ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS
FELLOWS' DISCUSSION PAPER SERIES

LESSONS FROM SEC v. CITIGROUP: THE OPTIMAL SCOPE FOR JUDICIAL REVIEW OF AGENCY CONSENT DECREES

Dorothy Shapiro

Discussion Paper No. 50

05/2013

Harvard Law School
Cambridge, MA 02138

Contributors to this series are John M. Olin Fellows or Terence M. Considine Fellows in Law and Economics at Harvard University.

This paper can be downloaded without charge from:
The Harvard John M. Olin Fellow's Discussion Paper Series:
http://www.law.harvard.edu/programs/olin_center/

This paper is also a discussion paper of the
John M. Olin Center's Program on Corporate Governance

JEL Class: K0, K22, K41

LESSONS FROM *SEC V. CITIGROUP*: THE OPTIMAL SCOPE FOR JUDICIAL REVIEW OF AGENCY CONSENT DECREES

Dorothy Shapiro[1]

Abstract

On November 28, 2011, Judge Jed S. Rakoff of the United States District Court in Manhattan declined to approve a consent judgment between the Securities and Exchange Commission (SEC) and Citigroup. Because Citigroup had not admitted or denied the allegations in the consent decree, Judge Rakoff concluded that he was unable to make an informed judgment about the merits of the settlement. Judge Rakoff's decision has met with serious criticism from legal observers and rekindled discussion about the scope of judicial review of agency consent decrees, which have become a valuable agency enforcement tool.

This paper attempts to articulate a clear standard of review focused on agency disability caused by a misalignment of interest or inadequate information. The concrete and deferential standard described in this paper would maintain an important gate-keeping function for the court without unduly interfering with agency policy. And a restricted inquiry, focused on conflicts of interest and adequate consideration, is appropriate given the limited institutional competence of the judiciary. The judiciary is not well situated to evaluate the terms of a settlement, which is the product of a complex balancing of agency priorities and is informed by the agency's overall strategy and policy objectives. It is difficult to see what advantages a judge with a heavy caseload can add to a deal brokered by an agency staff charged solely with promoting the public interest in a particular area. By contrast, judges can be alert to conflicts of interest, as they are in other areas of the law. When evaluating an agency's structure and information, the reviewing judge is not at an informational disadvantage relative to the parties. As a result, the court can determine whether the agency is properly accounting for social costs and benefits, and can ensure that the agency is not ignoring an important third party interest. Absent any indication of conflict or structural impairment, and given a reasonable justification for the settlement, the judge need not scrutinize the merits of the settlement and incur the costs of judicial review.

[1] J.D. candidate 2013, John M. Olin Fellow for Law and Economics, Harvard Law School. Support was provided by Harvard Law School's John M. Olin Center for Law, Economics, and Business. I am very grateful to Steven Shavell for detailed review on this project. I also thank Adrian Vermeule, Jennifer Arlen, Louis Kaplow, Allen Farrell, Anthony Casey, Robert Glauber, William McLucas, Roy Shapira, Nikolas Bowie, and participants in the Law and Economics Workshop at Harvard Law School for helpful comments and suggestions. Mistakes and misjudgments are attributable to the author.

LESSONS FROM *SEC V. CITIGROUP*: THE OPTIMAL SCOPE FOR JUDICIAL REVIEW OF AGENCY CONSENT DECREES

Dorothy Shapiro

LESSONS FROM *SEC V. CITIGROUP*: THE OPTIMAL SCOPE FOR JUDICIAL REVIEW OF AGENCY CONSENT DECREES

I. Introduction

On November 28, 2011, Judge Jed S. Rakoff of the United States District Court in Manhattan declined to approve a consent judgment between the Securities and Exchange Commission (SEC) and Citigroup. The SEC had alleged that Citigroup created a fund that allowed it to fraudulently distribute mortgage backed securities to investors. Because Citigroup had not admitted or denied the allegations in the consent decree, Judge Rakoff concluded that he was unable to make an informed judgment about the merits of the settlement. According to Judge Rakoff, the proposed settlement did "not serve the public interest, because it ask[ed] the Court to employ its power and assert its authority when it does not know the facts."[2]

Judge Rakoff's decision has met with serious criticism from legal observers and rekindled discussion about the scope of judicial review of agency consent decrees. Robert Khuzami, Director of Enforcement at the SEC, issued a statement immediately following the ruling, asserting that the decision "ignore[d] decades of established practice throughout federal agencies and decisions of the federal courts."[3] He warned that "[r]efusing an otherwise advantageous settlement solely because of the absence of an admission…would divert resources away from the investigation of other frauds and the recovery of losses suffered by other investors not before the court."[4] Other critics have

[2] *U.S. S.E.C. v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2d 328, 335 (S.D.N.Y. Nov. 28, 2011).
[3] Robert Khuzami, *Public Statement by SEC Staff: Court's Refusal to Approve Settlement in Citigroup Case* (Nov. 28, 2011), available at: http://www.sec.gov/news/speech/2011/spch112811rk.htm.
[4] Robert Khuzami, *Public Statement by SEC Staff: Court's Refusal to Approve Settlement in Citigroup Case* (Nov. 28, 2011), available at: http://www.sec.gov/news/speech/2011/spch112811rk.htm.

stated that the decision would threaten the ability of government agencies to settle cases and would create additional congestion in federal courts.[5]

Judge Rakoff's defenders praised his "courageous" attempt to hold "those who caused the 2008 crash" accountable.[6] In a similar vein, Senator Warren recently questioned federal regulators at her first Senate Banking Committee Hearing, suggesting that the regulators, including the SEC, should take banks to trial much more often. Her concerns echoed Judge Rakoff: "If they can break the law and drag in billions in profits and then turn around and settle, paying out of these profits, they don't have much of incentive following the law…It's also the case that every time there's a settlement and not a trial, we don't have those days and days of testimony about what those financial institutions were up to."[7]

---

[5] "Joseph Grundfest, a law professor at Stanford University, said there could be serious consequences if other courts adopted the same approach as Judge Rakoff by refusing to endorse a settlement unless the firm admitted wrongdoing—something 'no rational defendant' would do. 'Judge Rakoff's decision will likely be troubling to the entire federal government, and not just the SEC,' said Mr. Grundfest, who from 1985 to 1990 was a commissioner at the agency. 'By his logic, it's hard ever to support any settlement without a trial. So, will the federal courts be jammed with trials so that judges can know the 'truth' because they are unwilling to accept allegations negotiated in the shadow of a trial?'" Jean Eaglesham & Chad Bray, Citi Ruling Could Chill SEC, Street Legal Pacts, Wall Street Journal Online, November 29, 2011, available at: http://online.wsj.com/article/SB10001424052970203935604577066242448635560.html

[6] James Downie, *Judge Jed Rakoff courageously rejects SEC-Citigroup settlement*, Washington Post Opinion Blog, Posted on November 28, 2011, available at http://www.washingtonpost.com/blogs/post-partisan/post/judge-jed-rakoff-courageously-strikes-down-sec-citigroup-settlement/2011/11/28/gIQAIpaS5N_blog.html ("Since the 2008 crash, the SEC and other government officials have left the public in the dark by refusing to fully investigate Wall Street's failings and deceptions. Hopefully Rakoff's stand will finally inspire them to remember the public interest and do their jobs.") *See also*, Bill Singer, *Judge Rakoff Rejects SEC's "Contrivances" In Citigroup Settlement*, Forbes, November 29, 2011, available at: http://www.forbes.com/sites/billsinger/2011/11/29/judge-rakoff-rejects-secs-contrivances-in-citigroup-settlement/ (calling this opinion "a watershed moment"); John Cassidy, *Why Judge Rakoff Was Right To Block The Citigroup Settlement*, The New Yorker Blogs, available at: http://www.newyorker.com/online/blogs/johncassidy/2011/11/why-judge-rakoff-was-right-to-block-the-citigroup-settlement.html; Brief of *Amici Curiae* Securities Law Scholars in Support of the District Court's Order for the Petitioner, *Securities and Exchange Commission v. Citigroup Global Markets, Inc.* (No. 11-5227), available at: http://www.corporatecrimereporter.com/wp-content/uploads/2012/09/lawprofs.pdf.

[7] Ben Protess, *At Senate Hearing, Warren Comes Out Swinging*, N.Y. Times DealBook (February 14, 2013), available at: http://dealbook.nytimes.com/2013/02/14/at-senate-hearing-warren-comes-out-swinging/

While the outcome of the Citigroup/SEC appeal is still uncertain, it appears likely that Judge Rakoff's order will be overturned. On March 15, 2012, in a *per curiam* opinion, a three-judge panel of the Second Circuit stayed the district court's ruling pending the resolution of the SEC and Citigroup's interlocutory appeal. While stating that it needed to hear further arguments before deciding whether the settlement rejection was improper, the panel said that Citigroup and the SEC were likely to prevail in their challenge to Judge Rakoff's decision. The panel suggested that the decision was out of line with precedent and that Judge Rakoff had failed to show proper deference to the SEC's judgment, stating, "it is not…the proper function of federal courts to dictate policy to executive administrative agencies."[8]

This episode (and the surrounding media controversy) is reminiscent of Judge Stanley Sporkin's refusal to approve a consent decree between the Department of Justice Antitrust Division (DOJ) and Microsoft just six years earlier. Judge Sporkin's central concern was that the decree did not address anticompetitive practices such as "vaporware." This objection surprised the parties and outside observers: the agency had not targeted the "vaporware" practice when it filed its claim against Microsoft. Instead, Judge Sporkin had learned about "vaporware," or the practice of announcing a new product in order to deter customers from buying a competitor's product, while reading a book that criticized Microsoft's business practices.[9]

---

[8] *U.S. S.E.C. v. Citigroup Global Markets, Inc*., 673 F.3d 158, 165 (2012).

[9] *See* Randall E. Stross, The Microsoft Way: The Real Story of How the Company Outsmarts Its Competition, page 192 ("The content of his grumbling showed a lack of familiarity with the industry. For example, he wanted the government to outlaw 'vaporware,' the announcement of products before their release. This utterly impractical proposal would mean that customers would be denied any idea of when to expect updates or new software releases. But most disturbing was Sporkin's automatic disdain of evidence that originated anywhere but in the single book that he regarded as so insightful.") The book that Judge Sporkin had read was James Wallace & Jim Erickson, Hard Drive: Bill Gates and the Making of the Microsoft Empire (1992).

The decision was heavily criticized—a former head of the Antitrust Division called the decision "a judicial hijaking."[10] On June 16, 1995, just four months after the decision, the D.C. Circuit ruled that the consent decree was in the public interest and that the district court exceeded its authority in rejecting the decree.[11] Judge Sporkin was removed from the case.

These examples are part of an overall trend, at least at the district court level, toward more judicial scrutiny over proposed settlements and agency consent decrees.[12] This is true in the context of antitrust consent decrees, where Congress has mandated heightened scrutiny, but also in the context of SEC consent decrees, where the SEC's practice of settling on a no admit or deny basis has been called into question.

As these examples demonstrate, the proper level of review necessary before a court can approve a consent decree is undetermined.[13] Vague standards of review, such as the "fair, adequate, and in the public interest" standard that Judge Rakoff used to block

---

[10] Charles F. Rule, *Rule of Law: What Case Against Microsoft?,* WALL ST. J., at A21, Feb. 13, 1995.

[11] *United States v. Microsoft Corp*., 56 F.3d 1448 (D.C. Cir. 1995). In an opinion written by Judge Silberman, the court held that the court did not have authority to review practices that are not alleged in the complaint. The court also criticized Judge Sporkin for substituting his judgment for that of the Attorney General, and found that the decision violated the doctrine of separation of powers.

[12] *See, e.g*., Jonathan S. Sack & Ester Murdukhayeva, *Litigation: The Expanded Role of Courts in Settling Government Investigations,* Inside Counsel (June 27, 2013). Other courts have since followed Judge Rakoff's example and blocked no admit/deny consent decrees by the SEC. *See Judge Victor Marrero On SEC Neither Admit Nor Deny Consent Decrees—The Ground is Shaking, There are Tremors,* Corporate Crime Reporter (April 5, 2013), *available at:* http://www.corporatecrimereporter.com/news/200/marreroneitheradmitnordeny04052013/. Judge Gleeson of the Southern District of New York recently used a "public interest" standard to heavily scrutinize a deferred prosecution agreement between the government and HSBC. *U.S. v. HSBC Bank USA, N.A.*, Case No. 12-CR-763 (E.D.N.Y. July 1, 2013). Judge Gleeson ultimately approved the DPA, in part because the reviewing court must show appropriate deference to the executive branch and also because the DPA would "accomplish a great deal" by requiring HSBC to adopt and maintain compliance mechanisms, make management changes, and adopt a corporate compliance monitor to supervise HSBC's remedial measures.

[13] While Judge Rakoff's decision was surprising, it represents a recent trend towards greater judicial interference with the terms of consent decrees. In recent years, district courts have taken a more active role in blocking SEC consent decrees that fail to meet judicially created standards. *See e.g., SEC v. Lane,* No. 07-cv-1920, 2009 U.S. Dist. LEXIS 75556 (M.D. Fla. July 10, 2009); *SEC v. Globus Group, Inc.,* 117 F. Supp. 2d 1345 (S.D. Fla. 2000). If Judge Rakoff's decision is affirmed, it will open the door to much more uncertainty.

the SEC's settlement with Citigroup, are at the core of the problem. Most standards give little guidance and thus allow judges to substitute their judgment for that of the administrative agency. This interference raises separation of powers concerns and imposes social costs exceed the benefits.

The time is ripe for additional guidance on the proper scope of judicial review of agency consent decrees. The trend toward judicial scrutiny over the merits of agency consent decrees has influenced agency enforcement practices to the detriment of overall public welfare. In June, SEC Chairman Mary Jo White announced that the SEC would no longer maintain a policy allowing defendants to settle SEC cases without admitting or denying wrongdoing. In an internal email, Enforcement Division co-director George Canellos explained, "[T]here may be certain cases where heightened accountability or acceptance of responsibility through the defendant's admission of misconduct may be appropriate, even if it does not allow us to achieve a prompt resolution.…These may include misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm; where admissions might safeguard against risks posed by the defendant to the investing public, particularly when the defendant engaged in egregious intentional misconduct; or when the defendant engaged in unlawful obstruction of the commission's investigative processes. In such cases, should we determine that admissions or other acknowledgement of misconduct are critical, we would require such admissions or acknowledgement, or, if the defendants refuse, litigate the case."[14] If executed, the altered settlement approach could have negative consequences for the agency and the investors it has been charged with protecting.

Consent decrees are valuable tools for agency enforcement. Agencies, constrained by limited budgets, rely on consent decrees to settle cases on favorable terms while saving time and litigation costs. This saved time and money allows agencies to pursue a greater number of violations. Consent decrees also promote transparency and accountability for agency action: unlike settlements, consent decrees are filed with the court. The public nature of consent decrees allows the agency to use them as a tool for public guidance. And because a single court enforces the consent decree, consent decrees streamline enforcement efforts and reduce enforcement costs. In light of these benefits, it is easy to see how consent decrees have emerged as perhaps the single most important tool for agency enforcement efforts—the vast majority of agency enforcement actions are settled using consent decrees.

While consent decrees have important benefits, they may create social costs. Professor Shavell has observed that the private incentive to settle may diverge from the social incentive, leading to too much or too little settlement from a social welfare perspective.[15] While consent decrees provide additional social benefits (for one, they are public), it is possible that a consent decree could rationally be accepted by both parties even when it creates net social costs.

Generally, the expert agency which is charged with promoting the public interest in a particular field will properly account for the social costs and benefits to settling a

[14] Alison Frankel, *Should defendants fear new SEC policy on admissions in settlements?,* Thomson Reuters News & Insight (June 19, 2013), available at: http://blogs.reuters.com/alison-frankel/2013/06/19/should-defendants-fear-new-sec-policy-on-admissions-in-settlements/

[15] Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. of Legal Studies, 575-612 (1997).

case. However, the court may have reason to question a deal brokered by a government agency if it finds evidence that the agency is institutionally disabled. If the reviewing court determines that the agency is structurally impaired or is not fully informed, it could determine that the agency is not able to properly account for the public interest. Rather than scrutinize the merits of the settlement to ensure that it is the best agreement that the agency could have gotten, the court need only determine that the agency is institutionally able to prioritize the public interest, and that it has not failed to consider an important cost, benefit, or third party interest.

Prior scholarship on judicial review of consent decrees has emphasized the institutional strengths of the administrative agency relative to the courts[16] and has considered the costs and benefits of the judicial review mechanism.[17] Commentators have recognized that vague standards provide little guidance for reviewing courts,[18] and that crowded dockets and the lack of an adversarial proceeding create an incentive for courts to rubber-stamp proposed settlements.[19] Some claim that the rubber-stamp function is appropriate for the reviewing judge, as the consent decree should be viewed as a contract between the parties.[20] Others advocate for a more active role for a reviewing court in certain contexts, such as when the settlement impacts third parties that are not adequately represented in the settlement negotiations.[21]

---

[16] *See, e.g.*, Phillip G. Oldham, 62 U. Chi. L. Rev. 393 (1995).
[17] *See* Stanford I. Weisburst, *Judicial Review of Settlements and Consent Decrees: An Economic Analysis,* 28 U. Chi. J. Legal Studies 55 (1999).
[18] *See* Owen Fiss, *Against Settlement,* 93 Yale L. J. 1073 (1984); Lloyd C. Anderson, United States v. Microsoft, *Antitrust Consent Decrees, and the Need for a Proper Scope of Judicial Review,* 65 Antitrust L. J. 1 (1996).
[19] *See* Judith Resnick, *Judging Consent,* 1987 U. Chi. Legal F. 43.
[20] Frank H. Easterbook, *Justice and Contract in Consent Judgments,*1987 U. Chi. Legal F. 19.
[21] *See* Stanford I. Weisburst, *Judicial Review of Settlements and Consent Decrees: An Economic Analysis,* 28 U. Chi. J. Legal Studies 55 (1999).

This scholarship has not attempted to articulate a clear standard of review focused on agency disability caused by a misalignment of interest or imperfect information. The concrete and deferential standard described in this paper would maintain an important gate-keeping function for the court without imposing undue burdens on agencies. The restricted inquiry is appropriate given the limited institutional competence of the judiciary. The judiciary is not well situated to evaluate the terms of an agency settlement, which is the product of a complex balancing of agency priorities and is informed by the agency's overall strategy and policy objectives. It is difficult to see what advantages a judge with a heavy caseload can add to a deal brokered by an agency staff charged solely with promoting the public interest in a particular area. So far, scholarship evaluating the SEC's no admit/deny practice has failed to consider that the SEC has better tools and more personnel devoted to crafting an optimal litigation strategy.[22] Under such circumstances, judicial interference is an improper supersession of agency discretion.

By contrast, judges can be alert to conflicts of interest, as they are in other areas of the law. When evaluating an agency's structure and information, the reviewing judge is not at a disadvantage relative to the parties: the parties are required to provide the court with a factual record and a statement justifying the terms of the settlement. If the court is not satisfied with the agency's justification, it can require the parties to file additional briefs or it can hold a hearing. As a result, the court can determine whether the agency is accounting for social costs and benefits, and can ensure that the agency is not ignoring an important third party interest. Given a reasonable justification for the settlement and

[22] Samuel W. Buell, *Liability and Admissions of Wrongdoing in Public Enforcement of Law*, 81 U. Cin. L. Rev. (forthcoming 2013).

absent an indication of conflict or structural impairment, the judge need not scrutinize the merits of the settlement and incur the costs of judicial review.

II. Consent Decrees

A consent decree is an agreement between litigants to settle a lawsuit on mutually acceptable terms that the court agrees to enforce as a judgment.[23] Consent decrees (also known as consent judgments[24]) emerged in the United States during the 19th Century[25] and have since become an important tool in the arsenal of federal administrative agencies.[26] The "vast majority" of civil antitrust cases brought by the Department of Justice are resolved by consent decree, as are securities and environmental enforcement actions against private parties.[27] Certain statutes expressly require that the government

---

[23] Larry Kramer, *Consent Decrees and the Rights of Third Parties*, 87 Mich. L. Rev. 321, 325 (1988).
[24] The term "consent decrees" formerly described orders issued from courts of equity while "consent judgment" described orders issued from courts of law. This distinction has since been blurred. *See* Judith Resnick, *Judging Consent*, 1987 U. Chi. Legal F. 43, 45 (1987).
[25] Although consent decrees are a uniquely American invention, the EU has recently implemented Regulation 1/2003, which provides for settlements between the European Union's administrative executive and private actors, which has prompted greater settlement activity between the government and private parties. *See* George Stephanov Georgiev, *Contagious Efficiency: The Growing Reliance on U.S.-Style Antitrust Settlements in EU Law,* 2007 Utah L. Rev. 971, 992 (2007).
[26] *See* Philip G. Oldham, *Regulatory Consent Decrees: An Argument for Deference to Agency Interpretations,* 62 U. Chi. L. Rev. 393 (noting the increased reliance on consent decrees not only as a means of settling lawsuits but also as a regulatory tool).
[27] The SEC used consent decrees in 87% of its cases between 2005 and 2007. Brief for the Petitioner at 23, *Securities and Exchange Commission v. Citigroup Global Markets, Inc.* (No. 11-5227). *See also*, John M. Nannes, *Termination, Modification, and Enforcement of Antitrust Consent Decrees*, 15 Antitrust 55, 55 (2000); Jeffery G. Miller, *Private Enforcement of Federal Pollution Control Laws Part II,* 14 Envtl. L. Rep. 10063, 10080 (984). *See also* Kristi Smith, *Who's Suing Whom: A Comparison of Government and Citizen Suit Environmental Actions Brought Under EPA-Administered Statutes, 1995-2000,* 29 Colum. J. Envtl. L. 359, 387 (2004) (claiming that 70% of environmental enforcement actions are resolved by consent decree).
Note that the SEC often settles cases against corporations, but often takes individual defendants to trial. This distinction makes great sense. It is difficult to punish an abstract corporate entity (for wrongdoing that has occurred long before) without injuring current shareholders and the current management, who are often not responsible for the alleged wrongdoing. By contrast, taking an individual to trial may actually result in future deterrence or changed behavior.

use consent decrees when it decides to settle cases.[28] An agency may even rely on a consent decree as a substitute for protracted informal rulemaking.[29]

Settlement by consent decree combines "attributes both of contracts and of judicial decrees."[30] The consent decree is contractual in nature because it reflects an agreement between parties who have negotiated precise terms, but the decree also has attributes of a judicial order because the settlement is entered and enforced by a court.[31] Most consent agreements do not require the defendant to admit wrongdoing, and Professors Wright and Miller recognize that a "central characteristic of a consent judgment is that the court has not actually resolved the substance of the issues presented."[32]

Due to their hybrid nature, consent decrees offer many advantages to federal government agencies. Importantly, the fact that the government can reach an outcome without an admission of guilt allows the government to settle a great number of cases on favorable terms. The government agency can use consent decrees to levy substantial penalties but also to force beneficial institutional changes—defendants will often agree to

---

[28] The 1986 Amendments to the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") expressly require that the government use consent decrees in all but *de minimus* settlements of "imminent and substantial endangerment" actions under Section 106 of that Act. *See* Robert Percival, *Bounds of Consent*, 1987 U. Chi. Law Forum 327 (1987).

[29] In 1975, the Southern District of New York found the EPA's voluntary testing requirements for chemical manufacturers to be a violation of the Toxic Substances Control Act (TSCA) because the agreements were not enforceable through the mechanism established by TSCA. In response to this decision, the EPA and the chemical industry agreed on a policy of negotiating enforceable consent decrees instead of informal rulemaking. *See* EPA, *Procedures Governing Testing Consent Agreements and Test Rules Under the Toxic Substances Control Act*, 51 Fed. Reg. 23706 (1986). If the negotiations between the industry, the EPA, and other interested parties are successful, they will result in a consent agreement in which the members of the industry will agree to conduct testing subject to enforcement mechanisms. The EPA believes that "consent agreements can be finalized more promptly than rules . . . while affording equivalent procedural safeguards" because they will "be enforceable on the same basis as test rules." *Id.* at 23708.

[30] *United States v. ITT Continental Banking Co.*, 420 U.S. 223, 236 n. 10 (1975).

[31] In certain circumstances, the consent decree may be modified by the court even over the objections of a party. *See Local Number 93 v. City of Cleveland*, 106 S. Ct. 3063, 3076 (1986).

[32] The Supreme Court has recognized that defendants entering into consent judgments "often admit no violation of the law." *ITT Continental Banking*, 420 U.S. at 236 n. 10; *see e.g.* 18A Charles A. Wright and Arthur R. Miller, Federal Practice and Procedure Section 4443, at 256-57 (2d ed. 2002).

change their behavior in addition to paying a civil penalty in order to avoid the risk of protracted litigation.[33] The consent decree is filed, enforced, and interpreted by a single court, which lowers enforcement costs.[34] In the event of a breach, the government may seek relief directly from the court and need not file a new lawsuit. In addition, consent decrees may invoke "a flexible repertoire of enforcement measures" depending on the situation and context.[35] If the parties anticipate a change in circumstances, they may provide a vehicle for revolving disputes or adjusting the terms of the consent decree.

Importantly, the filing of a consent decree offers a government agency the opportunity to clarify the law in certain areas and inform the public of its expectations for future conduct. In a typical SEC consent degree, the agency will state the facts, outline deficiencies in accounting or other behavior, and specify required corrective steps. The government agency may require the defendant to cease engaging in prohibited conduct in the future and may also demand specific institutional changes. The terms of the consent decree appear in the public domain as soon as it is filed; the public has a right to know about the entry, modification, and enforcement of consent decrees.[36] Although the agency will not secure helpful precedent to use in future litigation, it will be able to guide industry action without incurring high litigation costs.

Government agencies like the SEC can also use consent decrees to transform inefficient common law rules. A key example is the use of consent decrees to reward

---

[33] For example, the SEC has been able to require changes to corporate structures in order to promote supervision and minimize risk-taking behavior through the consent decree. *See* Jennifer Arlen and Marcel Kahan, *Corporate Governance Regulation Through Non-Prosecution*, publication forthcoming.
[34] "[i]t is generally agreed that the fact that consent decrees are negotiated voluntarily but can be enforced by contempt sanction makes them the most effective—and cheapest—way to implement a remedial plan." Larry Kramer, *Consent Decrees and the Rights of Third Parties,* 87 Mich. L. Rev. 321, 328 (1988).
[35] *Local Number 93 v. City of Cleveland*, 106 S. Ct. 3063, n.13 (1986).
[36] *EEOC v. Nat'l Children's Ctr., Inc.*, 98 F.3d 1405, 1409 (D.C. Cir. 1996); *see also B.H. v. McDonald*, 49 F.3d 294, 300 (7th Cir. 1995) (recognizing that when parties utilize the judicial process to interpret and enforce settlements, they are no longer entitled to confidentiality).

firms that cooperate with the agency and self-report violations. The SEC and DOJ each have formal leniency programs that use consent decrees and deferred prosecution agreements to change the standard of liability imposed on firms from respondeat superior to duty-based liability.[37] These programs promote optimal deterrence by allowing the agency to avoid the perverse effects of the existing liability regime that holds firms liable even when they cooperate.[38] In the case of securities fraud cases, there are particularly good reasons for allowing the SEC to use consent decrees to avoid corporate liability. As Professors Arlen and Carney have demonstrated, once a firm is cooperating with the SEC and allows the agency to investigate individual misconduct, there is no reason to hold the firm liable from either a deterrence or compensation perspective.[39]

Consent decrees "have judicial character and efficacy but no judicial judgment."[40] This hybrid nature has created confusion about the proper role for a reviewing court. The Supreme Court has recognized this tension: "To be sure, consent decrees bear some of the earmarks of judgments entered after litigation. At the same time, because their terms are arrived at through mutual agreement of the parties, consent decrees also closely resemble contracts.... More accurately, then, ... consent decrees 'have attributes of both contracts and of judicial decrees,' a dual character that has resulted in different treatment for different purposes."[41] On the one hand, consent decrees resemble a private contract between the parties, and advocates of the "contract model" advocate enforcement of the

---

[37] *See generally,* Jennifer Arlen, *Corporate criminal liability: theory and evidence,* RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 144 (2012).
[38] *See* Jennifer Arlen, *The Failure of the Organizational Sentencing Guidelines*, 66 U. Miami L. Rev. 321, 329-40 (2012).
[39] Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets*, 1992 U. Il. L. Rev. 691 (1992). Of course, the analysis is slightly different in cases where the company is defrauding third parties and not the firm's own shareholders.
[40] Judith Resnick, *Judging Consent*, 1987 U. Chi. L. Forum, 43, 55 (1987).
[41] *Local Number 33 v. City of Cleveland,* 478 U.S. 501 (1986) (quoting *United States v. ITT Continental Baking Co.*, 420 U.S. 223, 235 (1975)).

bargain made between the parties.[42] Other courts describe the consent decree as "a judicial act" requiring independent evaluation of the settlement terms.[43]

Historically, courts played a limited role when reviewing proposed consent judgments. A reviewing court did not "make any determination of the merits" and made no "inquiry into, or preliminary adjudication of, the facts or the law applicable thereto."[44] The Supreme Court has not articulated any mandatory role for a reviewing court, but has articulated principles to guide the review. A court is required to at least make the "minimal determination of whether the agreement is appropriate to be accorded the status of a judicially enforceable decree."[45] Accordingly, the consent decree must bear some relationship to the complaint and pleadings that have invoked the federal court's jurisdiction.[46]

The Supreme Court has further indicated that broad discretion should be vested in the attorney general and government agencies (specifically, the Antitrust Division) when it secures a consent decree. In *Sam Fox Publishing Co. v. United States*, Justice Harlan wrote, "Apart from anything else, sound policy would strongly lead us to decline appellants' invitation to assess the wisdom of the Government's judgment in negotiating and accepting the 1960 consent decree, at least in the absence of any claim of bad faith or

---

[42] Frank H. Easterbrook, *Justice and Contract in Consent Judgments*, 1987 U. Chi. Legal F. 19 (1987).
[43] "Because the consent decree does not merely validate a compromise but, by virtue of its injunctive provisions, reaches into the future and has continuing effect, its terms require more careful scrutiny. . . . This requires a determination that the proposal represents a reasonable factual and legal determination based on the facts of record, whether established by evidence, affidavit, or stipulation." *United States v. City of Miami, Fla.*, 664 F.2d 435, 441 (5th Cir. 1981). Courts are more likely to take a rigorous approach when evaluating class action settlements. *See e.g., City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 462 (2d Cir. 1974).
[44] Resnick at 53-54, quoting A.C. Freeman, A Treatise on the Law of Judgments Section 1350, at 2773 (5th ed. 1925).
[45] *Int'l Bus. Machs Corp. v. Miller*, 163 F.3d 737, 740 (2d Cir. 1998) (quoting *Janus Films, Inc.*, 801 F.2d 578, 582 (2d Cir. 1986).
[46] *Firefighters v. City of Cleveland*, 478 U.S. 501, 525 (1986).

malfeasance on the part of the Government in so acting."[47] Lower courts have since struggled to reconcile the broad discretionary authority of the federal agency authorized by the Supreme Court with the requirement that the court engage in an independent review of the decree.

Over time, judicially created standards of review, which vary by court and by context, have developed.[48] In most courts, the standard of review is narrow but the terms are vague. For example, the Second Circuit uses an abuse of discretion standard: "Unless a consent decree is unfair, inadequate, or unreasonable, it ought to be approved."[49] These opaque criteria give reviewing courts substantial leeway to reject settlements or propose modifications. More commonly, a skeptical court will inform parties of any concerns regarding a proposed consent decree and give the parties an opportunity to address them. If the court is unsatisfied by the terms of the consent decree, it may insist on modifications or may refuse to approve the decree all together.

Only in the context of antitrust consent decrees has Congress specified factors that courts must consider before approving the settlement.[50] The Antitrust Procedures and Penalties Act,[51] commonly referred to as the Tunney Act, outlines a court's role in approving consent decrees proposed by the Antitrust Division of the Justice Department. The circumstances surrounding the legislation are somewhat unique: Congress passed the

---

[47] 366 U.S. 683 (1961).

[48] The standard contexts for judicial review of the merits of settlements is the class action settlement and the derivative settlement. In these cases, the court has good reason to be concerned about the lawyer and representative plaintiff's conflict of interest.

[49] *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991).

[50] This paper does not closely consider class action settlements, which require the reviewing court to consider factors specified under F.R.C.P. 23(a)(3) and (4).

[51] 15 U.S.C. § 16(b)-(h) (1982).

Tunney Act following allegations of corruption on the part of the reviewing court.[52] Among other things, the Act requires a district court to determine whether the decree advances the public interest.[53] Recent amendments provide that the court must consider: “1. the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment; and 2. the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint, including consideration of the public benefit, if any, to be derived from a determination of the issues at trial,” in addition to other factors.[54]

Despite the Congressional attempt to articulate a clear standard of review for consent decrees brokered by the Antitrust Division, the scope of the public interest determination varies by circuit. The D.C. Circuit has taken the position that the United States is entitled to deference in crafting its antitrust settlements and as such, the public interest inquiry is a limited one.[55] As such, the court need only ensure that the resulting settlement “is within the reaches of the public interest.”[56] By contrast, the Ninth Circuit has held that the public interest inquiry allows the court to review additional

---

[52]In 1969, the government challenged ITT, the nation’s ninth largest corporation, in its decision to acquire three major companies. In one of the cases, ITT and the government reached a settlement in which ITT would retain Hartford Fire Insurance Company in exchange for divesting itself of several smaller subsidiaries. The details of the negotiation process and the government’s reason for settlement were not revealed. Later, a Senate committee investigation suggested that ITT’s offer to help finance the 1972 Republican National Convention “had been a quid pro quo for the Nixon DOJ's decision to drop its opposition to the ITT/Hartford merger.” Stanford Weisburst, 28 J. of Legal Studies, 55, 93-94 (1999).
[53] 15 U.S.C. § 16(e) (1982).
[54] *Id.*
[55] *See generally United States v. Microsoft Corp.*, 56 F.3d 1448, 1458-62 (D.C. Cir. 1995); *United States v. SBC Commc'ns*, 489 F. Supp. 2d 1, 12-17 (D.D.C. 2007).
[56] *Microsoft*, 56 F.3d at 1460, aff’d sub nom *United States v. Bleznak*, 153 F.3d 16 (2d Cir. 1998).

anticompetitive practices not discussed in the complaint.[57]

The "public interest" standard appears in other contexts. Not surprisingly, the "public interest" standard of review provides a reviewing court with substantial leeway to reject a consent decree. For example, Judge Rakoff relied on a judicially created "public interest" standard of review in order to reject a proposed settlement between Citigroup and the SEC, which will be discussed in full. He found that the consent judgment did not meet the standard because it was not based on "solid facts," "established by either admissions or by trials."[58] This decision overlooked the fact that a central characteristic of a consent decree is that "the defendant agrees to stop the alleged illegal activity without admitting guilt or wrongdoing."[59] Requiring the parties to provide "solid facts" effectively turns the compromise into a mini-trial, interfering with an agency's ability to secure consent decrees and seriously compromising agency enforcement efforts.

III. Settlement—Law and Economics Analysis

Settlement benefits litigants and the public[60] generally, but may impose social costs. So long as the parties' private incentive to settle does not diverge substantially from the social incentive, the settlement will be welfare maximizing.

The private incentive to settle is often significant. Settlement allows both parties to avoid the costs and risks that accompany litigation. The parties to the settlement will not have to pay legal fees and also will avoid the risk of a bad outcome at trial. Defendants may have additional reasons for wanting to settle quickly. A defendant may

---

[57] *United States v. BNS,* 858 F.2d 456 (9th Cir. 1988).
[58] *SEC v. Citigroup Global Markets, Inc.,* 827 F.Supp.2d 328, 335 (S.D.N.Y. 2011).
[59] Black's Law Dictionary 410 (6th ed. 199).
[60] One obvious social benefit that comes from settlement is that trials are costly from a social perspective. The decision to resolve a dispute outside of court lessens the load of an overburdened judge, his or her staff, and the jurors.

worry that a loss at trial, however unlikely, would allow private plaintiffs to pile on private suits due to collateral estoppel.[61] Settlement also helps the defendant avoid reputational harms and injuries to firm value that come from protracted litigation.[62] Thus, settlement may have a corresponding social benefit—the firm's shareholders will benefit when a firm avoids protracted litigation.[63]

Consent decrees also provide special benefits for federal agencies, which are involved in *ongoing* litigation. Government agencies have limited budgets that prevent the agency from pursuing every worthy case. Consent decrees reduce the cost associated with pursuing a cause of action, which allows agencies to seek to enforce the law against a greater number of wrongdoers. If each case takes half as much time and money, the agency can address twice as many violations. And because the terms of the consent decree do not require the agency to compromise greatly on deterrence, the agency's decision to resolve a greater number of cases using consent decrees will result in ample social benefits.

The consent decree offers two features that help the agency deter future wrongdoing. First, the agency can impose injunctive relief, enforced by the court's power of contempt.[64] Because the settlement avoids significant risks and costs (especially when

---

[61] *See Parklane Hosiery v. Shore*, 439 U.S. 322 (1979), which approves offensive non-mutual collateral estoppel in securities class actions.

[62] An empirical study of settlements in almost 500 post-PSLRA suits found that the mere filing of securities fraud litigation caused $25 billion in shareholder wealth to be "wiped out just due to litigation." THAKOR, THE UNINTENDED CONSEQUENCES OF SECURITIES LITIGATION 14 (U.S. Chamber of Commerce Institute for Legal Reform 2005), available at http://tinyurl.com/2vz397. This may be because the public fears the uncertainty of a bad outcome at trial, and because a company that is involved in litigation suffers from the diversion of management attention from endeavors that may enhance firm value.

[63] *See e.g.*, Yaz Gulnur Muradoglu and Jennifer Clark Huskey, *The Impact of SEC Litigation on Firm Value*, available at: http://ssrn.com/abstract=1094948 (finding that SEC lawsuits have a negative effect on share price).

[64] While the SEC rarely asks courts to hold firms in contempt for violating inunctions, this suggests that companies will generally follow rules that are enforced by the court's contempt power. Brief of Amici Curiae Secs. Law Scholars for Affirmance in Support of the District Court's Order and Against Appellant

the defendant need not admit wrongdoing), the agency may find the defendant especially willing to incorporate beneficial institutional changes as part of the consent decree, and the defendant's failure to incorporate the changes will result in a penalty. In this way, the agency can force beneficial changes in defendant behavior that may avert future wrongdoing.

Second, consent decrees are public, which allows the agency to provide guidance to the defendant but also to the industry. While the agency loses its ability to establish helpful precedent (which it might do after a victory at trial and a favorable opinion), the recital of facts in the consent decree allows the agency to publicize its enforcement policy cheaply and quickly, allowing the agency to secure immediate changes in behavior. While parties to the settlement have discretion over the statement of facts that are filed with the court, the court could insist on a fuller explanation of the facts before approving the consent decree.

A conflict between the public and private incentive to settle may emerge if the agency stands to gain certain narrow benefits from the settlement. An agency may reap reputational, political, or financial benefits when it settles a case, which may cause it to settle more often than is socially optimal.

While the presence of institutional or individual conflicts of interest may result in a socially undesirable level of settlement, there are checks on gross abuse. For one, the public nature of consent decrees fosters accountability for agency action. Because the terms of the settlement become part of the public record, the agency is less likely to succumb to private interests. In addition, the agency is subject to oversight by the

---

and Appellee, Secs. & Exch. Comm'n v. Citigroup Global Mkts. Inc., No. 11-5375-cv (Con), (2d Cir. Aug. 16, 2012), at 15-16.

President and by Congress, which helps keep the agency focused on its mission.

While settlements offer these benefits, they can create social costs. Consider the patent infringer who settles with the holder of a bad patent.[65] The patent holder knows that his patent is bad, but will continue to reap monopoly profits so long as his secret remains undetected. He is content to settle and share his monopoly profits with the infringer, and the infringer is content to accept the payment rather than incur additional litigation costs. If forced to litigate, the public would learn that the patent is defective and would benefit from the access to information. In this case, the private interest diverges from the social interest.

As this example demonstrates, the infringer does not internalize the social cost that comes from having the bad patent monopoly remain in effect. In other cases, the parties might not fully consider that socially valuable interpretations of the law are established by trial.[66] However, in the context of an agency enforcement action, the private incentive to litigate will often be aligned with the social incentive. If the agency is given an opportunity to establish a precedent that could clarify the law and help future private litigants, it is not likely that the agency would ignore this cost. And the agency is in the best position to measure the probability that trial would produce a valuable interpretation of the law (rather than a resolution of facts) when deciding its litigation strategy.

A settlement may also result in a penalty that is too low from a deterrence

---

[65] Steven Shavell, "The Social versus the Private Incentive to Bring Suit in a Costly Legal System," 11 The Journal of Legal Studies 333 (1982).

[66] *See generally,* Steven Shavell, Foundations of Economic Analysis of Law, page 413 (2006); Frank H. Easterbrook, *Justice and Contract in Consent Judgments*, 1987 U. Chi. Legal F. 19, 27 (noting that ''precedents exist principally to help people conform their conduct to law'' and that settlement might result in the creation of ''too few precedents").

perspective. If the agency is forced to reduce its penalty to achieve compromise, deterrence may not be optimal. However, the agency cannot be certain that it will win at trial, or if it does, that the judge will give an award that is calibrated to the real amount of damage caused (which would result in optimal deterrence). Instead, overdeterrence is more likely when bad behavior is policed at many levels. In the securities context, state attorney generals, U.S. attorneys, and private lawsuits all challenge securities misconduct.[67] The passage of the PSLRA suggests that overdeterrence of beneficial conduct is of greater concern in this area.[68]

And while the agency may reduce the overall monetary penalty in order to achieve compromise, the reduced fine may not substantially impact overall deterrence. Corporate fines are levied against the corporation as a whole (years after the alleged wrongdoing has occurred), punishing current shareholders for conduct that benefitted a largely different group of shareholders (if any benefit was conferred at all). At this point, the individuals responsible for the wrongdoing have often left the company. For the new managers, the fine will not be likely to deter misconduct, and will instead be viewed as a tax for doing business. For these reasons, reduced monetary penalties will not reduce

[67] Securities fraud is a criminal violation punishable by fines and imprisonment. *See, e.g.*, 15 U.S.C. § 78ff. The Department of Justice, assisted by the FBI, aggressively enforces the securities laws: from 2002-2007, the Corporate Fraud Task Force obtained more than 1200 guilty pleas and convictions and more than $1 billion in forfeitures used to compensate investors. Department of Justice, Fact Sheet: President's Corporate Fraud Task Force (July 17, 2007), available at http://tinyurl.com/37hudk. These efforts are supplemented by state prosecutors. In New York, the Attorney General obtained more than $1 billion in settlements in 2004 alone. http://oag.state.ny.us/press/agpress04.html.

[68] *See* Michael A. Perino, *Did The Private Securities Litigation Reform Act Work?*, 2003 U. Il. L. Rev. 913, 914 (2003) ("In 1995 Congress set out to fix securities class action litigation when it passed the Private Securities Litigation Reform Act (the PSLRA, the Act, or the Reform Act). The Reform Act was designed to address a number of perceived abuses in these cases. In large part, its solution was to create a series of procedural hurdles that make it more difficult for plaintiffs' attorneys to bring and maintain nonmeritorious securities fraud class actions.")

overall deterrence.[69]

The threat of an SEC suit is a much stronger deterrent to bad behavior. And while the SEC most often settles cases using a consent decree, this does not weaken the threat of an SEC suit. In fact, the very threat of a government suit puts intense pressure on companies to avoid the suit and settle. Companies fear SEC lawsuits because of the high risk of follow-on private suits and also because of significant reputational harms for the firm and its executives. Such suits have substantial social costs as well, impinging on earnings and ultimately hurting current investors. For these reasons, the SEC wields a great deal of bargaining power in negotiations with companies, even if the SEC not likely to take the company to trial.

Because most consent decrees do not require the defendant to admit wrongdoing, the whole "truth" may never be revealed to the public when a case is settled using a consent decree. But, as mentioned, the court may insist on a fuller explanation from the parties before approving the decree. And while trial would flesh out the evidence, the benefit that comes from requiring the revelation of every fact at trial is not worth the social costs created by the interference. This is especially true because the consent decree recital is often detailed enough for a private plaintiff to use to file suit and start discovery (private lawyers often file complaints based on the government complaint alone).

By requiring the agency to include all relevant "facts," or admissions of guilt in the consent decree, a reviewing court compromises the agency's ability to enter into consent decrees. For most defendants, the corresponding costs that accompany self-accusation (including the substantial risk that private litigants would rely on collateral

[69] This point was first made by Professors Arlen and Carney. *See* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets,* 1992 U. Il. L. Rev. 691 (1992).

estoppel to file additional suits) would make settlement prohibitively costly. If required to litigate each case through trial, the agency would be forced to be very selective about which cases to pursue. Investor welfare on the whole would suffer, as the agency would be constrained in its ability to pursue wrongdoing in many places. A deontological command to seek the truth that is so squarely in conflict with an agency's overall mission must be avoided.

A consent decree offers benefits to an enforcement agency precisely because it allows the agency to secure a penalty without engaging in the costly trial process. While the public might lose out on the opportunity for aggrieved individuals to secure an admission of culpability, this cost will not outweigh the many benefits that come from allowing agencies flexibility in using this important enforcement tool.

The discussion above reveals an additional deterrence benefit: the SEC can use consent decrees to reward firms that cooperate and thus can avoid perverse incentives created by the existing liability regime. It is precisely the leniency that consent decrees provide that creates this social benefit. When a court prevents an agency from entering into a consent decree for fear that it is too lenient, and the leniency is in fact socially desirable because it encourages cooperation and self-reporting, the interference will increase the expected rate of corporate violations.

When the agency chooses to use a consent decree, it will have concluded that the costs from litigation exceed the benefits from settling by consent decree. The agency calculation would be optimal if the agency balanced the social benefits that come from litigation (including the creation of beneficial precedent, adequate deterrence, and information revealed to the public), discounted by the likelihood of winning, against the total costs of litigation (which include litigation costs, opportunity costs from diverted agency resources, and the cost to the investing public). In most cases, the agency's incentive to settle will be aligned with the public incentive. And so long as the agency is considering important social costs and benefits, the court need not scrutinize the merits of the settlement.

Of course, if a reviewing court had evidence that the agency was not adequately considering the social benefits or social costs of settlement, or that the agency was institutionally compromised, it would have reason to block the settlement. But as we will see, vague standards of review encourage the judiciary to intrude into the negotiations between the parties even when the agency's decision to settle is justified, creating additional social costs without corresponding benefits.

IV. Judge Rakoff and the SEC

A. The SEC/Citigroup Consent Decree

In November of 2011, Judge Rakoff of the Federal District Court in Manhattan declined to approve a consent decree between the SEC and Citigroup. The SEC alleged that Citigroup had created a fund that allowed it to unload risky assets on misinformed investors and filed a complaint that charged Citigroup with violating Sections 17(a)(2) and (3) of the Securities Act of 1933.

On the same day that it filed their complaint, the SEC submitted a proposed consent judgment that ordered three forms of relief. First, the judgment permanently enjoined Citigroup from violating provisions of the Securities Act cited in the complaint. Second, it ordered Citigroup to disgorge $160 million, pay $30 million in pre-judgment interest, and pay a $95 million penalty, which would be placed in a Fair Fund for injured investors. Third, it ordered Citigroup to strengthen its approval processes for initial offerings of residential mortgage-related securities, to enhance the role of legal counsel and compliance officers in reviewing the marketing materials for such securities, and to demonstrate its compliance with these orders by submitting to audits and monitoring by the SEC. Citigroup did not admit or deny the allegations in the consent decree.

Judge Rakoff was initially skeptical about the consent decree and ordered the SEC to prepare answers to nine questions regarding the terms of the settlement. In a hearing on November 9, 2011, the SEC defended the terms of its consent judgment. It explained that the proposed consent decree reflected the relief that was likely to be obtained if the SEC was successful at trial. While Judge Rakoff was correct in pointing out that investor losses likely exceeded $700 million, the SEC explained that the $285 million figure was based on the available remedies under law for violations of Section 17: disgorgement of ill-gotten gains and a civil penalty that cannot exceed such gain.[70] The agency also explained that it had considered the presence of litigation risk, the benefits of avoiding that risk, the opportunity to detail the SEC's factual conclusions, the allocation of resources among SEC enforcement actions, and Citigroup's unwillingness to settle while admitting wrongdoing, when negotiating the terms of the settlement.[71]

The parties initially took the position that the settlement need only be "fair, reasonable, and adequate," but Judge Rakoff stated that he could not approve the settlement without considering the public interest because the consent decree required the

[70] Brief for the Petitioner at 14-15, *Securities and Exchange Commission v. Citigroup Global Markets, Inc.* (No. 11-5227).
[71] *Id.*

court to impose injunctive relief.[72] Judge Rakoff reasoned that he could not approve the consent decree under this standard because the court "had not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment."[73] He wrote that the SEC had a duty to "see that the truth emerges."[74]

In the background was a concern that the SEC had not sufficiently protected investor interests and that Citigroup had gotten off too easily.[75] Judge Rakoff faulted the SEC for charging Citigroup under 17(a) when the charges suggested the existence of scienter that would warrant more serious charges. And because the SEC had not required Citigroup to admit allegations and because it had charged the company with negligence, the consent judgment would be of no assistance to private litigants who could use collateral estoppel to bring their own 10b-5 suits.

By Judge Rakoff's logic, a consent judgment cannot be "adequate, fair, or in the public interest" when it asks the court to "impose substantial injunctive relief, enforced by the court's own contempt power, on the basis of allegations unsupported by any proved on acknowledged facts." To put it another way, the SEC has a duty to ensure that the truth emerges once it files a complaint in court. The opinion, if upheld, would severely limit the SEC's ability to enter into consent decrees and would prevent socially desirable compromise.

---

[72] The judge wrote, "[w]hen a public agency asks a court to become its partner in enforcement by imposing wide-ranging injunctive remedies on a defendant, enforced by the formidable judicial power of contempt, the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts, while the public is deprived of ever knowing the truth in a matter of obvious public importance." *U.S. S.E.C. v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2d 328, 332 (S.D.N.Y. Nov. 28, 2011).

[73] *Id.* at 330.

[74] *Id.* at 335.

[75] He wrote, "if the allegations of the Complaint are true, this is a very good deal for Citigroup; and, even if they are untrue, it is a mild and modest cost of doing business." *Id.* at 333. The court thought the penalty was "very modest." *Id.*

But it appears likely that Judge Rakoff's decision to block the settlement will be overturned. The Second Circuit has yet to rule on the merits of the decision, but has stayed the district court's order pending the resolution of the SEC and Citigroup's interlocutory appeal. While the court stated that it needed to hear further arguments before deciding whether the settlement rejection was improper, it indicated that Citigroup and the SEC were likely to prevail in their challenge. The panel stated that the decision was out of line with precedent and that Judge Rakoff had failed to show proper deference to the SEC's judgment, writing, "it is not…the proper function of federal courts to dictate policy to executive administrative agencies."[76]

Under the facts of the case, the district court's interference was unjustified. The record reveals that the SEC considered important social costs and benefits when it determined the terms of the consent decree. By contrast, a discussion of these costs and benefits was wholly absent from Judge Rakoff's opinion. The Second Circuit highlighted this omission, stating, "the court does not appear to have considered the agency's discretionary assessment of its prospects of doing better or worse, or of the optimal allocation of its limited resources. Instead, the district court imposed what it considered to be the best policy to enforce the securities laws."[77]

B. The SEC/Bank of America Consent Decree

This is not the first time Judge Rakoff rejected an SEC settlement because he felt that it was too lenient: just two years before his decision to block the consent decree between the SEC and Citigroup, Judge Rakoff rejected a consent decree between the SEC and Bank of America. Judge Rakoff eventually relented and approved a modified

[76] *U.S. S.E.C. v. Citigroup Global Markets Inc.*, 673 F.3d 158, 165 (2d Cir. 2012).
[77] *Id.* at 163.

settlement following months of additional discovery. His ultimate decision to approve a substantially similar decree suggests that social waste is often the result of judicial interference in the name of public welfare.

On September 14, 2009, Judge Rakoff rejected a $33 million consent decree that would have settled an SEC suit that alleged that Bank of America mislead investors about bonuses that were paid to Merrill Lynch executives at the time of Bank of America's acquisition of the firm. In his opinion, Judge Rakoff stated that the SEC's "neither admit nor deny approach" as little more than "a contrivance designed to provide the SEC with the façade of enforcement and the management of the Bank with a quick resolution of an embarrassing inquiry"[78] and ordered the parties to prepare for trial.

Before this ruling, the parties had provided hundreds of pages of documents and defended the terms of the settlement in an August hearing. In the hearing, the SEC explained that the investigative record did not support additional charges against Bank of America or other officials, partially because the attorney-client privilege blocked its discovery of certain key documents. After the court blocked the settlement, lawyers for Bank of America waived the attorney client privilege and the parties presented additional statements of facts to the court. The lawyers also responded to additional questions from the court with hundreds of pages of deposition materials.

Following the second wave of document production, Judge Rakoff approved a modified consent decree. The settlement was altered to implement certain prophylactic remedies suggested by the court, but Bank of America refused to incorporate Judge Rakoff's proposal that would have allowed the court to choose a pay consultant for the

[78] *S.E.C. v. Bank of America, Corp.*, 653 F.Supp.2d 507 (S.D.N.Y. 2009).

bank. The penalty package was also raised to $150 million to reflect the settlement of another claim against Bank of America in addition to the previous settlement amount.

While Judge Rakoff stated that the settlement, was “far from ideal,” “[i]ts greatest virtue is that it is premised on a much better developed statement of the underlying facts and inferences drawn therefrom …”[79] Judge Rakoff further stated that he ultimately approved the consent decree because “the law requires the Court to give substantial deference to the SEC”[80] and he was obligated to refrain from imposing his own preferences: “we can balk when a bank tries to escape the implications of hiding material information from its shareholders, and we can protest when the regulatory agency in charge of deterring such misconduct seems content with modest and misdirected sanctions, but, in the words of a great former Justice of the Supreme Court, Harlan Fiske Stone, ‘the only check upon our own exercise of power is our own sense of self-restraint.’”[81]

In this case, Judge Rakoff rejected a consent decree only to approve a slightly modified decree months later. The delay cost the parties millions of dollars in lawyer’s fees, discovery expenses, and hundreds of hours preparing for an appeal. For an agency like the SEC, the cost of this effort was the missed opportunity to conduct enforcement in other areas. The ultimate result: Judge Rakoff determined that the consent decree was appropriate—the additional briefing confirmed that the SEC’s interpretation of the events was “a reasonable conclusion.” Would it not have been better to apply principles of judicial restraint and deference to the executive branch initially, which would have saved significant time and resources for both parties and society as a whole?

---

[79] *S.E.C. v. Bank of America*, 2010 WL 624581 at *4 (S.D.N.Y. 2010).
[80] *Id.* at *6.
[81] *Id.*

V. Deference

While Judge Rakoff cited a legal obligation to defer to the SEC when he decided to approve the Bank of America settlement, he showed no such deference when he blocked the Citigroup consent decree. This omission, as the Second Circuit pointed out, was an error. Due to its experience, manpower, and perspective, an administrative agency is best placed to evaluate the costs and benefits of settling a case. Unlike the court, the agency can evaluate how settling one case will impact its other enforcement actions, and it can set the terms of the compromise with an eye towards overall welfare. Unless the agency's ability to make decisions in the public interest is seriously compromised, the judge should not interfere with the terms of the settlement.

Most courts apply a presumption of adequacy for settlements negotiated and submitted by enforcement agencies.[82] The concept of deference is necessary to maintain the constitutionally mandated separation of powers that assigns executive agencies the authority to execute the laws. While the courts employ an important check on the power of the executive branch, the judicial system is not inquisitorial, but adversarial, with the ultimate momentum originating with the executive branch.

The Supreme Court has emphasized that the courts must not interfere with agency policy. Agencies alone must decide "whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts,"[83] and whether "the benefits of pursuing an adjudication" exceed "the costs to the agency (including the financial and opportunity costs)."[84] These decisions are best made by agencies because

[82] *See SEC v. Randolph*, 736 F.2d 525, 529 (9th Cir. 1984); *United States v. Cannons Eng'g Corp.*, 899 F.2d 79, 84 (1st Cir. 1990).
[83] *Heckler v. Chaney*, 470 U.S. 821, 831-32 (1985).
[84] *New York State Law Dep't v. FCC*, 984 F.2d 1209, 1213-15 (D.C. Cir. 1993).

an agency is "far better equipped than the courts to deal with the many variables involved in the proper ordering of its priorities."[85]

Unnecessary judicial review hampers agency policy and creates additional costs. A blocked settlement increases the cost of later settlement to the parties, which increases the likelihood of trial.[86] While this has obvious costs for the affected parties, a judicial rule that makes settlement more difficult also creates social costs. A court's decision to block a consent judgment has "enormous practical consequences for the government's ability to negotiate future settlements."[87]

The specific requirement that the agency secure an admission of guilt in a consent decree would severely interfere with agency policy. Many defendants would rather take their chances at trial rather than enter into a consent decree under such terms. Consequently, fewer consent decrees would be entered into, eliminating the many benefits that come from their use. With the knowledge that each case would be litigated to completion, the agency would also be forced to bring fewer actions. As the SEC stated in its brief before the Second Circuit: "The Commission could not try the substantial percentage of district court cases currently resolved by consent judgments each year—roughly 90%--given the agency's limited budget and its manifold statutory obligations to regulate the securities markets for the protection of investors. The Commission would then be unable to pursue some district court enforcement actions that would benefit

[85] *Heckler*, 470 U.S. at 831-32. As the SEC explained in its brief before the Second Circuit, "'[C]ase-versus-case is the daily tradeoff' that the agencies like the Commission must face, and the Commission's considerable experience overseeing its enforcement program puts the Commission in the best position to 'compare the value of pursuing one case against the value of pursuing another.'" Brief for the Petitioner at 43-44, *Securities and Exchange Commission v. Citigroup Global Markets, Inc.* (No. 11-5227), quoting *Board of Trade*, 883 F.2d at 531.
[86] *See* Stanford I. Weisburst, *Judicial Review of Settlements and Consent Decrees: An Economic Analysis*, 28 J. Legal Stud. 55 (1999); Judith Resnik, *Judging Consent*, U. Chi. Legal F. 43, 101 (1987).
[87] *Microsoft*, 56 F.3d at 1456.

investors if they were resolved by consent judgment. Or it would find it necessary to bring more administrative proceedings, losing the benefits of litigating in district court and frustrating Congress's objective in opening the federal courts to Commission enforcement actions."[88]

Separation of powers concerns reflect the practical realty that courts are poorly situated to evaluate what constitutes a welfare-maximizing compromise. Government agencies are charged with protecting the public in their area of expertise[89] and are responsive to the public and congressional oversight. Administrative agencies also have an institutional advantage: the agency has time and resources that are solely devoted to enforcing the law in a particular area. It has a wealth of tools that it can use to help it make a rational decision.[90] And the agency can decide what wrongdoing to pursue and what penalties are appropriate in light of its overall goals. A single judge with a heavy docket cannot duplicate the work of an agency with thousands of staff members and specialized experience.

Importantly, a reviewing court is more likely to overlook or under appreciate many factors that influence an agency's decision to settle a case (such as the agency's own calculation of its ability to win at trial and win again on appeal). The court is poorly positioned to evaluate the many variables involved in the proper ordering of agency priorities and the allocation of agency resources. In the case of the Citigroup settlement, the court failed to consider "the value of the particular proposed compromise, the

[88] Brief for the Petitioner at 49, *Securities and Exchange Commission v. Citigroup Global Markets, Inc.* (No. 11-5227)
[89] For example, the SEC's website states that "the mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." U.S. Securities and Exchange Commission, *The Investor Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation,* available at: http://www.sec.gov/about/whatwedo.shtml
[90] *See e.g., Gabelli v. SEC,* 568 U.S. __ (2013) (listing the SEC's many legal tools for rooting out fraud).

perceived likelihood of obtaining a still better settlement, [and] the prospects of coming out better, or worse, after a full trial."[91] A failure to account for these costs and benefits may result in an overall judicial bias against consent decrees.

VI. The Optimal Scope of Judicial Review

The Citigroup case illustrates how vague standards of review can encourage judges to block socially beneficial settlements. Judge Rakoff decided that the settlement was not "fair, adequate, and in the public interest" and ordered the parties to prepare for trial so that the "truth" would emerge. But the SEC provided ample documentation in support of the consent decree that demonstrated it had fully considered the benefits and costs to important affected interests. Instead of deferring to the agency's judgment, Judge Rakoff blocked the compromise due to concerns about the substantive merits of the settlement, ignoring the fact that the judiciary is not well positioned to make this judgment.

This does not mean that a reviewing court should rubber stamp each consent decree. If there is clear evidence that decree would infringe legal rights of a segment of public,[92] or if the decree would drain judicial resources through excessive supervision,[93] the court should withhold approval.

Further, a judge may also look for concrete indications that an agency is institutionally disabled. If the judge finds a misalignment of interest between the agency and the public, he or she would have good cause to block the settlement.

An agency may be incapable of adequately looking out for the public interest for two reasons: it could have improper motivation or incomplete information. If the

---

[91] *U.S. S.E.C. v. Citigroup Global Markets Inc.*, 673 F.3d 158, 164 (2d Cir. 2012).
[92] *See e.g., United States v. City of Hialeah,* 140 F.3d 968, 973 (11th Cir. 1998).
[93] *See e.g., In re United States,* 503 F.3d 638, 641 (7th Cir. 2007).

agency's incentive to settle diverges from the public incentive, the agency may agree to a compromise that is not in the public interest. This might occur if the agency has a conflict of interest that causes it to settle without a reasonable consideration of the social costs and benefits. Epistemic capture, by contrast, could create a systematic distortion. Even if the agency is genuinely trying to act in the public interest, it may agree to a bad settlement if it is getting the wrong information.

A. The Motivation Problem

i. Structural Impairment and Due Process

When evaluating a consent decree, a reviewing should consider the agency's motivation for settling: given its staffing and financing, the agency may be structurally incapable of making a decision that is in the public interest. Background principles of due process can inform the standard of review in such cases.

The due process clause of the Fifth Amendment entitles litigants to fair and impartial adjudication,[94] and administrative decisionmakers are held to the same standard of impartial decisionmaking as Article III judges.[95] While administrative officials are presumed to be objective and capable of judging particular controversies fairly and on the basis of their own circumstances,[96] the composition and structure of an administrative agency may create structural bias that would violate due process. According to the Supreme Court in *Tumey v. State of Ohio*, two main categories of due process challenges based on structural bias exist. First, due process is offended if the decisionmaker "has a

[94] *See Schweiker v. McClure*, 456 U.S. 188, 195 (1982); *Harline v. Drug Enforcement Admin*., 148 F.3d 1199, 1203 (10th Cir. 1998), cert. denied, 525 U.S. 1068 (1999).
[95] *See Schweiker,* 456 U.S. at 195.
[96] *Withrow v. Larkin*, 421 U.S. 35 (1975) ("Without a showing to the contrary, state administrators 'are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances.'" *United States v. Morgan,* 313 U.S. 409, 421 (1941).

direct, personal, substantial pecuniary interest" in the outcome of a proceeding. Second, "even when a decisionmaker does not have a personal stake in a particular proceeding, due process still stands violated if the decisionmaker, because of his institutional responsibilities, would have 'so strong a motive' to rule in a way that would aid the institution."[97]

The Supreme Court has relied on *Tumey* to strike down regulations that create an unconstitutional risk of bias due to pecuniary interest. In *Ward v. Village of Monroeville,*[98] the Court relied on *Tumey* to declare Ohio regulations unconstitutional that authorized the state's mayors to sit as judges in cases involving ordinance violations and traffic offenses. Because the cases conducted by the city's mayor produced substantial revenue for the city, the Court deemed the Mayor incapable of affording due process to defendants. The court did not evaluate the merits of the Mayor's decisions as a judge, but instead said that the "possible temptation" to execute his responsibilities for village finances was sufficient to compromise the neutrality of the system.[99] More recently, the Supreme Court held that West Virginia Supreme Court of Appeals Justice Brent Benjamin violated due process when he refused to recuse himself in *Caperton v. A.T. Massey Coal Co.*[100] Because defendant A.T. Massey's corporate board had donated $3 million in campaign contributions to the justice's campaign, "the probability of actual bias on the part of the judge or decisionmaker [wa]s too high to be constitutionally tolerable." Justice Kennedy highlighted the "temporal" relationship between the contributions and Justice Benjamin's election as well as the central role that Justice

[97] *Tumey v. State of Ohio*, 273 U.S. 510, 523 (1927).
[98] 409 U.S. 57 (1972).
[99] *Id.*
[100] 556 U.S. 868 (2009).

Benjamin played in two decisions that reversed a substantial jury verdict against Massey.[101] This case demonstrated that even legal campaign contributions can create circumstances in which the probability of bias on the part of the judge or decisionmaker is too high to be constitutionally tolerable.[102] However, the Court has also emphasized that the pecuniary interest must be concrete and relatively substantial in order to warrant a finding of unconstitutionality—speculative interest in the outcome is not enough.[103]

The Supreme Court has confronted the potential for structural bias in the design of a hybrid administrative-adjudicative body. Such a finding renders the decisionmaking of the entire agency invalid, and as such, is a more difficult case to make. The furthest the Supreme Court has gone in requiring structural impartiality was in *Gibson v. Berryhill.*[104] In this case, the Alabama Board of Optometry ("the Board") brought an action in state court that resulted an injunction against the practice of optometry by Lee Optical and its employees. Lee Optical countered with its own suit in federal court, claiming that because membership of the Board was statutorily limited to members of the Alabama Optometric Association, whose membership was limited to independent optometrists, "the Board was biased and could not provide the plaintiffs with fair and impartial hearing in conformity with due process of law."[105] The Supreme Court deferred to the reasoning of the District Court, which held that the inquiry was whether "in the natural course of

[101] *Id.* at 872, quoting *Withrow v. Larkin,* 421 U.S. 35, 47 (1975).
[102] "The Court asks not whether the judge is actually, subjectively biased, but whether the average judge in his position is 'likely' to be neutral, or whether there is an unconstitutional 'potential for bias.'" *Id.* at 881.
[103] *Withrow,* 421 U.S. at 55, quoting *United States v. Morgan,* 313 U.S. 409, 421 (1941) ("No specific foundation has been presented for suspecting that the Board had been prejudiced by its investigation or would be disabled from hearing and deciding on the basis of the evidence to be presented at the contested hearing. The mere exposure to evidence presented in nonadversary investigative procedures is insufficient in itself to impugn the fairness of the board members at a later [and presumable sufficient] adversary hearing. Without a showing to the contrary, state administrators 'are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances.")
[104] 411 U.S. 564 (1973).
[105] *Id.* at 570.

events, there is an indication of a possible temptation to an average man sitting as a judge to try the case with a bias for or against any issue presented to him "[106] and affirmed the possibility of bias based on the board's financial interest and lack of independence.[107]

In the past two decades, Federal Courts of Appeals have similarly held that adjudicative and quasi-adjudicative agencies are subject to scrutiny much like individual decisionmakers. For example, if the decisionmaking body has an institutional financial interest in the outcome, this conflict may violate the prohibition against bias. In *Alpha Epsilon Phi Tau Chapter Housing Association v. City of Berkeley*,[108] the Ninth Circuit considered whether an administrative agency, whose adjudicative decisions provided revenue for its operating budget in more than a *de minimus* fashion, could afford constitutionally requisite Due Process. The defendant Berkeley Rent Stabilization Board directly funded its budget by charging fees to landlords while also adjudicating matters such as whether landlords were covered by the local rent control ordinance (and hence were subject to registration fees and penalties). While acknowledging that in some cases, a strong institutional motive to rule impartially due to a pecuniary interest would violate due process standards, the court held that the Board's financial interest in coverage adjudications was insufficiently large to offend due process.[109]

---

[106] *Id.* at 571.
[107] Justice White wrote, "[T]he Board's efforts [which would result in revocation of the licenses of all optometrist-employees, not just those employed by Lee Optical] would possibly redound to the personal benefit of members of the Board, sufficiently so that in the opinion of the District Court, the Board was constitutionally disqualified from hearing the charges filed against the appellees." *Id.* at 578.
[108] 114 F.3d 840 (9th Cir. 1997).
[109] The court considered whether the conflict was sufficiently strong such that it would "'offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear, and true between the state and the accused.'" *Berkeley*, 114 F.3d at 845, quoting *Tumey*, 273 U.S. at 53. The court emphasized that the Board's decisions regarding coverage would affect only 5% of its budget, that the board could seek funding from other sources if necessary, and that evidence demonstrated that the board had refrained from systematically expanding its dominion. Because of this, "no person could 'reasonably…fear…partisan influence in [the] judgment.'"*Berkeley*, 114 F.3d at 848, quoting *Tumey*, 273 U.S. at 53.

More recently, the Second Circuit directed the district court to consider the possibility that the New York City Taxi and Limousine Commission's adjudicative system could be systematically biased in violation of Due Process. The court noted that financial conflicts of interest or "some other specific reason for disqualification," such as the Commission's ruling history, could rebut a presumption that the agency could render decisions with "honesty and integrity."[110]

Federal courts have also held that an administrative program or policy that creates systemic, structural bias falls outside the range of appropriate administrative conduct and violates due process. In *Barry v. Bowen,* the Ninth Circuit held that the SSA's "Bellmon Review" program failed to provide due process to claimants.[111] The district court found that the Bellmon review process, which focused on allowance rates,[112] "put pressure on selected ALJs to reduce their percentage of benefit allowances, thereby denying claimants of their right to an impartial ALJ" and sent a message suggesting that the decision should be reversed, which "impermissibly affected the Appeals Council."[113] The Ninth Circuit court upheld this reasoning.[114]

---

[110] *Rothenberg v. Daus*, 2012 WL 1970438 (2d Cir. 2012).
[111] 825 F.2d 1324 (9th Cir. 1987). The program was initiated following Congressional passage of the Bellmon Amendment, which mandated that the Secretary of Health and Human Services implement a program to review administrative law judges' (ALJ) SSA decisions.
[112] The program initially targeted ALJ decisions with an allowance rate of 66 2/3% or higher for review, but the program was expanded to target ALJs on the basis of their appeals council reversal rate. Plaintiff Barry sued after the appeals council, which reviewed his case on its own motion and reversed the ALJ decision, contending that Barry was not entitled to disability benefits.
[113] *Barry v. Heckler*, 620 F.Supp. 779 (N.D.Cal. 1985). Other district courts reached a similar conclusion, *see Salling v. Bowen*, 641 F.Supp. 1046, 1056 (W.D.Va. 1986) ("If there ever was a chilling of judicial independence, this is it. This is like threatening a lawyer with disbarment if he takes a case of a controversial nature. This is the same as saying that every law judge in the country should be deciding a certain percentage of cases against the claimant."); *W.C. v. Heckler*, 629 F.Supp. 791, 799–800 & n. 15 (W.D.Wash. 1985) ("To designate high allowance ALJs for ongoing review of their allowance decisions inexorably tends to discourage these ALJs from allowing benefits in close cases."); *AALJ v.Heckler*, 594 F.Supp. 1132, 1141–43 (D.D.C. 1984) (the SSA's "unremitting focus on allowance rates in the individual ALJ portion of the Bellmon Review Program created an untenable atmosphere of tension and unfairness which violated the spirit of the APA, if no specific provision thereof").
[114] *Barry v. Bowen*, 825 F.2d 1324 (9th Cir. 1987).

Lastly, the consent decree itself could create the disability. Such was the case in *St. Charles Tower, Inc. v. Kurtz.* In that case the Eigth Circuit held that a consent judgment that adversely affected non-consenting third parties was required to be vacated.[115] While the court based its holding on a violation of state law, evidence of structural agency impairment was also present.

St. Charles Tower had sued the county and the board of zoning adjustment, alleging that the denial of a conditional use permit to construct cell phone towers violated the Telecommunications Act (TCA). The parties entered into a consent judgment that required the county to issue all permits necessary for St. Charles Tower to begin construction. Trustees of a homeowners association filed a motion to intervene, asserting that the consent judgment circumvented state procedural protections specified in the applicable zoning regulations.

Because the consent decree required the board to issue any permit required for construction, it impermissibly cabined the board's discretion. The Eighth Circuit correctly reversed the district court's decision to let the consent judgment stand, not because the decision to award the permits would necessarily harm public welfare, but because the consent decree created an institutional disability, preventing the board from acting solely to promote the public interest.[116]

ii. Structural Agency Impairment: Red Flags for Reviewing Courts

This line of cases demonstrates that structural conflicts of interest can compromise decisions made by an administrative agency and leave the decision vulnerable to appeal. The *Tumey* Court emphasized that due process challenges exist 1)

---

[115] *643 F. 3d 264*, *268* (8th Cir. 2011).

[116] The district court denied the interveners motion for relief from the consent judgment, holding that it did not violate state law. The Eighth Circuit reversed on appeal, holding that the decree violated state law.

when the agency has a tangible stake in the outcome of the adjudication and 2) when institutional responsibilities exist that would prevent the decisionmaker from exercising her responsibilities with an independent mind.[117] The conflict may be at the agency or individual level.

While these cases involve administrative adjudication, they lay out broad principles that can be applied to an enforcement agency's decision to secure a settlement by consent decree. A reviewing court would be wise to scrutinize an agency's motivation and the constitutional adequacy of its decision to settle under the following circumstances:

1) The structure of the agency gives the agency as a whole a concrete and substantial pecuniary interest in the outcome of the settlement. Evidence of this kind suggests that the agency may be misguided in its settlement demands. For example, many state agencies and some federal agencies "eat what they kill"—their budgets depend on the penalties they acquire. If an agency relies on settlement fees from the affected industry, the agency may be too stringent when seeking settlements.[118] It could also lead to an underdeterrence problem if agencies would prefer to rely on small yet certain consent judgments instead of risky awards earned after a long trial. And if the agency stands to gain financial benefits from imposing lenient settlements, it

[117] *Tumey v. State of Ohio,* 273 U.S. 510, 523 (1927).
[118] "[I]t is increasingly common for federal and (especially) state law to permit public enforcers to retain a portion of the money recovered through civil judgments or negotiated settlements….such enforcement-funded revolving funds create incentives for enforcers to maximize financial recoveries." Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement* , 127 Harv. L. Rev. at 14 (publication forthcoming January 2014) available at SSRN: http://ssrn.com/abstract=2296087.

may be incapable of rendering an impartial decision. New Jersey City raised such an objection against FERC, claiming that because the agency was financed entirely by the energy industry, it was incapable of functioning as a neutral arbiter of the energy industry's requests to approve natural gas pipeline projects.[119]

2) The agency's institutional responsibilities could cause it to prioritize factors other than the public interest. The agency may be subject to excessive political interference that would cause it to be too lenient or too harsh in enforcing a particular policy. Relatedly, the agency might be unduly concerned with building a reputation as a tough enforcer, either to satisfy the public or Congres.[120] For example, Judge Rakoff was concerned that the SEC was anxious to settle the case for the "quick headline."[121] Professors Lemos and Minzner suggest that agency may demand financial penalties too often (instead of injunctive measures) because financial awards allow the agency to secure immediate reputational benefits and require low enforcement costs.[122] While these institutional pressures may create a conflict, the Supreme Court has made clear that the pecuniary interest must be concrete and relatively substantial in order to warrant a finding of

---

[119] *FERC Rejects Claims of Bias in Pipeline Approvals Commission Attributes Approval of 30 out of 31 Proposals Since 2010 to Effective Prefiling Process,* 28 No. 12 Nat. Gas Transp. Info. Service Newsl. 11 (2012).

[120] Professors Lemos and Minzner report that federal agencies commonly seek press coverage based on the large size of their settlements and number of enforcement actions filed and tout these results to Congress. Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement* , 127 Harv. L. Rev. at 21 (publication forthcoming January 2014) available at SSRN: http://ssrn.com/abstract=2296087.

[121] *U.S. S.E.C. v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2d 328, 333 (S.D.N.Y. Nov. 28, 2011).

[122] Margaret H. Lemos & Max Minzner, *For-Profit Public Enforcement* , 127 Harv. L. Rev. at 35 (publication forthcoming January 2014) available at SSRN: http://ssrn.com/abstract=2296087.

unconstitutionality.[123] If the reputational concern is speculative (as it was in the Citigroup case), it will be insufficient to warrant overturning the decision.

3) The terms of the consent decree will prevent the agency from exercising its discretion, as was the case in *St. Charles Tower*.

In addition, members of the agency's staff may stand to gain significant monetary or non-monetary benefits from the settlement. If the agency is staffed by members of the affected industry, or who have applied to work in the affected industry, the decisionmaking of the agency as a whole may be compromised. For example, PCAOB has faced staffing controversies since inception: the first chairman was forced to resign after undisclosed ties to a company under investigation were leaked to the press.[124]

This issue poses a daunting problem in the context of securities regulation. The SEC, which is famous for its "revolving door," regulates all publically traded firms. If remote ties to firms were seen to be sufficient evidence of a conflict, almost every case would be vulnerable to enhanced judicial scrutiny. The precedent makes clear that raising a bias challenge in the context of administrative adjudication is hard to do.[125] Any asserted bias must be evident from the record and cannot be based on speculation. Thus, the non-monetary benefits must be sufficiently definite and the conflict unambiguous in order to invite judicial scrutiny in such contexts. An indication that an agency has failed

---

[123] *Withrow*, 421 U.S. at 55.

[124] The Public Company Accounting Oversight Board (PCAOB), created by Sarbannes-Oxley to improve oversight of the auditing process for public companies, has faced staffing controversies since inception. William H. Webster, the first chairman of PCAOB, was forced to resign shortly after his appointment after newspapers revealed that he had served on the board audit committee of a company that was currently being investigated by PCAOB for accounting irregularities. *See* Jerry W. Markham, Financial History of Modern United States Corporate Scandals, page 453 (2006).

[125] *See Schweiker*, where the Supreme Court established a strong presumption in favor of impartiality in institutional decisionmaking the absence of direct evidence to the contrary. *See also United States v. Morgan*, 313 U.S. 409 (1941); *FTC v. Cement Institute*, 333 U.S. 683 (1948).

to follow its own recusal rules, [126] or evidence of bribery or corruption (as was alleged in the *ITT* case), would raise an obvious red flag.[127]

iii. Remedies for structural impairment

If a court finds that an agency is institutionally disabled, what is the correct course of action? Ideally, the court would identify the source of conflict and remand the consent decree, requiring the parties to address the structural problem. If the court learns that a member of the agency body has a strong conflict of interest, it could require reconsideration of the terms of the settlement after the agency has recused the conflicted party.

If the agency is severely disabled (and a simple recusal will not solve the problem) the court may find that the agency is incapable of rendering an unbiased decision, similar to the outcome in *Gibson.* In such cases, the court may demand that the agency refrain from reconsidering the issue until it has dealt with its structural infirmities, or it may require the agency to pass the problem to another agency.

In no case should the court force an agency that is structurally impaired to litigate. An agency has discretion over when to bring a case and a court cannot force an agency to prosecute.[128] By the same token, an agency should be given broad latitude to settle a case.

---

[126] Some agencies have recusal rules in place to guard against accusations of bias and favoritism. Prior to 1991, many government agencies had internal recusal policies. However, the Office of Government Ethics (OGE) adopted government-wide ethics rules, leading many agencies, such as the FCC, to eliminate their recusal policy. *See Adoption of Supplemental Standards of Ethical Conduct for Employees of the Federal Communications Commission and Revision of the Commission's Employee Responsibilities and Conduct Regulations*, 11 FCC Record, 15438, 15441 12 (1996). Under the relevant OGE rule, 5 C.F.R. 2635.604(b), an employee is not required to file a written disqualification statement when negotiating employment, but may elect to create a written record. OGE specifically found that "a possible regulatory requirement for notice and written disqualification statements was rejected as unnecessarily burdensome." *See Standards of Ethical Conduct for Employees of the Executive Branch*, 56 Fed. Reg. 3378 (1991).

[127]

[128] In *Heckler v. Chaney*, the Court held that the decision to investigate and prosecute is solely an executive function. This decision has been applied to decisions about whether to settle. *New York State Law Dep't v. FCC,* 984 F.2d 1209, 1213-15 (D.C. Cir. 1993).

If the court has reason to believe that the agency is not able to protect the public interest, requiring the agency to incur additional litigation expenses would exacerbate social welfare concerns.

B. The Information Problem

An agency with proper incentives may be incapable of acting in the public interest if it is not fully informed. Of course, agencies always lack complete information, and have to make decisions under risk or uncertainty. A court should consider whether the agency has made reasonable eforts in gathering information, up to the point at which the marginal benefit of further information gathering is equal to the marginal costs. If the court finds that the agency has satisfied its information-gathering responsibility, the agency cannot be faulted for acting with incomplete information.

There are several instances in which a court might find that the agency has not satisfied this information-gathering requirement. If a court has evidence that the agency has not adequately considered the case and the impact that the settlement would have on affected parties, the court would have reason to block the settlement. Perhaps the agency did not have the time and resources to give full consideration to the case. Alternatively, the agency may be receiving skewed information.

The interest group capture theory of agency action posits that interest groups are sometimes able to exert undue influence over regulatory action. The theory predicts that administrators will sometimes provide favorable supervision of the affected industry because they are subject to "informational capture." The first variation of this theory predicts that interest groups are able overcome barriers to coordination (given the narrowness of their interests and their small numbers) in order to influence regulatory outcomes.[129] The "epistemic capture"[130] theory posits that agencies have no choice but to rely on information provided by interest groups because they lack the means to generate information on their own and because it is most available to them. Compounding this problem is the fact that in "revolving door" agencies administrators (or their attorneys) are often taken from the regulated industry, which creates a tendency for the agency to view matters from the vantage point of the interest groups.[131] In sum, the theory predicts that administrators are sometimes biased in favor of regulated parties, either because the regulated parties are more vocal and organized, because the parties provide the information that the agency considers, or because the administrators are especially amenable to looking at issues from the industry's point of view.

A reviewing court is relatively well placed to evaluate whether the agency has made reasonable efforts to gather information, and can judge whether the agency's position is well thought out and adequately explained. The court is familiar with the facts of the case from the record and can require the parties to present evidence and explain their actions.

In evaluating the negotiations, the court should look for concrete examples of nonfeasance that suggest additional investment in information-gathering would be beneficial. Such examples include:

1. Acceptance of a settlement without *any* evaluation or intelligible explanation for why the settlement is in the public interest.
2. Evidence that the agency failed to consider an important social cost or benefit accompanying the settlement.

[129] Stigler 1971, 74.
[130] I am grateful to Adrian Vermeule for this term.
[131] Laffont and Tirole, 1993, DeFigueirido 2002, Reenok and Gerber 2007.

3. Evidence that negotiations between the parties failed to account for an important third-party interest that would be affected by the consent decree.

4. Evidence that the agency ignored a third party allegation that the settlement was not in the public interest (or that the agency failed to adequately justify its reasons for not giving weight to the allegation).

If the court is not satisfied with the agency's explanation, it can require that the agency consider the costs and benefits that it may have overlooked. This is often the first course of action for a district court that is skeptical of a consent decree.[132] However, once the agency provides a rational explanation for the terms of the settlement, which demonstrates that it has made a cost-justified investment in information gathering, this should end the judicial inquiry—the judge does not have latitude to pick his or her preferred enforcement policy. In addition, the court should not wield power to force the parties to litigate, nor should the court have power to demand substantial modifications. While the judge is well placed to evaluate whether the agency has conducted a thorough review of the facts at hand, it lacks the institutional competence and authority to set the terms of the consent decree.[133]

[132] District Courts often use their powers to demand further information from the parties before approving a consent decree. In one such order, Judge Ellen Huvelle of the District Court for the District of Columbia required the SEC to file a memorandum that justified the charges brought, who was charged (and and who was not charged), and the penalty demanded, among other things. After the parties submitted memoranda accompanied by exhibits in support of the judgment, she approved the consent judgment. *See also, SEC v. Koss Corp.*, No. 11-C-00991 (RTR) (E.D. Wisc. Dec. 20, 2011) (where the court requested that the SEC "provide a written factual predicate for why it believes the Court should find that the proposed final judgments are fair, reasonable, adequate, and in the public interest"). Judge Rakoff employed this technique before rejecting the SEC's proposed agreement with Bank of America and Citigroup.

[133] For an example of what can go wrong when judges require consent decree modifications and insert themselves as industry supervisors, consider the example of Judge Harold Greene of the United States District Court for the District of Columbia Circuit. On August 5, 1983, Judge Greene approved a consent decree that broke up the AT&T monopoly. In the decree, Greene "had the responsibility for administering the terms of the AT&T/DOG settlement for 12 years in accordance with what he perceived to be in the

C. Problems with existing standards

Despite the clear rationale for deference to administrative agencies in setting the terms of consent decrees, the existing standards of review fail to account for the institutional strengths and weaknesses of the judiciary.

Most judicially created standards resemble the "fair, adequate, and in the public interest" standard used by Judge Rakoff. Others ask the court to reject settlements made in bad faith.[134] As the SEC/Citigroup case demonstrates, vague standards, such as the "bad faith" or "public interest" standard ignore the agency's institutional strengths, encourage mini trials on the merits, and impose social costs on the settlement process.

Others have criticized selective enforcement as well as the choice to enter into a consent decree that departs from stated agency policy.[135] These criticisms mischaracterize the appropriate judicial inquiry. An agency should be free to depart from its own policy in securing a consent decree so long as it offers an intelligible explanation for doing so—the Supreme Court has blessed an agency's decision to change its interpretation of a

---

'public interest' in addition to the normally full docket of noteworthy cases assigned to a federal judge." William Yurckik. *Judge Harold H. Greene: A Pivotal Judicial Figure in Telecommunications Policy and His Legacy*, available at: http://www.ieeeghn.org/wiki/images/1/1d/Yurcik.pdf. Judge Greene's order was approved by the D.C. Circuit and also by the Supreme Court. The consent decree effectively converted the judge into a full time supervisor of the telephone industry and involved him in an endless number of disputes. Charles Rule, head of the Antitrust Division, pointed out that the MFJ decree, as expanded by Judge Greene, was unduly burdensome to the industry and the government. *See*, "Antitrust and Bottleneck Monopolies: The Lessons of the AT&T Decree, Remarks of Charles F. Rule before the Brookings Institution," Oct. 5, 1988, reprinted in TELEMATICS, Dec. 1988.
Congress agreed with that judgment in 1996 when it passed the Telecommunications Reform Act, which divested Judge Greene of jurisdiction. In fact, one of Congress's objectives, as evidenced by the addition of Section 601 to the 1996 Act, was to end the "government by consent decree" that had resulted in Judge Greene's lengthy oversight of AT&T's breakup and other ongoing judicial supervision. See Telecommunications Act of 1996, Pub. L. No. 104-104, ß 601, 110 Stat. 56, 143.

[134] *See* Lloyd C. Anderson, United States v. Microsoft, *Antitrust Consent Decrees, and the Need for a Proper Scope of Judicial Review*, 65 Antitrust L. J. 1, 17 (1996) ("The key to the *NBC* court's approach is its citation of the *Sam Fox* decision for the proposition that, in the absence of bad faith or malfeasance, a court should not question the government's judgment in settling an antitrust case.").

[135] As an example, Judge Rakoff was "troubled" by the SEC's decision to inflict a higher penalty on Goldman Sachs for "arguably less egregious conduct" in a separate consent decree. *U.S. SEC v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2d 328, 334 n.7 (S.D.N.Y. 2011).

statute and alter its policies based on experience and a policy change.[136] And while completely unjustified differences in treatment among similarly situated litigants may indicate a conflict, an agency may have valid reasons for selective enforcement. As long as the agency has demonstrated that it has carefully weighed the costs and benefits of settling in each case, the judge should not second-guess the agency's judgment.

The Congressional response to the judicial review problem should also be considered. Weak standards for review in the D.C. Circuit led Congress prescribe a standard for judicial review of antitrust consent decrees in the Tunney Act. The Act requires the DOJ to publicly justify its reasons for settling civil antitrust suits and directs reviewing courts to determine whether a consent decree reached between the government and a private entity is in the public interest. The act reads, "Before entering any consent judgment proposed by the United States under this section, the court shall determine that the entry of such judgment is in the public interest."[137]

Reviewing courts initially wavered in their understanding of the public interest inquiry required by the Tunney Act. Few courts chose to engage in close scrutiny, and no court used its powers to block a consent decree on substantive grounds until 1995. In *United States v. Microsoft Corp*, Judge Sporkin, writing for the D.C. District court, found that the DOJ "did not provide the court with the information it needs to make a proper public interest determination."[138] He also faulted the DOJ for the narrow scope of the remedy and for failing to address certain practices that concerned the court, such as "vaporware."[139] On appeal, the D.C. Circuit held that the district court had overstepped

---

[136] *State Farm Mut. Automobile Ins. Co. v. Campbell*, 538 U.S. 408 (2003).
[137] 15 U.S.C. § 16 (1982).
[138] *United States v. Microsoft Corp.*, 159 F.R.D. 318, 332 (D.D.C. 1995).
[139] *Id.* at 334.

and had "effectively redrafted the complaint."[140] The D.C. Circuit ordered the district court to approve the consent decree, implying that the decree should be accepted so long as it does not "appear[] to make a mockery of judicial power."[141]

In 2004, Congress amended the Tunney Act to "make clear" that the "mockery of the judicial function" language was too narrow.[142] The Act now provides that courts "shall" (instead of "may") take several enumerated factors into account in an analysis of the consent decree, including "the impact of the entry of such judgment upon competition in the relevant market or markets."[143] In a clear message to reviewing courts, the "congressional findings and declarations of purposes" preamble also states: "[I]t would misconstrue the meaning and Congressional intent in enacting the Tunney Act to limit the discretion of district courts to review antitrust consent judgments solely to determining whether entry of those consent judgments would make a 'mockery of the judicial function.'"[144]

The Tunney Act Amendments call in the abstract for more scrutiny, inviting the reviewing court to examine complex antitrust settlements on the merits, which creates social costs. Despite the additional enumerated factors, most courts have refused to broaden the scope of judicial review of antitrust consent decrees in practice.[145] Only the Ninth Circuit has held that the public interest inquiry allows the court to review

---

[140] *United States v. Microsoft Corp.,* 56 F.3d 1448, 1459 (D.C. Cir. 1995).
[141] *Id.* at 1463.
[142] 150 Cong. Rec. S3615-18 (Apr. 2, 2004) (statement of Sen. Kohl).
[143] 15 U.S.C. §§ 16(e)(1)(A) & (B).
[144] Pub. L. 108-237, Title II, § 221(a)(1)(B), June 22, 2004, 118 Stat. 668.
[145] When Judge Sullivan issued his opinion in *U.S. v. SBC Communications,* 489 F.Supp.2d 1 (D.D.C. 2007), he put to rest speculation that the 2004 Amendments drastically changed the way the statute worked in the District of Columbia District Court. He stated, "[t]he only question facing this Court, under the procedures crafted by Congress, is whether the divestitures agreed upon by the merging parties and the Department of Justice are 'in the public interest.'" And throughout his opinion he favorably cited the Justice Department's statement that the decree need only be "within the reaches of the public interest."

additional anticompetitive practices not discussed in the complaint.[146] Congress would be wise to revisit these amendments and guide the inquiry in light of the institutional competence of the judiciary.

D. The Optimal Standard

The optimal standard for judicial review should be concrete and should afford deference to expert agencies charged with primary responsibility for industry supervision. It should include a presumption of fairness, adequacy, and reasonableness unless the judge finds an indication of agency conflict. This presumption would reflect the agency's institutional advantage relative to the court.

An optimal standard would place the burden on the agency to demonstrate that it has considered important considerations and affected interests in securing the remedy. Where the agency considers the seriousness of the misconduct alleged, the social costs that come from settlement, and the uncertainties involved in litigation and its costs, the judge should not interfere with its expert judgment. The agency need not secure a determination of guilt, nor should it be required to force a confession of wrongdoing, before it accepts the compromise.

The court should apply a presumption that the compromise is in the public interest unless the court finds an objective indication that the agency's judgment is impaired. If the agency is structurally impaired or has not fully considered the costs and benefits from acting, the court can block the arrangement in order to cure the conflict. In such cases, the judge may ask the parties for more information, or it may remand the consent decree for further consideration.

---

[146] *United States v. BNS,* 858 F.2d 456 (9th Cir. 1988).

The standard should make clear that the judge is not to evaluate the compromise on the merits. If settlement negotiations account for all affected interests and the agency has an intelligible explanation for the terms of the compromise, it is unnecessary to incur the costs of further review.

VIII. Conclusion

The time is ripe for guidance on the proper scope of judicial review for agency consent decrees. The trend towards judicial non-interference has slowed, and judges have demonstrated an increased willingness to demand modifications and even block decrees all together. This is true in the context of antitrust consent decrees, where Congress has mandated heightened scrutiny, but also in the context of SEC consent decrees, where the SEC's practice of settling on a no admit or deny basis has been called into question.

If Judge Rakoff's decision to limit the SEC's discretion to settle on this basis is affirmed, this will open the door to far greater uncertainty and threaten agency enforcement policy.

Instead, courts should articulate a standard of review grounded in principles of judicial deference. For example, the court could apply the following standard when evaluating agency consent decrees: "In reviewing an agency consent decree, a court must employ a presumption that the decree is in the public interest unless the court observes a concrete indication of misalignment of interest between the agency and the public. This conflict may be the result of structural impairment: if the probability of agency bias is high, due to the agency's structure or its staffing, the court will have reason to question the terms of the settlement. Alternatively, if the court observes that the agency is acting on incomplete information, it may demand that the parties review the facts more thoroughly." This approach avoids the costs of judicial interference in most cases, but preserves an important role for the reviewing court without unduly discouraging the use of consent decrees, which have become a vitally important component of agency policy.