



## BACKGROUND<sup>1</sup>

Sentinel was a registered investment adviser that primarily managed short-term cash investment portfolios for clients such as hedge funds, financial institutions, pension funds, Futures Commission Merchants, and individuals. This SEC enforcement action alleges that Sentinel engaged in a massive fraud involving misappropriation and misuse of client assets. (Doc. 64 ¶¶ 1-2.) The fraud, which began no later than 2003, was allegedly devised and carried out by Bloom (then Sentinel's President and Chief Executive Officer), and co-defendant Mosley (Sentinel's Senior Vice President and Head Trader from October 2002 until August 2007). (*Id.* at ¶¶ 1, 3, 17-18.)

Defendants Sentinel, Bloom and Mosley allegedly exposed clients to substantial undisclosed risk by relying extensively on leveraging activities, using Client Portfolio assets contrary to stated investment objectives in order to finance risky trading for the benefit of Sentinel's house portfolio (owned by Sentinel insiders, including Bloom and Mosley). (*Id.* at ¶ 3.) In addition, Bloom and Mosley allegedly used Client Portfolio assets to collateralize a bank line of credit to Sentinel, thus subjecting clients to the additional risk that the lender would assert a security interest in the assets and sell them if Sentinel could not meet its loan obligations. (*Id.*)

When credit markets tightened dramatically in the summer of 2007, Sentinel faced a reduction in the value and liquidity of the debt securities held in the Client Portfolios and a surge in client redemption requests. (*Id.* at ¶ 6.) Because such a large amount of the Client Portfolio assets was tied up in Sentinel's leveraging strategy or being used to

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<sup>1</sup> The background facts are taken from the First Amended Complaint (Doc. 64).

collateralize the Line of Credit, Sentinel ran out of cash to meet client redemptions and filed for Chapter 11 bankruptcy. (*Id.*) The SEC expects to prove that the alleged misconduct resulted in Sentinel losing several hundred million dollars of the approximately \$1.4 billion in Client Portfolio assets that Sentinel had under management at the time of its collapse. (*Id.* at ¶ 7.) The SEC alleges that Defendants' conduct violated numerous securities laws and it seeks a permanent injunction from further violations, as well as an order requiring Bloom and Mosley to disgorge profits and pay civil monetary penalties.

## **DISCUSSION**

### **I. Document Request Seeking 2002 SEC Examination Papers**

In February 2009, Bloom served the SEC with document requests seeking, among other things, documents relating to the SEC's examinations of Sentinel. One of these examinations was conducted in January and February 2002 and culminated in the issuance of a deficiency letter. In response to Bloom's document request, the SEC produced communications between the SEC and Sentinel relating to the 2002 examination, including the deficiency letter and other documents that had been exchanged by Sentinel and the SEC. Numerous documents were withheld, however, based upon the SEC's assertion that these documents are protected by the government deliberative process privilege.<sup>2</sup> The SEC describes the withheld materials as: "internal SEC staff communications, SEC examination staff work product, working copies of documents received from Sentinel with examiner notes, internal memoranda, the examination report, and analysis and drafts of such materials." (Doc. 175, at 2-3.) The SEC later decided to

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<sup>2</sup> The SEC also initially claimed an examination privilege, which it later withdrew.

redact, to the extent practicable, any examiner notes appearing on the SEC's working copies of documents received from Sentinel and produced those documents.

In his motion to compel, Bloom challenges the SEC's assertion of the deliberative process privilege, arguing that the SEC has not satisfied the procedural requirements for asserting the privilege, and the privilege does not apply to the documents in any event. Bloom further argues that, even if the documents fall within the scope of the privilege, he has a particularized need for the documents and his need outweighs the SEC's interest in their confidentiality. The SEC disagrees. It also asserts that the documents are irrelevant.

**A. Relevancy**

As a preliminary matter, the Court is unable to conclude that the documents at issue do not "encompasses any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case." *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351, 98 S.Ct. 2380, 57 L.Ed.2d 253 (1978); see also *Camphausen v. Schweitzer*, No. 10 C 3605, 2010 WL 4539452, at \*3 (N.D. Ill. Nov. 3, 2010). The SEC argues that the 2002 examination papers are not relevant because the complaint alleges that the fraudulent conduct did not begin until sometime after October 2002 when Bloom hired co-defendant Mosley to work at Sentinel. (Doc. 175, at 8.) However, the examination took place in January and February 2002, only months before the SEC alleges the misconduct began.

Bloom argues that facts regarding what the SEC reviewed in early 2002 and what action it took or did not take are relevant to his state of mind and good faith defense. While the SEC argues that its non-public "perspectives" during the examination, if not

communicated to Sentinel, are not relevant, the SEC's silence on a practice arguably could be relevant to the SEC's allegation that Bloom knowingly committed fraud. At oral argument on October 18, 2010, Bloom also argued that certain issues identified by the SEC as being subjects of the 2002 examination are directly related to the allegations in the complaint, including Sentinel's disclosure to clients regarding ownership of securities held in trust accounts, Sentinel's compliance with Rule 206(4)-2 of the Investment Advisers Act of 1940, and Sentinel's daily reconciliation process. Given the closeness in time between the 2002 examination and the alleged wrongful conduct, the Court is unwilling to deny Bloom's motion based on the SEC's view that nothing in the withheld documents is relevant.

**B. Deliberative Process Privilege**

The SEC insists that the documents are nonetheless protected from disclosure by the deliberative process privilege. "The deliberative process privilege protects communications that are part of the decision-making process of a governmental agency." *United States v. Farley*, 11 F.3d 1385, 1389 (7th Cir. 1993). "The privilege has a number of purposes: it serves to assure that subordinates within an agency will feel free to provide the decisionmaker with their uninhibited opinions and recommendations without fear of later being subject to public ridicule or criticism; to protect against premature disclosure of proposed policies before they have been finally formulated or adopted; and to protect against confusing the issues and misleading the public by dissemination of documents suggesting reasons and rationales for a course of action which were not in fact the ultimate reasons for the agency's action." *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 866 (D.C. Cir. 1980). Thus, the privilege covers "recommendations, draft documents,

proposals, suggestions, and other subjective documents which reflect the personal opinions of the writer rather than the policy of the agency.” *Id.*

For the privilege to apply, the communications must be both “pre-decisional” and “deliberative.” *Evans v. City of Chicago*, 231 F.R.D. 302, 316 (N.D. Ill. 2005) (citing *Becker v. IRS*, 34 F.3d 398, 403 (7th Cir. 1994)). That is, the documents must be a direct part of the deliberative process in that they make recommendations or express opinions on legal or policy matters. *Vaughn v. Rosen*, 523 F.2d 1136, 1144 (D.C. Cir. 1975). “[P]re-decisional materials are not exempt merely because they are pre-decisional; they must also be part of the agency give-and-take of the deliberative process by which the decision itself is made.” *Id.* In addition, “even if the document is predecisional at the time it is prepared, it can lose that status if it is adopted, formally or informally, as the agency position on an issue or is used by the agency in its dealings with the public.” *Coastal*, 617 F.2d at 866.

Discussion of objective facts, as opposed to opinions and recommendations, generally is not protected by the deliberative process privilege. *Trentadue v. Integrity Comm.*, 501 F.3d 1215, 1227-28 (10th Cir. 2007); *K.L. v. Edgar*, 964 F.Supp. 1206, 1208 (N.D. Ill. 1997). For this reason, purely factual information must be segregated from deliberative material and produced unless it is inextricably intertwined with the privileged material or would itself reveal the deliberative process. *Trentadue*, 501 F.3d at 1227-28; *Feshbach v. SEC*, 5 F. Supp. 2d 774, 784-85 (N.D. Cal. 1997). “To be considered ‘deliberative,’ a document should reflect policy or decision-making processes, rather than

purely factual or investigative matters.” *SEC v. Nacchio*, No. 05-cv-0480, 2009 WL 211511, at \*3 (D. Colo. Jan. 29, 2009) (citing *Trentadue*, 501 F.3d at 1277).

The deliberative process privilege is not absolute. It may be overcome where the party seeking the documents establishes that he has a particularized need for the documents and his need outweighs the government’s interest in confidentiality. *Farley*, 11 F.3d at 1389.

**1. Has the SEC satisfied the procedural requirements?**

To make a threshold showing that the deliberative process privilege applies, the government must satisfy three procedural requirements: (1) the department head with control over the matter must make a formal claim of privilege, after personal consideration of the matter; (2) the responsible official must demonstrate, typically by affidavit, precise and certain reasons for preserving confidentiality of the documents in question; and (3) the official must specifically identify and describe the documents. *Evans*, 231 F.R.D. at 316 (citing *Ferrell v. U.S. Dep’t of Hous. and Urban Dev.*, 177 F.R.D. 425, 428 (N.D. Ill. 1998)).

In response to Bloom’s motion, the SEC submitted a declaration from the Secretary of the SEC, Elizabeth Murphy, which substantially complies with these requirements. In the declaration, Murphy states that the SEC’s Associate General Counsel for Litigation and Administrative Practice asserted the deliberative process privilege with respect to the documents after giving personal consideration to the matter. (Doc. 175-3 at ¶ 3.) Murphy further states that the Associate General Counsel determined that the “disclosure of this information would have an inhibiting effect upon the fullness and frankness of verbal and written expression among the SEC and its staff members and, thus would have a

detrimental effect on the SEC's decision-making processes." *Id.* Finally, Murphy describes the documents at issue as "documents received from Sentinel with examiner notes, internal memoranda, the examination report, and analysis and drafts of such materials, including draft external communications." *Id.*

Bloom argues that the declaration is insufficient because it fails to meet the requirements set forth in *Kelly v. City of San Jose*, 114 F.R.D. 653 (N.D. Cal. 1987), including the requirement that the government address why its interest cannot be protected with a carefully crafted protective order. (Doc. 179, at 2-3.) However, the *Kelly* court did not apply the deliberative process privilege. Rather, it considered a variety of privileges and the purposes behind those privileges and ultimately applied a privilege (which it called the "official information" privilege) and balancing test tailored specifically to the local police department records at issue in that case. *Kelly*, 114 F.R.D. at 660. Bloom has not cited any cases in this jurisdiction or others adopting the requirements in *Kelly* with respect to the deliberate process privilege, nor has the Court found any.<sup>3</sup> The Murphy declaration substantially complies with the procedural requirements in this district, as set forth in *Evans*, and is therefore sufficient to assert the privilege.<sup>4</sup>

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<sup>3</sup> Bloom did not mention the requirements set forth in *Kelly* until his reply brief, which was filed after the SEC provided the Murphy declaration.

<sup>4</sup> In the declaration, Murphy also states that the Associate General Counsel determined that producing the documents "*could* reveal predecisional staff deliberations." (Doc. 175-3 at ¶ 3 (emphasis added)). Murphy's use of the word "could" instead of "would" gives the Court some pause. However, the Court has reviewed the documents *in camera*, and, as discussed below, it has directed the SEC to produce any documents that in fact do not reveal pre-decisional deliberations.



## 2. Does the deliberative process privilege apply?

Bloom argues that the SEC's 2002 examination documents are not subject to the deliberative process privilege because they are not related to the process of formulating policy. (Doc. 166, at 7.) In his view, the privilege is strictly limited to documents relating to the formulation of policy and does not cover other agency decisions. (Doc. 179, at 4.) This Court disagrees that the privilege is so narrow. See *Nacchio*, 2009 WL 211511, at \*6 (expressly rejecting such limitation of the privilege). Instead, the privilege "protects communications that are part of the decision-making process of a governmental agency." *Farley*, 11 F.3d at 1389. For example, courts have applied the privilege to communications involved in agency decisions of whether to take enforcement action or sue. See *id.* (privileged documents were part of the agency's deliberative process leading to a decision to sue); *EEOC v. Continental Airlines, Inc.*, 395 F. Supp. 2d 738, 741 (N.D. Ill. 2005) (report created to assist EEOC in deciding whether to pursue enforcement action protected by deliberative process privilege); *Utah Med. Prods. v. McClellan*, No. 2:03-CV-0525, 2004 WL 988877, at \*2 (D. Utah Mar. 31, 2004) (documents relating to FDA's inspection of facility and decision of whether to initiate enforcement action protected by the deliberative process privilege); *Burke Energy Corp. v. Dep't of Energy*, 583 F.Supp. 507, 513 (D. Kan. 1984) (documents relating to department's audit of oil company and draft settlement papers protected by the deliberative process privilege). In this case, documents relating to the SEC's decision of whether to take action with respect to the 2002 examination of Sentinel may well be subject to the deliberative process privilege if the documents are pre-decisional, deliberative, and otherwise meet the definition of the privilege.

The Court has conducted an *in camera* review of the 2002 examination documents withheld by the SEC. Based on that review, the Court concludes that not all of the documents are protected by the deliberative process privilege. Some of the documents contain purely factual information that can be segregated from deliberative information. Other documents appear to include opinions or recommendations that the SEC ultimately adopted and included in its delinquency letter to Sentinel. As discussed above, this type of information is not protected by the deliberative process privilege since the privilege is limited to recommendations, proposals, suggestions, draft documents, and other materials that reflect the personal opinions of the writer rather than the policy of the agency. The privilege does not extend to purely factual information that can be disclosed without revealing the deliberative process. Nor does it protect opinions and recommendations that were adopted as the agency's final position.

With these principles in mind, the Court directs the SEC to re-evaluate the documents that have been withheld. The SEC is directed to produce those documents or portions of documents that contain purely factual information or contain opinions or recommendations that were ultimately adopted by the SEC as its final position with respect to the 2002 examination of Sentinel. As to any documents that the SEC continues to withhold under claim of privilege, the SEC must provide Bloom with a log that separately identifies each document rather than providing a general group description for all the withheld documents as the current log does. In addition, the log should provide the basis for asserting the deliberative process privilege as to each document (*e.g.*, document reveals opinions, recommendations, etc., as opposed to purely factual information), and comply with the other basic requirements for a privilege log (*e.g.*, date of the document,

author and recipients). See *Allendale Mut. Ins. v. Bull Data Systems, Inc.*, 145 F.R.D. 84, 88 (N.D. Ill. 1992). To the extent that Bloom believes there is a basis to compel any of the documents that the SEC continues to withhold, he should meet and confer with the SEC and, if unable to reach agreement, file a motion to compel.<sup>5</sup> The Court will then address whether the SEC has a basis for invoking the deliberative process privilege and, if so, whether Bloom has shown a particularized need for the information that outweighs the SEC's interest in confidentiality.

**II. Interrogatory Seeking Detailed Summaries of SEC Witness Interviews and Other Information**

Defendant Bloom served his "First Interrogatory to Plaintiff" on January 15, 2010, a month before the final discovery cutoff. (Doc. 166-5.) The pending motion seeks to compel answers to only three of the six subparts of the interrogatory: (a) the date(s) on which the SEC participated in any meetings and/or interviews of any witness or potential witness in relation to this case and its investigation; (b) the names, employer, and titles of all persons present at each meeting and/or interview; and (f) a detailed summary of what the witness or potential witness said at each such meeting or interview. (Doc. 166, at 4.)

The SEC contends that the motion should be denied because (1) Bloom waited too long before filing it, (2) the information is protected attorney work product,<sup>6</sup> and (3) the

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<sup>5</sup> Any such motion need only identify the documents at issue and provide the pertinent pages of the log. No further legal argument is necessary.

<sup>6</sup> The SEC's privilege log also asserted the law enforcement privilege and the common interest doctrine with respect to information concerning the identity of non-SEC personnel present at witness interviews. In its brief, however, the SEC relies solely on the work product doctrine. (Doc. 175, at 14, n.8.)