

**DISCOVERY OF REGULATORY DOCUMENTS:  
DEBUNKING THE MYTH OF AN  
“SEC PRIVILEGE” IN SECURITIES ARBITRATION**

*Philip M. Aidikoff, Esq., Robert A. Uhl, Esq.  
Ryan K. Bakhtiari, Esq. and Jeff Aidikoff<sup>1</sup>*

**I. INTRODUCTION**

Defective securities product cases have invited increased regulatory scrutiny by the U.S. Securities and Exchange Commission (SEC) and other financial regulatory agencies such as the Financial Industry Regulatory Authority (FINRA), formerly known as the National Association of Securities Dealers (NASD).<sup>2</sup> The increase in regulatory scrutiny has raised the level of awareness of civil litigants about the authority and power of regulatory bodies to order broker-dealers and/or issuers to produce documents related to product failures. Thus, it is common today for civil litigants to seek discovery of documents broker-dealers and/or issuers produce to regulators in court cases and securities arbitration.

Companies under investigation by the SEC often object to producing regulatory correspondence and documents submitted to the SEC and other regulatory agencies based on an alleged “SEC privilege.” In short, there is no such privilege. Specifically, there is no support for the proposition that relevant, otherwise nonprivileged documents, submitted by a party in a civil action to any regulatory agency are not discoverable from the producing party by the other litigant in a civil action.

---

1. The law firm Aidikoff, Uhl & Bakhtiari, LLC is located in Beverly Hills, CA. The primary authors can be contacted at paidi@aol.com, robertauhl@aol.com, rbakhtiari@aol.com, or (310) 274-0666.

2. On July 26, 2007, the U.S. Securities and Exchange Commission (SEC), approved the merger between the enforcement and arbitration functions of the New York Stock Exchange and NASD, creating “[FINRA], a single watchdog for brokers from Wall Street to Main Street.” See Carrie Johnson, *SEC Approves One Watchdog for Brokers Big and Small*, WASHINGTON POST, July 27, 2007, at D02.

## II. THERE IS NO PRIVILEGE IN CIVIL LITIGATION SHIELDING DISCOVERY OF RELEVANT NONPRIVILEGED DOCUMENTS SUBMITTED TO THE SEC

### 1. Courts Reject an “SEC Privilege”

In 2002, the court in *Kirkland v. Superior Court* held that there is no public policy treating SEC testimony and documents provided to the agency during an inquiry or investigation as private or confidential.<sup>3</sup> On appeal, the court upheld the trial court’s order compelling defendant to produce copies of documents and transcripts of testimony given in proceedings before the SEC in a separate investigation of that defendant. Specifically, the court found that the documents and transcripts in question were “relevant to [plaintiff’s] claim that [defendant], Kirkland, orchestrated . . . transactions in an effort to enhance PLB’s financial appearance.”<sup>4</sup> Kirkland argued that “documents and transcripts related to a private and confidential SEC investigation are not subject to discovery,”<sup>5</sup> relying on an SEC regulation that provides “information or documents obtained by the SEC in the course of any investigation or examination, unless made a matter of public record, shall be deemed nonpublic.”<sup>6</sup>

The court of appeals rejected Kirkland’s arguments for several reasons. First, “California’s pretrial discovery procedures are designed to minimize the opportunities for fabrication and forgetfulness, and to eliminate the need for guesswork about the other side’s evidence, with all doubts about discoverability resolved in favor of disclosure.”<sup>7</sup> Second, the testimony and documents were reasonably calculated to lead to the discovery of admissible evidence.<sup>8</sup> Third, “ample good cause” regarding the relevancy of the

---

3. *Kirkland v. Superior Court (Guess? Inc.)*, 115 Cal. Rptr. 2d 279 (Ct. App. 2002).

4. *Id.* at 284 (“Specifically, the documents and transcripts evidencing other transactions involving PLB, Western, and Pacific were relevant to show motive, intent, knowledge, plan, and absence of mistake.”) (citing Evid. Code § 1101, subd. (b); *Morris Stulsaft Foundation v. Superior Court (Shultsaft)*, 54 Cal. Rptr. 12 (Ct. App. 1966)(explaining that evidence of other transactions is admissible to show motive, intent, knowledge, plan, and absence of mistake)).

5. *Kirkland*, 115 Cal. Rptr. 2d at 283.

6. 17 C.F.R. § 203.2 (2001).

7. *Kirkland* at 283 (citing *Glenfed Dev. Corp. v. Sup. Ct.*, 62 Cal. Rptr. 2d 195 (Ct. App. 1997)).

8. *Id.* at 283-284.

documents and testimony had been shown.<sup>9</sup> Fourth, Kirkland never produced any evidence that “he or any witness actually believed the SEC investigation was private or confidential.”<sup>10</sup> In fact, the court determined that even if a request for confidential treatment was made prior to disclosure “it would mean only that Kirkland asked (and not that the SEC agreed) that the documents would ‘be deemed nonpublic;’” this would not mean disclosure to the SEC would be protected from discovery in a subsequent civil proceeding.<sup>11</sup> Fifth, the court found there is “no law to support Kirkland’s claim that the SEC testimony and documents should be as a matter of public policy treated as private or confidential, and the law that does exist supports the opposite conclusion.”<sup>12</sup> The *Kirkland* court also found significant that:

. . . the federal courts have uniformly rejected Kirkland’s claim that, in the absence of judicial protection for the SEC’s confidential investigatory process, witnesses will not be as forthcoming as they otherwise might be, and equally significant that the federal courts have refused to imbue such

---

9. *Id.* at 284.

10. *Id.* (“Generously construed, the record shows only that Kirkland’s lawyer made a timely request that any information submitted to the Commission . . . be given ‘confidential treatment’ pursuant to 17 C.F.R. 203.83. Assuming that such a request was made (we are not told when or to whom it was made or whether it was in writing or oral), it would mean only that Kirkland asked (and not that the SEC agreed) that the documents “be deemed non-public.”).

11. *Kirkland* at 284 (citing *In re Leslie Fay Companies, Inc. v. Sec. Litig.*, 152 F.R.D. 42, 45-46 (S.D.N.Y. 1993)(explaining that in the absence of a confidentiality agreement, the mere request that the SEC keep submissions confidential is insufficient to protect the submissions from disclosure to third parties)).

12. *Kirkland* at 284 (“Witnesses who testify or produce documents to the SEC usually have the right to obtain copies of the transcripts of their testimony and documents (17 C.F.R. § 203.6 (2001), and where they have done so (as has Kirkland) there is no cognizable claim of confidentiality or privacy in those documents or transcripts) (citing *LaMorte v. Mansfield*, 438 F.2d 448, 451 (2d Cir. 1971) (explaining that to the extent there is any privilege, it belongs to the SEC, not the witness); see also *White v. Jaegerman*, 51 F.R.D. 161, 163 (S.D.N.Y. 1970)(“ . . . the decision by the Securities and Exchange Commission to furnish White a copy of his testimony without any injunction against disclosure to a third party made the testimony public at least for the purposes of discovery by defendant; the secrecy provisions were for the benefit of the Commission and not plaintiff.”).

transcripts and documents with a patina of confidentiality that would trigger an exemption from normal discovery.<sup>13</sup>

Last, “the trial court’s order was not unduly burdensome.”<sup>14</sup>

Likewise, in *D’Addario v. Geller*,<sup>15</sup> the Fourth Circuit Court of Appeals rejected the defendant’s claim that nonprivileged documents involuntarily submitted to the SEC were protected by an “SEC privilege.”<sup>16</sup> On appeal from the District Court for the Eastern District of Virginia, D’Addario challenged the lower court’s various discovery rulings as well as the grant of summary judgment for defendants.<sup>17</sup> The Fourth Circuit vacated summary judgment and reversed the district court’s discovery ruling denying D’Addario access to documents and materials submitted by defendants to the SEC.<sup>18</sup> Defendants argued that because SEC investigations are nonpublic they should be protected from disclosure in subsequent civil litigation.<sup>19</sup> Rejecting that argument, the Fourth Circuit held that “the district court erred because there is no such thing as an SEC privilege.”<sup>20</sup> Moreover, the Fourth Circuit rejected an ‘SEC privilege’ based on reliance of 17 C.F.R. § 203.2 holding that the regulation:

---

13. *Kirkland*, 115 Cal. Rptr. 2d at 285 (emphasis added); *see also* *Zients v. LaMorte*, 319 F. Supp. 956, 958, (S.D.N.Y. 1970) mandamus denied, sub nom. *LaMorte v. Mansfield*, 438 F.2d 448 (2d. Cir. 1971) (explaining that the confidentiality provisions that do exist are to permit the SEC to enjoy confidentiality where it is necessary to complete its investigation); *In re Air Passenger Comp. Res. Sys. Antitrust Lit.*, 116 F.R.D. 390, 393 (C.D.Cal. 1986); *In re Woolworth Corp. Sec. Class Action Lit.*, 166 F.R.D. 311, 312-313 (S.D.N.Y. 1996); *Herbst v. Able*, 63 F.R.D. 135, 138 (S.D.N.Y. 1972); *In re Steinhardt Partners, L.P.*, 9 F.3d 230 (2d Cir. 1993); *Westinghouse v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991).

14. *Id.* at 285.

15. 129 Fed. App’x 1 (4th Cir. 2005); although *D’Addario* is unpublished, authoritative use is permitted pursuant to the Fourth Circuit local rule 32.1 which states in pertinent part: “If a party believes, nevertheless, that an unpublished disposition of this Court issued prior to January 1, 2007, has precedential value in relation to a material issue in a case and that there is no published opinion that would serve as well, such disposition may be cited . . . .”

16. *Id.* at 7.

17. *Id.*

18. *Id.* at 2.

19. *Id.* at 7.

20. *Id.*

. . . [P]rovides only that information and documents obtained by the SEC in the course of an investigation are deemed nonpublic. The regulation does not provide that documents and materials submitted to the SEC are not discoverable in a later civil proceeding. Because there is no SEC privilege, the district court erred in refusing to compel discovery of the documents and materials submitted by RMST to the SEC.<sup>21</sup>

No court has rejected the holdings in *Kirkland* and *D'Addario*.

## 2. The Financial Industry Regulatory Agency (FINRA) Provides for the Discovery of Documents Sent to Regulatory Agencies

The holdings in *Kirkland* and *D'Addario* are consistent with guidelines set forth by the Financial Industry Regulatory Authority (FINRA), which provide for the discovery of correspondence and documents sent to regulators. Specifically, the Arbitrator's Manual<sup>22</sup> "provides to parties in arbitrations guidance on which documents they should exchange without arbitrator or staff intervention, and guidance to arbitrators in determining which documents customers and member firms or associated persons *are presumptively required to produce* in customer arbitrations including "correspondence with regulators."<sup>23</sup>

Furthermore, List 5, Item 4 of the FINRA Discovery Guide<sup>24</sup> states that the following documents are discoverable in failure to supervise cases:

Those portions of examination reports or similar reports following an examination or an inspection conducted by a state or federal agency or a self-regulatory organization that focused on the Associated Person(s) or the transactions at issue or that discussed alleged improper behavior in the branch against other individuals similar to the improper conduct alleged in the statement of claim.

---

21. *D'Addario*, 129 Fed. App'x at 7.

22. See Fin. Industry Reg. Authority (FINRA), *The Arbitrator's Manual*, at 13, August 2007, available at <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@neutrl/documents/arbmed/p009668.pdf>.

23. *Id.* at 14 (emphasis added).

24. See Fin. Industry Reg. Authority (FINRA), *The Discovery Guide*, April 2007, available at <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbrul/documents/arbmed/p018922.pdf>.

In addition, List 1, Item 12 of the Discovery Guide also calls for the production of similar regulatory documents to be produced by the firm/associated person(s) in all customer cases, stating that: “Records of disciplinary action taken against the Associated Person(s) by any regulator or employer for all sales practices or conduct similar to the conduct alleged to be at issue.” In fact, the Discovery Guide expressly states that “[t]he arbitrators and the parties should consider the documents described in Document Production Lists 1 and 2 *presumptively discoverable*;<sup>25</sup> and “[a]rbitrators can order the production of documents not provided for by the Document Production Lists. . . .” Consistent with this notion is the fact that FINRA Rule 12507 allows parties to make additional discovery requests not covered by the Discovery Guide’s Production Lists.

Thus, FINRA guidelines governing securities arbitration support settled case law that nonprivileged documents submitted to regulatory authorities are discoverable.

### 3. Securities Arbitration Panels Reject an “SEC Privilege”

Numerous arbitration panels reject the “SEC privilege” argument and have ordered the production of documents exchanged between broker-dealers and regulators. In a claim against a major broker-dealer alleging breach of fiduciary duty and failure to supervise regarding the sale of “Principal Protected Notes,” Claimants sought from Respondent the production of correspondence and documents sent to any regulatory agency regarding the fund(s) at issue. The requests were as follows:

All documents received by Respondent from any federal or state regulatory authority and/or self-regulatory authority concerning [the Funds at issue] during the relevant time period; and All documents received from, or sent to any state, federal, SRO regulatory or securities agency pursuant to any investigation by any such agency of the Funds as recently disclosed in [Respondent’s] Form 10Q.

Respondent refused to produce regulatory documents claiming such production to the SEC was privileged. Claimants then filed a Motion to Compel production of regulatory correspondence and documents.

---

25. *Id.* (emphasis added).

In their moving papers, Respondent's cited to 17 C.F.R. 203.2, *Stanley v. Safekin Corp.*,<sup>26</sup> and *SEC v. Rogers*,<sup>27</sup> claiming documents exchanged between Respondent and a regulatory agency are protected from public disclosure. Claimants rebutted Respondent's interpretation of 17 C.F.R. 203.2 by relying on the holding in *D'Addario* as follows:

In *D'Addario*, the court held that there is no "SEC privilege," and further clarified that 17 Code of Federal Regulations section 203.2 does not prevent the production of the documents produced to the SEC when subpoenaed by one party to a civil suit from the other party which submitted the documents to the SEC during an investigation.

In addition, Claimants challenged Respondent's argument that Claimants' request would "subvert public policy and would potentially undermine pending regulatory inquiries" stating:

Respondent's policy argument contradicts the law of privilege, both generally and specifically. In general: "The privileges set out in the Evidence Code are legislative creations; the courts of this state have no power to expand them or to recognize implied exceptions."<sup>28</sup> Moreover, none of the privileges were set forth in Respondent's Responses to Claimants' First Request for Production of Documents and therefore cannot be properly raised here. Finally, Respondent cites few authorities to support its policy argument, none of which govern this dispute. Respondent's policy argument that the documents responsive to Claimants' requests should not be discoverable is also without merit: "California's pretrial discovery procedures are designed to minimize the opportunities for fabrication and forgetfulness, and to eliminate the need for guesswork about the other side's evidence, with all doubts about discoverability resolved in favor of disclosure."<sup>29</sup>

Moreover, as presented in Claimants' reply brief, Respondent's public policy argument was rejected by the *Kirkland* court. Specifically, that "there

---

26. *Stanley v. Safekin Corp.*, No. Civ.99CV454-BTM(LSP), 2001 WL 1870859 (S.D.Cal. July 11, 2001).

27. *Sec. Exch. Comm'n v. Rogers*, 283 Fed. App'x. 242 (5th Cir. 2008).

28. *Wells Fargo Bank v. Superior Court (Boltwood)*, 990 P.2d 591, 594 (Cal. 2000).

29. *See Glenfed Dev. Corp. v. Superior Court (Nat'l Union Fire Ins. Co. of Pittsburgh, PA)*, 62 Cal. Rptr. 2d 195, 199 (Ct. App. 1997).

is no law to support [defendant's] claim that the SEC testimony and documents should as a matter of policy be treated as private or confidential, and the law that does exist supports the opposite conclusion."<sup>30</sup>

Furthermore, Respondent's reliance on *Stanley v. Safeskin Corp.*<sup>31</sup> to support the creation of a regulatory privilege was inapposite to the case at bar. Claimants set forth why *Stanley* does not support a per se denial of requests for documents provided to regulatory agencies as follows:

In an order denying a motion to compel, the District Court for the Southern District of California in *Stanley v. Safeskin Corp.*<sup>32</sup> denied Plaintiffs motion to compel "all documents relating to any communication to/from the Securities Exchange Commission or other regulatory authorities."<sup>33</sup> The court denied the motion finding that there was insufficient nexus between the documents requested and matters at issue in the case (i.e., lack of relevance) because it was not limited to the relevant time period in issue.<sup>34</sup> *Stanley* does not stand for a per se denial of requests for documents provided to regulatory agencies. Rather, the court in *Stanley* applied a factual analysis to determine if the documents sought by the plaintiff were relevant and therefore discoverable.

Thus, because the request in *Safeskin* was unlimited as to time and scope, discovery was denied.

Likewise, *Sec. Exch. Comm'n v. Rogers*<sup>35</sup> concerned a document request which sought from the SEC "every document pertaining to every investigation, prosecution, or enforcement action against [plaintiff] by any federal agency since 1960."<sup>36</sup> There, plaintiff's request sought almost 50 years of documents from the SEC. In the arbitration at bar, Claimants

---

30. *Kirkland*, 115 Cal. Rptr. 2d at 284.

31. *Stanley v. Safeskin Corp.*, No. Civ.99CV454-BTM(LSP), 2001 WL 1870859 (S.D.Cal. July 11, 2001).

32. *Id.*

33. *Id.* at 1.

34. *Id.*

35. *Sec. Exch. Comm'n v. Rogers*, No. 07-10885, 2008 U.S. App. LEXIS 13259 (5th Cir. June 20, 2008).

36. *Id.* at 243.

limited the time period for the production of the requested documents to less than six years of the relevant time period. Consequently, Respondent's reliance on *Sec. Exch. Comm'n v. Rogers* was inapposite because Claimants' document request was limited to the relevant time period in issue.

Last, Respondent presented a privacy argument which was rebutted in Claimants' reply brief as follows:

Claims of right of privacy do not shield the production of relevant documents. Specifically, the constitutional right of privacy does not provide absolute protection against disclosure of personal information; rather it must be balanced against the countervailing public interests in disclosure.<sup>37</sup> Thus, it may be abridged to accommodate a compelling public interest.<sup>38</sup> A general public interest exists in "facilitating the ascertainment of truth in connection with legal proceedings,"<sup>39</sup> and in obtaining just results in litigation.<sup>40</sup>

Moreover, "relevant bank customer information should not be wholly privileged and insulated from scrutiny by civil litigants."<sup>41</sup> In *Valley Bank of Nevada*,<sup>42</sup> the court stated that: "In order to facilitate the ascertainment of truth and the just resolution of legal claims, the state clearly exerts a justifiable interest in requiring a businessman to *disclose communications, confidential or otherwise, relevant to pending litigation.*"<sup>43</sup>

Following oral argument on the motion, the Chairperson rejected Respondent's privilege argument and ordered production of all documents that were submitted by Respondent pursuant to any "regulatory agency's (including Self-Regulating Organizations ["SRO's"]) requests for documents

---

37. See *Vinson v. Superior Court (Peralta Cmty Coll. Dist.)*, 740 P.2d 404, 410 (Cal. 1987).

38. See *City of Santa Barbara v. Adamson*, 610 P. 2d 436, 439 (Cal. 1980).

39. *Moskowitz v. Superior Court (Zerner, Sims & Cibener)*, 187 Cal. Rptr. 4 (Ct. App. 1982)(quoting *Britt v. Superior Court*, 574 P.2d 766,774 (Cal. 1978)).

40. See *Valley Bank of Nevada v. Superior Court (Barkett)*, 542 P.2d 977, 979 (Cal. 1975).

41. *Valley Bank*, 542 P.2d at 980.

42. *Id.*

43. *Id.* (emphasis added).

. . . and Respondent's replies and responses . . . specific to the broker-dealer or the PPN or both," within forty-five days. Respondent filed a Motion to Reconsider before the whole panel which was rejected after a second hearing.

In yet another case involving a municipal arbitrage product, a FINRA panel expressly rejected an 'SEC privilege' after Respondent refused to produce regulatory correspondence and documents. Claimants alleged breach of fiduciary duty, breach of contract, unsuitability and failure to supervise the municipal arbitrage fund that was marketed as a safe, low-risk investment, whereby subscribers lost all or a substantial portion of their principal investment(s). Claimants sought the production of correspondence and documents sent to regulatory agencies regarding the fund. Specifically, Claimants requested:

All documents received by Respondent from any federal or state regulatory authority and/or law enforcement authority and/or self-regulatory authority concerning [hedge] Funds during the relevant period. And, all documents received from, or sent to any state, federal, SRO regulatory or securities agency pursuant to any investigation by any such agency of the Funds as recently disclosed in Respondent's Form 10Q.

Again, Respondent refused to produce regulatory documents claiming such production to the SEC was privileged. Claimants then filed a Motion to Compel production of regulatory correspondence and documents.

After a telephonic hearing on the Motion to Compel, the Chairperson ordered Claimants and Respondent to submit written briefs as follows:

As to Claimants' Document Request Nos. 51 and 56, counsel for the Claimants shall submit a brief in support of their requests, by no later than October 23, 2009, and counsel for the Respondent shall submit a brief in support of their opposition to these requests, by no later than October 28, 2009. As discussed, to the extent that the Respondent has previously agreed to produce, to any counsel for any other customers, the documents that the Respondent has produced to the U.S. Securities & Exchange Commission in connection with its investigation of the [hedge] funds, then the Respondent, in its brief, shall provide the following: (1) a description of the documents and audio recordings that have been produced to such other counsel; (2) copies of all agreements between the Respondent and such other counsel that memorializes their agreements with respect to such

documents; and (3) any documents which reflect and/or pertain to the Respondent having requested the permission and/or consent of the SEC prior to the production of such documents to any counsel for any other customers. Upon receipt and review of these submissions, the Chairman of the Panel shall issue a supplemental ruling.

In their responding brief, Respondent conceded no ‘SEC privilege’ exists then shifted to a public policy argument against disclosure stating: “While [Respondent] recognizes that there is no per se “SEC privilege,” the production of documents provided to the regulators in this case would operate as an “end run” around federal law and would restrict the ability of a party to fully and candidly participate in a regulatory investigation.” In support of their public policy assertion, Respondent cited to 17 C.F.R. § 203.2 which deems material acquired during an inquiry “nonpublic.”<sup>44</sup> However, the fallacy in Respondent’s argument is the assumption that if the SEC can refuse production of the requested documents so can Respondent, a proposition rejected by most courts.<sup>45</sup>

Respondent next argued that the requested documents were irrelevant to the case at bar, while repeating their concession that no “SEC privilege” exists. Specifically:

---

44. Specifically, Respondent argued: “17 C.F.R. § 203.2 explicitly provides that “[i]nformation or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public. . .” Thus, Claimants cannot obtain documents provided by [Respondent] to the Securities and Exchange Commission from the SEC (which is why Claimants have attempted to obtain the documents from [Respondent] through a document request, rather than a subpoena to the SEC).”

45. *See In re Penn Cent. Commercial Paper Litig.*, 61 F.R.D. 453, 462 n.20 (S.D.N.Y. 1973)(rejecting defendant’s reliance on SEC regulations that insure privacy in nonpublic SEC investigation, and stating that “these regulations are for the benefit of the [SEC] and not for witnesses who may appear before it.”; *see also* *Maryville Academy v. Loeb Rhoades & Co.*, 1978 U.S. Dist. LEXIS 14008 (“Any privilege attaching to non-public SEC testimony belongs to and is waivable by the Commission.”); *La Morte v Mansfield*, 438 F.2d 448, 451 (2d. Cir. 1971)(“To the extent that a privilege exists, it is the agency’s, not the witness’.”); *Herbst v. Able* 63 F.R.D. 135, 137 (S.D.N.Y. 1972)(“It is clear . . . [the] SEC has no objection to making available to Donald Douglas, Jr., a copy of the transcript of his testimony. More significantly, [the] SEC expressed no desire to keep any portion of Mr. Douglas’ testimony secret or confidential. Mr. Douglas’ claim here of confidentiality is, therefore, without merit.”).

[Respondent] acknowledges that producing relevant documents to the SEC does not make them privileged. However, Claimants should not be allowed to do an “end run” around 17 C.F.R. § 203.2 by requesting documents from a party (as opposed to the SEC) that are not relevant to the private arbitration. Thus, while relevant documents that would have to be produced otherwise in a private arbitration remain discoverable, 17 C.F.R. § 203.2 establishes that documents cannot be obtained from a private party merely because they are part of a regulatory inquiry. Rather, the requesting party must establish an independent basis for the relevancy of documents

Lastly, Respondent argued that compelling production in this case would be too burdensome,<sup>46</sup> even though the same Respondent had been ordered to produce the same documents, and had produced such documents in other arbitration proceedings.

The arbitration panel rejected Respondent’s arguments that compelling production would offend public policy; the requested production was irrelevant to the instant matter; and compliance would be too costly and burdensome. The order issued by the arbitration panel compelling production of regulatory documents and correspondence stated:

1) There is no privilege based upon the request and response for information from the Securities and Exchange Commission or any self-regulatory agency; 2) Because the claim raises issues of the design and management of the funds by respondent, the requests to the extent they relate to products sold to Claimants are relevant for discovery purposes even though the information sought does not directly relate to the Claimants; 3) To the extent respondent is required to provide such documents in any other arbitration the requests are not unduly burdensome.

---

46. “Claimants’ requests here are simply unduly burdensome, harassing and oppressive in scope. The cost to [Respondent] to produce regulatory documents to Claimants in this case will be enormous, and does not include the time required for [Respondent]’s attorneys to review the documents to identify and protect privileged documents. Unless the Chairperson orders that Claimants pay for the cost of producing these documents, the cost to respond to these requests alone could be staggering. This limited arbitration proceeding and the particular issues presented by Claimants in this case do not warrant such an intrusive and expensive production.”

In another securities arbitration, Claimant alleged breach of fiduciary duty, breach of contract, constructive fraud, fraud by misrepresentation and omission as well as negligence against a single broker-dealer regarding the failure of a yield fund that was marketed as a safe, low-risk investment. During discovery, Claimant requested and Respondent objected to, production of documents sent to regulators regarding the product failure at issue. Briefs were submitted by both parties and a telephonic hearing on Claimant's Motion to Compel took place.

Respondent argued that documents sent to regulators were a) not supported by the Arbitrator's Manual; b) not supported by the Discovery Guide; c) beyond the scope of discovery in arbitration; d) not relevant and; e) confidential and burdensome to produce.

In response, Claimant argued their request was within the scope of FINRA arbitration guidelines, was relevant to the claims alleged, and not burdensome to Respondent. Specifically, Claimant cited the Discovery Guide as well as the Arbitrator's Manual in support of Claimant's document requests as follows:

Respondent's argument that The Arbitrator's Manual does not support Claimant's request is without merit. Specifically, the Arbitrator's Manual, pgs. 13-14, item 6 states that "correspondence with regulators" are frequently ordered to be produced by the firm in customer cases. Although Respondent recognizes and concedes this point, Respondent argues that the Arbitrator's Manual compels production of correspondence with regulators "where those documents are *relevant* to the issue in the case." As noted above, Claimant has already established that correspondence with regulators is not only directly relevant to his case but that state and federal law support the production of such documents.<sup>47</sup>

Furthermore, List 5, Item 4 of the Discovery Guide states that the following documents are discoverable in failure to supervise cases:

---

47. See *D'Addario*, 129 Fed. App'x 1 (4th Cir. 2005); accord, *Kirkland*, 115 Cal. Rptr. 2d at 284 (holding that documents subpoenaed by one party to a civil suit from the other party which submitted the documents to the SEC during an investigation *are relevant, not subject to any privilege and must be produced* because there is no SEC privilege or other regulatory privilege barring such production.) (emphasis added).

Those portions of examination reports or similar reports following an examination or an inspection conducted by a state or federal agency or a self-regulatory organization that focused on the Associated Person(s) or the transactions at issue *or that discussed alleged improper behavior in the branch against other individuals similar to the improper conduct alleged in the statement of claim.*

Therefore, as evidenced by the language in the Discovery Guide set forth above, documents to be produced are not limited to Claimant or Claimant's account in issue. Rather, documents to be produced are those that either "focused on the Associated Person(s) . . . *or that discussed alleged improper behavior in the branch against other individuals similar to the improper conduct alleged in the statement of claim.*"

Citing List 5, Item 4 of the Discovery Guide, Respondent argued that documents and correspondence produced to regulators were not relevant to Claimant's arbitration claim because the documents sought also related to transactions other than Claimant's, and as such, was overbroad and not discoverable. Specifically, that ". . . like other documents contemplated by the Discovery Guide, 'correspondence with regulators' should be produced only if the correspondence relates to the *specific relationship* between the complaining customer and this broker, and *transactions specific* to the complaining customer."

However, Claimant countered that because it knew from other cases that individuals other than the Claimant in this action had brought *similar complaints* about the product against Respondent, documents relating to those complaints were discoverable pursuant to the Discovery Guide. The arbitration panel agreed.

The Chairperson ordered production of "[a]ll documents received by [Respondent] from any federal or state regulatory authority and/or law enforcement authority and/or self-regulatory authority concerning the Fund during the period from January 1, 2006 through the present, and [Respondent's] responses thereto;" and "[d]ocuments sufficient to show information provided by [Respondent] to any federal or state regulatory authority and/or law enforcement authority concerning the Fund during the period from January 1, 2006 through the present." To protect privacy or confidentiality interests of customers other than Claimant, the order provided that "[Respondent] may redact customer names and customer information on documents responsive to this request."

Respondent contended that compelling production of regulatory correspondence and documents was too burdensome and thus, Claimant should bear the cost of production- an argument broker-dealers often set forth once production of regulatory documents is ordered and which is often rejected by courts and securities arbitration panels.

#### 4. Cost-Shifting is Inapplicable When Documents are Readily Accessible

Many broker-dealer firms allege that compelling production of regulatory correspondence and documents is too burdensome and if so ordered, Claimant should bear the cost of production. However, a cost-shifting argument is without merit when the documents are readily accessible, especially in the modern world of electronic discovery, where the cost of producing documents is inexpensive.

Accordingly, the United States Supreme Court has set forth the presumption “that the responding party must bear the expense of complying with discovery requests . . . .”<sup>48</sup> And a federal court in the Southern District of New York opined in *Zubulake v. UBS*<sup>49</sup> that when the information sought is readily accessible on the responding party’s computer system, “the usual rules of discovery apply: the responding party should pay the costs of producing responsive data.”<sup>50</sup>

Therefore, because cost-shifting does not apply to accessible documents, “a court should consider cost-shifting *only* when electronic data is relatively inaccessible, such as in backup tapes.”<sup>51</sup> And even when cost-shifting is appropriate, “only the costs of restoration and searching should be shifted. Restoration, of course, is the act of making inaccessible material accessible.”<sup>52</sup> Therefore, “the responding party should *always* bear the cost

---

48. See *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 358 (1978).

49. See *Zubulake v. UBS Warburg LLC* (“Zubulake I”), 217 F.R.D. 309, 324 (S.D.N.Y. 2003).

50. *Id.*

51. *Id.* (emphasis in original); see *Toshiba v. Superior Court* (Lexar Media), 21 Cal. Rptr. 3d 532, 539 (Ct. App. 2004) (explaining that where requested information must be translated to render it intelligible or accessible, the requesting party bears the burden of the translation expense).

52. See *Zubulake v. UBS Warburg, LLC* (“Zubulake II”), 216 F.R.D. 280, 290 (S.D.N.Y. 2003).

of reviewing and producing electronic data once it has been converted to an accessible form.”<sup>53</sup>

Further, according to *Zubulake*, “whether electronic data is accessible or inaccessible turns largely on the media on which it is stored.”<sup>54</sup> Thus, “*in the world of electronic data, thanks to search engines, any data that is retained in a machine readable format is typically accessible.*”<sup>55</sup> In fact, the court noted how “electronic evidence is frequently cheaper and easier to produce than paper evidence because it can be searched automatically, key words can be run for privilege checks, and the production can be made in electronic form obviating the need for mass photocopying.”<sup>56</sup> Therefore, the *Zubulake* court reached the conclusion that “it would be wholly inappropriate to even consider cost-shifting” to the data the defendant maintained in an “accessible and usable format.”<sup>57</sup> In addition, *Zubulake* explained that:

Courts must remember that *cost-shifting may effectively end discovery, especially when private parties are engaged in litigation with large corporations.* As large companies increasingly move to entirely paper-free environments, the frequent use of cost-shifting will have the effect of *crippling discovery* in discrimination and retaliation cases. *This will both undermine the “strong public policy favoring resolving disputes on their merits,” and may ultimately deter the filing of potentially meritorious claims.*<sup>58</sup>

In California, the presumption is that all electronically stored information is accessible.<sup>59</sup> Therefore, when a party raises a burdensome objection to producing electronically stored information on the basis that the data is inaccessible, the burden to prove inaccessibility remains with the responding party.<sup>60</sup> *In meeting this burden, the responding party must provide detailed*

---

53. *Id.* (emphasis in original); *see also* *OpenTV v. Liberate Techs.*, 219 F.R.D. 474, 479 (N.D. Cal. 2003).

54. *Zubulake v. UBS Warburg, LLC* (“*Zubulake I*”), 217 F.R.D. 309, 318 (S.D.N.Y. 2003).

55. *Id.* (emphasis added).

56. *Zubulake I*, 217 F.R.D. at 318.

57. *Id.* at 320.

58. *Id.* at 317-18 (quoting *Pecarsky v. Galaxiworld.com, Inc.*, 249 F.3d 167, 172 (2d Cir. 2001) (emphasis added)).

59. *See* CAL. CIV. PROC. CODE § 2031.060(c) (West 2010).

60. *See* CAL. CIV. PROC. CODE § 2031.310(d) (West 2010).

*objections explaining why the electronically stored information is not reasonably accessible.*<sup>61</sup>

Securities arbitration panels also reject cost-shifting once production of regulatory correspondence and documents has been ordered. For example, in a securities arbitration claim against a major broker-dealer whereby Claimant alleged breach of fiduciary duty and failure to supervise regarding the sale of “Principal Protected Notes,” the Chairperson rejected Respondent’s arguments in their moving papers that Claimant should bear the cost of production if Respondent was ordered to produce regulatory documents.

In their brief, Respondent cited *Schweinfurth v. Motorola*,<sup>62</sup> a product liability case from Ohio as an example when a court ordered 50% of costs of producing over 1 million documents shifted to plaintiffs. Claimant asserted that Respondent’s use of this case was misplaced. In *Schweinfurth*, the plaintiffs sought production of documents relating to “all [of defendants] cellular telephones using an allegedly defective CE connector.”<sup>63</sup> The defendant argued that the request was broad, and thus, should be “limited to the cellular telephones purchased by the named plaintiffs.”<sup>64</sup> The court agreed with the defendants “because [plaintiff’s request] did not pertain to phones used by named plaintiffs.”<sup>65</sup> In addition, defendants had already produced over 200,000 pages, and the plaintiffs had delayed in moving for discovery.<sup>66</sup> Claimant argued that here, unlike *Schweinfurth*, Claimant was not seeking documents regarding all types of investment products that Respondent sold. Rather, all of Claimant’s requests were limited to documents regarding “Principal Protected Notes,” which was the only security in issue in that case. In addition, Claimant had neither delayed in moving for discovery nor had Respondent produced over 200,000 pages of documents.

Respondent also cited another product liability case from the Southern District of New York<sup>67</sup> for the proposition that “shifting some of the cost is

---

61. See CAL. CIV. PROC. CODE § 2031.210(d) (West 2010) (emphasis added).

62. *Schweinfurth v. Motorola*, 2008 U.S. Dist LEXIS 82772, at \*6-7 (N.D. Ohio Sept. 30, 2008).

63. *Id.* at \*2 (emphasis added).

64. *Id.*

65. *Id.* at \*7.

66. *Id.* at \*6-7.

67. *In re Fosamax Prods. Liab. Litig.*, 2008 US. Dist. Lexis 44323, \*31 (S.D.N.Y. June 5, 2008).

intended to create an incentive for plaintiffs to narrow their requests to focus on the documents they really want.”<sup>68</sup> Again, Claimant argued that Respondent’s reliance on this case was misplaced because there, Respondent ignored the fact that the defendants had already produced the “[O]fficial Investigational New Drug (“IND”) and New Drug Application (“NDA”) files . . . which contained documents relating to [defendant’s] *communications with the FDA* about the development, approval, and post-marketing surveillance of [the drug].”<sup>69</sup> In fact, those documents accounted for “856,992 of the roughly 1.4 million pages produced by [the defendants] so far.”<sup>70</sup> More importantly, Respondent ignored the primary reason why the court shifted some of the cost to the plaintiffs:

*An overarching reason for limitation is plaintiffs' delay in bringing this issue to the Court's attention. Plaintiffs learned of [the defendants] intended date limitation in January 2007. [The defendant] reaffirmed its position in its April 27, 2007 letter. Plaintiffs nevertheless waited until April 18, 2008, about a year later and less than four months before the scheduled conclusion of fact discovery in the early trial pool cases, to file this motion. Some restrictions appear necessary to keep proceedings in this MDL moving apace.*<sup>71</sup>

Those facts were not present in the securities arbitration. Specifically, Claimant highlighted that Respondent had not produced “roughly 1.4 million documents.” Second, Claimant argued that the defendants in *Fosamax* had already provided plaintiffs with over 850,000 pages of documents pertaining to communications with the FDA, which were the same type of documents Claimant sought from Respondent in the instant securities arbitration – communications with regulators. Third, Claimant contended there was no need to “incentivize” Claimant to narrow the scope of the requested documents because Claimant already narrowed the requests during pre-hearing discovery conference. And finally, Claimant had not abused the discovery process by delaying over a year before filing the motion to compel. Thus, there was no need for the Chairperson to grant Respondent’s requested cost-sharing restrictions to keep proceedings moving along.

---

68. *Id.*

69. *Id.* at \*5 (emphasis added).

70. *Id.*

71. *Id.* at \*30.

Moreover, Respondent cited to *Blue Chip Stamps v. Manor Drug Stores*<sup>72</sup> to support their proposition that “courts have recognized the costs associated with document productions in securities cases *can* impose an unfair burden on defendants.” Respondent quotes from *Blue Chip* that:

[T]o the extent that it [discovery] permits a *plaintiff with a largely groundless claim* to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a *reasonably founded hope that the process will reveal relevant evidence*, it is a social cost rather than a benefit.<sup>73</sup>

Therefore, the *Blue Chip* court recognized that production costs will impose an unfair burden on defendants *only when* a plaintiff has a “largely groundless claim” with little hope of finding relevant evidence from the production.<sup>74</sup> Claimant argued that the production of documents did not impose an unfair burden on Respondent since Claimant had already established that he not only had a valid claim against Respondent, but that the documents he sought were relevant.

### III. PRACTICE POINTERS

In any “product” case, it is an essential part of the attorney’s due diligence in determining whether or not to accept the case, to discover whether any regulatory actions have been initiated against the broker-dealer who sold the product to your potential client. With respect to investigations commenced by a state regulatory agency, such as a state’s securities commissioner, it is common that a state regulatory agency issues a press release announcing the commencement of an investigation against a broker-dealer involving the specific product purchased by your potential client. Often times the press release will not only report the commencement of an investigation but may also report at the same time a consent order whereby the broker-dealer has agreed to findings of fact and a remedy. In addition, the North American Securities Administrators Association (“NASAA”) has a website ([www.NASAA.org](http://www.NASAA.org)) which should be searched to discover any states that have commenced any such investigations. Finally, a check of the broker-dealer and the product in issue should be searched through Google or

---

72. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975).

73. *Id.* (emphasis added).

74. *Id.* (emphasis added).

some other search engine. Investigations commenced by the SEC, either against the broker-dealer or against the individual broker, may also be discovered by searching for press releases or at the SEC's website, [www.SEC.gov](http://www.SEC.gov).

Once the regulatory complaint has been discovered, they often contain exhibits in the form of internal emails, marketing materials, excerpts of interviews with individual brokers or supervisors about the products in issue. It is our firm's practice to attach a copy of any relevant investigatory complaint and/or consent order, with exhibits to the statements of claim. Attaching such a regulatory complaint and/or consent action is designed to demonstrate to the panel, that the wrongful conduct engaged in by the broker-dealer in selling the product was not isolated, but rather was part of a broad sales practice abuse engaged in by the firm.

Next, it is essential that one of the demands in your initial document request seeks discovery of all documents submitted by the broker-dealer to any state or federal regulator, or SRO.<sup>75</sup> Invariably, broker-dealers will object to such a request setting up an initial meet and confer letter which almost always is followed by a motion to compel citing the cases and authorities discussed previously in this article.

At the hearing, it is likely that notwithstanding the fact that the chairperson or the entire panel, granted the motion to compel production of the regulatory documents by the broker-dealer, the broker-dealer will object to their introduction into evidence or any reference to the investigation and/or consent. The objections by the broker-dealer often claim that because the investigation is not over, any reference to it is premature and therefore irrelevant. Alternatively, if the investigation is complete, and there is a consent order to findings of fact, the broker-dealer may cite to a portion of the consent order that sometimes states that by entering into the consent order the broker-dealer is not consenting or admitting to any liability. Alternatively, some consent orders may contain a statement that nothing in the consent order creates a private right of action.

It is our practice, regardless of whether or not the investigation is completed and regardless of the specific language in the consent order, to call the broker-dealer's corporate representative who is attending the hearing and ask him whether or not he is aware of the investigation of his firm by this

---

75. For example, "All documents received from, or sent to any state, federal, SRO regulatory or securities agency pursuant to any investigation by any such agency of the investment(s) at issue" and "All documents received from, or sent to any federal or state regulatory authority and/or law enforcement authority and/or self-regulatory authority concerning the investment(s) at issue."

specific state that has initiated the investigation. In addition, it is good practice to ask the corporate representative whether he agrees that the allegations in the state regulatory complaint are similar to the allegations in the statement of claim filed by your client in this particular arbitration. In practice, the allegations should be similar since you have discovered the existence of the state regulatory complaint prior to filing the statement of claim.

Sometimes, the corporate representative will be the local branch manager who may claim that he has no knowledge of the existence of the state or federal regulatory action. In such cases, it is our practice to then show the local branch manager the state regulatory complaint and walk him through the similarities between the state regulatory complaint and the statement of claim. Such examination of the local broker-dealer is not designed to prove the truth or untruth of the state regulatory allegations but rather to show the similarities between the state regulatory allegations and those set forth in your statement of claim, in a further effort to prove that the sales practice abuses in both are not isolated but rather are wide spread.

#### **IV. CONCLUSION**

There is no case law to support the argument that nonprivileged relevant documents and correspondence submitted to the SEC are protected from discovery in subsequent civil litigation between private litigants. Instead, case law supports the conclusion that SEC regulations deeming nonpublic certain disclosures to the agency, are for the benefit of the SEC and not for the party responding to the inquiry. Accordingly, courts and securities arbitration panels have rejected the “SEC privilege” argument, ordering the production of correspondence and documents submitted to the SEC.