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**Let Judges Judge: Advancing a Review Framework for
Government Securities Settlements Where Defendants Neither
Admit nor Deny Allegations Note**

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Note

LET JUDGES JUDGE: ADVANCING A REVIEW FRAMEWORK FOR GOVERNMENT SECURITIES SETTLEMENTS WHERE DEFENDANTS NEITHER ADMIT NOR DENY ALLEGATIONS

GEORGE L. MILES

It has become increasingly common in the years following the 2008 financial crisis for the public to read news headlines of the latest hundred million dollar settlements reached between the United States federal government and major corporations wherein the defendants do not admit or deny the charges alleged. This Note analyzes why one agency in particular, the Securities and Exchange Commission, has come to rely almost exclusively on these types of settlements, and, through a close examination of a recent case on appeal in the Second Circuit (SEC v. Citigroup Global Markets Inc.), documents how the courts have struggled with allowing them to be finalized due to the absence of sufficient factual support. It concludes that further development of the existing standard for judicial review is needed, and proposes a framework that would increase transparency and accountability surrounding these types of government settlements.

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FRAMEWORK FOR GOVERNMENT SECURITIES
SETTLEMENTS WHERE DEFENDANTS NEITHER ADMIT
NOR DENY ALLEGATIONS

GEORGE L. MILES*

I. INTRODUCTION

The history of the financial markets in the United States since the outset of the twentieth century is a story of periodic, catastrophic failures, starting with the Panic of 1907, through the Stock Market Crash of 1929, to the financial crisis of 2008.¹ In response to each crisis, the federal government enacted new laws or created new regulatory and enforcement agencies to better safeguard the public.² One such agency, the Securities and Exchange Commission (SEC), arose out of the Great Depression with a continuing mission to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”³

While the SEC can point to numerous examples where it has responded with indictments against bad actors,⁴ the agency has regrettably failed to deter multiple recent calamities from the dot-com crash of 2000, to the accounting scandals of 2001–2002 that led to the bankruptcies of Enron and WorldCom, through incidents in the mutual fund market in

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¹ Abigail Tucker, *The Financial Panic of 1907: Running from History*, SMITHSONIAN MAG. (Oct. 10, 2008), http://www.smithsonianmag.com/history-archaeology/1907_Panic.html.

² See, e.g., *Creating the Consumer Bureau*, CFPB, <http://www.consumerfinance.gov/the-bureau/creatingthebureau> (last visited Jan. 16, 2014) (detailing how the recent financial crisis led to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the creation of the Consumer Financial Protection Bureau); see also John C. Coffee, Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1020–21 (2012) (highlighting instances of new legislation following economic catastrophes and discussing the motivations for such legislation).

³ *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last modified June 6, 2013).

⁴ E.g., *SEC Enforcement Actions: Addressing Misconduct that Led to or Arose from the Financial Crisis*, SEC, <http://www.sec.gov/spotlight/enf-actions-fc.shtml> (last modified Sept. 3, 2013).

2003–2004 and stock option backdating in 2006, to the latest crisis.⁵ As a result of this poor performance, one of the SEC’s own Commissioners grimly acknowledged studies that have reported that “79% of investors have no trust in the financial system” and “61% of investors have no confidence in government regulators.”⁶ This is very troublesome considering the still fragile economy⁷ in which almost three-quarters of Americans’ financial assets are invested in securities-related products.⁸

The most frequent and freshest criticism leveled against federal enforcement agencies by the news media and Congress is that those who work in our nation’s largest financial institutions have become “too big to jail.”⁹ While the SEC, which is strictly a civil enforcement entity, has no authority to incarcerate criminals,¹⁰ several financial reporters and legal commentators have argued that the agency’s policies, specifically its overreliance on negotiating backdoor settlements instead of openly prosecuting illegal activity in courts, insufficiently punishes misconduct and is ineffective in deterring risky behaviors that create new crises.¹¹ Indeed, it has been argued that the SEC settles its investigations anywhere from 67%,¹² to 90%,¹³ or 98%¹⁴ of the time, often with recidivist

⁵ John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 712–13 (2009).

⁶ Luis Aguilar, Comm’r, U.S. Sec. & Exch. Comm’n, Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws, Address Before the Securities Enforcement Forum 2012 (Oct. 18, 2012), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171491510>.

⁷ See Jonathan Weisman, *Senate Passes \$3.7 Trillion Budget, Setting Up Contentious Negotiations*, N.Y. TIMES, Mar. 24, 2013, at A20 (quoting U.S. Senator Patty Murray who said “[w]ith an unemployment rate that remains stubbornly high, and a middle class that has seen their wages stagnate for far too long, we simply cannot afford any threats to our fragile recovery”).

⁸ Coffee & Sale, *supra* note 5, at 727.

⁹ E.g., Press Release, Sherrod Brown: Senator for Ohio, Sens. Brown, Grassley Press Justice Department on “Too Big To Jail” (Jan. 29, 2013), available at <http://www.brown.senate.gov/newsroom/press/release/sens-brown-grassley-press-justice-department-on-too-big-to-jail>; Editorial, *Too Big to Fail, Too Big to Jail*, NEW HAVEN REG. (Jan. 1, 2013), <http://www.nhregister.com/general-news/20130101/editorial-too-big-to-fail-too-big-to-jail>.

¹⁰ Robert Khuzami, Dir., U.S. Sec. & Exch. Comm’n Div. of Enforcement, Remarks Before the Consumer Federation of America’s Financial Services Conference (Dec. 1, 2011), available at <http://www.sec.gov/news/speech/2011/spch120111rk.htm>.

¹¹ E.g., Ross MacDonald, Note, *Setting Examples, Not Settling: Toward a New Enforcement Paradigm*, 91 TEX. L. REV. 419, 419–20 (2012); Matt Levine, *Maybe This Time Citi Actually Will Stop Violating Securities Laws, but Don’t Hold Your Breath*, DEALBREAKER (Nov. 8, 2011, 6:49 PM), <http://dealbreaker.com/2011/11/maybe-this-time-citi-actually-will-stop-violating-securities-laws-but-dont-hold-your-breath>.

¹² *Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. 28 (2012) [hereinafter *Settlement Practices Hearing*] (statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

¹³ Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 698 (2012).

¹⁴ MacDonald, *supra* note 11, at 421.

corporations.¹⁵ One specific aspect of these settlements, which allows defendants to settle without admitting or denying the allegations of wrongdoing in a complaint,¹⁶ has garnered considerable negative attention and drawn the ire of several judges tasked with reviewing the agreements.¹⁷

One case in particular, *SEC v. Citigroup Global Markets Inc.*,¹⁸ which is now before the United States Court of Appeals for the Second Circuit,¹⁹ has led to a congressional hearing²⁰ and sparked extensive coverage in the press,²¹ as well as analysis by industry lawyers²² and academics.²³ Around October 2006, various members of Citigroup's financial securities subsidiary Citigroup Global Markets Inc. ("CGMI") allegedly sought to profit by betting against assets from a collateralized debt obligation ("CDO") that CGMI itself structured and marketed.²⁴ Working with another investment company, CGMI created and opened a \$1 billion CDO titled "Class V Funding III" ("Class V III") that closed on February 28, 2007.²⁵ CGMI "exercised significant influence" over the construction of Class V III resulting in subprime residential mortgage-backed securities

¹⁵ Jayne W. Barnard, *Securities Fraud, Recidivism, and Deterrence*, 113 PENN ST. L. REV. 189, 220 (2008).

¹⁶ See 17 C.F.R. § 202.5(e) (2013) ("[T]he Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.").

¹⁷ *Rakoff's Revenge*, ECONOMIST (Apr. 13, 2013), <http://www.economist.com/news/finance-and-economics/21576132-rejections-settlements-financial-institutions-are-catching-rakoffs>.

¹⁸ 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

¹⁹ Peter Lattman, *Court Hears Arguments on Judge's Rejection of S.E.C.-Citigroup Deal*, DEALBOOK (Feb. 8, 2013), <http://dealbook.nytimes.com/2013/02/08/appeals-court-hears-arguments-over-judge-rakoffs-rejection-of-citigroup-settlement>.

²⁰ *Settlement Practices Hearing*, *supra* note 12, at 1–2 (statement of Rep. Spencer Bachus, Chairman, House Committee on Financial Services).

²¹ *E.g.*, David S. Hilzenrath, *Judge Chafes at Size of SEC Deal with Citigroup*, WASH. POST, Nov. 10, 2011, at A16; Nate Raymond, *Appeals Court Hears Arguments in SEC's Case Against Citigroup*, REUTERS (Feb. 8, 2013), <http://www.reuters.com/article/2013/02/08/us-citigroup-sec-appeal-idUSBRE9170YQ20130208>.

²² *E.g.*, William O. Reckler & Blake T. Denton, *Understanding Recent Changes to the SEC's "Neither Admit nor Deny" Settlement Policy*, LATHAM & WATKINS (Jan. 12, 2012), <http://www.lw.com/thoughtLeadership/sec-eliminates-denial-option-for-settling-defendants>; F. Joseph Warin et al., "Potential Game-Changer" at Two Years: The SEC's Use of Deferred and Non-Prosecution Agreements, FINDLAW (May 25, 2012), <http://practice.findlaw.com/practice-guide/-potential-game-changer-at-two-years-the-sec-s-use-of-deferred-.html>.

²³ *E.g.*, Michael C. Macchiarola, "Hallowed by History, but Not by Reason": Judge Rakoff's Critique of the Securities and Exchange Commission's Consent Judgment Practice, 16 CUNY L. REV. 51 (2012).

²⁴ Press Release, U.S. Sec. & Exch. Comm'n, Citigroup to Pay \$285 Million to Settle SEC Charges for Misleading Investors About CDO Tied to Housing Market (Oct. 19, 2011), available at <http://www.sec.gov/news/press/2011/2011-214.htm>.

²⁵ *Id.*

accounting for half of the CDO's value.²⁶ Additionally, CGMI used credit default swaps to purchase \$500 million worth of protection, which amounted, in financial terms, to taking a "short position" on the portfolio.²⁷ In evaluating the CDO, the SEC highlighted experienced traders who commented that "the portfolio is horrible," that the assets are "'dogsh!t' and 'possibly the best short EVER!'"²⁸ Almost nine months after the CDO was put on the market, it defaulted, causing approximately fifteen investors to lose "virtually their entire investments"²⁹ that had an original "face value of approximately \$843 million,"³⁰ while CGMI netted "at least \$160 million" in fees and trading profits.³¹

The general public became familiar with CDOs following the 2008 financial crisis in which these highly complex products magnified the severity of the disaster.³² Investors in CDOs who believed they were either misled or defrauded by marketing materials from bank underwriters or CDO managers have filed numerous lawsuits but, thus far, they have had limited success.³³ Notably, Citigroup alone marketed more than \$20 billion in CDOs during 2007, "most of which failed spectacularly."³⁴ A Citigroup spokesman in 2011 expressed the belief that the Class V III case is the only action the SEC will take concerning its CDOs.³⁵

At issue on appeal in the *Citigroup* case is District Court Judge Jed Rakoff's refusal to approve a settled \$285 million consent judgment reached between the two parties where CGMI neither admitted nor denied the allegations of the SEC complaint.³⁶ Judge Rakoff based his ruling on the failure of the settlement to present enough factual evidence to pass the accepted judicial review standard.³⁷ "whether the proposed Consent Judgment . . . is fair, reasonable, adequate, and in the public interest."³⁸

²⁶ Complaint at 1–2, *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387).

²⁷ *Id.* See generally JEFF CONNAUGHTON, *THE PAYOFF: WHY WALL STREET ALWAYS WINS* 148–49 (2012) (providing more information on short selling securities).

²⁸ Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 24.

²⁹ *Id.*

³⁰ Complaint, *supra* note 26, at 16.

³¹ *Id.* at 3.

³² Fanni Koszeg, *Will CDO Managers Be Held Accountable for Their Role in the Financial Crisis?*, BLOOMBERG BNA (Oct. 22, 2012), <http://www.bna.com/cdo-managers-held-n17179870393/>.

³³ *Id.*

³⁴ Jesse Eisinger & Jake Bernstein, *Did Citi Get a Sweet Deal? Bank Claims SEC Settlement on One CDO Clears It on All Others*, PROPUBLICA (Oct. 20, 2011), <http://www.propublica.org/article/did-citi-get-a-sweet-deal-banks-says-sec-settlement-on-one-cdo-clears-it-on>.

³⁵ *Id.*

³⁶ *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328, 330, 334 (S.D.N.Y. 2011).

³⁷ *Id.* at 330.

³⁸ *Id.* (alteration in original) (quoting Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement at 5, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387)) (internal quotation marks omitted).

Judge Rakoff blamed the SEC for the lack of proof, writing that the agency “has a duty, inherent in its statutory mission, to see that the truth emerges; and if it fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement.”³⁹

While several have commented on how the *Citigroup* case should affect the manner in which the SEC conducts its work in the future⁴⁰ or advocated that Congress should pass new laws to expand the SEC’s powers,⁴¹ no one yet has argued what role the judiciary should play in any change.⁴² Regardless of how the Second Circuit ultimately decides the *Citigroup* case, other judges in other districts have raised issues with or rejected similar settlements,⁴³ and so the topic will not be clearly resolved in the near future. At the heart of the controversy is a separation of powers issue concerning how much discretion federal judges must give executive agencies, and how jurists and regulators do and should consider the public interest when deciding to resolve cases.

This Note does not contend that courts can or should strip the agency of its ability to settle cases on a no admit, no deny (“NAND”) basis. But it argues, based on a careful examination of the history and policy machinations behind NAND settlements, that the current judicial review standard does not appropriately handle the complexity of the issues and interests involved. As this Note’s summary of the *Citigroup* case and others will demonstrate, NAND settlements can lead to the submission of factually deficient court documents that blur the lines of illegal conduct thereby weakening transparency of securities enforcement for the courts and the public. Recidivism by defendants is incited due to the opaqueness of these types of agreements coupled with the fact that they regularly diminish the size and scope of the punishments imposed. Absent a guilty admission of statutory violations, misconduct is written off as a cost of doing business, with the price worth paying because these types of

³⁹ *Id.* at 335.

⁴⁰ *E.g.*, MacDonald, *supra* note 11, at 447.

⁴¹ Letter from Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, to Senator Jack Reed, Chairman, Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., & Urban Affairs (Nov. 28, 2011), available at <http://www.scribd.com/doc/74820022/Mary-Schapiro-s-Letter-to-Senator-Jack-Reed>.

⁴² See Gadinis, *supra* note 13, at 682 (“[A]cademic commentators have largely ignored this area of the law in the last two decades, despite continuous practitioner interest.”).

⁴³ See SEC v. Hohol, No. 14-C-41, 2014 WL 461217 (E.D. Wis. Feb. 5, 2014) (order requesting additional information as to why the court should accept the proposed judgments); SEC v. Bridge Premium Fin., LLC, No. 1:12-cv-02131-JLK-BNB (D. Colo. Jan. 17, 2013) (order denying entry of final judgments); Edward Wyatt, *In Challenging S.E.C. Settlement, a Judge in Wisconsin Cites a Court in New York*, N.Y. TIMES, Dec. 29, 2011, at B4 (discussing a SEC settlement with the Koss Corporation before the Eastern District of Wisconsin); Christopher M. Matthews, *Judge Blasts IBM, SEC Bribery Settlement*, WALL ST. J. (Dec. 20, 2012), <http://online.wsj.com/article/SB10001424127887323777204578192040347143214.html> (summarizing a district court judge’s decision from the District of Columbia that rejected a SEC settlement with IBM).

settlements severely undercut efforts by members of the public who are harmed by violations to recover their losses.⁴⁴

Indeed, the central tradeoff with NAND settlements from a regulatory standpoint is that judgments *without* that provision would collaterally estop (i.e., preclude) the defendants from re-litigating the same allegations in later private civil suits, thereby increasing the probability that investors could successfully recover damages.⁴⁵ By contrast, a NAND settlement compels harmed investors to establish their own evidence to fully recover their losses. This is troubling. Consider, for example, the *Citigroup* case in which only \$285 million was potentially set aside to the group of investors⁴⁶ who collectively lost \$700 to \$843 million.⁴⁷ The investors are left on their own, unable to use the SEC's investigation as a basis for their claims. Given the time and taxpayer money the SEC undoubtedly spent investigating the case, it is worrisome that the current system sanctions settlements where only a fraction of the overall harm (34–41% in *Citigroup*) is penalized and members of the public are given little assistance in addressing the matter. It logically follows that extra costs are shifted onto the courts as well since they must spend more time overseeing private suits that are more drawn-out as a result of the SEC's deal-making.

This Note argues that the interests of the public, especially those of harmed investors, must be given more consideration by those who work at the SEC and in the judiciary, and the *Citigroup* case and those of its ilk present opportunities to cultivate a better enforcement framework that can more productively utilize the energies and balance the interests of the public, the courts, and the SEC. Instead of allowing ineffective NAND agreements to continue in their current form, this Note proposes that the courts are justified in elaborating upon the current standard for settlement review to demand that an adequate set of proven or admitted facts be presented to allow judges to sufficiently review settlements' terms. Agreements that establish a more solid evidentiary foundation will improve the overall enforcement scheme by empowering harmed investors within the general public to pursue private litigation that can further

⁴⁴ *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d at 333–34; see also Aguilar, *supra* note 6 (noting a SEC Commissioner's admission that "[i]n the case of senior executives and other highly-compensated persons, a defendant may very likely view a fine as an inconsequential cost of doing business").

⁴⁵ Brian A. Ochs et al., *Sanctions and Collateral Consequences: The Stakes in SEC Enforcement Actions*, in THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES 181, 242 (Michael J. Missal & Richard M. Phillips eds., 2d ed. 2007).

⁴⁶ Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 3–4, 6.

⁴⁷ There is a discrepancy between the original face value of the investments, \$843 million, Complaint, *supra* note 26, at 16, and the actual losses to investors, which the SEC later argued were "in excess of \$700 million," SEC's Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement at 17, *Citigroup Global Markets Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

discipline the conduct in the financial markets. The occurrence of such astoundingly large settlements of \$550 and \$616 million that have taken place recently⁴⁸ would arguably decrease in the face of a more robust enforcement system.

Part II will survey the factually deficient background of the *Citigroup* case and summarize the central legal arguments surrounding its current appeal to the Second Circuit. Next, Part III will examine the major actors behind public and private securities law enforcement, beginning with an analysis of the SEC, specifically the origin and development of its enforcement program and settlement processes. Part III concludes with a review of the hurdles placed in front of harmed investors seeking to privately recover for losses due to securities fraud. Part IV will assess the traditional role of the judiciary and the evolution of its standards for granting injunctive relief, followed by a brief survey of the SEC's recent case resolution history. Finally, before concluding, Part V will present a novel legal review framework that builds upon existing case law to create a stronger check against improper securities settlements.

II. CONTROVERSY SURROUNDING *SEC V. CITIGROUP GLOBAL MARKETS INC.*

A. *The Initial Filings*

On October 19, 2011, the SEC filed a complaint in the United States District Court for the Southern District of New York alleging that Citigroup's subsidiary CGMI misled investors by "negligently misrepresenting key deal terms" relating to Class V III.⁴⁹ The circular for the fund merely mentioned that "[t]he Initial CDS Asset Counterparty [i.e., CGMI] *may* provide CDS Assets as an intermediary with matching off-setting positions requested by the Manager or *may* provide CDS Assets alone without any off-setting positions."⁵⁰ CGMI buried this information on page 88 of its 192-page marketing document.⁵¹ The SEC argued that though CGMI had interests adverse to those of the other CDO investors, the investors were never put on notice that CGMI had a role in the CDO's asset selection process or that it had a \$500 million short position bet against those same assets.⁵² Put differently, because Class V III contained ultimately worthless subprime mortgage-backed securities,⁵³ CGMI was

⁴⁸ Michael Rothfeld et al., *SAC Hit With Record Insider Penalty*, WALL ST. J., Mar. 16, 2013, at A1.

⁴⁹ Complaint, *supra* note 26, at 3; Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 24.

⁵⁰ Complaint, *supra* note 26, at 15 (emphases added).

⁵¹ *Id.*

⁵² *Id.* at 16.

⁵³ *Id.* at 1; Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 24.

accused of crafting a bad bet and promoting it to clients as a good bet, while the company itself took the actual good bet by shorting the fund.⁵⁴

In relation to CGMI, the SEC submitted separate, additional charges against only one specific individual: former employee Brian Stoker.⁵⁵ The factual allegations in the *Citigroup* complaint indicated that other CGMI employees were also involved in this CDO scheme; however, the SEC was careful not to disclose those individuals by their full names and instead resorted to providing broad title descriptions such as “Trading Desk Head” or “senior Citigroup CDO structurer.”⁵⁶ Similarly, although the *SEC v. Stoker*⁵⁷ complaint alleged that the defendant was the “lead structurer on Class V III,”⁵⁸ it mentioned him regularly communicating with other unnamed Citi executives, indicating that Mr. Stoker was a lower-level employee in the company hierarchy.⁵⁹

The same day that the SEC brought charges, it announced a settlement with CGMI whereby the company would: (1) disgorge itself of \$160 million in alleged “net profits” (plus \$30 million in interest) as well as pay a civil penalty of \$95 million; (2) undertake for three years certain internal measures to prevent similar fraud from happening again; and (3) agree to be permanently restrained and enjoined from future violations alleged in the complaint.⁶⁰ The SEC made no guarantee that it would distribute any of those funds to harmed investors. Instead it merely noted that it “may by motion propose a plan” to do so in the future.⁶¹ CGMI agreed to this settlement “without admitting or denying” the SEC’s allegations.⁶² Since the deal sought future enforcement of the agreement’s terms, it required court approval.⁶³

Toward supporting the settlement’s authorization (also referred to as either a consent judgment or consent decree), the SEC filed a

⁵⁴ Claire A. Hill, *Bankers Behaving Badly? The Limits of Regulatory Reform*, 31 REV. BANKING & FIN. L. 675, 679–80 n.10 (2012).

⁵⁵ Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 4. The SEC brought separate settled charges against the collateral manager for the CDO transaction, Credit Suisse, as well as that company’s portfolio manager responsible for the transaction. Press Release, U.S. Sec. & Exch. Comm’n, *supra* note 24. This Note focuses exclusively on CGMI’s and its employees’ conduct within this fraudulent scheme.

⁵⁶ Complaint, *supra* note 26, at 9.

⁵⁷ 865 F. Supp. 2d 457 (S.D.N.Y. 2012).

⁵⁸ Complaint at 2, *Stoker*, 865 F. Supp. 2d 457 (No. 11 Civ. 7388).

⁵⁹ *See, e.g., id.* at 11 (“[A] Managing Director on Citigroup’s CDO trading desk sent Stoker a list of 21 recent-vintage, mezzanine CDOs on which the CDO trading desk wished to buy protection from the CDO squared.”).

⁶⁰ Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 3–4.

⁶¹ *Id.* at 3–4, 6.

⁶² Proposed Final Judgment as to Defendant Citigroup Global Markets Inc. at 1, *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387).

⁶³ *Id.* at 7.

memorandum to the court centrally arguing the settlement met the judicial evaluation standard in that it was “fair, reasonable, adequate, and in the public interest.”⁶⁴ Additionally, in this filing, the SEC listed nine relevant factors it had identified for determining the extent to which the agency may penalize a corporation:

(i) corporate benefits from the violation; (ii) impact on injured investors and current shareholders; (iii) need for deterrence; (iv) pervasiveness of the conduct; (v) degree of scienter; (vi) extent of the harm to investors; (vii) difficulty of detecting the violations; (viii) voluntary remedial measures; and (ix) extent of the cooperation, if any, with the Commission and other law enforcement agencies.⁶⁵

The SEC added that it “attempts to assess the extent of the sanction that will best serve the interests of investors and the public while maintaining consistency with penalty amounts previously imposed in similar cases.”⁶⁶

The SEC stated it was owed “substantial deference . . . as the regulatory body having primary responsibility for policing the securities markets,”⁶⁷ and that the court “should be satisfied that the penalty reflects an adequate consideration of relevant penalty factors.”⁶⁸ The SEC provided only four short paragraphs outlining *why* the settlement sufficiently satisfied the evaluation standards.⁶⁹ Within those paragraphs the agency restated certain factual allegations, such as the amount it suggested CGMI profited from the fraud, but it did not reference or provide any comparisons to other past SEC-Citigroup settlements, nor did it address certain factors such as the pervasiveness of the deceit in the company or the challenge in discovering the scheme.⁷⁰

B. *Opposition to Settlement*

Judge Rakoff was assigned to this case and on October 27, 2011, he issued an order to the parties where he laid out a series of questions he

⁶⁴ Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 4–5 (quoting SEC v. Bank of Am. Corp, No. 09 Civ. 6829 (JSR), 2009 WL 2842940, at *1 (S.D.N.Y. Aug. 25, 2009)) (internal quotation marks omitted).

⁶⁵ *Id.* at 5–6 (citing Press Release, U.S. Sec. & Exch. Comm’n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), *available at* <http://www.sec.gov/news/press/2006-4.htm>).

⁶⁶ *Id.* at 6.

⁶⁷ *Id.* at 5 (quoting SEC v. Bank of Am. Corp., Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 624581, at *6 (S.D.N.Y. Feb. 22, 2010)) (internal quotation marks omitted).

⁶⁸ *Id.*

⁶⁹ *Id.* at 6–7.

⁷⁰ *Id.*

would ask at a November 9, 2011 hearing toward reaching a decision concerning the consent judgment.⁷¹ Judge Rakoff's inquiries ranged from the methodological (how the SEC calculated the \$95 million penalty) to the philosophical (questioning how judgment can be imposed against someone who neither admits nor denies wrongdoing), permitting the parties to provide written responses in addition to speaking at the hearing.⁷² Further complicating matters were attempts from several outside parties to oppose the deal in court. On November 5, 2011, Better Markets submitted a motion to intervene.⁷³ In its supporting memorandum, Better Markets—a non-profit organization—argued that it should be allowed to object to the proposed settlement primarily because “the SEC has not, is not and will not adequately represent the public interest.”⁷⁴ Judge Rakoff denied Better Markets's motion on grounds presented by the SEC⁷⁵ in the agency's opposition memorandum.⁷⁶ Similarly, three insurance companies involved in private litigation against CGMI requested that they collectively be allowed to file an amicus curiae brief in opposition to the settlement so that the evidence collected by the SEC investigation would “see the light of day.”⁷⁷ Judge Rakoff denied their motion based on arguments made by CGMI.⁷⁸

The news media and industry commentators expressed substantial criticism of the settlement immediately before and after the court hearing, much of which centered on the SEC's failure to acknowledge Citigroup's recent past. Citigroup was characterized as a “serial fraud offender”⁷⁹ and

⁷¹ Order at 1, *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387).

⁷² *Id.* at 1–3.

⁷³ Motion to Intervene Pursuant to Federal Rule of Civil Procedure at 24, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

⁷⁴ Memorandum of Law in Support of Motion to Intervene at 1, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

⁷⁵ Order Denying Motion to Intervene, *Citigroup Global Mrkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

⁷⁶ Plaintiff's Memorandum of Law in Opposition to Motion to Intervene Pursuant to Federal Rule of Civil Procedure at 24, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387). The SEC argued that Better Markets had “no direct, concrete, and legally protected interest in the outcome.” *Id.* at 1. The agency also noted that “there is a presumption that the [SEC] is representing the interests of the public in the financial markets,” and that “Better Markets' disagreement with the terms of the proposed consent judgment does not establish that the public interest is represented inadequately by the [SEC].” *Id.* at 2.

⁷⁷ Union Cent. Life Ins. Co. et al. Notice of Motion and Motion for Leave to File Amicus Curiae Brief at 3, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

⁷⁸ Order Denying Motion to File Amicus Curiae Brief, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

⁷⁹ Matt Taibbi, *Finally, a Judge Stands Up to Wall Street*, TAIBBLOG (Nov. 10, 2011, 10:07 AM), <http://www.rollingstone.com/politics/blogs/taibblog/finally-a-judge-stands-up-to-wall-street-20111110>.

“repeat offender” of violating securities laws.⁸⁰ Reportedly, the SEC had accused CGMI of securities fraud five times since 2003⁸¹ and, in each instance, NAND settlements were reached where Citigroup either consented to a SEC order, barring it from committing the same types of violations again, or to a court injunction.⁸² A Citigroup spokesman denied that the Class V III-related settlement had any connection to these past charges, stating that “[l]ike all other major financial institutions, Citi has entered into various settlements with the S.E.C. over the years and there is no basis for any assertion that Citi has violated the terms of any of those settlements.”⁸³

However the media examined those past deals and seriously questioned why the SEC was not enforcing the terms of its prior agreements with Citigroup. The agency already had two cease-and-desist orders, one from a 2005 settlement and the other from a 2006 case, which barred Citigroup from “future violations of the same section of the securities laws that the company now stands accused of breaking again.”⁸⁴ One commentator suggested that the SEC could have charged Citigroup in its 2011 complaint for violating a different fraud statute such that the agency “could have triggered a violation of a court injunction that Citigroup agreed to in 2003, as part of a \$400 million settlement over allegedly fraudulent analyst-research reports.”⁸⁵ Yet even when the SEC had a prior chance to actually utilize that injunction in another instance involving Citigroup in December 2008, it decided not to ask that the existing court order be enforced but instead reached a new agreement that included a new injunction order.⁸⁶ Finally, in each of the settlements, the agency granted waivers so that Citigroup could continue its business; yet when the company would later be accused of breaking the same laws again, the SEC never revoked any of the prior waivers.⁸⁷

Several commentators also criticized the lack of facts provided by the SEC in support of the proposed 2011 agreement. It was argued the facts alleged in the complaint “suggested deliberate misconduct” by Citigroup and that the one named defendant was simply “a low-level banker who

⁸⁰ *Going to Court to Stop SEC Settlement with Citigroup*, BETTER MARKETS (Nov. 6, 2011, 2:48 PM), <http://bettermarkets.com/blogs/going-court-stop-sec-settlement-citigroup>.

⁸¹ Jonathan Weil, *Citigroup Finds Obeying the Law Is Too Darn Hard*, BLOOMBERG VIEW (Nov. 7, 2011), <http://www.bloomberg.com/news/2011-11-02/citigroup-finds-obeying-the-law-is-too-darn-hard-jonathan-weil.html>.

⁸² *Id.*

⁸³ Edward Wyatt, *Promises Made, and Remade, by Firms in S.E.C. Fraud Cases*, N.Y. TIMES, Nov. 8, 2011, at A1.

⁸⁴ Weil, *supra* note 81.

⁸⁵ *See id.* (claiming the agency “neatly avoided that outcome”).

⁸⁶ *Id.*

⁸⁷ *Id.*

clearly didn't act alone."⁸⁸ It was also noted that the SEC simply provided an estimate of the revenues and benefits Citigroup made from the alleged fraud without disclosing concrete details.⁸⁹ Better Markets's President asserted that, in what then was "the second quickest CDO deal to fail in history," Citigroup made "at least \$624 million and almost certainly much more" while its investors lost "at least \$847 million."⁹⁰

The scale of the settlement, as compared to the largess of Citigroup, was also a point of criticism. The \$95 million penalty in the proposed settlement was described as "a pittance compared with [Citigroup's] \$3.8 billion of earnings last quarter."⁹¹ Better Markets called the settlement "indefensible" and the penalty "so trivial it isn't even a rounding error to the global mega-bank" that has "\$2 trillion in assets and revenues of more than \$20 billion in the last three months."⁹² An analogy was made to "a mugger who steals \$70 from some lady's wallet being sentenced to walk free after paying back twelve bucks."⁹³ The consensus opinion was that "[e]nough is enough."⁹⁴

C. *The SEC and Citigroup Reactions*

In this environment, the SEC submitted a memorandum responding to Judge Rakoff's order that was over four times the length of its original filing supporting the proposed consent judgment.⁹⁵ The agency provided new background information claiming that it had conducted a "thorough investigation" and that the settlement was arrived at after "extensive

⁸⁸ *Id.*

⁸⁹ *Going to Court to Stop SEC Settlement with Citigroup*, *supra* note 80.

⁹⁰ Dennis M. Kelleher, *Are the SEC and Citigroup Deceiving a Federal Judge?*, HUFFINGTON POST BUS. (Nov. 17, 2011), http://www.huffingtonpost.com/dennis-m-kelleher/are-the-sec-and-citigroup_b_1096270.html.

⁹¹ Weil, *supra* note 81.

⁹² *Going to Court to Stop SEC Settlement with Citigroup*, *supra* note 80.

⁹³ Taibbi, *supra* note 79.

⁹⁴ Weil, *supra* note 81; *see also* Taibbi, *supra* note 79 (calling the SEC a "captured regulatory agency" that "does nothing except issue new (soon-to-be-ignored-again) injunctions"); *Going to Court to Stop SEC Settlement with Citigroup*, *supra* note 80 ("Such settlements don't deter crime. They reward it . . ."). *But see* Matt Levine, *So Maybe Citi Created a Mortgage-Backed Security Filled with Loans They Knew Were Going to Fail so that They Could Sell It to a Client Who Wasn't Aware that They Sabotaged It by Intentionally Picking the Misleadingly Rated Loans Most Likely to be Defaulted Upon, So What?*, DEALBREAKER (Oct. 19, 2011, 2:16 PM), <http://dealbreaker.com/2011/10/so-may-be-citi-created-a-mortgage-backed-security-filled-with-loans-they-knew-were-going-to-fail-so-that-they-could-sell-it-to-a-client-who-wasnt-aware-that-they-sabotaged-it-by-intentionally-picking/> (arguing that the investors should have recognized the risk of shorting involved, but acknowledging "the offering document isn't exactly putting reference security quality front-and-center, or making credit analysis transparent").

⁹⁵ Compare SEC's Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement, *supra* note 47 (twenty-nine pages), with Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38 (seven pages).

discussions and negotiations.”⁹⁶ It acknowledged that “[i]t is reasonable to estimate . . . that total investor loss or expected loss with respect to the Class V [III] CDO transaction is in excess of \$700 million,” but noted that “the precise calculation of investor losses is not required in connection with the resolution of an enforcement action brought by the SEC.”⁹⁷ The agency provided no new estimate in terms of how much Citigroup benefited monetarily from the CDO⁹⁸ and thus implicitly stood by its earlier net profits figure rather than revise it to a “gross gain” amount, which is mandated by statute.⁹⁹ The SEC noted, “Citigroup did not provide an extraordinary level of cooperation to the Commission in the investigation of this matter.”¹⁰⁰ The agency also recognized that Citigroup had been subject to prior enforcement actions but failed to state explicitly that recidivism was in fact considered.¹⁰¹

Most significantly, the SEC argued that “[t]he proposed consent judgment embodying this settlement is fair, adequate, and reasonable, and should be entered by this Court,”¹⁰² thereby excluding the “public interest” requirement it had originally asserted.¹⁰³ In a footnote, the SEC argued that:

Although [it] strongly believes that the proposed consent judgment here is in the public interest, that is not part of applicable standard of judicial review. As . . . the Second Circuit has held[,] . . . a consent decree in an SEC enforcement action ‘ought to be approved’ so long as it is not “unfair, inadequate, or unreasonable.”¹⁰⁴

The SEC next asserted that there was a presumption of fairness, adequacy, and reasonableness for the settlement since “the proposed consent judgment here was negotiated at arm’s length between parties represented by experienced counsel after a comprehensive

⁹⁶ SEC’s Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement, *supra* note 47, at 1.

⁹⁷ *Id.* at 17.

⁹⁸ *See id.* at 20 (“Citigroup directly benefited in the amount of approximately \$160 million as a result of the Class V CDO transaction.”).

⁹⁹ *See infra* note 248 and accompanying text.

¹⁰⁰ SEC’s Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement, *supra* note 47, at 21.

¹⁰¹ *See id.* (noting “recidivism is taken into account by the Commission in determining the appropriate penalty in a given case” but not manifestly in *this* case).

¹⁰² *Id.* at 1.

¹⁰³ Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 5 (quoting SEC v. Bank of Am. Corp, No. 09-CV-6829 (JSR), 2009 WL 2842940, at *1 (S.D.N.Y. Aug. 25, 2009)) (internal quotation marks omitted).

¹⁰⁴ SEC’s Memorandum of Law in Response to Questions Posed by the Court Regarding Proposed Settlement, *supra* note 47, at 4 n.1 (citations omitted) (quoting SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991)).

investigation.”¹⁰⁵ Given that presumption, the agency stated that a court may reject the agreement “only if any of the terms appear ambiguous, if the enforcement mechanism is inadequate, if third parties will be positively injured, or if the decree otherwise makes a mockery of judicial power.”¹⁰⁶ The SEC asserted there were no such defects and that ultimately the district court should enter the judgment.¹⁰⁷

The SEC also notably addressed its NAND policy and argued that it sufficiently notifies the public about what took place. It argued that “this approach has succeeded in clearly conveying that the conduct alleged did in fact occur.”¹⁰⁸ The agency also noted that the public filing of the allegations via the complaint creates “transparency regarding misconduct by companies in the securities industry.”¹⁰⁹ Finally it added that “whatever public interest is served by a factual resolution of any disputed issues is likely to be realized in the related proceedings against Mr. Stoker.”¹¹⁰

CGMI also filed a response brief on November 7, 2011, in which it largely deferred to the arguments presented by the SEC.¹¹¹ The company argued for the same legal standard that the agency asserted in its response filing.¹¹² Regardless of whether CGMI considered the public interest to be a review requirement, it advocated that “as a general matter, the ‘public interest’ is served by sophisticated litigants compromising complicated matters in a manner that avoids wasteful litigation and exposing both parties to extreme results.”¹¹³

CGMI also added to the factual background of the case by noting that the SEC’s investigation was a “multi-year inquiry” that created an “extensive record . . . which include[d] the review of over 30 million pages of documents and testimony from several current and former CGMI employees.”¹¹⁴ CGMI argued that there would be “a number of substantial factual and legal issues that would need to be litigated in the absence of a settlement.”¹¹⁵ For instance, it quoted from another page in its circular that

¹⁰⁵ *Id.* at 9.

¹⁰⁶ *Id.* at 10 (quoting *Massachusetts v. Microsoft Corp.*, 373 F.3d 1199, 1236 (D.C. Cir. 2004)).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 12.

¹⁰⁹ *Id.* at 15.

¹¹⁰ *Id.*

¹¹¹ Memorandum on Behalf of Citigroup Global Markets Inc. in Support of the Proposed Final Judgment and Consent at 6, *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387).

¹¹² *See id.* at 5 (citing *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991); *SEC v. WorldCom, Inc.*, 273 F. Supp. 2d 431, 436 (S.D.N.Y. 2003)) (“The standard for judicial review and approval of a proposed consent judgment in an SEC enforcement action is whether the settlement is fair, reasonable, and adequate.”).

¹¹³ *Id.* at 6.

¹¹⁴ *Id.* at 4.

¹¹⁵ *Id.*

“CGMI ‘may be expected to have interests that are adverse to the interests of the Noteholders.’”¹¹⁶ The company emphasized that based on the SEC allegations, there was no deliberate intent or coordination at CGMI to violate the law.¹¹⁷

D. Judge Rakoff’s Response

Media coverage of the hearing on November 9, 2011, characterized Judge Rakoff as “mock[ing] the SEC’s traditional way of doing business” as it concerned its NAND policy, and quoted him describing the agency’s unproven allegations as being “no better than rumor or gossip.”¹¹⁸ The Judge also “suggested that the injunctions are ‘just for show,’” and the requirement that CGMI take remedial steps to prevent future violations amounted to what he called “window dressing.”¹¹⁹ At one point, Judge Rakoff described the SEC’s argument that the court should not consider whether the settlement served the public interest as “[a]n interesting position,” adding that it left him “to exercise [his] power but not [his] judgment.”¹²⁰ Ultimately the Judge did not rule from the bench after the hour-long hearing.¹²¹

Instead he issued a written opinion on November 28, 2011, in which he rejected the parties’ consent judgment and set a trial date.¹²² Judge Rakoff began his opinion by questioning why the SEC chose to charge CGMI only with negligence when it seemed to allege intentional conduct against the company in its complaint against Brian Stoker by stating that:

Citigroup *knew* it would be difficult to place the liabilities of [the Fund] if it disclosed to investors its intention to use the vehicle to short a hand-picked set of [poorly rated assets] By contrast, Citigroup *knew* that representing to investors that an experienced third-party investment adviser had selected the portfolio would facilitate the placement of the [Fund’s] liabilities.¹²³

¹¹⁶ *Id.* (emphasis omitted).

¹¹⁷ *See id.* at 17–19 (“[T]he SEC has elected to charge a mid-level CGMI employee with nonscienter-based violations of the securities laws . . . and no employee senior to Mr. Stoker has been named in these proceedings.”).

¹¹⁸ David S. Hilzenrath, *Judge Chafes at Size of SEC Deal with Citigroup*, WASH. POST, Nov. 10, 2011, at A16.

¹¹⁹ *Id.*

¹²⁰ Jonathan Stempel & Grant McCool, *Update 1—Judge Questions Adequacy of SEC-Citigroup Accord*, REUTERS (Nov. 9, 2011), <http://www.reuters.com/article/2011/11/09/citigroup-sec-idUSN1E7A826C20111109>.

¹²¹ *Id.*

¹²² SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 335 (S.D.N.Y. 2011).

¹²³ *Id.* at 330 (alteration in original) (quoting Complaint, *supra* note 58, at 10) (internal quotation marks omitted).

Judge Rakoff then noted the change in review standards submitted in the SEC's original memorandum as compared to its reply brief, and flatly rejected the notion that the public interest is not a requirement, calling such an assertion "erroneous."¹²⁴ The Judge pointed to opinions from the Supreme Court and the Second Circuit that directed courts in the context of granting injunctive relief to consider the "public interest"¹²⁵ or "public consequences."¹²⁶

Though Judge Rakoff acknowledged he must give "substantial deference to the views of the administrative agency"¹²⁷ in these settlement matters, he rejected the idea that "the S.E.C. is the sole determiner of what is in the public interest."¹²⁸ Without directly citing any authority, the Judge argued that in these types of cases courts must apply "a modicum of independent judgment in determining whether the requested deployment of its injunctive powers will serve, or disserve, the public interest. Anything less would not only violate the constitutional doctrine of separation of powers but would undermine the independence that is the indispensable attribute of the federal judiciary."¹²⁹ On that basis, Judge Rakoff argued he could not conduct an independent analysis because the SEC did "not provide the Court with a sufficient evidentiary basis to know whether the requested relief [was] justified."¹³⁰

Going further, Judge Rakoff did not just question the paucity of facts presented, but also the existence and effects of the SEC's NAND rule, describing it as "hallowed by history, but not by reason," whereby it "deprives the Court of even the most minimal assurance that the substantial injunctive relief it is being asked to impose has any basis in fact."¹³¹ He rejected the SEC's argument that the public should view the allegations as facts because "[a]s a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect."¹³² Distinguishing NAND allegations from the information needed to conduct an independent review, Judge Rakoff indicated that he needed "proven or admitted facts"¹³³ or "proven or acknowledged facts"¹³⁴ and that ultimately, he was not given "any" of those specifics in this case.¹³⁵

¹²⁴ *Id.* at 330–31.

¹²⁵ *Id.* at 331 (citing *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006)).

¹²⁶ *Id.* (quoting *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 24 (2008)).

¹²⁷ *Id.* at 332.

¹²⁸ *Id.* at 331.

¹²⁹ *Id.*

¹³⁰ *Id.* at 332.

¹³¹ *Id.*

¹³² *Id.* at 333.

¹³³ *Id.* at 330.

¹³⁴ *Id.* at 335.

¹³⁵ *Id.* at 330, 335.

Turning to the relevant standard for judicial review,¹³⁶ Judge Rakoff argued that all four requirements—that an agreement be fair, reasonable, adequate, and in the public interest—“inform each other.”¹³⁷ As such, a deal must be “fair to parties *and* to the public.”¹³⁸ Judge Rakoff determined that the proposed settlement, along with the NAND policy, served the narrow interests of just the parties.¹³⁹ He argued that “[i]f the allegations of the Complaint are true, this is a very good deal for Citigroup,”¹⁴⁰ mere “pocket change to any entity as large as Citigroup,”¹⁴¹ and just “a cost of doing business.”¹⁴² He also noted that the agreement “imposes the kind of injunctive relief that Citigroup (a recidivist) knew that the S.E.C. had not sought to enforce against any financial institution for at least the last 10 years.”¹⁴³ Judge Rakoff could not discern what the SEC would achieve beyond getting “a quick headline.”¹⁴⁴

In evaluating the four requirements, Judge Rakoff asserted that notwithstanding “the substantial deference due the S.E.C. in matters of this kind,”¹⁴⁵ “the proposed Consent Judgment is neither fair, nor reasonable, nor adequate, nor in the public interest.”¹⁴⁶ He explained that:

It is not reasonable, because how can it ever be reasonable to impose substantial relief on the basis of mere allegations? It is not fair, because, despite Citigroup’s nominal consent, the potential for abuse in imposing penalties on the basis of facts that are neither proven nor acknowledged is patent. It is not adequate, because, in the absence of any facts, the Court lacks a framework for determining adequacy. And, most obviously, the proposed Consent Judgment does not serve the public interest, because it asks the Court to employ its power and assert its authority when it does not know the facts.¹⁴⁷

Judge Rakoff concluded that if he were to accept the SEC-CGMI agreement without “*some* knowledge of what the underlying facts

¹³⁶ “Whether the proposed Consent Judgment . . . is fair, reasonable, adequate, and in the public interest.” *Id.* at 330 (alteration in original) (quoting Memorandum by Plaintiff Securities & Exchange Commission in Support of Proposed Settlement, *supra* note 38, at 5) (internal quotation marks omitted).

¹³⁷ *Id.* at 331–32.

¹³⁸ *Id.* at 332.

¹³⁹ *Id.* at 333.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 334.

¹⁴² *Id.* at 333.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 330.

¹⁴⁶ *Id.* at 332.

¹⁴⁷ *Id.* at 335.

[were] . . . [then] the court [would] become[] 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.”¹⁴⁸ Having rejected the proposed agreement, Judge Rakoff decided to consolidate the CGMI case with the action against Brian Stoker and directed the parties to prepare for a trial date of July 16, 2012.¹⁴⁹

E. *The Appeal and Stoker Trial*

The SEC quickly reacted to this rejection by vehemently disagreeing with Judge Rakoff’s opinion and interpreting his rhetorical flourishes and desire for admitted facts as an order that it could no longer reach NAND settlements. The SEC Division of Enforcement Director stated that the agency believed “the district court committed legal error by announcing a new and unprecedented standard . . . in requiring an admission of facts—or a trial—as a condition of approving a proposed consent judgment.”¹⁵⁰ In other statements, the SEC sought to justify its NAND settlements (e.g., how they avoid the risk of litigation and conserve budgetary resources) while also arguing that the monetary penalties would go to harmed investors.¹⁵¹

Both the SEC and Citigroup filed appeals to Judge Rakoff’s decision.¹⁵² Following a hearing, a court of appeals merit panel filed a per curiam opinion on March 15, 2012, granting a permanent stay until another panel in the future could decide whether or not Judge Rakoff’s rejection of the consent judgment should be set aside.¹⁵³ While this panel stated that “we are satisfied . . . that the S.E.C. and Citigroup have made a strong showing of likelihood of success in setting aside the district court’s rejection of their settlement,” they also noted that they had “not had the benefit of adversarial briefing.”¹⁵⁴ As such, they added that “[t]he merits panel is, of course, free to resolve all issues without preclusive effect from this ruling.”¹⁵⁵ On March 16, 2012, the court appointed John Wing, a

¹⁴⁸ *Id.* at 332 (emphasis added).

¹⁴⁹ *Id.* at 335.

¹⁵⁰ Robert Khuzami, Director, U.S. Sec. & Exch. Comm’n Div. of Enforcement, SEC Enforcement Director’s Statement on Citigroup Case (Dec. 15, 2011), available at <http://www.sec.gov/news/press/2011/2011-265.htm>.

¹⁵¹ Robert Khuzami, Director, U.S. Sec. & Exch. Comm’n Div. of Enforcement, 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>; Khuzami, *supra* note 10.

¹⁵² Citigroup Global Markets Inc.’s Memorandum in Support of the Securities and Exchange Commission’s Motion for a Stay Pending Appeal, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387); SEC’s Memorandum of Law in Support of its Motion for Stay Pending Appeal, *Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328 (No. 11 Civ. 7387).

¹⁵³ SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158, 161 (2d Cir. 2012) (per curiam).

¹⁵⁴ *Id.* at 161, 169.

¹⁵⁵ *Id.* at 161.

former colleague of Judge Rakoff, to serve as pro bono counsel and advocate for the district court's position.¹⁵⁶

During the summer of 2012, while the *Citigroup* appeal was pending, the *Stoker* case proceeded through discovery and trial.¹⁵⁷ Through filed court documents in *Stoker*, the SEC revised the total losses by investors to \$893 million, and finally revealed that CGMI's gains from the CDO were \$284 million—a figure much higher than the \$160 million net profits provided in the CGMI filings.¹⁵⁸ Also, in Mr. Stoker's motion for summary judgment he “name[d] names” specifically identifying other CGMI individuals that he alleged were part of the Class V III deal.¹⁵⁹ Judge Rakoff rejected his motion, reasoning that just because Mr. Stoker was one of many people involved did not absolve him of liability for his actions.¹⁶⁰

Yet after a two-week trial in July 2012, a jury found Mr. Stoker not liable.¹⁶¹ Reportedly, his counsel gave an effective final argument utilizing the “Where's Waldo?” defense, which is based on a children's book that challenges readers to find the titular character.¹⁶² Mr. Stoker's attorney argued that his client was just a small part of the CDO and that “[m]ost of [the] trial had nothing to do with Brian Stoker.”¹⁶³ What this defense boiled down to was that even though Mr. Stoker participated in the grand scheme, he had limited authority and was being made a scapegoat for the company's misconduct.¹⁶⁴

Jury comments afterward matched defense counsel's conclusion. One jury member stated “I'm not saying that Stoker was 100 percent innocent, but Stoker structured a deal that his bosses told him to structure, so

¹⁵⁶ Jonathan Stempel, *Rakoff Turns to Ex-Colleague for U.S. SEC-Citi Appeal*, REUTERS (Mar. 16, 2012), <http://www.reuters.com/article/2012/03/16/us-citigroup-sec-lawyer-idUSBRE82F1F620120316>.

¹⁵⁷ Brief of Better Markets, Inc. as Amicus Curiae in Support of Pro Bono Counsel Appointed to Advocate for Affirmance of the District Court's Order at 30–31, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv); Susan Beck, *What Will We Learn from the SEC's Case Against Citi's Brian Stoker?*, CORP. COUNS. (July 13, 2012), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202562738776&What_Will_We_Learn_From_the_SECs_Case_Against_Citi's_Brian_Stoker.

¹⁵⁸ Brief of Better Markets, Inc. as Amicus Curiae in Support of Pro Bono Counsel Appointed to Advocate for Affirmance of the District Court's Order, *supra* note 157, at 35 n.24, 42.

¹⁵⁹ Beck, *supra* note 157.

¹⁶⁰ *Id.*

¹⁶¹ Litigation Release No. 22541, U.S. Sec. & Exch. Comm'n, *Brian Stoker Found Not Liable* (Nov. 21, 2012), [available at http://www.sec.gov/litigation/litreleases/2012/lr22541.htm](http://www.sec.gov/litigation/litreleases/2012/lr22541.htm).

¹⁶² Peter Lattman, *S.E.C. Gets Encouragement from Jury that Ruled Against It*, DEALBOOK (Aug. 3, 2012), <http://dealbook.nytimes.com/2012/08/03/s-e-c-gets-encouragement-from-jury-that-ruled-against-it/>.

¹⁶³ *Id.*

¹⁶⁴ Peter J. Henning, *S.E.C. Gets Encouragement, but Needs Something More*, DEALBOOK (Aug. 6, 2012), <http://dealbook.nytimes.com/2012/08/06/s-e-c-gets-encouragement-but-needs-something-more/>.

why didn't they go after the higher-ups rather than a fall guy?"¹⁶⁵ The jury foreman called CGMI's actions "appalling" and added that "[t]his was not a verdict about Citi being absolved of any wrongdoing."¹⁶⁶ To back up this assertion, the jurors "did something extremely rare" and issued a statement in conjunction with their verdict.¹⁶⁷ Judge Rakoff read aloud that statement in court saying "[t]his verdict should not deter the [SEC] from continuing to investigate the financial industry, review current regulations and modify existing regulations as necessary."¹⁶⁸ The SEC decided not to appeal the jury's decision.¹⁶⁹

The *Stoker* resolution clearly affected the *Citigroup* appeal, as evidenced by the pro bono counsel's brief in which he noted that thanks to the *Stoker* trial, "the district court has a substantial evidentiary record upon which to assess the proposed consent judgment on remand if the appeal is denied or dismissed."¹⁷⁰ However, before addressing pro bono counsel's arguments further, both the SEC and CGMI had filed their principal briefs in May 2012 prior to the conclusion of the *Stoker* trial.¹⁷¹ Consistent with its prior statements, the SEC's brief principally argued that Judge Rakoff was seeking to impose a "bright-line rule" preventing its ability to enter NAND consent decrees in the future and that this infringed on the independence of the agency.¹⁷² Among other issues, the SEC also argued that the \$285 million settlement met the judicial review standard because it represented "more than 80% of what it could have reasonably expected to obtain if it prevailed at trial."¹⁷³ CGMI made many similar arguments in its briefs that echoed the SEC's.¹⁷⁴

The pro bono counsel filed his only brief in August 2012,¹⁷⁵ and he rejected the settling parties' description of Judge Rakoff's opinion. Centrally, he argued that "[t]he ruling did not state that the 'proof' or 'facts' need[ed] to be tantamount to proof of *liability*—a term which easily

¹⁶⁵ Lattman, *supra* note 162.

¹⁶⁶ Susan Beck, *Susan Beck's Summary Judgment: Second Circuit Redeems Itself in SEC-Citi Oral Arguments*, AMLAW LITIG. DAILY (Feb. 13, 2013), http://www.americanlawyer.com/digestTAL.jsp?id=1202588044802&Susan_Becks_Summary_Judgment_Second_Circuit_Redeems_Itself_in_SEC_Citi_Oral_Arguments.

¹⁶⁷ Lattman, *supra* note 162.

¹⁶⁸ *Id.*

¹⁶⁹ Litigation Release No. 22541, U.S. Sec. & Exch. Comm'n, *supra* note 161.

¹⁷⁰ Brief of Appointed Pro Bono Counsel for the United States District Court at 4–5, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158 (2d Cir. 2012) (No. 11-5227-cv).

¹⁷¹ Brief of the Securities & Exchange Commission, Appellant/Petitioner, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv); Brief of Defendant-Appellee-Cross-Appellant, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv).

¹⁷² Brief of the Securities & Exchange Commission, Appellant/Petitioner, *supra* note 171, at 2.

¹⁷³ *Id.* at 50.

¹⁷⁴ Brief of Defendant-Appellee-Cross-Appellant, *supra* note 171, at 15–17.

¹⁷⁵ Brief of Appointed Pro Bono Counsel for the United States District Court, *supra* note 170.

could have been employed had the court so intended.”¹⁷⁶ Instead, he explained, Judge Rakoff could not approve the settlement because he “had not been provided with *any* ‘evidentiary basis,’ *any* ‘factual base,’ ‘*any* proven or acknowledged facts,’ or any other factual showing whatsoever on which to make the requisite determination.”¹⁷⁷ The pro bono counsel argued that what the SEC actually presented was merely “a bare-bones and largely conclusory seven-page memorandum.”¹⁷⁸ He also noted the conflict between the state of mind allegations as presented in the *Citigroup* and *Stoker* complaints (intentional conduct) and the actual charge made against CGMI (negligence), along with the lack of explanation for providing net profits instead of gross gain.¹⁷⁹ He added that the parties could have provided the court with additional information similar to what was done for other cases.¹⁸⁰

Both the SEC and CGMI filed reply briefs in September 2012, in which each argued that the pro bono counsel incorrectly interpreted Judge Rakoff’s decision.¹⁸¹ The SEC argued again that the ruling “establishe[d] a bright-line rule that ha[d] no support in the law.”¹⁸² Similarly, CGMI asserted that Judge Rakoff’s opinion “was extreme and unprecedented.”¹⁸³

Oral arguments for the appeal were heard in February 2013, in which the parties’ arguments generally reflected what they presented in their briefs. Notably the panel appeared to conclusively reject the SEC and CGMI argument that Judge Rakoff created a bright-line rule against NAND settlements as one of the judges on the panel described that issue as a “red herring.”¹⁸⁴ As of February 2014, the panel has yet to issue an opinion. The interest in this case has never abated as several other individuals or organizations, including former SEC Chairman Harvey Pitt,¹⁸⁵ various securities law professors,¹⁸⁶ and a group representing

¹⁷⁶ *Id.* at 2.

¹⁷⁷ *Id.* at 1–2 (quoting *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328, 332, 335, (S.D.N.Y. 2011)).

¹⁷⁸ *Id.* at 14.

¹⁷⁹ *Id.* at 2–3.

¹⁸⁰ *Id.* at 4.

¹⁸¹ Reply Brief of Defendant-Appellee-Cross-Appellant at 1, *SEC v. Citigroup Global Mkts. Inc.*, 673 F.3d 158 (2d Cir. 2012) (No. 11-5227-cv); Reply Brief of the Securities & Exchange Commission, Appellant/Petitioner at 2, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv).

¹⁸² Reply Brief of the Securities & Exchange Commission, Appellant/Petitioner, *supra* note 181, at 10.

¹⁸³ Reply Brief of Defendant-Appellee-Cross-Appellant, *supra* note 181, at 1–2.

¹⁸⁴ Nate Raymond, *Appeals Court Hears Arguments in SEC’s Case Against Citigroup*, REUTERS (Feb. 8, 2013), <http://www.reuters.com/article/2013/02/08/us-citigroup-sec-appeal-idUSBRE9170YQ20130208>.

¹⁸⁵ Brief of Amicus Curiae Former Securities and Exchange Commission General Counsel and Chairman, Harvey Pitt in Support of Affirmance of District Court’s Ruling, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv).

Occupy Wall Street¹⁸⁷ each submitted amicus briefs for the consideration of the appeal panel. Additionally, the courtroom for the panel's oral arguments was so overcrowded that more than fifty people had to watch it on closed-circuit television in another room.¹⁸⁸

Ultimately, the *Citigroup* case raises serious policy concerns about the current effectiveness of the U.S. securities enforcement structure and calls into question the proper roles and responsibilities of the SEC, the judiciary, and the public. The remaining Parts of this Note will provide background for these various groups, explore major historical trends involving each, and analyze whether and how change is possible.

III. THE PLAINTIFFS AND DEFENDANTS IN SECURITIES LAW

A. Federal Regulatory Philosophy and the SEC Enforcement Organization

To understand the proper level of deference owed to the SEC in cases like *Citigroup*, the agency's current capabilities and limitations must first be recognized along with how they affect its decision-making process and, consequently, the interests of defendants and harmed investors. Originally, the most significant developments in this regard were the passages of the Securities Act of 1933¹⁸⁹ (the "Securities Act"), and the Securities Exchange Act of 1934¹⁹⁰ (the "Exchange Act"), which created the SEC.¹⁹¹ Unlike state regulators, who may actively judge the merits of or oversee the quality of a new securities offering through their "blue sky" statutes, the SEC model, embracing a full disclosure philosophy that does not approve or guarantee the soundness of the financial product, is more passive.¹⁹² This was by design, as President Roosevelt recommended passage of the Securities Act by emphasizing that it would "protect the public with the least possible interference to honest business."¹⁹³

¹⁸⁶ Brief of Amici Curiae Securities Law Scholars to Advocate for Affirmance in Support of the District Court's Order and Against Appellant and Appellee, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv).

¹⁸⁷ Proposed Brief of Amicus Curiae Occupy Wall Street-Alternative Banking Group in Support of the Public Interest and Against Appellant and Appellee, *Citigroup Global Mkts. Inc.*, 673 F.3d 158 (No. 11-5227-cv).

¹⁸⁸ William Alper, *Oral Argument in SEC v. Citigroup*, SEC. L. PROF BLOG (Feb. 8, 2013), <http://lawprofessors.typepad.com/securities/2013/02/oral-argument-in-sec-v-citigroup.html>.

¹⁸⁹ Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 [hereinafter "Securities Act"] (codified as amended at 15 U.S.C. §§ 77a-77aa (2012)).

¹⁹⁰ Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 [hereinafter "Exchange Act"] (codified as amended at 15 U.S.C. §§ 78a-78pp (2012)).

¹⁹¹ *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

¹⁹² ROBERTA S. KARMEL, REGULATION BY PROSECUTION 41-42 (1982).

¹⁹³ *Id.* at 42.

The dominant rationale for disclosure is that providing all investors, large or small, with more comprehensive and accurate information will generate more informed and intelligent investment decisions that in turn will lead to more fairly priced products and, consequently, make price manipulation more difficult.¹⁹⁴ The cornerstones of this approach are the Securities Act (referred to as the “truth-in-securities law”), which requires issuers to reveal the financial underpinnings of their securities products, and the Exchange Act, which compels registration of exchanges and broker-dealers along with other reporting provisions.¹⁹⁵ While “[d]isclosures must not be misleading, either affirmatively or by half-truth or omission,”¹⁹⁶ that edict alone cannot guarantee stable and efficient markets; policemen are needed to provide a backstop to punish violators and ensure all participants are following the rules.

The SEC provides this watchdog function through its Division of Enforcement (DOE), which has arguably become its principal segment as exhibited by the agency today, openly describing itself as “[f]irst and foremost . . . a law enforcement agency.”¹⁹⁷ The DOE is divided into five specialized units with a nationwide scope, which investigate and prosecute securities law violations across several subject areas such as foreign corrupt practices and municipal securities.¹⁹⁸ Typical conduct investigated by the agency includes providing false or misleading information about securities, selling unregistered products, breaching fiduciary duties, and engaging in insider trading.¹⁹⁹

The SEC has enormous discretion to conduct investigations “as it deems necessary to determine whether any person has violated, is violating, or is about to violate” federal securities laws.²⁰⁰ Its powers are exercised by the DOE’s staff, which include attorneys, accountants, and other professionals.²⁰¹ The SEC gains investigative leads from whistleblowers, the news media, auditors, self-regulatory organizations, and other financial industry sources.²⁰² However, the agency usually lags

¹⁹⁴ SUSAN M. PHILLIPS & J. RICHARD ZECHER, *THE SEC AND THE PUBLIC INTEREST* 28 (1981).

¹⁹⁵ *Id.* at 9–10. Registration of new securities requires completing certain reports (e.g., S-7, S-14), and registered corporations must periodically submit certain forms (e.g., 10-K, 10-Q) as part of this SEC disclosure system. *Id.* at 28.

¹⁹⁶ Coffee & Sale, *supra* note 5, at 761.

¹⁹⁷ *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

¹⁹⁸ Khuzami, *supra* note 10.

¹⁹⁹ *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

²⁰⁰ Exchange Act, 15 U.S.C. § 78u(a)(1) (2012).

²⁰¹ Richard M. Phillips et al., *SEC Investigations: The Heart of SEC Enforcement Practices*, in *THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES*, *supra* note 45, at 35, 39.

²⁰² David M. Becker, *What More Can Be Done to Deter Violations of the Federal Securities Laws?*, 90 TEX. L. REV. 1849, 1869 (2012).

behind marketplace developments, and a former Commissioner described it as being “always in a reactive mode” rather than acting proactively.²⁰³

There are two types of SEC investigations: informal and formal, with the former usually leading to the latter.²⁰⁴ An informal investigation involves examining brokerage records, reviewing trading data, and interviewing witnesses, while a formal type allows the agency to issue subpoenas that may compel testimony or document production.²⁰⁵ A typical SEC investigation begins informally by DOE staff,²⁰⁶ and formal investigation orders are issued at the discretion of the Division’s Director.²⁰⁷

SEC enforcement actions are based on DOE recommendations, which are developed after months or years of building a comprehensive evidentiary record.²⁰⁸ The DOE substantiates its recommendations through “action memoranda” that lay out the factual and legal foundations for its cases, and which are presented for the consideration of the SEC Commissioners.²⁰⁹ The Commissioners decide at a formal meeting whether to bring violation charges, what type of actions to bring, the entities or persons to be named as defendants or respondents, and what relief to seek.²¹⁰ They will also usually ask the staff’s opinion regarding the terms that might appropriately resolve a case in advance of their meeting.²¹¹

Overall, the SEC seeks to ensure that “it has a sound basis for its allegations, and can meet statutory elements of the relief it is seeking.”²¹² An action recommendation is approved by a majority vote so long as there is a quorum of three or more Commissioners.²¹³ Most recommendations are approved.²¹⁴ They can authorize staff to bring an administrative action,

²⁰³ Roberta S. Karmel, *Creating Law at the Securities and Exchange Commission: The Lawyer as Prosecutor*, 61 L. & CONTEMP. PROBS. 33, 35 (1998). The SEC is led by a group of five Commissioners, one of whom is designated as Chairman, who are selected by the President and confirmed by the Senate. *Id.* at 38.

²⁰⁴ 6 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 16.2[7] (West, Westlaw through Jan. 2014).

²⁰⁵ *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

²⁰⁶ Phillips et al., *supra* note 201, at 44.

²⁰⁷ 6 HAZEN, *supra* note 204, § 16.2[7].

²⁰⁸ *Settlement Practices Hearing*, *supra* note 12, at 75 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

²⁰⁹ OFFICE OF CHIEF COUNSEL, SEC DIV. OF ENFORCEMENT, ENFORCEMENT MANUAL 25 (2013), available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

²¹⁰ Danné L. Johnson, *SEC Settlement: Agency Self-Interest or Public Interest*, 12 FORDHAM J. CORP. & FIN. L. 627, 644 (2007).

²¹¹ Brief of Amicus Curiae Former Securities and Exchange Commission General Counsel and Chairman, Harvey Pitt in Support of Affirmance of District Court’s Ruling, *supra* note 185, at 12.

²¹² *Id.* at 13.

²¹³ OFFICE OF CHIEF COUNSEL, *supra* note 209, at 26.

²¹⁴ Johnson, *supra* note 210, at 644.

file a case in federal court, or both.²¹⁵ Except under extraordinary circumstances, the SEC Commissioners do not read or review complaints before they are filed for civil enforcement actions and instead delegate their construction to DOE staff.²¹⁶

Usually, the agency will announce an enforcement action by publicly distributing a litigation release.²¹⁷ According to the SEC, the time it takes to start an investigation and ultimately resolve a case varies from one to three years for cases concluding in settlements, and two to four years for cases that go to trial (with another one to three years added to that if appealed).²¹⁸ Generally, civil actions are subject to a five year statute of limitations.²¹⁹

B. *The SEC Enforcement Powers*

The type of action brought, whether civil or administrative, dictates the type of sanction or relief the SEC can seek. In either setting, the agency can seek the return of illegal profits or the imposition of monetary penalties.²²⁰ While the administrative process has its own unique features,²²¹ this Note will focus primarily on civil actions like the *Citigroup* case. Exclusive to the civil course, the SEC can ask a federal district court to bar or suspend an individual from serving as a corporate officer or director, as well as for an injunction (i.e., a court order) to require certain supervisory arrangements or prohibit any further acts or practices that violate the law or the agency's rules.²²²

Injunctions have been the bedrock of the SEC's enforcement program since the agency's founding.²²³ The Securities Act empowers the agency to seek both temporary and permanent injunctive relief in federal court "[w]henever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will

²¹⁵ *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

²¹⁶ Brief of Amicus Curiae Former Securities and Exchange Commission General Counsel and Chairman, Harvey Pitt in Support of Affirmance of District Court's Ruling, *supra* note 185, at 23.

²¹⁷ 6 HAZEN, *supra* note 204, § 16.2[2][A].

²¹⁸ *Settlement Practices Hearing*, *supra* note 12, at 13 (statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

²¹⁹ OFFICE OF CHIEF COUNSEL, *supra* note 209, at 38.

²²⁰ *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

²²¹ *See id.* (describing how the agency can request "cease and desist orders, suspension or revocation of broker-dealer and investment advisor registrations, censures, [and] bars from association with the securities industry").

²²² *Id.*

²²³ David M. Weiss, Note, *Reexamining the SEC's Use of Obey-the-Law Injunctions*, 7 U.C. DAVIS BUS. L.J. 239, 240 (2006).

constitute a violation.²²⁴ The other major federal securities laws, including the Exchange Act, the Investment Company Act of 1940, and the Investment Advisers Act of 1940, each provide the SEC with similar authorization.²²⁵

The Supreme Court has characterized injunctive relief as “a drastic remedy, not a mild prophylactic.”²²⁶ Despite that characterization, an injunction cannot provide direct punishment unless someone violates its terms, and arguably its most substantial effects are its ancillary consequences, as broker-dealers, investment advisers, and other participants in the securities industry may be suspended or barred based solely on the issuance of an injunction if the SEC decides to act through an administrative hearing.²²⁷ Typically the agency undertakes that course of action.²²⁸

The SEC DOE Director has argued that injunctions “put the public on notice” about violations, and forces companies to establish, fund, and implement compliance programs to prevent future unlawful conduct.²²⁹ If a party breaches the terms of an agreement, then an injunction becomes “among the most formidable weapons” available to the courts.²³⁰ In this situation, the SEC does not have to do anything, and instead will expect a court to provide injunctive relief and enforce a contempt charge.²³¹ Civil contempt requires a party to cease any ongoing violations of the injunction.²³²

Beyond injunctive relief the SEC can impose two types of monetary sanctions: disgorgement and fines. The first type deprives violators of their unjust enrichment and orders them to give up any ill-gotten gains acquired, including pre-judgment interest.²³³ Though the Exchange Act did not expressly provide for such relief, the courts in 1971 found the SEC had the authority to seek restitution and disgorgement through its ability to pursue injunctions.²³⁴

The second type of monetary sanction, penalties and fines, has

²²⁴ Securities Act, 15 U.S.C. § 77t(b) (2012).

²²⁵ Exchange Act, 15 U.S.C. § 78u(d)(1) (2012); Investment Company Act of 1940, 15 U.S.C. § 80a-35(a) (2012); Investment Advisers Act of 1940, 15 U.S.C. § 80b-9(d) (2012).

²²⁶ Aaron v. SEC, 446 U.S. 680, 703 (1980) (Burger, J., concurring).

²²⁷ Ochs et al., *supra* note 45, at 187.

²²⁸ Gadinis, *supra* note 13, at 691.

²²⁹ Khuzami, *supra* note 10.

²³⁰ United States v. Local 1804-1, Int'l Longshoremen's Ass'n, AFL-CIO, 44 F.3d 1091, 1095–96 (2d Cir. 1995).

²³¹ Macchiarola, *supra* note 23, at 74.

²³² Khuzami, *supra* note 10; *see also* Int'l Union, United Mine Workers of Am. v. Bagwell, 512 U.S. 821, 827 (1994) (describing civil contempt as being “designed to compel future compliance”).

²³³ Gadinis, *supra* note 13, at 690.

²³⁴ Adam S. Zimmerman, *Distributing Justice*, 86 N.Y.U. L. REV. 500, 527–28 (2011) (citing SEC v. Tex. Gulf Sulphur Co., 446 F.2d 1301, 1307–08 (2d Cir. 1971)).

expanded over time. Before 1984, the entirety of the SEC's civil penalty authority was found in a single provision of the Exchange Act that permitted a \$100 per day penalty against issuers who failed to file certain statutorily required reports.²³⁵ But the passage of three statutes by Congress—namely, the Insider Trading Sanctions Act of 1984 (“ITSA”),²³⁶ the Insider Trading and Securities Fraud Enforcement Act of 1988 (“ITSFEA”),²³⁷ and the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the “Remedies Act”)²³⁸—increasingly broadened the agency's authority to seek damages or impose penalties.²³⁹

Historically, the SEC *did not* distribute funds it recovered to harmed investors but the Remedies Act changed this by directing the agency to design rules so that it could do so.²⁴⁰ The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”),²⁴¹ further developed this process by permitting the SEC to create “Fair Funds” accounts for injured investors whereby they can recover portions of any disgorgement or penalties received through an agency action.²⁴² However, unless they were originally assigned to create a Fair Funds distribution plan, injured investors are only afforded the ability to comment on a proposed plan and cannot formally intervene or challenge it.²⁴³ Usually “[t]he amount of an investor's claim is divided by the total amount of claims and then multiplied by available funds in the settlement.”²⁴⁴ Administrative costs of any distribution are subtracted from any amounts returned.²⁴⁵ If there are no harmed investors, or the amounts obtained are more than the harm caused, then the funds recovered are sent

²³⁵ Aguilar, *supra* note 6, n.33.

²³⁶ Pub. L. No. 98-376, 98 Stat. 1264.

²³⁷ Pub. L. No. 100-704, 102 Stat. 4677 (codified as amended at 15 U.S.C. §§ 78t-1, 78u-1, 80b-4a (2012)).

²³⁸ Pub. L. No. 101-429, 104 Stat. 931 (codified as amended at 15 U.S.C. §§ 78u-2, 78u-3, 78q-2 (2012)).

²³⁹ As they related to violations of the Exchange Act specifically, ITSA increased the maximum fine to \$100,000, and ITSFEA enhanced that amount to \$1 million for individuals and \$2.5 million for non-natural persons. MacDonald, *supra* note 11, at 424 (citing § 3, 98 Stat. at 1265; § 4, 102 Stat. at 4680). The Remedies Act authorized both the SEC and the courts in civil actions to impose monetary penalties for violations relating to the Securities Act and the Exchange Act with amounts based upon the gravity and magnitude of the violations caused or threatened. § 101, 104 Stat. at 932–33; § 201, 104 Stat. at 936–37.

²⁴⁰ Zimmerman, *supra* note 234, at 527–28 (citing 104 Stat. at 937–38).

²⁴¹ Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 and 18 U.S.C.).

²⁴² 15 U.S.C. § 7246 (2012).

²⁴³ 17 C.F.R. §§ 201.1101, 201.1103, 201.1106 (2013).

²⁴⁴ Zimmerman, *supra* note 234, at 532.

²⁴⁵ Richard M. Phillips & Brian A. Ochs, *Settlements: Minimizing the Adverse Effects of an SEC Enforcement Action*, in THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES, *supra* note 45, at 255, 277.

to the U.S. Treasury,²⁴⁶ which was the required practice prior to the passage of Sarbanes-Oxley.²⁴⁷

Taken all together, the SEC can presently penalize through two methods: first, through a per-violation calculation that is subject to certain caps, or second, through a calculation that allows for a fine equal to the “gross amount of the pecuniary gain” to the defendant “as a result of the violation.”²⁴⁸ The gross gain penalty is generally available only in federal courts.²⁴⁹ In practice, if a violator causes \$10 million in investor harm while profiting by \$2 million, the maximum amount the SEC could recover under this scheme would be \$4 million (i.e., \$2 million disgorging the profit and \$2 million for a penalty equaling the gain).²⁵⁰

It should be noted though that a SEC action involving disgorgement and penalty by gross gain does not necessarily need to be symmetrical. In one recent case the SEC settled with Goldman Sachs for a disgorgement of \$15 million coupled with a penalty of \$535 million,²⁵¹ and in another action involving Citigroup, the agency settled for disgorgement of only \$1 million matched with a penalty of \$75 million.²⁵² Thus, just because the SEC can seek maximum recovery in any action does not necessarily mean that it actually does or will in the future.

C. *The Basics Behind and Central Justifications for SEC Settlements*

Settlement is the civil analogue to criminal plea bargaining; “a truce more than a true reconciliation . . . [that] seems preferable to judgment because it rests on the consent of both parties and avoids the cost of a lengthy trial.”²⁵³ A SEC civil settlement typically involves three components: a complaint; a consent agreement by the settling party to a specified judicial decree; and a judgment embodying the agreed-upon relief.²⁵⁴ SEC consent decrees are publically accessible documents with injunctive provisions that must be stated in reasonable detail without

²⁴⁶ *Settlement Practices Hearing*, *supra* note 12, at 22 (statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

²⁴⁷ Becker, *supra* note 202, at 1855.

²⁴⁸ *E.g.*, Securities Act, 15 U.S.C. § 77t(d)(2) (2012); Exchange Act, 15 U.S.C. § 78u(d)(3)(B) (2012).

²⁴⁹ Aguilar, *supra* note 6.

²⁵⁰ Khuzami, *supra* note 10.

²⁵¹ Matt Phillips, *SEC's Greatest Hits: Biggest Penalties Ever.*, MONEYBEAT (July 16, 2010, 11:22 AM), <http://blogs.wsj.com/marketbeat/2010/07/16/secs-greatest-hits-some-of-the-other-biggest-penalties>.

²⁵² Memorandum of Plaintiff Securities and Exchange Commission in Support of Entry of the Proposed Consent Judgment at 3, *SEC v. Citigroup, Inc.*, No. 10-cv-01277-ESH (D.D.C. Aug. 13, 2010).

²⁵³ Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1075 (1984).

²⁵⁴ RICHARD A. ROSEN ET AL., *SETTLEMENT AGREEMENTS IN COMMERCIAL DISPUTES: NEGOTIATING, DRAFTING AND ENFORCEMENT* § 34.08 (2012).

incorporating other documents by reference.²⁵⁵ They can be revised or dismissed by the court, even over the protestations of one of the parties.²⁵⁶ In contrast, strictly private settlements may contain confidential terms that are not held to any requisite level of particularity, can incorporate other documents by reference, and cannot be changed by the courts without mutual consent.²⁵⁷

The most significant distinction between a consent decree and a private settlement is that a consent decree requires judicial approval while a private settlement does not.²⁵⁸ This makes sense since injunctive relief functions as a request that a court be retained as the SEC's "ongoing enforcement partner" that will issue contempt charges in the event of non-compliance.²⁵⁹ "The Supreme Court has long endorsed the propriety of the use and entry of consent judgments."²⁶⁰

In deciding whether to settle, the DOE takes many factors into account, starting with proof, but its overall policy is that it will not recommend settlement unless an agreement "is within the range of outcomes [it] reasonably can expect if [it] litigate[d] through trial."²⁶¹ The agency's settlements are negotiated outside of the public record and can be reached at any time during the enforcement process.²⁶²

The SEC provides two central justifications for settlement, first being that it avoids the risks of unexpected outcomes that might arise from litigating a case. The agency considers the possibility that it might not prevail at trial or that, even if it does prevail, a court might not grant all the relief sought; thus it could end up obtaining less than what may be offered in a proposed settlement.²⁶³ The SEC can and does lose at trial, and such losses, particularly for novel cases, can affect its enforcement in the future.²⁶⁴ By restraining itself to pursuing only winnable cases, the SEC can purportedly have a stronger bargaining position during settlements

²⁵⁵ Anthony DiSarro, *Six Decrees of Separation: Settlement Agreements and Consent Orders in Federal Civil Litigation*, 60 AM. U. L. REV. 275, 277–78 (2010). The Federal Rules of Civil Procedure require all litigators, including those at the SEC, to sign any filed complaint and certify that they have a reasonable basis for its claims supported by evidence. FED. R. CIV. P. 11(b).

²⁵⁶ DiSarro, *supra* note 255, at 278.

²⁵⁷ *Id.* at 277–78.

²⁵⁸ Macchiarola, *supra* note 23, at 72.

²⁵⁹ *Id.* at 72–73.

²⁶⁰ SEC v. Randolph, 736 F.2d 525, 528 (9th Cir. 1984) (citing *United States v. Armour & Co.*, 402 U.S. 673, 681 (1971); *Pope v. United States*, 323 U.S. 1, 12 (1944); *Swift & Co. v. United States*, 276 U.S. 311, 325–26 (1928)).

²⁶¹ *Settlement Practices Hearing*, *supra* note 12, at 75 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

²⁶² Macchiarola, *supra* note 23, at 78.

²⁶³ *Settlement Practices Hearing*, *supra* note 12, at 75 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

²⁶⁴ Johnson, *supra* note 210, at 672.

based on such a reputation.²⁶⁵

The second major justification is that settlement conserves agency budgetary resources. It is common knowledge that litigation is both resource and time intensive, and since trials often take longer to conclude than settlements, it follows that the SEC would be able to investigate fewer incidents if it focused exclusively on litigation.²⁶⁶ Settlements can preserve the SEC's scarce monetary and human resources, allowing it to have a wider breadth of enforcement.²⁶⁷

By comparison to the financial institutions that the SEC is charged with regulating, the agency is indisputably "under-funded and often legally outgunned" as banks can employ several Wall Street law firms while the agency's annual budget is just a match for a single one of those firms.²⁶⁸ During fiscal year 2012, the SEC possessed only 3,785 full-time employees,²⁶⁹ who collectively were responsible for regulating over 35,000 entities.²⁷⁰ The DOE Director stated in 2011 that the agency could only inspect roughly eight percent of all investment advisers annually.²⁷¹ Events like the funding freeze of 2011, which resulted in hiring freezes and cut backs for activities such as travel for examiners, undoubtedly affected the agency's ability to enforce the U.S. markets.²⁷² Ultimately, the SEC does not have the staff or the funding to litigate every enforcement action, and so it instructs SEC attorneys to prioritize cases that have significant public policy ramifications in order to conserve resources.²⁷³ In 1973, at a time when the SEC brought fewer actions than it does today, the Second Circuit remarked that the agency could "bring the large number of enforcement actions it does only because in all but a few cases consent decrees are entered."²⁷⁴

On the whole, these two major defenses of settlement revolve around

²⁶⁵ Samantha Dreilinger, *Is Three a Crowd? The Role of the Courts in SEC Settlements* 11 (Oct. 2010) (unpublished manuscript), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=samantha_dreilinger.

²⁶⁶ MacDonald, *supra* note 11, at 428.

²⁶⁷ Reckler & Denton, *supra* note 22, at 4.

²⁶⁸ Jordan Weissmann, *Why Populist Hero Judge Rakoff Could Help Wall Street Win*, ATLANTIC (Dec. 1, 2011), <http://www.theatlantic.com/business/archive/2011/12/why-populist-hero-judge-rakoff-could-help-wall-street-win/249366>.

²⁶⁹ U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2012 SUMMARY OF PERFORMANCE AND FINANCIAL INFORMATION 1 (2012).

²⁷⁰ Dreilinger, *supra* note 265, at 11.

²⁷¹ Khuzami, *supra* note 10.

²⁷² Luis A. Aguilar, Commissioner, U.S. Sec. & Exch. Comm'n, *Setting Forth Aspirations for 2011*, Address to Practising Law Institute's SEC Speaks in 2011 Program (Feb. 4, 2011), available at <http://www.sec.gov/news/speech/2011/spch020411laa.htm>.

²⁷³ Dreilinger, *supra* note 265, at 11.

²⁷⁴ *Settlement Practices Hearing*, *supra* note 12, at 77 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement) (quoting *SEC v. Everest Mgmt. Corp.*, 475 F.2d 1236, 1240 (2d Cir. 1973) (internal quotation marks omitted)).

money, which is largely an external force that the agency cannot fully control since the size of its annual budget is set by Congress.²⁷⁵ But the SEC does possess its own organizational and rule-making administrative powers,²⁷⁶ and while the basic responses to funding shortfalls outlined above are logical, it does not follow that the agency lacks any means or freedom in how it actually deals with those challenges. Indeed, the root of the *Citigroup* controversy arguably was planted from internal changes that the SEC consciously and independently undertook in 1972 that continue to significantly affect its settlement practices and case resolution decision-making to this day.

D. SEC Transformation

The first major change in 1972 was the elevation of the DOE from a component within the SEC's Division of Trading and Markets to its own divisional-entity.²⁷⁷ Second, the agency issued a release on September 27, 1972, announcing it had decided to allow subjects under investigation an opportunity to present their positions before an enforcement authorization.²⁷⁸ The SEC "concluded that it would not be in the public interest to adopt formal rules" and decided that such a presentation would not be made a procedural right, but instead may be done on an "informal basis."²⁷⁹ The agency published related new informal rules supporting this change in the Federal Register,²⁸⁰ and they are now part of the Code of Federal Regulations.²⁸¹ The shorthand descriptions for the various items in this process are named after chairman John Wells, whose committee recommended its adoption (e.g., alerting an investigation subject is called a "Wells notice").²⁸²

The SEC's enforcement manual sets out specific guidelines relating to Wells notices. The timing of issuing such a notice varies according to the completeness of an investigation and if immediate enforcement action is necessary; but, more importantly, it depends on whether approval has been granted from an Associate or Regional Director.²⁸³ A Wells notice may

²⁷⁵ Hester Peirce, *The SEC's Budget Blues Are Something to Celebrate*, REALCLEARMARKETS (Dec. 19, 2012), http://www.realclearmarkets.com/articles/2012/12/19/the_secs_budget_blues_are_something_to_celebrate_100052.html.

²⁷⁶ *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *supra* note 3.

²⁷⁷ Karmel, *supra* note 203, at 40.

²⁷⁸ Release No. 5310, U.S. Sec. & Exch. Comm'n, Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations (Sept. 27, 1972), *available at* <http://www.sec.gov/divisions/enforce/wells-release.pdf>.

²⁷⁹ *Id.*

²⁸⁰ 37 Fed. Reg. 23,829 (Oct. 12, 1972).

²⁸¹ 17 C.F.R. § 202.5(c)-(d) (2013).

²⁸² OFFICE OF CHIEF COUNSEL, *supra* note 209, at 22.

²⁸³ *Id.*

initially be given orally, but the SEC's manual advises that it should be followed by a written statement outlining the specific charges being considered along with background and instructions setting out how a recipient may respond.²⁸⁴ After receiving the notice, an investigation target's counsel can request a Wells meeting with staff to better understand the allegations.²⁸⁵ Staff has the discretion to allow subjects to review non-privileged portions of its investigative file.²⁸⁶

A written answer to a Wells notice is typically called a Wells submission.²⁸⁷ Counsel use it to convince SEC staff to absolve or decrease their client's culpability or penalties by presenting mitigating circumstances and highlighting factual deficiencies in their case, or by sometimes offering a settlement.²⁸⁸ New facts are rarely introduced—likely because respondents run the risk that their statements may be discoverable and admissible in subsequent litigation.²⁸⁹ While presenting their enforcement action recommendation to the Commissioners, SEC staff will include any Wells submission along with a staff response to it, which may include a position regarding any settlement offered.²⁹⁰

The last major development arising out of 1972 concerns the codification of a practice that the SEC had adopted long before—allowing defendants to neither admit nor deny the allegations of a consent decree.²⁹¹ Since a denial from a defendant may lead to the false impression that alleged conduct in a consent decree did not occur, the SEC's codified rule expressly prevents such denials and notes that “a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.”²⁹² Nothing in the rule requires that a defendant must admit allegations of wrongdoing as part of a consent decree. The agency's November 27, 1972 publication in the Federal Register argued that this rule did not require public notice and comment before taking effect.²⁹³

Evidently the SEC deemed it necessary to create this rule because immediately after entry of consent decrees, defendants would frequently engage in public campaigns denying the accusations and asserting that they agreed to settle simply to avoid the expenses of protracted litigation.²⁹⁴

²⁸⁴ *Id.* at 23–24.

²⁸⁵ Johnson, *supra* note 210, at 643.

²⁸⁶ OFFICE OF CHIEF COUNSEL, *supra* note 209, at 24–25.

²⁸⁷ Johnson, *supra* note 210, at 643.

²⁸⁸ *Id.*

²⁸⁹ *Id.*

²⁹⁰ *Id.* at 644.

²⁹¹ SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011).

²⁹² 17 C.F.R. § 202.5(e) (2013).

²⁹³ 37 Fed. Reg. 25,224, 25,224 (Nov. 28, 1972).

²⁹⁴ *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 308.

Thus, the NAND rule represents a slight foundational enhancement to what was already a common practice. If the SEC settles and allows a defendant to neither admit nor deny the allegations, boilerplate language referencing the agency's rule is included in any consent judgments given to the courts.²⁹⁵ In the past, DOE staff have threatened to rescind agreements if any public denials are made, but the prompt issuance of retractions or corrective press releases have generally been successful in preventing that from actually happening.²⁹⁶

Throughout the past decade the SEC has issued policy statements that supplement its original NAND rule. In 2003, it announced that all consent injunction cases, including NAND, must have their allegations treated as virtually conclusive for purposes of later disciplinary (i.e., suspension, bar, or registration revocation) proceedings against the same individuals.²⁹⁷ Additionally, in 2012, the SEC stated that it would not allow defendants who have already admitted guilt in parallel criminal proceedings from entering into a NAND SEC settlement.²⁹⁸ Importantly, while the rule and these policy changes curb *public* denials, defendants still possess the right to deny allegations in other civil court proceedings such as in lawsuits brought by harmed investors who may allege the same bad acts that were alleged by the SEC.²⁹⁹

E. *Effects of the Agency's Modifications for Defendants*

All in all, defense lawyers openly discuss the advantages of this enforcement set-up and strategize to their clients' benefit accordingly. Defense attorneys describe the Wells process as "the most critical phase in an SEC investigation,"³⁰⁰ and note that "the best opportunity to influence the outcome of an SEC investigation often occurs *during* the staff's investigation, rather than *after* its completion."³⁰¹ The Wells process can provide defendants a chance to review and comment on settlement

²⁹⁵ *Id.* at 308–09.

²⁹⁶ Ralph C. Ferrara & Philip S. Khinda, *SEC Enforcement Proceedings: Strategic Considerations for When the Agency Comes Calling*, 51 ADMIN. L. REV. 1143, 1195 (1999).

²⁹⁷ *In re* Marshall E. Melton, 80 S.E.C. Docket 2258, 2003 WL 21729839 (July 25, 2003).

²⁹⁸ Public Statement, Robert Khuzami, Director, U.S. Sec. & Exch. Comm'n Div. of Enforcement, Public Statement by SEC Staff: Recent Policy Change (Jan. 7, 2012), available at <http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171489600>.

²⁹⁹ *SEC's Andrew Ceresney Defends Neither Admit nor Deny Settlements*, CORP. CRIME REP. (June 6, 2013), <http://www.corporatecrimereporter.com/news/200/secceresneyneitheradmitordeny06062013>.

³⁰⁰ 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, 1924 (2002) (quoting Kenneth B. Winer & Samuel J. Winer, *Effective Representation in the SEC Wells Process*, 34 REV. SEC. & COMMODITIES REG. 59, 60 (2001)) (internal quotation marks omitted).

³⁰¹ Phillips et al., *supra* note 201, at 40 (emphasis altered).

documents,³⁰² which gives defense counsel an opportunity to shape the SEC's conclusions and gain "substantial room" to negotiate the language used in the agency's complaint so that it contains a more neutral retelling of the facts,³⁰³ and eliminates "some or all of a corporate defendant's employees from the charges."³⁰⁴ Consequently, "SEC settlements have long been 'admired' for their lack of factual basis."³⁰⁵

Similar to the SEC, defendants value settlement as a means to avoid risks associated with trial and to preserve time and resources (in terms of money and personnel) for business development rather than litigation.³⁰⁶ An enforcement action alone generates negative publicity for an institution.³⁰⁷ Attempting to litigate a matter across several news cycles compounds the problem and thus is disfavored by comparison to a situation where a complaint and settlement can be filed on the same day.³⁰⁸ Generally the market rewards settlements by raising the stock prices of a company for at least a few days afterward because the deals remove uncertainty.³⁰⁹

Arguably above all else, defendants value NAND SEC settlements for removing the threat of collateral estoppel. Historically, only the same parties in a particular case could collaterally estop the other in a subsequent suit.³¹⁰ This changed following *Parklane Hosiery Co. v. Shore*,³¹¹ when the Supreme Court approved its use by a class action group against a defendant who had an opportunity to fully and fairly litigate a prior action brought by the SEC.³¹² The agency acted as amicus curiae during that case and advocated for its final result.³¹³ The takeaway from *Parklane* is that defendants' liability to private plaintiffs is practically guaranteed if they lose an earlier SEC action that pertained to the same alleged illegal activity.³¹⁴

Settlements involving consent judgments generally do not have collateral estoppel consequences because the issues involved are not "actually litigated."³¹⁵ A consent judgment, however, may be conclusive if

³⁰² Johnson, *supra* note 210, at 665.

³⁰³ Phillips et al., *supra* note 201, at 41; Phillips & Ochs, *supra* note 245, at 272–73.

³⁰⁴ Dreilinger, *supra* note 265, at 13.

³⁰⁵ 21 MARVIN PICKHOLZ, SEC. CRIMES § 2:4 (2012).

³⁰⁶ Becker, *supra* note 202, at 1861.

³⁰⁷ Phillips et al., *supra* note 201, at 40.

³⁰⁸ Johnson, *supra* note 210, at 665.

³⁰⁹ Becker, *supra* note 202, at 1861.

³¹⁰ MacDonald, *supra* note 11, at 431.

³¹¹ 439 U.S. 322 (1979).

³¹² *Id.* at 322, 332–33.

³¹³ Ochs et al., *supra* note 45, at 242.

³¹⁴ MacDonald, *supra* note 11, at 431–32.

³¹⁵ RESTATEMENT (SECOND) OF JUDGMENTS § 27 cmt. b (1982).

the parties manifest their intention for it to be so.³¹⁶ SEC NAND consent judgments lack this requisite intent and so courts do not give them preclusive effect.³¹⁷

Ultimately defendants' motivation to settle on a NAND basis makes sense on a purely economic basis. Defendants frequently face far greater potential monetary judgments from parallel private civil actions than from any SEC action.³¹⁸ In one astonishing example, Bank of America agreed to a NAND settlement with the SEC for \$150 million.³¹⁹ Two years later, it agreed to settle a class action suit related to the same matter that was 1520% more than the SEC amount (\$2.43 billion)!³²⁰ Overall, it is incontestable that defendants greatly benefit from the enforcement and settlement process that the SEC has arranged.

F. *Consequences of Changes on Private Suits by Harmed Investors*

As implied by earlier discussions, securities laws provide investors private causes of action to file certain civil suits individually or collectively, by a class action, against violators.³²¹ For example, persons who purchase securities may recover for losses suffered if they can prove that an issuer disclosed incomplete or inaccurate material information.³²² Harmed investors attempting to use collateral estoppel bear the burden of introducing a sufficient record of the prior proceeding in order for the trial court to properly identify the issues already litigated.³²³

In instances when private plaintiffs must present their own case without the benefit of collateral estoppel, it is important to first note certain actions undertaken by the courts and Congress that have made it more difficult for plaintiffs to get to trial. Although the Federal Rules of Civil Procedure require pleadings to merely contain "a short and plain statement of the claim showing that the pleader is entitled to relief,"³²⁴ the Supreme Court has held that plaintiffs must plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged" in order to survive an opponent's motion to

³¹⁶ *Id.* at cmt. e.

³¹⁷ Mei Lin Kwan-Gett et al., *Assessing the SEC's New "Neither Admit nor Deny" Policy*, N.Y. L.J., Oct. 9, 2012, at S8.

³¹⁸ SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011).

³¹⁹ SEC v. Bank of Am. Corp., Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 624581, at *5 (S.D.N.Y. Feb. 22, 2010).

³²⁰ Peter J. Henning & Steven M. Davidoff, *For Bank of America, More Trouble from Merrill Lynch Merger*, DEALBOOK (Sept. 28, 2012), <http://dealbook.nytimes.com/2012/09/28/the-cost-of-putting-the-merrill-lynch-merger-behind-it>.

³²¹ Securities Act, 15 U.S.C. § 77d-1(c)(1)(A) (2012); Exchange Act, 15 U.S.C. § 78t-1(d) (2012).

³²² Securities Act, 15 U.S.C. § 77d-1(c).

³²³ Ochs et al., *supra* note 45, at 243.

³²⁴ FED. R. CIV. P. 8(a)(2).

dismiss.³²⁵ To satisfy this heightened pleading standard, claims must have “facial plausibility” which “asks for more than a sheer possibility that a defendant has acted unlawfully.”³²⁶ “Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.”³²⁷ “[P]laintiffs are not required to conform their pleadings to the rules of evidence,”³²⁸ however, and allegations are sufficient if they can “raise a reasonable expectation that discovery will reveal evidence.”³²⁹

But further complicating matters for harmed investors are conditions imposed by the Private Securities Litigation Reform Act of 1995 (“PSLRA”),³³⁰ which discourages the filing of weak or frivolous lawsuits.³³¹ It has been argued that the effect of PSLRA “leaves private enforcement of the federal securities laws in near terminal condition.”³³² Whereas under the Federal Rules of Civil Procedure allegations as to a defendant’s state of mind may usually be “alleged generally,”³³³ PSLRA imposes heightened pleading standards in actions brought under the Exchange Act’s antifraud provisions. A private claimant must “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,”³³⁴ as well as “specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading.”³³⁵

If the SEC becomes involved in a matter, private plaintiffs can attempt to guard their interests by moving to intervene in the agency’s enforcement actions.³³⁶ But as a policy, the agency opposes outside third parties from joining with its cases.³³⁷ However, plaintiffs can still benefit from the SEC’s actions in other ways. For pleading purposes, plaintiffs may rely on inadmissible evidentiary sources “including: confidential witnesses, news articles, analyst reports, government hearing testimony (that was not subject to cross examination), bankruptcy examiner reports, and even

³²⁵ Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009).

³²⁶ *Id.*

³²⁷ *Id.*

³²⁸ Brief of Amicus Curiae National Ass’n of Shareholders in Support of Neither Party at 9, SEC v. Citigroup Global Mkts. Inc., 673 F.3d 158 (2d Cir. 2012) (No. 11-5227-cv).

³²⁹ Bell Atl. Corp. v. Twombly, 550 U.S. 544, 556 (2007).

³³⁰ Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

³³¹ Jane Bryant Quinn, *Madoff Victims Face Grim Prospects in Court: Jane Bryant Quinn*, BLOOMBERG (Feb. 11, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&refer=columnist_quinn&sid=axkhffRnncl.

³³² Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1060 (1999).

³³³ FED. R. CIV. P. 9(b).

³³⁴ Exchange Act, Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(2)(A) (2012).

³³⁵ *Id.* § 78u-4(b)(1).

³³⁶ 6 HAZEN, *supra* note 204, § 16.2[0][A].

³³⁷ Johnson, *supra* note 210, at 667.

anonymous internet postings.”³³⁸ SEC complaints are similar to those items in that “there is no dispute that unadjudicated allegations are not *evidence* and cannot be used to *prove* facts in a subsequently-filed action, [but] such allegations may represent a source of factual information on which other plaintiffs may reasonably rely at the *pleading* stage when drafting their own complaints.”³³⁹

Ultimately, though private plaintiffs cannot collaterally estop defendants merely by citing the content within government filings, the factual allegations contained within those documents can be used to provide foundational support in plaintiffs’ pleadings toward satisfying the requirement that they will be able to prove their claims using other admissible evidence following discovery.³⁴⁰ However, while plaintiffs may cite government consent decrees, such references do not automatically result in clearing the initial pleadings hurdle. Though many courts have acknowledged “that specific factual allegations contained in a government pleading may be *more* reliable as a source of factual information than casual media reports,” there have been several instances when private plaintiffs cited SEC complaints and their cases failed to advance.³⁴¹ Thus, when the SEC employs NAND settlements in cases like *Citigroup*, where Judge Rakoff bemoaned the lack of “proven or admitted facts,”³⁴² the agency impairs the ability of private plaintiffs to proceed with their own cases.

While the SEC today claims that it considers how its actions affect private claims—for instance, taking into account, when making a settlement determination, the fact that going to trial would delay the return of funds to harmed investors³⁴³—historically the agency did not consider such recoveries to be important.³⁴⁴ Also, recall that any funds collected by the SEC merely constitute disgorgement and penalties, and since the agency prevents joinder with its actions, compensatory damages to directly remedy investor losses cannot be awarded by a court.³⁴⁵ Consequently, if the agency truly worried about making investors whole, it might consider how a NAND settlement affects private actions, specifically in denying them the use of collateral estoppel. The DOE Director recently testified to

³³⁸ Brief of Amicus Curiae National Ass’n of Shareholders in Support of Neither Party, *supra* note 328, at 10 (citations omitted).

³³⁹ *Id.* at 3. “[N]umerous courts—including the Supreme Court and [the Second] Circuit—have approved plaintiffs’ reliance on unadjudicated allegations from other complaints when drafting their own pleadings.” *Id.*

³⁴⁰ *Id.* at 19.

³⁴¹ *See id.* at 15–17 (citing cases).

³⁴² SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 330 (S.D.N.Y. 2011).

³⁴³ *Settlement Practices Hearing, supra* note 12, at 75 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

³⁴⁴ Zimmerman, *supra* note 234, at 527.

³⁴⁵ Gadinis, *supra* note 13, at 696.

Congress, however, that the SEC does not consider those consequences.³⁴⁶

In defending the agency's use of NAND, the SEC has argued that such agreements "are common not just across federal financial agencies, but across federal agencies more generally . . . [i]n enforcing the securities, antitrust, environmental, consumer protection, public health, and civil rights laws."³⁴⁷ At least two of those comparisons are disingenuous. First, antitrust settlements are fundamentally different from the SEC process because they incorporate interests beyond the immediate parties (i.e., the agency and defendants). Before a court can approve an antitrust consent judgment the parties are statutorily required to submit for judicial review a detailed assessment of the settlement's impact on third parties in the general public.³⁴⁸ This competitive impact statement must include "the remedies available to potential private plaintiffs damaged by the alleged violation in the event that such proposal for the consent judgment is entered in such proceeding."³⁴⁹ Additionally, any proposed judgment must be published in the Federal Register along with "any other materials and documents which the United States considered determinative in formulating such proposal," allowing the public to comment for at least a period of sixty days before the judgment may be entered.³⁵⁰ Second, the environmental laws require publication of proposed settlements and provide thirty days for the public to comment before a judge can enter a consent decree.³⁵¹ The SEC laws broadly discuss the "public interest" in several places,³⁵² but impose no analogous requirements of providing notice to the public of settlements with opportunities to comment.

In sum, the confluence of the current law, rules, and policy decisions have made investor loss recovery very difficult. The status quo, which the SEC and defendants seem to prefer, is unfortunate because private lawsuits arguably could supplement the agency's enforcement and help to deter future securities law violations. The remaining Parts of this Note will explore whether and how the judiciary could bring about change to this existing system.

³⁴⁶ *Settlement Practices Hearing*, *supra* note 12, at 37 (statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

³⁴⁷ *Id.* at 75, 80–81 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement) (footnotes omitted).

³⁴⁸ 15 U.S.C. § 16(e) (2012).

³⁴⁹ *Id.* § 16(b)(4).

³⁵⁰ *Id.* § 16(b).

³⁵¹ Dreilinger, *supra* note 265, at 23.

³⁵² *E.g.*, Securities Act, 15 U.S.C. § 77h-1(c)(1) (2012); Exchange Act, 15 U.S.C. § 78b (2012).

IV. ASSESSING THE USE AND UTILITY OF NAND SETTLEMENTS

A. *The Role and Capabilities of the Judiciary*

Since the founding of the United States, federal judges have been valued for their impartiality. Alexander Hamilton identified the courts as the “least dangerous” branch of government due to their detachment from the normal electoral processes.³⁵³ Yet, while the American appointment system affords federal judges a great amount of freedom, they would lack authority entirely if the public had not initially granted the judiciary power through the ratification of the Constitution.³⁵⁴ It is the public that sought and continues to expect to this day a government of divided powers and responsibilities.

When the SEC asks the courts to become its enforcement partner by approving settlements in cases involving violations of securities laws and regulations, the public has a significant interest that the operations of the executive and the judiciary remain separate and independent. If the courts merely rubber stamp a SEC consent judgment, they are not functioning in a constitutional manner. This does not mean that the courts should outright ban NAND agreements simply because they undermine private suits; to do so would usurp the independence of the SEC. Instead the proper response, as Judge Rakoff indicated in his *Citigroup* opinion, is to demand factually credible and supported complaints so that the courts can properly fulfill their role and conduct a neutral assessment of whether or not proposed settlements are fair, reasonable, adequate, and in the public interest.³⁵⁵

It is generally accepted that an agency’s decision whether and what to prosecute is within its discretion and usually not reviewable.³⁵⁶ The reasoning behind this conclusion is that since an agency conducted the necessary investigation before filing charges and proposing a consent judgment, it will generally have more prosecutorial expertise and access to information than a court at the start of proceedings, and as such, judges should provide agencies some deference for deciding to negotiate a

³⁵³ THE FEDERALIST NO. 78 (Alexander Hamilton).

³⁵⁴ As Chief Justice Marshall once wrote, “The government proceeds directly from the people; [and it] is ‘ordained and established,’ in the name of the people.” *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 403 (1819). In addition, before taking office every judge must take a statutory oath of office swearing to “support and defend the Constitution.” ADMIN. OFFICE OF THE U.S. COURTS, GETTING STARTED AS A FEDERAL JUDGE: AN ADMINISTRATIVE GUIDE TO ASSIST NEW JUDGES DURING THEIR FIRST YEAR ON THE BENCH 13–14 (2d ed. 2005).

³⁵⁵ *SEC v. Citigroup Global Mkts. Inc.*, 827 F. Supp. 2d 328, 331–32 (S.D.N.Y. 2011).

³⁵⁶ *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.”).

settlement.³⁵⁷ However, judges “can employ a number of measures to lessen the impact of distributional inequalities.”³⁵⁸ These measures include asking questions to supplement the parties’ presentation, calling their own witnesses, and allowing outside parties to participate as amici.³⁵⁹

A judge’s role and participation in a settlement case will typically be less than in one that goes to trial. Congress has established a strong public policy encouraging settlement by requiring district courts to implement plans that “ensure just, speedy, and inexpensive resolutions of civil disputes.”³⁶⁰ For settlements, there is usually not much reason for a judge to get heavily involved if the parties have reached a mutual agreement, and courts are generally happy to embrace them for helping to clear their busy dockets.³⁶¹ Settlements that contain admissions of guilt have added benefits for the courts, as collateral estoppel contributes to the conservation of judicial resources by allowing courts to avoid re-litigating already resolved issues.³⁶²

The courts have imposed certain common standards for reviewing and approving injunctive relief. First, a prosecuting agency must prove a defendant has violated the law and second, that he is likely to violate it again in the future unless enjoined.³⁶³ The agency must show that the threat of a future violation reasonably exists, and the courts assess this by looking at the totality of the circumstances including the historical profile of the defendant.³⁶⁴ Also among the factors that should be considered is “the connection between the settlement and any related pending or prospective criminal or civil cases.”³⁶⁵ Additionally, simply because violative activity has ceased does not preclude a court from granting an injunction.³⁶⁶

Assessing a case requires certain facts, and the general guideline from the Federal Rules of Civil Procedure is that “[e]very order granting an injunction . . . must: (A) state the reasons why it issued; (B) state its terms specifically; and (C) describe in reasonable detail—and not by referring to the complaint or other document—the act or acts restrained or required.”³⁶⁷ Along these lines courts have stated that “[b]ecause a consent judgment has a continuing [e]ffect on the rights of litigants, courts are required to

³⁵⁷ 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 ST. LAW., Nov. 2009, at 5.

³⁵⁸ Fiss, *supra* note 253, at 1077.

³⁵⁹ *Id.*

³⁶⁰ Civil Justice Reform Act of 1990, 28 U.S.C. § 471 (2012).

³⁶¹ Johnson, *supra* note 210, at 651.

³⁶² *Id.* at 666.

³⁶³ Ochs et al., *supra* note 45, at 187.

³⁶⁴ Ferrara & Khinda, *supra* note 296, at 1175–76.

³⁶⁵ United States v. Peterson, 859 F. Supp. 2d 477, 478 (E.D.N.Y. 2012).

³⁶⁶ Ferrara & Khinda, *supra* note 296, at 1176.

³⁶⁷ FED. R. CIV. P. 65(d)(1).

ascertain whether the parties agreement ‘represents a reasonable factual and legal determination based on the facts of the record.’”³⁶⁸ To gain the requisite knowledge, a judge may conduct oral hearings and request additional briefing.³⁶⁹

B. *Development of Judicial Review for Securities Settlements*

In concert with the basic tenant of reasonableness, courts over the years have settled on a few additional terms to their standards of review for assessing approval of SEC settlements: whether such agreements would also be fair, adequate, and in the public interest.³⁷⁰ The four elements of this test were arguably not consecutively combined until recently, but the roots of it arose from *SEC v. Randolph*,³⁷¹ in which the Ninth Circuit stated that “[u]nless a consent decree is unfair, inadequate, or unreasonable, it ought to be approved.”³⁷² At issue in that case was whether the district court correctly rejected a proposed NAND consent decree.³⁷³

The district court believed, because of the similarity in the purposes behind an antitrust law and the securities laws, that it needed to review whether the settlement was also in the “public’s best interest.”³⁷⁴ While the Ninth Circuit reversed the judgment of the district court for going too far by using a “best interest” standard,³⁷⁵ it wrote that “[w]e do not question the appropriateness of a requirement that the decree be in the public interest.”³⁷⁶ The Supreme Court has never directly commented on whether courts must consider the public interest in the context of approving consent decrees. But on two occasions in the past decade the Court has required plaintiffs seeking injunctive relief to establish that such an action was in the public interest.³⁷⁷

³⁶⁸ *Bayou Fleet, Inc. v. Alexander*, 234 F.3d 852, 858 (5th Cir. 2000) (quoting *United States v. City of Miami*, 664 F.2d 435, 441 (5th Cir. 1981) (en banc) (Rubin, J., concurring)).

³⁶⁹ FED. R. CIV. P. 78; *see also* Letter from Rudolf T. Randa, U.S. District Judge, to Andrea R. Wood & James A. Davidson, Counsel (Dec. 20, 2011), *available at* [http://www.wlrk.com/docs/Kosslett er.pdf](http://www.wlrk.com/docs/Kosslett%20er.pdf) (requesting the SEC “provide a written factual predicate” to permit the court to assess the proposed settlement).

³⁷⁰ *E.g.*, *SEC v. CR Intrinsic Investors, LLC*, No. 12 CIV. 8466 (VM), 2013 WL 1614999, at *3 (S.D.N.Y. Apr. 16, 2013); *SEC v. Cioffi*, 868 F. Supp. 2d 65, 72 (E.D.N.Y. 2012).

³⁷¹ 736 F.2d 525 (9th Cir. 1984).

³⁷² *Id.* at 529.

³⁷³ *Id.* at 527–28; *see also* *SEC v. Randolph*, 564 F. Supp. 137, 139 (N.D. Cal. 1983) (noting that the defendants agreed to the consent decree “without conceding liability”), *rev’d*, 736 F.2d 525 (9th Cir. 1984).

³⁷⁴ *Randolph*, 736 F.2d at 529.

³⁷⁵ *Id.* at 529–30.

³⁷⁶ *Id.* at 529.

³⁷⁷ *See* *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 20 (2008) (“A plaintiff seeking a preliminary injunction must establish . . . that an injunction is in the public interest.”); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006) (“According to well-established principles of equity,

Despite this evolution in review standards, “[i]t is extremely rare for a federal court to reject an SEC proposed settlement of an enforcement action.”³⁷⁸ Going against the trend, Judge Rakoff has openly challenged several SEC settlements presented to him when their structure or factual basis failed to meet the accepted standard of review. First, in *SEC v. Bank of America Corp.*,³⁷⁹ the SEC originally presented Judge Rakoff with a proposed NAND consent judgment requesting to enjoin the bank and impose a \$33 million fine.³⁸⁰ The case related to the company’s acquisition of Merrill Lynch and involved charges that Bank of America lied to shareholders in its proxy statement that it would not pay \$5.8 billion in bonuses to Merrill executives.³⁸¹ Second, in *SEC v. Vitesse Semiconductor Corp.*,³⁸² the SEC provided several NAND consent judgments, one against the company and two against individuals, containing various monetary penalties and either enjoinders or bars concerning future activity.³⁸³ The case involved several allegations of fraud occurring from 1995 to 2006, including the failure to record about \$184 million in compensation expenses.³⁸⁴

In each instance Judge Rakoff asked for a hearing and additional materials.³⁸⁵ While considering each action, he noted the deference owed to the SEC³⁸⁶ and that the final standard of review in each case was whether the settlement was “fair, reasonable, adequate, and in the public interest.”³⁸⁷ In *Bank of America*, without discussing the scope of review concerning the public interest, Judge Rakoff assessed the facts behind the proposed settlement and rejected it, concluding that “the proposed Consent Judgment [was] neither fair, nor reasonable, nor adequate.”³⁸⁸ The parties responded by presenting the court with “a 35-page Statement of Facts and

a plaintiff seeking a permanent injunction must satisfy . . . that the public interest would not be disserved by a permanent injunction.”).

³⁷⁸ Brief of Better Markets, Inc. as Amicus Curiae in Support of Pro Bono Counsel Appointed to Advocate for Affirmance of the District Court’s Order, *supra* note 157, at 3 n.3.

³⁷⁹ 653 F. Supp. 2d 507 (S.D.N.Y. 2009).

³⁸⁰ *Id.* at 508.

³⁸¹ *Id.*

³⁸² 771 F. Supp. 2d 304 (S.D.N.Y. 2011).

³⁸³ *Id.* at 305, 307.

³⁸⁴ *Id.* at 305, 306.

³⁸⁵ *Id.* at 306; *Bank of Am. Corp.*, 653 F. Supp. 2d at 508.

³⁸⁶ *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 306–07; *SEC v. Bank of Am. Corp.*, Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 624581, at *6 (S.D.N.Y. Feb. 22, 2010); *Bank of Am. Corp.*, 653 F. Supp. 2d at 508.

³⁸⁷ *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 306–07; *Bank of Am. Corp.*, 2010 WL 624581, at *3. Judge Rakoff phrased the standard slightly differently in his original *Bank of America* decision. See *Bank of Am. Corp.*, 653 F. Supp. 2d at 508 (“[T]he court is . . . obliged . . . to ascertain whether [the proposal] is within the bounds of fairness, reasonableness, and adequacy—and, in certain circumstances, whether it serves the public interest.”).

³⁸⁸ *Bank of Am. Corp.*, 653 F. Supp. 2d at 509.

a 13-page Supplemental Statement of Facts” along with “hundreds of pages of deposition testimony and other evidentiary materials bearing on the case” which Bank of America did not contest the accuracy of but refused to concede on their materiality.³⁸⁹ Additionally the parties presented a modified consent decree that added new prophylactic measures, created a Fair Fund for harmed Bank of America shareholders, and increased the fine to \$150 million.³⁹⁰ Though Judge Rakoff bemoaned that the fine was “paltry” and that the result would be “half-baked justice at best,” he ultimately approved this new consent judgment, noting that it was “premised on a much better developed statement of the underlying facts and inferences drawn therefrom.”³⁹¹

In *Vitesse*, Judge Rakoff argued that the SEC’s NAND rule creates a “stew of confusion and hypocrisy,” making it difficult for the public to discern the truth behind the agency’s actions.³⁹² Unlike in *Bank of America* though, Judge Rakoff was ultimately satisfied that the original supplemental materials allowed the parties to meet the aforementioned standard.³⁹³ Through the extra materials, he learned that though the individual defendants were neither admitting nor denying the SEC’s civil complaint, they had pleaded guilty to parallel criminal charges.³⁹⁴ Despite the small \$3 million fine, Judge Rakoff believed it to be adequate after considering that the company already committed to providing \$2.4 million to a parallel class action suit, and both figures were less than the net cash flow *Vitesse* took in that year (\$1.5 million).³⁹⁵ In several ways, these two cases laid the groundwork for the *Citigroup* case.

C. Surveying the SEC’s Reliance on and Effectiveness with NAND Settlements

Underlying Judge Rakoff’s critiques of the SEC’s actions is a sense that the agency uses its ability to reach NAND settlements as a shield to avoid closer scrutiny of its policy choices and overall performance. Although this Note agrees with the SEC that there are obvious case resolution efficiencies and worthwhile resource preservation in settling, it concludes that Judge Rakoff is correct to question the agency’s motives and actions. A brief look at some of the agency’s recent enforcement

³⁸⁹ *Bank of Am. Corp.*, 2010 WL 624581, at *1.

³⁹⁰ *Id.* at *3–5.

³⁹¹ *Id.* at *4–6.

³⁹² *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 308–09.

³⁹³ *Id.* at 306, 308.

³⁹⁴ *Id.* at 307. Notably, today those defendants would not have been allowed to enter into NAND consent decrees. See *supra* text accompanying note 298 (noting that the SEC does not allow “defendants who have already admitted guilt in parallel criminal proceedings from entering into a NAND SEC settlement”).

³⁹⁵ *Vitesse Semiconductor Corp.*, 771 F. Supp. 2d at 307, 310.

statistics demonstrates that the agency has struggled to win cases at trial and has adopted settlement as its default enforcement resolution.

For example, during the fiscal years 2010–2012, the agency brought an average of about 717 enforcement actions a year,³⁹⁶ with 95% (roughly 685) of those cases ending through settlement.³⁹⁷ By comparison, other agencies such as the Federal Trade Commission and Equal Employment Opportunity Commission resolved their cases through settlement only 80% of the time.³⁹⁸ The total number of SEC settlements through fiscal years 2003–2012 averaged about 726 annually.³⁹⁹ By contrast, the agency brought no more than fifteen to twenty cases a year to trial in federal court.⁴⁰⁰ The SEC claims it won between 82 and 86% of its trials during 2011 and 2012, but some commentators contend that the agency only wins about half of its trials.⁴⁰¹ Either figure is less than the Department of Justice's success rate of 90%.⁴⁰²

As to the effectiveness of its enforcement, the SEC has exhibited difficulty in reacting to recidivists. Despite the presence of injunctions, from 1996 to 2011 the largest Wall Street firms (including Bank of America, Citigroup, Goldman Sachs, and JP Morgan Chase) collectively repeated prior violations of anti-fraud securities laws at least fifty-one times.⁴⁰³ These companies were allowed second chances to break the law because the SEC granted at least 344 waivers during 2001–2011 to allow those companies and their employees to continue their businesses.⁴⁰⁴

While the SEC has argued that NAND settlements “serve the critical enforcement goals of accountability, deterrence, investor protection, and

³⁹⁶ See U.S. SEC. & EXCH. COMM'N, FISCAL YEAR 2012 AGENCY FINANCIAL REPORT 2 (2012) (announcing 734 enforcement actions); U.S. SEC. & EXCH. COMM'N, FY 2011 PERFORMANCE AND ACCOUNTABILITY REPORT 2 (2011) (announcing 735 enforcement actions); U.S. SEC. & EXCH. COMM'N, FY 2010 PERFORMANCE AND ACCOUNTABILITY REPORT 11 (2010) (announcing 681 enforcement actions).

³⁹⁷ See JORGE BAEZ ET AL., NERA ECON. CONSULTING, SEC SETTLEMENT TRENDS: 2H12 UPDATE 5 (2013), available at http://www.nera.com/nera-files/PUB_SEC_Trends_Update_2H12_0113_final.pdf (tallying 670 settlements in fiscal year 2010, another 670 in 2011, and 714 in 2012).

³⁹⁸ *Settlement Practices Hearing*, supra note 12, at 76–77 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

³⁹⁹ See BAEZ ET AL., supra note 397, at 5 (recording the total number of settlements for each year during this period).

⁴⁰⁰ N.Y. CITY BAR ASSOC. COMM. ON SEC. LITIG., SEC V CITIGROUP 2 (2012), available at <http://www2.nycbar.org/pdf/report/uploads/20072297-SECv.Citigroup.pdf>.

⁴⁰¹ Alison Frankel, *The Stoker Verdict and the Citi Settlement*, THOMPSON REUTERS (Aug. 2, 2012), <http://www.reuters.com/article/2012/08/02/us-citigroup-stoker-idUSBRE8711WL20120802>.

⁴⁰² Alison Frankel, *No Easy Solution to Rakoff's Challenge to SEC Settlements*, THOMPSON REUTERS (Nov. 3, 2011), http://newsandinsight.thomsonreuters.com/Legal/News/2011/11_-_November/No_easy_solution_to_Rakoff_s_challenge_to_SEC_settlements.

⁴⁰³ Wyatt, supra note 83.

⁴⁰⁴ *Giving Wall Street a Break*, N.Y. TIMES (Feb. 2, 2012), <http://www.nytimes.com/interactive/2012/02/02/business/Giving-Wall-Street-a-Break.html?ref=business>.

compensation to harmed investors,⁴⁰⁵ this Note argues that such settlements fail at all four levels. There cannot be true accountability if defendants do not admit to liability. NAND settlements have generated little, if any, positive deterrent effect as evidenced by the recent financial calamities outlined in Part I, and by the number of repeat offenders as detailed above. Additionally, they largely protect violators from harmed investors rather than the other way around. Finally, investors can be only partially compensated because, as discussed in Part III, the agency has a policy against joinder, and the SEC alone does not have the power to recover investor losses.

At the most basic level, NAND settlements are paradoxical. Why would someone agree to be restrained if they refuse to admit any wrongdoing? Along those lines, how can the SEC credibly argue that it “settle[s] cases for the right reasons,” while at the same time admit that “many companies would refuse to settle cases if they [were] required to admit unlawful conduct.”⁴⁰⁶

In truth, corporate defense lawyers are much more afraid of lawsuits initiated by private investors than they are of SEC actions. This fact is manifested by companies’ preference for NAND settlements. Through the Wells process, counsel can barter what their clients generally regard as mere monetary pittance to avoid their client admitting liability and to water down the factual clarity of the SEC’s complaints. Most frustrating of all is that the SEC recognizes this desire and, all too commonly, gives away the NAND bargaining chip. The SEC’s current co-director of the DOE recently commented that “[a]s a defense lawyer, I always clearly wanted from [sic] my clients no admit and no deny settlements.”⁴⁰⁷

On a strictly case-by-case basis, the argument for settling—to avoid litigation risks and conserve resources—is strong. However, when viewed in the aggregate, such decisions appear less thoughtful and deliberate, and instead demonstrate routine and predictable behavior. It is true that settlement frees up the SEC’s staff to investigate and bring more cases. But if the SEC’s opponents know and expect that it will settle, then the agency has lost a significant amount of negotiating power when it comes to drafting settlement agreements and this leads to the creation of factually diluted court filings and a reduction in the penalties imposed against defendants. One commentator made an apt observation that “[w]hen it complains, even legitimately, about its budget or how costly and difficult trials are, the S.E.C. is inadvertently showing its belly to Wall Street in a

⁴⁰⁵ *Settlement Practices Hearing*, *supra* note 12, at 75 (prepared statement of Robert Khuzami, Director, U.S. Securities and Exchange Commission, Division of Enforcement).

⁴⁰⁶ Khuzami, *supra* note 10.

⁴⁰⁷ *SEC’s Andrew Ceresney Defends Neither Admit nor Deny Settlements*, *supra* note 299.

sign of submission.”⁴⁰⁸

Not surprisingly, the agency’s overall performance and clear overreliance on settlement has drawn widespread public criticism, and its thinly supported complaints and consent decrees have garnered admonishment from the federal courts. The agency has tried to defend itself by repeatedly presenting certain straightforward figures in its annual reports, such as the number of actions brought and amount of money recovered, to provide a counterargument that in fact its enforcement is robust and substantial.⁴⁰⁹ The DOE Director once framed the agency’s performance by comparing its 2010 and 2011 combined budgets of \$2.3 billion against a total penalty recovery of \$5.6 billion during that period as delivering a return on investment that “[v]ery few companies can claim.”⁴¹⁰

While such figures may sound impressive on their own, the exorbitant recovery figures could demonstrate an insecure market just as much as a tightly regulated one. Working in favor of the former argument is the fact that the SEC has been able to accumulate larger collections simply because the legal reforms during the past twenty years have facilitated it. In support of this contention, in 2009 alone, the agency distributed \$2.1 billion, which was twice as much as it had collected between 1984 and 1992 all together.⁴¹¹ Notably the largest penalty the SEC had ever obtained up until the 2002 passage of Sarbanes-Oxley was just \$10 million.⁴¹²

Beyond monetary penalties, the agency could do more concerning recidivists, but it has not. Recall Citigroup’s repeated violations presented in Part II.B and the fact that the SEC did not present those charges in any detail during the *Citigroup* case. Michigan Senator Carl Levin appropriately commented that the SEC’s settlement practices are “like a cop giving out warnings instead of giving tickets . . . [i]t’s a green light to operate the same way without a lot of fear that the boom is going to be lowered on you.”⁴¹³

In a welcome new development, SEC Chairman Mary Jo White announced in June 2013 that the SEC would require an admission of guilt for certain cases in the future.⁴¹⁴ However, as of February 2014, the agency has neither published new rules to effectuate such a policy change, nor eliminated the NAND rule. Based on the SEC’s decades-long track

⁴⁰⁸ Jesse Eisinger, *Needed: A Cure for a Severe Case of Trialphobia*, PROPUBLICA (Dec. 14, 2011), <http://www.propublica.org/thetrade/item/needed-a-cure-for-a-severe-case-of-trialphobia>.

⁴⁰⁹ E.g., U.S. SEC. & EXCH. COMM’N, FISCAL YEAR 2012 AGENCY FINANCIAL REPORT, *supra* note 396, at 2.

⁴¹⁰ Khuzami, *supra* note 10.

⁴¹¹ Zimmerman, *supra* note 234, at 529–30.

⁴¹² MacDonald, *supra* note 11, at 425.

⁴¹³ Wyatt, *supra* note 83.

⁴¹⁴ Jenna Greene, *At the SEC, No Admit, No Deny Lives On*, BLOG LEGAL TIMES (Sept. 17, 2013, 3:21 PM), <http://legaltf.chaimes.typepad.com/blt/2013/09/at-the-sec-no-admit-no-deny-lives-on.html>.

record, the public should not put too much faith in the notion that the SEC has permanently changed without evidence of more substantive steps or regular denial of NAND agreements.

V. A WAY FORWARD THROUGH THE JUDICIARY

This Note has examined how NAND settlements afford violators of securities laws two great benefits: the opportunity to shroud their illegal actions from the public and time to delay the completion of private actions filed by harmed investors. To remedy the ineffectiveness of the current enforcement system, this Note contends that judges should be the engine for introducing much needed change. The vehicle for change, as Judge Rakoff surveyed in the *Citigroup* case, is the application of a public interest component when courts review SEC requests for injunctive relief.

While the SEC has argued that it is most capable of assessing the public interest,⁴¹⁵ courts should not automatically defer to the agency. Though the SEC is tasked with protecting investors and the markets in a broad way that arguably encompasses the entire public, its enforcement powers do not fully align with the scope of its mission. Because it cannot fully recover harmed investors' losses,⁴¹⁶ it cannot provide complete protection for them. Thus the U.S. securities enforcement system is splintered between two segments: public and private enforcement. Judges must not ignore this important fact.

Though the advent of Fair Funds may increase the agency's support for the interests of harmed investors, the SEC arguably puts its self-interest above those of all outside parties when it determines whether to reach a NAND settlement. It does not adequately consider the cost to specifically harmed investors (and indirectly to the public at large) of failing to require defendants to admit liability so they can be collaterally estopped from arguing their innocence in civil court. The SEC in the past has made a duplicitous argument that harmed investors are better served by a quick settlement rather than waiting longer for results from a trial.⁴¹⁷ Framing settlements as something that harmed investors desire hides the ignoble fact that the agency controls the process and prefers to settle for the myriad internal reasons discussed earlier. Ultimately, by using NAND agreements that weaken private investor suits, the SEC makes it more difficult to accomplish its principal purpose of maintaining fair and transparent security exchanges. It undermines the opportunity for private suits to

⁴¹⁵ See Brief of the Securities & Exchange Commission, Appellant/Petitioner, *supra* note 171, at 19 ("The district court did not defer to the Commission's decision . . . [which] reflected the Commission's judgment that settlement best served the public interest . . .").

⁴¹⁶ See *supra* Part III.B.

⁴¹⁷ E.g., Khuzami, *supra* note 10; *SEC's Andrew Ceresney Defends Neither Admit nor Deny Settlements*, *supra* note 299.

provide added accountability and deterrence.

Admittedly the SEC's job is difficult, but it does not follow that its policy decisions cannot be questioned by other branches of government or the public. While pushing for more admissions of guilt should be complimented, regardless of what the SEC *may* do going forward, the judiciary *must* fulfill its obligations of providing meaningful review that acknowledges the agency's biases. When dealing with cases involving government action, the judiciary has a duty to consider the entire public interest in a much broader sense than the narrow interests of any parties that come before it.

To meet that duty this Note argues that the current four-element standard of review should be fleshed out to assist judges in their evaluations as well as set clear expectations for settling parties (i.e., the SEC and defendants). Toward establishing this new framework, the lessons surrounding the *Bank of America*, *Vitesse*, and *Citigroup* cases are incorporated. Centrally, Judge Rakoff's exhortation in *Citigroup* of needing "proven or admitted facts" is a fundamental component.⁴¹⁸ Such facts do not dictate admitting liability but merely demonstrate that there is sufficient proof for a judge to determine that the settlement satisfies all four elements of the standard of review.

Proceeding through each part of the standard of review, I argue that judges should first analyze a consent decree against the *public interest*. To begin, if any third parties have been harmed by the alleged violations, this should be acknowledged in the SEC filings because it will affect the next steps of analysis. Courts should segregate cases where defendants admit fault from others where they do not. When liability is conceded, the public interest is generally satisfied. However, as is the case for NAND settlements, more careful scrutiny under the remaining three elements will be needed to sufficiently account for the public being denied clear accountability and the fact that the courts and harmed investors will likely have to undertake longer private litigation as a result. Such an imposition can be weighed against whether the SEC has committed to making a Fair Fund available to provide restitution.

The next element, concerning whether a settlement is *fair*, is relatively narrow and focuses on whether the agreement was fairly reached between the parties involved. Specifically, the inquiry under this element is whether the agreement was completed by an arm's length negotiation and whether each party consented to the agreement without coercion. The terms of the settlement should be clear and unambiguous to any defendants or outside observers.

The third element calls on a judge to analyze the charges and the proof

⁴¹⁸ SEC v. Citigroup Global Mkts. Inc., 827 F. Supp. 2d 328, 330 (S.D.N.Y. 2011).

provided to determine whether they are *reasonable*. The most basic inquiry is whether the agency and the court have the authority to impose the terms set out in the consent decree. For instance, it would be unreasonable for the SEC to charge a defendant for violating an environmental statute if the power to do so had not been delegated to the agency. On a more substantive level though, a judge must assess whether the SEC has provided a satisfactory factual basis that is sufficiently consistent with the legal requirements for the violations asserted.

The court should not reject a consent decree on a basis that the SEC could or should have charged a defendant under a different law. This would interfere with the executive branch's independence in deciding how it proceeds with a case and would ignore the fact that each side in a negotiation will logically tend to give up something in return for an agreement. However, as Judge Rakoff did in *Bank of America, Vitesse*, and *Citigroup*, courts should compare any complaint against parallel civil or criminal proceedings to ensure that the facts presented are consistent across each.⁴¹⁹ Courts may dismiss an agreement if there are significant ambiguities, material gaps, or inconsistencies that would prevent it from undertaking a meaningful review. This was the case in *Citigroup*, where there were questions concerning the mental state of CGMI's actions and the gross gain achieved.⁴²⁰

The final element, *adequacy*, is arguably the most complex part of a court's review and requires significant factual support. When third parties in the public have been harmed by a violation, the courts should assess NAND settlements differently from non-NAND ones. Since NAND agreements prevent collateral estoppel, judges should compare the adequacy of a settlement's terms against both the defendant's gross gain *and* any purported losses by injured investors. Thus, it should be a prerequisite that the parties to a NAND settlement provide the courts with those two amounts as well as the means to adequately explain and substantiate how the parties arrived at their figures. By contrast, a non-NAND settlement should not consider investor losses because those persons would benefit from the liability admission. The mix of any financial penalty, between the amount of fines and disgorgement, should be largely immaterial since both are combined for Fair Fund purposes.

Unfortunately, an exact equation for measuring a settlement's adequacy cannot be formulated—but certain variables can be used to assist judges in their determinations. Centrally, the quality of detail presented in the parties' filings should carry significant weight because any and all facts

⁴¹⁹ *Id.* at 329–30; SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 307–08 (S.D.N.Y. 2011); SEC v. Bank of Am. Corp., Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR), 2010 WL 624581, at *2 (S.D.N.Y. Feb. 22, 2010).

⁴²⁰ See *supra* text accompanying note 179.

outlined could benefit the private claims of harmed investors and, most importantly, could provide warnings and transparency to the general public and the courts about who specifically committed the alleged illegal activities and how. There may be instances where a \$285 million NAND agreement reached to settle almost \$1.2 billion in combined gross gains and investor losses should be ruled inadequate because of the poor quality of the facts supporting it. But another NAND settlement for just \$150 million against \$5.8 billion in total gross gains and investor losses could be ruled adequate due to the unambiguousness of the evidence presented. Alternatively, a third NAND settlement for \$298 million to resolve \$300 in combined gross gains and investor losses could be adequate even with minimal factual support because of how close the remedy financially covers the harm caused. Finally, a non-NAND settlement for \$15 million against \$400 million in total gross gains and investor losses sustained by a minimum number of facts could be adequate because of the admission of guilt.

Toward assessing the adequacy of a financial penalty against the facts presented, penalties should not be judged by how easily a company might be able to cover any monetary penalties. Cases like *Vitesse*, however, where a defendant company is constrained by the amount it could pay back,⁴²¹ may change the analysis due to that type of extenuating circumstance. Yet a judge should analyze the size and scope of a settlement against a defendant's past behavior comparing relevant past penalties imposed on that same individual or entity (regardless if the parties identify such penalties in the present filings or not). Judges may be tempted to, but they should not compare penalties that were previously imposed on another party against the company or individual that is presently before it (e.g., comparing Bank of America against Citigroup) because it is different to compare past settlements made involving the same company versus settlements made with another that entail distinct facts and players.

Lastly, as it relates to the injunction component of consent decrees, judges should be notified if the defendant individual or company has been or is subject to any relevant post-violation compliance procedures. Judges should evaluate the effectiveness of those past measures and insure that adequate supervision or new procedures will be established to prevent future violations.

VI. CONCLUSION

In the present era of economic instability, private securities actions could play a crucial, complementary role in providing accountability and

⁴²¹ See *supra* note 395 and accompanying text.

detering illegal activities in the markets, and the courts should give this more consideration in their standard of review. Judges can effectively make sure that the public interest is being considered even if the SEC falters at times in its enforcement. This Note's proposed course of review does not allow judges to insert themselves in crafting the scope of SEC settlements, but instead simply pushes the agency to be clearer in how it has developed them.

The agency should not be burdened by this type of judicial review. As outlined in Part III.A, considering the time spent investigating cases as well as the level of internal review, it is safe to assume that if the SEC presents a court with an enforcement action, then it has, at the very least, built a robust evidentiary record that it could deploy if needed. There is no good reason why the agency could not provide other types of materials such as "a verified complaint, an SEC affidavit, a joint statement of facts, record evidence like depositions or documents, a 21(a) report of investigation from the SEC, or any number of other ways"⁴²² if it were asked by a court for additional information beyond its initial filings.

Defendants may benefit less from this proposal, but this may not be an undesirable result. In agreeing to NAND settlements, violators of securities laws have already earned a tremendous litigation asset by denying harmed investors the option of collateral estoppel, but it is curious why it would be in the public interest for them to double their benefits by profiting from factually diluted government filings that make it harder for private claims to be brought against them. Though private plaintiffs would benefit from clearer submissions, government allegations would merely advance harmed investors to the next stage of litigation and would not guarantee victory to them or leave settling violators defenseless. Private claimants would still need to prove their allegations based on admissible evidence.

This proposed framework will lead to a more transparent and balanced system. It should allow continued SEC discretion in determining how it resolves its investigations, provide courts more sufficient information to fulfill its review responsibilities, and offer greater resources to the public to identify, understand, and possibly assist in deterring bad actors from committing future violations. If the SEC presents *Citigroup*-like settlements in the future, courts should follow the example set by Judge Rakoff by giving the agency an opportunity to provide further information, and, in the absence of any substantial updates, can reject them if they fail to meet the standard of review.

⁴²² Brief of Better Markets, Inc. as Amicus Curiae in Support of Pro Bono Counsel Appointed to Advocate for Affirmance of the District Court's Order, *supra* note 157, at 4.