

# INSIGHTS

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## SECURITIES ENFORCEMENT

### Executives Beware: The DOJ and SEC Have Set Their Sights on Individual Wrongdoing

*The DOJ's Yates Memo makes individual prosecutions a higher priority and makes a company's own identification of potentially culpable individuals an explicit factor in assessing cooperation credit. The Yates Memo is in line with recent SEC initiatives, speeches by SEC officials and other public statements signaling that the top securities regulator is also sharpening its focus against individuals.*

**By Jay A. Dubow, Martin S. Bloor, Pamela S. Palmer, and Chris Howard**

In the last several years, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have levied billions of dollars in fines against corporations in a wide variety of industries for corporate misconduct, largely through non-prosecution, deferred prosecution or plea agreements.<sup>1</sup> At the same time, there have

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been few prosecutions of individual executives who are responsible for the corporate misconduct. Critics ranging from federal judges to members of Congress on both sides of the aisle have argued that shareholders were left to pay the price for these hefty fines out of corporate earnings, while the responsible executives escaped personal accountability.<sup>2</sup>

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**DOJ now intends to focus on targeting individuals who are responsible for corporate wrongdoing.**

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Enter new Attorney General Loretta Lynch. In a memorandum to federal prosecutors and investigators dated September 9, 2015, the Yates Memo, Deputy Attorney General Sally Quillian Yates has made clear that the DOJ now intends to focus on targeting individuals who are responsible for corporate wrongdoing and will force corporations themselves to identify culpable individuals in order to obtain “any” credit for cooperation.<sup>3</sup> The DOJ’s policy announcement follows the SEC’s recently announced focus on pursuing corporate officers and directors.<sup>4</sup>

### The Yates Memo

The Yates Memo provides federal prosecutors and investigators with “six key steps” to

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strengthen the DOJ's pursuit of individual actors in order to hold them accountable for corporate misconduct.<sup>5</sup>

First, and most notably, the DOJ will now require that companies seeking cooperation credit identify all individuals responsible for possible misconduct, regardless of their position with the company, and completely disclose to the DOJ all relevant facts relating to the conduct of those individuals.<sup>6</sup> The policy is designed to undermine any corporate defense strategy of laying the blame on one rogue employee by forcing companies to identify all involved actors—ranging from the C-suite to an intern—who may be responsible for misconduct.<sup>7</sup>

In prepared remarks for a recent speech given at New York University on September 10, Yates noted that “there would be no partial credit for cooperation that doesn't include information about individuals.”<sup>8</sup> This policy will pressure companies to cast a wider net for potentially responsible officers and employees in internal investigations. By the same token, targeted officers and employees may be well advised to seek separate legal counsel early in an investigative process. This dynamic increases the importance of carefully considering the lines of engagement of investigative counsel. For example, to the extent internal investigations are going to focus on management, the board or a committee of the board may need to engage investigative counsel to ensure that those being investigated are not the same people who are directing the investigation. Where the investigation is being run by the board, it is sure to cause friction between boards of directors leading internal investigations and corporate managers in the hot seat. Similarly, investigative counsel should exercise caution before reporting the status of the investigation to potentially culpable individuals.

Second, the DOJ has instructed all criminal and civil prosecutors to focus on individuals from the very beginning of any corporate investigation.<sup>9</sup> In the past, the DOJ has complained that

companies insulated employees by withholding inculpatory evidence until after the statute of limitations expired.<sup>10</sup> Now, the DOJ will expect companies to promptly and thoroughly disclose individuals' misconduct at an early stage of the investigation. As a result, companies conducting internal investigations ahead of the government's investigation should aim to discover not only if there was misconduct, but also who was involved, who knew about it and when.

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Third, the DOJ memo instructs federal criminal and civil attorneys handling corporate investigations to be in routine communication with one another to effectively pursue individuals.<sup>11</sup> This policy is not particularly new, as criminal prosecutors at the DOJ have, for several years, worked on investigations parallel to civil enforcement attorneys.<sup>12</sup> However, there are limits as to what criminal prosecutors can share with civil attorneys under grand jury secrecy provisions.<sup>13</sup>

Fourth, absent extraordinary circumstances, the DOJ states that it will no longer agree to a corporate resolution that includes an agreement to dismiss charges against or immunize individual officers or employees.<sup>14</sup> Thus, for instance, companies hoping to protect their employees from prosecution cannot agree to a larger corporate fine to avoid individual liability.

Fifth, the memo instructs prosecutors not to resolve cases against a corporation unless they have a clear plan to also resolve individual cases before the statute of limitations expires.<sup>15</sup>

Finally, the memo instructs civil attorneys to consider bringing suit against culpable individuals for monetary recovery, even where an individual does not have sufficient resources to

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satisfy a money judgment.<sup>16</sup> This policy aligns with the DOJ's emphasis on holding wrongdoers criminally accountable, regardless of their position in the company. As a practical matter, by going after low-level wrongdoers, the DOJ often gains cooperators who provide information against individuals higher up in the corporate hierarchy.<sup>17</sup>

## Recent SEC Guidance

The Yates Memo is in line with recent SEC initiatives, speeches by SEC officials and other public statements signaling that the top securities regulator also is sharpening its focus against individuals. Many expect these parallel efforts will lead to an increase in cases against company insiders, as well actions seeking director and officer bars. A closer look reveals these efforts against individuals will be tied to cases brought against larger companies.

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The SEC's renewed focus on individuals was emphasized in a speech given by Andrew Ceresney, director of the SEC's Enforcement Division, on May 13, 2015, at the University of Texas School of Law's Government Enforcement Institute.<sup>18</sup> Ceresney discussed the Enforcement Division's increased use of reverse proffers, which the enforcement staff typically present in the later stages of enforcement lawsuits. According to Ceresney, in certain cases, his staff will now present evidence supporting actions against individuals earlier, most likely the during Wells Notice stage of an investigation. Ceresney stated that this use of early reverse proffers would be tailored for individuals who

are on "the bubble" or in a position to assist the staff with future complex enforcement lawsuits. Ceresney pointed to why individuals and their defense counsel should give this new tactic serious consideration: the enforcement division's track record over the last five years of negotiating charging decisions, monetary relief, and bars against individuals by way of settlements, rather than prosecutions.

Whether individual cooperation in SEC investigations and enforcement actions actually has resulted in better outcomes for targeted individuals is a topic of wide debate.<sup>19</sup> What is clear, however, is that the SEC has been looking to pursue individuals aggressively as part of an ongoing effort to handle larger cases more efficiently, using fewer resources. Ceresney's statements in May echo initiatives dating back to 2010, including: the Cooperation Program, which introduced the use of deferred prosecution and non-prosecution agreements;<sup>20</sup> the SEC's whistleblower program;<sup>21</sup> and guidance issued in September 2014 that the SEC was monitoring compliance officers more closely.<sup>22</sup> This strategy of pursuing and leveraging individual cooperation is likely to strengthen in the next several years as the SEC's recently assembled financial fraud task force makes headway.<sup>23</sup> The stated mission of the task force is to renew the agency's pursuit of disclosure and accounting fraud cases, which are notoriously large and involve multiple individuals.

## Implications for Businesses and Individuals

***Companies will face pressure to assess individual culpability early in an investigation.*** Although the Yates Memo serves as formal guidance concerning the pursuit of individuals by the DOJ, like the SEC, the DOJ repeatedly has announced in recent years that it intends to more actively pursue individuals involved in misconduct leading to corporate settlements.<sup>24</sup> Indeed, over the last two years, we have seen an uptick in the number of individuals charged in cases brought under the

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Foreign Corrupt Practices Act (FCPA).<sup>25</sup> What the Yates Memo appears to do is make these individual prosecutions a higher priority and make the company's own identification of potentially culpable individuals an explicit factor in assessing cooperation credit. Time will tell how the application of the Yates Memo will work in practice, but, on paper at least, companies will be pressured to assess individual culpability early on in an investigation, and report it to the DOJ or SEC in nearly real time, before all the facts resulting from the investigation are thoroughly known and understood.

***Corporate executives likely will retain counsel sooner in the investigative process.*** In light of the pressure on companies to identify individual wrongdoing early in the process, companies may find their officers and directors retaining counsel at an earlier stage to protect against any criminal or civil liability. In some cases, this can create a conflict between the company's counsel conducting the investigation and the individual corporate actor. Companies should review their corporate bylaws and D&O insurance coverage to ensure that it meets the needs of the company and its employees. For example, many bylaws provide for mandatory advancement of legal expenses for directors and officers, which may not be in the companies' best interests. Also, D&O insurance carriers may create new coverage options for this change, as most existing policies do not cover expenses for internal investigations.

***The Yates Memo will likely lead to increased consistency across U.S. Attorney's Office in the treatment of individuals and corporate settlement.*** According to Assistant Attorney General Leslie Caldwell, the Yates Memo was a reaction to "inconsistency among federal prosecutors around the country, both among divisions inside the department and also among the U.S. Attorney offices."<sup>26</sup> She added that some U.S. Attorney offices were quick to resolve cases involving corporations without investigating individuals. After the Yates Memo, and the subsequent internal

training that it will no doubt engender, look for U.S. Attorney offices nationwide to take a more consistent approach to individuals involved in corporate misconduct.

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***More prosecutions of individuals likely will clarify key civil and criminal laws.*** The tough guidance set forth in the Yates Memo and the SEC guidance may have a silver lining for companies. The DOJ's and SEC's reliance on corporate settlements, particularly in the area of the FCPA, has resulted in a dearth of case law interpreting key provisions of federal laws on which government prosecutors and attorney rely. Given the fact that individuals have greater incentive to litigate, we expect to see more challenges to the DOJ's and the SEC's interpretation of law. A recent example of this was seen in *United States v. Hoskins*, where a district court rejected the government's long-held view on the application of accomplice liability to foreign nationals.<sup>27</sup>

## Notes

1. See Press Release, Department of Justice, BNP Paribas Sentenced for Conspiring to Violate the International Emergency Economic Powers Act and the Trading with the Enemy Act, (May 1, 2015), <http://www.justice.gov/opa/pr/bnp-paribas-sentenced-conspiring-violate-international-emergency-economic-powers-act-and> (last accessed Sept. 25, 2015) (discussing nearly \$9 billion penalty); Press Release, Department of Justice, Justice Department, Federal and State Partners Secure Record \$7 Billion Global Settlement with Citigroup for Misleading Investors About Securities Containing Toxic Mortgages, (July 14, 2014), <http://www.justice.gov/opa/pr/justice-department-federal-and-state-partners-secure-record-7-billion-global-settlement> (last accessed Sept. 25, 2015).
2. See Judge Jed S. Rakoff, *The Financial Crises: Why Have No High-Level Executives Been Prosecuted?*, *N.Y. Rev. of Books*, Jan. 9, 2014, available at <http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/> (last accessed Sept. 25, 2015); Peter Schroeder, *Sens. Warren, Shelby: Criminal bank execs should face arrest*, *The Hill*, Sept. 9, 2014, available at <http://thehill.com/policy/>

- finance/217110-warren-shelby-agree-on-need-to-prosecute-bank-execs* (last accessed Sept. 25, 2015).
3. Sally Quillian Yates, *Individual Accountability for Corporate Wrongdoing*, Dep't of Justice, available at <http://www.justice.gov/dag/file/769036/download> [hereinafter, "Yates Memo"].
  4. See, e.g., Jean Eaglesham, *SEC Tries Flipping Witnesses*, *Wall Street J.*, Aug. 5, 2015 (discussing SEC's increased use of its Cooperation Program, started in 2010).
  5. Yates Memo at 2.
  6. *Id.* at 3 & 4.
  7. *Id.* at 3.
  8. Sally Quillian Yates, Deputy Attorney General, Address at New York University School of Law Announcing New Policy on Individual Liability in Matters of Corporate Wrongdoing (Sept. 10, 2015), available at <http://www.justice.gov/opalspeech/deputy-attorney-general-sally-quillian-yates-delivers-remarks-new-york-university-school>.
  9. Yates Memo at 4.
  10. See, e.g., Matt Apuzzo & Ben Protess, *Justice Department Sets Sights on Wall Street Executives*, *N.Y. Times*, Sept. 9, 2015, <http://www.nytimes.com/2015/09/10/us/politics/new-justice-dept-rules-aimed-at-prosecuting-corporate-executives.html>; Devlin Barrett et al., *U.S. Wants Firings at France's BNP*, *Wall St. J.*, May 30, 2014, <http://www.wsj.com/articles/BNP-paribas-shares-plummet-after-u-s-pushes-for-huge-settlement-1401436039>.
  11. Yates Memo at 4 & 5.
  12. See Memorandum from the Attorney General to U.S. Attorneys, et al., July 28, 1997, available at <http://www.justice.gov/lagreadingroom/970728.htm> (instructing DOJ attorneys to maximize government resources by fostering "greater cooperation, coordination and teamwork between the criminal and civil prosecutors who are often conducting parallel investigations of the same offenders and matters").
  13. See Fed. R. Crim. P. 6(e); see also U.S. Dep't of Justice, United States Attorneys' Manual CRM § 156(c) ("Disclosure of matters covered by Rule 6(e) to Department of Justice attorneys for use in a civil suit is permissible only pursuant to a court order under Rule 6(e)(3)(C)(i).").
  14. Yates Memo at 5.
  15. *Id.* at 6.
  16. *Id.* at 6 & 7.
  17. *Id.* at 4.
  18. See Ceresney *Weighs in on SEC Investigations Individuals on the Bubble and Declinations*, *Corporate Crime Reporter*, May 13, 2015, available at <http://www.corporatecrimereporter.com/news/200/andrew-ceresney-weighs-in-on-sec-investigations-individuals-on-the-bubble-and-declinations/>.
  19. See, e.g., Eaglesham, *supra* note 4.
  20. The Cooperation Program is discussed at *Enforcement Cooperation Program*, U.S. SEC, <http://www.sec.gov/spotlight/enfcoopinitiative.shtml>.
  21. The SEC's Office of the Whistleblower is discussed at *Welcome to the Office of the Whistleblower*, <https://www.sec.gov/whistleblower>.
  22. *Frequently asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act*, available at <http://www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm>.
  23. See, e.g., Jean Eaglesham & Michael Rapoport, *SEC Gets Busy With Accounting Investigations*, *Wall Street J.*, Jan. 20, 2015.
  24. See, e.g., Eric Holder, Attorney General, Remarks at NYU School of Law (Sept. 17, 2014), available at <http://www.justice.gov/opalspeech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law> ("Make no mistake: the Justice Department will continue to be relentless in our pursuit of anyone, anywhere, who violates the law. We have investigations open right now that are focused on the conduct of individuals at specific financial institutions. We are making good progress in these cases, which involve conduct that has undermined the integrity of our markets, and we expect to bring charges in the coming months."); Marshall Miller, Principal Deputy Assistant Attorney General for the Criminal Division, Address at the Global Investigation Review Program (Sept. 17, 2014), available at <http://www.justice.gov/opalspeech/remarks-principal-deputy-assistant-attorney-general-criminal-division-marshall-l-miller> ("Corporations do not act criminally, but for the actions of individuals. The Criminal Division intends to prosecute those individuals, whether they're sitting on a sales desk or in a corporate suite.").
  25. For instance, the DOJ prosecuted eleven individuals in 2014 as compared to only two in 2012. See Dep't of Justice, *Related Enforcement Actions: 2014*, available at <http://www.justice.gov/criminal/fraud/fcpal/cases/2014.html>.
  26. Marisa Iati, *GIR Live New York: Yates memo harmonizes approach to prosecutions*, *Caldwell says*, Main Justice (Sept. 22, 2015), <http://www.mainjustice.com/justanticorruption/2015/09/22/gir-live-new-york-yates-memo-harmonizes-approach-to-prosecutions-caldwell-says/>.
  27. *United States v. Hoskins*, No. 3:12-CR-238(JBA), 2015 U.S. Dist. LEXIS 106802 (D. Conn. Aug. 13, 2015).

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