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Outside Counsel

Applying the Proportionality Standard Under Rule 26 Against the SEC

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This article examines how the proportionality standard under Rule 26 can be used to limit deposition discovery of the government in enforcement proceedings brought by the U.S. Securities and Exchange Commission.

The SEC has long enjoyed the ability to conduct ex parte investigations into potential violations of the federal securities law with practically no limitation on the scope or duration of their inquiries.[1] Over these long investigations, the staff of the Enforcement Division can obtain vast amounts of data and—backed by national subpoena power—compel testimony under oath. In taking investigation testimony, the SEC staff faces none of the limits found in the Federal Rules of Civil Procedure as to the length of the testimony it takes or even the number of times the same individual can be compelled to testify. When these investigations lead to enforcement actions in federal court, attorneys for the SEC often see the cases as hitting a "reset button" and seek to begin the entire discovery process anew—including compelling testimony from the very persons who had already testified (sometimes for multiple days) in the investigation. This ability to conduct ex parte investigations while suffering no consequences from the length of its investigations or the efficiency with which they are conducted places great power in the hands of the SEC staff—and places a disproportionate burden on the parties responding to those inquiries. But some relief from this burden may be available when the actions move to federal court.

> New Rule 26 identifies six factors for courts to consider in ensuring discovery is "proportionate to the needs of the case."

The December 2015 amendments to the Federal Rules of Civil Procedure limited the scope of permissible discovery and sought to create a balance between the need for the evidence and the avoidance of undue burden and expense on the parties. See Fed. R. Civ. P. (amended 2015). New Rule 26 identifies six factors for courts to consider in ensuring discovery is "proportionate to the needs of the case." Fed. R. Civ. P. 26(b). These are:

- the importance of the issues at stake,
- the amount in controversy,
- the parties' relative access to relevant information,
- the parties' resources,
- the importance of the discovery in resolving the issues, and
- whether the burden or expense of the discovery is outweighed by the benefit.

Id. The Advisory Committee emphasized that the amendment "reinforces the … obligation of the parties to consider these factors in making discovery requests." See Fed. R. Civ. P. 26(b)(1) advisory committee's note to the 2015 amendment. The rule "encourage[s] judges to be more aggressive … in discouraging discovery overuse" and emphasizes the "need to analyze proportionality before ordering production." Id.

The proportionality limitation can be applied with particular force against the SEC in litigated enforcement cases. As the Supreme Court has recognized, the United States is no ordinary litigant. Its

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agencies have been given a wide range of legal tools to pursue their missions, far beyond what is available to a private litigant. For this reason, the court has found that the government should be held to a higher standard, for example, in determining the timeliness of its actions. See *Gabelli v. S.E.C.*, 568 U.S. 442, 451 (2013). The same higher standard should be applied when the government seeks discovery in civil cases.

Let's look again at the SEC. In its long ex parte investigations, the staff can compel testimony from as many individuals as it chooses,[2] for as many hours or days it chooses, with the ability to re-subpoena the same persons for additional testimony in the very same investigation. Its "access to relevant information" is extraordinarily high before it even reaches the courthouse steps. Indeed, by the time the SEC actually files an enforcement case, it has almost without exception (outside of emergency proceedings) already taken testimony from the defendants in the case as well as from the significant material witnesses. It also arrives at the courthouse having already had the power to compel documents from the named defendants and from third parties. These factors must be considered when federal judges evaluate what discovery requests are "proportionate to the needs of the case" when the party seeking that discovery is the SEC.

For defense counsel, the opportunity to assert proportionality against the discovery requests of the SEC arises most strongly in the context of depositions.[3] In a typical case brought against an officer or director of a public company, where that individual provided testimony to the staff in the administrative investigation, the SEC trial counsel will invariably seek to take the deposition of that same officer or director in the subsequent federal proceeding. But why should they be allowed to? Rule 26 was amended to "discourage[e] discovery overuse" and to ensure that the "burden or expense of the discovery" is not outweighed by its benefit. See Fed. R. Civ. P. 26. What need does the government have to take additional testimony from the same individual from whom they already secured sworn testimony?

Remember, many of the basic reasons for taking depositions in litigation are not present in the context of the SEC seeking depositions in the cases it files as plaintiff. The common reasons for taking depositions are: (1) to discover the underlying facts in a case; (2) to use for impeachment at trial; and (3) to secure testimony from a witness who would otherwise be unavailable at trial, based on geographic location or other reasons. None of these reasons is generally present where the SEC seeks deposition discovery: (1) the staff was already able to discover the underlying facts in the case through its administrative investigation, including of course through the testimony it took; (2) the investigation testimony can be used for impeachment of that same witness in the federal litigation; and (3) given that the parties in SEC enforcement cases enjoy national subpoena power for trial, see 15 U.S.C. §78aa, there is generally no need to secure trial testimony through deposition, regardless of where in the country the witness resides.

These arguments may fall on deaf ears before some federal judges, but they should be made in appropriate circumstances.

All of these factors create a bulwark behind which defense lawyers can argue aggressively against the SEC being given the opportunity in federal litigation to take depositions from persons who already provided sworn testimony in the prior administrative investigation. These arguments should apply equally to third-party witnesses and the defendants themselves. In each instance, the SEC should have to show—where challenged—that the benefit of the additional testimony outweighs the burden and expense placed on the deponent. Fed. R. Civ. P. 26(b)(1). These arguments may fall on deaf ears before some federal judges, but they should be made in appropriate circumstances. The government is held to a higher standard in other areas of the law. It should be here as well.

1. To the extent the federal five-year statute of limitations places time constraints on the Commission, 28 U.S.C. §2462, the subjects of investigations almost invariably agree to enter into tolling agreements—thereby removing any meaningful duration limit on the staff's investigations.

2. Contrast this with Rule 30 of the Federal Rules of Civil Procedure, which limits any party from taking more than ten depositions without leave of court. Cf Fed. R. Civ. P. 30. The local rules of various federal courts and the practices of individual judges also place additional limitations on deposition discovery in federal proceedings.

3. For document discovery, basic common sense principles apply. If information was already produced in the investigation, a party generally will not be asked to produce it again in the litigation, and the staff of the SEC has traditionally been reasonable in this regard.