

A Securities Law Update

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SEC Announces Sweeping Changes to Encourage Individuals and Companies to Cooperate and Assist in Investigations

Earlier this month, the Securities and Exchange Commission ("SEC") announced a series of measures intended to further strengthen its enforcement program by encouraging greater cooperation from individuals and companies in the agency's investigations and enforcement actions. The SEC termed this a "cooperation initiative." As the SEC press release noted, "[t]he cooperation initiative is expected to result in invaluable and early assistance in identifying the scope, participants, victims and ill-gotten gains associated with fraudulent schemes."

In essence, the SEC has aligned its standards of cooperation with its sister agency, the United States Department of Justice ("DOJ"). The cooperation initiative can be summarized as follows:

1. **New Tools to Promote Cooperation.** Attorneys at the SEC have been given new tools to foster cooperation. Among them are the following:

- a. **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 (This tool is similar to the tool given criminal prosecutors under Section 5K1.1 of the U.S. Sentencing Guidelines to request that a judge reduce a person's punishment based upon that person's cooperation).
- b. **Deferred Prosecution Agreements** — Formal written agreements in which the Commission agrees to forego an enforcement action against a cooperator if the individual or company agrees, among other things, to cooperate fully and truthfully and to comply with express prohibitions and undertakings during a period of deferred prosecution. Again, this is a tool used by federal prosecutors.
- c. **Non-Prosecution Agreements** — Like their counterparts at the DOJ, the SEC attorneys can now offer "non-prosecution agreements," which it characterizes as "[f]ormal written agreements, entered into under limited and appropriate circumstances, in which the Commission agrees 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."

d. **Witness Immunity Requests** — The SEC also announced that it has developed a system that "streamlined the process for submitting witness immunity requests to the DOJ for witnesses who have the capacity to assist in its investigations and related enforcement actions."

2. **Standard to Evaluate the "Value" of the Cooperation.** In 2001, the SEC issued a series of factors to consider in evaluating cooperation. Those standards were announced in the context of a settlement involving a company called Seaboard, and have since been called the "Seaboard Report." The SEC announced last week that the standards set forth in Seaboard would be replaced by the following four factors to be used by the Commission to evaluate cooperation:

- a. The assistance provided by the cooperating individual.
- b. The importance of the underlying matter in which the individual cooperated.
- c. The societal interest in ensuring the individual is held accountable for his or her misconduct.
- d. The appropriateness of cooperation credit based upon the risk profile of the cooperating individual.

In detailing all these changes, the SEC claimed that these changes "are the latest in a series of initiatives that are part of the most significant reorganization of the Enforcement Division in more than 30 years."

While the changes sound good and make for good sound bites on CNN news, they also raise a host of problems. First, it is not even clear that these are truly changes, as the SEC had power in the past to reward cooperation with leniency — either in how the case was charged or in the penalty sought.

Second, the SEC appears to be the sole arbiter of whether someone's cooperation warrants leniency. Indeed, the SEC has made clear that these rules do not "create or recognize any legally enforceable rights for any person." Thus, there seems to be no outlet for a party to appeal an unreasonable or unjustified decision by the SEC when the party feels proper consideration for cooperation was not given.

Moreover, these standards set up an arguably unhealthy incentive for all participants to be the first in line to get the "get out of jail free card." While that may be fine in some circumstances, in others it will encourage the more culpable parties to be the "first in the door" to provide "cooperation" to the SEC before the SEC has a handle on all the facts of the case. No doubt, the so-called cooperation in those instances will consist of false accusations designed to steer the investigation away from the truly guilty cooperator and toward other innocent parties. This has the two-fold disastrous effect of delaying and misdirecting the government's investigation and causing a non-culpable party to undergo an expensive and reputation-damaging investigation that

could lead to false charges.

Thus, the jury is out as to whether the changes announced by the SEC last week will result in speedier bona-fide investigations or in protracted and unfocused investigations that sweep up the innocent, as well as the guilty.

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