Hedge Fund Law Report
An Acuris company

SEC Enforcement Matters

Understanding the Wells Process: SEC Enforcement Staff Views of the Process (Part Two of Three)

Jun. 20, 2019
By Robin L. Barton, *Hedge Fund Law Report*

When employees of the SEC give speeches, participate in panels at conferences or otherwise speak publicly about the agency, its operations and the securities laws, they always give a standard disclaimer that the views they express are their own and do not necessarily represent the views of the SEC or its staff. Nonetheless, the personal views expressed by SEC employees provide valuable insight for fund managers on the regulator's inner workings.

For example, a 2018 speech by Steven Peikin, Co-Director of the SEC's Enforcement Division (Enforcement), spelled out his view of the Wells process. Peikin's speech provides suggestions for successfully navigating this process for the subjects of SEC investigations. In addition, other Enforcement staff provided tips for Wells submissions and Wells meetings at a recent conference.

This three-part series demystifies the Wells process – and the pre-Wells process – for fund managers. This second article examines the views of members of Enforcement on the Wells process. The first article discussed the origins of the Wells process and its key elements, as well as the impact of the Dodd-Frank Act. The third article will explain the increasingly important pre-Wells notice process and the key steps of the process overall, including ways for a manager to determine whether to offer a Wells submission in response to a Wells notice.

For coverage of another speech by Peikin, see "What Remedies and Relief Can Fund Managers Expect in SEC Enforcement Actions?" (Jan. 10, 2019).

Peikin's Speech

On May 9, 2018, Peikin gave the keynote address at the New York City Bar Association's 7th Annual White Collar Crime Institute in which he presented his view of the Wells process and Wells meetings. He noted that he and Co-Director Stephanie Avakian place great importance on the Wells process and Wells meetings in particular, adding, "I believe all of our Regional Directors and other Senior Officers are on the same page."

For commentary by Avakian, see "Despite Headwinds, Enforcement Remains Strong, Notes Co-Director of SEC Enforcement Division" (Sep. 27, 2018); and our two-part series: "SEC Officials Flesh Out Cybersecurity Enforcement and Examination Priorities" (May 11, 2017); and "SEC

Officials Discuss Cybersecurity Examination Priorities and Provide Guidance on When to Disclose Cyber Events" (May 18, 2017).

Thus, although the speech technically represents Peikin's views alone, it appears to reflect the views of other key Enforcement staff as well. In fact, King & Spalding partner Dixie Johnson opined, "Peikin's speech should be required reading for anyone who is handling an SEC investigation."

Peikin stressed the importance of productive communication between the Enforcement staff and defense counsel, along with the benefits for both sides. "An SEC investigation provides many opportunities for dialogue – from the time of the first contact with the staff through discussions about possible settlement or litigation," he explained. "[O]ne of the most significant opportunities for communication is the Wells process."

Some consider the Wells process to be adversarial, Peikin acknowledged, but he believes that the interests of Enforcement staff and defense counsel are often aligned. "A Wells notice is an invitation for defense counsel to respond to the Enforcement staff's preliminary conclusions and try to persuade us we are mistaken," he said. "We are focused on getting it right, not bringing cases for the sake of bringing cases. So if we are on the wrong track, we want to know that before we proceed further. That benefits everyone."

Although Peikin said he was "extremely impressed by the quality, sophistication, and effectiveness of the advocacy in the Wells process," he found that some Wells meetings were more productive than others. Based on that experience, Peikin provided some observations on what he has found makes for effective Wells meetings.

Peikin qualified his comments by stating that the SEC expects attorneys to zealously represent their clients, adding that "nothing I say should dissuade counsel from doing what they think is in their client's best interest." His intent was to share the following personal observations about what he has found "does – and does not – tend to foster the most constructive, effective, and productive dialogue between Enforcement staff and defense counsel during a Wells meeting."

1) Focus on Key Arguments and Issues

Peikin's first observation was that "Wells meetings tend to be the most productive when defense counsel focuses on the most important arguments and issues in the case, as opposed to taking a blunderbuss approach that attempts to address every possible argument, fact, element, and issue." He added that, in certain circumstances, "contesting facts and issues that are not subject to reasonable dispute adversely impacts credibility."

Given that these meetings typically last about an hour, in Peikin's experience, the most effective advocates pick their battles and focus on the central issues and arguments, which may mean foregoing discussion of every argument made in the Wells submission. "We read Wells submissions carefully, and we take them into account when preparing our charging recommendations," he observed.

2) Listen to the Staff and Adapt Accordingly

"I have also found that the best advocates listen carefully to us during a Wells meeting and adapt accordingly. If the discussion makes clear that we are not receptive to a particular argument, they move on," remarked Peikin. "And if we suggest that counsel address a particular issue, they pivot to address it. Simply marching through prepared talking points is seldom the best approach."

3) Identify Key Facts Before the Meeting

Peikin's next observation was that Wells meetings tend to be most productive when the staff is aware of what defense counsel will contend are key facts before the meeting. "By the time we reach a Wells meeting, the staff has concluded that the investigation is complete and that it has a sufficient record upon which to recommend charges," he explained. "But the reality is that defense counsel and their client may know things that we don't. We want to know as much as we can before we make a recommendation to the Commission."

For the discussion in a Wells meeting to be productive, however, what counsel believes to be the operative facts must be on the table before the meeting, so the staff can consider and analyze them and discuss them meaningfully at the meeting, noted Peikin. "In my experience, the parties are unlikely to make much progress during a Wells meeting if staff are surprised with new facts at the beginning of the discussion – especially if defense counsel takes the position that those facts are central to the case."

Likewise, Peikin warned that submitting lengthy supplemental submissions on the eve of a long-scheduled Wells meeting is not useful. "To be in a position to make progress at the meeting, we must know about – and have an opportunity to consider and test – information and arguments in advance," he said.

Peikin acknowledged that it also "makes no sense for defense counsel to go through the Wells process blind to key pieces of evidence that the staff has developed in its investigation." To that end, the staff is encouraged to share with defense counsel key documents and information upon which the proposed case will rest, although there may be some things the staff will be unable to share.

4) Be Prepared to Share Privileged Information If Relying on an Advice-of-Counsel Defense

It is not effective to suggest an advice-of-counsel defense without disclosing the key underlying facts, including the privileged communications themselves, observed Peikin. "For example, during a meeting, counsel may allude to – but not formally raise – an 'advice-of-counsel' defense by noting that they have privileged information that gives them comfort about the legality of the actions taken by a particular employee, or her lack of scienter."

The SEC staff cannot base decisions "on documents we cannot see or testimony we cannot hear," emphasized Peikin. Also, as noted in a prior observation, he cautioned against disclosing "supposedly key privileged information for the first time in a Wells meeting."

See "How Fund Managers Can Maintain Work Product Protection During Investigations After the *Herrera* Decision" (Feb. 22, 2018); and our three-part series on protecting attorney-client privilege and work product while cooperating with the government: "Establishing Privilege and Work Product in an Investigation" (Mar. 23, 2017); "Minimizing Cooperation Risks" (Mar. 30, 2017); and "Implications for Collateral Litigation" (Apr. 6, 2017).

5) Base Arguments on Case Law and Prior Commission Actions

It can be very effective when defense attorneys ground their arguments in case law and prior Commission actions, remarked Peikin. Because it is the Commission that ultimately decides whether to bring an action or accept a settlement, the staff considers how a particular case compares to what the Commission has done in past cases. "This ensures that we are both fair to

the parties in the case at hand and that we are sending clear, consistent messages to the public," he explained.

For example, if counsel is asking the staff to recommend that the Commission bring certain charges and not others, or only seek or impose certain types of relief, pointing to what has been done before in similar cases can be helpful, said Peikin. Likewise, showing the staff members that they are proposing something that is inconsistent with what they would likely obtain if they were to prevail in litigation can be powerful as well, he added.

Although pointing to what the Commission or courts have done in the past can be very effective, Peikin did have several caveats to this approach:

- The more recent the court decision or Commission action, the more persuasive it is likely to be.
- Do not rely too heavily on a prior action that appears to be an outlier and is at odds with what the Commission tends to do in a particular type of case.
- The fact the Commission suffered an adverse result in a particular litigation may be relevant, but more often it will not carry significant weight.
- It is not particularly persuasive when defense counsel argues that the staff will not have the votes for a particular case or that a particular Commissioner will not support the staff's recommendation. "In my experience," said Peikin, "telling us that you know the Commissioners' views better than we do is unlikely to meet with much success."

6) Carefully Consider the Use of Visual Aids

The most effective advocates think carefully about whether to use visual aids such as handouts or PowerPoint slides at a Wells meeting – and if they do, they are judicious about the materials they use, observed Peikin. Although handouts and presentations have their places, they can sometimes inhibit natural and open dialogue.

If counsel decides to use some type of visual aids, Peikin found that "succinct presentations that cover the key evidence and central issues often have the most impact." For example, if a particular issue turns on a handful of key documents, a short PowerPoint that highlights those materials can be helpful. If a specific witness is particularly important, it can be helpful to focus on key excerpts from his or her testimony, he added.

7) Avoid Saber-Rattling

"I have found that it is rarely productive when defense counsel uses a Wells meeting to threaten to take us to trial. For me, saber-rattling is a rhetorical dead-end," warned Peikin. He qualified this observation by noting that counsel should not "shy away from providing their views on the risks we will face in litigation and trying to explain to us why we are unlikely to prevail."

For instance, Peikin has found it very effective if defense counsel summarizes how it might try a case, such as by previewing anticipated trial themes or summarizing how it plans to use or diffuse key evidence or witnesses.

On a related point, Peikin cautioned counsel against raising what he called "non-starters" – that is, "issues of programmatic importance on which counsel knows that the Commission and the Division have taken clear and consistent positions, and on which we simply don't have any ability to compromise." An example of a non-starter is counsel asking the staff in a Wells meeting to

forego an injunction in a settled district court action due to possible *Kokesh* statute of limitations issues when "the Commission has consistently taken the position that the Supreme Court's *Kokesh* decision does not apply to injunctive relief," he said.

For discussion of the Supreme Court's holding in *Kokesh*, see "How the SEC May Circumvent the Five-Year Statute of Limitations on Disgorgement Under *Kokesh v. SEC*" (Jul. 20, 2017); and "Implications for Fund Managers of the Supreme Court's Ruling in *Kokesh v. SEC*" (Jun. 15, 2017).

8) Explain the Significance of Client's Cooperation to Obtain Credit

The SEC has a robust program that is intended to encourage and reward cooperation in SEC investigations and enforcement actions. The staff uses a framework to evaluate whether, how much and in what manner to credit cooperation by individuals and entities. The factors that the SEC considers are well known and have been set out in the Seaboard Report and other Commission policy statements, explained Peikin.

When arguing in a Wells meeting that a client should receive cooperation credit, Peikin advised counsel against simply running down a laundry list of actions the client has taken during the course of an investigation – especially when those actions include doing things the client was required to do, such as producing documents in response to a subpoena. Instead, he observed that a more effective approach is for counsel to explain the significance of the client's cooperation by carefully and specifically explaining at the Wells meeting how each action the client took materially aided the staff's investigation, such as by helping the staff tailor its investigation or discover new witnesses.

For more on the SEC's cooperation program, see "Why, When and How Fund Managers Should Self-Report Violations to the SEC (Part One of Two)" (Jan. 10, 2019).

9) Do Not Rehash Old Battles

"[A] Wells meeting is not the place to rehash battles fought with the staff during the investigation," commented Peikin. He acknowledged that long-running SEC investigations can be contentious and hard-fought, but he cautioned that "a Wells meeting is simply not the place to air grievances about the length of the investigation or shifting theories of the case, or positions the staff took on things like subpoenas, search terms, privilege logs, production deadlines, or testimony schedules."

10) Use the Meeting to Educate Staff

"We view Wells meetings as counsel's opportunity to educate us on their positions on the key facts and issues before we make a decision about a charging recommendation," explained Peikin. Thus, he recommended educating the staff on what counsel believes are the central facts – and explaining why counsel believes those facts do not support an enforcement action, or a particular charge or form of relief.

For more from SEC officials, see "SEC Chair Offers Observations on Culture at Fund Managers and the SEC" (Jun. 28, 2018); and "The Power of 'No': SEC Commissioner Peirce on Enforcement As Last Resort" (Jun. 21, 2018).

SEC Speaks 2019

On April 8, 2019, the Practising Law Institute's SEC Speaks 2019 event was held in Washington, D.C. Peikin and Avakian spoke on one of the panels along with other senior members of Enforcement (collectively, Enforcement staff). Based on reports by various law firms whose attorneys attended the panel, the Enforcement staff discussed, among other topics, effective advocacy in the Wells process.

In many respects, the Enforcement staff's remarks at this event echoed the observations Peikin made in his speech. Their key recommendations included the following.

Be Targeted

Attorneys should prioritize their arguments and focus on the facts actually in dispute, rather than responding to every claim or issue or providing long explanations of settled areas of law. Although the Enforcement staff members recognized the need for zealous advocacy, they posited that focusing on arguments with a realistic likelihood of success will be more effective than arguing that the SEC has no legal or factual support for a position where a basis clearly exists.

Be Realistic

The Enforcement staff advised counsel to be realistic, observing that if every single thing in the Wells notice is challenged, the Wells submission risks losing credibility. Instead, counsel would be better served by focusing on the role of a Wells submission – convincing the SEC not to bring any charges or to bring different or lesser charges – and drafting the submission accordingly.

Do Not Quote Commissioners

The Enforcement staff warned against telling the staff members that the Commission will not support their recommendation or citing speeches or comments from individual Commissioners to try and make this point. Because members of the staff regularly communicate with the Commissioners, they have a better understanding of each Commissioner's views than what can be distilled from a quote from a speech.

Highlight Potential Evidentiary Issues

The Enforcement staff suggested that counsel focus on areas where the staff's case may be vulnerable, such as trial logistics. For instance, counsel should consider pointing out specific documents or witness testimony that may not get into evidence, thus preventing the staff members from proving their claims. Counsel could also show how easy it would be for the defense to attack the credibility of an SEC witness during cross-examination.

Be Wary of Using Experts

Submitting expert reports with a Wells submission is only persuasive if the reports would be admissible, noted the Enforcement staff, warning that the submission of cursory or shoddy expert reports may hurt counsel's credibility. In addition, the Enforcement staff warned that having an expert at a Wells meeting is only helpful if there is something novel on which the expert might move the needle – do not bring an expert solely to show the staff that the defense has retained one.

Be Thoughtful About Requesting Meetings With High-Level Directors

The Enforcement staff noted that it is important to be thoughtful about when it is appropriate to request Wells meetings with senior staff or to go over a staffer's head even within his or her own office.

Be Respectful

It is not effective, noted the Enforcement staff, if an attorney representing an adviser describes how experienced he or she is; how smart he or she is; and how the staff should be intimidated. One panelist remarked that the SEC has gone up against some of the best trial lawyers in the country and will not be intimidated by those boasts.

For coverage of prior SEC Speaks events, see "Acting SEC Chair Emphasizes Agency Will Protect the 'Forgotten Investor'" (Mar. 2, 2017); and "SEC Commissioner Calls for Increased Transparency and Accountability in Capital Markets" (Mar. 3, 2016).