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SEC Announces New Enforcement Initiatives, Updates Enforcement Manual to Credit Cooperation

Introduction

On January 13, 2010, Robert Khuzami, Director of the Securities and Exchange Commission's Division of Enforcement, announced several new initiatives aimed at improving the SEC's enforcement program and fostering cooperation by individuals and companies involved in investigations and enforcement proceedings. These new initiatives, which Khuzami referred to as "game-changers," were announced in an SEC-issued press release¹ and incorporated into an updated version of the Division's Enforcement Manual.² Specifically, Khuzami presented formal guidelines for providing benefits to individuals and companies that provide substantial assistance to the SEC early in an investigation. These formal guidelines mirror the standards for cooperation used by the Department of Justice and rely upon the tools most commonly used by federal prosecutors in white collar fraud cases: cooperation agreements, deferred prosecution agreements and non-prosecution agreements.

New Tools at the Division's Disposal

The Division of Enforcement described the three types of agreements with parties who cooperate with the Commission in investigations and enforcement matters. These agreements were not previously available in SEC cases in such a formalized manner and provide guidance to SEC lawyers along with corporate counsel for early negotiation and resolution. Director Khuzami described the agreements as follows:

- **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. If the agreement is violated, the staff may recommend an enforcement action to the Commission against the individual or company without any limitation.
- **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 (not to exceed five years). If the agreement is violated during the period of deferred prosecution, the staff may recommend an enforcement action to the Commission against the individual or company without limitation for the original misconduct as well as any additional misconduct.

- **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 the individual or company agrees, among other things, to cooperate fully and truthfully and comply with express undertakings.

Importantly, the Enforcement Manual notes that the latter two types of agreements require “[a]n admission or an agreement not to contest the relevant facts underlying the alleged offenses.”³ Other factors considered by the Commission in determining the propriety of entering into any of the above types of agreements are discussed below.

Measuring and Rewarding Cooperation

For the first time, the Enforcement Division has explicitly acknowledged the factors it will use to measure an individual’s degree of cooperation, which will in turn be used by the Commission to determine how to reward that cooperation. These factors include:

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

With regard to companies that cooperate with the SEC, the new and expanded Enforcement Manual formalized the factors previously set forth in the 2001 Seaboard report.⁴ Specifically, the SEC announced that a company would be credited for cooperation through:

- Self-policing prior to discovery of the misconduct.
- Self-reporting of the misconduct.
- Remediation, improved internal controls, and discipline of wrongdoers.
- Cooperation with law enforcement authorities and full disclosure to the Commission.

Section 6.1 of the revised Enforcement Manual elaborates on each factor, providing guidance to enforcement staff on how to apply the factors to particular cases. In general, the Manual advises staff to develop a clear understanding of a party’s degree of cooperation before entering into one of the types of agreements discussed above.

Witness Immunity Requests

The updated Enforcement Manual also creates a streamlined process for submitting witness immunity requests to the Department of Justice. Newly added Section 6.2.5 reminds Commission staff that, “[p]rior to seeking approval to request an immunity order or letter from the Department of Justice, the staff should preferably receive a proffer of the individual’s expected testimony or have significant and reliable evidence regarding his or her ability to provide substantial assistance to the Commission’s investigation or related enforcement actions.”⁵ The Commission has delegated to the Director of Enforcement the authority to make immunity requests to the Department of Justice, and the request form may be submitted by the Director or a designated senior officer.

Creation of Specialized Units

At the January 13 press conference, Director Khuzami also announced the appointment of Unit Chiefs for the Division’s newly created, specialized units. The purpose of these new units, according to the announcement, is to “help provide the additional structure, resources, and expertise necessary for enforcement staff to keep pace

with ever-changing markets and more comprehensively investigate cases involving complex products, markets, regulatory regimes, practices and transactions.” The new units were identified as the Market Abuse Unit, the Structured and New Products, Foreign Corrupt Practices, and Municipal Securities and Public Pensions. The SEC also announced the creation of an Office of Market Intelligence. In creating these units, the SEC has signaled a shift in its enforcement priorities.

Impact

A review of the new provisions in the Enforcement Manual provides some indication as to how these new tools will be used by the SEC.

First, the full benefits of cooperation will be reserved for what is commonly referred to as the “first through the door.” Early cooperation, especially prior to the initiation of a formal investigation, will be viewed most favorably and will be rewarded with immunity or non-prosecution agreements, whereas later cooperators may not receive any benefit for their cooperation. Second, the SEC is unlikely to offer deferred or non-prosecution agreements to individuals or companies with records of prior, similar violations since they will not qualify as “first-offenders.” Third, individuals or entities under the microscope of both the SEC and the Department of Justice will have to negotiate and enter into separate cooperation agreements with each, although the standards and requirements appear to be nearly identical. Fourth, for all levels of credit for cooperation, the SEC will require proffers and will negotiate proffer agreements whereby information provided in the context of a proffer shall not be used against the individual unless the information is untruthful. Counsel should be prepared to negotiate the terms of proffer agreements with the SEC in the same manner as such agreements are negotiated with the Department of Justice. Finally, these agreements may create risks for cooperators in parallel civil litigation filed by private plaintiffs in that some of these types of agreements require admissions of guilt, and it may be difficult to keep those admissions out of the later proceedings.

These new initiatives and changes to the Enforcement Manual adopt many of the tools and practices commonly used by the Department of Justice, and counsel should be prepared to confront civil enforcement actions in the same manner as they do Department of Justice criminal investigations. And while the SEC’s move to formalize its previously ad hoc application of the Seaboard cooperation factors may bring more clarity and certainty to negotiations between counsel and SEC staff, only time will tell if truly uniform treatment for cooperation does occur in SEC matters. At this time, one thing is clear: Director Khuzami, a former federal prosecutor, is fundamentally changing and reshaping the Enforcement Division by adopting policies and procedures clearly derived from his experience with the Department of Justice.

¹ Securities and Exchange Comm’n, Release No. 2010-6, “SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations” (Jan. 13, 2009), available at <http://sec.gov/news/press/2010/2010-6.htm>. The Division of Enforcement also created a new web site aimed at promoting the new initiatives. See Enforcement Cooperation Initiative (last visited Jan. 14, 2009), available at <http://www.sec.gov/spotlight/enfcoopinitiative.shtml>.

² SECURITIES AND EXCHANGE COMM’N, DIVISION OF ENFORCEMENT, ENFORCEMENT MANUAL (revised Jan. 13, 2009), available at <http://sec.gov/divisions/enforce/enforcementmanual.pdf>.

³ *Id.* §§ 6.23 & 6.2.4, at 130, 132.

⁴ *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, SEC Rel. Nos. 34-44969 and AAER-1470 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/3444969.htm>.

⁵ ENFORCEMENT MANUAL, *supra* note 2, § 6.2.5, at 134.

This *GT Alert* was prepared by Michael Sklaire, Mike Piazza, and Daniel Kahan. Questions about this information can be directed to:

- [Michael Sklaire](mailto:sklairem@gtlaw.com) — 703.749.1308 (sklairem@gtlaw.com)
- [Mike Piazza](mailto:piazzam@gtlaw.com) — 949.732.6568 (piazzam@gtlaw.com)
- [Daniel Kahan](mailto:kahand@gtlaw.com) — 703.749.1359 (kahand@gtlaw.com)
- Or your [Greenberg Traurig](#) attorney

Albany
518.689.1400

Amsterdam
+31 20 301 7300

Atlanta
678.553.2100

Austin
512.320.7200

Boston
617.310.6000

Chicago
312.456.8400

Dallas
214.665.3600

Delaware
302.661.7000

Denver
303.572.6500

Fort Lauderdale
954.765.0500

Houston
713.374.3500

Las Vegas
702.792.3773

Los Angeles
310.586.7700

London*
+44 (0) 203 349 8700

Miami
305.579.0500

New Jersey
973.360.7900

New York
212.801.9200

Orange County
949.732.6500

Orlando
407.420.1000

Palm Beach County North
561.650.7900

Palm Beach County South
561.955.7600

Philadelphia
215.988.7800

Phoenix
602.445.8000

Sacramento
916.442.1111

Shanghai
+86 21 6391 6633

Silicon Valley
650.328.8500

Tallahassee
850.222.6891

Tampa
813.318.5700

Tysons Corner
703.749.1300

Washington, D.C.
202.331.3100

White Plains
914.286.2900

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