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April 15, 2004

Jonathan G. Katz
Office of the Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: File No. PCAOB-2003-07

PCAOB Proposed Rules on Investigations and Adjudications

Dear Mr. Katz:

Deloitte & Touche LLP is pleased to respond to the request for comments from the Securities and Exchange Commission ("SEC" or the "Commission") on the *Proposed Rules on Investigations and Adjudications*, filed by the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") for the Commission's approval. *See Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules Relating to Investigations and Adjudications*, 69 Fed. Reg. 15394 (Mar. 25, 2004) (hereinafter "Notice").[1]

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[1] The PCAOB also issued a release of its final proposed rules on September 29, 2003, containing more detailed explanations of the reasons behind its proposed rules and of its responses to the concerns of commenters. *See Rules on Investigations and Adjudications*, PCAOB Release No. 2003-015 (Sept. 29, 2003) (hereinafter "Release"). Some of these

[Footnote continued on next page]

INTRODUCTION

We support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") in restoring investor confidence, as well as the Board's efforts, under the review of the Commission, to develop rules that implement the Act faithfully. In particular, we applaud the Board for its conscientious efforts in creating a new investigatory and adjudicatory system. Nevertheless, we believe that the Board's proposed rules as drafted lack fundamental safeguards in many significant respects. For the reasons set forth below, it is essential that the Commission either make significant revisions to the proposed rules, or remand the proposed rules to the Board with specific instructions to modify the proposal. Our comments in this letter are designed so that either the Commission or the Board can make the revisions suggested herein to enhance the effectiveness of the proposed rules.[2]

The Board's proposal seeks to implement Section 105 of the Act, which authorizes the Board to conduct investigations of registered public accounting firms and associated persons, to institute disciplinary proceedings in the event that the Board has detected potentially improper conduct, and to impose certain sanctions through those disciplinary proceedings. Section 105(a)

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explanations are contained in the Notice; however, the Board has omitted from the Notice many of its explanations of why it rejected certain comments (as opposed to discussions of modifications that it made in response to certain comments). Because there is no indication in the Notice that it abrogates the Release, we rely on both of these documents as the Board's explanation for its proposed rules.

[2] Although not the subject of this rulemaking, the prospect of overlapping Board and Commission investigations presents concerns that the Commission needs to address promptly. Some of the issues involved in this rulemaking also will arise with regard to the coordination of Board and Commission proceedings. The Commission should consider initiating a separate process to address, among other things, the manner in which the Board and the Commission will coordinate their enforcement efforts so as not to waste the public's enforcement resources or to burden the regulated community with duplicative investigations.

of the Act requires the Board to establish "fair procedures for the investigating and disciplining of public accounting firms and the associated persons of those firms" within the limits of the Act.[3] On July 28, 2003, the Board proposed rules to govern its investigations and adjudications under Section 105. During the Board's own comment process, we provided comments on the Board's proposal and identified modifications and clarifications of the proposed rules necessary to make the Board's final rules workable and consistent with Congress's mandate under Section 105(a) of the Act.[4] In its revised release, the Board made some progress in this regard. The Board, however, has declined to adopt several revisions that we believe are *crucial* to the fairness of the Board's investigations and adjudications.

The Commission has a special responsibility with regard to its review of the Board's rules. Congress established the Board as a private "nonprofit corporation."[5] The Board's rules, however, must be approved by the Commission, which is a government agency and which, therefore, must act in accordance with the Constitution, the Administrative Procedure Act, and other federal statutes governing agency action. Moreover, the Commission ultimately will review the imposition of disciplinary sanctions imposed under the rules proposed by the Board. Accordingly, the Commission's thorough and judicious review of the proposed rules is necessary to ensure that the Board's procedures are fair, balanced, and transparent, to enable the Commission to review the product of the Board's disciplinary proceedings with confidence and

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[3] Indeed, the Notice reiterates that the Board is under a statutory duty to establish "fair procedures for Board investigations, fair procedures for Board disciplinary proceedings, and fair sanctions for violations." *See* Notice, 69 Fed. Reg. at 15395.

[4] Deloitte & Touche, *Comment on PCAOB Docket Matter No. 005, Proposed Rules on Investigations and Adjudications* (Aug. 19, 2003) (hereinafter "D&T Comment").

[5] Act, § 101(b).

in a manner consistent with its own constitutional and statutory obligations. To that end, we encourage the Commission to make certain that registered public accounting firms and associated persons are guaranteed fundamental procedural protections in Board investigations and adjudications.

Unfortunately, the Board's proposed rules are permeated by the Board's reliance on a premise that may be well-intentioned, but that is nevertheless invalid and unworkable. Throughout its release, the Board has declined to establish rules guiding the discretion of its enforcement staff because such rules, the Board asserts, would be necessary only if the staff acted unreasonably. The Board states that the presumption underlying its proposed rules is "that both the Board and its staff will act reasonably," and, thus, that the Board would not adopt rules that seek to avoid arbitrary or unreasonable actions by the Board or its staff.[6] The primary purpose of having any procedural rules in the first place, however, is to protect against the arbitrary or unreasonable exercise of discretion by agency officials. At a minimum, such rules are necessary to assure that decisionmaking authority is exercised appropriately. Taken to its logical conclusion, the Board's argument would obviate the need for *any* rules to govern the Board's investigations and adjudications if, as the Board claims, regulated parties could be "assured" that the Board and its staff simply will act reasonably under the circumstances. The Board's presumption of reasonableness, no matter how commendable as a statement of intention, is not an adequate foundation for its proposed rules, and this comment identifies proposals that will help to improve the fairness of the Board's proceedings.

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[6] Release at A2-11.

Moreover, as set forth below, many of the proposed rules are unfair on their face—and thus contrary to the Act—or would permit the Board to take actions without the checks and balances necessary to ensure that Board procedures are fairly applied. Although we have many concerns with respect to the proposed rules, we are particularly concerned about provisions that will impair the Board's ability to conduct fair hearings and that will limit the Commission's ability to review Board decisions on fair and complete records. Many shortcomings in the proposed rules also reinforce each other, exacerbating the effect of unfairness and seriously undermining Board proceedings. These include the Board's failures to adopt a *Wells* process; to provide for Board review of accounting board demands issued by the enforcement staff; to provide a reasonable minimum period for responding to Board document demands; to provide adequately for the confidentiality of Board proceedings in a variety of ways; and to eliminate the availability of summary judgment in circumstances where it is inappropriate. Particularly in light of the Act's mandate that the Board have "fair procedures," and the Commission's obligation to review Board decisions, these flaws require thorough and searching redress by the Commission.

Because of the serious infirmities in the proposed rules, we believe that the Notice does not permit the Commission sufficient time to complete its review. According to the Notice, the Commission either will approve the rules only fourteen days after comments are due or will announce that it will take up to another fifty-five days to review the rules.[7] We believe that the Commission should avail itself, at a minimum, of the latter option so that it may have a realistic period of time in which to address these numerous, substantial concerns.

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[7] Notice, 69 Fed. Reg. at 15411; *see also* Section 19(b)(2) of the Securities Exchange Act of 1934.

Our comments below track the order of the proposed rules, the text of which is set forth in the Board's Release and which are summarized in the Board's Notice filed with the Commission. These comments, which represent only our most serious concerns with the proposed rules, include the following:

- The Board should adopt the Commission's *Wells* notice practices. (Section I.A).
- The rules should provide for review of accounting board demands issued by the enforcement staff. (Section I.B).
- The rules should permit a witness to be accompanied by counsel *and* by non-attorney experts retained by counsel. (Section I.C).
- The rules should set a minimum period for responding to an accounting board demand. (Section I.D).
- The Board should retract its guidance stating that it will make negative evidentiary inferences from the invocation of the Fifth Amendment privilege in disciplinary proceedings. (Section I.E).
- The rules should be amended to implement fully the confidentiality requirements of the Act. (Section I.F).
- The proposed rule concerning non-cooperation proceedings should be narrowed. (Section I.G).
- The rules should provide that judicial actions to enforce Commission subpoenas requested by the Board will be filed under seal. (Section I.H).
- The Board should be prohibited from conducting investigations in aid of other law enforcement agency proceedings. (Section I.I).
- The Board's ability to consolidate disciplinary proceedings should be restricted to those instances where the proceedings concern the same transaction or occurrence. (Section II.A).
- The Board's rules should not permit *ex parte* communications in settlement proceedings. (Section II.B).
- The rules should provide respondents with more equitable opportunities to engage in discovery. (Section III.A).
- The provision permitting summary judgments against respondents in disciplinary proceedings should be eliminated. (Section III.B).

I. INQUIRIES AND INVESTIGATIONS

A. THE BOARD SHOULD ADOPT THE COMMISSION'S *WELLS* NOTICE PROCEDURES

The proposal provides investigated public accounting firms and persons with neither adequate notice nor a sufficient opportunity to state their case to the Board at an early stage. These omissions are inconsistent with the Commission's own long-established practices and imperil the ability of firms and persons to participate productively in a Board investigation.

The proposed rules do not require that the Board's staff inform a firm or associated person of its intent to recommend the commencement of disciplinary proceedings.[8] The Board thus proposes a different path from the one embodied in the Commission's *Wells* procedures. Without an explicit request, the Commission's staff generally issues a *Wells* notice, which states that the Commission's staff has conducted a formal investigation and that it intends to recommend the commencement of proceedings against a particular party, and which is intended to describe the grounds for its tentative recommendation.[9] At that point, the investigated party is

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[8] *See* Proposed Rule 5101(a). To be sure, Proposed Rule 5109(d) allows a public accounting firm or associated person to request a description of the "indicated violations" from the Board's staff, but the disposition of that request is left to the staff's "discretion." *See* Notice, 69 Fed. Reg. at 15399. Moreover, an investigated party will have no occasion to request such a description if the Board's enforcement staff is under no obligation to inform the party of an "indicated violation." No part of the proposal indicates that the staff will affirmatively notify a public accounting firm or associated person of a formal investigation.

[9] *See*, *generally*, Securities and Exchange Commission, *Commencement of Enforcement Proceedings and Termination of Staff Investigations*, Release No. 5310 (Feb. 28, 1973) at 1.

allowed to submit a *Wells* statement in which the party can address the allegedly improper conduct.[10]

The Commission's *Wells* procedures are the product of years of Commission experience and should be codified in the Board's rules.[11] In this regard, we suggested to the Board that its rules should specify that its enforcement staff must issue a notice to the investigated party that it intends to petition the Board to initiate disciplinary proceedings.[12] Like the Commission's *Wells* notice, the Board's notice at least should include a concise statement of the allegedly improper conduct and what action the staff is considering recommending to the Board.[13]

The Board rejected our suggestion. According to the Board, "the purpose of the Rule 5109(d) process is to assist the Board in its decision-making" and, therefore, respondents have no legitimate interest in a rule providing a right to a *Wells* notice or statement.[14] The institution of a disciplinary proceeding, however, is a grave matter: the mere initiation of disciplinary

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[10] *Id. See also* William R. McLucas, *A Practitioner's Guide to the SEC's Investigative and Enforcement Process*, 70 TEMP. L. REV. 53, 113 (1997) (noting that generally a one-month period for preparing a *Wells* submission is permitted).

[11] The Commission's *Wells* procedures, while not embodied in a firm rule, have become standard Commission practice as a matter of custom and are expected by those who appear before the Commission. Although Proposed Rule 5109(d) contains language similar to Commission Rule of Practice 202.5(c), the discretion of the Board's enforcement staff is unchecked by the long institutional tradition of the Commission to provide notice of the intent to initiate disciplinary proceedings. Accordingly, it is vital that these procedures be explicitly incorporated into the Board's rules.

[12] D&T Comment at 6-8.

[13] Indeed, there is no reason why the enforcement staff should not provide more detail in its notice than the Commission's *Wells* notice so that the Board has the benefit of a more informed briefing by a potential respondent before it must decide whether to initiate disciplinary proceedings.

[14] Release at A2-49; Notice, 69 Fed. Reg. at 15399.

proceedings, while not automatically assessing sanctions, may in some circumstances make the continuation of operations practically impossible for certain registered firms. As a matter of ordinary course, the subject of such a proceeding should be able to participate in that initial process. The current rule allows the Board's enforcement staff to avoid any scrutiny in its recommendation to the Board by not providing notice. Moreover, without a right to notice and information similar to the Commission's *Wells* procedures, the right to submit a "statement of position" pursuant to Rule 5109(d) essentially would be rendered a nullity and thus provides little protection to a respondent, or benefit to the Board's process of informed decisionmaking. Indeed, the Board's principle that the proposed rules are designed "to assist the Board in its decisionmaking" provides an additional imperative for a *Wells* procedure.

The Board also contends that there are special circumstances in which notice—and the corresponding opportunity to make a *Wells* submission—would be "contrary to the public interest or the interests of investors."[15] According to the Board, such circumstances include when "expedited enforcement action" is required or "when advance notice of particular charges to a respondent might undermine legitimate investigative objectives of the Board or of other regulatory or law enforcement agencies conducting parallel investigations."[16] It is hard to imagine, however, circumstances in which the emergency institution of disciplinary proceedings ever would be justified. Even if the enforcement staff skips the *Wells*-type notice and immediately institutes disciplinary proceedings, the target still will have been informed *at that*

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[15] Release at A2-48; Notice, 69 Fed. Reg. at 15399.

[16] Release at A2-49; Notice, 69 Fed. Reg. at 15399. The nature of the Board's coordination with law enforcement agencies raises independent concerns, which are addressed below. *See* Section I.I.

point that an investigation has been pending against him and of the rough contours of that investigation.[17] Accordingly, the preservation of secrecy cannot, as the Board claims, justify any choice between providing a *Wells*-type notice and directly instituting proceedings without notice, as the nature of the allegations would be revealed to the respondent at the same point in the development of the case under either scenario.[18]

Even if such circumstances sometimes would justify withholding notice from an investigated party, the Board's enforcement staff, at a minimum, should be required to make a showing to the Board that such rare and exceptional circumstances exist before initiating disciplinary proceedings *without* the input of the potential respondent.[19]

B. The Rules Should Provide For Board Review Of Accounting Board Demands Issued By The Enforcement Staff

The proposed rule does not provide for any review of the enforcement staff's issuance of an accounting board demand before production of documents or testimony is required. We suggested to the Board that it permit a registered accounting firm or associated person to file with the Board a motion to quash an accounting board demand before production or appearance

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[17] *See* Proposed Rule 5201 (requiring that a respondent be provided with the order instituting disciplinary proceedings and that the order contain a description of the allegedly improper conduct).

[18] In addition, because the Board is not authorized to freeze assets upon the institution of disciplinary proceedings, it is difficult to conceive of situations where a respondent might be prompted to flee the jurisdiction upon receiving a *Wells*-type notice as opposed to the order instituting proceedings.

[19] It is the enforcement staff's scope of discretion that is of particular concern. For this reason, the Board's statement that "[i]t is our expectation that the staff will routinely give a respondent a meaningful opportunity to make a Rule 5109(d) submission" does not address this comment. Notice, 69 Fed. Reg. at 15399. Indeed, the very circumstances in which the Board has predicted that its staff will deny a notice reinforces that an explicit right to *Wells*-type procedures should be codified in the Board's rules.

for testimony is required.[20] This procedure would allow for some Board review of the scope and burdens of the enforcement staff's demand.

1. The Board Review Mechanism Suggested In Our Comment Sought Less Review Than The Review To Which Commission Subpoenas Are Subject

Notably, our proposal sought more limited review of demands by the Board than the review to which the Commission's own subpoenas are subject. Commission subpoenas are not self-executing; instead, the Commission must file a petition in a federal district court to enforce the subpoena.[21] In the course of deciding whether a subpoena should be enforced, the Commission must convince an Article III, life-tenured judge that the subpoena is statutorily authorized, is reasonable in scope, is not unduly burdensome, and was not issued in bad faith by Commission staff.[22] If the court finds that these minimum requirements are met, it may issue an order enforcing the subpoena. Only after that order is issued, however, can the respondent be subject to penalties for failure to comply with the subpoena.

By demanding rapid production of the entirety of a document demand with no prospect of review of the burdens, scope, or propriety of that demand by any entity, the Board's proposed rule would authorize a quicker, harsher, and more punitive regime, with no timely oversight. To restore fairness to the process, the proposed rule should be revised at least to permit public

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[20] D&T Comment at 13-15.

[21] *See*, *e.g.*, 15 U.S.C. § 77v(b).

[22] *See*, *e.g.*, *United States v. Miller*, 425 U.S. 435, 445-46 (1976) ("The Fourth Amendment requires that administrative agency subpoenas be sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unduly burdensome."); *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1023 (D.C. Cir. 1978) (considering the Commission's authority to issue the subpoena and the reasonableness of the subpoena's burdens and scope during enforcement proceedings).

accounting firms and associated persons to request that the Board quash, or issue a protective order limiting, the accounting board demand. Such an amendment should permit parties subject to an accounting board demand to object on the basis that the demand seeks irrelevant documents, is redundant of other accounting board demands, is unduly burdensome, is unreasonable in scope, or extends beyond the authorization of the order instituting a formal investigation, the Act, or the Board's rules.

Under such a suggested revision, Board staff would not be required to initiate proceedings to enforce a demand. Instead, a person or registered public accounting firm would be required to petition the Board to quash or to issue a protective order limiting an accounting board demand issued by Board staff. In addition, the revision would not place the disposition of a motion to quash or for a protective order before an independent external tribunal in the first instance, but would allow registered public accounting firms and associated persons to seek review from the Board itself, under some semblance of the scrutiny to which a Commission subpoena would be exposed before enforcement. Without such a revision, registered public accounting firms and associated persons would be able to seek review of a demand only through non-compliance, exposing themselves to substantial sanctions in non-cooperation proceedings.

2. THE BOARD'S OBJECTIONS TO THE SUGGESTED REVIEW MECHANISM ARE WITHOUT MERIT

The Board claims that the suggested revision is a "statutorily invalid" mechanism to seek Commission review.[23] While some commenters may have urged the Board to provide an avenue for Commission review, we sought a mechanism that, at a minimum, would permit the *Board* to

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[23] Release at A2-23-24.

review the propriety of accounting board demands issued by its *enforcement staff*.[24] We took no position on whether the product of that review would be appealable to the Commission and beyond. Without revision, however, the scope of, and burdens imposed by, accounting board demands would be left to the unfettered discretion of the enforcement staff without any practical mechanism for review even by the Board.

The Board also contends that procedures for motions to quash were unnecessary because a respondent could always decline to comply with an accounting board demand, have non-cooperation proceedings initiated, and argue the infirmities of the accounting board demand to the Board in that setting.[25] Forcing respondent firms and persons to risk substantial punishment, however, in order to obtain any review of a demand for testimony or documents from the enforcement staff of an agency is unworkable and unfair; such a process would also be highly inefficient for the Board.

The Board's hedged prediction that it might not automatically impose punishment if a respondent were to present a good faith, but ultimately unsuccessful, objection to an accounting board demand during non-cooperation proceedings provides little protection or comfort to a registered firm or associated person confronted with a demand.[26] The Board does not commit to withhold sanctions even when there is, in its view, a good faith objection to the accounting board demand. The Board also contends that Rule 5109(d)—which authorizes the enforcement staff to permit a registered firm or associated person to submit a statement to the Board before it

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[24] D&T Comment at 13-15.

[25] Release at A2-24.

[26] Release at A2-24-25 ("That is not to say, however, that a person proceeding reasonably and in good faith can only obtain Board review in a process that necessarily ends in a sanction.").

authorizes non-cooperation proceedings—would provide a sufficient opportunity for a respondent to state any objections to the Board.[27] Permitting Rule 5109(d) statements, however, is left entirely to the discretion of the enforcement staff, and thus this mechanism does not provide any effective check on the staff's issuance of accounting board demands. After all, as noted above, the enforcement staff could avoid any meaningful review by declining to provide a respondent with the opportunity to submit a Rule 5109(d) statement.[28] Even if the enforcement staff were to allow a Rule 5109(d) statement addressed to an accounting board demand, the Board would not be required to consider that statement. Moreover, the Board never commits to allow an opportunity for cure if it ultimately decides that the accounting board demand is appropriate. Without a right to cure, the Board could immediately institute non-cooperation proceedings, based on the failure to comply with the challenged accounting board demand, and impose sanctions—further demonstrating that there is no adequate vehicle for review of overbroad or burdensome accounting board demands.

By leaving access to any Board review in the sole discretion of the enforcement staff and by deterring the raising of objections in disciplinary proceedings for non-cooperation by significant penalties (including the termination of registration and up to $15 million fines), the proposed rules effectively insulate accounting board demands from any review by the Board or any other entity.[29] The Board concedes as much, claiming that it would not afford a "no-risk

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[27] Release at A2-25; Notice, 69 Fed. Reg. at 15399.

[28] *See* Section I.A.; *see also* Notice, 69 Fed. Reg. at 15399.

[29] *See* Proposed Rule 5300(b) (authorizing fines of up to $15 million for failure to comply with an accounting board demand for testimony, in addition to the termination of registration).

mechanism for delaying compliance with every accounting board demand."[30] The Board's refusal places in stark contrast the assumption underlying its rules: that the enforcement staff will act reasonably at all times, thus obviating any need for Board review,[31] but that respondents will predominately act unreasonably by, in this case, filing motions to quash for the sole purpose of delay. In addition, even if delay is a risk, depriving respondents of a mechanism to seek Board review is not necessary to protect against that risk. The Board clearly has many other mechanisms to deter, to overcome, and to sanction any attempt to secure delay merely for its own sake, or merely for tactical reasons.[32]

C. THE BOARD'S SEQUESTRATION RULE INAPPROPRIATELY EXCLUDES EXPERTS RETAINED FOR THE ASSISTANCE OF COUNSEL

Rule 5102(c) limits the persons who may attend a demanded examination to the examinee, the examinee's counsel, and other persons whom the enforcement staff permits to be present. We asked the Board to clarify that, in addition to the examinee's counsel, experts and other persons *retained by counsel* for assistance in the representation of the examinee explicitly be permitted to attend.[33] The Board rejected our proposal. Instead, the Board claims that the enforcement staff may exercise its discretionary authority to permit some consultants "in appropriate circumstances and on appropriate terms."[34] The Board states, however, that the

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[30] Release at A2-25.

[31] Release at A2-11, A2-16.

[32] Moreover, because the review would be conducted by the Board, the Board could adjudicate objections quickly.

[33] D&T Comment at 10.

[34] Release at A2-18.

enforcement staff will exercise its discretion to ensure that a consultant's presence will not permit "a firm's internal personnel effectively to monitor an investigation by sitting in on testimony of all firm personnel."[35]

The Board's rule, allowing the enforcement staff to exercise discretion over whether consultants are permitted, is again squarely inconsistent with the Commission's practice. In *Securities and Exchange Commission v. Whitman*,[36] the court ordered the Commission to allow the attendance of consultants retained by counsel at its investigatory examinations.[37] According to the court, the attendance of experts to assist counsel was essential to the examinee's right to counsel. To deny counsel the assistance of attending experts, the court reasoned, would be to ignore the realities of the intricate matters before the Commission: "Given the extraordinary complexity of matters raised in agency investigations in this modern day, counsel trained only in the law, no matter how skillful, may on occasion be less than fully equipped to serve the client in agency proceedings."[38]

The Board dismissed the reasoning of *Whitman*, claiming that the court was interpreting the Administrative Procedure Act and that the Board, in contrast to the Commission, is not bound by the APA.[39] The court's interpretation of the right to counsel to include the attendance

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[35] Release at A2-19.

[36] 613 F. Supp. 48 (D.D.C. 1985).

[37] Of particular relevance to the types of proceedings that will be brought before the Board is that the consultant in *Whitman* was "a non-lawyer accountant . . . who would provide technical assistance to respondents' counsel on accounting and auditing issues." *Id.* at 49.

[38] *Id.*

[39] Release at A2-19 n.1.

of consultants, however, did not turn on any particularized language in the APA, which provides in only the most general terms for the right to counsel in agency proceedings.[40] Instead, the court held that the attendance of technical consultants to assist counsel was fundamental to any meaningful right to counsel. The Board cannot seriously contend that the examinees do not have a right to counsel, phrased in terms at least as detailed as the APA, during a demanded examination. That right necessarily carries with it the right to have counsel assisted by retained experts.

The Board also contends that amendment of the rule is unnecessary because, under the rule as currently proposed, the enforcement staff may in their discretion permit persons other than counsel to be present.[41] As the court recognized in *Whitman*, the assistance of technical consultants in these complex proceedings is essential to the right to counsel; consequently, it cannot be left to the discretion of the enforcement staff. Moreover, this discretion to bar consultants is not required, as the Board contends, to prevent personnel from the examinee's accounting firm from "monitor[ing] an investigation."[42] Our proposed amendment would require the consultant to be retained by the examinee's *counsel* and would not, for example, be an open invitation for firm personnel who are not the witness's attorneys to attend. The Board has not advanced any legitimate reason for deviating from the Commission's practice and for

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[40] The APA's reference to the right to counsel consists of the following: "a person compelled to appear in person before an agency or representative thereof is entitled to be accompanied, represented and advised by counsel, or if permitted by the agency, by other qualified representative." 5 U.S.C. § 555(b).

[41] Release at A2-19.

[42] *Id.*

refusing to guarantee a full right to the counsel required for the complex matters that will come before the Board.

D. ACCOUNTING BOARD DEMANDS FOR THE PRODUCTION OF DOCUMENTS PROVIDE INSUFFICIENT NOTICE

Proposed Rule 5103 requires that a Board demand for the production of documents "set forth a reasonable time and place for production." The Board has indicated in the section-by-section analysis accompanying the initial proposed rule, however, that it interprets the rule to provide no "minimum notice requirement before production shall be due."[43] That initial section-by-section analysis stated that, while the Board "anticipates that the staff will provide at least five business days notice before production is due," such notice may also "be less than five days."[44]

We asked the Board to set a definite minimum period of time for the production of documents that could be shortened only by the enforcement staff petitioning the Commission (or, at least, the Board) for a shorter period.[45] At a minimum, we requested that the Board eliminate

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[43] PCAOB Release No. 2003-012, *Proposed Rules on Investigations and Adjudications*, at A2-xii (July 28, 2003) (initially releasing the proposed rules for the submission of comments to the PCAOB).

[44] *Id.* In the Notice, the Board announces that it "anticipate[s] that it will not be unusual for the staff to provide two to three weeks notice." 69 Fed. Reg. at 15397. The Board expressly states, however, that it may seek a shorter period; and has not repudiated its statement in the initial section-by-section analysis that the response period may be less than five days, despite several requests by commenters that it do so. *See id.* ("Rule 5103(b) does not impose any minimum notice requirement before production shall be due.").

[45] D&T Comment at 11-12. Specifically, we requested that the Board adopt the standard set by Federal Rule of Civil Procedure 34 and establish a thirty-day minimum response period unless a shorter period is ordered by the Commission, or at least the Board. Indeed, our proposal would provide less protection than Rule 34 because: (1) Rule 34(b) only requires a written response to the request for production within thirty days, not the actual documents

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its guidance that periods even shorter than five days will be deemed reasonable notice under certain circumstances.[46] The Board rejected our proposed revisions. The Board contended that setting a minimum period for production would deprive the enforcement staff of flexibility when there are "legitimate reasons for requiring the documents sooner."[47] The Board simply failed to address, however, the feature of our proposed revision that would enable the enforcement staff to petition the Board or the Commission for an order permitting a shorter response period.[48] Instead, the Board simply repeated its aspiration that its enforcement staff will act reasonably on a case-by-case basis and threatened that failure to comply with any Board demand will be followed by the institution of non-cooperation proceedings.[49]

We do not believe that the enforcement staff should have the unfettered discretion to order production in such short periods of time. Our proposed revision, with an ordinarily protective minimum response period of thirty days, but with the ability of the enforcement staff to seek an order permitting a shorter period in extraordinary circumstances, appropriately balances the prospect of the emergency need for documents with dangers of otherwise unchecked authority to place unduly burdensome demands on respondents, enforced by significant penalties for non-compliance.

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requested; and (2) under Rule 34, leave for a shorter response period is required from an independent, Article III judge.

[46] D&T Comment at 9.

[47] Release at A2-26; Notice, 69 Fed. Reg. at 15397.

[48] This apparent failure to address a significant comment itself would be grounds for rendering a rulemaking invalid under the APA. *See*, *e.g.*, *Motor Vehicles Mfg. Ass'n v. State Farm Mut. Ins. Co.*, 463 U.S. 29 (1983).

[49] Release at A2-27.

We are particularly concerned that the Board's unwillingness to set a standard minimum response period, and its evident view that less than five-days notice generally can be adequate notice, ignore the practicalities of responding to certain document production requests served on public accounting firms. Under the proposed rule, the Board's staff would be authorized to demand the production of broad categories of documents. In many cases, the demand would be the first indication for the firm that the Board is investigating a matter and, thus, the firm would not have been preparing for the possibility of a document production. In response to such a demand, an accounting firm would be required to question dozens of employees in order to locate responsive documents. Once identified, responsive documents—which may be maintained in multiple locations across the firm's offices or in the possession of auditors working at the offices of audit clients on a pending audit—would need to be gathered into a centralized location and reviewed by attorneys for privilege, relevance, and completeness. Then, the firm generally would Bates stamp the documents and send them to vendors for copying.

The obligation to engage in privilege review, in particular, should not be understated. In order to preserve the firm's privileges, a public accounting firm would be required carefully to analyze the documents for privileged material before it could responsibly produce those documents. If an accounting firm produced privileged material in response to an accounting board demand, the firm would risk waiving that privilege even with regard to entities well beyond the Board.[50] These problems are aggravated by the Board's proposed rule governing the identification of privileged information, which requires extensive documentation about material

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[50] *See*, *e.g.*, *In re Columbia / HCA Healthcare Corp. Billing Practice Litig.*, 293 F.3d 289 (6th Cir. 2002) (holding that the production of privileged documents to the SEC, even under a confidentiality agreement, waived the privilege as to private third parties).

claimed to be privileged and that such documentation be filed at the time the demand response is due.[51] The practicalities of production make a definite minimum response period of at least thirty days—the minimum period guaranteed by the Federal Rules of Civil Procedure and used in other similar proceedings—necessary for the protection of registered public accounting firms and associated persons.

E. The Board's Guidance On The Effect Of Asserting The Fifth Amendment Privilege Against Self-Incrimination Should Be Revised

Proposed Rule 5106 establishes procedures for the assertion of various privileges in response to an accounting board demand for documents, testimony or an accounting board inspection of a registrant's books and records. Some commenters asked for clarification on which privileges would be honored by the Board. We commend the Board for stating, in response to those comments, that the Board "do[es] not intend to invade the province of any legitimately asserted privilege that would, under prevailing law, be treated as a valid basis for declining to provide documents or information in response to a Commission subpoena."[52]

Although the Board expressly committed to honoring the assertions of the Fifth Amendment privilege against self-incrimination, the Board also stated that it would use assertions of the privilege against the respondent in disciplinary proceedings: "The Board fully intends . . . that assertions of the Fifth Amendment privilege may be used as evidence in Board disciplinary proceedings and will be the basis for evidentiary inferences against the person

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[51] Proposed Rule 5106(a) (specifying the information necessary for a claim of privilege); Proposed Rule 5106(c) (requiring privilege documentation to be filed at the time that the response is due).

[52] Release at A2-33; Notice, 69 Fed. Reg. at 15398.

asserting the privilege."[53] The Board's commentary vitiates the privilege and, as discussed below, is contrary to governing law.

Integral to the Fifth Amendment right against self-incrimination is that no evidentiary inferences may be drawn from the invocation of the privilege. Such evidentiary inferences would amount to a "penalty imposed [by the Board] for exercising a constitutional privilege."[54] For this reason, the Supreme Court has determined in a variety of contexts that an explicit inference by a tribunal from the invocation of the Fifth Amendment privilege constitutes an unconstitutional condition. The Board's commentary threatens to impose penalties on respondents—from the termination of the capacity to serve as an associated person of a registered firm to crippling monetary sanctions—through an evidentiary inference from their invocation of the privilege.[55] The enforcement of the rule against evidentiary inferences is "an essential feature of our legal tradition," and the Board cannot simultaneously purport to follow the Fifth Amendment while permitting such negative inferences.[56]

This issue should be of particular concern for the Commission. Although the Board has taken the position that it is not bound to follow the Constitution or the Administrative Procedure

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[53] Notice, 69 Fed. Reg. at 15398.

[54] *Griffin v. California*, 380 U.S. 609, 614 (1965).

[55] The termination of the right to practice one's profession—such as the termination of the ability to act as an associated person of the registered firm—also is an unconstitutional penalty on the invocation of the Fifth Amendment. The Supreme Court made this principle clear in *Lefkowitz v. Cunningham*, 431 U.S. 801 (1977), where it held unconstitutional the termination of public employment because of the assertion of the privilege against self-incrimination. *Id.* at 805 ("When a State compels testimony by threatening to inflict potential sanctions unless the constitutional privilege is surrendered, that testimony is obtained in violation of the Fifth Amendment.").

[56] *Mitchell v. United States*, 526 U.S. 314, 330 (1999).

Act, the Board's decisions will be enforced by the Commission, which, as a federal agency, is bound by both the Constitution and the Administrative Procedure Act.[57] The Board's failure to comply with the Fifth Amendment may disable the Commission from affirming Board decisions. To preserve the authority of the Commission to review and to approve Board disciplinary actions, it is crucial that the Commission take this opportunity to ensure that the Board's proceedings comport with the most fundamental of constitutional requirements.

F. THE PROPOSED RULE DOES NOT ADEQUATELY MAINTAIN THE CONFIDENTIALITY OF INVESTIGATORY RECORDS

Proposed Rule 5108, governing the confidentiality of investigatory records, is contrary to the Act, and the Commission cannot approve it without substantial revision. Congress struck a delicate balance in Section 105 of the Act by giving the Board the ability to obtain a wide range of information from registered firms and associated persons in exchange for the assurance of confidentiality for that information once it is given to the Board. The proposed rule upsets that balance, by purporting to expand the Board's authority to disclose investigatory information beyond the clear limitations of the Act and by failing to implement the confidentiality protections required by the Act.

1. THE PROPOSED RULE SHOULD NOT PURPORT TO GRANT THE BOARD THE VIRTUALLY UNLIMITED DISCRETION TO DISCLOSE INVESTIGATORY INFORMATION TO PARTIES BEYOND THOSE ENUMERATED IN THE ACT

The Board revised its Proposed Rule 5108 to permit the enforcement staff to disclose any investigatory information, not only to the limited parties specified in the Act, but also "to any other person" when the staff deems the disclosure "reasonably necessary to carry out the Board's

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[57] Release at A-19 n.1.

responsibility."[58] This sweeping assertion of authority eviscerates the confidentiality provisions of the Act. The Act makes clear that investigatory information must remain confidential, except for disclosures to certain specified governmental agencies.[59]

The Board contends that the Act grants the Board and its staff this broad authority to disclose information.[60] But if the Board had such broad underlying authority to disclose investigatory information whenever, in its discretion, such disclosure assisted the investigation, there would have been no need for Congress to authorize the disclosure of such information to the specified agencies.[61] Under the fundamental canon of statutory construction, *expressio unius est exclusio alterius*, the specification of certain parties to whom investigatory information may be released signifies that the information may not be released to parties other than those listed.[62]

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[58] Proposed Rule 5108(b).

[59] Act, § 105(b)(5).

[60] Release at A2-37-38; Notice, 69 Fed. Reg. at 15398.

[61] The Board claims that the broad language of Rule 5108(b) "does not extend outside the sphere of a Board investigation. It is not authority for disclosing information other than to a person from whom the Board demands or requests information in connection with an investigation." Release at A2-38; Notice, 69 Fed. Reg. at 15398. But if that is the limitation on the Board's authority to disclose information, it should appear in the Board's rule. Instead, the rule allows the enforcement staff to release information "to *any person*," with the only limitation that the enforcement staff itself believe the disclosure to be necessary for its investigation. Proposed Rule 5108(b) (emphasis added). The sweeping breadth of the rule's language threatens to disrupt the Act's regime for maintaining the confidentiality of investigatory information.

[62] *See*, *e.g.*, *TRW, Inc. v. Andrews*, 534 U.S. 19, 28 (2001). The operation of this canon of construction is especially strong against Section 105's background guarantee of confidentiality. Courts have been particularly rigorous in holding that a list of specific exceptions to a general rule is exclusive.

This system of limited disclosure is particularly important given the nature of the information that the Board is likely to handle in its investigations. Accountant workpapers, for example, are almost always confidential or protected by privilege under a variety of state laws. The Act may authorize the Board to discover this confidential information, notwithstanding the breach of confidentiality and privilege that the Board's access might effect.[63] But the Act's specification of a limited number of parties who may receive that information from the Board is part of the Act's delicate balance to limit the scope of any breach. Proposed Rule 5108(b)'s purported authorization to disclose confidential accountant information to any party in the enforcement staff's discretion displaces that careful judgment of Congress.

Just as importantly, by permitting the Board to release investigatory information to only a limited set of agencies, Congress was able to ensure that those agencies would keep the released information confidential. Specifically, Congress required that the specified agencies "maintain such information as confidential and privileged."[64] No provision of the Act directly addresses the confidentiality of information disclosed beyond the specific agencies enumerated in the Act. This is not surprising, as the Act did not contemplate such disclosures. Accordingly, the proposed rule's indiscriminate authorization for the enforcement staff to disclose investigatory information in its discretion disrupts the confidentiality protections established by the Act.

At a minimum, the proposed rule's broad authorization of disclosures to any person reinforces the need for the rule to provide that no investigatory information may ever be

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[63] Release at A2-33-34 (stating that the Board will not honor assertions of a state-law accountant-client privilege or any other accountant-based confidentiality protection in response to a Board demand for documents or testimony).

[64] Act § 105(b)(5)(B).

disclosed to any party in the absence of a confidentiality agreement. We proposed precisely such a modification in our comments before the Board, but the Board rejected our proposal.[65] According to the Board, the Act placed sufficient restrictions on the treatment of investigatory information after disclosure to make confidentiality agreements unnecessary.[66] But as noted above, because the Act does not contemplate disclosure to the universe of persons now covered by the proposed rule, the Act does not speak directly to the confidentiality obligations of those persons. Thus, if the final rules allow staff discretion to make further disclosures, a confidentiality agreement, at least, is necessary to fill the gap and to avoid an even more serious undermining of the structure of the Act than the proposed rule already would effect. Without such a revision, neither the Act nor the Board's proposed rules fills this gap. This outcome could not have been what Congress intended by including Section 105 in the Act.

2. THE PROPOSED RULE SHOULD INCLUDE RESTRICTIONS ON THE USE OF INFORMATION BY RECIPIENT PARTIES

The Board rejected our proposal that its rule specify the proper treatment of investigatory information once given to the agencies specified in the Act. Specifically, we suggested that the rule make clear that state freedom of information or open records laws are preempted to the extent that they would require or permit the disclosure of investigatory information given to

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[65] D&T Comment at 16-17.

[66] Notice, 69 Fed. Reg. at 15399.

agencies by the Board.[67] In addition, we proposed that the rules forbid the disclosure of information to any agency except under a confidentiality agreement.[68]

Although we understand that making investigatory records available to certain government agencies is contemplated by the Act,[69] we are concerned that, unless the proposed rules are clarified, such availability may be administered in a manner inconsistent with the Act's provisions protecting the confidentiality of this information.[70] The Board stated that it would not concern its rules with the treatment of investigatory information once in the hands of recipient agencies, on the theory that the matter is the exclusive province of the Act.[71] Yet, elsewhere in the proposed rule, the Board provides its interpretation on other matters that are equally the exclusive province of the Act. The absence of any explanation of the Board's view of the requirements imposed on recipient agencies could imply that, in the Board's view, those restrictions do not exist.[72]

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[67] D&T Comment at 17-18.

[68] D&T Comment at 16-17.

[69] Act, § 105(b)(5)(B). Proposed Rule 5108, in part, tracks the Act by permitting the Board to disclose investigatory records to the Commission, the Attorney General of the United States, an "appropriate Federal functional regulator," state attorneys general, and "any appropriate State regulatory authority."

[70] Act, § 105(b)(5)(B)(ii)(IV) (requiring that "each of [the agencies receiving Board investigatory information] shall maintain such information as confidential and privileged.")

[71] Release at A2-42; Notice, 69 Fed. Reg. at 15399.

[72] The Board's statement regarding the likely preemptive effect of the Act on state public records laws is welcome. *See* Notice, 69 Fed. Reg. at 15398 & n.1. We believe, however, that the Board should explicitly state that recipient agencies may not make further disclosure of the information. Again, the Board takes no steps to articulate the restrictions that the Act places on such agencies or the contours that the preemptive effect would have.

In addition, the Board is mistaken in suggesting that it has no responsibility for the treatment of information that, in its discretion, it discloses to the agencies listed in the Act. Nothing in the Act *requires* the Board to make this information available to those agencies. Moreover, the Board is arguably the only party that has standing to enforce the Act against agencies to which it gives information, if these agencies violate the Act's requirement that information be "maintain[ed] as confidential and privileged."[73] Whether respondents or other parties that give information to the Board would have a private cause of action to enforce the Act's confidentiality provisions against recipient agencies would be a complex legal question at best.[74]

The Board claims that the proposed rule allows the Board "the flexibility to decline to supply certain information to that agency or to require appropriate assurances of confidentiality . . . in the event that [the Board] discover[s] that any particular agency makes disclosures that [the Board] believes are inconsistent with Section 105(b)(5)."[75] The Board should not abide violations of the Act by agencies to which it has entrusted investigatory information. The Board's statement indicates, however, that it may or may not do anything about clear violations of Section 105's confidentiality requirements by those agencies. The statement even contemplates that it may continue to release information to agencies that ignore

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[73] Act, § 105(b)(5)(B).

[74] *See*, *e.g.*, *Cannon v. University of Chicago*, 441 U.S. 677 (1979) (describing the test for determining whether a federal statute provides a private cause of action). Suits against state agencies, by private parties, for violating the Act's confidentiality provisions may also raise complex sovereign immunity questions. *See*, *e.g.*, *Board of Trustees of the Univ. of Alabama v. Garrett*, 531 U.S. 356 (2001) (holding that sovereign immunity blocked a suit under the Americans with Disabilities Act against a state government).

[75] Release at A2-42; Notice, 69 Fed. Reg. 15399.

the Act's confidentiality requirements. The statement also falls short of committing to other measures crucial to the Board's responsibility to keep investigatory information confidential, including seeking injunctions against the violation of the Act when circumstances warrant. Most fundamentally, the Board indicates that it will do nothing to protect the confidentiality of investigatory information prospectively, but at best that it might react only after the information has been disclosed and the damage has been done. The confidentiality provisions of the Act are sufficiently clear that they should not be subject to "flexibility" and "discretion"; and the Board's statements themselves, by suggesting possible responses to violations that would be wholly inconsistent with the Act, indicate that these matters should be addressed explicitly in the Board's rule.

3. THE BOARD SHOULD NOTIFY THE PARTY PROVIDING INFORMATION OF ITS DISCLOSURE TO A THIRD PARTY

The Board rejected our proposal that it notify the investigated firm, or as other parties suggested, the party providing the information, when the Board discloses this information outside the Board.[76] None of the Board's justifications for rejection of these proposals withstands scrutiny.

As an initial matter, the Board summarily contends that there is no "reasonable rationale for providing notice" to an investigated firm or associated person regarding release of information that it did not provide the Board.[77] Section 105(b)(5) of the Act, however, provides that rationale. This section of the Act was designed to protect investigated parties from the

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[76] D&T Comment at 18; *see* Release at A2-42-43 (discussing the proposals of other commenters to notify the parties providing information to the Board).

[77] Release at A2-43.

disclosure of investigatory actions short of formal agency action.[78] Because the Board has disavowed any obligation to monitor the treatment of investigatory information once it has passed it to coordinate agencies,[79] this protection will be secure only if the Board gives the investigated party, at a minimum, an opportunity to protect the information from disclosure through notification.

With regard to notification of the parties supplying the information under an accounting board demand (which, as a practical matter, will often be the investigated registered public accounting firm or associated person), the Board contends that "providing such notice might well undermine the legitimate investigative needs of the agency to whom the documents and information are supplied."[80] Notifications are not warranted, the Board states, because the Board is "loathe to neglect the obvious interests of federal and state regulators and law enforcement agencies in maintaining the confidentiality of aspects of their processes."[81]

Notification of the party providing the information, however, would reveal nothing more than that the agency has received certain information—not what the agency may or may not be investigating, how they may be investigating a matter, or even whether they requested the information from the Board. Thus, the Board's claim that notification of the mere fact of disclosure would lay plain the recipient agency's investigative processes is unsupportable. In addition, an agency can avoid even this revelation by declining the information. In any event,

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[78] S. Rep. 107-205 at 10.

[79] Release at A2-42; Notice, 69 Fed. Reg. at 15399.

[80] Release at A2-43.

[81] Release at A2-43-44.

disclosure to at least the party providing the information is a reasonable condition on such an agency obtaining information through the extraordinary processes of the Board. These agencies—generally subject to standard judicial limitations on their procuring of information—may not be able to obtain (or at least not as easily) the same information on their own, and they may seek to evade these restrictions on their powers by piggybacking on the Board's procedures. Some notice of such an agency's possession of that information is a reasonable protection against such possible abuse of the Board's procedures.

The Board further contends that the Supreme Court rejected the proposition that fairness requires notification of investigated parties in *S.E.C. v. Jerry T. O'Brien, Inc.*[82] In *O'Brien*, the investigated party argued that it had the right to notice of Commission subpoenas to third parties so that the party could contest the subpoenas. The foundation of the plaintiff's argument was that it had a right to be investigated in compliance with the *Coleman* requirements limiting administrative subpoenas and that it needed notice in order to enforce that right.[83] The Court held, however, that the *Coleman* tests were for the protection of the recipient of a subpoena, not the target of the investigation. That holding lies in stark contrast to the clear confidentiality provisions of the Act, which are, at a minimum, for the benefit of the party providing the information. In addition, the target of the investigation in *O'Brien* sought notice of the gathering of information by the Commission, not, as here, its distribution. Finally, to the extent that the Court voiced concern about interfering with the Commission's investigatory process in *O'Brien*, notice to the party providing information before distribution to a wider set of agencies would not

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[82] 467 U.S. 735 (1984); Release at A2-44.

[83] *See* Section I.B. (describing the judicial limitations on the Commission's subpoena power).

reveal any material information. After all, that party already would have been notified that the information is relevant to an investigation, by the Board's demand for that information. The concerns discussed in *O'Brien* regarding Commission subpoenas to third parties cannot support the Board's rejection, in the very different context of its rules, of the notification necessary to protect the confidentiality requirements of the Act.

G. The Proposed Rule Concerning Non-Cooperation Proceedings Should Be Narrowed

1. The Rule Should Specifically Set Forth The Acts Constituting Non-Cooperation With An Investigation

In our comments before the Board, we argued that Proposed Rule 5110 did not provide sufficient notice of those acts that would constitute "non-cooperation" and would subject respondents unfairly to the massive penalties that may arise from non-cooperation proceedings.[84] The Board accepted one of our suggestions, by eliminating language that would render the "omission of material information" punishable non-cooperation.[85]

The Board declined, however, to remove language stating that a respondent may be subject to discipline if he "may otherwise have failed to cooperate in connection with an investigation."[86] Clarity and adequate notice are vitally important for potential non-cooperation charges because of the grave penalties, including the termination of registration and $15 million civil penalties, and the expedited process for imposing those sanctions that the Board seeks to create. This vague catch-all provision makes it impossible for respondent to know which

[84] D&T Comment at 19-21.

[85] Release at A2-50-51; Notice, 69 Fed. Reg. at 15410.

[86] Proposed Rule 5110(a)(4); Release at A2-50; Notice, 69 Fed. Reg. at 15399.

conduct would constitute non-cooperation and is fundamentally inconsistent with the schedule of harsh sanctions established by the proposed rules.

The Board contends that there is no reason for it to set forth each way in which actions may constitute non-cooperation.[87] We believe that the provisions regarding knowingly false testimony and the refusal to comply with properly issued accounting board demands cover the full range of conduct that could reasonably be subject to the proposal's severe penalties for non-cooperation.[88] If the Board believes that there is still *other* punishable conduct and wants the benefit of severe sanctions afforded by the proposed rule, the Board should specify those particular acts that would constitute non-cooperation.

The Board appears to take some comfort in the fact that the words "refuse to testify, produce documents or otherwise cooperate" with an investigation are found in the Act.[89] But this provision is nothing more than an invitation for the Board to specify what acts would constitute non-cooperation through rulemaking.[90] Congress did not intend to provide the Board with authorization for *ad hoc* and *ex post* decisionmaking, where the Board would define acts as

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[87] Release at A2-51.

[88] The Board also mentions the prospect that non-cooperation proceedings may be initiated for "allegedly false" testimony. Notice, 69 Fed. Reg. at 15405. The Commission should make it clear that any non-cooperation proceedings for "allegedly false" testimony would be limited to those actions that satisfy all the elements of Proposed Rule 5110(a)(2), which incorporates the federal perjury statute, 18 U.S.C. § 1623. *See* Release at A2-51; Notice, 69 Fed. Reg. at 15410.

[89] Act, § 105(b)(3)(A); Release at A2-51; Notice, 69 Fed. Reg. at 15399.

[90] *See* Act § 105(a) (requiring the Board "*by rule* . . . to establish fair procedures") (emphasis added).

"non-cooperation" only after they have already occurred, and proceed to punish respondents for those acts.

The Board also states that "it may be appropriate in many circumstances for the staff to provide notice that it views certain conduct as non-cooperation, and to afford an opportunity to cease or cure the conduct before recommending non-cooperation proceedings," suggesting that this potential practice should somehow assuage any notice concerns.[91] Again, the Board leaves the availability of this notice-and-cure process to the unfettered discretion of its staff. Accordingly, this statement provides little protection against the Board imposing severe punishments for acts that were not specifically prohibited by any rule.

2. THE PROPOSED RULE'S ABUSE OF PROCESS PROVISION SHOULD BE REMOVED

The clarity and notice concerns raised by the Board's first Proposed Rule 5110 are only aggravated by the revised rule, which adds "abuse of the Board's processes" as grounds for non-cooperation proceedings.[92] This provision provides no workable standard and, again, introduces the potential for the Board's enforcement staff to retaliate against legal or factual arguments that the staff finds inconvenient or misguided. At a minimum, the availability of unilateral sanctions for conduct that breaches no specific rule of the Board will chill the vigorous testing of the enforcement staff's allegations and threaten the accuracy of the proceedings.

The proposed rule's reference to "abuse of process" may authorize the enforcement staff to initiate non-cooperation proceedings whenever it could be argued that a party had acted to delay the Board's investigation, even if the party's actions were reasonable. The enforcement

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[91] Release at A2-51; Notice, 69 Fed. Reg. at 15399-400.

[92] Proposed Rule 5110(a)(3).

staff is not required to demonstrate that the argument or motion or procedural action that would be the subject of non-cooperation proceedings under this provision was frivolous and had no basis in governing law or fact.[93] In addition, the proposed rule makes no provision for sanctions, either monetary or non-monetary, against the enforcement staff for misrepresentations of fact or the assertion of frivolous legal arguments. This asymmetry increases the risk of a distorted disciplinary proceeding in which respondents alone are chilled from vigorously presenting their arguments to the Board.

Although the proposed rule is limited by an intent requirement, the Board states in its commentary that the requisite intent may be inferred from "circumstantial evidence."[94] Such circumstances include situations in which "a reasonable person would not have believed there was any genuine chance of prevailing on a particular petition for review of staff action or of a hearing officer ruling short of finding a violation."[95] The Board should at least make clear, however, that non-cooperation proceedings will not be initiated simply when the *Board* is unlikely to accept the argument. In order to preserve legal arguments for review by the Commission and, ultimately, judicial review of Board proceedings, respondents generally will have to exhaust their administrative remedies.[96] Because of this standard requirement, respondents must not be punished for advancing arguments that the Board is unlikely to accept,

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[93] *Compare* Fed. R. Civ. P. 11(b).

[94] Release at A2-52; Notice, 69 Fed. Reg. at 15400.

[95] Release at A2-52; Notice, 69 Fed. Reg. at 15400.

[96] *FTC v. Standard Oil Co.*, 449 U.S. 232 (1980); *Gearhart & Otis Inc. v. SEC.*, 348 F.2d 798, 801 (D.C. Cir. 1965) (holding that objections to a disciplinary order could not be raised before the court since they had not been raised properly before the Commission); 15 U.S.C. § 17v(a).

or even arguments that are foreclosed by Board precedent. Instead, the Board should not be allowed to apply this rule to prevent respondents from preserving issues for Commission review or litigation.

3. Expedited Procedures Are Inappropriate For Non-Cooperation Proceedings

The Board also wholly rejected our argument that "expedited proceedings" were inappropriate for non-cooperation allegations and that such expedited proceedings should be eliminated. The Board's proposed rules comprehensively discard procedural protections for the adjudication of non-cooperation charges. Those curtailed procedures include: standards allowing less detailed allegations in the order instituting proceedings;[97] abbreviated deadlines for answering that order;[98] the discretion to eliminate post-hearing briefing in which respondents would ordinarily make their closing argument;[99] a shortened period for filing a petition for Board review;[100] and significantly limited discovery.[101]

We explained to the Board that, without limitation of the grounds for non-cooperation proceedings, such proceedings may require the adjudication of very complex factual and legal issues.[102] In such proceedings, expedited procedures could lead to inaccurate results and could jeopardize the rights of respondents. More ominously, the grounds for non-cooperation

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[97] *See* Proposed Rule 5201(b)(3).

[98] *See* Proposed Rule 5421(b).

[99] *See* Proposed Rule 5445(b).

[100] *See* Proposed Rule 5460(a)(2)(ii).

[101] *See* Proposed Rule 5422(a)(2).

[102] D&T Comment at 22.

proceedings are so broad that the Board could use such proceedings to adjudicate the underlying merits of the primary case at hand. For example, if a designated witness for a firm testified that a firm complied with generally accepted auditing standards in a particular engagement, the Board's enforcement staff could initiate non-cooperation proceedings if it believed that the statement was false. The resolution of those proceedings would directly implicate the subject of the investigation itself and matters that would ordinarily be addressed in primary disciplinary proceedings. Without revision, such expedited proceedings could be used by the Board's enforcement staff to avoid the procedural protections of primary disciplinary proceedings.

The Board's only response to these comments is that the expedited proceedings are meant for "ongoing recalcitrance even in the absence of any significant factual or legal issue" and that the enforcement staff might not use these expedited proceedings to truncate the adjudication of "genuinely complex factual or legal issues."[103] But if the Board believes that expedited proceedings should be limited to a persistent unwillingness to comply with accounting board demands, they should be formally limited to such situations by rule. Indeed, it would be simple to limit such expedited proceedings to allegations under Proposed Rule 5110(a)(1), regarding the failure to comply with an accounting board demand. The Board does not even attempt to justify the use of such procedures for other types of "non-cooperation" proceedings, and their availability, therefore, cannot be sustained. Procedural rights, the implementation of which is left to the discretion of the enforcement staff, provide little protection.[104]

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[103] Release at A2-53; Notice, 69 Fed. Reg. at 15400.

[104] D&T Comment at 7 n.12.

H. ACTIONS TO ENFORCE COMMISSION SUBPOENAS REQUESTED BY THE BOARD SHOULD BE FILED UNDER SEAL

Proposed Rule 5111 authorizes the Board to seek the issuance of a subpoena by the Commission. We asked the Board to provide in Rule 5111 that any judicial action to enforce a Commission subpoena arising out of a Board investigation would be filed under seal. The Board declined to adopt such a provision because it viewed the matter as being one for the Commission, as it would be the Commission that would file an action to enforce any subpoena.[105] The Commission's review of the Board's rules is the appropriate context for the Commission to add such a provision.

We understand that it is not the Commission's practice to file petitions to enforce its subpoenas under seal. Nevertheless, subpoenas arising out of Board investigations are unique for several reasons.

First, the Board's investigations—for both the benefit of the Board and the investigated firms and persons—are protected from public disclosure by a clear and unambiguous *statutory* confidentiality provision. Without the adoption of our proposal, the initiation of judicial proceedings to enforce such a subpoena will be public and may reveal the existence of a Board investigation concerning certain registered public accounting firms or associated persons. Such a public disclosure of this information through filing an action to enforce a subpoena is inconsistent with the Act's stringent requirement that Board investigations remain confidential and privileged.[106]

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[105] Release at A2-55.

[106] *See* Act § 105(b)(5)(A); Proposed Rule 5108.

In this regard, subpoenas arising out of Board investigations are very similar to grand jury subpoenas. Grand jury proceedings, like the Board's investigatory and disciplinary process, are subject to strict confidentiality rules.[107] Because of those rules, courts consistently have permitted the litigation of grand jury subpoenas under seal, recognizing that public litigation over the enforceability or scope of those subpoenas could not be reconciled with the confidential nature of grand jury proceedings.[108] Indeed, reasoning from the restriction of grand jury proceedings, courts have *required* administrative agencies to file investigative subpoenas under seal when the authorizing statute contains confidentiality provisions.[109] The reasoning of these courts in ensuring the confidentiality of grand jury proceedings is fully applicable to the Act's confidentiality restrictions on the Board's proceedings.

Second, because of the availability of accounting board demands, the Board generally will not be required to seek Commission subpoenas against registered public accounting firms and associated persons. The recipients of Commission subpoenas arising out of a Board investigation, therefore, will not be the registered accounting firms and associated persons over whom the Board has regulatory authority. Accordingly, the recipients of such Commission subpoenas will never have the same incentives to maintain the confidentiality of the investigation on which the Commission often relies in the course of initiating enforcement proceedings.

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[107] *See*, *e.g.*, Fed. R. Crim. P. 6(e).

[108] *See*, *e.g.*, *In re Sealed Case*, 676 F.2d 793, 798 (D.C. Cir. 1982).

[109] *See*, *e.g.*, *In re Sealed Case*, 237 F.3d 657, 666-67 (D.C. Cir. 2001) (requiring the FEC to file actions to enforce its investigatory subpoenas under seal due to the confidentiality provisions in its authorizing statute).

We believe that the prospect of public enforcement proceedings to enforce Commission subpoenas for the Board against third parties significantly threatens the Act's protections for the confidentiality of Board proceedings. As the Commission recognized, this is a matter for the Commission's close attention.[110] The Commission should amend the Board's rule to require the filing of such subpoenas under seal.

I. THE BOARD SHOULD BE EXPRESSLY PROHIBITED FROM CONDUCTING INVESTIGATIONS IN AID OF OTHER PROCEEDINGS

Proposed Rule 5112 requires the Board to inform the Commission of a formal investigation and permits the Board to refer an investigation to the Commission and certain other agencies. Because the Board will have unique investigatory powers over registered public accounting firms and associated persons, other agencies may often ask the Board to employ its procedures to gather information for use in the other agencies' proceedings. We explained that procuring information for another agency's proceedings would be an inappropriate and unauthorized use of the Board's special investigatory powers. We suggested to the Board that Proposed Rule 5112 should be amended to make clear that its cooperation with other agencies does not extend to initiating investigations or utilizing its investigatory powers in aid of another agency's parallel proceedings.[111]

The Board rejected our proposal. According to the Board, the proposed amendment was "too nebulous to be meaningful."[112] The meaning of the restriction, however, is clear: the sole

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[110] *See* Notice, 69 Fed. Reg. at 15411 n.7 (specifically requesting comments on the proper procedures for handling requests for Commission subpoenas by the Board).

[111] D&T Comment at 24.

[112] Release at A2-56.

purpose of a Board investigation must be to determine whether the initiation of Board disciplinary proceedings is appropriate. With the Board's extraordinary investigative powers comes an important responsibility to resist becoming a tool for other agencies to procure information that they cannot procure on their own. If the Board were to initiate investigations and to demand documents and testimony for the purpose of doing the bidding of other law enforcement agencies, the Board could effectively be requiring that registered firms and associated persons forfeit the rights they would otherwise enjoy before such other agencies, without a justification tied tightly to the purposes of the specialized oversight and powers of the Board. This vigilance against becoming a "stalking horse" for other agencies is vital to maintain the integrity of the Board.[113]

The Board's suggestion that such a rule will become the basis for "resource-consuming peripheral disputes" is also unsupportable.[114] Ultimately, the Board in most cases will be the authoritative judge of whether an investigation complies with such a rule. Moreover, the Board's system for punishing ill-founded objections to an investigation will restrict any claims that the investigation is motivated by an invalid purpose to those that are the most meritorious.[115]

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[113] In a somewhat similar context, courts have recognized that the pursuit of an investigation by an SRO on behalf of another law enforcement agency may raise concerns about the integrity of the regulatory process, because of the unique investigatory powers of SROs. *See*, *e.g.*, *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162-63 (2d Cir. 2002).

[114] Release at A2-56.

[115] *See* Proposed Rule 5110; *see also* Section I.G.2.

II. DISCIPLINARY PROCEEDINGS

A. THE ABILITY TO CONSOLIDATE DISCIPLINARY PROCEEDINGS SHOULD BE NARROWED

Proposed Rule 5200(d) would permit the Board to consolidate any disciplinary proceedings involving "a common question of law or fact." We requested that the Board narrow this standard, and permit consolidation of disciplinary proceedings only when they involve the same transaction or occurrence.[116] We believe that the "common question of law or fact" standard is excessively broad and, thus, threatens the ability of the Board to guarantee fair and individualized adjudications of the charges against a public accounting firm or an associated person. If the ability to consolidate proceedings is not sufficiently cabined, the individualized facts and other issues attendant to a particular respondent's circumstances may not receive appropriate consideration in multi-respondent hearings, leading to judgments poorly calibrated to a particular respondent's conduct.

For this reason, both the federal civil and criminal joinder rules are substantially narrower, authorizing the consolidation of actions only when the claims arise out of the "same transaction or occurrence."[117] Under the standard used in federal courts, only those actions that share a core bundle of facts concerning the liability-causing event are permitted to be consolidated. In contrast, under the proposed rule, disciplinary proceedings may be consolidated if they share an abstract question of law that requires resolution. Such an approach carries obvious risks of unfairness and threatens the erroneous imposition of the grave penalties authorized by the Act and the Board's proposed rules.

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[116] D&T Comment at 26-27.

[117] Fed. R. Civ. P. 19; Fed. R. Crim. P. 8.

The proposed consolidation standard appears to be drawn from Federal Rule of Civil Procedure 23 governing class actions, but the federal rule differs significantly from the Board's proposed standard. Specifically, the Board's proposed consolidation test is only *one* of the several minimum requirements necessary for maintaining a class action in a civil case.[118] In addition, Federal Rule of Civil Procedure 23 contains additional procedural protections that the proposed rule lacks, including the requirement that such common questions of law or fact "predominate" over individualized questions. Moreover, civil class actions are a poor model for the Board's consolidation rule in disciplinary proceedings. Whereas class actions are primarily designed to provide an efficient method for the adjudication of civil claims that plaintiffs may not otherwise have the incentive to prosecute separately, the Board has a statutory duty to perform its functions, and its disciplinary proceedings entail substantial sanctions for respondents for which the Board is solely responsible. Class actions, unlike Board disciplinary proceedings, are also conducted before a life-tenured Article III judge.

The Board's only response to our suggestion is that the proposed rule would not permit consolidation when a party would be prejudiced.[119] But this case-by-case standard does not protect against the distortive effects of consolidating actions that do not share a core bundle of facts. The prejudice of such combined adjudications may not be apparent at the beginning of proceedings when consolidation determinations are made. Moreover, the concept of "prejudice" is so flexible that consolidation decisions would be unpredictable and uneven.

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[118] Fed R. Civ. P. 23(a)(2).

[119] Release at A2-62.

Before the Board imposes the grave sanctions authorized by the Act, a respondent firm or associated person is entitled to an appropriately individualized hearing on the merits. The Board should adopt the time-tested joinder standard used in federal courts and permit consolidation only if the respondents are accused of participating in the same allegedly impermissible "transaction or occurrence."

B. THE BOARD SHOULD REVISE ITS SETTLEMENT PROCEDURES TO PRESERVE THE IMPARTIALITY OF THE ADJUDICATION PROCESS

We requested that the Board delete Proposed Rule 5205(c)(3)(i), which would permit any employee of the Board, including members of the Division of Enforcement and Investigations prosecuting the respondent, to advise in secret the Board or the hearing officer regarding an offer of settlement.[120] As such, Proposed Rule 5205(c)(3)(i) both requires a waiver of the separation of functions requirement and permits *ex parte* communications between the prosecutorial staff and the Board. This provision is unnecessary and threatens the impartiality of the adjudication process. The Board's rejection of our suggestion cannot be justified.[121]

To be sure, the prosecutorial staff should be able to *advocate* their position on the settlement to the Board or a hearing officer. Any arguments or recommendations the staff might have, however, should be *on the record with an opportunity for the respondent to respond*. Under the proposed waiver rule, the prosecutorial staff may make all sorts of claims about the facts in the case that the respondent will not be permitted to test adversarially. This impact on the fairness of the process extends far beyond the determination of whether the settlement offer should be rejected or accepted. If the offer is rejected, the Division of Enforcement's *ex parte*

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[120] D&T Comment at 31-32.

[121] Release at A2-73.

advice and recommendations to the Board or the hearing officer, including assertions about the facts in the case, could taint the subsequent adjudication. This provision endangers the proposal's attempt to ensure that a respondent has a fair hearing before an impartial judge through adversarially tested arguments.

The Board does not contest that the settlement procedures constitute a gaping hole in the prohibition against *ex parte* communications or that they threaten the impartiality of the adjudication process. Instead, the Board contends merely that it is important that it be able to receive the "confidential recommendations" of its staff.[122] The *ex parte* communications rule, however, preserves the perception of fairness only if it is absolute. After all, any exception would permit the enforcement staff simply to highlight its least supported assertions regarding the case in the settlement process, in order to present those assertions in a context that avoids the normal testing of the adversarial process. In this way, the Board's subsequent adjudication of matters that are not settled would be poisoned by the staff's unrebutted assertions to the Board during the *ex parte* settlement discussions.

A hybrid solution—which would permit *ex parte* communications to occur, but which would have a record made of those communication and would release that record to the respondent if the offer of settlement were rejected by the Board—would allow largely confidential advice on whether to accept an offer of settlement and would protect the integrity of any potential proceedings. Under such a system, the Board could receive the recommendations of its enforcement staff in confidence, and those communications would remain confidential if the process led to final settlement. On the other hand, if the offer were rejected, the respondent

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[122] Release at A2-73.

would have an opportunity to rebut factual or legal assertions made to the Board in the course of settlement consultations during subsequent disciplinary proceedings. The hybrid solution would ensure either that the proceedings were terminated on terms acceptable to all parties through the confidential settlement communications between the staff and the Board, or that disciplinary proceedings following a rejected offer would be transparent and perceived as fair.

The hybrid solution would also address the Board's concern that access to the enforcement staff's settlement advice will create subsidiary litigation about whether the Board should approve a proposed settlement.[123] Simultaneous arguments by respondents to the Board regarding the propriety of settlement would be avoided, as respondents would receive the record of settlement communications only after the settlement had been considered and rejected by the Board and would only be able to address the merits of substantive assertions about the case itself during future primary disciplinary proceedings.

The Board also argues that its proposed rule has the virtue of being the historic practice of agencies governed by the Administrative Procedure Act.[124] It is true that the Board's rule is similar to that of some agencies, including the Commission.[125] These rules have been the subject of significant controversy in federal courts and, as a practical matter, have been refined by judicial construction.[126] The Board's rule ought to reflect that limiting jurisprudence, to the

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[123] *See* Release at A2-73.

[124] *Id.*

[125] *See*, *e.g.*, 17 C.F.R. § 201.240(c)(5).

[126] *See*, *e.g.*, *MCI Telecomm. Corp. v. FCC*, 57 F.3d 1136, 1143 (D.C. Cir. 1995).

extent that it seeks, as it claims at least in this context, to rest its rule on the actual practice of other agencies governed by the Administrative Procedure Act.[127]

III. THE RULES OF BOARD PROCEDURE

A. THE DISCOVERY MEASURES AVAILABLE TO RESPONDENT FIRMS AND ASSOCIATED PERSONS ARE INADEQUATE

The proposed rules provide the Board's prosecutorial staff with a battery of discovery measures for use against respondents. In our comments to the Board, we explained that the proposed rules did not create a remotely even playing field in terms of discovery—and we suggested several ways in which the Board could alter its rules to eliminate the profound asymmetry in discovery powers between the enforcement staff and the respondent.[128] The Board accepted some of our suggestions and has made some progress in developing a fair system of discovery that would permit respondents some reasonable chance to prepare for disciplinary proceedings. For example, the Board has altered its rules to require the enforcement staff to disclose material exculpatory evidence to the respondent, even if that evidence is in a form that otherwise would be excluded from production.[129] In addition, the Board has committed to submitting to the hearing officer and the respondent a partial "privilege log" that would detail some types of withheld documents and the grounds for their withholding.[130]

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[127] Moreover, there is some tension in the Board's general rejection of suggestions that the APA should operate as a floor on the Board's procedural protections, while it simultaneously asserts that the APA serves as a ceiling limiting such protections.

[128] D&T Comment at 34-42.

[129] Proposed Rule 5422(b)(2); Notice, 69 Fed. Reg. at 15411.

[130] Proposed Rule 5422(c).

The Board has failed to correct, however, the most fundamental inequities in the discovery system established by the proposed rules. By beginning to eliminate the asymmetry in the discovery measures available to the Board and respondents, our suggestions would enhance not only the fairness of the proceedings, but also their accuracy. These suggestions reflect some of the procedural protections that are afforded defendants in various proceedings, including civil and criminal proceedings throughout federal and state courts, as well as proceedings before the Commission.

1. THE PROPOSED RULE DENIES RESPONDENTS REMOTELY EQUAL ACCESS TO AFFIRMATIVE DISCOVERY

The Board has not provided sufficient measures for affirmative discovery by respondents. We proposed to the Board that it allow respondents to request the presence of witnesses for depositions in preparation for the disciplinary hearings.[131] As we argued, the availability of pre-hearing witness interviews is crucial to gather the evidence sufficient to test the enforcement staff's allegations. The Board all but ignored this proposal. Instead, the Board asserted: "The Division and the respondent have the same opportunity to seek board demands, board requests, or Commission subpoenas, and the same opportunity to interview prospective witnesses."[132] This statement is simply untrue. Whether or not the Board actually believes this, its discovery rules rest on a false premise and, therefore, must not be approved by the Commission.

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[131] D&T Comment at 40-41.

[132] Release at A2-108.

For respondents, the proposed rule continues to provide no means to interview witnesses or to secure testimony outside of the disciplinary hearing itself.[133] Well before the beginning of proceedings, however, the proposal authorizes the enforcement staff to demand the testimony of registered public accounting firms and associated persons and to seek the issuance of Commission subpoenas for the testimony of others. The enforcement staff is able to use these examinations not only as an investigative tool, but also in preparation for disciplinary hearings. The Board has afforded the target of an investigation no right even to be present at these pre-hearing proceedings, much less to ask questions of the examinees.[134]

While respondents are permitted to request the Board to issue accounting board demands for the testimony of registered public accounting firms or associated persons or to seek the issuance of subpoenas by the Commission for the testimony of others, these measures are for the exclusive purpose of securing the presence of witnesses at the disciplinary hearing itself.[135] Respondents are granted no procedure by which they can require the attendance of fact witnesses at pre-hearing depositions or interviews.[136] At best, the respondent may have an opportunity to interview those witnesses who agree to be interviewed. It cannot reasonably be said, however, that the respondent and the Board's staff have "the same opportunity to interview prospective

[133] Proposed Rule 5425; Notice, 69 Fed. Reg. at 15407.

[134] *See* Proposed Rule 5102(c)(3).

[135] Proposed Rule 5424(a) (permitting respondents to request accounting board demands that "call for the attendance and testimony of a witness *at the designated time and place of the hearing*") (emphasis added); Proposed Rule 5424(b) (allowing respondents to ask the Board to seek the issuance of Commission subpoenas "*in connection with any hearing* ordered by the Board") (emphasis added).

[136] Indeed, the proposal expressly denies to respondents the use of depositions for discovery purposes. Proposed Rule 5425(a), Note.

witnesses" when the Board's staff may *compel* those unwilling witnesses to be interviewed before the hearing, and the respondent has no similar pre-hearing power of compulsion.

The Board has suggested in another context that the lack of affirmative discovery for respondents does not raise fairness issues because "the respondent has access to the evidentiary record compiled by the Division during the investigation."[137] Because of this access to the Board's evidentiary record, the Board argues that the respondent is somehow similarly situated to the Board. The Board, however, would have the opportunity to place in that evidentiary record that information it finds crucial to establish sanctionable conduct. Questions—designed to elicit exculpatory information—that could have been posed by respondents would have created a very different evidentiary record. By limiting the parties to an evidentiary record that is of the enforcement staff's own creation and in service of its interests, the Board has placed the respondent at an undeniable and unfair disadvantage. This imbalance guarantees that the disciplinary charges will be adjudicated on an incomplete set of facts and threatens fundamentally the accuracy of the proceedings.

Even with regard to this limited power to seek the attendance of witnesses *at the hearing itself*, the proposed rule does not provide the "same opportunity to seek board demands, board requests, or Commission subpoenas."[138] The proposal leaves the issuance of demands and requests for subpoenas for respondents to the discretion of the hearing officer. Conversely, the Division of Enforcement and Investigations requires no such hearing officer or Board permission

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[137] Release at A2-107.

[138] Release at A2-108.

to issue accounting board demands.[139] In effect, the proposal creates a discovery system that will not provide for a vigorous adversarial process to test the accuracy of evidence—it would permit the Board significant advance preparation and would leave the respondent to hear witness testimony for the first time at the hearing.

2. The Proposal Excludes Certain Types of Documents From Discovery Without Justification

We asked the Board to modify or to eliminate several provisions that excluded broad categories of documents from production.[140] Pursuant to our comments, the Board made some progress on these proposals by inserting a provision that barred the enforcement staff from withholding any document that contained "material exculpatory evidence."[141] This provision, however, grants only limited protection because, as a practical matter, it leaves the judgment of what evidence is exculpatory to the enforcement staff.[142] It is thus important that the proposal's categories of excluded documents be tailored to legitimate purposes. We continue to believe that the Board has excluded categories of documents from discovery without justification.

First, we asked the Board to narrow a provision permitting the withholding of any document "prepared by a member of the Board or of the Board's staff" that has not been disclosed to anyone other than the Board, its staff, or outside consultants retained by the

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[139] Proposed Rules 5102(a).

[140] D&T Comment at 35-40.

[141] Proposed Rule 5422(b)(2).

[142] *See*, *e.g.*, *United States v. Bagley*, 473 U.S. 667, 696-97 (1985) (explaining the limitations of the *Brady* regime due to the fact that the prosecutor himself is often the only party to make a judgment as to whether information is "exculpatory" and should be disclosed).

Board.[143] In support of our request, we argued that documents prepared by the enforcement staff and given to Board members or a person who ultimately becomes the hearing officer in a disciplinary proceeding should not be withheld from production.[144] As a matter of fairness, a respondent should be able to inspect every document reviewed by a Board official who may ultimately participate in the decision of a respondent's case.

To be sure, the prohibition against *ex parte* communications may prevent some of this activity after disciplinary proceedings are initiated.[145] However, respondents should have an opportunity to evaluate and to contest any assertions about the respondent's conduct that were made before the initiation of disciplinary proceedings. Moreover, the proposed exclusion of "internal documents" would appear to bar the disclosure of even a prohibited *ex parte* written communication, compounding the damage to the fairness of the proceedings.

We understand that the purpose of the provision may have been to enable the Board's Division of Enforcement and Investigations to prepare confidentially for a case, just as a U.S. Attorney's office or a private law firm should be able to prepare private memoranda evaluating the facts and law candidly. This concern, however, is fully addressed by the proposed rule exempting documents covered by the attorney work-product protection from disclosure. Although the attorney work-product protection appears adequate for this purpose, our proposal itself was sensitive to this concern. We asked the Board to revise the rule to protect only those documents prepared by the Division of Enforcement and Investigations and not disclosed outside

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[143] Proposed Rule 5422(b)(1)(i).

[144] D&T Comment at 35-37.

[145] *See* Proposed Rule 5403.

that division other than to persons retained by the division for assistance in the investigation.[146] Such a revision would have made documents disclosed to Board members and other Board staff outside the Division of Enforcement and Investigations appropriately discoverable.

The Board remarkably contends that its proposed rule withholding from a respondent any documents shown to the eventual adjudicators of a disciplinary proceeding was nothing more than an implementation of Section 105(b)(5)(A) of the Act.[147] That provision, however, makes confidential all documents pertaining to an investigation as against the public. This section of the Act clearly does not protect any documents from discovery *by a respondent* in a Board disciplinary proceeding. If the Board's purported interpretation of the Act were correct, then no investigatory documents could be produced to the respondent. The Board cannot rest on the Act as a legitimate basis for withholding documents about the respondent that were distributed to the potential judges of his disciplinary proceedings.

The Board also asserts that the disclosure of such documents is not required by the Administrative Procedure Act and that, therefore, the Board should not be required to disclose such documents.[148] The Board, however, repeatedly has argued that the Administrative Procedure Act is irrelevant to the composition of its rules because it is not bound by the Act. The Board cannot simultaneously argue that its statutory legal status renders the APA inapposite and that the lack of a procedural protection in the APA requires that the Board also not adopt it.

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[146] D&T Comment at 36.

[147] Release at A2-100.

[148] Release at A2-101.

Consequently, the Board cannot reasonably rely on either the Act or the APA to support this unjustified limitation on discovery.[149]

Second, the Commission should clarify Proposed Rule 5422(b)(1)(ii), which allows the enforcement staff to withhold documents on the basis of the attorney-work product doctrine. As a matter of principle, we have no objection to the enforcement staff withholding documents on the basis of the attorney work-product protection. We asked only that the Board make clear that the attorney work-product protection incorporates the full definition specified in Federal Rule of Civil Procedure 26(b)(3).[150] Under our suggestion, the proposed rule would state that a respondent would be able to obtain materials prepared by the Board's Division of Enforcement in preparation for the disciplinary proceedings if the respondent "has a substantial need of the materials in the preparation of [the respondent's] case and . . . is unable without undue hardship to obtain the substantial equivalent of the materials by other means."[151]

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[149] The Board also rejected our proposal for a complete log for all withheld documents to the extent that it would include "internal communications" covered by Proposed Rule 5422(b)(i). According to the Board, the proposed rule is so clear that there could not possibly be disputes over whether a document fell under the exception and, thus, that a privilege log is unnecessary. Release at A2-100. The Board's contention, however, turns entirely on how aggressively the enforcement staff seeks to apply the privilege. If the Board were correct that the classes of documents that "clearly" should not be produced are not appropriate for privilege logs, the respondent also should be permitted to exclude obviously privileged materials, such as letters between respondent and counsel, from their privilege logs.

[150] D&T Comment at 36 n.65.

[151] Fed. R. Civ. P. 26(b)(3).

The Board ignored our proposal.[152] Instead, the Board added further problematic language to its commentary that should be removed. Specifically, the Board claimed that Proposed Rule 5422(b)(1)(ii) would prevent the disclosure of documents covered by the attorney-work product protection of a third party. According to the Release, the Board could, therefore, withhold "documents that were privileged in the hands of the person who supplied them to the Board, but who supplied them pursuant to an understanding that doing so would not otherwise waive the privilege."[153] The assertion of privilege here may not be defensible due to several judicial decisions holding that the privilege is waived when documents are produced to a third party—in this case, the Board.[154] In any event, the production of the documents to respondents—under circumstances where the documents, just as all investigatory information, would be privileged and confidential—would not *further* jeopardize the privilege and, thus, the privilege of a third party cannot reasonably be grounds for withholding documents.[155] Without revision, the implication of the Board's commentary is that its enforcement staff could even introduce as evidence in disciplinary proceedings documents protected by a third-party's privilege, while withholding other documents on the basis of that very privilege. Such a prospect cannot be squared with the statutory requirement of conducting fair proceedings.

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[152] Again, standard principles of administrative law make clear that the failure to respond to a comment can itself invalidate a rule. *See*, *e.g.*, *Motor Vehicles Mfg. Ass'n v. State Farm Mut. Ins. Co.*, 463 U.S. 29 (1983).

[153] Release at A2-101; Notice, 69 Fed. Reg. at 15406.

[154] *See*, *e.g.*, *In re Columbia / HCA Healthcare Corp. Billing Practice Litig.*, 293 F.3d 289 (6th Cir. 2002) (holding that confidentiality agreements with government agencies, much less purported private parties, are not sufficient to prevent a waiver of the privilege).

[155] *See* Act § 105(b)(5).

Third, the Board declined our request to clarify that what is now Proposed Rule 5422(b)(1)(iii) provides no broader a protection than the common law confidential informant privilege.[156] At common law, the government's privilege against revealing a confidential source is "by no means absolute," and does not extend to an informant "who was a participant, an eyewitness, or a person who was otherwise in a position to give direct testimony concerning" the allegedly illegal conduct and whose testimony, therefore, may assist in the respondent's defense.[157] If this proposed rule were interpreted to protect from discovery any document concerning an informant "who would prefer to remain anonymous," the rule would unjustifiably expand the traditional privilege and would aggravate the respondent's distinct informational disadvantage in the Board's disciplinary proceedings.[158]

B. RESOLVING DISCIPLINARY PROCEEDINGS AGAINST RESPONDENTS ON MOTIONS FOR SUMMARY DISPOSITION IS INAPPROPRIATE

Contrary to our arguments, the Board retained Proposed Rule 5427, which would permit the Board's enforcement division to seek summary judgment, without an evidentiary hearing, in

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[156] Release at A2-102; D&T Comment at 38.

[157] *United States v. Warren*, 42 F.3d 647, 654 (D.C. Cir. 1994).

[158] The unfairness created by these overbroad exclusions from discovery is reflected in Proposed Rule 5422(g). That proposed rule requires that the respondent prove that an actual violation of even these minimal discovery protections was not harmless error before any relief is granted. *See also* Notice, 69 Fed. Reg. at 15406. This rule turns the traditional harmless error analysis on its head. Generally, the *government*, not the defendant, is required to prove that its violations of constitutional, statutory, or procedural rights were not harmless in order to avoid a reversal of a conviction. *See*, *e.g.*, *Chapman v. California*, 386 U.S. 18 (1967). Requiring the aggrieved party to prove that the Board's violation of its own rules was not harmless in order to obtain any relief cannot be squared with this fundamental principle of our legal system.

a disciplinary proceeding.[159] Such a procedure, similar to Fed. R. Civ. P. 56 proceedings, is categorically inappropriate in this quasi-criminal context. Moreover, because a respondent firm or associated person is limited in the extent to which it can seek discovery before a *hearing*, the abolition of a hearing in summary judgment proceedings will unfairly handicap respondents' ability to set forth evidence establishing a genuine issue of material fact.

The Board claims that the disparity in discovery measures does not counsel against summary proceedings because "[b]y the time of any summary disposition motion, . . . a respondent would have access to the full evidentiary record available to the Division."[160] The Board's Division of Enforcement and Investigations, however, would have no incentive to obtain facts contrary to its theory of the case that would establish a genuine issue of material fact. Because (as described above) respondents are disabled from compelling the testimony of witnesses until the *hearing*, summary disposition deprives respondents of their only opportunity to test the assertions of the enforcement staff's witnesses. In this crucial respect, the Board's rules for discovery differ from civil discovery and make disposition against a respondent without a hearing fundamentally unfair.

CONCLUSION

The Commission should not approve the Board's rules as currently drafted. The defects in the proposed rules identified above—from the insulation of enforcement staff demands from any review to the potential summary resolution of disciplinary proceedings against respondents with no opportunity for them to develop a defense—would render the Board's investigations and

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[159] D&T Comment at 42; Release at A2-111; Notice, 69 Fed. Reg. at 15407.

[160] Release at A2-111.

disciplinary proceedings inaccurate and unfair. The Commission would not be able to review the product of the Board's disciplinary proceedings in a manner consistent with the Act, the Administrative Procedure Act, and the Constitution unless the proposed rules are substantially revised. The Commission either should modify the proposed rules to ensure the fairness of Board's investigations and disciplinary proceedings, or remand the proposed rules to the Board with specific instructions for it to do so.

We would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579 or Philip R. Rotner at (212) 492-4012.

Very truly yours,

/s/ Deloitte & Touche LLP

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