JED RAKOFF TO SEC: DO YOU THINK I'M A TOOL?

Judge Jed Rakoff has rejected the SEC's proposed wrist slap of Citibank for selling mortgage-backed securities it knew to be of poor qualify.

Effectively, what he did was join this complaint with SEC's complaint—filed at the same time as they filed the proposed Citi settlement—against a Citi employee, Brian Stoker, in which the SEC explicitly alleged that Citi knew what it was doing when it dealt shitty securities it intended to short. By doing so, Rakoff imposed the same trial process on this complaint as on Stoker. Effectively, he's saying, "If you're prepared to prove that Stoker knew what he was doing in selling shitty MBS, you're prepared to prove that Citi did too."

But the rest of his ruling focuses more generally on his demand that the SEC stop treating him—and federal judges generally—as tools of their efforts to cover over corporate crime. When he uses "tool" in this passage, I couldn't help thinking he mean tool both literally, but also in the derogatory sense.

> Without multiplying examples, it is clear that before a court may employ its injunctive and contempt powers in support of an administrative settlement, it is required, even after giving substantial deference to the views of the administrative agency, to be satisfied that it is not being used as a tool to enforce an agreement that is unfair, unreasonable, inadequate, or in contravention of the public interest. [my emphasis]

After showing that Citi changed its mind, once it became clear Rakoff would be judging the issue, about the standard for judicial review in such cases,

> In its original Memorandum in support of the proposed Consent Judgment, filed before the case had been assigned to any judge, the S.E.C. expressly endorsed the standard of review set forth by this Court in its Bank of America decisions, i.e., "whether the proposed Consent Judgment … is fair, reasonable, adequate, and in the publc interest."
>
> [snip]
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> In its most recent filing in this case, however, the S.E.C. partly reverses its previous position and asserts that, while the Consent Judgment must still be shown to be fair, adequate, and reasonable, "the public interest … is not part of [the] applicable standard of judicial review."

Rakoff then went on to argue that fact finding was necessary to serve the public interest, repeating his angry language about being used by the SEC.

> Purely private parties can settle a case without ever agreeing on the facts, for all that is required is that a plaintiff dismiss his complaint. But when 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,3 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.
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> 3 The Second Circuit has described the contempt power as "among the most

> formidable weapons in the court's arsenal."

At which point he really starts to vent.

> An application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous. The injunctive power of the judiciary is not a free roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression.
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> Finally, in any case like this that touches on the transparency of financial markets whose gyrations have so depressed our economy and debilitated our lives, there is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the S.E.C., of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges; and if fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement to the agency's contrivances. [my emphasis]

Now, I'll leave it to the legal types to debate whether joining this case with the Stoker case helps Rakoff avoid having his decision reviewed by the Appeals Court. Assuming he succeeds, however, this will ultimately lead Citi to be faced with a whole slew of expensive lawsuits (Rakoff notes the investors are out $700 million).

But I'm also fascinated by his emphasis on the way contempt should play a role in such settlements. Perhaps that's because—as he notes—the 2nd Circuit has found the SEC's inclusion of a gag rule in settlement enforceable by contempt to be problematic in the past. Perhaps it's tactical. I can't help but think he's itching to use that contempt power, however. As Rakoff points out several times in this ruling, Citi is a recidivist, and it knows the SEC itself is not going to enforce its promises not to engage in the same kind of behavior again.

> [The proposed settlement] imposes the kind of injunctive relief that Citigroup (a recidivist) knew that the S.E.C. had not sought to enforce against any financial institution for at least the last 10 years,

So in addition to insisting on a result that will make it easy for victims of Citi's crime to sue for justice, Rakoff seems intent on pursuing a result that will make it far easier for him to use his contempt powers against Citi directly.

And even more refreshing, Rakoff seems intent on forcing the truth to come out.

Update: Shorter SEC Enforcement Director Robert Khuzami: "Yes, I do think you are a tool."