Responses of SEC Inspector General Walter Stachnik
to Questions from Senator Grassley
"Examining Enforcement of Criminal Insider Trading and Hedge Fund Activity"
Hearing on December 5, 2006

(1) During the course of our investigation, it appears to me that your office does not operate as independently of the SEC as it should. For instance:

- **One of your staff spent 8 years in the SEC Office of General Counsel prior to joining the SEC Office of Inspector General (SEC/OIG).**

- **Emails and notes show early consultation on the Aguirre investigation between SEC Office of the General Counsel and the former attorney from that office on your staff. The General Counsel's Office told your staff that they "suspect nothing there" and that Aguirre had filed an EEO complaint, which isn't really relevant to his allegations of preferential treatment for John Mack.**

- **Records show that you, the Inspector General, were forwarding internal OIG emails about Mr. Aguirre to SEC officials outside the IG's office including at least one who was also a subject in your Aguirre investigation: Linda Thom[]sen, the Director of the Enforcement Division.**

(a) Why did you forward internal emails related to Mr. Aguirre to non-OIG staff?

On the evening of June 28, 2006, the Securities and Exchange Commission (SEC) Office of Information Technology (OIT) informed the SEC's Office of Inspector General (OIG) that someone in the Chairman's Office had noticed that former Division of Enforcement (Enforcement) attorney Gary J. Aguirre was still registered in the computerized Outlook address book, raising a question as to whether his computer privileges were properly terminated at the time of his departure from the Commission. *See* documents numbered 000592-93. Early the following morning, Mary Beth Sullivan, Counsel to the Inspector General and Associate Inspector General for Investigations (AIGI), informed me and others within OIG of this development, identifying two issues: (1) whether the account had been used after Mr. Aguirre's departure; and (2) why the account had not been cancelled. *Id.*

I forwarded the information provided by Ms. Sullivan and OIT to Anil Abraham, Counsel to the Chairman; Richard Humes, Associate General Counsel for Litigation and Administrative Practice; Walter Ricciardi, Deputy Director of the Division of Enforcement; and Linda Thomsen, Director of the Division of Enforcement. I did so because, in my view, the security concern was potentially serious enough to warrant the immediate attention of senior personnel in these offices and division. Later that same day, OIT advised that Mr. Aguirre's account had been "disabled" since December 2005. *See* documents numbered 000616-17 and 000621-22. Subsequently, OIT informed Ms.

Sullivan and others that Enforcement, in consultation with the Office of General Counsel (OGC), had taken steps to disable the account in connection with Mr. Aguirre's termination. *See* documents numbered 000059-62.

Please note that, at the time I forwarded the emails in question, the OIG had no pending investigation concerning Mr. Aguirre's allegations, having concluded its initial investigation on November 29, 2005.

(b) Have you done so on other occasions? If so, please identify those instances and explain.

On the morning of June 29, 2006, I forwarded to Messrs. Abraham, Humes, and Ricciardi and Ms. Thomsen an email from Ms. Sullivan to me and other OIG staff, forwarding additional information from OIT indicating that Mr. Aguirre's email account had been disabled in December 2005. *See* documents numbered 000616-17 and 000621-22. I forwarded this email to Messrs. Abraham, Humes, and Ricciardi and Ms. Thomsen because it contained information relevant to the security concern raised in the emails I had forwarded to them earlier that morning.

Other than the instances described above, I recall no other occasions on which I forwarded internal emails related to Mr. Aguirre to non-OIG staff.

(c) In light of all this, why should we believe that your office is independent from the SEC and able to conduct investigations without undue influence?

The OIG is organizationally independent of SEC management, its staff are personally independent, and its investigations are not subject to undue influence.

During my tenure as SEC Inspector General, the OIG has investigated Commissioners and Chairmen, as well as members of senior management. Since 1989, our investigations have led to numerous terminations, retirements or resignations, some involving senior executives. We have also on occasion referred matters involving senior executives to the Department of Justice or other appropriate entities. The OIG is not hesitant to investigate senior managers, and we conduct our investigations on the merits. I am not aware of any attempt by SEC management to influence improperly any investigation during my tenure. In my experience, the agency takes our investigative results seriously and generally acts on them.

To address some of the specific concerns raised in question (1), the OIG is independent of the SEC's OGC. One of the OIG's Associate Counsels, Kelly Andrews, worked in OGC from April 1998 through July 2005. Since July 2005, while Ms. Andrews has been with the OIG under my direct supervision, she has conducted fair, objective and independent investigations. No one from OGC has interfered with or influenced Ms. Andrews in conducting any of the investigations assigned to her, including the investigation of Mr. Aguirre's allegations. Moreover, Ms. Andrews did not have the authority to close the investigation of Mr. Aguirre's allegations without my approval and the concurrence of another OIG attorney.

The SEC Chairman's Office forwarded Mr. Aguirre's September 2, 2005 letter to Chairman Christopher Cox to the OIG on or about September 30, 2005. OGC had also received Mr. Aguirre's correspondence. On October 6, 2005, Richard Humes and Samuel Forstein of OGC spoke briefly with Ms. Andrews. They indicated that they planned to respond to Mr. Aguirre's letter and provided Ms. Andrews with some background information. My staff informed Mr. Humes and Mr. Forstein that the OIG would conduct an investigation of Mr. Aguirre's allegations. They requested that the OIG inform them of the outcome of the investigation.

Subsequently, on October 12, 2005, Mr. Forstein contacted Ms. Andrews and informed her that Mr. Aguirre had sent a second letter to Chairman Cox, dated October 11, 2005, that made additional allegations. Ms. Andrews then obtained a copy of Mr. Aguirre's October 11, 2005 letter, and the OIG expanded the scope of its investigation to include the allegations contained in that letter. Neither Ms. Andrews, nor anyone else in the OIG, had any further communications with OGC about the investigation of Mr. Aguirre's allegations until we closed the investigation on November 29, 2005. At that time, Ms. Andrews contacted Mr. Humes at my direction to notify him that the OIG had closed its investigation of Mr. Aguirre's allegations.

The communications described above constitute the extent of the OIG's contacts with OGC regarding the OIG's initial investigation of Mr. Aguirre's allegations. Our files contain no emails that "show early consultation" regarding that initial investigation between my staff and OGC. Moreover, the OIG chose promptly to open an investigation notwithstanding any comments or opinions expressed by OGC attorneys concerning the merits of Mr. Aguirre's allegations. I believe that my staff's limited contacts with OGC regarding our initial investigation of Mr. Aguirre's allegations were entirely appropriate and consistent with the independence of my Office. There is no evidence that any OGC attorney interfered with or exerted undue influence on our investigation.

(d) What role does the Office of General Counsel (OGC) play in providing advice and guidance to the OIG?

The OIG operates independently of OGC and has its own Counsel. The Counsel and the two Associate Counsels report directly to me and provide the OIG with independent legal advice and guidance.

From time to time, my staff or I may ask OGC attorneys for information or for their opinion or interpretation of a matter, particularly in legal areas that fall within the expertise of OGC attorneys, such as the Commission's rules concerning the disclosure of non-public information to persons outside the Commission. While my staff and I will consider OGC's views or opinions, we are not bound by them and make independent decisions.

(e) Is advice from OGC solicited by SEC/OIG?

See my response to question 1(d).

(f) If so, please provide detailed examples and explanations why the SEC/OIG has solicited such advice over the past 2 years.

During the past two years, my staff solicited comments from OGC about the action memoranda through which the OIG sought Commission authorization to share non-public information with the Senate Finance and Judiciary Committees in the context of the Aguirre matter. The OGC attorneys are more familiar with the Commission's rules regarding disclosure of non-public information to persons outside the Commission. The OIG accordingly sought their input to facilitate the disclosures sought by the Committees.

In addition, the OIG has recently consulted with OGC attorneys in connection with OIG documents that are at issue in ongoing Freedom of Information Act (FOIA) litigation involving Mr. Aguirre. OGC is representing the Commission in this litigation and has requested information from the OIG in connection with that representation.

(2) The SEC/OIG's website states that the "Office's primary functions are to 1) perform audits of Commission operations, programs, activities, functions, and organizations, and 2) conduct investigations of alleged staff (and contractor) misconduct." [Footnote omitted.] However, in transcribed interviews with a member of your staff, my staff was told, "we don't second-guess management decisions and we don't necessarily look at every unlawful allegation." [Footnote omitted.] Further the testimony stated, "That's not something we normally look at. We don't second-guess why employees are terminated." [Footnote omitted.]

The allegations presented to Chairman Cox, by Mr. Aguirre, in his letters dated September 2, 2005, and October 11, 2005, outline serious charges that his termination from the SEC was improper and related to his continued efforts to pursue an investigation. I have a hard time reconciling these statements against your core mission outlined on your website. How can an Inspector General say his office "Conducts investigations of staff misconduct" and at the same time have employees stating the staff of the OIG does not second-guess management decisions and does not look at every unlawful allegation?

Mr. Stachnik, in light of this testimony from your staff please respond to the following:

(a) How do you reconcile these statements? Does the testimony of your staff represent the policy of the entire SEC/OIG?

I have not been afforded the opportunity to review the transcripts of my staff's interviews and am therefore unable to review the context in which my staff's statements were made.[1] Nonetheless, as explained below, I believe that the statements quoted in question (2) do reflect the policy of the OIG and are consistent with the description of the OIG's mission on its website.

During its investigation into Mr. Aguirre's allegations, the OIG investigated whether management decisions were made for improper or unlawful reasons, but did not otherwise second-guess the merits of those decisions. For example, the OIG found insufficient evidence that Mr. Aguirre was terminated for complaining about the alleged preferential treatment of John Mack, instead finding evidence that he was terminated for other legitimate management reasons. The OIG did not conduct further inquiry into the merits of those legitimate management reasons or whether another management decision would have been more reasonable. I do not believe that it would be appropriate for the OIG, absent evidence of misconduct, to substitute its own views for those of management, or to second-guess or interfere with decisions made for legitimate, lawful reasons. As we make clear to complainants to the OIG, the OIG is not an appellate body and does not review the merits of agency decisions in the absence of abuse of authority or other misconduct.

Ms. Andrews has informed me that she indicated in her interview with Senate Committee staff that the OIG did not second-guess management's decision to terminate Mr. Aguirre, a probationary employee, once it found insufficient evidence that he was terminated for complaining about the preferential treatment of Mr. Mack, as Mr. Aguirre alleged. This statement accurately reflects of the application of OIG policy in this instance.

The statement that the OIG does not "necessarily look at every unlawful allegation" is also correct. While the OIG reviews all allegations that come to its attention to determine what action, if any, is warranted, many of the allegations that the OIG receives are outside its jurisdiction and are referred to other offices or agencies. For example, the OIG does not investigate allegations of unlawful race, sex or age discrimination and refers those allegations to the SEC's Office of Equal Employment Opportunity (OEEO). Thus, if Mr. Aguirre was alleging that he was terminated because of his age, the OEEO, not the OIG, would have jurisdiction to investigate that allegation.

Ms. Andrews has told me that her statement that the OIG does not "necessarily look at every unlawful allegation" was made in the context of explaining that not all allegations received are within the OIG's jurisdiction. In fact, Ms. Andrews informed me that she specifically explained to Committee staff that if Mr. Aguirre were alleging that he was terminated because of his age, the OEEO, not the OIG, would have jurisdiction to investigate that allegation. Given the context in which Ms. Andrews told me her statement was made, it accurately reflects the OIG's policy.

---

[1] After receiving these questions, I sent an email to a Senate Finance Committee staff member requesting copies of the transcripts of my staff's interviews to assist me in responding to your questions. I again made this request in a meeting with another Senate Finance Committee staff member on December 19, 2006. To date, I have not been provided the requested transcripts.

(b) How does the SEC/OIG conduct its core mission of investigating alleged staff misconduct without second-guessing the decisions made by management?

As I explained in my answer to question 2(a), the OIG investigates allegations of staff misconduct by gathering evidence to determine whether statutes, rules and regulations may have been violated, or whether other misconduct occurred. The OIG does not review management decisions to determine whether the OIG might have reached a different decision.

(c) If the SEC/OIG doesn't necessarily look at every unlawful allegation how does the SEC/OIG decide which cases to pursue? What happens to cases that are not pursued?

The OIG investigative staff review every allegation received by the OIG. Based upon a number of relevant factors, the OIG investigative staff decide whether to: (1) open an investigation; (2) open a preliminary inquiry (something less than a full investigation); (3) refer the matter to the OIG audit staff; (4) refer the allegation to another office or agency with jurisdiction over the matter; or (5) take no action. Allegations that are not pursued by the OIG are, where appropriate, referred to another office or agency. If a decision is made that no action or referral is warranted, the incoming complaint is retained in a miscellaneous complaints file for the required time period.

(3) The Privacy Act of 1974 was often cited during the transcribed interviews with your staff as a reason why the SEC/OIG chooses to interview subjects of an investigation prior to interviewing any complainant that brings forth allegations of waste, fraud, abuse, or mismanagement at SEC. More specifically, your staff stated, "There is a provision of the Privacy Act that requires you to elicit information from the subjects first." [Footnote omitted.]

It is my understanding that your staff was referring to section (e)(2) of the Privacy Act of 1974 [footnote omitted] which states,

(e) Agency Requirements

"Each agency that maintains a system of records shall--

(2) collect information to the greatest extent practicable directly from the subject individual when the information may result in adverse determinations about an individual's rights, benefits, and privileges under Federal programs."

This language does not explicitly require that the subject of misconduct or mismanagement allegations be interviewed before a complainant is interviewed. It merely requires that information in agency records be gathered directly from the subject of those records "to the greatest extent possible." Mr. Aguirre and his

supervisors were all the subject of records gathered by your office during the course of its investigation, so it is unclear how the provision you cite would require you to treat Mr. Aguirre any differently than his supervisors. It appears nothing in this section of the Privacy Act expressly prohibits the Office of the Inspector General from obtaining information from a complainant such as Mr. Aguirre.

(a) Please provide a detailed explanation as to how the Privacy Act requires the SEC/OIG to interview the subjects of an investigation (including criminal investigations) first, before gathering facts from all relevant sources, including a complainant.

It is my understanding, based upon the advice of OIG Counsel, that Section (e)(2) of the Privacy Act of 1974 requires the OIG, in non-criminal cases,[2] to obtain information from the subjects of the investigation first before going to other sources to the greatest extent practicable. As I understand this provision and how it has been interpreted in administrative investigations, the OIG should interview the subject(s) of the investigation first before going to any other sources, including the complainant, to the greatest extent practicable. In its initial investigation of Mr. Aguirre's allegations, the OIG determined that it had sufficient information from Mr. Aguirre's letters to allow it to interview the subjects first before interviewing other witnesses, including Mr. Aguirre. Further, as Mr. Aguirre was not a subject of the OIG's investigation, Section (e)(2) of the Privacy Act did not require us to interview or obtain information from Mr. Aguirre before obtaining information from other sources.

While I have not had an opportunity to review the transcript of Ms. Sullivan's interview, she told me that she informed Committee staff several times during the interview that the Privacy Act provision in question was not an absolute requirement, but contained qualifying language, *i.e.,* "to the greatest extent practicable." Ms. Sullivan also said she provided Committee staff with an example of an investigation in which the OIG did not interview the subject first because is was not practical to do so under the circumstances of that case.

(b) In complying with this request please provide a list of authorities and cite any outside legal opinions used to formulate this position.

The position that I described in my answer to question 3(a) is based upon the following legal authorities: *Dong v. Smithsonian Institution*, 943 F. Supp. 69 (D.D.C. 1996); *Waters v. Thornburgh*, 888 F.2d 870 (D.C. Cir. 1989), *rev'd on other grounds*, *Doe v. Chao*, 540 U.S. 614 (2004); and Joseph V. Kaplan & John P. Mahoney, *Reckless Disregard: Intentional and Willful Violations of the Privacy Act's Investigatory Requirements*, The Federal Lawyer 38 (May 1997) (copy attached).

---

[2] The OIG is exempt from Section (e)(2) of the Privacy Act when investigating violations of criminal statutes. *See* 71 Fed. Reg. 31,230, 31,232 (June 1, 2006); 55 Fed. Reg. 1744, 1746 (Jan. 18, 1990).

(4) On August 14, 2006, your office served a subpoena duces tecum upon Mr. Aguirre. This subpoena requested, among other things, confidential communications between Mr. Aguirre and the Senate Finance Committee and the Senate Judiciary Committee. On November 3, 2006, the Department of Justice filed a Motion to Show Cause [footnote omitted] on your behalf in the U.S. District Court for the District of Columbia. This motion[] sought enforcement of the subpoena your office sent to Mr. Aguirre. At the December 3, 2006, Judiciary Hearing you testified regarding the subpoena that you were "advised by the Department of Justice not to comment on that." As a follow-up to your response at the hearing please answer the following:

(a) Who specifically at the Department of Justice advised you not to speak to Congress regarding the subpoena to Mr. Aguirre?

My testimony at the Judiciary Committee Hearing on December 5, 2006, requires some clarification. The Department of Justice (Department) did not advise me "not to speak to Congress regarding the subpoena to Mr. Aguirre," but rather to refrain from commenting publicly on the pending litigation, which I understood to encompass discussions concerning settlement. Attorneys in the Federal Programs Branch of the Department's Civil Division have also told us that this advice is consistent with the Department's standard instruction to client agencies not to comment publicly on pending litigation. This was what I intended to convey during my testimony at the December 5, 2006 hearing, and I apologize if there was any confusion in that regard.

(b) When were you advised not to speak about the subpoena?

On or about November 21, 2006, attorneys in the Federal Programs Branch advised the OIG not to comment publicly on the pending litigation seeking to enforce the subpoena to Mr. Aguirre.

(c) Please provide a list of all individuals who provided advice and counsel to you and your office regarding the issuance of the subpoena to Mr. Aguirre. In responding to this request please provide a list of names, the employer of that individual, the date of the advice, and in the event of a meeting, provide the list of all meeting participants.

I discussed the possibility of issuing a subpoena to Mr. Aguirre with Mary Beth Sullivan, Counsel to the Inspector General and AIGI, and Kelly Andrews, Associate Counsel, shortly after the OIG reopened its investigation into Mr. Aguirre's allegations.

On July 27, 2006, I met with Ms. Sullivan, Ms. Andrews, Nelson Egbert, Deputy Inspector General, and Richard Woodford, Associate Counsel. During that meeting, we discussed, among other matters, the possibility of issuing a subpoena *duces tecum* to Mr. Aguirre if he refused to provide information to us voluntarily and if we were unable to obtain the required information from another source.

In addition, Ms. Sullivan had a brief conversation with an attorney in the Federal Programs Branch of the Department of Justice's Civil Division on August 10, 2006. The purpose of this conversation, however, was not to obtain advice regarding the issuance of the subpoena to Mr. Aguirre. Rather, Ms. Sullivan contacted the Department to discuss what might happen if the OIG needed to have the subpoena enforced in court.

Reckless Disregard: Intentional and Willful Violations of the Privacy Act's Investigatory Requirements

By Joseph V. Kaplan & John P. Mahoney

In a case that serves as a strong wake-up call to federal agencies, the U.S. District Court for the District of Columbia recently ruled in *Dong v. Smithsonian Institution*, that a federal agency was liable for damages to reputation and attorneys fees for recklessly disregarding often-ignored provisions of the Privacy Act by improperly conducting an investigation into allegations of employee misconduct. Agencies have obligations under the Privacy Act when conducting employee investigations. The *Dong* case serves as an example of the consequences of violating those obligations.

In an important case that strengthens the individual Privacy Act[1] rights of federal employees, Judge Gladys Kessler of the U.S. District Court for the District of Columbia ruled in *Dong v. Smithsonian Institution*[2] that the Smithsonian Institution acted with reckless disregard for the Privacy Act rights of its more than 4,000 federal civil service employees when it violated the Privacy Act rights of Margaret Dong in the way that the Smithsonian conducted an investigation into alleged job misconduct. This case concerned the often-ignored requirement in section 552a(e)(2) of the Privacy Act, which requires that agencies must, when conducting investigations into alleged employee misconduct, gather information from the individual first "to the greatest extent practicable."[3] In the *Dong* case, one of Ms. Dong's supervisors heard a rumor of misconduct — that Ms. Dong had taken an unauthorized trip for the agency — the supervisor did not approach Ms. Dong for fear of upsetting her. Rather, Smithsonian supervisors contacted third parties, outside the agency, and questioned them about Ms. Dong's trip, impugning her reputation in the process. The district court held that the Smithsonian acted with a reckless disregard for Ms. Dong's rights under the Privacy Act, and awarded her damages and attorneys fees.

The Privacy Act: Investigatory Requirements

As its name suggests, the Privacy Act is fundamentally concerned with protecting individual privacy.[4] Specifically, the act supports "the principle that an individual should to the greatest extent possible be in control of information about [himself/herself] which is given to the government . . . principle designed to insure fairness in information collection which should be instituted wherever possible." On this point, Congress has stated that "the right to privacy is a personal and fundamental right protected by the Constitution of the United States."[6] When conducting personnel investigations, the Privacy Act requires each agency to "collect information to the greatest extent practicable from the subject individual when the information may result in adverse determinations about an individual's rights, benefits, and privileges under federal programs."[7]

The leading case in the District of Columbia Circuit (D.C. Circuit), which construed this provision of the Privacy Act, *i.e.*, 5U.S.C. § 552a(e)(2), is *Waters v. Thornburgh*.[8] In *Waters*, the D.C. Circuit ruled that "[i]n the context of an investigation that is seeking objective, unalterable information, reasonable questions about the person's credibility cannot relieve an agency from its responsibility to collect that information first from the subject." In so holding, the D.C. Circuit found that the legislative history of section 552a(e)(2) of the Privacy Act "reflects congressional judgment that the best way to ensure accuracy in general is to require the agency to obtain information 'directly from the individual whenever practicable.'"[10]

Standards for Liability

In order to be liable for a violation of section 552a(e)(2) of the Privacy Act, the governmental actor must be an "agency that maintains a system of records."[11] Further, in order to be actionable and to justify an award of attorneys fees, an agency's violation of the act must be "intentional or willful."[12] In this regard, the legislative history of the Privacy Act describes the intentional or willful standard in the following manner: "[o]n a continuum between negligence and the very high standard of willful, arbitrary, or capricious conduct, this standard is viewed as only somewhat greater than gross negligence."[13] Construing this standard in language more helpful to individuals and litigants, the D.C. Circuit has interpreted the "intentional or willful" standard to include an act committed "without grounds for believing it to be lawful, or the flagrant disregard for others' rights under the act."[14] Moreover, in *Tijerina v. Walters*,[15] the D.C. Circuit rejected the government's argument that a plaintiff must show that an agency official acted with the actual intent to violate the act.[16] In applying the correct standard of law, a court must view the agency's actions in their context to determine whether the agency acted in a willful or intentional manner.[17]

Separately, in order to recover under the Privacy Act, the plaintiff must also show that the defendant's violation had an "adverse effect" on the plaintiff. The D.C. Circuit has held that emotional trauma alone is sufficient to qualify as an "adverse effect" under the Privacy Act. The rationale is that emotional trauma is logically the type of adverse effect that flows from a violation of the fundamental constitutional right of privacy.[18]

Once the Privacy Act plaintiff establishes that the agency's intentional or willful violation had an adverse effect on the him or her, the plaintiff is entitled to the greater of either $1,000 or the actual damages sustained in excess of that minimum amount. The showing of actual damages is not a legal prerequisite to the awarding of $1,000 to a victim who has been adversely affected by an intentional or willful violation of the Privacy Act. Rather, a showing of actual damages is only necessary for an award in excess of $1.000.[19]

Notwithstanding, the meaning of the term "actual damages," has traditionally been a matter of contention among the courts. Of course, in construing the "actual damages" provision of the Privacy Act, judicial inquiries must begin with the language of the statute itself. As is widely known, absent a clearly-expressed legislative intent to the contrary, the plain meaning of the language of the statute is ordinarily controlling.[20]

Courts have recognized that the plain meaning of the Privacy Act term "actual damages" is uncertain. Courts have sought illumination in the legislative history of the Privacy Act. Based upon that legislative history, it has been held that victims of intentional or willful violations of the act are entitled to compensation for proven mental and physical injuries, including harm to their reputation, mental anguish, symptoms of sleeplessness, nervousness, and frustration, even when the plaintiff has suffered no lost wages or incurred medical expenses on account of the injuries.[21] In short, the legislative history of the "actual damages" language of the Privacy Act has been best summarized as follows: "[W]hile Congress expressed some concern over the scope of potential government liability for damages under the act, this concern was in no way intended to limit recovery of damages for loss of reputation, embarrassment, and other forms of emotional distress."[22]

Moreover, support for the view that "actual damages" includes emotional distress comes from the language of the Privacy Act itself. The stated purpose of the Privacy Act is set forth in its preamble: "The purpose of this act [enacting this section and notes set out under this section] is to provide certain safeguards for an individual against an invasion of personal privacy by requiring federal agencies, except as otherwise provided by law, to . . . be subject to civil suit for any damages which occur as a result of willful or intentional action which violates any individual's rights under this act.[23] Support for the recovery of actual damages under the Privacy Act for emotional distress is abundant.[24]

To obtain relief under subsection (e)(2) of the Privacy Act, a plaintiff must establish that (1) the agency failed to elicit information directly from her "to the greatest extent practicable"; (2) the violation of the act was "intentional or willful"; and (3) this action had an "adverse effect" on the plaintiff. If these three factors are satisfied, the plaintiff is entitled to the greater of $1,000 or the actual damages sustained. If these provisions are satisfied, the successful plaintiff is also entitled to receive reasonable attorneys fees. The statute of limitations for a Privacy Act lawsuit is two years, commencing on the date when the plaintiff knows, or has reason to know, of the alleged violation.[25]

(continued on page 40)

Dong v. Smithsonian Institution: Reckless and Damaging Violations of the Privacy Act

In 1994, Margaret Dong brought a civil action under the Privacy Act against her employer, the Smithsonian Institution, for damages due to the Smithsonian's breach of its statutory obligations regarding the collection of employment information under 5 U.S.C. § 552a(e)(2).[26] The district court's jurisdiction was based upon 28 U.S.C. § 1331 and 5 U.S.C. § 552a(g)(1).

As noted in her court complaint, Ms. Dong was employed as a museum registration specialist, GS-9 federal civil servant, by the Hirshhorn Museum and Sculpture Garden (Hirshhorn), a museum within the Smithsonian. Ms. Dong alleged in her complaint that two of her supervisors at the Hirshhorn engaged in an investigation in violation of the Privacy Act by failing to discuss charges of her rumored misconduct with her before commencing the investigation and disclosing the nature of the charges against her to her colleagues outside the Smithsonian. Ms. Dong claimed damages for, *inter alia*, the emotional trauma and the harm to her professional reputation that she suffered as a result of the defendant's actions.

Findings of Fact

Specifically, Ms. Dong's job duties include working with individuals and organizations outside the Smithsonian to arrange for the loan of art objects to other museums. As found by the district court, over the years, Ms. Dong's performance evaluations have been "highly successful and, on occasion, outstanding." When appropriate, Ms. Dong acts as a courier for loan objects in transit.

During the period of Sept. 13-17, 1993, Ms. Dong served as a courier for the Hirshhorn's painting *Circus Horse* by Joan Miro. Ms. Dong accompanied the painting from Barcelona, Spain, to the Museum of Modern Art (MOMA) in New York City, due to her concern over the condition of the painting's frame — a concern that was shared by the shipping company handling the exhibit. Indeed, the shipping company asked Ms. Dong to act as a courier. As the district court found, "[n]othing in the record suggests that [Ms. Dong] did anything but serve as a courier on this trip. Her trip was not for vacation or pleasure." Notwithstanding, Ms. Dong did not obtain the approval of the director of the Hirshhorn for this courier trip. As the court found, "[t]here is no question that the failure to obtain the director's approval was a violation of museum procedures and regulations." Ms. Dong was ultimately suspended for five days for the violation. As the district court also properly recognized, "[t]hat suspension [was] not in issue in [the] lawsuit."[27] As for the reason Ms. Dong did not follow prescribed procedures, the district court stated that it was an unusual one. Specifically, the court fully credited Ms. Dong's testimony on this point, as follows:

> According to [Ms. Dong's] testimony, the reason that she did not seek approval for the trip was related to problems she was having with a co-worker. Apparently, the co-worker caused problems when Ms. Dong was away on couriering duty, but not when she was simply out of the office on annual leave. Therefore, Ms. Dong chose to avoid problems with that co-worker by simply taking annual leave and not letting anyone know that she was acting as a courier for the Miro painting.[28]

During the week of Oct. 18, 1993, the administrator of the Hirshhorn heard a rumor from an employee (not the employee with whom Ms. Dong was having difficulties at the time) that Ms. Dong had taken an unauthorized couriering trip. The Hirshhorn administrator discussed that rumor with the long-time registrar of the Hirshhorn — Ms. Dong's direct supervisor — who, in turn, is supervised by the museum's administrator. The Hirshhorn administrator asked the Hirshhorn registrar to investigate the rumor. The registrar found no evidence of such a trip or its authorization in any of the Hirshhorn files. He then called the registrar of the MOMA and asked MOMA's registrar to check her museum's files. Thereafter, the Hirshhorn's administrator also spoke to MOMA's registrar.

Through telephone calls and faxes to/from the registrar at MOMA, and to another professional colleague of Ms. Dong who was now working at the Metropolitan Museum of Art in New York City (Met), the Hirshhorn's administrator confirmed that, in fact, Ms. Dong had acted as courier during the trip of the Miro painting from Barcelona to the MOMA in New York.

Thereafter, the Hirshhorn's administrator conferred with employees at the Smithsonian in the office of general counsel and in the office of human resources regarding the appropriate procedure to be followed and the appropriate sanctions to be imposed for violation of the rules. At no time prior to contacting any of these people was Ms. Dong herself contacted or interviewed about her alleged misconduct or her version of the events that transpired. Both the Hirshhorn's administrator and its registrar testified that they proceeded without first contacting Ms. Dong, because they hoped to establish that the original rumor was false. In their eyes, that would end the entire incident, and "all unpleasantness would be avoided."

The district court found it apparent from various exhibits as well as the witness testimony, that there were many personnel frictions and problems in the registrar's office at the Hirshhorn. Further, Ms. Dong had discussed and complained about some of them over the years. Even though her competence, integrity, and trustworthiness had never been questioned, it was clear to the district court that both the Hirshhorn's administrator and its registrar did not wish to question Ms. Dong directly about a major professional issue, thus creating further complications in an office already beset with personnel problems. Indeed, they hoped to determine that there was absolutely no factual basis for what was at least in its inception a mere rumor.

The district court also found it was perfectly apparent from the Hirshhorn registrar's testimony and demeanor that he is an administrator who avoids employee confrontation, as well as direct answering of questions, if at all possible. In addition, the court found that the Hirshhorn administrator never even considered what the impact of going outside the Hirshhorn to question strangers, *i.e.*, non-Hirshhorn employees, about the incident in question, might be on Ms. Dong's reputation.

As recognized by the district court, the Smithsonian has always taken the legal position that it is neither covered by the Freedom of Information Act (FOIA) nor by the Privacy Act.[29] However, as the district court pointed out, in 1992, Judge Charles Richey of the U.S. District Court for the District of Columbia had previously held in *Cotton v. Adams*,[30] that the Smithsonian is an agency subject to FOIA and, consequently, the related Privacy Act.[31]

The agency in *Dong* conceded that it never took any action to inform its employees of the holding in *Cotton*, because it believed that case to have been wrongly decided. All of the Smithsonian's employees who testified on the subject at the *Dong* trial testified that they had never received any training or education about the substance or the requirements of the Privacy Act. Further, they testified that it was their understanding that the Smithsonian, including, of course, the Hirshhorn museum, was not covered by the Privacy Act.

Judge Kessler went on to point out that she had independently ruled at an earlier stage in *Dong*, that the Smithsonian is an agency within the meaning of FOIA and the Privacy Act.[32] This ruling agreed with the conclusion of Judge Richey in *Cotton*.

Conclusions of Law

Based on these findings of fact, the district court reached the following conclusions of law. The plaintiff based her claim against the Smithsonian, as previously indicated, on 5 U.S.C. 552a(e)(2) of the Privacy Act, which provides that each agency collect information to the greatest extent practicable from the subject individual when the information may result in adverse determinations.

The district court recognized the mandatory authority of the D.C. Circuit *Waters* decision, and echoed the principle that, as the Privacy Act is fundamentally concerned with privacy, "'it supports the principle that an individual should, to the greatest extent possible, be in control of information about him [or her] — which is given to the government . . . principle designed to ensure fairness in information collection which should be instituted whenever possible.'"

According to Judge Kessler, the *Waters* opinion points out that the agency does not have the option of choosing which source would provide the most accurate information. Based on the district court's analysis of *Waters*, Judge Kessler stated that "[t]he point of the provision in question, namely, 552a(e)(2), is that it, 'reflects congressional judgment that the best way to ensure accuracy in general is to require the agency to obtain information directly from the individual whenever practicable.'"[33]

The district court also recognized and applied the *Office of Management and Budget Privacy Act Guidelines* (*OMB Guidelines*). Specifically, the district court listed several of the *OMB Guidelines*' practical considerations, which had direct bearing on the facts in *Dong*. The *OMB Guidelines* considerations thought to be relevant in *Dong* included the nature of the program. For example the court pointed to instances in which the information can only be obtained from third parties as in criminal investigations (which, of course, *Dong* was not); the costs; the risk that the information collected from the third party, if inaccurate, could result in an adverse determination; the need to ensure the accuracy of information supplied by an individual; and once the agency has determined that it was not practicable to obtain the information from the subject, the provisions for verifying that third-party information with the subject individual.

As found by the district court, the Smithsonian did not allege, nor was there reason in the record to believe, that the plaintiff was not a credible witness. As recognized by the district court, quite the contrary was true, given Ms. Dong's long record of exemplary employment at the Hirshhorn. In addition, there was no evidence that the defendant feared that the plaintiff would either tamper with, falsify, secrete evidence, or coerce or pressure any witnesses into giving false testimony for the same reasons, or that the plaintiff engaged in previous impropriety that would give the defendant reason to question Ms. Dong's veracity.

In fact, as the district court correctly found, when the Hirshhorn's administrator and registrar ultimately confronted Ms. Dong with questions regarding the trip, Ms. Dong immediately admitted to having taken the trip and that it had not been authorized.

In light of the entire record, the plain language and legislative history of the Privacy Act, the *OMB Guidelines*, and the D.C. Circuit's decision in *Waters*, the district court in *Dong* concluded that concern over Ms. Dong's possible reaction did not warrant a clear violation of her privacy interests. In the district court's view, the record sufficiently supported Ms. Dong's claim that the agency failed to elicit information regarding her alleged unauthorized courier trip directly from her to the greatest extent practicable. Therefore, the district court held that this prong of the Privacy Act test was satisfied.

To recover damages, however, the district court stated that the plaintiff also must show that the violation of the act by the agency was intentional or willful.

In *Dong*, the defendant admitted that top Smithsonian management had been informed of the district court's holding in the earlier *Cotton* case. As such, top Smithsonian management was on notice that the the institution was subject to FOIA.[40] The district court had already found that there was no effort made either to educate or instruct employees about the procedures and substance of the Privacy Act and FOIA. The court concluded that there were clear indications and facts that the agency intentionally chose to ignore the law merely because of its disagreement with the district court's ruling in *Cotton.* Therefore, Judge Kessler held that the Smithsonian's decision to ignore the prior decision holding it subject to FOIA and the Privacy Act constituted "reckless disregard for the Privacy Act rights of the approximately two-thirds of the Smithsonian staff who are federal civil service employees and promotes an environment in an agency where Privacy Act violations could readily and easily occur."

In an attempt to avoid the holding ultimately reached by the court, the defendant in *Dong* responded to the plaintiff's claim that the Smithsonian had acted with reckless disregard for Ms. Dong's Privacy Act rights by arguing that the agency reasonably concluded from 1992 to 1995 that it was not covered by the Privacy Act. The defendant's position in that regard relied on its interpretation of the D.C. Circuit's appeals decision in *Cotton.* As pointed out by Judge Kessler, however, while *Cotton* on appeal was the same basic case decided by Judge Richey in his district court opinion, it was in a very different procedural posture before the D.C. Circuit. Specifically, no appeal was taken from Judge Richey's holding that the Smithsonian was covered by FOIA.

As pointed out by Judge Kessler, the appeal in *Cotton* that was filed in the D.C. Circuit related only to the appropriateness of the award of attorneys' fees granted by the district court. The Smithsonian did not appeal the holding that it was covered under FOIA. In *Cotton,* the D.C. Circuit held that the Smithsonian's position that it was not subject to FOIA *prior* to Judge Richey's original decision in *Cotton* was reasonable for purposes of avoiding an award of attorneys fees. However, in Judge Kessler's opinion, by the time of its actions in *Dong, i.e.,* the fall of 1993, the Smithsonian could no longer reasonably conclude that it was exempt from coverage under the Privacy Act, given that the district court's holding in *Cotton,* which specifically recognized the Smithsonian to be an agency covered under FOIA and thus the Privacy Act, was issued in 1992.

As Judge Kessler reasoned, the investigation of Ms. Dong took place long after the *Cotton* decision was issued. In short, the court found that the agency, during the events that formed the core of the *Dong* case, was on notice that Judge Richey's opinion had been issued, that the *Cotton* decision indeed applied, and that it was the only decision in existence at that point on the particular issue of the Smithsonian's coverage under FOIA and the Privacy Act.[41] It was unreasonable for the Smithsonian to totally disregard and ignore the only existing applicable case law (which it failed to appeal) simply because it thought that the case was wrongly decided. For those reasons, the district court held that "the defendant's violation of the Privacy Act was clearly willful and intentional."

Next, the district court turned to the issue of whether the Smithsonian's intentional or willful violation of section 552a(e)(2) had an adverse effect on Ms. Dong. If Ms. Dong suffered such an effect, she would be entitled to recover actual damages she sustained. Actual damages under that provision of the statute, in the district court's view, encompasses not only pecuniary losses, but also all the ordinary elements of compensatory damages, including mental depression as well as physical injury, if these elements are supported by record evidence.

The plaintiff claimed damages for emotional trauma, emotional distress, pain and suffering, and harm to her reputation, each of which was discussed by the district court. First, the district court noted that there were no claims submitted for any out-of-pocket expenses. The district court next turned to the plaintiff's claim of emotional harm. The plaintiff testified — and the court credited her testimony — that she has suffered from extensive and constant sleeplessness at night. The district court found, however, that the condition had not been severe enough to require either medical or psychiatric care. As the district court stated, "although that is certainly not a requirement of establishing emotional distress, however, it is certainly also indicia of its existence and its severity."

In addition, the district court found no evidence in the record that the emotional distress that the plaintiff did suffer was so severe that it impacted her in any other area of her life, *e.g.,* at work, where she continued to excel and be promoted. Nor did the court find that the plaintiff had been damaged with regard to any interpersonal relationships outside of work. The district court credited the evidence that the plaintiff was certainly upset over this matter, suffered sleeplessness, *etc.,* But the distress, which undoubtedly existed, was not severe enough in the court's view to warrant an award of damages.

Ms. Dong also claimed damages for harm to her reputation. The district court found that "there was definitely some adverse reaction on the part of the plaintiff's colleagues at MOMA and 'the Met' in New York, some of which adversely effected Ms. Dong's reputation." In the court's view, suspicions were created; red flags were raised in the minds of both of those museum officials. Specifically, after analyzing the deposition transcripts of each New York museum official, the court found that both officials knew that the calls from the Hirshhorn's administrator and registrar were "most unusual and unorthodox." One such New York colleague was found by the court to have indicated clearly that, in the future, if there were any kind of a problem, conflict, or suspicion about what Ms. Dong was requesting or negotiating for a loan, she would go to Ms. Dong's supervisor.

In the court's view, while there was nothing tangible in the record to show the loss of reputation or an actual impact on the plaintiff's reputation, such as lost opportunities or honors within the profession, the court recognized that Ms. Dong's was a very small professional world. Many of the registrars know each other and it is easy for one negative phrase, hint, or intimation, even from either of the two New York museum officials about Ms. Dong's integrity, could have a ripple effect that could adversely affect her throughout that small professional community.

Therefore, the district court concluded that there was direct injury to Ms. Dong's reputation in terms of the reactions and responses of the New York museum officials as well as indirect injury in terms of the small, rather close-knit professional community in which Ms. Dong worked. Again, in the court's view, the injury was not severe, but, as Judge Kessler stated, "when we are speaking of something as important, as amorphous, as evanescent as reputation, even the slightest whisper can stain a lifetime of hard work."

Taking into account all of the facts that the district court recited — the existence of damages but the absence of any severity — the court awarded as damages in *Dong* the sum of $2,500 and, thereafter, granted the parties' stipulated attorneys fees incurred by the plaintiff, *i.e.*, $89,500 by separate order filed Oct. 1, 1996. The Smithsonian Institution has filed an appeal to the D.C. Circuit, which was still pending at press time. The saga in *Dong* continues.

Federal Wake-Up Call

Section 552a(e)(2) of the Privacy Act plays a critical role in protecting the privacy rights of federal employees. Few federal employees or, for that matter, agency management and human resources officials, are even aware of the rights and investigatory requirements that statutory section provides. Consequently, the district court's decision in *Dong* serves as an important wake-up call to federal agencies that section 552a(e)(2) of the Privacy Act must be taken seriously. Otherwise, agencies may find themselves in willful violation of constitutional and statutory privacy rights and on the losing end of a damages award, just like the Smithsonian Institution in *Dong*. ■

Joseph V. Kaplan & John P. Mahoney, co-counsel for the plaintiff in Dong v. Smithsonian Institution, *are the managing principal and senior associate, respectively, in the Washington-D.C.-based employment law firm of Passman & Kaplan, P.C.*

Endnotes

[1]The Privacy Act of 1974, 5 U.S.C. § 552a.

[2]943 F. Supp. 69 (D.D.C. Oct. 31, 1996).

[3]Section 552a(e)(2) states that: "[E]ach agency that maintains a system of records shall . . . collect information to the greatest extent practicable directly from the subject individual when the information may result in adverse determinations about an individual's rights, benefits, and privileges under federal programs. 5 U.S.C. § 552a(e)(2). In the authors' experience, few agency officials tasked with the responsibility to undertake misconduct investigations are aware of this provision.

[4]*Waters v. Thornburgh*, 888 F.2d 870, 875 (D.C. Cir. 1989).

[5]*Id.* (quoting *Analysis of House and Senate Compromise Amendments to the Federal Privacy Act* [hereinafter "Staff Analysis"], 120 Cong. Rec. 40,405, 40,407, *reprinted in Legislative History of the Privacy Act of 1974* [hereinafter Sourcebook], 991 (1976).

[6]Section 2(a)(4), Privacy Act, 5 U.S.C. 552a note, *reprinted in* 1974 U.S.C.C.A.N at 2178.

[7]5 U.S.C. § 552a(e)(2).

[8]888 F.2d 870, 873 (D.C. Cir. 1989).

[10]*Id.* at 874 (citing *Office of Management and Budget (OMB) Privacy Act Guidelines*, 40 *Fed. Reg. 28,949, 28,961* (1975)[hereinafter "OMB Guidelines"]). The *OMB Guidelines* list several practical considerations that should be considered by agencies where they propose to collect information from a third party source. These practical considerations include: the nature of the program (where the information can only be obtained from third parties, as in criminal investigations); the costs; the risk that the information to be collected from the third party, if inaccurate, could result in an adverse determination; the need to insure the accuracy of information supplied by an individual; and, once the agency has determined that it is not practicable to obtain the information from the subject, the provisions for verifying that third-party information with the individual. *OMB Guidelines*, 40 Fed. Reg. at 28,961; *see also Waters*, 888 F.2d 874-75 n.7.

[11]5 U.S.C. § 552a(e); Dong, 878 F. Supp. at 244; *Cotton v. Adams*, 798 F. Supp. 22 (D.D.C. 1992). In fact, under the Privacy Act, a plaintiff may only file civil actions against an "agency." See 5 U.S.C. § 552a(g). It is well settled law that the term "agency" does not encompass individual government officials. *See, e.g., Connely v. Comptroller of the Currency*, 876 F.2d 1209, 1215 (5th Cir. 1989); *Bruce v. United States*, 621 F.2d 914, 916 n.2 (8th Cir 1980). As the U.S. Court of Appeals for the Sixth Circuit expressly observed, "Congress could have exposed individuals to civil liability under section 552a(g) [of the Privacy Act] but chose not to do so . . . ." *Windsor v. The Tennessean*, 719 F.2d 155, 160 (6th Cir. 1984).

[12]5 U.S.C. § 552a(g)(4).

[13]*Staff Analysis*, 120 *Cong. Rec.* at 40,406, *reprinted in* Sourcebook, at 990.

[14]*Waters*, 888 F.2d at 875 (quoting *Albright v. United States*, 732 F.2d 181, 189 (D.C. Cir. 1984)(*Albright II*)).

[15]821 F.2d 789 (D.C. Cir. 1987).

[16]*See Tijerina*, 821 F.2d at 799.

[17]*Albright II*, 732 F.2d at 189.

[18]*See* U.S.C. § 552a(g)(1)(D) *Waters*, 888 F.2d at 874-75; *Johnson v. Department of Treasury*, 700 F.2d at 977-78

(5th Cir. 1983).

[19]*See* 5 U.S.C. § 552a(g)(1)(D); *Waters*, 888 F.2d at 872.

[20]*See Johnson*, 700 F.2d at 973.

[21]*See Johnson*, 700 F.2d at 984-86 (quoting *Millstone v. O'Hanlon Reports, Inc.*, 528 F.2d 829, 834-35 (8th Cir. 1976)(noting that the legislative history of the Privacy Act includes specific references to judicial interpretations of the provision for "actual damages" under the Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq.*)).

[22]*Johnson*, 700 F.2d at 979.

[23]Sec. 2(b), Privacy Act, 5 U.S.C. § 552a note, *reprinted in* 1974 U.S.C.C.A.N. 2177, 2178 (emphasis added).

[24]In relying on legislative history to support an interpretation of "actual damages" in favor of awards for emotional distress, it should be noted that such reliance does not violate Supreme Court instruction regarding reliance on legislative history. *See United States v. Nordic Village, Inc.*, 503 U.S. 30, 37 (1992). Specifically, such reliance on legislative history does not create a waiver of sovereign immunity. Rather, the legislative history is utilized to explain Congress' intent in creating a waiver of sovereign immunity in the express language of the Privacy Act. The use of legislative history in this regard is specifically endorsed by both the D.C. Circuit, *Waters*, 888 F.2d at 874, and the 5th Circuit in *Johnson*, 700 F.2d at 979.

[25]5 U.S.C. §§ 552a(e)(2), (g); *Rose v. United States*, 905 F.2d 1257 (9th Cir. 1990).

[25]*See Dong v. Smithsonian Institution*, 878 F. Supp. 244 (D.D.C 1995).

[26]*Dong*, 943 F. Supp. at 71.

[27]*Id.* As Judge Kessler also stated during her bench decision, Ms. Dong "took annual leave for [the days during which she was on the courier trip in question], even though she was entitled to take this trip on regular work time." *Dong*, C.A. No. 94-628 GK, slip op. Tr. at 3 (D.D.C. Sep. 5, 1996) (Transcript of the Bench Ruling Before the Honorable Gladys Kessler, U.S. District Court Judge). After its issuance, Judge Kessler decided to publish that bench decision in the *Federal Supplement*. *See Dong*, 943 F. Supp 69 (D.D. C. 1996).

[28]Dong, 943 F. Supp. at 71.

[29]*Id* at 72. The FOIA and the Privacy Act share the same definition of federal agency. *See* 5 U.S.C. §§ 552(f); 552a(a)(1); *see also id.* § 551(1).

[30]798 F. Supp. 22 (D.D.C. 1992)(holding that the Smithsonian is an agency subject to FOIA.

[31]*Dong*, 943 F. Supp. at 72 (citing *Cotton*, 798 F. Supp. at 22).

[32]*Dong*, 943 F. Supp. at 72 (citing *Dong*, 878 F. Supp. at 244).

[33]*Id.* (quoting *Waters*, 888 F.2d at 874 (citing *OMB Guidelines*, 40 *Fed. Reg.* 28,949, 28,961)).