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The SEC's First Non-Prosecution Agreement

The SEC yesterday announced its first use of a non-prosecution agreement, one of the new investigative tools that the agency unveiled nearly a year ago. The SEC simultaneously filed an enforcement action against a former sales executive of Carter's, Inc. See *SEC v. Elles,* Civ. Action No. 1:10-CV-4118 (N.D. Ga.). The Commission did not bring any enforcement action against the company.

At first blush, this appears to be the sort of case in which the SEC historically would likely have brought charges against a public company. According to the complaint, the executive granted and concealed substantial unauthorized discounts to the company's largest customer. By misrepresenting the facts and creating false documents, the executive allegedly caused the company to delay recognizing these discounts until later periods, thereby inflating the company's reported earnings in the earlier periods. When the company discovered the scheme, it conducted an internal investigation, self-reported the matter to the SEC and ultimately restated its financial statements covering a five-year period.

In explaining the decision to accept a non-prosecution agreement rather than bring an enforcement action against the company, the SEC identified the following factors: (1) the "relatively isolated nature" of the unlawful conduct; (2) the company's "prompt and complete" self-reporting of the misconduct to the SEC; and (3) the company's "exemplary and extensive" cooperation in the inquiry, including undertaking a "thorough and comprehensive" internal investigation.

The isolated nature of the conduct was likely a significant factor in the SEC's determination to use this case to demonstrate its willingness in some cases to address a company's responsibility for the misconduct of a corporate employee through a non-prosecution agreement. The SEC has not asserted that the company's most senior management or the accounting function had any complicity in the alleged misconduct. While the sales executive had a significant management position, he allegedly acted alone, misled other members of management and pocketed $4.7 million from sales of stock before the company discovered his misconduct.

The SEC has also publicly released its non-prosecution agreement with the company. While the agreement requires the company to continue to cooperate with the SEC, it does not require any waiver of attorney-client privilege – although it appears that the company has in some manner shared the results of its internal investigation with the SEC. In the event that the SEC Enforcement Staff determines that the company has failed to comply with any of its obligations under the agreement (such as the obligation to cooperate), the Staff may then proceed with an enforcement recommendation to the Commission.

The SEC's willingness to resolve this case without an enforcement action against the company is an encouraging first step. The SEC should demonstrate in future cases that this form of resolution is also available in scenarios in which it is not possible to isolate the misconduct to a single culpable individual. The policy rationale for such an outcome is equally strong where multiple employees have involvement, but the company had reasonable controls and an appropriate compliance culture in place, responded promptly to indications of wrongdoing and cooperated with the SEC's investigation.

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