



SECURITIES LITIGATION, GOVERNMENT ENFORCEMENT AND WHITE COLLAR DEFENSE UPDATE | JANUARY 15, 2010

SEC ANNOUNCES NEW MEASURES TO ENCOURAGE COOPERATION FROM WITNESSES AND CORPORATIONS IN AGENCY INVESTIGATIONS AND ENFORCEMENT ACTIONS

In late August 2009, Robert Khuzami, Director of the SEC's Division of Enforcement, announced a restructuring of the division as well as an [initiative to create comprehensive guidance for individual cooperation](#). These structural and procedural efforts were released on January 13, 2010.

Cooperating with the SEC

In an effort to encourage greater cooperation from individuals, the Division of Enforcement [released its long-awaited guidelines](#) for individuals to cooperate with the Division's investigations. Spelled out in the [Division of Enforcement Manual](#), these new tools take a page out of the Department of Justice ("DOJ") handbook.

- **Formal Written Cooperation Agreements** – The Enforcement Division would agree to recommend to *the Commission* that an individual or company receive credit for cooperating in investigations or related enforcement actions if the cooperator provides substantial assistance such as full and truthful information and testimony.
- **Formal Written Deferred Prosecution Agreements** – *The Commission* would agree to forego an enforcement action against a cooperator in exchange for both full and truthful information and compliance with express prohibitions and undertakings during a period of deferred prosecution.
- **Non-Prosecution Agreement** – *The Commission* would agree not to pursue an enforcement action against a cooperator if the individual or company agrees, among other things, to cooperate fully and truthfully and comply with express undertakings. However, the Manual states that a Non-Prosecution Agreement will not be appropriate in "virtually all cases" involving an individual who previously has violated the securities laws.¹

In evaluating whether to enter into an agreement with an individual cooperator, the SEC will consider four factors:²

1. the assistance provided by the cooperating individual, including an analysis of whether the cooperation resulted in substantial assistance to the investigation, the timeliness of the cooperation, and the quality of the information provided;
2. the importance of the underlying matter in which the individual cooperated, including whether the Commission has made the subject matter of the investigation a priority, the types of securities

¹ SEC Division of Enforcement, Enforcement Manual § 6.2.4. The SEC issued a revised version of its Enforcement Manual on January 13, 2010 as well, which includes a new section 6 that discusses the new cooperation tools.

² See Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, SEC Release No. 36-61340 (Jan. 13, 2010).

violations involved, and the danger to investors or others posed by the underlying violations, including the amount of harm caused and the number of individuals or entities harmed;

3. the societal interest in ensuring the individual is held accountable for his or her misconduct, including the severity of the nature of the conduct, the level of responsibility that the individual had for the conduct, and the degree to which the individual attempted to remediate that harm; and
4. the appropriateness of cooperation credit based upon the risk profile of the cooperating individual, which includes the individual's history of lawlessness, the degree to which the individual accepted responsibility for his or her conduct and the risk that the individual may commit additional securities violations.

In considering whether to enter into a similar agreement with a company or otherwise credit it for its cooperation, the SEC referred to the 13 factors it previously had announced in its Seaboard Report in 2001.³

Those 13 factors include an analysis of the nature of the conduct involved and whether it resulted from a mistake or negligence or reckless or willful conduct, whether the conduct was systemic or the action of just a few employees, what type of harm resulted from the conduct and how many persons and entities were hurt, what steps did the company take upon learning of the misconduct, whether the company committed to learn the truth of the conduct and took prompt and effective steps to remediate the problems that arose, and whether the company promptly informed the SEC about the problems.

Despite the enumeration of these factors for both individuals and companies, the Enforcement Division has left itself a lot of room to define adequate cooperation. Many questions remain unanswered. For example, how will the SEC define "substantial assistance" in determining whether to enter into an agreement with an individual? Will the SEC's different regional offices weigh this and other factors consistently? Many of these same questions have existed since 2001 when the SEC first issued the "Seaboard" principles and clearly will continue to exist for both individuals and companies into the foreseeable future.

Immunity Requests

In addition, the SEC issued a policy statement in which it delegated authority to the Director of the Enforcement Division to submit requests for immunity for criminal prosecution to the DOJ for witnesses who have provided or have the potential to provide "substantial assistance" to an SEC investigation or related enforcement action.⁴ This change is designed to speed up the process for such requests, which previously only could be made by the Commission itself. However, individuals should tread carefully here. This is not a free pass by any means. The SEC in almost all cases will require a proffer of an individual's expected testimony or have significant and reliable evidence that an individual will be able to provide substantial assistance to the Commission before the immunity request is made to the DOJ.⁵

Despite the newly announced policies and the implementation of these new tools, the Division may not see an appreciable difference in the level of cooperation from individuals and companies. The fact remains that the SEC has civil authority only. Criminal authority for securities law violations remains with the DOJ. As a result, an individual or company entering into a Cooperation Agreement, a Deferred

³ Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, SEC Release No. 44969 (Oct. 23, 2001).

⁴ Delegations of Authority to the Director of its Division of Enforcement, SEC Release No. 34-61339 (Jan. 13, 2010).

⁵ SEC Division of Enforcement, Enforcement Manual § 6.2.5 at p. 134.

Prosecution Agreement or a Non-Prosecution Agreement with the SEC may still face criminal charges for the same conduct.

Absent immunity from criminal prosecution, an individual or company will gain no real advantage by entering into a cooperation agreement with the SEC. In addition to potential criminal exposure, any admissions made under such an agreement will pose risks to an individual or a company in parallel or subsequent civil securities class action or other civil litigation cases. Moreover, such admissions may bar an individual or company from settling their case with the SEC by stating that they neither admit nor deny liability.

We urge individuals and companies to exercise caution before concluding that these written agreements are the way to proceed. In addition to the risks outlined above, the Commission will have the final say on any proposed deal. Any agreement hammered out with the Staff of the Enforcement Division will only be valid when the Commission approves it. Individuals should not get ahead of themselves, despite the rush the Staff may be in, to cooperate until such agreements are authorized by the Commission and a thorough review of any potential criminal exposure is complete.

With these new tools, a larger, re-organized staff, newly appointed specialized unit heads,⁶ and the bigger budget that Congress has provided to the SEC for 2010, it is likely that the Enforcement Division will ramp up its prosecution of securities law violations in the coming months.

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FOR FURTHER INFORMATION:

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⁶ See SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence, SEC Press Release No. 2010-5 (Jan. 13, 2010) [<http://www.sec.gov/news/press/2010/2010-5.htm>]

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