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SEC faces lawsuit over 'gag orders' in enforcement settlements

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The Cato Institute, a conservative think tank, is suing the Securities and Exchange Commission in federal court to challenge its decades-old policy of imposing "gag orders" on settling defendants in civil enforcement actions.

As a routine condition of settling civil or administrative actions, defendants agree to a promise that they will never publicly contest, challenge, or deny any of the allegations the SEC has made against them—even after the case has been settled and the underlying lawsuit or administrative proceeding dismissed.

The reason, according to the Commission, is to "avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur."

"The sole purpose of the gag regulation is to affect public perception of the SEC and the SEC's enforcement activities," the Cato lawsuit says. "It accomplishes its purpose by restricting constitutionally protected speech—specifically, speech critical of the SEC itself … The SEC demands blanket, perpetual gag orders of this sort in every case it settles without making any individualized determinations about the need for such an order or the appropriate scope of such an order in a given case."

These clauses, Cato says, violate the First Amendment. It is asking the D.C. federal court to find all such agreements unenforceable, arguing that they are "content-based regulations of speech."

"The clear point of that policy is to prevent people with the best understanding of how the SEC uses its vast enforcement powers from sharing that knowledge with others," the think tank said in a statement. "In effect, the government uses its extraordinary leverage in civil litigation to extract from settling defendants a promise to never tell their side of the story, no matter how outrageous the government's conduct may have been and no matter how strong the public's interest may be in knowing how the government conducts itself in high-stakes civil litigation."

Cato's interest in the newly filed case began when "a well-known law professor" approached it with his desire to publish a memoir about his experience being sued by the SEC and prosecuted by the Justice Department over a business he created and ran for several years prior to the 2008 financial crisis.

The case "raises interesting questions about the First Amendment and the policy at the SEC itself. It's a longstanding policy [roughly four decades old]. Mary Jo White, when she was chair, referred to it as a nearly universal protocol used in settling enforcement cases."

Matt Rossi, Partner, Mayer Brown

“The memoir explains in compelling detail how both agencies fundamentally misconceived the author’s business model—absurdly accusing him of operating a Ponzi scheme and sticking with that theory even after it fell to pieces as the investigation unfolded—and ultimately coerced him into settling the SEC’s meritless civil suit and pleading guilty in DOJ’s baseless criminal prosecution after being threatened with life in prison if he refused,” Cato says, regarding the as-yet-unnamed author. Publishing the book, however, would run afoul of the SEC settlement agreement that prohibits “any public statement denying, directly or indirectly, any allegation in the [SEC’s] complaint or creating the impression that the complaint is without factual basis.”

Provisions of this sort are not unique to SEC cases. The Commodity Futures Trading Commission and Consumer Financial Protection Bureau include similar language in their settlements but are not a party to the recent lawsuit. The legal filing points out that 97 percent of federal criminal convictions are obtained through plea bargains, and a similar percentage of SEC civil enforcement actions are settled instead of adjudicated.

“This means that, contrary to the constitutional prescription for a public airing of the government’s case, most enforcement actions—both civil and criminal—unfold behind closed doors and under the radar,” the plaintiffs say. “It is increasingly clear that the process by which the government extracts confessions, plea deals, and settlement agreements from defendants in those cases can be incredibly (and even unconstitutionally) coercive.”

Cato has partnered with the Institute for Justice for legal representation in the self-described “civil-rights lawsuit.” The legal action, which names SEC Chairman Jay Clayton, aims “to strike down not only the specific gag order at issue in this case, but all perpetual gag orders in all existing civil settlements with federal agencies—and to terminate the government’s policy of silencing those whom it accuses of wrongdoing.”

The case “raises interesting questions about the First Amendment and the policy at the SEC itself,” says Matt Rossi, a partner in Mayer Brown’s Washington, D.C. office and co-leader of the firm’s Securities Litigation & Enforcement practice. “It's a longstanding policy [roughly four decades old]. Mary Jo White, when she was chair, referred to it as a nearly universal protocol used in settling enforcement cases.”

The policy, he surmises, was—and is—motivated by concerns that allowing a settling party to claim their case was baseless would undermine the public’s faith in SEC civil law enforcement.

“The SEC is trying, with that policy, to strike up balance between the interests of the defendant and the agency in a way that reflects the compromise nature of settlements,” Rossi, who previously worked in the SEC’s Enforcement Division as assistant chief litigation counsel, says. The policy also connects to the often-criticized SEC policy of agreeing to settlements where the offending party neither admits nor denies the accusations brought against them.

“If the SEC were to require admissions, it would be much harder for it to settle cases because of defendants concerned about the potential collateral effects of admissions,” Rossi says. “The SEC wants to settle cases quickly in order to preserve its resources and also, in cases with discouragement, to return money quickly to injured investors and get them the relief it wants. If you allow a defendant to go out and deny the merits of a case that they've settled with the SEC, that might undermine the public face of SEC enforcement. There's a good argument to be made,

however, that allowing a free, fair, and frank discussion of the merits of a particular case, and allowing a settling defendant to participate in that discussion, might actually increase the public's faith in SEC law enforcement over time."

Jeff Robbins, a partner with law firm Saul Ewing Arnstein & Lehr and a specialist in First Amendment matters involving public companies, describes the Cato lawsuit as "enormously significant."

"From a First Amendment perspective, the Cato Institute has a very meritorious argument for the very purpose of preventing those pursued by the SEC from being required to give up what otherwise would be their Constitutional right to speak about what government has done," he said. "What could be more antithetical to the First Amendment then permitting the government to condition the resolution of a dispute on the defendant's agreement not to criticize the government. They don't just prohibit somebody from denying that they did something to which they already admitted, they prohibit them from talking publicly about anything related to the case in any critical way."

The gag resolution is arguably "an overly broad demand," especially as it has no built-in time limitations, Robbins adds. "Even if you assume that the government has a compelling interest in prohibiting a defendant that has admitted [certain acts] from subsequently denying that they did so, these gag orders go far beyond that. These are not narrowly tailored, even for that purpose. They prohibit somebody from defending their reputation by saying publicly, after the SEC has issued its own battery of press releases, 'Now, wait a second, I didn't do this, and the government was incorrect when it said this or that.' The gag order prohibits somebody from commenting, even in a generally critical way, about how the SEC conducted itself."

Robbins framed the settlement language with his past experience as an assistant U.S. attorney for the District of Massachusetts.

"I happily and proudly represented governmental agencies in cases against citizens, but for the notion that governmental agencies are supposed to be immune to, and protected from, criticism, and can extract an agreement not to be critical from citizens, I question what the justification for that would be. Wherever you fit on the political spectrum, any reasonable person has to understand that this democracy depends entirely on there being a free flow of discussion and criticism of governmental agencies," he says. "That that has been enshrined in case after case after case needs to be belabored."