

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

---

)  
In re SEC Rule Imposing Speech Restraints )  
in Consent Orders )  
17 C.F.R. § 202.5(e) )  

---

**PETITION TO AMEND**

Margaret A. Little  
Mark Chenoweth  
NEW CIVIL LIBERTIES ALLIANCE  
1225 19<sup>th</sup> Street NW  
Suite 450  
Washington, DC 20036  
(202) 869-5212  
[peggy.little@ncla.legal](mailto:peggy.little@ncla.legal)

*Counsel for Petitioner New Civil Liberties Alliance*

October 30, 2018

## TABLE OF CONTENTS

INTRODUCTION .....	1
BACKGROUND .....	3
I.    The Rule Restraining Speech.....	3
A.    The Rule and Its Enactment.....	3
B.    A Brief History of the Rule and Its Shifting Policy Justifications .....	3
C.    The Rule as Applied in Consent Orders .....	4
D.    NCLA’s Modest Proposed Amendment to the Rule .....	6
II.   New Civil Liberties Alliance’s Interest .....	6
ARGUMENT .....	7
I.    The SEC’s Gag Rule Violates First Amendment Freedoms of Speech and the Press.....	7
A.    The Gag Rule Is a Forbidden Prior Restraint .....	8
1.    Prior Restraints Are Forbidden .....	8
2.    The Gag Rule Is a Prior Restraint .....	9
B.    The Gag Rule Is a Content-Based Restriction on Speech .....	10
1.    The Gag Rule Mandates the Content of Speech .....	10
2.    The Speech Ban Serves No Compelling Government Interest.....	11
3.    The Gag Rule Is Anything but the Least Restrictive Means .....	14
C.    The Gag Rule Prohibits Truthful Speech .....	15
D.    The Gag Rule Silences Defendants in Perpetuity.....	16
E.    The Gag Rule Unconstitutionally Compels Speech .....	16
F.    The Gag Rule Is an Unconstitutional Condition .....	19
II.   The Gag Rule Violates Due Process.....	21
A.    The Gag Rule Is Unconstitutionally Vague.....	21
B.    The Gag Rule Is Void as Against Public Policy.....	23
III.  The Gag Rule Violates the First Amendment Right to Petition.....	24
IV.  The Commission Lacked Statutory Authority to Issue the Gag Rule .....	26
A.    Legal Background.....	26
B.    None of the Statutes Cited by SEC Gave It Authority to Issue the Gag Rule.....	26
C.    SEC Circumvented the APA’s Requirement for Notice and Comment.....	27
V.    The Gag Rule Is Bad Public Policy.....	28
A.    The Rule Suppresses Information Critical to Agency Oversight .....	28
B.    The Rule Implicates the Judiciary in Violating the Constitution and Law .....	32
C.    The Rule Advances No Legitimate Public Policy .....	32
VI.  The Proposed Amended Rule.....	33
CONCLUSION .....	34

## INTRODUCTION

Pursuant to the Administrative Procedure Act, 5 U.S.C. § 553(e), and Rule 192(a) of the U. S. Securities and Exchange Commission (“SEC” or “Commission”), 17 C.F.R. § 201.192(a), the Petitioner New Civil Liberties Alliance (“NCLA”) hereby petitions the Commission to amend its rule restricting speech that is set forth in 17 C.F.R. § 202.5(e) (“The Gag Rule”). *See* Exhibit A. The Rule is unconstitutional, without legal authority, and further is ill-conceived policy.

The SEC Rule adopts “the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct did not, in fact, occur.” Accordingly, 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”—although at the same time the SEC provides that the defendant or respondent may state “that he neither admits nor denies the allegations.” 17 C.F.R. § 202.5(e).<sup>1</sup>

Pursuant to this policy and Rule, the Commission has required persons or entities charged in judicial or administrative proceedings of an accusatory nature who enter into consents to agree *in perpetuity* not to take any action or to make or cause to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis. The SEC in practice thus goes further than the rule and binds defendants to silence permanently under threat of a reopened prosecution, a penalty and enforcement power neither mentioned in nor authorized by the rule—or by any law.

The Gag Rule on its face and as applied in perpetuity in Consent Orders fails to pass constitutional or legal muster under many doctrines:

---

<sup>1</sup> The full text of the Gag Rule appears at Exhibit A to this Petition.

It is a forbidden prior restraint.

It is a content-based restriction on speech.

The Gag Rule prohibits truthful speech.

The Gag Rule silences defendants in perpetuity.

The Rule as applied in consent orders unconstitutionally compels speech.

It is an unconstitutional condition.

It not only serves no compelling public interest, it disserves the public interest.

It violates due process in that it is unconstitutionally vague and is against public policy.

It violates the First Amendment's right to petition.

The SEC lacked authority to issue the Gag Rule.

The Rule directly infringes upon the First Amendment rights of Americans and works to conceal the operations of agency enforcement from the American people. *Congress* could not lawfully pass a *statute* that silenced defendants about their prosecutions—such a statute would be held unconstitutional in short order. The SEC cannot accomplish through rule-making what the Constitution forbids to Congress.

“The loss of First Amendment freedoms, for even minimal periods of time, unquestionably constitutes irreparable injury.” *Elrod v. Burns*, 427 U.S. 347, 373 (1976). Given this ongoing irreparable injury, Petitioner requests that the Commission review this petition to amend on an expedited basis.

The proposed amended rule, removing the offending language, appears alongside the original rule at Exhibit A to this Petition.

## BACKGROUND

### I. The Rule Restraining Speech

#### A. The Rule and Its Enactment

In 1972, the Commission announced “adoption of a policy with respect to consent decrees in judicial or administrative proceedings” enacted because

it is important 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. Accordingly, it hereby announces its policy not to 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. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.

37 Federal Register 25224 (Exhibit B); *See also* 17 C.F.R. § 202.5(e) (Exhibit A).

Asserting that “the foregoing amendment relates only to rules of agency organization, procedure and practice, and therefore, notice and procedures specified in 5 U.S.C. 553 are unnecessary,” SEC announced that the amendment was effective immediately. 37 Federal Register 25224 (1972). (Reproduced in its entirety at Exhibit B).

#### B. A Brief History of the Rule and Its Shifting Policy Justifications

The rule was summarily adopted in 1972 “principally out of concern that defendants and respondents were entering into consent decrees and then publicly denying that they had done anything wrong or violated any law or regulation”:

Defendants and respondents would claim that there was no basis for the enforcement action and that they were settling the matter only to avoid the expense and hassle of litigation brought upon by an over-zealous, over-bearing and very powerful government agency. The ... policy reflected a concern that the public might buy in to this narrative and conclude that the SEC was acting arbitrarily, or worse unlawfully, which would undermine the agency’s integrity and compromise its ability to protect the investing public. The purpose of the policy, in other words, *was to avoid the perception that the SEC had entered into a settlement when there was not in fact a violation.*

D. Rosenfeld, Admissions in SEC Enforcement Cases: The Revolution that Wasn’t, 103 Iowa L. Rev. 113, 118-119 (2017) (Emphasis added, footnotes omitted), citing *SEC v. Vitesse Semiconductor Corp.*, 771 F. Supp. 2d 304, 308 (S.D.N.Y. 2011) (describing the policy’s origins).

Then, “[i]n the wake of the financial crisis of 2008” and blistering judicial criticism of the rule’s application to post-2008 settlements, the SEC’s original concern ... gave way to a new concern that the public might believe that the agency was acting collusively with wrongdoers and allowing them to escape serious punishment with a slap on the wrist.” *Id.* at 120. (footnote omitted).

In June 2013, in a major change, the SEC announced a policy that it would begin to require admissions from settling defendants. “The change was a reaction to stinging criticism that the agency was willing to sweep wrongdoing under the rug, or even worse, that it was acting collusively with wrongdoers.” *Id.* at 114. That new policy, rarely and inconsistently applied, has led to further criticism of the agency, discussed in Section V.

### **C. The Rule as Applied in Consent Orders**

Typical consent agreements secured by the SEC include some or all of the following language:

Defendant understands and agrees to comply with the terms of 17 C.F.R. § 202.5(e), which provides in part that it is the Commission’s policy “not to 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,” and “a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.” As part of Defendant’s agreement to comply with the terms of Section 202.5(e), Defendant: (i) will not take any action or make or permit to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis; (ii) will not make or permit to be made any public statement to the effect that Defendant does not admit the allegations of the complaint, or that this Consent contains no admission of the allegations, without also stating that Defendant does not deny the allegations; (iii) upon the filing of this Consent, Defendant hereby withdraws any papers filed in this action to the extent that they deny any allegation in the complaint. If Defendant breaches this agreement, the Commission may petition the Court to vacate the Final Judgment and restore this action to its active docket. Nothing in this paragraph affects Defendant’s: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which the Commission is not a party.

The Gag Rule expressly permits defendants to enter into consents “[w]ithout admitting or denying the allegations of the complaint.” 17 C.F.R. § 202.5(e). At the same time, the Rule seeks not only to prohibit defendants from making any public statement denying, directly or indirectly, any allegation in the complaint or from creating the “impression” that the complaint is without factual basis, but it also threatens the penalty of a reopened enforcement action should a defendant call into question any of the allegations of the complaint—a power authorized neither by the rule nor by law. In short, to secure a consent agreement, the SEC simultaneously 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.

Judge Jed Rakoff, in *S.E.C. v. Vitesse Semiconductor Corp.*, 771 F. Supp. 2d 304, 308–9 (S.D.N.Y. 2011) took a hard look at these internally contradictory provisions of the SEC’s “standard” consent judgments and concluded:

The result is a stew of confusion and hypocrisy unworthy of such a proud agency as the S.E.C. The defendant is free to proclaim that he has never remotely admitted the terrible wrongs alleged by the S.E.C.; but, by gosh, he had better be careful not to deny them either ... here an agency of the United States is saying, in effect, “Although we claim that these defendants have done terrible things, they refuse to admit it and we do not propose to prove it, but will simply resort to gagging their right to deny it.” The disservice to the public inherent in such a practice is palpable.

771 F. Supp. 2d at 309.

---

<sup>2</sup> NCLA does not represent Mark Jackson and has had no contact with him or his counsel in preparing this Petition to Amend. This example of a consent order was pulled from public sources.

#### **D. NCLA's Modest Proposed Amendment to the Rule**

Appellate courts have recognized that the no-admit-no-deny agreements are essential tools of settling civil enforcement proceedings; “requiring [] an admission [of culpability] would in most cases undermine any chance for compromise” with corporate defendants who face additional exposure from private lawsuits. *S.E.C. v. Citigroup Glob. Markets Inc.*, 673 F.3d 158, 165 (2d Cir. 2012). This Petition’s proposed amendment of the rule, set forth in Section VI. below, would still allow parties to *consensually* agree to admit, deny or to neither-admit-nor-deny specific allegations in the complaint or order. It would merely end SEC’s requirement of a sweeping—and unconstitutional—prior restraint in perpetuity as a condition of settlement

#### **II. New Civil Liberties Alliance’s Interest**

The New Civil Liberties Alliance is a nonprofit civil rights organization founded to defend constitutional rights through original litigation, *amicus curiae* briefs, and other means. The “civil liberties” of the organization’s name include rights at least as old as the U.S. Constitution itself, such as free speech, right to petition, jury trial, due process of law, the right to live under laws made by the nation’s elected lawmakers rather than by prosecutors or bureaucrats, and the right to be tried in front of an impartial and independent judge whenever the government brings cases against private parties.

NCLA defends civil liberties primarily by asserting constitutional constraints on the administrative state. Although Americans still enjoy the shell of their Republic, there has developed within it a very different sort of government—a type that the Constitution was framed to prevent. This unconstitutional administrative state within the Constitution’s United States violates more rights of more Americans than any other aspect of American law, and it is therefore the focus of NCLA’s efforts.

NCLA encourages agencies themselves to curb the unlawful exercise of administrative power. The courts are not the only government bodies with the duty to attend to the law. Even



more immediately, agencies and agency heads have a duty to follow the law, not least by avoiding unlawful modes of governance. NCLA therefore advises that all agencies and agency heads must examine whether their modes of rulemaking, adjudication, and/or enforcement comply with the APA and with the Constitution. In this case, NCLA respectfully suggests that the SEC amend the Gag Rule, 17 U.S.C. § 202.5(e), for the reasons set forth below.

NCLA also brings this Petition to Amend, because defendants are justifiably afraid to challenge the Gag Rule in litigation, lest they incur the displeasure of the agency and suffer on that account. That understandable concern is present during the original proceedings when a defendant hoping to settle is presented with the SEC's non-negotiable "policy not to 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). That fear is only heightened thereafter when the non-negotiable language of the consent order provides that if a defendant or respondent *ever* takes any action or makes or permits to be made "any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis" or speaks in any way that the SEC construes as a denial, or gives the impression of a denial, the settlement can be vacated and the SEC can petition to restore adversarial proceedings against that defendant or respondent to an active docket.

NCLA is an "interested" party concerning the proposed amendment, *see* 5 U.S.C. § 553(e), and petitions for amendment of the Gag Rule pursuant to 17 C.F.R. § 201.92(a).

## **ARGUMENT**

### **I. The SEC's Gag Rule Violates First Amendment Freedoms of Speech and the Press**

The SEC's Gag Rule violates the freedoms of speech and the press in several ways.

## **A. The Gag Rule Is a Forbidden Prior Restraint**

### **1. Prior Restraints Are Forbidden**

Prior restraints on speech and publication “are the most serious and the least tolerable infringement on First Amendment rights.” *Nebraska Press Ass’n v. Stuart*, 427 U.S. 539, 559 (1976). “A prior restraint ... has an immediate and irreversible sanction,” “[while] a threat of criminal or civil sanctions after publication ‘chills’ speech, prior restraint ‘freezes it,’” and it is therefore presumptively impermissible. *Id.* at 559. An injunction against future expression issued because of prior acts is incompatible with the First Amendment. *Gayety Theatres, Inc. v. City of Miami*, 719 F.2d 1550, 1551–52 (11th Cir. 1983).

There are “two evils” that will not be tolerated in such schemes. *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 225 (1990), *holding modified by City of Littleton, Colo. v. Z.J. Gifts D-4, L.L.C.*, 541 U.S. 774 (2004). First, no system of prior restraint may place “unbridled discretion in the hands of a government official or agency” to determine what speech may be uttered. *Id.* at 225 (quoting *City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 757 (1988)). Second, “a prior restraint that fails to place limits on the time within which the decisionmaker must issue the license is impermissible.” *Id.* at 226. The Gag Rule perpetrates both “evils.” It gives unfettered discretion to the SEC to decide if the speech could be construed as a denial or giving the impression of a denial, and it has no time limits at all.

A “predetermined judicial determination restraining specified expression” that is judicial in origin, that suppresses speech, punishable by contempt or other court sanction that seeks by judicial order to preclude a litigant from challenging its constitutionality, is unconstitutional. *City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 757 (1988). A “free society prefers to punish the few who abuse rights of speech after they break the law than to throttle them and all others beforehand.” *Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 559 (1975); *Bernard*, 619 F. 2d at 469. Such “[p]rior restraints fall on speech with a brutality and a finality all their own.

Even if they are ultimately lifted, they cause irremediable loss, a loss in the immediacy, the impact of speech.” *Id.* at 469 (quoting A. Bickel, *The Morality of Consent* 61 (1975)).

## **2. The Gag Rule Is a Prior Restraint**

The Gag Rule unlawfully enacts a speech licensing scheme whereby a defendant is permanently forbidden from contesting *all* allegations in the Commission’s complaint, regardless of their accuracy and regardless of the truth of the forbidden speech, on pains of reopened and renewed prosecution. The First Amendment does not allow such a policy.

First, the Gag Rule requires defendants to enter unlawful consent decrees to settle any case brought by the Commission. As a condition of settlement, the rule requires any defendant to agree to be forever barred from “denying the allegations in the complaint or order for proceedings.” This language puts the defendant in the position of authorizing future judicial proceedings against him if he speaks—irrespective of the truth of his utterance—a form of censorship that the Supreme Court held unconstitutional in *Near v. State of Minnesota ex rel. Olson*, 283 U.S. 697, 716 (1931). In *Near*, a publisher, because of past conduct, was subjected to active state intervention that controlled his future speech. Such state intervention is a prior restraint, because it embodies “the essence of censorship.” *Near*, 283 U.S. at 713. The First Circuit similarly recently invalidated a judicially imposed order prohibiting future speech, even when past conduct suggested that future defamatory conduct was likely to continue. *Sindi v. El-Moslimany*, No. 16-2347, 2018 WL 3373549, at \*21–22 (1st Cir. July 11, 2018). Simply put, the Constitution forbids the kind of censorship the Gag Rule enforces.

That the defendant or respondent has “consented” to the ban on his future speech by entering into a consent decree does not make the practice lawful. In *Crosby v. Bradstreet Co.*, 312 F.2d 483, 485 (2d Cir. 1963), the court voided a consent order which bound a defendant from publishing matter about the plaintiff in the future. The Second Circuit held that such a prior

restraint, even when entered on consent, which prohibits a defendant by court order from publishing material in the future, is void:

Such an injunction, enforceable through the contempt power, constitutes a prior restraint by the United States against the publication of facts which the community has a right to know and which Dun & Bradstreet had and has the right to publish. The court was without power to make such an order; that the parties may have agreed to it is immaterial.

*Id.* at 485.

This constitutional infirmity with gag orders was recognized by Judge Rakoff reviewing an SEC Consent Order, who noted: “On its face, the SEC’s no-denial policy raises a potential First Amendment problem.” *S.E.C. v. Citigroup Glob. Markets Inc.*, 827 F. Supp. 2d 328, 333 n. 5 (S.D.N.Y. 2011), *vacated and remanded on other grounds*, 752 F.3d 285 (2d Cir. 2014). Citing *Crosby*, 312 F.2d at 485, Judge Rakoff noted that law in the Second Circuit provides for reversing a consent settlement between two parties because the “injunction, enforceable through the contempt power, constitute[d] a prior restraint by the United States against the publication of facts which the community has a right to know.” *Id.* at 333 n.5.

## **B. The Gag Rule Is a Content-Based Restriction on Speech**

### **1. The Gag Rule Mandates the Content of Speech**

Even if considered merely a post-publication restraint, the Gag Rule is an unconstitutional content-based restriction. The gag order regulates the content of speech because it mandates views about the content of the complaint that led to the consent agreement and it threatens penalties if a defendant creates even an impression of a forbidden view of the complaint. Such restrictions are “presumptively invalid” and subject to the highest level of judicial scrutiny. *R.A.V. v. City of St. Paul, Minn.*, 505 U.S. 377, 382 (1992). *Sorrell v. IMS Health Inc.*, 564 U.S. 552 (2011), held that “heightened judicial scrutiny is warranted” anytime a “content-based burden” is placed “on protected expression.” 564 U.S. at 565. As an example, under the “Son of Sam” laws—which seek to prohibit criminals from profiting from accounts of their crimes—courts have held that the

content of the publication may not be restrained. *See Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 118 (1991) (“The Son of Sam law establishes a financial disincentive to create or publish works with a particular content. To justify such differential treatment, ‘the State must show that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end.’”) (quoting *Arkansas Writers’ Project v. Ragland*, 481 U.S. 221, 231 (1987)).

If murderers are free to publish books about their crimes and their prosecutions—as they must be in a free society—*a fortiori*, the SEC ought not to be able to silence SEC targets from speaking about their enforcement proceedings.

## **2. The Speech Ban Serves No Compelling Government Interest**

To pass constitutional muster, speech bans must be narrowly tailored and serve a compelling government interest by the least restrictive means. *United States v. Playboy Entm’t Group*, 529 U.S. 803, 813 (2000); *Burk v. Augusta-Richmond County*, 365 F.3d 1247, 1255 (11<sup>th</sup> Cir. 2004).

As noted above, the Gag Rule was enacted in 1972 “to avoid the perception that the SEC had entered into a settlement when there was not in fact a violation” of the securities laws. D. Rosenfeld, *supra*, p. 3 at 119-120. The 2008 financial crisis “gave way to a new concern that the public might believe that the agency was acting collusively with wrongdoers and allowing them to escape serious punishment.” *Ibid.*<sup>3</sup> Judge Rakoff memorably articulated this latter concern

---

<sup>3</sup> Indeed, Judge Jed Rakoff’s influential critiques of the Rule have consistently echoed both concerns. His refusal to approve a consent judgment in one case in part because it contained no admissions of wrongdoing and therefore did not get to the “truth,” expressed concerns about the public perception of letting defendants off lightly, or even SEC collusion. *SEC v. Bank of Am. Corp.*, 653 F. Supp. 2d 507, 512 (S.D.N.Y. 2009). At the same time, Judge Rakoff has acknowledged that the SEC was also likely bringing actions that lacked merit: “Another possibility ... is that no fraud was committed. This possibility should not be discounted.” Hon. Jed S. Rakoff, “Why Have No High-Level Executives Been Prosecuted in Connection with the Financial Crisis?” SPEECH, in *Corporate Crime Reporter*, (Nov. 12, 2013).

about SEC collusion in *Securities and Exchange Commission v. Bank of America Corporation*, 653 F. Supp. 2d 507, 508-12 (S.D.N.Y. 2009):

The proposed Consent Judgment in this case suggests a rather cynical relationship between the parties: the S.E.C. gets to claim that it is exposing wrongdoing on the part of the Bank of America in a high-profile merger; the Bank's management gets to claim that they have been coerced into an onerous settlement by overzealous regulators. And all this is done at the expense, not only of the shareholders, but also of the truth.

Neither policy justification for the enactment or enforcement of the rule is a legitimate basis for extracting silence from SEC targets, let alone a compelling one. Whether the SEC is being overaggressive in its charges or is underenforcing the laws while colluding with its targets at taxpayer expense, purchasing settlements at the price of eternal silence from defendants ill-serves public understanding of the agency and its workings.

In fact, it is hard to imagine a policy better designed to suppress truth about these important matters than the Gag Rule. Securities law professor John Coffee describes these consent settlements as an "artifact": "The SEC is premised on the idea that sunlight is the best disinfectant, and a nontransparent settlement harms the SEC's reputation." Z. Goldfarb, *SEC may require more details of wrongdoing to be disclosed in settlements*, WASH. POST, Apr. 1, 2010.

If the SEC in 1972 was extracting settlements when there had been no violation of the securities laws, *it is important for the American public to know that*. By the same token, if the post-2008 SEC was letting powerful defendants off lightly, or even entering into collusive deals, *it is equally important to shed light on those practices*. The government is institutionally highly unlikely to admit to either practice. Silencing the only other parties to the arrangements with a government enforced muzzle allows the government to act with impunity.

The government has no compelling interest in suppressing speech or suppressing complaints about government regulation and enforcement. The fact that SEC *systematically* imposes gag orders as a condition of all or nearly all its settlements is profoundly dangerous. Such a practice prevents the public, Congress, courts and policymakers from learning the specifics of

how the SEC conducts its enforcement actions. Shielding such an important exercise of government power from oversight and scrutiny prevents lawmakers from knowing when to rein in or unleash SEC authority and engage in course correction.

By systematically silencing all defendants, the Gag Rule insulates the SEC from criticism by the very people best placed and motivated to expose wrongdoing, over-aggressive prosecutions and/or flawed enforcement policies or practices. Such a restriction “operates to insulate ... [government laws] from constitutional scrutiny and ... other legal challenges, a condition implicating central First Amendment concerns.” *Legal Services v. Velazquez*, 531 U.S. 533, 547 (2001).

Furthermore, the interests protected by the First Amendment are not only the right of the speaker to free expression, but also the right of those *hearing* him to receive information unfettered by any government constraints. As one court stated, “these settlements do not always take adequate account of another interest ordinarily at stake as well: that of the public and its interest in knowing the truth in matters of major public concern.” *U.S. Securities and Exchange Comm’n v. CR Intrinsic Investors*, 939 F. Supp. 2d. 431, 443 (S.D.N.Y. 2013) (Marrero, J.). In a 2017 article, Judge Rakoff repeated these concerns noting that a complaint “which largely consists of unproven allegations” filed by the SEC suggests that “very serious misconduct is being alleged ... [t]he public ... has an obvious interest in knowing whether such serious allegations made by a government agency are true or untrue.” That article argues that the “predominance” of the SEC rule this petition seeks to amend,

in addition to impeding transparency and accountability—also means that wrongly accused parties are incentivized not to prove their innocence if they can get a cheap settlement without admitting anything. By the same token, the SEC can avoid having to litigate questionable cases by the simple expedient of offering a cheap settlement. And to make matters worse, the SEC hides the flimsiness of such cases from the public by imposing a “gag” order that prohibits the settling defendants from contesting the SEC’s allegations in the media.

Hon. Jed S. Rakoff, AGAINST: Neither admit nor deny, *Compliance Week*, Sept. 6, 2017.

### 3. The Gag Rule Is Anything but the Least Restrictive Means

The Gag Rule's sweeping and perpetual speech restriction is far from the least restrictive means of achieving any compelling interest the government may claim. If the SEC believes specific allegations of the complaint or order should be admitted by the defendant, those specific admissions, with the opportunity provided to defendants to truthfully qualify them, can always be negotiated as part of the settlement. As a practical matter, a defendant proclaiming innocence after paying a significant monetary sanction is unlikely to be deemed credible by anyone; the severe industry bans, harsh fines and other penalties imposed by SEC carry heavy deterrence value and already work to discredit defendants. Furthermore, if, after settling with the SEC, a defendant can show that some or all of the claims brought against him were excessive, or based on legally dubious theories, or simply were not true, that defendant should be free to speak—and the public to learn about it—without the defendant risking renewed prosecution. If a settling party asserts his innocence untruthfully, the SEC need only issue a press release to the contrary, a remedy far preferable and less restrictive than the lifetime ban on the defendant's speech procured under the government's boot and enforced by the threat of renewed prosecution.

As the Second Circuit acknowledged, SEC's neither-admit-nor-deny settlements are not about truth, but "are primarily about pragmatism." *Citigroup*, 752 F. 3d. at 296. Given these obvious and judicially acknowledged concerns, a gag order permits an agency that may have overreached or undercharged to do so with impunity—and no one will be the wiser. There is no possible public interest served by silence on such questions. The relative guilt or innocence of persons prosecuted by government officials requires the utmost transparency and vigilant and enduring scrutiny.

These policy concerns are especially vital, where, as here, one of the parties to the contract is a government agency acting not under a law of Congress but under a rule written and enacted by unelected bureaucrats shielding their own activity from public view.



The Gag Rule is unlimited in time and restricts speech based on its content. It serves no compelling government interest, and it conflicts with the important public interest in transparency and agency oversight and does so by the most restrictive, unnecessary, and unconstitutional means.

“If the First Amendment means anything, it means that regulating speech must be a last—not first—resort. *Thompson v. Western States Med. Ctr.*, 535 U.S. 357, 373 (2002). The SEC can offer no compelling—or even defensible—state interest in silencing the targets of its administrative proceedings. The core interest at stake in the First Amendment in government transparency and the free flow of information about how our government works argues entirely against any rules restraining speech in this context. Thus, both settled constitutional principles and fundamental policy interests forbid gag orders.

### **C. The Gag Rule Prohibits Truthful Speech**

The Rule is also unconstitutional because it forbids true speech just the same as it does false speech. The typical consent agreement ends with a provision that “lifts” the gag order—and its substantive commands about admissions and denials—for testimonial obligations or defendants’ “rights” to take legal or factual positions in judicial proceedings in which the Commission is not a party. The SEC’s “lift” of the speech ban in its consent decrees for later testimonial or other legal proceedings is a tacit concession that the gag order *must* contain an exception where it conflicts with a defendant’s obligation to speak the truth under oath. This telling exception is fatal to any defense of the Gag Rule by the Commission because it concedes that defendants’ obligations to tell the truth under oath may be at odds with the SEC’s “You must admit all allegations; you may deny nothing” diktat. This exception would not be necessary unless SEC knows that the gag policy otherwise leads to false impressions or even perjury. SEC’s self-favoring exemption from the exception—“in which the Commission is not a party”—also disturbingly places SEC’s thumb on the scales of justice in any subsequent proceeding in which the Commission is a party.

Indeed, the Gag Rule’s original justification when it was adopted in 1972 was that it was “important to avoid creating ... an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur.” Yet the Gag Rule itself creates the false impression that every fact in the complaint or order is accurate, when that is seldom, if ever, the case. Complaints, as noted by Judge Rakoff, consist “largely ... of unproven allegations.” Rakoff, *AGAINST: Neither admit nor deny, Compliance Week*, supra, p. 1. Thus the text of the SEC’s original justification for the Gag Rule argues *against* having a rule that gives the false impression that the complaint is completely true.

This “lift” of the ban in testimonial situations appears to be a strategic exception designed to avoid a gag order’s coming to the attention of a judge in subsequent judicial proceedings who might well invalidate such a disturbing and unconstitutional speech ban unheard of in normal state or federal judicial settlements or consent decrees.

But this exception is much too parsimonious. The government doesn’t get to decide *when* defendants are allowed to speak the truth, by carving out a caveat calculated to shield the ban from scrutiny in subsequent judicial or testimonial proceedings, but otherwise silencing defendants for life. The statement of the proposition suffices to expose its raw unconstitutionality.

#### **D. The Gag Rule Silences Defendants in Perpetuity**

The Gag Rule never expires. The ban is longer even than a criminal sentence would be for the charged violation. The Gag Rule requires a defendant to enter a consent decree that prevents speech forever and without end—a restriction that cannot be justified under any level of constitutional precedent. *See FW/PBS, Inc.*, 493 U.S. at 226-7. Its perpetually mandated silence cannot be constitutional.

#### **E. The Gag Rule Unconstitutionally Compels Speech**

The SEC Sample Consent Order (see p. 4 above) provides at part ii that defendant “will not make or permit to be made any public statement to the effect that Defendant does not admit

the allegations of the complaint, or that this Consent contains no admission of the allegations, *without also stating that Defendant does not deny the allegations*” (emphasis added). That “script” is a raw assertion by the SEC of power to compel future speech by persons with whom it settles judicial or administrative enforcement proceedings.

The First Amendment prohibits the government from compelling persons from expressing beliefs they do not hold. “The right of freedom of thought protected by the First Amendment ... includes both the right to speak freely and the right to refrain from speaking at all” or expressing beliefs that are not one’s own. *Wooley v. Maynard*, 430 U.S. 705, 714 (1977) (state cannot compel motorists to display “Live Free or Die” on their license plates). *West Virginia State Bd. of Ed. v. Barnette*, 319 U.S. 624 (1943) (state cannot force flag salute). Any attempt by the government to compel individuals to either express certain views or to refrain from speaking in the future implicates “complementary components of the broader concept of individual freedom of mind” protected by the First Amendment. *Wooley*, at 714. *See also Pac. Gas & Elec. Co. v. Pub. Utils. Comm’n*, 475 U.S. 1, 16 (1986) (protecting corporations from such compelled speech).

Government-compelled speech in this context is subject to strict scrutiny. *Riley v. National Fed’n of the Blind of N. Carolina, Inc.*, 487 U.S. 781, 796–97 (1988). “Mandating speech that a speaker would not otherwise make necessarily alters the content of the speech.” *Id.* at 795. Speech compelled by the government is generally subject to strict scrutiny, even where the compelled speech is limited to factually accurate or non-ideological statements. *F.C.C. v. Fox Television Stations, Inc.*, 567 U.S. 239 (2012).

The Supreme Court’s recent compelled speech cases invalidate government-imposed speech like the consent orders favored by the SEC. In *Janus v. AFSCME*, 585 U.S. \_\_\_\_ (2018), the Court held that public employees could not be compelled to subsidize speech on matters with which they disagree. *National Institute of Family and Life Advocates v. Becerra*, 585 U.S. \_\_\_\_

(2018) stopped the State of California from forcing faith-based pregnancy centers to propound government-scripted speech about abortion clinics.

The quoted language in part ii of the sample consent decree requires a defendant criticizing his prosecution to call into question *his own integrity*. The fundamental free speech and Fifth Amendment interests at stake are thus arguably even more intrusive to individual liberty than those presented in *Janus* or *Becerra*. SEC consent orders require a settling defendant to spit out words that infer his own guilt as to *all* aspects of a complaint in a settled matter, a form of state-forced self-condemnation.

In *Nat'l Ass'n of Mfrs. v. SEC*, 800 F. 3d 518, 522 (D.C. Cir. 2015) the court held that an SEC mandated publication that minerals used by companies were not conflict-free was impermissible: “It requires an issuer to tell customers that its products are ethically tainted ... [b]y compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment.” 800 F.3d at 530 (holding both Congress’s *statute* and SEC’s rule requiring disclosure of “conflict minerals” unconstitutional).

Government efforts to compel citizens to utter speech with which they disagree deeply offends the fundamental “principle that each person should decide for himself or herself the ideas and beliefs deserving of expression, consideration, and adherence.” *Agency for Int'l Dev. v. All. For Open Soc'y, Int'l, Inc.*, 570 U.S. 205, 213 (2013). Such efforts are routinely struck down. States, for example, have been forbidden to compel dairy manufacturers to “warn” consumers about their methods for producing milk. *Int'l Dairy Foods Ass'n v. Amestoy*, 92 F. 3d 67 (2d Cir. 1996).

The government-drafted consent decrees enforced by SEC gag orders offend the precepts recently reaffirmed by the Supreme Court in *Janus* and *Becerra* and are unconstitutional. *Becerra* expressly condemned “government-drafted scripts” as unconstitutional regulation of speech. Citing *Riley*, the *Becerra* court stated that “compelling individuals to speak a particular message”

contained in a “government-drafted script” that “drowns out the facility’s own message” violates the First Amendment. *Becerra*, slip op. at 7, 19. The Consent Order’s requirement that a defendant who wishes to utter exculpatory speech cancel it out with self-condemning counter-speech is an Orwellian contrivance that Congress itself could never lawfully enact.

#### **F. The Gag Rule Is an Unconstitutional Condition**

In *Legal Services v. Velazquez*, 531 U.S. 533 (2001), the Supreme Court held that Congress could not condition aid to public defenders to prohibit them from giving advice or making arguments about the lawfulness or constitutionality of welfare laws. *Velazquez* ruled that Congress is not permitted to restrict the expression of attorneys in courts, as this would be an unconstitutional “distort[ion] of the legal system.” *Id.* at 543-44. Likewise, the SEC cannot condition a citizen’s ability to settle with the government upon the surrender of his First Amendment rights with respect to the prosecution.

*Koontz v. St. Johns River Water Management Dist.*, 570 U.S. 595 (2013) similarly held that “the government may not deny a benefit to a person because he exercises a constitutional right.” *See also Rutan v. Republican Party of Ill.*, 497 U.S. 62, 78 (1990); *Frost & Frost Trucking Co. v. Railroad Comm’n of Cal.*, 271 U.S. 583, 592-593 (1926) (invalidating regulation that required the petitioner to give up a constitutional right “as a condition precedent to the enjoyment of a privilege”); *Southern Pacific Co. v. Denton*, 146 U.S. 202, 207 (1892) (invalidating statute “requiring the corporation, as a condition precedent to obtaining a permit to do business within the State, to surrender a right and privilege secured to it by the Constitution”). In *Perry v. Sindermann*, 408 U.S. 593 (1972), for example, the Court held that a public college would violate a professor’s freedom of speech if it declined to renew his contract because he was an outspoken critic of the college’s administration. *Accord Pickering v. Board of Ed.*, 391 U.S. 563 (1968). In *Board of Trustees Leland Stanford Jr. Univ. v. Sullivan*, 773 F. Supp. 472 (D.D.C. 1991), the court held that government withdrawal of a contract for a refusal to agree to confidentiality and prior

governmental approval to publish was unconstitutional. As the *Koontz* court stated, these “cases reflect an overarching principle, known as the unconstitutional conditions doctrine, that vindicates the Constitution’s enumerated rights by preventing the government from coercing people into giving them up.” Moreover,

regardless of whether the government ultimately succeeds in pressuring someone into forfeiting a constitutional right, the unconstitutional conditions doctrine forbids burdening the Constitution’s enumerated rights by coercively withholding benefits from those who exercise them.

*Koontz*, 570 U.S. at 606.

SEC gag orders require an agreement to not question the merits of the prosecution as a condition precedent to settlement, and further, they impose reopened prosecution as a penalty if a defendant subsequently speaks about his prosecution in a manner that the SEC construes as “creating the impression that the complaint is without factual basis.” Both “conditions” are impermissible. The unconstitutional conditions doctrine applies regardless of whether the “condition” is a condition precedent or a condition subsequent to the settlement—both of which are presented by the unusual terms of SEC gag orders, which coercively control defendants’ speech in the making of the settlement and forever thereafter.<sup>4</sup> And as in *Velazquez*, the gag orders thus simultaneously abridge a defendant’s freedom of speech and distort the legal system by cutting off an avenue of redress against agency abuses.

---

<sup>4</sup> The Supreme Court’s “unconstitutional conditions cases have long refused to attach significance to the distinction between conditions precedent and conditions subsequent. See *Frost & Frost Trucking Co. v. Railroad Comm’n of Cal.*, 271 U.S. 583, 592-593 (1926) (invalidating regulation that required the petitioner to give up a constitutional right “upon the condition that it strip itself of ... protection given it by the Federal Constitution”); *Southern Pacific Co. v. Denton*, 146 U.S. 202, 207 (1892) (invalidating statute “requiring the corporation, as a condition precedent to obtaining a permit to do business within the State, to surrender a right and privilege secured to it by the Constitution”). See also *Town of Flower Mound v. Stafford Estates L. P.*, 135 S.W.3d 620, 639 (Texas 2004) (“The government cannot sidestep constitutional protections merely by rephrasing its decision from ‘only if’ to ‘not unless’.”). *Koontz*, at 607. The *Koontz* court held that to do so “would effectively render *Nollan* and *Dolan* a dead letter .... [a]s in other unconstitutional conditions cases in which someone refuses to cede a constitutional right in the face of coercive pressure, the impermissible denial of a governmental benefit is a constitutionally cognizable injury.” *Koontz*, at 607.

Nor does it make a difference that the government could have refused to settle at all with the SEC target. Virtually all unconstitutional conditions cases involve an optional governmental action of some kind. *See, e.g., Perry*, 408 U.S. 593 (non-tenured public employment). As Koontz holds, “we have repeatedly rejected the argument that if the government need not confer a benefit at all, it can withhold the benefit because someone refuses to give up constitutional rights.” *E.g., United States v. American Library Assn., Inc.*, 539 U.S. 194, 210 (2003) (“[T]he government may not deny a benefit to a person on a basis that infringes his constitutionally protected ... freedom of speech *even if he has no entitlement to that benefit.*” (emphasis added and internal quotation marks omitted)); *Wieman v. Updegraff*, 344 U.S. 183, 191 (1952) (explaining in unconstitutional conditions case that to focus on “the facile generalization that there is no constitutionally protected right to public employment is to obscure the issue.”) Even if SEC would have been entirely within its rights in refusing to settle, that greater authority does not imply a “lesser” power to condition the settlement upon defendant’s forfeiture of his constitutional rights. *See Nollan v. California Coastal Commission*, 483 U.S. 825, 836-837 (1987). Just as Congress cannot condition its funding “lest the First Amendment be reduced to a simple semantic exercise,” *Velazquez* at 547, similarly here, the SEC cannot condition the benefit of a conclusively settled case on eternal silence by those it prosecutes about the merits of the case.

## **II. The Gag Rule Violates Due Process**

### **A. The Gag Rule Is Unconstitutionally Vague**

The Gag Rule is also unconstitutionally vague. It forces those who “enter into consents to agree not to take any action or to make or cause to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis”—a formulation that leaves a party speechless with respect to his prosecution and a reader unable to define any discernible limits on what is prohibited. Such a broad, all-encompassing and impressionistic prohibition fails to provide clear notice of what speech is

forbidden or to articulate any limits on the reach of the speech ban. A settling defendant had better stay mum altogether, rather than navigate at his peril what he can say about his own prosecution under the terms of the gag order. In *Connally v. General Constr. Co.*, 269 U.S. 385, 391 (1926), the Supreme Court recognized that a penal law “must be sufficiently explicit to inform those who are subject to it what conduct ... will render them liable to its penalties ... a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at [the law’s] meaning and differ as to its application, violates the first essential of due process of law.”

“A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required.” *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) (citing *Connally v. General Constr. Co.*, 269 U.S. 385, 391 (1926)). Rules that are “impermissibly vague” must be “invalidat[ed]” for failing to satisfy this “requirement of clarity[.]” *Id.* And “[w]hen speech is involved,” it is particularly important “to ensure that ambiguity does not chill protected speech.” *Id.* at 253-254. The Gag Rule has no limiting principle. The rule forbids a defendant from even creating “an *impression* that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur.” 17 C.F.R. § 202.5(e). This wording places unlimited discretion in the hands of the Commission to decide what future speech is and is not permissible.

Persons who settle with the SEC should not be required to guess at the Rule’s scope. “It is one thing to expect regulated parties to conform their conduct to an agency’s interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency’s interpretations in advance or else be held liable” when the agency interprets it “for the first time in an enforcement proceeding and demands deference.” *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 158-59 (2012); *see also Unity08 v. FEC*, 596 F.3d 861, 865 (D.C. Cir. 2010) (“Our reluctance to require parties to subject themselves to enforcement proceedings to challenge agency



positions is at its peak where, as here, First Amendment rights are implicated and arguably chilled by a ‘credible threat of prosecution.’”); *see also Brown v. Entm’t Merchants Ass’n*, 564 U.S. 786, 807 (2011) (Alito, J., concurring) (“Vague laws force potential speakers to steer far wider of the unlawful zone ... than if the boundaries of the forbidden areas were clearly marked.”) (quotation marks omitted).

Given the breadth and lack of clarity as to the Rule’s scope, and the attendant chill of First Amendment activity, the Rule is unconstitutionally vague.

### **B. The Gag Rule Is Void as Against Public Policy**

Consent decrees agreed upon by the parties as a compromise to litigation are treated by courts as contracts for enforcement purposes, *Segar v. Mukasey*, 508 F.3d 16, 21-22 (D.C. Cir. 2007), and accordingly “reliance upon certain aids to construction is proper, as with any other contract.” *Id.* (citing *United States v. ITT Cont’l Baking Co.*, 420 U.S. 223, 238 (1975)). *See generally* James Valvo, *The CFTC and SEC Are Demanding Unconstitutional Speech Bans in Their Settlement Agreements*, NOTICE & COMMENT, A Blog from Yale J. Reg. and ABA Sec. of Admin. Law & Regulatory Practice, Dec. 4, 2017. When construing and enforcing contracts, courts will not enforce contractual provisions that are void because they violate public policy. *Fomby-Denson v. Dep’t of the Army*, 247 F.3d 1366, 1377-78 (Fed. Cir. 2001) (Settlement agreement cannot silence defendant from making a truthful report about plaintiff to authorities.) Courts routinely disfavor unlimited waivers of rights in contracts, for example, refusing to enforce non-compete clauses as unreasonable and unenforceable if they do not contain a time limit. *See, e.g., Diversified Fastening Sys., Inc. v. Rogge*, 786 F. Supp. 1486, 1492 (N.D. Iowa 1991) (“The failure to limit the time period and geographical restriction essentially make the [non-compete] contract one imposing a restrictive covenant of unlimited time and space. Such an unlimited covenant is clearly unreasonable and unenforceable.”)

Further, the “consent” is procured by force in the inducement (it is a non-negotiable condition of settlement) and by force in the enforcement (via a threatened renewed prosecution). Consequently, the purported consent is a fiction.

SEC gag orders forbid all speech, even truthful speech by a settling defendant about the merits of his prosecution, and they are unlimited in time. They accordingly violate public policy and are unenforceable and invalid.

### **III. The Gag Rule Violates the First Amendment Right to Petition**

The First Amendment provides that “Congress shall make no law ... abridging ... the right of the people ... to petition the Government for a redress of grievances.” U.S. Const. amend. I. Its protections include the right of petition by defendants or corporations “with respect to the passage and enforcement of laws.” *Eastern R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 138 (1961). The First Amendment “was fashioned to assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people.” *N. Y. Times Co. v. Sullivan*, 376 U.S. 254, 269 (1964) (quoting *Roth v. United States*, 354 U.S. 476 (1957)). The Gag Rule offends our “profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open.” *Snyder v. Phelps*, 562 U.S. 443, 452 (2011) (quotation marks omitted).

The SEC rule restraining speech which NCLA seeks to amend prohibits targets of an agency enforcement action who settle from ever questioning the merits of the prosecution against them. But history is replete with compelling accounts of prosecutorial abuse of power, including prosecutors who deny their targets access to exculpatory evidence, who engage in misconduct, sharp practice or intimidation tactics that can and have brought defendants or respondents to their knees. The prospect of potentially ruinous costs, crippling time demands, and collateral damage mean that even innocent people may find settling with the government preferable to hazarding a full-fledged prosecution. Consent agreements may well represent either the SEC’s failure to make

a case when put to its burden of proof or a settling target's guilt—or some combination thereof. Any person who waves the white flag to end the process should not be forever silenced on the topic of his prosecution—*most especially not by the prosecutor!*

“Speech on matters of public concern is at the heart of the First Amendment’s protection. *Snyder*, at 451-52 (quotation marks omitted). “That is because speech concerning public affairs is more than self-expression; it is the essence of self-government.” *Id.* at 452. Thus, “speech on public issues occupies the highest rung of the hierarchy of First Amendment values and is entitled to special protection.” *Id.*

When prosecutors abuse their considerable powers beyond lawful and/or ethical bounds, their targets should be free to tell that story and petition appropriate government bodies for change. When agencies regulate through enforcement, guidance or other legislatively unauthorized means, the persons affected should never be silenced by the regulator. Whether the standards of conduct governing Americans should be set prospectively by lawmakers or retroactively by bureaucrats is a matter of self-evident public concern. There are no better witnesses to testify before a legislative body and no better public advocates than the targets of regulatory overreach. A healthy democratic republic should encourage such self-examination. A constitutional democratic republic requires it.

At bottom, the Gag Rule stifles informed public debate on these matters. It requires defendants to choose between surrendering their constitutional rights to speak freely and to petition the government on the one hand and forgoing consent settlements with the Commission and facing the potentially ruinous costs and risks of contesting the proceedings to the bitter end, on the other. Under the Rule, the only way for a defendant to settle an enforcement proceeding is to surrender forever his future First Amendment rights of speech and petition with respect to the government’s prosecution of him. Our Constitution does not permit that baleful bargain.

#### **IV. The Commission Lacked Statutory Authority to Issue the Gag Rule**

Quite apart from the constitutional objections discussed thus far, the SEC issued the Gag Rule without statutory authorization. It is therefore unlawful under the Administrative Procedure Act.

##### **A. Legal Background**

No agency has any inherent power to make law. Article I, § 1 of the U.S. Constitution vests “[a]ll legislative powers” in the Congress, and “the lawmaking function belongs to Congress ... and may not be conveyed to another branch or entity.” *Loving v. United States*, 517 U.S. 748, 758 (1996). This is a constitutional barrier to an exercise of legislative power by an agency. Further, “an agency literally has no power to act ... unless and until Congress confers power upon it.” *Louisiana Pub. Serv. Comm’n v. FCC*, 476 U.S. 355, 374 (1986). Thus, even if an independent agency could constitutionally exercise the legislative power to write a Gag Rule, it cannot purport to bind anyone without congressional authorization, which is utterly lacking here.

##### **B. None of the Statutes Cited by SEC Gave It Authority to Issue the Gag Rule**

The 1972 Federal Register entry announcing the enactment of this rule, claimed authority “[p]ursuant to section 19 of the Securities Act of 1933, section 23(a) of the Securities Exchange Act of 1934, section 20 of the [now-repealed] Public Utility Holding Company Act of 1935, section 38 of the Investment Company Act of 1940 and section 211 of the Investment Adviser’s Act of 1940.”<sup>5</sup> Those regulatory sections—each of which simply read empowers the agency to make internal housekeeping rules for its own administration—provide no authority whatsoever for agencies to impose a Gag Rule that binds third parties brought before them who decide to settle

---

<sup>5</sup> Section 19 of the Securities Act of 1933 gives the Commission special powers “to make, amend and rescind such rules and regulations as may be necessary to carry out [the Act]” including “rules and regulations governing registration statements and prospectuses ... defining accounting, technical and trade terms .... prescrib[ing] the form or forms in which required information shall be set forth, the items and details to be shown in the balance sheet and earning statement ... methods to be followed in the preparation of accounts, in the appraisal or valuations of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation ... of consolidated balance sheets or income accounts of any person” identified with the issuer. The statute allows these accounting standards to be effective upon publication. The other four authorizing statutes under the ‘34 Act and other financial regulation statutes similarly address such “housekeeping” rules. The exact language of all five statutes setting forth the subjects upon which the SEC can promulgate these housekeeping rules is fully set forth in Exhibit C to this petition.

judicial or administrative proceedings. *None* of the statutes under which SEC purported to act gave it authority to issue the Gag Rule.

Congress has not given the SEC—or anyone else, for that matter—any authority to impose additional restrictions on the constitutional rights of persons they prosecute, either in court or administratively. Nor is this surprising, as the First Amendment and the unconstitutional conditions doctrine would forbid it.

### **C. SEC Circumvented the APA’s Requirement for Notice and Comment**

Because the Gag Rule is a forbidden prior restraint, the details on how it was enacted do not matter. It must be amended.

A Gag Rule, binding upon parties brought before the SEC in “any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature” is anything but a rule that “relates only to rules of agency organization, procedure and practice.” An agency’s *ad hoc* promulgation of a self-protective rule by which SEC not only seeks to bind private parties with the force of law, but to silence them on the topic of their prosecution is a wholly illegitimate exercise of government power.

Not only does a fair reading of the authorizing statutes reveal that a Gag Rule binding upon third parties whom SEC prosecutes does not possibly fall within their purview, but the APA would have required notice and comment with respect to the SEC’s enactment of any such binding rule. The SEC’s disingenuous assertion that publication, notice and comment were not required, only strengthens the case for immediate amendment of the rule.

Given the “stinging criticism” of the rule that has emerged in courts from federal judges and in law journals—*see* D. Rosenfeld, *supra*, p. 3 at 114—it is fair to assume that a proposed rule giving the agency power to gag its targets as to how regulations have been enforced against them would attract vigorous negative comments if published for notice and comment. We have no

record of such public objection because the SEC chose to view this as a “housekeeping rule” that could bypass APA requirements.

The Gag Rule sets forth a policy that potentially binds anyone brought before the agency who makes the difficult decision to settle its case. Rules that bind persons outside the agency are not “housekeeping” rules. They require notice and comment and violate the APA when they are promulgated without it. In this instance, they also exceed any power Congress granted to the SEC in enabling statutes. Thus, in addition to the Gag Rule’s fatal constitutional infirmities, it also is unlawful because it was made without statutory authority.

## **V. The Gag Rule Is Bad Public Policy**

### **A. The Rule Suppresses Information Critical to Agency Oversight**

Defendants who enter into plea deals with the Department of Justice are free to criticize any aspect of their prosecution, which is as it should be. Other federal agencies permit defendants to outright deny the government’s allegations upon settlement.<sup>6</sup>

Not so with the SEC. The SEC Gag Rule not only infringes defendants’ First Amendment rights, but also shields agencies such as SEC (and CFTC which has a similar rule) from public oversight and scrutiny. A defendant charged by an agency may be the single best informed and most well-situated critic of how the agency uses—or abuses—its power. For an agency—not Congress, but an agency—to enact a rule that ensures that anyone who settles an enforcement action will be permanently unable to speak about the process, means that administrative agencies can immunize themselves from criticism and scrutiny of their actions, and render their uses of

---

<sup>6</sup> For example, see *In the Matter of Facebook, Inc.*, U.S. Federal Trade Comm’n Docket No. C-4365 (July 27, 2012); *U.S. v. Bank of America Corp., et al.*, No. 120361 (D.D.C. Apr. 4, 2012) (Department of Justice); *In the Matter of Morgan Stanley*, Docket No. 12-015-B-HC (April 2, 2012); *U.S. v. American Electric Power Serv. Corp.*, C.A. No. C2-99-1250 (S.D. Ohio Oct. 9, 2007) (Environmental Protection Agency); *F.D.I.C. v. Killinger et al.*, Docket No. 2:11-cv-00459-MJP, cited in G. Matsko, *SEC “Gag Orders”: Does Settling in Silence Advance the Public Interest?*, Washington Legal Foundation Legal Backgrounder, Vol. 29 No. 6, March 28, 2014. See also DOJ Release, *Tennessee Fraud Settlement Announced* (July 13, 2011) (settling a civil fraud case for \$220K where a defendant ‘does not admit liability in the settlement’) cited in Reckler & Denton, *Understanding Recent Changes to the SEC’s “Neither Admit Nor Deny” Settlement Policy*, Corporate Governance Advisor, Vol. 20, No. 2 (2012).

power “unaccountable” in a way a real Article III court would never be allowed to do. The DOJ does not presume to be able to issue such broad prior restraints on speech in its consent decrees and settlements. It is presumptuous and lawless for an independent agency to arrogate such powers through rulemaking.

As further evidence of the asymmetries of power that attend the Gag Rule, it appears that at least some SEC agency officials do not feel that the no-admit-no-deny rule applies to them. In a CNBC article, one target of an SEC enforcement action noted that, shortly after his no-admit-no-deny settlement, the agency’s acting director of enforcement released a statement to the press characterizing the financial payment as levied for the respondents’ “misconduct,” omitting the word “alleged” even though, because the case was settled, the complaints were never proven in court. *See* Leon Cooperman, “Two changes that could help fix what is wrong with our regulatory process,” CNBC, May 22, 2018.

Actual prosecutors know they cannot demand gag orders. Targets of SEC enforcement actions routinely face parallel criminal proceedings, and many of them enter into settlement agreements with the Department of Justice in which they make narrow and specified admissions with respect to the complaints against them. But Article III court orders do not require wholesale silence with respect to every allegation of the complaint. No self-respecting U.S. Attorney would dare to insert such a proposed gag order into his settlement agreement. Nor has Congress enacted a gag order statute empowering U.S. Attorneys to request such orders. If Congress should ever try, it would run head-on into the First Amendment’s prohibition that “Congress shall make no law . . . abridging the freedom of speech.” *See, e.g., Nat’l Ass’n of Mfrs. v. SEC*, 800 F. 3d 518, 522 (D.C. Cir. 2015). Agencies do not possess legislative powers denied by the Constitution to *Congress*.

In essence, the Gag Rule amounts to a permanent bar on all future speech by defendants or respondents with the temerity to call into question government enforcement actions against them. If a defendant or respondent publicly asserts something the government disagrees with, the SEC

is free to issue its own statement, and the public can sort out the truth in the free marketplace of ideas. The government should never be in the business of silencing anyone, particularly persons against whom it has already brought the formidable powers of the state to bear.

One commentator has noted that the Gag Rule allows the SEC to pursue weak cases without public scrutiny of the practice: “the SEC ‘pushes the envelope at times, advancing aggressive and novel legal theories and versions of the facts that, if fully litigated, might not succeed.’” G. Matsko, n. 5 above.<sup>7</sup> Matsko also notes: “Although SEC’s speech restrictions affect all civil enforcement defendants, they have an especially acute impact on smaller businesses and individuals who may not have the resources for a prolonged, expensive defense, and thus may have to forgo the fight even when frailties in the case might otherwise offer them a viable avenue of defense.” *Id.* This insight that the rule falls harder on individuals was confirmed by an empirical study of settlements entered after the SEC announced its policy in 2013 that it would require admissions to further public accountability. The data showed that settlements with admissions remained low, and while some admissions were secured in high-profile cases, nearly half of the admissions were in cases with low or no monetary sanctions. V. Winship and Jennifer K. Robbennolt, *Admitting Wrongdoing to the SEC; An Empirical Study of Admissions in SEC Settlements 2011-2017*, Corporate Civil Liability, Deterrence, Enforcement, Enforcement Policy, Sanctions, Securities and Exchange Commission (SEC), Securities Fraud, (NYU, Oct. 24, 2017).

A second comprehensive empirical study found the inconsistent application of SEC’s admissions policy to be “troubling,” remarking that the “lack of clear standards, consistency, and transparency has undermined the fairness and effectiveness of the policy and has bred cynicism that the SEC may be using the threat of a required admission to extract higher penalties in settlements.” D. Rosenfeld, *supra*, p. 3 at 117-18. That article sets forth examples where the SEC

---

<sup>7</sup> See S. Lynch & A. Viswanatha, *Weak trial witnesses hinder a more aggressive SEC*, Reuters, March 10, 2014 (SEC success rate at trial has declined to 58% and SEC explains that the pursuit of challenging cases was a factor.)



secured admissions from some defendants, whereas “perpetrators of [a] far more egregious scheme were allowed to settle ... on a no-admit/no-deny basis.” *Id.* at 155-57. The author, a former SEC lawyer, concluded that if such inconsistency and lack of transparency continues, “the policy should be reconsidered or abandoned altogether.” *Id.* at 118. Yet another observer has noted that SEC’s new insistence on admissions has led to situations where settling with the SEC could be worse than losing at trial, D. Fisher, *Why Settling With The SEC Can Be Worse Than Losing At Trial*, Forbes.com, Jan. 29, 2014, which no doubt helps explain why the post-2013 SEC policy of requiring admissions has proven such a practical and conceptual failure.

Consider a situation where a defendant may be able to secure a favorable settlement because a government witness had perjured himself or the prosecution was otherwise based on compromised evidence. That defendant should be able to freely call the tainted prosecution to public attention, to ask why the SEC didn’t ferret out the perjury itself prior to bringing the prosecution, or question how the agency is selecting the cases it prosecutes. As it now stands, defendants who operate under the SEC Gag Rule can only buy peace with their enforced silence.

Regulation by enforcement action—rather than statutory authority—is a recognized aspect of administrative agency abuse of power. One SEC Commissioner has described its particularly pernicious reach in the context of settled enforcement actions:

The practice of attempting to stretch the law is a particular concern when it occurs in *settled* enforcement actions. Often, given the time and costs of enforcement investigations, it is easier for a private party just to settle than to litigate a matter. The private party likely is motivated by its own circumstances, rather than concern about whether the SEC is creating new legal precedent. However, the decision made by that party about whether to accede to ... SEC’s proposed order can have far-reaching effects. Settlements—whether appropriately or not—become precedent for future enforcement actions and are cited within and outside the Commission as a purported basis for the state of the law. Quite simply, a settlement negotiated by someone desperate to end an investigation that is disrupting or destroying her life should not form the basis on which the law applicable to others is based.

SEC Commissioner Hester M. Peirce, *The Why Behind the No*, Remarks at the 50<sup>th</sup> Annual Rocky Mountain Securities Conference, May 11, 2018 (emphasis added).

When SEC pushes beyond the bounds of its lawful authority and secures a settlement of a claim for which there was no fair notice of illegality, gagging the besieged target means that this form of regulation will have no check, no sunlight will expose it, and it will fester in the dark. It may also prevent adequate notice from reaching other potential targets.

### **B. The Rule Implicates the Judiciary in Violating the Constitution and Law**

Agencies that settle charges with their targets are not just acting under their own power. They have harnessed the machinery of the state, whether a court or an administrative tribunal, and they thereby imperil the livelihood, resources and liberty of defendants. Consent decrees impose injunctive prohibitions and fines enforceable by judicial contempt power. Such applications of judicial power by administrative agencies are “inherently dangerous” as noted by Judge Rakoff and implicate a coordinate branch in the constitutional breach:

The injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression ....

[T]here is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the S.E.C., of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges; and if it fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement to the agency’s contrivances.

*SEC v. Citigroup Global Markets Inc.*, 827 F. Supp. 2d at 335 (footnotes omitted).

All judges, whether administrative or members of a coordinate branch, have a duty to follow the law of the land, and should not be the enforcers of that which they know to be against the law, even though the parties themselves may have agreed to the conditions.

### **C. The Rule Advances No Legitimate Public Policy**

SEC’s contrivance of a power to fashion a gag order out of rule 202.5(e)’s “policy” works to suppress truth, oppress defendants, and insulate the agency from public understanding and criticism. It is hard to fathom any policy justification for such suppression of speech. SEC’s notorious industry bans, large monetary sanctions and broad injunctive relief transmit powerful

messages to the public that operate to deter like misconduct. That deterrence will not be diminished by a defendant's exercise of free speech.

No matter how uncomfortable later criticism of the agency enforcement may be, if untrue, it is readily corrigible by agency statements. If true—if a target can make a persuasive case for innocence or over-prosecution after the fact—the value of the free flow of information far outweighs such illegitimate “policies” as bureaucratic discomfort with the appearance of over-reaching or underenforcement, which serves solely power's inherent aversion to criticism. Agencies do not have some special grant of power to shield themselves from public scrutiny, a power actual courts, prosecutors and legislatures all lack under well-established law.

The Gag Rule violates an impressive array of constitutional doctrines, including infringement of First Amendment Rights to freedom of speech and the press, the right to petition, prior restraint, compelled speech, void-for-vagueness, void as against public policy, and unconstitutional conditions. It also ignores statutory constraints on agency power and basic requirements of the APA. Any rule that racks up a list of constitutional and legal violations that lengthy compels the conclusion that some fundamental tenet of our constitutional republic has been violated by the offending provisions of the rule this Petition seeks to amend.

## **VI. The Proposed Amended Rule**

NCLA's proposed amended rule, set forth below and alongside the existing rule at Exhibit A to this petition, removes the offending language used by the SEC in securing gag orders in its consents, and provides instead that defendants or respondents may admit, deny, or neither admit nor deny the allegations against them in any settlement with the agency:

- e) The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, a defendant or respondent may consent to a judgment or order in which he admits, denies, or states that he neither admits nor denies the allegations in the complaint or order for proceedings.

By providing for admissions, denials, or no-admit-no-deny for specific allegations of the charges against defendants, the proposed amended rule allows the SEC to bargain for admissions

when it has a clear-cut case of specific wrongdoing, allows defendants to specifically deny erroneous or overreaching charges against them, and leaves intact the pragmatic no-admit-no-deny approach that the Second Circuit has recognized as a useful approach from all perspectives. This amended rule is designed to secure to all parties maximum freedom in negotiating fair, truthful and transparent settlements and to secure the blessings of liberty—including the free exercise of speech—forever after.

### CONCLUSION

Because “[f]ragile First Amendment rights are often lost or prejudiced by delay,” *Bernard v. Gulf Oil Co.*, 619 F.2d 459, 470 (5<sup>th</sup> Cir. 1980), NCLA requests prompt determination of this Petition to Amend the SEC Rule under which the agency has been unconstitutionally silencing persons who enter into consents with the SEC. The Gag Rule is unconstitutional, unauthorized, unjustified, and operates to shield the government from criticism and reform, contrary to the First Amendment’s guarantees of freedom of speech, of the press and of the right of petition.

Respectfully submitted,  
/s/Margaret A. Little  
Margaret A. Little  
Mark Chenoweth  
NEW CIVIL LIBERTIES  
ALLIANCE  
1225 19<sup>th</sup> St. NW, Suite 450  
Washington, DC 20036  
202-869-5212  
peggy.little@ncla.legal

*Counsel for Petitioner New Civil Liberties Alliance*

October 30, 2018

# EXHIBIT A

## Current Rule, Proposed Rule, Comparison

### CURRENT RULE:

#### Code of Federal Regulations

#### Title 17 - Commodity and Securities Exchanges

§ 202.5 Enforcement activities....

(e) The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important 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. Accordingly, it hereby announces its policy not to 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. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.

### PROPOSED AMENDED RULE:

#### Code of Federal Regulations

#### Title 17 - Commodity and Securities Exchanges

§ 202.5 Enforcement activities....

(e) The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, a defendant or respondent may consent to a judgment or order in which he admits, denies, or states that he neither admits nor denies the allegations in the complaint or order for proceedings.

\* \* \* \* \*

### PROPOSED AMENDED RULE COMPARED WITH CURRENT RULE:

(Deleted material highlighted in yellow, added material in green, and language moved in blue.

(e) [The Commission has adopted the policy that] in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important 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. Accordingly, it hereby announces its policy not to permit a defendant or respondent to may consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings., In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial unless the defendant or respondent in which he admits, denies, or states that he neither admits nor denies the allegations in the complaint or order for proceedings.

# EXHIBIT B

## 1972 Enacting Publication of Gag Rule in Federal Register

(37 Fed. Reg. 25224)

### Title 17-COMMODITY AND SECURITIES EXCHANGES

Chapter II-Securities and Exchange Commission

[Release Nos. 33-5337, 34-9882, 35-17781, IC-7526, IA-352.]

### PART 202-INFORMAL AND OTHER PROCEDURES

#### Consent Decrees in Judicial or Administrative Proceedings

The Securities and Exchange Commission today announced adoption of a policy with respect to consent decrees in judicial or administrative proceedings under the laws which it administers. In this connection it has amended § 202.5 of Part 202 of the Code of Federal Regulations relating to informal and other proceedings, as indicated below.

#### COMMISSION ACTION

Pursuant to the authority granted in section 19 of the Securities Act of 1933, section 23 (a) of the Securities Exchange Act of 1934, section 20 of the Public Utility Holding Company Act of 1935, section 38 of the Investment Company Act of 1940 and section 211 of the Investment Advisers Act of 1940, the Securities and Exchange Commission hereby amends § 202.5 of Chapter II of Title 17 of the Code of Federal Regulations by adding thereunder a new paragraph (c) reading as follows:

§ 202.5 Enforcement activities.

\* \* \* \* \*

(e) The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important 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. Accordingly, it hereby announces its policy not to 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. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.

(Secs. 19, 209, 48 Stat. 85, 908, 15 U.S.C. 77s; sec. 23(a), 48 Stat. 901, sec. 8, 49 Stat. 1379, 15 U.S.C. 78w(a); sec. 20, 49 Stat. 833, 15 U.S.C. 79t; sec. 38, 54 Stat. 841, 15 U.S.C. 80a-37; sec. 211, 54 Stat. 855, sec. 14, 74 Stat. 888, 15 U.S.C. 80b-11)

The Commission finds that the foregoing amendment relates only to rules of agency organization, procedure and practice and, therefore, notice and procedures specified in 5 U.S.C. 553 are unnecessary. The foregoing amendment is declared to be effective immediately.

By the Commission.

RONALD F. HUNT, Secretary.

NOVEMBER 28, 1972.

[FR Doc.72-20559 Filed 11-28-72; 8:54 am]

## **EXHIBIT C**

### **THE GAG RULE’S FIVE “AUTHORIZING” STATUTES**

#### **1. Securities Act of 1933, Sec. 19, 15 U.S.C. § 77s**

##### **Special powers of Commission**

###### **(a) Rules and regulations**

The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this subchapter, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this subchapter. Among other things, the Commission shall have authority, for the purposes of this subchapter, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe.

#### **2. Securities Exchange Act of 1934, Sec. 23(a), 15 U.S.C. § 78w**

##### **Rules, Regulations, and Orders; Annual Reports**

###### **(a) POWER TO MAKE RULES AND REGULATIONS; CONSIDERATIONS; PUBLIC DISCLOSURE**

###### **(1)**

The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within

their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof.

### **3. Public Utility Holding Company Act of 1935, Sec. 20 (now repealed) Rules, Regulations, and Orders**

SEC. 20(a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title, including rules and regulations defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purpose of this title, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost accounting procedures and the preparation of reports, in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate, of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding-company system.

### **4. Investment Company Act of 1940, Sec. 38, 15 U.S.C. § 80a-37-39**

#### **Rules, Regulations, and Orders; General Powers of Commission**

SEC. 38, 15 U.S.C. § 80a-37

(a) Powers of Commission

The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this subchapter, including rules and regulations defining accounting, technical, and trade terms used in this subchapter, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. For the purposes of its rules or regulations the Commission may classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters.



## **5. Investment Adviser’s Act of 1940, Sec. 211**

### **Rules, Regulations and Orders of Commission**

#### **(a) Power of Commission**

The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in this subchapter, including rules and regulations defining technical, trade, and other terms used in this subchapter, except that the Commission may not define the term “client” for purposes of paragraphs (1) and (2) of section 80b–6 of this title to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser. For the purposes of its rules or regulations the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters.

## CERTIFICATE OF SERVICE

I hereby certify that on October 30, 2018, I served the foregoing Petition to Amend by email filing with the SEC at [rule-comments@sec.gov](mailto:rule-comments@sec.gov) and first-class mail to:

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

/s/ Margaret A. Little