UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

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February 16, 2007

Peter G. McCabe, Secretary
Committee on Rules of Practice and Procedure of the
Judicial Conference of the United States
Thurgood Marshall Federal Judiciary Building
One Columbus Circle, NE
Washington, D.C. 20544

Re: Proposed Rule of Evidence 502

Dear Mr. McCabe:

The Commission has authorized me to submit the following comments regarding the "selective waiver" provision in subdivision (c) of Proposed Rule of Evidence 502 ("the Rule"), which include several proposed clarifications that we urge the Committee to address to ensure that the Rule achieves its intended purpose.

The Commission's Current Approach to Receiving Privileged Materials

The Commission is responsible for administering and enforcing the federal securities laws, which are designed to protect investors and the integrity of our capital markets. The Commission devotes much of its resources to investigating possible violations of those laws, bringing actions against violators, obtaining penalties and disgorgement of ill-gotten funds, and distributing disgorged funds and penalties to defrauded investors.

In its investigations, the Commission has frequently obtained documents from companies that the companies contend are protected by the attorney-client privilege or the work-product doctrine. The privileged and protected documents that the Commission is most interested in, and has most benefited from, are reports and related materials prepared by retained counsel for companies conducting their own internal investigations into potential past violations of the securities laws. These reports typically include information from (or are produced with) memoranda of attorney interviews with company employees prepared as part of the internal investigation. The Commission recognizes that the attorney-client privilege and the work-product doctrine serve important social interests. Accordingly, it does not view a company's waiver of privilege or protection for reports of internal investigations as an end in itself, but only as a means (where necessary) to obtain relevant and sometimes critical factual information. While proposed Rule 502(c) would provide a needed protection for those who agree to waive,

the Commission recognizes that it is equally important for the government to have appropriate policies and procedures governing waiver requests.

Obtaining Privileged and Protected Information in the Past Has Decreased the Cost of Commission Investigations.

In the last five years, the Commission has taken the position that allowing companies under investigation to produce privileged or protected materials to the Commission without waiving otherwise applicable privileges or protections as to private parties serves the public interest because it significantly enhances the Commission's ability to conduct expeditious investigations and, where appropriate, to obtain prompt relief for defrauded investors.[1]

The Commission's investigations tend to be complex and document-intensive. They include: financial fraud investigations which typically require significant Commission resources; investigations of broker-dealers involving voluminous trading or transactions; and Foreign Corrupt Practices Act investigations where much of the key evidence and many of the important witnesses are located outside the United States. Privileged information obtained from internal company investigations in such cases has been extremely valuable to Commission staff in more than 100 significant Commission investigations over the past ten years. While it is difficult to quantify the time savings to the Commission when companies provide privileged information and work product to the staff, there is no question that the amount of time saved is significant. In complex cases, the privileged or protected materials have saved the Commission months -- and in some instances years -- of work, as well as enormous amounts of money. The materials have enabled the Commission to bring cases faster and resolve them more expeditiously, to the benefit of the public and defrauded investors. For example:

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[1] The Commission has taken that position in amicus briefs filed in state and federal courts in support of companies that had produced such materials to the Commission pursuant to a confidentiality agreement (*see, e.g.*, the Commission's Feb. 2004 amicus brief in *McKesson Corp. v. McCall* available under "Amicus / Friend of the Court Briefs" in the "Litigation" section of the Commission's website, www.sec.gov); in findings accompanying the Commission's attorney-conduct rules (SEC Rel. 33-8185 (Implementation of Standards of Professional Conduct for Attorneys, Final Rule), 68 Fed. Reg. 6296, 6312-13 (Feb. 6, 2003) (available at www.sec.gov/rules/final/33-8185.htm (Jan. 29, 2003)); in recommendations to Congress called for by the Sarbanes-Oxley Act (Report Pursuant to Section 704 of the Sarbanes-Oxley Act of 2002, Jan. 24, 2003) (available at www.sec.gov/news/studies/studiesarchive/2003archive.shtml); and in related testimony to Congress (Testimony of Stephen M. Cutler, Director, Division of Enforcement, before the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, re: The Securities Fraud Deterrence and Investor Restitution Act, H.R. 2179, Section III (June 5, 2003) (available at www.sec.gov/news/testimony/060503tssmc.htm)).

- In a major, high-profile financial fraud investigation, counsel for the Independent Directors Committee conducting the internal investigation devoted almost 50,000 hours to a broad investigation of improper accounting at the company.[2] They reviewed nearly two million pages of documents, collected more than one million e-mail messages, and interviewed more than 120 current and former company employees. They provided Commission staff with real-time progress reports of their investigation, binders containing key documents for witnesses, and a detailed annotated version of their 340-page investigative report. The information that the Commission obtained was extremely valuable to the Commission's investigation and the staff was able to benefit fully from the work performed by dozens of attorneys and accountants conducting the internal investigation.

- In another major, high-profile financial fraud investigation, the Commission received a 200-page report prepared by the Special Committee of the Board of Directors. In addition, the Commission received copies of the interview memoranda prepared by counsel to the Special Committee summarizing interviews with more than 75 company employees and totaling more than 700 pages. This was the result of the work of a large team of lawyers from a prominent law firm that worked long hours at the company for several months. The time saved by the Commission in its investigation as the result of the work by the counsel to the Special Committee was immense.

- In another investigation, counsel for a company's Audit Committee provided the Commission with 134 binders of back-up material to an internal investigative report. The binders were prepared or collected by counsel or by accountants at the direction of counsel. The binders included interview memoranda and analysis of financial documents. Producing this material saved the Commission thousands of hours of time reviewing documents and interviewing witnesses and helped the Commission complete the investigation much sooner than without the documents. Accountants logged 29,000 hours over 16 weeks in assisting in the preparation and collection of the back-up material. It is reasonable to assume that if the Commission had not obtained the work product, it would have needed approximately the same number of hours to gather, organize and analyze the documents.

- Corporate counsel in another case produced to the Commission interview memoranda and notes and made presentations to Commission staff explaining in detail a complex scheme carried out at the company. The information provided to the Commission helped explain the contents of over 40 boxes of subpoenaed material that the Commission

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[2] 50,000 hours at an hourly rate for Commission attorneys and accountants conservatively estimated at $50.00 an hour is equivalent to over $2.3 million.

received from the company. The company's investigation required the expert forensic assistance of two major accounting firms and cost over $9 million.

- In a Foreign Corrupt Practices Act case, the company's audit committee had engaged special counsel to investigate the allegations, and the audit committee provided Commission staff with a summary report of the investigation, cross-referenced with supporting documents, pursuant to a confidentiality agreement. In addition, special counsel gave multiple oral briefings to Commission staff regarding the investigation, including oral summaries of witness interviews. This information materially advanced the staff's investigation and saved months of work. Given the breadth of the potential misconduct and the related volume of potentially relevant records, having access to the special counsel's report significantly decreased the time and expense necessary for the staff to identify key documents and issues. In addition, although public reports of misconduct focused only on specific behavior in one foreign country, the special counsel's investigation uncovered extensive, potential misconduct in two other countries. Moreover, special counsel's investigation included interviews of foreign nationals. The staff was able to make use of much of the information gained through these interviews without incurring the costs in time and money of interviewing those witnesses.

- In a case involving the fraudulent valuation of hedge fund securities, the Commission was able to take action against the portfolio manager within 20 months after first learning of the matter because Commission staff benefited from an internal investigation and independent counsel's identification and organization of relevant documents pursuant to a confidentiality agreement. In particular, interview memos and quantitative analysis from the internal investigation showed that the portfolio manager's valuations of the funds' portfolio of convertible securities were far higher than numerous other market indices.

In these investigations, as in many others, access to privileged or protected materials has saved the Commission months of work, as well as large amounts of money. Although the Commission must verify that internal reports are accurate and complete and must conduct a confirming investigation, doing so is far less time-consuming and less difficult than starting and conducting investigations without the internal reports. The public interest in timely enforcement of the federal securities laws is clearly served when the Commission can promptly identify illegal conduct and provide compensation to victims of securities fraud. More expeditious investigations are likely to lead to more prompt enforcement actions, with a greater likelihood of recovering assets to return to investors.

In addition, the companies themselves can benefit from providing privileged and protected materials to the Commission. Providing privileged or protected materials to Commission staff can reduce overall disruption for the companies by limiting the number of executives and other employees whose testimony will be sought by the Commission staff and by reducing the length of the investigation. In some cases, providing privileged or protected

information to the Commission directly benefits the companies that provided it by allowing the Commission to decide more quickly that *no* enforcement action against the company or its officers is warranted.

The Rule's "Selective Waiver" Provision, if Appropriately Clarified, Would Likely Increase the Number of Companies Providing Protected Material to the Commission Staff.

Even though some companies have provided privileged and protected material to Commission staff, many companies continue to express great concern about waiving privilege or protection as to third parties by disclosing privileged or protected information to the Commission. Because of this concern, companies under investigation have often held back privileged information and/or work product or limited *how* they will share information with the Commission (summarizing or reading sections of an internal report, for example, rather than producing the report itself). The proposed Rule is intended to increase the number of companies providing privileged and protected material to federal government agencies. To achieve this result and be truly effective, however, the Rule, or at a minimum the associated Notes, should address some additional issues to clarify the current draft language stating that a government agency may disclose protected material "as otherwise authorized or required by law."

First, the Rule or the Committee Notes should state explicitly that a receiving government agency may use the privileged or protected materials without waiving the privilege or allowing third parties to use the materials. Government agencies should be able to use the material in normal ways in an enforcement investigation and proceeding, including in open court, without that use permitting a private party other than the defendant in the enforcement proceeding from obtaining and using the material. The Advisory Committee should state expressly in the Notes that, even if the communications or information are disclosed or become available to non-governmental persons or entities through the use of the material during an enforcement proceeding, the communications or information will continue to be privileged and protected. Any communications or information that remains privileged or protected may not be used as evidence by any non-governmental person or entity in any federal or state proceeding.

Permitting these uses by the government would be consistent with the current draft language of the Rule, which states that disclosure to the government does not operate as a waiver "in favor of non-governmental persons or entities." The approach also would be consistent with the principle that only the holder of a privilege can waive it.[3] A federal agency like the SEC, to

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[3] *See, e.g.,, SEC v. Lavin*, 111 F.3d 921, 930 (D.C. Cir. 1997) (distinguishing cases in which a holder of the privilege discloses privileged information from cases in which disclosure is by "third parties over whom the holder of the privilege has virtually no control, i.e., involuntary disclosures" and holding that "the privilege is preserved in involuntary disclosures if the

which a company under investigation provides privileged information under Rule 502(c), is not the holder of the privilege, so its use of privileged or protected information may not and should not waive the privilege or protection. Clarification of this issue would be important and beneficial because, if privilege holders fear that government use of the materials will permit private parties to obtain them, then the objective of the proposed Rule will not be met and companies will continue to be reluctant to provide privileged and protected information to government agencies.

Second, the current draft does not explicitly address whether a government agency must produce Rule 502(c) materials in response to a Freedom of Information Act ("FOIA") request or a subpoena or discovery request. Although, as discussed below, existing law affords agencies some authority to withhold another person's or entity's privileged and protected information in response to a request from a private party, dealing with the issue explicitly in a note would help achieve the objectives of the proposed Rule.

With respect to FOIA requests, privileged information will often come within Exemption 7(A) as long as there is an open investigation, and thereafter it will often come within Exemption 4. 5 U.S.C. 552(b)(4), (7)(A). Exemption 7(A) protects "information compiled for law enforcement purposes" to the extent it "could reasonably be expected to interfere with enforcement proceedings." That exemption allows agencies to withhold documents categorically, and documents from internal investigations will usually be a type of information whose disclosure could interfere with enforcement proceedings.[4] Exemption 4 applies to "trade secrets and commercial or financial information obtained from a person and privileged or confidential." Information that is protected by Rule 502(c) and is voluntarily provided to the government is likely to satisfy these requirements, although some risk exists.[5]

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privilege holder has made reasonable efforts designed to protect and preserve the privilege") (adopting the reasoning of the Ninth Circuit in *United States v. de la Jara*, 973 F.2d 746, 749-50 (9th Cir.1992)); *In re Lott*, 424 F.3d 446, 455 (6th Cir. 2005) ("important to cabin the implied waiver of privileges to instances where the holder of the privilege has taken some affirmative step to place the content of the confidential communication into the litigation").

[4] *See, e.g., NLRB v. Robbins Tire & Rubber Co.*, 437 U.S. 214, 236 (1978); *Swan v. SEC*, 96 F.3d 498, 500 (D.C. Cir. 1996); *Moorefield v. U.S. Secret Service*, 611 F.2d 1021, 1026 (5th Cir. 1980); *Solar Sources v. United States*, 142 F.3d 1033, 1039 (7th Cir. 1998); *Ctr. for Nat'l Sec. Studies v. U.S. Dep't of Justice*, 331 F.3d 918, 928 (D.C. Cir. 2003).

[5] *See Critical Mass Energy Project v. NRC*, 975 F.2d 871, 879 (D.C. Cir. 1992); *Pub. Citizen Health Research Group v. FDA*, 704 F.2d 1280, 1290 (D.C. Cir. 1983); *Flathead Joint Bd. of Control v. United States Dep't of the Interior*, 309 F. Supp. 2d 1217, 1221 (D. Mont. 2004); *Starkey v. United States Dep't of Interior*, 238 F. Supp. 2d 1188, 1195 (S.D. Cal. 2002).

Similarly, courts could and should conclude that an agency is not required to produce information protected by Rule 502(c) in response to a subpoena or discovery request from a private party because the attorney-client privilege and work product protection are not waived as to non-governmental entities.[6] Again clarification is preferable so that the Rule achieves its intended objectives.

Preemption of State Laws and Rules on Waiver

A final issue of importance to the Commission is that, to be effective, the Rule must provide protection in state proceedings as well as in federal proceedings. Companies will likely have the same concerns they currently have if plaintiffs can obtain privileged or protected information provided to the federal government simply by bringing an action in a state court. The current version of the rule satisfies this concern by expressly providing that it applies in "a federal or state proceeding." We urge the Committee to add to the Notes that this language is intended to preempt any contrary state law. To ensure this result and make the Rule effective and likely to be used, Congressional action to enact the Rule is essential.

Thank you for this opportunity to comment on this important provision.

Yours truly,

Brian G. Cartwright

Brian G. Cartwright
General Counsel

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[6] *See United States v. American Telephone and Telegraph Co.*, 642 F.2d 1285 (D.C. Cir. 1980).