# RECENT SEC DECISION REMINDS REGULATED ENTITIES TO ACT PROMPTLY AND TAKE SPECIAL CARE WHEN RESPONDING TO SEC REQUESTS

A recent decision by a Securities and Exchange Commission ("SEC" or "Commission") administrative law judge ("ALJ") illustrates the SEC's rigorous enforcement of the requirement that a registered entity's books and records be available upon request and "in an easily accessible place."[1] In a recent administrative decision, *In the matter of vFinance Investments, Inc.*, the SEC successfully obtained civil monetary penalties of $100,000 against the company for willful violation of the Exchange Act's books and records provisions and $30,000 against its Chief Compliance Officer for aiding and abetting those violations. This case serves as a reminder that the SEC may fine regulated entities for failing to make documents available and that compliance officers may be liable for employees' or independent contractors' failures to preserve or produce requested documents.

## Factual Background

vFinance is a broker-dealer based in Florida with independent-contractor representatives located in various branch offices throughout the country. A registered representative in vFinance's Flemington, New Jersey branch office (the "New Jersey representative") had been using instant messaging ("IM") software in his trading activities as well as various web-based private email accounts to communicate with retail clients. Both IM and the web-based email accounts were beyond the company's ability to capture and retain potential communications with the public. During the course of an earlier audit, the company's Chief Compliance Officer became aware of the New Jersey representative's use of unsanctioned technology resources and instructed the representative to stop conducting company business through these email accounts. The New Jersey representative continued to use the private email accounts for eighteen months from the time of the initial warning, despite the Chief Compliance Officer's subsequent follow-up requests and threats of disciplinary action.

When the SEC's Enforcement Division contacted vFinance's Chief Compliance Officer to request documents related to the New Jersey representative's possible manipulation of a given issuer's stock, the company was not able to make a complete production because it had not been capturing the contents of the representative's private email accounts. The Chief Compliance Officer asked the New Jersey representative suspected of wrongdoing to collect his own emails, phone logs, and notes in response to the SEC's request. The representative proceeded to destroy responsive files located on various computers he used in connection with his vFinance work. After nearly two years of failed attempts to respond completely to the SEC's various document requests, the Chief Compliance Officer visited the Flemington, New Jersey branch, himself, and collected whatever responsive documents he could find to produce to the SEC.

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[1] Exchange Act Rule 17a-4, 17 C.F.R. 240.17a-4 (2003); *see* Exchange Act Rule 17a-3, 17 C.F.R. 240.17a-4 (2003).

Failure to Produce Books and Records Promptly Is a Violation of the Exchange Act

The books and records provisions of the Exchange Act require that regulated entities retain, among other things, business communications with the public for at least three years. For the first two years of retention, those communications must be kept in an easily accessible place.[2] Regulated entities must produce books and records materials to the Commission "promptly" as requested by a representative of the Commission.[3] Commission staff may require copies of a broker-dealer's records without a formal Commission request or subpoena.

In the vFinance case, the company's production remained incomplete for over eighteen months before the company marshaled the resources necessary to respond in earnest to the SEC's request. For instance, the company had not within eighteen months provided even those emails sent or received by the New Jersey representative through the company's email system. The ALJ found that this "extraordinary length of time to produce documentation is clearly not what the plain language of the statute and rules contemplate."[4] He concluded that vFinance had neither maintained the required information, including the New Jersey representative's client communications sent through a private email account, in an "easily accessible place" nor turned it over to the SEC "promptly" and assessed civil penalties of $100,000 against the company accordingly. This is the second case in the past two years in which the SEC has sought significant relief based solely on the books and records requirements.

Compliance Officers May Be Subject to Aiding and Abetting Liability

The ALJ also found that vFinance's Chief Compliance Officer had willfully aided and abetted and caused the company's books and records violations by failing to: restrain the New Jersey representative's use of IM and personal email for customer communication; design and enforce procedures to capture the New Jersey representative's communications; or respond promptly to the SEC's records requests. Contributing to the ALJ's conclusion that the Chief Compliance Officer's inaction had "substantially assisted" the company's primary violations[5] were the facts that the Chief Compliance Officer had permitted the alleged wrongdoer to do his own document collection and tolerated six months of non-responsiveness from the New Jersey representative to his document collection requests before threatening to terminate the representative. The Chief Compliance Officer received a six-month suspension from association with a broker or dealer and a $30,000 fine.

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[2] 17 C.F.R. 240.17a-4(b)(4).

[3] 17 C.F.R. 240.17a-4(j).

[4] In re vFinance Investments, Inc., Initial Release No. 360, __ SEC Docket __, at *14 (Nov. 7, 2008), *available at* www.sec.gov/litigation/aljdec/2008/id360rgm.pdf (last visited Nov. 26, 2008).

[5] SEC v. Treadway, 430 F. Supp. 2d 293, 339 (S.D.N.Y. 2006) (inaction is insufficient to demonstrate substantial assistance unless the inaction furthers the primary violation).

Lessons from this Decision

Regulatory requirements, such as the record-keeping requirements at issue here, can easily turn into enforcement matters, even when the underlying conduct may not independently support an enforcement action.

- Regulated entities should heed this case's warning to maintain their books and records in an easily accessible place for prompt production in case of request by the SEC. Failure to do so can be costly for the firms involved, and can be career-altering for the individuals involved.
- Broker-dealers and their compliance officers cannot escape vicarious liability simply because their registered representatives are independent contractors, as opposed to employees.
- Regulated entities should not, in most circumstances, delegate document collection to employees or independent contractors directly involved in an investigation. At a minimum, the regulated entity must preserve and collect documents using its compliance and legal personnel, and should consider using outside legal and forensic resources in cases of any complexity.
- A regulated entity's compliance officer can be subject to aiding and abetting liability, and to severe personal sanctions, for condoning or tolerating representatives' use of non-company technology resources to communicate with the public insofar as that use interferes with the entity's recordkeeping obligations.

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If you have any questions concerning the foregoing or would like additional information, please contact Gregory S. Bruch (202-303-1205, gbruch@willkie.com), Elizabeth P. Gray (202-303-1207, egray@willkie.com), Julie A. Smith (202-303-1209, jasmith@willkie.com), or the attorney with whom you regularly work.

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