CHAPTER 16

THE SEC WELLS PROCESS

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SYNOPSIS

§ 16.01 Introduction

Towards the conclusion of each investigation, the SEC Staff typically makes a preliminary decision regarding whether to recommend that the Commissioners authorize an enforcement action against any individual or entity ("prospective defendant"). Before making such a recommendation, the SEC Staff typically notifies each prospective defendant of the Staff's preliminary decision and offers each prospective defendant an opportunity to file a document commonly referred to as a "Wells Submission," after John A. Wells, who chaired the Advisory Committee on Enforcement Policies and Practices (known as the Wells Committee) in 1972.[1] The Wells Committee recommended that the Commission reflect in a rule or published release the then-existing practice by which experienced SEC defense attorneys conferred with the Staff in order to learn the Staff's view of the facts and the nature of the alleged violations. The Committee

[1] The other committee members were former SEC Chairman Manuel F. Cohen and former SEC Commissioner Ralph H. Demmler.

recommended that this rule or release detail the practice by which these defense attorneys submitted a written rebuttal to the Staff's position, which the Staff then forwarded to the Commission with the Staff memorandum recommending an enforcement action.

In response to recommendations made by the Wells Committee, the Commission published Securities Act Release No. 5310, *Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations*, a copy of which the Staff routinely makes available to all witnesses prior to testimony.[2] In the Release, the Commission expressed its agreement with the objective "to place before the Commission prior to the authorization of an enforcement proceeding, the contentions of both its staff and the adverse party concerning the facts and circumstances which form the basis for the staff recommendation."[3] The Release gave the Staff discretion to advise prospective defendants of the indicated violations and allow the prospective defendants to submit to the Staff a written statement setting forth their "interests and position." As described in the Commission's rules, if the Staff recommends that the Commission authorize an enforcement action, the Staff must forward the submission to the Commission with the Staff's recommendation memorandum:

> Persons who become involved in preliminary or formal investigations may, on their own initiative, submit a written statement to the Commission setting forth their interests and position in regard to the subject matter of the investigation. Upon request, the Staff, in its discretion, may advise such persons of the general nature of the investigation, including the indicated violations as they pertain to them, and the amount of time that may be available for preparing and submitting a statement prior to the presentation of a Staff recommendation to the Commission for the commencement of an administrative or injunction proceeding. Submissions by interested persons should be forwarded to the appropriate Division Director, Regional Director, or District Administrator with a copy to the staff members conducting the investigation and should be clearly referenced to the specific investigation to which they relate. In the event a recommendation for the commencement of an enforcement proceeding is presented by the Staff, any submissions by interested persons will be forwarded to the Commission in conjunction with the Staff memorandum.[4]

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[2] 38 Fed. Reg. 5457 (Mar. 1, 1973).

[3] Securities Release No. 5310, Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations.

[4] Rule 5(c), SEC Rules Relating to Investigations, 17 C.F.R. § 202.5(c). The Staff arguably must provide an opportunity to submit a Wells Submission with respect to enforcement actions arising from investigations conducted under either the Investment Company Act or the Investment Advisers Act. The provision of the Investment Company Act of 1940 authorizing

In the Wells Submission, the prospective defendant can make factual, legal, and policy arguments as to why it would be inappropriate for the Commission to bring the contemplated enforcement action. The Wells process is often one of the most critical phases in an SEC investigation and provides a valuable opportunity to persuade the Staff or the Commission that the Staff's understanding of the matter is either incorrect or incomplete and that the indicated enforcement action should not be instituted. Even if defense counsel cannot persuade either the Staff or the Commission that no enforcement action should be authorized, defense counsel may persuade the Staff to narrow the charges or seek less severe remedies. This chapter provides an overview of the Wells process and discusses seven steps to effectively represent a prospective defendant in the Wells process.

§ 16.02 Overview

The Wells Submission should be viewed as part of a process that begins when defense counsel first becomes involved in the investigation and continues until the matter is resolved. From the time that defense counsel first becomes involved in the investigation, defense counsel should attempt to monitor the evidence being gathered by the Staff and the Staff's incipient concerns and to develop exculpatory evidence. As the investigation progresses, defense counsel should consider communicating with the Staff in order to address and defuse their concerns and bring exculpatory evidence to their attention. After having received notice of the Staff's tentative decision to recommend an enforcement action, defense counsel should attempt to learn as much as possible about the Staff's concerns and the legal and factual bases for those concerns and should redouble efforts to develop exculpatory evidence.

After the SEC Staff has tentatively decided that an enforcement action is appropriate, but before it submits the recommendation memorandum to the Commission, the Staff ordinarily will contact counsel to each prospective defendant and provide notice of its tentative decision. Although the SEC rules

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the SEC to conduct investigations relating to violations of the act requires the Commission to "permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matterto be investigated." Section 42(a) of the Investment Company Act of 1940, 15 U.S.C.S. § 80a-41(a). Similarly, the provision of the Investment Advisers Act of 1940 authorizing the SEC to investigate violations of the Act provides in part:

[w]henever it shall appear to the Commission, either upon complaint or otherwise, that the provisions [of the Investment Advisers Act] or of any rule or regulation prescribed under the authority thereof, have been or are about to be violated by any person, [the Commission] may in its discretion require, and in any event shall permit, such person to file with it a statement in writing, under oath or otherwise, as to all the facts and circumstances relevant to such violation, and may otherwise investigate all such facts and circumstances.

Section 209(a) of the Investment Advisers Act of 1940, 15 U.S.C.S. § 80b-9(a).

provide the Staff discretion not to provide such notice,[1] the Staff routinely provides such notice absent unusual circumstances (e.g., when the Staff intends to seek a temporary restraining order freezing funds, or the Staff fears that the prospective defendant might flee the country).

Comment

While the Staff usually provides Wells Notices to potential defendants, there are circumstances in which the Staff might exercise its discretion to not provide such notices. The Staff is especially likely not to provide such notice where the Staff plans to seek emergency relief or where criminal prosecutors are conducting a criminal investigation.

The Staff can provide the notice by telephone call or letter or (most often) a telephone call promptly followed by a letter. This notification is commonly referred to as a "Wells Call." The letter will typically state that the prospective defendant will be given an opportunity to make a written or videotaped submission setting forth the position and arguments of the individual or entity.[2]

Comment

In 2004, it was the policy of the SEC Staff to provide written notice of the Wells Call, although the Staff sometimes provides oral notice of the Wells Call in advance of the written notice.

If, after reviewing the Wells Submission, the Staff decides to recommend an enforcement action, then the Staff's memorandum, along with the prospective defendant's Wells Submission, is distributed to the Commission and senior officers of any other offices and divisions of the SEC that are involved in the matter. If the Staff's proposal is to be addressed in the ordinary course of business, the Commission will meet to act on the recommendation within several weeks of docketing of the matter. The Commission considers the recommendation of the Staff at a closed meeting, which the Staff, but neither the prospective defendant nor defense counsel, can attend.

Nevertheless, the Staff's unwillingness and the sheer press of time may limit counsel's ability to plumb the depths of the Staff's concerns and the evidence on which the Staff is relying and thus hinder their ability to prepare an extensive rebuttal. It is not unusual for the Staff to inform defense counsel that he or she has only 14–30 days or less from the date of the initial Wells Call to file the Wells

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[1] *But see* n.4 regarding Investment Act and Investment Advisers Act investigations.

[2] The letter typically states that a written submission should not exceed forty pages and that a videotape submission should not exceed twelve minutes. The Commission does not specify whether the written submissions must be double spaced, but prospective defendants often submit written submissions that are single spaced.

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Submission. Often the Staff will grant limited extensions if warranted by the circumstances; however, the Staff is under considerable pressure bymanagement to conclude the Wells process without delay. Accordingly, it is often prudent to begin work on a Wells Submission before receipt of the Wells Notice.

§ 16.03 Seven Steps to Preparing an Effective Wells Submission

[1] Anticipate Impact of Possible Wells Call

The receipt of a Wells Call can have a substantial adverse impact on an individual or company. For example, the NASD requires that a person associated with a securities firm that is a member of the NASD update his/her Form U-4 upon, among other things, written notification that he or she is the subject of an SEC investigation that could result in an adverse finding against the person.[1] In light of the significant adverse ramifications that such an amendment can have on a securities professional, SEC Staff members will sometimes agree to notify defense counsel in advance of a Wells Call that the Staff has serious concerns which could ultimately lead to the initiation of the Wells process. Defense counsel can at this earlier stage attempt to persuade the Staff that an enforcement action is inappropriate. A certified public accountant might be required to notify the state accountancy board if the accountant receives a Wells Call. For example, California Board of Accountancy Regulation 5063(b)(4) provides: "Any licensee shall report to the board in writing the occurrence of any of the following events occurring on or after January 1, 2003, within 30 days of the date the licensee has knowledge of the events. . . .(4) Any notice from the Securities and Exchange Commission to a licensee requesting a Wells Submission."

[2] Evaluate Conflicts of Interest

In many instances it is both ethical and appropriate for one counsel to represent both the company and a number of company employees who testify during the information-gathering phase of the investigation. Representation of multiple witnesses during the fact-finding process can often provide a number of benefits both to the company and to the individual employees. Upon receiving a Wells Call, counsel should promptly evaluate whether it remains both ethical and appropriate to continue representing multiple clients.[2] It often will be appropriate for separate counsel to be retained to represent one or more of the prospective defendants. For example, it is difficult for counsel representing two company employees to provide impartial advice to one client on the wisdom of making an argument that might be detrimental to the other client. Thus, it is not uncommon

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[1] *See* NASD Form U-4, Item 22I & Explanation of Terms.

[2] A discussion of multiple representation can be found in Chapter 11.

for defense counsel to spin off individual clients upon receipt of a Wells Call identifying those individuals as prospective defendants.

Even if counsel and the clients initially determine that separate representation remains neither necessary nor appropriate, counsel should periodically reevaluate this determination as additional information is gathered. In addition, counsel should consider updating the disclosure to the clients regarding possible conflicts and the impact of those conflicts.

[3] Obtain as Much Information as Possible Regarding the Staff's Case

When seeking authority from the Commission to institute an enforcement action, the Staff submits to the Commissioners a memorandum recommending the institution of an enforcement action.[3] Because the Staff's recommendation memorandum is a confidential document and will not be made available to defense counsel, it is important to elicit from the Staff as much detail as possible regarding the bases for its proposed recommendation.

As indicated above, throughout the information-gathering phase of the investigation, counsel should endeavor to identify the Staff's concerns and potential arguments. Usually, counsel can ascertain many of the Staff's concerns and potential arguments by becoming familiar with the priorities and management realities which drive the SEC's enforcement program, conferring with other defense counsel, and reviewing documents and testimony.[4] Counsel also can learn valuable information by engaging in an ongoing dialogue with the Staff throughout the information-gathering phase of the investigation.

Upon receiving a Wells Call, defense counsel should attempt to supplement this information. In the initial Wells Call and letter, the Staff will typically provide a cursory outline of the charge that the Staff has tentatively decided to recommend. For example, the letter might do little more than identify the statutory provisions allegedly violated and the nature of the relief the Staff has tentatively decided to

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[3] The Staff's memorandum usually sets forth the key evidence and legal theories on which the Staff has based their conclusion that the federal securities laws have been or are about to be violated and that an enforcement action should be brought. The line investigators usually bear primary responsibility for preparing the first draft of the memorandum. The branch chief to whom the line investigators report and the assistant director, or assistant regional administrator or assistant district director to whom that branch chief reports also typically provide substantial input in the drafting of the memorandum. The preparation of the memorandum can consume weeks or even months as it winds its way through the various layers of supervisory review and is amended to respond to factual or legal arguments set forth in a Wells Submission.

[4] The SEC Staff will typically permit a witness to purchase the transcript of his or her testimony. While the SEC will typically not share with one witness the transcripts of the testimony of other witnesses, counsel often can obtain from the other witnesses or their counsel information regarding the substance of the testimony of those other witnesses.

seek (e.g., an injunction, civil penalties, a cease-and-desist order, a bar from association with a broker-dealer).

Comment

It is often appropriate for defense counsel to have a second lawyer present during the Wells Call in order to take detailed notes.

Upon receiving a Wells call, defense counsel should attempt to engage in a detailed discussion with the Staff. These discussions often involve the investigators who conducted the investigation and the branch chief supervising the investigation. It is sometimes desirable for these discussions to take place in a meeting, which is sometimes also attended by the Assistant Director (or Assistant Regional Administrator or Assistant District Director) responsible for the investigation, especially if counsel to the prospective defendant is new to the matter.

There is a significant range of practices regarding the extent to which the Staff will provide details regarding the theories and evidence underlying its tentative decision. There are several reasons why the SEC Staff should disclose their concerns and potential arguments to defense counsel. Full disclosure improves the ability of the Senior Staff and the Commission to evaluate the Staff's recommendation after having been tested by a well-informed Wells Submission that carefully addresses the Staff's concerns and arguments. It is in no one's interest for the SEC to institute an enforcement action based on a mistaken view of the evidence or the law. In addition, the more information they provide to defense counsel, the more likely it is that the Staff can persuade defense counsel that prompt settlement is in the best interests of counsel's client. For these reasons, among others, the Staff typically is willing to share information in some detail as they set forth their perception of the evidence and the law during the Wells process.

Comment

If the prospective defendant/respondent testified during the investigation and the Staff members are nevertheless unwilling to provide detailed information, counsel should consider involving a more senior member of the SEC Staff.

While a limited amount of defense advocacy is sometimes appropriate at this stage, defense counsel's primary goal is usually to obtain as much information as possible regarding the Staff's view of the evidence and the law. In general, the Staff is likely to be more forthcoming with information if defense counsel is open about the defense view of the evidence and the law. The Staff is also more likely to be forthcoming if defense counsel avoids putting the Staff on the defensive. Defense counsel should strive to keep the discussion civil and pleasant; it is rarely productive to debate the facts with the Staff at this stage.

It will sometimes be appropriate to have more than one meeting with the Staff prior to filing the Wells Submission. In general, the Staff is particularly likely to agree to multiple meetings if defense counsel has only limited information regarding the matter, because, for example, defense counsel was not retained until the Staff issued the Wells call. In addition, the Staff will sometimes respond to factual and legal questions in follow-up telephone calls. The Staff will sometimes provide access to relevant transcripts and exhibits. In most cases, defense counsel will obtain sufficient information to prepare an effective Wells Submission. If unable to obtain sufficient information, defense counsel should consider speaking with the more senior members of the Staff who are assigned to the investigation.

Comment

Some Staff members take the position that the Privacy Act and other confidentiality requirements bar the Staff from providing defense counsel with access to specific testimony from witnesses other than their clients or to documents supplied by persons other than their clients.

Often, it will also be important to gather information possessed by other witnesses. Counsel should consider contacting counsel for other individuals and entities believed to be prospective defendants, individuals believed to have provided testimony to the Staff, and individuals and entities believed to have provided documents to the Staff. In addition, defense counsel should contact other individuals and entities who might be able to provide exculpatory evidence.

Comment

Often, the Staff will provide relatively little information where the prospective defendant declined to testify based on the Fifth Amendment right against self-incrimination.

[4] Decide Whether to File a Wells Submission

A Wells Submission serves a number of purposes. Ideally, it might persuade either the Staff or the Commission that an enforcement action is not appropriate. Alternatively, the statement might persuade either the Staff or the Commission to narrow the scope or change the form of the proposed enforcement action. In addition, the Wells process often serves as a vehicle for arriving at a more favorable settlement than might otherwise be the case.

In deciding whether to file a Wells Submission, consideration should be given to the possibility that (1) the Enforcement Staff may at trial attempt to introduce into evidence factual statements in the Submission or use the factual statements to impeach the prospective defendant/respondent; (2) the Wells Submission may be made available to criminal prosecutors or other law enforcement or regulatory agencies; (3) private plaintiffs may obtain the Wells Submission through discov-

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ery; and (4) the media or other members of the public may obtain the Wells Submission pursuant to FOIA or otherwise.

In some cases, it will be clear whether the prospective defendant should file a Wells Submission. In many other cases, the decision whether to file a Wells Submission will be a judgment call based on a number of factors. These factors include:

- Counsel's judgment regarding the likelihood that either the Staff or the Commission can be persuaded not to proceed with an enforcement action. A Wells Submission is especially likely to be effective where the prospective defendant is peripheral to the alleged violation, the Staff appears to be proceeding on a mistaken interpretation of the law, or the Staff appears to be proceeding on an understanding of the facts that is not supported by the record. Even if the SEC Staff members appear to be unmovable, a Wells Submission might persuade either senior members of the SEC Staff or the Commissioners that the proposed action should not be pursued.

- Counsel's judgment regarding the likelihood that the Wells Submission might persuade either the Staff or the Commission to agree to a settlement that would be acceptable to the prospective defendant. By highlighting evidence that favors the prospective defendant and by identifying the weaknesses in the Staff's position, the Wells Submission might persuade either the Staff or the Commission to agree to a settlement that would be acceptable to the prospective defendant. For example, where the Staff's position expressed in the Wells Call involved a fraud charge and a penalty, the Staff might be persuaded through the Wells process to recommend a settlement involving a charge of negligence and no penalty.

- The extent to which the filing of an SEC action would have a devastating impact on the career of the prospective defendant/respondent even if the prospective defendant/respondent were ultimately to prevail in the enforcement action. For many individuals who are senior executives of publicly owned companies, are employed by public accounting firms, or who are employed by regulated entities (e.g., broker-dealer firms, investment companies, investment advisors), the very filing of an SEC enforcement action can have severe adverse consequences. Accordingly, it will often be appropriate to file a Wells Submission on behalf of such individuals even though, in the judgment of counsel, the Wells Submission is unlikely to avoid an enforcement action and might, for the reasons set forth below, reduce the strategic advantage possessed by the prospective defendant in ensuing litigation.

There are a number of factors that sometimes indicate that the prospective

defendant should not file a Wells Submission. The filing of a Wells Submission is usually unnecessary if the Staff and the prospective defendant or respondent have reached a settlement in principle before the Wells Submission is filed. In addition, there are other factors that sometimes indicate that the filing of a Wells Submission would be inappropriate:

- It appears likely that an acceptable settlement can be negotiated without incurring the effort and expense entailed in preparing an effective Wells Submission.
- There is little likelihood that the Wells Submission will dissuade the Staff from recommending the proposed action and the Commission from authorizing the action. In these circumstances, the prospective defendant might be better advised to conserve for litigation resources that would be expended in the Wells process. By revealing the strategies and positions of the prospective defendant, a Wells Submission may impair the ability of the defendant to mount an effective defense against the enforcement action. On the other hand, even in this circumstance, a Wells Submission may be effective in persuading the Staff or the Commission to drop aspects of the proposed enforcement proceeding.
- There is a significant possibility that the person against whom the Staff wishes to proceed will become a target of a parallel civil or criminal investigation or criminal prosecution. Given that the Wells Submission might be admissible in these matters and often discloses the defense's arguments and strategies, a Wells Submission is often inappropriate in matters involving a substantial risk of a criminal prosecution unless counsel forms the judgment that the Wells Submission will likely reduce the possibility of a criminal prosecution or the consequences of an SEC enforcement action would be devastating to the prospective defendant. The risk can also be addressed by filing a Wells Submission that makes general arguments without a detailed presentation of the key facts.
- There are serious deficiencies in the Staff's case that the Staff could cure with relative ease once they are identified in the Submission. In drafting the Wells Submission, counsel should be aware that the SEC Staff might respond to the Submission by conducting additional discovery to obtain the evidence that was otherwise missing from the record or by modifying the theory of the case in a manner that will make it harder for the prospective defendant/respondent to prevail in litigation.
- The danger that the Wells Submission will lock the defendant into a litigation position before the defense counsel can learn all of the evidence.

[5] Consider Whether to Initiate Settlement Discussions

In connection with the Wells process, defense counsel must consider whether to

initiate settlement discussions. The vast majority of SEC enforcement actionsare resolved through settlements. Often these settlements arise from discussions that defense counsel initiates during the Wells process.

The Staff often responds favorably to settlement discussions initiated by defense counsel. The initiation of settlement discussions often is appropriate if defense counsel believes that the Staff is highly likely to recommend, and the Commission is highly likely to authorize, an enforcement action. Many defense counsel believe that the Staff is more flexible in fashioning settlements during the Wells process than after the Commission has authorized an enforcement action. Indeed, some defense counsel believe that the Staff is more likely to be flexible early in the Wells process, before Staff positions have hardened, than near the conclusion of the Wells process. This danger of hardened Staff positions is especially significant if defense counsel does not initiate settlement discussion until after the Commission has authorized the action. On the other hand, the initiation of settlement discussions arguably reduces the likelihood that the Staff will be persuaded not to recommend any enforcement action or that the Commission will be persuaded not to authorize an enforcement action.[5]

Comment

Counsel should also consider submitting a video Wells instead of, or in addition to, the written submission. The usual practice is not to submit video Wells submissions. Video Wells submissions are, however, appropriate to drive home certain issues (e.g., character issues) or to put a human face on a sympathetic potential defendant.

[6] Draft the Wells Submission

Many Wells Submissions begin with an executive summary, then set forth a detailed statement of the facts, and conclude by presenting the defense's factual, legal and policy arguments. In addition, defense counsel sometimes includes in the Wells Submission an argument that even if the Commission authorizes an enforcement action, the Commission should not seek the sanctions sought by the Staff.

In drafting the Wells Submission, defense counsel should bear in mind that the Submission is likely to be reviewed by a number of Commission personnel including:

- the Staff members who conducted the investigation;

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[5] If the client is an issuer and has not previously disclosed the existence of the SEC investigation, the client should also consider whether disclosure is appropriate in light of the Wells Call.

- their supervisors, usually including senior members of the Staff;[6]
- the Commissioners or their personal legal assistants;
- the SEC Office of the General Counsel; and
- personnel from other relevant divisions or offices (e.g., Division of Market Regulation in a case involving broker-dealers, trading practices, or market structure, the Office of the Chief Accountant in a case involving accounting or auditing issues). The Enforcement Staff will consult with the other interested divisions and offices who also will have input into the position of the Commission.

The executive summary should be targeted to the senior members of the Staff, the Commissioners, and the legal assistants to the Commissioners. These people are extremely busy, and the primary purpose of the executive summary is to persuade them that they should scrutinize the Staff's recommendation and carefully consider the more detailed arguments set forth in the body of the Submission.

In Securities Act Release No. 5310,[7] the SEC advises that Wells Submissions are most useful in connection with questions of policy and law, and that disagreements regarding factual matters can rarely be resolved through the Wells process. Defense counsel should largely disregard this advice. If the Staff's recommendation is based on an inaccurate or incomplete factual predicate, counsel should seriously consider including in the Wells Submission evidence demonstrating that the predicate is inaccurate. This evidence can be drawn from the record assembled by the Staff during the investigation or from other sources. For example, in an insider trading investigation, it may be appropriate to submit newspaper articles showing that the allegedly nonpublic information was in the public domain; trading records showing that the trades by an alleged tippee were typical of trades previously made by him or her; and an affidavit from the person (e.g., a stockbroker) who, based on publicly available information, recommended the trade to the alleged tippee. Similarly, in an accounting case, it may be appropriate to submit affidavits from experts explaining why the company's accounting was thought to be in accordance with generally accepted accounting

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[6] A Wells Submission responding to an investigation conducted by a regional office will be reviewed by the Enforcement Staff in the regional office, but also by Office of the Chief Counsel in the Division of Enforcement in Washington. The Office of the Chief Counsel typically will review each enforcement recommendation and accompanying Wells Submission for consistency with the policy objectives of the division and treatment of prospective defendants or respondents relative to other cases and soundness on the merits and legal theory.

[7] Securities Act Release No. 5310, 1972 SEC LEXIS 238, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,010 (Sept. 27, 1972).

principles ("GAAP"). The Staff sometimes includes in its recommendation memoranda claims based on aggressive interpretations of the federal securities laws. In such instances, counsel should set forth the reasons why the Staff's interpretation is wrong as a matter of both law and policy. If the Staff or the Commission is persuaded that the legal premise is in doubt, they might modify their position in order to avoid the controversial legal theory.

The Wells Submission should set forth the facts that are central to the defense. To the extent possible, the Wells Submission should address and defuse evidence on which the Staff places substantial reliance. While legal and policy arguments are often important, in most instances the facts will be decisive. Even if defense counsel does not dispute the facts relied upon by the Staff, there frequently are other mitigating facts that defense counsel should bring to the attention of both the Staff and the Commission. For example, in drafting the detailed statement of the facts in a matter where the Staff alleges that the issuer had prematurely recognized revenue, defense counsel should consider whether effective arguments can be made that:

- the disclosure was consistent with GAAP;
- the disclosure was not materially false or misleading in light of the mix of information available to investors;
- the prospective defendant acted in good faith;
- the company had reasonable procedures;
- the conduct at issue complied with industry practice, especially if the SEC has known of the practice and not objected to it (e.g., in broker-dealer matters);
- once the disclosure issue was identified, the prospective defendant acted promptly to remedy the situation and prevent a recurrence;
- the disclosure issue was an isolated incident in the client's otherwise unblemished record;
- the client fully disclosed the relevant facts to a professional and relied on advice from the professional;
- the client was the individual who ultimately forced the corrective disclosure;
- new management has come in and the alleged malefactors are no longer associated with the company;
- the alleged defendant cooperated with the Staff investigation; and
- the conduct at issue was not egregious.

The Wells Submission should set forth the most powerful arguments available to the defense. Sometimes, the arguments will center on whether certain conduct, undisputed for the purpose of the Wells Submission, warrants an enforcement action. Sometimes, the arguments will center on whether the record supports the Staff's view of the facts.

Comment

In preparing a Wells Submission, defense counsel should consider retaining an expert to assist in the articulation of technical arguments or to submit a supporting affidavit.

In advance of arguing for the appropriate sanction, defense counsel should review recent settlements to determine whether the enforcement remedy that the Staff has tentatively decided to recommend is consistent with the remedies in recent prior settlements based on similar allegations. The SEC and the Staff believe that similarly situated defendants should be treated similarly. Accordingly, the Commission and the Staff might well be persuaded by an argument that the tentatively recommended remedy is not consistent with remedies in recent settlements involving comparable facts.

If the proposed defendant-respondent is a public company and the Staff has indicated that it intends to recommend the imposition of monetary penalties, counsel should consider including a discussion of whether monetary penalties are appropriate under the Commission's Statement on Corporate Penalties.[8] Similarly, if the corporation is willing to agree to a settlement including the imposition of a monetary penalty but believes that the amount of penalty sought by the Staff is excessive, counsel should consider including a discussion based on the Seaboard § 21(a) Report.[9]

If the Staff has assembled sufficient evidence that a violation has occurred, it might be appropriate to draft a Wells Submission that focuses on the proposed remedy. For example, a company might argue that even if prior management violated the securities law, the proposed remedy is excessively harsh given that new management has taken over, internal controls have been enhanced, and previously issued representations have been corrected or clarified.

The Wells Submission should set forth the available policy arguments. If applicable, the Wells Submission should include arguments that the proposed enforcement proceeding is contrary to public policy. If the enforcement action represents a substantial expansion of the law, the Wells Submission can argue that

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[8] The Statement is discussed in Chapter 17, "Settlement Discussions."

[9] A discussion of the Seaboard § 21(a) Report is included in Chapter 17, "Settlement Discussions."

an enforcement proceeding is an inappropriate vehicle for implementing such an expansion.

Comment

Often, defense counsel prepares a Wells Submission using a format similar to the typical format of a brief, with a cover page, a table of contents, a summary of the facts, and argument.

Many matters do not pose novel legal issues. If the matter involves only legal issues that the Commission has repeatedly addressed, there often is little benefit to attacking an established legal position. Legal argument is often appropriate, however, if the legal issues are novel.

There is a danger that the Wells Submission might be discoverable and might be admissible in litigation.[10] In order to strengthen the argument that a Wells Submission is settlement material inadmissible at trial under Federal Rule of Evidence 408,[11] it is often advisable to include in the Wells Submission a footnote indicating that the Submission is being filed for the purpose of resolving the matter without litigation. Defense counsel should nevertheless be aware of the danger that the Commission (or other litigants, such as plaintiff shareholders) will attempt to introduce the Wells Submission into evidence. Indeed, the SEC Staff routinely informs defense counsel in the Wells Call that the Staff may use the Wells Submission as an admission in any enforcement proceeding.

The appropriate length of the Wells Submission varies according to the complexity of the case. In most instances, a serious effort should be made to limit the Submission to no more than 40 pages. In light of its considerable docket, the Commission may not be prepared to plough through more lengthy documents.

Comment

One common practice when the Staff gives a Wells Notice to both a company and company employees is for the company to submit the primary Wells Submission and for the employees to submit separate Wells Submission that make the points that are of special significance to the individual employees. Accordingly, it often is important for counsel for the company to coordinate with counsel for company personnel and other potential defendants.

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[10] *In re* Steinhardt Partners, 9 F.3d 230 (2d Cir. 1993) (a document that a prospective defendant submitted to the staff before a Wells Submission is discoverable in private litigation). In addition, once the investigation has been concluded, members of the press and others might be able to obtain copies of the Wells Submissions from the SEC through Freedom of Information Act requests.

[11] *See In re* Allied Stores Corp., Administrative Proceeding File No. 3-6869, 1998 SEC LEXIS 5247, 52 SEC Docket (CCH) 451 (Mar. 21, 1988) (decision of administrative law judge excluding Wells Submission on grounds that admitting the statement would impair settlement negotiations).

[7] Follow-Up with the Staff After Submitting a Wells Submission

The Wells process does not end with the filing of the Wells Submission. Defense counsel should contact the Staff after filing the Wells Submission. There are a number of reasons for making such contact.

It is important for defense counsel to ascertain whether the Staff's position has shifted in response to the Wells Submission. The Staff sometimes changes the theory underlying its recommendation for enforcement action in response to the arguments set forth in the Wells Submission. While defense counsel can include in the Wells Submission a request that the Staff notify counsel if it materially changes its position after receipt of the Submission, the Staff does not always notify defense counsel of such changes.

In appropriate circumstances, after filing the Wells Submission, defense counsel should attempt to meet again with the Staff to discuss the issues raised in the Submission. Such a meeting will help counsel ensure that the Staff understands the defense theory and its implications and identify and address any changes in the Staff's position and any lingering concerns. Similarly, the Staff might articulate its position in a manner that provides new insights into the Staff's view of the case. If counsel gains new insights into the Staff's view of the case or learns that the Staff has altered its theory, it might well be appropriate for defense counsel to consider preparing a supplemental Wells Submission.

In addition, a post-filing meeting provides an opportunity for oral advocacy. While senior members of the Staff review the Wells Submissions, they only have a limited amount of time to devote to most Wells Submissions. A meeting that includes members of the Senior Staff (e.g., the Director, Deputy Director, Regional Administrator, Associate Directors, Associate Regional Administrator, the Chief Counsel of the Division of Enforcement, the Chief Enforcement Accountant) provides a valuable opportunity to focus the Senior Staff on defense arguments unfiltered by junior staff. Similarly, a post-filing meeting provides an opportunity to ensure that representatives of other interested Divisions (Division of Market Regulation, Division of Corporation Finance, Office of the General Counsel, etc.) focus on the potential defenses.

Comment

The Director and Deputy Director have very demanding schedules. Defense counsel should exercise discretion in asking for very senior members of the Division to attend the meeting. Asking that a Director or Deputy Director attend a meeting involving a relatively minor matter can impair the credibility of defense counsel and annoy the Staff and thereby prove counter-productive.

Defense counsel can also attempt to influence who will attend the meeting. If

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VER: [SC_64645-Local:14 May 07 13:09**][MX-SECNDARY:** 18 Apr 07 15:24**][TT-:** 30 Aug 06 13:14 loc=usa unit=ch0016**]** 0

the matter presents significant legal issues, then defense counsel might suggest that the meeting be attended by a representative of the Office of General Counsel. If the matter presents technical issues, it is appropriate to ask whether a representative of another relevant division will attend. For example, if the matter involves GAAS and GAAP issues, it might be appropriate to ask whether representatives of the Office of Chief Accountant plan to attend the meeting. If the presentation will focus on the evidentiary weakness of the case, defensecounsel can suggest that a member of the trial unit attend the meeting. Prior to attending the meeting, defense counsel should attempt to learn (1) the Staff's reactions to the Wells Submission and (2) the identity of the SEC personnel who are expected to attend the meeting. This information can assist defense counsel in determining the appropriate focus and emphasis for his presentation.

The issue of whether to meet with other divisions or offices is highly sensitive. For example, it is appropriate to ask for the Office of General Counsel to participate in a meeting only if the matter involves a significant unsettled legal issue. If defense counsel wants to involve another office or division, defense counsel should seek that meeting through the Enforcement Staff.

Defense counsel can take various approaches to this meeting. Sometimes, defense counsel will simply ask whether the Staff has any questions and whether the Staff's position has evolved in response to the Wells Submission. More often, defense counsel will use this meeting as an opportunity to advance his client's position through further articulation of the theory of the defense. Accordingly, defense counsel should consider preparing a detailed presentation of the defense, including visual aids, designed to engage and hold the interest of the attendees. Sometimes, however, defense counsel should simply prepare talking points similar to the presentation that an advocate would make in an oral argument. Counsel should take extreme care to ensure there is adequate evidence to support each factual point and to base the theory of the defense on a factual background as similar as possible to that described by the Staff as the basis for their preliminary determination. By so doing, defense counsel will minimize clashes with the Staff not needed to advance his client's interests.

Comment

Defense counsel should prepare thoroughly for this meeting. Defense counsel should master the record and prepare responses to articulated questions.

As a result of the post-filing meeting and other communications, defense counsel may detect a shift in the Staff's position or gain greater insight into their reasoning. If appropriate, these can be addressed in a supplemental or superseding Wells Submission.

§ 16.04 Conclusion

The Wells process provides a prospective defendant with an important opportunity to persuade the Staff and the Commission that an enforcement action would be inappropriate. The Wells process often constitutes a prospective defendant's last best chance of avoiding a crippling SEC enforcement action. In order to represent a prospective defendant effectively, defense counsel must learn as much of the relevant evidence as possible, gain insight into the Staff's view of the matter, and engage in effective written and oral advocacy.