

1 of 3 DOCUMENTS

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70 *Temp. L. Rev.* 53**LENGTH:** 33467 words**ARTICLE:** A PRACTITIONER'S GUIDE TO THE SEC'S INVESTIGATIVE AND ENFORCEMENT PROCESS**NAME:** William R. McLucas, J.LynnTaylor, & Susan A. Mathews \***BIO:** © William R. McLucas, J. Lynn Taylor, & Susan A. Mathews. This Article incorporates substantial revisions by William R. McLucas et al. to An Overview of Various Procedural Considerations Associated with the Securities and Exchange Commission's Investigative Process, 45 *Bus. Law.* 625 (1990).

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**SUMMARY:**

... Of course, registrants and issuers must disclose information responsive to particular line item disclosure requirements and must otherwise evaluate the materiality of the matter under inquiry for purposes of registration statement and periodic reporting. ... iii. requests that the issuer represent that the acceleration of the effective date of the registration statement does not relieve the issuer of its responsibility for disclosure in the document. ... In particular, where a registration statement is materially deficient, this twenty-day period would preclude constructive review and comment by the staff. ... The filing of a registration statement without the delaying amendment or removal of the amendment by a registrant prior to completion of the process may result in a stop order examination or, if deficiencies are clear, a stop order. ... Rule 461 states that the Commission may refuse to accelerate the effective date of a registration statement: ... Thus, if the staff declines to exercise its delegated authority to accelerate the effectiveness of a registration statement, the staff must take the matter to the Commission to deny acceleration. ...

**TEXT:**

[\*53]

Every year the Securities and Exchange Commission brings between 400 and 500 enforcement proceedings to address violations of the federal securities law. n1 While the number of active investigations varies from year to year, n2 and the types of issues that the Commission confronts change rapidly with developments in the capital markets, n3 the enforcement process itself remains relatively constant. This Article provides an overview of the procedural issues that individuals and entities, as well as their counsel, will face in dealing with the Commission in its enforcement investigations.

## I. Commission Investigations

The Securities and Exchange Commission (the "SEC" or "Commission") has broad authority to investigate actual or potential violations of the federal securities laws. The SEC also has broad authority to determine the scope of its investigations and the persons and entities subject to investigation. n4

#### A. Statutory Authority

The following statutes authorize the Commission to investigate past, ongoing, or prospective violations of the federal securities laws, SEC rules or regulations, and self-regulatory organizations ("SROs") rules: [\*54]

. Section 20(a) of the Securities Act of 1933 (the "Securities Act"); n5

. Section 8(e) of the Securities Act; n6

. Section 21(a)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"); n7

. Section 21(a)(2) of the Exchange Act; n8 [\*55]

. Section 209(a) of the Investment Advisers Act of 1940 (the "Advisers Act"); n9

. Section 42(a) of the Investment Company Act of 1940 (the "Investment Company Act"); n10

. Section 18(a) of the Public Utility Holding Company Act of 1935 (the "Public Utility Holding Company Act"); n11 and

. Section 321(a) of the Trust Indenture Act of 1939 (the "Trust Indenture Act"). n12 [\*56]

#### B. Informal Investigations

Commission investigations generally begin as "informal" or "preliminary" investigations. In an informal investigation, the staff cannot issue subpoenas and relies instead upon the cooperation of individuals and entities to obtain information, documents, and testimony.

The guidelines for informal investigations are contained in 5 of the Commission's Informal and Other Procedures. n13 Informal investigations are non-public unless ordered public by the Commission - an exceptionally rare occurrence. n14 Certain procedural safeguards that apply to formal investigations also apply to informal investigations. n15

During an informal investigation, the staff typically requests the voluntary production of documents. n16 The staff also may request the creation of documents, such as chronologies of events. In addition, the staff may request interviews or transcribed testimony from witnesses. Depending upon the urgency of the matter and the willingness of the witness to voluntarily cooperate, the staff may request that interviews be conducted either face-to-face or on the telephone.

The staff cannot require and administer oaths or affirmations in informal investigations, as it can in formal investigations (discussed below). Neverthe- [\*57] less, the staff often conducts interviews with a court reporter present and a verbatim transcript is produced. A witness may be willing to testify on the record in an informal investigation. If so, the staff, after obtaining the witness's consent, will have the court reporter place the witness under oath. If the witness is placed under oath, false testimony may be subject to punishment under federal perjury laws. n17 In addition, *18 U.S.C. 1001*, which prohibits false statements to government officials, applies even if a witness is not under oath. n18

At the conclusion of an informal investigation, the staff has several options. The staff may recommend that the Commission: (1) authorize an administrative proceeding seeking remedial sanctions; (2) seek injunctive relief; (3) in the case of willful violations, refer the matter to the Department of Justice (the "DOJ") for criminal prosecution; n19 (4) conclude the investigation without recommending the commencement of an enforcement proceeding; or (5) seek a formal order of investigation to conduct a formal investigation. n20 The staff may choose this last option if witnesses have not been cooperative, or if subpoena power otherwise is required to obtain the necessary information. Although cooperation by a witness from whom the staff seeks information may keep an investigation informal, non-cooperation by third party witnesses or the need to obtain documents from entities that require a subpoena, such as banks and telephone companies, often necessitates a request by the staff for Commission authorization for a formal investigation. [\*58]

## C. Formal Investigations

### 1. Function of Formal Order of Investigation

Before the staff can conduct a formal investigation, the staff must obtain authorization from the Commission through the issuance of a formal order of investigation by the Commission. n21 The Commission will issue a formal order of investigation if it finds that there is a likelihood that a violation of the federal securities laws is occurring or has occurred. The formal order serves two important functions: (a) it generally describes the nature of the investigation that the Commission has authorized; and (b) it grants the staff the power to issue subpoenas and to administer oaths. Formal investigative proceedings are non-public unless otherwise ordered by the Commission - an exceptionally rare occurrence. n22

In authorizing the issuance of a formal order of investigation, the Commission delegates broad fact-finding and investigative authority to the staff. n23 Various statutes provide for the designation of officers of the Commission who can administer oaths, subpoena witnesses, take testimony, and compel production of documents. n24 These statutory provisions do not limit the designation of Commission "officers" to attorneys. Staff accountants, analysts, and investigators also may be designated as "officers" and empowered to take testimony and issue subpoenas. Thus, for instance, in an investigation involving the application of generally accepted accounting principles or auditing standards, accountants often examine witnesses.

The SEC's Rules Relating to Investigations afford witnesses in formal investigations certain procedural protections. n25 These rules provide, among other things, that a witness is entitled to review the Commission's formal order of investigation and may be accompanied by counsel when proffering testimony. n26

### 2. Provisions of Formal Orders of Investigation

In addition to a caption (which provides the name and file number of an investigation), formal orders typically contain:

- (1) a "Public Official Files" section;
- (2) a "Staff Report" section; and
- (3) a "Purpose and Order" section. [\*59]

The Public Official Files section identifies, describes, and provides basic facts about the named individuals and entities, as disclosed in the Commission's official public files. The Staff Report section recites the general information that tends to show the statutory and rule violations that may have occurred. The Purpose and Order section recites the potential violations which justify the commencement of a formal investigative proceeding. In addition, this section directs that an investigation be made and names the staff members who are "officers" for the purpose of administering oaths and issuing subpoenas. n27

### 3. Obtaining Copies of Formal Orders

Rule 7(a) of the Commission's Rules Relating to Investigations provides that any person who is compelled or required to furnish documents or testimony in a formal investigation shall, upon request, be shown the formal order of investigation. n28 A witness also may submit a written request to the Assistant Director of the Division of Enforcement supervising the investigation for a copy of the formal order. While provision of a copy of the formal order is within the discretion of the staff, in many instances, a copy is provided. n29

### 4. Transcript Availability

Rule 6 of the Commission's Rules Relating to Investigations provides that a witness in a public formal investigative proceeding may purchase a copy of his testimony. n30 In a non-public investigative proceeding, the staff typically provides a witness with an opportunity to purchase a copy of the transcript of his testimony. In rare circumstances, the staff, after obtaining Commission approval, has refused to permit a witness to purchase a copy of his testimony. n31 In any

event, under Rule 6, a witness has the right to inspect [\*60] the official transcript of his testimony. The Commission's rules do not provide for any right to purchase or inspect testimony transcripts of other witnesses.

#### 5. Control of the Record

An independent court reporter transcribes testimony in a Commission investigation. The staff, not the witness nor his counsel, control the record and any instructions to "go on or off the record." n32

#### D. Attorneys and Clients

##### 1. Right to Counsel

A witness in a formal investigation has the right to be "accompanied, represented and advised by counsel." n33 Rule 7(c) of the Commission's Rules Relating to Investigations limits the witness's rights to the following:

To have an attorney present with him during any formal investigative proceeding and to have this attorney (i) advise such person before, during and after the conclusion of such examination, (ii) question such person briefly at the conclusion of the examination to clarify any of the answers such person has given, and (iii) make summary notes during such examination solely for the use of such person. n34

In conducting investigations, the staff observes applicable ethical rules when contacting witnesses or their counsel. Where a bona fide attorney-client relationship exists, the staff does not directly contact persons who are known to be represented by counsel. Generally, the staff also does not take a position on ethical or conflict issues which may arise in counsel's representation of multiple witnesses in an investigation. n35 In some instances, however, corporate counsel will claim to represent all present and former employees of a company, even though these employees may not be aware that the company is purporting to represent them and may have made no decisions with respect to representation. Where corporate counsel makes blanket assertions of representation of potentially hundreds or thousands of employees, the staff's determination whether to contact company counsel before contacting [\*61] a present or former employee depends upon the facts and circumstances of the case. n36 If the staff does contact an employee, the staff routinely informs the employee that he may obtain counsel of his choice. If corporate counsel previously has established an attorney-client relationship with an employee, the employee can so inform the staff and the staff will cease direct contact with the employee. n37

##### 2. Sequestration

The Commission's Rules Relating to Investigations restrict a witness's ability to have his or her counsel present during the testimony of other witnesses. Rule 7(b) provides in pertinent part that "all witnesses shall be sequestered, and unless permitted in the discretion of the officer conducting the investigation, no witness or the counsel accompanying any such witness shall be permitted to be present during the examination of any other witness called in such proceeding." n38

As a practical matter, the Commission's sequestration rule requires that counsel representing a witness may only be present during the testimony of that witness and not during the testimony of any other witness. The staff, however, rarely invokes the rule when counsel represents more than one witness in an investigation. Further, courts have restricted the Commission's ability to enforce it. n39

#### E. Sources of Investigations

SEC investigations derive from a number of sources, including: examinations of filings made with the Commission; broker-dealer, investment company, and investment adviser inspections conducted by Commission staff and SROs; market surveillance conducted by Commission staff and SROs; complaints from members of the public, including competitors of issuers and their [\*62] current or former employees; the news media; referrals from other government agencies; and other investigations.

#### F. Investigative Techniques

At the outset of most SEC investigations, the staff from the SEC's Enforcement Division will:

- . Obtain information about the individuals or entities connected with the investigation from public and internal sources including: public filings, such as registration statements, annual and quarterly reports and Forms 3, 4, and 5; SEC and national stock exchange computer surveillance systems; news stories; Who's Who; Standard & Poor's; and the Internet.
- . Gather and analyze relevant facts.
- . Analyze applicable legal theories.
- . Develop a plan of investigation.

Set forth below is a general description of the investigative techniques often employed in the following types of cases:

- (1) insider trading and other market-related investigations;
  - (2) financial fraud/financial statement investigations;
  - (3) regulated entity and failure to supervise investigations; and
  - (4) other types of fraud in connection with the offering and sale of securities.

While this is by no means an exhaustive list of the types of investigations that the Commission conducts, the investigative techniques described below are typical of those used in most investigations.

#### 1. Insider Trading and Other Market-Related Investigations

At the outset of an insider trading investigation, the staff identifies the relevant material events, such as a proposed merger, tender offer or earnings decline, and the timing of such events, including the timing of public announcements. The staff often conducts informal telephone interviews with persons knowledgeable about the material events, including the issuer's management, investment bankers and lawyers, and requests chronologies from such persons.

##### a. "Blue Sheet" Information

After determining the relevant events and time periods, the staff will obtain trading information from brokers. By reviewing clearing data, the staff determines which brokers had accounts that traded securities during the relevant period. The staff then utilizes what is characterized as the electronic "Blue Sheet" n40 process to contact the identified brokers. The Blue Sheet process, simply put, is the gathering of all trading information from all accounts that traded in a particular stock during the period in question. The [\*63] staff analyzes Blue Sheet information to determine if any relationships appear to exist among identified customers and those known to have been in possession of non-public information. Factors that are examined include: customer names and addresses; the size, quantity, date, and nature of the transactions, such as whether it was solicited or unsolicited; and the identity of the account executive for such transactions.

If the review identifies accounts that warrant further review, the staff requests account opening statements and other documentary information, such as monthly account statements, from the brokerage firm. The staff uses the account information and monthly statements to further uncover relationships between or among traders and people who were in possession of non-public information. The staff also may interview account executives and obtain additional documents such as: phone records; bank statements and checks; personal calendars; and personal telephone or address books. Finally, the staff will request or issue subpoenas to compel the testimony of the persons who traded.

If the Blue Sheet responses indicate that suspicious foreign trading occurred, the staff determines the most practical approach to identify the trader and, if appropriate, freeze, or obtain an agreement to maintain, the assets in the trader's account pending identification. The Commission uses negotiated treaties and Memoranda of Understanding with certain countries to obtain evidence from abroad. n41 In other instances, the staff must consider how to obtain evidence from foreign countries on an ad hoc basis.

After completing these steps, the staff determines whether a violation of 10(b) of the Exchange Act n42 and Rule 10b-5 n43 promulgated thereunder has occurred based upon trading while in the possession of material, non-public information. There are two primary theories of insider trading. Under the classic theory involving a traditional insider, a person has engaged in insider trading when he buys or sells securities on the basis of material non-public information and, at the same time, is a fiduciary or "insider" of the corporation whose securities are being traded. n44 Under the misappropriation theory, impermissible insider trading has occurred when a person misappropriates material non-public information by breaching a duty arising out of a relationship of trust and confidence and uses that information in a securities transaction. n45 [\*64]

#### b. Market Manipulation

Market manipulation investigations also require an examination of trading activity over a defined time period. n46 After establishing the appropriate time period for review, the staff requests Blue Sheet information as it would in an insider trading investigation. The staff looks for evidence of manipulative trading designed to artificially inflate or deflate the price of a stock, including related parties trading the same stock, wash sales, matched orders, or, if relevant, transactions at the close of the market. n47 Typically, the staff also obtains records from the issuer's transfer agent.

### 2. Financial Fraud/Financial Statement Investigations

Financial fraud and financial statement investigations generally involve publicly-held corporations whose securities are registered with the Commission. n48 These investigations focus on frauds accomplished through the use of false financial information and the failure to disclose material facts relating to a public company's financial condition. n49 Often, those who commit financial fraud also engage in insider trading during the period that the company's financial condition is misrepresented in public filings. n50 Financial fraud investigations typically are document intensive.

The variety and complexity of financial fraud investigations make it difficult to generalize the investigative steps normally employed in these cases. The most common issues encountered in financial fraud and financial statement cases are:

- . accounting for revenue; n51
- . valuation of assets; n52
- . the timing of the creation of loss reserves, as well as the adequacy of loss reserves; n53 [\*65]
- . incomplete or inadequate disclosure in Management's Discussion and Analysis of Financial Condition; n54
- . in broad terms, the application of generally accepted accounting principles in issuer transactions; n55 and
- . the failure of an independent accountant to apply generally accepted accounting principles, or to employ generally accepted auditing standards, when auditing an issuer's financial statements. n56

The staff typically seeks all of the relevant work papers from the issuer's independent public accountants, as well as all relevant documents from the issuer. Frequently, documents from banks, creditors, customers, and others with a business relationship with the issuer also will be subpoenaed. The staff analyzes the documents received, and takes the testimony of the appropriate personnel, from the issuer and independent accountants.

### 3. Regulated Entities/Failure-to-Supervise Investigations

The SEC may bring enforcement actions against "regulated" persons and entities, which include broker-dealers, investment advisers, investment companies, and their associated persons. n57 These proceedings may (a) seek to prevent ongoing and future violations of the federal securities laws or the rules and regulations promulgated thereunder; and (b) sanction those regulated entities and their associated persons for failure to reasonably supervise individuals subject to their supervision who commit violations of the federal securities laws and the rules and regulations promulgated thereunder. n58

#### a. Broker-Dealer, Investment Adviser, and Investment Company Cases

The staff typically begins a regulated entity investigation following: (i) an oversight inspection where deficiencies were noted; (ii) a referral from a self-regulatory organization; or (iii) the receipt of customer or broker-dealer complaints. The staff may conduct an inspection of the entity's books and records, subpoena documents, and take the testimony of employees, supervisors, clients, and customers, if appropriate. The Commission may charge a broker-dealer or investment adviser, and individuals associated therewith, [\*66] with direct violations of the law, committing or causing violations of the law, or with aiding and abetting violations of others. n59

(i) Broker-Dealers

The Commission routinely brings enforcement actions to remedy violations of Exchange Act rules that pertain to broker-dealers. Examples of actions involving violations of the broker-dealer rules include:

(a) violations of the net capital rule, n60 which specifies the methods for computing net capital, and which ensures that a broker-dealer maintains sufficient liquid assets to promptly satisfy the claims of customers and to cover potential market and credit risks;

(b) the customer protection rule, n61 which requires a broker-dealer to maintain possession and control of fully paid or excess margin customer securities, and which prevents a broker-dealer from using customer money to finance its business, except as related to customer transactions;

(c) the books and records and reporting requirements, n62 which obligate broker-dealers to make and maintain certain books and records and to file certain reports with the Commission; and

(d) violations of the general antifraud provisions of the federal securities laws, n63 which include market manipulation, making false and misleading statements of material facts in connection with the purchase or sale of securities, failing to disclose material facts in connection with the purchase or sale of securities, misappropriating customer funds and securities, engaging in unsuitable trading, unauthorized trading, churning, or charging excessive markups, and violations of the broker-dealer antifraud provisions of the Exchange Act. n64 [\*67]

Other enforcement actions against broker-dealers may involve violations of the credit extension rules, n65 the short-sale rule, n66 the trading practices rules, n67 and rules relating to contingency offerings. n68

(ii) Investment Advisers

The Commission also routinely brings enforcement actions against investment advisers and their associated persons to remedy violations of the Advisers Act and the rules thereunder. n69 Such enforcement actions frequently involve violations of:

(a) the prohibitions against the use of, among other things, testimonials and false and misleading advertisements by investment advisers; n70

(b) the prohibition against the receipt of performance fees by investment advisers that are required to be registered; n71

(c) the general antifraud provisions, n72 which prohibit any investment adviser from engaging in acts and practices which defraud, or operate as a fraud, on clients or prospective clients; and

(d) the books and records and reporting requirements, n73 which require registered investment advisers to maintain certain books and records and to file certain reports with the Commission.

(iii) Investment Companies

In recent years, the number of investment companies registered with the Commission and the amount of their assets have grown explosively. n74 As a result, enforcement actions involving investment companies have become a more significant part of the Commission's enforcement program. Enforcement actions brought to remedy violations under the Investment Company Act and the rules thereunder frequently involve violations of: [\*68]

(a) the affiliated and joint transaction provisions of the Investment Company Act, n75 which generally prohibit purchases and sales of securities, loans, and joint transactions or arrangements between registered investment companies and their affiliated persons;

(b) the registration provisions, n76 which generally require all investment companies to be registered with the Commission;

(c) the provisions governing personal securities trading by affiliated persons of registered investment companies; n77 and

(d) the books and records and reporting requirements, n78 which require registered investment companies to maintain certain books and records, file certain reports with the Commission, and to disseminate certain reports to shareholders.

#### b. Failure to Supervise

The Commission also may seek to sanction, through its administrative process, those persons and entities who fail to supervise others subject to their supervision with a view toward detecting and preventing such violations. n79 These allegations of failure to supervise may be adjudicated only in Commission administrative proceedings and are not actionable in civil actions in federal court. n80

Under 15(b) of the Exchange Act, the Commission can: (i) censure, suspend or revoke the registration of a broker-dealer or place limitations on the activities of a broker-dealer found to have failed to supervise; and (ii) censure, suspend or bar from, or otherwise place limitations upon their, association with a broker-dealer any individual found to have failed to supervise. n81 The Commission may impose suspensions or bars from particular activities, such as suspending an individual from acting in a supervisory or proprietary capacity, or suspending a firm from opening new accounts or participating in underwritings. Since 1990, 21B of the Exchange Act has authorized the Commission to impose a civil money penalty on any broker- [\*69] dealer or associated person found to have failed to supervise. n82 Similar sanctions are available against investment advisers and their associated persons for failure to supervise. These sanctions also are available only in administrative proceedings, under 203(e) and (i) of the Advisers Act. n83

The SROs also impose supervisory responsibilities on their members and associated persons. n84 The SROs have the power to impose censures, fines, suspensions, bars, and other appropriate sanctions. The Commission has interpreted the SROs' authority to permit the imposition of equitable remedies such as disgorgement and restitution. n85 Under 19(d) of the Exchange Act, the Commission reviews sanctions imposed by the SROs which are appealed to the Commission. n86 The scope of the Commission's review of SROs' findings and sanctions is more limited than its full de novo review of Commission administrative proceedings. In particular, the Commission does not have discretion to increase the sanctions imposed in SROs' disciplinary proceedings. n87

#### 4. Other Types of Fraud in Connection with the Offer and Sale of Securities

The investigative techniques outlined above apply to most types of Commission investigations. Technological advances and the globalization of the securities markets, however, now present new opportunities for perpetrators of securities fraud and, correspondingly, new challenges for the Commission. Recently, the staff, using the techniques outlined in this section, brought enforcement actions involving abuses of the Commission's Regulation S exemption from registration, n88 fraudulent offerings of securities on the Internet, n89 [\*70] "prime bank" schemes n90 and "wireless cable" schemes. n91 The staff also has used these techniques to bring enforcement actions involving problems with municipal bond offerings and violations of "pay to play" regulations. n92



## II. Challenges to Investigations

### A. First Amendment

First Amendment issues have arisen in a variety of cases involving the application of the federal securities laws to conduct which is associated with publishing. n93 For example, many jurisdictions recognize a qualified federal common law privilege for journalists to protect their sources and background notes and materials. n94 The privilege belongs to the journalist and can be waived only by the journalist. n95 The journalist's privilege can be overcome by a clear showing that the information sought is material and relevant, is necessary to the maintenance of the claim, and cannot be obtained from other sources. n96 In determining whether the privilege will withstand challenge, courts typically weigh the party's need for the information against the journalist's First Amendment interests. n97

### B. Fourth and Fifth Amendments

The Fourth and Fifth Amendments have been invoked to challenge SEC subpoenas in an attempt to prevent the SEC from obtaining documents or testimony. [\*71]

#### 1. Fourth Amendment

The Fourth Amendment safeguards against unreasonable regulatory searches and applies to individuals, as well as to corporations, in civil investigations. n98 The Fourth Amendment requires that administrative agency subpoenas be sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unreasonably burdensome. n99 Shareholders cannot claim the Fourth Amendment privilege of the corporation. n100 Similarly, an agency subpoena to a bank for records relating to an individual account-holder does not violate the accountholder's Fourth Amendment rights because the subpoenaed materials are business records of the bank. n101

#### 2. Fifth Amendment

Any evidence proffered by a witness may be used against that person in any federal, state, local, civil, or criminal proceeding, and in many foreign administrative proceedings. n102 A witness testifying before the SEC may assert his or her Fifth Amendment privilege against self-incrimination when providing documents or testimony to the SEC. This privilege allows the witness to refuse to provide evidence that may tend to incriminate him or subject him to a fine, penalty, or forfeiture. n103

##### a. Assertion of the Fifth Amendment Privilege

The Fifth Amendment privilege is personal in nature. n104 Generally, the staff will insist that a witness appear and assert the privilege in person, although assertions of the privilege by a witness in an affidavit have, in some instances, been accepted. In order to successfully assert the privilege, the requested testimony must tend to incriminate the witness, not merely subject [\*72] the witness to disgrace or disrepute. n105 If a previous grant of immunity, or the expiration of the time limits prescribed by the statute of limitations, eliminates the danger of self-incrimination, the witness may not invoke the privilege.

##### b. Scope of the Fifth Amendment Privilege

The Fifth Amendment privilege against self-incrimination protects individuals and sole proprietorships, but does not protect a collective entity, such as a corporation, or papers held by an individual in a representative capacity for a collective entity. n106 The Fifth Amendment privilege may protect records of a sole proprietorship because the act of production may result in the individual admitting the existence of the records, his or her possession thereof, or their authenticity, any or all of which may be incriminating. n107 A corporate officer, by contrast, must produce corporate records even if they may incriminate the officer. n108 Moreover, no Fifth Amendment privilege exists as to records required to be maintained by law. n109 The privilege also is not available to a taxpayer to prevent production of the taxpayer's business and tax records in an accountant's possession. n110

Waiver of the privilege may occur. Voluntary disclosure of an incriminating fact waives the privilege as to the fact and all other relevant facts where no further incrimination would result. n111 Similarly, a witness who waives the privilege during testimony in an SEC investigation may not assert the privilege with respect to the subject matter of that testimony in a subsequent civil or criminal proceeding. n112

### c. Effect of Assertion of Fifth Amendment Privilege

Courts have held that the Commission, in subsequent civil and administrative proceedings, can draw an adverse inference against a witness who in- [\*73] vokes his Fifth Amendment privilege against self-incrimination. n113 A witness can invoke the privilege during an investigation and thereafter decide to testify in subsequent litigation so that no adverse inference can be drawn from the earlier assertion of the privilege. n114 The effect of asserting the privilege during the investigation may, itself, have consequences. Depending upon the facts and circumstances at issue, the staff may argue that the Commission should draw an adverse inference when considering whether to authorize an enforcement action. Moreover, the assertion of the Fifth Amendment privilege in response to questions regarding a registration statement involving an offering of securities to the public is effectively a failure to cooperate with an examination under section 8(e) of the Securities Act and is, in and of itself, grounds for the issuance of a stop order. n115

### d. Double Jeopardy

The Double Jeopardy clause of the Fifth Amendment protects criminal defendants against multiple prosecution and multiple punishment for the same offense. If the Commission obtains sanctions in a civil action that are deemed punitive rather than remedial against a defendant who previously has been criminally punished, the defendant may assert his rights under the Double Jeopardy clause of the Fifth Amendment. n116 In order to determine if a sanction constitutes punishment, courts must ascertain whether the purpose served by the sanction is punitive or remedial. n117 Defendants' attempts at challenging governmental sanctions as punitive, and thereby barred by the Double Jeopardy clause, often have been unsuccessful. n118 [\*74]

## C. Immunity

### 1. Grants of Immunity

"Use immunity," as opposed to transactional immunity, can be conferred upon witnesses in Commission investigations. Immunity grants sought by the Commission, while not routine, are conferred in cases where the Commission, after approval by the Attorney General, concludes that a particular grant is proper and advances the investigation. Use immunity, as the term implies, prevents the government from using the witness's immunized testimony, or any information directly or indirectly obtained from that testimony, against the witness in a criminal proceeding. n119 Note, however, that use immunity conferred in Commission investigations will not shield a witness from Commission proceedings. In other words, the Commission can bring a civil proceeding against the witness based upon the immunized testimony.

All federal immunity grants are controlled by statute and must be authorized in advance by the Attorney General of the United States. n120 If a witness asserts the Fifth Amendment privilege against self-incrimination and refuses to answer questions, the Commission can seek approval from the Attorney General to immunize the witness from criminal prosecution. n121 If the Attorney General approves the Commission's request, the Commission will issue an order immunizing the witness and compelling his testimony. n122 The witness cannot continue to refuse to testify either in the investigation or in a related enforcement action once the Commission issues the immunization order. n123 No information compelled by the order may be used against the witness in a criminal case, except in a prosecution for perjury, false statement, or failure to comply with the order. n124

### 2. Inadvertent Grant of Immunity

"Inadvertent immunity" grants can occur if a witness is compelled to testify after claiming the Fifth Amendment privilege against self-incrimination- [\*75] tion. n125 The staff seeks to prevent claims that questions posed after a witness's assertion of the Fifth Amendment privilege confer immunity. To prevent such claims, the staff usually will state on the record that it has no authority to confer immunity, that it has no intention of doing so, and that any questions asked from that point on in the testimony will be with the understanding that the witness may decline to answer on the basis that the response may tend to incriminate the witness.

## D. Attorney-Client Privilege

Any witness who testifies in a Commission investigation can assert the attorney-client privilege. The attorney-client privilege can be successfully invoked only if:

- . the asserted holder of the privilege is, or sought to become, a client;
- . the person to whom the communication was made is a member of the bar and was acting as a lawyer in connection with this communication;
- . the communication relates to a fact told to the attorney by his client, outside the presence of strangers, for the purpose of securing primarily either an opinion of law or legal services or assistance in some legal proceeding, and not for the purpose of committing a crime or tort; and,
- . the privilege has been claimed and not waived by the client. n126

The party invoking the privilege has the burden of proof. To maintain a claim of attorney-client privilege, the communication between attorney and client must have been made and maintained in confidence. n127 The privilege does not protect documents and information acquired by a lawyer from third parties. n128 The privilege applies even after termination of the attorney-client relationship as long as the communication was made while such a relationship existed. n129

Voluntary disclosure by the holder of the privilege of information to third parties, including the Commission, is inconsistent with a confidential relationship and results in a waiver of the privilege. n130 Whether a witness has [\*76] permitted a general or limited waiver of the privilege by testifying or producing documents is often a hotly contested issue. n131

#### E. Work-Product Doctrine

Written materials prepared or obtained by an attorney while representing a client in anticipation of litigation have a qualified immunity from discovery. n132 The privilege is qualified because the materials may be discoverable upon a proper showing of substantial need by the party seeking discovery if the substantial equivalent of the materials cannot be obtained by other means without undue hardship. n133 The client can intentionally or unintentionally waive the protections afforded by the work-product doctrine through voluntary disclosure of materials to the SEC. n134

#### F. Self-Evaluative Privilege

In some investigations, the SEC may request production of internal, self-evaluative reports prepared by companies. n135 In deciding whether to request such reports, the staff carefully weighs the public policy issues and attempts to balance the benefits of access to such a report against the possible chilling effect such a demand may have on self-evaluative behavior. [\*77]

Although the attorney-client privilege extends to communications between corporate employees and a corporate attorney in certain circumstances, n136 it may not protect corporate self-evaluative activity. Courts have recognized a qualified self-evaluative privilege for self-evaluative reports in civil actions. n137 Courts, however, have afforded government agencies wider latitude to discover self-evaluative materials because the governmental interest in the investigation of possible unlawful activity often outweighs any potential chilling of future internal evaluations. n138 The United States Circuit Courts of Appeals are split regarding whether a party waives the self-evaluative privilege when the party provides arguably privileged, self-evaluative documents to a government agency. n139 Moreover, some courts fail to protect self-evaluative reports in civil actions involving securities issues. n140 [\*78]

#### G. Other Privileges

Federal courts refuse to recognize the accountant-client, n141 broker-client, n142 banker-depositor, n143 parent-child, n144 or physician-patient n145 privileges. However, federal courts do recognize the husband-wife, n146 psychotherapist-patient, n147 and priest-penitent n148 privileges. n149

### III. Procedural Issues in Commission Investigations

#### A. The Freedom of Information Act

Under the Freedom of Information Act ("FOIA"), n150 information and documents submitted to the SEC in an investigation may be disclosed to [\*79] third parties. There are nine exemptions to disclosure under the FOIA. n151 The

SEC generally relies on three particular exemptions in refusing to disclose documents relating to an investigation: (1) the documents contain trade secrets or confidential business information; (2) the documents constitute inter/intra-agency communications; or (3) the records or information sought were compiled for law enforcement purposes. n152 The FOIA does not create or alter existing substantive rights for persons submitting information to the Commission, and it does not affect the Commission's right, authority, or obligation to disclose information in any other context. For instance, the FOIA does not apply to the process by which the Commission makes information available to regulatory agencies or prosecutorial authorities. Thus, any attempt to condition production of documents and information to the Commission upon an understanding that such materials cannot be made available to other governmental agencies will be ineffective.

### 1. Requesting Confidential Treatment

A person seeking to obtain information from the SEC can use the FOIA. The FOIA also provides a mechanism for a person who submits information to the SEC to request confidential treatment. n153

Rule 83 of the FOIA provides a procedure by which a person submitting information to the Commission during an investigation, voluntarily or pursuant to subpoena, may request confidential treatment under the FOIA. n154 Rule 83 applies only when no other statute or Commission rule provides procedures for requesting confidential treatment or where the Commission has not specified the use of an alternative procedure. n155 This rule specifies three reasons for requesting confidentiality: personal privacy; business confidentiality; and any other reason permitted by law, such as FOIA's nine disclosure exemptions. n156 Blanket requests for confidential treatment of all information provided in reliance upon every possible exemption under the FOIA are ineffective and far less likely to protect any truly confidential information. Thus, counsel or the witness should be both specific and discriminating when making such requests.

Rule 83(c) provides that information for which confidential treatment is requested should be: (1) segregated from other information; (2) clearly marked as confidential with a stamp, legend, or other form of notice stating "Confidential Treatment Requested by [name]"; and (3) accompanied by a written request for confidential treatment which specifies the information for [\*80] which confidential treatment is requested. A copy of the written request should be forwarded to the SEC's FOIA officer. n157

A witness should request confidential treatment for testimony given in the course of an investigation at the time testimony is provided, or as soon thereafter as possible. A written request for confidential treatment should be submitted within thirty days after testifying. n158

Determinations as to the validity of a request for confidential treatment are not made until a request for disclosure of the information is made under the FOIA. n159 The Commission notifies the person or entity requesting confidentiality of a FOIA request and asks the person or entity to substantiate the claim of confidentiality within ten calendar days. n160 The SEC FOIA officer determines whether to grant the confidentiality request. n161 The person or entity requesting confidentiality may appeal these decisions to the SEC's Office of General Counsel. n162 Generally, if a FOIA request is filed while the staff is investigating a matter, the Commission asserts an exemption from disclosure for continuing law enforcement activities. This exemption protects all information and documents while the case or inquiry remains open or active. n163

### 2. Effect of Not Requesting Confidential Treatment

The Commission presumes that any person who has not requested confidential treatment has waived any interest in asserting an exemption from disclosure under the FOIA. n164 Notwithstanding this presumption, the staff may, but is not required to, contact any person who would be affected by such disclosure to determine if he wishes to make a request for confidentiality. n165

Information submitted to the Commission with a confidential treatment request may nonetheless be disclosed to third parties under various circumstances. For instance, the submitted material may be disclosed: to witnesses in investigations; in response to requests for access to Commission files made by other agencies; to third party litigants pursuant to a judicial subpoena; or for other lawful purposes. n166 Not surprisingly, counsel submitting information to the Division of Enforcement often attempt, unilaterally, to impose conditions on the use or transfer of such information. In the absence of a written agreement with the Commission, these attempts at preserving confi- [\*81] dentiality, or limiting the Commission's use of the information, are ineffective. n167

### B. The Privacy Act of 1974

## 1. In General

The Privacy Act of 1974 ("Privacy Act") n168 provides certain notice and protection to persons from whom the federal government solicits information. The Privacy Act governs the procedures applicable to the SEC for obtaining, maintaining, and disseminating information obtained from individuals. n169 Generally speaking, the Privacy Act establishes requirements for the solicitation and maintenance by agencies of personal information regarding members of the public. Among other things, the Commission is required to: (1) identify all "systems of records" which the agency maintains and publish a public notice of the existence of such systems of records; (2) provide a prescribed notice to any individual from whom the Commission requests information; (3) maintain a record of all disclosures of information concerning individuals, except disclosure to Commission employees who have an official need for the information or disclosures made to the public under the FOIA; and (4) permit individuals to have access to records pertaining to themselves and provide an opportunity to have such records amended if they are inaccurate, except records that have specifically been exempted from these requirements. n170

The protections of the Privacy Act apply only to an individual who is "a citizen of the United States or an alien lawfully admitted for permanent residence." n171 Thus, corporations, businesses, partnerships, and foreign nationals living abroad or residing illegally in the United States are not afforded the rights granted under the Privacy Act.

The Privacy Act requires that the Commission provide each individual asked to supply information with the following notice:

- (a) the authority pursuant to which the information is being requested, and whether compliance is mandatory or voluntary;
- (b) the principal purposes for which the information will be used;
- (c) the "routine uses" of information; and
- (d) the effect, if any, of not providing the requested information. n172

As discussed above, the Commission's enforcement authority for requesting information derives from statute and usually arises in the context of [\*82] an informal or preliminary inquiry or pursuant to a formal order of investigation. n173 When notifying individuals of the Commission's authority for requesting information, the staff distinguishes between mandatory or voluntary compliance with the request. n174 The notices required by the Privacy Act, including the list of Routine Uses, are set forth on SEC Forms 1661 and 1662.

## 2. Systems of Records

Under the Privacy Act, a "record" is defined broadly to include any item, collection or grouping of information about an individual that is maintained by an agency and that contains information that identifies the individual. n175 The Privacy Act requires that the Commission publish a description of all "systems of records" in the Federal Register. n176 All of the Commission's "systems of records" have been published in the Federal Register. n177 Among other things, these systems and notices include the various "routine uses" for which information in these systems of record may be used. n178

## 3. Routine Uses

Generally, under the Privacy Act, disclosure of information obtained in an investigation from an individual, which pertains to that individual, can only be made with the permission of the individual or pursuant to an exception. n179 The SEC discloses information most often pursuant to the "routine use" exception. n180 A "routine use" is defined as the use of the record for a purpose which is compatible with the purpose for which it was collected. n181

Routine uses permit disclosure by the SEC to, among others: (a) other enforcement agencies and organizations; (b) SROs; (c) trustees, receivers, and court appointed officers; and (d) any person during the course of an investigation or in connection with litigation, if the staff has reason to believe that the person to whom the record is disclosed may have further information [\*83] relevant to the matter under investigation. n182 Although the Privacy Act allows disclosure

pursuant to a "routine use," n183 the release of information will be authorized only if it is consistent with other applicable statutes and Commission rules and procedures.

#### 4. Disclosures and Accounting

In general, the Privacy Act requires an accounting of each instance in which information about an individual is disclosed to third parties. n184 The accounting must include the date, nature, and purpose of each such disclosure. n185 Such an accounting, however, is not required for disclosures made to members of the Commission staff who have a need for the information in the performance of their duties, or for disclosures required by the FOIA. n186

#### 5. Civil Penalties

If the SEC violates the Privacy Act, an aggrieved person may bring action against it. n187 An individual who has been injured by agency action may recover only for intentional or willful violations of the Privacy Act. n188 The Privacy Act authorizes courts to order compliance by an agency and to award litigation costs and attorney's fees. n189 In addition, the Act authorizes courts to award minimum statutory damages of \$ 1,000 and any actual damages in excess of that amount. n190

The Privacy Act requires that the Commission maintain records "with accuracy, completeness, timeliness, and relevance as is reasonably necessary to assure fairness to the individual in the determination," and an individual may bring suit challenging a Commission determination "based upon an improperly constituted record." n191 This requirement that the Commission maintain records with "accuracy, completeness, timeliness, and relevance," however, does not permit individuals to challenge the Commission's maintenance of information in its investigative files during the course of an investigation; therefore, a challenge cannot occur prior to use of information in any determination concerning an individual. n192 Further, a party may not use this provision to make a collateral attack on any determination "which has al- [\*84] ready been the subject of or for which adequate judicial review is available." n193

#### 6. Criminal Penalties

It is a criminal violation of the Privacy Act for any agency officer or employee willfully to disclose a record if the officer or employee knows that disclosure of the specific information is prohibited by the Act. n194 It also is a criminal violation for any officer or employee willfully to maintain a system of records without meeting the Act's notice requirements. n195 Violations of these provisions are punishable by fines of not more than \$ 5,000. n196 In addition to criminal penalties for violations of the Privacy Act by Commission staff, a fine of not more than \$ 5,000 may be imposed upon any other person who, under false pretenses, knowingly and willfully requests or obtains from an agency any record concerning an individual. n197

### C. Subpoenas to Financial Institutions for Customer Records - The Right to Financial Privacy Act of 1978

#### 1. Summary

The Right to Financial Privacy Act of 1978 (the "RFPA") n198 generally requires that individuals and small partnerships who are customers of financial institutions be given notice of any governmental request for their financial records and an opportunity to challenge such request. The RFPA governs Commission access to and disclosure of customer account records maintained by financial institutions and restricts subsequent transfer of such records to other federal agencies.

#### 2. Definitions

The RFPA generally prohibits disclosure by a "financial institution" to the Commission of a "customer's" "financial records," except where Commission access is required in connection with a "legitimate law enforcement inquiry." The RFPA defines these basic terms as follows:

(a) "Financial institution" is broadly defined to include all banks, savings and loans, consumer finance businesses, credit unions, and companies issuing credit cards located within the United States or its territories. n199 The definition does not include broker-dealers, investment advisers, or investment companies subject to the Commission's jurisdiction. [\*85]

(b) "Customer" is defined to include only natural persons, and authorized representatives of natural persons, or partnerships of five or fewer individuals that utilize a financial institution in connection with an account maintained under the person's or partnership's name. n200 The definition does not include corporations, associations, larger partnerships, or other large legal entities. n201

(c) "Financial record" means an original of, a copy of, or information known to have been derived from, any record held by a financial institution pertaining to a customer's relationship with the financial institution. n202 The RFPFA does not directly protect records pertaining to a person that appear in the account of another customer, such as check endorsements, or items drawn by an individual and deposited into the account of a corporation if the item is obtained through a search of the corporation's account.

(d) "Legitimate law enforcement inquiry" is defined as a lawful investigation or official proceeding inquiring into a violation of, or failure to comply with, any criminal or civil statute or any regulation, rule, or order issued pursuant thereto. n203

### 3. Certification of Compliance Requirement

As a prerequisite to access to customer financial records under any provision of the RFPFA, the Commission must submit to the financial institution a written statement certifying its compliance with all applicable provisions of the RFPFA. n204 A financial institution is prohibited from affording access absent such certification. n205 A good-faith reliance upon such certification absolves the financial institution of any civil liability arising from disclosure. n206

### 4. Restrictions upon Government Access to Financial Records

The RFPFA prohibits an agency from obtaining, and financial institutions from providing, financial records unless the records are provided pursuant to one of the five access mechanisms recognized by the RFPFA. n207 The Commission may obtain documents through three of the five access mechanisms:

- (a) customer authorization; n208
- (b) administrative subpoena; n209 or [\*86]
- (c) judicial subpoena. n210

The RFPFA provides for two other access mechanisms that are not available to the Commission; the RFPFA provides access to records pursuant to a search warrant n211 and pursuant to a formal written request. n212

Documents provided pursuant to an access mechanism must be reasonably described. n213 The requirement that the records sought must be "reasonably described" is intended to preclude blanket requests lacking in specificity. Notwithstanding these restrictions, financial institutions are permitted (but not required) to make limited disclosure of customer financial records when notifying government authorities of possible violations of law. n214

### 5. Access Mechanisms of the RFPFA Available to the Commission

#### a. Customer Authorization

Under the RFPFA, a customer may voluntarily permit access to his financial records by executing an authorization, valid for no more than three months, which identifies the records to be disclosed to the Commission and the purposes for which disclosure is authorized. The authorization also must summarize the customer's rights under the RFPFA, including the right to revoke the authorization at any time prior to disclosure and the fact that the authorization cannot be required as a condition to doing business with the financial institution. n215 Financial institutions are required to keep a record of each disclosure pursuant to an authorization and must make the records available for the customer's inspection.

#### b. Administrative Subpoena

The SEC may obtain financial records pursuant to an administrative subpoena if the following three conditions are satisfied:

- (i) there is reason to believe that the records are relevant to a legitimate law enforcement inquiry;
- (ii) a copy of the subpoena has been served upon the customer or mailed to his last known address on or before the date on which the subpoena or summons was served on the financial institution. A notice, customer motion to challenge form, and sworn statement must accompany the subpoena; and
- (iii) ten days have expired from the date of service of the notice or fourteen days have expired from the date of mailing to the customer and the customer has not filed a sworn statement and motion to quash in an appropriate court, or the customer's challenge proceeding is complete. n216 [\*87]

#### c. Judicial Subpoena

The SEC also may obtain financial records pursuant to a judicial subpoena, as contrasted with an administrative investigative subpoena. A "judicial subpoena" includes any court order or process requiring the production of records. In the context of SEC enforcement proceedings, a judicial subpoena may be issued in the form of a trial or discovery subpoena directed at customer records held by a non-litigant financial institution. The procedural protections provided by the RFPA for judicial subpoenas n217 are similar to those provided by the RFPA for administrative subpoenas. n218

#### d. Customer Notice

Under the RFPA, the Commission must provide the customer with advance written notification of an attempt to gain access to financial records through either an administrative or judicial subpoena. The text of the notice required in each instance is specified in the RFPA. n219 The notice must contain:

- (i) a description of the records sought, typically accomplished through attachment of the subpoena;
- (ii) a statement of the purpose of the pertinent law enforcement inquiry, accomplished by including a generic classification of the offense(s) involved;
- (iii) an explanation of the procedure by which a customer may challenge the intended access in court; and
- (iv) the name and address of the Commission employee designated to receive service of any customer challenge papers. Together with this notice, the customer also must be provided with a blank customer challenge motion and sworn statement forms. n220

#### e. Customer Challenge Proceeding

Customers may file a court challenge seeking to prevent Commission access to their financial records. n221 The customer must file the challenge within ten days of service, or fourteen days from the date of mailing, of the customer notice. n222 The customer's application must include a sworn statement attesting to the complainant's identity as the customer whose financial records are sought and specifying the factual and legal basis upon which the Commission's intended access is challenged. Once a customer properly files a challenge action, the Commission must show that there is both a "demonstrable reason to believe" that the Commission's law enforcement inquiry is legitimate and a "reasonable belief that the records sought are relevant to the inquiry." n223

The RFPA requires that federal courts decide customer challenges within seven calendar days of the filing of the Commission's response. If the court determines that the Commission has met its burden, it must deny the customer's



motion and, in the case of an administrative or judicial subpoena, order that the subpoena be enforced. n224 If the court determines that the Commission has not met its burden, the subpoena will be quashed. The court also may quash the subpoena upon a finding that there has not been "substantial compliance" with the provisions of the RFPA.

A denial of a customer challenge is not appealable as a final order until after the conclusion of any collateral legal proceeding brought against the customer based upon the financial records involved in the customer challenge action. n225 Even then, the court may take the appeal only as part of any appeal of the collateral legal matter. n226 If the Commission determines not to bring a collateral proceeding, the customer may appeal an adverse customer challenge ruling within thirty days of the Commission's prompt notification of such determination. n227

#### 6. Interagency Transfer of Records Obtained Under the RFPA

The RFPA restricts the Commission's transfer of any records originally obtained under the RFPA. n228 Such records may be transferred to "another agency or department" only if a Commission official certifies that there is reason to believe that the records are relevant to a legitimate law enforcement inquiry within the jurisdiction of the receiving agency. n229 Additionally, the customer normally must be provided with notice of such transfer within fourteen days after the transfer. Transfers of customer financial records to the DOJ and bank regulatory agencies are exempt from the customer notice provisions. n230 [\*89]

#### 7. Exceptions to the RFPA

The RFPA contains a number of exceptions which dispense with some or all of the RFPA's requirements. n231 The exceptions most often relied upon by the Commission include:

- a. Non-customer information. The RFPA does not pertain to a record or to information which is "not identified with or identifiable as being derived from the financial records of a particular customer;" n232
- b. Reports required by federal statute to be filed by financial institutions; n233
- c. Court and administrative litigation where the customer is a party to the litigation; n234
- d. Account identifying information; n235 and
- e. Investigation of the financial institution. The general procedures of the RFPA do not apply where the Commission requires access to financial records in connection with a lawful investigation directed at the financial institution (whether or not the investigation also is directed at a customer), or at any other legal entity which is not a "customer." n236

#### 8. Reimbursement of Financial Institutions

The RFPA provides that financial institutions are to be reimbursed by the Commission, in most instances, for reasonable costs directly incurred by them incident to their compliance with Commission requests for access under the RFPA. n237 The Federal Reserve Board adopted Regulation S to implement this. n238 Exceptions to the reimbursement requirements set forth in Regulation S generally track the exceptions contained in the RFPA. n239

#### 9. Civil Remedies for Violations of the RFPA

In addition to the customer challenge action established by the RFPA, n240 the RFPA also permits a customer to initiate a separate cause of action to seek money damages in connection with any disclosure of his records in violation of the RFPA. n241 The customer may recover a statutory [\*90] minimum of \$ 100, compensatory damages, discretionary punitive damages where the violation is "willful or intentional," and reasonable attorney's fees and costs. n242 Damages are assessable against the Commission and the financial institution involved, but not against individual employees. n243 Injunctive relief also may be obtained. n244

The RFPA also provides for a mandatory investigation by the Office of Personnel Management of any instance where a court determines that the circumstances surrounding a violation "raise questions of whether an officer or employee of the [defendant] department or agency acted willfully or intentionally with respect to the violation." n245

#### 10. Section 21(h) of the Securities Exchange Act of 1934

In general, 21(h) of the Exchange Act contains a special exception for the Commission from the otherwise applicable customer notice provisions of the RFPA. n246 During its investigations, under certain circumstances, the Commission may obtain customer financial records pursuant to an administrative subpoena without prior notice to the customer to whom the financial records relate. n247 In many circumstances when the Commission is conducting an investigation, notice of a subpoena to a customer could severely damage the inquiry and raise the possibility of flight or the transfer of assets. In these instances, the Commission may rely on the exemption contained in 21(h).

Section 21(h)(2) specifies the manner and the circumstances under which the Commission may delay notice to the customer. Under 21(h)(2), the Commission must make an ex parte showing to an appropriate district court that it seeks financial records pursuant to an administrative subpoena authorized by the federal securities laws and that the Commission has reason to believe that:

(a) delay in obtaining access to such financial records or the required notice, will result in:

(i) flight from prosecution;

(ii) destruction or tampering with evidence;

(iii) a transfer of assets or records outside the territorial limits of the United States;

(iv) an improper conversion of investor assets; or

(v) an impediment to the Commission's ability to identify or trace the source or disposition of funds involved in any securities transactions.

(b) such financial records are necessary to identify or trace the record or beneficial ownership interest in any security; [\*91]

(c) the acts, practices, or course of conduct under investigation involve:

(i) the dissemination of materially false or misleading information concerning any security, issuer, or market, or the failure to make disclosures required under the federal securities laws, which remain uncorrected; or

(ii) a financial loss to investors or other persons protected under the securities laws which remains substantially uncompensated; or

(d) the acts, practices, courses of conduct under investigation:

(i) involve significant financial speculation in securities; or

(ii) endanger the stability of any financial or investment intermediary. n248

The Commission's application for a delay in notice must be made with reasonable specificity. n249

#### 11. Court Order

Once the Commission makes the showing described above, which may be made in camera, the court enters an order delaying the notice to the customer for a period not to exceed ninety days and an order prohibiting the financial institution involved from disclosing that records have been obtained or that a request has been made. The Commission also may obtain extensions of up to ninety days upon further application. n250

#### 12. Delayed Notice to Customer

At the expiration of the period of delay of notification ordered by the court, the Commission must provide the customer with a copy of the subpoena issued to the financial institution together with a notice that describes the nature of the investigation, indicates that financial records held by the subpoenaed financial institution have been supplied to the Commission pursuant to 21(h) of the Exchange Act, and states the purpose of the investigation. n251

### 13. Customer Challenge Procedure and Relief

The customer may file a motion with the district court that issued the delay order seeking to reopen the proceeding. If the court determines that there were improprieties in the use of 21(h), it may order relief comparable to that provided by *12 U.S.C. 3417*. n252 [\*92]

#### D. The Electronic Communications Privacy Act of 1986

The Electronics Communications Privacy Act of 1986 n253 (the "ECPA") expanded the federal wiretap laws to encompass a wide range of modern communication technologies. Among other things, the federal criminal code now protects e-mail and other computerized communications via on-line information services and Internet access providers. In general, the ECPA

(1) limits governmental access to the contents of stored electronic communications in the possession of third-party service providers n254 or "remote computing services;" n255

(2) provides for customer notice of and, in some cases, challenge to, governmental access to the contents of stored electronic communications; n256

(3) permits governmental access to records of stored electronic communications, other than the contents of such communications; n257 and

(4) provides civil and criminal penalties for violations. n258

The ECPA's restrictions severely limit the Commission's ability to issue subpoenas for the contents of electronic communications from a third-party service provider. n259 The ECPA, however, does not limit the Commission's ability to subpoena communications in the hands of the sender or recipient, and does not prevent access to e-mail systems other than those maintained by third-party service providers. Thus, the Commission may subpoena information routinely maintained by a corporation on an internal computer network. The ECPA also places no restrictions on the Commission's ability to conduct surveillance of public areas of the Internet or of those networks maintained by on-line information services. n260

The Commission often needs telephone records during the course of its investigations, particularly in insider trading investigations. In this regard, the ECPA generally requires that access to a telephone company's records must be by subpoena, n261 or pursuant to customer consent. n262 The ECPA also [\*93] requires that the Commission pay telephone companies for the costs of producing records other than telephone billing records. n263 The same provisions permit the Commission to obtain records related to computerized communications, other than the contents of such communications.

#### E. The Fair Credit Reporting Act

The Fair Credit Reporting Act n264 (the "FCRA"), places restrictions on the release of consumer reports prepared by consumer reporting agencies, such as credit bureaus.

For purposes of the FCRA, a "consumer reporting agency" means any person "regularly engaged in whole or in part in the practice of assembling or evaluating consumer credit information on consumers for the purpose of furnishing consumer reports to third parties." n265 A "consumer report" is broadly defined to include "any written, oral or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living," when such information is to be used in determining the consumer's eligibility for credit, employment, or for other purposes specified in the FCRA. n266

The FCRA limits disclosure of consumer reports by consumer reporting agencies to the following situations:

- (1) in response to a court order or a subpoena issued in connection with a federal grand jury proceeding;
- (2) in accordance with written instructions by the consumer; and
- (3) to a person who intends to use the information for employment purposes or in connection with a credit transaction, insurance underwriting, the issuance of a license or other benefit, or otherwise in connection with a business transaction involving the consumer. n267

While the courts have not addressed the applicability of the FCRA limitations in Commission investigations, the restrictions of the FCRA have been applied to the federal government in other contexts. n268

#### F. Tax Returns and *Section 6103 of the Internal Revenue Code*

*Section 6103 of the Internal Revenue Code* n269 covers the confidentiality of tax returns and related tax liability information, and sets forth the conditions under which a government agency may obtain return information from the Internal Revenue Service ("IRS"). Specifically, Section 6103 provides [\*94] that information may be disclosed by the IRS to a government agency for use by the agency in preparation for administrative and judicial proceedings that pertain to the enforcement of a non-tax criminal statute. n270 Although willful violations of the securities laws carry potential criminal penalties, n271 the DOJ, not the Commission, has the authority to prosecute criminal actions.

The Commission may obtain tax return information from the taxpayer, and, where relevant during the course of an investigation, does request such information from the taxpayer. In addition, the Commission often requests taxpayer information from a taxpayer/respondent submitting an offer of settlement to the Commission to verify the respondent's financial condition.

##### 1. Testimony by Tax Return Preparers

It is a misdemeanor punishable by a fine of not more than \$ 1,000 and imprisonment of not more than one year for any tax return preparer to disclose information furnished to the preparer in connection with the preparation of a tax return or to use such information other than in the preparation of such return. n272 There are, however, exceptions to the prohibition. Such disclosure by a tax preparer may be made: (i) pursuant to any other provision of the statute; and (ii) pursuant to a court order. n273 The Commission has obtained information from tax preparers pursuant to *26 C.F.R. 301.7216-2(c)* which permits disclosure by tax preparers in response to a subpoena and pursuant to a court order. n274

#### G. Notice of Third Party Subpoenas in Commission Investigations

Unlike the grand jury process where "targets" of an investigation are often identified, the Commission investigative process does not have "targets." Thus, the Commission is not required to provide any type of "target" notification when it issues subpoenas to "third parties" for testimony or documents in its non-public investigations of possible violations of the federal securities laws. The Supreme Court, in *SEC v. O'Brien*, n275 noted that "the imposition of a notice requirement on the SEC would substantially increase the ability of persons who have something to hide to impede legitimate investigations by the Commission." n276 Citing the Commission's broad [\*95] investigatory responsibility under the federal securities laws, the Court found no statutory, due process, or other standard regarding judicial enforcement of such subpoenas to support the proposition that notice is required. n277

#### H. Failure to Comply with Commission Subpoenas - Subpoena Enforcement

##### 1. In General

As set forth above, the Commission is authorized to subpoena witnesses, to compel their attendance, to take evidence, and to require the production of books, papers, correspondence, memoranda, or other records that the Commission deems relevant to its investigation. n278 To accomplish this in a formal investigation, the staff can issue a subpoena compelling testimony and the production of documents. n279

While a "willful" violation of a subpoena may be a criminal offense, Commission subpoenas are not self-enforcing. n280 If a subpoenaed party refuses to comply with a subpoena, the Director of the Division of Enforcement, by delegation of authority from the Commission, can authorize Commission application to a federal district court for an order enforcing the subpoena. n281

The federal district courts have exclusive jurisdiction over Commission subpoena enforcement actions. n282 The Commission must file its application seeking enforcement of the subpoena in a federal district court located in a district reasonably related to its investigation. n283 Specifically, subpoena enforcement actions may be filed in a judicial district where the investigation is being conducted or where the subpoenaed person resides or does business. n284 Process may be served in the judicial district wherever the person resides or wherever he may be found. n285

If a subpoenaed person continues to refuse to testify or produce the required documents after a court has issued an order, then the Commission can [\*96] move for a contempt order. n286 In addition, as noted above, with respect to subpoenas issued pursuant to the Exchange Act, Investment Company Act and the Advisers Act, it is a misdemeanor, punishable by imprisonment of one year or a \$ 1,000 fine or both if a person, without just cause, refuses to obey a subpoena issued in a lawful inquiry. n287

Aside from the strictly legal considerations associated with the issue of subpoena enforcement, the process carries certain potentially negative consequences to a person whose conduct may be under scrutiny or to others whose activities may be under investigation. The filing of such an action by the Commission makes public the fact of the investigation, along with any details included in the papers which support the Commission's application.

## 2. Pleadings and Summary Nature of Proceedings

A Commission subpoena enforcement action typically is initiated by application to the court for an order compelling compliance, accompanied by memorandum of law and affidavit. Commission subpoena enforcement actions may be given judicial precedence over other business to avoid delays which can result in information becoming stale or in the running of statutes of limitation. n288

Because of the need for expeditious action, Commission subpoena enforcement proceedings are treated as summary in nature. n289 Commission subpoena enforcement actions utilize the summary procedure authorized by the provisions of the Federal Rules of Civil Procedure. n290 The advantage of this procedure is that it avoids the discovery procedures of the Federal Rules of Civil Procedure. Allegations of improper purpose may entitle a recipient to a hearing or limited discovery. Without evidence of improper purpose, however, such allegations are inadequate to permit general discovery in a subpoena enforcement proceeding. n291 [\*97]

## 3. Standards

In order for a court to determine whether or not to grant the Commission's application for an order compelling compliance with a subpoena, a court considers the Commission's authority to issue a subpoena and the scope of the subpoena. n292 A court also may consider whether the enforcement of a Commission subpoena would result in an abuse of the court's process. n293

The Commission must show that: (1) the inquiry is within the authority of the Commission; (2) the demand is not too indefinite; and (3) the information sought by the subpoena is reasonably relevant to the matter under inquiry. n294 In order to show that an inquiry is within the authority of the Commission, the Commission must show that its investigation is a statutorily authorized and administratively approved inquiry to determine whether specific violations of the federal securities laws have occurred or are occurring. n295

To show that the information demanded in a subpoena is not too indefinite, the Commission need only demonstrate that the information sought, regardless of breadth, is of legitimate concern to the Commission in its discharge of its statutory responsibilities. n296 In evaluating the breadth of a Commission subpoena, "the test is relevance to the specific purpose, and the purpose is determined by the investigators." n297 Even when the purpose of the Commission's request for information is only "official curiosity," the Commission is still entitled to satisfy itself that "corporate behavior is consistent with the law and the public interest." n298

The Commission's burden to show that the subpoenaed documents are reasonably relevant to a lawful purpose is met by demonstrating that the testimony or documents sought are not "plainly incompetent or irrelevant for any lawful purpose." n299 [\*98]

A recipient of a subpoena may attempt to show that an exercise of the court's contempt power would result in an abuse of process. n300 Where the Commission demonstrates that its inquiry is authorized by law, the materials sought are relevant to the inquiry and the materials sought are not too indefinite, the recipient's burden is difficult to meet. n301

#### 4. Staff Misconduct and Negligence

In attempting to prove that enforcement of a Commission subpoena would result in an abuse of process, subpoena recipients frequently allege staff misconduct. Specifically, subpoena recipients contesting enforcement of subpoenas frequently attempt to show that the subpoena was issued in bad faith n302 or for an improper purpose n303 or that the staff acted in a deceitful manner. n304

##### I. Discussions with Other Governmental Authorities and Access to the Commission's Investigative Files

Various provisions of the federal securities laws state that information obtained during the course of the Commission's enforcement, inspection, and other activities is non-public and, together with other non-public records of the Commission, may not be disclosed without authorization of the Commission. n305 Rule 2 of the Commission's Rules Relating to Investigations, however, permits members of the staff to engage in discussions with various entities, including other governmental entities and SROs, concerning non- [\*99] public investigations. n306 Requests for access to the Commission's files often are made following an informal referral by the Commission to the criminal authorities.

Rule 30-4(a)(7) of the Commission's Rules of Organization n307 delegates to the Director of the Division of Enforcement authority to grant access requests to the Commission's non-public enforcement and regulatory files. n308 An access grant generally provides authority to disclose both existing information and information acquired in the future to those entities listed in Rule 24c-1(b) of the Exchange Act. n309

Access requests normally are granted unless doing so would: (1) interfere with an ongoing Commission investigation; (2) be adverse to the Commission's enforcement interests; or (3) be contrary to the public interest. n310 Nevertheless, where appropriate, the Division Director may submit access requests to the Commission. n311

The Commission may refer or grant access to its files to other entities, whether or not it appears that there has been a violation of the federal securities laws. n312 In addition to referrals to other federal, civil, or criminal agencies, the Commission may refer matters to SROs, state or local agencies, or state bar or other professional organizations. n313

The staff forwards the SEC's Form 1662 or Form 1661 with subpoenas or information requests that it serves during its investigations. These forms explain how the information that the SEC obtains may be used and state that [\*100] the SEC often makes its files available to other governmental agencies. Forms 1662 and 1661 also warn:

Unless the Commission or its staff explicitly agrees to the contrary in writing, you should not assume that the Commission or its staff acquiesces in, accedes to, or concurs or agrees with, any position, condition, request, reservation of right, understanding, or any other statement that purports, or may be deemed, to be or to reflect a limitation upon the Commission's receipt, use, disposition, transfer, or retention, in accordance with applicable law, of information provided.

Thus, recipients of subpoenas or information requests are on notice that information provided to the SEC will be kept confidential only in limited circumstances. As noted in the discussion of the FOIA in Part III.A., above, efforts to condition production of information and documents upon an understanding that the Commission cannot grant access to such information and documents to other governmental agencies are ineffective.

##### J. Parallel Proceedings

###### 1. In General

Because the federal securities laws provide for both civil and criminal enforcement, SEC investigations and proceedings often occur simultaneously with enforcement activity by the DOJ, as well as other federal and state agencies. n314

The securities laws contemplate communication between the Commission and the DOJ and expressly authorize the Commission to transmit evidence of violations to the DOJ. n315

The staff can refer information that it acquires during an informal investigation to other governmental agencies for use in parallel proceedings. n316 Similarly, other agencies can provide the SEC with information that is relevant to its investigations. Generally, information obtained from other agencies will be subject to conditions of use and confidentiality similar to those imposed by the SEC when granting access to its non-public files.

Federal courts have discretion to stay civil proceedings pending the outcome of parallel criminal proceedings. The courts have fashioned varying tests to determine when a stay is warranted. Absent some showing of sub- [\*101] stantial prejudice to the parties involved, however, parallel proceedings are not objectionable. n317 In fact,

effective enforcement of the securities laws may require prompt civil and criminal enforcement and...neither proceeding can always await the completion of the parallel proceeding without jeopardizing the public interest in protection of the efficient working of the securities markets and of investors from the dissemination of false or misleading information. n318

## 2. Investigations

The leading Commission case dealing with parallel proceedings is *SEC v. Dresser Industries*. n319 In *Dresser*, the respondent sought to prevent enforcement of a Commission subpoena duces tecum. n320 The subpoena sought materials about a matter which also was the subject of a grand jury investigation. The Commission previously had granted access to its investigative files in the matter to the DOJ. *Dresser* argued that: (1) the grant of access was a "referral" of the matter to the DOJ for criminal prosecution; and (2) the "policy interest" in avoiding any broadening of the government's criminal discovery rights precluded enforcement of the subpoena because the Commission, as part of its continuing grant of access, would provide the subpoenaed information to the DOJ. n321

The court enforced the subpoena, noting that the strict limitations on criminal discovery imposed by the Federal Rules of Criminal Procedure apply only after a grand jury has returned an indictment. n322 Thus, where no indictment has been returned, the court reasoned that enforcement of the Commission's subpoena would not broaden the government's criminal discovery rights. n323

In deciding whether to stay parallel civil proceedings, courts also may examine the extent to which the defendant's Fifth Amendment rights are implicated. n324 As one court noted, "the case for staying civil proceedings is 'a far weaker one' when 'no indictment has been returned' [and] no Fifth Amendment privilege is threatened." n325 Absent special circumstances which may unfairly prejudice the parties, courts typically decline to stay parallel investigations, informational exchanges, or discovery in either proceeding. n326 [\*102] In fact, absent special circumstances, courts rarely stay the discovery process of parallel civil proceedings at the request of a defendant. n327 On the other hand, courts routinely stay the discovery process of parallel civil proceedings at the request of the U.S. Attorney where the U.S. Attorney intervenes and seeks the stay to prevent the defendant from using the civil discovery process to obtain discovery that would not be available in the criminal proceeding. n328

## 3. Litigation and Settlement

The issue of parallel proceedings also arises when the SEC continues an investigation while simultaneously instituting a civil action. In such situations, the SEC's investigative powers are not limited by the parallel civil proceeding. n329 Similarly, in accordance with Rule 5(f) of the Commission's Informal and Other Procedural Rules, settlement of an SEC proceeding will not affect an actual or potential criminal action based on the same underlying conduct. n330 Rule 5(f) is intended to provide clear notice to persons settling Commission enforcement proceedings that an agreement not to make a criminal referral cannot be included as part of the SEC settlement package. n331

### K. Disclosure of Grand Jury Materials Pursuant to Rule 6(e) of the Federal Rules of criminal Procedure

In many instances, information needed by the Commission may already have been obtained by a federal grand jury and be in the hands of government employees, such as an Assistant U.S. Attorney. Rule 6(e) of the Fed- [\*103] eral Rules

of Criminal Procedure codifies the traditional principle of grand jury secrecy by prohibiting government employees from disclosing "matters occurring before the grand jury." n332 As discussed below, Rule 6(e) can make it difficult for the Commission to obtain information from grand jury proceedings.

Rule 6(e) authorizes disclosure without a court order to, among others:

- (1) a government attorney for use in the performance of such attorney's duty;
- (2) government personnel assisting a government attorney; and
- (3) when so directed by a court, preliminarily to, or in connection with, a judicial proceeding. n333

Federal administrative attorneys, including SEC attorneys, are not "attorneys for the government" within the scope of Rule 6(e). n334 Where the Commission initiates an enforcement action in District Court, it can seek access to grand jury materials "in connection with" the Commission's proceeding. n335

District courts have wide discretion to determine whether to permit disclosure. n336 A government entity seeking disclosure of grand jury materials must demonstrate a "particularized need" which outweighs the public interest in grand jury secrecy. n337 Government movants, like private parties, must show that: (1) the material is needed to avoid a possible injustice in another judicial proceeding; (2) the need for disclosure is greater than the need for continued secrecy; and (3) the request covers only material so needed. n338

Disclosure pursuant to Rule 6(e) usually will occur only if the Commission can show, through detailed and specific averments, that it has tried and failed to obtain the information through other means, including available discovery methods. n339 In determining which methods a government movant should pursue to obtain the information, a court may "take into account any alternative discovery tools available by statute or regulation to the agency seeking disclosure." n340 When the Commission seeks grand jury materials during the pendency of the grand jury investigation, it will have an "especially heavy burden" to meet to obtain disclosure pursuant to Rule 6(e). n341

In determining whether to permit disclosure, some courts consider the cost and delay in obtaining the information. Some courts also consider the unavailability of information, including the unavailability of a witness's testimony because of the assertion of a privilege such as the privilege against self-incrimination. n342 While Rule 6(e) prohibits disclosure of what occurred before the grand jury, it does not require "that a veil of secrecy be drawn over all matters occurring in the world that happen to be investigated by a grand jury." n343 Courts have permitted the use of grand jury materials to impeach a witness, refresh recollection, or otherwise test credibility at trial or deposition. n344

Court decisions vary on whether materials subpoenaed by or submitted to the grand jury, but prepared independently of the grand jury process, such as business records, can be disclosed. Arguably, such documents do not reveal what occurred before the grand jury and may not be protected from subsequent disclosure under Rule 6(e) if they are sought "for their own sake" and not to learn what occurred before the grand jury. n345 An argument can be made, however, that every document subpoenaed or reviewed by the grand jury is subject to Rule 6(e), since examination of any document reviewed by a grand jury will reveal, to some extent, what occurred before the grand jury. n346 Some courts resolve this issue by examining the potential effect of disclosure and protecting documents that may reveal a secret aspect of the grand jury investigation. n347 The majority of courts, however, do not permit disclosure to agencies seeking to use the information in administrative proceedings. n348

When necessary to preserve the secrecy of grand jury proceedings, government petitioners may file ex parte petitions seeking disclosure. n349 If government petitioners cannot justify ex parte proceedings, written notice of the petition must be served on those persons as the court may direct and on parties to the litigation if materials are sought in connection with existing litigation. n350

A knowing violation of Rule 6(e) is punishable as a contempt of court. n351 Violations of Rule 6(e) also may lead to motions in SEC civil actions to suppress evidence or to obtain other relief designed to correct the improper disclosure. n352

#### IV. Collateral Disclosure Effects Relating to an SEC Enforcement Action



### A. Disclosure

The disclosure obligations of an issuer, registrant or an individual involved in an SEC enforcement investigation or action depend upon a number of factors. These factors include: the nature of the disclosure document; the status of the company n353 or the individual; n354 and the context in which the investigation or action arises, such as whether it is a pending proceeding, and whether there has been the entry of findings of violation or the entry of an administrative or court order. Of course, registrants and issuers must disclose information responsive to particular line item disclosure requirements and must otherwise evaluate the materiality of the matter under inquiry for purposes of registration statement and periodic reporting.

Applying a general materiality analysis, disclosure of the existence of a Commission investigation may or may not be required in a particular situa- [\*106] tion; disclosure of the facts and circumstances giving rise to the investigation, however, very well may be required. For example, disclosure in a registration statement or annual report of the existence of a Commission investigation of a related party transaction, without a description of the facts underlying the investigation, would not be responsive to disclosure requirements. Instead, disclosure responsive to Item 404 of Regulation S-K n355 of specific transactions with management and others which may give rise to the inquiry would be required for the issuer to properly discharge its disclosure obligations. Outside counsel often advise registrants that disclosure of the matters under investigation and/or the existence of an investigation is prudent even if such disclosure is not specifically responsive to required disclosure items.

Clearly, management must evaluate disclosure requirements and weigh the materiality of the facts and their possible impact on both operations and investment decisions to determine if disclosure of the matters underlying the investigation, and/or if disclosure of the investigation, is required. Similarly, management will have to assess the status of the investigation as it proceeds because changes in the evolution of the facts will affect the disclosure analysis.

This section describes the collateral disclosure effects of an SEC enforcement investigation or action with respect to registration statements, periodic reports, and the processes of the Division of Corporation Finance. n356 The Division of Investment Management generally follows the same policies and procedures when reviewing registration statements, statements of additional information and other disclosure documents filed by investment companies.

### B. Processing of Disclosure Documents During Pendency of an Enforcement Investigation or Inquiry n357

Currently, for issuers and registrants whose filings are reviewed by the Division of Corporation Finance, the process is directed at obtaining accurate and complete disclosure. In determining how best to process a particular filing or report when there is an enforcement investigation or inquiry pending, the Division staff carefully weighs a number of factors, including, for [\*107] example: the type of corporate action contemplated by the disclosure document; the subject matter of the investigation; the current status of the investigation; and the nature and extent of the public disclosure concerning the matter under inquiry.

In some circumstances, the matters under investigation may be deemed of such importance to the registrant's operations or financial condition that disclosure of not only the investigation, but also the facts and circumstances surrounding the investigation, may be considered necessary to aid the investing public in making an investment decision. In general, the Division of Corporation Finance will attempt to provide comments that may help the registrant meet its disclosure obligations. The disclosure obligation, however, is always that of the registrant regardless of the comments given by the Division. Under rare circumstances, the Division staff, prior to completion of the investigation by the Division of Enforcement, may lack sufficient information about the matters under inquiry to complete its analysis and to formulate comments and, therefore, will be unable to exercise its delegated authority with respect to declaring a registration statement effective.

Where the staff determines that it is unable to review and comment upon a disclosure document, the staff will inform the issuer of its position and remind persons responsible for the adequacy and accuracy of the document of the issuer's disclosure obligations to its shareholders. The staff also may note that it may consider recommending that the Commission take appropriate action in the event that the company uses the disclosure document in its present form.

### C. Acceleration and the "Tandy Letter"

The "Tandy Letter" was developed in 1976 in response to the numerous problems which arose as a result of corporate mergers, acquisitions, and public offerings during a period when disclosure as to questionable or illegal payments or practices was the subject of a substantial number of inquiries or investigations by the Division of Enforcement. The

term "Tandy Letter" derived from the name of the company who first received such a comment letter. Different versions of the Tandy Letter comments are used for documents filed under the Securities Act and the Exchange Act. n358

Under the Securities Act, there are two versions of the Tandy Letter comments that are issued. In the event that a document is reviewed by the staff and the issuer is aware that it is the subject of an enforcement investigation, the issuer will receive a Tandy Letter comment that:

i. advises the issuer that any information provided in connection with the review process may be given to the staff of the Division of Enforcement;

ii. requests an acknowledgement from the issuer that the issuer is responsible for the disclosure in the document; and [\*108]

iii. requests that the issuer represent to the staff that staff comments, changes made in response to staff comments, and/or the acceleration of effectiveness of the registration statement does not relieve the issuer of its responsibility for the disclosure in the document.

In the event that a filing does not undergo staff review and the issuer is aware that it is the subject of an enforcement investigation, the issuer will receive a Tandy Letter comment that:

i. advises the issuer that no review will be made of the document;

ii. requests that the issuer acknowledge that the issuer is responsible for the disclosure in the document; and

iii. requests that the issuer represent that the acceleration of the effective date of the registration statement does not relieve the issuer of its responsibility for disclosure in the document.

In the event that a document filed under the Exchange Act is selected for review and the registrant is aware that it is the subject of an enforcement investigation, the registrant will receive a Tandy Letter comment similar to that given to issuers who are aware that they are the subject of an enforcement investigation and who file documents under the Securities Act that undergo a staff review.

#### D. Acceleration Considerations n359

1. Effect of Enforcement Inquiry on Acceleration Powers Under Sections 8(a) and 8(c) of the Securities Act of 1933

Section 8(a) of the Securities Act n360 provides that a registration statement, unless amended, becomes effective on the twentieth day after filing. Section 8(a) also provides for acceleration of that twenty-day period. Given the number of public companies and the volume of initial public offerings from new registrants, this time period has, for all intents and purposes, become wholly impractical. In particular, where a registration statement is materially deficient, this twenty-day period would preclude constructive review and comment by the staff. To address the practical problems posed by this time constraint, various administrative practices were developed to facilitate the review and comment process, the most significant of which is the delaying amendment under Rule 473 of the Securities Act. n361 [\*109]

##### a. The Delaying Amendment

In order to provide an easy method to prevent a registration statement from becoming effective either in deficient form or at a date earlier than that desired by the registrant, the Commission adopted Rule 473, n362 whereby a registrant could "automatically" delay the effective date of any registration statement by use of a "permanent delaying amendment." n363

Generally, most registrants use the delaying amendment to afford the staff time to determine whether a review will be undertaken and, if so, to receive comments on the document before it becomes effective. The filing of a registration statement without the delaying amendment or removal of the amendment by a registrant prior to completion of the process may result in a stop order examination or, if deficiencies are clear, a stop order. n364

#### b. Acceleration of Effectiveness of Registration Statements and Post-Effective Amendments

In considering a request by an issuer pursuant to 8(a) to accelerate the effective date of a registration statement to a date earlier than the twentieth day after filing, the staff considers:

(a) whether adequate information regarding the issuer is available to the public;

(b) the type of the securities to be registered, the relationship of the securities to the capital structure of the issuer, and whether the rights of holders thereof can be understood; and

(c) the public interest and protection of investors. n365

Consideration of the public interest and the protection of investors also comes into play under 8(c) of the Securities Act n366 in determining when to declare a post-effective amendment effective. Unlike 8(a), 8(c) requires that the Commission must determine that a post-effective amendment "on its face, appears to the Commission not to be incomplete or inaccurate in any material respect" prior to declaring it effective. n367

In exercising its statutory authority to declare registration statements effective under 8(a), the Commission or staff must consider the provisions of Rule 461 of Regulation C. n368 Rule 461 states that the Commission may refuse to accelerate the effective date of a registration statement:

where the Commission is currently making an investigation of the issuer, a person controlling the issuer, or one of the underwriters of [\*110] the securities to be offered pursuant to any of the Acts administered by the Commission; n369 or

where there have been transactions in securities of the registrant by persons connected with or proposed to be connected with the offering which may have artificially affected or may artificially affect the market price of the security being offered. n370

## 2. Effect of an Inquiry Instituted Under Section 8(e)

While the Commission's formal investigative process often commences pursuant to 19(b) of the Securities Act, 21(b) of the Exchange Act, and 42(b) of the Investment Company Act, as noted above, where a registration statement is at issue, those investigative powers are augmented by the Commission's examination authority. n371 If there are questions about false statements or material disclosure deficiencies in a registration statement, the staff may seek to investigate the matter pursuant to a formal order of examination and investigation under 8(e) and 20(a) of the Securities Act. n372

An examination and investigation undertaken pursuant to 8(e) of the Securities Act to determine whether a stop order should be issued with respect to a registration statement may preclude any sale of securities under that registration statement pursuant to 5(c) of the Act. n373 Section 5(c) makes it unlawful to offer to sell or buy securities unless a registration statement has been filed and such registration statement is not subject to a refusal order, stop order, or "subject to any public proceeding or examination." n374 Even if an inquiry under 8(e) is commenced, such inquiry may have the effect of barring offers to sell or sales of securities until the examination and investigation is complete. n375 Failure to cooperate with a Section 8(e) examination also may be grounds for the issuance of a stop order. n376

## 3. Decision Not to Exercise Delegation of Authority to Accelerate Effective Date

The failure to grant promptly a registrant's request for acceleration is, in effect, an administrative denial, a power that the Commission has not delegated to the staff. Thus, if the staff declines to exercise its delegated authority to accelerate the effectiveness of a registration statement, the staff must take the matter to the Commission to deny acceleration. [\*111]

## V. Completion of Investigation

### A. Staff Recommendation

At the conclusion of an investigation, the staff may determine to take no action or to recommend that the Commission bring enforcement proceedings. The staff is not required to inform a witness or an individual or entity whose activities were under scrutiny if the investigation is terminated without action. The staff may, in its discretion, use a "closing letter" to advise a witness that its investigation has been terminated. n377

Historically, the staff issued these letters only when counsel made a request for such a communique. Recognizing that the uncertainty of the status of an investigation may have adverse consequences for individuals and businesses, the staff changed its practice. Currently, the staff notifies individuals and entities whose activities were under scrutiny of the termination of an investigation. n378 If an investigation is terminated without the staff recommending or the Commission authorizing an action, the staff will notify those persons and entities: (1) named in the formal order of investigation or (2) provided with a Wells submission notification. n379 Other persons or entities involved in the investigation, such as those subpoenaed or whose activities were under scrutiny, also may request such notification. Notification of the termination of an investigation is not an exoneration or an indication that no enforcement action ultimately may result from the staff's investigation. Rather, such notification simply means that the staff has completed its investigation and is not, as of the date of the letter, recommending enforcement action to the Commission.

If the staff determines that remedial action is necessary as a result of its investigation, it will make a recommendation to the Commission that identifies the proposed defendants or respondents, states the evidentiary and legal bases supporting the claimed violations, and sets forth a proposed remedy and the rationale therefor. The staff, at the time that it makes its recommendation, will forward to the Commission any Wells Submissions received from proposed defendants. n380

### B. Wells Submissions

#### 1. In General

In Securities Act Release 5310 ("Release 5310"), the Commission discussed its discretionary practice "of permitting persons involved in an investigation to present a statement to [the Commission] setting forth their interests [\*112] and position." n381 In order to advise the public of its practice, the Wells Committee procedure was set forth in the Commission's regulations relating to Informal and Other Procedures. n382

In Release 5310, the Commission indicated that interested persons may find it useful to discuss the matter under investigation with the staff. To that end, the Commission stated that the staff, in its discretion, may advise prospective defendants of the general nature of the investigation and violations contemplated by the staff and permit the proposed defendant to submit a response to the allegations within a time frame determined by the staff. n383 The Commission viewed the submissions from the proposed defendants to be of the greatest benefit when addressing questions of policy or law. n384 The Commission indicated that it did not view a discussion of factual disagreements between the staff and proposed defendants as particularly useful. n385 Notwithstanding the language of the Release, many Wells Submissions do address factual issues, evidentiary matters, and the inference and/or weight to be given the evidence, and they often highlight factual disagreements with the staff's position. Generally, unless circumstances otherwise warrant, the staff will describe in its Wells notice the proposed enforcement recommendation, and provide a summary of the evidence and legal theories on which the staff relies.

The Wells Submission practice has not created, nor has the Commission employed, any formal, pre-proceeding notification or solicitation procedure. Release 5310 was not intended to, and did not, confer any rights upon the subjects of Commission investigations. While there is no requirement that the Commission provide a Wells notice to persons or entities which may be the subject of an enforcement recommendation by the staff, and although no due process rights attach to this practice, the staff generally provides the opportunity for such a submission as an investigation nears completion. The Commission, however, does not provide such an opportunity when there are concerns about dissipation of

assets, destruction of documents, or any other [\*113] situations which may require the Commission to act quickly to protect the public interest. n386

## 2. Strategic Considerations in Making Wells Submissions

A substantial number of proposed respondents and defendants do make Wells Submissions. The submissions are evaluated carefully, not only by the Commissioners and by the enforcement staff, but also by other offices and divisions within the Commission which may have an interest in the matters involved in the case. While statistics are not maintained on the number of successful submissions, the Commission staff often has modified its recommendations, or dropped individuals altogether, after evaluating a submission. The Commission has done likewise in considering whether to authorize an enforcement action. The following points regarding Wells Submissions bear noting:

(a) A submission may highlight factual and legal deficiencies in a proposed enforcement action.

(b) The Division of Enforcement takes the position that a submission may be utilized subsequently as an admission or for impeachment purposes.

(c) Submissions may be particularly helpful in analyzing the role of "peripheral" defendants or persons charged with "aiding and abetting" violations.

(d) Novel, unique, or unusual policy issues may be highlighted, especially the nature of relief sought and the statutory provisions alleged to have been violated.

(e) A concise submission is likely to be more effective than a lengthy discourse. Currently, Commission policy is that Wells Submissions should be limited to no more than 40 pages. n387

(f) The Commission's current policy is that a videotaped statement by counsel of no more than twelve minutes may be submitted in lieu of a written Wells Submission. A transcript of the videotaped statement also should be submitted.

(g) A submission must be timely. n388 In general, a one-month period for the submission of Wells statements is permitted, although the time frame may vary somewhat depending upon the complexity of a case. Extensions of time are granted in certain circumstances, but should not be counted upon as they are not granted as a matter of course. [\*114]

## 3. Freedom of Information Act Considerations in Making Wells Submissions

### a. During Pendency of Active Investigation or Enforcement Action

Certain exemptions from the FOIA disclosure requirements may prevent disclosure of Wells submissions during the pendency of an enforcement investigation. Exemption 7(A) of the FOIA provides that disclosure is not required of "records or information compiled for law enforcement purposes, but only to the extent that the production of such law enforcement records or information could reasonably be expected to interfere with enforcement proceedings." n389 Given that the identity of a subject of a Commission investigation generally is non-public information during the pendency of an investigation, and thereafter if no enforcement action ultimately is brought by the Commission, exemption 7(D) may preclude disclosure of "the identity of a confidential source." n390

### b. After Completion of Enforcement Proceeding

In general, after the completion of an enforcement proceeding, Wells Submissions may become available under the FOIA unless

(i) Disclosure would "constitute an unwarranted invasion of personal privacy" [or] "disclose the identity of a confidential source"; n391

(ii) It is likely that additional proceedings may be brought, even if a particular enforcement action has been concluded; n392

(iii) Disclosure would deprive a person of a fair trial or impartial adjudication in proceedings other than the Commission's action; n393 or

(iv) Disclosure would disclose Commission investigative techniques or procedures; n394

Notwithstanding the above, it is important to note that 552 of the Administrative Procedures Act contemplates disclosure of "any reasonably segregable portion of a record" and thus, disclosure of nonexempt portions of a Wells Submission may be appropriate. n395 Further, considerations of personal privacy do not apply to Wells Submissions made solely on behalf of a [\*115] corporate entity. n396 Note also that Wells Submissions may be discoverable in civil proceedings between private litigants. n397

#### c. Submissions of Persons Against Whom No Enforcement Proceedings Were Ever Brought

In general, the Commission denies access to records relating to investigations for which no enforcement action was brought because such disclosure often would invade the personal privacy of persons who have been investigated, but not charged with any violations of the securities laws. Upon a showing of a particularized need for the records, which outweighs any possible harm resulting from an invasion of personal privacy, disclosure may be appropriate. n398

#### d. Use of Statements in Wells Submissions as Evidence in Subsequent Proceedings

The Division of Enforcement's long-standing position is that Wells Submissions, unlike offers of settlement and statements made during negotiations, may be used as evidence in subsequent proceedings for impeachment or corroborative purposes or as admissions by a party opponent. Because of this position, the Division includes a statement in the letter advising a prospective defendant of a proposed recommendation of an enforcement action that the staff routinely seeks to introduce Wells Submissions as evidence in Commission enforcement proceedings, if the staff deems it appropriate. n399 Wells Submissions that purport to be privileged, submitted for settlement purposes or otherwise barred from use as evidence against the submitter are returned to the submitter. [\*116]

### C. Document Retention

Upon closing its investigations, the Commission retains the following documents in its files:

(i) Transcripts of testimony taken in an investigation and the exhibits to such testimony;

(ii) Formal orders of investigation, Privacy Act accounting forms, subpoenas, correspondence, Wells Submissions, FOIA requests, and confidential treatment requests;

(iii) Other inter- or intra-agency memoranda, including all notes and other records prepared by the staff that the staff believes important to retain;

(iv) Records that have been made part of the record in an injunctive or administrative proceeding;

(v) Such other records that the staff believes important to retain; and

(vi) Other material that must be held due to FOIA concerns.

Documents not listed above are discarded or, upon request, may be returned to the party that submitted them.

#### Conclusion

Although the types of enforcement actions that the Commission may bring vary widely, many of the substantive and procedural questions that will confront counsel and witnesses during the process are common to all such investigations. This Article summarizes those issues that most frequently arise in SEC investigations. Understanding these procedures -

ranging from whether a copy of a transcript can be obtained to the guidelines for submission of a Wells statement - is crucial to participants and their counsel in an SEC investigation.

#### FOOTNOTES:

n1. In 1996, the Commission brought 453 enforcement actions; 486 in 1995; 497 in 1994; and 416 in 1993. See U.S. Securities and Exchange Comm'n Budget Estimate Fiscal 1998 (Feb. 1997) at II-11, II-12; 1995 Annual Report of the U.S. Securities and Exchange Comm'n, at 1.

n2. As of April 7, 1997, the Commission had 1,532 enforcement investigations underway.

n3. In recent years, for example, the Commission has brought enforcement actions involving fraudulent offerings of securities on the Internet, wireless cable schemes, and violations of the securities laws in municipal bond offerings. See *infra* Part I.F.4.

n4. See *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1033-34 (D.C. Cir. 1978).

n5. Pub. L. No. 94-210, Title I, 48 Stat. 74 (codified as amended at 15 U.S.C. 77t(a) (1994)). Section 20(a) of the Securities Act states:

Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this title, or of any rule or regulation prescribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

Id.

n6. Id. 77h(e). Section 8(e) states:

The Commission is hereby empowered to make an examination in any case in order to determine whether a stop order should issue under subsection (d). In making such examination the Commission or any officer or officers designated by it shall have access to and may demand the production of any books and papers of, and may administer oaths and affirmations to and examine, the issuer, underwriter, or any other person, in respect of any matter relevant to the examination, and may, in its discretion, require the production of a balance sheet exhibiting the assets and liabilities of the issuer, or its income statement, or both, to be certified to by a public or certified accountant approved by the Commission. If the issuer or underwriter shall fail to cooperate, or shall obstruct or refuse to permit the making of an examination, such conduct shall be proper ground for the issuance of a stop order.

Id.

n7. Pub. L. No. 94-29, 48 Stat. 881 (codified as amended at *15 U.S.C. 78u(a)(1)* (1994)). Section 21(a)(1) states:

The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized, in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this title, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates.

Id.

n8. Id. 78u(a)(2). Section 21(a)(2) of the Exchange Act allows the Commission to conduct investigations on behalf of foreign securities authorities where a violation of foreign securities laws has occurred, is occurring, or will occur, even if no violation of United States laws is involved. Section 21(a)(2) states:

On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States.

Id.

n9. Pub. L. No. 91-452, 54 Stat. 789 (codified as amended at *15 U.S.C. 80b-9(a)* (1994)). Section 209(a) states:

Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this title or of any rule or regulation prescribed under the authority thereof, have been or are about to be violated by any person, it may in its discretion require, and in any event shall permit, such person to file with it a statement in writing, under oath or otherwise, as to all the facts and circumstances relevant to such violation, and may otherwise investigate all such facts and circumstances.

Id.



n10. Id. 80a-41(a). Section 42(a) states:

The Commission may make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of this title or of any rule, regulation or order hereunder, or to determine whether any action in any court or any proceeding before the Commission shall be instituted under this title against a particular person or persons, or with respect to a particular transaction or transactions. The Commission shall permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated.

Id.

n11. Pub. L. No. 91-452, 49 Stat. 803 (codified as amended at *15 U.S.C. 79r(a)* (1994)). Section 18(a) states:

The Commission, in its discretion, may investigate any facts, conditions, practices, or matters which it may deem necessary or appropriate to determine whether any person has violated or is about to violate any provision of this title or any rule or regulation thereunder, or to aid in the enforcement of the provisions of this title, in the prescribing of rules and regulations thereunder, or in obtaining information to serve as the basis for recommending further legislation concerning the matters to which this title relates. The Commission may require or permit any person to file with it a statement in writing, under oath or otherwise as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation.

Id.

n12. Pub. L. No. 94-210, 48 Stat. 908 (codified as amended at *15 U.S.C. 77s(b)* (1994)). Section 321 of the Trust Indenture Act states:

For the purpose of any investigation or any other proceeding which, in the opinion of the Commission, is necessary and proper for the enforcement of this title, any member of the Commission, or any officer thereof designated by it, is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda, contracts, agreements, or other records which the Commission deems relevant or material to the inquiry. Such witnesses and the production of any such books, papers, correspondence, memoranda, contracts, agreements or other records may be required from any place in the United States or in any Territory at any designated place of investigation or hearing. In addition, the Commission shall have the powers with respect to investigations and hearings, and with respect to the enforcement of, and offenses and violations under, this title and rules and regulations and orders prescribed under the authority thereof, provided in sections 20, 22(b), 22(c) of the Securities Act of 1933.

Id.

n13. *17 C.F.R. 202.5* (1996).

n14. Id. 202.5(a).

n15. See, e.g., U.S. Securities and Exchange Comm'n, Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a Commission Subpoena, SEC Form 1662 (Feb. 1996); Supplemental Information for Regulated Entities Directed to Supply Information Other than Pursuant to a Commission Subpoena, SEC Form 1661 (Feb. 1996).

n16. Pursuant to 17(a) of the Exchange Act, 15 U.S.C. 78q, 31(b) of the Investment Company Act, id. 80a-30, and 204 of the Advisers Act, id. 80b-4, the staff may obtain and examine copies of records from, among others, any broker-dealer, national securities exchange, registered municipal securities dealer, transfer agent, clearing agency, registered investment company or registered investment adviser. Rules 17a-3 and 17a-4, 17 C.F.R. 240.17a-3, 240.17a-4, set forth the records required to be maintained by registered securities exchange members, brokers, and dealers. Rule 31 of the Investment Company Act, id. 270.31a-1-a-3, sets forth the records required to be maintained by registered investment companies, certain majority-owned subsidiaries thereof and other persons having transactions with registered investment companies. Rules 204-2 and 204-3 of the Advisers Act, id. 204-2, 204-3, set forth the books and records required to be maintained by an investment adviser.

n17. Section 1621 provides in pertinent part:

Whoever...having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered,...willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true...is guilty of perjury and shall, except as otherwise expressly provided by law, be fined under this title or imprisoned not more than five years or both ...

18 U.S.C. 1621 (1994).

n18. Section 1001 provides:

Whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, knowingly and willfully falsifies, conceals, or covers up by any trick, scheme, or device a material fact; makes any materially false, fictitious, or fraudulent statement or representation; or makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry; shall be fined under this title or imprisoned not more than 5 years or both.

18 U.S.C. 1001 (1996); see also *United States v. Rodgers*, 466 U.S. 475, 479 (1984) (holding 1001 applicable in a criminal investigation); *United States v. Knox*, 396 U.S. 77, 80-81 (1969) (holding 1001 applicable to forms filed with district director of Internal Revenue Service).

n19. As a practical matter, the Commission rarely makes formal referrals to the criminal authorities. Most often, the Commission informally refers matters to the criminal authorities and responds to the access request submitted by the criminal authorities thereafter. See *infra* Part III.I.

n20. See 17 C.F.R. 202.5(b) (1996).

n21. See Securities Act 20(a), *15 U.S.C. 77t(a)* (1994); Exchange Act 21(a)(1), *id.* 78u(a)(1); Advisers Act 209(a), *id.* 80b-9(a); Investment Company Act 42(a), *id.* 80a-41(a); Public Utility Holding Company Act 18(a), *id.* 79r; and Trust Indenture Act 321(a), *id.* 77s.

n22. *17 C.F.R. 203.5* (1996).

n23. See, e.g., *SEC v. Arthur Young & Co.*, *584 F.2d 1018, 1028 (D.C. Cir. 1978)*.

n24. See, e.g., Securities Act 19(b), *15 U.S.C. 77s* (1994); Exchange Act 21(b), *id.* 78u(2); Advisers Act 209(b), *id.* 80b-9(b); Investment Company Act 42(b), *id.* 80a-42(b).

n25. *17 C.F.R. 203.7(a)-(c)* (1996).

n26. *Id.* 203.7.

n27. See, e.g., Securities Act 19(b), *15 U.S.C. 77s(b)* (1994); Exchange Act 21(b), *id.* 78u(2).

n28. *17 C.F.R. 203.7(a)* (1996).

n29. Rule 7(a) states that a copy of the formal order may be provided upon written request if the staff determines that "there exist reasons [for approving the request] consistent both with the protection of privacy of persons involved in the investigation and with the unimpeded conduct of the investigation." *Id.*

n30. Rule 6 of the Commission's Rules Relating to Investigations states:

A person who has submitted documentary evidence or testimony in a formal investigative proceeding shall be entitled, upon written request, to procure a copy of his documentary evidence or a transcript of his testimony on payment of the appropriate fees: Provided, however, that in a non-public formal investigative proceeding the Commission may for good cause deny such request. In any event, any witness, upon proper identification, shall have the right to inspect the official transcript of the witness's own testimony.

*Id.* 203.6.

n31. Courts have upheld the Commission's right to deny a request to purchase a copy of a witness's testimony. See, e.g., *SEC v. Sprecher*, *594 F.2d 317 (2d Cir. 1979)*; *Commercial Capital Corp. v. SEC*, *360 F.2d 856 (7th Cir. 1966)*. In *Sprecher*, the Second Circuit also rejected the witness's claim that he should be allowed to tape record his testimony. *Sprecher*, *594 F.2d at 319*.

n32. See *United States v. Lieberman* [1979-1980 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 97,167 (D.C. Mass. 1979)* (finding that due process was not violated when SEC went "off the record" during investigatory proceeding).

n33. See Rule 7(b) of the Commission's Rules Relating to Investigation, *17 C.F.R. 203.7(b) (1996)*; see also Administrative Procedure Act, Pub. L. No. 89-554, 555(b), 80 Stat. 378 (codified as amended at *5 U.S.C. 555(b) (1994)*).

n34. Rule 7(c) of the Commission's Rules Relating to Investigations, *17 C.F.R. 203.7(c) (1996)*.

n35. See *Holloway v. Arkansas*, *435 U.S. 475, 485-86 (1978)* (finding that defense attorneys have obligation to advise court about any conflict of interests); ABA Code of Professional Responsibility DR-5-105, DR-2-110(b)(2). Counsel for the witness should consider potential future conflicts of interest that may arise as a result of representation of a witness during an investigation. See, e.g., *Brown v. E.F. Hutton*, *305 F. Supp. 371 (S.D. Tex. 1969)*.

n36. "Whistle-blower" or "confidential informant" situations highlight the staff's concern about corporate counsel's overbroad claims of representation of all former and present employees. In these situations, the employee's interest may be adverse to the company, and corporate counsel may be precluded under applicable ethical rules from representing the employee. *Id.*

n37. For a summary of the staff's position on this point, see William R. McLucas, *Contacts with Corporate Officers and Employees in SEC Investigations*, 9 *Insights*, Mar. 1995, at 2, available in LEXIS, News Library, Insight File. This letter was written in response to an article which challenged the staff's position. See K.B. Winer & S.J. Winer, *Ex Parte Contacts with Officers and Employees of Corporations in SEC Investigations*, 8 *Insights*, Nov. 1994, at 13, available in LEXIS, News Library, Insight File.

n38. Rule 7(b) of the Commission's Rules Relating to Investigations, *17 C.F.R. 203.7(b) (1994)*.

n39. See *SEC v. Higashi*, *359 F.2d 550, 553 (9th Cir. 1966)* (finding that SEC's sequestration rule not enforceable where witness would be deprived "of the services of the attorney most familiar with the source of his vulnerability"); see also *SEC v. Csapo*, *533 F.2d 7, 11 (D.C. Cir. 1976)* (holding that SEC's sequestration rule not enforceable where no "concrete evidence" that counsel's multiple representation of witnesses in investigation would "obstruct and impede" investigation).

n40. Due to the color of the paper on which these questionnaires formerly were printed, they are known as "Blue Sheets."

n41. Office of Int'l Affairs, *The SEC's International Enforcement Program and Bilateral and Multilateral Initiatives*, Vol. III, *The SEC Speaks in 1996* (Practicing Law Inst. 1996).

n42. *15 U.S.C. 78j (1994)*.

n43. *17 C.F.R. 240.10b-5 (1994)*.

n44. See *SEC v. Cherif*, *933 F.2d 403, 408 (7th Cir. 1991)*.

n45. See *SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990); *SEC v. Lenfest*, No. 95- CV-7597, 1996 U.S. Dist. LEXIS 18961, at \*7-\*8 (E.D. Pa. Dec. 23, 1996). This theory has been adopted by the Second, Third, Seventh, and Ninth Circuits. See, e.g., *SEC v. Maio*, 51 F.3d 623, 631 (7th Cir. 1995); *United States v. Libera*, 989 F.2d 596, 599-600 (2d Cir. 1993); *United States v. Chestman*, 947 F.2d 551, 564 (2d Cir. 1991); *Cherif*, 933 F.2d at 410; *Clark*, 915 F.2d at 453; *Rothberg v. Rosenbloom*, 771 F.2d 818, 822 (3d Cir. 1985), rev'd after remand, 808 F.2d 252 (1986). Note, however, that the Fourth and the Eighth Circuits have refused to apply the "misappropriation" theory of insider trading to "outsider" traders who possess material non-public information about a company and use the information in a securities transaction, but do not owe a fiduciary duty to the shareholders of such company. See *United States v. O'Hagan*, Nos. 94-3714, 94-3856, 1996 U.S. App. LEXIS 18913 (8th Cir. Aug. 2, 1996), cert. granted, 117 S. Ct. 759 (1997); *United States v. Bryan*, 58 F.3d 933 (4th Cir. 1995). The Supreme Court considered this issue in *United States v. O'Hagan*, which was argued on April 16, 1997.

n46. See, e.g., *SEC v. Jefferies*, SEC Lit. Rel. No. 11,370, 1987 WL 111997 (S.E.C.) (Mar. 19, 1987); *Pagel, Inc. v. SEC*, 803 F.2d 942 (8th Cir. 1986).

n47. See, e.g., *SEC v. McMichael*, SEC Lit. Rel. No. 14,900, 1996 WL 225960 (S.E.C.) (May 3, 1996).

n48. See, e.g., *SEC v. Hebding*, SEC Lit. Rel. No. 14,034, 1994 WL 100669 (S.E.C.) (Mar. 29, 1994).

n49. Id.

n50. See, e.g., *SEC v. Romito*, SEC Litig. Rel. No. 14,776, 1996 WL 17057 (S.E.C.) (Jan. 4, 1996); *Hebding*, SEC Litig. Rel. No. 14,034, 1994 WL 100669.

n51. See, e.g., *Romito*, SEC Litig. Rel. No. 14,776, 1996 WL 17057.

n52. See, e.g., *SEC v. Comparator Sys. Corp.*, SEC Lit. Rel. No. 14,927, 1996 WL 290221 (S.E.C.) (May 31, 1996).

n53. See, e.g., *SEC v. McDonnell Douglas Corp.*, SEC Lit. Rel. No. 14,958, 1996 WL 343322 (S.E.C.) (June 14, 1996).

n54. See, e.g., *In re Advanced Micro Devices, Inc.*, Exch. Act Rel. No. 37,730, 1996 WL 549106 (S.E.C.), at \*4-\*9 (Sept. 26, 1996); *In re Caterpillar, Inc.*, Exch. Act Rel. No. 30,532, 1992 WL 71907 (S.E.C.), at \*4-\*5 (Mar. 31, 1992).

n55. See, e.g., *In re Valley Sys., Inc.*, Exch. Act Rel. No. 36,227, 1995 WL 547801 (S.E.C.), at \*4 (Sept. 14, 1995).

n56. See generally Report of the Nat'l Comm'n on Fraudulent Fin. Reporting, Oct. 1987.

n57. Municipal securities dealers, government securities dealers, clearing agencies, and transfer agents also are regulated entities. See *15 U.S.C. 77* (1994).

n58. See, e.g., *In re Speaker and Janus Capital Corp.*, *Exch. Act Rel. No. 38,161*, 1997 WL 9871 (S.E.C.), at \*2-\*3 (Jan. 13, 1997); *In re Refco Sec., Inc.*, *Exch. Act Rel. No. 37,531*, 1996 WL 444366 (S.E.C.), at \*2-\*3 (Aug. 6, 1996).

n59. See 20(f) of the Exchange Act, *15 U.S.C. 77t(f)*, which permits aiding and abetting charges to be brought against any person who knowingly provides "substantial assistance" to another person in violating the Exchange Act in both injunctive actions brought under 21(d)(1), *id.* 78u(d), and in actions seeking civil penalties pursuant to 21(d)(3), *id.* 78u(d). Section 15(b)(4)(E) of the Exchange Act, *id.* 78o(b)(4)(E), authorizes the Commission to bring administrative proceedings against persons who have "willfully aided and abetted" violations of the Exchange Act. Sections 203(e)(4), 203(f), and 209(d), *id.* 80b-3(e)(4), 80b-3(f), 80b-9(e), of the Advisers Act contain similar provisions.

n60. *17 C.F.R. 240.15c3-1* (1996).

n61. *Id.* 240.15c3-3.

n62. *Id.* 240.17a-3 to 17a-11.

n63. See Exchange Act 10(b), *15 U.S.C. 78j* (1994), and Rule 10b-5 promulgated thereunder, *17 C.F.R. 240.10b-5* (1996); Securities Act 17(a), *15 U.S.C. 77(1)* (1994).

n64. Rules 15c1-2, 15c2-2 under the Exchange Act, *17 C.F.R. 240.15c1-2*, *240.15c2-2* (1996).

n65. See, e.g., Regulation T, *12 C.F.R. 220.1* to *220.132* (1996).

n66. *17 C.F.R. 240.10a-1* (1996).

n67. See Regulation M, *62 Fed. Reg. 520* (1997) (to be codified at *17 C.F.R. 242*); Rules 101, 102, *62 Fed. Reg. 520*, *546-548* (1997) (to be codified at *17 C.F.R. 242.1-10243.102*), promulgated thereunder, which place certain trading restrictions on issuers and distribution participants.

n68. *17 C.F.R. 240.10b-9*, *240.15c2-4* (1996).

n69. See Advisers Act 209(a), *15 U.S.C. 80b-9(a)* (1994).

n70. See Advisers Act 206(4), *15 U.S.C. 80b-6(4)* (1994), and Rule 206(4)-1 promulgated thereunder, *17 C.F.R. 275.206(4)-1* (1996).

n71. See Advisers Act 205, *15 U.S.C. 80b-5* (1994), and Rule 205-3 thereunder, *17 C.F.R. 275.206(4)-1* (1996).

n72. See Advisers Act 206(1), (2), *15 U.S.C. 80b-6(1)*, *80b-6(2)* (1994).

n73. See Advisers Act 204, 297, *15 U.S.C. 80b-4*, *80b-7* (1994), and Rule 204 thereunder, *17 C.F.R. 275.204-2* (1996).

n74. Since 1991, the number of registered investment companies has increased by approximately 34%, and the amount of assets held by registered investment companies has increased by approximately 119%. See 1995 Annual Report of the U.S. Securities and Exchange Comm'n, at 133.

n75. See Investment Company Act 17(a), 17(d), *15 U.S.C. 80a-17(a)*, *80a-17(d)* (1994); Rule 17d-1 thereunder, *17 C.F.R. 270.17d-1* (1996).

n76. See Investment Company Act 7, *15 U.S.C. 80a-7* (1994).

n77. See Investment Company Act 17(j), *15 U.S.C. 80a-17(j)* (1994); Rule 17j-1 thereunder, *17 C.F.R. 270.17j-1* (1996).

n78. See Investment Company Act 30, 31, *15 U.S.C. 80a-30*, *80a-31* (1994); Rules 30, 31 thereunder, *17 C.F.R. 270.30a-1*, *270.31a-3* (1996).

n79. The Commission may charge broker-dealers with failure to supervise under 15(b)(4)(E) of the Exchange Act, *15 U.S.C. 78o(b)(4)(E)* (1994), and may charge the associated persons of broker-dealers with failure to supervise under 15(b)(6), *id.* 78o(b)(6). The Commission may charge investment advisers and their associated persons with failure to supervise under 203(e)(5) of the Advisers Act, *id.* 80b-3(e)(5). Note that both 15(b)(4)(E) of the Exchange Act and 203(e)(5) of the Advisers Act contain safe harbor provisions whereby, in general, if a broker or investment adviser has procedures to prevent and detect violations and has reasonably discharged the duties and obligations incumbent upon it by reason of such procedures, it will not be deemed to have failed to reasonably supervise.

n80. *15 U.S.C. 78o(b)(4)*, *80b-3(e)* (1994).

n81. See *id.* 78o(b)(4)(E), 78o(b)(6)(A).

n82. *15 U.S.C. 78u-z* (1996).

n83. See, e.g., *In re VanKampen Am. Capital Asset Management, Inc.*, *Advisers Act Rel. No. 1,525*, 1995 WL 579533 (S.E.C.), at \*4-\*5 (Sept. 29, 1995).

n84. See Exchange Act 15A(b)(7), *15 U.S.C. 78o-3(b)(7)* (1994).

n85. See *In re Application of David Joseph Dambro*, *Exch. Act Rel. No. 32,487*, 1993 WL 226038 (S.E.C.) (June 18, 1993).

n86. 15 U.S.C. 17s(d)(1) (1994).

n87. See Exchange Act 19(e), 15 U.S.C. 78s(d)(1) (1994).

n88. See *In re Candies, Inc.*, *Sec. Act Rel. No. 7,263*, 1996 WL 75741 (S.E.C.), at \*1 (Feb. 21, 1996) (involving cease-and-desist proceeding against law firm for assisting broker in scheme to violate registration requirements of Securities Act by distributing abroad unregistered stock of four companies where such stock was immediately resold back into United States); *SEC v. Scorpion Technologies, Inc.*, *SEC Lit. Rel. No. 14,814*, 1996 WL 74046 (S.E.C.), at \*1 (Feb. 9, 1996) (bringing injunctive action to stop fraudulent Regulation S offering of Scorpion stock in 20 countries).

n89. See *SEC v. Spencer*, *SEC Lit. Rel. No. 14,856*, 1996 WL 145918 (S.E.C.) (Mar. 29, 1996) (filing complaint against Spencer in connection with solicitation of investors on Internet promising over 50% returns on investment in ethanol plant in Dominican Republic); *SEC v. Frye*, *SEC Lit. Rel. No. 14,720*, 1995 WL 686628 (S.E.C.) (Nov. 15, 1995) (granting preliminary injunction based on SEC's allegation of solicitation of investors on Internet promising riskless profits for Costa Rican venture); *SEC v. Odulo*, *SEC Lit. Rel. Nos. 14,591*, 1995 WL 493347 (S.E.C.) (Aug. 7, 1995), and 14,616, 1995 WL 505138 (Aug. 24, 1995) (filing injunctive action in connection with solicitation made on Internet promising 20% return on investment in eel farm).

n90. See *SEC v. Glantz*, *SEC Lit. Rel. No. 14,833*, 1996 WL 109470 (S.E.C.) (Mar. 5, 1996); *SEC v. Beatty*, *SEC Lit. Rel. No. 14,718*, 1995 WL 686624 (S.E.C.) (Nov. 14, 1995).

n91. *SEC v. Vision Communications, Inc.* 74 F.3d 287, 288-89 (D.C. Cir. 1996).

n92. *In re County of Orange*, *Sec. Act Rel. No. 72,620*, *Exch. Act Rel. No. 36,760*, 1996 WL 34362 (S.E.C.) (Jan. 24, 1996); *SEC v. Citron*, *SEC Lit. Rel. No. 14,792*, 1996 WL 26753 (S.E.C.) (Jan. 24, 1996); *In re Lazard Freres & Co.*, *Exch. Act Rel. No. 36,419*, 1995 WL 630924 (S.E.C.) (Oct. 26, 1995); *SEC v. Stifel, Nicolaus & Co.*, *SEC Lit. Rel. No. 14,587*, 1995 WL 457595 (S.E.C.) (Aug. 3, 1995).

n93. See generally Henry N. Butler & Larry E. Ribstein, Corporate Governance Speech and the First Amendment, 43 *Kan. L. Rev.* 163, 184-202 (1994) (analyzing constitutionality of regulating speech relating to federal securities law, including proxies, prospectuses, and disclosures). The First Amendment to the United States Constitution generally protects against abridgement of speech. U.S. Const. amend. I.

n94. See, e.g., *United States v. Cuthbertson*, 630 F.2d 139, 147 (3d Cir. 1980) (holding that journalists have qualified privilege not to disclose confidential sources or unpublished information); *Riley v. City of Chester*, 612 F.2d 708, 715 (3d Cir. 1979) (holding journalists have qualified federal common law privilege to refuse to disclose sources based on public policy that supports open communication).

n95. *Cuthbertson*, 630 F.2d at 147.



n96. *In re Petroleum Prod. Antitrust Litig.*, 680 F.2d 5, 7 (2d Cir. 1982).

n97. See *Liebhard v. Square D Co.*, No. 91- C-1103, 1992 U.S. Dist. LEXIS 11971, at \*2 (N.D. Ill. Aug. 4, 1992); see also *In re Scott Paper Co. Sec. Lit.*, 145 F.R.D. 366, 370 (E.D. Pa. 1992) (stating that court must balance party's need for information against journalist's First Amendment interests when determining whether qualified privilege is overcome).

n98. See *Hale v. Henkel*, 201 U.S. 43, 76 (1906) (finding that corporation can claim Fourth Amendment privilege to guard against unreasonable search or seizure). See generally Carl J. Mayer, *Personalizing the Impersonal: Corporations and the Bill of Rights*, 41 *Hastings L.J.* 577, 592-611 (1990) (discussing evolution of corporation's Fourth Amendment rights). The Fourth Amendment to the United States Constitution protects citizens against unreasonable governmental search and seizure. U.S. Const. amend IV. The Fifth Amendment provides citizens with protection against self-incrimination in criminal matters and guards against multiple prosecutions and multiple punishment for the same offense. U.S. Const. amend. V.

n99. See *United States v. Miller*, 425 U.S. 435, 445-46 (1976) (interpreting requirements of Fourth Amendment searches pursuant to administrative agency subpoenas); *See v. City of Seattle*, 387 U.S. 541, 544 (1967) (same); *United States v. Morton Salt*, 338 U.S. 632, 652-53 (1950) (same); *Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186, 208-09 (1946) (same); *United States v. Arthur Young & Co.*, 584 F.2d 1018, 1024 (D.C. Cir. 1978) (same).

n100. *Lagow v. United States*, 159 F.2d 245, 246 (2d Cir. 1946).

n101. *Miller*, 425 U.S. at 440.

n102. See SEC Form 1662, *supra* note 15; see *United States v. Teyibo*, 877 F. Supp. 846, 855 (S.D.N.Y. 1995) (citing *United States v. Unruh*, 855 F.2d 1363, 1374 (9th Cir. 1987)) (allowing prosecutor to use evidence previously obtained in civil investigation), *aff'd*, 101 F.3d 681 (2d Cir. 1996).

n103. See SEC Form 1662, *supra* note 15.

n104. *Couch v. United States*, 409 U.S. 322, 328 (1973).

n105. See *Hale v. Henkel*, 201 U.S. 43, 66-67 (1906).

n106. *Bellis v. United States*, 417 U.S. 85, 87-88 (1974); *SEC v. Kingsley*, 510 F. Supp. 561, 563 (D.D.C. 1981).

n107. *United States v. Doe*, 465 U.S. 605, 610-14 (1984) (finding that act of producing records was privileged).

n108. *Braswell v. United States*, 487 U.S. 99, 117 (1988); *Bellis*, 417 U.S. at 88; see *In re Application to Enforce Admin. Subpoenas Duces Tecum of the SEC v. B.M.C. Enter., Inc.*, No. 96-55464, (9th Cir. Apr. 12, 1996) (denying company's motion to stay enforcement of SEC subpoenas following lower court's decision that subpoena of corporate records did not infringe Fifth Amendment privilege against self-incrimination); cf. *SEC v. First Jersey Sec., Inc.*, 843 F.2d 74, 76 (2d Cir. 1988) (stating that corporation must produce corporate documents but should produce them by means of employee not claiming privilege).

n109. *Shapiro v. United States*, 335 U.S. 1, 7 (1948); see *United States v. Lehman*, 887 F.2d 1328, 1332-33 (7th Cir. 1989).

n110. *Couch v. United States*, 409 U.S. 322, 334-35 (1973).

n111. *Rogers v. United States*, 340 U.S. 367, 372-74 (1951).

n112. *In re Franklin Nat'l Bank Sec. Litig.*, [1975-1976 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 95,293 (E.D.N.Y. 1976)*.

n113. See *Baxter v. Palmigiano*, 425 U.S. 308, 318 (1976); *SEC v. Musella*, 578 F. Supp. 425, 429 (S.D.N.Y. 1984), *aff'd*, 898 F.2d 138 (2d Cir. 1990); *SEC v. Interlink Data Network*, [1993-1994 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 98,049, at P 98,472 (C.D. Cal. 1993)*.

n114. But see *Gutierrez-Rodriguez v. Cartagena*, 882 F.2d 553, 575-77 (1st Cir. 1989) (holding defendant's Fifth Amendment right was not violated when trial court precluded him from testifying at trial because he had asserted Fifth Amendment privilege and refused to answer questions during discovery).

n115. See Securities Act 8(e), 15 U.S.C. 77h(e) (1994); see also *In re Blimpie Corp. of Am., Sec. Act Rel. No. 5,146, 1971 WL 11250 (S.E.C.)*, at \*2 (May 6, 1971); *In re Scientific Res. Dev. Co., Sec. Act Rel. No. 5,040, 1970 WL 10529 (S.E.C.)*, at \*2 (Jan. 26, 1970).

n116. See *United States v. Halper*, 490 U.S. 435, 448-49 (1989). In *Halper*, the government in a civil enforcement action sought to recover a \$ 130,000 statutory penalty from an individual who had been criminally convicted for essentially the same conduct. *Id.* at 438-39. The Court stated that based on the district court's approximation of the government's actual damages and costs to be \$ 16,000, and because the penalty was disproportionate to the loss suffered by the government, the penalty was punitive in nature, thereby triggering the Double Jeopardy prohibition against multiple punishments for the same offense. *Id.* at 452. However, the Court remanded to allow the government to show that the district court's approximation was erroneous. *Id.*

n117. *United States v. Morgan*, 51 F.3d 1105, 1114-15 (2d Cir.) (citing *United States v. Halper*, 490 U.S. 435, 448-49 (1989)), cert. denied, 116 S. Ct. 171 (1995).

n118. See *United States v. Ursery*, 116 S. Ct. 2135, 2145 (1996) (stating that "case-by-case balancing test set forth in *Halper*, in which a court must compare the harm suffered by the Government against the size of the penalty imposed, is inapplicable to civil forfeiture"); *United States v. Gartner*, 93 F.3d 633, 635 (9th Cir. 1996) (holding disgorgement of "exact amount" fraudulently obtained from investors did not constitute punishment under Double Jeopardy Clause); *Morgan*, 51 F.3d at 1114-15 (civil sanction not punishment under double jeopardy).

ardly analysis where sanction does little more than compensate government for its damages and costs); *SEC v. Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994) (holding disgorgement order was not within meaning of Double Jeopardy Clause and thus not barred by prior conviction for securities violation because disgorgement was remedial, not punitive); *United States v. United States Currency (Etim)*, 18 F.3d 73, 74 (2d Cir. 1994) (holding civil forfeiture following conviction did not violate double jeopardy because forfeiture is remedial).

n119. *Kastigar v. United States*, 406 U.S. 441, 453 (1972). The government could bring a criminal action against the witness for the conduct about which the witness testified under immunity if the evidence upon which the action is based was obtained from a source wholly unrelated to the immunized testimony. *Id.* at 460. As a practical matter, it may be difficult to demonstrate that the prosecution is not tainted by the immunized testimony. See *id.* at 459 (discussing petitioner's argument).

n120. See 18 U.S.C. 6001-6005 (1994).

n121. See *id.* 6002, 6004.

n122. See *id.* 6004.

n123. *Dupuy v. United States*, 518 F.2d 1295, 1295 (9th Cir. 1975).

n124. 18 U.S.C. 6002.

n125. Cf. *United States v. Abrams*, 357 F.2d 539, 548-49 (2d Cir. 1966) (denying grant of immunity claimed under 15 U.S.C. 77v(c) as witness was not compelled to answer any questions to which he asserted Fifth Amendment privilege).

n126. *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358 (D. Mass. 1950).

n127. See *In re Martin Marietta Corp.*, 856 F.2d 619, 623-24 (4th Cir. 1988) (holding disclosures to agency during settlement negotiations waived attorney-client privilege); see also *In re Horowitz*, 482 F.2d 72, 81 (2d Cir. 1973) ("subsequent disclosure to a third party by the party of a communication with his attorney eliminates whatever privilege the communication may have originally possessed"); *United States v. Tellier*, 255 F.2d 441, 447 (2d Cir. 1958) (holding communication made in private between attorney and client not privileged because both understood that information in their communication was to be conveyed to others).

n128. See *United States v. Doe*, 959 F.2d 1158, 1165 (2d Cir. 1992).

n129. *United States v. Foster*, 309 F.2d 8, 15 (4th Cir. 1962).

n130. See *United States v. Billmyer*, 57 F.3d 31, 36-37 (1st Cir. 1995) (stating that disclosure to government of internal corporate information received from corporation's outside counsel waived attorney-client privilege); *Westinghouse Elec. Corp. v. Republic of the Philippines Nat'l Power Corp.*, 951 F.2d 1414, 1425-26 (3d Cir. 1991) (finding waiver of privilege upon voluntary disclosure of information to SEC); *In re Subpoenas Duces*

*Tecum*, 738 F.2d 1367, 1369-70 (D.C. Cir. 1984) (finding privilege waived upon voluntary disclosure to SEC); see also *In re John Doe Corp.*, 675 F.2d 482, 489 (2d Cir. 1982) (noting that disclosure of internal reports to underwriter's counsel during public offering waived privilege); *Permian Corp. v. United States*, 665 F.2d 1214, 1222 (D.C. Cir. 1981) (finding that voluntary disclosure to SEC waives attorney-client privilege); SEC v. Falbo, [1995-1996 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 99,018*, at P 93,787-88 (S.D.N.Y. Jan. 25, 1996) (finding that pro se defendant waived privilege when he testified as to conversations he had with his former attorney).

n131. See *Pritchard-Keang Nam Corp. v. Jaworski*, 751 F.2d 277, 281-82 (8th Cir. 1984) (holding that witness does not waive attorney-client privilege when he discloses information to SEC relating to communication to independent outside counsel retained by witness for purpose of assisting in investigation of witness's wrongdoing); see also *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1978) (en banc) (concluding that disclosure of self-investigative documents to SEC did not fully waive attorney-client privilege because disclosure was not voluntary).

n132. See *Hickman v. Taylor*, 329 U.S. 495, 509-10 (1947).

n133. *Fed. R. Civ. P. 26(b)(3)*.

n134. See *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 235-36 (2d Cir. 1993); *In re Subpoenas Duces Tecum*, 738 F.2d at 1371; see also *In re Sealed Case*, 676 F.2d 793, 817-18 (D.C. Cir. 1982) (holding that work product privilege waived upon voluntary disclosure to SEC where grand jury investigation was dependent on such documents); *In re Leslie Fay Cos., Inc., Sec. Litig.*, 152 F.R.D. 42, 45-46 (D.C.N.Y. 1993) (holding that corporation's audit committee waived protections afforded by work product doctrine in report by voluntarily disclosing report to SEC); *In re Worlds of Wonder Sec. Litig.*, 147 F.R.D. 208, 212 (N.D. Cal. 1992) (holding that corporation waived work-product doctrine protections by voluntarily producing document to SEC in informal investigation).

n135. See *SEC v. Dean Witter Reynolds, Inc.*, *Litig. Rel. No. 12,047*, 1989 WL 256616 (S.E.C.), at \*2 (Mar. 29, 1989).

n136. See *Upjohn Co. v. United States*, 449 U.S. 383, 391-97 (1981).

n137. See *Harding v. Dana Transp., Inc.*, No. 94-426 1996 U.S. Dist. LEXIS 1015, at \*21-\*23 (D.N.J. Jan. 25, 1996); see also *Bredice v. Doctors Hosp., Inc.*, 50 F.R.D. 249, 251 (D.D.C. 1970) (holding that hospital minutes from staff meetings are privileged information), *aff'd*, 479 F.2d 920 (D.C. Cir. 1973); see generally John C. Conway, Note, Self-Evaluative Privilege and Corporate Compliance Audits, 68 *S. Cal. L. Rev.* 621, 634-50 (1995) (discussing scope and analysis of courts' application of self-evaluative privilege); Nancy C. Crisman & Arthur F. Mathews, Limited Waiver of Attorney-Client Privilege and Work Product Doctrine in Internal Corporate Investigations: An Emerging Corporate "Self-Evaluative" Privilege, 21 *Am. Crim. L. Rev.* 123, 171-72 (1983) (noting that self-evaluative privilege, although established by courts, is not widely accepted and contains variety of exceptions).

n138. *In re Grand Jury Proceedings*, 861 F. Supp. 386, 388 (D. Md. 1994). It has been noted that "courts with apparent uniformity have refused the [privilege's] application where...the documents in question have been sought by a governmental agency." *Id.*; see also *Reich v. Hercules, Inc.*, 857 F. Supp. 367, 371 (D.N.J. 1994) (rejecting application of self-critical analysis privilege to safety audit reports subpoenaed by Dep't of Labor).

n139. Compare *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 236 (2d Cir. 1993) (refusing to create exception to waiver doctrine for disclosures to investigatory government agencies) with *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 611 (8th Cir. 1977) (en banc) (creating exception to waiver doctrine for disclosures to investigatory government agencies).

n140. See *In re Salomon Inc., Sec. Litig.*, [1992-1993 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 97,254*, at P 95,148 (S.D.N.Y. Nov. 12, 1992) (holding that internal reports are not protected by self-evaluative privilege because reports would continue even if discovery was allowed). But see *In re Leslie Fay Cos., Inc., Sec. Litig.*, 152 F.R.D. 42, 45-46 (S.D.N.Y. 1993) (finding that company waived self-evaluative privilege when it voluntarily provided SEC with copy of internal audit report).

n141. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 806 (1984); *Couch v. United States*, 409 U.S. 322, 335-36 (1973); *In re Grand Jury Proceedings*, 658 F.2d 782, 784 (10th Cir. 1981) (holding that worksheets based on business records prepared by accountant are not privileged); *In re An Application to Enforce an Admin. Subpoena Duces Tecum of the SEC v. Cahan & Co.*, 33 Fed. R. Serv. 3d (Callaghan) 847, 849 (E.D. Pa. Aug. 10, 1995); *In re Sahlen & Assocs. Inc.*, [1990-1991 Decisions] *Fed. Sec. L. Rep. (CCH) P 95,822*, at P 98,961 (S.D. Fla. Nov. 5, 1990) (holding that documents sought in discovery from accounting firm are not privileged from disclosure).

n142. See *McMann v. SEC*, 87 F.2d 377, 378 (2d Cir. 1937).

n143. *United States v. Miller*, 425 U.S. 435, 442-43 (1976); see also *United States v. Blackwood*, 582 F.2d 1244, 1246 (10th Cir. 1978) (holding that bank records may be summoned by IRS for investigation despite objections by depositor). See *infra* Part III.C for a discussion of The Right to Financial Privacy Act of 1978.

n144. See *In re Grand Jury Proceedings*, 103 F.3d 1140, 1146 (3d Cir. 1997) (declining to recognize parent-child privilege).

n145. See *Patterson v. Caterpillar, Inc.*, 70 F.3d 503, 506 (7th Cir. 1995); see also *Gilbreath v. Guadalupe Hosp. Found.*, 5 F.3d 785, 791 (5th Cir. 1993) (citing *United States v. Moore*, 970 F.2d 48 (5th Cir. 1992)) (holding that plaintiff cannot block release of medical records because federal law does not recognize physician-patient privilege); *Hancock v. Dodson*, 958 F.2d 1367, 1372-73 (6th Cir. 1992) (holding that testimony of plaintiff's husband's physician admissible in federal claim arising from husband's injuries).

n146. See *Trammel v. United States*, 445 U.S. 40, 53 (1980) (witness-spouse has privilege to refuse to testify but cannot be prevented from testifying voluntarily); see also *Blau v. United States*, 340 U.S. 332, 333-34 (1951) (holding that husband's refusal to testify as to whereabouts of wife allowed under privilege against disclosure of confidential communication between spouses).

n147. See *In re Zuniga*, 714 F.2d 632, 639 (6th Cir. 1983).

n148. See *In re Grand Jury Investigation*, 918 F.2d 374, 384 (3d Cir. 1990); see also *Mullen v. United States*, 263 F.2d 275, 277 (D.C. Cir. 1958) (holding that confessing sins to minister was privileged communica-

tion). But see *United States v. Gordon*, 655 F.2d 478, 486 (2d Cir. 1981) (finding no priest-penitent privilege where conversations were solely for business purposes).

n149. In addition, two governmental privileges have been recognized. First, federal common law recognizes the right of the United States to assert a privilege on the basis of national security. See *United States v. Reynolds*, 345 U.S. 1, 7-10 (1953); see also *Ellsberg v. Mitchell*, 709 F.2d 51, 59 (D.C. Cir. 1983) (holding that government's assertion of state's secret privilege of information concerning electronic surveillance of plaintiff's allowable where reasonable danger existed if information were made public). Second, the Speech and Debate Clause of the Constitution protects against inquiry into federal legislative acts and into the motivation for those acts. See *United States v. Brewster*, 408 U.S. 501, 525 (1972).

n150. 5 U.S.C. 552 (1994); see also 17 C.F.R. 200.80 (1996) (describing FOIA and SEC).

n151. See 5 U.S.C. 552(b)(1)-(9) (1994).

n152. See *id.* 552 (b)(4), (5), (7).

n153. See 17 C.F.R. 200.83(c) (1996).

n154. See *id.*

n155. See *id.* 200.83(b).

n156. See *id.* 200.83(c). Requests for confidentiality with respect to documents which, in the normal course of business, would be placed in public files are not covered by this rule, but by other provisions, such as *id.* 240.24b-2(a).

n157. *Id.* 200.83(c)(1)-(3).

n158. See *id.* 200.83(c)(4).

n159. See *id.* 200.83(c)(6).

n160. See *id.* 200.83(d)(1). The information required to substantiate a request for confidentiality is set out in 200.83(d)(2).

n161. See *id.* 200.83(e).

n162. See *id.*

n163. See *5 U.S.C. 552(b)(7)* (1994).

n164. See *17 C.F.R. 200.83(g)(1)*.

n165. See *id.* 200.83(g)(2).

n166. See SEC Form 1662, *supra* note 15.

n167. See SEC Forms 1661, 1662, *supra* note 15.

n168. *5 U.S.C. 552a*.

n169. See *id.* 552a(b)-(f).

n170. See *id.* 552a(d)(1)-(3), (c)(3)-(6). Enforcement records have specifically been exempted from the requirement that a record subject have access to records and opportunity to amend inaccurate records. See *id.* 552a(k)(2). Access may be granted pursuant to the FOIA. *Id.* 552a(b)(2). However, the FOIA does not provide a record subject with an opportunity to amend inaccuracies.

n171. *Id.* 552a(a)(2).

n172. See *id.* 552a(e)(3).

n173. See *supra* Parts I.A-C for a discussion of SEC investigations.

n174. Compliance with information requested pursuant to: a subpoena; or the recordkeeping provisions of (i) 17(a), (b) of the Exchange Act, *15 U.S.C. 78q* (1994), and the rules thereunder, *17 C.F.R. 240-17a-1(a)-(c)* (1996); (ii) the rules adopted by the Municipal Securities Rulemaking Board under 15B of the Exchange Act, *15 U.S.C. 78o-4*; (iii) 204 of the Advisers Act, *15 U.S.C. 80b-4*, and the rules thereunder, *17 C.F.R. 275.204-2(a)-(j)*; and (iv) 31 of the Investment Company Act, *15 U.S.C. 80a-30*, and the rules thereunder, *17 C.F.R. 270.31a-1(a), (b), (e), (f)*, is mandatory. The production of information other than pursuant to subpoena or the above-listed statutory and rules provisions is voluntary. *Id.*

n175. *5 U.S.C. 552a(a)(4)* (1994).

n176. See *id.* 552a(e)(4). A "system of records" is defined as "a group of any records under the control of any agency from which information is retrieved by the name of the individual or by some identifying number, symbol, or other identifying particular assigned to the individual." *Id.* 552a(a)(5).

n177. See Privacy Act of 1974, *59 Fed. Reg. 27,626 (SEC 1994)*; see also Privacy Act of 1974, *54 Fed. Reg. 24,454 (SEC 1989)* (noting modification of systems and records).

n178. Privacy Act of 1974, *54 Fed. Reg. at 24,454*.

n179. *5 U.S.C. 552a(b)* (1994).

n180. *Id. 552a(b)(3)*.

n181. *Id. 552a(a)(7)*.

n182. See SEC Forms 1661, 1662, *supra* note 15; see also *59 Fed. Reg. 27,626* (May 26, 1994); *54 Fed. Reg. 24,454* (May 30, 1989).

n183. *5 U.S.C. 552a(b)(3)* (1994).

n184. *Id. 552a(c)*. A "disclosure" includes any means of disclosure (written or oral) or any type of access to the documents. See *id. 552a(b)*.

n185. *Id. 552a(c)(1)(A)*.

n186. *Id. 552a(b)(1), (2)*.

n187. *Id. 552a(g)(1)(A)-(D)*.

n188. *Id. 552a(g)(4)*.

n189. *Id. 552a(g)(2)(A), (B)*.

n190. *Id. 552a(g)(3)(B)(4)*.

n191. See *id. 552a(e)(5)*; Office of Management and Budget, Privacy Act Implementation - Guidelines and Responsibilities, *40 Fed. Reg. 28,949, 28,969* (1975) ("OMB Guidelines").

n192. *5 U.S.C. 552a(d)(5)* (1994).

n193. OMB Guidelines, *40 Fed. Reg. at 28,969*.

n194. *5 U.S.C. 552a(i)(1)* (1994).



n195. Id. 552a(i)(2).

n196. Id.

n197. Id. 552a(i)(3).

n198. Pub. L. No. 95-630, Title XI, 92 Stat. 3710 (codified as amended at 12 U.S.C. 3401-3422 (1994)).

n199. Id. 3401(1).

n200. Id. 3401(5).

n201. See *Pittsburgh Nat'l Bank v. United States*, 771 F.2d 73, 75 (3d Cir. 1985) (holding that term "customer" includes only financial records of individuals and small partnerships).

n202. 12 U.S.C. 3401(2) (1994).

n203. Id. 3401(8).

n204. Id. 3403(b).

n205. Id. 3403(a), (b).

n206. Id. 3417(c).

n207. Id. 3402, 3403(a).

n208. See id. 3404.

n209. See id. 3405.

n210. See id. 3407.

n211. See id. 3406.

n212. See id. 3408.

n213. Id. 3402.

n214. Id. 3403(c).

n215. Id. 3404(a), (b).

n216. Id. 3405(1)-(3).

n217. Id. 3407.

n218. Id. 3405.

n219. Id. 3405(2), 3407(2).

n220. Id. 3405(2), 3407(2).

n221. Id. 3410.

n222. Id. 3410(a).

n223. Id. 3410(c).

n224. Id. 3410(c).

n225. Id. 3410(d). For example, a customer could not appeal the denial of a customer challenge until after the conclusion of a Commission enforcement proceeding.

n226. Id. 3410(d)(1).

n227. Id. 3410(d)(2).

n228. Id. 3412.

n229. Id. 3412(a). Note that the RFPA's proscription of uncertified transfer to "another agency or department" appears to apply only to interagency transfers within the federal government; transfers to state or local agencies, to self-regulatory organizations, or to foreign governments, apparently are not prohibited. *Nikrasch v. State*, 698 S.W.2d 443, 449 (Tex. Ct. App. 1985).

n230. See *12 U.S.C. 3412(e)*; *15 U.S.C. 78u(h)(9)* (1994).

n231. *12 U.S.C. 3413* (1994).

n232. *Id.* 3413(a).

n233. *Id.* 3413(d).

n234. *Id.* 3413(e), (f).

n235. *Id.* 3413(g).

n236. *Id.* 3413(h).

n237. *Id.* 3415. Frequently, recipients of SEC investigative subpoenas demand reimbursement for costs of production before compliance. Because the subpoena duces tecum calls for the production, and not the duplication, of documents, such demands generally are ineffective. See *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1033-34 (D.C. Cir. 1978).

n238. *12 C.F.R. 219* (1996).

n239. *12 U.S.C. 3415* (1994); *12 C.F.R. 219.2* (1996).

n240. *12 U.S.C. 3410* (1994).

n241. *Id.* 3417.

n242. *Id.* 3417(a).

n243. *Id.* 3417.

n244. *Id.* 3418; *Hunt v. SEC*, 520 F. Supp. 580, 609 (N.D. Tex. 1981).

n245. *12 U.S.C. 3417(b)* (1994).

n246. *15 U.S.C. 78u(h)* (1994).

n247. Id.

n248. Id. 78u(h)(2).

n249. Section 21(h)(2)(D)(3) of the Exchange Act, *15 U.S.C. 78u(h)(2)(D)(3)* (1994).

n250. Exchange Act 21(h)(4)(B); *15 U.S.C. 78u(h)(4)(B)* (1994).

n251. *15 U.S.C. 78u(4)(C)* (1994).

n252. See id. 78u(h)(7); see *supra* PartIII.C.9 for a discussion of civil remedies.

n253. Pub. L. No. 99-508, 100 Stat. 1848 (codified as amended at *18 U.S.C. 2510-2522, 2703-2711* (1996)).

n254. Id. 2703(a). Under this provision of the ECPA, governmental access to e-mail held for downloading would be limited.

n255. Id. 2703(b). This provision of the ECPA limits governmental access to companies that provide computer processing services.

n256. See, e.g., id. 2703 (stating requirements for governmental access); 2704(b) (allowing for customer challenges); 2705 (providing for delayed notices).

n257. Id. 2703(c)(1)(C). This provision permits governmental access to telephone billing records.

n258. Id. 2701(b).

n259. As with wiretaps, either customer consent or a warrant is required for such access by government agencies, absent an exception. Id. 2703(c)(1)(B).

n260. Id. 2511(2)(g).

n261. In other words, a formal order must be issued by the Commission and the telephone company cannot voluntarily provide telephone toll records to the Commission. Id. 2703(c)(1)(C).

n262. Id.

n263. *Id.* 2706.

n264. *15 U.S.C. 1681* (1994).

n265. *Id.* 1681a(f).

n266. *Id.* 1681a(d).

n267. *Id.* 1681b.

n268. See *United States v. Puntorieri*, 379 F. Supp. 332, 334 (E.D.N.Y. 1974) (requiring that IRS obtain court order or otherwise comply with FCRA when seeking consumer report).

n269. *26 U.S.C. 6103* (1994).

n270. *Id.* 6103(i)(2)(A), (i)(4)(A).

n271. See, e.g., Securities Act 24, *15 U.S.C. 77x* (1994); Exchange Act 32, *id.* 78o; Trust Indenture Act 325, *id.* 77x; Investment Company Act 49, *id.* 80a-48; Advisers Act 217, *id.* 80b-17.

n272. *26 U.S.C. 7216* (1994).

n273. *Id.*

n274. See *SEC v. Cymaticolor*, 106 F.R.D. 545, 547 (S.D.N.Y. 1985).

n275. *467 U.S. 735* (1984).

n276. *Id.* at 750; see also *SEC v. Pacific Bell*, 704 F. Supp. 11 (D.D.C. 1989), in which the court found that:

The effectiveness and integrity of an SEC investigation is largely dependent upon the Commission's ability to conduct it in a timely and confidential manner without having to embark on numerous "mini trials" in order to obtain relevant information.

*Id.* at 15 (citing *SEC v. O'Brien*, 467 U.S. 735, 750 (1984)).

n277. *SEC v. O'Brien*, 467 U.S. 735, 741-42 (1984).

n278. See Exchange Act 21(b), *15 U.S.C. 78u(b)* (1994); Securities Act 19(b), *id.* 77s(b); Investment Company Act 42(c), *id.* 80a-41(b); Advisers Act 209(b), *id.* 80b-9(b).

n279. See *supra* note 22 and accompanying text.

n280. See Exchange Act 21(c), *15 U.S.C. 78u(c)* (1994); Securities Act 22(b), *id.* 77v(b); Investment Advisers Act 209(c), *id.* 80b-9(c); Investment Company Act 42(c), *id.* 80a-41(c).

n281. Rule 30-4 of the Rules Delegating Functions to Division Directors, Regional Administrators and the Secretary of the Commission, 17 C.F.R. 200-30-4(a)(10) (1996).

n282. See Securities Act 22(a), *15 U.S.C. 77v(a)* (1994); Exchange Act 21(c), *id.* 78u(c); Investment Advisers Act 209(c), *id.* 80b-9(c); Investment Company Act 42(c), *id.* 80a-41(c), all of which provide that subpoena enforcement actions may be brought in the federal district court located where the investigation or proceeding is carried on or where the subpoenaed person resides or carries on business.

n283. See *supra* note 282 for the pertinent statutory authorities.

n284. *Id.*

n285. *Id.*

n286. See *15 U.S.C. 77v(a), 78u(c), 80a-41(c), 80b-9(c)* (1994).

n287. See Exchange Act 21(c), *15 U.S.C. 78u(c)* (1994); Investment Advisers Act 209(c), *id.* 80b-9(c); Investment Company Act 42(c), *id.* 80a-41(c).

n288. See generally *SEC v. First Sec. Bank of Utah*, 447 F.2d 166, 168 (10th Cir. 1972); *United States v. Davey*, 426 F.2d 842, 845 (2d Cir. 1970).

n289. The summary nature of subpoena enforcement proceedings stems from the requirement that agencies conduct their law enforcement activities promptly in order to protect the public. "The very backbone of an administrative agency's effectiveness in carrying out the congressionally mandated duties ... is the rapid exercise of the power to investigate." *Federal Maritime Comm'n v. Port of Seattle*, 521 F.2d 431, 433 (9th Cir. 1975). The summary nature of subpoena enforcement proceedings has been recognized by the Supreme Court in *Donaldson v. United States*, 400 U.S. 517, 528-29 (1971).

n290. *Fed. R. Civ. P. 81(a)(3)*.

n291. See *United States v. Fensterwald*, 553 F.2d 231, 232-33 (D.C. Cir. 1977) (allowing taxpayer limited discovery for showing of possible bad faith); *SEC v. Howatt*, 525 F.2d 226, 229 (1st Cir. 1975) (finding no evi-

dence that SEC abused its authority); *United States v. McCarthy*, 514 F.2d 368, 373-76 (3d Cir. 1975) (finding need to conduct evidentiary hearing prior to decision on discovery).

n292. *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1023 (D.C. Cir. 1979).

n293. See, e.g., *SEC v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118, 124-25 (3d Cir. 1981) (noting court's concern for integrity of judicial process).

n294. *Arthur Young*, 584 F.2d at 1023 (citing *United States v. Morton Salt*, 338 U.S. 632, 652 (1950)). Note that the First, Second, and Third Circuits require the slightly different showing set forth in *United States v. Powell*: (1) the inquiry is being conducted pursuant to a legitimate purpose; (2) the inquiry is relevant to that purpose; (3) the information sought by the subpoena is not already within the Commission's possession; and (4) the relevant administrative procedures have been followed. See *United States v. Powell*, 379 U.S. 48, 56 (1964); see also *Wheeling-Pittsburgh*, 648 F.2d at 128; *Howatt*, 525 F.2d at 229; *SEC v. Brigadoon Scotch Distrib. Co.*, 480 F.2d 1047, 1056 (2d Cir. 1973).

n295. *Arthur Young*, 584 F.2d at 1022-23.

n296. *Id.* at 1023.

n297. *Id.* at 1031 (quoting 1 K. Davis, *Administrative Law Treatise* 306, at 188-89 (1958)).

n298. *Id.* at 1030 (quoting *United States v. Morton Salt Co.*, 338 U.S. 632, 642 (1950)).

n299. *Endicott Johnson Corp. v. Perkins*, 317 U.S. 501, 509 (1943).

n300. *SEC v. Wheeling-Pittsburgh*, 648 F.2d 118, 126 (3d Cir. 1981) (enforcing subpoena would constitute abuse of process where SEC acted in bad faith); *SEC v. Brigadoon Scotch Distrib. Co.*, 480 F.2d 1047, 1056 (2d Cir. 1973) (enforcing subpoena would constitute abuse of process where compliance would be unduly burdensome or where subpoena issued for improper purpose); see also *United States v. Powell*, 379 U.S. 48, 58 (1964).

n301. *Brigadoon Scotch*, 480 F.2d at 1056.

n302. See *Wheeling-Pittsburgh*, 648 F.2d at 123 n.9 (stating that "bad faith connotes a conscious decision by an agency to pursue a groundless allegation without hope of proving that allegation").

n303. See *Powell*, 379 U.S. at 58 (noting that court would be bound to not enforce subpoena issued in bad faith or with improper purpose such as to harass or pressure subject of investigation).

n304. See *SEC v. ESM Gov't Sec., Inc.*, 645 F.2d 310, 316 (5th Cir. 1981) (remanding to district court for factual findings regarding whether SEC "intentionally or knowingly misled" broker-dealer to gain access to information).

n305. See, e.g., Rule 122 under the Securities Act, *17 C.F.R. 230.122 (1996)*:

Information or documents obtained by [the staff] in the course of any examination or investigation pursuant to sections 8(e) or 20(a) [of the Securities Act, *15 U.S.C. 77h(e), 77t(a) (1994)*] shall, unless made a matter of public record, be deemed confidential. This information may not be disclosed unless the Commission ... authorizes the disclosure of such information or the production of such documents as not being contrary to the public interest.

Id.; see also Advisers Act 210(b), *15 U.S.C. 80b-10(b) (1994)*; Investment Company Act 45(a), id. 80a-44(a); Rule 0-4 under the Securities Exchange Act, *17 C.F.R. 240.0-4 (1996)*; Rule 104(c) under the Public Utility Holding Company Act, id. 250.104(c); Rule 0-6 under the Trust Indenture Act of 1939, id. 260.06.

n306. Rule 2 provides:

Information or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public, but the Commission approves the practice whereby officials...may engage in and may authorize members of the Commission's staff to engage in discussions with persons identified in 240.24c-1(b) of this chapter concerning information obtained in individual investigations or examinations, including formal investigations conducted pursuant to Commission order.

*17 C.F.R. 203.2 (1996)*.

n307. *17 C.F.R. 200.10 to 200.30-18 (1996)*.

n308. Id. 200.30-4(a)(7); see also Exchange Act 24(c), *15 U.S.C. 77x(c) (1994)*.

n309. *17 C.F.R. 240.24c-1(b) (1996)*.

n310. See id. 200.30-4(b).

n311. Id.

n312. Rule 202.5(b) provides:

After investigation or otherwise, the Commission may in its discretion take one or more of the following actions: institution of administrative proceedings looking to the imposition of remedial sanctions, initiation of injunctive proceedings in the courts, and, in the case of a willful violation, reference of the matter to the Department of Justice for criminal prosecution. The Commission may also, on some occasions, refer the matter to, or grant requests for access to its files made by, domestic and foreign governmental authorities or foreign securities au-



thorities, self-regulatory organizations such as the stock exchanges or the National Association of Securities Dealers, Inc., and other persons or entities.

17 C.F.R. 202.5(b) (1996).

n313. Id.

n314. For example, in a collaborative effort to enhance the Commission's campaign against "rogue brokers," the Commission recently joined forces with the DOJ to indict eleven brokers. In these cases, the brokers had been caught and fired by their employers, and were charged with crimes ranging from theft to mail and securities fraud. See Jeffrey Taylor, *Eleven Ex-Brokers Indicted as Part of U.S. Crackdown*, Wall St. J., Dec. 1, 1995, at B1.

n315. See Securities Act 20(b), 15 U.S.C. 78t(b) (1994); Exchange Act 21(d)(1), id. 78u(d)(1); Advisers Act 209(d), id. 80b-9(d); Investment Company Act 42(d), id. 80a-41(d).

n316. See *United States v. Fields*, 592 F.2d 638, 645-48 (2d Cir. 1979) (affirming SEC's disclosure to U.S. Attorney's office of information obtained in civil action); *United States v. Bloom*, 450 F. Supp. 323, 329 (E.D. Pa. 1978) (finding that absent demonstrable harm, staff referrals do not violate prospective defendant's due process rights).

n317. See generally *United States v. Kordel*, 397 U.S. 1, 11-12 (1970); *United States v. Gel Spice Co.*, 773 F.2d 427, 432-34 (2d Cir. 1985); see also SEC v. Horowitz & Ullman, P.C., [1982 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 98,488 (N.D. Ga. 1982)*.

n318. *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1377 (D.C. Cir. 1980).

n319. 628 F.2d 1368 (D.C. Cir. 1980).

n320. *Id.* at 1370.

n321. *Id.* at 1379-81.

n322. *Id.* at 1381.

n323. Id.

n324. *Id.* at 1375-76.

n325. *FSLIC v. Molinaro*, 889 F.2d 899, 903 (9th Cir. 1989) (quoting *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1376 (D.C. Cir. 1980)).

n326. *Dresser*, 628 F.2d at 1374.

n327. *SEC v. First Fin. Group of Texas*, 659 F.2d 660, 665 (5th Cir. 1981); *SEC v. Zimmerman*, 854 F. Supp. 896, 899-900 (N.D. Ga. 1993); see also *United States v. Kordel*, 397 U.S. 1, 11-12 (1970) (finding that special circumstances are required for government agencies to defer civil proceedings that parallel criminal proceedings); *SEC v. Musella*, [1982-1983 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 99,516* (S.D.N.Y. 1983) (denying stay of civil action); *SEC v. Rubinstein*, 95 F.R.D. 529, 530 (S.D.N.Y. 1982) (refusing to seal discovery or prevent SEC from disclosing information to Department of Justice).

n328. *SEC v. Chestman*, 861 F.2d 49, 51 (2d Cir. 1988) (affirming stay of discovery in SEC proceeding); *SEC v. Mersky*, No. 93-5200, 1994 U.S. Dist. LEXIS 519 (E.D. Pa. Jan. 25, 1994) (staying civil action during pendency of criminal proceedings). See also *SEC v. Brumfield*, *SEC Lit. Rel. No. 14,706*, 1995 WL 653487 (S.E.C.) (Oct. 31, 1995) (Commission withdrew, and later refiled, complaint against 17 individuals alleging insider trading in connection with four AT&T acquisition targets pending completion of related criminal case against eight of same defendants in Commission action).

n329. *SEC v. F.N. Wolf & Co., Inc.*, No. 93- CIV-0379, 1993 U.S. Dist. LEXIS 18851 (S.D.N.Y. Dec. 15, 1993).

n330. See Rule 5(f) of the Commission's Informal and Other Procedures Rules, which provides in pertinent part:

Any person involved in an enforcement matter before the Commission who consents, or agrees to consent, to any judgment or order does so solely for the purpose of resolving the claims against him in that investigative, civil, or administrative matter and not for the purpose of resolving any criminal charges that have been, or might be, brought against him.

17 C.F.R. 202.5(f) (1996).

n331. *Id.* See *United States v. Fields*, 592 F.2d 638, 645-47 (2d Cir. 1978).

n332. The Rule's prohibition against disclosure does not apply to witnesses who testify before the grand jury. Advisory Comm. Note, *Fed. R. Crim. P. 6(e)(2)*.

n333. *Fed. R. Crim. P. 6(e)(3)(A)(i)-(ii)*, (C)(i).

n334. *Fed. R. Crim. P. 54(c)*; *United States v. Bates*, 627 F.2d 349, 351 (D.C. Cir. 1980) (applying Rule 6(e) to preclude disclosure); *In re Perlin*, 589 F.2d 260, 266-68 (7th Cir. 1978) (same); *In re Grand Jury Proceedings*, 309 F.2d 440, 443-44 (3d Cir. 1962) (same).

n335. See *United States v. Baggot*, 463 U.S. 476, 479 (1983); see also *In re J. Ray McDermott & Co.*, 622 F.2d 166, 171 (5th Cir. 1980) (applying Rule 6(e) to preclude disclosure).

n336. See *United States v. John Doe, Inc.*, 481 U.S. 102, 116 (1987) (reviewing district court findings under clearly erroneous standard); *In re Charlotte Observer*, 921 F.2d 47, 49-50 (4th Cir. 1990) (same); *In re Grand Jury Proceedings (GJ-76-4 & GJ-75-3)*, 800 F.2d 1293, 1298-99 (4th Cir. 1986) (same).

n337. *United States v. Sells Eng'g, Inc.*, 463 U.S. 418, 420 (1983); *Douglas Oil Co. v. Petrol Stops Northwest*, 441 U.S. 211, 223 (1979). See *In re Grand Jury Subpoenas Duces Tecum*, 904 F.2d 466, 468-69 (8th Cir. 1990) (applying factors of "particularized need"); *In re Grand Jury Proceedings (Kluger)*, 827 F.2d 868, 873-74 (2d Cir. 1987) (same).

n338. *Sells Eng'g*, 463 U.S. at 443 (quoting *Douglas Oil Co. v. Petrol Stops Northwest*, 441 U.S. 211, 222 (1979)). This standard is "highly flexible." *Id.* at 445; see also *John Doe, Inc.*, 481 U.S. at 116.

n339. *Sells Eng'g*, 463 U.S. at 431 (stating requirements for disclosure); *Lucas v. Turner*, 725 F.2d 1095, 1102 (7th Cir. 1984) (same); *In re Petitions for Disclosure of Documents*, 617 F. Supp. 630, 632 (S.D. Fla. 1985) (same).

n340. *Sells Eng'g*, 463 U.S. at 445.

n341. *In re Federal Grand Jury Proceedings (Doe)*, 760 F.2d 436, 439 (2d Cir. 1985) (finding that government has heavy burden to meet); *United States v. Payden*, 613 F. Supp. 800, 810-11 (S.D.N.Y. 1985) (same); see also *United States v. Fischbach & Moore, Inc.*, 776 F.2d 839, 844 (9th Cir. 1985) (referring to heavy burden that Commission must meet to obtain disclosure).

n342. See, e.g., *In re Grand Jury Proceedings (Miller Brewing Co.)*, 717 F.2d 1136, 1139 (7th Cir. 1983); *In re Corrugated Container Antitrust Litig.*, 687 F.2d 52, 57 (5th Cir. 1982); *SEC v. Everest Management Corp.*, 87 F.R.D. 100, 105 (S.D.N.Y. 1980).

n343. *SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1382 (D.C. Cir. 1980).

n344. *Pittsburgh Plate Glass Co. v. United States*, 360 U.S. 395, 399 (1959) (quoting *United States v. Proctor & Gamble Co.*, 356 U.S. 677, 683 (1958)); *United States v. Fischbach & Moore, Inc.*, 776 F.2d 839, 845 (9th Cir. 1985) (same); *SEC v. National Student Mktg. Corp.*, 430 F. Supp. 639, 641 (D.D.C. 1977) (citing *Proctor & Gamble*, 356 U.S. at 683).

n345. See *United States v. Dynavac, Inc.*, 6 F.3d 1407, 1412 (9th Cir. 1993) (listing various tests and weight given to grand jury materials when determining disclosure).

n346. See, e.g., *In re Sealed Case*, 801 F.2d 1379, 1381 (D.C. Cir. 1986) (finding that any disclosure reveals direction of grand jury's investigation); *In re Grand Jury Investigation of Cuisinarts, Inc.*, 516 F. Supp. 1008, 1022 n.17 (D. Conn.) (collecting cases), *aff'd*, 665 F.2d 24 (2d Cir. 1981).

n347. See, e.g., *In re Grand Jury Investigation (New Jersey State Comm'n of Investigation)*, 630 F.2d 996, 1001 (3d Cir. 1980); *In re Special February 1975 Grand Jury*, 662 F.2d 1232 (7th Cir. 1981).

n348. *Bradley v. Fairfax*, 634 F.2d 1126, 1128-29 (8th Cir. 1980); *United States v. Bates*, 627 F.2d 349, 350-51 (D.C. Cir. 1980).

n349. See *Fed. R. Crim. P. 6(e)(3)(D)*; see also *In re Special March 1981 Grand Jury*, 753 F.2d 575, 78-81 (7th Cir. 1985).

n350. *Fed. R. Crim. P. 6(e)(3)(D)*; *In re Special March 1981 Grand Jury*, 753 F.2d at 578.

n351. *Fed. R. Crim. P. 6(e)(2)*; *DiLeo v. Commissioner*, 959 F.2d 16, 19 (2d Cir. 1992).

n352. See, e.g., *United States v. Sells Eng'g, Inc.*, 463 U.S. 418, 467-68 (1983) (Burger, C.J., dissenting); *In re April 1977 Grand Jury Subpoenas*, 584 F.2d 1366, 1370 (6th Cir. 1978) (en banc) (discussing remedies for improper use of Grand Jury materials); *United States v. DiBona*, 601 F. Supp. 1162, 1166 (E.D. Pa. 1984) (same); *Donovan v. Smith*, 552 F. Supp. 389, 390 (E.D. Pa. 1982) (same).

n353. Disclosure obligations might differ, for instance, for an issuer in registration.

n354. Similarly, a control person or an affiliate likely would have a heightened disclosure obligation.

n355. *17 C.F.R. 229.404 (1996)*.

n356. The Division of Corporation Finance reviews registration statements filed pursuant to the Securities Act, and periodic reports filed pursuant to the Exchange Act, for compliance with such Acts. The Division of Corporation Finance does not, however, review registration statements and periodic reports filed by registered investment companies; those filings are reviewed by the Division of Investment Management.

n357. A full discussion of the processing of disclosure documents by the Division of Corporation Finance is beyond the scope of this Article. See generally Rules 202.2, 202.3, 17 C.F.R. 240.202.2, 202.3 (1996). The criteria for the Division's determination as to what filings to review and what level of review is appropriate are not generally publicized. In general, first time or new issuer registration statements are virtually assured of being reviewed, as are certain other types of documents (e.g., merger proxies). The goal of the comment process is to assist registrants in complying with the full disclosure requirements of the federal securities laws and to ensure that investors receive the information necessary to make informed investment decisions.

n358. The Division of Investment Management also issues Tandy Letter comments.

n359. Note that the shelf registration process alters the timing considerations discussed below. Shelf registrants may more quickly access the capital markets once the "base" registration statement has been declared effective. Thus, in the context of shelf registration, the timing considerations discussed below apply to the review

and declaration of effectiveness of the base shelf registration statement, but not to the prospectus supplements filed when registrants seek to issue securities "off the shelf."

n360. *15 U.S.C. 77h(a)* (1994).

n361. *17 C.F.R. 230.473* (1996). See generally Byron D. Woodside, Development of SEC Practices in Processing Registration Statements and Proxy Statements, *24 Bus. Law. 375, 376-79* (1969) (discussing problems presented by constraints of review process and methods employed to correct them).

n362. *17 C.F.R. 230.473* (1996).

n363. *Id.*

n364. See generally *15 U.S.C. 77h(e)* (1994) (empowering Commission to make examination to determine whether stop order will issue).

n365. Securities Act 8(a), *15 U.S.C. 77h(a)* (1994).

n366. *15 U.S.C. 77h(c)* (1994).

n367. *Id.*

n368. *17 C.F.R. 230.461* (1996).

n369. Rule 461(b)(3), *17 C.F.R. 230.461(b)(3)* (1996).

n370. Rule 461(b)(5), *17 C.F.R. 230.461(b)(5)* (1996).

n371. *15 U.S.C. 77h(e), 77t(a)* (1994).

n372. *Id.* 77h(e), 77t(a).

n373. *Id.* 77e(c).

n374. *Id.*

n375. See William R. McLucas, Stop Order Proceedings Under The Securities Act of 1933: A Current Assessment, *40 Bus. Law. 515, 526-28* (1985) (discussing *Las Vegas Hawaiian Dev. Co. v. SEC*, *466 F. Supp. 928* (D. Haw. 1979)); see *Las Vegas Hawaiian Dev. Co. v. SEC*, *466 F. Supp. 928, 933* (D. Haw. 1979) (holding that

Commission has authority to delay or thwart expectations of individual who purchases security while investigation is pending).

n376. See discussion *supra* Part II.B.2.c.

n377. The Commission has instructed the staff that "in cases where such action appears appropriate, it may advise a person under inquiry that its formal investigation has been terminated." *U.S. Securities and Exchange Commission, Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Sec. Act Rel. No. 5,310, 1972 WL 18218* (S.E.C.), at \*3 (Sept. 27, 1972).

n378. See *Sec. Reg. & L. Rep. (BNA) No. 19, vol. 27, at 708* (May 12, 1995).

n379. See discussion *infra* Part V.B.

n380. See *Sec. Act Rel. No. 5,310, 1972 WL 18218* (S.E.C.) (Sept. 27, 1972).

n381. See *id.* at \*1. In this release, the Commission considered certain recommendations of the Advisory Committee on Enforcement Policies, typically referred to as the "Wells" Committee after the Committee's chairman. *Id.*

n382. See *Sec. Act Rel. No. 5,320, 1972 WL 18228* (S.E.C.) (Oct. 12, 1972). This release added subsections (c) and (d) to *17 C.F.R. 202.5*.

n383. See *Sec. Act Rel. No. 5,310, 1972 WL 18218* (S.E.C.), at \*1 (Sept. 27, 1972).

n384. *Id.* at \*2.

n385. *Id.* Specifically, the release states that:

Where a disagreement exists between the staff and a prospective respondent or defendant as to factual matters, it is likely that this [disagreement] can be resolved in an orderly manner only through litigation. Moreover, the Commission is not in a position to, in effect, adjudicate issues of fact before the proceeding has been commenced and the evidence placed in the record. In addition, where a proposed administrative proceeding is involved, the Commission wishes to avoid the possible danger of apparent prejudice involved in considering conflicting contentions, especially as to factual matters, before the case comes to the Commission for decision.

*Id.*

n386. See generally *SEC v. National Student Mktg. Corp., 538 F.2d 404* (D.C. Cir. 1976) (per curiam) (holding that Commission is not required to provide notification if this would impede investigation).

n387. Arthur Levitt, Remarks on Private Litigation Under the Federal Securities Laws delivered at the Securities Regulation Institute Conference (Jan. 26, 1996); *The SEC Speaks in 1995*, 9 Insights, Apr. 1995, at 25.

n388. See *The SEC Speaks in 1995*, supra note 387.

n389. 5 U.S.C. 552(b)(7)(A) (1994); see also *NLRB v. Robbins Tire and Rubber Co.*, 437 U.S. 214, 222 (1978) (discussing exemption 7(A) of FOIA).

n390. 5 U.S.C. 552(b)(7)(D) (1994).

n391. *Id.* 552(b)(7)(C), (D).

n392. See *In re Request of Dow Jones & Co.*, FOIA Rel. No. 12, 1975 WL 19496 (S.E.C.) (June 19, 1975) (noting that critical factor was that Commission's inquiry was ongoing, not that orders of permanent injunction had been entered against defendants in one particular enforcement action).

n393. 5 U.S.C. 552(b)(7)(B) (1994).

n394. *Id.* 552(b)(7)(E).

n395. *Id.* 552(a)(6)(C).

n396. *In re Request of First Nat'l City Bank*, FOIA Rel. No. 36, 1975 WL 35843 (S.E.C.) (Nov. 4, 1975). In *First Nat'l City Bank*, the Wells submission contained statements from both corporate entities and individuals. The Commission found that no protection of privacy is contemplated for corporate entities under the FOIA, which refers only to "personal" privacy. Note that with respect to the statements of the individuals, the Commission found that considerations of personal privacy do apply, but because the submissions did not contain any material of an "intimate nature" for which an individual "could reasonably assert an option to withhold from the public because of its intimacy or its possible adverse effects upon himself or his family" or for which disclosure would offend expectations of privacy, disclosure was permitted. *Id.* at \*9-\*10 (citing Attorney General's Memorandum on 1974 Amendments to FOIA (Feb. 1975)).

n397. See *Goldberg v. Touche Ross & Co.*, [1976-1977 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 95,759* (S.D.N.Y. 1976) (finding SEC testimony and submissions are discoverable).

n398. See *In re Jung Ja Malandris*, FOIA Rel. No. 8, 1975 WL 19354 (S.E.C.) (May 29, 1975) (finding that because evidentiary materials appeared relevant to private action, even though disclosure of those materials could have been considered invasion of privacy, it was "clearly not an 'unwarranted' invasion of privacy to disclose the files").

n399. See *In re Allied Stores Corp. and George Kern*, Admin. Proceeding File No. 36869, 1988 WL 357006 (S.E.C.) (March 21, 1988) (refusing to allow staff to use Wells Submission as admission against interest where

staff had not advised Kern's counsel that Wells Submission, if made, would be used at staff's discretion as such admission in any enforcement action).



