



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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SENIOR VICE PRESIDENT

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December 4, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission 100 F Street, NE
Washington, D.C. 20549

**Re: Proposed Amendments to the Commission's Rules of Practice—17 CFR
Part 201; Release No. 34-75976; File No. S7-18-15**

Dear Mr. Fields:

The U.S. Chamber of Commerce (“Chamber”)¹ created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century global economy. The CCMC welcomes the opportunity to comment on the proposed amendments to the Commission’s rules of practice (“Release” or “Proposal”), issued by the Securities and Exchange Commission (“SEC” or “Commission”) on September 24, 2015.

The CCMC believes that a robust and balanced enforcement program is an essential component of a sound regulatory system for America’s capital markets.

The use of the administrative proceedings to adjudicate violations has increased dramatically over the past several years, but the rules of practice have not changed since 1995. This has caused an uneven playing field as defendants do not have the opportunity for full discovery, right to depositions, evidentiary safeguards, and only given 120 days to prepare for trial. Conversely, the Commission has unfettered power for discovery and can take years to prepare its case.

This lack of balance in due process raises issues of fairness and impedes the credibility of the Commission to be the strong cop on the beat needed for efficient capital markets.

¹ The U.S. Chamber of Commerce is the world’s largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

We applaud the Commission for beginning the process to review the rules of practice. However, while this proposal is a useful starting point, it is too limited. We are concerned that the proposal, although a step in the right direction, does not go far enough to leveling the playing field for respondents. Far more extensive amendments are urgently required.

We offer the following comments on what changes are needed to provide respondents with a fair adjudicatory proceeding:

- 1. The proposed amendments to rule 233 on the use of depositions are insufficient to provide respondents with meaningful discovery.*
- 2. The proposed amendments to rule 230(a) on document production should require enforcement staff to promptly provide a list of all persons interviewed and/or deposed during the investigation.*
- 3. The proposed amendments should permit an ALJ to extend the time available for pre-trial process for proceedings in which the staff has compiled a huge documentary record.*
- 4. A clear standard governing the use of hearsay testimony should be adopted that is consistent with the standard proposed for deposition testimony.*
- 5. The proposed amendment to rule 230(b) enabling staff to withhold or redact documents reflecting settlement negotiations should also prohibit staff from introducing Wells submissions or white papers as evidence in an administrative proceeding.*
- 6. The proposed amendment of rule 900 that extends the time period for completion of the Commission's review exacerbates a long-standing problem.*
- 7. The proposing release does not discuss the important issue of choice of venue.*

The CCMC's concerns are discussed in greater detail below.

Discussion

While the Commission has used its authority to litigate enforcement actions through the administrative proceeding process virtually since its creation, there has been a fundamental shift in the Commission's enforcement program during the last five years. Today, the Enforcement Division increasingly brings contested actions as administrative proceedings rather than litigate in U.S. District Courts in front of judges appointed under Article Three of the U.S. Constitution.

In July 2015, the CCMC published a detailed report "Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices". Our report examined in detail the administrative proceeding practice. In fact, this rulemaking proposal directly responds to one of our recommendations:

RECOMMENDATION 4: The Commission should review its Rules of Practice to give effect to its changed authority, its increased experience with the broader utilization of administrative proceedings, and the substantial increase in the volume of investigation materials and to ensure that the SEC's administrative forum is a fundamentally fair and impartial venue, especially for persons and entities not directly regulated by the SEC. Among other things, its rules should be revised to provide adequate opportunities for pre-trial discovery and depositions. Commission rules on completion of the initial decision should be amended to provide sufficient time for the expansion of pre-hearing process.²

A number of news articles have highlighted the higher success rate of the SEC in these administrative proceedings and suggested or implied that this reflects a lack of

² *Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices*, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, July 2015. Page 4. ("2015 Chamber Report"). Because our report discusses in detail many of the issues raised in this proposal, we are attaching to this letter an electronic copy of our report and request that it be included in the public comment file and record of this rulemaking. It may also be found at http://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf.

impartiality in the administrative process.³ We believe that the antiquated rules of practice, designed to function in a very different regulatory context, and aimed at different enforcement objectives, are the principal contributor to this disparity. Simply put, the current rules do not adequately afford defendants the same due process protections and pre-trial discovery safeguards that are provided in the Federal Rules of Civil Procedure (“FRCP”).

As discussed in detail in the 2015 Chamber Report the lack of adequate pre-trial discovery in administrative proceedings is a glaring inadequacy of the current process. The inadequacy of pre-trial discovery under the current rules is magnified by the enormous advantage that the enforcement staff possesses through their use of the formal investigation process. As the SEC public performance statistics reveal, the majority of investigations extend for two or more years. During the multi-year process, the staff may interview or depose an unlimited number of person or entities and subpoena millions of pages of documents. Then, after completion of this extensive and extended process, the division may initiate an administrative proceeding in which the respondents are denied the opportunity to depose even one person. Furthermore the ability to adequately review the documents provided by the staff is further compromised by an SEC rule that presumes that a hearing will commence within four months of the beginning of the proceeding. In effect, a documentary file of millions of pages, collected over two or more years of investigation, must be reviewed and digested by respondent’s counsel in four months or less.

The Chamber 2015 report also, contains a detailed analysis of the SEC investigation program. It is based on a survey of Chamber members who have been the subject of an investigation. While the majority of SEC investigations (formal and informal investigations) are closed by the staff with no enforcement action, this typically occurs only after an investigation that may have spanned five or more years and cost tens of millions of dollars. For public companies, the overhang of a disclosed investigation can greatly impact shareholder value for long periods and effectively prevent the company under investigation from raising capital through the issuance of equity or debt. We acknowledge that the investigative process is outside the scope of these rule proposals. However, the process is so closely intertwined with

³ See, e.g. Jean Eaglesham, *SEC Wins With In-House Judges*, Wall St. J., May 6, 2015. Available at: <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803>

the issues identified in this proposal that we strongly urge the Commissioners to closely examine the process and reestablish Commission oversight of the staff's activities.⁴

Concerns and Suggested Improvements

1. The proposed amendments to rule 223 on the use of depositions are insufficient to provide respondents with meaningful discovery

The most egregious disparity between an administrative proceeding and litigation in Federal District court arises from the inability of respondents to engage in pre-hearing discovery via deposition. As the proposing release explains, "Rule 233 currently permits parties to take depositions by oral examination only if a witness will be unable to attend or testify at a hearing." This effectively deprives a respondent of any opportunity to ascertain the evidence supporting the staff's allegations, to adequately prepare to cross-examine SEC witnesses, to identify and prepare witnesses who could refute or rebut direct testimony, or to focus the scope of the hearing on the issues and facts that are in dispute.

In its release the Commission proposes that respondents and the Division would be permitted to take the same number of depositions. "If a proceeding involves a single respondent, the proposed amendment would allow the respondent and the Division to each file notices to depose three persons (i.e., a maximum of three depositions per side) in proceedings designated in the proposal as 120-day cases (known as 300-day cases under current Rule 360). If a proceeding involves multiple respondents, the proposed amendment would allow respondents to collectively file notices to depose five persons and the Division to file notices to depose five persons in proceedings designated in the proposal as 120-day cases (i.e., a maximum of five depositions per side)."⁵

⁴ See 2015 Chamber Report page 38 and 40. We also examined many of these issues previously in our 2011 Report. The 2011 Report is available at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/16967_SECREport_FullReport_final.pdf.

⁵ Proposing Release, p. 7.

We believe the proposed change in pre-hearing depositions is deficient in four respects:

- a) Mandating the same number of depositions for the staff and the respondents;**
 - b) Imposing a three deposition limit for one respondent or five to be shared by multiple respondents is arbitrary, capricious and unreasonable;**
 - c) Requiring multiple respondents to share the limited number of depositions; and**
 - d) Failing to differentiate between fact witnesses and expert witnesses.**
- a) Mandating the same number of depositions for the staff and the respondents does not level the playing field.**

On first appearance a rule that dictates the same number of depositions for both sides would seem equitable. In fact, it is not. Rather than “leveling the playing field” it merely maintains the disparity that was created during the investigation process. Litigated proceedings are preceded by a detailed and time-consuming investigation. As noted earlier, there are no limitations on the length of time of a staff investigation, no limitations on the number of persons that may be subpoenaed for testimony and interviewed informally, and no limitations on the quantity of documents that may be subpoenaed.⁶ In FY2014 only 64% of enforcement actions (including settled and litigated matters) were filed within two years from the opening of an investigation.⁷ Stated another way, almost 40% of Commission enforcement actions are preceded by an SEC investigation of more than two years! During the course of a typical investigation it is common for the staff to interview or depose dozens of persons and review huge quantities of documents, frequently spanning time periods in excess of five years.

⁶ See Chamber’s 2015 Report page 38 and 40. See also the Chamber’s 2011 Report. The 2011 Report is available at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/16967_SECReport_FullReport_final.pdf.

⁷ FY2016 SEC Annual Performance Report, Performance Goal 2.3.2, page 39. Available at: <http://www.sec.gov/about/reports/sec-fy2014-fy2016-annual-performance.pdf>

Given the unlimited opportunity to obtain testimony and documents, it is difficult to envisage why the staff would need to take additional depositions to supplement this investigative record. For this reason, we recommend that the Commission not adopt a rule mandating that its staff have the same number of depositions as the respondents. Instead, the Commission should adopt a rule providing that its staff should only be permitted to take depositions based upon a proffer to the Administrative Law Judge (“ALJ”) providing: 1) an explanation of why the staff were unable to take sworn testimony during its investigation; or 2) an explanation that demonstrates that a specific deposition is needed because of new information obtained after completion of its investigation.

b) Imposing a three-deposition limit for one respondent and a maximum of five depositions to be shared by multiple respondents is arbitrary, capricious, and unreasonable

The proposing release accurately enumerates the benefits of an adequate pre-trial hearing process:

The proposed amendment is intended to provide parties with an opportunity to develop arguments and defenses through deposition discovery, which may narrow the facts and issues to be explored during the hearing. Allowing depositions should facilitate the development of the case during the prehearing stage, which may ultimately result in more focused prehearing preparations, with issues distilled for the hearing and post-hearing briefing.⁸

We fully agree with the benefits of providing adequate pre-hearing discovery. However, the expansion proposed is far too restricted to achieve these benefits. In its proposing release, the Commission provides no explanation of why there should be a limit of three or five depositions for the most complex category of administrative proceeding (“120 day proceedings”). For example, it does not appear to be related to the number of persons that are deposed or interviewed in a typical investigation. Anecdotally, it is common for the staff to interview or depose literally dozens of

⁸ Proposing Release, page 7.

witnesses in a typical investigation. There is also nothing stated in the release to suggest that it is related to the number of witnesses that the division staff typically calls in a litigated proceeding. Given the wide range of fact patterns and violations that may be the basis for the proceeding it does not appear related to the type of misconduct that is alleged to have occurred. Rather than specify a maximum number, it would be preferable to identify a minimum number. We suggest a minimum of ten depositions for each respondent named in the order instituting proceedings in a 120-day proceeding. This mirrors the baseline number of depositions typically permitted in federal court before leave of the Court is required to take more.

In addition to this minimum, the ALJ presiding should be afforded broad latitude to authorize a sufficient number of additional depositions based upon a respondent's request and after the staff's disclosure of the total number of persons deposed or interviewed during its investigation.

c) Requiring multiple respondents to share the limited number of depositions is inherently inequitable.

When the Commission names more than one respondent in a proceeding, there may be different factual allegations and different violations alleged. For example, a broad market manipulation may involve officials at the public company whose shares were manipulated. Other parties may have worked at one or more broker-dealers engaged in manipulative trading. Still other parties at a firm may be named for "failing reasonably to supervise" these individuals, even if they did not actually engage in the misconduct. Finally, there may be one or more "promoters" who masterminded or coordinated the scheme, but who were not officially associated with the company or the broker-dealers involved. The fundamental interests of the group of respondents may be widely divergent. In such a proceeding, how can it be in the interests of justice to dictate that multiple respondents with overlapping but divergent interests share a finite number of depositions? Once again, the Commission's release provides no explanation. The absence of a compelling rationale, in fact any rationale, for this onerous requirement demonstrates that it should be dropped from a final rule.

d) Failing to differentiate between fact witnesses and expert witnesses

SEC administrative proceedings are frequently complex matters involving sophisticated transactions that may hinge on the correct interpretation of a technical rule and consideration of how the rule is commonly interpreted and applied by the financial sector. The outcome of an administrative proceeding may turn on testimony as to the correct interpretation and application of the Commission's "net capital rule" or its regulation M pertaining to stabilizing transactions in the secondary market by market-makers following an initial public offering. The testimony of expert witnesses is often essential. A pre-hearing deposition of an expert witness may be extremely important in focusing and narrowing the issues to be examined during the hearing. The relative importance of expert testimony compared with factual testimony depends upon the type of misconduct that is alleged to have occurred and the types of violations that are charged. Once again, it is imprudent to adopt a "one size fits all" approach in specifying the number of and need for expert witnesses and for pre-hearing depositions of possible expert witnesses. Given the very different functions of a fact-based witness and an expert witness, it is difficult to understand why two distinct categories of witnesses should be combined into a single category, with each respondent forced to choose between the two. A more responsible approach would be to treat expert witnesses as a separate category and provide the ALJ with latitude to authorize depositions of one or more expert witnesses per respondent, as appropriate to the facts and issues in the matter.

2. Proposed amendments to rule 230(a) on document production should be expanded to require disclosure of all persons interviewed and/or deposed during the investigation

In order to facilitate effective use of the proposed deposition opportunity, it is vital that the staff promptly provide respondents with a complete list of all persons who were interviewed or deposed during the investigation of the matter. Only with access to this list may a respondent effectively identify persons who should be deposed prior to the hearing. Currently, in order to obtain this list, respondent's counsel must file a subpoena request with the ALJ.⁹ In the interest of efficiency and reducing unnecessary delay, rule 230(a) should be amended to specifically require the

⁹ See In the Matter of Ironridge Global Partners, LLC and Ironridge Global IV, LTD., A.P. File No. 3-16649, Second Order on Subpoenas, A.P. Release No. 3228, October 15, 2015.

staff to provide this list as part of its routine production of non-privileged materials contained in its investigation file.

In conjunction with the list of persons, respondents should be provided with a brief summary of the factual topics covered in each interview. Currently, rule 230(a) requires the staff to provide transcripts prepared in the investigation. However there is no comparable record if a person is “interviewed” rather than questioned in a deposition. This inconsistency appears to have resulted in a preference by staff to “interview” key witnesses, so as to avoid creating a transcript. Requiring the staff to provide a brief summary of an interview would enable respondents to sift through a long list of witnesses so as to identify those most likely to have relevant testimony.

3. Extending the time available for pre-trial process is appropriate but it may be insufficient for proceedings in which the staff has compiled a huge documentary record.

The proposing release recognizes that an expansion in the use of pre-hearing discovery requires a change in the current deadlines for completion of administrative proceedings. It proposes a new method for managing the process. Instead of specifying a maximum time period for completion of the proceeding in the instituting order, the proposed amendment to rule 360 would specify a time period for issuance of the initial decision—30, 75, and 120 days from the completion of post-hearing or dispositive briefing. The amended rule 360 also would provide that the hearing must be scheduled to begin approximately four months after service of the order instituting proceedings, but not later than eight months after service of the order.

This is an appropriate change that we support. However, there may be instances in which the investigative record is so voluminous that even eight months may be insufficient time to prepare adequately for a hearing, particularly if there is a need for numerous pre-hearing depositions.¹⁰ As proposed, it does not appear that the amended rule 360(a)(2)(ii) permits an ALJ to extend the pre-hearing period

¹⁰ In a 2014 proceeding an ALJ denied a motion for a six-month extension of the pre-hearing period that respondents contended was needed to review an investigative record that respondents asserted “is larger than the entire printed Library of Congress”. *In the Matter of Harding Advisory LLC and Wing F. Chan*, File 3-15574, A.P. Ruling No. 1195, January 24, 2014. While the comparison to the Library of Congress may appear to be hyperbole, it may in fact have been accurate, and not unique.

beyond eight months. We recommend that the language be revised to enable the ALJ, for good cause, to extend this period beyond eight months.

4. A clear standard governing the use of hearsay testimony should be adopted that is consistent with the standard proposed for deposition testimony.

The Commission proposes to add new Rule 320(b) “to clarify that hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair.”

While the use of hearsay evidence has a long history in administrative proceedings, it also relates back to an era when the SEC used its administrative proceedings for more limited, largely regulatory purposes. When the APA was enacted in 1946, the SEC used administrative proceedings as an adjudicatory adjunct to its core regulatory activities—registering securities and registering persons and entities as broker-dealers, investment advisers and investment companies. Administrative proceedings were the vehicle used by the Commission to issue stop orders to halt a securities offering or to revoke the registration of a broker-dealer, investment company, or investment adviser or to deny an application for registration.

Today, the administrative proceeding forum is used for a wider array of purposes and a far broader range of persons, including against persons and entities that may not be registered with the Commission. The misconduct giving rise to the proceeding and the sanctions that result more closely resemble a criminal action than a regulatory licensing function. With the advent in recent years of severe sanctions including huge monetary penalties, there is a greater need for rules that ensure that decisions are predicated firmly on solid evidence. The current proposals, while a beginning, are insufficient. Permitting hearsay and allowing the introduction of affidavits and investigative testimony all effectively undercut the ability of a party to challenge the offered evidence through cross-examination, traditionally considered as an essential trial right to discovering the truth. For this reason, the broad use of hearsay evidence is no longer appropriate.

While there may be certain circumstances where it is appropriate to admit hearsay or an affidavit (or staff testimony) the proponent of such evidence should have the burden of justifying its admission with factual evidence establishing the

reliability of the proposed testimony and demonstrating that its admission will not abridge the opposing party's right to effective cross-examination. To rectify this problem, the Commission should adopt an evidentiary standard consistent with the one embedded in its proposed deposition rules. Under that standard it must be demonstrated that the proposed deponent "was a witness of or participated in any event, transaction, occurrence, act or omission that forms the basis for any claim asserted by the Division of Enforcement, or any defense asserted by any respondent in the proceeding..."¹¹ Adoption of this standard to hearsay evidence would require the party offering the witness to establish a foundation for the testimony that the witness proposes to offer. Absent evidence demonstrating that the witness has a firm foundation from which to testify such as first-hand knowledge, the hearsay testimony should not be admitted.

The proponent of the evidence should provide notice of the intent to seek the introduction of such evidence prior to the hearing to permit affected parties to take any necessary depositions. Any deposition taken as a result of the admission of such evidence should not count against the limited number of depositions permitted under the Rules.

5. The proposed amendment to rule 230(b) enabling staff to withhold or redact documents reflecting settlement negotiations should also prohibit staff from introducing Wells submissions or white papers as evidence in an administrative proceeding.

The Commission proposes to amend Rule 230(b) "to clarify that the Division may withhold or redact documents that reflect settlement negotiations with persons or entities who are not respondents in the proceeding at issue. This proposed amendment is intended to preserve the confidentiality of settlement discussions and safeguard the privacy of potential respondents with whom the Division has negotiated and is consistent with case law that favors the important public policy interest in candid settlement negotiations."¹² We fully support the proposed change. However, we believe, the exemption of materials concerning settlement negotiations should

¹¹ Proposing Release, page 43.

¹² Proposing Release, page 16.

specifically include all Wells submissions, pre-Wells submissions, and white papers submitted by a named party.

The Wells submission process at the SEC has existed for more than 40 years. It has provided persons and entities subjected to an SEC investigation with an opportunity to make a direct statement to the Commission concerning a proposed action, ensuring that the five Commissioners are aware of mitigating circumstances and or contrary interpretations of applicable law or inadequacies in the factual predicate supporting a proposed staff recommendation. Ensuring that the Commission has a complete understanding of the proposed action is an important safeguard to the integrity of the SEC.

Unfortunately, for many years, the staff has taken the position that they should be free to introduce Wells submissions as evidence in litigation. In fact, the SEC Enforcement Manual explicitly states “the staff may reject a submission if the person making the submission limits its admissibility under Federal Rule of Evidence 408 or otherwise limits the Commission’s ability to use the submission pursuant to Form 1662.”¹³ As such, it is difficult for a Wells submission to be fulsome in discussing the entirety of the conduct at issue for fear that it may be introduced as an admission in a subsequent proceeding. The strong public policy arguments that support an exemption from disclosure of settlement negotiations also apply to the content of a Wells submission. We strongly urge the Commission to use this rule-making to correct this disparity.

6. Extending time period for Commission review exacerbates a continuing and long-standing problem.

The Commission routinely asserts that speedier adjudication is an advantage of administrative proceedings over District court litigation. In doing so, they typically compare the length of time from case initiation to the entry of an initial decision with the length of time in District court from filing the complaint until entry of the judge’s decision. This is not an appropriate comparison for the simple reason that an ALJ initial decision is not by itself a final judgment. The final judgment only occurs at such time as the Commission issues an opinion on appeal or a notice of finality, in the

¹³ SEC Enforcement Manual page 25. October 2013

event that no party appeals the initial decision to the Commission. Furthermore the Commission's review process is fundamentally different from a Court of Appeals review of a District Court case. The Commission review is *de novo*.

When one includes the time involved in Commission review into the overall process, it appears that a Commission administrative proceeding is a more time-consuming process.¹⁴

The problem of delay at the Commission level is long-standing and it is becoming greater. In 1995, when the Commission last completed a comprehensive review of its rules of practice, it established non-binding guidelines for the Commission review of eleven months. In 2003, the Commission acknowledged that delay continued to be a serious problem. "The Commission recognizes that it too must shoulder responsibility for delays in its appellate review process." At that time the Commission addressed the problem by amending rule 900 and reducing the guideline for completion of its review from eleven months to seven months. In our 2015 Report we found that in an eighteen-month period (October 1, 2013—March 31, 2015), the Commission published 15 opinions (including opinions reviewing SRO disciplinary actions). Only two of the fifteen opinions were completed in the seven-month time frame.

In 2015, the Commission is proposing once again to address the problem. However, this time the proposed solution is to abandon the seven month standard in favor of an eight month standard, or a ten month standard for complex matters; with further extensions contemplated as the Commission determines.¹⁵ This relaxation of its internal guidelines seems inconsistent with the Commission's stated purpose of improving the efficiency of the process and utilizing administrative proceedings because they are speedier.

¹⁴ See 2015 Chamber Report, page 16 for a discussion of completion times of administrative proceedings and District Court litigation.

¹⁵ "We propose to amend Rule 900(a) to state that a decision by the Commission with respect to an appeal from the initial decision of a hearing officer...will be issued within eight months from the completion of briefing... and, if the Commission determines that the complexity of the issues presented in an appeal warrant additional time, the decision of the Commission may be issued within ten months of the completion of briefing. We also propose to amend Rule 900(a) to provide that if the Commission determines that a decision by the Commission cannot be issued within the eight or ten-month periods, the Commission may extend that period by orders as it deems appropriate in its discretion." Proposing Release, page 24.

7. The proposing release does not discuss the important issue of choice of venue.

One of the central issues discussed in the 2015 Chamber Report was the lack of an objective standard for determining whether an enforcement action should be litigated in an administrative proceeding or an injunctive action in Federal District Court. The Chamber Report provided a detailed analysis of the substantial issues arising from the lack of an objective and defensible standard. In the Report, we proposed a solution to this problem.¹⁶

During the past year, a number of legal challenges to the current practice have been brought.¹⁷ Recently, a bill has been introduced in Congress in response to the problem.¹⁸ Given the controversy and multiple constitutional challenges, it is surprising that the Commission has not acknowledged the significance of this issue in the proposing release. The absence of any discussion of the choice of venue is striking. Once again, it appears that the Commission prefers to resolve an important question of regulatory policy, and one of essential procedural fairness, via enforcement litigation rather than through the regulatory notice and comment process.¹⁹ The potential cost of declining to use the “notice and comment” approach to setting policy may be that the SEC effectively cedes control over the decision to an appellate court, via litigation, or to the U.S. Congress. We urge the Commission to formally propose for notice and comment a meaningful choice of venue policy. The Chamber Report includes three recommendations to achieve a fair and principled policy for the choice of venue. We propose the following:

RECOMMENDATION 1: The Commission should formally adopt, and uniformly apply, a policy that it will use administrative proceedings

¹⁶ 2015 Chamber Report, pages 11-18, Recommendation 1 on page 18.

¹⁷ See *Hill v. SEC*, No. 1:15-cv-01801-LMM, 2015 WL 4307088, at *42 (N.D. Ga. June 8, 2015); *Duka v. SEC*, No. 1:15-cv-003570RMB, 2015 WL 4940083, at *2 (S.D.N.Y. Aug. 12, 2015); *Gray Financial Group v. SEC*, No. 1:15-cv-00492-LMM, Dkt. No. 56, at *13-14 (Dist. Ga. Aug. 4, 2015).

¹⁸ H.R. 3798, the Due Process Restoration Act.

¹⁹ In May 2015, the Division of Enforcement posted on its Division webpage a statement entitled “Division of Enforcement Approach to Forum Selection in Contested Actions.” As we discussed in the 2015 Report, the statement does not represent a policy of the SEC. Rather it represents the views of the Division of Enforcement describing the factors that it considers in making a recommendation to the Commission. Not surprisingly, the factors are examples of considerations that make one forum advantageous to the Division, rather than considerations based upon the principles of due process and equity.

to adjudicate contested matters if:

- The proceeding is based upon well-established legal principles that have been adopted by Article III courts;
- The factual predicate for the alleged violations is substantially equivalent to those asserted and upheld in past enforcement actions; and
- The matter does not entail an extensive investigative record such that considerations of fairness warrant providing the respondent/defendant with adequate opportunity for pretrial discovery and time within which to fully review the investigative record; or
- The staff is alleging a cause of action that may be brought only in an administrative proceeding, such as a stop order proceeding, a section 12(j) revocation proceeding, a license revocation or bar proceeding, or a rule 102(e) proceeding, or proceedings based upon a failure reasonably to supervise or causing a violation.

RECOMMENDATION 2: The Commission should create a procedure to enable respondents to challenge the choice of forum by filing a motion for change of forum with the Commission prior to institution of the proceeding (described in detail in this report). The separation of function doctrine should apply to Commission consideration of the motion.

RECOMMENDATION 3: The Commission should adopt a policy that any party named in an administrative proceeding that desires a jury trial may file a notice to remove the proceeding to federal district court.

Conclusion

We applaud the Commission for initiating the process of updating its rules of practice, as we recommended in July 2015. However, we believe much more is required to achieve fair and balanced due process. We thank you for your

Mr. Brent Fields
December 4, 2015
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consideration of these comments and hope that you take our proposals as a constructive good faith effort to achieve that goal. We would be happy to discuss these issues further with the Commissioners or Staff.

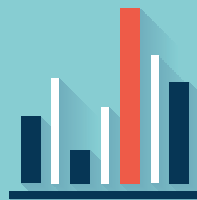
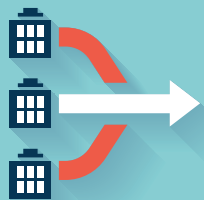
Sincerely,

A handwritten signature in black ink, appearing to be 'TK' followed by a long, sweeping horizontal stroke.

Tom Quaadman

CC: The Honorable Mary Jo White
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

Attachment: *Examining U.S. Securities and Exchange Commission Enforcement:
Recommendations on Current Processes and Practices*



Examining U.S. Securities and Exchange Commission Enforcement:

Recommendations on Current Processes
and Practices

July 2015



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Preamble

The U.S. Chamber of Commerce is releasing several recommendations to the U.S. Securities and Exchange Commission (SEC) in an effort to support the agency's ongoing enforcement activities and to ensure clear, predictable, and efficient practices for market participants while eliminating unnecessary ambiguity.

The mission of the SEC is to promote investor protection, competition, and capital formation. Capital markets that are efficient for both investors and businesses must be a level playing field with the certainty that clear rules provide. This level playing field can occur only if there is a strong Enforcement Program that helps to keep bad actors out of the marketplace.

The SEC has always been recognized for its Enforcement Program. SEC Chair Mary Jo White and Enforcement Division Director Andrew Ceresney have put in place measures to strengthen the program and this report looks to build on those efforts.

The certainty of clear rules of the road also means that SEC Enforcement should have a fair process for all to ensure that the rights of the accused are preserved while allowing the process to achieve its goals of finding the truth, punishing the wrong-doers, and preventing future harm. We believe that the recommendations found in this report will ensure that the process is fair and that all stakeholders can benefit from the SEC Enforcement activities that will engender efficient capital markets.

In developing these recommendations we first surveyed more than 75 companies to identify areas where there is ambiguity or lack of clarity in the process. Second, we conducted extensive interviews with a wide range of more than 30 former SEC officials, legal experts, and corporate counsels to develop specific recommendations. We included the ideas that have broad support from those who generously participated in this process.

It would be a mistake to misinterpret any of these recommendations as calling for changes that would either weaken enforcement or erect any process barriers that would impede vigorous action by the SEC. We were very careful to propose changes that will both further enable tough-as-nails efforts to punish and deter fraud while ensuring that honest market participants benefit from a clear and predictable process. Investors, market participants, and the SEC all benefit from this approach—vigorous, effective enforcement coupled with a clear and fair process.



SUMMARY OF RECOMMENDATIONS

RECOMMENDATIONS ON SEC ENFORCEMENT POLICIES

Providing a Structure for the Choice of Forum Decision that Incorporates Due Process Protection

Congressional action has expanded the administrative proceeding process so that it is possible to bring almost all enforcement actions as either an administrative proceeding or as a civil action. While the types of actions and the remedies that may be obtained are similar, the two forums have substantial differences in process. These differences can have a significant impact on the procedural rights of a defendant/respondent and, ultimately, on the respondent's ability to obtain a full, fair, and impartial adjudication.

The Division of Enforcement, as the prosecutor, should consider the different aspects and implications of the two forums in making its recommendation to the Commission. However, the Commissioners acting as a decisional body should not view their role in the same way as a prosecutor. The Commission has a responsibility to consider the broader statutory questions of what is "necessary and appropriate in the public interest for the protection of investors." More broadly, it must also adhere to its multiple statutory mandates to protect investors, promote capital formation, and ensure fair and orderly markets. Accordingly, the Commission should predicate its forum selection decisions solely upon a clear determination that its choices uphold and further its responsibility as a government agency to promote the public interest and the protection of investors, while respecting the important rights of those whose conduct the SEC chooses to scrutinize.

The Commission must recognize that its decisions, even those that are fundamentally a matter within

its discretion, are subject eventually to review by an independent judiciary. In decades past, aggressive Commission positions in enforcement actions have been overturned by appellate courts.¹ For this reason, the Commission's reputation within the judiciary as a fair and evenhanded regulator is a precious commodity that must be protected.

The following recommendations identify how the Commission can adopt policies and procedures that would achieve these objectives.

RECOMMENDATION 1: The Commission should formally adopt, and uniformly apply, a policy that it will use administrative proceedings to adjudicate contested matters if:

- The proceeding is based upon well-established legal principles that have been adopted by Article III courts;
- The factual predicate for the alleged violations is substantially equivalent to those asserted and upheld in past enforcement actions; and
- The matter does not entail an extensive investigative record such that considerations of fairness warrant providing the respondent/defendant with adequate opportunity for pretrial discovery and time within which to fully review the investigative record; or
- The staff is alleging a cause of action that may be brought only in an administrative proceeding, such as a stop order proceeding, a section 12(j) revocation proceeding, a license revocation or bar proceeding, or a rule 102(e) proceeding, or proceedings based upon a failure reasonably to supervise or causing a violation.

RECOMMENDATION 2: The Commission should create a procedure to enable respondents to challenge the choice of forum by filing a motion for change of forum with the Commission prior to institution of the proceeding (described in detail in this report). The separation of function doctrine should apply to Commission consideration of the motion.

RECOMMENDATION 3: The Commission should adopt a policy that any party named in an administrative proceeding that desires a jury trial may file a notice to remove the proceeding to federal district court.

RECOMMENDATION 4: The Commission should review its Rules of Practice to give effect to its changed authority, its increased experience with the broader utilization of administrative proceedings, and the substantial increase in the volume of investigation materials and to ensure that the SEC's administrative forum is a fundamentally fair and impartial venue, especially for persons and entities not directly regulated by the SEC. Among other things, its rules should be revised to provide adequate opportunities for pre-trial discovery and depositions. Commission rules on completion of the initial decision should be amended to provide sufficient time for the expansion of pre-hearing process.

STRENGTHENING THE WELLS PROCESS

The "Wells" process has been a core element of the SEC Enforcement Program virtually since the creation of the Division of Enforcement. While the Wells process has been an integral part of the SEC investigation process for more than 40 years, it has changed over time, frequently through informal decisions by the Commission and staff that have not been reflected in the Commission's Rules on Informal Practice. The recommendations that follow address the importance of returning to time-honored practices and codifying changes to the process.

RECOMMENDATION 5: The Division should adopt a uniform policy that all Wells submissions will be provided to the Commission at the same time along with the action memorandum containing the recommendation for enforcement action.

RECOMMENDATION 6: The Division should consistently provide access to its investigative files with adequate time to permit a meaningful response to a staff Wells Notice or request for a white paper by establishing a presumption in favor of granting access and requiring that a senior-level official review preliminary decisions to deny such access.

RECOMMENDATION 7: The Division should formally adopt, and uniformly apply, a "reverse proffer" policy and provide potential defendants/respondents with a full presentation of the nature of its proposed case and the supporting evidence before commencing the Wells submission or white paper process.

RECOMMENDATION 8: The Division should formally adopt a policy that any party that has made a Wells submission or requested advance notice should be provided reasonable advance notice, such as three business days, that the staff will file an enforcement action.

CLARIFYING THE SEC POLICY ON ADMISSIONS

From the earliest days of its existence until 2012, the SEC had permitted defendants to settle proposed enforcement actions without either admitting or denying the allegations in the Commission's charging documents and, with very few exceptions, had applied that policy across the spectrum of its enforcement cases. In 2012, the SEC announced that it would no longer adhere to a blanket policy permitting defendants to settle SEC cases based upon criminal convictions without admitting to the allegations that were the factual predicate for the criminal conviction. The SEC has indicated that decisions about whether to require admissions will be made on a "case-by-case" basis in cases involving "widespread harm to investors," "egregious intentional misconduct," or obstruction of SEC investigations. As the SEC develops experience, the Commission should review its Revised Admissions Policy. This review will help clarify when and how best to implement the Revised Admissions Policy. This reexamination of policy should carefully study, inter alia, the collateral impact that making the admissions has had on settling parties, whether the requirement has had any impact on the Commission's prompt and effective resolution of actions and on the public perception of the effectiveness of the SEC Enforcement Program.

RECOMMENDATION 9: The Commission should regularly review its policy requiring admissions in some enforcement actions to learn from its experience to date and consider the policies of other government agencies.

RECOMMENDATION 10: Following a careful examination, if the Commission determines that the admissions policy should be continued, a clear statement of the policy should be added to the Commission's Informal and Other Procedures.

RECOMMENDATION 11: The codified guidance should articulate meaningful standards that provide guidance on when admissions will be required, promoting consistency in the exercise of the SEC's broad discretion. The policy should describe the level of detail used for admissions, including the description of the misconduct and the articulation of the statutory provisions or regulations that were violated to promote consistency within the Division. The purpose of these admissions statements should be to provide normative guidance to other persons or entities similarly situated.

RECOMMENDATION 12: The Commission should publish guidance on the how the issue of requiring admissions will be incorporated into settlement negotiations.

REDUCING DUPLICATION IN REGULATORY ENFORCEMENT

Regulation of the financial markets in the United States has historically involved multiple entities, including multiple agencies at the federal level (the SEC, CFTC, and DOJ), multiple self-regulatory organizations, and at the state level, multiple state securities regulators and state attorneys general. For businesses engaged across the financial sector, prudential supervision can mean multiple examinations by more than one SEC regional office (SRO) in addition to a designated SRO, and multiple federal banking regulators. Globalization of the securities markets has added additional layers of foreign regulation for multinational companies. Responding to multiple regulators with respect to the same conduct or transaction is not, and should not be allowed to become, a regular attribute of doing business. It is counterproductive—and damaging to shareholders—to subject firms and individuals serially to multiple SEC inquiries, or multiple regulators and self-regulators, for the same alleged misconduct.

RECOMMENDATION 13: The Commission should eliminate duplicative and overlapping enforcement responses within the Commission and by multiple enforcement authorities, against the same individuals or entities for effectively the same misconduct. The Commission should take a leadership role among regulatory bodies at the federal, state, and international levels to reduce or eliminate duplicative and overlapping investigations and duplicative enforcement actions for the same conduct. A list of ideas on how unnecessary duplication could be reduced is contained in the body of this report.

THE BROKEN WINDOWS POLICY AND THE NEED FOR ALTERNATIVE METHODS OF RESOLVING MATTERS

The “Broken Windows” policy is a component of the SEC Enforcement Program. As generally understood, the Broken Windows policy presumes that aggressive action against infractions of all sizes, including minor infractions, sends a broad message that deters others from violating the law, including more serious misconduct. As articulated by the SEC, the major foundation of the “Broken Windows” program is publicizing the fact that the Commission will pursue big and small violations, and eliminating the perception that there is a so-called “de minimis” exception to enforcement.

However, the Commission will never have sufficient resources to pursue every infraction, large or small. Moreover, the allocation of resources to this approach could diminish the Commission's capacity to investigate and bring enforcement actions involving difficult and complex major violations. The best way to balance these competing objectives is the creative use of informal remedies, just as the Commission has done throughout its history. Empowering the Division to resolve minor infractions informally in ways that protect investors is consistent with the Broken Windows concept and consistent with the Commission's historic mission.

RECOMMENDATION 14: The Commission should incorporate into its Broken Windows policy the use of alternative case resolution methods to rapidly resolve minor, non-systemic infractions, and to encourage and reward effective internal compliance and systems of internal controls. Creative use of informal remedial actions, such as deficiency letters, desk injunctions, reports of investigations and voluntary

disclosure of internal investigations and remediation actions will enable the SEC to devote its limited resources to major instances of misconduct.

RECOMMENDATIONS ON COMMISSION OVERSIGHT OF THE ENFORCEMENT PROGRAM

IMPROVING COMMISSION OVERSIGHT

Macro-level Commission oversight of the overall Enforcement Program, in terms of priorities and areas of emphasis, allocation of resources, and periodic assessment of effectiveness has traditionally been extremely limited. Given the importance of the SEC's Enforcement Program, a macro-level oversight process is required. First, there must be systematic collection of quantitative and qualitative information on the program operations. Second, there must be a regular periodic process for presenting this information to the Commission in a manner that provides them with a meaningful, not a pro forma, opportunity to provide input and direction.

RECOMMENDATION 15: The Division of Enforcement should submit a quarterly management report to the Commission containing productivity and efficiency metrics developed by the Division of Economic and Risk Analysis.

RECOMMENDATION 16: The Commission should receive quarterly oversight briefings on the Enforcement Program. The briefings should focus on investigations in these areas:

- Significant "National Priority" investigations;
- Investigations raising novel or complex legal questions;
- Oldest active investigations;
- Post-mortem analysis of litigated decisions not in favor of the SEC; and
- New or emerging areas warranting investigation.

IMPROVING TRANSPARENCY AND PUBLIC DIALOGUE

RECOMMENDATION 17: The Commission should periodically alert those subject to the Agency's regulations of emerging trends. New standards, or new interpretations of existing standards, should be addressed through Agency rulemaking or formal interpretive guidance, not through negotiated settled enforcement proceedings.

RECOMMENDATION 18: The Commission should publish annually a report on its Enforcement Program, provide a public comment period on relevant issues, and conduct an annual public roundtable to discuss the report and the operations of its Enforcement Program.

RECOMMENDATION 19: In the interest of maintaining the highest levels of integrity and fairness, Commission staff should adhere to the American Bar Association Code of Professional Conduct Rules on Trial Publicity (Rules 3.6 and 3.8) when drafting litigation and press releases. To ensure conformity with these standards and consistency within the Division, all litigation-related press releases should be reviewed pre-release by personnel outside the Division of Enforcement. Releases concerning litigated actions should state explicitly that the description of events represents allegations that must be proven. In settled cases, the Enforcement Division should provide counsel for settling parties an advance opportunity to review the proposed Litigation Release or press release solely as to accuracy and fairness.

RECOMMENDATIONS TO IMPROVE THE EFFICIENCY AND EFFECTIVENESS OF THE SEC INVESTIGATION PROCESS

STREAMLINING THE SEC INVESTIGATION PROCESS

The SEC investigation process is the largest program at the SEC. It is also the most opaque. The Commission provides very limited information on the process, except when a formal enforcement action is filed. The process is often long and costly, both to the SEC and to persons and entities that are the subject of the investigation. Because the great majority of SEC investigations are closed without

any action taken, these substantial costs are incurred by significant numbers of persons and entities that are never charged with committing violations. For public companies that are unable to raise capital because of the uncertainties associated with an open SEC investigation or that suffer large share-price decreases upon the announcement of an investigation, the consequences can be significant. By improving the efficiency of the investigation process, the SEC would make more effective use of its limited resources and, at the same time, reduce the substantial costs incurred by persons and entities that are subjected to the process. Our recommendations focus on the importance of better internal management of the process and on ways to streamline the document production process.

DOCUMENT REQUESTS, PRODUCTION, AND PRESERVATION

An SEC investigation, in all but a few types of inquiry, is grounded in the review of large quantities of documents, supplemented by on-the-record testimony of persons involved in the question under review or having relevant knowledge. The IT revolution of the past 30-plus years has been a mixed blessing for the Division of Enforcement. It has afforded the staff access to vast quantities of potentially relevant information, as well as email and voicemail records that, in many cases, reveal exactly what people were communicating at critical points in time. However, in some cases the “smoking gun” materials may be hidden in plain sight within tens of millions of pages of irrelevant documents. In other cases, there is no “smoking gun” or misconduct, but companies may be required to produce tens of millions of pages of irrelevant documents. The cost of providing access to millions of pages of documents and emails is substantial, costing companies millions of dollars. As the majority of SEC investigations are closed without action, this is a substantial burden and expense for individuals and companies that have done nothing wrong. We recommend that the Division adopt the following steps to minimize the burdens of document production and, at the same time, to improve the efficiency of SEC investigations, reducing the burden on enforcement staff of examining such a large volume of material.

RECOMMENDATION 20: At the earliest stage of an investigation—whether formal or informal—the Division

should notify companies, individuals, and their counsel, to the extent appropriate, that it has an investigative interest in a matter (or matters), and request that companies and individuals immediately institute “information preservation measures” to prevent the destruction (automatic or otherwise) or alteration of any documents, data, or other information that may be relevant to the investigation. The Division should require and receive satisfactory assurances regarding the continuing preservation of all documents, data, and information relevant to the investigation and the understanding that no change in this status will occur without advance communications with the Division.

RECOMMENDATION 21: To expedite and focus an investigation, the Division should, at an early stage of its investigative efforts, engage in dialogue with counsel for persons and entities receiving subpoenas to identify the scope of the inquiry and promote an efficient production of materials. In this dialogue, recipients of subpoenas should be encouraged to provide the following information:

- A description of the categories of documents deemed by the company or individual involved to be most relevant to the matter(s) under review; and
- An identification of individuals and entities deemed by the company or individual to have relevant information or knowledge about the circumstances relating to the matter(s) under review.

RECOMMENDATION 22: Following the exchange of initial documents and information described above, Division staff and defense counsel should discuss document production, balancing the Division’s need for relevant information with the need of those involved to control costs of document production. Among other things, the Division should:

- Implement concepts of *access* to information, as an alternative to actual production of information, wherever that approach can be implemented feasibly, and without adding unnecessary time to the investigative process;
- Utilize rolling production of documents, rather than requiring all potentially relevant documents to be produced at the same time;

- o Negotiate document demands or subpoenas that take into account the actual costs associated with production of certain data, especially where information preservation measures have been implemented;
- o Jointly identify aspects of the request that may impose disproportionate costs and time burdens; and
- o Memorialize written agreements with defense counsel regarding document requests and subpoenas, to avoid any future misunderstandings and to provide new or future investigators with an understanding of production obligations.

IMPROVING THE EFFICIENCY OF THE INVESTIGATION PROCESS

Improving management of the investigative process requires greater internal controls over the duration of investigations, the metrics that are used to evaluate and incentivize the staff, the problems resulting from staff turnover, and the case closing process.

RECOMMENDATION 23: To improve the management of the investigative process, all requests for formal order authorization should contain a discussion of the anticipated resources needed to complete the investigation and provide a target completion date. If additional time is required, a justification memorandum should be submitted for approval to the Division Director or designee. This memorandum should be promptly sent to the Commission as an information memorandum, so that any Commissioner may request Commission review of the time extension.

RECOMMENDATION 24: The Commission should adopt evaluation metrics for the Division and for individual staff that emphasize prompt, effective, and appropriate resolution of investigations. A sound decision to promptly conclude an investigation without formal action, or through informal remediation, should receive credit that is comparable to the credit received for investigations that result in a formal enforcement action.

RECOMMENDATION 25: All departing staff should be required, as part of the agency departure policy, to prepare a summary memo on each open investigation and to

organize all documents files, paper or electronic, to enable a successor attorney to quickly assume responsibility.

RECOMMENDATION 26: Written notification that a formal or informal investigation has been closed should be sent promptly to persons and entities whose conduct was under investigation, within two weeks of closure.

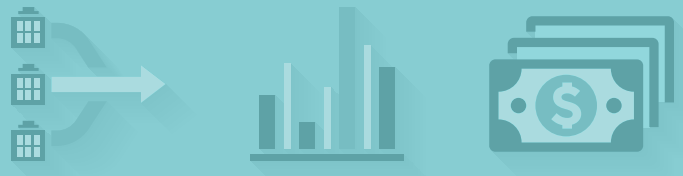
RECOMMENDATION 27: The Division should establish an in-depth training program for its staff in the following areas:

- o Understanding document production and analysis to promote targeted subpoenas and document requests, in order to increase staff sensitivity to the costs and time demands associated with document production, to ensure a uniform approach to document production, and to promote effective and efficient document production and analysis;
- o An internal autopsy process should be created by which current staff involved in both successful and unsuccessful matters would prepare a detailed analysis, highlighting the lessons that could be applied in the future; and
- o Understanding of evidentiary requirements in litigation to ensure that an investigative record is sufficient and suitable for litigated matters.

RECOMMENDATION 28: The Division should increase the integration of its trial attorneys into the investigative process to ensure that investigative records collect all evidence necessary for successful litigation and are based upon appropriate legal theories. Division trial attorneys should actively participate in Division training programs described in Recommendation 27.

CONCLUSION

By adopting these recommendations, as well as recommendations made by others, the Chamber believes that the SEC's Enforcement Program will benefit by becoming more vigorous while also efficiently using limited resources to penalize bad actors in the capital markets. We also believe that these recommendations will provide clarity to market participants and eliminate unnecessary ambiguity, which benefits both the SEC and the U.S. capital markets.



INTRODUCTION

The mission of the U.S. Securities and Exchange Commission (SEC) is to promote investor protection, competition, and capital formation. Central to this mission is a level playing field for all. This level playing field can occur only if there is a strong and effective enforcement program that helps to keep bad actors out of the marketplace.

Having a strong enforcement program is an important priority for investors, honest market participants, and the SEC. Each of these parties also benefit from a clear process and fair enforcement process. The certainty of a clear and fair process protects the rights of the accused and allows the enforcement program to achieve its goals of finding the truth, punishing the wrong-doers, and preventing future harm. In short, everyone benefits from tough-as-nails, vigorous, effective enforcement coupled with a clear and fair process.

The SEC has significantly enhanced the scale and scope of its enforcement program in recent years. We welcome this. Nothing in this report should be construed as either seeking to weaken enforcement against bad actors or otherwise make it harder for the SEC to act swiftly and effectively to protect investors. While we have examined some of the recent efforts and suggested what we believe are constructive recommendations, this report was not initiated as a reaction to recent enforcement initiatives by the current SEC leadership. Instead, it was generated by our shared interest to strengthen the effectiveness of the SEC in Enforcement and all areas. In discussing the SEC Enforcement Program with our members we identified a growing list of areas where there is unnecessary and in some cases counter-productive ambiguity in the SEC Enforcement Process. The recommendations in this report are designed to constructively recommend ways to address those ambiguities as well as to contribute toward further improvements in the SEC Enforcement Program.²

Our analysis and recommendations are organized into three categories:

- Recommendations on SEC Enforcement Policy;
- Recommendations on Commission Oversight of the Enforcement Program; and
- Recommendations on SEC Investigation Process and Practices.

Study Methodology

Because of the complexity of the program and the confidentiality associated with the investigation process, we used three interrelated methods to conduct this inquiry. First, we retained FTI Consulting to conduct a survey of more than 75 general counsels and other legal and compliance executives of public U.S. companies on their experiences with non-public SEC investigations. Given the confidential nature of SEC investigations, the data collected by FTI provide a unique insight into the investigative process. A series of charts summarizing the survey responses are attached as Appendix A.

Following the completion of the survey, we used this information to identify key research questions. We conducted a series of more than 30 in-depth interviews with persons having direct knowledge of the program. The group included a significant number of attorneys in private practice, many of whom were at one time members of the SEC Division of Enforcement. Finally we held a series of meetings with a variety of groups to discuss and refine the specific recommendations contained in this report. Overall, this report reflects the input of countless individuals who generously provided their insights on how the program is and is not working as intended.



SUMMARY OF PAST STUDIES OF THE SEC ENFORCEMENT PROGRAM

Our current review of the Commission's Enforcement Program is the latest in a series of *ad hoc* reviews of one or more aspects of the SEC's Enforcement Program.³ Over four decades ago, the SEC itself, under then Chairman William Casey, initiated the first major review of its Enforcement Policies and Practices, appointing a three-person Advisory Committee (Wells Committee),⁴ some of the recommendations of which have been implemented,⁵ although others—that we believe are still relevant today—have not been implemented or addressed.⁶ The Wells Committee's Enforcement Program review was followed by five other Commission-inspired or co-sponsored reviews that included the Agency's Enforcement Program as a subject of consideration, in 1977,⁷ 1984,⁸ 1994,⁹ 1998,¹⁰ and 2001.¹¹ With the exception of the *Wells Committee Report*, however, there has been minimal public information about the scope, conclusions, or follow-up actions taken as a result of these various internal enforcement-related reviews.¹²

The first of the Commission reviews of the Enforcement Process subsequent to the *Wells Committee Report*—the SEC's 1977 Major Issues Conference—was initiated under the leadership of former SEC Chairman Roderick M. Hills. A report was published detailing the consensus arrived at during the Conference.¹³ In 1984, SEC Chairman John S.R. Shad organized a Major Issues Conference, coinciding with the 50th anniversary of the SEC, which included a panel on SEC Enforcement. A report of the proceedings was published.¹⁴ In 1994, an internal review was conducted by the Enforcement Division's Staff and discussed in an article co-authored by then Enforcement Division Director William R. McLucas.¹⁵ The fourth Commission-initiated review was undertaken by then SEC Commissioner Laura Unger, at the request of then SEC Chairman Arthur Levitt, and focused on delays in bringing new cases and completing existing ones. Details on the scope of the review, and its conclusions, were not made public.¹⁶

In 2001, a public conference similar to the 1984 Major Issues Conference was held, a collaborative effort between the SEC Historical Society, under the leadership of former SEC Chairman David Ruder (then Chairman of the SEC Historical Society), and the SEC, under the leadership of then SEC Chairman Harvey Pitt. This last conference was announced publicly, participated in by Commission, non-Commission, and former Commission personnel, foreign regulators, and private sector representatives, and resulted in the preparation and publication of five formal papers on each of the major topics discussed and considered by the Conference.

To the best of our ability to ascertain this, with one possible exception, it does not appear that there has been a Commission-initiated or co-sponsored review of the Enforcement Program in the nearly 15 years since the last of these efforts.¹⁷

Apart from the six Commission-initiated (or co-sponsored) reviews into all or portions of the Enforcement Program, a number of private sector efforts have reviewed one or more aspects of the SEC's Enforcement Program, including the Chamber's 2006 and 2011 Reports.¹⁸ Also, the General Accountability Office (GAO) has published numerous reports on aspects of the SEC Enforcement Program.¹⁹ In 2010, the International Monetary Fund and the World Bank published their assessment of the U.S. system for capital markets regulation, as part of the ongoing Financial Sector Assessment Program (FSAP). The sharply critical report provides insight into how the U.S. regulatory system is viewed internationally.²⁰

In light of the substantial changes in the strategic vision of the SEC Enforcement Program, the expansion in its statutory authority, and the nearly doubling of its size during the past 25 years, we believe this is an appropriate point in time for another examination of the program.



RECOMMENDATIONS ON SEC ENFORCEMENT POLICIES

Providing a Structure for the Choice of Forum Decision that Incorporates Due Process Protections

Evolution in the use of administrative proceedings

Since the SEC's creation, it has had the authority to bring administrative proceedings to address violations of the securities laws. The scope of its authority to bring an administrative proceeding and the sanctions that can be ordered in an administrative proceeding have grown dramatically over time.

Early in the history of the SEC, the administrative proceeding was limited to proceedings to halt an offering of securities to the public, a so-called stop order, under section 8 of the Securities Act,²¹ and proceedings to reject an application for or revoke the registration of a broker-dealer²² or investment adviser.²³ Administrative proceedings were adjuncts of the Commission's authority to register securities and register broker-dealers, investment advisers, and investment companies. When the occasion arose to deny a registration or to revoke one, the administrative proceeding was the vehicle to provide the affected entity with a right to hearing prior to Commission action.

In 1964, Congress amended the Exchange Act²⁴ and provided the Commission with the authority to institute administrative proceedings to censure, place limitations on the activities of, suspend for a period up to 12 months, or bar associated persons of broker-dealers. The grounds for denying or revoking a broker-dealer registration or other disciplinary sanction were also expanded. These new bases included willful violations of the Investment Company Act or the Investment Advisers Act, willful aiding

or abetting violations, and importantly, a broker-dealer's failure reasonably to supervise a person who commits a violation. In 1970, Congress amended similarly the Investment Advisers Act. Comparable authority is also contained in the Investment Company Act.²⁵ This authority has become a staple of the SEC Enforcement Program.

In 1990, Congress enacted the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the Remedies Act). The Remedies Act dramatically expanded the nature of SEC administrative proceedings. For the first time, the Commission could proceed administratively against persons and entities not directly registered with the Commission and, also for the first time, it could impose monetary penalties on registered entities and associated persons. It authorized the Commission to enter a cease and desist order²⁶ against any person who is violating, has violated, or is about to violate any provision of the securities laws or any rule or regulation thereunder.²⁷ In a cease and desist proceeding, the Commission can order a party to take steps to comply with its rules, to provide an accounting, and to disgorge profits gained or losses avoided. This Act also created a proceeding to enable the SEC to issue a temporary cease and desist order. While the Commission has used its cease and desist authority extensively, it has brought only one proceeding under its temporary cease and desist authority.²⁸

The Remedies Act also expanded the remedies that the SEC can order in an administrative proceeding against broker-dealers, investment advisers, investment companies, and persons associated with these registered entities. The SEC can order disgorgement and civil penalties comparable to those available in an injunctive action.²⁹

The Sarbanes-Oxley Act (SOX) expanded the remedies available in a cease and desist proceeding by authorizing the

SEC to bar an individual from serving as an officer or director of a public company if they violated the antifraud provisions of the Securities Act or Exchange Act.³⁰ Section 602 of SOX added section 4C to the Exchange Act and provided explicit statutory authority for administrative proceedings against an attorney, an accountant, or other professional such as an engineer or geologist, engaging in improper professional conduct. This codified Commission rule 102(e).

Section 925 of the Dodd-Frank Act (Dodd-Frank) further expanded the Commission’s sanctioning power to include a “collateral” bar from association under all of the securities laws.³¹ It also provided the authority to impose money penalties against persons or entities not registered with the Commission. In effect, the Commission could, in an administrative proceeding, impose substantially the same penalties available in a civil injunctive action.

The substantial expansion in administrative proceeding authority, both in the scope of who may be charged in an administrative proceeding (AP) and in the penalties available in an AP, has coincided with a dramatic increase in the total number of administrative proceedings brought by the SEC. While the controversy over this shift in policy has been largely focused on the period following Dodd-Frank, and in particular the past two years, the increased reliance on administrative proceedings has been growing steadily for more than two decades.

An analysis of the types of APs brought by the SEC suggests that caution should be exercised in making this causal connection. During the period prior to enactment of the Remedies Act in 1990, civil injunctive actions were the preferred enforcement tool. In 1988, two years prior to the Remedies Act, the SEC instituted 109 administrative proceedings and filed 142 civil injunctive actions. This was consistent with previous years. In 1993, three years after the Remedies Act was enacted, the ratio had shifted: 229 administrative proceedings and 172 civil injunctive actions. The shift continued to grow. In 2010, there were 429 administrative proceedings and 252 civil injunctive actions. In 2014, the shift became more dramatic: 610 administrative proceedings compared with 145 civil injunctive actions.

This dramatic shift is not due solely to the expansion in the scope of the administrative proceeding process and

the availability of comparable sanctions. Two other factors have contributed strongly to the shift. One obvious factor influencing the trend is the preference to settle negotiated enforcement actions through issuance of an administrative proceeding order rather than the filing of a civil injunctive consent order. Historically, the SEC has relied heavily upon negotiated settlements rather than litigation. Today, these settlements are increasingly likely to be settled administrative proceedings rather than settled civil injunctive actions.³² This has generally been the preference of the subjects of Commission orders, and likely has become even more preferable since Commission settlement agreements came under close judicial scrutiny.³³

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Historically, the SEC has relied heavily upon negotiated settlements rather than litigation. Today, these settlements are increasingly likely to be settled administrative proceedings rather than settled civil injunctive actions.

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The second important factor that largely explains the shift in choice of forum is an increase in the number of routine administrative proceedings that the Division files each year. These are types of actions that have always been brought as administrative proceedings. These include proceedings under section 12(j) of the Exchange Act to deregister public companies that have been delinquent in filing periodic reports. Another category is proceedings against registered persons (e.g., investment advisers and persons associated with a registered broker-dealer or investment company) who have already been enjoined or criminally convicted, in which the staff is seeking to suspend or bar the person from association with registered entities. While these proceedings are counted as litigated enforcement actions, in reality they typically are more of an administrative formality than a contested action.

The number of largely ministerial administrative proceedings has an enormous distorting impact on annual statistics. For example, during calendar year 2014,³⁴ SEC administrative law judges (ALJs) issued 183 initial

decisions in technically litigated proceedings; a number greater than the total number of initial decisions issued in the previous five years. In the five years 2009–2013, 176 initial decisions were issued.³⁵ This dramatic increase could be interpreted as demonstrating that the Division of Enforcement has made a dramatic shift in its preference for administrative proceedings over civil injunctive actions.

Drawing such a conclusion would be highly misleading. In 2014, the total of 183 initial decisions included 119 decisions terminating the registration of public companies for failure to file periodic reports. One hundred thirteen of these proceedings were resolved by a default order, as the company failed to even make an appearance. The remaining 6 proceedings were resolved by the issuance of a summary judgment, signifying that the adjudication did not even include a hearing. The Division won all 119 proceedings.

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This dramatic increase could be interpreted as demonstrating that the Division of Enforcement has made a dramatic shift in its preference for administrative proceedings over civil injunctive actions.

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The 2014 total also included other largely pro forma proceedings. There were 44 “follow-on” administrative proceedings brought to bar persons or entities from registration as broker-dealers, investment advisers, or as associated persons, based upon the prior entry of a civil injunction or criminal conviction. Twenty-four of these proceedings resulted in default judgments and the remaining twenty were resolved on a summary judgment motion by the staff. None of the 44 involved a hearing. Eight more litigated proceedings were resolved by the entry of a default judgment³⁶ and two others were resolved by entry of a summary motion judgment.

Of the 183 initial decisions in 2014, a mere 11 should be considered as truly litigated proceedings. While the Division prevailed in all 11, in four proceedings the ALJ

ordered a sanction that was substantially less than what the Division sought.³⁷

While the analysis of initial decisions issued in recent years does not demonstrate that the administrative proceeding has supplanted the civil injunctive action as the primary venue to litigate complex cases, several proceedings initiated in recent years and the public statements of SEC officials provide ample evidence that a fundamental shift has occurred. Toward the end of last year, the Commission’s Enforcement Director, Andrew Ceresney, confirmed that the Enforcement Division had embarked upon a policy of recommending that the Commission make increased use of administrative proceedings. He explained that, due to the Dodd-Frank, the Commission can “obtain many—though not all—of the same remedies in administrative proceedings [against unregulated entities or individuals] as we could get in district court.”³⁸

An administrative proceeding brought in 2011 provides clear insight into how the forum choice could be used to favor the Enforcement staff. The proceeding was brought against Rajat Gupta,³⁹ one of the many cases instituted by the Commission involving the Galleon Management, LP insider trading ring.⁴⁰ Among other things, the Commission—in the 18 months prior to instituting its administrative action against Gupta, an individual not directly regulated by the SEC, for insider trading—had brought a series of related actions charging 21 individuals and 7 companies with Galleon-related insider trading. While many of these defendants were in fact subject to direct regulation by the Commission, the SEC instituted each of those in federal district court.⁴¹

In commencing its administrative proceeding against Gupta, the Commission did not articulate the basis for utilizing a different venue from that used for the 28 persons or entities that preceded him, an omission that seemingly influenced the district court and resulted in a ruling that Gupta’s complaint stated a justiciable claim that his constitutional rights may have been violated, a claim over which the district court ruled it had jurisdiction.⁴² Without providing an explanation for the rationale behind its decision to file the Gupta matter as an administrative proceeding, after the district court denied the SEC’s motion to dismiss the claims, the Commission agreed to withdraw its administrative action in return for Gupta’s agreement to withdraw his lawsuit claiming the administrative

proceeding violated his constitutional rights.⁴³ Thereafter, another judge in the same court held that the court lacked jurisdiction to consider similar claims.⁴⁴

Other litigated matters also provide support for the change. Prior to the Gupta matter, the SEC had never litigated insider trading cases before an administrative law judge. Even though Gupta was eventually tried in federal court, the Division has not stopped its use of administrative proceedings to litigate insider trading by persons not directly subject to its regulation. For example in 2015, the Division of Enforcement initiated an insider trading case as an administrative proceeding.⁴⁵ By bringing the matter as an AP, the staff eliminated the opportunity for the respondent to request a jury trial, an automatic right in a civil action that entails the possibility of a substantial monetary penalty. Of equal importance, the Commission sidestepped the possibility of a district judge applying the legal standard recently adopted by the Second Circuit Court of Appeals in a criminal insider trading prosecution.⁴⁶ When the respondent in this proceeding raised a constitutional challenge to the proceeding, the ALJ denied his motion.⁴⁷ Following the denial by the ALJ, the respondent filed a civil action in federal court seeking to enjoin the administrative proceeding on constitutional grounds. On June 8, 2015, a federal district judge issued a preliminary injunction, halting the administrative proceeding.⁴⁸

The preference for litigation of significant cases before administrative law judges has not been confined to insider trading violations. In December 2014, the staff initiated an AP based upon alleged market manipulations.⁴⁹

A principled policy on choice of forum is needed

Throughout its modern history, there has been criticism of the Commission's use of administrative proceedings to create regulatory policy outside of the notice and public comment process required under the Administrative Procedure Act. This has occurred most frequently through a negotiated settlement that results in an SEC administrative order that describes in detail the conduct that occurred and includes a legal analysis that is intended to provide guidance to others. Not infrequently this criticism has come from members of the Commission itself.⁵⁰ Recently it has also come from notable federal

jurists who have suggested that utilizing administrative proceedings to render significant legal decisions "hinders the balanced development of the securities laws."⁵¹

The use of AP orders to set out new regulatory standards or new interpretations of established regulatory policies is a long-standing debate, dating back more than 50 years to Cady Roberts.

The public statements concerning the increased use of administrative proceedings for litigated matters have raised the issue of how the decision on forum is made, and whether a public statement of policy is needed. In February 2015, Commissioner Michael Piwowar highlighted this question: "To avoid the perception that the Commission is taking its tougher cases to its in-house judges, and to ensure that all are treated fairly and equally, the Commission should set out and implement guidelines for determining which cases are brought in administrative proceedings and which in federal courts."⁵²

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In early May 2015, the Division of Enforcement posted on its page on the SEC website a document titled *Division of Enforcement Approach to Forum Selection in Contested Actions*.⁵³ As the title indicates, the document provides an explanation of the factors that the Division will consider when making a forum recommendation to the Commission. As it is a Division statement, it is not clear whether it has been reviewed by the Commission, and as such it should not be viewed as the indication of what factors the Commission itself will consider when a Division recommendation is submitted.

Four factors are identified and discussed:

- The availability of the desired claims, legal theories, and forms of relief in each forum (factor 1);
- Whether any charged party is a registered entity or an individual associated with a registered entity (factor 2);
- The cost-, resource-, and time-effectiveness of litigation for the Commission in each forum (factor 3); and
- Fair, consistent, and effective resolution of securities law issues and matters (factor 4).

Factor one acknowledges that certain causes of action are unique to each forum. For example, charges based upon a failure reasonably to supervise or based upon a theory of causing a violation can be brought only as an administrative proceeding. Liability based upon a controlling person theory, or charging someone as a relief defendant may be brought only in federal district court. A civil injunctive action is also necessary if the Commission is seeking emergency relief, such as an asset freeze, or document protection order (subpoena enforcement action), or a temporary restraining order or temporary injunction.⁵⁴

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The speed of the administrative proceedings process is largely a byproduct of two factors. One factor is the limited availability of pre-hearing discovery. The second factor is the time limits imposed by Commission rule on the length of the process.

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Factor two restates the long-standing use of the AP process for actions against registered entities and associated persons. As part of its explanation, it notes that revocation of registration for entities and associational suspension and bars for individuals require an administrative proceeding. The Division states that this makes the AP a more efficient forum. While this may be

true in theory, the fact that in 2014, ALJs issued 44 initial decisions based on so-called follow-on APs, in which the Division had already completed an injunctive action (or a criminal conviction had occurred), suggests that the relative efficiency of using only a single litigated AP is a recent discovery by the Division. The fact that the Division prevailed in all 44 proceedings, 24 by entry of a default and 20 by summary judgment, further suggests that the burden of a second proceeding may be small.

Factor three describes additional time and resource benefits that the staff derive from each type of forum, under certain circumstances. These time and resource considerations highlight the benefits exclusive to the Division. No recognition or consideration is given to the impact of the forum decision on the parties charged. In this respect, the policy is most troubling. While the apparent efficiency of an administrative proceeding may be a benefit to the Division, it may be a serious and inequitable impediment to the person charged. As a factual matter, the claimed rapidity of an administrative proceeding over a federal court action may also be incorrect.

The speed of the AP process is largely a byproduct of two factors. One factor is the limited availability of pre-hearing discovery. The second factor is the time limits imposed by Commission rule on the length of the process.

The lack of pre-hearing discovery adversely affects the respondent rather than the SEC staff. This is because the staff has been able to compile its evidentiary record, including sworn depositions, through its investigation process. In effect, the staff is able to conduct its pre-hearing discovery before beginning the proceeding. The respondents in an administrative proceeding have no comparable opportunity. While they may be provided with the staff's investigative record, this does not provide them with an opportunity to ask their own questions of witnesses or seek documentation to support their position. More important, they may have only a very short amount of time in which to review an investigative file, compiled over years of investigation and encompassing literally millions of pages of material. The unequal impact of this limitation is discussed further below, under the discussion of factor three.

The second factor, specific time deadlines, may not result in the level of efficiency that the Division suggests. The

Commission in 2003, in an effort to improve the chronic delays that were occurring in even routine APs, adopted guidelines for the timely completion of administrative proceedings.⁵⁵ The guidelines provide that when instituting an AP, the order instituting the proceeding will specify a maximum time period from the date the proceeding is instituted until an initial decision is entered, with 300 days being the longest time period permitted.

In the same release adopting these time limits, the Commission adopted a non-binding time frame for completion of its deliberations whenever an initial decision is appealed to the Commission. This is codified in the Rules of Practice as a non-binding guideline. It states “(iii) Ordinarily, a decision by the Commission with respect to an appeal from the initial decision of a hearing officer, a review of a determination by a self-regulatory organization, or a remand of a prior Commission decision by a court of appeals should be issued within seven months from the date the petition for review, application for review, or mandate of the court is filed, unless the Commission determines that the matter presents unusual complicating circumstances, in which case a decision by the Commission on the matter may be issued within 11 months from the date the petition for review, application for review, or mandate of the court is filed.”⁵⁶

When one considers the timeliness and efficiency of the administrative proceeding process compared with a federal civil action, one must factor in the delays that occur during the Commission’s review. This is because an ALJ initial decision is essentially a recommendation. It is not a final action until the Commission acts, either by conducting its de novo review and issuing its own opinion and decision or by issuing a finality order because the staff and the respondent have not appealed and the Commission has decided not to review the initial decision on its own motion.

Since adoption of the guidelines in 2003, the Commission’s ALJs have been exemplary in meeting the specified deadline. Unfortunately, the Commission has not achieved the same success in timely completion of its de novo review. Under rule 900, the Commission’s Secretary must publish semi-annually a report on compliance in meeting these time frames. The most recent report, issued on March 31, 2015, reveals that during the 18-month period (covering three

reports) from October 1, 2013, through March 31, 2015, the Commission issued 15 opinions (including opinions on appeals of SRO proceedings). Only two SEC opinions were issued within the guidelines period.⁵⁷ In the three report periods, the median disposition time for the issued opinions respectively was 399 days, 524 days, and 600 days. This time period is in addition to the time required by the ALJ to hold a hearing and issue an initial decision.

According to the most recent available statistics for federal district courts, in 2013, the median judicial disposition from filing through trial was 24 months.⁵⁸

Factoring in the extended time period for completion of the Commission’s review suggests that the overall period for completion of an administrative proceeding is likely slower than the time required to complete a trial in district court. A precise comparison is not possible as the Commission’s processing statistics for initial decisions include the large number of summary proceedings described previously.

Factor three also refers to the costs and benefits arising from the “additional time and types of pre-trial discovery available in federal court.” While the current AP rules may provide benefits to the staff in terms of resources, they affirmatively disadvantage the respondents in these proceedings. Commission rule 360 provides that “Under the 300-day timeline, the hearing officer shall issue an order providing that there shall be approximately 4 months from the order instituting the proceeding to the hearing, approximately 2 months for the parties to obtain the transcript and submit briefs, and approximately 4 months after briefing for the hearing officer to issue an initial decision.”⁵⁹

At the time they were adopted, the Division was not bringing complex matters administratively, and there was little experience with the explosion of electronic documents that is commonplace today. As such the time periods in Rule 360 never considered the possibility that litigants in some matters would be forced to review in four months literally millions of pages of documents turned over by the staff. Of course in 1994, when the Commission last completed a material update of its Rules of Practice, it also did not consider the possibility of complex litigation in an AP. This explains why the rules provide only the most limited forms of discovery and depositions for respondents.

The lack of adequate discovery opportunities and sufficient time to prepare for trials are serious disadvantages that raise fundamental issues as to the efficacy of bringing complex litigation under the existing Rules of Practice.

The fourth factor broadly raises these fundamental considerations of fairness and efficacy. The only aspects of it that are discussed in the Division's statements are the traditional statement concerning the superior expertise and experience of ALJs and the Commission, and the benefits that may come from having these experts be the first to examine and interpret the law, subject to appellate review.

Notably absent from this factor is the issue of the right to a jury trial. One of the core constitutional protections is the right of persons to demand a jury trial. The Supreme Court has held that a defendant is entitled to a jury every time the government demands a civil penalty. Various circuit courts of appeal have held in recent years that "penalties" include injunctions, professional bars, and other relief, not just monetary sanctions. Ironically, under the new forum choice process, instead of the defendant controlling the right to request a jury, through the choice of forum the government will have complete control over the right to a jury. If the Division believes a jury would be advantageous, then it can file in district court. If the Division prefers not to have a jury hear a case, then it can file an administrative proceeding. Of all the consequences of the choice of forum controversy, it is likely that most objective persons would view this usurpation of a defendant's right to request a jury as the most objectionable consequence.

Other fairness issues are also worthy of examination. As previously explained, the lack of time and lack of discovery options also raise serious fairness issues. In addition, one should be careful not to overstate the superior expertise that resides with the Commission's adjudicators. Under the procedure governing the appointment of ALJs, direct substantive expertise in the applicable law is a minor consideration. The dominating factor in the selection process is experience as an ALJ in the federal government. During the past 30 years, the SEC has not hired a single ALJ who had directly relevant experience or expertise related to the federal securities laws. While one may reasonably assume that each ALJ will, over time, acquire this expertise, currently only two of the six SEC ALJs have

been at the Commission for more than two years.⁶⁰

This lack of substantive experience is particularly relevant when one considers the different standard for appellate review of SEC opinions compared to federal district court decisions. In a well-publicized speech in 2014, Judge Jed Rakoff of the Southern District of New York explained the difference clearly:

This is because, at least in the case of administrative decisions that have been formally approved by the S.E.C., such decisions, though appealable to the federal courts of appeals, are presumed correct unless unreasonable. In other words, while the decisions of federal district courts on matters of law are subject to de novo review by the appellate courts, the law as determined by an administrative law judge in a formal administrative decision must be given deference by federal courts unless the decision is not within the range of reasonable interpretations.⁶¹

This limited standard of review applies even in matters in which the Commission interprets the law differently from judicial interpretation. The Second Circuit has held that SEC adjudications that subsequently reject pre-existing legal interpretations of the federal securities laws (articulated by the Second Circuit) are entitled to deference from reviewing courts in accordance with the principles set forth in *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837 (1984).⁶² This can be read as recognition that the Commission can re-litigate in an administrative forum judicially resolved issues with the substance of which it disagrees.

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Of all the consequences of the choice of forum controversy, it is likely that most objective persons would view this usurpation of a defendant's right to request a jury as the most objectionable consequence.

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The fact that the Commission *can* supersede a judicial holding with which it disagrees, however, is not the same as concluding that it *should* necessarily do so.

The Commission should resist utilizing its administrative forum for these purposes in the absence of compelling circumstances making such an effort an appropriate use of its Dodd-Frank-granted choice-of-forum capabilities.

Principles for determining the appropriate choice of forum

The fact that the staff views the administrative forum as being advantageous for litigation and the defense bar views it as disadvantageous suggests that the decision on choice of forum should not be made on the basis of calculating which forum provides an advantage to the Enforcement staff. A perception that the choice of forum is made for the benefit of the government can seriously jeopardize the reputation and credibility of the SEC. This in turn, can undermine its regulatory effectiveness and create distrust in the appellate courts when reviewing SEC final actions.

The Commission should proactively adopt a structure for making this decision that is based upon objective principles grounded in and consistent with its broad statutory mandate.

The Commissioners acting as a decisional body should not view their role in the same way as a litigator. The Commission has a responsibility to consider the broader statutory questions of what is “necessary and appropriate in the public interest for the protection of investors.” More broadly it must also adhere to its multiple statutory mandates to protect investors, promote capital formation, and ensure fair and orderly markets.

The Commission should proactively adopt a structure for making this decision that is based upon objective principles grounded in and consistent with its broad statutory mandate. It should also adopt a procedural mechanism to enable a possible respondent to challenge the application of these principles to a specific matter, in a way that is fair and that does not unduly delay the proceeding or impose awkward adjudicative duties on an

ALJ. Finally, as acknowledged by SEC General Counsel Small, changes should be made to the Commission’s rules governing administrative proceedings to provide respondents with an adequate opportunity for pre-trial discovery, including the use of pre-hearing depositions to balance out the staff’s use of subpoenas and depositions during the investigation stage. The Commission should also revise its time frame for completion of the proceeding that enables respondents and counsel to review and absorb the literally millions of pages of documents and testimony that were collected by staff in an investigation that took years.⁶³

RECOMMENDATION 1: The Commission should formally adopt, and uniformly apply, a policy that it will use administrative proceedings to adjudicate contested matters if:

- The proceeding is based upon well-established legal principles that have been adopted by Article III courts;
- The factual predicate for the alleged violations is substantially equivalent to those asserted and upheld in past enforcement actions; and
- The matter does not entail an extensive investigative record such that considerations of fairness warrant providing the respondent/defendant with adequate opportunity for pre-trial discovery and time within which to fully review the investigative record; or
- The staff is alleging a cause of action that may be brought only in an administrative proceeding, such as a stop order proceeding, a section 12(j) revocation proceeding, a license revocation or bar proceeding, or a rule 102(e) proceeding, or proceedings based upon a failure reasonably to supervise or causing a violation.

This recommendation proposes that the Commission adopt a policy to refrain from using its administrative forum as an avenue to adopt new interpretations of the federal securities laws or to apply existing interpretations to new or unique factual circumstances. Adoption of such a policy, facially, may appear to contradict the well-established principle that a federal regulatory agency is presumed to have technical expertise that makes it uniquely positioned to examine complex facts and apply the legal interpretive

positions that it has created.⁶⁴ However, when taken in conjunction with the next recommendation, it actually reflects the view that the expansion of the Commission's authority as it concerns persons or entities that it does not directly oversee should be exercised with restraint and respect for the traditional responsibilities of an independent federal judiciary.

The fundamental problem in the use of an administrative forum to break new ground is the inherent risk of an unchecked expansion of existing legal policy that is not adequately overseen by a truly impartial third-party judicial forum. As Judge Rakoff explained, utilizing administrative proceedings to render significant legal decisions "hinders the balanced development of the securities laws."⁶⁵ As discussed previously, this is in large measure a consequence of an appellate standard of review for Commission decisions rendered in its own administrative proceedings that is less hospitable to respondents than the standard that applies in federal district and appellate court proceedings.⁶⁶

The discretion provided to the SEC when interpreting its own statutes and regulations is even applied in cases in which the Commission adopts a legal position that is inconsistent with or directly contradicts existing appellate court rulings.⁶⁷ The fact that the Commission *can* supersede a judicial holding with which it disagrees, however, is not the same as concluding that it *should* necessarily do so. The Commission should resist utilizing its administrative forum for these purposes in the absence of compelling circumstances making such an effort an appropriate use of its Dodd-Frank-granted choice of forum capabilities.

The final portion of this recommendation requires the existence of certain types of enforcement actions that have always been conducted through an administrative proceeding. These categories of proceedings are not available in a civil injunctive action. As such the Division should be permitted to continue to bring administrative proceedings in these areas, even those involving untested legal standards or unique factual circumstances, as provided by law.⁶⁸ With respect to regulated entities and persons, the SEC's use of administrative proceedings to articulate important and novel legal principles, or elucidate others, has long been part of the Agency's history.⁶⁹

RECOMMENDATION 2: The Commission should create a procedure to enable respondents to challenge the choice of forum by filing a motion for change of forum with the Commission prior to institution of the proceeding (described in detail below). The separation of function doctrine should apply to Commission consideration of the motion.

When Congress expanded the scope of persons and entities that could be charged in an administrative proceeding and expanded the remedies available for sanctioning, it did not provide guidance to limit or structure the Commission's discretion in making this decision, other than through the broad policy framework that controls the application of the federal securities laws. The preceding recommendations offer a framework for making this decision. However, there is no existing procedure that provides affected persons or companies with an opportunity to challenge the Commission's exercise of its discretion.

An ALJ is not authorized to summarily dismiss a proceeding authorized by the Commission prior to completion of its hearing and adjudication. An ALJ also lacks the authority to act affirmatively on a motion to transfer the proceeding to an Article III court. While the federal judge in the Gupta matter issued a ruling that Gupta's complaint stated a justiciable claim over which the district court ruled it had jurisdiction, recent attempts by respondents to obtain relief from an Article III court have been unsuccessful.⁷⁰

Recognizing that Congress has provided broad discretion to the Commission to choose the forum, one must conclude that creation of a procedural opportunity for respondents to challenge the exercise of this discretion should be built around a request that the Commission itself reexamine its decision during a period after the authorization of the proceeding and prior to its assignment to an ALJ for hearing. The following is proposed:

- Immediately after a Commission vote to authorize an administrative proceeding and prior to publicly instituting the proceeding, the Division of Enforcement should notify named respondents and inform them that they may challenge the choice of forum by filing a motion for reconsideration of the forum decision within five business days of actual

notice, or for a mutually agreed longer period to facilitate settlement discussion.

- The motion for reconsideration must articulate why the decision on forum is inconsistent with the policies identified in Recommendation 1. The Division of Enforcement may respond to the motion no later than five business days after filing.
- The separation of functions doctrine for litigated administrative proceedings will apply to Commission consideration of the motion. The Adjudication Group within the Office of the General Counsel will have responsibility for reviewing the motion and response and submitting a recommendation to the Commission within 10 business days of filing the motion and response.
- If the Commission approves the motion, the Division and respondents will be notified. The Division may then submit a new recommendation to the Commission for authorization of a civil action.
- If the Commission, as an exercise of its discretion, declines to act on the motion, the respondents and the Division will be notified and the Division may file an order instituting proceedings.⁷¹

The factors identified above that should form the standards for choosing the appropriate forum are largely subjective. When does a matter raise new questions of law or unique factual predicates? When is a matter sufficiently complex that a respondent requires the full panoply of pre-trial discovery opportunities available in a federal proceeding? There is one additional factor that is not subject to interpretation and that is a cornerstone of the American judicial system. This is the right to a jury trial.

RECOMMENDATION 3: The Commission should adopt a policy that any party named in an administrative proceeding that desires a jury trial may file a notice to remove the proceeding to federal district court.

It is paradoxical that, under the Commission's current policy, the government controls the decision to have a jury trial. If the Commission's staff believes it is advantageous to have a jury, it controls that decision by having the Commission authorize a civil action. If the Commission's staff prefers not to have a jury, then it may choose an administrative proceeding.

The defendant, for whom the right to a jury is intended as protection against government overreaching, has no control over the exercise of this right. While there is jurisprudence that limits when a right to a jury exists, one would be hard pressed to argue that a proceeding that may result in multi-million dollar penalties and that may result in the loss of a profession or career is not sufficiently punitive as to entitle the defendant to the benefits of a jury.

For this reason, the Commission should acknowledge this basic principle and permit persons and entities seeking a jury trial to immediately have the case removed to a federal court, conditioned on timely filing of a notice of removal for a jury trial. This notice should be filed after a respondent has been informed that the Commission has authorized an administrative proceeding and prior to the Commission issuing an order instituting proceedings.⁷²

RECOMMENDATION 4: The Commission should review its Rules of Practice to give effect to its changed authority, its increased experience with the broader utilization of administrative proceedings, the substantial increase in the volume of investigation materials, and to ensure that the SEC's administrative forum is a fundamentally fair and impartial venue, especially for persons and entities not directly regulated by the SEC. Among other things, its rules should be revised to provide adequate opportunities for pre-trial discovery and depositions. Commission rules on completion of the initial decision should be amended to provide sufficient time for the expansion of pre-hearing process.

The most significant difference between an administrative proceeding and a civil action is in the area of pre-trial discovery. Through its investigation and the use of investigative subpoenas, the Commission's staff will have developed an extensive investigative record over a significant period of time, before instituting an enforcement action. The Division of Enforcement effectively has had extensive discovery. While the current Rules of Practice create a possibility for issuance of subpoenas by an ALJ, the rigorous deadlines for completion of a proceeding often result in ALJ reluctance to delay a hearing by approving the issuance of subpoenas. The disparity in discovery rules between Commission administrative proceedings and federal litigation is a sore point with SEC defense counsel.

The Commission's Rules of Practice have not been significantly amended since 1993. The comprehensive review at that time reflected the substantial changes in authority and sanctions contained in the Remedies Act. Since the new authority was in its infancy, there was limited experience to provide a benchmark. It was also not possible to anticipate the additional expansions affected by SOX and Dodd-Frank. As such the project was an effort to anticipate what would be needed to ensure that administrative proceedings would be conducted and adjudicated in a timely, fair, and impartial manner. It is fair to conclude that no member of the Task Force working on that project envisioned what the norm is more than 20 years later. For this reason, the Commission should update and review its Rules of Practice. This should not be a controversial recommendation, given that the current general counsel of the SEC has publicly suggested that it is time for a review.⁷³

A review of the Rules of Practice should also encompass a reexamination of the time deadlines for completion of a proceeding. When these guidelines were adopted in 2003, they responded to a long-standing problem at the SEC—the length of time required to complete the administrative hearing and subsequent Commission *de novo* review process. Based upon the data published quarterly by the SEC, the rules have been successful in improving the timeliness of the process. However, if changes are made in the pre-hearing discovery process, then changes must be made in the time guidelines to accommodate an effective pre-hearing process. An additional time period should be adopted for completion of the hearing and issuance of the initial decision in matters in which the staff has compiled an extensive investigative record, or in which it is clear that the respondent is entitled to adequate pre-trial discovery to ensure a fair and impartial proceeding.

To provide comparable opportunities, the Commission's Rules of Practice should be amended to permit limited use of written interrogatories⁷⁴ and requests for admissions.⁷⁵ The rules should also require all evidence introduced to be based on personal knowledge of the witness or the creator of the document, unless subject to specific exceptions to well-established evidentiary exclusion rules.⁷⁶

Strengthening the Wells Process

The Wells process has been a core element of the SEC Enforcement Program virtually since the creation of the Division of Enforcement. The SEC Enforcement Manual describes the process:

The Commission's Wells Rule:

Rule 5(c) of the SEC's Rules on Informal and Other Procedures states that "[p]ersons who become involved in . . . investigations may . . . submit a written statement to the Commission setting forth their interests and position in regard to the subject matter of the investigation." The rule further provides that, "[u]pon request, the staff, in its discretion, may advise such persons of the general nature of the investigation, including the indicated violations as they pertain to them, and the amount of time that may be available for preparing and submitting a statement prior to the presentation of a staff recommendation to the Commission for the commencement of an administrative or injunction proceeding." 17 C.F.R. Section 202.5(c).

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While the Wells process has been an integral part of the SEC investigation process for more than 40 years, it has changed over time, frequently through informal decisions by the Commission and staff that have not been reflected in the Commission's Rules on Informal Practice.

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The practice reflected in Rule 5(c) evolved from recommendations made by an advisory committee chaired by John Wells. The objective of the practice is, as the Commission stated in the original Wells Release, for the Commission "not only to be informed of the findings made by its staff but also, where practicable and appropriate, to have before it the position of persons under investigation at the time it is asked to consider enforcement action." (See Securities Act of 1933 Release No. 5310, "Procedures Relating to the Commencement of Enforcement

Proceedings and Termination of Staff Investigations.”) As the Commission stated in the Release, “[t]he Commission, however, is also conscious of its responsibility to protect the public interest. It cannot place itself in a position where, as a result of the establishment of formal procedural requirements, it would lose its ability to respond to violative activities in a timely fashion.” The Commission made clear in the Release that the practice is “informal” and involves the exercise of discretion by the staff.⁷⁷

While the Wells process has been an integral part of the SEC investigation process for more than 40 years, it has changed over time, frequently through informal decisions by the Commission and staff that have not been reflected in the Commission’s Rules on Informal Practice. For example, at one time during the early 1980s the Commission occasionally permitted defense counsel to make a direct oral presentation at a closed Commission meeting. Later in that decade, the Commission allowed persons to submit a videotaped Wells presentation. During the 1990s the Commission decided that written Wells submissions should be limited to 50 pages. The Enforcement Manual specifies that video submissions should be no longer than 12 minutes and written Wells papers should be no longer than 40 pages.⁷⁸

The formal Wells process has been informally augmented in two unwritten but well-established methods. One process is referred to as the “pre-Wells” submission, and the other is the “white paper” submission.⁷⁹

A pre-Wells notice and submission is just what it says. Under an informal agreement between enforcement staff and defense counsel, the staff often engages in substantive dialogue prior to giving a Wells Notice, providing an opportunity to submit a pre-Wells. In substance it is identical to a Wells submission. But because it is not called a formal Wells Notice, defendant companies may decide that it does not create a circumstance requiring a public disclosure obligation. Because the document is not formally a Wells submission, the staff believes that they are not required to submit the document to the Commission when a recommendation for action memorandum is submitted.

The white paper process is similar in many respects to the pre-Wells process. It represents an informal submission

by defense counsel. The difference is that the white paper process frequently focuses on a specific factual or legal question that is significant for the investigation. It is intended to facilitate the narrowing of a complex investigation by resolving specific issues or eliminating one or more potential defendants. During the course of one investigation it is possible that more than one white paper will be submitted. Persons interviewed endorsed the white paper process as an effective tool to resolve legal issues and, in the process, eliminate or narrow the legal questions posed in the investigation.

One other event has had a significant impact on the Wells process and the increasing preference for pre-Wells or white papers. The Dodd-Frank Act established a six-month time requirement from the date on which the Enforcement Staff provides a “written Wells notification to any person,” to file an action against that person, or provide notice to the Enforcement Division’s Director of the intent not to file an action.⁸⁰ The provision enables the Enforcement Division to obtain one or more extensions of this six-month period if an investigation is sufficiently complex (the first can be rendered by the Enforcement Division’s Director, and subsequent extensions must be granted by the Commission itself).⁸¹

Since the enactment of this provision, there is a strong consensus among practitioners that the Enforcement Division has made greater use of voluntary white paper submissions, which are treated by the Division as not being subject to the six-month time limit, since there is no definition of the term “Wells Notice” in either the Dodd-Frank or the Securities Exchange Act.⁸² It is unlikely there will be any immediate judicial determination whether a “white paper” is the equivalent of a “Wells Notice” for purposes of Dodd-Frank §929U, since the only court cases to address this provision have ruled that it is merely a guideline for internal SEC purposes and does not give rise to a right on the part of any person involved in an investigation to have an investigation concluded or to obtain an order barring the SEC from taking any action if the time limits set forth are not met.⁸³

During the course of our interviews with practitioners, we were alerted to one more highly significant, apparent change in the Wells process that has not been publicized

by the Commission and that is not even widely known by the defense bar, including persons who specialize in SEC enforcement matters. Since the institution of the “Wells Notice process” over 40 years ago, the Enforcement Division automatically has attached a copy of proposed defendant/respondent’s entire Wells submission to its action memorandum. Indeed, in announcing its implementation of the Wells Notice process, the Commission expressly noted that the written statement (the Wells submission or, presumably, a white paper) “would accompany the staff recommendation” recommending enforcement action to members of the Commission.⁸⁴

We understand that the process has changed. Today, apparently, a prospective defendant/respondent’s Wells submission is now made “available” to Commissioners via access to an electronic copy, but not actually “forwarded” to them in hard copy as an attachment to a hard copy of the Enforcement action memorandum. However, individual Commissioners are able to request copies or, alternatively, rely on the Enforcement Division staff’s summary of the substance of a Wells submission. In conducting this study we have not been able to obtain a clear answer to the question of whether pre-Wells submissions or white paper submissions are provided to the Commission, or if the Commissioners are even made aware of their existence.

The Wells process has worked well for more than 40 years. Its benefit has not been limited to informing the Commissioners of competing legal arguments or conflicts in the interpretation of factual events. The process has benefitted the Enforcement staff by providing them with a better understanding of the facts and law and an appreciation of issues that will be litigated if a settlement is not reached. Evidence of the impact of the process on the Division was obtained by the *Wall Street Journal* through a Freedom of Information Act (FOIA) request made in 2014. Using FOIA, the *Wall Street Journal* received access to otherwise unpublished data regarding the Enforcement Program for the two-fiscal-year period 2010–2012, and found that “159 of the 797 Wells Notices issued went nowhere or stalled”⁸⁵ As the *Journal* article noted, many informed observers (including former SEC Commissioner Grundfest) found these statistics on the effect of the Commission’s Wells Notice process unanticipated and that they demonstrated the Agency’s

ability to give credit to persuasive arguments against instituting specific enforcement actions.

Given the benefits to the Enforcement staff from reading a Wells submission, and recognizing the effort and expense that goes into preparation of a Wells submission or a white paper, it is important that these documents continue to be provided to the Commissioners as part of their deliberations on an Enforcement recommendation. In the event that the Commission, for good cause, determines that it will not revert to its published policy, it should publicly amend its rules on informal practice to conform to a new policy.⁸⁶ The Commission should also amend its informal rules to define the terms “pre-Wells submission” and “white paper” and establish the procedures for submission of these materials and articulate whether, and under what circumstances, these materials will be submitted to the Commission.

RECOMMENDATION 5: The Division should adopt a uniform policy that all Wells submissions will be provided to the Commission at the same time along with the action memorandum containing the recommendation for enforcement action.

In conjunction with the Division’s examination of the Wells process, two additional aspects should also be considered:

- Adoption of a uniform Division process on access to the investigation file; and
- Adoption of a reverse proffer procedure.

Adoption of a uniform Division process on access to the investigation file

The *Wall Street Journal* article data demonstrate the substantial value to the Commission, including its staff, of a carefully presented Wells paper. Of course the quality of the submission is inevitably tied to the level of knowledge that defense counsel has as to the facts in question and the evidence supporting the staff’s position. For this reason, the Commission and the defense bar mutually benefit when the staff provides access to its investigative record so it may be used in preparation of the Wells submission. The *Enforcement Manual* provides the

staff with discretion to provide access to non-privileged materials in the file: “On a case-by-case basis, the staff has discretion to allow the recipient of the notice to review portions of the investigative file that are not privileged.” The *Manual* identifies three factors to guide the decision: 1) whether access would be productive for assessing the strength of evidence; 2) whether the person has been cooperative in providing information; and 3) the stage of the investigation, specifically in terms of other persons’ testimony or the pendency of criminal investigations or prosecutions.⁸⁷

Several persons interviewed commented on the lack of consistency among staff and offices in providing access to the file and in deciding at what stage of the investigative process access may be provided. Others suggested that the trend in recent years has been away from providing access.

RECOMMENDATION 6: The Division should consistently provide access to its investigative files with adequate time to permit a meaningful response to a staff Wells Notice or request for a white paper by establishing a presumption in favor of granting access and requiring that a senior-level official review preliminary decisions to deny such access.

Adoption of a reverse proffer procedure

Recently, in a growing number of its investigations, the Enforcement Division has been providing defense counsel with presentations that lay out the nature of the Division’s cases, as well as the evidence supporting the charges. This presentation enables defense counsel to make a realistic assessment of the matter, so they may advise the client on whether or not to seek a proposed settlement and, if so, on what terms. These efforts have been dubbed “reverse proffers” by both the Division of Enforcement and the defense bar.⁸⁸ This commendable practice by a number of Division attorneys is not an entirely new phenomenon, having been the subject of recommendations in the Wells Committee Report.⁸⁹ However, the practice is apparently not universally followed within the Division,⁹⁰ nor is it necessarily applied in all similarly situated investigative matters.

We believe the staff’s utilization of this type of tool is constructive and a useful means of expediting resolution of a matter. The advantages to the Division are manifest—it

demonstrates the seriousness of the potential case, and it saves a great deal of unnecessary staff time devoted to filling in the interstices of its case outline, when that time could be better spent focusing on possible settlement options with defense counsel. It also enables defense counsel to inform and advise their clients and explain the reasons why extending the duration of a pending investigation is not in their clients’ best interests.

Even when “reverse proffers” do not promote settlements, they permit defense counsel to prepare well-focused white papers or Wells submissions and provide the staff with an advance look at the possible defenses that may be raised should enforcement proceedings become inevitable. In short, these proffers are a creative mechanism for the Division and defense counsel to cut through cumbersome investigative processes and come to a more efficient resolution of the matters that led to the investigation. While the Division should reserve the right to forgo this process in appropriate circumstances, we recommend that the process be added to the Commission’s codification of informal procedures, and that these proffers be made uniformly available across the entire spectrum of Division investigative efforts.

As part of the implementation of this process, we recommend that the Division’s *Enforcement Manual* be revised to provide that appropriate discovery of the Division’s investigative record will be provided to permit the preparation of a meaningful white paper or Wells submission.

RECOMMENDATION 7: The Division should formally adopt, and uniformly apply, a “reverse proffer” policy and provide potential defendants/respondents with a full presentation of the nature of its proposed case and the supporting evidence before commencing the Wells submission or white paper process.

Providing defense counsel and defendants with appropriate notice prior to commencing litigation

Historically, the overwhelming majority of SEC enforcement actions have been settled prior to filing. The staff typically provides defense counsel with advance notice of the date when the settled action will be filed. There is no comparable presumption for filing litigated actions. For some types of

cases, the lack of advance notice is understandable—for example, cases involving ongoing misconduct, cases seeking a freeze of assets, or instances in which the Commission is seeking a Temporary Restraining Order (TRO). These cases are the minority of SEC actions. As this report explains, the overwhelming majority of SEC actions are filed after extended investigations, extending over a year or more, following receipt of a Wells Notice and frequently after extended settlement negotiations. For these matters, selection of a date for filing is not an emergency decision and the fact of filing should not be a surprise. Nonetheless, interviewees in this study described staff occasionally or frequently (depending on the person interviewed) notifying a person or entity of the filing date mere hours or a day before the event. Such a process does not appear appropriate and does not enhance the Commission’s reputation for fairness.

RECOMMENDATION 8: The Division should adopt a policy that any party that has made a Wells submission or requested advance notice should be provided reasonable advance notice, such as three business days, that the staff will file an enforcement action.

Clarifying the SEC Policy on Admissions

From the earliest days of its existence until 2012, the SEC permitted defendants to settle proposed enforcement actions without either admitting or denying the allegations in the Commission’s charging documents. This policy was adopted for a very practical reason: It enabled the Commission to achieve its desired result quickly via a settled action, without the expenditure of limited resources needed for a trial, and without assuming the uncertainties that accompany a trial. Importantly, as a critical component of this policy, settling parties were required to agree that they would not make any public statements denying the allegations contained in the Commission order or Commission complaint.⁹¹ With very few exceptions,⁹² the SEC applied that policy across the spectrum of its enforcement cases.⁹³

In November 2011, Judge Rakoff in the Southern District of New York rejected a proposed Commission settlement with Citigroup and harshly criticized the Commission’s “neither admit nor deny” policy.⁹⁴ This criticism was subsequently echoed by other federal judges.⁹⁵

In January 2012, the SEC modified its long-standing settlement policy. Then SEC Enforcement Director Robert Khuzami announced that persons who were criminally convicted (or agreed to either non-prosecution or deferred-prosecution criminal agreements) would no longer be allowed to settle parallel or follow-on civil or administrative proceedings with the theretofore standard language of “without admitting or denying” the Commission’s allegations.⁹⁶

In 2013, during the pendency of the Commission’s appeal from Judge Rakoff’s decision, SEC Chair White told a gathering sponsored by the *Wall Street Journal* that the SEC would no longer adhere to a blanket policy permitting defendants to settle SEC cases without admitting to wrongdoing (Revised Admissions Policy).⁹⁷ Chair White told reporters that decisions—about whether to require admissions—would be made on a “case-by-case” basis,⁹⁸ but indicated that admissions would be required, potentially, in cases involving “widespread harm to investors,” “egregious intentional misconduct,” or obstruction of SEC investigations.⁹⁹ In her remarks she explained that the change in policy was not in response to Judge Rakoff’s action but rather an action predicated on accountability.¹⁰⁰

The question of whether to continue to settle cases on a “neither admit nor deny” basis is not new. It has been discussed informally by Commissioners and staff for decades.

A contemporaneous *internal* email to the Enforcement Division staff—reportedly given to several reporters, but not made available on the SEC’s website¹⁰¹—described cases that might warrant admissions as involving misconduct that harms large numbers of investors, placing investors or the market at risk of potentially serious harm, threatening serious risks by the defendants to the investing public, involving a defendant engaging in egregious intentional misconduct, or obstructing the Commission’s investigative processes.¹⁰²

In a subsequent speech, Chair White outlined the characteristics of cases likely to require admissions:

- Large number of investors harmed by the alleged misconduct;¹⁰³
- Egregious conduct, irrespective of the number of investors, if any, that were harmed;
- Conduct that posed a significant risk to the markets or investors;
- A need to assist investors in deciding whether to deal with a particular party in the future;¹⁰⁴ and
- Circumstances where the recitation of unambiguous facts would send an important message to the market about a particular case.¹⁰⁵

Not surprisingly, in the three years since this change in a foundational SEC policy was made, it has been controversial. Criticism of the policy, largely from the defense bar, has focused on four issues:

- Was the change warranted;
- Should the change have been made by a speech rather than through a formal statement of policy or rule;
- The lack of meaningful standards on when admissions will be required;
- Inconsistent and inappropriate application of the policy by Enforcement staff.

The question of whether to continue to settle cases on a “neither admit nor deny” basis is not new. It has been discussed informally by Commissioners and staff for decades. During the past two decades, we are aware of at least two Chairmen who specifically directed the Director of Enforcement and the General Counsel to examine the policy. In both instances, the Chairman was strongly advised to adhere to the long-standing policy. While Chair White stated that the principal rationale for the Revised Admissions Policy relates to “accountability,” the public perception is that it was a response to Judge Rakoff’s

criticism of the “neither admit nor deny” former settlement policy. In either case, the rapidity with which Director Khuzami and subsequently Chair White announced the policy, following closely on Judge Rakoff’s rebuke, suggests that the change was hurried and not carefully considered.

Not surprisingly, a number of interviewees questioned the wisdom of the Commission’s retention of the Revised Admissions Policy, in light of the reversal of the *Citigroup* district court decision refusing to approve the SEC’s proposed settlement. To the extent the Revised Admissions Policy was adopted as a response to Judge Rakoff’s decision, the changes in policy it affected would no longer seem to be required.

Regardless of the motivation for the new policy, in light of the Second Circuit’s reversal of the *Citigroup* case, we believe the Commission should review its Revised Admissions Policy. This reexamination of the policy should carefully assess the impact on settling parties of making the admissions. Did the admission have collateral consequences in private litigation? For regulated entities, did the admissions affect licensing decisions or ancillary business activities unrelated to the misconduct? Did the admissions have an impact in relation to other regulatory bodies (domestically and globally)?

The examination should also study the settlement policies and practices of other government agencies. For example, some persons commented that because the Commission’s policy prohibited settling parties from publicly disputing or denying the Commission’s description of the misconduct, it was actually more robust than other agencies that merely require a party to “consent” to the settlement.

The review of the policy should also consider the impact of the other change in Commission practice, the apparent shift of settled actions to administrative proceedings. Historically the “neither admit nor deny” language was used in civil consent agreements. Because a Commission administrative proceeding must be based upon a finding of violation or willful violation, settled administrative proceedings have always included language that states that the settling respondent “*consents, solely for the purpose of this proceeding or any other proceeding brought by or on behalf of the Commission to the entry of this order*

finding violations".¹⁰⁶ If AP settlements, which contain a finding of violation, become "the new normal," is there a meaningful policy reason to insist upon admissions in what may become a limited number of settled civil actions? A careful and studied examination of the policy should consider all of these questions.

RECOMMENDATION 9: The Commission should regularly review its policy requiring admissions in some enforcement actions to learn from its experience to date and consider the policies of other government agencies.

RECOMMENDATION 10: Following a careful examination, if the Commission determines that the admissions policy should be continued, a clear statement of the policy should be added to the Commission's Informal and Other Procedures.

It has been three years since the first public announcement of the Revised Admissions Policy. To date the Commission has not offered:

- A formal announcement of the Revised Policy, indicating full Commission support;
- A codification of its policy in the Commission's Informal and Other Procedures chapter of the Code of Federal Regulations; or
- A formal articulation of either the precise goals of the policy or how it will apply the policy to specific cases.

While we understand the Commission's need to retain a significant amount of discretion (both within the Enforcement Division and at the Commission level), to make case-by-case determinations of which settlements will require admissions, there still must be standards that will be applied by the Agency in making each determination, as a matter of pragmatic management, if for no other reason.

The use of speeches and other informal vehicles to announce policy has a long history at the SEC. In 2006, when the Commission articulated standards to govern when it would seek large money penalties from public corporations, it did so in a press release.¹⁰⁷ Nonetheless, we believe that even if the Commission does choose to announce policy changes by speech or interview, it

is important to follow up promptly with a more formal announcement of the policy and the rationale for it, as well as the criteria that will be employed in deciding whether and when to exercise its discretion vis-à-vis the new policy.

RECOMMENDATION 11: The codified guidance should articulate meaningful standards that provide guidance on when admissions will be required, promoting consistency in the exercise of the SEC's broad discretion. The policy should describe the level of detail used for admissions, including the description of the misconduct and the articulation of the statutory provisions or regulations that were violated to promote consistency within the Division. The purpose of these admissions statements should be to provide normative guidance to other persons or entities similarly situated.

Decisions that pertain to the settlement of enforcement actions necessarily must entail a significant amount of prosecutorial discretion. The question of when to require an admission is only one of a series of discretionary questions. Discretion must be applied to the decisions to open an investigation, on who should be charged, on what charges should be brought, on which forum the action should be brought in, and of course, on the type and extent of sanctions. The reality that discretion is an essential component of the process in part explains why the Commission continues to retain final authority on specific enforcement actions, while it has delegated comparable authority to other divisions on specific matters.

The use of speeches and other informal vehicles to announce policy has a long history at the SEC.

Because enforcement decisions are always, in large measure subjective conclusions, and because there will always be an effort by others to use them in future, often different circumstances, it is always difficult to create guidelines that are flexible while still providing useful benchmarks and limiting principles to discipline the exercise of judgment. The Commission's or the Division's

enunciation of a policy on the use of admissions is in many respects similar to past efforts at the SEC. As noted, the Commission in 2006 published a broad policy on the factors it would consider when determining whether to impose money penalties on public corporations. More recently, in 2011, Director Khuzami in Congressional testimony set forth a series of principles that would be used to identify national priority cases in order to better evaluate the performance of Enforcement staff.¹⁰⁸

A comparison of the statements of policy reveals the similarities in the factors that will be considered. This similarity should not be interpreted as meaning that the considerations are not germane. Rather it demonstrates that they are limited in their capacity to provide a structure or discipline to the process. For this reason, it is important that the Commission in constructing guidelines look carefully to the actual cases in which admissions have been required and use its experience to provide greater clarity.

RECOMMENDATION 12: The Commission should publish guidance on how the issue of requiring admissions will be incorporated into settlement negotiations.

The most troubling aspect of the experience with the admissions policy is not the rapidity with which it was adopted, or the use of speeches to announce the policy, or the limited guidance on when it would be applied. Based upon comments during the interview process, there appears to be a significant lack of consistency in how the staff is using the possibility of requiring admissions to influence the investigation process and the negotiation of a settlement.

One might reasonably assume that consideration of whether admissions are appropriate would be left to the very end of the investigation process, after the facts are fully apparent and the scope of the misconduct and culpability have been identified. Anecdotally this may not always be the case. In our interviews, we were told by a number of practitioners that, in some regional offices, since the announcement of the Revised Admissions Policy, staff have raised the issue of admissions at the outset of a number of investigative matters, frequently using the notion of compelling admissions as a response to requests to narrow the scope of document demands and other similar fundamental enforcement-related issues.

Similar inconsistencies occur during settlement negotiations. Director Ceresney has stated publicly that when staff concludes that a matter warrants admissions, they will not negotiate as to this decision. Anecdotally, persons interviewed described how the issue of an admission is one of the many issues that are part of the settlement negotiation process, with some staff agreeing to drop the requirement for an admission in exchange for a larger penalty.

Reducing Duplication in Regulatory Enforcement

RECOMMENDATION 13: The Commission should eliminate duplicative and overlapping enforcement responses, within the Commission and by multiple enforcement authorities, against the same individuals or entities for effectively the same misconduct. The Commission should take a leadership role among regulatory bodies at the federal, state, and international levels to reduce or eliminate duplicative and overlapping investigations and duplicative enforcement actions for the same conduct. A list of ideas on how unnecessary duplication could be reduced is contained in the body of this report.

Regulation of the financial markets in the United States has historically involved multiple entities, including multiple agencies at the federal level (the SEC, U.S. Commodity Futures Trading Commission, and the Department of Justice), multiple self-regulatory organizations, and at the state level, a state securities regulator and a state attorney general. For businesses engaged across the financial sector, prudential supervision can mean multiple examinations by more than one SEC regional office in addition to a designated SRO, and the multiple federal banking regulators. Globalization of the securities markets has added one more layer of foreign regulation for multinational companies.

When companies respond to allegations of improper activities, management's focus is necessarily diverted from the day-to-day running of its business. That is an ineluctable attribute of doing business in a regulated society. But, there should be some understanding on government's part that, in the current era, firms are frequently subject to multiple domestic and foreign regulators. Responding to multiple regulators with respect

to the same conduct or transaction is not, and should not be allowed to become, a regular attribute of doing business. It is counterproductive—and damaging to shareholders—to subject firms and individuals serially to multiple SEC inquiries or multiple regulators and self-regulators for the same alleged misconduct.

Regulatory duplication occurs on three different levels—duplicative or overlapping investigations and exams by different offices of the SEC; duplicative or overlapping efforts within the United States at the federal and state levels; and most recently duplicative or overlapping efforts internationally.

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Overlapping investigations and exams by more than one office of the SEC has been a recurring problem and complaint for years. In the early 1990s, two reorganizations occurred that were intended to improve the efficiency and consistency of the SEC regional offices and reduce or eliminate problems such as overlapping investigations and examinations. Managerial responsibility for all regional offices was transferred to the Division of Enforcement. Shortly thereafter Office of the Compliance, Inspections and Examination (OCIE) was created to improve national coordination of the examination program. While these changes provided some improvement on redundant processes, the substantial number of interviewees who raised duplication as a significant problem suggests that more work is needed.

There is a limit to what the Commission can accomplish with regard to duplication at the federal level, the federal and state levels, or the international level, given the sovereignty and/or independence of other enforcement authorities that can pursue the same (or similar) conduct that the

Commission can pursue. Even with respect to SROs, over whom the Commission exercises oversight review, there are limits to the Agency's ability to cabin all duplicative proceedings. However, the scope of the problem appears to be increasing. During our interviews, we learned from multiple interviewees of firms that were regulated by the SEC, FINRA, the Office of the Comptroller of the Currency, the Federal Reserve Board and the Consumer Financial Protection Bureau that they frequently experienced upward of 60 regulatory examinations each year.

SEC Chair Mary Jo White aptly described this problem last year, in a speech delivered at the New York City Bar Association's Third Annual White Collar Crime Institute:

[W]e regulators need to keep in mind the impact we have on those we regulate and ensure that our own respective interests do not lead to unjust, duplicative outcomes. Collectively, we should also try to avoid unnecessary competition among ourselves for cases and headlines.¹⁰⁹

The SEC Chair's recognition of this concern is a critical first step in the Commission's efforts to cabin the growth of what can only be deemed "duplicative enforcement creep." While the SEC has endeavored to work cooperatively with other enforcement authorities whose jurisdictions may overlap with the Commission's own, more concrete action could, and should, be undertaken, provided, of course, that the Commission's flexibility to deal with particular situations is not compromised.

Within the United States, the Commission should:

- Consider greater use of memoranda of understanding (MOU) with one or more other enforcement authorities to avoid "duplication of efforts, unnecessary burdens on businesses, and ensuring consistent enforcement" of securities-related requirements.¹¹⁰
- Seek to proceed jointly with other enforcement authorities at the early stages of an investigation.¹¹¹
- Coordinate non-cause examinations with other regulatory agencies and self-regulatory organizations.¹¹²

- Before commencing an enforcement action, contact other agencies to try to file a single action reflecting the common interest of multiple regulators.
- Consider standing down, or utilizing a deferred prosecution agreement, where effective action already has been taken (or commenced) by another enforcement authority.¹¹³
- Develop mutual coordination agreements with domestic enforcement authorities, and jointly pledge to eliminate, where appropriate, duplicative enforcement actions.
- Pursue special efforts to eliminate or diminish the extensive duplication of efforts that occurs on the part of state and local enforcement authorities.¹¹⁴

At the international level, the Commission has developed several creative approaches to promote international harmonization and coordination. It has made effective use of MOUs with other regulatory authorities for decades,¹¹⁵ has attempted to provide for “mutual recognition” of non-U.S. regulatory regimes deemed significantly comparable to U.S. regulation,¹¹⁶ and has promoted regulatory convergence on a broad array of topics.¹¹⁷

Negotiating revisions to its existing enforcement-related MOUs with other countries that reflect the Agency’s commitment to avoiding duplicative and burdensome enforcement for the same offenses against the same entity or individual, would go far toward making Chair White’s expressed goal—of avoiding duplication—a reality. Similarly, harmonizing common standards to avoid enforcement/regulatory arbitrage would be a positive step forward.

The Broken Windows Policy and the Need for Alternative Methods of Resolving Matters

The SEC currently endorses “Broken Windows” as a component of its Enforcement Program. In general terms, the “Broken Windows” policy presumes that aggressive action against infractions of all sizes, including minor infractions, sends a broad message that deters others from violating the law, including more serious misconduct.

In the world of securities regulation, crime prevention equates to effective regulation and compliance. Informal control mechanisms and community involvement are the equivalent of internal compliance departments and internal control systems. For the SEC, the application of the Broken Windows doctrine should be viewed as a reaffirmation that the agency is first and foremost a regulator, the maintainer of order in the securities markets, and secondarily a crime solver and enforcer.

Throughout its history the SEC has been forced to deal with constraints in budget, and pre-Remedies Act, SOX, and Dodd-Frank constraints in its legal authority. Rather than try to be the cop on every corner, the SEC stressed the importance of the quality of its cases over the quantity of its cases. It also used creative approaches to resolving problems in the securities markets that emphasized industry self-correction in lieu of formal punishment.

Consider these comments by SEC Chairman Harold Williams in 1979:

Our enforcement resources would be utterly inadequate to the task of policing all securities law violations which may take place. As a result, our enforcement activities are designed not only to correct specific wrongdoing, but also to alert the private sector as to the kinds of activities which we believe to be illegal. We also tend to be programmatic in our enforcement efforts, concentrating on a particular area of concern in order that the parameters of appropriate conduct in that area may be fleshed out. In this way, we hope to stimulate the private sector to self-police inappropriate conduct.¹¹⁸

Possibly the most successful use of industry self-disclosure and self-remediation occurred during the Watergate era. Unearthed during the Watergate investigation was the discovery that literally hundreds of public companies had made huge illegal payments (often disguised as consulting fees) to major politicians in the United States and around the world. Major public companies were involved (e.g., Gulf Oil, Lockheed Aviation, and Northrup Aviation), as were major public officials (including President Nixon; Senators Humphrey, Scott, and Jackson; and many others). The total number of companies involved was

nearly 500. Eventually the SEC would bring formal actions against 62 companies. However, more than 400 other companies avoided formal action by participating in a voluntary internal investigation, remediation, and a public disclosure program. If a company conducted an independent investigation of its questionable payments, supervised by its non-employee directors, and filed a detailed report of the investigation under Form 8-K, it could avoid further SEC action. In preparing its report, a company could meet with SEC staff from Enforcement and Corporation Finance and obtain informal private guidance on the disclosures that had to be made.

In past decades the Commission also issued carefully negotiated Reports of Investigations under section 21(a) to resolve matters without a formal finding of violation or sanction. Even earlier in its history, the Agency employed so-called desk injunctions to deal with minimal or negligent wrongful conduct, much like the intended substance of the Commission's Broken Windows program. With desk injunctions, individuals and entities agreed to certain restraints, effected changes in behavior, and made certain commitments—usually by undertakings. In return the Commission's staff exercised its discretion to forgo recommending formal enforcement proceedings. There was no publicity attached to these desk injunctions, unless the recipient of one breached his, her, or its commitments. More recently the Commission's Cooperation, Non-Prosecution, and Deferred Prosecution programs have also been creative initiatives to regulate the securities markets effectively using methods other than a formal enforcement action.

The OCIE inspection program has for years used “deficiency letters” to notify registered entities of minor deficiencies uncovered during an on-site inspection. Firms receiving a deficiency letter are expected to provide a response that explains how the deficiency will be resolved. Future on-site examinations are used to confirm that the problem has been remediated. Deficiency letters could be used productively in cases of minor infractions by entities, such as public corporations, that are not subject to OCIE on-site examinations.

This list of informal resolutions—desk injunctions, voluntary disclosure programs, deficiency letters, section 21(a) reports—are particularly appropriate in instances

where a limited or isolated infraction occurred in a large corporation, especially for corporations with effective and robust internal controls and compliance programs where those departments were instrumental in identifying the misconduct and timely reporting it to the Commission. In situations involving large organizations with robust compliance regimens, enforcement-related judgments should focus on whether the violations are systemic, or rather reflect a one-off type of occurrence, as the Commission itself has recognized.¹¹⁹ Assessing these situations is where the need for the Commission's exercise of discretion and judgment is greatest, and reliance on hard and fast rules is counterintuitive and non-productive.¹²⁰

We recognize that the major foundations of the Broken Windows program are publicizing the fact that the Commission will pursue big and small violations and eliminating the concept of a so-called *de minimis* exception to the institution of enforcement proceedings.¹²¹ However, the Commission will never have sufficient resources to pursue every infraction, large or small. Moreover, the allocation of resources to this approach will diminish the Commission's capacity to investigate and enforce major infractions. The solution must be the creative use of informal remedies, just as the Commission has done throughout its history. Empowering the Division to resolve minor infractions informally in ways that protect investors is consistent with the “Broken Windows” concept.

RECOMMENDATION 14: The Commission should incorporate into its Broken Windows policy the use of alternative case resolution methods to rapidly resolve minor, non-systemic infractions, and to encourage and reward effective internal compliance and systems of internal controls. Creative use of informal remedial actions, such as deficiency letters, desk injunctions, reports of investigations, and voluntary disclosure of internal investigations and remediation actions will enable the SEC to devote its limited resources to major instances of misconduct.

RECOMMENDATIONS ON COMMISSION OVERSIGHT OF THE ENFORCEMENT PROGRAM



Improving Commission Oversight

An objective examination of the SEC Enforcement Program during the past 25 years, since enactment of the Remedies Act, would quickly identify the fundamental trend of expansion—expansion in enforcement powers, coupled with the increasing sophistication and complexity of the capital markets in the United States, and the substantial, albeit not commensurate, increase in the number of staff assigned to the Enforcement Program.

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Historically, Commission oversight of the Enforcement Program has been conducted on a case-by-case basis, rather than through a broad programmatic process.

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Prior to the Remedies Act the Commission's authority, in either administrative or civil injunctive proceedings, was focused largely on remedial sanctions—an injunction as to future misconduct, associational bars or suspensions of persons in regulated activities, stop orders halting the sale of a security, and disgorgement of ill-gotten gains. Monetary penalties could be obtained only in cases of insider trading, and only since 1983.

The capital markets of 1990 were dramatically more sophisticated than a decade before, but still substantially less complex than a decade later. Automated trading was in its infancy. Derivatives were largely limited to exchange-traded products. Credit Default Swaps and other Over the Counter derivatives were limited and exotic. The private

144A style market had just begun and international global markets were still evolving. The massive enforcement frauds of the next two decades, financial frauds such as Enron and WorldCom, the dot.com bubble, the NASDAQ and NYSE price-fixing scandals, and the asset-backed sub-prime securities could not be anticipated.

In 1990, the Enforcement Program of the SEC (home office and regional enforcement staff) totaled approximately 700.¹²² In 2014, the Enforcement Program had grown to 1,373 staff.¹²³

These dramatic increases in the size of the program, its responsibilities, and its powers and of the capital markets that it polices have been accompanied by a significant decrease in the level of Commission oversight of the Enforcement Program. The SEC Enforcement Program is bigger, it has more powerful weapons, and it has greater autonomy in how it uses its powers.

Historically, Commission oversight of the Enforcement Program has been conducted on a case-by-case basis, rather than through a broad programmatic process. Commission oversight was exercised by direct action on each specific matter investigated by the staff. At one time, this entailed a specific Commission vote at multiple stages in the process. The Commission voted at the investigative stage to authorize issuance of a formal order of investigation. Following completion of the investigation, it would vote to authorize a formal enforcement proceeding, whether administrative or civil injunctive (or to formally refer a matter to the criminal authorities). Finally if a settlement was negotiated, it would vote to approve the settlement. During the past 25 years, this multi-stage oversight process has been curtailed.

The delegation of authority for authorization of formal orders of investigation effectively eliminated the Commission's involvement at the outset of an investigation.¹²⁴ The principal benefit of Commission action at the formal order stage was not based upon an assessment of whether there was a sufficient basis for a staff investigation. Rather, it was the opportunity for the Commission to assess whether the matter was an appropriate use of resources and consistent with programmatic priorities before the expenditure of any meaningful staff time.¹²⁵

When the Commission delegated to the staff the authority to provide access to investigative files to other law enforcement agencies, it eliminated the Commission's capacity to determine which matters should be criminal referrals. Instead of a Commission vote to refer a matter for criminal action, the staff through its delegated authority could make a criminal referral by providing access to the investigative record.

Although a substantial portion of the Commission's weekly workload historically has been devoted to approving specific enforcement matters submitted by the Enforcement Division staff, the Commissioners' responsibility to provide direction to, set policy choices for, and oversee the performance of, the Agency's Enforcement Program is effectively limited to the "back end" of the Enforcement process. Even this case-specific oversight has limited impact. The practice of staff negotiation of a settlement prior to Commission authorization of an action substantially diminishes the Commission's capacity to influence the outcome of a specific matter. At that juncture, Commissioners are confined to deciding whether to bring the recommended action (or some variation thereof), usually entailing an analysis of the statutory and precedential support for the proposed action, and the adequacy of the sanction that has been negotiated. As a practical matter, it is too late for Commissioners to consider whether the staff's completed investigation and case resolution reflects a good—much less the best—utilization of staff resources.¹²⁶ After the expenditure of the considerable staff efforts that precede most recommendations for enforcement action, it becomes effectively impossible for Commissioners to vote against an enforcement action solely on the ground that there were more pressing problems that should have been the staff's major focus.

Given the size and number of discrete enforcement actions every year and the competing regulatory demands on the time of each Commissioner, it is not realistic to believe that the micro-level case-specific approach to oversight can be resurrected and provide a meaningful result. Instead the time has come for the Commission to shift to a macro-level oversight process that focuses on identifying broad priorities, reviewing whether the investigation process is sufficiently directed to these priorities, periodically monitoring whether the program is operating efficiently and effectively, and finally providing retroactive assessment of program successes and failures so as to inform and guide future activities. Creation of such a process would be a major change in agency management and operations.

Macro-level Commission oversight of the overall Enforcement Program, in terms of priorities and areas of emphasis, allocation of resources, and periodic assessment of effectiveness has traditionally been extremely limited. While the Agency's Chair, as the chief executive of the SEC, can use the power to assign personnel and resources to set programmatic policies, agendas, and similar matters,¹²⁷ the many time-consuming demands of the position, and the reality that responding to short-term crises always takes precedence over long-term planning, make the SEC Chair the person least likely to have time available for broad strategic planning.

Creating an effective macro-level oversight process requires two components. There must be systematic collection of quantitative and qualitative information on the program operations. This must be conducted by staff with the appropriate skill sets for collection and analysis of these data. Second there must be a regular periodic process for presenting this information to the Commission in a manner that provides them with a meaningful, not a pro forma, opportunity to provide input and direction.

Establishing a useful data collection and analysis process

One of the recurring criticisms of the SEC is that it is not a "data-driven" organization. This is not surprising, given its history as an agency dominated by attorneys. During the past five years, the SEC has made a concerted and genuine effort to increase its capacity for quantitative analysis of issues, primarily in the area of regulatory

policy. While the Division of Enforcement has substantially increased its IT capacity and its ability to do quantitative analysis, the focus has been on using this to conduct market surveillance and identify specific misconduct. Statistical data used to measure operations continue to be at the most basic level—counting the number of investigations opened and closed, the number of enforcement actions brought, the amount of money penalties assessed and collected. As many have pointed out, these measures reveal little about program efficiency or effectiveness, and may in fact distort staff incentives to pursue the wrong types of cases and conduct the wrong investigations.¹²⁸

Even the statistics collected by the Division, such as the average time from investigation to filing an enforcement action, that are published annually by the SEC are of limited use as they combine into a single average a wide range of different types of investigations. For example, an insider trading investigation originating from suspicious international trading in options must be completed in a few days because of the need to file an emergency action so as to freeze assets. Or an administrative proceeding to terminate a company's registration due to a failure to file periodic reports may require only weeks or months to complete. At the opposite end of the spectrum, an investigation into an accounting fraud may typically require years of investigation. Taking an average of such a diverse array of investigations reveals little of value. The data may be of even less use, if they include only investigations that led to a formal enforcement action and omit investigations that have been closed without action.¹²⁹

To remedy these problems, the Commission should enlist the expertise of staff in its Division of Economic and Risk Analysis (DERA) to develop statistical techniques and analytic methods to improve the quantitative oversight of its Enforcement Program. While the Division of Enforcement would continue to have responsibility for the collection of data and reporting to the Commission, DERA would be charged with developing the metrics used and engaging in the quantitative analysis that is uniquely within their area of expertise. In addition to collecting data for internal use, much of the information collected could be published to inform the interested public and regulated industry on the operations of the Enforcement Program.

RECOMMENDATION 15: The Division of Enforcement should submit a quarterly management report to the Commission containing productivity and efficiency metrics developed by the Division of Economic and Risk Analysis.

Periodic strategic Commission oversight

On a number of occasions, the Commission has undertaken to schedule occasional staff briefings focused on broad program objectives rather than discrete activities. Typically these initiatives have not been institutionalized. In large measure, briefings have not been regular because they accomplished little. In part, this has been due to concerns that the government in the Sunshine Act limits the Commissioners to a passive role, as collective action to direct the staff might violate the prohibition on non-public meetings resulting in joint deliberation to conduct agency activities. In part, the limited utility of the briefings has been due to the lack of a directed agenda that enabled Commissioners individually or collectively to engage in constructive dialogue. The staff presented too much detail on too many activities, precluding meaningful dialogue on what is most important.

Both of these concerns could be addressed if the Commission scheduled oversight meetings that had a defined agenda focused on four areas. The following is suggested as a framework agenda:

- Report on significant “National Priority” investigations
- Report on investigations raising novel or complex legal questions
- Report on the oldest active investigations
- Report on litigation that resulted in losses
- Report on new or emerging areas warranting investigation

The quarterly briefing would be scheduled after distribution of the quarterly briefing memorandum from DERA. Staff from the Division of Enforcement, DERA, and Office of General Counsel would participate in the discussion. Following completion of the discussion, the Commission would have the discretion to determine whether formal

Commission direction would be provided in each subject area or if the Commission would defer to the staff on how to proceed regarding specific investigations.

RECOMMENDATION 16: The Commission should receive quarterly oversight briefings on the Enforcement Program. The briefings should focus on investigations in these areas:

- Significant “National Priority” investigations;
- Investigations raising novel or complex legal questions;
- Oldest active investigations;
- Post-mortem analysis of litigated decisions not in favor of the SEC; and
- New or emerging areas warranting investigation.

Improving Transparency and Public Dialogue

Enforcement settlements that create regulatory policy

The federal securities laws, and the Commission’s rules thereunder, have grown increasingly complex over the 80-plus years of the Agency’s existence.¹³⁰ It is extremely challenging for even the most determined and conscientious entities or individuals subject to the SEC’s jurisdiction to keep up with the plethora of new rules that emanate from the Agency regularly. Recognizing this axiomatic fact of life, in the 1977 Major Issues Conference, the Commission was advised that it:

- Had not always demonstrated its awareness that individual enforcement actions can involve the creation of new policies, “even when not so expressed”;
- Reacts too often to problems, rather than anticipating them;
- Often relies too heavily on an *ad hoc* approach for the effectuation of policy; and
- In a number of areas where it had been needed, the SEC has not articulated policy in advance of the application of those policies.¹³¹

The importance of the SEC’s Enforcement Program cannot be overstated. Nevertheless, almost all persons we interviewed expressed varying degrees of concern about using the Enforcement Program as a substitute for carefully considered guidance issued *in advance of* formal enforcement proceedings. As the SEC and its individual members have frequently recognized,¹³² the SEC has a tripartite mission—protecting investors, ensuring fair and orderly markets, and facilitating capital formation. This means the Commission is a *regulatory* agency at heart, charged with regulating the Country’s capital markets, and has been vested with powerful enforcement abilities to ensure that its regulatory mandates are honored.¹³³

While agencies must be prepared to, and should, take effective enforcement action in the face of violations, if enforcement actions are the primary tool by which regulatory policy is developed and put into effect, the significance and impact of enforcement actions will decrease. Moreover, increasing reliance on individual enforcement cases effectively squanders the Commission’s available assets to secure increased protection of investors through enhanced regulatory compliance.

RECOMMENDATION 17: The Commission should periodically alert those subject to the Agency’s regulations of emerging trends. New standards, or new interpretations of existing standards, should be addressed through Agency rulemaking or formal interpretive guidance, not through negotiated settled enforcement proceedings.

Annual interpretive release and roundtable on enforcement

Just as the SEC and its Enforcement Program would benefit if the five Commissioners, as a group, convened regularly to consider the overall themes, policy choices, resource allocations, and priorities of the Agency’s Enforcement Program, the same is also true for the views of knowledgeable members of the public, including former Enforcement Division staff, former Commissioners, and former Senior Agency Officials that served in divisions other than the Enforcement Division.

The absence of a carefully constructed methodology to provide persons outside the Agency with an opportunity

to offer constructive commentary on *general* attributes of the Enforcement Program, effectively relegating the private sector to commenting on *specific* SEC Enforcement actions *after the fact*. This is of limited utility to the Commission (since those actions are pending or else have already been resolved). Frequently it results in negative commentary due to the absence of a complete understanding of the rationale for the action.

The SEC, the regulated industry, and the investing public would all benefit from a regular public dialogue between those who make decisions to bring enforcement actions, and those who either may be the subjects of enforcement actions or must respond to them. Equally important, it would provide a way for those outside the Agency to gain a better understanding of the difficult decisions the Commission often must make in deciding which cases to bring, against whom, and on what theories, as well as understanding the rationale behind decisions.

To effectuate this dialogue, the Commission could annually publish for comment a detailed report on the activities of the Enforcement Division. The report would describe the most significant actions brought during the preceding year, discuss the status of its investigative operations, in terms of priority subject areas and areas of greatest effort, and highlight significant legal or policy questions that arose. In conjunction with the publication of the report, the Commission would host a one- or two-day public roundtable at which members of the Commission and its staff would discuss informally the contents of the report as well as significant relevant issues proposed by the roundtable participants. Members of the general public and industry would be invited to submit public comments or raise issues for discussion before the meeting and for a brief period after the roundtable.

RECOMMENDATION 18: The Commission should publish annually a report on its Enforcement Program, provide a public comment period on relevant issues and conduct an annual public roundtable to discuss the report and the operations of its Enforcement Program.

Publishing generic reports of the results of its programmatic reviews would assist the Commission in several ways—it would allow the Agency to make known and promote its policy choices, explain its rationale, and

avoid confusion on the part of those outside the Agency as to the motivation for specific policy decisions.

Indeed, it is a staple of the Agency's rules, and its guidance about those rules to those it regulates, in a variety of contexts, that those subject to the federal securities laws (and the SEC's regulations) should perform at least an annual review of their existing policies and procedures to :

- Implement various requirements;
- Ensure that those policies and procedures are up-to-date; and
- Confirm that they reflect the best learning based on Commission initiatives and judicial decisions.¹³⁴

The Commission would benefit from following its own well-established regulatory requirement of annual reviews and updates—required to be utilized by those the Agency regulates—in connection with its own Enforcement Program. This approach would also prevent the Commission from addressing enforcement issues solely from a reactive frame of reference. Perhaps as important, it would satisfy the Agency's obligations under the Government Performance and Results Act of 1993 (GPRA), as recently amended.¹³⁵

Commission press releases and publicity of enforcement actions

An important component of the Enforcement Program is its method of ensuring that those required to comply with the statutes and rules the Agency administers are aware of current enforcement initiatives that may also affect their business conduct. By publicizing the specifics of conduct that has required the initiation of enforcement proceedings (as well as the resolution thereof), the Commission alerts the public to the kinds of activities that will provoke enforcement proceedings. Additionally, that publicity may stimulate better compliance on the part of far more individuals and entities than the litigation itself.¹³⁶

Moreover, press releases can notify individuals who are currently dealing, or might inadvertently begin to deal, with persons/entities that have been charged with serious misconduct by the Commission. It is also true that those who

were victimized by defendants/respondents in Commission enforcement actions may have legal rights, and the Commission's publication of its charges aptly alerts potential victims to consider and pursue any remedies they may have.

As a result, it is inevitable—not to mention a likely legal obligation—that the Commission will (and should) continue to issue press releases announcing the institution of enforcement proceedings, as well as settlements of anticipated or actual proceedings, and the resolution of litigated enforcement proceedings.

That said, however, fundamental ethical obligations require all attorneys to refrain from making any extrajudicial commentary about a case being litigated (or about to be litigated) that might prejudice those defending themselves in a judicial or administrative proceeding.¹³⁷ Concerns have been raised publicly by some observers about the accuracy or fairness of certain Commission litigation-related press releases,¹³⁸ and those concerns were echoed by a number of the interviewees with whom we met.¹³⁹

The challenge for the SEC is to meet its legal responsibilities to notify the public of its actions and, at the same time, recognize its ethical and legal responsibilities to accurately and fairly describe these actions without making extrajudicial statements that prejudice the capacity of a defendant to fully defend their conduct. The challenge of balancing these interests is not unique to the SEC. It applies to any government agency that has the responsibility of enforcing the law. The American Bar Association (ABA) has published guidelines in its Model Rules of Professional Conduct (ABA Model Rules) for balancing these responsibilities.¹⁴⁰

Rule 3.6 Trial Publicity:

- (a) A lawyer who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that the lawyer knows or reasonably should know will be disseminated by means of public communication and will have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.
- (b) Notwithstanding paragraph (a), a lawyer may state:
 - (1) the claim, offense or defense involved and,

except when prohibited by law, the identity of the persons involved;

- (2) information contained in a public record;
- (3) that an investigation of a matter is in progress;
- (4) the scheduling or result of any step in litigation;
- (5) a request for assistance in obtaining evidence and information necessary thereto;
- (6) a warning of danger concerning the behavior of a person involved, when there is reason to believe that there exists the likelihood of substantial harm to an individual or to the public interest.

Rule 3.8 Special Responsibilities of a Prosecutor:

The prosecutor in a criminal case shall: ... (f) except for statements that are necessary to inform the public of the nature and extent of the prosecutor's action and that serve a legitimate law enforcement purpose, refrain from making extrajudicial comments that have a substantial likelihood of heightening public condemnation of the accused and exercise reasonable care to prevent investigators, law enforcement personnel, employees or other persons assisting or associated with the prosecutor in a criminal case from making an extrajudicial statement that the prosecutor would be prohibited from making under Rule 3.6 or this Rule.

While Rule 3.8 is written as guidance for a criminal prosecutor, the policies implicit in its language are relevant for the type of law enforcement actions brought by the Division of Enforcement.

RECOMMENDATION 19: In the interest of maintaining the highest levels of integrity and fairness, Commission staff should adhere to the American Bar Association Model Rules of Professional Conduct (on Trial Publicity Rules 3.6 and 3.8) when drafting litigation and press releases. To ensure conformity with these standards and consistency within the Division, all litigation-related press releases should be reviewed pre-release by personnel outside the Division of Enforcement. Releases concerning litigated actions should state explicitly that the description of events represents allegations that must be proven. In settled cases the Enforcement Division should provide counsel for settling parties an advance opportunity to review the proposed Litigation Release or press release solely as to accuracy and fairness.



RECOMMENDATIONS TO IMPROVE THE EFFICIENCY AND EFFECTIVENESS OF THE SEC INVESTIGATION PROCESS

Streamlining the SEC Investigation Process

More SEC staff work on enforcement investigations than any other program or function at the SEC. According to the Fiscal Year 2015 SEC Annual Budget submission, in FY2014 approximately one-third of all SEC staff work in the Enforcement Program. Enforcement staffing is roughly 40% larger than the inspection program (OCIE) and almost 300% larger than the Division of Corporation Finance.¹⁴¹ In FY2014, the SEC opened 995 informal investigations and 576 formal investigations.¹⁴² While many, if not most, formal investigations begin as informal investigations,¹⁴³ some number of formal investigations did not.¹⁴⁴ In addition to the new investigations opened each year, there are always a substantial number of ongoing investigations that were opened in the previous year or earlier. As of September 30, 2014, the Division had 1,612 open investigations (including those opened during the year).

It is paradoxical that the largest program at the SEC has traditionally been the program for which the SEC provides the most limited productivity information. It publishes annual statistics on the number of investigations opened, closed, and ongoing, and it discloses the percentage of actions that were filed within two years of opening an investigation.

There are very few other sources of information on the investigation process. Standard practice at the SEC is not to disclose the existence of individual investigations (formal and informal).¹⁴⁵ Public corporations that are the subject of an informal investigation frequently do not disclose information on an informal matter, taking the position that it is not “material information” until it becomes a formal investigation, or until the company is advised by SEC staff that they intend to recommend an enforcement action. Occasionally, a corporation may disclose the closure of an

investigation in a periodic filing. Sometimes a corporation’s financial statement will contain a footnote containing the legal or other expenses it incurred due to the investigation.

In an effort to learn more about this important aspect of the SEC Enforcement Program, CCMC asked FTI Consulting to conduct a survey of general counsels and executives in public U.S. companies concerning their experience, if any, with an SEC investigation within the past five years.

The FTI survey provides important information about all aspects of the SEC Enforcement Program. It documents the costs to companies charged with a violation. It documents the considerable size and scope of the typical investigation, involving subpoenas for literally millions of pages of documents extending over several years. It documents the length of time of a typical investigation. And it documents the diversion of management’s time and the time of the corporate board away from company operations. Most important, this survey provides important information on the size, scope, and impact of SEC investigations that are closed with no action taken.

The information collected by the FTI survey provides strong corroboration for the information and opinions collected during the 30 interviews conducted for this study. Together they illuminate aspects of the current investigation process that warrant serious consideration by the SEC and topics that are addressed in the recommendations that follow.

The investigation process is long and time-consuming

In its FY2015 Budget Submission, the SEC included, as one of its performance goals, an objective of filing 65% of its enforcement cases within two years of the start of an investigation. It reported that in FY2012, 63% of

enforcement cases were filed within two years. This means that almost 40% of its cases were filed more than two years after beginning an investigation.

This statistic likely understates the length of a typical investigation. Because it measures the time between the opening of an investigation and the date an action is filed, it excludes from the calculation all investigations that do not result in a formal action. A quick comparison of the number of open investigations (1,612 in 2014) with the number of cases filed (675, with multiple cases often coming out of a single investigation, including investigations opened in previous years), highlights the very large number of investigations that are excluded from the calculation. The average time is further distorted by the different characteristics of different types of investigations. For example, in 2014 107 of the 675 enforcement actions were delinquent filing proceedings. In most cases, the investigation of these matters can be completed in weeks or a few months. Incorporating them into an average will likely substantially reduce the average time.

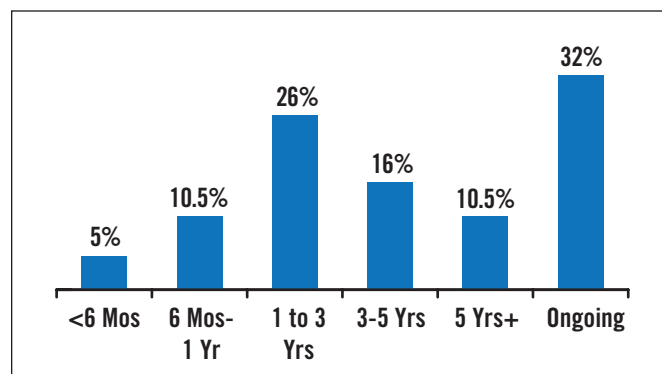
Respondents to the FTI survey describe an investigative process that is lengthy. While there is an internal time limit on the length of a matter of investigation, no such time limit exists for informal investigations. Not surprisingly, informal investigations may remain open for long periods before being closed, becoming formal investigations or becoming the subject of an enforcement action. Fourteen of 49 respondents¹⁴⁶ reported that an informal investigation closed or was converted in less than six months, and an additional 11 respondents reported the time lapse as between six months and one year. Conversely, 11 responses reported that the informal investigation continued for one to three years and four more reported three to five years.

While the length of time of an informal investigation is significant, it is actually shorter than the time consumed by a formal investigation.

A formal investigation is frequently lengthier than an informal investigation, notwithstanding that some formal investigations are preceded by an informal investigation. Of 19 responses,¹⁴⁷ only three reported a time period of less than one year, from first contact to resolution. Five responses reported a one- to

three-year period, three in the three- to five-year period and two reported more than five years from start to finish.

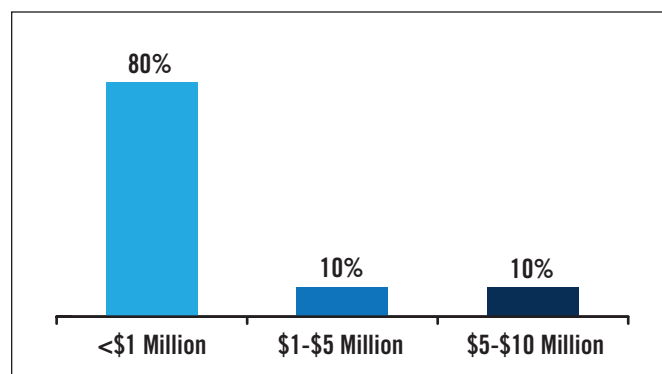
Reported length of time—Formal investigations



The cost of an informal investigation is significant for the company under investigation

The FTI survey requested information on the direct costs to a company at the informal and formal investigation stages. Even though the overwhelming majority of responses indicated that informal investigations did not result in enforcement action, the direct costs for some companies of this stage was significant. While 39 of 49 responses reported costs under \$1 million, five companies reported costs of \$1–\$5 million and five companies reported costs exceeding \$5 million.¹⁴⁸ Typically, the cost of outside legal counsel was the most significant cost, on average \$518,080. The average cost of external accountants and other non-legal professional staff averaged \$127,098.¹⁴⁹

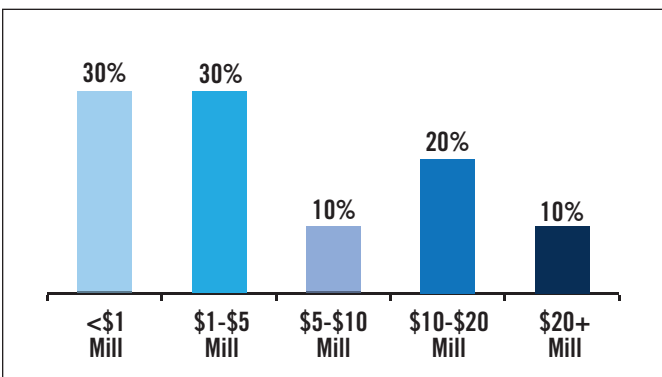
Average costs for responding to an informal investigation



The cost of a formal investigation is significantly greater

FTI received 24 responses to its question on the costs associated with a formal investigation. Not surprisingly, the cost of responding to a formal investigation is substantially greater than the costs associated with an informal investigation.¹⁵⁰ The average cost of external legal counsel at the formal investigation stage, \$3,358,750, was almost six times greater than at the informal stage.¹⁵¹ The second-largest cost for companies was computer programming or processing, \$399,701. This is consistent with the fact that at the formal order stage, the staff may issue subpoenas for substantial quantities of documents, electronic data, and computer hardware. Other direct costs, including company staff time, to companies averaged \$385,833. The costs of external accountants and other non-legal professionals averaged \$305,416. The provision of materials (such as duplication costs) averaged \$117,625. It is not surprising that 20% of companies reported total costs of \$10–20 million and an additional 10% reported costs exceeding \$20 million.¹⁵²

Average costs for responding to a formal investigation

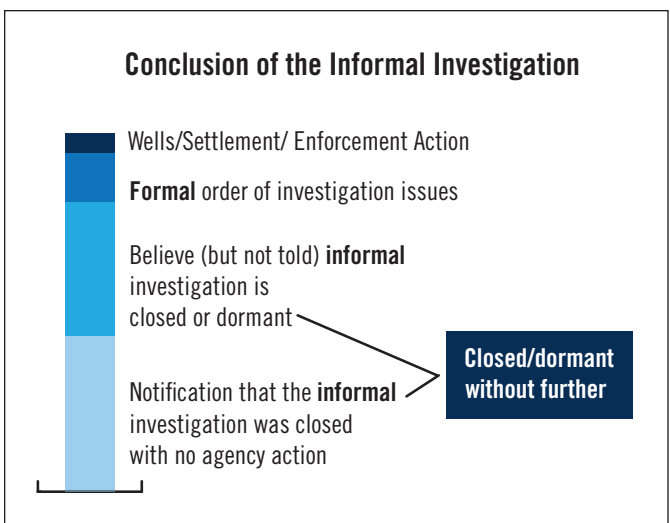


A significant proportion of SEC investigations are closed without action

Because the SEC publishes only limited information on its investigation program, it has been difficult to quantify the number of investigations that are closed without action, the size and scope of these investigations, the length of time between beginning and closure, or the ultimate impact on corporations that in the end are not charged with misconduct. As noted previously, the number of investigations that are closed without enforcement action

is substantial. This is demonstrated by comparing the number of open investigations (1,612 in 2014) with the number of cases filed (675, with multiple cases often coming out of a single investigation that may have been opened in a prior year). One can plausibly infer from these data that probably two-thirds of all investigations are closed without action. The FTI survey provides evidence that the percentage is likely to be greater.

The FTI survey found that a substantial proportion of investigations do not result in an enforcement action. Based on the 68 companies that responded to the FTI survey who had experience with an informal investigation, 74% of these informal investigations did not even proceed to the formal investigation stage.¹⁵³



FTI survey responses concerning the outcome of formal investigations reveal similar results. Of the 20 companies that reported on the outcome of formal investigations, 8 received closure letters from the SEC and 2 reported that the investigation has been inactive for six months (but have not received a closure letter). Seven more companies reported that the investigation was ongoing.¹⁵⁴

Document Requests, Production, and Preservation

An SEC investigation, in all but a few types of inquiry, is grounded in the review of large quantities of documents, supplemented by “on the record” depositions of persons involved in the question under review or having relevant

knowledge. The IT revolution of the last 30-plus years has been a mixed blessing for the Division of Enforcement. The typical investigation begins with an avalanche of data produced under subpoena, including internal documents, email, and voicemail records that in many cases reveal exactly what people were thinking and communicating at critical points in time. However, calling it information is likely too generous a description.

In some cases the “smoking gun” materials are hidden in plain sight by tens of millions of irrelevant documents. Persons responding to the FTI survey reported the average time period covered by an SEC subpoena as 6.3 years.¹⁵⁵ Even when subpoena demands are eventually narrowed, interviewees suggested that the cost of identifying and preserving documents and communications has already been incurred. When the coverage of a subpoena extends to millions of emails from numerous persons, the cost of collection, formatting, and preservation can be in the millions of dollars. When one recognizes that the vast majority of SEC investigations are closed without action, it means that companies that have done nothing wrong have been required to produce tens of millions of irrelevant documents, at a substantial cost to the company.

A significant number of the persons interviewed tied the problem in part to the criticism the SEC received for not uncovering the Madoff fraud in repeated closed investigations. As one person explained, “I do think that they have the fear of missing something. But ironically, they probably make their task harder by asking for all that information.”

At the earliest stages of investigations, even the most experienced and thoughtful staff attorneys cannot be expected to accurately assess the scope of the issues on which the investigation ultimately will focus, or the time periods that will prove relevant. It is easy for companies and their advocates to complain about staff overreaching in document requests and subpoenas and being insensitive to the burdens broad document demands can impose. However, the fact is that, given a choice between fashioning an unduly narrow or an unduly broad document demand, almost any prosecutorial authority will opt for the broader, rather than the narrower, one.

Based on our interviews, we believe there are ways to overcome these natural tensions, but doing so requires

accommodations by the Enforcement Division and the defense bar, as well as mutual trust and a willingness to indulge the legitimacy of countervailing arguments. In brief, the competing concerns that will need to be overcome in order to reach a rational approach to document demands include:

- Ensuring that all potentially relevant documents will be preserved and remain fully accessible by the Enforcement staff for the duration of the investigation;
- Providing Commission investigators flexibility in identifying which documents may ultimately prove relevant and the timing of that decision; and
- Providing subpoena recipients with general guidance during the initial collection and identification of documents to reduce the initial size and cost of the data collection effort.

In some cases the “smoking gun” materials are hidden in plain sight by tens of millions of irrelevant documents.

In recent years, the federal courts have adjusted to this avalanche of data by introducing new procedures that call for “initial disclosures” and early discovery conferences with judges so that the parties can work together to plan an efficient and cost-sensitive method of producing the required documents. We suggest that the SEC consider a similar framework. To accomplish this, we recommend that the Division adopt the following steps to minimize the burdens of document production while at the same time reducing the burden on enforcement staff to examine tens of millions of pages of documents and emails:

RECOMMENDATION 20: At the earliest stage of an investigation—whether formal or informal—the Division should notify companies, individuals, and their counsel, to the extent appropriate,¹⁵⁶ that it has an investigative interest in a matter (or matters), and request that companies and individuals immediately institute “information preservation measures” to prevent the destruction (automatic or otherwise) or alteration of any

documents, data, or other information that may be relevant to the investigation.¹⁵⁷ The Division should require and receive satisfactory assurances regarding the continuing preservation of all documents, data, and information relevant to the investigation and the understanding that no change in this status will occur without advance communications with the Division.

RECOMMENDATION 21: To expedite and focus an investigation, the Division should, at an early stage of its investigative efforts, engage in dialogue with counsel for persons and entities receiving subpoenas to identify the scope of the inquiry and promote an efficient production of materials. In this dialogue, recipients of subpoenas should be encouraged to provide the following information:

- o A description of the categories of documents deemed by the company or individual involved to be most relevant to the matter(s) under review; and
- o An identification of individuals and entities deemed by the company or individual to have relevant information or knowledge about the circumstances relating to the matter(s) under review.

RECOMMENDATION 22: Following the exchange of initial documents and information described above, Division staff and defense counsel should discuss document production, balancing the Division's need for relevant information with the need of those involved to control costs of document production. Among other things, the Division should:¹⁵⁸

- o Implement concepts of access to information, as an alternative to actual production of information, wherever that approach can be implemented feasibly, and without adding unnecessary time to the investigative process;
- o Standardize the procedures for rolling productions of documents, rather than requiring all potentially relevant documents to be produced at the same time;
- o Negotiate document demands or subpoenas taking into account the actual costs associated with production of certain data, especially where

information preservation measures have been implemented;

- o Jointly identify aspects of the request that may impose disproportionate costs and time burdens; and
- o Memorialize written agreements with defense counsel regarding document requests and subpoenas, to avoid any future misunderstandings, and to provide new or future investigators with an understanding of production obligations.

As the relevance of electronic data continues to grow, the Division is, on occasion, confronted with the need to secure digital devices and protect the integrity of data stored on those devices. On occasion, the Commission has utilized so-called forthwith subpoenas to prevent the disappearance both of the storage device itself and of the data stored on the device. In cases presenting the risk of destroyed information, or the flight of the person having custody of the device, the use of a forthwith subpoena may be necessary and appropriate. But such subpoenas should be the exception, rather than a common practice. The *Enforcement Manual* recognizes the exceptional nature of the practice: "Staff should use forthwith subpoenas sparingly, when there is a reasonable good faith belief that a subpoena should require forthwith production.

A reasonable good faith basis for issuing a forthwith subpoena may include seeking documents from an individual or custodian (1) that is uncooperative or obstructive, (2) that is a flight risk, and (3) who may destroy, alter, or otherwise falsify records.¹⁵⁹ The Division's senior officials have recognized this.¹⁶⁰ However, during our interviews, we received indications that SEC Enforcement staff were serving forthwith subpoenas on persons in the process of being interviewed, under circumstances that did not seem to require such treatment. The federal securities laws empower the Commission to "require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry."¹⁶¹ The law is silent on the authority of the Commission to confiscate physical equipment such as

electronic storage devices or computers. While the term “records” is broad, there is uncertainty over the extent of the Commission’s authority to confiscate hardware. This uncertainty has been discussed at length by commentators.¹⁶² As such, the cautionary language contained in the *Enforcement Manual* should be followed.

Improving the Efficiency of the Investigation Process

Improving the procedures for determining when an investigation should be closed without formal action

One of the most interesting findings of the FTI survey is the significant proportion of SEC investigations that are closed without action. As these unproductive investigations typically remain open for years, they cost the subjects millions of dollars in expenses, and for the Enforcement Division they consume substantial man-hours of enforcement staff time that might have been used on more productive investigations. In an era when the SEC annually requests increases in staff for its Enforcement Program, procedures that will reduce the expenditure of staff time unproductively should be considered carefully.

While it is possible that the decision to delegate formal order authority to the staff has resulted in the opening of lower-priority investigations, there are no data available to those outside the SEC to examine this question. For that reason, the focus should be on whether it is possible to improve the “triage” process that all organizations use to identify higher-priority matters and to early identify investigations that are unlikely to lead to formal action, or warrant formal action.

Numerous persons interviewed described this as the post-Madoff environment problem. Simply put, the staff is reluctant to close an investigation at an early stage for fear of missing something important, “the next Madoff.” One person commented, “I was talking to someone at Enforcement about the ‘living dead’ cases that never go away. He said that post-Madoff, everyone has nightmares about closing investigations and then having it blow up. And that creates a real incentive for keeping them open.”

The “post-Madoff” phenomenon was identified by other interviewees as the reason staff occasionally keep

investigations open even after the original issues have been resolved, and ultimately pursue minor violations to rationalize the length of the investigation and the expenditure of significant staff resources on the matter. The multiple references in our interviews to the impact of the Madoff matter on enforcement staff’s reluctance to close investigations suggest that the solution must relieve some of the burden that is placed on the attorney or attorneys investigating a matter. Three changes in Division practices would improve this situation, and improve the efficiency and accountability of the enforcement process.

One change would be to establish at the outset a target plan for the investigation, including estimated resources and a target date for completion of the investigation. The date selected could be generally set based upon the type of investigation, its complexity, and its time sensitivity. If at the expiration of the time period, the staff believed that the investigation should be extended, an extension request could be submitted to the Director, or a designee that would make the decision. An information memo would be sent to the Commission informing it of the decision and reasons for the extension. This would enable the Commission, as part of its oversight function, to determine whether it should review the extension.

The second change is more subtle, but potentially more significant. Simply put, the SEC and the Division should devise a method for recognizing the efforts of an attorney that result in the termination of an investigation. For many years the priority the agency places on the total number of cases brought each year has fundamentally permeated the entire division. Bringing a case, no matter how small or old, is career enhancing, and closing an investigation without action is not. During our interviews, we heard comments that the rewards to staff for bringing an enforcement action, regardless of its significance or timeliness, far outweigh the recognition obtained by correctly deciding to close an investigation without enforcement action. The practice of naming in the litigation and press releases all individuals that participated in the investigation is a subtle affirmation of the unequal rewards for the staff.

The third change addresses a long-standing problem that contributes to investigation delays. In the typical investigation, one person has lead responsibility. If that

person leaves the Commission, or is assigned to a new unit or office, often an open investigation becomes an orphan. It might be assigned to another attorney, who likely has a full plate of other matters, or it may be assigned to a new attorney who has no knowledge or familiarity with the matter. While internal policy requires departing staff to review open matters and provide summary memos for open investigations, the practice is not uniformly or consistently followed. It is important for the Division to mandate as part of the employee “check-out” process that status memos be prepared for all open investigations and that all document files be reviewed and organized to enable a successor attorney to quickly assume responsibility.

RECOMMENDATION 23: To improve the management of the investigative process, all requests for formal order authorization should contain a discussion of the anticipated resources needed to complete the investigation and provide a target completion date. If additional time is required, a justification memorandum should be submitted for approval to the Division Director or designee. This memorandum should be promptly sent to the Commission as an information memorandum, so that any Commissioner may request Commission review of the time extension.

RECOMMENDATION 24: The Commission should adopt evaluation metrics for the Division and for individual staff that emphasize prompt, effective, and appropriate resolution of investigations. A sound decision to promptly conclude an investigation without formal action, or through informal remediation, should receive credit that is comparable to the credit received for investigations that result in a formal enforcement action.

RECOMMENDATION 25: All departing staff should be required, as part of the agency departure policy, to prepare a summary memo on each open investigation and to organize all documents files, paper or electronic, to enable a successor attorney to quickly assume responsibility.

Ensuring that parties are informed that an investigation has been closed

Both the FTI survey responses and the interviews we conducted highlighted a problem: the failure of the staff to notify persons that an investigation has been closed. Under

the Commission’s Informal Rules, the staff is not required to provide notification that an investigation has been closed.¹⁶³ While notification is voluntary, the consequence of not providing notice is particularly concerning in the context of a public company that has disclosed publicly the existence of the investigation, but does not receive formal notice of termination to enable that to be disclosed.

Among the survey respondents, 17 out of 44 respondents (39%) indicated that they believed an informal investigation was closed, but they were never informed of closure by the SEC staff. Nearly 4 in 10 investigations close or remain dormant without notification to the company involved. Even when the staff does notify a company, there is often a significant delay. Among the companies that had informal investigations closed with no agency action, half received the notice 90 days or less from the initiation but 25% received the notice more than a year after the initiation.¹⁶⁴

The failure by SEC staff to notify a company promptly when the informal investigation is closed is also a problem in a formal investigation. Ten percent of survey respondents indicated that they had not received notification of closure although the investigation had been inactive for more than six months. Even when the respondents reported the receipt of a closure letter, the delay in notification is significant. While 40% of respondents reporting a formal investigation received a closure letter, 25% of this group reported that the closure letter was received 90–180 days after the “last efforts” of the SEC staff and 25% reported the lag between the “last efforts” and receipt of the notification at 365 days. The lack of timely notice of closure is troublesome given the length of time for a formal investigation.

As one interviewee commented, “Sometimes it’s frustrating because you don’t know what to expect, and you don’t receive clear answers, and you’re left dangling. And yet you don’t want to push them on it because you don’t want to poke the sleeping dog. You’ve given them information and you think you’re in good shape. I’ve had situations where they’ve gone on for four years like that.”

RECOMMENDATION 26: Written notification that a formal or informal investigation has been closed should be sent promptly to persons and entities whose conduct was under investigation, within two weeks of closure.

The importance of training staff in investigation techniques

The Wells Committee Report published in 1972 recommendation. The Commission should substantially upgrade the training program for enforcement personnel.”¹⁶⁵ The 2011 Chamber Report on the SEC included a similar recommendation—“Recommendation 16—The Office of the Managing Executive for Enforcement should develop an in-depth training program on investigative techniques.” This report once again makes this recommendation. Simply put, the division must rely upon new attorneys to conduct difficult and complex investigations, with limited direct supervision.

It is essential that the Division provide rigorous training. There is a significant difference between understanding the nuances of the laws and regulations the Commission administers and understanding how an industry segment applies those policies to its business. This poses distinct problems for the Commission, as well as for the private sector, that we believe should be the subject of Division attention. The over-arching concern from both the Agency’s and the private sector’s perspectives should be that both are better off if the staff of the Enforcement Division is knowledgeable and up-to-date, about industry practices as well as operative regulatory, statutory, and interpretive legal obligations. The downside of a lack of sufficient expertise about particularized industry segments is that the Enforcement staff may spend valuable and scarce time and resources pursuing issues that may not prove significant.

Given the varying level of expertise that Enforcement Division attorneys may have vis-à-vis regulatory requirements pertaining to a particular facet of the securities industry, general training programs are apt to provide the best method for educating incoming Division staff, something we understand the Division already provides.¹⁶⁶ Short general training is unlikely to provide more sophisticated, specialized staff expertise. It is our understanding that the Division takes advantage of continuing legal education programs discussing specific topics of current importance to various members of the Division staff. In the past it was frequently difficult for all staff to attend programs due to competing obligations such as scheduled testimony or trials. However the development of “web-based” training programs has substantially

reduced or eliminated this problem. For these reasons, we concur with the recommendation in the 2011 Report on the need for the Division’s Managing Executive to make training a priority.

.....

It is essential that the Division provide rigorous training. There is a significant difference between understanding the nuances of the laws and regulations the Commission administers and understanding how an industry segment applies those policies to its business.

.....

An important adjunct of the training program should be the development of an internal autopsy process by which current staff involved in both successful and unsuccessful matters would prepare a detailed analysis, highlighting the lessons that could be applied in the future.¹⁶⁷ The publicized string of litigation losses the SEC suffered in 2013–2014 should form the basis for a case study approach to train new staff.

Our final recommendation is one that we believe would improve the efficiency and effectiveness of the investigation process and contribute to the development of a stronger training program for Enforcement Division staff. This recommendation concerns greater integration of the home office Trial Unit into the home office investigation program. While many regional offices (with fewer staff) have traditionally operated with close daily interaction between investigation attorneys and trial attorneys, the SEC home office has clearly delineated these functions. We recommend greater ongoing integration of these functions.

Defense attorneys we interviewed routinely commented on the high quality and excellence of the Division’s Trial Unit staff. As the Trial Unit has evolved and grown since its formation in the mid-1970s, the experience and expertise of its trial lawyers have increased dramatically. As the number of litigated matters has increased, the SEC has increased the size of its Trial Unit. The Division now recruits seasoned trial attorneys, both from the Department of Justice and from the partnership ranks of major U.S. law firms. However,

because of this increased workload and as a matter of long-standing practice, the Trial Unit staff frequently does not participate in an investigation until the latter stages when it becomes apparent that a matter might be litigated.

While it makes administrative sense to delay the Trial Unit's commitment of personnel to matters that might not result in a recommendation for enforcement action, or that might settle without the need for participation by senior Division litigators, waiting until the end of the investigative process to bring to bear the seasoned eyes of experienced litigators may adversely affect the Division's—and, concomitantly, the Commission's—ability properly to assess the litigation risks inherent in a specific matter. The consequence could be either deciding to pursue a matter where the evidence may not be as strong and compelling as those who conducted the investigation believe, or rejecting a settlement that might be appropriate if the litigation risks were better understood.¹⁶⁸

This delayed involvement by the litigating attorney also may undermine the efficiency and effectiveness of the investigation process. In complex matters, having members of the Trial Unit participate in taking investigative depositions likely could help speed up the process. This would be accomplished by having seasoned litigators positioned to familiarize themselves with crucial testimonials and documents at the outset streamlining trials preparations. A stronger evidentiary record would reduce the likelihood of bringing weak cases and improve the quality of Commission decisions.

In making this recommendation, we do not mean to suggest that the Division's experienced cadre of litigators should be utilized in all or even most of the Division's investigation. Rather, we believe the Division should encourage staff conducting investigations to routinely consult, at an early point in the process, with seasoned litigators on complex legal or evidentiary issues to ensure that the investigation focuses on obtaining evidence necessary to litigate an issue. This is a practice that has been used routinely in some of the Commission's regional offices. In making this recommendation, we note that Director Ceresney has made public statements recently indicating his interest in closer integration of the investigative units with the litigation unit.¹⁶⁹

RECOMMENDATION 27: The Division should establish an in-depth training program for its staff in the following areas:

- o Understanding document production and analysis to promote targeted subpoenas and document requests, in order to increase staff sensitivity to the costs and time demands associated with document production, ensure a uniform approach to document production, and promote effective and efficient document production and analysis;
- o An internal autopsy process should be created by which current staff involved in both successful and unsuccessful matters would prepare a detailed analysis, highlighting the lessons that could be applied in the future; and
- o Understanding of evidentiary requirements in litigation to ensure that an investigative record is sufficient and suitable for litigated matters.

RECOMMENDATION 28: The Division should increase the integration of its trial attorneys into the investigative process to ensure that investigative records collect all evidence necessary for successful litigation and are based upon appropriate legal theories. Division trial attorneys should actively participate in Division training programs described in Recommendation 27.

CONCLUSION

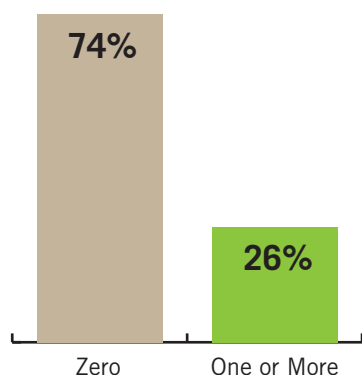
By adopting these recommendations, as well as recommendations made by others, the Chamber believes that the SEC's Enforcement Program will benefit by becoming more vigorous while also efficiently using limited resources to penalize bad actors in the capital markets. We also believe that these recommendations will provide clarity to market participants and eliminate unnecessary ambiguity, which benefits both the SEC and the U.S. capital markets.

Appendix A: THE U.S. CHAMBER OF COMMERCE SEC ENFORCEMENT SURVEY

Conducted by FTI Consulting July-October 2014

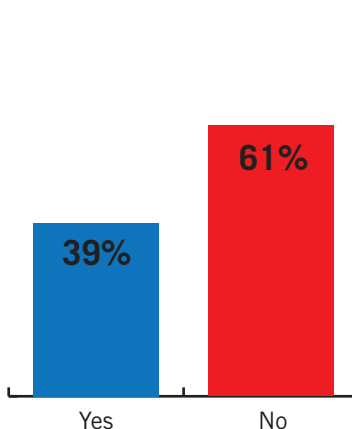
ANY INVESTIGATIONS

How many of those INFORMAL investigations resulted in either a formal order of investigation or proceeded directly to an enforcement action?



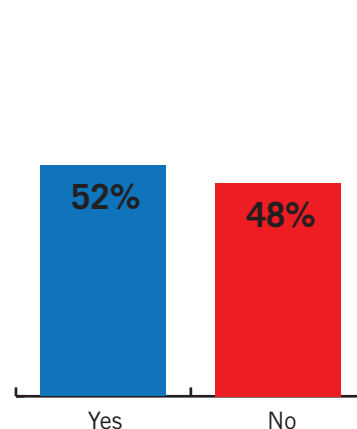
Among those with Informal Investigation Experience

Is your company currently involved in at least one unclosed INFORMAL investigation?



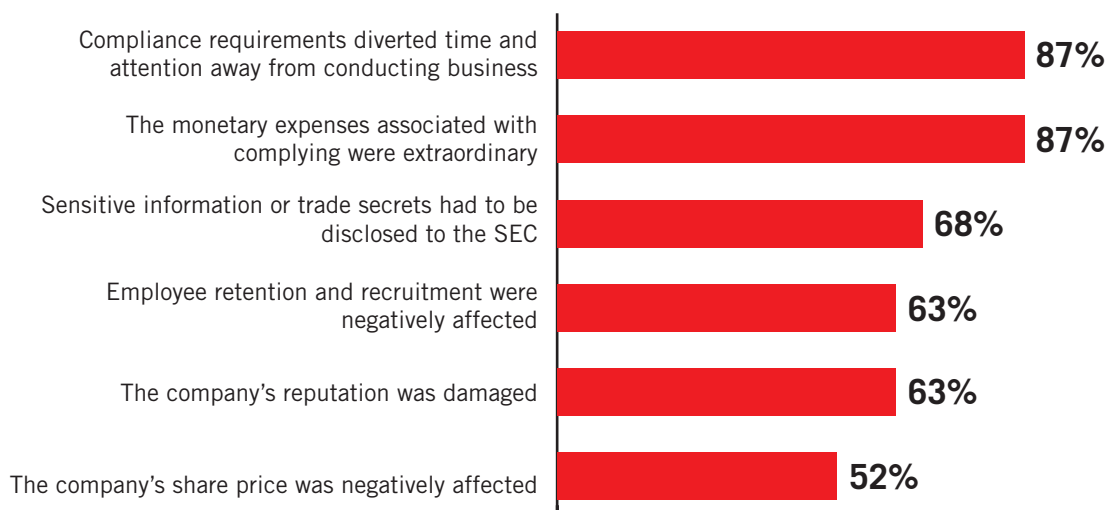
Among those with Informal Investigation Experience

Is your company currently involved in at least one unclosed FORMAL investigation?



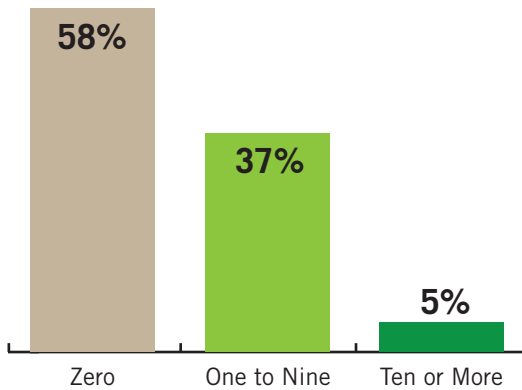
Among those with Formal Investigation Experience

Now, as you know, SEC investigations can vary in time, scope and size. From your general experience, please rate the following impacts SEC investigations had on your company.



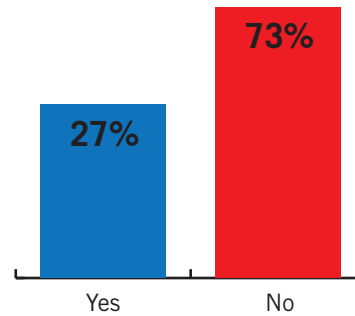
Among those with either Formal or Informal Investigation Experience

Within the past 5 years, how many SEC Staff investigations did your company receive subpoenas for that related directly to your company?



Among those with either Formal or Informal Investigation Experience

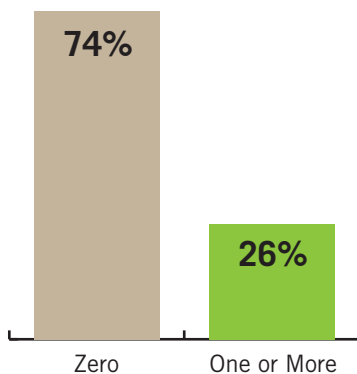
Were any SEC investigations, whether formal or informal, conducted in parallel with other government investigations (e.g., the Department of Justice)?



Among those with either Formal or Informal Investigation Experience

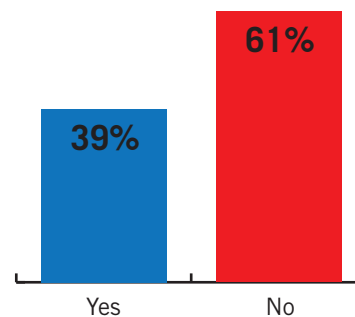
INFORMAL INVESTIGATIONS

How many of those INFORMAL investigations resulted in either a formal order of investigation or proceeded directly to an enforcement action?



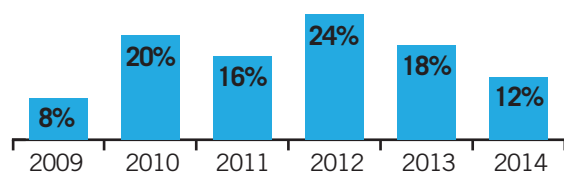
Among those with Informal Investigation Experience

Is your company currently involved in at least one unclosed INFORMAL investigation?



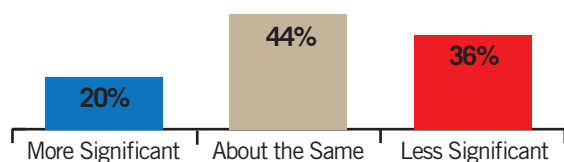
Among those with Informal Investigation Experience

In what year did the investigation begin?



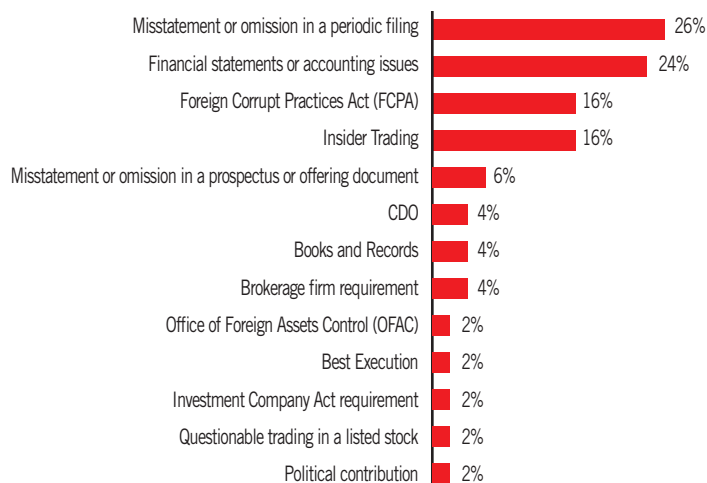
Among those with Informal Investigation Experience

Compared to other investigations, was the impact of this investigation?



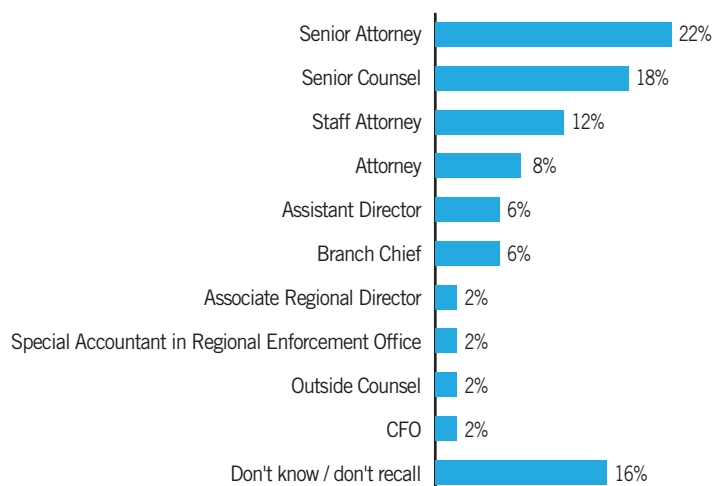
Among those with Informal Investigation Experience

Please identify the subject matter(s) of the investigation (select all that apply).



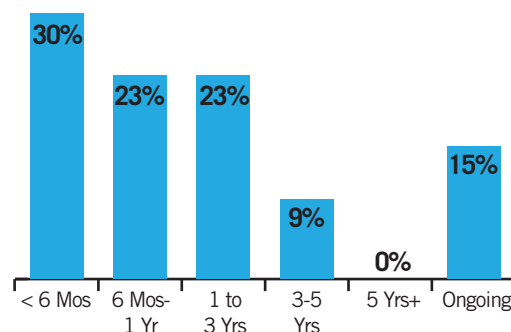
Among those with Informal Investigation Experience

At what level of seniority was your company's main point of contact within the SEC?



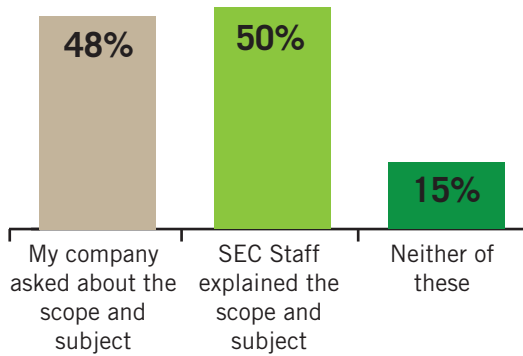
Among those with Informal Investigation Experience

Overall, how much time elapsed from the first SEC Staff communication your company received to learning the informal investigation had ended (transition to a formal investigation, institution of formal proceedings or notification the matter was closed)?



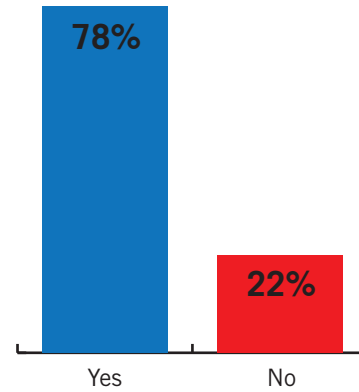
Among those with Informal Investigation Experience

Which of the following applies to the inquiry?



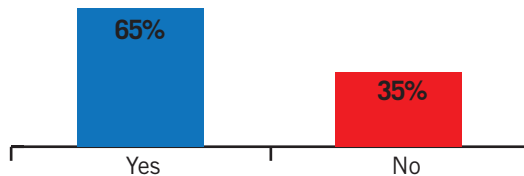
Among those with Informal Investigation Experience

Did your company have a dialogue with the SEC Staff that enabled you to understand what information was relevant to the inquiry (and in what underlying events the SEC Staff was interested)?



Among those with Informal Investigation Experience

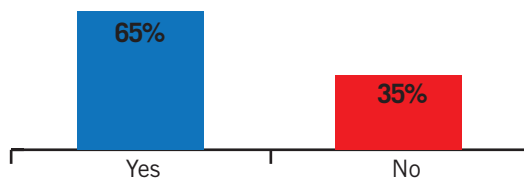
Did your company ask that the scope of the information requested be narrowed?



Among those with Informal Investigation Experience

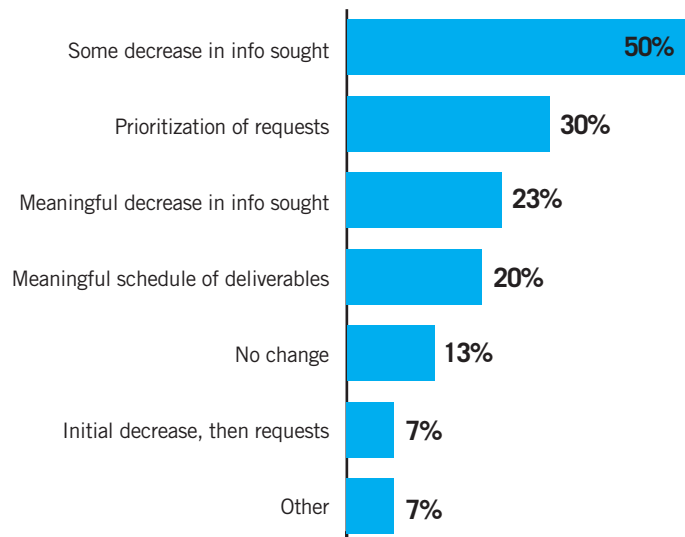
ASKED IF REQUESTED SCOPE BE NARROWED

Was your company given (or did it understand) the reason(s) for the Staff's response(s)?

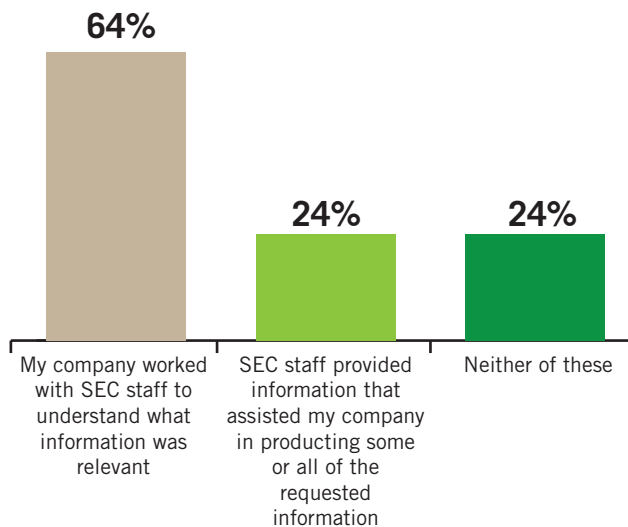


ASKED IF REQUESTED SCOPE BE NARROWED

Did your company's request to narrow the information sought result in...

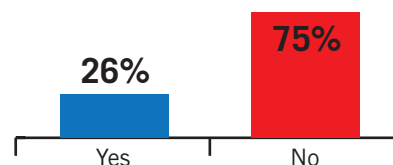


And, which of the following applies to the inquiry?



Among those with Informal Investigation Experience

Did you ask (and were you informed of) the origin of the SEC Staff's inquiry?



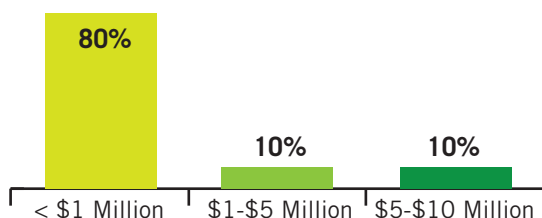
Among those with Informal Investigation Experience

ASKED IF INFORMED OF ORIGIN OF INQUIRY

Please indicate the general origin of the INFORMAL investigation (e.g., newspaper article, company filing, whistleblower, self-report).

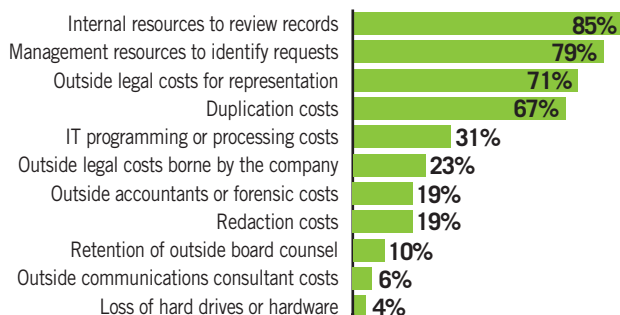
- Whistleblower (3)
- Company filing (1)
- NYAG Investigation (1)
- Self-disclosure (1)
- Public stock trading records (1)
- Class action lawsuit (1)
- SEC's review of Company's Form 10-K (1)
- Newspaper article (1)
- Company filing (1)
- Government database of political contributions (1)

What was the approximate aggregate direct cost incurred by your company in order to comply with the SEC Staff's INFORMAL investigation? (Note, this does not include indirect costs, such as diversion of management or employee time, but only includes direct cash outlays)



Among those with Informal Investigation Experience

Which direct or indirect costs did your company incur in the INFORMAL investigation?



Among those with Informal Investigation Experience

For the most recent INFORMAL investigation you have experience with, if possible, can you estimate and quantify in dollars the following expenses? (AVERAGE VALUES)

\$518,080
\$127,098

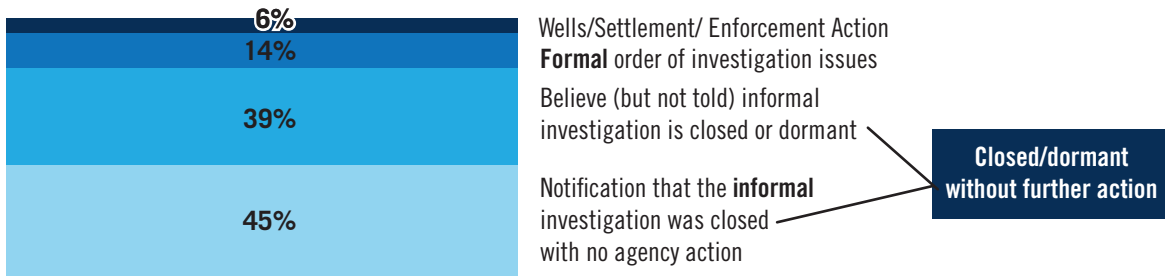
External Legal Counsel
External Accountants and other
external non-legal professionals

\$89,272
\$18,656
\$44,758

Company Staff Time
Provision of materials
Programming or Processing

Among those with Informal Investigation Experience

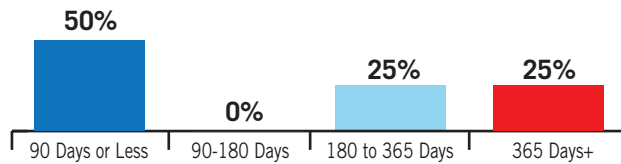
At the conclusion of the INFORMAL investigation, which of the following occurred?



Among those with Informal Investigation Experience

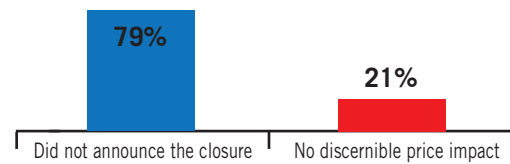
IF CLOSED WITH NO AGENCY ACTION

How much time elapsed from the INFORMAL investigation's initiation and the Staff's notification that the INFORMAL investigation was closing?



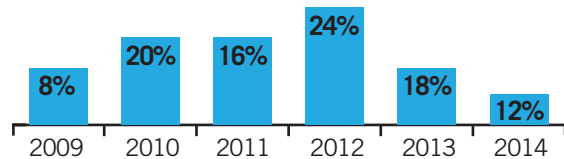
IF CLOSED WITH NO AGENCY ACTION

What impact did the disclosure of the INFORMAL investigation appear to have on your company's stock for the five business trading days following the announcement?



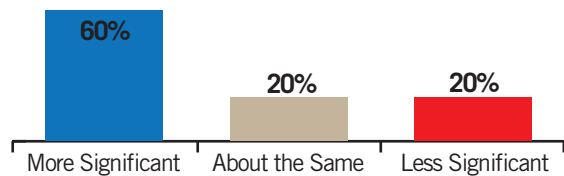
FORMAL INVESTIGATIONS

In what year did the investigation begin?



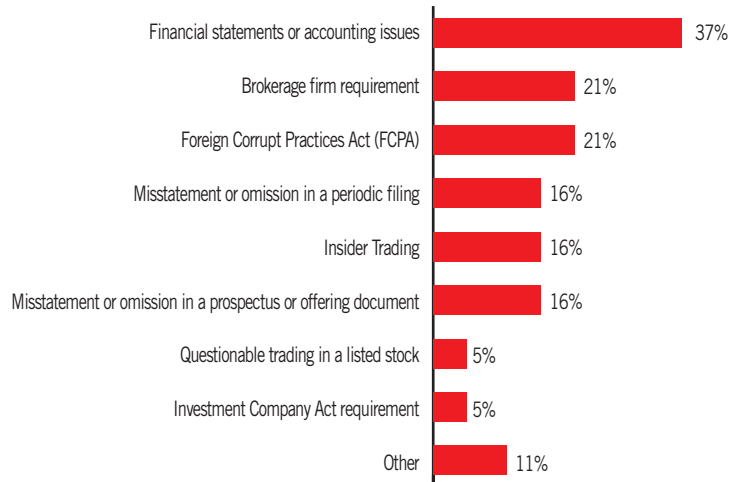
Among those with Formal Investigation Experience

Compared to other investigations, was the impact of this investigation?



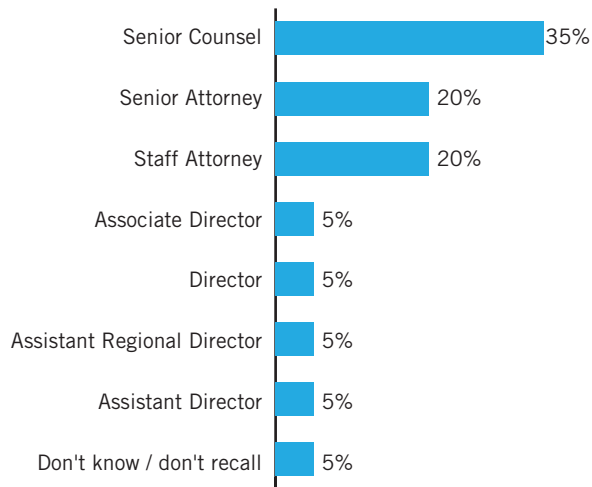
Among those with Formal Investigation Experience

Please identify the subject matter(s) of the investigation (select all that apply).



Among those with Formal Investigation Experience

At what level of seniority was your company's main point of contact within the SEC?

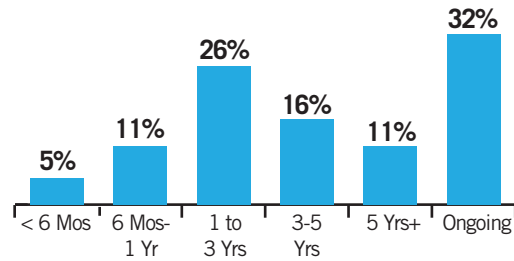


Among those with Formal Investigation Experience

How many years were encompassed by the subpoenas received?

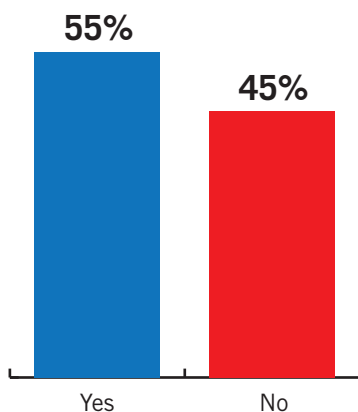
AVERAGE 6.3 YEARS

Overall, what was the length of time from the first SEC Staff communication in the FORMAL investigative phase to the ultimate resolution?



Among those with Formal Investigation Experience

Did you ask (and were you informed of) the origin of the SEC Staff's inquiry?



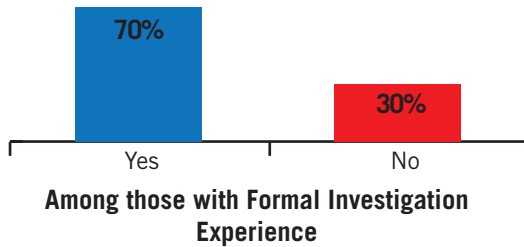
Among those with Formal Investigation Experience

ASKED IF INFORMED OF ORIGIN OF INQUIRY

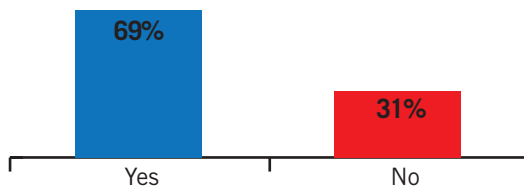
Please indicate the general origin of the FORMAL investigation (e.g., newspaper article, company filing, whistleblower, self-report).

- Whistleblower (3)
- NYAG Investigation (1)
- Company Filing (1)
- Company filing & whistleblower (1)
- SEC knowledge of the Company's business operations (i.e., involvement in rollovers from the federal Thrift Savings Plan) (1)
- Self-reported (1)
- Recurring formal review of financial statements (every 36 months) as a foreign private issuer (1)
- Newspaper article (1)
- Believed to be a whistleblower, as well as press attention (1)

Did your company (directly or through non-employees) ask the Staff to voluntarily limit the scope of the original subpoena?

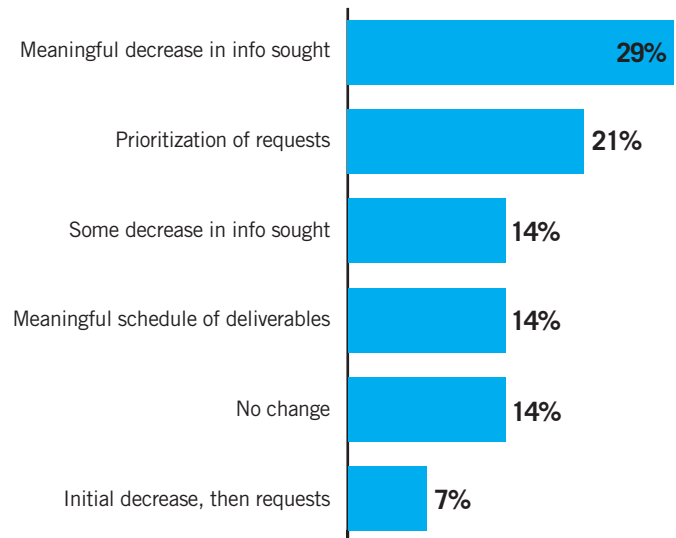


ASKED IF ASKED STAFF TO LIMIT SCOPE
Was your company given (or did it understand) the reason(s) for the Staff's response(s)?

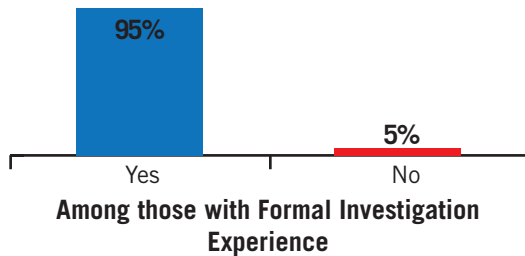


ASKED IF ASKED STAFF TO LIMIT SCOPE

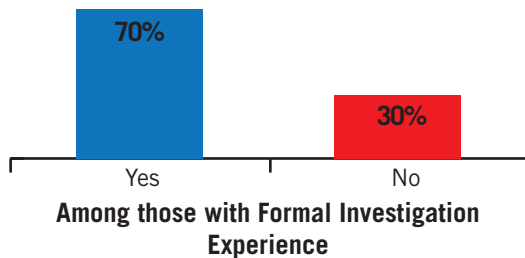
Did your company's request to narrow the information sought result in...



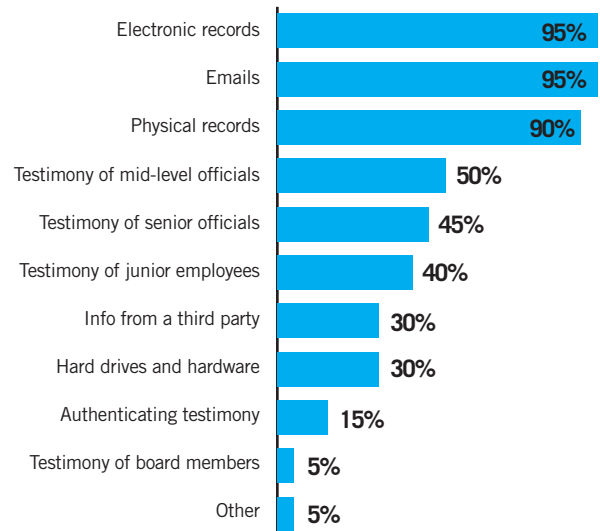
Was your company required to produce proprietary or confidential information?



Were you able to protect the confidential or proprietary information from release?

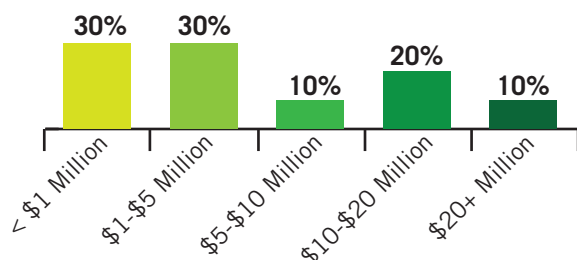


Which of the following did the subpoenas request?



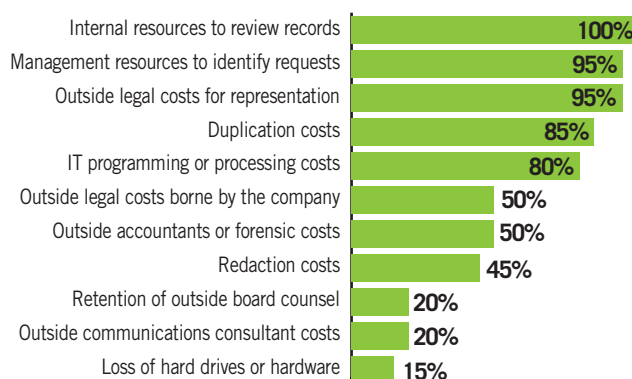
Among those with Formal Investigation Experience

What was the approximate aggregate direct cost incurred by your company in order to comply with the SEC Staff's FORMAL investigation? (Note, this does not include indirect costs, such as diversion of management or employee time, but only includes direct cash outlays)



Among those with Formal Investigation Experience

Which of the following direct or indirect costs did your company incur as a result of the FORMAL Investigation?



Among those with Formal Investigation Experience

If possible, can you estimate and quantify in dollars the following expenses? (N=24) (AVERAGE VALUES)

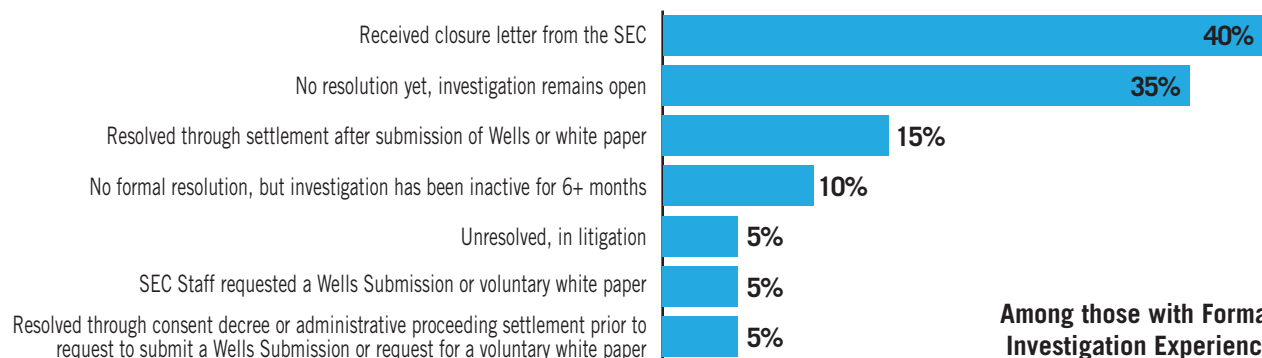
\$3,358,750
\$399,791
\$385,833

External Legal Counsel
Programming or Processing
Company Staff Time

\$305,416
\$117,625

External Accountants and other
external non-legal professionals
Provision of materials

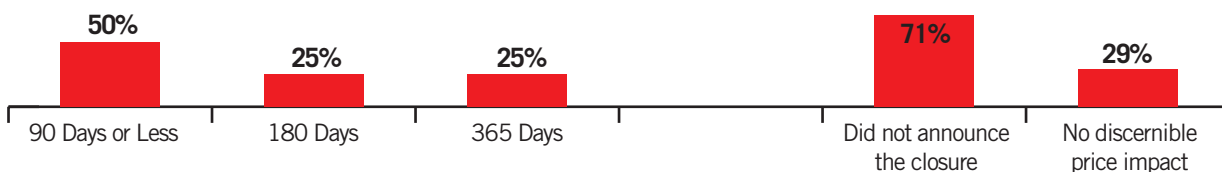
At the conclusion of the FORMAL investigation, which of the following occurred?



Among those with Formal Investigation Experience

IF RECEIVED CLOSURE LETTER

How much time elapsed, if any, between "last efforts" on the part of the SEC Staff and receipt of a closure letter?



Endnotes

- 1 See, for example, *Checkosky v. SEC*, 139 F.3d 221 (D.C. Cir. 1998), overturning use of negligence standard under rule 102(e); *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945 (1980), finding a need for scienter in rule 10b-5 actions; *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), application of a five-year statute of limitations in administrative proceedings.
 - 2 The U.S. Chamber of Commerce has released several reports on making recommendations how to improve and modernize the SEC in other areas as well including the operational capabilities of the SEC.
 - 3 For a useful history of the SEC's Enforcement Program, see D. Hawke, *A Brief History of the SEC's Enforcement Program 1934–1981*, SEC Historical Society Oral Histories Committee Roundtable on Enforcement at p. 3 (Sept. 25, 2002), available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/2000/2002_0925_enfo (Hawke History of the SEC's Enforcement Program). See also, *Atkins Evaluating the SEC Enf. Prog.*, *supra* n. 1, at 374, citing SEC, Thirty-Eighth Ann. Rpt. at p. xxvii (1972), available at http://www.sec.gov/about/annual_report/1972.pdf.
 - 4 The Committee consisted of John A. Wells (Committee Chairman) and two former SEC Chairmen, Manuel F. Cohen and Ralph H. Demmler. See *Report of the SEC's Advisory Committee on Enforcement Policies and Practices* (June 1, 1972) (*Wells Committee Report*), available at www.sechistorical.org, and reprinted there in three parts.
 - 5 All told, the *Wells Committee Report* (*supra* n. 9) contained 43 discrete recommendations. Among those that were adopted by the Commission was the recommendation to create what is now known as the “Wells Notice” process—giving potential defendants/respondents notice of the staff's intention to recommend that the Commission institute enforcement action against them (as well as the likely substance of the action and the proposed forum in which it will be brought), and permitting the filing of a submission countering the staff's factual assertions and legal theories, a discretionary practice that is codified as part of the SEC's INFORMAL AND OTHER PROCEDURES, at 17 C.F.R. §202.5 (2015). See *Wells Committee Report*, *supra* n. 5, at p. iv (Recommendation No. 16).
 - 6 See *Wells Committee Report* (*supra* n. 9). Among the recommendations apparently not expressly implemented were Recommendations No. 10 (“The Commission should give continuing attention to the conduct of investigations”) and 11 (“A procedure should be established for auditing the investigative practices and techniques of enforcement personnel on a continuing basis. . . .”). *Id.*
- Our reference to the fact that the Commission has not given attention to *Wells Committee Report's* Recommendation No. 10 does not mean the Commission fails to pay *any* attention to the conduct of investigations, or that there have not been any audits of the Enforcement staff's investigative processes. Rather, it reflects that the *Wells Committee Report's* recommendation for continuous monitoring of the Enforcement Program *by the Commission* does not occur, at least as far as the public is aware. It is also relevant that,
- since the *Wells Committee Report's* issuance, the position of SEC Inspector General (IG) has been created, and the IG is authorized to investigate specific complaints about the Enforcement Process as well as perform programmatic audits. As discussed later in this report, periodic Commission review of the Enforcement Program would enable the Agency to ensure that its critically important programmatic responsibilities are up-to-date and reflect current Commission policies, priorities, and preferences.
- 7 See *Final Report of the SEC Major Issues Conf.* (Jan. 13–15, 1977) (*1977 SEC Major Issues Conf. Report*), at p. 3, available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1977_0113_SECMICFinalReport.pdf (examining, among other issues, the development of policies and standards by the Commission and expressing disagreement with the Commission staff's “perception” that it was appropriate to rely “on enforcement activities to develop and enunciate Commission policy”).
 - 8 See *SEC News Digest Issue No. 84–96* (May 16, 1984), at p. 1, available at <http://www.sec.gov/news/digest/1984/dig051684.pdf> (announcing the 1984 Major Issues Conference to coincide with the celebration of the SEC's 50th Anniversary).
 - 9 In an article in early 1994, two officials in the SEC's Division of Enforcement, including its then Director, William McLucas, stated, “Over the past several months, the Commission has undertaken a thorough review of how we conduct the entire enforcement process.” See W. McLucas & J. Polise, *A Critical Examination of the SEC's Enforcement Process*, *INSIGHTS* (Jan. 1994), at 3.
 - 10 See J. Burns, *SEC's Enforcement Division Receives High Marks for Speedup in Past Year*, *WALL ST. J.* (Jul. 23, 1999), at p. B9 (available on LexisNexis®).
 - 11 The most recent conference, held in 2001, was the *SEC Historical Society's Major Issues Conference*, and had an international orientation. See SEC, *Five Papers to Be Delivered at SEC Historical Society Major Issues Conference*, SEC Press Rel. No. 2001–132 (Nov. 7, 2001), available at <http://www.sec.gov/news/headlines/globalinetpapers.htm>. See conference brochure, available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/2000/2001_SecRegGIE_intro.pdf; and the actual discussion of the Enforcement panel available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/2000/2001_SecRegGIE_Panel_4.pdf.
 - 12 See, for example, S. Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 *BUS. LAW.* 679, 681 n. 7 (2012), available at <http://ssrn.com/abstract=1333717> (*The SEC and the Financial Industry*).
 - 13 See *supra*, n. 12.
 - 14 See *supra*, n. 15.
 - 15 See *supra*, n. 16.
 - 16 See *The SEC and the Financial Industry*, *supra* n. 17, at p. 681 n.7.
 - 17 In 2013, upon her arrival, Chair Mary Jo White conducted her own review of the Commission's practice of settling matters without requiring those settling to admit that they had violated the federal securities laws, a review that resulted in a major change

- to the SEC's settlement practice. See M. White, *Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.VO4JiXZkoUE>.
- 18 See, for example, U.S. Chamber of Commerce, *Report on the Current Enforcement Program of the SEC* (March 2006), available at <https://www.uschamber.com/sites/default/files/legacy/reports/0603seccurrentenforcementstudy.pdf>. See also ABA Committee on Fed. Reg. of Secs., *Report of the Task Force on SEC Settlements*, 47 BUS. LAW. 1083 (May 1992); H. Pitt, M. Rauch & A. Strauss, *A Constructive Appraisal of the SEC's Enforcement Program*, 7 INSIGHTS 2 (1993); P. Wallison & C. Smith, *The Responsibility of the SEC for Efficiency, Competition and Capital Formation—Reforms for the First 1000 Days* (Oct. 6, 2005), at pp. 13–19, available at https://www.aei.org/wp-content/uploads/2011/10/20051021_secPaper.pdf; J. Katz, "Reviewing the SEC, Reinvigorating the SEC." 71 PITT L R 3.
 - 19 See, for example, General Accountability Office (GAO), SECURITIES AND EXCHANGE COMMISSION: Greater Attention Needed to Enhance Communication and Utilization of Resources in the Division of Enforcement, GAO Report No. GAO-09-358, March 2009. Also GAO, SECURITIES AND EXCHANGE COMMISSION: Additional Actions Needed to Ensure Planned Improvements Address Limitations in Enforcement Division Operations, GAO Report No. GAO-07-830, August 2007.
 - 20 Available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10125.pdf>.
 - 21 15 U.S.C. §77h.
 - 22 15 U.S.C. §1578o.
 - 23 15 U.S.C. §80b-3.
 - 24 Securities Acts Amendments of 1964. Public Law 88-467.
 - 25 15 U.S.C. §80a-9(b).
 - 26 While much of the Remedies Act reflected legislative changes requested by the SEC, cease and desist authority was not included in the original package of legislative reforms submitted by the SEC. It was added at the eleventh hour. As such there is no record of Congressional hearings discussing the authority and the existing legislative record is limited to summary references to conformance of SEC authority with that of the federal banking regulators.
 - 27 15 U.S.C. §78u-3. The same authority was added to the Securities Act of 1933, 15 U.S.C. §77h-1; the Investment Company Act of 1940, 15 U.S.C. §80a-9(f); and the Investment Advisers Act of 1940, 15 U.S.C. §80b-3(k).
 - 28 In the Matter of A.R. Baron & Co., Inc., Proceeding 3-9010. Release No. 34-37240, May 23, 1996.
 - 29 15 U.S.C. §78u-2.
 - 30 Section 1105 of Sarbanes-Oxley Law.
 - 31 While the SEC had routinely imposed collateral bars in its settled administrative proceedings, in 1999 the Court of Appeals for the D.C. Circuit issued an opinion finding that the SEC lacked this authority. *SEC v. Teicher*, 177 F.3d 1016 (D.C. Circuit 1999). The Dodd-Frank Act reversed this decision and explicitly provided the SEC with collateral bar authority.
 - 32 See A. Ceresney, *Remarks to the American Bar Association's Business Law Section Fall Meeting*, Washington D.C., Nov. 21, 2014, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297>.
 - 33 See, for example, *SEC v. Citigroup Global Markets, Inc.*, 752 F.3d 285, 297 (2d Cir. 2014). (Noting that the Commission is free to utilize administrative proceedings to effect settlements, rather than bringing them to district court).
 - 34 Typically the SEC publishes performance data on a fiscal year basis. These data were collected for this report from the list of initial decisions available on the SEC website, where the data are provided on a calendar-year basis. The list of initial decisions is available at <http://www.sec.gov/alj/aljdec/aljdecarchive/aljdecarc2014.shtml>.
 - 35 SEC.gov website at <http://www.sec.gov/alj/aljdec.shtml>.
 - 36 One order, Initial Decision No. 580, consolidated 20 separate orders instituting proceedings under section 8(d) of the Securities Act of 1933 ("stop order" proceedings) into a single default order, further evidence of the ministerial nature of the action.
 - 37 Some have suggested that the very high success rate of the SEC in administrative proceedings compared with a much lower rate in litigated civil actions reflects a bias by ALJs that favors the enforcement staff. The distorting effect of so many pro forma proceedings, in which the outcome is largely a certainty, demonstrates why caution should be exercised in drawing a conclusion of bias.
 - 38 See A. Ceresney Speech, *supra* n. 37.
 - 39 See *In re Raja K. Gupta*, Secs. Act Rel. No. 9192 (Mar. 1, 2011), available at <https://www.sec.gov/litigation/admin/2011/33-9192.pdf>.
 - 40 See *Gupta v. SEC*, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).
 - 41 *Id.*, at 506.
 - 42 *Id.* at 509–512. In another case, the district court judge ruled that he had no jurisdiction to consider the claims. See *Jarkesy & Patriot 28 LLC v. SEC*, Fed. Sec. L. Rep. 97,990 D.D.C. (June 10, 2014), *appeal pending*, No. 14-5196 (D.C. Circuit, filed Aug. 12, 2014).
 - 43 See *In re Rajat K. Gupta*, Secs. Act Rel. No. 9249 (Aug. 4, 2011), available at <https://www.sec.gov/litigation/admin/2011/33-9249.pdf>; and see *Rajat Gupta, SEC Agree to Bury the Hatchet, for Now* (Aug. 14, 2011), FIRSTPOST.COM, <http://www.firstpost.com/world/rajat-gupta-sec-agree-to-bury-the-hatchet-for-now-54665.html>. When the SEC did pursue Gupta in federal court, the result was an unambiguous victory for the Commission's Enforcement Division. Among other remedies, Gupta was ordered to pay a \$13.9 million penalty and was permanently barred from serving again as an officer or director of a public company. See *SEC Obtains \$13.9 Million Penalty Against Rajat Gupta*, SEC Press Rel. No. 2013-128 (Jul. 17, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539724228#.VN6fy3Zkri8>.
 - 44 *Chau v. SEC*, 14-cv-1903 (LAK) (S.D.N.Y. Dec. 11, 2014), available at <http://securitiesmosaic.com/gateway/courtcase/Chau.121114.pdf>. But see *Free Enterprise Fund v. PCAOB*, 561 U.S. at 490.

- 45 In the Matter of Charles H. Hill, Administrative Proceeding file 3-16383, Release No. 34-74249 / February 11, 2015. Available at <http://www.sec.gov/litigation/admin/2015/34-74249.pdf>.
- 46 *United States v. Newman, et al.*, Nos. 13-1837-cr, 13-1917-cr (2nd Cir. Dec. 10, 2014).
- 47 In the Matter of Charles Hill, ORDER DENYING RESPONDENT'S MOTION FOR SUMMARY DISPOSITION ON CONSTITUTIONAL ISSUES, ADMINISTRATIVE PROCEEDINGS RULINGS SEC Press Rel. No. 2675 (May 14, 2015, available at <http://www.sec.gov/alj/aljorders/2015/ap-2675.pdf>).
- 48 *Charles L. Hill, Jr. v. Securities and Exchange Commission*, June 8, 2015, CIVIL ACTION NO. 1:15-CV-1801-LMM, U.S. District Court for the Northern District of Georgia. Available at <http://www.compliancebuilding.com/wp-content/uploads/2015/06/order-in-charles-hill-v-SEC.pdf>.
The SEC has informed the court that it will appeal this order. See *SEC Says It Will Appeal Hill v. SEC Decision, Seek to Stay the Case, and Try to Prevent Discovery*. Available at <http://securitiesdiary.com/2015/06/16/sec-says-it-will-appeal-hill-v-sec-decision-seek-to-stay-the-case-and-try-to-prevent-discovery>. In another administrative proceeding on appeal to the Commission, the SEC postponed a scheduled oral argument to enable the parties to submit briefs on the applicability of the Hill order to that proceeding. See ORDER GRANTING MOTION TO POSTPONE ORAL ARGUMENT AND PERMIT ADDITIONAL BRIEFING, In the Matter of RAYMOND J. LUCIA COMPANIES, INC. and RAYMOND J. LUCIA, SR., File No. 3-15006, SECURITIES EXCHANGE ACT OF 1934 Release No. 75262, June 22, 2015. Available at <https://www.sec.gov/litigation/opinions/2015/34-75262.pdf>.
- 49 In the Matter of PAUL J. POLLACK and MONTGOMERY STREET RESEARCH, LLC, SECURITIES EXCHANGE ACT OF 1934 Release No. 73844, December 16, 2014.
- 50 See R. Karmel, *Emerging Issues Concerning Administrative Procedures*, January 26, 1979. Available at <http://www.sec.gov/news/speech/1979/012679karmel.pdf>. See also, S. Friedman, *Policy Making and Enforcement at the SEC*, June 10, 1980. Available at <http://www.sec.gov/news/speech/1980/061080friedman.pdf>.
- 51 The Honorable Jed S. Rakoff, Judge, Southern District of New York, PLI Securities Regulation Institute Keynote Address: *Is The S.E.C. Becoming a Law unto Itself?* November 5, 2014. (Judge Rakoff AP speech). Available at <http://media.jrn.com/documents/secaddress.pdf>.
- 52 Commissioner Michael S. Piwowar, Remarks at the "SEC Speaks" Conference 2015: A Fair, Orderly, and Efficient SEC. Feb. 20, 2015. Available at <http://www.sec.gov/news/speech/022015-spchcmsp.html>.
- 53 <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf>. The document was not announced with a press release, or included on the website's "Latest News" box.
- 54 The Remedies Act created a temporary cease and desist order proceeding. The one such case brought by the Division demonstrated that an AP is not an appropriate process to obtain emergency relief. Since that action was filed in 1991, no others have been brought. See *In the Matter of A.R. Baron*, *supra* n. 35.
- 55 17 C.F.R. 201.900.
- 56 17 C.F.R. 201.900(a)(iii).
- 57 Report on Administrative Proceedings for the Period October 1, 2014, through March 31, 2015; Securities Exchange Act of 1934 Release No. 74850, April 30, 2015.
- 58 Administrative Office of the U.S. Courts, "Judicial Facts and Figures 2013," Table 6.3, available at <http://www.uscourts.gov/statistics/table/63/judicial-facts-and-figures/2013/09/30>.
- 59 17 C.F.R. §201.360(a)(1).
- 60 We wish to stress that during the interview process, attorneys in private practice uniformly praised the expertise, experience, professionalism, and integrity of the two ALJs who have served for an extended period of time, Chief ALJ Brenda Murray and ALJ Carol Fox Folack.
- 61 See *Judge Rakoff AP Speech*, *supra* n. 56.
- 62 See *VanCook v. SEC*, 653 F.3rd 130, 140 & n. 8 (2nd Cir. 2011), cited in *J. Rakoff AP Speech*, *supra* n. 55. The Supreme Court has also adopted this position. See *Nat'l. Cable & Telecomm. Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005) (according deference to an FCC declaratory adjudication that effectively overruled a prior judicial interpretation of the same statutory provision).
- 63 See *In the Matter of: HARDING ADVISORY LLC and WING F. CHAU*, Initial Decision 734, File 3-15574, January 12, 2015. Available at <http://www.sec.gov/alj/aljdec/2015/id734ce.pdf>.
- 64 To the extent an enforcement matter involves complex or technical expertise clearly within the Agency's jurisdiction, the utilization of an administrative proceeding may help both the Commission and the proposed respondent. See, for example., P. Verkuil, *The Purposes and Limits of Independent Agencies*, 1988 DUKE L.J. 257, 262 ("Unlike courts, commissions have jurisdiction over limited types of subject matter; they are called upon to decide complex or routine matters on a repetitive basis. Independent agencies develop an expertise with the subject matter that, in the ideal world, also makes their more reflective decisionmaking cost-efficient") (footnote and citation omitted).
- 65 See *Judge Rakoff AP Speech*, *supra* n. 56, at p. 7.
- 66 See, for example, Geoffrey F. Aronow, *Back to the Future: The Use of Administrative Proceedings for Enforcement at the CFTC and SEC*. 35 FUTURES AND DERIVATIVES LAW REPORT 1 (January/February 2015), at p. 4-5.
- 67 The Second Circuit has held, however, that SEC adjudications that subsequently reject pre-existing legal interpretations of the federal securities laws (articulated by the Second Circuit) are entitled to deference from reviewing courts in accordance with the principles set forth in *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837 (1984). This can be read as a recognition that the Commission can relitigate in an administrative forum judicially resolved issues, the substance of which it disagrees. See *VanCook v. SEC*, 653 F. 3rd 130, 140 & n. 8 (2nd Cir. 2011), cited in *J. Rakoff AP Speech*, n. 55, *supra*. The Supreme Court has also adopted this position. See *Nat'l. Cable & Telecomm. Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005) (according deference to an FCC declaratory adjudication that effectively overruled a prior judicial interpretation of the same statutory provision).

- 68 There are significant types of remedies that exist only in the administrative forum. These include suspensions, associational bars, limitations on activities, and registration revocations for entities and associated persons directly registered and regulated by the SEC, for example, broker-dealers, investment advisers, transfer agents, and other entities. While these sanctions may not be imposed in a civil action, the Commission has the authority to institute an administrative proceeding to obtain these sanctions based upon the entry of an injunction or criminal conviction. As discussed previously, the Commission routinely follows this approach.
- 69 See, for example, *In re Cady Roberts & Co.*, 40 SEC 907 (1961), available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1960/1961_1108_CadyRoberts.pdf. (Registered broker-dealer involved, and SEC rejects common-law fraud notion requiring disclosure of material facts only in face-to-face transactions); *In re Oppenheimer & Co.*, Secs. Exch. Act Rel. No. 12319, 9 SEC Docket No. 7 (Apr. 2, 1976) (Registered broker-dealer involved, and SEC holds for the first time that “the misuse of undisclosed, material ‘market information’ can be the basis of antifraud violations,” although no violations were found in that matter and the proceeding was dismissed).
- 70 See *supra*, n. 47.
- 71 When the Commission declines to act, as an exercise of its discretion, it is not considered a final agency action that is appealable to a federal court.
- 72 In an administrative proceeding instituted in 2012, counsel for the respondent notified the Division of Enforcement staff, prior to formal SEC action, of his clients’ intent to seek a jury trial and requested that the matter be litigated in federal district court. When the administrative proceeding was instituted, the respondent filed suit against the SEC in federal district court in Washington, D.C. That action was later voluntarily dismissed as part of the settlement of the administrative proceeding. See *In the Matter of EGAN-JONES RATINGS COMPANY and SEAN EGAN*, Rel. 34-66854, File No. 3-14856, April 24, 2012. Available at <http://www.sec.gov/litigation/admin/2012/34-66854.pdf>. The civil complaint was filed in *EGAN-JONES RATING COMPANY and SEAN EGAN v. UNITED STATES SECURITIES AND EXCHANGE COMMISSION*, Case 1:12-cv-00920, June 6, 2012, U.S. District Court for the District of Columbia.
- 73 See D. Wilson, *SEC Administrative Case Rules Likely Out of Date*, *GC Says*, *LAW360* (June 17, 2014), available at <http://www.law360.com/banking/articles/548907/sec-gc-praises-analysis-improvements-after-rule-disputes>. See also, S. Russell-Kraft, *Attys Ready to Pounce on SEC’s Outdated Admin Rules*, *LAW360* (June 18, 2014), available at <http://www.law360.com/articles/549549/attys-ready-to-pounce-on-sec-s-outdated-admin-rules>.
- 74 Written interrogatories can facilitate a respondent’s understanding of the nature of the claims being asserted against it and to refine and narrow the eventual issues at trial—see, for example, A. Schoone & E. Miner, *The Effective Use of Written Interrogatories*, 60 MARQ. L. REV. 29 (1976), available at <http://scholarship.law.marquette.edu/cgi/viewcontent.cgi?article=2153&context=mulr>—and are specifically authorized under FRCP Rules 31 (Depositions by Written Questions) and 33 (Interrogatories to Parties). Under the Commission’s Rules of Practice, it is possible to obtain the right to serve written interrogatories, but it is not a matter of right. See Rule 221(c), 17 C.F.R. §201.221(c) (Pre-hearing Conference; *Subjects to Be Discussed*). This leaves a non-directly regulated person or entity to the Enforcement staff’s willingness to agree to such a process, or the ALJ’s decision to order it.
- 75 Requests for admissions are an “extremely valuable” device that saves litigation time, makes a proceeding vastly more efficient, and enables parties to conserve resources solely for the issues contested. See, for example, D. Cole, *Federal Discovery—10 Tips for Propounding and Answering Requests for Admission*, JAMES PUBLISHING BLOG (Jan. 6, 2014), available at <http://jamespublishing.com/2014/federal-discovery/>. A party in civil litigation has an absolute right to utilize this valuable procedure, pursuant to FRCP Rule 36 (Requests for Admission). As is true of written interrogatories, the Commission’s Rules of Practice make it possible to obtain admissions, but it is not a matter of right. See Rule 221(c), *supra* n. 82.
- 76 Pursuant to the FRE, all relevant evidence is admissible (Rule 402), unless its probative value is minimal, outweighed by potential prejudice, could cause confusion vis-à-vis the issues, or prove to be a waste of time (Rule 403). There are a number of additional exclusionary provisions, including hearsay objections and, as an overarching proposition, witnesses may not testify with respect to any matter unless it is clear that the witness has personal knowledge of the matter that is the subject of his or her testimony (Rule 602). In sharp contrast, under the Commission’s Rules of Practice, an ALJ may receive any relevant evidence, whether or not it would be excluded under the FRE. See Rule 320, 17 C.F.R. §201.320 (2015).
- 77 *SEC Enforcement Manual*, p. 22. Available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>.
- 78 *SEC Enforcement Manual*, p. 23, *Id.*
- 79 Though the current version of the *Enforcement Manual* defines the term “Wells Notice,” the terms “White Paper” and “pre-Wells Paper” are not defined in the *Enforcement Manual*, and the circumstances under which they will be invited are also not set forth.
- 80 Dodd-Frank §929U, codified at 15 U.S.C. §78d-5.
- 81 15 U.S.C. §78d-5(a)(2).
- 82 Commentators have suggested the new “white paper” process is an “informal pre-Wells settlement exploration” “to delay the start of the Dodd-Frank [180-day] time frame.” See B. Bondi & T. Sporkin, *The SEC’s Wells Process Turns 40*, *LAW360*, available at http://www.buckleysandler.com/uploads/36/doc/Law-360_The-SEC%27s-Wells-Process-Turns-40.pdf.
- 83 See *SEC v. NIR Group, LLC*, CV 11-4723 (E.D.N.Y. Mar. 24, 2013), at 7 (citing *SEC v. Levin*, 2013 U.S. Dist. LEXIS 20027, at *34-35 (S.D. Fla. Feb. 14, 2013)) available at <http://www.goodwinprocter.com/~media/EF0EC98F56BB41739A8364031C3C4203.pdf>.
- 84 See Securities Act Rel. No. 5310 (Sept. 27, 1972) at p. 1, available at <http://www.sec.gov/Archives/edgar/data/1090908/000095013408013040/f42278exv99w1.htm>. The Commission “codified” its informal Wells Submission practice in 17 C.F.R. §202.5(c) (2015), available at <http://www.gpo.gov/fdsys/pkg/CFR-2011-title17-vol2/pdf/CFR-2011-title17-vol2-sec202-5.pdf>.
- 85 See J. Eaglesham, *SEC Drops 20% of Probes after ‘Wells Notice,’ WALL*

- St. J.L.* (Oct. 9, 2013), available at <http://www.wsj.com/news/s/0001424052702304500404579125633137423664?autologin=y>.
- 86 See FOIA, §552(a)(1)(E) (requiring agencies to publish their informal procedures as well as any “amendment, revision, or repeal” of those procedures).
- 87 SEC Manual, p. 24, *supra* n. 82.
- 88 See, for example, D. Nathan, R. Fons, B. Hoffman, & T. Rowe, *SEC Annual Conference Highlights 2014 Accomplishments and Promises to Turn up the Heat in 2015*, MORRISON & FOERSTER CLIENT ALERT, at p. 3 (Mar. 10, 2015), available at <http://www.mofo.com/~media/Files/ClientAlert/2015/03/150309SECConference.pdf>. (Noting that the Division’s “Complex Financial Instruments Unit . . . looks for ways to streamline its investigations through the aggressive use of cooperation and resolution tools such as reverse proffers, in which the staff lays out the case for counsel and the firm at a relatively early stage with a view to cutting past much of the investigative work and heading straight to settlement discussions”).
- 89 See *Wells Committee Report*, *supra* n. 9 at pp. v (Recommendation Nos. 19, 23, and 24), 37–39. See also, *Atkins Evaluating the SEC Enf. Prog.*, *supra* n. 7, at pp. 411–412 (recommending that the SEC establish a new Enforcement Advisory Committee to look at the “implementation of a written and uniform ‘full-disclosure’ policy for enforcement matters”).
- 90 At a recent PLI Program, the Division’s Staff suggested that this policy was largely the domain of the Division’s Complex Financial Instruments Unit. See, e.g., D. Nathan, R. Fons, B. Hoffman & T. Rowe, “*SEC Annual Conference Highlights 2014 Accomplishments and Promises to Turn Up the Heat in 2015*, Morrison & Foerster Client Alert, at p. 3 (Mar. 10, 2015) (“*2015 SEC Speaks Synopsis of Enf. Div. Developments*”), available at <http://www.mofo.com/~media/Files/ClientAlert/2015/03/150309SECConference.pdf> See also, T. Cimino, Jr. & J. Zubairi, *Highlights from SEC Speaks 2015: Enforcement and Litigation Trends*, VEDDER PRICE THOUGHT LEADERSHIP (Feb. 24, 2015), available at <http://www.vedderprice.com/highlights-from-sec-speaks-2015/>. Several months earlier, Division Director Ceresney indicated that this was a Division-wide approach. See, for example, D. Smyth, “*Securities Enforcement Forum 2014—Directors Panel*, Cady Bar the Door (Oct. 14, 2014), available at <http://www.secmiscellany.com/2014/10/14/securities-enforcement-forum-2014-directors-panel/> (noting Ceresney’s observation that “We’ve been doing reverse proffers, laying out what our case would look like. It breeds transparency”).
- 91 17 CFR §202.5(e).
- 92 See, for example, *SEC v. Goldman Sachs & Co. and Fabrice Tourre*, 10-CV-3229 (BSJ) (Jul. 14, S.D.N.Y. 2010), available at <http://www.sec.gov/litigation/litleases/2010/consent-pr2010-123.pdf>; and SEC Press Rel. No. 2010-123, *Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO; Firm Acknowledges CDO Marketing Materials Were Incomplete and Should Have Revealed Paulson’s Role* (Jul. 15, 2010), available at <http://www.sec.gov/news/press/2010/2010-123.htm>.
- 93 This policy is codified in the Commission’s Informal Procedures, at 17 C.F.R. §202.5(e) (2015).
- 94 *SEC v. Citigroup Global Markets, Inc.*, 827 F. Supp. 2^d (S.D.N.Y. 2011), *reversed and remanded*, 752 F. 3^d 285 (2^d Cir. 2014).
- 95 See, for example, J. Siegel, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 GEORGETOWN L. J.L. 433, 439 n. 39 (2015), available at <http://georgetownlawjournal.org/files/2015/01/AdmitIt.pdf>; (citing “at least seven other federal judges [who] questioned or refused to approve SEC settlements, for varying reasons”).
- 96 See R. Khuzami, *Recent Policy Change* (Jan. 7, 2012), available at <http://www.sec.gov/news/speech/2012/spch010712rsk.htm>.
- 97 See J. Eaglesham & A. Ackerman, *SEC Seeks Admissions of Fault*, WALL ST. J.L. (June 18, 2013), available at “<http://www.wsj.com/articles/SB10001424127887324021104578553931876196990>.”
- 98 *Id.*
- 99 *Id.* See also M. Fagel, *The SEC’s Troubling New Policy Requiring Admissions*, BLOOMBERG BNA SECURITIES REG. & LAW RPT. (June 24, 2013), available at <http://www.gibsondunn.com/publications/Documents/Fagel-SECs-Troubling-New-Policy-Requiring-Admissions.pdf>; A. Frankel, *Should Defendants Fear New SEC Policy on Admissions in Settlements?* REUTERS (June 19, 2013), available at <http://blogs.reuters.com/alison-frankel/2013/06/19/should-defendants-fear-new-sec-policy-on-admissions-in-settlements/>.
- 100 See, for example, P. Radvany, “*The SEC Adds a New Weapon: How Does the New Admission Requirement Change the Landscape?*” 15 CARDOZO J. CONFLICT RESOL. 665, 687–688 & nn. 192 & 193 (2014), available at http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1533&context=faculty_scholarship (apparently citing J. Stewart, *The SEC Has a Message for Firms Not Used to Admitting Guilt*, NY TIMES (June 22, 2013), at p. B1. Available at <http://www.nytimes.com/2013/06/22/business/secs-new-chief-promises-tougher-line-on-cases.html?pagewanted=all&r=0>).
- 101 See A. Frankel REUTERS article, *supra* n. 104, and J. Stewart NEW YORK TIMES article, *supra* n. 105, in which both reporters reference the fact that they were given access to the Enforcement Division’s internal email memorandum discussing the Revised Admissions Policy.
- 102 See J. Stewart NEW YORK TIMES article, *supra* n. 105.
- 103 In theory, almost all cases brought by the SEC should involve a large number of investors who were harmed by the allegedly improper conduct, given the Agency’s limited enforcement-related resources. Smaller numbers of investors would establish more of a “collection agency” role for the Commission, one it has traditionally eschewed, and one that could have adverse consequences for investors. See, for example, B. Black, “*Should the SEC Be a Collection Agency for Defrauded Investors?*” 63 BUS. LAWYER 317 (2008), available at http://scholarship.law.uc.edu/cgi/viewcontent.cgi?article=1054&context=fac_pubs.
- 104 This standard is difficult to place in context, since the Commission announces all its enforcement proceedings—both at the initiation stage and at the settlement or conclusion stage—and those announcements serve to put the public on notice about the nature of the charges. Moreover, for those in the securities industry, there is usually considerable time out for cases involving “egregious” conduct, one of the other standards the Commission apparently adopted. For non-regulated persons, there are officer and director bars, and a requirement (even if no officer and director bar order is entered) to make disclosure of sanctions imposed for allegedly wrongful conduct. See, for example, Item 401 of SEC Regulation S-K, 17 C.F.R. §229.401(f) (2015).

- 105 See SEC Chair White, *Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.VOp3RXZkoUE> (M. White Full Enforcement Arsenal Speech).
- 106 17 CFR §202.5.
- 107 Statement of the Securities and Exchange Commission Concerning Financial Penalties. SEC Press Rel. No. 2006-4, Jan. 4, 2006. Available at <http://www.sec.gov/news/press/2006-4.htm>.
- 108 *The Stanford Ponzi Scheme: Lessons for Protecting Investors from the Next Securities Fraud*, Robert Khuzami, Director, Division of Enforcement and Carlo di Florio, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, Subcommittee on Oversight and Investigations, Committee on Financial Services, U.S. House of Representatives, May 13, 2011.
- 109 See M. White, *Three Key Pressure Points in the Current Enforcement Environment* (May 19, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541858285#.VOUa6HZkri9>.
- 110 The language quoted in the text is taken directly from an MOU between the Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC). See MOU between the CFPB and the FTC (Jan. 20, 2012), at p. 2, available at <http://www.ftc.gov/system/files/120123ftc-cfpb-mou.pdf>. The CFPB has entered into a number of similar MOUs with other financial services regulators, but has no such agreement with the SEC.
- 111 The Commission has done this frequently on an *ad hoc* basis during its history. See, for example, *SEC Announces Latest Charges in Joint Law Enforcement Effort Uncovering Penny Stock Schemes*, SEC Press Rel. No. 2014-105 (May 22, 2014), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541881247#.VOZkTHZkreQ>.
- 112 OCIE has adopted coordination agreements with other examining authorities on an *ad hoc* basis. See, for example, S. Faia, *SEC Announces Municipal Advisor Exam Initiative* (Aug. 19, 2014), <http://vigilantllc.com/sec-announces-municipal-advisor-exam-initiative/> (“The SEC is working with the [MSRB] and [FINRA] to facilitate a coordinated approach to oversight of municipal advisors”).
- 113 See, for example, SEC, *Application of Security-Based Swap Dealer and Major Security-Based Swap Participant*, Secs. Exch. Act Rel. No. 72472 (June 25, 2014), available at <http://www.sec.gov/rules/final/2014/34-72472.pdf>.
- 114 While the Commission has had good success working with federal and international regulators and state securities regulators, it has been less successful—through no fault of the Agency—in obtaining accommodations with state and local attorneys general. See, for example, J. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOKLYN L. REV. 117 (2004), available at http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2416&context=fss_papers (describing many initiatives of state and local attorneys general as “regulatory entrepreneurship by ambitious politician-bureaucrats”). Attempts to implement any accommodation may eventually not bear fruit, but should nonetheless be attempted. Ultimately, this is an issue that may call for legislative pre-emption foreclosing certain aspects of independent legal action by state regulators to vindicate conduct governed by federal legislation. See, for example, The Securities Fraud Deterrence and Investor Restitution Act of 2003, H.R. 2179, 108th Cong. (2003), available at <https://www.congress.gov/bills/108th-congress/house-bill/2179/text>; and see, for example, C. Lane, *Halting the March Toward Preemption: Resolving Conflicts between State and Federal Securities Regulators*, 39 N. ENGL. L. REV. 317, 318 (2005), available at <http://www.nesl.edu/userfiles/file/lawreview/vol39/2/lane.pdf> (discussing H.R. 2179).
- 115 See, for example, *SEC Establishes New Supervisory Cooperation Arrangements with Foreign Counterparts*, SEC Press Rel. No. 2012-49 (Mar. 23, 2012), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171487908#.VOVCg3Zkri8>. The SEC’s MOUs with foreign regulators provide for cooperation in assisting foreign (or U.S.) enforcement efforts, but lack any provision explicitly directed toward avoiding duplication of efforts.
- 116 See, for example, SEC and Australian Securities and Investments Commission, Mutual Recognition Arrangement (Aug. 25, 2008), available at https://www.sec.gov/about/offices/oia/oia_mutual_recognition/australia/framework_arrangement.pdf.
- 117 The Commission is already doing this, in a variety of areas. See, for example, D. Nicolaisen, *A Securities Regulator Looks at Convergence*, 25 NW J.L. OF INT’L LAW (Apr. 2005), available at <http://www.sec.gov/news/speech/spch040605dtn.htm>. See also, for example, “Private Sector Task Force Calls on G-20 to Promote Regulatory Convergence” PRNEWSWIRE (Oct. 6, 2011), available at <http://insurancenewsnet.com/oarticle/2011/10/06/private-sector-task-force-calls-on-g-20-to-promote-regulatory-convergence-a-281526.html#.VOaew3ZkreQ>.
- 118 THE STATE OF THE SECURITIES AND EXCHANGE COMMISSION—1979. An Address by Harold M. Williams, Chairman. Available at http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1970/1979_0302_Speech_Williams.pdf.
- 119 See SEC, *Statement Concerning Financial Penalties*, *supra* n. 112 (differentiating between “pervasive” participation in a corporate violation and “isolated conduct by only a few individuals.”) Of course, even a one-off type of violation can reflect systemic problems, but not every violation (or even every group of violations) for which a corporation is responsible is necessarily an indication of systemic problems. See also, U.S. Sentencing Commission, *2014 USSC Guidelines Manual* Ch. 8, available at <http://www.ussc.gov/guidelines-manual/2014/2014-ussc-guidelines-manual> (2014 Sentencing Guidelines Manual).
- 120 See, for example, SEC, *Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, Secs. Exch. Act Rel. No. 44969 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm> (Seaboard Release). (T)he paramount issue in every enforcement judgment is, and must be, what best protects investors. There is no single, or constant, answer to that question. . . . In the end, no set of criteria can, or should, be strictly applied in every situation to which they may be applicable.”)
- 121 See, for example, H. Pitt & K. Shapiro, “*Securities Regulation by Enforcement: A Look Ahead at the Next Decade*,” 7 YALE J.L. REG. 149 (1990) (referencing the SEC’s “small dollar” enforcement program).
- 122 This is an approximate figure. The actual number is not available on the SEC website.

- 123 SEC FY2014 Annual Performance Report and FY2016 Annual Performance Plan. Available at <http://www.sec.gov/about/reports/sec-fy2016-budget-request-tables.pdf>.
- 124 See SEC, “Delegation of Authority to Director of Division of Enforcement,” 1934 Act Rel. No. 60448 (Aug. 5, 2009) (initial one-year delegation), available at <https://www.sec.gov/rules/final/2009/34-60448.pdf>, and 1934 Act Rel. No. 62690 (Aug. 11, 2010) (removal of initial one-year sunset provision), available at <https://www.sec.gov/rules/final/2010/34-62690.pdf>. It is worth noting that the *Wells Committee Report* recommended that the staff be given delegated authority to issue formal orders, but only with respect to “routine classes of cases” See *Wells Committee Report*, *supra* n. 11, at p. iii (Recommendation No. 9) (emphasis supplied).
- In addition, the *Report* noted, “oversight would be assured by a requirement that the Commission or designated members of the staff be notified of the issuance of an investigative order.” *Id.* When the Commission implemented this delegation of authority more than five years ago, it did not reference the *Wells Committee Report*, and it did not include a notice requirement, as recommended by the *Wells Committee Report*. Because this change was deemed related “solely to agency organization, procedure, or practice,” the proposal was adopted without affording the public any notice-and-comment procedures. See Administrative Procedure Act, 5 U.S.C. §553(b)(3)(A).
- 125 Under §4A(b) of the Securities Exchange Act, 15 U.S.C. §78d-1(b), “[t]he vote of one member of the Commission shall be sufficient to bring any [delegated] action before the Commission for review.” It is our understanding that, since the delegation of this authority, no Commissioner has exercised this authority, possibly because there does not appear to be a notice procedure through which a Commissioner could learn in a timely manner about specific formal orders.
- 126 After the expenditure of the considerable staff efforts that precede most recommendations for enforcement action, it becomes effectively impossible for Commissioners to vote against an enforcement action solely on the ground that there were more pressing problems that should have been the staff’s major focus. At that juncture, Commissioners are confined to deciding whether to bring the recommended action (or some variation thereof), usually entailing an analysis of the statutory and precedential support for the proposed action, against whom the action should be brought, and in what forum the matter should be instituted.
- 127 See Reorg. Plan No. 10 of 1950, §1(a), 64 Stat. 1265 (Mar. 13, 1950), available at <http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title5a-node83-leaf113&num=0&edition=prelim>.
- 128 See, for example, M. Fagel, *What the SEC Enforcement Stats Really Tell Us*, LAW360 (Mar. 3, 2015) (Observing that “it is no great secret that the SEC’s stats are a poor indicator of the division’s actual productivity or accomplishments”), available at <http://www.gibsondunn.com/publications/Documents/Fagel-What-The-SEC-Enforcement-Stats-Really-Tell-Us-Law360-3.3.2015.pdf>.
- 129 In its most recent Annual Performance Report, the Commission indicated that the average length of time invested in investigations that led to some type of enforcement proceeding is 21 months. The Commission also disclosed its aspirational goal of reducing that number further, and reported that, in the most recently completed fiscal year, it had been unable to reduce the number in accordance with its pre-determined targets. 2014 SEC Annual Performance Report, Performance Goal 2.3.3, p. 40. Available at <http://www.sec.gov/about/reports/sec-fy2014-fy2016-annual-performance.pdf>. The Annual Performance Report does not disclose the average length of other investigations that have been closed without action or that are ongoing. Also, there is no explanation of how the goals set forth were arrived at. For example, was this a process where all Commissioners considered what the average length of investigations should be, or was it done solely by the Enforcement Division’s Senior Management, and whether those goals reflect optimal conditions or should be modified. Consistent with the Commission’s commitment to transparency and accountability, we believe these additional facets of the priorities disclosed in its Annual Performance Reports should be disclosed.
- 130 For example, in 2010, the Dodd-Frank Act was adopted, spanning 2,313 pages—or exponentially more than the aggregate total number of pages devoted to the four principal statutes originally administered by the Commission—the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940—obligating the SEC to promulgate approximately 100 new rules and conduct 20 studies.
- 131 See 1977 Major Issues Conf., *supra* n. 12, at p. 3.
- 132 See, for example, Chair M. White, *The SEC in 2014* (Jan. 27, 2014), at p. 1, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540677500#.VNhHZkoUE>; Commissioner M. Piwowar, *Advancing and Defending the SEC’s Core Mission* (Jan. 27, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540671978#.VNhOP3ZkoUE>.
- 133 See, for example, D. Gallagher, *Remarks at FINRA Enforcement Conference*, (Nov. 7, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540310199#.VQSNtUZkreQ> (nNoting, “The SEC is a capital markets regulator, and its enforcement function should support its efforts to maintain and improve our capital markets”); H. Pitt, *Written Testimony: “Fixing the Watchdog: Legislative Proposals to Improve and Enhance the SEC,”* Before the House Financial Services Committee 3 (Sept. 15, 2011), available at <http://financialservices.house.gov/uploadedfiles/091511pitt.pdf> (“Although some perceive the SEC as an enforcement agency that also has regulatory powers, in reality it is a regulatory agency that also has enforcement powers”).
- 134 See, for example, J. Gould, I. Duckor, A. Brewster, & M. Wu, *Registered Investment Advisers: Annual Compliance Obligations—What You Need to Know* LEXOLOGY.COM (Feb. 7, 2013), available at <http://www.lexology.com/library/detail.aspx?g=055cfad4-780d-415b-82e4-a624eebf60eb>.
- 135 Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.). The GPRA was amended in 2011 by the GPRA Modernization Act of 2010, Pub. L. No. 111-352 (Jan. 4, 2011), available at <http://xml.fido.gov/stratml/references/PL111-532StratML.htm>. The GPRA requires government agencies to set clear goals and identify management priorities, and then measure, analyze, and communicate performance information, as well as conducting frequent in-depth performance reviews. See Office of Management and Budget, *Delivering on the Accountable Government Initiative and Implementing the GPRA Modernization Act of 2010* (Apr. 14, 2011), available at <http://www.whitehouse.gov/sites/default/files/omb/memoranda/2011/m11-17.pdf>.

- 136 The importance of public awareness of the Agency's enforcement activities is particularly important, given the SEC's limited resources. See S. Buell, *What Is Securities Fraud?* 61 DUKE L. J.L. 511, 519 (2011), available at [http://www.bankruptcylitigationblog.com/uploads/file/What%20Is%20Securities%20Fraud%20\(1\).pdf](http://www.bankruptcylitigationblog.com/uploads/file/What%20Is%20Securities%20Fraud%20(1).pdf) ("Because enforcement resources are limited, public awareness of enforcement is at least as important as the price that enforcement imposes").
- 137 See American Bar Association, Model Rules of Professional Conduct Rule 3.6 (Prohibiting lawyers who have participated in the investigation or litigation of a matter from making extrajudicial statements the lawyer knows or should know will have a substantial likelihood of materially prejudicing an adjudicative proceeding), cited in D. Katz, *Extrajudicial Statements: Lawyers' Ethical Obligations in Communicating with the Press*, (2007), available at http://files.ali-cle.org/thumbs/datastorage/skoobesruoc/pdf/19KatzEthicsPressCG047_thumb.pdf; see also J. Moses, *Legal Spin Control: Ethics and Advocacy in the Court of Public Opinion*, 95 COLUM. L. REV. 1811 (1995), available at http://www.jstor.org/stable/1123196?seq=2#page_scan_tab_contents (noting that the proposition that a "lawyer should not argue her case outside the courtroom has long been a basic principle of the legal profession"). Available at http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents.html.
- 138 See, for example, R. Ryan, "Get the SEC out of the PR Business," WALL ST. J.L. (Nov. 30, 2014), available at <http://www.wsj.com/articles/russell-g-ryan-get-the-sec-out-of-the-pr-business-1417386821>.
- 139 Some observers have pointed to quotations attributed to overzealous enforcement attorneys as a cause for such mischaracterizations. See, for example, R. Ryan, *Get the SEC out of the PR Business*, *supra* n. 87, (noting a general pattern whereby prosecuting Staff attorneys insert "gratuitous quotations" into press releases in order to use "more colorful words and phrases like 'tricks,' 'calculated fraud,' 'reaping substantial profits,' and 'choosing profits over compliance,'" and pointing out that, in contrast, "[t]he accused is never extended similar courtesies").
- Others have linked such language to an alleged pattern in SEC litigation-related press releases where the Enforcement Division emphasizes its initial allegations but downplays any ultimate findings that don't vindicate those allegations. See, for example, Prof. S. Bainbridge, *On the Need to Tone Down the SEC's Litigation Press Releases*, PROFESSORBAINBRIDGE.COM BLOG (Dec. 1, 2014), available at <http://www.professorbainbridge.com/professorbainbridge.com/2014/12/on-the-need-to-tone-down-the-secs-litigation-press-releases.html> (pointing to the SEC's insider trading case against Mark Cuban). Prof. Bainbridge concluded, "An impartial arbitrator would give losses at least as much publicity as victories." *Id.* See also Prof. S. Bainbridge, *The SEC's Flawed Public Relations Strategy*, PROFESSORBAINBRIDGE.COM BLOG (Dec. 4, 2014), available at <http://www.professorbainbridge.com/professorbainbridge.com/2014/12/the-secs-flawed-public-relations-strategy.html> (citing R. Ryan, *Mum's the Word About SEC Defeats*, WALL ST. J.L. (June 2, 2013), available at http://www.wsj.com/news/articles/887324659404578504842305831564?mod=ITP_opinion_Q&mg=reno64-wsj) (pointing to several litigation matters—including those alleging fraud against Gabelli, executives at Knight Securities, and a former accountant at Lucent Technologies—in which the SEC made considerable efforts to publicize its initial accusations of wrongdoing, but did not issue any press release or make any announcement when "those accusations were not deemed substantiated or were characterized as overreaching").
- 140 American Bar Association, Model Rules of Professional Conduct. Available at: http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents.html.
- 141 2015 SEC Budget Submission, p 14. Available at <http://www.sec.gov/about/reports/sec-fy2015-budget-request-tables.pdf>.
- 142 SELECT SEC AND MARKET DATA FISCAL 2014, Securities and Exchange Commission, page 21. Available at <http://www.sec.gov/about/secstats2014.pdf>.
- 143 SEC statistical information does not define the term "informal investigation." It is assumed that the term includes MUIs and investigations conducted without a formal order.
- 144 "Investigations are opened in two ways: (1) the investigation is opened when a MUI is converted to an investigation, or (2) an investigation is opened independent of a MUI." *SEC Enforcement Manual*, page 16. *Supra* n. 85.
- 145 17 C.F.R. 203.5.
- 146 FTI Survey. Nine respondents reported that the informal investigation was ongoing and did not provide a specific length of time.
- 147 FTI Survey. Six of 19 responses reported ongoing status and did not identify a time period.
- 148 FTI Survey.
- 149 FTI Survey.
- 150 FTI Survey. An unspecified number of respondents reported costs for both the informal and formal stages, thus increasing the overall aggregate cost of the investigation.
- 151 FTI Survey.
- 152 FTI Survey.
- 153 FTI Survey.
- 154 FTI Survey.
- 155 FTI Survey.
- 156 In all cases, the Division would be sole arbiter whether a specific matter should be treated in the manner recommended. For example, in cases where there is reason to believe document destruction is imminent (or ongoing), or that a general notice of the type we recommend would not cause *all* documents, data, and information to be preserved, this recommendation presumably would not be implemented. And, as we have noted throughout these recommendations, a determination by the Division not to follow this procedure would not give rise to any rights in any person or entity.
- 157 Most courts believe that the moment a company can foresee a governmental interest, or the possibility of an investigation, a concomitant obligation arises to protect any and all data and

information that might ultimately prove relevant, notwithstanding otherwise appropriate document management policies. See, for example, *Silvestri v. General Motors Corp.*, 271 F.3rd 583, 590 (4th Cir. 2001). The intent of this recommendation is to spare the Division from the necessity of having to formulate the precise scope of subpoenas as a means of creating legal obligations on the part of those who may become the subject of an investigation. Such a notice should compel the preservation of any data or information, and compel the cessation of automatic document removal or destruction programs that would otherwise be in effect.

staff are involved earlier in the investigations, and vice versa.” See E. Beeson, *SEC Silences Critics with Resounding Victory in Wyly Trial*, LAW360.COM (May 14, 2014), <http://www.law360.com/articles/537677/sec-silences-critics-with-resounding-victory-in-wyly-trial>.

- 158 Many of these recommendations are already utilized in some fashion in some cases. The objective is to provide a uniform framework of reference for all those involved in the Enforcement Process and to provide greater consistency of application of these approaches.
- 159 *SEC Enforcement Manual*, *supra* n. 82, p. 60.
- 160 See, for example, S. Dockery, *SEC's Use of Rare 'Forthwith' Subpoena Raises Red Flags for Defense Counsel*, DOJ ANTI-CORRUPTION BLOG (Nov. 7, 2013), available at <http://www.scribd.com/doc/208801215/SEC-s-Use-of-Rare-Forthwith-Subpoena-Raises-Red-Flags-for-Defense-Counsel#scribd> (noting that “Commission officials say such subpoenas are used sparingly”).
- 161 Section 21(b) of the Exchange Act, 15 U.S.C. § 78(u)(b).
- 162 A variety of uncertain legal issues are presented by SEC subpoenas that demand production of computer hard drives and other electronic storage medium, including the question of whether these pieces of hardware are technically “records” that may be subpoenaed by the SEC. For a detailed discussion of these issues see John Reed Stark, *When to Say When: Handling Emerging Technology-Related SEC Enforcement Tactics*, BLOOMBERG BNA SECURITIES REGULATION & LAW REPORT, 45 SRLR 1737, September 23, 2013.
- 163 17 C.F.R. 202.5(d).
- 164 FTI Survey.
- 165 Wells Committee Report, *supra* n. 9, p. iii.
- 166 The Division routinely provides incoming staff with a three-day training program to apprise them of general matters of importance. We do not know if this training encompasses specific substantive issues, but we assume that, even if there are specific substantive subjects covered, the coverage is general in nature—a valuable foundation for further training, but not necessarily an end in itself.
- 167 The 2011 Chamber Report included this recommendation. Recommendation 20, *supra* n. 4, p. 79.
- 168 See, for example, S. Lynch & A. Viswanatha, *Analysis: SEC Plans to Take More Cases to Trial Despite Losses*, CHICAGO TRIBUNE (Dec. 12, 2013) (quoting former SEC Trial Unit Member, David Kornblau, as stating his belief that “the issue is case selection, not the competence of the SEC’s trial lawyers”), available at http://articles.chicagotribune.com/2013-12-12/business/sns-rt-us-sec-trials-20131212_1_sec-chair-sec-votes-the-sec.
- 169 This recommendation echoes published comments from Enforcement Division Director Ceresney that the SEC “has begun restructuring its Washington, D.C., trial unit by pairing groups of trial attorneys with groups of investigative lawyers so that trial



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