

SEC ANNOUNCES NEW GUIDANCE FOR COOPERATION WITH INVESTIGATIONS

In March and August 2009 advisories, we reported on several initiatives by the new leadership of the Securities and Exchange Commission's Division of Enforcement, including efforts to "foster cooperation" by individuals and companies with enforcement investigations and proceedings.¹ On January 13, 2010, the Division of Enforcement released new guidance on these initiatives. This advisory discusses these and other recent significant developments.

CRITERIA FOR ASSESSING AN INDIVIDUAL'S COOPERATION

On January 13, the SEC issued a "policy statement" setting forth the "analytical framework it uses to evaluate cooperation by individuals."² This policy statement follows similar guidance the SEC announced in 2001 concerning the framework for evaluating cooperation by registrants, in connection with a settlement sanctioning the former controller of a Seaboard Corp. subsidiary. Release No. 34-44969 (Oct. 23, 2001). That release praised Seaboard's actions, which included prompt investigation, involvement of the Board and the Audit Committee, firing culpable employees, and, importantly, notifying the SEC and giving "complete cooperation to our staff." The Seaboard release went on to identify, in 13 separate paragraphs, a non-exclusive list of factors that might influence a decision not to sanction a public company (or at least mitigate any sanctions imposed). One impact of the Seaboard release has been to encourage companies to self-investigate and self-report, which can effectively leverage the SEC's enforcement resources.

The January 13 policy statement concerning individual cooperation emphasizes that there is a "wide spectrum of tools" available to the Enforcement Staff to promote and encourage cooperation—"ranging from taking no enforcement action to pursuing reduced charges and sanctions."³ The guidance specifies that the Enforcement Staff will evaluate cooperation on a "case-by-case" basis, focusing on four "considerations."

First, the Enforcement Staff will consider the "assistance provided by the individual." This consideration encompasses both the "value" and "nature" of

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¹ See "Implications of Recent Developments in SEC Enforcement," March 2009, available at: http://www.arnoldporter.com/resources/documents/CA_ImplicationsOfRecentChangesInSECEnforcement_031909.pdf and "Implications of Recent Developments in SEC Enforcement: A Six Month Review," August 2009, available at: http://www.arnoldporter.com/resources/documents/Advisory_ImplicationsOfRecentDevelopmentsInSECEnforcement_081709.pdf.

² 17 C.F.R. § 202.

³ 17 C.F.R. § 202.12.

the cooperation, and considers such factors as whether (i) the individual was the first to report misconduct, (ii) cooperation was provided before the individual knew of an investigation, (iii) the investigation started as a result of the cooperation, (iv) the information provided “substantial assist[ance]” to the Staff, (v) the assistance allowed the SEC to conserve time and resources, (vi) cooperation was voluntary or required by the terms of an agreement with another agency, (vii) the individual provided information that was not requested by the staff or that might not have been uncovered, and (viii) the individual encouraged others to cooperate with the investigation.

Second, the Enforcement Staff will consider the “importance of the underlying matter.” This criterion encompasses both the “character” of the investigation and the “dangers to investors” from the overall conduct, and considers such factors as the type, age, frequency, and number of violations, whether the subject matter is a priority investigative area, and the amount of harm or potential harm caused by the conduct.

Third, the Enforcement Staff will consider the “interest in holding the individual accountable,” which includes such factors as the “context of the individual’s knowledge, education, training, experience, and position of responsibility,” whether the individual acted with scienter and/or tolerated illegal activity, and the efforts taken by the individual to remediate and/or pay disgorgement to investors.

Fourth, the Enforcement Staff will consider the “profile of the individual,” which includes such factors as the individual’s past history and whether there have been prior instances of securities violations, whether the individual has accepted responsibility for his/her conduct, and the extent to which the individual would have the opportunity to commit further violations of the securities laws.

While many of these criteria are similar to the factors the Enforcement Staff uses to assess corporate cooperation under the Seaboard factors, the new criteria place particular emphasis on the timing and quality of cooperation (*i.e.*, there will be significant credit to individuals who self-report or are whistleblowers), as well as the individual’s culpability

in the underlying conduct. Additionally, it remains to be seen how the various considerations will be weighed or applied by the SEC in particular cases.

NEW TOOLS TO FOSTER COOPERATION

The SEC’s January 13 guidance was accompanied by revisions to its Enforcement Manual, setting forth a series of new “cooperation tools” available to the Enforcement Staff to “foster cooperation.” These tools range from formalized proffer agreements to deferred and non-prosecution agreements to immunity requests.⁴ As the SEC emphasized in its announcement, these tools were “not previously available in SEC enforcement matters,” but similar tools “have been regularly and successfully used by the Justice Department in its criminal investigations and prosecutions.” While it is clear that the SEC is committed to these new tools and to creating greater incentives for individuals and companies to cooperate, it remains to be seen exactly how these tools will work in practice.

Proffer Agreements: A proffer is a presentation of facts by a subject of an investigation to the government pursuant to the government’s agreement that the statements may not be used directly against the individual in any subsequent proceedings (although the government may use the statements as a source of leads, or for impeachment, or for the basis for a perjury charge). While the Enforcement Staff has previously accepted proffers both from individual witnesses and from counsel on behalf of witnesses, the new guidance suggests that use of proffers may be far more common in the future. In particular, the new sections of the Enforcement Manual make clear that the Enforcement Staff should “require a potential cooperating individual to make a detailed proffer before” providing an oral assurance, entering into a cooperation agreement, entering into a deferred or non-prosecution agreement, or making an immunity request.⁵

The Enforcement Manual also states that proffers are governed by standard written proffer agreements, and

⁴ The new sections of the Enforcement Manual may be found at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf#6.2>

⁵ Enforcement Manual § 6.2.1.

must be approved by a senior supervisor in the Enforcement Division. Although the standard form has not been released, it will likely contain provisions similar to those used by federal prosecutors which make clear that information provided and statements made in the proffer may be used to build other leads, may be used for cross-examination, and are made under penalties of perjury.

Oral Assurances: The Enforcement Manual revisions provide that, under certain circumstances, the Enforcement Staff may advise an individual or company that the Enforcement Division does not anticipate recommending an enforcement action.⁶ The Enforcement Manual states that such assurances may only be given after “the investigative record is adequately developed,” meaning among other things, that the staff has received proffers from potential cooperating witnesses. Such assurances must be approved by a senior supervisor in the Enforcement Division.

In practice, oral assurances may be of limited utility. The Enforcement Staff has traditionally given such assurances rarely, and the Enforcement Manual requires the Staff to “clearly inform” the cooperating party that any assurance is based only “upon the evidence currently known,” the Staff’s position may change if it learns of new evidence, and the assurance is not binding on the Commission, which has “final authority to accept or reject enforcement recommendations.”⁷

Cooperation Agreements: The revisions to the Enforcement Manual authorize the Enforcement Staff to enter into written agreements with cooperating individuals or companies, under which the Enforcement Division will agree to recommend to the Commission that an individual or company “receive credit for cooperating in its investigation and related enforcement action and, under certain circumstances, to make specific enforcement recommendations.”⁸ While these recommendations are not binding on the Commission, historically the Commission has shown significant deference to enforcement recommendations made by the Enforcement Division.

The new guidance provides that the Enforcement Staff may enter into such agreements if the individual or company has provided or is likely to provide “substantial assistance” to the SEC—which the Enforcement Staff will likely assess based on proffers by individuals or companies. The new guidance also states that the Enforcement Staff should offer cooperation agreements only if the individual or company has agreed to “cooperate fully” with the staff’s investigation and enforcement proceeding. Such “full cooperation” includes waiving any applicable statute of limitations defense, as well as production of “all potentially relevant non-privileged documents and materials” to the Enforcement Staff, “responding to all inquiries, appearing for interviews, and testifying at trials...as requested by the staff,” and an ongoing commitment not to engage in further violations of the securities laws.⁹ The Enforcement Manual also provides that “upon the written request of cooperating individuals and companies,” senior supervisors in the Enforcement Division may submit letters to courts, regulatory authorities or other law enforcement authorities describing the cooperation provided.

Deferred Prosecution and Non-Prosecution Agreements: The Enforcement Manual revisions authorize the Enforcement Staff for the first time to enter into deferred prosecution and non-prosecution agreements with particular individuals or companies.

In a deferred prosecution agreement the SEC agrees to forego an enforcement action if the individual or company agrees to (a) cooperate fully (as described above) with the investigation and enforcement proceedings, (b) enter into a tolling agreement, and (c) implement certain undertakings and/or abide by certain prohibitions during a set term—typically five years or less. The Enforcement Staff may also condition entry into an agreement on the individual’s or company’s agreement to either admit or not to contest particular facts that the SEC could assert to establish a securities violation.

A non-prosecution agreement goes further. The SEC agrees that it will not pursue an enforcement action if the

⁶ Enforcement Manual § 6.2.1.

⁷ Enforcement Manual § 6.2.1.

⁸ Enforcement Manual § 6.2.2.

⁹ Enforcement Manual § 6.2.2.

individual or company (a) agrees to cooperate fully with the investigation and enforcement proceedings, and (b) implements certain undertakings.

The revised Enforcement Manual provides that the processes for entering into either a deferred prosecution agreement or a non-prosecution agreement are similar—the Enforcement Staff should receive proffers from the cooperating individual or company, and the agreement must be approved by the full Commission. In either case, if the company or individual violates the agreement, the Enforcement Staff reserves the right to bring an enforcement action.

Immunity Requests: In its January 13 pronouncements, the SEC authorized the Director of the Division of Enforcement to submit witness immunity requests to the Department of Justice—a request that previously had to be approved by the full Commission.¹⁰ The revisions to the Enforcement Manual also lay out the procedure for requesting witness immunity—immunity should only be sought where the information provided by the witness “may be necessary to the public interest” and the witness has refused or is likely to refuse to provide testimony based on their privilege against self-incrimination.¹¹ Prior to requesting immunity, the Enforcement Staff should receive witness proffers “or have significant and reliable evidence” regarding a witness’ “ability to provide substantial assistance” to the Staff.

SPECIALIZED UNITS

On January 13, the Division of Enforcement also announced personnel appointments to head five specialized units within the Enforcement Division:

1. An “Asset Management” unit to focus on investment advisers, investment companies’ hedge funds, and private equity funds;
2. A “Market Abuse” unit to focus on investigations involving large-scale market abuses and complex manipulation schemes by institutional traders and market professionals;
3. A “Structured and New Products” unit to focus on derivatives and other complex financial products;
4. A “Foreign Corrupt Practices Act (FCPA)” unit to signal increased enforcement of FCPA anti-bribery provisions; and
5. A “Municipal Securities and Public Pensions” unit to focus on disclosure issues as well as so-called “pay to play” practices.

In addition to these units, the Director of Enforcement announced the creation of a new Office of Market Intelligence, that will be responsible for the collection, analysis, and monitoring of referrals, tips, and complaints the SEC receives. At the press conference announcing these units, the Director of Enforcement anticipated that up to 20 percent of the Enforcement Staff will be assigned to the specialized units.

There remain a number of important open questions about the operation of these units—in particular how responsibility will be divided among the units, and how the units will interact with other Enforcement Division offices. In particular, it is not clear whether the units will be assigned all cases in a particular category, or will focus on major cases.

SIGNIFICANCE OF THE SEC’S GUIDANCE

When a company finds its activities being investigated, it has a strong interest in achieving a coordinated, orderly response. Senior management may initially be unfamiliar with the facts that will eventually be uncovered. Informed decision-making by a company requires accurate reconstruction of past events before the company commits itself in statements to government investigators and to the public. By putting a premium on an individual’s “cooperation” even before an investigation has begun and on encouraging others to cooperate, the SEC’s guidance will have an effect on the process of intra-company fact-finding and development of an appropriate company response.

It is imperative for companies to plan for and execute strategies for expeditious fact-finding and development of a response when circumstances arise that invite a potential

¹⁰ 17 C.F.R. 200.30-4(a)(14).

¹¹ Enforcement Manual § 6.2.5.

governmental investigation. In light of the uncertainties surrounding the implementation of the new individual cooperation guidelines and cooperation tools in practice, both companies and affected individuals will be well advised to consult counsel experienced in civil and criminal securities enforcement matters promptly when issues arise.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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