

Hot Issues Alerts – Law Firms

SEC Announces Measures To Encourage Cooperation And Names Specialized Unit Chiefs

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On January 13, 2010, the Securities and Exchange Commission announced a new initiative directed at encouraging cooperation by individuals and entities during the course of SEC enforcement investigations. The initiative, which is documented in the SEC's revised Enforcement Manual, provides the SEC staff with new tools such as written cooperation agreements as well as deferred and non-prosecution agreements that have traditionally been used by the Department of Justice in criminal investigations. This policy continues the SEC's focus on leveraging its resources by rewarding and encouraging cooperation, as first formally articulated in the Commission's Seaboard Report in 2001. In the long run, a publicly announced, consistently applied cooperation policy may well increase the efficiency of the Commission's investigations. We applaud the Commission and the Staff for thinking creatively about adapting the enforcement program to respond to the vast challenges it faces. In the near term, however, we think the new cooperation policies present great challenges to the Commission Staff and to individuals and companies involved in SEC investigations, and could have the unintended consequence of complicating and lengthening investigations.

The cooperation policy, which is effective immediately, includes the following five tools:

- **Proffer Agreements** – The policy formalizes the use of proffer agreements by the staff to evaluate the likely value of cooperation by individuals and companies and allows for any statements made on specific dates to be protected from use in subsequent proceedings.

- **Cooperation Agreements** – The policy outlines the use of cooperation agreements whereby the Enforcement Division formally agrees to recommend to the Commission that an individual or company receive cooperation credit. To be eligible for a cooperation agreement under the policy, it must be likely the individual or company will provide substantial assistance, cooperate fully and truthfully in the investigation and enforcement action, waive the applicable statute of limitations, and satisfy the obligations under the agreement. If the individual or company violates the agreement, the staff may recommend an enforcement action without any limitation. The staff may continue to consider an individual or company's level of cooperation when making recommendations even in the absence of a formal agreement.

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- **Deferred Prosecution Agreements** – Borrowing from Department of Justice practice, the SEC can now enter into deferred and non-prosecution agreements. The policy explains that under a deferred prosecution agreement the SEC agrees to forego an enforcement action in exchange for the individual or company 1) cooperating fully and truthfully in SEC investigation and enforcement actions; 2) entering into a long-term tolling agreement; 3) complying with either express prohibitions or undertakings during the period of deferred prosecution; and 4) in some cases, agreeing to either admit or not to contest facts the SEC could assert to establish a violation of federal securities laws.

The policy notes that deferred prosecution agreements are particularly appropriate for officers and directors of public companies, attorneys and accountants, registered brokers or dealers, fiduciaries for other individuals or entities regarding financial matters and individuals or companies with a prior history of violating the securities laws. Deferred prosecution agreements may facilitate settlements whereby an individual avoids a formal bar by instead agreeing to certain undertakings set out in the deferred prosecution agreement.

- **Non-prosecution Agreements** – The policy outlines the use of non-prosecution agreements where the SEC agrees not to pursue an enforcement action if the individual or company agrees to 1) cooperate fully and truthfully; and 2) comply with express undertakings. These agreements, according to the policy, are generally not appropriate for individuals who have previously violated the federal securities laws.

- **Immunity Requests** – For witnesses who may not be willing to cooperate or provide testimony without receiving protection against criminal prosecution, the SEC has formalized and streamlined its procedures for requesting immunity from the Department of Justice. The SEC staff must have significant and reliable evidence regarding the individual's ability to provide substantial assistance to the SEC, either in the form of a proffer or otherwise, before seeking approval from the Director of Enforcement to request immunity.

In addition to these tools, the policy describes foundational criteria for assessing whether, how much, and in what manner to credit cooperation. These include: 1) the assistance provided; 2) the importance of the underlying matter; 3) the societal interest in ensuring the individual is held accountable for the misconduct; and 4) the

appropriateness of cooperation credit based upon the risk profile of the cooperating individual. The policy also explicitly adopts the Seaboard Report and refers the staff to the Report for the framework by which a company's cooperation should be evaluated. Specifically, the staff should consider if a company engaged in self-policing, self-reporting, remediation and cooperation with law enforcement authorities.

Finally, the policy specifically directs the staff to publicize the benefits of cooperation by including references to cooperation in litigation releases and settlement documents. In what is likely a first illustration of this aspect of the policy, the day before this cooperation initiative was announced, the SEC released a settlement agreement with NATCO Group which included a detailed discussion of the remedial efforts undertaken by the company and considered by the Commission in accepting the settlement for certain FCPA violations. *In the Matter of NATCO Group Inc.*, Securities Exchange Act Release No. 61325, Administrative Proceeding File No. 3-13742, January 11, 2010. The NATCO order is a clear departure from the Commission's traditional reluctance to include mitigating and explanatory language in settled orders, and, if followed in other matters, will result in settlements that provide better guidance to the regulated community.

The implications of the new cooperation policy are not clear, but no doubt will provide both hazards and opportunities for counsel and for investigative subjects. Some possible things to watch for in the coming months and years:

- **The SEC is a big place.** The SEC has over a thousand employees spread across the country in a dozen offices. The implementation of these new tools may be slow and uneven as a result of a wide diversity of practices that already exist.

- **Will the Commission cooperate?** The SEC Staff can only recommend leniency to the five presidentially appointed SEC Commissioners. The Commission can be a strong-willed and independent group but will need to support the Staff in its dealings with potential cooperators for this program to have any chance of success.

- **Same product, new package.** Like the Seaboard Report before it, much of the new cooperation policy simply codifies long-standing staff practices. For instance, the Staff has long used proffer agreements to interview witnesses, particularly in conjunction with parallel criminal proceedings. The Commission has likewise had a relatively simple process by which to seek criminal immunity from the Department of Justice. It remains to be seen whether the Department of Justice is interested in streamlining its process in responding to the SEC's requests.

- **New disclosure questions.** While potentially providing greater certainty as to the rewards of cooperation, the three new kinds of agreements (cooperation,

deferred prosecution, and non-prosecution) may well require considerable thought and caution on potential disclosure obligations to other audiences (shareholders, employers, lenders, other regulators).

- **Gatekeepers.** The SEC has consistently focused on accountants, lawyers, and other professionals in its rhetoric, if not always in its investigations. The new carrot of leniency in exchange for cooperation is likely to be emphasized for this group in coming months. Conversely, the perceived failure to volunteer, and thus to cooperate, is likely to be viewed even more dimly by the staff once the cooperation protocol is available.

- **Public cooperation.** The deferred prosecution agreement will be a public document. The standards are silent on whether cooperation agreements or non-prosecution agreements will be public documents, though the Commission, the champion of disclosure, has a traditional and understandable reluctance to have any secret agreements with regulated entities and individuals, even in conducting investigations. At the very least, all three agreements are likely to be discoverable.

- **Statement of facts?** In seeking to follow the traditional practice of federal prosecutors, it remains to be seen whether the SEC will require a statement of facts to accompany a deferred- or non-prosecution agreement, and, if so, whether that statement of facts will be on the SEC's traditional "neither admit nor deny" basis.

- **Is cooperation worth it?** We expect every company and individual to continue to ask whether cooperation is worth the near certain and considerable cost. Cooperation may well increase the risk of liability elsewhere in the form of civil lawsuits and other regulatory investigations. While the new framework may ultimately increase cooperation by individuals and companies, it may also prove to be less effective than anticipated in a civil enforcement context where the consequences of prosecution are less severe and the benefits of signing cooperation and related agreements may be less clear than they are in the criminal context.

Specialized Group Leaders announced. On the same day, Director of Enforcement Robert Khuzami also announced the six individuals chosen to lead the previously announced national specialty units as well as the creation of a new Office of Market Intelligence. The five unit chiefs include: Bruce Karpati and Robert Kaplan, Asset Management; Daniel Hawke, Market Abuse; Kenneth Lench, Structured and New Products; Cheryl Scarboro, Foreign Corrupt Practices and Elaine Greenberg, Municipal Securities and Public Pensions. The Office of Market Intelligence, which will collect, analyze and monitor the tips, complaints and referrals received by the SEC each year, will be led by Thomas Sporkin.

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