

SEC Lifts the Veil on Its Enforcement Process by Publishing Enforcement Manual

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In an effort to make its processes more transparent, last week the SEC made public its Division of Enforcement Manual. Substantial sections of the 122-page manual will be familiar to veterans of the Division of Enforcement, because a version of this document, known internally at the SEC as the “Red Book,” has long been used by the Division’s staff as a guide to conducting investigations. Notably, the release of the manual comes only eight months after former Commissioner Paul Atkins publicly encouraged the staff to publish such a document to bring more “predictability” to the SEC’s enforcement process.¹

Future investigations will test how much predictability the manual actually brings. The manual does set forth standard practices for key SEC enforcement processes, such as opening and closing investigations, obtaining formal orders of investigation, conducting witness interviews and testimony, and issuing Wells notices. However, with regard to certain practices, in particular those that occur after an investigation is completed but before an action is instituted, the manual is either silent or provides Division staff, as well as those facing an SEC investigation, with much flexibility. As a result, such issues as the scope of investigations or particular subpoena requests, the usefulness of “pre-Wells” submissions, who and what violations will be covered in a potential settlement, the sanctions that will be included in the settlement, and many other issues will continue to be negotiated with the staff on a case-by-case basis.

Nevertheless, individuals and entities that are facing SEC scrutiny should find that the manual offers guidance on what they can expect when the SEC staff come calling, and offers some predictability on issues over which individual Division offices have historically been afforded broader discretion.

Some of the key aspects of the manual are summarized below.

Opening Investigations. The manual formally publishes the Division’s policy that senior Division officials must approve the opening of each informal investigation, also known as a Matter Under Investigation (MUI). This greater oversight of the MUI-opening process—which has been in place since last year—appears to be a direct response to a recommendation contained in a U.S. Government

1. See Paul Atkins, Remarks to the “SEC Speaks in 2008” Program of the Practising Law Institute (February 8, 2008) (available at <http://www.sec.gov/news/speech/2008/spch020808psa.htm>).

Accountability Office report of the Division's practices issued in August 2007.² In deciding whether to open a MUI, the manual encourages the staff to consider the investigation's potential to substantively and effectively address conduct that violates the federal securities laws, the programmatic importance of any potential enforcement action, the magnitude of the potential violations involved, and the resources required to investigate the potential violations. The manual also makes public the process for periodic reviews of open investigations by the Division's senior officials, which is designed to speed up the investigative process.

Termination Notices. Several years ago, the Division adopted an internal policy that was designed to provide uniformity to the practice of sending termination notices at the conclusion of an investigation that did not result in an enforcement action. The manual publishes this internal guidance, which provides that a termination letter should be sent to those parties identified in the caption of a formal order, those who submitted or were solicited to submit a Wells notice, and those who asked for a termination notice. Additionally, notices should be sent to anyone who "reasonably believes the Staff was considering recommending an enforcement action against them."

Post-Notice Wells Process. Unfortunately, the manual does not provide any uniformity to the practice of making the staff's investigative file available to recipients of Wells notices. Counsel for recipients of Wells notices have long complained that although the staff typically allows such access, periodically a request to review the investigative file is denied. The manual does not resolve this inconsistency, and instead recognizes the ability of the staff to determine, on a case-by-case basis, whether to provide the recipient of a Wells notice with access to the nonprivileged portions of the staff's investigative file.

Communications between Senior Enforcement Officials and Persons Outside the SEC. With limited exception, best practices outlined in the manual strongly discourage senior Division officials from engaging in communications with persons outside the SEC who are involved in an investigation, without the participation of other staff members assigned to the investigation. These best practices appear to have been established, at least in part, in response to criticism leveled at the Division in a recent report issued by the SEC's Office of the Inspector General over the handling of a high-profile insider trading investigation. Specifically, the OIG criticized what it viewed as "the common practice in Enforcement that allows outside counsel the opportunity to communicate with those above the line attorney level on behalf of their clients when they have issues or disagreements with the [line attorney]."³ As a result of the OIG report and the manual's best practices, defense counsel will likely be expected to go through the SEC "line attorney" responsible for an investigation in order to raise any issues with senior Division officials.

Productions in Response to Subpoenas. The manual sets forth rather detailed standards for productions in response to SEC subpoenas. For example, it states that productions should be accompanied by a list describing each item produced and to which paragraph in the subpoena attachment each item responds. The manual also suggests that if items are withheld on the basis of privilege or work product protections, a log of such items should be provided. Although the SEC staff

2. See U.S. Gov't Accountability Office, GAO-07-830, Report to the Ranking Member, Committee on Finance, U.S. Senate, Securities and Exchange Commission, Additional Actions Needed to Ensure Planned Improvements Address Limitations in Enforcement Division Operations (2007).

3. U.S. Securities and Exchange Commission, Office of the Inspector Gen., Report of Investigation, Case No. OIG-431, Re-Investigation of Claims by Gary Aguirre of Improper Preferential Treatment and Retaliatory Termination, at 189 (2008).

likely has no legal authority to require a party to produce a privilege log during an investigation, the staff may cite the manual as a basis for insisting on a privilege log, which can often be a costly undertaking.

Production of Privileged or Nonresponsive Documents. The manual bases its approach to inadvertently produced privileged documents on new Rule 502 of the Federal Rules of Evidence, which provides that inadvertent disclosure does not operate as a waiver if the holder of the privilege took reasonable steps to prevent disclosure and promptly takes reasonable steps to rectify the error. Under the policy outlined in the manual, if the staff receives inadvertently produced privileged documents, it will generally notify the party of the receipt of such documents. However, the staff may still decide to keep and use the documents if it determines that it has “a legally sound and defensible basis” for doing so. Finally, the manual demonstrates the importance of applying caution to the document production process, by noting that the staff may use inadvertently produced nonresponsive documents to open *another* investigation or to make a referral to another law enforcement agency.

Confirming Completeness of Production. In accordance with a practice established by former Enforcement Director Stephen Cutler, the manual states that settling individuals, or the representatives of settling entities, must certify, under penalty of perjury, that they have made a diligent search of all files in their possession, custody, or control “that are reasonably likely to contain responsive documents and that those documents have either been produced or identified in a privilege log.” This certification is applicable to SEC subpoenas, document requests, and requests for voluntary productions of documents.

Contacting Employees of Issuers and Broker-Dealers. The manual codifies what has long been the staff’s internal policy regarding contacting employees of issuers and broker-dealers: Staff should generally go through corporate counsel, or, for broker-dealers, the compliance department, in order to speak to employees. With respect to employees of broker-dealers, the manual also makes public the longstanding practice that the staff will not contact the employer’s legal or compliance departments where the information being sought is unrelated to the employee’s job.

Parallel Investigations. The manual makes clear the staff’s belief that it is appropriate for the government to undertake simultaneous criminal and civil investigations. The manual expressly endorses the view that the staff need not directly answer questions regarding whether a witness is the subject of a parallel criminal investigation or even which criminal authority the witness might contact to determine whether a criminal investigation is ongoing.

Provision of Template Forms. The manual provides template forms for various letters and agreements, such as witness assurance letters (which provide that the staff does not intend to bring enforcement action against a witness, and that in return the witness agrees to provide testimony, documents, and information), tolling agreements, proffer agreements, and confidentiality agreements. The model confidentiality agreement is particularly important to entities that may be inclined to produce potentially privileged documents, although, as the Manual notes, the existence of a confidentiality agreement does not necessarily protect a party from a waiver of any applicable privileges.

The full text of the manual can be found online at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.

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SEC, including a former Chief Trial Counsel for the SEC's Division of Enforcement and other former senior Division of Enforcement attorneys.

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