Second Circuit Affirms Legality of "Gag Orders" in SEC Settlements

By Rachel Maimin

The Second Circuit today affirmed the legality of so-called "gag orders" in U.S. Securities and Exchange Commission (SEC) settlements: the rule that defendants settling with the commission cannot contradict the allegations against them even when the settlement itself does not involve any admission of guilt.

The "gag order" policy is codified at 17 C.F.R. § 202.5, which states that the SEC will not "permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings." 17 C.F.R. § 202.5(e). Settlement agreements with the SEC typically contain a clause confirming a defendant's agreement to comply with this policy. In practical terms, this means that settling with the SEC precludes defendants from complaining publicly–be it in the press, to Congress, or otherwise–about the allegations against them. This extends to objections about the factual allegations as well as the SEC's tactics. Breaching a settlement agreement with such a clause has dire consequences: settlement agreements expressly provide that breaching this section enables the SEC to petition to vacate the judgment, thereby bringing the case back to life.

This policy has been in effect for over 40 years and, naturally, has always had its detractors, who argue that forcing silence on settling defendants prevents important truths from being revealed about SEC investigations and unfairly infringes on defendants' First Amendment rights. Today, in *SEC v. Romeril,* 19-4197 (2d Cir. Sept. 27, 2021), the Second Circuit expressly ruled on the legality of the gag policy, holding that it is constitutional and lawful.

Romeril had been the CFO of Xerox from 1997-2000, and was accused by the SEC of manipulating earnings reports. Romeril settled with the SEC. He conceded in his settlement agreement that the court had proper jurisdiction, but did not admit or deny the allegations in the complaint against him–a typical resolution in SEC enforcement actions. Sixteen years later, in 2019, Romeril moved in the district court for relief from the judgment against him pursuant to Federal Rule of Criminal Procedure 60(b)(4), arguing that the "gag order," which had been expressly incorporated into the judgment, violated his constitutional rights to due process and free speech.

Today, the Second Circuit affirmed the district court's denial of Romeril's motion. The court emphasized that Romeril bargained for his settlement agreement, taking on the gag order restriction in exchange, presumably, for a more favorable disposition than a trial might have produced. He knowingly waived his right to publicly deny the allegations against him. In other words, there is nothing unique about the gag order clause in SEC settlements; they are similar to NDAs or other agreements binding one's right to speak.

Romeril was, as one would expect, not the first challenge to the gag order. For example, the D.C. Circuit rejected a similar challenge by the Cato Institute, a Libertarian think tank, in 2019. It is conceivable that other challenges may succeed, but defeats in the Second Circuit and D.C. Circuit are particularly significant in the context of SEC enforcement. Barring action by the U.S. Supreme Court, the gag rule is almost certainly here to stay. While this may be disappointing to some detractors of the rule, the benefits of a pretrial disposition usually outweigh the downside of being silenced–hence the small percentage of enforcement actions that proceed to trial. And whether a defendant is an individual or an entity, the less said the better after a judgment is entered is often the best P.R. policy. It is hard to imagine that prolonging news coverage of a judgment–even to raise legitimate concerns about the SEC's tactics–benefits a defendant in the eyes of investors and the public.

Contact

Please contact the listed attorney for further information on the matters discussed herein.

RACHEL MAIMIN
Partner
T: 212.419.5876
rmaimin@lowenstein.com