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Defending SEC Investigations and Enforcement Actions

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These are difficult times for companies and individuals who have the misfortune to come under the scrutiny of the U.S. Securities and Exchange Commission (SEC). From the agency's establishment during the New Deal era, the SEC has long been known for aggressive enforcement tactics. In the aftermath of the corporate mega-scandals of recent years, which include such familiar names as Enron, WorldCom, and HealthSouth, the SEC has stepped up its enforcement efforts with even greater aggressiveness than before. The passage of the Sarbanes-Oxley Act in 2002 not only significantly enhanced the SEC's authority, but also increased the civil and criminal penalties for securities-related offenses. Of equal if not greater importance, Sarbanes-Oxley also increased the SEC's budget by more than \$300 million, or about 70 percent. The SEC used much of this increase to hire more enforcement attorneys and examiners, with the not-unexpected result that the SEC has brought more investigations and enforcement actions in the last several years than ever before.

One key factor leading to the SEC's increased aggressiveness is the stinging criticism the agency has received for supposedly being asleep at the switch during the boom market years from 1995 to 2000. Much of this criticism seems unfair in retrospect, given that many critics simultaneously disparaged the SEC back then for what they perceived as the agency's over-regulatory and anti-business attitudes. The recent criticism of the SEC became even more pointed after New York Attorney General Eliot Spitzer brought a number of large-scale investigations of securities-related misconduct, obtaining large financial settlements in several of them, in areas that many thought were more appropriate for federal regulation and enforcement by the SEC. In its core area of securities regulation, the SEC does not like to be seen as taking a backseat to anyone, and some felt the favorable publicity Spitzer received for his cases led to competition between his office and the SEC. Whatever the reasons, the SEC and its enforcement staff have clearly taken a more aggressive and harder line in the years after the Enron scandal became public in 2001 and the passage of the Sarbanes-Oxley Act in 2002.

Types of SEC Inquiries and Investigations

The SEC conducts several different types of inquiries and investigations. At the lowest level, a staff attorney in the SEC's Division of Enforcement, with the approval of a senior-level supervisor, may open a matter under inquiry (MUI). As part of this informal process, SEC enforcement staff often asks companies and individuals to provide information voluntarily. Of course, those receiving such requests from the SEC usually perceive nothing "voluntary" about them. Refusing to provide information pursuant to a voluntary request from the SEC may well have adverse consequences, particularly to those organizations subject to direct regulation by the SEC, including brokers and firms in the securities industry. Thus, there may be no realistic choice but to comply with a voluntary request for information from the SEC.

As a matter of policy, the SEC does not inform those it contacts whether it regards them as targets of the inquiry or merely as witnesses. For historical reasons, the SEC officially denies even that its inquiries and investigations have targets. The SEC defends this practice by, among other things, its practice of providing a boilerplate form, Form 1662, which is captioned "Supplemental Information for Persons Requested to Supply Information Voluntarily or Directed to Supply Information Pursuant to a Commission Subpoena," to those from whom it requests information. Form 1662 contains a number of crucial disclosures, and it merits careful study. Under the caption "[r]outine uses of information," the form discloses that "[t]he Commission often makes its files available to other governmental agencies, particularly United States Attorneys and state prosecutors," and that the SEC generally will not inform defense counsel when it chooses to share information with criminal prosecutors. Because of the high stakes and uncertainties involved, companies should have policies and procedures in place that require an in-house attorney or outside counsel, if circumstances warrant, to handle any type of inquiry from the SEC.

Failure to respond properly to even the initial contact with the SEC can have severe consequences. SEC enforcement staff may well interpret casual remarks by low-level employees as admissions of responsibility. In addition, those contacted by the SEC should not be lulled into complacency by the

apparent informality of the staff's questions. The main reason the SEC typically assigns two attorneys to even preliminary telephone requests for information is to document these seemingly casual conversations. Whether or not under oath, false statements made to the SEC or other government agencies, including the Federal Bureau of Investigation, can lead to a criminal prosecution. In fact, Form 1662 sets forth in full the Federal False Statement Statute, 18 U.S.C. §1001, at the very top of its first page. Many of those contacted by the SEC would be well advised to delay the initial conversation with the SEC until he or she has had the opportunity to collect relevant records and consult with counsel, as appropriate. Including a second person on the subsequent telephone conversation with the SEC, possibly legal counsel who will take detailed notes, is one way of creating an accurate record of the SEC's questions and the witness's answers, should any dispute later arise.

It is worth noting that Martha Stewart did not go to jail for a securities offense. In fact, in the criminal case, the U.S. Department of Justice (DOJ) did not even charge her with insider trading. Rather, all of Stewart's convictions arose from her conduct during an SEC and DOJ investigation, as part of an alleged conspiracy to cover up her insider trading, which included a charge (for which she was convicted) of making false statements during an informal interview with attorneys from the SEC's Division of Enforcement. Ms. Stewart was not under oath during her interview with the SEC.

Unless closed within sixty days, an MUI is automatically upgraded to an "informal investigation." When conducting an informal investigation, the SEC staff may still only make voluntary requests for information and documents. The staff can only issue subpoenas, requests that have the force of law, after the five-member commission approves and issues a formal order of private investigation. Although the issuance of formal orders is a significant step in an SEC investigation, the staff usually can obtain them on short notice, when circumstances warrant. The commission almost always issues formal orders through its seriatim procedure, under which a single commissioner may quickly approve the request. (The commission approves virtually all requests for formal orders—so much so that the staff has periodically suggested, so far without success, that the commission formally

delegate the authority to issue formal orders to the director of the Division of Enforcement.) Only in the rarest of circumstances will the commission meet to deliberate over a formal order request.

Some matters are sufficiently serious that they go straight to the formal order stage without starting out as an MUI. If circumstances warrant, the commission can approve and issue formal orders very quickly, sometimes only a few hours after the staff first becomes aware of the facts giving rise to the investigation.

After the issuance of a formal order, enforcement staff may serve subpoenas rather than make voluntary requests for information. SEC subpoenas are not self-enforcing, but the SEC can and does file actions in federal courts to compel compliance. Courts generally give broad deference to SEC investigations, and as a result, the SEC has a high rate of success in subpoena enforcement actions.

Persons who receive SEC subpoenas may request a copy of the formal order through an established procedure, and such requests are usually granted. Formal orders are summary documents that state the circumstances and potential violations the staff seeks to investigate. Formal orders can be deliberately skeletal in their lack of detail, so they often will not provide much of an indication of the investigative direction the staff intends to pursue.

SEC Subpoenas: Document Production and Testimony

Once the commission issues a formal order, the staff is free to begin serving subpoenas. Often, the staff will start by seeking records from third parties. For instance, in insider trading investigations, the staff will usually seek telephone, bank, and brokerage records, seeking to establish contacts and communications between a suspected “tipper”—for instance, a corporate executive with knowledge of an upcoming merger—who passes on the material non-public information to a “tippee,” a friend or relative who actually does the trading. In such an investigation, relevant evidence might include records showing the tipper and tippee had telephone conversations immediately before the tippee traded, or that the tippee later

made cash payments to the tipper, which the SEC will likely interpret as payoffs for the inside information, absent some other credible explanation.

In all types of investigations, the SEC is notorious for making extremely broad document requests, which may call for all documents possessed by the witness relating to the matter under investigation, which could be an entire business unit or product line going back ten years or more. It is dangerous to interpret such requests narrowly in a way that is counterintuitive or contrary to common sense. If the SEC staff concludes that a response to a subpoena has not been prepared in good faith, the chances of having to defend a subpoena enforcement action to compel a more thorough response will increase substantially.

A better and more appropriate strategy is for counsel to discuss with the staff the SEC's legitimate investigative needs, candidly and forthrightly. Sometimes, counsel may succeed in convincing the staff to narrow the requests so the time and expense of responding is less onerous. Often, the staff will condition any such agreement by stating that the respondent may initially produce a narrower category of documents, without prejudice to the SEC's right to insist on full production later. The staff generally shows more flexibility in narrowing document requests to those individuals they view as mere witnesses, as compared to those they suspect may have committed or participated in wrongdoing.

The staff also specifies methods for producing documents, including a format for sequentially numbering each page with a unique Bates number. Electronic documents such as e-mails, computer files, and photographic records present special problems. Often, counsel will have to work with the SEC staff to produce electronic documents in a useable format.

In producing documents for the SEC, counsel will usually want to request "confidential treatment" as a routine matter so the documents are not made available to the public under the Freedom of Information Act. The SEC has established procedures for requesting such treatment that require stamping each page produced with the legend "confidential treatment requested" and sending a copy of the request to the SEC's Freedom of Information Act Office.

If the witness is fortunate, the SEC staff will be satisfied with the document production. More often, the staff will seek sworn testimony as well. In fact, SEC subpoenas often seek both documents and testimony. The staff usually shows more flexibility regarding scheduling dates for testimony, because they will want to have ample time to review documents and otherwise ensure that they are fully prepared to examine the witness.

Testifying before the SEC can be much different from depositions in ordinary civil litigation. SEC testimony is not governed by the Federal Rules of Civil Procedure, the Federal Rules of Evidence, or comparable state procedural and evidentiary rules. Because the staff will not usually disclose the precise allegations under investigation, the witness may be asked questions that seem to be irrelevant. Often, the staff's questions can also be overly broad, leading, without factual basis, or even accusatory. SEC testimony is also not public so that only the witness and his or her attorney may attend. Counsel for one witness may not attend the testimony of another witness unless counsel also represents the second witness. Although it is commonly done, the SEC officially frowns on a single lawyer or law firm representing multiple witnesses in the same investigation.

Testifying before the SEC can raise issues regarding the right of an individual to avoid self-incrimination under the Fifth Amendment to the U.S. Constitution. Corporations and other business entities do not have Fifth Amendment rights. (Producing documents will not usually raise Fifth Amendment issues, absent unusual circumstances such as where the act of producing documents itself is incriminating.) Counsel representing a corporation must be sensitive to conflict issues that may arise from representing employees during SEC testimony. It is possible that testifying will serve the company's interest, but will not serve the employee's. In such circumstances, counsel for the company may be ethically precluded from also representing the employee.

Many of the benefits from joint representation of a company and its employees can be achieved through alternative means such as a joint defense agreement. A joint defense agreement permits parties and their counsel to share information about the investigation with waiving applicable privileges and protections such as the attorney-client privilege or

the work product doctrine. It is important to note that communications under a joint defense agreement must be channeled through respective counsel, and that communications directly between separately represented parties without the participation of counsel will not be protected from compelled disclosure.

An effective joint defense agreement may prevent the SEC from employing a divide-and-conquer strategy that seeks to drive a wedge between the company and its executives. A joint defense agreement will often result in savings in time and expense if parties and their counsel do not have to duplicate efforts in discovering information and developing legal theories. For these reasons, companies will want to carefully consider requests to pay legal fees of employees who are separately represented, even when the company does not have a contractual or legal obligation to do so. Some observers feel the SEC looks suspiciously at joint defense agreements and arrangements under which companies voluntarily pay for the separate representation of employees.

Asserting one's right to avoid self-incrimination, or "taking the Fifth," during an SEC investigation will likely have severe consequences. For an individual employed in the securities industry, such as a stockbroker, taking the Fifth will likely result in suspension, termination, and/or loss of license. In addition, the staff is likely to point to such invocation later as a compelling reason supporting the authorization by the commission of an enforcement action. Should an individual persist in taking the Fifth during a subsequent civil enforcement action, the SEC will be entitled to an adverse inference: the jury or other fact finder will be instructed that it may infer that, had the witness answered the question, the response would have been adverse to the witness's interests. No such adverse inference is permissible in criminal proceedings.

Even though taking the Fifth will likely have severe consequences to an individual's career and in a subsequent civil action, it may well be the best, if not the only, prudent choice for an individual implicated in wrongdoing. Otherwise, the individual will either testify truthfully to facts that provide the basis for criminal and civil charges (including charges possibly beyond the scope of the initial investigation that the SEC might not otherwise find

out about) or testify falsely and open himself or herself up to potential criminal charges for perjury or obstruction of justice. The SEC has civil law enforcement authority only. The SEC may not bring criminal charges in its own name; rather, the SEC must make a criminal referral to the DOJ. Before the Enron scandal, it seemed that many U.S. attorneys' offices had little interest in expending the resources necessary to bring large-scale securities prosecutions. That attitude has changed in the last several years, although it is too soon to tell whether that change will be permanent or temporary.

It is a truism that the surest way to make an SEC investigation go criminal is to lie to the staff or destroy documents during an SEC investigation. Thus, an individual may find that taking the Fifth is in his or her best interests, notwithstanding negative career consequences and the adverse effects it may have in an SEC enforcement action. There are probably more individuals, including Martha Stewart, who regret not taking the Fifth than there are individuals who regret taking the Fifth.

Strategic decisions can also change over time. Counsel may advise his or her client to take the Fifth early in an SEC investigation, but later recommend waiving such an assertion if it then appears that the chances of a criminal referral have become slight. Likewise, a witness who has taken the Fifth during an SEC investigation may decide to testify once the SEC has filed an enforcement action.

The Wells Process

After it completes its investigation, the SEC staff determines whether it is appropriate to bring an enforcement action. If so, the staff cannot institute such proceedings on its own, but must request authorization from the commission. Absent unusual circumstances, the staff will notify potential defendants or respondents that it intends to recommend the institution of an enforcement action to the commission through a Wells notice. The Wells notice derives its name from recommendations made by an advisory committee the SEC established in the early 1970s. This committee was known as the Wells committee, after its chairman, John Wells. The Wells notice identifies the proposed charges and alleged violations in general

terms. Potential defendants or respondents may find it helpful to request a meeting (a Wells meeting) at which the staff usually provides further details regarding its factual conclusions and legal theories. Sometimes, the staff may be persuaded to eliminate certain charges as a result of the discussions that occur at a Wells meeting, or in rare (if not hypothetical or nearly so) circumstances, the staff may be persuaded not to recommend bringing a case at all.

In most cases, however, the Wells meeting will not change the staff's recommendation. The potential defendants or respondents then have an opportunity to file a written statement (a Wells submission) that goes directly to the commission. Some securities practitioners discourage routine filing of Wells submissions, because the chances of convincing the commission to reject the enforcement staff's recommendation are almost always slight. In such situations, the Wells submission may have no positive effect, but may only provide the enforcement staff with information about possible defenses it might not otherwise be able to obtain. The SEC can use any statements in a Wells submission as potential admissions in ensuing litigation.

Furthermore, Wells submissions are not confidential, and thus third parties can obtain them for use in private lawsuits that may parallel SEC enforcement actions. Wells submissions that only dispute the staff's interpretation of the facts have little chance of success, because the staff usually has additional evidence that will not be known to defense counsel. In any event, the staff always has the last word. The staff tailors its written recommendation to the commission to rebut arguments made in Wells submissions. The staff does not disclose its internal memoranda to the commission, and defense counsel thus rarely has an effective way to respond to the staff's contentions.

Settlement Discussions with the SEC

The Wells process may present a good opportunity to initiate settlement discussions with the SEC. The SEC staff lacks the authority to approve settlements directly; rather, the five-member commission must vote on and approve all settlements, just as the commission must approve the filing of

all enforcement actions. Nevertheless, the Division of Enforcement recommends to the commission whether to accept a particular settlement offer, and the commission usually will follow that recommendation.

Before engaging in settlement negotiations with the staff, counsel will generally find it productive to review recent commission settlements involving similar facts and alleged misconduct. SEC settlements are publicly available through many online services and the SEC's own Web site, www.sec.gov. The SEC claims it makes strenuous efforts to achieve consistency and uniformity in its settlement demands, but outside observers often see things differently, perceiving the process as random and arbitrary depending on which staff members are conducting the investigation.

Times do change. In the years since 2001, after the Enron scandal and the Sarbanes-Oxley Act, the SEC has insisted on harsher settlement terms, particularly in terms of financial penalties and disqualifications, such as officer and director bars that prohibit individuals from serving as officers or directors of a public company. Settlement policies may also change depending on the views and priorities of senior officials in the Division of Enforcement. Because of strong criticism, including criticism from dissenting commissioners, regarding the level of financial penalties imposed on corporations in a number of high-profile cases, the SEC issued a formal policy statement on corporate penalties in January of 2006, which is discussed below.

SEC Incentives for Cooperation

One of the reasons the vast majority of companies voluntarily complies with SEC informal requests for information and do not object to broad-ranging document requests is the premium the agency has long placed on cooperation. In October of 2001, the commission issued a formal report—the Seaboard Report—setting forth specific details of its policy regarding cooperation.

Even though it may not seem that way to those subject to its scrutiny, the SEC is a law enforcement agency with limited resources. The SEC could not function if it did not settle a substantial majority of its enforcement

matters, perhaps as high as 90 percent or more. Accordingly, the SEC has always offered substantial incentives for self-reporting and voluntary cooperation. The Seaboard Report represented an attempt by the SEC to formalize its traditional procedures regarding settlement. In the Seaboard Report, the SEC set forth a non-binding list of thirteen factors it would generally consider in evaluating cooperation:

1. What was the nature of the misconduct involved? Did it result from inadvertence, honest mistake, simple negligence, reckless or deliberate indifference to indicia of wrongful conduct, willful misconduct, or unadorned venality? Were the company's auditors misled?
2. How did the misconduct arise? Was it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?
3. Where in the organization did the misconduct occur? How high up in the chain of command did the knowledge or participation of the misconduct go? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Was it symptomatic of the way the entity does business, or was it isolated?
4. How long did the misconduct last? Was it a one-quarter or onetime event, or did it last several years? In the case of a public company, did the misconduct occur before the company went public? Did it facilitate the company's ability to go public?
5. How much harm did the misconduct inflict upon investors and other corporate constituencies? Did the share price of the company's stock drop significantly upon its discovery and disclosure?
6. How was the misconduct detected, and who uncovered it?
7. How long after discovery of the misconduct did it take to implement an effective response?

8. What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for any misconduct still with the company? If so, are they still in the same positions? Did the company promptly, completely, and effectively disclose the existence of the misconduct to the public, to regulators, and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies? Did the company identify additional related misconduct likely to have occurred? Did the company take steps to identify the extent of damage to investors and other corporate constituencies? Did the company appropriately recompense those adversely affected by the conduct?

9. What processes did the company follow to resolve many of these issues and ferret out necessary information? Were the audit committee and the board of directors fully informed? If so, when?

10. Did the company commit to learn the truth, fully and expeditiously? Did it conduct a thorough review of the nature, extent, origins, and consequences of the conduct and related behavior? Did management, the board, or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons conducted the review, had they done previous work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?

11. Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?

12. What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company provide SEC staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?

13. Is the company the same company in which the misconduct occurred, or has it changed through a merger or bankruptcy reorganization?

In aggregate, one might sum up the factors the SEC will consider in determining to grant leniency as: (a) self-policing, (b) self-reporting, (c) remediation, and (d) cooperation. The SEC issued the Seaboard Report in connection with an enforcement action that named only the employee responsible for the alleged misconduct; no charges were brought against the company involved (Seaboard) because of the quality of its cooperation, as measured by the factors discussed above.

In what can only be described as unfortunate timing for defendants and respondents, the SEC issued the Seaboard Report right before the details of the Enron scandal became public. The WorldCom, HealthSouth, Peregrine, and other corporate mega-scandals followed Enron in quick succession. These scandals spurred politicians into action, and Congress quickly enacted the Sarbanes-Oxley Act of 2002. In this environment, many questioned the continuing viability of the Seaboard Report, at least as to the possibility of cooperation enabling a company to avoid being named in an enforcement action altogether. In the view of many knowledgeable observers, the SEC's carrot became a stick, in that the SEC did not so much reward cooperation as punish those who refused to submit.

The SEC's settlement in May of 2006 with a large New York-based investment bank (Morgan Stanley & Co.) provides a dramatic, if extreme, example of the potential consequences of failing to meet the SEC's expectations in responding to requests for documents and other evidence. In that case, Morgan Stanley agreed to pay a \$15 million civil penalty to settle the SEC's allegations that it had repeatedly failed to provide tens of thousands of e-mails the SEC had sought in investigations over a period of

several years. As is typical, Morgan Stanley neither admitted nor denied the SEC's allegations, but consented to a permanent injunction barring future violations of the federal securities laws and requiring the firm to fix its system for retaining e-mails and to hire an independent consultant to ensure compliance. It seems clear that Morgan Stanley could have spared itself substantial time and expense, not to mention negative publicity, had it been more proactive and scrupulous in attempting to fulfill its disclosure obligations to the SEC.

Privilege Issues

In cooperating to obtain leniency, most companies find that a particularly sensitive and controversial area is providing privileged information to the SEC. As part of the self-policing process, many companies undertake internal investigations, often conducted by outside counsel under the direction of a committee of outside directors. Counsel to the committee typically interviews employees with knowledge of the suspected misconduct, and prepares memoranda documenting these interviews. Outside counsel may also prepare a report to the committee summarizing the findings of the internal investigation. The SEC enforcement staff frequently finds such memoranda and reports to be invaluable in conducting follow-up investigations, which may seek mainly to confirm the findings of the internal investigation. The SEC cannot compel companies to produce such memoranda and reports, because they are protected from compelled disclosure by the attorney-client privilege and/or the Work Product Doctrine, assuming counsel has taken appropriate steps to preserve such protections.

The main danger in turning over such materials is not the use the SEC may make of them, but rather the possibility they may be used by third parties in parallel class actions or derivative suits. In order to preserve, insofar as possible, the company's privilege as to third parties, the SEC sometimes enters into confidentiality agreements. Although the matter has not been conclusively resolved and remains an open issue in many jurisdictions, some courts have refused to recognize the effectiveness of such confidentiality agreements with the SEC, and accordingly have held that disclosure to the

SEC waives all privileges even as to third parties such as class action plaintiffs.

SEC Policy on Corporate Penalties

In what might fairly be characterized as a sequel to the Seaboard Report, the SEC issued an important statement on corporate penalties in January of 2006. Corporate penalties, particularly substantial fines, have long been controversial. Over the years, many SEC commissioners and securities commentators have been troubled by the contradiction inherent in corporate penalties, which can be construed as exacting a second punishment on innocent shareholders who have already suffered once from the underlying fraud. As the SEC has collected a series of record financial penalties in recent years, many well into the hundreds of millions of dollars, the criticism has become even more frequent and heated.

In its January of 2006 policy statement, the SEC responded to these concerns. The policy was announced in conjunction with the filing of settled enforcement actions against two different corporations, one in which the company paid no financial penalty and the other in which the company was hit with a \$50 million financial penalty. The SEC used these cases to illustrate the considerations expressed in the policy statement.

After reviewing and reaffirming its own authority under Sarbanes-Oxley and other securities laws to impose corporate penalties, the SEC's 2006 policy statement identified two main factors in determining their appropriateness: (a) "[t]he presence or absence of a direct benefit to the corporation as a result of the violation" and (b) "[t]he degree to which the penalty will recompense or further harm the injured shareholders." Both factors turn on notions of unjust enrichment. For instance, the commission explained that the corporation's receipt of a direct benefit from the alleged misconduct supports the imposition of a financial penalty. The commission contrasted this situation to one in which the corporation's shareholders were themselves the principal victims of the alleged securities law violations.

In addition to these two main factors, the commission identified additional considerations as proper for determining whether to impose corporate penalties:

1. The need to deter the particular type of offense. The likelihood that a corporate penalty will serve as a strong deterrent to others similarly situated weighs in favor of the imposition of a corporate penalty. Conversely, the prevalence of specific circumstances that render the particular offense unlikely to be repeated in other contexts is a factor weighing against the need for a penalty on the corporation rather than on the responsible individuals.
2. The extent of the injury to innocent parties. The egregiousness of the harm done, the number of investors injured, and the extent of societal harm if the corporation's infliction of such injury on innocent parties goes unpunished are significant determinants of the propriety of a corporate penalty.
3. Whether complicity in the violation is widespread throughout the corporation. The more pervasive the participation in the offense by responsible persons within the corporation, the more appropriate the use of a corporate penalty. Conversely, within this parameter, isolated conduct by only a few individuals would tend not to support the imposition of a corporate penalty. Whether the corporation has replaced those persons responsible for the violation will also be considered in weighing this factor.
4. The level of intent on the part of the perpetrators. Within this parameter, the imposition of a corporate penalty is most appropriate in egregious circumstances where the culpability and fraudulent intent of the perpetrators are manifest. A corporate penalty is less likely to be imposed if the violation is not the result of deliberate, intentionally fraudulent conduct.
5. The degree of difficulty in detecting the particular type of offense. Because offenses that are particularly difficult to detect call for an especially high level of deterrence, this factor weighs in support of the imposition of a corporate penalty.

6. Presence or lack of remedial steps by the corporation. Because the aim of the securities laws is to protect investors, the prevention of future harm (as well as the punishment of past offenses) is a high priority. The commission's decisions in particular cases are intended to encourage the management of corporations accused of securities law violations to do everything within their power to take remedial steps from the first moment the violation is brought to their attention. Exemplary conduct by management in this respect weighs against the use of a corporate penalty; failure of management to take remedial steps is a factor supporting the imposition of a corporate penalty.

7. Extent of cooperation with the commission and other law enforcement. Effective compliance with the securities laws depends upon vigilant supervision, monitoring, and reporting of violations. When securities law violations are discovered, it is incumbent upon management to report them to the commission and other appropriate law enforcement authorities. The degree to which a corporation has self-reported an offense, or otherwise cooperated with the investigation and remediation of the offense, is a factor the commission considers in determining the propriety of a corporate penalty.

Many of the factors the SEC described in its 2006 policy statement as being relevant to determining corporate penalties are the same as those the SEC previously identified as being relevant to evaluating cooperation in the 2001 Seaboard Report.

Conclusion

Given the SEC's increased aggressiveness in the post-Enron era, as well as the enhanced penalties available to it under Sarbanes-Oxley, many corporations choose to cooperate with the agency, notwithstanding the dangers in terms of increased potential liability to third parties. Although the considerations differ, many individuals likewise choose to cooperate with the SEC as the preferred course, particularly licensed individuals working within the securities industry. In all situations, however, those involved in SEC investigations should give careful consideration to what may realistically be gained through such a strategy. If the SEC views the

alleged misconduct as sufficiently egregious, even the best cooperation may not result in the SEC bestowing any leniency in settlement and may only bolster the SEC's evidence in a potential enforcement action. In addition, there is no guarantee that waiving privilege and providing otherwise exempt materials to the SEC will result in tangible settlement benefits with the agency, and may well hamstring the defense of private litigation.

Ross A. Albert is a partner at Morris, Manning & Martin LLP in Atlanta, where he represents individuals and entities involved in investigative and regulatory inquiries conducted by the U.S. Securities and Exchange Commission, the Georgia securities commissioner, other federal and state law enforcement authorities, and self-regulatory organizations. He also counsels clients on securities regulatory and compliance issues and represents parties involved in securities litigation, class actions, and other complex cases before state and federal courts, administrative agencies, and arbitration panels. He conducts internal investigations of alleged corporate misconduct.

From 1993 to 2001, Mr. Albert served in various positions with the Securities and Exchange Commission at its Washington, D.C., headquarters, including senior special counsel for the Division of Enforcement and legal counsel to Commissioner Norman S. Johnson. From 1994 to 1999, he concurrently served as a special assistant U.S. attorney with the U.S. Attorney's Office for the Northern District of Georgia. As a special assistant U.S. attorney in Atlanta, Mr. Albert assisted with trials and was lead appellate counsel for what was reportedly the largest criminal securities fraud prosecution in the history of Georgia, one that resulted in the convictions of twelve defendants. From 1988 to 1993, Mr. Albert was an associate in the securities litigation and enforcement group at the law firm of Wilmer, Cutler & Pickering in Washington, D.C. From 1986 to 1988, Mr. Albert served as law clerk to the Honorable Alexander Harvey II, chief judge for the U.S. District Court for the District of Maryland.

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Dedication: *This chapter is dedicated to my wife, Nancy Albert, who has put up with me for some twenty-five years. I would also like to thank my good friend and partner, John Williamson, who reviewed and supplied helpful comments on this chapter, not once but twice.*



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