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OPINION

■ NEW SEC MANUAL ■

A welcome addition

By *David Z. Seide & Jonathan J. Walsh* special to the nlj

The ongoing financial crisis has catapulted the conduct of the nation's financial regulators to the top of the conversation. Much of that attention has been far from laudatory—many ask why the regulators have not done more to prevent the crisis and to detect abuses. The U.S. Securities and Exchange Commission (SEC) has faced the severest criticism of all—reflected in its failure to detect and stop Bernard Madoff's multibillion-dollar Ponzi scheme notwithstanding its repeated receipt of suspicious reports.

President Obama's selection of Mary Schapiro as the new SEC chairwoman, someone with deep regulatory and enforcement experience, augers well for change in the commission. But there is an additional bright spot for the SEC that

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deserves praise: the first-time publication in October 2008 of its Enforcement Manual—describing policies and procedures hitherto disbursed in separate SEC pronouncements and internal documents, and known only to SEC staff and experienced practitioners. It is a welcome addition, placing the SEC on the same footing as the U.S. Department of Justice (DOJ), which has long published the U.S. Attorney's Manual, as well as the Financial Industry Regulatory Authority (FINRA), which Schapiro previously headed and which recently issued similar guidance.

The most beneficial aspect of the manual is that it lays out—in one single place—the rules and procedures the SEC and its enforcement staff are expected to follow. Its existence provides a transparent mechanism for understanding the SEC enforcement process. Moreover, the SEC is using its publication to make significant changes in at least five areas. These changes, along with the systematic changes

Schapiro has brought, should bolster the SEC's enforcement efforts and potentially its reputation in the marketplace.

Changes in five areas

■ *Opening, monitoring and closing matters.* The manual notes that the staff may issue subpoenas once a formal order

of investigation has been issued. Schapiro has returned to an approval process for issuing such an order that allows for the approval of a single SEC commissioner. This process had been abolished in favor of one that required review and approval of the five commissioners.

The new system should allow

the staff to act more quickly in response to major cases. The manual also directs SEC Enforcement Division supervisors to review regularly open investigations and, as part of that process, calls for senior managers to rank their top 10 open investigations in order of importance. Notably, Schapiro has also abandoned the two-year-old "penalty pilot" program that required the staff to seek authority

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from commissioners before negotiating penalties with public companies. The manual also states the principles affecting closing matters. They include an evaluation of the seriousness of the potential violations, the available investigative resources, the sufficiency of the evidence and the age of the conduct at issue.

■ *Discovery during the Wells process.* Subjects of an SEC investigation are afforded the opportunity to weigh in on the case, before an enforcement action is commenced, through the Wells process. The manual—and this is a new and potentially promising development—gives the staff discretion to allow subjects of an investigation the opportunity to review the investigative file. This process, if actually used, should facilitate the enforcement process by promoting more effective communication between the subjects and the SEC concerning real issues in a case.

■ *Witness immunity.* The SEC's willingness not to prosecute, and/or to confer immunity upon, cooperating witnesses is another significant development. It gives the staff the discretion to provide "witness assurance letters" in which the SEC assures the

cooperating witness that, in exchange for testimony, the witness will not be subject to an enforcement action by the SEC. The manual also contemplates that witnesses can be immunized, subject to approval by DOJ. These practices have long been part of the repertoire of federal prosecutors in criminal cases and have proven to be highly effective.

■ *Interactions with other government agencies and outside counsel.* Mindful of recent cases in which district courts dismissed criminal charges based on findings of improper coordination between the SEC and DOJ, the manual reaffirms that the SEC may cooperate with other government agencies but that each agency must conduct its own independent investigation. Such joint cooperation has been on display in the past few weeks with major cases brought by the SEC, with assistance of the FBI and other DOJ entities, in New York and Texas. The manual also attempts to account for criticism concerning allegedly inappropriate interactions between senior SEC enforcement staff and outside counsel. It directs that the investigative team should participate in any such communications whenever possible and, to the extent that the

team is unable to participate, the senior official should document any material communications within a reasonable time period.

■ *Waiver of privilege no longer encouraged.* Another notable change is the fact that the manual now directs that the "staff should not ask a party to waive the attorney-client or work product privileges and is directed not to do so." Further, such waiver is not necessary in order for a party to be credited with cooperation. Instead, the manual instructs the staff to ask for fact material. This represents a departure from prior SEC policy. But whether it actually can work, or is a meaningful change, is yet to be seen.

The SEC Manual is a significant step in favor of transparency and consistency for those who interact with SEC. It will benefit all SEC practitioners and is an important step on the path of restoring confidence in a battered agency. **NLJ**

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