

Chasing Carrots: The Uncertain Rewards of SEC Self-Reporting and Cooperation

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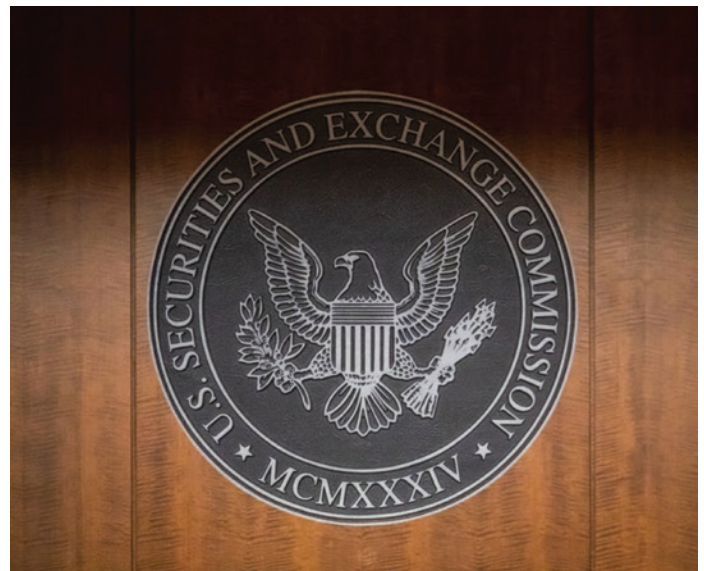
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On May 23, 2024, at the Securities Enforcement Forum West 2024, Gurbir Grewal, the director of the Division of Enforcement at the U.S. Securities and Exchange Commission (SEC), gave remarks entitled “The Five Principles of Effective Cooperation in SEC Investigations.” In his speech, Grewal reemphasized the SEC’s focus on corporate cooperation during the agency’s investigations, including that companies self-report to the SEC, including before a company knows all the facts.

Despite these recommendations, the SEC’s silence on precisely how that reporting and cooperation will benefit the company continues to create uncertainty.

While Grewal announced purported benefits for companies that cooperate and promptly self-report, such as the SEC recommending reduced charges, declining charges, and possibly recommending reduced or zero penalties, the SEC has declined to give any specifics as to when and how a company might receive such potential benefits.

This stands in stark contrast to other detailed government voluntary self-disclosure policies, such as the U.S. Department of Justice’s (DOJ) National Security Division’s (NSD) Enforcement Policy for Business Organizations (NSD Policy) and the DOJ’s Criminal Division’s Corporate Enforcement and Voluntary Self-Disclosure Policy (the Criminal Division Policy), which provide presumptions of either



declinations or non-prosecution agreements (NPAs) for companies that meet specific criteria when they voluntarily self-disclose potential violations to DOJ and provide full cooperation. See Department of Justice, “National Security Division, NSD Enforcement Policy for Business Organizations”, (March 7, 2024); Department of Justice, “Criminal Division Corporate Enforcement and Voluntary Self-Disclosure Policy” (updated March 2024)).

The DOJ’s Antitrust Division has similarly provided specific guidance about the required level of cooperation for companies and individuals to be eligible to participate in the Antitrust Division’s leniency program. No outcome is assured under the NSD Policy

or Criminal Division Policy as the DOJ has certain escape clauses for elements such as aggravating circumstances. And, because there are new DOJ policies continually being announced, outside counsel advising companies can point to these policies and the attendant potential benefits on the complex questions of whether or not to self-report.

The SEC, however, continues to be vague at the pre-self-report stage not only with respect to *what* benefits a company may obtain for cooperation and self-reporting, but also *how* it may obtain these benefits (*i.e.*, the requirements). Grewal observed this uncertainty himself: “Now, this doesn’t mean that if you do all of the things highlighted in recent orders discussing cooperation or what I discuss today, you’ll always get to a no penalty resolution or a declination.”

While Grewal’s speech reaffirms the analytical considerations set forth in the SEC’s 2001 Seaboard Report, which outlines whether a public company could receive credit in the form of reduced charges, lighter sanctions, or “mitigating language” in settlement documents for “self-policing, self-reporting, remediation and cooperation,” the SEC has not promulgated a written policy analogous to the NSD Policy or the Criminal Division Policy that explicitly states the benefits of cooperation and self-reporting. Securities and Exchange Commission, “Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions”, Exchange Act Release No. 44969. (Oct. 23, 2001)).

Rather, companies and defense counsel are left with the *Seaboard Report* and its further articulation in Section 6.1.2 of the SEC’s Enforcement Manual, the latter of which has “general principles but does not limit the Commission’s broad discretion.”

Grewal went beyond the *Seaboard Report* and articulated a fifth principle of “collaboration,” which seems to create a new ongoing communication expectation that embodies the four principles of the Seaboard Report. This could include, for example, a company providing transparency into its document collection and production. But this overlooks the reality of many SEC investigations, where the staff often asks for information and

documents, but declines to provide early views on theories and issues.

While there are always exceptions to this, it would be a welcome change to understand where an investigation might be heading before a penalty might be proposed.

Nor has the SEC consistently advocated the benefits of self-reporting and cooperation. For example, it appears that the SEC has entered into fewer corporate NPAs since 2016. In two 2016 FCPA NPAs, the SEC noted that the “companies self-reported the misconduct promptly, and they cooperated extensively with the ensuing SEC investigations.” See Securities and Exchange Commission, Press Release, “SEC Announces Two Non-Prosecution Agreements in FCPA Cases”, (June 7, 2016).

By contrast, the DOJ’s Fraud Section closed its investigations into both of these companies, although taking into consideration the companies’ disgorgement to the SEC. See, e.g., Ltr. from D. Kahn to J. Levy (June 6, 2016)).

Similarly, the most recent publicized SEC corporate declination was in fact a partial declination, with the SEC declining to bring charges against the company for the type of violation, but still charging the company for a different, unrelated securities law violation. See Securities and Exchange Commission, Press Release (June 20, 2023)). While that company received no civil money penalty as part of its settlement, the outcome leaves much to be desired in understanding whether and how other companies can benefit from similar types of self-reporting and cooperation.

To its credit, the SEC seems to be imposing no civil money penalties in a wider array of corporate settlements. See, e.g., SEC, Press Release, “SEC Charges China-Based Tech Company Cloopen Group with Accounting Fraud” (Feb. 6, 2024). There, the SEC credited the company’s prompt self-disclosure and proactive cooperation, including summarizing interviews of witnesses located in China, identifying and translating key documents, taking substantive remedial measures including clawing back bonus compensation.

By contrast, the NSD Policy states explicitly that where a company (1) voluntary self-discloses to NSD potentially criminal violations arising out of or

relating to the enforcement of sanctions or export control laws, (2) fully cooperates, and (3) timely and appropriately remediates the violations—absent aggravating factors—there is a presumption that NSD generally will not seek a guilty plea and the company will receive a non-prosecution agreement, and will not pay a fine. See NSD Policy at 2.

NSD seems to be delivering on its assurances. In April 2021, for example, a major software company received a non-prosecution agreement for unlawful exports of software products to Iran. See Department of Justice, Non-Prosecution Agreement (April 20, 2021)). While that company admitted to the violations and disgorged approximately \$5 million in gross revenue associated with the conduct, NSD did not criminally prosecute it and credited the company with a voluntary self-disclosure, full cooperation, timely and significant remediation and continuing cooperation with NSD.

More recently, in May 2024, NSD similarly issued its first-ever declination under the NSD Policy to a disclosing company. See Department of Justice, Declination Letter (May 14, 2024)). There, a supplier of products and services for the life sciences industry received a declination under the NSD Policy when the company timely and voluntarily self-disclosed misconduct involving a company employee in violation of U.S. export controls, specifically making the disclosure a week after the company retained outside counsel.

The DOJ characterized the company's cooperation as "exceptional and proactive," and also credited the company's timely and appropriate remediation, and that the company turned out to be a victim of the conduct in question. In announcing the declination, Deputy Attorney General Lisa Monaco stated that the company's "timely disclosure and exceptional cooperation" resulted in the guilty plea of a company insider, and DOJ's decision to provide a declination. See Department of Justice, "Ringleader and Company Insider Plead Guilty to Defrauding Biochemical Company and Diverting Products to China Using Falsified Export Documents", (May 22, 2024)).

Of note, the company's document production helped DOJ establish probable cause to search residences and electronic devices of culpable individuals. While this outcome may be an outlier, it still provides an example of what type of self-reporting and cooperation can support a favorable outcome from NSD.

While the SEC's current guidelines in the Seaboard Report and its Enforcement Manual are helpful in describing the skeletal framework of the level of corporate cooperation required to receive benefits, it still leaves much to the imagination for when "facts and circumstances" will lean in a company's favor. Nevertheless, companies are best positioned to receive credit from the SEC by maintaining robust compliance programs to detect potential issues, self-reporting potential violations, fully cooperating with the SEC and remediating as appropriate.

In 2023, SEC Chair Gary Gensler highlighted that companies are receiving zero or reduced penalties through such steps:

Across numerous actions last fiscal year, the Commission ordered zero or reduced penalties based on the respondents' cooperation. Keep these actions in mind as you in the audience advise clients on the benefits of self-reporting and cooperation.

Securities and Exchange Commission, "Partners of Honest Business and Prosecutors of Dishonesty": Remarks Before the 2023 Securities Enforcement Forum.

The SEC clearly favors companies who provide transparent communication, self-report, cooperate and timely and appropriate remediate. It would be a welcome development if the agency took a page from other existing enforcement policies and provided similar clarity on potential benefits.

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