



Are SEC, DOJ Getting Too Cozy?

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Senator Charles Grassley (R-Iowa) recently focused his sights on an important issue involving cooperation between the Securities and Exchange Commission and the Department of Justice. The ranking Republican on the Senate Judiciary Committee recently fired off biting inquiries to the heads of both federal agencies regarding how they share information when they are both investigating the same allegations.

Grassley's probe was instigated by statements made by Robert Khuzami, the SEC's Director of Enforcement, at a New York securities law conference last November. Discussing the SEC's new initiative to encourage financial executives to report fraud in exchange for reduced penalties, Khuzami said that in this circumstance, the SEC will inform people being investigated about whether or not the Justice Department has any interest pursuing actions against them. After all, it would be difficult to strike a deal with the SEC unless the target has assurance that the Justice Department is not waiting in the wings.

Here's the common scenario. Often, the SEC and DOJ will have interests in the same matters, with the SEC looking at possible civil penalties and the DOJ at criminal prosecution. It makes sense for the two agencies to share their findings with each other. So people being investigated by the SEC are quite aware of the possibility that, if the SEC is investigating, so well may the DOJ – and that the information they provide to the SEC may very well be passed on to the DOJ. That could make the target of an SEC investigation reluctant to talk to the SEC, fearing that any cooperation could lead to criminal charges being brought by the DOJ.

Thus, as Khuzami noted at the conference, if the SEC provides a target with notice about the status of any parallel DOJ investigation, or absence thereof, that person may feel freer to provide information in exchange for lesser penalties. And such openness may even promote proactive fraud reporting by financial executives.

So why should Senator Grassley be concerned? The SEC's practice seems in direct contrast with official SEC policy in its enforcement manual, which advises SEC employees not to respond to questions by a target about the existence of a pending criminal inquiry. But this potential



discrepancy between policy and practice does not appear to be the overarching basis for Grassley's concern.

Grassley's real concern seems to be (1) that financial executives being investigated by the SEC are getting off too leniently, notably without DOJ action and (2) that the information sharing – between the SEC, the DOJ, and the target financial executive – is nothing more than a dance of government enforcers and those they are supposed to be investigating/prosecuting. A recent, rather biting, *Rolling Stone* article by Matt Taibbi may shed some light on Grassley's concerns:

Khuzami was basically outlining a four-step system for banks and their executives to buy their way out of prison. "First, the SEC and Wall Street player make an agreement on a fine that the player will pay to the SEC ... Then the Justice Department commits itself to pass, so that the player knows he's 'safe.' Third, the player pays the SEC — and fourth, the player gets a pass from the Justice Department."

We understand these concerns. However, there is significant value for both sides if open communication exists between government staffers and those they are investigating. The freer the information flow, the better both sides will be able to accomplish their goals and the more just the result will be.

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