

Securities Litigation and Enforcement Client Service Group

To: Our Clients and Friends

February 24, 2010

SEC Effort To Foster Cooperation Shows Its Attempt to Create “New Reality” Chilling Violators Through Fear of Being Reported

When the Securities and Exchange Commission last month disclosed an initiative to encourage cooperation with its investigations, it sought to send a warning to securities market participants that there is a “new reality” in which violators have greater reason to fear being reported by informants.

To create that reality, the SEC is borrowing from tools previously used by criminal prosecutors to induce both individuals and corporations to cooperate with SEC investigators.

An understanding of the SEC’s new effort to generate cooperating witnesses is important to any securities market participant who deals with SEC enforcement issues, including corporate counsel, company officers and directors, and investment advisers and other portfolio managers. Also important is understanding the broader message the SEC is trying to send.

In its cooperation initiative, the SEC’s Division of Enforcement stressed that it will be more inclined to reward cooperators who come forward quickly, as criminal prosecutors typically do. And it announced that the Division of Enforcement will now use cooperation agreements, deferred prosecution agreements and non-prosecution agreements, tools previously used by criminal prosecutors, to spur informants to cooperate.

Robert Khuzami, Director of the Division of Enforcement, declared that the cooperation initiatives are a “potential game-changer for the Division of Enforcement.” He added that information from cooperating witnesses “can expand our ability to conduct our investigations more swiftly, and to act quickly to file charges, freeze assets and protect investors.”

The measures to promote cooperation are set forth in a new section of the SEC’s Enforcement Manual. They include a framework for evaluating cooperation by individuals, a reaffirmation of the Commission’s standards for determining whether companies should receive credit for cooperating with investigations, and new tools to encourage cooperation.

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1. The SEC's Policy Statement Concerning Cooperation by Individuals

For the first time, the SEC has articulated the factors it will consider in determining whether, how much, and in what manner it will credit cooperation. It identified four factors:

- **Value and nature of assistance provided by the cooperating individual.**
 - To appraise the *value* of the cooperation, the SEC will consider whether the individual was the first to report the misconduct, the quality of the assistance, and the time and resources saved by the cooperation.
 - To appraise the *nature* of the cooperation, the SEC will consider whether it was voluntary, or required by the terms of an agreement with another law enforcement or regulatory agency, and whether the individual encouraged others to cooperate.
- **Importance of the underlying matter.** The SEC will consider such factors as whether the subject matter is an SEC priority, the number and type of securities violations, the amount and type of harm caused by the underlying violations, and the number of people or companies injured.
- **The societal interest in holding the individual accountable for his or her misconduct.** Factors will include the severity of the cooperating individual's misconduct, his or her culpability, the extent to which the individual tolerated illegal activity, the individual's effort to remediate the harm caused and the sanctions imposed by other agencies.
- **Profile of the individual.** To determine whether an individual's profile makes it appropriate to grant cooperation credit, the SEC will consider the individual's history of lawfulness, the degree to which he or she has accepted responsibility, and the extent to which the individual will have an opportunity in light of his or her occupation to commit future violations.

2. Framework for Evaluating Corporate Cooperation

A major concern of many public companies has been how much "credit" the SEC will give to corporations who cooperate with the SEC in investigating wrongdoing by employees. In announcing the cooperation initiative last month, the Enforcement Division reaffirmed that it will continue to consider the factors set forth in the 2001 "Seaboard Report" (<http://www.sec.gov/litigation/investreport/34-44969.htm>) on company cooperation. The report identifies four factors:

- The company's "self-policing" practices prior to the investigation, including the effectiveness of its compliance policies and procedures and senior management's attitude regarding compliance, or "tone at the top";
- Self-reporting of the misconduct when it is discovered;
- Remedial measures adopted by the company, including disciplining or dismissing wrongdoers, modifying and improving internal controls, and compensating victims of the misconduct; and
- Cooperation with law enforcement, including providing the Commission's staff with all information relevant to the underlying violations and the company's remediation efforts.

3. New Tools

The Commission has authorized the Division's staff to use various tools, such as proffer, cooperation, deferred prosecution, and non-prosecution agreements, to encourage and reward cooperation. The

SEC Enforcement Manual refers to at least three techniques not previously available that Division staff will now be able to use:

- **Cooperation agreements**. A written agreement in which the Division agrees to recommend to the five commissioners of the SEC that an individual or company receive cooperation credit for providing substantial assistance to the Division's staff such as full and truthful information and testimony and waiver of the statute of limitations. It should be noted that Division recommendations are not binding upon SEC commissioners.
- **Deferred prosecution agreements**. A written agreement between the SEC and a potential cooperating individual or company in which the SEC agrees to forego an enforcement action if the individual or company agrees, among other things, to (i) cooperate truthfully and fully with the SEC's investigation; (ii) enter into a long-term tolling agreement; (iii) comply with express prohibitions and/or undertakings; and (iv) agree, under certain circumstances, either to admit or not to contest underlying facts that the SEC could assert to establish a violation of the federal securities laws.
- **Non-prosecution agreements**. A written agreement, entered into in limited circumstances, in which the SEC agrees not to pursue an enforcement action against an individual or company, provided that the individual or company agrees to cooperate truthfully and fully with the SEC's investigation and comply under certain circumstances, with express undertakings. If the terms of the agreement are violated, the Division's staff retains its ability to recommend an enforcement action.

The Commission also streamlined its process for submitting witness immunity requests to the Department of Justice.

4. Conclusion

The ultimate impact of these measures remains to be seen, but the SEC's objective is clear: to encourage individuals and companies to cooperate with investigations, and send a message to those contemplating misconduct that there is an increased risk that others will report their "secret conversations," "hushed plans," "schemes" and "deceptions." Echoing the approach long used by criminal prosecutors, the Division warns those considering cooperation to "seriously consider contacting the SEC quickly" because the SEC will reserve the benefits of cooperation for those whose assistance is both "timely and necessary." According to the SEC, latecomers will seldom qualify for cooperation credit.

For questions or further information concerning the SEC's Cooperation Initiatives, please speak to your Bryan Cave contact or the authors of this client alert:

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