CASE NO. 24-1899

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

THOMAS JOSEPH POWELL, BARRY D. ROMERIL, CHRISTOPHER A. NOVINGER, RAYMOND J. LUCIA, MARGUERITE CASSANDRA TOROIAN, GARY PRYOR, JOSEPH COLLINS, REX SCATES, MICHELLE SILVERSTEIN, REASON FOUNDATION, THE CAPE GAZETTE, AND NEW CIVIL LIBERTIES ALLIANCE,

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review from the United States Securities and Exchange Commission No. 4-733

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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June 24, 2024

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation, founded in 1977 and dedicated to advancing the principles of individual liberty, free markets, and limited government. Toward that end, Cato's Robert A. Levy Center for Constitutional Studies publishes books and studies, conducts conferences, produces the annual *Cato Supreme Court Review*, and files *amicus* briefs.

This case interests Cato because the right to freedom of speech—and especially the freedom to criticize the actions of the government—is essential to liberty and must be protected against government infringement. *Amicus* also has an interest in highlighting and challenging government overreach and in ensuring that administrative agencies respect the Constitution and the law.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

For over fifty years, the SEC has unilaterally claimed—and exercised—a broad power of prior restraint over potential agency critics. Since 1972 the SEC has maintained that it will not enter into any settlement agreement with a person the SEC has investigated unless that person agrees *never* to dispute the SEC's accusations. *See* 17 C.F.R. § 202.5. This "no-admit-no-deny" policy has come to be known as the

[1] Fed. R. App. P. 29 Statement: No counsel for either party authored this brief in whole or in part. No person or entity other than *amicus* made a monetary contribution to its preparation or submission. Pursuant to Ninth Circuit Local Rule 29-2(a), all parties have been notified and have consented to the filing of this brief.

SEC Gag Rule. Since its inception, the SEC Gag Rule policy has prohibited hundreds of Americans from even *creating the impression* that the SEC's charges against them were less than fully merited, under the threat of renewed investigation and prosecution.

The notion that regulated parties subject to the Gag Rule have voluntarily waived their First Amendment right to criticize their government and their regulator is a fiction that must be rejected. The Gag Rule's coercive effect is obvious. The SEC is a powerful arm of the federal government, with a multi-billion-dollar budget. Few defendants have the resources to defend themselves against a lengthy SEC investigation or lawsuit, and consequently, nearly all defendants agree to settle.[2] Yet, after settlement, the SEC's complaint stands as the last word on the matter, and defendants—even those who have done nothing unlawful—must remain silent for life. The SEC's Gag Rule means that the government's side of the story will be the *only* side of the story the public ever knows.

In October 2018, the New Civil Liberties Alliance ("NCLA") filed a petition for rulemaking to amend the SEC's settlement policy so that it does not operate as a coercive prior restraint. NCLA Pet. at 1. The SEC ignored the petition for over five

[2] Approximately 98 percent of SEC enforcement cases end in a settlement. *See* Luis A. Aguilar, Commissioner, Securities and Exchange Comm'n, A Stronger Enforcement Program to Enhance Investor Protection, 20th Annual Securities and Regulatory Enforcement Seminar (Oct. 25, 2013), available at https://www.sec.gov/news/speech/2013-spch102513laa.

years. *Id*. After the NCLA renewed its petition in December 2023, the SEC finally responded, denying the petition on January 30, 2024. *Id*.[3] After fifty years, the SEC must now finally defend the lawfulness of its content-based speech restriction in court.

The SEC's imposition on parties is a prior restraint that violates the First Amendment, which forbids the federal government from "abridging the freedom of speech[.]" U.S. CONST. amend. I. The Gag Rule is unlawful under settled First Amendment law. This Court should apply Ninth Circuit and Supreme Court precedent and vacate the Gag Rule as an unconstitutional abridgment of the freedom of speech.

ARGUMENT

I. THE SEC'S GAG RULE IS A CONTENT-BASED RESTRICTION ON SPEECH THAT CANNOT SURVIVE STRICT SCRUTINY.

The First Amendment prohibits the government from "abridging the freedom of speech[.]" U.S. CONST. amend. I. This prohibition applies to every "government agency—local, state, or federal[.]" *Herbert v. Lando*, 441 U.S. 153, 168 n.16 (1979). Above all, the First Amendment means that the government "has no power to restrict expression because of its message, its ideas, its subject matter, or its content." *Reed*

[3] SEC Commissioner Hester M. Peirce issued a strong dissent, stating that "a regulatory policy that prevents people from speaking against government action necessarily raises First Amendment concerns." *Id*.

v. Town of Gilbert, 135 S. Ct. 2218, 2226 (2015) (quoting *Police Dep't of Chicago v. Mosley,* 408 U.S. 92, 95 (1972)). Furthermore, "[c]ontent-based laws—those that target speech based on its communicative content—are presumptively unconstitutional and may be justified only if the government proves that they are narrowly tailored to serve compelling state interests." *Id*. (citing *R. A. V. v. St. Paul*, 505 U.S. 377, 395 (1992); *Simon & Schuster, Inc. v. Members of N. Y. State Crime Victims Bd.*, 502 U.S. 105, 115, 118 (1991)).

The SEC's Gag Rule is clearly a content-based restriction on speech. The typical language used by the SEC in its consent agreements reads as follows:

> 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[.]

New Civ. Liberties All., Petition to Amend, In re SEC Rule Imposing Speech Restraints in Consent Orders 17 C.F.R. § 202.5(e), at 4 (Oct. 30 2018) (hereinafter "NCLA Pet. To Amend 4-733").[4] Simply, the Gag Rule prevents a party from speaking about a defined subject—denying the particular allegations of regulatory

[4] Available at https://tinyurl.com/ywnukx37.

violations. According to the Supreme Court, "[g]overnment regulation of speech is content based if a law applies to particular speech because of the topic discussed or the idea or message expressed." *Reed,* 135 S. Ct. at 2227. The Gag Rule clearly meets the Supreme Court's standard for a content-based restriction: it prohibits a party's speech on a particular topic (the SEC's allegations against the defendant) as well as the expression of particular messages (that the allegations are contested or without factual basis).[5]

According to the Supreme Court, content-based restrictions on speech are "presumptively unconstitutional[.]" *Id*. at 2226. They can only be upheld if the restriction satisfies "strict scrutiny." *Id*. at 2227. Under strict scrutiny review, a restriction "may be justified only if the government proves that [the restriction is]

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[5] Indeed, the SEC Gag Rule is likely a viewpoint-based restriction as well as a content-based restriction. According to the Supreme Court:

> Discrimination against speech because of its message is presumed to be unconstitutional. . . . When the government targets not subject matter, but particular views taken by speakers on a subject, the violation of the First Amendment is all the more blatant. . . . Viewpoint discrimination is thus an egregious form of content discrimination. The government must abstain from regulating speech when the specific motivating ideology or the opinion or perspective of the speaker is the rationale for the restriction.

Rosenberger v. Rector & Visitors of the Univ. of Va., 515 U.S. 819, 829 (1995). Since the Gag Rule is directed towards silencing a particular opinion (namely, that a defendant in SEC litigation was wrongly targeted), it likely represents viewpoint discrimination, as SEC Commissioner Peirce points out. NCLA Pet., Ex. B at 3.

narrowly tailored to serve compelling state interests." *Id*. at 2226. But the SEC Gag Rule cannot survive this level of scrutiny—it does not serve a compelling government interest, nor is it narrowly tailored.[6]

A. The Gag Rule Does Not Further a Compelling Government Interest.

It is the government's burden to show that a content-based restriction on speech advances a compelling governmental interest. *Id*. at 2231. But the SEC's asserted interest is not compelling. Indeed, the SEC's primary justification for its Gag Rule is merely *to protect the SEC's reputation*. In denying the NCLA's petition to amend the Gag Rule, the SEC explained:

> [I]f a defendant settles without admissions and then later denies the allegations, that turnabout can negatively impact the public interest. The filing of a complaint memorializes the results of an investigation and reflects a determination by the Commission that the evidence reveals a violation of the securities laws. In settlements without admissions, a defendant who later denies the allegations in the complaint can *create the incorrect impression that there was no basis for the Commission's enforcement action*.

[6] Strict scrutiny—and not any form of lesser scrutiny—is the appropriate standard for evaluating the constitutionality of the Gag Rule. The speech restricted by the Gag Rule is not commercial speech, because disputing the SEC's allegations is quite different from "speech proposing a commercial transaction" which receives "lesser protection" under the Constitution. *Cent. Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 562–63 (1980). And although some courts in the past have recognized "professional speech" as a category of speech which receives lesser protection, the Supreme Court has explicitly rejected such a "professional speech" doctrine. *Nat'l Inst. of Family & Life Advocates v. Becerra*, 585 U.S. 755, 766–68 (2018).

NCLA Pet., Ex. A at 4 (emphasis added). The SEC adds:

> Because such a denial would come only after the Commission had relinquished the opportunity to prove its case in court with evidence, *it could undermine confidence in the Commission's enforcement program*.

NCLA Pet., Ex. A at 4–5 (emphasis added). The governmental interest, apparently, *is the power of the government to protect its reputation by silencing potential critics.* No court has held that that is a cognizable government interest in the First Amendment context.

The SEC's justification rests on the implicit premise that the SEC's allegation had merit in every case where the Gag Rule is enforced. But that premise is faulty. Of course, the SEC's allegations may be true in *some* settled cases. When that is the case, it is a regrettable possibility that a party could create the incorrect impression that the SEC's allegations were unfounded. But that ostensible harm is, at the very least, offset by an alternative possibility—that an overpowered party who has entered into a settlement with the SEC will be forever tainted, in the public eye, by baseless or speculative SEC allegations. When a case is settled and the SEC's allegations have not been proven, reputational concerns cut both ways. The SEC's reputational interest cannot be allowed to prevail over defendants' reputational interests, much less defendants' constitutional interests.

The government does not have a compelling interest in protecting its employees and their actions from criticism. Indeed, an interest in censoring criticism

of the government would be contrary to the principles of American liberty and our constitutional system of government. Public speech criticizing the government is not only protected by the First Amendment—it receives *the highest possible protection*. *See Carey v. Brown,* 447 U.S. 455, 467–68 (1980) ("Public-issue picketing . . . has always rested on the highest rung of the hierarchy of First Amendment values."). As the Supreme Court has explained,

> neither factual error nor defamatory content suffices to remove the constitutional shield from criticism of official conduct, [and] the combination of the two elements is no less inadequate. This is the lesson to be drawn from the great controversy over the Sedition Act of 1798, . . . which first crystallized a national awareness of the central meaning of the First Amendment.

New York Times Co. v. Sullivan, 376 U.S. 254, 273 (1964). The Sedition Act criminalized "'any false, scandalous and malicious writing or writings against the government of the United States, . . . with intent to defame . . . or to bring them, . . . into contempt or disrepute[.]'" *Id*. at 273–74. In modern terms, the Act prohibited speech that would "undermine confidence" in the United States government.

The Sedition Act was vigorously condemned as unconstitutional by many figures, including Thomas Jefferson and James Madison, the Father of the Constitution. *Id*. at 274. In the view of Madison, "the right of free public discussion of the stewardship of public officials [is] . . . a fundamental principle of the American form of government." *Id*. at 275. After the Sedition Act expired, there emerged "a broad consensus that the Act, *because of the restraint it imposed upon criticism of*

government and public officials, was inconsistent with the First Amendment." *Id*. at 276 (emphasis added). Today, "[w]hatever differences may exist about interpretations of the First Amendment, there is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs." *Mills v. Alabama*, 384 U.S. 214, 218 (1966).

Protecting the reputation of a federal agency is not a cognizable government interest in prior restraint cases. Far from furthering a compelling government interest, the SEC's Gag Order Rule directly stifles criticism of the SEC itself. In doing so, it "strikes at the very center of the constitutionally protected area of free expression." *Sullivan*, 376 U.S. at 292.

B. The Gag Rule Is Not Narrowly Tailored.

Whether it furthers a compelling interest or not, the SEC's Gag Rule must fail strict scrutiny because it is not narrowly tailored. The Supreme Court has held that a restriction on speech is narrowly tailored if it is "the least restrictive means to further the articulated interest." *Sable Commc'ns of Cal. v. FCC*, 492 U.S. 115, 126 (1989). This means that "[i]f a less restrictive alternative would serve the Government's purpose, the [government] must use that alternative." *United States v. Playboy Entm't Group*, 529 U.S. 803, 813 (2000).

The relevant question is whether the Gag Rule is the least restrictive means by which the SEC can protect its reputation. And the answer is an emphatic *no*. The

Gag Rule is so broad in its potential scope that it chills defendants' speech (and possibly even third parties' speech) about the SEC. In her dissent to the SEC's denial of the NCLA petition to amend the Gag Rule, Commissioner Peirce noted the Gag Rule's unclear boundaries:

> Defendants must agree that they will not "indirectly" deny "any allegation in the complaint." What is an "indirect" denial? Defendants must also agree not to "take any action" that "create[s] the impression that the complaint is without factual basis." What is an action that "create[s] the impression" that the complaint lacks a factual basis? A defendant looking at this language is not going to have any idea where it ends.

NCLA Pet., Ex. B at 4. Commissioner Peirce gave a slew of examples of speech that arguably would violate the SEC's Gag Rule. Indeed, the Gag Rule is so broad that it arguably *mandates that defendants interfere with the speech of others not subject* to the consent agreement. *Id*.

The SEC has far less restrictive alternatives at its disposal. The NCLA offered two examples in its petition to amend the Gag Rule:

> 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. . . . 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.

NCLA Pet. to Amend 4-733 at 14. The Constitution commands "that regulating speech must be a last—not first—resort." *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 373 (2002).

The fact that the Gag Rule is an agency policy, and may be enforced via a judicially enforceable consent decree,[7] is of no consequence to the First Amendment analysis. The Supreme Court "look[s] at the injunction as [the Court] look[s] at a statute, and if upon its face it abridges rights guaranteed by the First Amendment, it should be struck down." *United Transp. Union v. State Bar of Mich.* 401 U.S. 576, 581 (1971). Furthermore, "[a]n injunction can issue only after the plaintiff has established that the conduct sought to be enjoined is illegal[.]" *Id.* at 584. For this reason, injunctions must be narrowly tailored and cannot be so broad as to sweep in protected speech.[8] Even in libel and harassment cases, courts cannot issue overbroad injunctions on speech. *See* Eugene Volokh, *Overbroad Injunctions Against Speech (Especially in Libel and Harassment Cases)*, 45 HARV. J.L. & PUB. POL'Y 147 (2022).

Lastly, the SEC Gag Rule is inexplicably *underinclusive*, which signals a lack of narrow tailoring. While the SEC's settlement conditions forbid *public* statements

[7] The Gag Rule is typically enforced by renewed litigation by the SEC, not by a court.
[8] The Ninth Circuit affirmed this principle when it invalidated an injunction on all communication about the plaintiff in a defamation case, limiting the injunction only to those remarks that had been found to be defamatory. *Ferguson v. Waid*, 798 Fed. Appx. 986, 989 (9th Cir. 2020).

denying the SEC's allegations, *private* denials appear to comply with the conditions. *See* NCLA Pet. to Amend 4-733 at 4. It is unclear why the SEC is concerned with public criticism but apparently indifferent to the "incorrect impressions" about its enforcement actions spread by word-of-mouth. "[A] 'law cannot be regarded as protecting an interest of the highest order, and thus as justifying a restriction on truthful speech, when it leaves appreciable damage to that supposedly vital interest unprohibited[.]'" *Reed*, 135 S. Ct. at 2232 (quoting *Republican Party of Minn. v. White*, 536 U.S. 765, 780 (2002)). Whatever the rationale for this under inclusivity, it is one more sign that the Gag Rule is not narrowly tailored.

Because the Gag Rule does not further a compelling government interest and is not narrowly tailored, it fails strict scrutiny and is unconstitutional.

II. THE SEC'S GAG RULE VIOLATES THE UNCONSTITUTIONAL CONDITIONS DOCTRINE.

The SEC's Gag Rule cannot pass constitutional muster for an additional reason: it violates the prohibition on unconstitutional conditions. The Supreme Court "[has] said in a variety of contexts that 'the government may not deny a benefit to a person because he exercises a constitutional right.'" *Koontz v. St. Johns River Water Mgmt. Dist.*, 570 U.S. 595, 604 (2013) (quoting *Regan v. Tax'n With Representation of Wash.*, 461 U.S. 540, 545 (1983)). This is because the Supreme Court has recognized "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." *Id*.

Further, in the words of this Court:

> Government is a monopoly provider of countless services, notably law enforcement, and we live in an age when government influence and control are pervasive in many aspects of our daily lives. Giving the government free rein to grant conditional benefits creates the risk that the government will abuse its power by attaching strings strategically, striking lopsided deals and gradually eroding constitutional protections.

United States v. Scott, 450 F.3d 863, 866 (9th Cir. 2006). In other words, this Court has recognized that allowing the government to use its immense monopoly power to pressure citizens into forfeiting their rights presents an unacceptable risk of creating a loophole through which the government may violate the Bill of Rights with impunity.

This Court went on to explain the implication of the unconstitutional conditions doctrine in the context of alleged "waivers" of constitutional rights in exchange for a government benefit:

> It may be tempting to say that such transactions—where a citizen waives certain rights in exchange for a valuable benefit the government is under no duty to grant—are always permissible and, indeed, should be encouraged as contributing to social welfare. . . . But our constitutional law has not adopted this philosophy wholesale. The "unconstitutional conditions" doctrine[] . . . limits the government's ability to exact waivers of rights as a condition of benefits, *even when those benefits are fully discretionary*.

Id. (emphasis added). In other words, it is not enough for the government to claim that a person has waived a constitutional right, or to assert that the government has full discretion as to whether to bestow a particular benefit. The government is *limited* in its ability to induce people into waiving their rights, and such waivers are subject to constitutional scrutiny.

The First Amendment right to freedom of speech is undoubtedly one of the rights protected by the unconstitutional conditions doctrine. The Supreme Court has 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." *Koontz*, 570 U.S. at 604 (citing *Perry v. Sindermann*, 408 U.S. 593 (1972)). In the words of the Supreme Court:

> [The government] may not deny a [governmental] benefit to a person on a basis that infringes his constitutionally protected interests—*especially, his interest in freedom of speech*. For if the government could deny a benefit to a person because of his constitutionally protected speech or associations, his exercise of those freedoms would in effect be penalized and inhibited. This would allow the government to "produce a result which [it] could not command directly." . . . Such interference with constitutional rights is impermissible.

Id. at 597 (quoting *Speiser v. Randall*, 357 U.S. 513, 526 (1958)) (emphasis added). If the government cannot condition a college professor's job on refraining from criticizing the college administration, it follows that the SEC cannot require defendants to refrain from criticizing the SEC's allegations as a condition of offering

a settlement. After all, a settlement (and the consequent end to costly litigation) may be just as valuable as a government job—indeed, it may be even more valuable.

To be sure, the Supreme Court has held that constitutional rights may sometimes be validly waived. For example, a guilty plea is the waiver of a defendant's right to a trial before a jury or a judge. *Brady v. United States*, 397 U.S. 742, 748 (1970). But even such a widely accepted practice as encouraging guilty pleas in criminal cases is subject to constitutional scrutiny; courts must ensure that the government does not exert undue pressure on defendants to forfeit their constitutionally guaranteed rights.

In *United States v. Jackson*, the Supreme Court invalidated a provision of the Federal Kidnapping Act that imposed the death penalty on only those defendants who chose to go to trial instead of pleading guilty. *United States v. Jackson*, 390 U.S. 570 (1968). The Supreme Court noted that if a "provision ha[s] no other purpose or effect than to chill the assertion of constitutional rights by penalizing those who choose to exercise them, then it would be patently unconstitutional." *Id.* at 581. Yet, the SEC Gag Rule's main purpose seems to be "to chill the assertion of constitutional rights by penalizing those who choose to exercise them." It restricts the free speech rights of defendants who submit to the SEC's pressure to settle and punishes them if they criticize SEC allegations. *See Crawford-El v. Britton*, 523 U.S. 574, 592 (1998) ("[T]he law is settled that as a general matter the First Amendment prohibits

government officials from subjecting an individual to retaliatory actions, including criminal prosecutions, for speaking out.").

Fortunately, the government cannot coerce us to surrender our constitutional rights by withholding government benefits. Because "[t]he Constitution deals with substance, not shadows[,]" it follows that "[w]hat cannot be done directly cannot be done indirectly." *Students for Fair Admissions, Inc. v. President & Fellows of Harv. Coll.*, 600 U.S. 181, 230 (2023) (quoting *Cummings v. Missouri*, 71 U.S. 277, 325 (1867)). This Court should defend the substance of our constitutional rights by preventing these coerced waivers of free speech rights.

CONCLUSION

The SEC's Gag Rule represents a prior restraint on regulated parties who have entered a settlement with the SEC. It is a content-based regulation that does not satisfy strict scrutiny and impermissibly coerces parties into waiving their First Amendment rights. This Court should declare the Gag Rule unconstitutional and enjoin the SEC from enforcing its provisions against any party.

Respectfully submitted,

Dated: June 24, 2024

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of 9th Cir. R. 29(a)(2) because it contains 4,036 words, excluding the parts exempted by Fed. R. App. P. 32(f).
2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface in Times New Roman, 14-point font.

/s/ Thomas A. Berry

Dated: June 24, 2024

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of Court, who will enter it into the CM/ECF system, which will send a notification of such filing to the appropriate counsel.

/s/ Thomas A. Berry

June 24, 2024