Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Law360's SEC Survival Guide: Approaching The Agency

By **Ed Beeson**

Law360, New York (July 28, 2014, 8:16 PM ET) -- The moment a company realizes it may have a securities law violation on its hands is crucial, especially for its attorneys. They must promptly take control and start preparing their client to contact the last person any CEO wants to call: an enforcement official at the U.S. Securities and Exchange Commission.

All this week, Law360 is speaking with defense counsel on how they guide their clients through the difficult and treacherous road of an SEC investigation, with an eye on some of the best practices to follow and pitfalls to avoid.

The story starts at the beginning, when outside counsel's phone rings. A company has detected some wrongdoing — be it overseas bribery, cooked books or insider trading — but has yet to alert the SEC.

This call sets in motion a process that could take years and cost hundreds of thousands of dollars, if not millions, to resolve, and attorneys' next steps may define how well — or poorly — the process goes for their client. While it is impossible to predict the outcome of any potential investigation, the degree to which counsel takes control over a matter at the outset can go a long way toward building trust with the SEC and helping the client reach a more favorable resolution, attorneys say.

In a way, these first steps are battening down the hatches in advance of a storm. "Before you even think about whether you call the government, you need to think about what the issue is," said Deborah Meshulam, chair of DLA Piper's securities enforcement practice and a former assistant chief litigation counsel at the SEC.

Meeting with in-house counsel, compliance staff and anyone else who may be involved is an important first step to determining the scope of the potential violation, or whether one indeed exists. These meetings also help counsel understand better who they are working for and their familiarity with the SEC's investigative process.

Preservation mode comes next. Counsel say they quickly look to collect and maintain as many records as they can while putting a stop to any destruction, automatic or otherwise, of paperwork and files that could be germane.

"You want to preserve evidence, gather and go through it as quickly as you can," said Matthew Rossi, a partner at Mayer Brown LLP and a former assistant chief litigation counsel at the SEC.

Added Meshulam, “You don’t want to be in a situation where someone could claim there was a loss of key information.”

Asserting privilege and work-product rights over documents is another key consideration for counsel, especially as they consider the prospects of dealing with an SEC subpoena down the road. Ensuring such protections over documents produced before outside counsel was tapped is one particular challenge.

“By the time the issue has come to us, a lot may have happened already,” said Zachary Brez, a partner with Ropes & Gray LLP and co-chair of its securities and futures enforcement practice.

Among other things, a company’s compliance or audit staff may have prepared initial reports on the possible violation before outside counsel was called, and it can be difficult to maintain protection over these.

“If the general counsel or someone in the legal department takes control of a matter rather than compliance personnel, you have a much better argument that the ‘in-house’ review is covered by privilege,” said Christopher Conniff, a former federal prosecutor and current Ropes & Gray partner.

Control also extends beyond wrangling documents. The last thing a company wants is for word of a problem to slip out beyond a close set of advisers and key employees.

“You want to be careful that word doesn’t spread at the company internally that we have this problem,” said Brian Rubin, partner at Sutherland Asbill & Brennan LLP.

Company management and counsel likely will be tempted to figure out if a potential whistleblower is out there and could end up tipping off the SEC before the company does. Under the agency’s rules, tipsters who come forward about a company’s violations could be in line for a substantial bounty if a case turns on the evidence they provide.

Figuring out if there is a whistleblower could determine how aggressively a company self-reports a potential violation. But attorneys say companies must tread a careful path around the question of a whistleblower. The SEC has spoken forcefully against whistleblower retaliation and recently brought charges against a hedge fund adviser for alleged retaliation.

“You want to try to determine it if you can, but you don’t want to engage in a witch hunt across the company,” said Rossi of Mayer Brown, specifically ruling out tactics like email searches to see if any workers have contacted the SEC. “That can easily be perceived as step one on the road to retaliation.”

Eventually, though, companies will come to crossroads on whether they need to go to the SEC with the problems they have detected. While some companies may not have a legal obligation to report possible securities law violations to the agency, attorneys say it is often in their best interests to do so, particularly if there is a chance the agency could get wind of it some other way.

“It’s often advantageous to get to them first, to give them your context and spin before they hear it from someone else,” said Rubin of Sutherland.

Stephen Cohen, associate director of SEC enforcement, said whether a company comes forward is an important factor in how future talks with the agency go.

"It does start the dialogue in a completely different way than if we open up an investigation on our own," Cohen said. "It really makes credible the argument that the company is trying to be cooperative and do the right thing."

But many companies get tripped up at this stage, attorneys say. Knowing there is pressure to speak up on a problem and appear upstanding and cooperative, some companies or counsel may rush to report to the SEC before they have a firm grasp on the facts behind the wrongdoing.

"Trying to explain too early is a serious pitfall," Rossi said.

Among other things, a company could find itself in the awkward situation of having to correct something it told SEC staff. Having to do so could end up being used against the company, or the staff could give the later explanation less credence if it ends up being more favorable to the company than the initial report.

And unlike cooperating with the agency during the investigation, attorneys say there is little clear evidence that going to the SEC early wins companies favors down the road. "The bang for the buck is just getting diminished," said Brez of Ropes & Gray.

To balance the pressure to report a matter with the need to do more fact-finding, it may be appropriate to make an initial disclosure to SEC staff that the company is investigating an issue and will release a full report on its conclusions on a specified date. Depending on the issue, SEC staff may be satisfied with that response, attorneys said.

But along the way, companies also need to bear in mind the possibility the Enforcement Division will come knocking before they are ready.

"If the SEC calls tomorrow and we haven't reported, are we comfortable with what we've done in terms of an investigation?" asked Conniff of Ropes & Gray.

--Additional reporting by Stephanie Russell-Kraft. Editing by Kat Laskowski and Edrienne Su.
