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U.S. Judges Sound Off on Bank Settlements

By BINYAMIN APPELBAUM

WASHINGTON — Everything was rolling along traditional lines. A bank broke the rules. The government found out. The company agreed to pay a fine and improve its behavior.

And then the judge assigned to approve the deal blew his top.

In a scene that is becoming increasingly common, Judge Emmet G. Sullivan of Federal District Court chewed out federal prosecutors at a hearing in Washington last week for a proposed settlement with Barclays.

“Why isn’t the government getting tough with banks?” he asked.

Just one day earlier in the same courthouse, Judge Ellen Segal Huvelle refused to sign a settlement between the government and Citigroup, demanding, “Why would I find this fair and reasonable?” She ordered government lawyers to return with answers next month.

The scoldings from the bench are a striking departure from a long tradition of judicial deference to settlements formulated by federal agencies, reflecting broad disenchantment not just with Wall Street, but with its government overseers.

It is a pattern that began last year, when Judge Jed S. Rakoff of Federal District Court in Manhattan denounced the Securities and Exchange Commission for going easy on Bank of America, which the agency had accused of misleading its shareholders.

“The courts are staking out a role that frankly we seem to need,” said Jill E. Fisch, a law professor at the University of Pennsylvania. “They are standing in for the general public, the public interest, and demanding more” from regulators.

The immediate impact, however, has varied. Courts have limited power over settlements. Judge Rakoff persuaded the S.E.C. to punish Bank of America with a larger fine, but Judge Sullivan gave grudging approval last week to the deal between the Justice Department and Barclays after airing his concerns for a second day.

Experts also disagree about the long-term consequences. Some, like Professor Fisch, expect regulators to seek more punitive settlements. Others said that agencies instead would favor lenient penalties that do not require judicial review.

M. Todd Henderson, a law professor at the University of Chicago, said the impact would be determined by the public's reaction.

"I think it's a public relations stunt more than anything else," Professor Henderson said. "The court is trying to make it public that the government may be cutting cozy deals, because it is the public that ultimately controls the executive branch," which includes the Justice Department and the S.E.C.

Litigants are generally free to settle cases on agreed terms, but the law grants judges a narrow mandate in some cases to reject settlements that they believe do not serve the public interest. In the cases at hand, the judges expressed concern that the government was claiming victory without holding companies properly accountable — an approach Judge Rakoff described last year as creating a "façade of enforcement."

The Barclays settlement, which Judge Sullivan approved last week, involved charges that the British bank helped customers in Iran, Cuba and other sanctioned nations move more than \$500 million into the United States, breaking federal law — and undermining national policy — for more than a decade. The bank distributed instructions to employees for circumventing internal controls, for example by obscuring the source of the transfers.

Moreover, employees knew the transfers were illegal.

The cover sheets "must not mention" the offending entity, which could cause the funds to be seized, one employee wrote in an e-mail quoted by prosecutors. "A good example is Cuba, which the U.S. says we shouldn't do business with but we do."

The Justice Department agreed not to pursue criminal charges against the bank. In exchange, Barclays admitted to wrongdoing, forfeited \$298 million and agreed to improve employee training.

Justice defended the settlement as a "serious sanction," and said it did not seek a larger fine because Barclays had disclosed the crimes and cooperated with prosecutors.

"The public looks at this and says, you know, they're getting a free ride here," Judge Sullivan told government lawyers last Wednesday. He said he had agreed to approve the settlement despite his concerns because it was not his job to supervise the department.

Under the terms of Citigroup's proposed settlement, which Judge Huvelle has questioned, the bank would acknowledge concealing from shareholders the extent of its investment in subprime mortgages, which totaled more than \$50 billion in 2007. The chief financial officer at the time, Gary L. Crittenden, told investors that the bank's exposure totaled only \$13 billion.

The S.E.C. calculated that the company realized an economic benefit of up to \$123 million from its misrepresentations, but proposed to settle for a fine of \$75 million.

“You expect the court to rubber stamp, but we can’t,” Judge Huvelle said.

Judge Rakoff told an audience at Stanford in June that he hoped other judges would follow the example that he set last year in the Bank of America case. That case, he said, “may enable some of my colleagues to be a little more proactive in assessing S.E.C. settlements in the future.”

“I like to think that it will contribute to greater justice.”

But David S. Ruder, chairman of the S.E.C. in the late 1980s, said that regulators were in a better position to determine the fairness of a settlement because they commanded both the specifics and context of each case.

“It’s my view that by and large the judge ought to give great deference to the judgment of the agency as to what’s the appropriate punishment,” said Mr. Ruder, now a law professor at Northwestern University.

The three judges, all appointed to the district courts by President Bill Clinton, have shown particular frustration with the government’s failure to punish individuals.

Judge Rakoff repeatedly questioned the S.E.C.’s decision not to bring charges against the Bank of America’s executives. The agency described their conduct as negligent but not fraudulent. The New York attorney general, Andrew M. Cuomo, has since filed civil fraud charges against the former chief executive Kenneth D. Lewis and another executive. They have denied the allegations, and the case is pending.

The Citigroup case includes companion settlements with Mr. Crittenden and another executive. But the S.E.C. said in its complaint that other executives also had been aware of the legerdemain, prompting Judge Huvelle to demand an explanation as to why other Citigroup executives were not cited.

And the Justice Department did not seek to hold any employees responsible for the crimes that it attributed to Barclays, leading Judge Sullivan to observe that corporations are inanimate objects.

“You agree there must have been some human being who violated U.S. laws?” he asked the government’s lead lawyer.

He proceeded to ask that same question in a dozen different ways, growing increasingly exasperated with the answers, until he finally interrupted the government lawyer to ask, “Can I just share a thought with you?”

“You know what?” he asked. “If other banks saw that the government was being rough and tough with banks and requiring banking officials to stand before federal judges and enter pleas of guilty, that might be a powerful deterrent to this type of conduct.”