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Outside Counsel

Need for Narrower Subpoenas in SEC Investigations

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Two common criticisms of investigations by the Securities and Exchange Commission have been the length of time investigations take and the enormous costs they impose on private parties. The issues raised by those criticisms have grown in significance in recent years as the SEC staff has used vague and overbroad subpoenas and requests for documents in the age of email and electronically stored information. Unduly broad requests for electronic documents slow the production process, extend investigations, and significantly increase the associated costs.

Without sacrificing enforcement goals, the staff of the Division of Enforcement could use narrower, more specifically tailored document requests, which would speed up investigations, allow the agency to allocate its resources more efficiently, reduce costs for recipients of the requests, and treat those recipients more fairly. As a bonus, more limited document requests would be far more likely to satisfy the legal requirements governing the validity of administrative subpoenas. The purpose of this article is to discuss these issues.

Broad Subpoenas

The SEC staff has a practice of using extremely broad subpoenas and requests for documents. The typical subpoena has a long list of categories of document to be produced, and that list follows broad instructions and definitions. Each category can seek a large volume of material. A favorite formulation is to demand "all documents concerning" or "all documents related to" a broad subject matter over the course of many years, and many of the requests can be vague or ambiguous.¹

Often, some requests are not bounded by any subject limitation. An example is a request for all the emails over many years of selected employees or a copy of everything stored on a mobile phone or a computer hard drive. That kind of request sweeps in messages on all subjects, including areas with no suspected misconduct, and with all people, including family, friends, therapists, doctors and lawyers.

The staff has understandable interests in being over-inclusive in requesting documents. At the beginning of an investigation, the staff is less well informed about the issues and relevant personnel. They do not want to miss important documents and want to run their own searches over large quantities of documents in electronic form.

The result of broad SEC document requests is the need to search, collect, review, and produce extremely large volumes of material.² For example:

- In an investigation into CDOs that began in 2008, Goldman Sachs reported that it produced eight million pages of documents to the SEC staff.³ Usually, the number of pages produced is much smaller than the number collected and reviewed.
- In 2010-2011, the staff conducted an investigation of RMBS sold by Wells Fargo, sending six subpoenas for documents, including one after 7 p.m. on Friday Dec. 23, with a return date of Jan. 9. Wells Fargo said the SEC staff had made 96 requests for information and it had made 68 separate document productions of more than 750,000 pages. More than 100 people—including internal and outside counsel and employees—spent thousands of hours gathering and producing the information requested by the SEC.⁴
- In an options backdating investigation lasting several years, a company ultimately produced over five million pages of documents but, because of

production difficulties, produced, retrieved, and re-produced 13 million pages.⁵

Costs of Complying

For a business of any size, much less a large financial institution, responding to a typical SEC subpoena incurs significant costs. The recipient might be able to narrow some requests in discussions with the staff but otherwise has no practical choice except to comply, which generally entails hiring outside lawyers, teams of contract lawyers to review documents, and specialists in handling large volumes of electronic material. The cost of responding can easily be in the millions of dollars.

The Rand Institute for Civil Justice studied the costs and process of producing electronic documents in civil litigation and regulatory investigations and found that the median total production expenditure in the 45 cases in which it had cost data was \$1.8 million.⁶ Sometimes the costs are in the tens of millions of dollars.⁷ Those are shocking amounts and cannot be ignored as just an acceptable cost of participating in the securities markets.

The costs are more than just out-of-pocket expenses. As the U.S. Supreme Court said: "Officious examination can be expensive, so much so that it eats up men's substance. It can be time consuming, clogging the processes of business. It can become persecution when carried beyond reason."⁸ Dealing with an SEC request for documents takes time and attention from the operations of the business and leads to loss of personal and commercial privacy. When a subpoena goes further than necessary, the costs are higher and the government's intrusion into private matters worsens. Each overbroad SEC investigation takes a nick out of liberty.

Prolonged investigations

Overbroad subpoenas contribute to the problem of prolonged SEC investigations. Other factors also contribute, but over-inclusive subpoenas require more document collection, more processing, and more review by both the producing party and the SEC staff, all of which take more time.

SEC investigations lasting for many years are not atypical. A few examples illustrate.

- One federal trial court recently dismissed an SEC action in its entirety because the investigation lasted for approximately seven years.⁹
- In a case that reached the Supreme Court on a statute of limitations issue, the SEC began to investigate in late 2003, after being prodded by the public announcement of another regulator, and obtained several tolling agreements in 2007. The tolling agreements ended, but the SEC did not commence an enforcement proceeding until four months later, in April 2008.¹⁰ The investigation had lasted over 4½ years.
- The SEC began to investigate the structuring of CDOs in 2008 but did not initiate enforcement actions until years later. After obtaining a series of tolling agreements, the commission brought cases as late as December 2013, approximately five years after the investigations began.¹¹

Extended investigations disserve the enforcement effort, the persons being investigated, and the overall process. Delays reduce deterrence and lead to inefficient use of SEC resources. Delays also send the costs of defense soaring and impose protracted burdens and uncertainty on private parties. Long investigations mean that trials, when they occur, reconstruct old events and depend on aged evidence. Narrower, more specific SEC subpoenas would help speed up investigations and mitigate these consequences.

Questions of Legal Validity

Overbroad and burdensome SEC subpoenas raise questions of legal validity. Rarely noted today is that the Fourth Amendment applies to agency subpoenas and requires that they not be unreasonable. The "Fourth Amendment demands of subpoenas not only relevance in purpose and specificity in command but also such limitation in scope that compliance will not be unreasonably burdensome."¹²

Sweeping requests for documents from the SEC staff can bump against these requirements. Overbroad subpoenas can certainly be extremely burdensome, as the examples above demonstrate, even though courts have

not tended to be receptive to claims of burden. In addition, widely drawn SEC subpoenas can be susceptible to challenge for lacking specificity or relevance in purpose. This is true particularly when a subpoena is based on a formal order of investigation that fails to give any factual reason for the investigation. The formal order's description of factual concerns is important to satisfying the specificity and relevance requirements, but current formal orders often fail to describe any factual basis prompting the investigation. For example, the formal order in the Wells Fargo RMBS matter cited no information suggesting that the company engaged in any misconduct, yet the order, approved by the staff under delegated authority, gave subpoena power to 103 SEC employees.¹³

Simple Solution

A ready solution to the problem of overbroad SEC subpoenas exists, but it requires controls and discipline within the Division of Enforcement. Investigating staff can and should significantly narrow requests for documents. They can be more specific about the types of information being sought by sticking to the events actually being examined for a possible problem, taking guidance from whistleblowers, and talking with experts within the agency. They could proceed without a subpoena more frequently. They should pare the number of employees covered by a request and shorten the time period. They should agree to a short list of search terms for electronic documents and not insist on commonly used words. Subpoenas should stop demanding all documents "to the present." That phrase is difficult and costly to apply.

These steps would reduce the burden on the person receiving a document subpoena or request and also would help the SEC speed up investigations. The staff might resist these suggestions out of a fear that they will miss key documents, but they always have the ability to request additional documents if they determine that an initial request overlooked an area of importance. Objections to a second or even third request will diminish if the staff has made good faith efforts from the beginning to be reasonable and limited in seeking information.

Endnotes:

1. Examples of SEC subpoenas are in documents filed to support the

subpoena enforcement actions in *SEC v. Coronati*, No. 1:13-mc-00372 (S.D.N.Y. filed Nov. 5, 2013) (subpoena requested all documents concerning all of the defendant's companies and requested all agreements between any of the defendant's companies and any other person), and *SEC v. Wells Fargo & Co.*, No. 3:12-mc-80087 (N.D. Cal. filed March 23, 2012).

2. Thomas O. Gorman, *The SEC, Subpoenas and Protecting Privilege*, SEC Actions (Nov. 9, 2012) ("The typical investigation" will require the production of hundreds of thousands if not millions of pages.), available at <http://www.secactions.com/the-sec-subpoenas-and-protecting-privilege/>; Mark Astarita, *Tips for Responding to an SEC Subpoena*, The Securities Law Blog (January 6, 2014) ("The SEC is notorious for asking for reams of documents, using demands that include 'all documents relating to' an issue, and which can consume dozens of hours of time to identify, review and produce responsive documents."), available at <http://seclaw.blogspot.com/2014/01/tips-for-responding-to-sec-subpoena.html>.

3. The number is from page 17 of the Sept. 10, 2009, Wells submission of Goldman Sachs in the Abacus CDO investigation. The document is available at <http://online.wsj.com/public/resources/documents/GSWellsSubmission.pdf>.

4. See the SEC's application to enforce the subpoenas and accompanying documents in *SEC v. Wells Fargo & Co.*, No. 3:12-mc-80087 (N.D. Cal. filed March 23, 2012); Yin Wilczek, "SEC Fails in Bid to Force Wells Fargo To Comply With Administrative Subpoenas," *Bloomberg BNA Securities Law Daily* (April 2, 2012) (reporting statements from Wells Fargo).

5. *SEC v. Mercury Interactive*, 2012 WL 3277165 (N.D. Cal.).

6. Nicholas M. Pace and Laura Zakaras, *Where the money goes: understanding litigant expenditures for producing electronic discovery* 17 (Rand Institute for Civil Justice, Rand Corporation monograph 2012).

7. See, e.g., *Office Depot v. National Union Fire Ins. Co.*, 453 F. App'x. 871 (11th Cir. 2011) (not for publication) (over \$20 million in legal fees to respond to SEC inquiries); *MBIA v. Federal Ins. Co.*, 2009 WL 6635307 at *4 (S.D.N.Y.) (over \$29 million in costs to respond to SEC and New York investigations and follow-on litigation), *aff'd in part, rev'd in part*, 652 F.3d

152 (2d Cir. 2011).

8. *Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 213 (1946).

9. *SEC v. Graham*, No. 13-10011-Civ-King (S.D. Fla. May 12, 2014).

10. Petitioners' Brief on the Merits, *Gabelli v. SEC*, 133 S. Ct. 1216 (2013), 2012 WL 5532193 at *2-*4.

11. See SEC Press Release, SEC Charges Merrill Lynch With Misleading Investors in CDOs (Dec. 12, 2013).

12. *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1031 (D.C. Cir. 1978) (internal quotation marks omitted).

13. See *SEC v. Wells Fargo & Co.*, No. 3:12-mc-80087 (N.D. Cal. filed March 23, 2012) (Ex. A to Salzmann Declaration).

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