

**SEC Agrees to Reduce Penalties  
in Exchange for Cooperation**

Theodore A. Levine, Wayne M. Carlin  
& Kevin S. Schwartz

*Wachtell, Lipton, Rosen & Katz*

In two recent insider trading actions, the SEC agreed to settlements with substantially reduced civil penalties based on the defendant's agreement to cooperate with an ongoing investigation and related enforcement action. *SEC v. Cutillo et al.*, No. 09 Civ. 9208 (S.D.N.Y. Mar. 30, 2010); *SEC v. Galleon Management, LP et al.*, No. 09 Civ. 8811 (S.D.N.Y. Apr. 19, 2010). These cases merit attention as the SEC reportedly considers revising its framework for assessing penalties against entities.

The Commission brought these two actions against Schottenfeld Group LLC—a registered broker-dealer—based on alleged insider trading by individuals who, at the time of the trading, were registered representatives and proprietary traders at Schottenfeld. The SEC is statutorily authorized to obtain civil penalties of up to three times the profit gained or loss avoided as a result of insider trading. Historically, the Commission's practice in insider trading settlements has been to secure a "one-time" penalty equal to the amount of disgorgement.

In the *Cutillo* and *Galleon* actions, however, the Commission submitted and the courts approved settlements that included civil penalties equal to only 50% of the disgorgement amounts. In a joint

submission to the court in *Galleon*, the parties explained that the penalty in that case represented a 50% "discount from a one-time penalty, in exchange for [Schottenfeld's] agreement to cooperate with the Commission." The final judgments in both cases stated that penalties in excess of the amounts agreed were not being ordered "based on Defendant's agreement to cooperate in a Commission investigation and related enforcement action." While this is not stated explicitly in the filings, the settlements suggest that Schottenfeld may have entered into a formal cooperation agreement, as contemplated by the initiatives announced by the SEC in January. It is also unclear whether the settlements are based on the defendant's forward-looking promise to cooperate or, rather, are based in whole or in part on cooperation that has already occurred.

The Schottenfeld settlements suggest a willingness on the part of the SEC to extend quantifiable benefits in return for cooperation, at least in some cases. In insider trading cases, a "discount" has verifiable meaning, in view of the historical baseline of one-time penalties. Yet even here, the Schottenfeld settlements do not articulate what the cooperation entailed (or promised for the future), or by what criteria the SEC determined that the appropriate discount level was 50%. In other types of cases, whether a penalty amount is discounted for past or future cooperation is a much more subjective question. As the Commission revisits its framework for seeking penalties against entities, some meaningful transparency from the SEC as to its methodology for determining penalty amounts and discounts is important.

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