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POLICING COMPENSATORY RELIEF IN AGENCY SETTLEMENTS

Verity Winship*

Administrative agencies sometimes act as "public class counsel": they seek money that they then distribute to victims. The Securities and Exchange Commission, for instance, often creates Fair Funds through which it distributes money collected as fines and disgorgement to injured investors. This Essay examines the consequences of this role for judicial review of agency settlements and other protections of absent group members. It argues that such protections should be triggered when the rights of absent "class members" to their day in court are compromised. This may happen when the agency's action precludes related actions or otherwise limits potential recovery elsewhere. The Essay resists the wholesale import of private litigation mechanisms to the agency context, instead identifying the situations in which protections developed in the context of private aggregate litigation should apply to the public agency context.

I. Introduction
II. The Analogy to Private Aggregate Actions
III. Due Process Rights of Absent Group Members
IV. Consequences for Agency Settlements
V. Conclusion

I. INTRODUCTION

Administrative agencies sometimes settle with companies for millions of dollars in civil money penalties. Where does that money go? The answer increasingly is that the agency directs the money to victims of the wrong. The Securities and Exchange Commission (SEC) in particular has used its power to create "Fair Funds" to distribute penalties and disgorgement to injured investors.¹ When an agency seeks compensatory relief, it acts as what I have called elsewhere "public class

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counsel. Agencies and other public actors have increasingly used money recovered as restitution, disgorgement, or even fines to compensate victims, and a growing literature examines aggregate actions by public class counsel in varied administrative and other public contexts.²

Focusing on the SEC’s compensation of injured investors, this Essay identifies some limits to the comparison between private and public aggregate actions. It focuses on the effect of these actions on the basic due process rights of absent group members. In the context of private aggregate actions such as class actions and derivative suits, legislators and judges have built an extensive apparatus to protect absent class members, including judicial review of the adequacy of representation, notice requirements, and more. This Essay argues that similar protections should be triggered in public actions when the right of absent represented parties to their day in court is compromised. This may happen when, for instance, absent “members” are precluded from bringing other related actions or when their potential recovery is limited by the agency’s action. One consequence of this concern with due process rights is that judges and regulators should devote close attention to the preclusive effects of consent decrees and to whether amounts recovered in agency actions reduce amounts paid in related private actions (the offset rules). When absent parties’ rights are implicated in this way, they should get additional protections. For instance, judicial evaluation of whether a settlement or a distribution plan is fair, adequate, and reasonable should more closely mirror the procedural protections developed in the context of private litigation.

II. THE ANALOGY TO PRIVATE AGGREGATE ACTIONS

Agency actions in which the agency functions as public class counsel resemble private aggregate actions for damages in two main ways. First, the remedy is compensatory, at least in part. Second, most or all of the group members who benefit from this relief are absent from the

². Winship, Fair Funds, supra note 1, at 1107. See also Verity Winship, Public Agencies and Investor Compensation: Examples from the SEC and CFTC, 61 ADMIN. L. REV. 137, 139 (2009) (contrasting the approaches of the SEC and CFTC to investor compensation).

Compensatory relief traditionally was a remedy within the near-exclusive domain of private litigants. For a long time policymakers were reluctant to have any administrative agency compensate particular individuals or entities. Over time, however, compensatory relief has become an available and widely accepted remedy. In the SEC context, disgorgement and restitution were an early source of compensation. The power of the courts to distribute this money was initially based on their inherent remedial powers and was later codified. In recent years, agency compensation in the securities context has grown in magnitude in part because of the “Fair Fund” provision of Sarbanes–Oxley. This provision permits (but does not require) the SEC to direct civil money penalties to injured investors rather than the U.S. Treasury. The SEC has repeatedly used this provision, and Congress incorporated a new version into the Dodd–Frank securities statute.

This compensatory relief is usually obtained through a settlement between the enforcement arm of the agency and the target of investigation. The vast majority of SEC enforcement actions are settled, often simultaneously with filing. Moreover, this practice is not limited to the SEC; many lawsuits about public policy and institutional

4. As late as the 1970s, a commentator involved in the Administrative Conference’s evaluation of money penalties wrote that “[b]y definition, a civil money penalty does not serve a ‘specific’ compensatory function of making whole an identifiable individual specifically injured by the offending conduct,” which was instead a job for private remedies. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 COLUM. L. REV. 1435, 1456 n.135 (1979). Moreover, it took the SEC thirty years before it sought and received disgorgement in an adjudicated action. Winship, Fair Funds, supra note 1, at 1112.


7. See Winship, Fair Funds, supra note 1, at 1110–23.


10. Although colloquially referred to as “settlements,” agreements by agencies such as the SEC or the DOJ are often in the form of a consent decree. Consent decrees are also sometimes called consent judgments. Although the terms are distinguishable, this Essay adopts common usage and uses them interchangeably.

reform are resolved by consent decree.\textsuperscript{12} When a government agency is one of the parties, settlement has been viewed as a way to maximize the agency’s limited resources,\textsuperscript{13} as well as being considered beneficial for many of the same reasons that the U.S. legal system endorses resolution through agreement between private parties—efficient and amicable settlement of disputes; increased “buy in” by the parties; or conservation of judicial resources.\textsuperscript{14}

Compensation is a component of many settlements, even those that draw attention for other reasons. For instance, proposed SEC settlements with Bank of America and with Citigroup following the recent financial crisis attracted attention because the trial judge took the unusual step of rejecting the proposed settlements, provoking a debate about whether the agency should require admissions of liability when settling.\textsuperscript{15} A less publicized aspect of these agreements was that the SEC designated fines and other monetary recoveries for compensation. In the Bank of America matter, for instance, not only did the SEC propose distribution of the $150 million penalty to injured investors through a Fair Fund, but the court required its distribution as a condition of settlement approval.\textsuperscript{16} The proposed Citigroup settlement included $285 million in monetary relief, all of which could be allocated to a Fair Fund for distribution to injured investors.\textsuperscript{17}

The fact that both private and public actions can result in a

\textsuperscript{12} Maimon Schwarzchild, \textit{Public Law by Private Bargain: Title VII Consent Decrees and the Fairness of Negotiated Institutional Reform}, 1984 DUKE L.J. 887, 888 (1984) (“Consent decrees first became prominent in antitrust cases, and are now common in every variety of lawsuit over public policy, including environmental cases, litigation over the rights of the institutionalized, school and housing desegregation suits, and equal employment litigation.” (footnotes omitted)).

\textsuperscript{13} Committee on Federal Regulation of Securities, \textit{Report of the Task Force on SEC Settlements}, 47 BUS. LAW. 1083 (1992); SEC v. Clifton, 700 F.2d 744, 748 (D.C. Cir. 1983) (“Because of its limited resources, the SEC has traditionally entered into consent decrees to settle most of its injunctive actions” and is “thus able to conserve its own and judicial resources . . . .”).


\textsuperscript{17} The SEC noted in its description of the proposed terms that the SEC “may by motion propose a plan to distribute the funds subject to the Court’s approval” and that “[s]uch a plan may provide that the funds be distributed pursuant to the Fair Fund provisions of Section 308(A) of the Sarbanes-Oxley Act of 2002.” \textit{See Memorandum by Plaintiff Securities and Exchange Commission in Support of Proposed Settlement, SEC v. Citigroup Global Mkts., Inc.,} 827 F. Supp. 2d 328 (S.D.N.Y. 2011) (No. 11 Civ. 7387 (JSR), 2011 WL 4965843, at 14.

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compensatory remedy is not the only reason to compare them. In both contexts, most or all of those allegedly wronged are absent from the action. Private aggregate actions such as class actions and derivative suits are representative. The class representatives and class counsel speak for the absent members of the class. In a derivative suit, the plaintiff sues on behalf of the corporation (speaking, in other words, for all of the shareholders). In agency aggregate actions, those who are harmed are not involved in the action and do not make any decisions about how it proceeds. In the SEC context, the injured investors who have a claim to distributions from the Fair Funds can be said to make up the “class.” The agency acts as the public class counsel, representing those injured in addition to representing the public more generally. Both of these sources of comparison—the compensatory remedy and the representative nature of the suit—have prompted proposals to import protections from the private context into the public. The basic due process rationale for these protections, and the limits they suggest, is the subject of the next part.

III. DUE PROCESS RIGHTS OF ABSENT GROUP MEMBERS

Parallels between aggregate actions by public actors and by private litigants certainly exist and can be a rich source of inquiry into fundamental issues about the function of agencies, lines between public and private action, and commitments to due process. It is not self-evident, however, that the specific mechanisms of the two types of action should be the same. Commentators have proposed increased protections in certain public contexts, including aspects of judicial review or participation rights such as formal intervention, a notice and comment process, or other mechanisms.\(^\text{18}\) The suggestion here is simply that these protections should be triggered when the interests of absent group members are compromised by the public aggregate action and the group members had no chance to represent themselves.\(^\text{19}\)

Protection of absent group members is rooted in basic notions of due process captured by the idea of the right to a day in court. The classic case that articulated the due process rationale for protections in

\(^{18}\) See, e.g., Zimmerman, Distributing Justice, supra note 3, at 556 (proposing three categories of procedural protection for agency aggregate actions: "multidistrict coordination, negotiated rulemaking, and judicial hard look review").

\(^{19}\) Cf. Lemos, supra note 3, at 546 (arguing that the parens patriae action should not preclude private litigation because the state attorney general should be considered to represent the injured "class" inadequately); Adam S. Zimmerman, The Corrective Justice State, J. OF TORT LAW (forthcoming 2014) (including consideration of "the extent to which state action forecloses private litigation" as a reason to relax certain safeguards in public compensatory actions).
representative suits is *Hansberry v. Lee*.\(^{20}\) There the Supreme Court pointed to "a failure of due process" in "cases where it cannot be said that the procedure adopted fairly insures the protection of the interests of absent parties who are to be bound by it."\(^{21}\) More recently, the Supreme Court has signaled how seriously it takes the basic premise that litigants get a day in court by preventing lower courts from expanding the scope of preclusion. In *Taylor v. Sturgell*, the Court rejected the idea of "virtual representation," and declined to expand on existing categories of nonparty preclusion.\(^{22}\) Representative actions such as class actions or derivative suits depart from this strong norm, but to compensate for this departure, mechanisms are put in place to make sure the absent class members are adequately represented so that adjudication of their rights in their absence is fair.

**IV. CONSEQUENCES FOR AGENCY SETTLEMENTS**

A consequence of this focus on protecting absent "class" members' due process rights is that the court should determine the extent to which the action by the agency, representing a group, precludes members of that group from obtaining relief in a separate private suit. How this approach might work can be illustrated by applying it to the existing securities context. Because of current preclusion rules and offset practices, the focus on preclusion as a main driver of protective measures should reduce the need for additional protections for investors who may recover from a Fair Fund.

First, settlement for monetary relief in an SEC action generally does not preclude other actions by injured investors.\(^{23}\) In fact, private securities class actions were filed in approximately 65% of the cases in which the SEC created a Fair Fund.\(^{24}\) Under the analysis proposed here, the fact that investors have another route to recovery reduces the need to protect them within the SEC action.

Another way in which a public settlement potentially affects the amounts available to the injured individuals or entities is if the amounts are offset against those collected in other actions.\(^{25}\) In the securities enforcement context, no formal rule exists for determining whether the

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21. *Id.* at 42.
25. See Winship, *Fair Funds*, *supra* note 1, at 1120–21 (detailing the consequences of different offset rules).
agency should allow offset against other actions based on the same facts. Where this is the case, offset may be set forth in the terms of the consent decree. At least in some instances, SEC settlements have prohibited offset in related actions. A clause in the SEC’s settlement with Bank of America, for instance, provided that the settling company agreed not to offset penalty amounts paid in an SEC action against any damages they pay in a related private action:

To preserve the deterrent effect of the civil penalty, [the bank] agrees that it shall not, after offset or reduction of any award of compensatory damages in any Related Investor Action based on [the bank’s] payment of disgorgement in the Actions, argue that it is entitled to, nor shall it further benefit by, offset or reduction of such compensatory damages award by the amount of any part of [the bank’s] payment of a civil penalty in the Actions (‘Penalty Offset’).

In the review framework suggested in this Essay, this limitation of offset would reduce the need for protections akin to those necessary for private aggregate actions. However, these policies change with time and vary by agency or other public actor. Moreover, the question of offset may not always be simple or binary, particularly to the extent that it also arises in complex negotiated settlements among different private and public entities. This Essay’s suggestion is merely that courts consider the provisions for offset, whether in formal rules or in the agreements, and that offsets, when present, should trigger additional care of absent group members, including the type of analysis incorporated into judicial review.

So far, the proposed comparison focuses on the effects of the public action on rights in other, related proceedings, but sometimes the agency action will be the only source of compensation. Some agency-only actions are simply not good candidates for distribution, and do not give

26. See Final Consent Judgment as to Defendant Bank of America Corporation at 8, SEC v. Bank of Am. Corp., 653 F. Supp. 2d 507 (S.D.N.Y. 2009) (Nos. 09 Civ. 6829 (JSR), 10 Civ. 0215 (JSR)), 2010 WL 430122 (providing that the agreement not to offset reaches any “private damages action brought against [the bank] by or on behalf of one or more investors based on substantially the same facts as alleged in the [agency’s] complaints . . . “).

27. Id. at 11 (further providing that, if a court in a private action based on the same facts grants an offset, respondent has to notify the SEC’s counsel and “pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs”). See also Nevis Capital Mgmt., LLC, Investment Act Release No. 2214, 82 SEC Docket 523, 2004 WL 236571, at *9–11 (Feb. 9, 2004) (noting that the respondent agreed not to “benefit from any offset or reduction of any investor’s claim by the amount of any Fair Fund distribution to such investor in this proceeding that is proportionally attributable to the civil penalty paid by [the] Respondent” and to pay the Treasury or a Fair Fund any offsets or reductions granted by a court in a private action).

rise to the concerns discussed here. At least one category, however, raises the question of whether victims should have extra protections in an agency action that is the sole source of compensation. In the SEC context, for instance, actions for aiding and abetting securities violations are limited to the SEC; there is no private right of action. In these circumstances, injured investors are identifiable and the compensatory amounts are potentially high. The agency suit has no impact on the rights of absent plaintiffs to sue that defendant based on the underlying facts—the individuals have no private right of action—so agency-obtained compensation is potentially the only source of compensation. Applying this Essay’s proposed criteria, such agency suits would not trigger additional protections, even for compensation and even when these suits are the only cause of action. In a sense, this approach defers to the initial legislative allocation of power between public actors and private attorneys general, identifying participation rights where a private right of action on the same facts exists.

Although concerned with the due process rights of the represented individuals or entities, this standard may limit (rather than expand) participation rights in practice. To the extent that recovery through the agency process does not affect the rights of the represented individuals to litigate the wrong, this approach would suggest that the individuals are not entitled to extra protection or say in the amount or distribution of funds. Underlying this approach is a normative judgment about the appropriate balance of agency attention to the public interest as a whole in comparison to the identifiable injured, compensable persons. In the context of limited offset and preemption rules, it suggests that the agency’s main focus should be on the public. Even if one disagrees about this balance, the more narrow point holds that private protections should not be unthinkingly imported into the public context. Providing additional protections to those who may receive compensation, when due process concerns are absent, should be justified by a separate reason having to do with the public function of the settlement.

The argument here is that protections modeled on private actions are called for when the agency action seeks compensatory relief and the outcome compromises absent “class members”’ interests. The full class action apparatus is beyond the scope of this Essay, but judicial review of settlements provides an example of the type of protection that might be

29. Examples of actions that do not lend themselves to distribution include those where no clear victims exist (such as for a books and records violation, 15 U.S.C. § 78m(b)(2)(A) (2012)) or the amounts are so low that distribution is impractical.

imported. Judges review both private and public aggregate settlements. Federal Rule of Civil Procedure 23, which governs class actions, requires courts to evaluate whether settlements are "fair, reasonable, and adequate."\(^3\) The Class Action Fairness Act makes this requirement statutory in the more limited category of coupon settlements, requiring a judicial hearing and written statement from the judge that the settlement is "fair, reasonable, and adequate for class members" before approval.\(^3\) Likewise, derivative suits brought in federal court and settled by consent decree are subject to judicial review.\(^3\)

The standard of review for agency settlements is nominally similar. Courts have often evaluated whether SEC settlements and distributions are fair, reasonable, and adequate.\(^3\) The Court of Appeals for the Second Circuit recently called for reviewing courts to determine whether an agency settlement is "fair and reasonable" and that the "public interest would not be disserved".\(^3\) Beyond the SEC, judges often have broad discretion to review other agencies' settlements for fairness and accord with the public interest.\(^3\)

Despite these surface similarities, one set of concerns is more prominent in the private context. Although the factors courts identify vary,\(^3\) courts and others have suggested that the main aim of settlement review in the private context—as with other protective features of formal aggregate litigation—is to protect the absent class members.\(^3\)

\(^{31}\) FED. R. CIV. P. 23(e)(2).
\(^{33}\) See FED. R. CIV. P. 23.1(c) ("A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval.").
\(^{34}\) See, e.g., SEC v. WorldCom, Inc., 273 F. Supp. 2d 431, 436 (S.D.N.Y. 2003) ("A Court reviews such a settlement proposal not on the basis of what it might itself determine is the appropriate penalty but on the basis of whether the settlement is fair, reasonable, and adequate."). See also KENNETH B. WINER & SAMUEL J. WINER, SECURITIES ENFORCEMENT: COUNSELING AND DEFENSE § 17.08 (2004) (noting that the relevant federal district court must approve any settlements of a civil court case with the SEC).

\(^{35}\) SEC v. Citigroup Global Mkts., Inc., Nos. 11-5227-cv (L), 11-5375-cv(con), 11-5242-cv(xap) (2d Cir. June 4, 2014) (citations omitted) (vacating the opinion of Judge Rakoff rejecting the SEC settlement).

\(^{36}\) See, e.g., United States v. Trucking Emp’rs, Inc., 561 F.2d 313, 317 (D.C. Cir. 1977) ("[P]rior to approving a consent decree a court must satisfy itself of the settlement’s ‘overall fairness to beneficiaries and consistency with the public interest.’"); Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights, 616 F.2d 1006, 1014 (7th Cir. 1980) ("The trial court in approving a settlement... need only determine that the settlement is fair, adequate, reasonable and appropriate under the particular facts and that there has been valid consent by the concerned parties."); 15 U.S.C. § 16(e) (2004) (detailing the factors that courts shall consider when reviewing antitrust settlements to see whether they are "in the public interest" as required by statute). But see Lemos, supra note 3 (noting the absence of judicial review of settlements by state attorneys general).

\(^{37}\) MANUAL FOR COMPLEX LITIGATION § 10.1 (Judicial Supervision).

\(^{38}\) Krell v. Prudential Ins. Co. Am., 148 F.3d 283, 316 (3d Cir. 1998) ("Rule 23(e) imposes on the trial judge the duty of protecting absentees, which is executed by the court’s assuring the settlement
particular, in both the class action and derivative context, judges review the adequacy of representation at various stages of the process, addressing directly the question of whether the absent group members had a say through their representative in court.39

Importing standards from the highly contested context of private aggregate actions is clearly not a perfect fix. Standards for adequacy of representation, for example, are both central and under-theorized, as is the efficacy of judicial review in this context.40 Nonetheless, this proposal would shift the court’s focus. Where the trial court rejected the proposed settlement in the Bank of America and Citigroup cases, the judge’s review focused on the amount and whether admissions were required. To the extent that the court discussed the compensatory function, it was either to require the creation of a Fair Fund (Bank of America)41 or to lament the fact that the SEC had said only that it “may” direct the monetary relief to compensate injured investors (Citigroup).42 One way to implement this Essay’s proposal is to add adequacy of representation to the mix when the agency action implicates due process rights. Review might thus involve more judicial scrutiny of inter-class conflicts and conflicts of interest between the agency acting as public class counsel and the class, drawing on the case law from private aggregate actions.

V. CONCLUSION

The remedies available to public actors have converged with those of private plaintiffs in recent years, as the power of government agencies to obtain and distribute money to compensate individuals has increased and as the agencies and other public actors have expanded their use of these mechanisms. The SEC, for example, frequently acts as “public class counsel”, creating Fair Funds for distribution to injured investors. For private aggregate actions, policymakers and judges have developed an apparatus to protect the due process rights of absent group members. In the public context, the need for protection is up for debate. Because of the connection between these protections and the due process rights of absent parties, this Essay suggests that protections should be triggered

40. See, e.g., Lemos, supra note 3, at 543 (noting that “adequate representation” is under-theorized).
when agency action leads to preclusion or impairment of the remedy available to class members—when agency-recovered compensation limits the absent group members’ right to a day in court.