UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 755 / March 5, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15127

In the Matter of	:	
	:	ORDER ON MOTION FOR
J. KENNETH ALDERMAN, CPA,	:	PROTECTIVE ORDER
ET AL.	:	

BACKGROUND

The Securities and Exchange Commission (Commission) issued its Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on December 10, 2012, pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940. The hearing is scheduled to commence on April 2, 2013.

Pending before me is the Division of Enforcement's (Division) Brief in Support of Its Motion for Protective Order Sealing the Independent Directors' Supplemental Response in Opposition to the Division's Motion to Strike (Motion) with four exhibits attached thereto (Div. Exs. A-D),[1] filed on February 11, 2013. Respondents J. Kenneth Alderman and Allen B. Morgan, Jr. (collectively, the Interested Directors) filed their Brief in Opposition to the Division's Motion (Brief) with one exhibit attached thereto,[2] on February 19, 2013. That same day, Respondents Jack R. Blair, Albert C. Johnson, James Stillman R. McFadden, W. Randall Pittman, Mary S. Stone, and Archie W. Willis III (collectively, the Independent Directors) filed their Memorandum in Opposition to the Division's Motion (Memorandum). On February 25,

[1] Div. Ex. A identifies the documents inadvertently produced by the Division and includes the eleven emails the Division asserts are privileged; Div. Ex. B is the February 8, 2013, Declaration of William P. Hicks, Associate Regional Director of the Division, including four exhibits attached thereto (Hicks Exs. 1-4); Div. Ex. C is the February 8, 2013, Declaration of Wanda Gray, Information Technology Specialist in the Atlanta Regional Office, including three exhibits attached thereto; Div. Ex. D is a January 23, 2013, letter from Kristen B. Wilhelm, Senior Trial Counsel for the Commission, to Respondents' counsel.

[2] Resp. Ex. A is a series of emails between the Division and Respondents' counsel dated January 23, 24, and 25, 2013.

2013, the Division filed a reply brief (Reply) with four exhibits attached (Reply Exs. A-D).[3] Each of these filings was made under seal.

The Division seeks a protective order and other relief as to eleven emails they assert were inadvertently produced to the Interested Directors and Independent Directors (collectively, Respondents). Motion, pp. 1, 15. Specifically, the Division requests that I find that the eleven emails, identified in Div. Ex. A, are privileged, that the Division did not waive any privilege by their inadvertent production, that the emails are inadmissible, and that I order Respondents to return or destroy all copies of the emails. Id. Respondents assert that any privilege associated with these eleven emails has been waived and state that they intend to use the emails in litigation of this proceeding. Brief, pp. 1, 8, 10-17; Memorandum, pp. 4-5. For the reasons set forth below, I GRANT the Division's Motion.

DISCUSSION

A. Procedural Issues

Federal Rule of Civil Procedure (FRCP) 26(b)(5)(B) provides the soundest practice where a claim of inadvertent production of privileged material is made. The party making a claim of privilege may notify the recipient of the claim and the basis for it. Fed. R. Civ. P. 26(b)(5)(B). After being notified, the recipient "must promptly return, sequester, or destroy the specified information and any copies it has; must not use or disclose the information until the claim is resolved; must take reasonable steps to retrieve the information if the party disclosed it before being notified; and may promptly present the information to the court under seal for a determination of the claim." Id. Although FRCP 26(b)(5)(B) does not apply in this proceeding, the procedure it outlines is eminently sensible and calculated to mitigate any harm resulting from inadvertent production.

The procedure outlined in FRCP 26(b)(5)(B) was not followed in this case. Counsel for the Independent Directors notified Division counsel on January 18, 2013, that the Division appeared to have produced privileged emails. Div. Ex. B, p. 3; Hicks Ex. 2. The Division requested identification of the possibly privileged emails and counsel for the Independent Directors declined to do so. Div. Ex. B, p. 3. On January 23, 2013, Division counsel notified Respondents' counsel that the Division "asserts privilege to internal emails among the staff, as well as any draft or final action memos." Id., p. 4; Hicks Ex. 3.

Under FRCP 26(b)(5)(B), the Division's claim of privilege would have obligated Respondents to at least sequester their copies of internal emails between staff, and would have

[3] Reply Ex. A is the Protective Order in Morgan Asset Management, Inc., Administrative Proceedings Rulings Release No. 665 (Feb. 10, 2011); Reply Ex. B is the February 5, 2013, Declaration of Paula Drake, Associate Director and Chief Counsel of the Commission's Office of Compliance Inspections and Examinations; Reply Ex. C is the November 10, 2006, minutes from the joint meeting of the boards of directors of RMK Advantage Income Fund, Inc., RMK High Income Fund, Inc., RMK Multi-Sector High Income Fund, Inc., and RMK Strategic Income Fund, Inc.; Reply Ex. D is an August 14, 2006, email from Michele Fowler Wood, Chief Compliance Office of Morgan Asset Management, regarding the Commission subpoenas.

barred any use or disclosure of them by Respondents pending resolution of the issue by the court. However, the Independent Directors did not do this. Instead, on January 30, 2013, the Independent Directors disclosed one of the emails as an attachment to a "Supplemental Response" to the Division's Motion to Strike, a document not contemplated by the Commission's Rules of Practice, and which the Independent Directors did not file under seal. Although the Independent Directors thereafter agreed, on February 1, 2013, to return two emails that contained attached action memos, the Independent Directors' only effort to bring this matter to my attention was a footnote included in their Supplemental Response. Div. Ex. B, p. 5.

It is laudable that the Independent Directors notified the Division of a possible inadvertent production and agreed to return two obviously privileged emails; it is most definitely not laudable that they otherwise declined to specifically identify the suspect materials and eventually disclosed one of them in a publicly available filing. I am at a loss to understand why the Independent Directors have been so cavalier about the sensitivity of the materials at issue, particularly because they are almost entirely irrelevant in this proceeding.

B. Relevance

I have reviewed the emails at issue and determined that they fall into four categories: (1) emails between Commission staff forwarding information of potential use in the investigation leading to the present OIP (Div. Ex. A, Emails 1-4, 6-7); (2) emails between Commission staff that evidence deliberations over whether to file the present OIP (Div. Ex. A, Emails 8-10); (3) an email between Commission staff about a possible separate administrative proceeding against an entirely different respondent (Div. Ex. A, Email 11); and (4) an email forwarding a complaint from the Commission's Tips, Complaints, and Referrals (TCR) system (Div. Ex. A, Email 5). Four of these emails contain printed attachments (Emails 1, 2, 5, and 11).

With the exception of references to two boxes of materials in Emails 2-4 and 6-8, all eleven emails at issue are irrelevant.[4] Emails 1-7 deal almost entirely with the exchange of information between Commission staff, and are in and of themselves of no probative value. Div. Ex. B, Emails 1-7. Email 11, which pertains to a different investigation of a different respondent, and deals with activities that post-date the relevant period alleged in the present OIP, is obviously of no probative value whatsoever. Id., Email 11.

Emails 8-10, which Respondents rely on heavily, are in fact irrelevant. These emails are exchanges between two senior Commission staff, with carbon copies of the emails sent to various other staff members, including the Director of the Division. Id., Emails 8-10. They document a portion of the deliberative process leading up to the filing of the present OIP, including an opinion on the merits of the case and a discussion of certain evidence that at least one person thought was pertinent to evaluating those merits. Id.

The opinions of the various staff members involved in deciding whether to bring this proceeding are of no concern to me. In fact, it would be illegal for me to consider such opinions. Commission Rule of Practice 121 states:

[4] The Division represents that the reference to the two boxes of materials recurs in Email 8, although that cannot be determined solely from the contents of Email 8. Reply, pp. 13-14.

> Any Commission officer, employee or agent engaged in the performance of investigative or prosecutorial functions for the Commission in a proceeding as defined in Rule 101(a) [of the Commission's Rules of Practice] may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Commission review of the decision pursuant to Section 557 of the Administrative Procedure Act, 5 U.S.C. 557, except as a witness or counsel in the proceeding.

17 C.F.R. § 201.121. I construe this provision broadly; it is a violation of Rule 121 of the Commission's Rules of Practice for me to admit into evidence or to consider the opinion of any person cited in Emails 8-10 regarding the merits of the case. The same is true as to the opinion of any such person regarding what evidence is relevant.

C. Privilege

Because they are irrelevant, the emails at issue will not be used in litigation, and Respondents have no legitimate interest in using or even keeping them. The Division argues that they should be destroyed or returned because they are privileged. I agree.

Category 1, emails between Commission staff forwarding information of potential use in the investigation leading to the present OIP, includes material that is subject to the work-product doctrine. Div. Ex. A, Emails 1-4, 6-7. The work-product doctrine protects against disclosure of documents prepared in anticipation of litigation or for trial by a party. Fed. R. Civ. P. 26(b)(3). Such documents include "written statements, private memoranda and personal recollections prepared or formed by an adverse party's counsel in the course of his legal duties." Hickman v. Taylor 329 U.S. 495, 510 (1947). Under Commission Rule of Practice 230(b)(1)(ii), such documents also include "an internal memorandum, note or writing prepared by a Commission employee . . . [that] will not be offered in evidence." 17 C.F.R. § 201.230(b)(1)(ii).

Emails 1-4, 6, and 7 all clearly fall into the category of work product; they are internal writings prepared by Division counsel in the course of counsel's legal duties. Further, the printed attachments to Emails 1 and 2 are either entirely irrelevant or are also covered by the work-product doctrine, with one exception – the reference to two boxes of materials in the attachment to Email 2 and recurring in Emails 3, 4, 6, 7, and according to the Division Email 8. Reply, pp. 13-14. The Division has agreed to make these materials available to Respondents, and I need not address their privileged status. Id.

Category 2, emails evidencing deliberations over whether to file the present OIP, is a paradigmatic example of materials subject to the deliberative-process privilege. Div. Ex. A, Emails 8-10. The deliberative-process privilege protects "'documents reflecting advisory opinions, recommendations and deliberations comprising part of a process by which governmental decisions and policies are formulated."' Dep't of the Interior v. Klamath Water Users Protective Ass'n, 532 U.S. 1, 8 (2001) (quoting NLRB v. Sears, Roebuck & Co., 421 U.S. 132, 150 (1975)); see Morgan Asset Mgmt., Inc., Administrative Proceedings Rulings Release No. 669 (Mar. 7, 2011), 100 SEC Docket 39030, 39032 (recognizing deliberative-process

privilege in Commission administrative proceedings). Emails 8-10 unquestionably fall within the scope of the privilege; they are transparently documents memorializing deliberations over whether to file the present proceeding.

Category 3, an email between Commission staff about a possible separate administrative proceeding against an entirely different respondent, is similarly subject to the deliberative-process privilege. Div. Ex. A, Email 11. Indeed, Email 11 and its attachments are so obviously sensitive – and irrelevant, as explained above – that I cannot understand why Respondents did not return this email immediately upon discovering it.

Category 4, an email forwarding a complaint from the TCR system, is clearly subject to the law-enforcement privilege. Div. Ex. A, Email 5. The law-enforcement privilege is intended to protect "law enforcement techniques, procedures and sources, to protect witnesses and others involved in an investigation and to prevent interference with an investigation," which includes Commission investigations. Hunter v. Heffernan, No. 94-5340, 1996 WL 363842, *2 (E.D. Pa. June 28, 1996) (citing Dept. of Investigation of City of New York, 856 F.2d 481, 484 (2d Cir. 1988)). Although I have found no Commission administrative cases recognizing the law-enforcement privilege, it is well established in civil proceedings, and has been recognized by at least one other administrative agency. Id. (collecting cases); Landry v. FDIC, 204 F.3d 1125, 1135 (D.C. Cir. 2000).[5] Email 5 and its attachment are essentially a "tip," and fall within this privilege.

Based on the foregoing, I conclude that all eleven of the emails at issue are privileged, or subject to the work-product doctrine. Although they reserved the right to do so, Respondents do not actually argue otherwise in their Oppositions. Memorandum, p. 2 n.1.

D. Remedy

The Division will be greatly prejudiced if the emails are not returned or destroyed. By contrast, because the emails are irrelevant, Respondents have no legitimate basis for keeping them. Respondents thus will not be prejudiced by their return or destruction. Because there is no reason to consider or admit the emails as evidence, there is no reason to address the question of waiver, and Respondents' extensive arguments on that issue are beside the point.

Privilege "protects against both disclosure and use." U.S. ex. rel. Bagley v. TRW, Inc., 204 F.R.D. 170, 184 (C.D. Cal. 2001). "Although the harm that [the producing party] has suffered due to its inadvertent production of privileged documents cannot entirely be undone, that is not necessarily a reason why the court should refrain from doing what it can." Id. (citing

[5] Landry stands for the proposition that invocation of the law-enforcement privilege requires a formal claim of privilege by a sufficiently high-ranking official, based on personal consideration by that official, and a detailed specification of the allegedly privileged information, with an explanation for why the privilege applies. 204 F.3d at 1135. Because no Respondent raises this issue, I need not formally reach it, but the Landry standard appears to have been satisfied here in any event. Div. Ex. B, p. 6.

Telephonics Corp. v. U.S., 32 Fed. Cl. 360, 362 (1994)). The appropriate remedy here is to order the emails returned or destroyed.

ORDER

The Division's Motion is GRANTED and it is ORDERED that all copies of the eleven emails at issue, in whatever form, be returned to the Division or destroyed; and

IT IS FURTHER ORDERED that all documents which refer to the contents of the eleven emails will be treated as confidential, including all filings in this proceeding designated by any party as "FILED UNDER SEAL" and the Independent Directors' Supplemental Response in Opposition to the Division's Motion to Strike Defenses, filed on February 5, 2013.

SO ORDERED.

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Cameron Elliot
Administrative Law Judge