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SEC Cooperation Agreements: With the Right Approach, Potentially a Valuable Tool for Those Facing Sanctions

Brownstein Hyatt Farber Schreck attorneys recently worked with staff in the Denver Regional Office of the U.S. Securities and Exchange Commission (“SEC”) to negotiate both a proffer agreement and a cooperation agreement on behalf of a client who faced a serious SEC regulatory investigation. For a host of reasons the client viewed this as preferable to being sued by the SEC in an enforcement action. Individuals facing the prospect of an SEC enforcement action traditionally have had to choose between settling early, with the hope that the SEC would be willing to reduce penalties to avoid a costly enforcement action, and litigating against the SEC in an adversarial context. That changed somewhat in the wake of the SEC’s January 2010 Cooperation Initiative, which was intended to provide incentives for companies and individuals to cooperate with the SEC to provide it with valuable information and assistance in its investigations and enforcement actions. Under the Cooperation Initiative, the SEC may employ a number of tools, ranging from proffer agreements and cooperation agreements to deferred- or non-prosecution agreements, to encourage and reward meaningful cooperation by individuals and companies facing enforcement actions. Individuals who agree to provide substantial cooperation may receive credit for doing so, which may include reduced financial penalties, reduced charges, deferred prosecution, or no prosecution at all. Since the program was introduced in 2010, the SEC has publicly announced only a handful of agreements with individuals who received credit for cooperation^[1]. Those who face threats by regulators should be aware of the entire array of defenses available to them to respond to regulatory allegations.

Factors the SEC Considers in Deciding Whether to Enter a Cooperation Agreement

Despite the critical role cooperation can play in SEC enforcement actions, including enhancing the SEC’s ability to detect violations in the first place, the SEC has provided relatively little guidance regarding the availability of cooperation credit. The SEC’s Enforcement Manual^[2] sets forth four factors the SEC considers in determining whether, how much, and in what manner to credit cooperation by individuals: (1) the value and nature of the assistance provided, (2) the importance of the underlying matter, (3) the societal interest in holding the cooperating individual fully accountable, and (4) the profile of the individual, including the individual’s history of lawfulness and the degree to which he or she has accepted responsibility for the alleged misconduct. The Enforcement Manual states, however, that these factors are not intended to be all-inclusive, some may not apply at all in particular cases, and the SEC may weigh these factors differently in different cases. Moreover, while the SEC’s Enforcement Manual provides some additional detail as to the facts it considers relevant to the four factors, it gives little guidance as to how the SEC actually determines the nature or extent of cooperation credit it may give to an individual.

Some additional guidance may be gleaned from announcements the SEC has made regarding individual cooperation agreements. For example, in March 2012, the SEC announced it had entered a cooperation agreement with an unnamed senior executive from AXA Rosenberg, an institutional money manager^[3]. In light of the senior executive’s substantial cooperation, the SEC declined to take enforcement action

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against him. In its announcement, the SEC discussed its application of the four factors listed in its Enforcement Manual. With regard to the first factor, the SEC stated that the senior executive's "substantial assistance" contributed to the efficiency and effectiveness of the SEC's investigation, in part due to the timeliness and quality of the individual's cooperation. The executive was the first witness to offer his cooperation, voluntarily requested to be considered under the Cooperation Initiative, was truthful and forthcoming, and provided complete and reliable information without conditions or a promise of any specific outcome in exchange for his testimony. With regard to the second factor, the SEC stated that the investigation concerned a "priority area" for the agency and resulted in the first-ever enforcement actions in that area. The SEC recovered from the entities it charged the full \$217 million in losses suffered by the firm's clients, and imposed an additional \$27.5 million in penalties. The third factor favored cooperation credit because the senior executive played only a limited role in the events, but he had advocated that the company's CEO be informed of the underlying error. Finally, the senior executive was not an associated person of any regulated entity and was not an officer of a public company at the time of the announcement because he had since retired from the industry. As a result, he was no longer in a position to commit future violations. The SEC did not, however, provide further insight into how the four factors were weighed in determining not to take enforcement action.

Potential Benefits to Individuals From Entering Cooperation Agreements

The SEC has outlined the benefits cooperation may bring to the SEC, but has said very little regarding the benefits that individuals may hope to gain from cooperating, instead remarking that cooperation credit must be based on a "case-by-case analysis of the specific circumstances presented" The senior executive at AXA Rosenberg avoided an enforcement action entirely by cooperating, and another individual secured a deferred-prosecution agreement^[4]. Other SEC cooperators have not been as fortunate.

Some individuals have earned reductions in financial penalties. In two of the SEC's earliest announcements of cooperation agreements, two individuals charged with violations of the Securities Exchange Act of 1934 were not assessed any financial penalty because of their cooperation with the SEC, while other individuals charged in each matter were assessed penalties of \$438,038 and \$100,000^[5]. More recent announcements indicate^[6] that cooperators have received reduced financial penalties from cooperation, though, in some of these cases, it is unclear that cooperation provided any meaningful benefit^[6].

One of the chief challenges individuals face in negotiating cooperation agreements is that the SEC may not agree to any particular benefit in advance of actually obtaining the cooperation it desires. Typically, the SEC will require a potential cooperator to make an initial proffer of information and evidence to allow the SEC to evaluate the potential value of the witness's cooperation before entering a cooperation agreement. While these proffer sessions are usually held pursuant to a written proffer agreement that specifies that the SEC may not use statements made during the proffer session against the witness in subsequent proceedings (with certain delineated exceptions), the proffer agreement does not typically ensure or even suggest that a witness will receive any cooperation credit. Moreover, full cooperation agreements generally specify only that the SEC enforcement staff agrees to request cooperation credit

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from the SEC, without specifying what credit might be sought, and without assurance that the SEC will grant any credit, even upon full cooperation.

The Role of Trust in Negotiating a Cooperation Agreement

Cooperation may require an individual to provide self-incriminating testimony—indeed, an individual's willingness to accept responsibility is one of the key factors the SEC considers in evaluating cooperation credit. An individual may be required to admit to certain facts or even violations of law that are set forth in the cooperation agreement. Because the SEC will typically base cooperation credit on the actual cooperation provided, an individual cooperator will usually not know what benefit he or she may obtain from cooperation until after he or she has provided key information, including self-incriminating information or admissions of liability. Moreover, the value to the SEC of the information provided may depend heavily on factors beyond the cooperator's control, such as testimony from other individuals seeking cooperation credit at the same time. Cooperation may therefore expose an individual to additional liability that the SEC would otherwise be required to establish through an enforcement action.

As a result, cooperating individuals must be in a position to trust that the SEC will evaluate their cooperation fairly and will provide meaningful credit. A decision whether to cooperate should be based, of course, on a careful consideration of all of the potential costs and benefits to cooperation, and an understanding of the SEC's approach to providing cooperation credit. The potential benefits may, however, be influenced by the witness's ability to develop a rapport of trust with SEC enforcement staff, particularly through counsel. Individuals facing enforcement actions should therefore consider consulting reputable counsel familiar with the SEC's practices regarding investigations, enforcement, and the provision of cooperation credit.

This document is intended to provide you with general information regarding SEC cooperation agreements. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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[1] As of March 21, 2014, more than four years after it announced its Cooperation Initiative, the SEC has publicly identified 13 individuals with whom it has entered cooperation agreements (including one who was not named but identified by position) and one individual with whom it entered a deferred-prosecution agreement in November 2013. See Enforcement Cooperation Program, <http://www.sec.gov/spotlight/enfcoopinitiative.shtml>.

[2] The SEC's Enforcement Manual is available at <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>. Section 6 of the Enforcement Manual addresses cooperation, which incorporates the SEC's policy statement on cooperation, codified at 17 C.F.R. § 202.12 ("Policy statement concerning cooperation by individuals in its investigations and related enforcement actions.").

[3] See U.S. Secs. & Exch. Comm'n, Litigation Release No. 22298, *SEC Credits Former AXA Rosenberg Executive for Substantial Cooperation During Investigation* (March, 29, 2012), available at <http://www.sec.gov/litigation/litreleases/2012/lr22298.htm>.

[4] See Deferred Prosecution Agreement executed between the SEC and Scott Jonathan Herckis, available at <http://www.sec.gov/news/press/2013/2013-241-dpa.pdf>.

[5] See U.S. Secs. & Exch. Comm'n, Release No. 2010-141, *SEC Charges Two Individuals for Roles in Innospec FCPA Scheme* (Aug. 5, 2010), available at <http://www.sec.gov/news/press/2010/2010-141.htm>; U.S. Secs. & Exch. Comm'n, Litigation Release No. 21665, *SEC Files Settled Insider Trading Action Involving XTO Energy Securities, SEC v. Michael Jobe and Richard Vlasich*, Civil Action No. 4:10-cv-711-Y, United States District Court for the Northern District of Texas (Fort Worth Division) (Sept. 24, 2010), available at <http://www.sec.gov/litigation/litreleases/2010/lr21665.htm>.

[6] See, e.g., U.S. Secs. & Exch. Comm'n, Release No. 2012-167, *SEC Charges Eight in Georgia-Based Insider Trading Ring* (Aug. 28, 2012), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171484100>. The SEC reduced the financial penalty it imposed on R. Jeffrey Rooks on the basis of his cooperation, but Rooks was the only individual whose settlement included a permanent prohibition from appearing or practicing before the SEC in a particular capacity. See also U.S. Secs. & Exch. Comm'n, Release No. 2012-193, *SEC Charges Three in North Carolina With Insider Trading* (Sept. 20, 2012), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171484866>. The SEC reduced the financial penalty it imposed on Kenneth F. Wrangell to \$11,380.39 as a reward for cooperation. Presumably, in the absence of cooperation credit, the financial penalty would have equaled the amount he was required to disgorge—\$42,521.55—as it was for another individual charged in the matter. One other individual charged in the same matter was able to avoid a definite financial penalty altogether, instead agreeing to disgorgement and penalty amounts to be "determined by the court."