



To read the SEC press release announcing the new cooperation initiatives, please [click here](#).

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## SEC Announces Significant New Initiatives to Encourage Cooperation in Investigations and Enforcement Actions

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The Securities and Exchange Commission announced a series of measures on Wednesday designed to incentivize companies and individuals to provide earlier and more meaningful cooperation in Enforcement Division investigations. First, the Division of Enforcement has authorized its staff to use cooperation tools frequently employed by the Department of Justice in criminal investigations that have not previously been used by the SEC, including formal written cooperation agreements, deferred prosecution agreements and non-prosecution agreements. Second, the Commission has developed a framework for evaluating and providing credit for cooperation by individuals, similar to the guidelines already in place for cooperation by corporations. The new initiatives were characterized by the SEC's Director of Enforcement, Robert Khuzami, as a "potential game-changer" for the Division of Enforcement and they clearly reflect the Director's criminal prosecution background. It remains unclear, however, whether these techniques imported from the criminal sphere will prove to be easily adaptable to the civil and regulatory context, and whether and to what extent the SEC will modify the use of these techniques in its civil investigations. Individuals and corporations involved in SEC matters should carefully evaluate both the opportunities and the risks posed by the new initiatives. In particular, while the prospect of entering into a deferred prosecution or non-prosecution agreement as an alternative to consenting to a Judgment in an SEC injunctive action may appear enticing at first blush, very real risks of increased liability in private civil cases may result from pursuing that course of action.

### BACKGROUND

The cooperation initiatives announced on Wednesday enable the SEC to solicit cooperation from individuals and corporations by offering a number of new incentives, including:

- **Cooperation Agreements** – Formal written agreements in which the Enforcement Division agrees to recommend to the Commission that a cooperator receive credit for cooperating in investigations or related enforcement actions if the cooperator provides substantial assistance such as full and truthful information and testimony.
- **Deferred Prosecution Agreements** – Formal written agreements in which the Commission agrees to forego an enforcement action against a cooperator if, among other things, the individual or company cooperates fully and truthfully and complies with express prohibitions and undertakings during a period of deferred prosecution.

- Non-prosecution Agreements — Formal written agreements, entered into under limited and appropriate circumstances, in which the Commission agrees not to pursue an enforcement action against a cooperator if, among other things, the individual or company cooperates fully and truthfully and complies with express undertakings.

In addition to unveiling these new tools, the SEC also issued a policy statement intended to guide the Commission and its staff in determining how much credit to extend to cooperating individuals. Providing credit for cooperation is not a new concept for the SEC. Indeed, for many years, Enforcement Division staff have been instructed to consider cooperation provided by individuals, as well as corporations, in all their charging decisions and evaluation of appropriate remedies. Guidelines for evaluating and providing credit for cooperation by corporations were set forth in a 2001 report commonly referred to as the "Seaboard Report." But until this week the SEC had never before publicly articulated a framework for evaluating credit for cooperation by individuals.

In the policy statement, the SEC identifies four factors that will be used to evaluate cooperation by individuals: (1) the assistance provided by the cooperating individual in the investigation; (2) the importance of the underlying matter in which the individual cooperated; (3) the societal interest in ensuring that the cooperating individual is held accountable for his or her misconduct; and (4) the appropriateness of cooperation credit based upon the profile of the individual.

For each of the four factors to be used in evaluating cooperation by individuals, the SEC has set forth a list of specific considerations that should be taken into account. For example, in evaluating the first factor, "assistance provided by the individual," the SEC instructs its staff to consider, *inter alia*, whether the individual was the first to report the misconduct to the SEC or to offer his or her cooperation, the time and resources conserved as a result of the individual's cooperation in the investigation, and whether the individual's cooperation yielded information that might not otherwise have been discovered by the staff. Similarly, for the second factor, "importance of the underlying matter," the staff must consider whether the subject matter of the investigation is a priority for the Commission and the dangers to investors presented by the underlying violations.

The third and fourth factors, "interest in holding the individual accountable" and "profile of the individual," are said to be designed to balance the objective of encouraging cooperation with ensuring that cooperating individuals remain accountable for their misconduct.

#### IMPLICATIONS

The SEC will be charting new territory in applying criminal techniques in the civil regulatory context. It is unclear how the new initiatives are meant to be folded into the SEC's well established investigative, enforcement, and settlement procedures. One important question is whether corporations that enter into deferred prosecution or non-prosecution agreements with the SEC will be required to admit to the facts alleged by the SEC. The SEC's longstanding practice has been to allow a settling party to resolve matters with the SEC without admitting or denying the allegations in the SEC's Complaint. In contrast, criminal prosecutors frequently require parties entering into deferred or non-prosecution agreements to explicitly accept and acknowledge the

statement of the facts alleged by the Government. Thus the price for entering into such an agreement with criminal authorities is that a company greatly increases its exposure to civil damage actions. While it is not entirely clear the extent to which the SEC plans to depart from its decades-old practice of not requiring admissions from settling parties, the indications provided by its recent announcements are very unsettling. New language added on Wednesday to the SEC Enforcement Manual states that to obtain a deferred prosecution agreement the individual or corporation must "under certain circumstances, agree either to admit or not to contest underlying facts that the Commission could assert to establish a violation of the federal securities laws." Thus, the price of entering into such an agreement with the SEC may be that a company must make admissions damaging to its position in private lawsuits. As a result, any company considering entering into a deferred prosecution or non-prosecution agreement with the SEC should carefully evaluate whether the attendant risks are worth the benefits.

It is also unclear how the new cooperation initiatives will effect the SEC's Wells process, which affords parties an opportunity to make a submission to the SEC staff – and the SEC's Commissioners – setting forth the reasons why a complaint should not be filed or why the particular charges or remedies sought by the staff should not be approved. It is now open to question whether cooperators will be able to make such submissions effectively. Wells submissions are typically made after the SEC has concluded its factual investigation but before charges are filed. But if the SEC staff now expects parties to make proffers and sign cooperation agreements as early as possible in the investigative process, the ability to make a meaningful Wells submission may be diminished if not lost.

In addition, it remains to be seen whether the SEC will be willing to give sufficient credit to individuals associated with regulated entities to make their cooperation worthwhile. The Commission may be hard pressed to conclude that it can allow brokers or investment advisers that appear to have engaged in serious misconduct to remain in the securities business simply because they happen to provide early cooperation. For individuals at regulated entities, the prospect of gaining meaningful credit for cooperation may prove illusory. As a result, persons associated with regulated entities considering entering into cooperation agreements with the SEC should carefully evaluate the relative costs and benefits.

*For further information about the SEC's new cooperation initiatives, please feel free to contact members of the Firm's Litigation Department, including:*

**Washington D.C.:**

Peter Bresnan  
202-636-5569  
[pbresnan@stblaw.com](mailto:pbresnan@stblaw.com)

Peter Thomas  
202-636-5535  
[pthomas@stblaw.com](mailto:pthomas@stblaw.com)

Arman Oruc  
202-636-5599  
[aoruc@stblaw.com](mailto:aoruc@stblaw.com)

**New York City:**

Mark Stein  
212-455-2310  
[mstein@stblaw.com](mailto:mstein@stblaw.com)

Paul Curnin  
212-455-2519  
[pcurnin@stblaw.com](mailto:pcurnin@stblaw.com)

Michael Chepiga  
212-455-2598  
[mchepiga@stblaw.com](mailto:mchepiga@stblaw.com)

Joshua Levine  
212-455-7694  
[jlevine@stblaw.com](mailto:jlevine@stblaw.com)

**Palo Alto:**

James Kreissman  
650-251-5080  
[jkreissman@stblaw.com](mailto:jkreissman@stblaw.com)

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## UNITED STATES

### **New York**

425 Lexington Avenue  
New York, NY 10017  
212-455-2000

### **Los Angeles**

1999 Avenue of the Stars  
Los Angeles, CA 90067  
310-407-7500

### **Palo Alto**

2550 Hanover Street  
Palo Alto, CA 94304  
650-251-5000

### **Washington, D.C.**

1155 F Street, N.W.  
Washington, D.C. 20004  
202-636-5500

## EUROPE

### **London**

CityPoint  
One Ropemaker Street  
London EC2Y 9HU England  
+44-(0)20-7275-6500

## ASIA

### **Beijing**

3119 China World Tower One  
1 Jianguomenwai Avenue  
Beijing 100004, China  
+86-10-5965-2999

### **Hong Kong**

ICBC Tower  
3 Garden Road, Central  
Hong Kong  
+852-2514-7600

### **Tokyo**

Ark Mori Building  
12-32, Akasaka 1-Chome  
Minato-Ku, Tokyo 107-6037, Japan  
+81-3-5562-6200

## LATIN AMERICA

### **São Paulo**

Av. Presidente Juscelino Kubitschek, 1455  
São Paulo, SP 04543-011, Brazil  
+55-11-3546-1000