INSIGHTS
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SECURITIES ENFORCEMENT

Imposing *Brady*-Like Obligations on the SEC?

*The SEC currently denies civil defendants one of the most basic protections afforded to every criminal defendant—the right to favorable evidence, or "*Brady *material." Given the "quasi-criminal" punishments the SEC can impose, should the SEC policy be changed?*

By Stephen A. Best, Paul F. Enzinna, and Evan N. Turgeon

In recent years, the SEC has seen its enforcement powers expanded, and has made enforcement a "key priority."[1] The SEC may not imprison individuals, a fact apparently regretted by its current Chair, Mary Jo White.[2] But although Chair White believes they are "too low," the "quasi-criminal" punishments[3] the SEC can impose are significant, and may include large monetary payments and loss of livelihood.[4] Nevertheless, the SEC denies civil defendants one of the most basic protections afforded to every criminal defendant: the right to favorable evidence, or "*Brady* material." The SEC's policy in this regard denies defendants a fair trial, and undermines the truth-seeking function of those trials.

The *Brady* Rule

In *Brady v. Maryland*, the Supreme Court held that the Due Process Clause requires the government in criminal cases to disclosure exculpatory evidence "material to guilt or punishment," which is known to the government but unknown to the defendant.[5] This obligation covers not only evidence supporting the accused's defense, but also information that may be used to impeach government witnesses.[6] Violations of this rule can result in a reversal of conviction and/or a new trial for the accused.[7] The *Brady* doctrine reflects an acknowledgement that when seeking to punish its citizens, the State's interest is not to win the case, but to ensure that "justice shall be done."[8]

However, the *Brady* decision affords these protections only to defendants in criminal proceedings; the Supreme Court has not decided whether *Brady* requires government agencies to make affirmative disclosure of exculpatory material to defendants in civil cases.[9] Instead, it falls to each individual agency to decide whether to follow the *Brady* rule in its civil litigation or administrative actions. The SEC purports to follow the *Brady* rule in administrative proceedings before it.[10] Its rule, however, requires the defendant to request such information, and applies only to certain categories of information, such as transcripts and documents obtained by subpoena.[11] Because the rule imposes no affirmative duty to disclose exculpatory evidence as such, the SEC need not disclose all exculpatory information in its possession, as the *Brady* decision requires. And the SEC has *no Brady* obligation in civil actions it brings in federal court.

A More Significant and Aggressive SEC Enforcement Role

After the 2008 financial crisis, Congress expanded and enhanced the SEC's enforcement powers. The Dodd-Frank Act authorized extraterritorial application of U.S. securities

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laws,[12] authorized nationwide service of process,[13] expanded the SEC's authority to impose quasi-criminal civil penalties in cease-and-desist actions,[14] expanded the reach of aiding and abetting liability,[15] and provided strong incentives and protections for whistleblowers who alert the SEC to securities violations.[16]

Shortly after being named SEC Chair, Mary Jo White, a former criminal prosecutor, stated that the agency, in enforcing the securities laws—which White identified as a "key priority"—the SEC would "deploy[] the full enforcement arsenal," and use "all available means."[17] She promised to be a "tough cop," to be "aggressive and creative," and to "maintain and enhance our ability to win at trial."[18]

Unjust Outcomes

At the same time the SEC seeks to enhance its prosecutorial role, it refuses to provide defendants with the same fairness provided in criminal trials. The SEC's failure to adopt a meaningful *Brady* rule prejudices defendants and produces patently unjust outcomes. It also undermines the ostensible purpose of SEC enforcement actions—to ascertain the truth.

SEC Civil Actions

Having adopted no *Brady* rule in its civil actions, the SEC has no affirmative duty to disclose exculpatory evidence to defendants. While defendants in civil actions may seek discovery under the Federal Rules of Civil Procedure, a defendant who fails to formulate a discovery request that captures a document—which the defendant may not know exists—will never see that document, however exculpatory it is. Nor will the court or jury deciding the case.

Even if *Brady* material is responsive to a discovery request, the SEC may withhold it by claiming that it is immune from disclosure based on privilege or attorney work product protection. In the insider trading suit *SEC v. Cuban*,[19] for example, the SEC sought to withhold attorney notes documenting exculpatory statements that Mr. Cuban made during an interview with SEC attorneys immediately after the trade at issue—classic *Brady* material. Mr. Cuban won access to the notes only after extensive litigation, and even then the SEC filed motions *in limine* and objected at trial in an effort to prevent this evidence from being shown to the jury. The notes eventually were admitted, and the jury acquitted Mr. Cuban of all wrongdoing. But defendants unwilling or unable to engage in such protracted and costly litigation routinely are denied access to material that could prove their innocence.

The rules governing parallel or joint SEC-DOJ investigations add another wrinkle, and create a danger of collusion between the SEC and DOJ that would deny defendants access to *Brady* material in civil and criminal proceedings alike. In the *Gupta* case, the U.S. Attorney's Office for the Southern District of New York and the SEC brought parallel criminal and civil charges against the defendant after a broad insider-trading investigation.[20] As part of the factual investigation, the U.S. Attorney's Office and the SEC conducted joint interviews of numerous witnesses.[21] The SEC attorney who attended the joint interviews prepared memoranda that summarized the portions of the interviews he deemed relevant.[22]

Gupta moved for production of these memoranda on two fronts. Gupta contended that in the criminal case, the U.S. Attorney's Office had an obligation under *Brady* to review the SEC's memoranda and to turn over any exculpatory evidence.[23] He also argued that in the civil action, he was entitled to the material under Federal Rule of Civil Procedure 26(b) as "matter relevant to the subject matter involved in the action."[24] The U.S. Attorney's Office objected on the ground that it had no *Brady* obligation to review or disclose the SEC's materials because the SEC was not an "arm of the prosecutor" or part of a "joint prosecution

team."[25] The SEC argued that the memoranda were entitled to work product protection and exempt from disclosure under Rule 26(b)(3).[26]

The court rejected the government's positions and required the U.S. Attorney's Office to review the memoranda and disclose any *Brady* material to Gupta.[27] The court held that where an investigation includes joint fact-gathering, the government is charged with reviewing all documents and information connected to that joint investigation and disclosing any exculpatory information.[28] The court also rejected the SEC's argument, holding that although the memoranda were "classic work product under Fed. R. Civ. P. 26(b)(3)," that protection was overcome by the defendant's "substantial need" for the material.[29]

Defendants in SEC administrative actions face penalties tantamount to criminal sanctions.

Although Gupta was eventually able to access the *Brady* material he sought, it exposes a very real danger for defendants. Because the SEC is under no *Brady* obligation in civil litigation, the SEC may conduct an investigation independent from the U.S. Attorney's Office, review the material collected, and selectively disclose information suggesting the defendant's culpability to criminal prosecutors while withholding exculpatory material.[30] Prosecutors who "outsource" fact-gathering to the SEC in this way could deny defendants *Brady* material even in criminal prosecutions.

SEC Administrative Actions

Numerous factors make SEC administrative actions the sort of proceedings that warrant meaningful procedural protections. Defendants in SEC administrative actions face penalties tantamount to criminal sanctions.[31] The costs of defending an administrative action can be huge, as can the financial penalties (including punitive sanctions) that the SEC may impose if the defendant loses.[32] And the damage to an individual's reputation or the imposition of a trading ban can further damage or even destroy a defendant's business. Additionally, the SEC's fact-finding power in administrative actions is broad and one-sided. The discovery provisions of the Federal Rules of Civil Procedure do not bind the SEC in such proceedings.[33] Instead, the SEC is bound only by its own discovery rules, which restrict the material available to defendants but grant the SEC wide latitude. Moreover, the SEC gathers large amounts of information from potential defendants in its role as a regulator.[34]

SEC regulations do impose a watered-down, quasi-*Brady* obligation in its enforcement proceedings, where it enjoys "home-court advantage."[35] Rule 230 requires that the Division of Enforcement make available to defendants in administrative proceedings certain documents it obtains prior to the institution of proceedings, including transcripts and documents obtained from persons outside the SEC.[36] The rule permits the Division to withhold from this production certain documents, including those subject to privilege, work-product protection, or the disclosure of which would reveal the identity of a confidential source.[37] The rule states that this power to withhold does not authorize the Division of Enforcement to "withhold, contrary to the doctrine of *Brady v. Maryland*, documents that contain material exculpatory evidence."[38]

But this quasi-*Brady* obligation is insufficient to safeguard defendants.[39] First, *Brady* imposed a rule of disclosure, not a rule of discovery. This means that in criminal proceedings, the *Brady* rule applies whether or not a defendant requests exculpatory information.[40] The SEC rule does not mandate that the SEC disclose anything unless the defendant requests it. In cases where the defendant does not know that exculpatory material exists, and therefore does not request it, the SEC is under no obligation to disclose it.[41]

Second, even where a defendant requests disclosure of information that would be exculpatory, the rule does not require the SEC to produce it unless it fits one of the categories the disclosure of which is mandated. The rule requires the SEC to disclose documents obtained by subpoena and all documents obtained from persons not employed by the Commission, as well as transcripts and transcript exhibits.[42] However, it does not require the SEC to disclose, for example, notes taken by its staff in interviews, such as the exculpatory notes in the *Cuban* case.

Several other agencies have adopted* Brady *rules voluntarily.

Third, the SEC interprets its own *Brady* rule narrowly, that defendants are not entitled to "engage in 'fishing expeditions' through confidential Government materials in hopes of discovering something helpful to their defense"—language quoted regularly in SEC administrative decisions denying defendants access to *Brady* material.[43] The SEC instead requires that a defendant make a "plausible showing" that the information requested is both "favorable and material" to his defense.[44] The SEC's expansive discovery power results in the SEC collecting vast stores of data about prospective defendants, and "[w]ithin the thousands of pages of data reported to these administrative bodies, it becomes difficult for even the most sophisticated defendant to find the information sufficient for exoneration."[45]

Finally, the SEC applies a good-faith exception to its rule; it is intended only to "insure that exculpatory material *known to* the [Enforcement] Division is not kept from the respondent."[46] *Brady* obligations, on the other hand, include no exception for failing to disclose exculpatory information on the ground that prosecutors were unaware of it.[47]

The problem of impotent *Brady* protections in administrative proceedings is all the more pressing given that Dodd-Frank has expanded the categories of cases that the SEC can choose to bring before its internal tribunal. Before Dodd-Frank, the SEC could only bring administrative actions against employees of regulated entities, such as brokerage firms or investment advisers—actions against others were required to be heard in district court.[48] Dodd-Frank, however, removed that restriction, giving the SEC the ability to bring administrative actions and levy fines on even more categories of defendants.[49]

Suggested Reforms

Reforms are needed to protect defendants in proceedings brought by the SEC. These reforms could take many forms. The simplest solution would be for the SEC to abide by the *Brady* rule in its civil litigation, and to adopt a full-fledged *Brady* rule for its administrative actions. The SEC could implement a written, uniform "full-disclosure" policy—which would serve the truth-seeking function of its proceedings—for all enforcement matters.[50] Such a policy would require the enforcement staff to show defense counsel all the evidence it has against the prospective defendant—the essence of due process.[51] Indeed, the Wells Committee in 1972 proposed implementing just such a policy in an era when enforcement proceedings did not carry the severe potential negative consequences and ruinous fines that they do today.[52]

The SEC would not be the only agency with such a policy; several other agencies have adopted *Brady* rules voluntarily.[53] However, in the SEC's case, voluntary reform seems unlikely. The SEC has refused to adopt any *Brady* policy in its civil proceedings, and routinely fights to withhold exculpatory material from defendants, even when the Federal Rules of Civil Procedure require its disclosure.[54]

Reform by legislation is also a possibility. In 2012, the Senate considered the Fairness in

Disclosure of Evidence Act,[55] which would have required that any investigating agency, including the SEC, turn over exculpatory information without regard to its materiality. The bill, however, died in committee.

Finally, the Supreme Court could extend *Brady* protections to defendants in administrative actions and civil litigation brought by the government. Grounding this safeguard in the U.S. Constitution's Fifth Amendment due process protections would ensure that defendants' constitutional rights are honored regardless of the prosecutorial forum.[56] After all, in criminal, civil, and administrative actions alike, "the ultimate objective is not that the Government 'shall win a case, but that justice shall be done.'"[57]

Conclusion

Now more than ever, reforms are needed to render SEC administrative actions and civil litigation fair to defendants. The SEC's increased reliance on administrative actions, the heightened penalties available in such actions, and the SEC's recent push to secure admissions of wrongdoing call for a corresponding increase in procedural protections for defendants. Fairness dictates that civil defendants also receive *Brady* material, which the SEC routinely fights to keep secret. Civil government attorneys and criminal prosecutors serve the same cause of justice and the same public interest, and should be bound by the same procedural rules.[58]

The SEC's Enforcement Division pledges to "act[] honestly, forthrightly, and impartially," and to "assur[e] that everyone receives fair and respectful treatment."[59] Indeed, "fairness" is second only to "integrity" on the Enforcement Division's list of values integral to its mission.[60] The SEC should recognize that true fairness requires more than treating all defendants alike—it requires treating all defendants fairly. That requires the SEC to abide by the *Brady* rule.

Notes

1. Mary Jo White, Chair, Sec. & Exch. Comm'n, Address at Council of Institutional Investors Fall Conference: Deploying the Full Enforcement Arsenal (Sept. 26, 2013), *http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.U0f7yvldX6M*.
2. *See id.*
3. *See* Oral Arg. Transcript, *Gabelli v. SEC*, No. 11-1274 (Jan. 8 2013) at 24, 32, 35, available at *http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-1274.pdf* (last visited Apr. 25, 2014).
4. *See* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program,* 13 Ford. J. Corp. & Fin. L. 367, 410 n.197 (2008), *http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1013&context=jcfl*.
5. *Id.* at 88.
6. *See Giglio v. United States*, 405 U.S. 150, 154-55 (1972).
7. *See Smith v. Cain*, 132 S. Ct. 627 (2012).
8. *Berger v. United States*, 295 U.S. 78, 88 (1935); *see also Young v. United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 803 (1987) (citing American Bar Association, *Model Code of Professional Responsibility* Canon 7, Ethical Consideration 7–13 (1982) ("[t]he responsibility of a public prosecutor differs from that of the usual advocate; his duty is to seek justice, not merely to convict").
9. *See Goldberg v. United States*, 425 U.S. 94, 98 n.3 (1976) (leaving this question open); *see also* Justin Goetz, Note, *Hold Fast the Keys to the Kingdom: Federal Administrative Agencies and the Need for Brady Disclosure*, 95 Minn. L. Rev. 1424, 1430 n.43 (2011) ("Surprisingly, lower federal courts have been reticent to extend the *Brady* rule to civil government prosecutions.") (citing *Demjanjuk v. Petrovsky*, 10 F.3d 338, 353 (6th Cir. 1993)).
10. 17 C.F.R. § 201.230(b).
11. *Id.* § 201.230(a).
12. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 929P(b) (2010).
13. *Id.* § 929E.
14. *Id.* § 929P(a).
15. *Id.* § 929M-O.
16. *Id.* § 922.
17. Mary Jo White, *supra* note 6.
18. *Id.*
19. No. 08-CV-2050-D (N.D. Tex., filed Nov. 17, 2008).
20. *United States v. Gupta*, 848 F. Supp. 2d 491 (S.D.N.Y. 2012); *SEC v. Gupta*, No. 11-civ-07566 (S.D.N.Y. filed Oct. 26, 2011).
21. *Gupta*, 848 F. Supp. 2d at 492-93.
22. *Id.* at 493.

23. *Id.*

24. *Id.*

25. *Id.* at 494.

26. *Id.* at 493.

27. *Id.*

28. *Id.* at 494-95.

29. *Id.* at 496.

30. *See* 17 C.F.R. § 240.24c-1(b)(1) (permitting the SEC to disclose non-public information to any "federal, state, local or foreign government or any political subdivision, authority, agency or instrumentality" thereof).

31. Atkins & Bondi, *supra* note 9, at 410 n.197 ("These consequences at times can be tantamount to criminal sanctions, including large monetary payments and loss of livelihood."); *see also* Sec. & Exch. Comm'n, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, *http://www.sec.gov/about/whatwedo.shtml#.U0gWXPldX6M* (last visited Apr. 14, 2014) ("First and foremost, the SEC is a law enforcement agency. The Division of Enforcement assists the Commission in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the Commission bring civil actions in federal court or as administrative proceedings before an administrative law judge, and by prosecuting these cases on behalf of the Commission.").

32. In 2010, the Dodd-Frank Wall Street Reform Act granted the SEC broad authority to impose civil monetary penalties in administrative proceedings, in addition to the cease-and-desist orders previously available to the SEC. *See* Kenneth B. Winer & Laura S. Kwaterski, *Assessing SEC Power In Administrative Proceedings*, Law360 (Mar. 24, 2011), *http://www.law360.com/articles/233299/assessing-sec-power-in-administrative-proceedings*) (citing Section 929P of Dodd-Frank, amended Section 8A of the Securities Act, Section 21B(a) of the Securities Exchange Act, Section 9(d)(1) of the Investment Company Act, and Section 203(i)(1) of the Investment Advisers Act). This is part of a broader administrative agency evolution from formal to informal adjudication, and a corresponding loss of procedural due process rights. Goetz, *supra* note 14, at 1426 n.18 (citing Richard E. Levy & Sidney A. Shapiro, *Administrative Procedure and the Decline of the Trial*, 51 U. Kan. L. Rev. 473, 496-97, 500-02 (2003) (noting the evolution of administrative agencies from formal to informal adjudication, and the concomitant loss of procedural due process rights)). *See also* Jeffrey E. Shuren, *The Modern Regulatory Administrative State: A Response to Changing Circumstances*, 38 Harv. J. on Legis. 291, 298 (2001) ("[A]gency creation and expansion of existing agency authority have tended to occur during periods of national crisis[.]").

33. Goetz, *supra* note 14, at 1425 (citing *Katzson Bros. v. EPA*, 839 F.2d 1396, 1399 (10th Cir. 1988); *Hess & Clark v. FDA*, 495 F.2d 975, 984 (D.C. Cir. 1974) ("Of course, administrative agencies are not bound by the same details of procedure as the courts.")).

34. *Id.*

35. *See* Gretchen Morgenson, *At the S.E.C., a Question of Home-Court Edge*, N.Y. Times (Oct. 5, 2013), *http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html?_r=0* ("some legal experts say these proceedings suffer from potential bias because the judges operate within the agency bringing them. The possibility of a home-court advantage or a sympathetic adjudicator, critics say, raises questions of fairness, especially for individuals defending themselves in these matters."); *accord* Sarah N. Lynch, *SEC judge who took on the 'Big Four' known for bold moves*, Reuters (Feb. 2, 2014), *http://www.reuters.com/article/2014/02/02/us-sec-china-elliot-idUSBREA1107P20140202* ("Critics say the internal court system gives the SEC a home-court advantage.").

36. 17 C.F.R. § 230(a)(1).

37. *Id.* § 230(b)(1).

38. *Id.* § 230(b)(2).

39. *See* Atkins & Bondi, *supra* note 9, at 411-12 (advocating for a "written and uniform 'full-disclosure' policy for [SEC] enforcement matters").

40. *See United States v. Agurs*, 427 U.S. 97, 107-10 (1976).

41. *See also* Atkins & Bondi, *supra* note 9, at 380 n.71 ("[t]oday, there are no specific guidelines concerning the amount and type of information that staff must share with a prospective defendant, so practices vary among the staff and across the regional offices").

42. 17 C.F.R. § 230(a)(1).

43. *In re Orlando Joseph Jett*, 52 S.E.C. 830, 830 (June 17, 1996) (continuing, "Unless defense counsel becomes aware that exculpatory evidence has been withheld and brings it to the judge's attention, the government's decision as to whether or not to disclose information is final."). *See*, *e.g.*, Order, *In re Nevis Capital Mgmt., et al.*, S.E.C. No. 3-11201 (Nov. 10, 2003), *https://www.sec.gov/alj/aljorders/2003/3-11201-2.pdf;* Order on Motion to Compel Production of Documents, *In re Bandimere & Young*, S.E.C. No. 3-15124 (Mar. 12, 2013), *http://www.sec.gov/alj/aljorders/2013/ap-759.pdf;* Order Denying Respondent's Motion Requesting Release of Information Without Prejudice, *In re Jantzen*, S.E.C. No. 3-14880 (July 5, 2012), *http://www.sec.gov/alj/aljorders/2012/ap709ce.pdf*.

44. *Jett*, 52 S.E.C. at 831.

45. Goetz, *supra* note 14, at 1425-6 ("This asymmetry of information poses a problem of fundamental fairness for defendants."); *see also* Mark Latham, Environmental Liabilities and the Federal Securities Laws: A Proposal for Improved Disclosure of Climate Change-Related Risks, 39 Envtl. L. 647, 677 (2009) (referencing the SEC enormous amount of data the SEC collects).

46. *In re Warren Lammert*, Release Nos. 33-8833 & 34-56233, 91 S.E.C. 761 (Aug. 9, 2007) (quoting *In re David M. Haber*, Exchange Act Release No. APR-418, 55 S.E.C. 3333, 3334 (Feb. 2, 1994)).

47. *Brady*, 373 U.S. at 87 (enforcing disclosure requirements "irrespective of the good faith or bad faith of the prosecution.").

48. Morgenson, *supra* note 40.

49. *See* Levy & Shapiro, *supra* note 37, at 500-02 (2003) (noting the rise of informal adjudication within administrative agencies and a resulting loss of procedural due process rights).

50. Atkins & Bondi, *supra* note 9, at 411.

51. *Id.*

52. *Id.*; *see also id.* at 411 n.199 (citing U.S. Sec. & Exch. Comm'n, Report of the Advisory Committee on Enforcement Policies and Practices 37 (June 1, 1972), *reprinted in* Arthur F. Mathews et al., Enforcement and Litigation Under the Federal Securities Laws 275 (Practicing L. Inst. 1973).

53. *See*, *e.g.*, Federal Energy Regulatory Commission (FERC) (Policy Statement on Disclosure of Exculpatory Materials, 129 FERC ¶ 61,248 (2009)); Federal Deposit Insurance Corporation (FDIC) (*First Guar. Bank*, No. FDIC-95-65e, 1997 WL 33774615, at *2 (F.D.I.C. Apr. 7, 1997)); Commodity Futures Trading Commission (CFTC) (*First Guar. Metals, Co.*, Nos. 79-55 to -57, 1980 WL 15696, at *9 (C.F.T.C. July 2, 1980)).

54. *See*, *e.g.*, Order on Motion to Compel at 4-5, *SEC v. Pentagon Capital Mgmt., PLC et al.*, No. 1:08-cv-03324 (S.D.N.Y. Oct. 8, 2010); *United States v. Gupta*, 848 F. Supp. 2d 491 (S.D.N.Y. 2012); *SEC v. Cuban*, No. 08-CV-2050-D (N.D. Tex. filed Nov. 17, 2008).

55. S. 2197, 112th Cong. (2012).

56. Goetz, *supra* note 14, at 1430, 1455. Indeed, the few decisions that support extending the *Brady* rule to civil government prosecutions "share the same quality: they blend traditional elements of criminal prosecutions within a civil enforcement context." *Id.* at 1430 n.43 (citing *Demjanjuk v. Petrovsky*, 10 F.3d 338, 353 (6th Cir. 1993)).

57. *Sperry & Hutchinson Co. v. FTC*, 256 F. Supp. 136, 142 (S.D.N.Y. 1966) (upholding the concept of extending the *Brady* rule to civil prosecutions) (quoting *Campbell v. United States*, 365 U.S. 85, 96 (1961)).

58. Goetz, *supra* note 14, at 1455.

59. SEC Enforcement Division, *Enforcement* Manual §1.4.1 (Oct. 9, 2013), available at *http://www.sec.gov/divisions/enforce/enforcementmanual.pdf* (last visited Apr. 23, 2014).

60. *Id.* at 1.