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The Second Circuit Grants the S.E.C. Power Over Settlements
By Nahal Bahri, JD Candidate 2015

Earlier this month, the United States Court of Appeals for the Second Circuit made a decision that would give the S.E.C. greater authority to settle cases. This was the result of an earlier decision in 2011 by U.S. District Judge Jed S. Rakoff who "refused to approve a $285 million settlement between Citigroup and the S.E.C."

In his decision, Judge Rakoff believed that the settlement was unfair and did not serve the public interest. The case dealt with Citigroup's "sale of a collateralized debt obligation tied to subprime mortgages before the financial crisis in which Citigroup made about $160 million by taking a negative position on the underlying securities, while investors lost $700 million." He thought this settlement was unacceptable because it failed to properly penalize Citigroup for its actions leading up to the financial crisis. Had the S.E.C. shown that the settlement was "fair, reasonable, adequate and in the public interest," Judge Rakoff would have approved the agreement.

Despite Judge Rakoff's disapproval, the S.E.C. and Citigroup "provided additional information" in the settlement, but this too was still insufficient for showing the "truth in a matter of obvious public importance."

Given Judge Rakoff's stern position against the settlement between the S.E.C. and Citigroup, the Second Circuit reigned in the power that district judges have in approving settlement agreements between the government and other entities. This decision effectively allows "the government [to] determine what's best when it comes to settling with companies or individuals accused of wrongdoing."

Rather than requiring parties to admit to wrongdoing, as Judge Rakoff would prefer, the S.E.C. can enter into settlement agreements without being concerned with how district judges will value the merits of the agreement regarding the admission of blame. The Second Circuit "found that a district judge reviewing a settlement must be more deferential to the S.E.C. by not asking whether the terms were "adequate."

While district judges will continue to oversee settlement agreements between the S.E.C. and individuals or other entities, a "judge's responsibility in sizing up the public-interest aspect of any agreement should be limited to determining whether the public "would not be disserved" by the settlement.""

Ultimately, the Second Circuit's decision has a great impact on the authority of the S.E.C. and a district judge's ability to scrutinize a proposed settlement agreement; "the S.E.C. now has a precedent that accords it substantial latitude to resolve cases with only minimal judicial scrutiny of the terms of the agreement."