

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 754 / February 28, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15127

In the Matter of	:	ORDER ON MOTIONS TO QUASH
	:	SUBPOENA REQUESTS AND ON
J. KENNETH ALDERMAN, CPA,	:	CROSS MOTIONS TO COMPEL
ET AL.	:	

BACKGROUND

The Securities and Exchange Commission (Commission) issued its Order Instituting Administrative and Cease-and-Desist Proceedings 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.

PROCEDURAL HISTORY

On January 29, 2013, this Office received three Requests of Independent Directors for Issuance of Subpoena (Subpoena Requests) from Respondents Jack R. Blair, Albert C. Johnson, James Stillman R. McFadden, W. Randall Pittman, Mary S. Stone, and Archie W. Willis III (collectively, Independent Directors). The Subpoena Requests are directed to the Commission's Division of Investment Management (IM), Norm Champ, Director; the Commission's Atlanta Regional Office (ARO), Rhea Kemble Dignam, Regional Director; and the Commission's Office of Compliance Inspections and Examinations (OCIE), Carlo V. di Florio, Director. That same day, I ordered motions to quash and/or modify the Subpoena Requests to be filed by February 5, 2013, and oppositions to be filed by February 11, 2013.

MOTIONS TO QUASH SUBPOENA REQUESTS

Pending before me is (1) the Division of Enforcement's (Division) Motion to Quash the Subpoena Requested by the Independent Director Respondents for Issuance to the Commission's ARO (Division Motion); and (2) a Consolidated Motion to Quash Subpoenas Requested by Certain Respondents to be Issued to IM, OCIE, and ARO (Consolidated Motion) and Memorandum of Law in Support of Consolidated Motion (Memorandum), with two Exhibits

(Exs. A-B) attached,¹ filed by IM, OCIE and OCIE’s examination program in ARO (collectively, Movants), through the Office of the General Counsel. The Division joins and explicitly adopts the reasoning set forth in the Memorandum. The Independent Directors filed an Opposition to Consolidated Motion (Opposition), and Respondents J. Kenneth Alderman and Allen B. Morgan, Jr. (collectively, Inside Directors), filed an Opposition to Motions to Quash Subpoenas, incorporating by reference those arguments set forth in the Independent Directors’ Opposition.²

Characterized broadly, the Subpoena Requests seek two categories of information: (1) documents related to examinations or evaluations of the Funds³ valuation process (Requests 1 – 6) and (2) documents related to the Commission or staff guidance concerning valuation (IM Request 5, Request 7).⁴

In general, the Movants and the Division seek to quash the Subpoena Requests because (1) they are vague, overbroad, and unduly burdensome; and (2) they unreasonably seek documents protected by the attorney work-product doctrine, government deliberative-process privilege, the law enforcement/investigatory files privilege, and/or Commission Rule 230(b)(1). Consolidated Motion, p. 2; Division Motion, p. 2.

The Independent and Inside Directors contend that the Subpoena Requests should be issued and that the Division’s Motion and the Consolidated Motion should be denied because (1) the information sought in the Subpoena Requests is “unquestionably relevant to the issues raised” in this case; (2) “the burden to comply [with the Subpoena Requests] is insubstantial;” and (3) no application of any privilege has been established. Opposition, pp. 2, 5-21.

A party may request the issuance of subpoenas requiring the production of documentary or other tangible evidence. 17 C.F.R. § 201.232. However, a subpoena may be quashed “[i]f

¹ Ex. A is a Declaration of Douglas J. Scheidt, Associate Director and Chief Counsel of IM and Ex. B is a Declaration of Paula Drake, Associate Director and Chief Counsel of OCIE.

² The Division filed a Reply in Support of Its Motion dated February 15, 2013, and the Movants filed a Reply in Support of Consolidated Motion dated February 19, 2013. The Independent Directors filed a Response on Motions to Quash dated February 20, 2013. Because reply and response briefs are neither contemplated by the procedures set forth in Rule 232(e), nor provided for in my January 29, 2013, Order setting forth a briefing schedule, I have not considered them in reaching a conclusion.

³ The ‘Funds’ refers to RMK High Income Fund, Inc., RMK Multi-Sector High Income Fund, Inc., RMK Strategic Income Fund, Inc., RMK Advantage Income Fund, Inc., and Morgan Keegan Select Fund, Inc. Subpoena Requests, Definitions and Instructions.

⁴ For ease of reference, this Order adopts the numbering of requests used in the Independent Directors’ Opposition (i.e., the numbering is based on the OCIE subpoena (Request 1-7) and includes a unique request from the IM subpoena (IM Request 5)). Memorandum, pp. 14, n.5, 16, n.7, 17, n.8 ; Opposition, p. 1, n.1. Request 5, Request 6, and Request 7 refer to production request numbers 5, 6, and 7 in the subpoenas to OCIE and ARO and to the identical production requests, numbers 6, 7, and 8, respectively, in the subpoena to IM.

compliance with the subpoena would be unreasonable, oppressive or unduly burdensome.” 17 C.F.R. § 201.232(e)(2). For the reasons set forth below, the Division’s Motion and the Movants’ Consolidated Motion will be granted and the Subpoena Requests will be quashed in their entirety.

A. Requests for documents relating to examinations or evaluations of the Funds’ valuation process, including documents related to the examination procedure. (Requests 1 – 6)

The Independent Directors assert, generally, that Requests 1-6 are relevant to the standards to be applied in this case, their good faith and lack of negligence, and their fair notice defense; are not unduly burdensome; and/or that the deliberative-process privilege may not cover all materials requested and may be overcome in favor of disclosure. Opposition, pp. 5-10, 16-19.

1. Request 1 & Request 5 (Request 6 to IM)

Request 1 seeks “[a]ll documents concerning the adequacy, implementation, or effectiveness of the Funds’ valuation of securities, including but not limited to the Funds’ Valuation Procedures, during the period January 2003 through December 2007.” Request 5 (Request 6 to IM) seeks “[a]ll documents concerning valuation-related issues raised by the [Movants] or any other office or division within the Commission in 2003 through 2007 with respect to the Funds.”

With respect to Request 1, the Movants state that the Division has produced substantially all non-privileged documents relating to valuation and therefore a subpoena is not necessary. Consolidated Motion, pp. 8-9; Ex. A, pp. 1-2. They also state that the non-privileged documents that have not been produced are “correspondence with and documents from third parties that are not affiliated with the Funds” and that these documents “were not produced previously because in the prior action in which these documents were at issue they . . . raised significant issues about disclosure of proprietary information.” Consolidated Motion, pp. 8-9. According to Movants, OCIE staff is reviewing the third-party correspondence “to determine whether it contains any proprietary information that can be disclosed only pursuant to a protective order” and that OCIE may need to notify the parties that provided the documents to allow them the opportunity to object to any production. Id.

Movants also state that documents not disclosed relating to the examinations of the Funds are privileged, as determined in the prior action by the Administrative Law Judge (ALJ) following an in camera review. See Morgan Asset Mgmt., Inc., Administrative Proceedings Rulings Release No. 669 (Mar. 17, 2011). On the other hand, the Independent Directors argue that the deliberative-process privilege is narrow, not all-encompassing as suggested by Movants; that communications must be “pre-decisional” and “deliberate” to be protected; that it is qualified and may be overcome where certain factors weigh in favor of disclosure; and that the Movants’ reliance on Morgan Asset Management is misplaced because the parties and the procedural and factual circumstances differ in that proceeding.

With respect to Request 5 (Request 6 to IM), the Movants argue that this request should be quashed because it is duplicative of Request 1 and distinguishing between issues raised by

others and issues raised within the Commission has no bearing on whether the Independent Directors complied with the law. Consolidated Motion, p. 14.

Both Request 1 and Request 5 (Request 6 to IM) are quashed because they are unreasonable. Request 5 (Request 6 to IM) does appear to be duplicated by the production requests set forth in Request 1. Movants state that OCIE staff is conducting a review of the non-privileged third-party communications to determine if any can be disclosed under a protective order after providing notification of, and opportunity for objections by, the parties that provided the documents. With respect to disclosure of documents from the examination of the Funds, the same documents at issue in this proceeding were previously viewed *in camera* by an ALJ and determined to be protected by the deliberative-process privilege; I see no need to revisit that determination.

2. Request 2 & Request 3

Request 2 seeks “[a]ll documents concerning issues giving rise to any examination of the Funds conducted by Commission staff from January 2007 through October 2007.” Request 3 seeks “[a]ll documents concerning the examination of the Funds conducted by Commission staff from 2003 through October 2007.”

The Movants argue that Request 3 should be quashed because (1) it is overbroad; (2) the relevant documents have already been produced or properly withheld as protected by the deliberative-process privilege, work-product doctrine, or law-enforcement privilege; and (3) the burden of retrieving and reviewing any additional responsive documents outweighs their limited relevance. Consolidated Motion, pp. 10-13; Ex. A, pp. 1-2. The Movants argue that Request 2 should be quashed because it is duplicative of Request 3, and making the arbitrary determination of which documents are responsive could reveal deliberations about the direction of the examination, which are protected by the deliberative-process privilege. Consolidated Motion, pp. 9-10. The Independent Directors argue that identifying responsive materials would not require an arbitrary search, and the request is not duplicative because some documents could concern information that would have led to an examination but would not have been interpreted by Movants as “concerning” the examination. Opposition, p. 1 n.2.

Both Request 2 and Request 3 are quashed as unreasonable. Although not raised by Movants or the Division, it is implicit in Rule 230 of the Commission’s Rules of Practice that any final examination or inspection reports must be made available if they will be used as evidence or to refresh witness recollection; however, any other documents relating to the examinations, including draft reports, need not be disclosed and are likely privileged. See 17 C.F.R. § 201.230. Additionally, I find that Request 2 is wholly duplicative of Request 3. It is reasonable to conclude that the production sought by Request 2 encompasses that sought in Request 3.

3. Request 4

Request 4 seeks “[a]ny manuals, procedures, and policies or other documents prepared by” the Movants, the Commission, or any of its employees or staff “concerning examination

procedures or policies to be used by Commission staff in 2003 through 2007.” The Movants argue that this request should be quashed because examination policies and procedures are not relevant to this matter and are protected by the law-enforcement and deliberative-process privileges. Consolidated Motion, pp. 13-14.

Request 4 is quashed because the information sought is unreasonable and irrelevant to this proceeding. While these documents may be relevant for determining the manner in which Commission staff carry out a Commission examination, it is unclear how, if at all, this information is relevant to any claim or defense in this proceeding.

4. Request 6 (Request 7 to IM)

Request 6 (Request 7 to IM) seeks “[a]ll documents concerning steps taken or contemplated to be taken to apprise the Funds’ Board of Directors of valuation-related issues arising in 2003 through 2007.” The Movants argue that this request should be quashed because (1) the Division has already produced non-privileged documents apprising Respondents of the valuation-related issues; (2) the request does not seek relevant documents; and (3) any documents related to internal Commission deliberation that contemplated notifying Respondents about valuation-related issues are protected by the deliberative-process privilege. Consolidated Motion, pp. 15-17.

Request 6 (Request 7 to IM) is quashed because it is unreasonable and irrelevant to this proceeding. The Division has produced non-privileged documents apprising Respondents of the valuation-related issues alleged in this proceeding. Also, in a February 1, 2013, Order Striking Certain Affirmative Defenses of Respondents, I struck the defense of estoppel. Accordingly, I find that an examination of the manner in which the Commission sought to apprise Respondents of valuation-related issues is not relevant to any claim or a relevant defense in this proceeding.

B. Requests for documents related to Commission or staff guidance concerning valuation (IM Request 5 and Request 7)

The Independent Directors assert that evidence related to the valuation guidance available at the time at issue, including draft or proposed guidance prepared by Commission staff and any materials reflecting the prevailing industry standards, is relevant to what the Commission knew, what the Independent Directors should have known, and the fairness of the standards to be applied in this proceeding. Opposition, p. 8. They argue that the documents requested are relevant to the objective component of the directors’ state of mind, and any evidence regarding the lack of publicly-available guidance is relevant to the Independent Directors’ fair notice defense. *Id.*, pp. 8-9.

1. IM Request 5

IM Request 5 seeks “[a]ll documents concerning Guidance related to valuation or pricing of securities held by investment companies.” Respondents define the guidance they seek as “the draft or final version.” Consolidated Motion, p. 15. The Movants argue that this request should be quashed because the Commission’s publicly available website contains the guidance that the

Commission and its staff have provided on this issue, and any drafts of documents that have not been issued are protected by the deliberative-process privilege. Id.

IM Request 5 is quashed as unduly burdensome. I find that any unprivileged documents relating to this production request would appear to be publicly available on the Commission's website and therefore equally available to both parties. To the extent that any documents responsive to this request are drafts or unpublished, I find that they are irrelevant to this proceeding and should not be produced.

2. Request 7 (Request 8 to IM)

Request 7 (Request 8 to IM) seeks “[a]ll documents concerning prevailing valuation-related practices of fund boards during 2003 through 2007.” The Movants argue that IM does not have any single study or focused set of responsive documents, and any internal discussions as to what represents a prevailing practice would be protected by the deliberative-process privilege. Id., p. 17; Ex. A, p. 2. They also argue that trying to locate all relevant fund policies in examination files and determining which ones represent prevailing practices would be a nearly impossible undertaking, and producing other funds’ valuation-related practices would raise significant issues regarding competitors’ proprietary information. Consolidated Motion, p. 18. The Independent Directors argue that the request does not impose an undue burden and if no such compilation of information exists, this fact would support their fair notice defense. Opposition, p. 12.

Request 7 (Request 8 to IM) is quashed as unreasonable. Respondents do not describe with clarity the nature of the documents sought. It is not clear if they are seeking examination materials related to the examination of other companies, studies performed by the Commission regarding valuation practices, or final valuation reports. Therefore, it is unclear what is actually being requested.

CROSS MOTIONS TO COMPEL

Also pending before me is the Independent Directors’ Cross-Motion to Compel (Cross Motion) and a Memorandum in Opposition to Division’s Motion for Protective Order and in Support of Respondents’ Cross-Motions to Compel (Memorandum) filed on February 19, 2013. That same day the Inside Directors filed a Cross-Motion to Compel (Motion to Compel) and a Brief in Opposition to the Division’s Motion for Protective Order Sealing the Independent Directors’ Supplemental Response and in Support of Their Cross-Motion to Compel (Brief), with one exhibit⁵ attached thereto.⁶ On February 25, 2013, this Office received the Division’s

⁵ Brief Ex. A contains a series of emails between the Division and counsel for Directors dated January 23-25, 2013, relating to the production of documents.

⁶ The Brief and Memorandum include arguments in direct response to the Division’s Brief in Support of Its Motion for Protective Order Sealing the Independent Directors’ Supplemental Response in Opposition to the Division’s Motion to Strike filed on February 11, 2013. The propriety of any protective order will be addressed in a separate order.

Reply Brief in Support of Its Motion for Protective Order Sealing the Independent Directors' Supplemental Response in Opposition to the Division's Motion to Strike and Response to Respondents' Motion to Compel (Reply), with four exhibits attached thereto. Each of these filings was made under seal.

The Inside Directors and Independent Directors (collectively, the Directors) request the Division be ordered to (1) satisfy its Brady requirements under Rule 230(b)(2) of the Commission's Rules of Practice; (2) produce additional documents required by Rule 230(a) of the Commission's Rules of Practice; and (3) provide a document-by-document privilege log. Cross Motion, p. 1; Motion to Compel, p. 1. The Directors assert that documents inadvertently produced by the Division, and the Division's conduct, raise serious questions as to their compliance with their Brady obligations and their good faith in gathering and producing documents pursuant to Rule 230 of the Commission's Rules of Practice. Motion to Compel, p. 1; Memorandum, pp. 5-7; Brief, pp. 18-20.

The Division contends that the documents it inadvertently produced do not raise any questions about its compliance with Rule 230 of the Commission's Rules of Practice. Reply, p. 11. The Division also asserts that none of the documents that are the subject of the Cross Motion and Motion to Compel were "obtained by the Division in connection with the investigation that led to the Division's recommendation to institute this proceeding." Id. Rather, the "documents identified in Email Nos. 9 and 10 . . . were obtained by . . . OCIE pursuant to a sweep exam of various investment companies" and the "documents referenced in Email No. 8 were documents obtained in connection with an entirely separate investigation." Id., p. 13. The Division states that it is "willing to make available to Respondents the documents that the [Los Angeles Regional Office] provided the ARO from its investigation" but requests that the Cross Motion and Motion to Compel be otherwise denied. Id., pp. 13-14.

The Commission's Rules of Practice, which govern in this case, provide for the withholding of internal memoranda, notes, or writings prepared by Commission employees, and for attorney work product, unless they constitute Brady material. 17 C.F.R. § 201.230(b). I am not persuaded by Respondents' arguments that the Division's disclosures suggest a failure to satisfy its Brady obligation. For reasons I will explain in my order resolving the Division's motion for protective order, the Division's inadvertent disclosures are almost entirely irrelevant. I am mindful, however, of the fundamental difficulty the Division's discovery obligations present, particularly with respect to Brady: "some prosecutors have determined unilaterally that evidence will not be material and, often in good faith, have disclosed it neither to defense counsel nor to the court." U.S. v. Oxman, 740 F.2d 1298, 1310 (3rd Cir. 1984). Out of an abundance of caution, however, I will follow a procedure similar to the one outlined in City of Anaheim, 70 SEC Docket 881, 887 (July 30, 1999), where the administrative law judge held that "affidavits should be the primary tool for resolving Brady disputes." See also Orlando Joseph Jett, 52 S.E.C. 830, 831 (June 17, 1996) (an affidavit regarding Brady "remove[d] any doubt about the matter").

I GRANT the Cross Motion and Motion to Compel to the extent that the Division will be required to submit for my review a withheld documents list and a declaration which describes its compliance with Brady v. Maryland, 373 U.S. 83 (1963), and its progeny, and 17 C.F.R. §

201.231. Given the lack of relevance of the materials sought by Respondents, a document-by-document privilege log is unnecessary at this stage. I will review the withheld documents list and determine if further details, up to and including a document-by-document privilege log, are needed.

ORDER

It is ORDERED that, pursuant to Rule 232(e) of the Commission's Rules of Practice, the Division's Motion and the Movants' Consolidated Motion, requesting that the Subpoena Requests be quashed, are GRANTED in their entirety, as set forth above.

It is further ORDERED that the Independent Directors' Cross Motion and the Inside Directors' Motion to Compel are GRANTED IN PART as outlined above.

It is further ORDERED that the Division shall file, no later than March 11, 2013, a declaration as outlined above which describes its compliance with Brady v. Maryland and its progeny and with 17 C.F.R. § 201.231, and which specifically states that a search for Brady material has been made.

It is further ORDERED that the Division shall submit by March 15, 2013, a withheld documents list in compliance with Rule 230(c) of the Commission's Rules of Practice.

Cameron Elliot
Administrative Law Judge