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The SEC's Wells Process Turns 40

Law360, New York (August 31, 2012, 12:17 PM ET) -- In September 1972, the U.S. Securities and Exchange Commission formally adopted its "Wells process" as a result of recommendations arising out of a report authored by three distinguished private practitioners. The committee chair, John A. Wells, submitted the report to then-SEC Chairman William Casey containing a multitude of recommendations geared toward enhancing and improving the SEC's enforcement program.

The so-called "Wells committee" was an unusual and truly remarkable example of a government agency seeking advice from the private sector. The most significant of the recommendations, numbers 16 and 17, resulted in the commission formally implementing its prelitigation process that became known as the Wells process. While novel at the time, the Wells process has served as a model for other agencies — including, most recently, the Consumer Financial Protection Bureau — to afford due process to accused parties by allowing them to respond to allegations prior to charging them.

The SEC's Wells process generates spirited debate over the facts and law underpinning a particular enforcement case, passionate advocacy between the parties and within the SEC, and often great anxiety for all of those involved. Through a Wells submission, counsel for individuals or entities under SEC investigation try to persuade SEC staff or a majority of the commissioners to forego bringing an enforcement action. Because the Wells process can have so much significance in the enforcement process, companies often choose — though they are not required — to disclose even the fact of a Wells notice, along with the likelihood that an SEC enforcement action may ensue.

Although the process has remained virtually unchanged for 40 years, there have been two significant twists in recent years. Dodd-Frank now requires the SEC to decide whether to file an action within 180 days of the Wells notice, which imposes a tight time frame for the SEC staff to negotiate a potential settlement, circulate a recommendation memorandum to the subject matter experts in the SEC's other divisions and offices, meet with counsel for the commissioners and present the recommendation to the commission for a vote.

As a result of the new 180-day deadline, an informal pre-Wells settlement exploration period has developed where SEC enforcement lawyers ask counsel for individuals and entities under investigation to submit "white papers" instead of "Wells submissions" to delay the start of the Dodd-Frank timeframe. If settlements can be reached quickly and efficiently in the absence of a formal Wells notice, the staff can avoid the pressure of the 180-day deadline, and public companies may be able to avoid the challenge of describing a Wells notice in their public filings. If informal settlement discussions break down, the staff either can close the investigation, or move forward with a Wells notice.

Another change is the discretionary “open-jacket” policy, which allows the SEC staff lawyers to provide Wells recipients with access to the SEC’s investigative file in instances where doing so would assist both sides in assessing the strengths and weaknesses of the evidence. The open-jacket policy is an additional procedural safeguard that derives from the process followed by many of the U.S. Attorney offices.

Once the Wells process commences, the discussions can sometimes be contentious. For example, in an investigation into the sale of securities by Mark Cuban, the SEC’s inspector general opined that SEC staff crossed the line when one staff member — in the course of being dismissive of defense counsel’s position that it would have been illogical for Cuban to have risked his reputation over an insignificant amount of money — opined that Cuban took “irrational and silly risks” every day. The inspector general characterized this as a personal attack on Cuban and concluded that it should not have been part of the Wells process. Senior officials within the Division of Enforcement have taken issue with this finding, believing that this type of back and forth constitutes standard litigation banter between highly skilled attorneys and that such vigorous debate often leads to settlements that conserve resources.

While there is no empirical study tending to show that Wells submissions change the minds of those within the SEC, there is plenty of anecdotal evidence. Just ask an SEC enforcement attorney or a commissioner’s counsel; he or she will tell you that a well-written submission will spark critical thinking and will require enforcement staff to provide the commission with a response that addresses and rebuts the arguments and factual analyses contained in the submission. If a submission is persuasive, the staff, on its own, may consider lesser charges or none at all, or seek less in penalties.

More importantly, a Wells submission can influence the commission. Commissioner Paul Atkins famously read every word of every Wells submission and would question the enforcement staff on the merits of the arguments. In instances where two or three commissioners are on the fence about an enforcement recommendation, a well-reasoned argument as to why a particular action is unwarranted, inappropriate or in conflict with pre-existing authority or policy can fuel the debate at the commission level and potentially have significant influence over the outcome of the commission’s deliberations.

A Wells submission can be expensive, and they do have risks. Attorneys must be careful when drafting descriptive factual portions of a submission. Wells submissions can be subject to discovery requests by private plaintiffs, and statements in Wells submissions can be considered admissions in ensuing litigation. An individual with potential criminal exposure may wish to avoid a Wells submission altogether.

While the Wells process likely will continue to evolve over time, the blueprint set forth in the original committee report remains the exemplar of due process for persons and entities that are accused of violating the federal securities laws. The reason it has remained such a firmly established part of the enforcement process may be due to the fact that it originated from a cooperative exercise between the government and the private sector. Perhaps there is hope for more of these partnerships in today’s regulatory climate.

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