

SEC “OBEY-THE-LAW” INJUNCTIONS HELD INVALID

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To Our Clients and Friends:

The Eleventh Circuit Court of Appeals last week dealt a blow to the Securities and Exchange Commission (“SEC”) and its long-standing practice of seeking broad federal court injunction orders directing defendants to refrain from any future violations of securities laws, often referred to as “obey-the-law” injunctions. In *SEC v. Goble*, No. 11-12059, 2012 WL 1918819 (11th Cir. May 29, 2012), the Eleventh Circuit vacated the “obey-the-law” injunctions entered against defendant Richard Goble, the founder of North American Clearing, Inc. (“North American”), because the injunctions did not satisfy Federal Rule of Civil Procedure 65(d)(1), which requires that injunctions describe, “in reasonable detail . . . the act or acts [sought to be] restrained or required.” Although the decision appears to widen an existing gap between the Eleventh and Second Circuits on the propriety of “obey-the-law” injunctions in SEC settlements, the full impact of the *Goble* decision remains unclear. The Eleventh Circuit’s strongly worded opinion and careful analysis could prompt other courts to question the benefit and efficacy of the SEC’s frequent practice of seeking such broad “obey-the-law” injunctions.

FACTUAL BACKGROUND AND THE ELEVENTH CIRCUIT’S OPINION

The SEC brought a civil enforcement action against Goble and others in 2008 alleging that Goble, the founder and owner of North American, had orchestrated a scheme to manipulate the amount of money required to be set aside in North American’s reserve account to protect the assets of its customers in the event the firm failed. After a bench trial, a district judge in the Middle District of Florida found that Goble had directed an employee to make a false entry in the company’s books, and thus found Goble liable for securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”). The Court also found Goble liable for aiding and abetting violations of the Customer Protection Rule, which is Section 15(c)(3) of the Exchange Act, and the books and records requirements in Section 17(a) of the Exchange Act.

On appeal to the Eleventh Circuit, defendant Goble argued, among other things, that the injunctions imposed by the district court were impermissible “obey-the-law” injunctions that violated Rule 65(d)(1) because they did not describe in sufficient detail the conduct that was prohibited. Rule 65(d)(1) states that “Every order granting an injunction and every restraining order must: (A) state the reasons why it issued; (B) state its terms specifically; and (C) describe in

reasonable detail – and not by referring to the complaint or other document – the act or acts restrained or required.” In considering the propriety of the district court’s injunctions, the Eleventh Circuit was troubled by the conclusory language that restrained and enjoined *Goble* from violating cited laws and rules, without specifying the actual enjoined conduct. The Court concluded that the injunctions under Sections 15(c)(3) and 17(a) were impermissible “obey-the-law” commands and vacated them. The Court vacated the injunction under Section 10(b) on other grounds, but also said in dicta that it too appeared to be an impermissible “obey-the-law” injunction.

The Eleventh Circuit explained that because “obey-the-law” injunctions lack specificity, they necessarily deprive defendants of procedural safeguards alerting them to what could be a future charge of a violation of the securities laws. In making its ruling, the Court discussed its previous ruling in *SEC v. Smyth*, 420 F.3d 1225, 1233 n.14 (11th Cir. 2005), where the Court went out of its way to comment, albeit in dicta, that an SEC “obey-the-law” injunction was “unenforceable.” According to the Circuit Court, the specificity requirements of Rule 65(d)(1) were designed to prevent uncertainty and confusion by those subject to the injunction orders and to “avoid the possible founding of a contempt citation on a decree too vague to be understood.” *Goble*, at *11 (quoting *Schmidt v. Lessard*, 414 U.S. 473, 476 (1974)). A defendant faced with an injunction should therefore be able to determine from the four corners of the injunction the proscribed conduct. The injunctions ordered by the district court failed this test and therefore had to be vacated. In making this ruling, the Eleventh Circuit acknowledged that in some circumstances, injunctions that order a defendant to comply with a statute can be appropriate where the terms of the statute at issue are specific enough so that the defendant “clearly [knows] what conduct the injunction address[es].” In dicta, the Court added that the issue of specifying the prohibited conduct is especially acute in the context of injunctions for Section 10(b) and Rule 10b-5 violations – perhaps the most common of the “obey-the-law” injunctions sought by the SEC – because of the “ever-changing judicial landscape” of rulings on § 10(b) violations.

SEC V. GOBLE MAY SIGNAL THAT BROAD INJUNCTIONS FACE FURTHER SCRUTINY

The *Goble* decision will undoubtedly have a significant impact on the SEC’s ability to continue seeking and enforcing “obey-the-law” injunctions in district courts in the Eleventh Circuit. What remains to be seen is whether the decision will have a more far-reaching impact. In *SEC v. Zwick*, No. 03 Civ. 2742(JGK), 2007 WL 831812, *19 (S.D.N.Y. Mar. 16, 2007), the District Court for the Southern District of New York expressly rejected the Eleventh Circuit’s analysis in *Smyth*, and upheld a broad “obey-the-law” injunction. The *Zwick* court relied on the Second Circuit’s decision in *SEC v. Manor*, 458 F.2d 1082, 1103 (2nd Cir. 1972), a decision that pre-dated *Smyth* but which expressly provided that an injunction that mirrored the text of Section 10(b)

and Rule 10b-5 was appropriate. Given that the Eleventh Circuit has not backed down from its view in *Smyth*, and in fact has given it an articulate defense, other courts may be prompted to question future attempts by the SEC to obtain broad “obey-the-law” injunctions. It is also possible that the SEC may shift on its own towards a policy of pursuing more specifically tailored injunctions, although tailored injunctions may be viewed by many as diminishing the deterrent impact of SEC injunctions – and the threat of contempt that stands behind them. In light of the *Goble* decision, individuals and companies in active litigation with the SEC, as well as those considering settlement with the agency, may want to consider challenging any attempt by the SEC to impose “obey-the-law” injunctions. Although it is likely that the SEC will continue to pursue vigorously broad injunctive orders, the recent trend by federal judges to scrutinize SEC settlements may result in the SEC being more open to the suggestion that injunctions should be narrowly tailored and sufficiently specific so as to comply with Rule 65(d)(1).

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