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Cato sues SEC over gag order practice

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The Securities and Exchange Commission's practice of silencing defendants who settle charges with the agency for alleged misconduct violates the Constitution's First Amendment, the libertarian Cato Institute said in a lawsuit filed Wednesday.

The lawsuit, filed in U.S. District Court for the District of Columbia by the Institute for Justice on behalf of Cato, alleges that the SEC's 1972 gag regulation restricts constitutionally protected speech, specifically speech that is critical of the SEC.

The agency routinely prohibits people who agree to settlements from ever publicly saying that any parts of the allegations might be untrue, the lawsuit says.

In the vast majority of SEC settlements, defendants neither admit nor deny the agency's allegations. In order for defendants to avoid having to admit to alleged misconduct, which can expose them to an array of legal problems, the SEC says defendants cannot deny the allegations either.

In December, when asked about the gag orders at a Senate Banking Committee hearing, SEC Chairman Jay Clayton said "the no-admit, no-deny approach has enabled us to get to settlements, to get people their money back, get bad actors out of the marketplace."

"If we can settle matters quickly we can move on to look at other matters," Clayton said in response to questions from Sen. Tom Cotton (R.-Ark.).

Cotton had asked Clayton what public interest the rule serves, criticizing it as "quite over-broad [and] not at all narrowly tailored anymore."

"It can undermine other legitimate public interests," Cotton said. "The SEC should probably reconsider it."

Some have argued that the SEC uses its no admit-no deny agreements to strong-arm defendants into settlements. If accused individuals believe they have a chance to beat the agency in court but do not want a drawn-out legal fight, then they will likely settle and agree to the post-settlement restraint on speech, said Gary Matsko, a lawyer who was formerly an enforcement branch chief for the SEC's New England region.

"It can be incredibly expensive to defend a complicated case," Matsko, who has written about the issue, said in an interview on Wednesday. And if people settled simply because they could not afford to fight the SEC, "it just seemed that people ought to be able to publicly defend themselves," he said.

The SEC’s recent settlement with Tesla CEO Elon Musk is a high-profile example of the gag order being included in a settlement, the Institute for Justice said. The group said the Consumer Financial Protection Bureau and the Commodity Futures Trading Commission have similar orders as part of no admit-no deny settlement practices.

“The SEC’s policy of demanding lifetime gag orders as a condition of settlement flouts the First Amendment,” Clark Neily, Cato’s vice president for criminal justice, said in a statement.

A representative from the SEC, which is mostly closed amid the government shutdown, did not immediately respond to a request for comment.