

## Non-Prosecution Agreement Suggests SEC May Take New Approach to Corporate Cooperators

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The U.S. Securities and Exchange Commission's decision to enter into a first-time non-prosecution agreement with a public company could portend a new trend toward rewarding cooperating companies with meaningful benefits.

On December 20, 2010, the U.S. Securities and Exchange Commission (SEC) announced its first non-prosecution agreement (NPA), one of the tools available to the SEC's Division of Enforcement as part of the new Cooperation Program. (See [SEC's New Individual Cooperation Program Could Have Significant Ramifications for Companies](#) for more information.) Under the NPA, the SEC agreed not to bring charges against Carter's Inc., an Atlanta-based marketer of children's clothing, related to the alleged unlawful conduct of its former executive vice president (VP) of Sales. The SEC's decision to enter into the NPA could portend a new trend toward rewarding cooperating companies with meaningful benefits.

According to the SEC's complaint, the former VP of Sales negotiated discounts with Carter's largest retailer that far exceeded budgeted amounts, then used falsified documents to delay recognition of the discounts until future reporting periods. Accounting principles require matching expenses to the related revenues, so that both are recognized in the same reporting period. The VP of Sales' alleged conduct occurred from March 2004 through 2009, during which time he also exercised options and sold company stock. The SEC has charged him with accounting fraud, circumventing internal controls, insider trading, and aiding and abetting the company's violations of internal controls, and books and records provisions of the securities laws. The alleged accounting fraud affected numerous filings and required Carter's to perform a multiyear restatement of financial statements.

The SEC explained in its press release the decision to enter into the NPA with Carter's "reflects the relatively isolated nature of the unlawful conduct, Carter's prompt and complete self-reporting of the misconduct to the SEC, its exemplary and extensive cooperation in the investigation, including undertaking a thorough and comprehensive internal investigation, and Carter's extensive and substantial remedial actions." The NPA requires Carter's to continue to cooperate in the action against the VP of Sales and the ongoing investigation, but is limited to providing only non-privileged information. The press release is not clear as to whether Carter's voluntarily agreed to waive any privilege or provide work product to the SEC from Carter's internal investigation. In any event, based on the SEC's policy (See [SEC Enforcement Manual, Section 4.3](#)), waiver of privilege or work product is not required to obtain credit for cooperation.

The most interesting aspect of this matter was not addressed by the SEC's release: whether the SEC's use of an NPA in this case signals a trend toward the Commission providing meaningful benefits to companies that fully cooperate with SEC investigations. In the past, under the so-called "Seaboard factors," if the SEC rewarded cooperative companies, it did so by reducing charges and/or penalty amounts. However, these benefits were often perceived as being too little, too late. Companies that expended enormous resources in cooperating have often done so without the benefit of knowing whether they would receive any credit for cooperation until the end of an investigation, and often the credit received did not appear to be commensurate with the significant cooperation provided to the SEC. Additionally, in those instances where the SEC brought an enforcement action despite a company's cooperation, shareholders paid twice: once for the significant costs associated with an internal investigation and again in the form of financial and other sanctions imposed.

Because the decision to enter into the NPA in this matter stemmed from isolated conduct involving only one senior officer, the question remains as to whether the SEC will enter into NPAs with companies where the misconduct is broader. Still, the NPA in the Carter's matter is certainly a step in the right direction. Hopefully, the SEC is now on the path of providing commensurate benefits for companies' significant cooperation. This will further incentivize companies to provide exemplary cooperation with SEC investigations, while furthering the stated goals of the SEC's enforcement program.

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