Bloomberg BNA

BNA's
Corporate Counsel Weekly™

The SEC Enforcement Process: Latest Tips and Trends

Bloomberg BNA recently conducted an e-mail interview with Skadden, Arps, Slate, Meagher & Flom LLP partner Colleen P. Mahoney on recent SEC enforcement concerns.

Bloomberg BNA: Securities and Exchange Commission Enforcement Director Andrew Ceresney recently promised to file more cases in the SEC's administrative forum, particularly insider trading cases. In what ways are civil and administrative enforcement actions similar? In what ways do they differ?

Colleen P. Mahoney: The differences are significant. As to why the SEC is now shifting to the administrative forum: Following the Dodd-Frank Act, the SEC can now assert the same charges and seek the same remedies administratively as it can in federal court (26 CCW 51, 2/16/11). The SEC can seek penalties, disgorgement, and other equitable relief, including securities industry bars, in either forum. The SEC also can seek similar orders, in the form of injunctions in federal civil actions and cease-and-desist orders in administrative actions, prohibiting future violations of the federal securities laws.

The SEC likes the administrative forum because the process and procedure (generally but not always) tilts in their favor. An administrative action is overseen by an administrative law judge who is an SEC employee, and who also serves as the factfinder. Respondents have limited means of discovery and a limited time period in which to complete it, as administrative actions typically do not allow discovery such as interrogatories or depositions and follow a much more expedited schedule than federal civil actions. Moreover, as the Federal Rules of Evidence do not apply, hearsay, for example, may be admissible. Respondents do not have the right to trial by jury and must appeal to the Commission before appealing to a federal appellate court.

Another significant difference is in the collateral consequences. SEC charges in federal civil actions are in the form of allegations in a complaint, which generally cannot be used as evidence in subsequent litigation. The SEC's charges in administrative actions, however, are in the form of findings in an order instituting proceedings, which may be admissible in subsequent proceedings.

BBNA: The SEC's whistle-blower office has increased activity, recently filing its first lawsuit enforcing Dodd-Frank whistle-blower retaliation protections. How should the SEC's increased attention to whistle-blowers impact companies' approach to whistle-blowers?

Mahoney: The best way to avoid learning about a possible violation after a whistle-blower has already reported it to the SEC is to have in place an internal reporting and compliance system that is widely known within the company and regarded by employees as credible, responsive, and non-retaliatory. Even if a whistle-blower chooses not to make use of such a system, the SEC is more likely to afford a company the opportunity to self-investigate and receive cooperation credit if the company has a credible system in place.

Companies should also take steps to protect themselves from allegations that they have retaliated against a whistle-blower. Companies should understand that retaliation extends beyond simply firing a whistle-blower and may encompass other actions that are regarded as materially adverse to an employee, such as a transfer, suspension, or reassignment of duties. Finally, companies should consult with experienced counsel and carefully document reasons for taking any adverse employment actions.

BBNA: What are the pros and cons of conducting an internal investigation?

Mahoney: Internal investigations have become more critical in recent years, including as a result of Dodd-Frank's whistle-blower bounty program, and provide several benefits to companies involved in SEC investigations. A company, for example, may be able to persuade the SEC to postpone seeking testimony or documents to allow it time to complete an internal investigation. This gives the company an opportunity to learn and assess the relevant facts in a timely and orderly fashion. This also allows the company more control over the investigation,

Colleen P. Mahoney is a partner at Skadden, Arps, Slate, Meagher & Flom LLP. Ms. Mahoney heads the firm's Securities Enforcement and Compliance practice and regularly represents financial services firms, corporations, their officers, board committees, directors and employees in Securities and Exchange Commission and other law enforcement investigations. Ms. Mahoney is co-author—along with Skadden attorneys Charles F. Walker, Joshua A. Ellis, Erich T. Schwartz and Andrew M. Lawrence—of Bloomberg BNA's Corporate Practice Portfolio Series title, "The SEC Enforcement Process."

 ISSN 0886-0475

as opposed to reacting to requests from the SEC regarding, for example, which documents must be produced and which witnesses will be interviewed and in what order.

A company may also use an internal investigation as a tool to inform the board of directors and other applicable constituencies of important relevant information. Facts uncovered by an internal investigation may assist the company in making timely and accurate disclosures to its shareholders about the events under investigation. Further, voluntary disclosure of misconduct learned through an internal investigation may result in cooperation credit when negotiating a resolution with the SEC, and it is a factor under the Federal Sentencing Guidelines for Organizations that could result in a reduction in the amount of any fine.

Conducting an internal investigation has disadvantages, the most significant of which is that materials prepared in the course of the investigation (such as memoranda or notes of employee interviews, summaries of the investigation's findings, or the investigation report) may become discoverable in other litigation. Having counsel oversee the investigation should permit the company to maintain privilege, but there are always risks. The SEC also may seek to obtain an investigation report and supporting materials as part of any agreement to defer its investigation until the internal investigation concludes. In addition, even after an internal investigation, the SEC may decide to conduct its own investigation.

BBNA: Should a company disclose when it's being investigated by the SEC?

Mahoney: Whether and when to disclose an SEC investigation is a difficult and nuanced issue that every public company involved in an investigation must consider. No statute or SEC rule specifically requires public companies to disclose that they are under investigation. While certain provisions of the federal securities laws, including Items 103 and 303 of Regulation S-K, impose obligations to disclose certain information in documents filed with the SEC, those provisions do not require that an investigation be disclosed. Case law lacks clear guidance, although it generally indicates that disclosure may be required when a company has made disclosures that could be deemed misleading in the absence of further disclosure.

In the end, the decision of whether or not to disclose an SEC investigation is often as much a business or strategic decision as it is a legal decision. Thus, although a company legally may not be required to disclose the existence of an SEC investigation, it must consider whether disclosure is advisable. To decide, the company should consider several factors, including the nature of the disclosure, the materiality of the investigation, the facts being investigated, and the possible and probable outcomes of the investigation. Moreover, a company should consider the consequences of disclosing, such as additional government or regulatory investigations, and shareholder lawsuits.

No SEC rule specifically requires public companies to disclose that they are under investigation.

BBNA: What are some considerations for companies in responding to an SEC document request or subpoena?

Mahoney: The first contact a party receives from the SEC is often a request for documents or other information. Significant advantages can be gained from responding effectively to such a request. Conversely, a mishandled document request or subpoena can be disastrous for a company, unnecessarily prolonging its involvement in an investigation, increasing the possibility of an unfavorable outcome, and, in the worst case, creating potential obstruction concerns. For these reasons, it is essential that a company and its counsel carefully oversee this aspect of the investigation.

The nature and substance of the document request, among other things, will inform how a company responds, but all requests should be thoroughly reviewed and considered before documents are collected and reviewed for production. In most cases, the document request will provide the best insight into the staff's concerns and interests in the investigation. Consideration should also be given to whether the scope of the request is overbroad or under-inclusive. It is frequently advisable to discuss the request with the staff in order to narrow the scope of the request or to clarify the staff's intention.

Another important part of any response to a document request is document preservation. When a company receives a document request, it should promptly identify all officers and employees who may have relevant information. The company should expeditiously distribute a memorandum to these individuals (i) instructing them to preserve all documents, including e-mail and other electronic documents, related to the Commission's investigation, and (ii) ordering the suspension of all regularly scheduled destruction of those documents. In most cases, counsel should interview these individuals and provide each a copy of the document request in an effort to gather the relevant information. Steps must be taken to preserve all electronic documents that may be relevant to the matters under investigation and to disable any function that automatically deletes electronic records.

Thereafter, prompt production of responsive documents and communication regarding those productions are often effective in establishing a good working relationship with the staff, demonstrating a company's cooperation, and learning more about the staff's concerns and interests.

CCW ISSN 0886-0475