

Securities Litigation and White Collar Defense Alert: Khuzami Announces Initiative To Encourage Cooperation by Individuals and Companies with SEC Investigations

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On January 13, 2010, Securities and Exchange Commission (SEC) Director of Enforcement Robert Khuzami announced new tools that the SEC will be using to secure cooperation from individuals and companies in order to enhance its investigative and case efforts. The SEC has authorized its staff to use cooperation, deferred prosecution, and non-prosecution agreements, which have long been in use by the U.S. Department of Justice (DOJ). The SEC has also set forth the way in which it will evaluate a witness's cooperation, with substantial assistance—another key DOJ concept—being central. Additionally, the SEC streamlined the process for obtaining immunity for witnesses.

Khuzami is continuing his implementation of initiatives announced early in his tenure at a speech given to the City Bar in New York. This cooperation initiative highlights that he is remaking the Enforcement Division in the image of a prosecutor's office. Khuzami expects that this step will further facilitate swift and comprehensive steps against securities fraud as it unfolds, thus better protecting investors. One aspect is that the SEC will be able to more easily pursue a company and its high-level officers by entering into these agreements with lower level employees.

Cooperation Agreements

In order to facilitate developing cooperating witnesses and tapping inside information on securities fraud schemes, the Enforcement Division is going to begin using agreements like those that their counterparts at DOJ use:

- **Cooperation Agreements:** As an incentive to cooperate in investigations, a cooperator who provides "substantial assistance" can enter a formal written cooperation agreement with the Enforcement Division, which will then recommend to SEC that the cooperator receive credit for assisting in the investigation.
- **Deferred Prosecution Agreements:** If an individual agrees to cooperate "fully and truthfully and to comply with express prohibitions" during a period of deferred prosecution, the individual can enter into a written agreement in which the SEC agrees to forego enforcement action against the cooperator.
- **Non-Prosecution Agreements:** If an individual agrees to comply fully and truthfully with an investigation, the individual can enter into a formal written agreement with the SEC where the Commission agrees not to pursue enforcement action against that individual or company. This occurs under "limited and appropriate circumstances" only.

See Section 6 of the SEC Division of Enforcement Manual. (It is worth noting that the Policy Statement in the revised Manual, on its face, applies to individuals. However, the press release and the tenor of Khuzami's remarks suggest that this initiative was to encourage cooperation by both individuals and companies.)

It has been the DOJ standard that cooperation must be truthful and complete, and arise to substantial assistance, a concept that resides in Section 5K1.1 of the U.S. Sentencing Guidelines. Substantial assistance typically means that the information is of a nature that others can be charged for their misconduct based on it. Whether the cooperator avoids charges altogether, albeit with other conditions, *e.g.* fines, restitution and a compliance program or monitoring (a non-prosecution agreement); avoids charges being pursued after a specified period of time, but with conditions like those referred to with respect to a non-prosecution agreement (a deferred prosecution agreement); or must admit to a charge, but is eligible for some lesser penalty based on his cooperation, has been determined by DOJ based on a variety of factors.

Guidelines for Evaluating Cooperation

The SEC has identified four guidelines that it will use to evaluate cooperation:

1. the type of assistance provided
2. the importance of the matter in which the individual is cooperating
3. the "societal interest" in making sure that the individual is held accountable for his or her role and misconduct
4. considering the risk that the person presents, the appropriateness of "cooperation credit."

See Section 6 of the SEC Division of Enforcement Manual. These open-ended guidelines encompass the types of considerations that DOJ takes into account. DOJ's considerations typically include the nature and circumstances of the offense, the nature and value of the cooperation, the cooperator's criminal history, the timeliness of the cooperation, and whether the cooperation will contribute to the prompt and complete charging and disposition of others. See United States Attorney's Manual 9-27.420. The SEC has given itself room to consider these and other factors.

Immunity Requests

Finally, the SEC has simplified the process for submitting witness immunity requests to the DOJ. This appears to involve expediting obtaining the appropriate approvals within the Commission. See Section 6 of the SEC Division of Enforcement Manual.

Announcement of Chiefs of New Specialized Units

In his January 13 remarks, Khuzami also announced chiefs of the five new specialized investigative units he announced in his August 5 speech:

- The Asset Management Unit, which oversees investment advisors, investment companies, hedge funds and private equity firms. Led by **Bruce Karpati**, head of the SEC's Hedge Fund Working Group, and **Robert B. Kaplan**, who has served as Assistant Director of the SEC's Division of Enforcement.
- The Foreign Corrupt Practices Unit, which will focus on violations of the Foreign Corrupt Practices Act (prohibiting companies from bribing foreign officials for government business). Led by **Cheryl J. Scarboro**, who has served as Associate Director of the SEC's Division of Enforcement.
- The Market Abuse Unit, addressing insider trading and market manipulation. Led by **Daniel Hawke**, Director of the SEC's Philadelphia Regional Office.
- The Municipal Securities Unit, which focuses on misconduct in the municipal securities market, most specifically offering and disclosure fraud; tax or arbitrage-driven fraud; pay-to-play and public corruption violations; public pension accounting and disclosure violations; and valuation and pricing fraud. Led by **Elaine C. Greenberg**, Associate Regional Director of the SEC's Philadelphia Regional Office.
- The Structured and New Products Unit, covering derivatives and newly developed products. Led by **Kenneth R. Lench**, who has served as Assistant Director of the SEC's Division of Enforcement.

The SEC also announced that **Thomas Sporkin**, Deputy Chief of the SEC's Office of Internet Enforcement since 2001, has been named head of the Office of Market Intelligence.

Other Initiatives

On August 5, Khuzami also announced other new initiatives. One is to streamline review (and redeploy branch managers to manage cases). The Director of Enforcement can issue Formal Orders. No advance Commission approval is needed to issue a subpoena; a local senior officer can do so. If defense counsel is dilatory with voluntary production, they will receive a subpoena immediately. Senior officers will have authority with respect to routine settlements and the opening of routine investigations. However, tolling agreements will require approval of the Enforcement Director.

The SEC is also going to increase the number of trial attorneys and has brought on a new COO, **Adam Storch**, formerly of Goldman Sachs' Business Intelligence unit.

Conclusion

At least as interesting as any of the recent steps by the SEC Enforcement Division is the overall impression that Khuzami is making the division more like a prosecutor's office—stripping away bureaucracy, focusing on subject matter areas designed to have maximum impact, providing

tools to develop witnesses quickly, and beefing up the trial unit. Of particular note is the cooperation guidelines for individuals. This forecasts that the SEC—on its own and without the need of DOJ or its tools—plans to bring more high-profile cases, and to do so more quickly, with the cooperation of corporate employees.

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