

SECURITIES LITIGATION ALERT

MAJOR STRUCTURAL CHANGES AT THE SEC'S DIVISION OF ENFORCEMENT)

In a speech on August 5, 2009, Securities and Exchange Commission (SEC) Enforcement Director Robert Khuzami announced significant structural changes to the SEC's Enforcement Division.¹ These changes appear designed to speed up the agency's process, encourage greater cooperation and realign at least a portion of the Division's resources by subject matter. The policy changes, taken as a whole, suggest that the Enforcement Division intends to act in a swifter, more aggressive manner. Coupled with the significant increase in resources from the 2010 fiscal year budget, we also expect the number of SEC investigations to increase significantly in the coming year.

These changes come at perhaps the lowest point in the Division's history. Although considered one of the premier law enforcement agencies, the Division has come under criticism for missing or not pursuing several major cases. In particular, the Madoff scandal has called into question the agency's competency and effectiveness. While an inspector general report on the SEC's relationship with Madoff is due out later this month, from media accounts it appears as though there were several investigations of Madoff that could have—and perhaps should have—led to charges much sooner. The policy changes appear to be a response to this criticism and an effort, more broadly, to reinvigorate and energize the SEC's enforcement program.

POLICY CHANGES

The changes announced last week can be broadly placed into three categories: (1) changes designed to speed up the Enforcement Division's process, (2) changes designed to encourage cooperation and (3) changes designed to implement realignment.

Changes Designed to Speed Up the Enforcement Division's Process

- *Commission approval no longer needed to authorize the issuance of a formal order.* A formal order of investigation is a Commission order that allows the staff to issue subpoenas for documents and testimony. In the past, the staff would

¹ See Remarks by Robert Khuzami, director of the SEC's Division of Enforcement Before the New York City Bar Association (Aug. 5, 2009) located at <http://www.sec.gov/news/speech/2009/spch080509rk.htm>.

prepare memoranda recommending that the Commission authorize the order in a specific case. Under the new system, the Commission is delegating the approval process to the enforcement director. Mr. Khuzami has stated that he intends to further delegate this approval to lower supervisory levels. This change is designed, as Mr. Khuzami stated in his speech, so that “if defense counsel resist the voluntary production of documents or witnesses, or fail to be complete and timely in responses or engage in dilatory tactics, there will very likely be a subpoena on your desk in the morning.”

- *The branch chief position will be eliminated.* Branch chiefs were the first line of supervisors in the Enforcement Division. Under the prior systems, branch chiefs were heavily involved in each of the cases the four or five attorneys they supervised were investigating. Under the change that Mr. Khuzami announced, the branch chief position will be eliminated. Some of the current branch chiefs will now be promoted, while the vast majority will leave their supervisory duties and pick up assignments as line attorneys. Line staff attorneys will now report to assistant directors, who will supervise about six to eight staff attorneys.
- *The director’s approval will be required for tolling agreements.* It has been typical in the past several years for the staff to seek tolling agreements in any case where the conduct at issue approached the statute of limitations. Under this new policy, the director’s approval is required before such an agreement can be entered into. Mr. Khuzami stated that his approval would be the exception and not the rule, and it appears as though the goal is to force the staff to complete its investigation before the time runs out.
- *Internal recommendation memoranda will be shorter and subject to quicker review, and routine case decisions will be delegated down.* As veterans of the Enforcement Division can attest, the process of preparing a recommendation for enforcement action to the Commission has been long and complex. Without offering specifics, Mr. Khuzami has indicated that he will take steps to speed up this process. Additionally, the authority to open and close cases will be delegated from the deputy director to lower-level supervisors.

Changes Designed to Encourage Cooperation

- *The immunity request process will be streamlined.* Previously, the Commission had to approve requests to the Department of Justice to seek immunity. Under the new policy, this approval will be delegated to the enforcement director. While the decision to proceed with immunity still lies in the hands of the Department of Justice, this more-streamlined approach clearly sends a message that the staff will more frequently utilize immunity to gain the information that it believes it needs.
- *The Division may provide witnesses with oral assurances that they will not be charged.* The staff has generally refrained from providing guidance to counsel representing individuals as to whether or not their clients are likely to be charged by the Commission. For defense counsel, this practice has sometimes been frustrating. By suggesting that the staff might provide oral assurances to defense counsel, Mr. Khuzami seems to be moving toward the model that has long been established in the Department of Justice in which prosecutors are required to notify defense counsel, in good faith, whether their client is presently viewed as a target, subject or witness in an investigation. Mr. Khuzami

apparently believes that individual witnesses will more readily provide the staff with timely information if they receive indications that they are unlikely to be charged in a given case.

- *The Division will now recommend deferred prosecution agreements in certain circumstances.* As a general matter, the SEC has not utilized deferred prosecution agreements in the past. As a result, this new policy is a significant departure from past Division practice. Under a deferred prosecution agreement, an individual or entity would not be charged with any wrongdoing if certain undertakings are complied with for a period of time. There were few specifics about deferred prosecution agreements in Mr. Khuzami's speech, and it remains to be seen what criteria the staff would apply in resolving cases this way.

Changes Designed to Implement Realignment

- *The Division will create five specialized units.* Those units include: Asset Management/Hedge Funds; Market Abuse; Structured and New Products; Foreign Corrupt Practice Act; and Municipal Securities and Public Pensions. In addition, the Division will keep its existing Subprime Working Group. Traditionally, the Division was not organized around particular subject matters. Rather, the vast majority of the staff were generalists. Under this new system, at least a portion of the staff will become specialists in the areas listed above.
- *The Division will create the Office of Market Intelligence to handle complaints and tips.* As the Madoff case has shown, the Commission's complaint process has lacked focus and organization. While few specifics were announced, the obvious goal of the new office will be to bring some organization to the process of sorting out and pursuing complaints and tips.

CONCLUSION

There are several likely outcomes from the new policies.

First, it is likely that the number of SEC investigations will increase significantly. Between the new staff that the Division will receive in the 2010 fiscal year budget and the large number of former branch chiefs due to return to line investigations, there will be a significant increase in the Division's investigative footprint.

Second, there will be less supervision of line attorneys in investigations. Eliminating branch chiefs and removing a layer of supervision will provide line attorneys with more autonomy, but it will also remove some of the most experienced lawyers from day-to-day involvement in cases. At least in some cases, this will present a challenge for those appearing in front of the staff, as it will be more difficult to obtain relief for unreasonable staff requests or unreasonable staff conduct. Additionally, the onus will be on defense counsel from day one to make sure the staff understands the issues and the factual context for the investigation.

Third, it is likely that the new policies that encourage individuals to cooperate with the staff will impact the way cases are defended. Counsel for individuals will likely aggressively pursue immunity or agreements not to sue their clients. For corporations, care will have to be given as to whether and when counsel should be provided for individuals.

Fourth, the staff is likely to engage in more wide-ranging investigations. While eliminating the requirement of Commission approval for a formal order will speed the Commission’s process, the process of drafting a memo that the Commission would review certainly led the staff to think about the case and its underlying legal theories. With this check removed, it is at least likely that some critical thinking about a case will occur only after the investigation is truly underway. The burden clearly will be on defense counsel to educate the staff and attempt to limit the scope and contain the costs of investigations.

CONTACT INFORMATION

If you have any questions regarding this alert, please contact—

Michael A. Asaro	masaro@akingump.com	212.872.8100	New York
James J. Benjamin Jr.....	jbenjamin@akingump.com.....	212.872.8091	New York
Paul W. Butler.....	pbutler@akingump.com	202.887.4069	Washington, D.C.
John M. Dowd.....	jdowd@akingump.com.....	202.887.4386	Washington, D.C.
Samidh Guha	sguha@akingump.com	212.872.1015	New York
Robert H. Hotz Jr.....	rhotz@akingump.com	212.872.1028	New York
Steven Kaufhold	skaufhold@akingump.com	415.765.9562	San Francisco
Jeffrey M. King.....	jking@akingump.com	202.887.4347	Washington, D.C.
Terence J. Lynam.....	tlynam@akingump.com.....	202.887.4045	Washington, D.C.
Stephen A. Mansfield.....	smansfield@akingump.com.....	415.765.9519	San Francisco
Douglass B. Maynard.....	dmaynard@akingump.com.....	212.872.1019	New York
Nicholas I. Porritt.....	nporritt@akingump.com.....	202.887.4019	Washington, D.C.
William E. White	wwhite@akingump.com.....	202.887.4036	Washington, D.C.
Richard B. Zabel	rzabel@akingump.com	212.872.8060	New York