

# The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2011

PHILADELPHIA, TUESDAY, OCTOBER 25, 2011

An **ALM** Publication

## E-Discovery in SEC and FINRA Investigations

BY RACHEL TAUSEND AND JOSH DUTILL

*Special to the Legal*

**E**lectronic discovery (e-discovery), and the risks of failing to properly retain and produce electronically stored information (ESI), is frequently discussed in the context of state and federal court litigation. It is also an increasingly prevalent issue in Securities and Exchange Commission and Financial Industry Regulatory Authority (FINRA) investigations.

The failure to know and comply with the requirements and expectations for e-discovery in these contexts can have a number of adverse consequences for both firms and their personnel, as well as potentially for their counsel. This article highlights some of the key requirements and considerations in identifying, collecting and producing ESI to the SEC or FINRA during an investigation.

### SEC INVESTIGATIONS

• **The SEC's Electronic Production Guidelines.** The SEC Enforcement Manual, which was first made public in October 2008 and was most recently updated in August 2011 (the manual), includes several pages of information pertaining to the production of documents pursuant to subpoena, including a section specifically addressing the format for electronic production of documents to the SEC, including e-mail and other ESI. The manual is designed to provide guidance to enforcement division staff in the investigation of potential violations of the federal securities laws. However, it also provides a helpful roadmap to individuals and entities who may be asked to respond to a voluntary request for information or served with a document subpoena as to what to expect with respect to the electronic production of documents, including the production of e-mail and other ESI.

The manual includes specific guidelines for document production that should be included in a subpoena or in the cover letter accompanying a subpoena. SEC staff are encouraged to request the production



**TAUSEND**

**RACHEL TAUSEND** focuses her practice on securities enforcement and securities and business litigation, with an emphasis on e-discovery issues. She is co-chair of Stradley Ronon Stevens & Young's e-discovery task force.



**DUTILL**

**JOSH DUTILL** represents clients in complex commercial cases and legal matters, including prosecuting and defending business torts and commercial contract disputes.

of documents in electronic format, because, among other reasons, it may allow the staff to search for specific terms and to tag and review data more easily. The manual section addressing the format for electronic production of documents sets forth several detailed technical guidelines. These guidelines also are outlined in the SEC Data Delivery Standards (the production specifications), a multipage document that typically will be enclosed with a subpoena or document request and outlines the technical requirements for electronic productions to the SEC. Such productions may include the production of scanned paper collections as well as the production of e-mail and electronic document/native file collections.

Individuals and entities responding to an SEC document request or subpoena are well advised to carefully review both the general instructions and the delivery formats set forth in the production specifications or to seek the assistance of someone familiar with them to ensure that these requirements are appropriately

considered and followed in planning the party's document collection and production. The failure to do so risks potentially costly mistakes. The production specifications include, for example, that documents created or stored electronically must be produced in their original electronic format, not printed to paper or PDF. They further state that all scanned paper, e-mail and native file collections should be converted or processed to Tagged Image File Format (TIFF) files and Bates-numbered, using a specified protocol, and that the documents should include fully searchable text. In addition, productions of e-mail and native file collections are to include links to the native files and otherwise follow specific technical requirements. In preparing for a production, it is therefore important to be aware of the nature of the documents to be produced and the implications that may flow from the data formats outlined in the production specifications. For example, if the collection includes a large volume of native Excel spreadsheets or other documents that may not convert to TIFF images effectively, this could result in unexpectedly high costs for what may effectively be unusable data if the party is charged for data conversion and production on a per-page basis. The production specifications also include that the media used to produce documents, such as a CD-ROM, DVD or portable hard drive, should be labeled with specific information and encrypted.

• **FOIA Confidential Treatment Requests.** Rule 83 of the SEC's rules and regulations provides a procedure by which individuals or entities producing documents to the SEC in investigations, among other contexts, may request that some or all of the documents be afforded confidential treatment and be withheld from disclosure if the documents are requested by a member of the public pursuant to the Freedom of Information Act (FOIA) and fall within one of the categories of information that are

exempt from FOIA, such as trade secrets. Rule 83 requires that each page for which confidential treatment is sought must be labeled with both a Bates-stamped number or other identifying number and code and the legend “Confidential Treatment Requested by [requesting party].” The FOIA confidential treatment procedures do not differentiate between different document types and do not address the potential and practical complexities of requesting confidential treatment for ESI, particularly native files. Accordingly, an individual or entity producing ESI will need to consider the options for following the FOIA confidential treatment request procedures, particularly, in light of the SEC’s Production Specifications, to determine the best approach in a given situation.

- **Certification of Completeness of Production.** Prior to recommending that the commission accept a settlement offer from an entity or individual, the staff must first obtain an executed certification as to completeness of document production from the settling party. The certification applies to requests for the voluntary production of documents, document requests (for example, to regulated entities) and document subpoenas and serves as an acknowledgement by the settling party that in settling the matter, the commission has relied upon, among other things, the completeness of the party’s production. By signing the certification, the settling party declares under penalty of perjury that the party has made a diligent search of all files in the party’s possession, custody or control that are reasonably likely to contain responsive documents (or for an entity, that it has made a diligent inquiry of all persons who reasonably had possession of responsive documents) and that those documents have been either produced or identified in a privilege log. The vast growth in the volume and types of ESI in the past several years has added a layer of complexity, and risk, to the certification process, as parties contemplating settlement must ensure that they have adequate knowledge, resources and/or processes to undertake the search and production of electronic files necessary to make the required representations.

## FINRA INVESTIGATIONS

FINRA Rule 8210 gives FINRA staff and adjudicators the right to require a member, person associated with a member or person subject to FINRA’s jurisdiction to produce ESI, in electronic format, in connection with

an investigation, complaint, examination or adjudicatory proceeding. Failure to provide requested information is a violation of Rule 8210 and may result in serious sanctions. The complexities and challenges of efficiently and effectively identifying, collecting and producing ESI in private litigation and in SEC matters are also present in responding to a FINRA investigation.

While FINRA does not currently provide detailed technical specifications for the format of electronic productions, Rule 8210 does now require the encryption of documents produced in electronic format on a portable media device, such as a flash drive, CD-ROM, DVD, portable hard drive or laptop computer. In other words, prior to delivery of the data to FINRA, the responding party must encode the data into a form that cannot be meaningfully interpreted without the use of a confidential process or key, using an encryption method acceptable to FINRA. The responding party also must provide FINRA staff with the information needed to unencrypt the production in a communication separate from the transmission of the encrypted data itself.

## PRACTICAL TAKEAWAYS

Robert Khuzami, director of the SEC’s Division of Enforcement, said in a Sept. 8 news release: “Compliance with an SEC subpoena is not an option, it is a legal obligation. The ability of the SEC to conduct swift and thorough investigations requires that subpoena recipients promptly comply with that legal obligation. Subpoena recipients who refuse to comply should expect serious legal consequences.” (See [www.sec.gov/news/press/2011/2011-180.htm](http://www.sec.gov/news/press/2011/2011-180.htm)).

The SEC and FINRA, like many courts, have shown signs that they are increasingly impatient with a claimed lack of understanding of ESI- and e-discovery-related issues by parties and their counsel and will not hesitate to bring an action based on the failure to preserve or produce documents. Parties, including their counsel, that are not aware of the applicable e-discovery requirements and expectations in the context of SEC or FINRA investigations and fail to appropriately consider and follow them risk several potential undesirable consequences, ranging from higher-than-expected production costs or “do-overs” to serious sanctions. The failure of a party to comply with its discovery obligations in an investigation, including the obligation to identify, collect and produce responsive ESI, may give rise to its own violation and sanction, separate from and potentially in addition to any

violations or sanctions in connection with the conduct or event that gave rise to the investigation. Parties may reduce the risk of such problems by:

- Staying up to date on e-discovery related developments, both specific to the SEC or FINRA and generally.
- Involving individuals and service providers with experience in producing documents, including ESI, in connection with SEC or FINRA investigations; planning ahead.
- Coordinating and communicating with the SEC or FINRA staff about the contemplated production, as appropriate.
-