

WSGR ALERT

FEBRUARY 2010

SEC ANNOUNCES INITIATIVES TO ENCOURAGE COMPANIES AND INDIVIDUALS TO COOPERATE IN ENFORCEMENT INVESTIGATIONS AND ACTIONS

On January 13, 2010, the Securities and Exchange Commission (SEC) announced new initiatives that are intended to encourage companies and individuals to cooperate in SEC enforcement investigations and proceedings through the use of techniques that typically have been associated with criminal investigations conducted by the Department of Justice.

The new tools that are being adopted by the SEC are as follows:

1) Cooperation Agreements: These are formal written agreements in which the SEC's Division of Enforcement would agree to recommend to the commission that an individual or entity receive credit for cooperating in its investigations or related enforcement actions. Such credit only would be extended if the cooperator provided substantial assistance to the SEC. As discussed further below, a recently settled SEC enforcement action, *SEC v. General Re Corporation*, filed on January 20, 2010, signals the SEC's continued emphasis on the importance of individuals and companies cooperating in investigations.

2) Deferred Prosecution Agreements: These are formal written agreements in which the SEC would agree to forego an enforcement action if it received full and truthful cooperation, as well as an agreement by the individual or company to comply with specifically identified reforms, controls, and other undertakings.

3) Non-prosecution Agreements:

These are formal written agreements that would be entered into only under very limited circumstances in which the SEC would agree not to pursue an enforcement proceeding against an individual or company that agreed to cooperate fully and truthfully, and to comply with express undertakings.

Cooperation by Individuals and Companies

The SEC issued a Policy Statement that described the analytical framework that it will use to evaluate cooperation by individuals. This framework also was included in a new section in the Enforcement Manual published by the Division of Enforcement. The SEC outlined four major factors, each clarified by sub-points, for use in determining when crediting cooperation by individuals would be appropriate. These factors are:

- the assistance provided by the individual, which assesses, among other things, the value of the individual's cooperation, whether the cooperation provided substantial assistance to the SEC's investigation, the quality and timeliness of the individual's cooperation, whether the individual's cooperation was voluntary, the type of assistance that was provided, and whether the individual provided information that otherwise might not have been discovered by the SEC;

- the importance of the underlying matter, which includes the severity of the misconduct and the actual or potential harm resulting from or threatened by the underlying violations;
- the interest in holding the individual fully accountable for the individual's misconduct notwithstanding the cooperation that has been provided; and
- the profile of the individual, including whether the individual has accepted responsibility for any misconduct and the degree to which the individual will have an opportunity to commit future violations.

The new section in the Enforcement Manual also discussed the framework for evaluating cooperation by companies, which reaffirmed the general principles articulated by the SEC in 2001 in the so-called *Seaboard* matter. These principles are:

- self-policing prior to the discovery of the misconduct, including establishing effective compliance procedures and an appropriate tone at the top;
- self-reporting of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins, and consequences of the misconduct, and promptly, completely, and effectively disclosing the misconduct to the public and regulatory agencies;

Continued on page 2...

SEC Announces Initiatives . . .

Continued from page 1...

- remediation, including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected; and
- cooperation with law enforcement authorities, including providing the SEC staff with information relevant to the underlying violations and the company's remedial efforts.

In *SEC v. General Re Corporation*, the SEC alleged that a subsidiary of General Re entered into sham reinsurance transactions with AIG to improperly allow AIG to falsify its financial statements. Without admitting or denying the SEC's allegations, General Re consented to a judgment enjoining it from aiding and abetting violations of the internal control provisions of the securities laws and requiring the payment of \$12.2 million in disgorgement and prejudgment interest. The SEC's litigation release stated that in deciding to accept General Re's settlement offer, the SEC took the company's remediation efforts and cooperation into account, including 1) the company's comprehensive, independent review of its operations, conducted at the outset of the government's investigation and shared with investigators; 2) the company's substantial assistance in the government's successful civil and criminal actions against individuals involved in the scheme; and 3) the company's internal reforms, which included dissolving the subsidiary involved with AIG, appointing an independent director, forming a committee of senior executives to review and approve complex transactions, requiring legal review of certain contracts, and improving internal audit functions.

Deferred Prosecution and Non-prosecution Agreements

It remains to be seen how meaningful deferred prosecution and non-prosecution agreements will be in practice. Individuals and companies may be reluctant to enter into such agreements to the extent that they require an acknowledgment of wrongdoing because of the potential collateral effect on parallel shareholder class actions and derivative actions and possible criminal liability. Indeed, a standard settlement with the SEC, in which the defendant neither admits nor denies the SEC's allegations, may be considered preferable. On the other hand, a deferred prosecution may be preferable where a settlement based on fraud allegations could have adverse collateral consequences for a company's business. It also may be difficult, if not impossible, for individuals and companies to know in advance the degree of credit that the SEC eventually will award for any particular level of cooperation, given the ambiguity of the factors enunciated by the SEC.

Other SEC Actions

In addition to the cooperation initiative, the SEC on January 13 also announced several other measures that are intended to strengthen its enforcement agenda. One initiative concerned the creation of separate units in five priority areas that are dedicated to highly specialized and complex sectors of the securities laws. One such unit would focus solely on violations of the Foreign Corrupt Practices Act, while the others would focus on complex derivative and other financial products; municipal securities and public pensions; asset management, including investment advisors, investment companies,

and hedge funds; and large-scale market abuse by institutional traders and market professionals. The other initiatives involved the establishment of a new Office of Market Intelligence and the adoption of procedures to expedite the ability of the Division of Enforcement to obtain witness immunity agreements from the Department of Justice.

For more information on the new SEC initiatives and how they might affect your business, please contact an attorney in Wilson Sonsini Goodrich & Rosati's securities litigation department.



Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

This WSGR Alert was sent to our clients and interested parties via email on February 2, 2010. To receive future WSGR Alerts and newsletters via email, please contact Marketing at wsg_resource@wsg.com and ask to be added to our mailing list.

This communication is provided for your information only and is not intended to constitute professional advice as to any particular situation. We would be pleased to provide you with specific advice about particular situations, if desired. Do not hesitate to contact us.

650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsg_resource@wsg.com

www.wsg.com

© 2010 Wilson Sonsini Goodrich & Rosati,
Professional Corporation
All rights reserved.