

# The Impact Of Judge Rakoff's Settlement Odyssey

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Law360, New York (September 05, 2014, 10:15 AM ET) -- Judge Jed S. Rakoff has become pretty well-known of late. For many, it has been his very public questioning of the [U.S. Department of Justice's](#) "failure(s)" to prosecute financial executives for the near apocalypse of 2008 (see "The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?" *The New York Review of Books* (Jan. 9, 2014); "Why Have Top Executives Escaped Prosecution?" *The New York Review of Books* (April 3, 2014)).

For most lawyers, especially those in the securities bar, his recent prominence has been highlighted more by the public "rebuke" delivered on June 4, 2014, by the Second Circuit Court of Appeals to his rejection of [Citigroup's](#) settlement with the [U.S. Securities and Exchange Commission](#), and his subsequent approval (albeit reluctantly) of that same settlement on Aug. 5, 2014. Beyond the sound bites, what really happened?

## How It Started

In October of 2011, the SEC filed a

complaint in federal court in New York, charging Citigroup with securities fraud in connection with a synthetic collateralized debt obligation sold to investors in 2007. Simultaneously, the SEC announced, inter alia, that it was settling the matter with Citigroup for \$285 million. Judge Rakoff drew the assignment of overseeing and approving the lawsuit's resolution.

Perhaps in response to Citigroup's press release about the settlement (in which the bank highlighted that it had not been charged with "intentional or reckless misconduct"), Judge Rakoff wondered aloud how "a securities fraud of this nature and magnitude [could] be the result simply of negligence?" After a hearing before him to test whether the settlement was "fair, adequate, and reasonable," the judge answered each question in the negative. Both the SEC and Citigroup appealed to the Second Circuit.

## The Second Circuit Speaks

The Second Circuit vacated Judge Rakoff's order and remanded the settlement back to court for "further proceedings in accordance" with the court's ruling. On its face, that sounds like

a “rebuke”; but was it really?

Clearly, on one front, the Second Circuit ruled that Judge Rakoff had in fact overstepped his authority in criticizing and rejecting the SEC’s policy of not requiring the settling party to admit to legal wrongdoing; in other words, it was an abuse of discretion for Judge Rakoff to require the SEC to prove the “truth” of its claims against Citigroup.

But on three other fronts, the court of appeals pretty much lined up with Judge Rakoff: (1) the court cautioned the SEC that it might want to rethink its reflexive approach of always going into federal court to seek judicial approval of settlements (since it is not necessary, and the SEC never seems thereafter to invoke the court’s injunctive/contempt powers); (2) the court agreed that, if the SEC is going to come into federal court in such circumstances, the district judge is not to be a mere “potted plant,” but in fact does have a role to play in assessing the settlement; and (3) the court articulated standards as to what the district judge is to employ in reviewing such settlements.

On this last point, the district judge must first determine that it is “fair and reasonable.” The Second Circuit laid out four indicia to measure those concepts: (1) whether the settlement has a basis in law; (2) whether its terms are clear; (3)

whether it resolves the actual claims in dispute; and (4) whether it is tainted by some form of collusion or corruption.

Finally, if the court’s injunctive/contempt powers are invoked, the district court judge is also to determine that the “public interest would not be disserved” by the settlement. The Second Circuit then concluded: “[a]bsent a substantial basis in the record” that the settlement fails to meet these requirements, a district judge “is required to enter the order.”

### **Back to Judge Rakoff**

Obviously not thrilled with the vacatur and remand, Judge Rakoff started off his three-page opinion on Aug. 5 with the caustic: “They who must be obeyed have spoken.” Applying the “modest standard[s] imposed” by the higher court, Judge Rakoff then approved the settlement. He concluded by wondering whether courts going forward would entertain “no meaningful oversight whatsoever” on such matters; but given that the Second Circuit had “fixed the menu,” he was left “with nothing but sour grapes.”

Judge Rakoff’s original shot across the SEC’s bow in 2011 emboldened a number of other Article III judges to take on a more active oversight role in evaluating SEC settlements. Notwithstanding Judge Rakoff’s “sour grapes,” the Second

Circuit's opinion does not vitiate that oversight role; rather, it should provide a clearer road map on how to navigate the process without adverse appellate review.

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