Civil liberties groups are suing the SEC, saying policy of 'no admit, no deny' is unconstitutional

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For nearly 50 years, it has been standard practice for the Securities and Exchange Commission to settle civil suits against securities lawbreakers with agreements that do not require them to admit to any wrongdoing, but bar them from denying the charges publicly either. But this policy of "no admit, no deny" has become the target of criticism from both the political left and right in recent years, threatening to upend the way U.S. financial regulators police financial misconduct.

In the wake of the 2008 financial crisis, critics on the left assailed the practice as a "cop-out" that enabled large financial firms to escape significant consequences, as the penalties and disgorgements they were forced to pay were often a small fraction of even one quarter's earnings.

Today, attacks on the practice are coming from the right, with the libertarian advocacy groups including the Cato Institute suing the SEC with the argument that barring a person or company from publicly denying a charge that was settled out of court is a violation of their First Amendment rights.

Conservative Republican Sen. Tom Cotton of Arkansas has also taken issue with the no admit/no deny policy, saying in a 2018 SEC hearing that he believes the regulator should scale back the practice. "It was passed at a time in 1972 when first amendment precedent was much different and frankly more favorable to government than it probably should have been," he said.

On Friday, the U.S. Court of Appeals for the Second Circuit heard arguments in the case Romeril v. SEC, in which the former chief financial officer of Xerox Holdings Corp. **XRX, -0.38%**, Barry Romeril, is challenging the constitutionality of the gag order the SEC imposed on him in a 2003, when he settled claims that he directed his employees to make misleading accounting adjustments that inflated Xerox earnings, without admitting nor denying the allegations. He was forced to pay more than $4 million in penalties and disgorgements.

SEC policy in these cases "directly infringes upon the First Amendment rights of Americans and works to conceal the operations of agency enforcement from the American people," wrote Peggy Little, senior counsel at the New Civil Liberties Alliance in a petition in support of Romeril's case.

"Congress could not lawfully pass a statute that silenced defendants about their prosecutions—such a statute would be held unconstitutional in short order," she added. "The SEC cannot accomplish through rule-making what the Constitution forbids to Congress." The Cato Institute is pursuing a similar case in court on behalf of a businessman who sought out Cato to publish a book he wrote on his experience battling the SEC.

Legal observers say this attack on no admit, no deny faces a much better chance of succeeding than did liberals attempts to shame the SEC into reform.

"I think this is a real problem for the SEC," Jeremiah Williams, former senior counsel in the SEC's enforcement division and Ropes & Gray partner, told Law.com. "The Supreme Court, as it's currently situated, has been very protective of First Amendment rights in this context. If you look at how broadly the gag rule is used, I think there's a credible argument that it is problematic under the First Amendment."

If the Second Circuit judges agree with the lower court ruling that these agreements are in fact, constitutional, Romeril could appeal to a Supreme Court that has become increasingly willing to assert broad free speech rights for individuals and corporations.

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If the policy were to be overturned in the courts, it could have wide-ranging implications for a financial regulatory apparatus that relies heavily on these agreements to police the financial services industry, given the SEC's limited budget of roughly $1.9 billion. JPMorgan Chase & Co. **JPM, 0.95%**, for sake of comparison had a revenue of more than $29 billion in the fourth quarter alone.

"The SEC is vastly outgunned by the companies it oversees," according to Kurt Schacht, managing director of the advocacy division of CFA Institute. These figures "demonstrate that the SEC is gravely outmatched and that private industry is increasing its spending at a rate more than twice that of its regulator," he added.

If the SEC were to have to prove the guilt of each party it brings and enforcement action against, it would likely be forced to address far less wrongdoing than it does today, given that 98% of all enforcement actions during the past decade have ended in settlements.

Large corporations, however, may also be concerned if no admit, no deny were deemed unconstitutional, given that it enables them to quickly settle matters in a way that doesn't open them up to greater civil liability, and that concern could grow if the ruling results in a large increase in regulators' budgets so they can contend with the new legal landscape.