



Portfolio Media, Inc. | 648 Broadway, Suite 200 | New York, NY 10012 | www.law360.com
Phone: +1 212 537 6331 | Fax: +1 212 537 6371 | customerservice@portfoliomedia.com

Fresh Insights From The SEC Enforcement Manual

Law360, New York (October 20, 2008) -- For the first time ever, the U.S. Securities and Exchange Commission's Division of Enforcement on Oct. 6, 2008, made publicly available a detailed policy and procedure document outlining the operations of the Enforcement Division and key aspects regarding the conduct of its investigations.[1]

The 122-page "Enforcement Manual" provides insights into all aspects of the Enforcement Division's processes from the inception of a new investigation through the Wells Process and conclusion of a case.

For practitioners before the SEC, the Manual provides important information about the SEC's processes that may affect strategic decisions in representing clients before the SEC – including to whom to self-report, what information to request during the Wells Process, and when to reach out to senior Enforcement officials.

Case Opening Considerations

The Enforcement Manual provides a window into the Enforcement Division's process and considerations for opening investigations and determining which office will investigate a case.

If the staff does decide to open a new case, the Manual enumerates factors the Division will consider in determining which SEC office should handle an investigation and outlines the centralized review by senior Division officials of that decision.

The factors governing which particular office will handle the investigation include the location of the wrongful conduct, potential wrongdoers, and witnesses, as well as the available resources and expertise of the office.

The Associate Director in the home office in Washington, D.C. or the Regional Head of Enforcement in a regional office must provide the Deputy Director a brief explanation regarding the investigation's potential to address violative conduct and why their group

is the appropriate one to handle the investigation. The Deputy reviews the notice to determine whether an investigation is an appropriate use of resources.

This centralized review of case openings and assignment to a particular office is a relatively new process and has practical implications for defense counsel.

Traditionally, when self-reporting potential wrongdoing or providing a tip to the Enforcement staff, one could strongly influence which office would conduct the investigation.

Since responsibility was decentralized, the office receiving the self-report or tip generally opened and retained the investigation. Defense counsel was in a position to select an office based not necessarily on the locus of the conduct or entities at issue but based on other strategic considerations.

The practical implication of the policy now outlined in the Manual, however, is that counsel may need to consider the factors that Division management will assess in determining which office should be assigned a particular case when deciding where to self-disclose.

If counsel self-discloses to a preferred office, counsel should be prepared to give the staff information to justify the case remaining in the selected office.

In addition, as a practical matter, the SEC's office in Washington, D.C., is home to approximately 300 of the 1000 people of the Enforcement Division. The other 700 are in the eleven regional offices. Few of the Commission's investigations have particular geographic ties to Washington, D.C.

Consequently, the new policy may result in the Enforcement staff in Washington focusing on those investigations with few ties to any particular jurisdiction and those where they have resource or expertise advantages.

Consequently, in selecting a particular office, counsel should consider whether the case is more likely to be handled from Washington, and, if so, initiate the self-disclosure there.

Informal Inquiry V. Formal Investigation

For the Enforcement staff to obtain subpoena power, the Commission must issue a "Formal Order of Investigation."

Historically, the Enforcement staff sometimes waited to seek formal order authority until there was a need to compel testimony or production of documents – if witnesses were cooperating, there could be a delay in seeking formal order authority. As a result, there would be no Commission consideration of the investigation until it reached a more advanced stage.

The Manual clarifies that the staff should consider whether the action memorandum for formal order authority is being provided to the Commission in a timely manner, and states that the staff should “allow the Commission an opportunity to review the investigation for both policy and resource concerns at a relatively early stage.” Manual § 2.3.4 at 21.

This suggests a preference for an early request for formal order authority. Often, those defending Commission investigations hope informal inquiries do not turn into formal investigations. In particular, there is often a hope that thorough early cooperation may result in the staff deciding not to escalate an informal inquiry to a formal investigation. That result may now be harder to achieve.

The formalization of this preference may have significant implications. The staff has to take additional steps to close a formal investigation, making it potentially harder to convince the staff to close an inquiry at an early stage.

Moreover, issuers have disclosure obligations related to formal Commission investigations, and investors often have significant negative reactions when formal investigations are disclosed.

Although these may be unintended consequences of the preference for obtaining formal orders early in cases, defense counsel aware of this policy can educate their clients that escalation to a formal order does not necessarily signal that the staff views the conduct under review as more serious or that cooperation has been lacking – it may reflect implementation of the policy outlined in the Manual or some other need for access to evidence requiring subpoena power.

The Wells Process

The Manual also provides insight regarding aspects of the Wells process. First, the Manual clarifies that before the staff may issue a Wells Notice, the staff must obtain the approval of a Deputy Director of the Division of Enforcement.

This is a more senior level of review than was required before, and presumably requires the staff to have marshaled the evidence and made a determination about their view of the potential violations in writing.

Once the staff has sought and obtained this senior-level approval to issue a Wells Notice, it increases the possibility that an Enforcement recommendation ultimately will follow.

For this reason, and because companies often determine that receipt of a Wells Notice is an event requiring disclosure, it may be advisable to request an opportunity to meet with the staff when the investigative phase of the case is nearing completion to assess the staff’s view of the case and to provide an opportunity to advocate for the client before the Wells Process begins.

Such a “pre-Wells” meeting may not forestall the issuance of a Wells Notice, but may preview the staff’s thinking on likely charges and provide an advanced ability to begin discussions with the client about whether to settle and how to respond to a Wells Notice if one is issued.

Second, the Manual also clarifies an issue about the Wells Process that has not been handled consistently across the Commission. After a Wells Notice is issued, the recipient typically requests access to the evidentiary basis for the staff’s conclusions. The staff has not had a uniform approach in responding to such requests – often providing little or no access to the underlying record.

The Manual, for the first time, makes clear that recipients of a Wells Notice may request access to the record and that the staff may, in its discretion, allow recipients to “review non-privileged portions of the investigative file, including documents that the recipient likely would receive during discovery if the Commission were to file a recommended action or proceeding.” Manual § 2.4 at 25.

This may enable practitioners to gain access to a wider array of material than has been permitted by certain of the Commission’s offices during the Wells Process.

Because transcripts of testimony and other documents may be obtained during litigation, practitioners can request the opportunity to review witness statements and other documents to gain a more complete understanding of the evidence and prepare a more effective Wells submission.

Contacting Senior Division Personnel

The Manual includes information about a new policy regarding external communications between senior Enforcement officials and persons outside the SEC who are involved in investigations.

The policy emphasizes that “it is important that outside persons involved in investigations feel that they may contact the staff in the Division without hesitation, including senior officials.” Manual § 3.1.1 at 37.

The policy sets out best practices for dealing with such contacts and, notably, encourages senior officials to include the investigative team in them.

Although the policy recognizes that one-on-one meetings can be more productive and permits them in certain circumstances, the policy generally requires senior officials to document the circumstances and content of the communications when other staff are not available and to inform the other staff regarding the purpose and contents of the communication.

Senior officials generally only are excused from sharing the contents of the communications with the staff when the outsider raises issues regarding the professionalism or conduct of the staff.

The policy also provides that the senior official “should be sensitive to the possibility that allegations about questionable conduct may serve as a pretext to complain about minor events or annoyances ... to undermine the progress of the investigation.” Manual § 3.1.1 at 39.

The senior official is encouraged to consider whether to inform the staff of such criticism “[d]epending on the apparent motivation of the communication.” Id.

Senior officials are encouraged to be “particularly sensitive that an external communication may appear to be or has the potential to be an attempt to supersede the investigative team’s judgment and experience.” Id.

Given this policy, defense counsel should tread carefully in deciding whether to communicate with senior Division officials about a case.

Because such a communication generally will be reported to the more junior staff under the policy, it may be advisable to discuss counsel’s desire to approach a senior official with more junior staff before going ahead.

This enables the primary staff in charge of the investigation to communicate internally about the requested communication, to prepare the more senior official for the communication, and to avoid unnecessarily alienating the more junior staff.

Investigation Closing Process

Historically, the decision whether to inquire with the staff whether an investigation is ongoing with respect to a particular person has been a difficult one for defense counsel.

Although clients want to understand whether their conduct is still under review, the defense bar did not know if making such an inquiry was likely to yield an answer and, for a variety of reasons, counsel often decided it was better not to ask.

As a result, an individual or entity who was involved in some way in an investigation may never have received any formal notice that the investigation was complete with respect to that person. The Manual clarifies the Division’s policies with respect to closing cases and makes clear that individuals and entities are more likely to receive such notice in the future.

The Manual states that the “staff is encouraged to close an investigation as soon as it becomes apparent that no enforcement action will be recommended.” Manual § 2.6.1 at 33.

It states that it is the “Division’s policy ... to notify individuals and entities at the earliest opportunity when the staff has determined not to recommend an enforcement action against them.” Manual § 2.6.2 at 34.

The staff is explicitly permitted to send termination letters before the investigation is closed and before a determination has been made with respect to other individuals or entities.

In addition to the general policy preference for early notification, the policy requires termination notices to be provided to certain categories of persons.

Specifically, a termination letter “must” be sent to anyone who: (1) is identified in the caption of a formal order, (2) provides a Wells submission, (3) requests such a notice, and (4) reasonably believes that the staff was considering recommending an action against them. Manual § 2.6.2 at 36.

Consequently, although other considerations may counsel against such a request, the policy clarifies that if counsel requests a termination notice the staff is required to provide one at the appropriate time. This policy should enable defense counsel to better advise clients about whether and when they are likely to receive notice that the investigation is complete as to them.

Conclusion

The SEC’s Enforcement Manual provides a variety of insights regarding the internal machinery of the Division. Practitioners are well advised to consult it as it relates to particular aspects of the life cycle of a given case. The level of detail provided in it previously would only have been available to those who had worked in the Division.

--By Charles E. Davidow, Walter G. Ricciardi and Kevin M. Loftus, Paul Weiss Rifkind Wharton & Garrison LLP.

Charles Davidow and Walter Ricciardi are both partners with Paul Weiss in the firm's Litigation Department. Davidow is based in the firm's Washington, D.C., office and Ricciardi is based in the New York office. Kevin Loftus is counsel with the firm in the Litigation Department, based in the Washington office.