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SEC Gag Rule Under Attack Again. Are Its Days Numbered?

For decades, the SEC has used gag orders to prevent defendants from ever speaking about cases that have been settled. Now, two lawsuits are challenging the constitutionality of the rule. But one former SEC lawyer-turned-defense attorney says the rule's demise could be bad for defendants.

By Phillip Bantz

Nearly 16 years ago, former Xerox Corp. chief financial officer Barry Romeril was among six executives at the company who settled fraud charges with the U.S. Securities and Exchange Commission without admitting or denying guilt. Now, Romeril wants the public to hear his side of the story.

But in order to speak out about what happened, Romeril and the New Civil Liberties Alliance are going to have to convince a federal judge to overturn the SEC's controversial and long-standing gag rule. To that end, the NCLA on Monday filed a motion for relief from judgment on Romeril's behalf with the U.S. District Court for the Southern District of New York.

The nonprofit civil rights organization argues that the SEC's lifetime gag order, which is folded into Romeril's 2003 consent order with the federal agency, infringes on his free speech rights in violation of the First Amendment.

U.S. Securities and Exchange Commission headquarters in Washington, D.C. Photo: Diego M. Radzinschi/ALM

The NCLA first challenged the SEC's gag orders in October 2018, when it argued in a petition that the SEC lacked the authority to silence defendants in perpetuity and that doing so was unconstitutional and against public policy. The SEC has yet to rule on that petition.

NCLA senior litigation counsel Peggy Little asserts in a memo supporting Romeril's motion that the SEC, in seeking to settle cases,

"assures defendants that they are not admitting or denying guilt, yet promises to punish any who might later create the impression of denying any part of the complaint against them with a reopened civil enforcement proceeding."

"To put it another way, what SEC giveth with one hand, it taketh away with a gloved fist," she wrote.

Little added in an interview Tuesday that the SEC can issue "devastating, very extreme" press releases announcing charges against defendants. Later, if those same defendants "make a very sensible decision to settle, the SEC demands that they be silenced for the rest of their lives," she said.

SEC spokeswoman Judith Burns declined to comment on the NCLA's suit. The gag rule also is facing a challenge from the Cato Institute in the U.S. District Court for the District of Columbia. The SEC's answer to Cato's complaint is due Friday. The suit was filed on the heels of the NCLA's petition.

"I think this is a real problem for the SEC," said Washington, D.C.-based Ropes & Gray partner Jeremiah Williams, formerly a senior counsel in the SEC's enforcement division. "The [U.S.] 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."

But Williams cautioned that the gag rule's demise could have negative ramifications for defendants. For instance, he said the SEC might take more of a hardline approach to settlement negotiations and become more aggressive about demanding that defendants admit wrongdoing.

The SEC also could refuse to exclude potentially incriminating details from consent orders, according to Williams. He said he and his defense bar colleagues have had some success in negotiating with the SEC to keep certain damaging details out of consent orders, including potentially incriminating quotes or emails from their clients.

But if the gag rule goes away, the SEC might "decide to be more specific about what's in the order," he said.

Little, the NCLA's lawyer, believes the SEC will continue entering into no-admit, no-deny settlements, even if the court torpedoes the gag rule. She noted SEC Chairman Jay Clayton's comments during a Senate Banking Committee hearing in December, when he trumpeted the usefulness of dangling the no-admit, no-deny carrot in front of defendants.

Taking that approach, Clayton said, has enabled the SEC "to get to settlements, to get people their money back, get bad actors out of the marketplace and draw a line under that matter."

"It has been an effective means of pursuing remedies," he added.

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