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SEC INVESTIGATIONS—SEC NEED NOT NOTIFY TARGET OF THIRD-PARTY SUBPOENAS

SEC v. Jerry T. O'Brien, Inc., 104 S. Ct. 2720 (1984)

I. INTRODUCTION

In *SEC v. Jerry T. O'Brien, Inc.*,[1] the Supreme Court reversed the Ninth Circuit Court of Appeals and held that the Securities and Exchange Commission (SEC) does not have to give a target[2] of an SEC investigation notice of subpoenas issued to third parties in connection with the investigation.[3] The Court reasoned that the Constitution, the statutes administered by the SEC, and prior case law did not require that the SEC give targets notice of third-party subpoenas.[4]

The Court identified special problems associated with securities investigations, most notably the difficulty that the SEC sometimes has in identifying targets and some targets' propensity to interfere with SEC investigations.[5] The Court's holding, however, does not address the Ninth Circuit's concern that without notice, SEC targets have no means of ensuring that the SEC investigates them in accordance with the standards of *United States v. Powell*.[6] This Note will contend that Congress could enact a statutory scheme, similar to that governing Internal Revenue Service (IRS) investigations, that would alleviate the problems that the Court identifies in *O'Brien* and ensure that the SEC conducts its investigations in accordance with the standards of *Powell*.

II. THE *POWELL* STANDARDS

In *United States v. Powell*, the Commissioner of Internal Revenue summoned Respondent Powell, the president of a corporate

1 104 S. Ct. 2720 (1984).

2 "Target," as this Note will use the term, means the party whose conduct is the focus of an agency's investigation. *See, e.g.*, United States v. Baggot, 103 S. Ct. 3164, 3165 (1983).

3 *O'Brien*, 104 S. Ct. at 2725.

4 *Id.* at 2725-30.

5 *Id.* at 2730.

6 379 U.S. 48 (1964).

taxpayer, to appear before an IRS agent and produce certain records.[7] The statute of limitations barred the IRS from assessing tax deficiencies for the year in question except in cases involving fraud.[8] Respondent Powell refused to obey the IRS summons and asserted that it was not enforceable unless the IRS could show probable cause for its belief that the respondent had committed some fraud.[9] The Supreme Court held that the IRS need not show probable cause to have a court enforce its administrative subpoena, but must show that the subpoena does meet certain threshold standards.[10] The standards are:

> (1) The Commissioner of Internal Revenue must show that he is conducting the investigation giving rise to the summons for a legitimate purpose;
> (2) The Commissioner must show that the inquiry giving rise to the summons may be relevant to the legitimate purpose;
> (3) The Commissioner must show that he does not already possess the information he seeks; and
> (4) The Commissioner must show that he has followed the administrative steps the tax code requires him to follow.[11]

When individuals under investigation challenge SEC attempts to enforce subpoenas, courts routinely use the *Powell* standards to determine whether the SEC subpoena in question is within the scope of SEC authority.[12] But the standards are rarely used to limit SEC power. In *SEC v. Peoples Bank of Danville*,[13] for example, a court held that the SEC subpoena of Respondent Bank of Danville conformed to the *Powell* standards and was therefore enforceable despite the bank's contention that enforcement "will create injurious rumors regarding the Bank and will necessarily result in harm to the Bank's financial stability."[14]

When courts do limit SEC subpoena authority, they find that the subpoenaed party is, prima facie, protected from the subpoena and that the SEC is unable to rebut the presumed protection. For example, in *SEC v. Wall Street Transcript Corporation*,[15] a court held an

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7 *Id.* at 49.

8 *Id.*

9 *Id.*

10 *Id.* at 57-58.

11 *Id.*

12 *See, e.g.*, Ayers v. SEC, 482 F. Supp. 747 (D. Mont. 1980); SEC v. OKC Corp., 474 F. Supp. 1031 (N.D. Tex. 1979); SEC v. Dresser Industries, Inc., 453 F. Supp. 573 (D. D.C. 1978); SEC v. Peoples Bank of Danville, FED. SEC. L. REP. (CCH) ¶ 96,382 (W.D. Va. 1978); SEC v. Wall Street Transcript Corp., 294 F. Supp. 298 (S.D.N.Y. 1968), *rev'd*, 422 F.2d 1371 (2d Cir. 1970).

13 FED. SEC. L. REP. (CCH) at ¶ 96,382.

14 *Id.*

15 294 F. Supp. 298 (S.D.N.Y. 1968), *rev'd*, 422 F.2d 1371 (2d Cir. 1970).

SEC subpoena unenforceable because the SEC was unable to rebut the presumed first amendment protection of the respondent newspaper.[16] Thus, courts generally view the *Powell* standards as threshold criteria easily met by the SEC except in cases where the subpoenaed party is prima facie protected.

III. FACTS

O'Brien arose out of a 1980 SEC investigation of the business practices of Harry F. Magnuson.[17] In September of 1980, the SEC issued a Formal Order of Investigation,[18] which authorized the staff of the SEC's Seattle Regional Office to conduct a private investigation into Mr. Magnuson's securities transactions.[19] The Formal Order authorized SEC employees to subpoena testimony and documents " 'deemed relevant or material to the inquiry.' "[20] Acting in accordance with the order, SEC staff members subpoenaed the records of Jerry T. O'Brien, Inc. and Pennaluna & Co.[21] O'Brien voluntarily complied with the subpoena, but Pennaluna re-

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16 *Id.* at 302-03. Although the *Powell* standards say nothing about the first amendment, the court used the standards as justification for its inquiry as to whether the SEC's subpoena comported with the first amendment and thus whether the subpoena was within the SEC's authority. *Id.* The court's decision was later reversed by the Court of Appeals for the Second Circuit, which held that the SEC should determine whether the respondent newspaper was a "bona fide newspaper" before the issue went to the district court, and that the SEC's subpoena therefore posed no immediate first amendment problems. SEC v. Wall Street Transcript Corp., 422 F.2d 1371, 1379-80 (2d Cir.), *cert. denied*, 398 U.S. 958 (1970).

17 *O'Brien*, 104 S. Ct. at 2723. The purpose of the investigation was to determine whether Magnuson's transactions involving five mining companies violated the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. Brief for Respondents Harry F. Magnuson and H.F. Magnuson & Co. at 3, SEC v. Jerry T. O'Brien, Inc., 104 S. Ct. 2720 (1984).

18 A Formal Order of Investigation "is issued bv the SEC only after its staff has conducted a preliminary inquiry, in the course of which 'no process is issued [nor] testimony compelled.' " *O'Brien*, 104 S. Ct. at 2723 n.1 (quoting 17 C.F.R. § 202.5(a) (1983)).

19 *Id.* at 2723.

20 *Id.* (quoting Complaint, Exhibit A at 3-4). Jerry T. O'Brien, Inc. and Pennaluna & Co. were two companies that SEC investigators thought may have been involved in transactions with Mr. Magnuson. The role of Pennaluna & Co. in the investigation is not clear from the Supreme Court opinion, the lower court opinions, or the briefs that the parties filed with the Supreme Court. In *O'Brien*, the Court wrote:

> [T]he relationships between Jerry T. O'Brien, Inc., Pennaluna & Co., and their individual owners is not fully elucidated by the papers before us. Because, for the purposes of this litigation, the interests of all these respondents are identical, hereinafter they will be referred to collectively as O'Brien, except when divergence in their treatment by the courts below requires that they be differentiated.

Id. at 2723 n.2.

21 *Id.* at 2723.

fused to comply.[22]

Shortly after the SEC issued the subpoenas, SEC employees informed O'Brien that the SEC considered it, as well as Mr. Magnuson, a target of investigation.[23] O'Brien, Pennaluna, and their owners filed suit in the United States District Court for the Eastern District of Washington, attempting to enjoin the SEC investigation and prevent Mr. Magnuson from complying with subpoenas that the SEC had issued to him.[24] O'Brien alleged that the SEC's Formal Order of Investigation was defective and that the SEC was conducting the investigation improperly.[25] O'Brien also filed motions seeking discovery of the SEC's files and depositions of SEC employees.[26] In addition, Mr. Magnuson filed a cross-claim, also seeking to enjoin parts of the investigation.[27] The government moved to dismiss all these claims and the district court granted the motion.[28]

The district court reasoned that injunctive relief was not appropriate because the plaintiffs had an adequate remedy at law—they could challenge the subpoenas if and when the government sought to enforce them.[29] In addition, the district court held that the subpoenas conformed to the standards of *Powell*; thus, the subpoenas would be judicially enforceable if the SEC brought an action to enforce them.[30]

Following this decision, Mr. Magnuson and O'Brien brought to the district court a new request for injunctive relief, a motion for a stay pending appeal, and a request for notice of subpoenas that the SEC had issued to third parties in connection with the investiga-

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22 *Id.*

23 *Id.*

24 *Id.*

25 Brief for Petitioners at 3-4, SEC v. Jerry T. O'Brien, Inc., 104 S. Ct. 2720 (1984). The petitioners noted the details of the respondents' allegations: "that the Commission's formal order did not expressly name it and others under investigation and that therefore the Commission had not found that each person being investigated likely committed a violation," *id.* (citing Complaint, at 3-16); "that the Commission did not have a valid purpose for its investigation and should have provided each person subject to the subpoena with notice of, and an opportunity to comment on, the commencement of the investigation," *id.* (citing Complaint, at 10); "that the Commission was reinvestigating matters litigated and settled by the parties in 1975," *id.* (citing Complaint, at 9); "and that the Commission had violated the constitutional, statutory, and common law privacy rights of the persons subject to the investigation," *id.* (citing Complaint, at 10, 14).

26 *O'Brien*, 104 S. Ct. at 2723-24.

27 *Id.* at 2723.

28 *Id.* at 2724 (citing Jerry T. O'Brien, Inc. v. SEC, No. C-81-540, slip op., (E.D. Wash. Jan. 20, 1982)).

29 *Id.*

30 *Id.*

tion.[31] The district court denied the requested relief.[32] The district court reasoned that Mr. Magnuson and O'Brien lacked standing to challenge third parties' voluntary compliance with subpoenas and that if the SEC instituted any further proceedings, Mr. Magnuson and O'Brien could move to suppress evidence obtained from third parties through abusive subpoenas.[33]

Mr. Magnuson and O'Brien appealed to the Court of Appeals for the Ninth Circuit. The court of appeals affirmed the district court's denial of injunctive relief, but held that the appellants were entitled to notice of third-party subpoenas.[34] The Ninth Circuit held that targets have a right to have the SEC investigate them in a manner consistent with the *Powell* standards.[35] Thus, the Ninth Circuit concluded that the SEC must give notice of third-party subpoenas to targets of investigations.[36]

Following the court of appeals decision, the SEC petitioned for rehearing *en banc* and the United States government accompanied the SEC's petition with an *amicus curiae* brief on behalf of over twenty other administrative agencies whose investigative practices might be affected by the decision.[37] The court of appeals denied the petition.[38] Five judges dissented from the denial, however, and contended that the decision was not a reasonable interpretation of *Powell* and would create too much difficulty for agencies trying to conduct administrative investigations.[39] Because of the importance of the question of notice of third-party subpoenas, the Supreme Court granted certiorari.[40]

IV. The Supreme Court Opinion

Justice Marshall wrote the opinion for the Supreme Court's unanimous reversal of the Ninth Circuit. The Court examined constitutional, statutory, and common law rationales that might support a target party's claim of a right to notice of third-party subpoenas and held that a target party has no such right.[41]

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[31] *Id.*

[32] *Id.* (citing *O'Brien*, No. C-81-546, slip op.).

[33] *Id.*

[34] Jerry T. O'Brien, Inc. v. SEC, 704 F.2d 1065, 1069 (9th Cir. 1983), *rev'd*, 104 S. Ct. 2720 (1984).

[35] *Id.* at 1068.

[36] *Id.* at 1069.

[37] Jerry T. O'Brien, Inc. v. SEC, 719 F.2d 300 (1983).

[38] *Id.*

[39] *Id.* at 300 (Kennedy, J., dissenting).

[40] *O'Brien*, 104 S. Ct. at 2720.

[41] *Id.* at 2725.

The Court first discussed constitutional considerations and concluded that the Court's previous holdings leave no constitutional arguments available to support the court of appeals' holding.[42] The Court pointed out that in *Hannah v. Larche*,[43] it held that neither the due process clause of the fifth amendment, nor the confrontation clause of the sixth amendment prevented an agency from issuing third-party subpoenas without notice to the target party.[44] The Court in *Hannah* reasoned that the due process clause cannot be offended by administrative investigations "because an administrative investigation adjudicates no legal rights."[45] Similarly, the Court in *Hannah* reasoned that the confrontation clause is not relevant to an administrative investigation because an administrative investigation is not a criminal proceeding.[46]

The Court in *O'Brien* noted that the SEC has statutory authority that allows it to conduct nonpublic investigations and to issue subpoenas to obtain relevant information in connection with such investigations.[47] The question presented, the Court wrote, is whether the SEC's statutory authority is limited to the extent that it must provide notice of third-party subpoenas to targets of its investigations.[48]

The Court discussed possible statutory rationales for the court of appeals holding and concluded that the statutes administered by the SEC provide no basis for the lower court's holding.[49] First, the Court found that the securities statutes give the SEC expansive authority to conduct investigations.[50] Second, the Court found that Congress has never indicated that it expected the SEC to adopt procedures whereby the SEC must notify targets of third-party subpoe-

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42 *Id.*

43 363 U.S. 420 (1960).

44 *O'Brien*, 104 S. Ct. at 2725.

45 *Hannah*, 363 U.S. at 440-43.

46 *Id.* at 440 n.16.

47 *O'Brien*, 104 S. Ct. at 2765.

48 *Id.* at 2723.

49 *Id.* at 2726. Justice Marshall noted that § 19(b) of the Securities Act of 1933 "empowers the SEC to conduct investigations 'which, in the opinion of the Commission, are necessary and proper for the enforcement' of the Act and to 'require the production of any books, papers, or other documents which the Commission deems relevant or material to the inquiry.'" *Id.* (quoting 15 U.S.C. § 77s(b)). He further pointed out that §§ 21(a) and (b) of the Securities Exchange Act of 1934

> authorize the Commission to "make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter [or] the rules and regulations thereunder" and to demand to see any papers "the Commission deems relevant or material to the inquiry."

Id. (quoting 15 U.S.C. §§ 78u(a)-(b)(1977)).

50 *O'Brien*, 104 S. Ct. at 2726.

nas.[51] Finally, the Court noted the complexity of the Right to Financial Privacy Act,[52] a statute requiring the SEC and other agencies to give notice of third-party subpoenas "in one special context,"[53] and reasoned that Congress would not approve of the crude notification requirement that the Ninth Circuit adopted in *O'Brien*.[54]

The Court in *O'Brien* also held that case law does not support the Ninth Circuit's holding in favor of notice to targets of third-party subpoenas.[55] The Court found that the self-incrimination clause of the fifth amendment is not relevant to the instant situation because the self-incrimination clause prohibits only compelled self-incrimination, and a subpoena to a third party does not compel anyone to act as a witness against himself.[56] Thus, targets themselves have no direct fifth amendment right to challenge a third-party subpoena, and targets have no derivative right to make such a challenge based on a third party's fifth amendment rights.[57]

The Court also used prior case law to support the holding that the targets of an SEC investigation cannot successfully assert, under the fourth amendment, that notice is required before the SEC can conduct a search and seizure of the target's papers.[58] The Court concluded that prior cases have established that "when a person communicates information to a third party even on the understanding that the communication is confidential, he cannot object if the third party conveys that information or records thereof to law enforcement authorities."[59]

In addition, the Court rejected the argument that prior case law establishes that *Powell* requires targets to receive notice of third-party subpoenas.[60] The Court reasoned that although the *Powell*

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[51] *Id.* at 2727.

[52] 12 U.S.C. §§ 3401-22 (Supp. V 1982).

[53] *O'Brien*, 104 S. Ct. at 2727; *see infra* note 69.

[54] *O'Brien*, 104 S. Ct. at 2727. The Court argued that Congress has acted on the issue of notification of SEC subpoenas in a specific context, but has not acted on the issue generally. This indicates that Congress has never intended to legislate on SEC subpoenas in general. *Id.*

Moreover, the Court asserted that the enactment of the Right to Financial Privacy Act suggests that Congress assumed that the SEC was not subject to a general obligation to give targets notice of third-party subpoenas. *Id.* at 2728.

[55] *Id.* at 2725.

[56] *Id.* at 2725-26.

[57] *Id.* at 2726.

[58] *Id.*

[59] *Id.* (citing United States v. Miller, 425 U.S. 435, 443 (1976)).

[60] *Id.* at 2728-30. Respondents argued first that the SEC must issue subpoenas in a manner consistent with the standards established in United States v. Powell, 379 U.S. 48 (1964). *O'Brien*, 104 S. Ct. at 2728. They contended that an individual subpoenaed by the SEC or any person affected by an SEC subpoena has a substantive right to demand

standards apply to SEC investigations, the standards themselves do not mandate notice.[61]

The Court ultimately found that policy considerations justified its conclusion that a target has no right to notice of third-party subpoenas. First, the Court reasoned that administration of the notice requirement would place a great burden on the judicial system.[62] Second, the Court pointed out that the SEC cannot always identify targets at the start of an investigation.[63] Finally, the Court reasoned that the notice requirement would enable a target to intimidate witnesses, alter or destroy documents, and discourage witnesses from disclosing information.[64]

In sum, the Supreme Court held that there is no constitutional or statutory basis for a target party's asserted right to notice of third-party subpoenas. Further, the Court held that any asserted common law basis for such a right will not prevail because of overriding policy considerations. Hence, the Court has refused to extend the standards of *Powell* to require that the SEC provide notice of third-party subpoenas.

V. ANALYSIS

Although the Court in *O'Brien* held that Congress had not yet created a general statutory basis for an SEC target's right to notice of third-party subpoenas,[65] the Court did not hold that Congress

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that the SEC comply with the *Powell* standards. *Id.* They argued that an SEC target may assert his right in two ways. *Id.* First, the target may seek to intervene in any enforcement action that the SEC brings against a subpoena recipient. *Id. See* Donaldson v. United States, 400 U.S. 517 (1971) (petitioner's interest in records of his former employer was not sufficient to authorize his intervention in enforcement proceedings, but did not foreclose other possible bases for intervention in administrative summons enforcement proceedings); Reisman v. Caplin, 375 U.S. 440 (1964) (injunctive relief not granted where petitioner alleged Internal Revenue subpoena was invalid, because the petitioner may have appeared or intervened before the district court and challenged the summons and thus had a remedy at law). Second, if the subpoena recipient threatens to voluntarily comply, the target can restrain the recipient's compliance and force the SEC to file suit to enforce the subpoena. *O'Brien*, 104 S. Ct. at 2729. *See Reisman*, 375 U.S. at 450. Therefore, Respondents argued, the SEC must notify targets of third-party subpoenas because, absent such notification, they cannot take steps to protect their rights under *Powell*. 104 S. Ct. at 2729.

61 104 S. Ct. at 2729.

62 *Id.*

63 *Id.* The Court feared that even if the SEC could identify targets, parties that the SEC had not classified as targets would contend that they should be so classified and, hence, should have notice of all subpoenas that the SEC has issued in connection with a particular investigation. *Id.* Should the issue come before a district court, the court would have to inquire into the details of the investigation, thus making them public. *Id.*

64 *Id.* at 2730.

65 *Id.* at 2726.

could never create such a right.[66] Congress has created a notice requirement in the context of tax investigations, and courts have previously recognized the similarity between tax and securities investigations.[67] Thus, the tax statute concerning administrative subpoenas[68] provides a good model for a possible securities investigation statute.[69]

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66 *Id.* at 2727, 2730 n.25.

67 *See, e.g.*, SEC v. Wheeling-Pittsburgh Steel Corp., 648 F.2d 118 (3d Cir. 1981) (*Powell* standards are criteria by which a court should determine whether an SEC subpoena is abusive); SEC v. ESM Gov't Sec. Inc., 645 F.2d 310, 314 (5th Cir. 1981) (*Powell* standards are criteria, but not exclusive criteria, for a finding of fraud in connection with an SEC subpoena); SEC v. Arthur Young & Co., 584 F.2d 1018, 1024 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 1071 (1979) (*Powell* cited for the proposition that it is the proper function of the courts to guard against abuse of the subpoena enforcement process); SEC v. Hovatt, 525 F.2d 226, 229 (1st Cir. 1975) (*Powell* standards are judicial limitations on SEC's subpoena power); SEC v. Brigadoon Scotch Distrib. Co., 480 F.2d 1047, 1053 (2d Cir. 1973), *cert. denied*, 415 U.S. 915 (1974) (because an SEC subpoena conformed with the *Powell* standards, it was judicially enforceable).

68 26 U.S.C. § 7609 (1977). The relevant portion of the Internal Revenue statute provides:

> (a) *Notice.*—
> (1) *In general.*—If—
> (A) any summons . . . is served on any person who is a third-party recordkeeper, and
> (B) the summons requires the production of any portion of records made or kept of the business transactions of any person (other than the person summoned) who is identified in the description of the records contained in the summons, then notice of the summons shall be given to any person so identified . . . . Such notice shall be accompanied by a copy of the summons which has been served and shall contain directions for staying compliance with the summons . . . .
> (c) *Summons to which section applies.*—
> . . . .
> (2) *Exceptions.*— A summons shall not be treated as described in this subsecton if—
> (A) it is solely to determine the identity of any person having a numbered account (or similar arrangement) with a bank or other institution . . . or
> (B) it is in aid of the collection of—
> (i) the liability of any person against whom an assessment has been made or judgement rendered, or
> (ii) the liability at law or in equity of any transferee or fiduciary of any person referred to in clause (i).
> . . . .
> (g) *Special exception for certain summonses.*—. . . [t]he . . . [above] . . . provisions shall not apply if, upon petition by the Secretary, the court determines, on the basis of the facts and circumstances alleged, that there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or the production of records.

26 U.S.C. §§ 7609(a), (c), (g) (1977).

69 *See also* Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3401-22 (Supp. V 1982), which requires all federal government agencies to give notice of third-party summonses or subpoenas in a specific kind of situation. Under that Act, a "[g]overnment authority may obtain financial records . . . pursuant to an administrative subpoena or summons otherwise authorized by law only if . . . (2) a copy of the subpoena or summons has been served upon the customer or mailed to his last known address on or

The tax statute requires that when the Internal Revenue Commissioner knows the identity of a taxpayer under investigation, the Commissioner must notify the taxpayer of any subpoena served on a third party for "records made or kept of the business transactions or affairs" of the taxpayer.[70] The tax statute also provides for exceptions to its notice requirement.[71] The most significant of these exceptions allows the Commissioner to refuse to give the taxpayer notice when "there is reasonable cause to believe that the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination."[72] Hence, the statute generally requires the Commissioner to give notice of third-party subpoenas, but the Commissioner can invoke an exception to the requirement should it appear that notice would hinder the investigation.

Congress' intent in enacting the statute requiring the Internal Revenue Commissioner to notify targets of third-party subpoenas was that "the use of this important investigative tool should not unreasonably infringe on the civil rights of taxpayers, including the right to privacy."[73] One commentator has suggested that, given Congress' intent, courts will tend to enforce the tax statute's notice requirement only in situations where the taxpayer under investigation has a reasonable expectation of privacy or a protectable interest in the records kept by the summoned third party.[74] Targeted taxpayers, then, with a reasonable expectation of privacy in information held by third parties can obtain notice of third-party subpoenas. Thus, targeted taxpayers can take steps to protect their privacy interest by ensuring that the IRS complies with the *Powell* standards when the IRS investigates them, whereas SEC targets have no means of ensuring SEC compliance with the *Powell* standards.[75]

Courts often have recognized the analogy between IRS and

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before the date upon which the subpoena or summons was served on the financial institution . . . ." 12 U.S.C. § 3405 (1982).

The statute applies only when the third party that the government agency subpoenas is a "financial institution." 12 U.S.C. § 3401(1) (1982). In addition, the statute applies only when the government agency subpoenas the third party to produce "financial records." 12 U.S.C. § 3401(2) (1982).

The Court in *O'Brien* argued that this statute indicates that Congress did not intend to subject agencies to a general obligation to notify targets in all administrative subpoenas. *O'Brien*, 104 S. Ct. at 2728.

70 26 U.S.C. § 7609(a)(1)(B) (1977). *See supra* note 68.

71 26 U.S.C. §§ 7609(c)(2), (g) (1977). *See supra* note 68.

72 26 U.S.C. § 7609(g) (1977). *See supra* note 68.

73 H.R. REP. No. 658, 94th Cong., 2d Sess. 310-312 (1976), *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 2897, 3203.

74 Kenderdine, *The Internal Revenue Service Summons to Produce Documents: Powers, Procedures, and Taxpayer Defenses*, 64 MINN. L. REV. 73, 85 (1979).

75 *O'Brien*, 704 F.2d at 1069.

SEC investigations with respect to administrative subpoenas and have used IRS subpoena cases to support their holdings in SEC subpoena cases.[76] These cases indicate that courts tend to view the administrative investigation procedures of most agencies, especially the IRS and the SEC, as largely similar.

An SEC statute similar to the IRS statute would provide a greater measure of fairness in SEC investigations for two reasons. First, in situations where target parties are cooperative,[77] the SEC could conduct investigations in a less adversarial manner, with both parties working toward a solution to the problem. In fact, a statutory policy of notice in all routine cases would encourage target parties to cooperate with the SEC so that the SEC would not have to resort to the statutory exceptions and refuse to give notice.

Second, a statutory notice scheme similar to the scheme in the tax code would guard against SEC "fishing expeditions," where an SEC staff member conducts a groundless investigation of an innocent target.[78] Although the SEC might nevertheless conduct a "fishing expedition" by using the statutory exceptions as subterfuges, a target suspecting this could use the statute to bring the issue of notice into the district court. Targets would then have some basis for deciding whether they can invoke the *Powell* standards to ensure a fair investigation.

Circuit courts of appeals have uniformly agreed that the *Powell*

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[76] In SEC v. Wheeling-Pittsburgh Steel Corp., 648 F.2d 118 (3d Cir. 1981), the court wrote:

> We assume, as do the parties, that the same standards are applicable to enforcement of SEC subpoenas as Internal Revenue summonses. Thus, the subpoena issued by the Securities and Exchange Commission, 15 U.S.C. § 78u, like the administrative subpoena issued by the Federal Trade Commission, 15 U.S.C. § 49, and the Interstate Commerce Commission, 49 U.S.C. § 20, 6, as well as the administrative summons issued under § 7602 of the Internal Revenue Code, I.R.C. § 7602, is subject to the same judicial scrutiny prior to enforcement.

Id. at 123 n.5.

In SEC v. ESM Government Securities, Inc., 645 F.2d 310 (5th Cir. 1981), the court wrote:

> *Reisman v. Caplin*, [375 U.S. 440 (1964),] *United States v. Powell*, [379 U.S. 48 (1964),] and *United States v. LaSalle National Bank*, [437 U.S. 298 (1978)] . . . all involved enforcement of an IRS summons . . . . It is generally agreed, however, that the principles of these cases apply to SEC subpoenas as well.

Id. at 313 n.3.

[77] *See, e.g.*, PepsiCo, Inc. v. SEC, 563 F. Supp. 828 (S.D.N.Y. 1983) (record indicated that Pepsico cooperated fully with the SEC and agreed to supply the agency with extensive information).

[78] The SEC "has permitted, and at times encouraged, the abuse of its investigating function." SEC v. Wheeling-Pittsburgh Steel Corp., 482 F. Supp. 555, 565 (W.D. Pa. 1979), *vacated*, 648 F.2d 118 (3d Cir. 1981) (the reviewing court agreed that the SEC may have abused its investigatory power in this case and remanded so the district court could review further the SEC's motivation).

standards apply to Internal Revenue Service administrative subpoenas and summonses.[79] In addition, courts routinely apply the *Powell* standards in cases involving SEC subpoenas,[80] as well as in cases involving a variety of other agencies' subpoenas.[81]

Thus, in *O'Brien*, the Ninth Circuit Court of Appeals stressed that notice of third-party subpoenas is necessary if target parties are to have a means of ensuring that the SEC is conducting all aspects of their investigations in accordance with the *Powell* standards.[82] The court of appeals reasoned that third parties do not appear to have standing to require an agency to conduct its investigation in accordance with the *Powell* standards.[83] Assuming that the court of appeals is correct, only the target party can ensure compliance with the *Powell* standards by seeking permission to intervene when an agency institutes proceedings to enforce the third-party subpoena.[84] Thus, "unless the target of an SEC investigation receives notice of subpoenas served on third parties, no one will question compliance with the *Powell* standards as to those subpoenas."[85]

A statute governing SEC investigations might require the SEC to give targets notice of all third-party subpoenas under ordinary circumstances with certain exceptions to allow for the problems

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79 *E.g.*, Matter of Newton, 718 F.2d 1015, 1019 (11th Cir. 1983), *cert. denied*, 104 S. Ct. 1678 (1984); United States v. Will, 671 F.2d 963, 966 (6th Cir. 1982); United States v. Stuckey, 646 F.2d 1369, 1375 (9th Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982); United States v. Wyatt, 637 F.2d 293, 300 (5th Cir. 1981); United States v. Richards, 631 F.2d 341, 344 (4th Cir. 1980); United States v. Moon, 616 F.2d 1043, 1045-46 (8th Cir. 1980); United States v. Freedom Church, 613 F.2d 316, 319 (1st Cir. 1979); United States v. MacKay, 608 F.2d 830, 832 (10th Cir. 1979); United States v. Garden State Nat'l Bank, 607 F.2d 61, 67 (3d Cir. 1979); United States v. Moll, 602 F.2d 134, 138 (7th Cir. 1979); United States v. Chase Manhattan Bank, 598 F.2d 321 (2d Cir. 1979).

80 *See, e.g.*, Wedbush, Noble, Cooke, Inc. v. SEC, 714 F.2d 923 (9th Cir. 1983); SEC v. Arthur Young & Co., 584 F.2d 1018 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 1071 (1979); PepsiCo, Inc. v. SEC, 563 F. Supp. 828 (S.D.N.Y. 1983).

81 *See, e.g.*, EEOC v. Michael Constr. Co., 706 F.2d 244 (8th Cir. 1983) (EEOC subpoena); United States v. Thriftyman, Inc., 704 F.2d 1240 (Emer. Ct. of App. 1983) (subpoena issued by Department of Energy); ICC v. Gould, 629 F.2d 847 (3d Cir. 1980), *cert. denied*, 449 U.S. 1077 (1981) (court applied *Powell* standards to show ICC had issued an administrative summons in good faith); Federal Election Comm'n v. Committee to Elect Lyndon LaRouche, 613 F.2d 849 (D.C. Cir. 1979) (FEC subpoena); FTC v. Turner, 609 F.2d 743 (5th Cir.), *reh'g denied*, 614 U.S. 294 (1980) (FTC subpoena); Civil Aeronautics Board v. United Airlines, 542 F.2d 394 (7th Cir. 1976) (CAB subpoena); Lynn v. Biderman, 536 F.2d 820 (9th Cir. 1976) (subpoena issued by Department of Housing and Urban Development).

82 *O'Brien*, 704 F.2d at 1069.

83 *Id. See also id.* at 1067 (subpoenaed third party not likely to have ability, resources, or motive to challenge subpoena).

84 *But see* Donaldson v. United States, 400 U.S. 517, 528-29 (1971) (intervention by target permissive only and not mandatory).

85 *O'Brien*, 704 F.2d at 1069.

associated with some securities investigations. For example, the SEC statute might provide for exceptions to the notice requirement in cases where the SEC has reason to believe that a target will use the notice to intimidate or influence witnesses or to destroy documents.[86] The statute might provide another exception for cases when it is difficult or impossible for the SEC accurately to identify a target or set of targets for an investigation.[87] Congress could tailor the statute to allow the SEC discretion as to notice in certain problematic cases, and to require notice only in those cases where the SEC does not expect to encounter problems specified in the statute.

VI. Conclusion

Lack of constitutional, common-law, or statutory support led the Supreme Court to hold in *O'Brien* that current law does not require the SEC to notify investigation targets that it has issued subpoenas to third parties. Current law, however, does not preclude a notice requirement, and difficulty in identifying targets and the possibility of sabotage by targets are not present in all SEC investigations. Under circumstances where those problems do not exist, the SEC and the target party can benefit if the SEC gives the target notice of third-party subpoenas.

The tax code generally requires the Commissioner of Internal Revenue to notify targets of tax investigations when issuing subpoenas to third parties. Congress enacted this requirement to protect the civil rights of taxpayers. Courts have often recognized that the needs of the IRS and the SEC concerning administrative subpoenas are largely the same. Likewise, the targets of IRS and SEC investigations have similar civil rights interests requiring similar protection.

An SEC statute similar to the tax statute requiring notice of third-party subpoenas would add a measure of fairness to SEC investigations by encouraging parties to an SEC investigation to cooperate and by guarding against the threat of abusive SEC "fishing expeditions."

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86 *See O'Brien*, 104 S. Ct. at 2730 (Court fears notice to third party would lead to destruction of documents, etc.).

87 *See id.* at 2729 (Court fears that the need to identify target parties would make investigations more cumbersome for SEC).