



THE SEC STEPS UP ENFORCEMENT EFFORTS: THE ENFORCEMENT COOPERATION INITIATIVE

On January 13, 2010, the SEC continued its efforts to put pressure on companies and individuals to come forward with evidence of potential violations of the federal securities laws. The SEC announced its adoption of the Enforcement Cooperation Initiative (the “Initiative”), a formal framework for witness cooperation that is modeled closely on the program used by federal prosecutors in federal criminal cases. The program includes cooperation agreements, deferred prosecution agreements, and nonprosecution agreements—tools used for decades by federal prosecutors in persuading corporations and individuals to cooperate against others.

The Initiative also details the incentives for individuals to cooperate with enforcement officials by clarifying how the SEC will evaluate an individual’s cooperation and offering immunity to some informers. Robert Khuzami, the head of SEC enforcement and a former federal prosecutor, explained in a statement that the program is designed to make those who engage in misconduct “think even harder about the possibility

of others coming forward to report to the SEC your secret conversations, your hushed plans, your schemes and your deceptions.” The SEC hopes that the Initiative will increase the speed of its investigations and the strength of its cases. Details concerning the Initiative can be found in a Policy Statement the SEC issued, codified at 17 CFR 202.12, and in a new Section of the SEC’s Enforcement Manual, entitled “Fostering Cooperation.”

COOPERATION AGREEMENTS

A cooperation agreement will set forth circumstances under which the SEC staff will grant credit for cooperation and may include an agreement to make specific recommendations from the Enforcement Division staff to the Commission, although the Commission (like a federal judge with DOJ cooperation agreements) is not bound by the agreement in its final determination. The cooperating company or individual must agree to provide “substantial assistance”

to the staff, to cooperate “truthfully and fully,” and to waive any applicable statutes of limitation. Cooperation requires (1) producing all relevant nonprivileged documents, (2) responding to all inquiries, (3) appearing for interviews, (4) testifying at trials and judicial proceedings as requested, and (5) waiving territorial limits on service. Before entering into a cooperation agreement, the SEC must have sufficient information to believe that the corporation or individual can provide substantial assistance to the investigation. Companies that have not entered into a cooperation agreement can still request that the SEC staff take cooperation into account in the settlement recommendation and can make written requests for cooperation letters.

DEFERRED PROSECUTION AGREEMENTS

A deferred prosecution agreement is a written agreement between the Commission and the cooperating company to forego a civil enforcement action if the company agrees to (1) cooperate truthfully and fully, (2) enter into a long-term tolling agreement, (3) comply with express prohibitions during a period of deferred prosecution, (4) either admit or not contest certain underlying facts that could establish a violation of federal securities laws, and (5) make any agreed-upon disgorgement or penalty payments. If the agreement is violated during the deferred prosecution period, which should not exceed five years, the staff may recommend an enforcement action for the original misconduct and any additional misconduct, and it may use any admissions made by the cooperating company to file a motion for summary judgment. These agreements may be made public upon request, unless the Commission agrees otherwise.

NONPROSECUTION AGREEMENTS

A nonprosecution agreement is an agreement entered into in limited circumstances that provides that the Commission will not pursue an enforcement action if the company agrees to cooperate truthfully and fully with the SEC in its investigation and any subsequent enforcement actions, and

to comply with express undertakings. The agreement is also likely to require the company to make a disgorgement or penalty payment. If the agreement is violated, the SEC can pursue enforcement without limitation and will not be subject to the statute of limitations. In such an action, any statements, information, or materials provided under the agreement may be used against the company.

Under the proposal, these agreements cannot be entered into in the early stages of the investigation but would be entered into before a termination notice would issue. A termination notice would be sent after the completion of the investigation as to a cooperating company and would recommend that no enforcement action be taken against the company.

FEDERAL PROTECTION OF WHISTLEBLOWERS

To the extent the Initiative leads to an increase in the number of corporate “whistleblowers” who approach the SEC, one of the issues companies will face is what action may be taken against an employee who has admitted wrongdoing but is cooperating with the SEC. The Sarbanes-Oxley Act (“Sarbanes-Oxley”) protects a whistleblower against retaliation by his employer. Sarbanes-Oxley protects employees who have provided information to (1) law enforcement agencies or regulators, (2) government bodies conducting investigations, and (3) supervisors or other persons authorized to investigate the alleged misconduct. It also shields employees who file, testify in, or otherwise assist proceedings regarding violations of certain laws. Specifically, Sarbanes-Oxley protects corporate whistleblowers who report violations of the federal mail, wire, and bank fraud provisions; any SEC rule or regulation; and any provision of federal law relating to fraud against shareholders.

A cooperating employee who believes his employer has taken improper retaliatory action against him is authorized under Sarbanes-Oxley to file a complaint with the U.S. Department of Labor (“DOL”) within 90 days after the retaliatory action. After the employer is given an opportunity to

respond to the complaint, the DOL may conduct an investigation to determine whether there is reasonable cause to believe a violation has occurred and issue a preliminary order. The whistleblower employee must establish a prima facie case of a violation. In doing so, the employee need not prove that his employer violated the law, only that he reasonably believed that to be the case, and that there is a sufficient connection between that violation and the employer's retaliatory conduct against the employee.

If an employee fails to establish a prima facie case, the DOL will dismiss his complaint without further investigation. If the DOL proceeds with an investigation, the burden shifts to the corporate employer to demonstrate by clear and convincing evidence that it would have taken the same action in the absence of the employee's protected cooperation. A successful Sarbanes-Oxley whistleblower is entitled to all relief necessary to make him whole, including reinstatement, back pay with interest, and attorneys' fees and costs. Sarbanes-Oxley also authorizes prosecutors to levy fines or imprisonment of up to 10 years for any person who "knowingly, with the intent to retaliate" takes any action harmful to a whistleblower.

RECOMMENDATIONS/CONCLUSION

The SEC touts the Initiative as a way to increase the speed of its investigations and the strength of its cases, but companies should be mindful that it also increases the need for strong compliance programs and thorough and prompt corporate responses to internal allegations of wrongdoing inside the company. When allegations of securities fraud come to the attention of the company, management should conduct a prompt, thorough review and work with counsel to determine whether and when to disclose any evidence of wrongdoing to the SEC and how to cooperate with any SEC investigation.

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