

# **23rd Annual Institute on Federal Securities**

## **Cooperation and Remediation What Is It Good For?**

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A blurred image of a 'WALL' sign, likely Wall Street, in the top left corner of the slide.

# Cooperation and Remediation

- What does cooperating with the SEC really mean?
  - a rose by any other name?
- What are the costs and benefits of cooperation?
  - is a shield really a (Damocles) sword?
- What is sufficient remediation?
  - why remediate: if it ain't broke, why the heck fix it?

# The *Seaboard* Section 21(a) Report

- Issued October 23, 2001 – one of Chairman Pitt’s principal achievements:

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions

- [www.sec.gov/litigation/investreport/34-44969.htm](http://www.sec.gov/litigation/investreport/34-44969.htm)
- [www.sec.gov/news/headlines/prosdiscretion.htm](http://www.sec.gov/news/headlines/prosdiscretion.htm)
- financial statement case in which SEC decided not to take action against public company
- but did bring settled C&D against Controller

# The *Seaboard* Section 21(a) Report

- Stephen M. Cutler, Director of Enforcement:

"Crediting those who seek out, self-report and rectify illegal conduct is critical to achieving the Commission's goal of 'real-time enforcement.' We hope that, by setting forth a framework for exercising its prosecutorial discretion, the Commission will encourage companies to address unlawful conduct swiftly and meaningfully and to cooperate with law enforcement authorities. The result will be more efficient and effective enforcement of the federal securities laws."

The top left corner of the slide features a blurred image of a 'WALL STREET' sign. The word 'WALL' is clearly visible in white capital letters on a dark background.

# The *Seaboard* Section 21(a) Report

- Press release:

“Credit for cooperative behavior may range from the extraordinary step of taking no enforcement action at all to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents the Commission uses to announce and resolve enforcement actions.”

# The *Seaboard* Section 21(a) Report

- Four principal issues SEC will consider in deciding whether and how to charge company faced with financial fraud issues:
  - **Self-policing** prior to the discovery of the misconduct, including establishing effective compliance procedures and an appropriate tone at the top
  - **Self-reporting** of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins and consequences of the misconduct, and promptly, completely, and effectively disclosing the misconduct to the public, to regulators, and to self-regulators;
  - **Remediation**, including dismissing or appropriately disciplining wrongdoers, modifying and improving internal controls and procedures to prevent recurrence of the misconduct, and appropriately compensating those adversely affected; and
  - **Cooperation** with law enforcement authorities, including providing the Commission staff with all information relevant to the underlying violations and the company's remedial efforts.

# The *Seaboard* Section 21(a) Report

- Full Report: <http://www.sec.gov/litigation/investreport/34-44969.htm>
- Identifies 13 issues SEC will consider:
  - Nature of conduct: intentional, scope, management level, duration, size
  - Response to conduct: cessation of conduct, how uncovered, whether reported, involvement of Audit Committee, removal of offender(s), etc.
  - Dealings with regulators: self-reporting, cooperation, waiver of A/C privilege

# The *Seaboard* Section 21(a) Report

Why was Seaboard given a pass?

- it self-policed:
  - internal auditors quickly investigated (one week), reported to management, who immediately told the Audit Committee
  - Audit Committee hired outside law firm to do investigation
- it remediated:
  - Controller fired 4 days later
  - day later, Seaboard disclosed and told the SEC -- no effect on stock
  - strengthened its financial reporting processes to address conduct
- it cooperated:
  - bared soul to SEC: unfettered access to details of investigation, including notes and transcripts of interviews, no assertion of any privilege

# *In the Matter of Monsanto Company – January 6, 2005*

- settled Foreign Corrupt Practices Act ("FCPA") and books and records case
  - federal court action for \$500k penalty
  - cease-and-desist proceeding finding FCPA, books and records and internal controls provisions violations
- arose out of alleged bribes to Indonesian officials from 1997-2002 totaling @ \$750,000
  - including recent \$50k payment to "Senior Environmental Official"

## *In the Matter of Monsanto Company – January 6, 2005*

- somewhat mixed message:
- SEC quite critical of Monsanto
  - ineffective self-policing:
    - investigation did not uncover \$59k payment to “Senior Environmental Official”
    - never audited Indonesian operations
    - accepted Indonesian financials at face value

## *In the Matter of Monsanto Company – January 6, 2005*

- but recites favorably Monsanto's cooperative conduct:
  - Monsanto became aware of irregularities in 2001 and started investigating on its own
    - notified the staff of the results of the investigation;
    - cooperated with the staff's investigation
    - declined to assert its attorney-client privilege with respect to communications during the relevant time period.

## *In the Matter of Monsanto Company – January 6, 2005*

- and recites favorably Monsanto's remedial actions:
  - revised accounting treatment of payments
  - terminated all relevant Monsanto employees and their supervisors
  - terminated relationship with the consulting firm that had been conduit
  - restructured its Indonesian affiliates
  - appointed a new Director of Business Conduct
  - implemented an improved and expanded FCPA compliance program

## *In the Matter of Monsanto Company – January 6, 2005*

- Little hard to get behind public facts to get to real meaning of case
- SEC may have foregone any number of other sanctions:
  - no individuals charged – Controller for that unit??
  - by today's standards, penalty quite modest
  - no fraud charge
- but still, this is certainly no free pass
- agreed to charges and very significant undertakings

## Other “Pro” Cooperation Matters

- *SEC v. Royal Ahold* – announced October 13, 2004:
  - press release:<http://www.sec.gov/news/press/2004-144.htm>
  - settled fraud action with no penalty
  - Ahold:
    - conducted extensive internal investigation
    - expanded investigation to 17 other operating units
    - self-reported, gave SEC internal reports, waived any privileges, facilitated interviews abroad
    - revised its internal controls and terminated employees
- but note that SEC sued nine former Ahold employees for fraud at the same time

## Other “Pro” Cooperation Matters

- *In the Matter of Conseco, Inc.* – announced March 10, 2004:
  - Order: <http://www.sec.gov/litigation/admin/34-49392.htm>
  - settled C&D proceeding for books and records, internal controls issues
  - no penalty
  - Conseco conducted internal audit, disclosed overstatements
- again, note that former CFO and CAO still sued for fraud in federal court

## Other “Pro” Cooperation Matters

- *In the Matter of BJ Services* – March 10, 2004
  - <http://www.sec.gov/litigation/admin/34-49390.htm>
  - long discussion of remedial actions
- *Homestore* matter – September 25, 2002
  - <http://www.sec.gov/news/press/2002-141.htm>
  - Homestore not charged “because of its swift, extensive and extraordinary cooperation in the Commission's investigation.”



# Consequences of Non-Cooperation

## *SEC v. Lucent* – May 17, 2004

- settled fraud action involving payment of \$25 million penalty
  - \$25 million penalty was specifically for lack of cooperation
  - press release: <http://www.sec.gov/news/press/2004-67.htm>

“Companies whose actions delay, hinder or undermine SEC investigations will not succeed. Stiff sanctions and exposure of their conduct will serve as a reminder to companies that only genuine cooperation serves the best interests of investors.”



## *SEC v. Lucent* – May 17, 2004

- Lucent's alleged failures:
  - provided incomplete document productions
  - produced key documents after the testimony of relevant witnesses
  - failed to ensure that a relevant document was preserved and produced pursuant to a subpoena



## *SEC v. Lucent* – May 17, 2004

- But was the SEC at least equally motivated by
  - characterization in Fortune interview by Lucent's former Chairman/CEO and outside counsel of alleged fraudulent booking of \$125 million deals as "failure of communication"?
    - possible violation of SEC's "neither admit nor deny" policy
  - Lucent's alleged extension of indemnification rights to employees not previously covered and after the SEC named them?
  - Lucent's alleged failure to provide information to SEC on indemnification?

## *In the Matter of American International Group (BrightPoint) – announced September 11, 2003*

- settled C&D fraud action involving payment of \$10 million penalty
  - AIG paid \$100,000 in disgorgement, so 100 time penalty
  - press release: <http://www.sec.gov/news/press/2003-111.htm>

“The \$10 million penalty against AIG reflects the gravity of its misconduct. It also reflects the fact that, in the course of the Commission's investigation, AIG did not come clean. On the contrary, AIG withheld documents and committed other abuses, as outlined in the administrative order, compounding its overall misconduct.”

## *In the Matter of American International Group (BrightPoint) – announced September 11, 2003*

- According to the SEC, AIG's misconduct included the following:
  - AIG gave SEC sworn certification that production was complete, and then produced additional documents that should have been produced earlier
  - AIG's search leading to the certification did not include files of the key personnel at the key unit that had committed the alleged fraud
  - AIG did not produce critical document that was directly relevant to a position AIG took in a Wells meeting and in its Wells Submission, until well thereafter

# *In the Matter of Banc of America Securities, LLC – announced March 10, 2004*

- settled administrative action against broker-dealer for failing to produce documents
  - payment of \$10 million penalty
  - press release: <http://www.sec.gov/news/press/2004-29.htm>

“BAS repeatedly failed to promptly furnish documents requested by the staff, provided misinformation concerning the availability and production status of such documents, and engaged in dilatory tactics that delayed the investigation.”

Cutler: “Today's action makes clear that we will not tolerate unreasonable delay in responding to our inquiries and will act aggressively to protect the integrity of the Commission's investigative processes.”

## *In the Matter of Banc of America Securities, LLC – announced March 10, 2004*

- BAS allegedly
  - did not produce documents
  - was repeatedly late without permission in producing documents
  - did not tell staff that its productions were only partial
  - did not tell staff promptly that documents had been destroyed or had been “rendered unavailable for inspection by the staff”

## *In the Matter of Banc of America Securities, LLC* – announced March 10, 2004

- BAS failed in a timely manner
  - (i) to produce electronic mail, including a particular e-mail exchange relating to matters that BAS knew were under investigation,
  - (ii) to produce certain compliance reviews after the staff had requested them,
  - (iii) to produce compliance and supervision records concerning the personal trading activities of a former senior employee of the firm, and
  - (iv) BAS provided the staff with misinformation concerning the availability and the production status of such documents, and engaged in dilatory tactics that delayed the investigation.

A blurred image of a sign with the word "WALL" in white capital letters on a dark background, likely a street sign in a financial district.

# Christian R. Bartholomew

- Mr. Bartholomew is a partner at Morgan Lewis with offices in Washington, D.C. and Miami. Prior to joining Morgan Lewis, he spent five years as Senior Trial Counsel of the Southeast Regional Office of the SEC, where he specialized in accounting and financial disclosure cases and litigated the seminal W.R. Grace “earnings management” case. Mr. Bartholomew now represents public companies and their senior officers and directors in connection with SEC enforcement matters and securities class actions. He can be reached at 202.739.6400, 305.415.3400, or [cbartholomew@morganlewis.com](mailto:cbartholomew@morganlewis.com).