, reasonable, adequate and in the public interest.

The dilemma the SEC finds itself in now is of its own making: the only reason the agency is required to obtain judicial approval is because its settlement includes injunctive relief. If the SEC does not want judicial review of its settlements, it has other options. The agency could, for example, eliminate the request for injunctive relief. Since the SEC has not brought civil contempt proceedings against a major financial institution in the past ten years, it is unlikely that this would have any appreciable effect on defendants' future conduct.

The SEC also has statutory alternatives to judicial relief. In recent years Congress significantly increased the SEC's power to bring administrative actions against defendants and expanded the availability of relief it can obtain in

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allow private parties to use the consent judgment as offensive collateral estoppel to establish scienter, the requisite intent for private securities fraud litigation.

administrative proceedings. The SEC may obtain permanent cease-and-desist orders against "any person" found to have violated "any provision" of the federal securities laws and may also order the respondent to "comply" with the relevant provision and take steps to ensure future compliance, Exchange Act § 21C(a), 15 U.S.C. § 78u-3(a); Securities Act § 8A(a), 15 U.S.C. § 77h-1(a). The SEC may order disgorgement of profits, Exchange Act § 21B(e), 15 U.S.C. §78u-2(e); Securities Act § 8A(e), 15 U.S.C. § 15 U.S.C. § 77h-1(e); and may also impose monetary penalties in accordance with a statutory three-tier structure, Exchange Act § 21B, 15 U.S.C. § 78u-2; Securities Act § 8A(g), 15 U.S.C. § 77h-1(g). The SEC regularly institutes administrative proceedings against alleged violators of federal securities laws, including major securities firms; *see, e.g.*, *In re AXA Advisors, LLC*, Sec. Exch. Act Rel. No. 66206 (Jan. 20, 2012) (settling allegations of failure to supervise); *In re UBS Sec. LLC*, Sec. Exch. Act Rel. No. 65733 (Nov. 10, 2011) (settling allegation of short-selling violations).

Given these available alternatives that give the agency considerable flexibility, the parties are not persuasive in their claim that the district court's order, if allowed to stand, will wreak havoc on the agency's allocation of resources.

CONCLUSION

Federal district courts play an important role in reviewing proposed consent judgments that include injunctive relief. The district court acted well within its discretion in this case when it refused to approve the proposed consent judgment because it did not have information to determine whether, after giving deference to the agency, the proposed consent judgment was fair, reasonable, adequate, and in the public interest. The SEC's practice of settling enforcement actions alleging serious fraud without any acknowledgement of facts in exchange for modest sanctions, which this case exemplifies, does not further the public interest in ascertaining the truth or deterring future securities laws violations. Finally, affirming the district court's order will not seriously constrain the agency's enforcement efforts, because it has available a number of alternative strategies.

The SEC and Citigroup essentially argue that district court should play no meaningful role in reviewing consent judgments and that the court must give total deference to the desire of the parties to compromise, without taking into account the public interest. This is not the law, nor should it be. This court should affirm the district court's order denying entry of the parties' proposed consent decree.

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