



The SEC Cooperation Initiative And Its Criminal Roots

Matthew P. Allen
February 2013

Mr. Allen is a securities, IP, and business lawyer with the international law firm of Miller, Canfield, Paddock and Stone. Mr. Allen is licensed in Illinois, Michigan, and New York, and practices out of Miller Canfield's Detroit and Troy, Michigan offices, as well as Miller Canfield's offices in Chicago and New York. Mr. Allen is grateful for the opportunity to discuss the topics herein as a moderator of a panel at the 2013 ABA Section of Litigation Annual Meeting in Chicago, which includes Merri Jo Gillette, SEC Regional Director in Chicago, Julie Porter, Chief of the Financial Crimes & Special Prosecutions Unit for the US Attorney's Office in Chicago, Jack Sena, leader of Bank of America's Regulatory Inquiries Group, and Ghillaine Reid with the Gibbons PC law firm in New York. Each of the panelists participated on the panel in their personal capacity only, and did not participate in the drafting of this Article. The views expressed in this Article do not represent the views of the panelists, nor the DOJ, SEC or any of their members, officers, or staff. These panelists represent some of the finest and most capable parts of the U.S. securities law enforcement process.

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	1
DISCUSSION	3
I. Criminal and Civil Securities Laws and Parallel Proceedings.....	3
A. Background.....	3
B. Examples of Parallel Proceedings and Charging and Sentencing Decisions — Individuals, Companies, and Subsidiaries and the Great Debate About Corporate Criminal Liability.....	7
1. Libor Settlements	7
2. Tyco International, Ltd	9
3. Raj Rajaratnam.....	11
C. When and How to Seek a Stay of Parallel Civil Proceedings.....	11
II. Use of Non-Prosecution and Deferred Prosecution Agreements by the SEC	13
A. Agreements with Companies	13
B. Agreements with Individuals	15
III. SEC’s Immunity Program.....	17
A. Protections and Permissible Uses of Immunized Testimony.....	17
B. Types of SEC Immunity	17
C. Types of DOJ Immunity	18
D. Non-Exclusive Factors Considered by the DOJ to Determine “Public Interest” Requirement for Statutory Use Immunity Under 18 USC 6003	19
IV. Fifth Amendment Privilege Against Self-Incrimination and the Attorney Client Privilege — Complications Arising from the SEC Cooperation Initiative.....	19
A. Fifth Amendment Privilege in Context of SEC Civil Proceeding	19
B. Attorney Client Privilege in the Context of Internal Investigations, Parallel Proceedings, and the SEC Cooperation Initiative — Issues to Consider	22
V. SEC Whistleblower Program.....	23
A. Summary of Salient Provisions of Rule 21F.....	24
B. 2012 Statistics From the SEC Office of the Whistleblower	27
C. Whistleblower Compliance Tips For Companies	27
CONCLUSION.....	28

EXECUTIVE SUMMARY

After Lehman Brothers, Bernie Madoff, and the mortgage-backed securities meltdown of 2008, Dodd-Frank and the public have charged the U.S. Securities & Exchange Commission (“SEC” or “Commission”) with doing its part to help prevent another financial and economic catastrophe by regulating with more authority various securities products and industries. From money market funds, to private equity funds, to foreign private issuers, the SEC has stepped up its efforts to effectively examine, investigate, and charge securities violations that it views as endangering investors. However, it appears the Commission’s budget has not kept up with the increased scope of its duties.¹ So the Commission must be effective and judicious with its resources, which has resulted in a reorganization of the SEC’s divisions and reporting structure, enactment and implementation of new examination and investigation procedures and protocols, and increased cooperation with settling defendants and other state, federal, and international regulators and authorities.

One of the primary tools developed by the SEC to carry out the increased scope of its duties, with the relatively modest budget provided to do so, is the creation of the SEC’s Cooperation Initiative in 2010. One of the goals of the Cooperation Initiative is to facilitate and reward timely and quality assistance that permits “the SEC to conserve its investigative resources” by learning about complex schemes more quickly and achieving quick and successful resolutions to enforcement actions.²

One of the SEC’s goals in crafting its Cooperation Initiative was to mold it in the image of criminal cooperation tools employed by the U.S. Department of Justice (“DOJ”). Indeed, when introducing the SEC’s Cooperation Initiative in 2010, then SEC Enforcement Division Chief and former federal prosecutor Robert Khuzami stated that the heavy reliance on the DOJ tools and format would “dovetail more nicely” with the DOJ cooperation tools.³ In 2013, President Obama nominated as SEC Chairman the former U.S. Attorney for the Southern District of New York, Mary Jo White, which some see as “portending increased policing of Wall Street.”⁴ It appears that the “criminalization” of the SEC’s policies and procedures is continuing.

Some SEC cooperation tools expressly adopt by reference historically criminal DOJ tools. For example, the SEC’s new immunity tools permit the SEC, with prior approval from “the US Attorney General,” to seek a court order of immunity for a witness — which will compel the witness to testify if he asserts his Fifth Amendment right against self-incrimination in

¹ See, e.g., Sarah N. Lynch, *SEC Chairman to Request Budget Boost As Sequestration Looms*, REUTERS, Feb. 13, 2013.

² See, e.g., SEC Enforcement Manual, §6.1.1. See also *In re AXA Rosenberg*, SEC Lit. Release No. 22298 (Mar. 9, 2012) (first ever SEC cooperation agreement with an individual applying the SEC’s new guidelines for individual cooperation, set forth in section 6.1.1 of the SEC Enforcement Manual).

³ See *SEC, DOJ Use of NPAs, DPAs, to Become More Uniform Over Time, Khuzami Says*, SEC. REG. & LAW RPT (BNA) (Nov. 19, 2012).

⁴ *SEC Nominee Signals Shift: Obama Taps Ex. Prosecutor Mary Jo White, Portending Increased Policing of Wall Street*, WALL ST. J., Jan. 25, 2013 at A1.

SEC enforcement actions.⁵ Therefore, lawyers representing SEC defendants or witnesses should understand, among other things:

- the differences between and among statutory (or “formal”) immunity, letter (or “informal” or “pocket”) immunity, use immunity, derivative use immunity, and transactional immunity, which are not covered in detail in the SEC Enforcement Manual
- how these various types of immunity affect the burdens of proof for the DOJ, SEC, and other regulators
- how these various types of immunity affect their client’s civil and criminal liability
- how proffer agreements are affected by, or affect, immunity agreements
- the difference between and among oral proffers, written proffers, and client interviews
- how to handle proffer sessions and agreements with the SEC and DOJ, or both
- whether, when, and how to propose a reverse proffer, and to which agency
- whether, when, and how to submit a Wells response or white paper, especially in light of the new timing requirements Dodd-Frank imposes on the SEC
- how constitutional and attorney-client privileges are affected when defendants or witnesses subject themselves to the cooperation tools of the DOJ or SEC
- whether target company employees involuntarily participated in proffers or interviews in a foreign jurisdiction that does not recognize the direct equivalent of the US Fifth Amendment privilege against self-incrimination, and how that potentially “poisonous fruit” affects the use of that evidence by US prosecutors

The movement by the SEC towards increased use of historically criminal tools indicates an increased emphasis on the SEC’s “mission” to “work cooperatively with criminal authorities, to share information, and to coordinate their investigations with parallel criminal investigations when appropriate.”⁶

Securities practitioners should have a working understanding of the SEC cooperation tools, and the DOJ cooperation tools that are incorporated by reference into the SEC Cooperation Initiative. This Article summarizes some of the salient portions of the SEC Cooperation Initiative and some of the issues that may arise upon its continued implementation.

Part I of this Article provides a high-level overview of how and why the securities laws are subject to both civil and criminal enforcement, sometimes at the same time, and some of the salient differences between civil and criminal investigations, law, procedure, and remedies. Part II of the Article explores the parameters, terms, and the SEC’s use of Deferred Prosecution Agreements (“DPAs”) and Non-Prosecution Agreements (“NPAs”) in its Cooperation Initiative. Part III discusses the SEC’s new immunity program and rules, as well as the DOJ immunity rules and procedures which will be used to carry out SEC requests for immunity. Part IV discusses how the Fifth Amendment and attorney-client privileges of a witness or defendant may be

⁵ See SEC Enforcement Manual, § 6.2.5.

⁶ SEC Enforcement Manual, § 5.2.1.

affected by some of the SEC's cooperation tools. Finally, Part V provides an overview of the SEC's new whistleblower rule and how the new SEC whistleblower program may affect the SEC's Cooperation Initiative.

DISCUSSION

I. Criminal and Civil Securities Laws and Parallel Proceedings

A. Background

To be criminally liable under the securities laws, a defendant must “willfully” violate them.⁷ But what makes a violation “willful”? And why do criminal authorities prosecute some “willful” violations but not others? And what is the difference between civil and criminal securities law, investigations, procedures, and remedies? The nominee for SEC Chair, Mary Jo White, has been credited with the following cautionary advice: “What you should not do is fail to distinguish between what is actually criminal and what is just mistaken behavior. . . .”⁸ While there are not hard answers to some of these questions, certain parameters and guiding principles can be observed. For example, while the SEC staff will usually provide the general response referenced in section 5.2.1 of the SEC Enforcement Manual to an inquiry about the existence of parallel criminal investigations or proceedings, some indicia that sometimes indicate that a pending criminal investigation is more likely include, among other things:

- Significant losses
- High profile or public matter
- Compelling facts of fraud
- Whether the subject matter of investigation is a “National Priority Matter”⁹ or other government or regulatory priority
- Sympathetic or vulnerable victims, and/or an unsympathetic defendant
- Government wants to send a message of deterrence
- Grand jury subpoenas have been served on parties related to the SEC case or matter under inquiry
- Presence of FBI special agents or Assistant US Attorneys at interviews or proffer sessions

Courts have ruled that it is constitutional for the SEC and DOJ to separately or simultaneously pursue civil and criminal charges for the same violation of the securities laws, with the courts there to monitor and remedy any “substantial prejudice” that may result from these parallel proceedings:

⁷ See 15 USC 78ff (criminal provision of the Securities Exchange Act of 1934); 15 USC 77x (criminal provision of the Securities Act of 1933).

⁸ Scott Patterson, *A Market-Cop Image May Be Challenged: SEC Nominee's Views on Corporate Indictments, Whistleblowers May Draw Questions at Her Confirmation Hearings*, WALL ST. J., Jan 31, 2013 at C3.

⁹ See SEC Enforcement Manual, § 2.1.1.

The civil and regulatory laws of the United States frequently overlap with the criminal laws, creating the possibility of parallel civil and criminal proceedings, either successive or simultaneous. In the absence of substantial prejudice to the rights of the parties involved, such parallel proceedings are unobjectionable under our jurisprudence. As long ago as 1912 the Supreme Court . . . held that the government could initiate such proceedings either “simultaneously or successively,” with discretion in the courts to prevent injury in particular cases. . . Effective enforcement of the securities laws requires that the SEC and Justice be able to investigate possible violations simultaneously.¹⁰

However, the SEC and DOJ may not improperly “commingle” or merge their respective parallel investigations.¹¹ The SEC Enforcement Manual sets forth the general authority and procedures under which the SEC may share information with other foreign and domestic law enforcement and regulatory authorities, including a section dedicated to “Parallel Investigations.”¹²

Generally speaking, US criminal laws exist as a punitive measure to punish and stigmatize actions and conduct US society views as especially menacing to society as a whole. US civil laws generally protect legal rights and compensate economic victims of the offending conduct. Criminal laws look at the subjective *mens rea* (or guilty mind) of the defendant, while civil laws are primarily interested in objective, businesslike liability.¹³

¹⁰ *SEC v Dresser Indus.*, 628 F2d 1368, 1374, 1377 (DC Cir 1980) (en banc) (citing *Standard Sanitary Mfg v. United States*, 226 US 20, 52 (1912)).

¹¹ *See, e.g., US v. Scrushy*, 366 F Supp 2d 1134 (ND Ala. 2005) (holding that the “civil action and criminal investigation improperly merged” when: (1) the SEC changed defendant’s deposition locations in the civil action at the request of the DOJ to accommodate the DOJ’s jurisdiction over a false statement prosecution from the deposition; (2) the SEC agreed to the DOJ’s request that the SEC refrain from asking certain questions at defendant’s deposition so as not to reveal the subjects of the criminal investigations; (3) the SEC participated in interviews of witnesses in the criminal case).

¹² *See* SEC Enforcement Manual, §§ 5.1 – 5.6.5.

¹³ *See generally* Thomas C. Newkirk, Associate Director, Division of Enforcement, SEC, The Advantages of a Dual System: Parallel Streams of Civil and Criminal Enforcement of the US Securities Laws, Speech at the 16th International Symposium on Economic Crime, Jesus College, Cambridge, England (Sept. 19, 1998) (“Newkirk Speech”).

Some differences between criminal and civil **investigations** of the securities laws include:

Criminal	Civil
<p>Greater police powers to investigate:</p> <ul style="list-style-type: none"> • right to search & seize • conduct undercover operations • intercept electronic and telephonic communications • pay informants • interrogate and subpoena witnesses before a grand jury • grant immunity to compel testimony otherwise protected by the Fifth Amendment privilege against self-incrimination 	<p>More limited investigatory powers:</p> <ul style="list-style-type: none"> • Privacy Act requires civil agency to identify itself before and explain the purpose of its inquiry • SEC can issue subpoenas to compel testimony or documents upon issuance of a Formal Order of Investigation • SEC cannot itself grant immunity to overcome assertion of Fifth Amendment privilege (but as of 2010 SEC can make immunity requests to the DOJ) • SEC can use adverse inference of a witness's assertion of Fifth Amendment • SEC can use its supervisory powers to inspect and examine anyone in the securities industry
<p>Federal criminal investigative agencies include the DOJ, US Attorney offices, Federal Bureau of Investigation (FBI), Internal Revenue Service (IRS), Postal Inspector, among others</p>	<p>Federal civil investigative agencies include the SEC, Commodities Futures Trading Commission (CFTC), the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Regulatory Board (MSRB), New York Stock Exchange (NYSE), NASDAQ, among others.</p>

Some differences between criminal and civil **procedure** in securities cases include:

Criminal	Civil
<ul style="list-style-type: none"> • Limited discovery for defendants under Federal Rules of Criminal Procedure • Fifth Amendment privilege cannot be used against a criminal defendant as an adverse inference • Government must prove each offense beyond a reasonable doubt 	<ul style="list-style-type: none"> • Broad discovery for defendants under Federal Rules of Civil Procedure • Fifth Amendment privilege can be used against civil defendant as an adverse inference • SEC generally only required to prove claims by a preponderance of the evidence

<ul style="list-style-type: none"> • Government must prove defendant “willfully” violated the securities laws at issue • Government can also prosecute securities fraud under mail and wire fraud statutes, RICO, charges for obstruction of SEC investigations, making false statements to the SEC or DOJ, and can bring aiding and abetting and conspiracy charges 	<ul style="list-style-type: none"> • SEC has the option to prosecute claims against regulated persons in administrative actions before an SEC administrative law judge rather than an enforcement action in court; the administrative action generally has more limited discovery and more expedited procedures
--	--

Some differences between criminal and civil **remedies** in securities cases include:

Criminal	Civil
Remedies are more limited — imprisonment, monetary fines, disgorgement, imposition of independent corporate monitors ¹⁴	Broad array of remedies available: <ul style="list-style-type: none"> • Injunctions • “Collateral consequences” of a fraud injunction • Cease and desist orders • Monetary penalties • Disgorgement • Treble penalties¹⁵ • Private plaintiff claims • Debarments • License revocations • Compliance receivers and monitors • Halting sale of issuer’s stock

We reserve our harshest moral and legal artillery for criminal violations and wrongdoers. So Congress’s determination to include criminal provisions into US securities laws reflects a policy and intent that some securities violations are so menacing that they must be punished and stigmatized with our heaviest moral artillery. Some posit that criminal laws are not as effective at rooting out and prosecuting subtler species of fraud. The broad array of civil tools and remedies available to the SEC, coupled with a less rigorous standard of proof, provide more flexibility to the SEC when prosecuting and resolving certain fraud cases — Why use a bazooka when you can use a hammer? Also, leaving particularly sympathetic victims of securities fraud

¹⁴ See, e.g., DOJ Memorandum for Heads of Department Components, United States Attorneys re: Additional Guidance on the Use of Monitors in Deferred Prosecution Agreements and Non Prosecution Agreements (May 25, 2010) (expounding on March 7, 2008 “Morford Memorandum,” which set forth “nine basic principles for drafting monitor-related provisions in agreements. . .”).

¹⁵ See 15 USC 78u-1(a)(2)-(3) (treble civil penalties for insider trading).

to pursue civil remedies without assistance would make it harder to quash the offending conduct because many defendants simply have victims legally and financially outgunned; thus labeling securities fraud as criminal only would tie the government's hands with a higher standard of proof, more formal processes, limited remedies, and arguably more limited remedies for victims. The flexibilities and lower standard of proof available to government-agency civil enforcement actions are especially important given the increasingly sophisticated communication, economic, financial, and social relationships law enforcement face when investigating and prosecuting potentially unlawful conduct.¹⁶

B. Examples of Parallel Proceedings and Charging and Sentencing Decisions — Individuals, Companies, and Subsidiaries and the Great Debate About Corporate Criminal Liability

Corporations can be held criminally responsible for the criminal acts of its agents or employees when they are “acting within the scope of their authority or the course of their employment so long as the action is motivated, at least in part, to benefit the corporation.”¹⁷ This means that corporate subsidiaries can also be criminally charged. However, neither corporations nor their subsidiaries enjoy a Fifth Amendment privilege against self-incrimination because it is a personal privilege enjoyed solely by natural persons.¹⁸ This framework permits lawyers for companies to creatively structure simultaneous resolution to both civil and criminal proceedings in a manner that preserves certain licenses, business units, banking charters, etc.

There is currently a debate about the utility of criminally charging corporate entities, as opposed to the individual corporate employees who commit the crime. Some argue that corporations should rarely if ever be charged for criminal wrongdoing because corporate “indictments are too often fatal to companies and can needlessly harm innocent employees and shareholders.”¹⁹ Others argue that companies must be held criminally responsible for unlawful conduct that benefits their bottom lines, otherwise the government will create a moral hazard of companies being “too big to indict,” along with a perceived double standard when it comes to Wall Street.²⁰ Below are some case studies to illustrate these issues and settlement strategies.

1. Libor Settlements

US and UK prosecutors levied a \$1.5 billion fine on UBS in the Libor manipulation scandal, but did not charge UBS criminally to avoid UBS having its banking

¹⁶ See generally Newkirk Speech.

¹⁷ *US v Philip Morris, Inc*, 449 F Supp 2d 1, 892 (D DC 2006).

¹⁸ See *US v. White*, 322 US 694, 699 (1944).

¹⁹ Scott Patterson, *A Market-Cop Image May Be Challenged: SEC Nominee's Views on Corporate Indictments, Whistleblowers May Draw Questions at Her Confirmation Hearings*, WALL ST. J., Jan 31, 2013 at C3 (citing as an example the fall of Arthur Anderson after its 2002 criminal conviction resulting from the Enron investigations).

²⁰ See Evan Weinberger, *DOJ Settlements Let Big Banks Off Too Easy, Senators Say*, Law360 (Jan 29, 2013); Letter from US Senators Sherrod Brown and Charles Grassley to US Attorney General Eric Holder (Jan 29, 2013).

charter revoked for a fraud conviction, “fearing such a move could endanger its stability.”²¹ Instead, two UBS traders were charged criminally, while a UBS Japanese subsidiary took a criminal plea. Now, the US must extradite the traders that were criminally charged, which may set up an extradition battle between the US and UK.

The lack of criminal prosecution of the UBS parent — involved in an “epic” fraud involving “dozens of employees” around the world who attempted to manipulate the Libor rate “at least 2,000 times” over a five year period — has created a debate about the potential moral hazard of being too big or important to indict.²² We discussed above the view that criminal sanctions are generally reserved for the largest, most pervasive, most intentional fraud. In the UBS Libor settlements, UBS traders and managers willfully and intentionally manipulated Libor rates for UBS’s gain, allegedly costing Fannie Mae, Freddie Mac and others who tied their instruments to the Libor untold billions of dollars. But the US, UK, and Swiss criminal authorities all refrained from indicting the UBS parent because a felony conviction would revoke UBS’s bank charter and risk putting it out of business. Instead, UBS’s Japanese subsidiary took a criminal plea while UBS paid an enormous fine and agreed to other compliance measures.²³ Seeing no drastic fallout from the criminal charges against UBS, the DOJ then wanted Royal Bank of Scotland (RBS) to allow one of its units to plead guilty to criminal charges as part of a Libor settlement.²⁴ RBS, like UBS, agreed to allow its Japanese subsidiary to plead guilty to wire fraud in the US under a deferred prosecution deal with the DOJ. But unlike UBS, no individual RBS employees were criminally charged. RBS agreed to pay \$325 million in fines to the CFTC, \$150 million to DOJ, and 87.5 million pounds (\$137.10 million) to the UK Financial Services Agency.²⁵ US prosecutors cooperating with foreign regulators abroad have been mindful that attending compelled witness interviews in a country that does not have a direct equivalent of the US Fifth Amendment right against compelled self-incrimination, or reviewing transcripts of those interviews, may require exclusion of that evidence in US courts.²⁶

²¹ David Enrich, *UBS Admits Rigging Rates in ‘Epic’ Plot*, WALL ST. J., Dec. 20, 2012 at A1, A14.

²² See Evan Weinberger, *DOJ Settlements Let Big Banks Off Too Easy, Senators Say*, Law360 (Jan 29, 2013); Letter from US Senators Sherrod Brown and Charles Grassley to US Attorney General Eric Holder (Jan 29, 2013).

²³ See generally David Enrich, *UBS Admits Rigging Rates in ‘Epic’ Plot*, WALL ST J, Dec. 20, 2012 at A1; Kara Scannell, *\$1.5b Libor Penalty Rocks UBS*, FINANCIAL TIMES (Dec 20, 2012); Evan Weinberger, *UBS Deal Shows Some Banks Still Too Big to Indict*, Law360 (Dec. 19, 2012); Daniel Schafer, *UBS Seeks Global Deal Over Libor Scandal*, FINANCIAL TIMES, Dec. 4, 2012 at 13; Caroline Binham, *Trader and Two Brokers Held in First Arrests Over Libor Scandal*, FINANCIAL TIMES, Dec 12, 2012 at 1; Brooke Masters, *Watchdog Unveils Blueprint for Libor*, FINANCIAL TIMES, Dec 6, 2012 at 14; *UBS to Pay \$1.5 Billion to US, Foreign Regulators in LIBOR Probe*, SECS. REG & LAW RPT (BNA), Vol. 44, No. 50, at 2321 (Dec 24, 2012).

²⁴ David Enrich, *US Wants Criminal Charges for RBS*, WALL ST. J., Jan 29, 2013 at A1; Lindsay Naylor, *US Pushing for RBS to Enter Libor Guilty Plea*, Law360 (Jan 29, 2013).

²⁵ Thompson Reuters, *RBS to Pay \$612 Million in Libor Fines to US, UK* (Feb. 6, 2013); Jean Eaglesham, *RBS On Deck to Pay in Rate Probe*, WALL. ST. J., Feb. 6, 2013 at C1; Max Stendahl, *Libor Prosecutors In Control As Holdout Banks Squirm*, Law360 (Feb. 6, 2013).

²⁶ See, e.g., Eaglesham, *supra*.

UBS, RBS, and other national and international banks and investment firms are facing additional significant penalties from foreign regulators and private civil suits, and having to markedly slash executive bonuses to help fund the significant monetary penalties and potentially significant civil judgments.²⁷ Bank executives are trying to craft a multi-bank settlement to resolve the Libor investigations, a resolution which the banks want to include private litigation, “which is more worrisome to the industry than the financial penalties imposed by regulators.”²⁸ The fallout of the Libor scandal is also illustrating the conflicts between legal defenses for companies and their executives.²⁹

2. Tyco International, Ltd

The 2012 SEC and DOJ cooperation agreements and settlements with Tyco provide an interesting study of the international reach of the SEC, the powerful remediating affect of cooperation, and another example of how companies can use subsidiaries to take criminal charges to preserve the central business of the parent.

In 2006, Tyco settled various Foreign Corrupt Practices Act (“FCPA”) charges with the SEC. In the 2006 settlement, Tyco paid a \$50 million penalty, agreed to an injunction against future FCPA violations, and agreed to conduct a comprehensive, global internal FCPA investigation. Tyco’s years-long internal investigation involved, among other things, the following actions:

- a review of 454 entities doing business in 50 separate countries
- active monitoring and evaluation of all Tyco agents and third parties
- quarterly ethics and compliance training by over 4,000 middle managers
- FCPA-focused on-site reviews of higher risk entities
- Creation of a corporate Ombudsman’s office and numerous segment-specific compliance counsel positions
- Exiting of operations in high-risk areas and countries
- Termination of over 90 employees for FCPA compliance concerns.

²⁷ See generally James Shotter, *UBS Cuts Bonuses to Recoup Libor Fine*, FINANCIAL TIMES, Feb. 6, 2013 at 14; Gavin Finch, *RBS May Face \$800 Million Libor Fine as Soon as Next Week*, BLOOMBERG (Jan. 15, 2013); *RBS to Slash Bonuses to Pay Libor Fines*, THOMPSON REUTERS (Jan 11, 2013); Mark Scott, *UBS Executives Questioned by Parliament Over Rate-Rigging Case*, NY TIMES (Jan 9, 2013); Melissa Lipman, *Calif. Cities Sue Big Banks Over Libor Manipulation*, LAW360 (Jan 9, 2013); Karin Matussek, *Libor Lending Rates Were Probably Fixed, German Regulator Says*, BLOOMBERG (Nov 28, 2012).

²⁸ David Enrich, *US Wants Criminal Charges for RBS*, WALL ST. J., Jan 29, 2013 at A1. See also Editorial, *Libor Banks Should Consider Global Deal With Victims*, BLOOMBERG, Jan 31, 2013 (positing that over 30 pending private federal court Libor cases in New York, many seeking treble damages under anti trust and other laws, could result in judgments worth many hundreds of billions of dollars, and suggesting that banks settle and create a “well-executed compensation fund” for victims of the Libor manipulation).

²⁹ See, e.g., Brooke Masters, *We Knew Nothing of Our Libor Troubles, Say Former UBS Bosses*, FINANCIAL TIMES, Jan 11, 2013 at 1.

Tyco's internal investigation revealed twelve post-injunction illicit payment schemes at Tyco subsidiaries around the world. Tyco voluntarily reported these violations to the SEC, which resulted in criminal charges and another SEC settlement in September 2012, which is examined below.

In the settled complaint filed by the SEC in the US District Court for the District of Columbia in September 2012, the SEC alleged that Tyco, a Swiss company, had violated the FCPA through various, sometimes elaborate, illicit payment schemes that funneled money and other "things of value" to foreign officials through various Tyco subsidiaries in countries around the world (but not in the US). The SEC had jurisdiction in part because Tyco listed its securities on the New York Stock Exchange, and was thus an "issuer" under the FCPA, even though Tyco was not a US company and the illicit conduct did not occur in the US or involve US citizens.

Tyco entered into a Non Prosecution Agreement ("NPA") with the DOJ, and a non-public settlement with the SEC. In the criminal NPA, a Tyco wholly-owned subsidiary allocated to falsifying their books and records to hide payments to foreign officials to remove the subsidiary's interests from Saudi oil "black lists," obtain product approvals, among other false entries to hide illicit payments over ten years in twenty one countries. The subsidiary pled guilty to conspiracy to violate the FCPA anti-bribery provisions, paid a \$2.1 million penalty, and agreed to work with Tyco, the parent company, to fulfill their compliance obligations. Tyco, the parent, agreed to separately pay a \$13.7 million penalty and agreed to strengthen its compliance, bookkeeping, and internal controls. The parent company was not criminally charged.

But in a separate settlement with the SEC, the parent company paid \$10.6 million in disgorgement, \$2.6 million in prejudgment interest, and agreed to a books and records injunction. This settlement is lenient when one considers that Tyco paid \$50 million to the SEC in 2006 for the same types of unlawful conduct and violated a fraud injunction by repeating the FCPA violations. But the SEC made clear that its penalties against Tyco considered Tyco's "extensive efforts to identify and remediate wrongdoing," and its "voluntary disclosure" of its extensive global internal investigation findings.³⁰

Notice the cooperation and settlement strategy: the Tyco subsidiary was not an "issuer" of Tyco's US securities, Tyco was. However, criminal FCPA bribery charges (as opposed to books and records charges) do not require the defendant to be an "issuer," and therefore the subsidiary could plead guilty to conspiracy to violate the FCPA bribery provisions. Meanwhile, the issuing parent company can avoid criminal charges that could affect its US listing. The parent company could then settle monetary and injunction charges with the SEC, and use its extensive and voluntary cooperation to remediate what could otherwise be potential "death penalty"-type sanctions for significant, repeat violations in the face of a fraud injunction.

³⁰ See *SEC v. Tyco, Int'l, Ltd*, Case No. 12-cv-01583, Complaint (D DC Sept 24, 2012); SEC Lit. Release 22491 (Sept 24, 2012); September 20, 2012 DOJ Non-Prosecution Letter to and Agreement with Tyco.

3. Raj Rajaratnam

Former hedge fund manager Raj Rajaratnam was charged criminally by the DOJ and two separate times by the SEC in connection with insider trading charges. In 2011, Mr. Rajaratnam was ordered to pay more than \$92 million in a lawsuit brought by the SEC in connection with the insider trading scheme. In a separate DOJ criminal proceeding, Mr. Rajaratnam was sentenced to eleven years in prison after being convicted of conspiracy and securities fraud with broad insider trading charges, and was ordered to forfeit \$63 million. In 2012, Mr. Rajaratnam settled a second SEC suit relating to narrower charges in connection with his insider trading using tips from ex-Goldman director Rajat Gupta. In the 2012 settlement, Rajaratnam paid \$1.45 million in disgorgement and pre-judgment interest, representing profits gained or losses avoided based on his trading off of Gupta's tips.³¹

The Rajaratnam convictions and penalties demonstrate the seriousness and extreme prejudice with which the government can wield its significant parallel civil and criminal securities tools and remedies.

C. When and How to Seek a Stay of Parallel Civil Proceedings

Sometimes a defendant in an SEC enforcement action that is also subject to a parallel criminal investigation or prosecution will ask the court to stay the SEC proceedings because, among other things, the defendant does not want to give the DOJ access to unfettered civil discovery, wants to avoid exposing his theory of defense to the DOJ in the civil case, and wants to avoid the adverse inference and consequences of invoking his Fifth Amendment privilege in the civil case. Concomitantly, the DOJ may want the civil case stayed so as not to interfere with its criminal investigation. If the SEC has already filed its case, then it is up to the court presiding over the SEC case to determine whether to grant a motion to stay.

The seminal case addressing the circumstances and factors courts can consider when faced with a motion to stay is *US v. Dresser Industries*.³² The *Dresser* court began by noting that the Constitution does not require a stay of a civil enforcement case pending the outcome of a parallel criminal case.³³ However, courts retain the discretion to stay civil enforcement proceedings, postpone discovery in the civil case, or impose protective orders or conditions ““when the interests of justice seem to require such action, sometimes at the request of the prosecution, sometimes at the request of the defense.””³⁴ This determination must be made on a case-by-case basis.

³¹ See generally Chad Bray, *Rajaratnam, SEC Settle Gupta Suit*, WALL ST. J, Dec 28, 2012 at C3; Max Stendahl, *Gupta Case Shows Sentencing Guidelines Losing Favor in NY*, Law360 (Oct 25, 2012); *Gupta Sentenced to Two Years in Prison, Vows to Appeal on Wiretaps, Other Issues*, SECS. REG. & LAW RPT. (BNA), Vol 44, No 43, at 1985 (Oct 29, 2012).

³² 628 F2d 1368 (DC Cir. 1980) (en banc).

³³ See *id.* at 1375 (citing *Baxter v. Palmigiano*, 425 US 308 (1976)).

³⁴ *Id.* (quoting *US v. Kordel*, 397 US 1, 12, n27 (1970)).

Absent indications of bad faith or malicious government tactics, the court opined that the “strongest case” for granting a stay of civil enforcement proceedings until the criminal proceedings are completed “is where a party under indictment for a serious offense is required to defend a civil or administrative action involving the same matter:”

The noncriminal proceeding, if not deferred, might undermine the Fifth Amendment privilege against self-incrimination, expand rights of criminal discovery beyond the limits of Federal Rule of Criminal Procedure 16(b), expose the basis of the defense to the prosecution in advance of the criminal trial, or otherwise prejudice the case. If delay of the noncriminal proceeding would not seriously injure the public interest, a court may be justified in deferring it.³⁵

The Court also considered reasons why a court may not grant a motion to stay civil proceedings, including but not limited to the following:

- The court may protect the government and civil defendant with more limited remedies, including deferring civil discovery or entering an appropriate protective order
- Limit civil disclosures to those that do not require the defendant to reveal the basis for his or its defense
- Lengthy grand jury investigations may risk the running of civil statutes of limitation, loss of witness testimony due to moves, death, or fading memories, all of which potentially divert if not waste enforcement resources
- SEC’s regulatory and investor-protection mission may require the SEC to move quickly with injunctive or other emergency action to protect imminent threats to investors or global markets.³⁶

The *Dresser* court denied defendant’s motion to stay the civil enforcement proceedings in that case because, among other things, “[n]o indictment has been returned; no Fifth Amendment privilege is threatened; Rule 16(b) has not come into effect; and the SEC subpoena does not require Dresser to reveal the basis for its defense:”

The strict limitations on discovery in criminal cases, embodied in Federal Rules of Criminal Procedure 15-17, do not take effect until after a grand jury has returned an indictment. Until then there is no danger that Justice might broaden its discovery rights, because the subpoena power of the grand jury is as broad [and] perhaps broader than that of the SEC. Justice can procure from Dresser directly whatever materials it might procure indirectly through the SEC. In fact, a party investigated under SEC rules instead of grand jury

³⁵ *Id.* at 1375-76 (citations omitted).

³⁶ *See id.* at 1377-81.

procedures is accorded far greater procedural protection, and has no cause to complain.³⁷

II. Use of Non-Prosecution and Deferred Prosecution Agreements by the SEC

“A deferred prosecution agreement is a written agreement between the Commission and a potential cooperating individual or company in which the Commission agrees to forego an enforcement action against the individual or company if the individual or company agrees to:”

- Cooperate fully in the investigation and enforcement action
- Enter a long term tolling agreement
- Comply with express prohibitions or undertakings during a period of deferred prosecution
- “agree either to admit or not to contest underlying facts that the Commission could assert to establish a violation of the federal securities laws.”³⁸

The SEC’s Enforcement Manual contains lists of considerations for Staff to consider when determining whether a DPA is appropriate, and what the terms of the DPA should include.³⁹

A non-prosecution agreement also results in the SEC foregoing prosecution, but it usually comes with less strings than a DPA, and is therefore “entered in limited and appropriate circumstances.”⁴⁰

A. Agreements with Companies

A review of some recent SEC NPAs and DPAs with various companies reveals the following terms:⁴¹

Deferred Prosecution Agreements	Non Prosecution Agreements
<ul style="list-style-type: none"> • Enforceable for a defined period of time (“Deferred Period”) • Requires defendant to “accept responsibility for its conduct” as set 	<ul style="list-style-type: none"> • Used in “limited and appropriate circumstances” • “Without admitting or denying liability, defendant has offered to

³⁷ *Id.* at 1381.

³⁸ SEC Enforcement Manual, §6.2.3.

³⁹ *See id.*

⁴⁰ SEC Enforcement Manual, §6.2.4.

⁴¹ *See generally In re Amish Helping Fund* SEC DPA (March 2012); *In re Federal National Mortgage Association (“Fannie Mae”)* SEC NPA (December 2011); *In re Federal Home Loan Mortgage Corporation (“Freddie Mac”)* SEC NPA (December 2011); *In re Tenaris, SA* SEC DPA (March 2011); *In re Cater’s, Inc.* SEC NPA (November 2010). *Compare In re The NORDAM Group* DOJ NPA (July 6, 2012); *In re Pfizer HCP Corp.*, DOJ DPA (August 2012); *In re Tyco, Int’l, Ltd* DOJ NPA (Sept. 20, 2012).

<p>forth in the Statement of Facts (some DPAs contain preface “without admitting or denying liability”)</p> <ul style="list-style-type: none"> • Must cooperate in the Investigation “and any related action or proceeding against other persons to which the Commission is a party, regardless of the time period in which the cooperation is required” • Must cooperate with other federal, state, and SRO actions related to Investigation • Must produce all relevant documents whenever requested • <u>Must enter tolling agreement during Deferred Period</u>, and not include that period in any statute of limitations defense to any future enforcement action • Must use “best efforts to secure the full, truthful, and continuing cooperation of current and former directors, officers, and employees” by making them available at defendant’s expense, and requiring them to produce documents and appear for testimony or interviews and enter tolling agreements • Allocute to “Statement of Facts” that the SEC “would have presented sufficient evidence to prove” its claims • Agree not to violate federal and state securities laws or SRO rules • Agree to various “Undertakings” • Agree not to make any public statements that directly or indirectly imply that the Statement of Facts are without factual basis (if an entity is entering the DPA, this does not apply to individual members of the entity who may still be parties to civil, criminal, or SRO proceedings) • SEC must approve any press release by defendant concerning the DPA • If defendant breaches DPA, SEC can sue defendant for it and the substantive 	<p>accept responsibility for its conduct” as set forth in the Statement of Facts</p> <ul style="list-style-type: none"> • Must cooperate in the Investigation “and any related action or proceeding against other persons to which the Commission is a party, regardless of the time period in which the cooperation is required” • Must produce all relevant documents whenever requested • <u>Must enter tolling agreement during Cooperation Period</u>, and not include that period in any statute of limitations defense to any future enforcement action. There is no limit to the Cooperation Period — it is continuing • Must use “best efforts to secure the full, truthful, and continuing cooperation of current and former directors, officers, and employees” by making them available at defendant’s expense, and requiring them to produce documents and appear for testimony or interviews and enter tolling agreements • Allocute to “Statement of Facts” • Agree to various “Undertakings” • Agree not to make any public statements that directly or indirectly imply that the Statement of Facts are without factual basis (if an entity is entering the NPA, this does not apply to individual members of the entity who may still be parties to civil, criminal or SRO proceedings) • If defendant breaches NPA, SEC can sue defendant for it and the substantive securities violations in the NPA. • If defendant breaches the NPA and is sued by the SEC, defendant cannot contest or contradict the Statement of Facts in the NPA in the enforcement action by the SEC. • If defendant complies with cooperation obligations, prohibitions, and
---	---

<p>securities violations in the DPA.</p> <ul style="list-style-type: none"> • If defendant breaches the DPA and is sued by the SEC, defendant cannot contest or contradict the Statement of Facts in the DPA in the enforcement action by the SEC. • If defendant complies with cooperation obligations, prohibitions, and undertakings in DPA during Deferred Period, SEC will agree not to bring Enforcement Action against defendant after the Deferred Period based on the Investigation • DPA does not bind DOJ or other agency but defendant can request that SEC issue cooperation letter to DOJ or other agencies • Entity defendant must bind purchaser in any sale to the defendant’s DPA obligations 	<p>undertakings in NPA, SEC will agree not to bring Enforcement Action against defendant based on the Investigation — SEC obligation begins immediately; no Deferred Period</p> <ul style="list-style-type: none"> • NPA does not bind DOJ or other agency but defendant can request that SEC issue cooperation letter to DOJ or other agencies • Entity defendant must bind purchaser in any sale to the defendant’s NPA obligations
---	--

B. Agreements with Individuals

In 2010, the SEC added to its Enforcement Manual a “Framework for Evaluating Cooperation by Individuals.”⁴² The Commission’s framework for evaluating cooperation by companies was set forth in a 2001 SEC Report commonly referred to as the Seaboard Report.⁴³ The SEC Enforcement Manual devotes four pages to setting forth the following four factors the SEC considers when evaluating individual cooperation, including detailed sub-factors:

1. the assistance provided by the cooperating individual in the Commission’s investigation and related enforcement action;
2. the importance of the underlying matter in which the individual cooperated;
3. the societal interest in ensuring that the cooperating individual is held accountable for his or her misconduct; and
4. the appropriateness of cooperation credit based upon the profile of the cooperating individual.

On March 19, 2012, the SEC published its first individual cooperation agreement in a matter styled *In re AXA Rosenberg*.⁴⁴ The SEC used this publication as an opportunity to “provide guidance regarding the circumstances under which individuals may receive credit as part of the

⁴² See SEC Enforcement Manual, §6.1.1. See also SEC Release 34-61340 (eff. Jan 19, 2010).

⁴³ See SEC Enforcement Manual, §6.1.2. See also SEC Release No. 34-44969 (Oct 23, 2001).

⁴⁴ SEC Litig. Release No. 22298 (Mar 19, 2012).

SEC's Cooperation Initiative." The SEC noted that it declined to seek enforcement against an AXA "senior executive" in exchange for his "substantial cooperation." The SEC credited, among other things, the individual being the first to offer cooperation (before the company) and his provision of key information in a complex investigation that led to settled enforcement actions against the company, which included a significant penalty.

Below are the four factors cited in the SEC Enforcement Manual as considerations for evaluating individual cooperation, underneath which are summaries of the key points cited by the SEC in the AXA *Rosenberg* agreement in applying each factor:

Assistance Provided

- "timeliness and quality" of assistance "allowed the SEC to conserve its investigative resources"
- Executive "was the first to offer his cooperation"
- Executive "voluntarily requested to be considered under the SEC's Cooperation Initiative"
- Executive "provided substantial assistance without condition. By doing so, he enhanced his credibility by showing that he had not been promised any specific outcome in exchange for his truthful testimony"

Importance of Underlying Matter

- Investigation involved a priority area for the Division of Enforcement — compliance policies for quantitative investment models
- First quantitative investment model error case
- SEC able to return to clients all \$217 million in losses from the error
- SEC able to impose additional penalties on company totaling \$27.5 million
- SEC required AXA to hire independent consultant to conduct study of compliance and control procedures

Interest in Holding Senior Executive Accountable

- Executive advocated that the CEO be informed of the error
- Executive was instructed to conceal the error and not fix it
- "The senior executive's cooperation maximized the SEC's law enforcement interests by facilitating the quick and successful resolution of its enforcement actions against [the Company]."

Senior Executives' Profile

- Executive was not an associated person of a regulated entity, a fiduciary for others regarding financial matters, nor was he an officer or director of a public company
- Executive does not have any disciplinary or regulatory history
- Executive resigned from AXA and retired from the investment advisory industry
- So Executive is "no longer in a position to commit future violations of the federal securities laws."⁴⁵

⁴⁵ *Id.*

III. SEC's Immunity Program

A. Protections and Permissible Uses of Immunized Testimony

In January 2010, the SEC added immunity requests to its list of cooperation tools.⁴⁶ When a witness or defendant asserts his Fifth Amendment privilege against self-incrimination in an SEC investigation or enforcement action, the SEC can obtain or facilitate the witness's testimony by seeking a court order that the witness will be immune from criminal prosecution if he provides incriminating testimony or other evidence to the SEC. The SEC must first follow the protocol set forth in its Enforcement Manual to obtain approval by the "US Attorney General" before requesting immunity. **IMPORTANT:** the SEC Manual makes it clear that immunity orders requested by the SEC to compel incriminating testimony in an SEC enforcement action only protect the witness from being criminally prosecuted with the immunized testimony; it does NOT prevent the SEC from using the immunized testimony against the witness in any SEC enforcement actions:

Neither an immunity order nor an immunity letter, however, prevents the Commission from using the testimony or other information provided by the individual in its enforcement actions, including the actions against the individual for whom the immunity order or letter was issued.⁴⁷

In other words, it appears from the SEC Enforcement Manual that if a witness invokes his Fifth Amendment privilege in an SEC investigation or enforcement proceeding, the SEC can compel that witness to testify in the SEC action with the immunity order, and then use that testimony against the witness in the same SEC action. **This adds an additional but very important consideration when assessing whether a client should invoke his Fifth Amendment criminal privilege in civil SEC proceedings.**

B. Types of SEC Immunity

The SEC is permitted to obtain one of two types of immunity: statutory immunity or letter immunity. Statutory (or "Formal") Immunity permits the SEC, pursuant to 18 USC 6001-6004, to seek a court order compelling the witness to give testimony or provide information necessary to the public interest, if the request is approved by the DOJ. Letter ("Informal" or "Pocket") Immunity is conferred by agreement between the witness and the DOJ, not the SEC. "Both types of immunity prevent the use of statements or other information provided by the individual, directly or indirectly, against the individual in any criminal case, except for perjury, giving a false statement, or obstruction of justice."⁴⁸

⁴⁶ See SEC Enforcement Manual, § 6.2.5. See also SEC Release No. 34-61339 (eff. Jan 19, 2010).

⁴⁷ SEC Enforcement Manual, § 6.2.5.

⁴⁸ *Id.* (emphasis added).

Other than summarizing the procedures and considerations for making an immunity request, the SEC Enforcement Manual does not provide any additional guidance on immunity or how it relates to immunity in criminal cases. So the next section provides a summary of the immunity rules and caselaw applicable to the DOJ, and now perhaps the SEC.

C. Types of DOJ Immunity

This section provides a brief summary of the different types of immunity used by the DOJ: Use immunity, derivative use immunity, transactional immunity, and informal immunity.⁴⁹

- Use Immunity: protects the witness against the government’s use of his immunized testimony in a prosecution of the witness
- Derivative Use Immunity (18 USC 6002): protects the witness against the government’s use of his immunized testimony or other information compelled under a court order — “or any information directly or indirectly derived from such testimony or other information” — against the witness in any criminal case.⁵⁰ A witness can be prosecuted with evidence obtained independently of the immunized testimony. The government has an “affirmative duty to prove that the evidence it proposes to use is derived from a legitimate source wholly independent of the compelled testimony.”⁵¹
- Transactional Immunity: protects the witness from prosecution for the offense or offenses to which the compelled testimony relates. After *Kastigar* — which found constitutional the use immunity statute as coextensive with the Fifth Amendment privilege — transactional immunity is rarely offered by federal prosecutors. But some states permit or require transactional immunity in exchange for compelled incriminating testimony, unless affirmatively waived by the defendant.⁵²
- Informal (“Letter” or “Pocket”) Immunity: immunity that is conferred by agreement between the government and the witness. Examples of informal immunity agreements are plea agreements, non-prosecution agreements, and deferred prosecution agreements. Testimony provided under letter immunity is not compelled but is an agreement to provide it voluntarily. “The principles of contract law apply in determining the scope of informal immunity.”⁵³ “Grants of informal immunity that do not expressly prohibit the government’s derivative use of the witness’s testimony will be construed to prohibit such

⁴⁹ See generally United States Attorney Manual, Ch. 9-23.100-400; US Attorney Criminal Resource Manual §§ 716-727; 18 USC 6001-6005; 28 CFR 0.175; DOJ Witness Immunity Form: Authorization to Apply for a Compulsion Order.

⁵⁰ See 18 USC 6002.

⁵¹ *Kastigar v US*, 406 US 441, 460 (1972); see also US Attorney Criminal Resource Manual § 726.

⁵² See, e.g., NY Crim. Proc. Law § 190.40, 190.45.

⁵³ US Attorney Criminal Resource Manual § 719 (citing federal court precedent).

derivative use. Correspondingly, a grant of informal immunity that expressly provides for derivative use of the testimony by the government will be upheld.”⁵⁴

D. Non-Exclusive Factors Considered by the DOJ to Determine “Public Interest” Requirement for Statutory Use Immunity Under 18 USC 6003

A US Attorney can only request use immunity under 18 USC 6002 “when in his judgment:” 1) the testimony “may be necessary to the public interest,” and 2) the witness is likely to refuse to testify on the basis of the privilege against self-incrimination.⁵⁵

The US Attorney Manual sets forth some factors “that should be weighed in making” a judgment about the public interest of the immunity request, including:

- The importance of the investigation or prosecution to effective enforcement of the criminal laws;
- The value of the person's testimony or information to the investigation or prosecution;
- The likelihood of prompt and full compliance with a compulsion order, and the effectiveness of available sanctions if there is no such compliance;
- The person's relative culpability in connection with the offense or offenses being investigated or prosecuted, and his or her criminal history;
- The possibility of successfully prosecuting the person prior to compelling his or her testimony;
- The likelihood of adverse collateral consequences to the person if he or she testifies under a compulsion order.⁵⁶

IV. Fifth Amendment Privilege Against Self-Incrimination and the Attorney Client Privilege — Complications Arising from the SEC Cooperation Initiative

A. Fifth Amendment Privilege in Context of SEC Civil Proceeding

The Fifth Amendment protects a person from being “compelled in any criminal case to be a witness against himself.”⁵⁷ “The privilege extends not only to answers which would in and of themselves support a criminal conviction, but also to answers which would furnish a link in the chain of evidence needed to prosecute.”⁵⁸ Thus, the privilege entitles a person not to answer questions in any proceeding, “civil or criminal, formal or informal, where the answers might incriminate him in future proceedings.”⁵⁹ Therefore, “[a] witness testifying before the

⁵⁴ *Id.* (citing *US v Lyons*, 670 F2d 77, 80 (7th Cir. 1982), *cert. denied*, 457 US 1136).

⁵⁵ *See* 18 USC 6003(b) (emphasis added).

⁵⁶ US Attorney Manual § 9-23.210.

⁵⁷ U.S. Const. amend. V (emphasis added).

⁵⁸ *Morganroth v. Donovan*, 718 F2d 161, 164 (6th Cir. 1983) (citing *Hoffman v US*, 341 US 479, 486 (1951)).

⁵⁹ *Id.* at 164-65 (citing *Leftkowitz v. Turley*, 414 US 70 (1973); *Leftkowitz v. Cunningham*, 431 US 801, 805 (1977)).

SEC may assert his or her Fifth Amendment privilege against self-incrimination.”⁶⁰ An SEC witness is not entitled, however, to assert a blanket privilege, but instead must assert it with respect to particular questions or subject matter so that the SEC may probe the scope of the privilege to determine if it has any grounds to challenge or narrow its assertion.⁶¹ An SEC witness must show a “real danger” of criminal prosecution, not a remote possibility.⁶² And as discussed *supra*, the privilege is personal and may only be asserted by individuals and sole proprietorships, and not collective entities like a corporation.⁶³

As analyzed earlier in this Article, the SEC’s Cooperation Initiative has empowered the SEC to overcome the assertion of the Fifth Amendment privilege in SEC proceedings by granting immunity from criminal prosecution. However, the SEC Enforcement Manual indicates that the compulsion to provide incriminating testimony by a grant of immunity does not prohibit the SEC from using the criminally immunized testimony against the witness in the civil SEC proceedings.⁶⁴ So a witness in an SEC proceeding who asserts his Fifth Amendment privilege should consider that asserting the privilege may reduce or eliminate criminal liability, yet concomitantly increase the risk of civil and/or regulatory liability. Moreover, the SEC’s emphasis on the value of early cooperation, combined with the financial incentives under the whistleblower program for early cooperation, may in some instances further alienate the interests of corporate entities and their individual employees or members. This may affect the “*Upjohn* warnings” and assessments by corporate counsel in a particular investigation or case.

If an SEC witness asserts the Fifth Amendment privilege and it is not overcome with an immunity order or agreement, then the witness should understand how the SEC may use the adverse inference of the privilege assertion in various stages of the civil enforcement action. For example, Federal Rule of Civil Procedure 8 ordinarily requires that allegations not specifically admitted or denied will be deemed admissions. So invocation of the Fifth Amendment privilege in response to an SEC civil complaint could operate as an admission under Rule 8. However, some federal circuits find that this rule of civil procedure gives way when a civil defendant invokes the privilege, and “treat his claim of privilege as the equivalent of a specific denial and put the [SEC] to [its] proof of the matter covered by the ‘denial.’”⁶⁵

The decision calculus becomes more complicated after the answer is filed. Courts need to balance the civil defendant’s right to assert the privilege against the prejudice to the SEC if the defendant asserts the privilege in his answer and throughout discovery but then seeks to marshal proofs and evidence in summary judgment or at trial, evidence which the SEC had no

⁶⁰ SEC Enforcement Manual, § 4.1.3.

⁶¹ See *Morganroth*, 718 F2d at 167 (citing *Hoffman*, 341 US at 486-88)). See also SEC Enforcement Manual § 4.1.3.

⁶² See *US v. Apfelbaum*, 445 US 115, 128 (1980).

⁶³ See *US v. White*, 322 US 694, 699 (1944).

⁶⁴ See discussion *supra* Part III (citing SEC Enforcement Manual, § 6.2.5).

⁶⁵ *Rogers v. Webster*, 776 F2d 607, 611 (6th Cir. 1985) (adopting the holding in *National Acceptance Co. v. Bathalter*, 705 F.2d 924 (7th Cir. 1983)).

opportunity to discover. Given this concern about prejudice to the SEC, some courts require defendant to choose in the pleadings stage whether to invoke the privilege in pleadings and in discovery, and if so then waive any right to offer any evidence to rebut the allegations on which he claimed the privilege:

[Defendant] has asserted his Fifth Amendment privilege regarding basic aspects of the case --- his defenses and denials. Discovery obtained regarding these areas will have a definite impact on the course of the SEC's discovery and should be obtained at the outset of discovery. It is likely that the SEC will pursue different avenues of discovery depending on [defendant's] decision. . . . Defendant has ten days following the date of this opinion to make an election regarding his privilege. [Defendant] shall be barred from offering into evidence any matter relating to the factual bases for his denials and defenses as to which he continues to assert his fifth amendment rights at that time.⁶⁶

Other courts reject this hard-line evidentiary preclusion consequence in favor of a more balanced, fact specific inquiry as to whether the SEC has been prejudiced by invocation of the privilege, and if so, to what extent.⁶⁷ Counsel should understand how the courts in a particular circuit or district treat invocation of the privilege in civil proceedings as part of the litigation strategy, and perhaps as part of a jurisdiction or venue challenge. Regardless of the jurisdiction, courts usually do not hesitate to enter civil judgment against a defendant that asserts the privilege and remains silent if the SEC supports its case with evidence in summary judgment and trial.

⁶⁶ *SEC v. Cymaticolor*, 106 FRD 545, 550 (SDNY 1985).

⁶⁷ *See, e.g., SEC v. Graystone Nash, Inc*, 25 F3d 187 (3d Cir. 1994) (rejecting the hard-line preclusion test in *Cymaticolor* and noting that the decision on the extent of prejudice to the SEC resulting from a civil defendant's invocation of the privilege is fact specific and must be determined based on the particular circumstances of each case). Another argument against the precedentially binding effect of *Cymaticolor* is that it relied squarely on *Kimm v Rosenberg*, 363 US 405 (1960) to support its order precluding defendant from submitting evidence on any "denial or defense" on which he claimed the privilege. *See Cymaticolor, supra*, at 550. But *Kimm* was decided based on *Cohen v Hurley*, 366 US 117 (1961), which held that "the Self Incrimination Clause of the Fifth Amendment was not applicable to the States by reason of the Fourteenth." *Spevak v. Klein*, 385 US 511, 513 (1967). And the Court expressly overruled *Cohn* and its progeny, including *Kimm*, in *Spevak, see id.* at 514, which noted that *Cohn* did not survive the Court's decision in *Malloy v. Hogan*, 378 US 1 (1964). *Malloy* holds "that the Self Incrimination Clause of the Fifth Amendment [is] applicable to the States by reason of the Fourteenth." *Spevak, supra*, at 513. *See also id.* at 514 n2 ("*Kimm v Rosenberg* . . . , much relied on here, . . . accurately reflected the pre-*Malloy v. Hogan* construction of the Fifth Amendment."). This distinguishing point is dulled in federal jurisdiction cases to which the Fifth Amendment applies directly.

B. Attorney Client Privilege in the Context of Internal Investigations, Parallel Proceedings, and the SEC Cooperation Initiative — Issues to Consider

A full analysis of the issues involved when invoking the attorney-client privilege during internal investigations, with the SEC during its investigations, and when representing companies and their employees is outside the scope of this Article, as is the analysis of when the privilege is deemed waived in these circumstances. The starting points for any such analysis are Federal Rule of Evidence 502, SEC Enforcement Manual § 4.1.1 – 4.1.2, the Supreme Court’s *Upjohn* decision and its progeny, and the particular circuit’s case law on selective and partial waiver. In lieu of a lengthy legal analysis, this section sets forth some issues to consider when assessing privilege and waiver issues in internal, SEC, and parallel investigations and proceedings:

- Did counsel perform an adequate *Upjohn* analysis for employees of US entities?
- What is the particular jurisdiction’s view of an in-house counsel privilege?
- Does foreign state where investigation may be conducted recognize privilege for in-house lawyers or non-lawyer consultants or professionals?
- Does foreign state where investigation may be conducted recognize certain employment, data privacy, or trade secret laws not recognized in the US that may be impacted by provision of information to the SEC, especially given the SEC’s notice to witnesses that the information may be shared with foreign law enforcement and regulatory bodies?
- Does target company have foreign employees subject to compelled interviews by foreign regulators in countries that do not recognize an equivalent to the US Fifth Amendment right against compelled self-incrimination? If so, how does that affect the constitutional and/or attorney-client privileged nature of that interview in the US?
- Is the US a party to a Mutual Legal Assistance in Criminal Matters Treaty (“MLAT”) with a foreign state where the investigation may be conducted, or does the foreign country have a blocking statute?
- Understand: the targets, the scope of investigation, the government and regulatory bodies involved, the rules governing each such body, the company’s regulatory history in general and on the issue(s) under investigation in particular, and the company’s goal(s) with the investigation (all of which may change as the investigation unfolds).
- Do the parent and its subsidiaries both enjoy the same privilege?
- Should counsel execute joint defense or common interest agreements? If so, with whom? Should the agreements be oral or in writing?
- Who should conduct an internal investigation — general counsel, in-house counsel, outside counsel, outside special counsel to audit or other board committee, outside general counsel and auditors, etc.?
- How are communications and documents collected and marked, where are they sent and stored, and how are they produced?
- Should counsel or internal investigation team prepare written interview memos or a written internal investigation report?
- Should counsel keep privileged notes and present findings to law enforcement personnel orally or in summary format?

- When representing multiple witnesses, or the company and its personnel, consider Model Rule 1.7, SEC Enforcement Manual 4.1.1.1, SEC Form 1662, the SEC’s new cooperation tools, and the SEC and other regulatory whistleblower programs, *see* discussion in the next section of this Article
- When can counsel invoke privilege with third parties or consultants under the *Koval* or other doctrines?
- When considering sharing privileged internal investigation materials, determinations should be made as to whether there is a real likelihood of a criminal proceeding, and if so the extent to which cooperation without disclosure of privileged materials or reports will provide the same or similar sentencing point reductions or cooperation credit as cooperation that discloses privileged reports or materials.⁶⁸
- Should a Wells response or white paper contain privileged materials to increase appearance of cooperation?
- Can and should a company save resources by making a “purposeful production with no privilege review” pursuant to section 4.2.1 of the SEC Enforcement Manual, or does the relevant district or circuit court precedent limit or prohibit selective disclosure in these circumstances? *See also* FRE 502.
- Can and should a company produce privileged information pursuant to an SEC Model Confidentiality Agreement and section 4.3.1 of the SEC Enforcement Manual, or does the relevant district or circuit court precedent limit or prohibit selective disclosure in these circumstances? *See also* FRE 502.
- What is the affect of the SEC’s FOIA obligations regarding privileged materials provided to it, and have you addressed the relevant FOIA provisions when providing information to the SEC or DOJ?
- Has a company employee reported to the SEC Office of the Whistleblower, and if so is the SEC communicating directly with that employee under Rule 21F-17⁶⁹ of the SEC Whistleblower Rule?

V. SEC Whistleblower Program

The Whistleblower provisions of the 2010 Dodd-Frank legislation were enacted to empower the SEC to financially reward, and protect from retaliation, securities fraud whistleblowers. Congress legislated the parameters for the SEC whistleblower program, created an Office of the Whistleblower, and directed the SEC to issue final regulations implementing the whistleblower legislation no later than mid-2011.⁷⁰ In May 2011, the SEC issued its final

⁶⁸ *See, e.g.*, US Sentencing Guidelines Manual § 8C2.5(f), (g) & nn. 10, 12-13 (2012). The SEC and DOJ have implemented policies which provide that “[a] party’s decision to assert a legitimate claim of attorney-client privilege or work product protection will not negatively affect their claim for cooperation. The appropriate inquiry in this regard is whether, notwithstanding a legitimate claim of attorney-client privilege or work product protection, the party has disclosed all relevant underlying facts within its knowledge.” SEC Enforcement Manual § 4.3. *See also* US Attorney Manual, ch. 9-28.760, 9-28.800 (2008); 2008 DOJ Filip Memo; 2006 DOJ McNulty Memo; 2001 SEC Seaboard Report; NYSE Listed Company Manual, § 303A.09-10 (2009); FINRA Regulatory Notice 08-70.

⁶⁹ 17 CFR 240.21F-17.

⁷⁰ *See* 15 USC 78u-6, 78u-7.

whistleblower program and rules, which became effective on August 12, 2011 and are embodied in SEC Rule 21F.⁷¹

Former SEC Chairman Mary Shapiro remarked that the SEC’s whistleblower program has already “proven to be a valuable tool in helping us ferret out financial fraud. . . . When insiders provide us with high-quality road maps of fraudulent wrongdoing, it reduces the length of time we spend investigating and saves the agency substantial resources.”⁷² SEC Commissioner and interim SEC Chair Elisse Walter commented in December 2012 that she was “bothered” by two issues with the whistleblower rules: (1) the impact of the program on internal corporate compliance processes; and (2) that culpable whistleblowers may receive an award as long as they are not criminally convicted.⁷³

This Section provides the following information about the SEC’s new whistleblower program: (A) summary of some of the more relevant provisions of Rule 21F; (B) statistics from the SEC’s whistleblower report for 2012; and (C) whistleblower compliance suggestions and issues for companies and counsel to consider.

A. Summary of Salient Provisions of Rule 21F⁷⁴

Rule 21F-3: SEC will pay award to one or more whistleblowers who:

1. “Voluntarily provide” the SEC
2. “original information”
3. “that leads to the successful enforcement” by the SEC in court or admin action
4. where SEC “obtains monetary sanctions totaling more than” \$1million (“1M”)

Whistleblowers can also receive award in “related action” (such as DOJ, CFTC, FINRA, IRS parallel proceedings) if the whistleblower satisfies Rule 21F

Rule 21F-4: definitions of key terms

- Voluntary submission of information: provide information “before a request, inquiry, or demand that relates to the subject matter of your submission is directed to you or anyone representing you” by the SEC, PCAOB or any other SRO, or any federal government branch or agency. It will not be voluntary even if your response is not compelled by a subpoena; any inquiry counts. But it will be voluntary if you provide original information to another agency prior to the SEC request or inquiry. It will not be voluntary if your submission is required as part of a pre-existing duty.

⁷¹ See SEC Release No. 34-64545 (May 25, 2011). The whistleblower rules are published in 17 CFR 240.21F-1 – 21F-17.

⁷² *SEC’s Whistleblower Office Received 3,001 Tips in Fiscal Year 2012, Report Says*, SECS. REG. & LAW RPT., (BNA) Vol 44, No 46 at 2109 (Nov 19, 2012).

⁷³ See Yin Wilczek, *SEC Seeing Poor Controls Over Fees During Exams of Private Fund Advisers*, SECS. REG. & LAW RPT (BNA) at 2227-28 (Dec. 10, 2012).

⁷⁴ 17 CFR 240.21F-1 – 21F-17.

- Original information: information that is “derived from your independent knowledge or independent analysis,” not already known to the SEC from another source (unless you are the original source of that information), not derived from a public allegation, reports, news story, etc., and provided after 7/21/10 date of Dodd Frank enactment. “Independent analysis” can mean your evaluation of public information which reveals information not generally known or available to the public. Company officers, directors, compliance, accountants, auditors, and lawyers cannot be whistleblowers UNLESS 120 days elapses after they report a violation to the responsible person or committee and nothing happens or no action is taken.
- **When internal reporting still counts as original information**: If you provide original information through your company’s internal compliance reporting procedures, you can submit the same information to the SEC within 120 days of your internal report and still receive credit as the source of the original information, with the date you internally reported counting as the date you reported to the SEC, even if the Company voluntary discloses your information to the SEC before you within that 120 day period.
- “Leads to successful enforcement:” when you provide “sufficiently specific, credible, and timely” original information that “significantly contributes” to a “successful judicial or administrative action”
- Monetary sanctions of more than \$1M: SEC will count two or more administrative or judicial proceedings together towards the \$1M number, even if their individual penalties are less than \$1M, if the proceedings “arise out of the same nucleus of operative facts”

Rule 21F-5: Amount of Award

- SEC has discretion to award an amount “at least 10% and no more than 30% of the monetary sanctions” the SEC “and other authorities **are able to collect**”
- Amounts paid to multiple whistleblowers in the same action will not in the aggregate be less than 10% or more than 30% of the amount the SEC or other authorities “**collect**”

Rule 21F-6: Criteria for determining amount of award

Factors that increase the amount of the award

- Significance of the information
- Assistance provided by the whistleblower
- Law enforcement interest in case
- **Participation in internal compliance systems**

Factors that decrease the amount of the award

- Culpability of whistleblower in infraction
- Unreasonable reporting delays
- **Interference with internal compliance and reporting systems**

Rule 21F-8: Eligibility

You are ineligible if “you are **convicted of a criminal violation** that is related to the Commission action for which you otherwise could receive an award.”

Rule 21F-14: Procedures applicable to payment of awards

- Only entitled to award amount “to the extent that a monetary sanction is collected in the Commission action or in a related action upon which the award is based.”

Rule 21F-15: No Amnesty

- Your status as a whistleblower does not preclude enforcement action against you by the SEC for your own conduct in connection with the securities violations.
- But if the SEC brings such an action against you, it will “take your cooperation into consideration” in accordance with its Statement Concerning Cooperation by Individuals
- Only a criminal conviction will make the whistleblower ineligible for an award

Rule 21F-16: Awards to Whistleblowers Who Engage in Culpable Conduct

- SEC will not count towards the \$1M penalty threshold amount any sanctions for violations that are “based substantially on conduct that the whistleblower directed, planned, or initiated.”
- If the whistleblower is entitled to an award, the amount of the sanction upon which the award is calculated will be reduced by any amount the whistleblower is required to pay for his or its own culpable conduct

Rule 21F-17: Staff Communications with Individuals Employed by Companies

- “No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, **including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications.**”
- The SEC staff is authorized to communicate directly with an entity’s director, officer, member, agent or employee that has initiated communication with the SEC, even if that entity has counsel, without the SEC seeking the consent of the entity’s counsel.

Section 78u-6(h):⁷⁵ Protections and Remedies for Whistleblowers and Their Lawyers

- “No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by whistleblower”
- Retaliation plaintiffs are entitled to nationwide service of process in prosecuting

⁷⁵ 15 USC 78u-6(h)

whistleblower retaliation claims

- Remedies available to whistleblowers include:
 1. “reinstatement with the same seniority status that the individual would have had, but for the discrimination”
 2. “2 times the amount of back pay otherwise owed to the individual; and”
 3. “compensation for litigation costs, expert witness fees, and reasonable attorneys’ fees”

B. 2012 Statistics From the SEC Office of the Whistleblower

2012 was the first full year for which data was available to begin to assess the SEC’s whistleblower program. On November 15, 2012, the SEC released its Annual Report on the Dodd-Frank Whistleblower Program (“2012 Annual Report”), a requirement of the Dodd-Frank legislation. Some of the data revealed in the 2012 Annual Report include:

- 3,050 hotline calls from members of the public
- the SEC Office of the Whistleblower received 3,001 formal whistleblower tips via submission of Form-TCR (tips, complaints, and referrals)
- The most frequent tips concerned corporate disclosures (547 tips, 18.2%), offering fraud (465 tips, 15.5%), and manipulation (457 tips, 15.2%)
- 115 complaints, or 3.8%, related to the FCPA
- The state from which the largest number of tips emanated was California (435 tips, 17.4%), followed by New York (246 tips, 9.8%) and Florida (202 tips, 8.1%)
- The Office of the Whistleblower received tips from whistleblowers from 49 countries outside the US, including 74 tips from the United Kingdom, 46 tips from Canada, 33 tips from India, and 27 tips from China.

The SEC posted notices of 143 “covered actions” — SEC enforcement actions in which a final judgment or order resulted in monetary sanctions exceeding \$1 million. However, to date the SEC has issued only one award under the Whistleblower program — a \$50,000 award to an anonymous tipster who revealed a multi-million dollar fraud.⁷⁶

C. Whistleblower Compliance Tips For Companies

The following are general tips and considerations for companies and compliance personnel considering Rule 21F, the SEC Annual Report, and relevant case law and regulatory reports and notices:

⁷⁶ See generally SEC Annual Report on the Dodd Frank Whistleblower Program, Fiscal Year 2012 (Nov. 2012); *SEC’s Whistleblower Office Received 3,001 Tips in Fiscal Year 2012, Report Says*, SECS. REG. & LAW RPT. (BNA) Vol 44, No 46 at 2109; *Lessons From the Whistleblower Report*, Law360 (Nov. 12, 2012); *\$104M Whistleblower Award — A Sign of Things to Come*, Law360 (Dec. 6, 2012); *Cross-Border Implications of the SEC Whistleblower Report*, Law360 (Nov. 15, 2012).

- Craft compliance investigation plan that can be immediately customized as needed
- Publicize remediation and resultant disciplinary action when appropriate to demonstrate that the company is serious about compliance and expects no less from its employees
- Construct formal whistleblower hotline that is well-known within the company
- Publicize in compliance program that internal compliance reporting first can still qualify the whistleblower for an award under the whistleblower law, and that internal reporting first is an element that may increase the award paid by the SEC
- Incentivize internal whistleblowing by making it the easiest course, with flexible reporting mechanisms, prompt investigations, regular briefings to whistleblowers, and internal recognition for bringing compliance issues to management
- To incentivize internal reporting consider setting up internal award scheme but perhaps with less hurdles than Rule 21F (to support perhaps less generous company awards)
- Consider making valid whistleblower reports part of the company's compensation or bonus scheme
- Multi-national companies with potential non-US whistleblowers must be mindful that any whistleblower compliance program should account for potential civil or criminal liability under privacy and secrecy laws of some non-US countries for sharing certain information with the SEC. It is relevant to note that the SEC may share the information from a whistleblower with foreign law enforcement or regulators
- Multi-national compliance programs should also account for the cultural stigmas or biases that may attach to whistleblowers in certain cultures, countries, or regions
- Be mindful of Rule 21F-17 and the right it provides the SEC to speak directly with company employee whistleblowers, even if the company has counsel, and without the SEC seeking the consent of the company's counsel.
- Be mindful of the harsh whistleblower retaliation laws and procedures and that sub-par or non-performing employees may use this law to try and protect themselves from termination

CONCLUSION

The SEC's Cooperation Initiative is derived in part from some of the tools used by the DOJ in criminal securities cases. Therefore, it may behoove SEC witnesses to become familiar with these new cooperation tools, and also the affects that using the cooperation tools may have in parallel criminal proceedings, how the tools may help and hurt the witness in the SEC and/or DOJ proceedings, how the cooperation tools affect the witness's Fifth Amendment and attorney-client privileges, and the impact that the SEC whistleblower rules and incentives will have on SEC witnesses and their respective privileges and incentives. Hopefully this Article helps identify some of the issues you or your client may need to consider in these circumstances.