

SEC Enforcement Update for Health Care Public Companies

The Sixth Annual National Congress
on Health Care Compliance

February 7, 2003

Disclaimer

The views expressed in this presentation are Lawrence West's and are not necessarily shared by the Commission or its staff.



U.S. SECURITIES AND EXCHANGE COMMISSION

"We are the investor's advocate."

William O. Douglas
SEC Chairman, 1937-1939

Today's Topics

- Significant Developments at SEC Since 5th Annual Compliance Congress
- Financial Reporting and Issuer Disclosure
- Insider Trading
- Regulation Fair Disclosure

What We Won't Cover –

Sarbanes-Oxley Act Material You
Heard Yesterday

SEC: Significant Developments Related to Corporate Governance, Responsibility and Ethics

- Spectacular Failures at Corporations, from Enron to WorldCom
- Commission Responds with More Aggressive Enforcement Actions, Closer Coordination with Criminal Authorities
- Congress Passes Sarbanes-Oxley Act, Commission Issues Rules Under Act

SEC Enforcement: FY 2002

- 598 total cases
- Largest categories:
 - ➔ **Financial fraud and issuer reporting (27%)**
 - ➔ Offering fraud (20%)
 - ➔ Broker-dealer (14%)
 - ➔ **Insider trading (10%)**
 - ➔ Market manipulation (7%)
 - ➔ Investment adviser/Investment company (8%)

Financial Reporting and Issuer Disclosure: Actions Filed

- 163 actions filed in FY 2002
 - ⇒ Compared to:
 - 112 in FY 2001
 - 103 cases in FY 2000
 - 94 cases in FY 1999
 - 79 cases in FY 1998

Actions Brought in the Last 12 Months

- Michael Kopper and Andrew Fastow (Enron)
- WorldCom
- RiteAid and its senior management
- Adelphia Communications and its senior management
- Microsoft
- Senior management of Waste Management
- Amazon.com
- Xerox
- PricewaterhouseCoopers
- Ernst & Young

How does the SEC fit into the overall enforcement scheme?

- We bring civil enforcement actions for violations of the federal securities laws.
- The Department of Justice (including the U.S. Attorney's Offices) brings criminal prosecutions.
- The self-regulatory organizations, such as the NASD and NYSE, regulate the securities industry.
- State prosecutors and a variety of state agencies oversee compliance with state securities laws.
- Plaintiffs' securities bar.

The SEC was underfunded for years. Now the President and Congress have promised more funding.

Is the SEC a “deeply demoralized agency”? No.

FINANCIAL REPORTING AND ISSUER DISCLOSURE:

Themes and Trends

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities

Ex-Enron Official Will Plead Guilty

First Case Against a Company Executive

By **CARRIE JOHNSON**
Washington Post Staff Writer

Former Enron Corp. executive Michael J. Kopper will plead guilty to financial wrongdoing as early as today and has agreed to surrender \$12 million in the first criminal case against a company official, sources close to the investigation said yesterday.

Kopper, a former director in Enron's global finance unit, will plead guilty to single counts of conspiracy to commit wire fraud and conspiracy to commit money laundering, sources said. The Securities and Exchange Commission will file



FILE PHOTO/BY JAMES PARCELL—THE WASHINGTON POST

Former Enron executive Michael J. Kopper will also face civil charges.

Enron's Fastow Charged With Fraud

*Complaint by U.S. Sign
Peril for Other Ex-Offic
Merrill Lynch Role Is C*

Federal prosecutors charged Corp.'s former chief financial officer Andrew Fastow, with fraud, money laundering and conspiracy in a criminal complaint that signals further charges against other former executives of the collapsed energy company.

The charges are the first against a senior Enron executive since the firm

*By Alexei Barrionuevo, Jonathan
and John R. Wilke.*

company imploded late last year, costing tens of billions of dollars in losses. Enron's demise triggered a new scrutiny of financial-reporting practices and a global loss of confidence in corporate integrity that continues to plague markets.

The complaint, filed in federal court in Houston, also points to the role of **Merrill Lynch & Co.** in aiding one element of the alleged fraud and to that of other executives, including the former chief accounting officer, Richard Causey. It alleges that Mr. Causey, along with another former Enron chief executive, mis-



become familiar as the federal government has cracked down aggressively on alleged corporate fraud in recent months. Several former Enron employees and their small children looked on in the packed courtroom as Mr. Fastow, dressed in a dark-gray suit and red tie, politely responded to the magistrate judge that he understood the litany of charges against him.

Later, Mr. Fastow was released after posting a \$5 million cash bond and several properties. If convicted of all the charges against him, Mr. Fastow could face a maximum of more than 100 years in federal prison, prosecutors said.

In addition to allegedly defrauding Enron shareholders by hiding debt and inflating the company's profit, prosecutors charged that Mr. Fastow engaged in numerous schemes to defraud Enron himself through a series of transactions between Enron and a host of unconsolidated "special-purpose entities"—off-the-books partnerships with names such as LJM, RADR, Southampton and Newco. They charged that he reaped billions of dollars in profits from these schemes, enriching himself, his family and a family foundation. He is also charged with taking kickbacks, disguised as gifts, including a series of 10,000 checks made out to his sons and wife from another alleged conspirator, Michael Kopper, another former Enron

Please Turn to Page A4, Column 4

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
 - ➔ Greater use of O&D bars
 - ➔ Disgorgement of compensation
 - ➔ Larger penalties

Officer and Director Bars

Officer and Director bars sought in all categories of cases:

➡ FY 2002: 126

➡ FY 2001: 51

➡ FY 2000: 38

Disgorgement of Stock Options and Other Compensation

- FY 2002: Sought from 28 individuals
- FY 2001: Sought from 18 individuals
 - ⇒ 55% increase in FY 2002

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Cooperate and coordinate with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations

SEC Charges WorldCom With Fraud

By CHRISTOPHER STERN
and YUKI NOGUCHI
Washington Post Staff Writers

The Securities and Exchange Commission yesterday charged WorldCom Inc., the nation's second-largest long-distance telephone company, with defrauding investors by improperly accounting for \$3.9 billion in expenses during 2001 and the early part of this year.

"In a scheme directed and approved by its senior management



WorldCom

- Commission filed case less than 24 hours after the company announced its intention to restate.
- Within 48 hours, Commission obtained a court order preventing destruction of documents; prohibiting extraordinary payments to current and former officers, directors and other employees; and appointing a corporate monitor.
- Commission's investigation is continuing, along with investigation of criminal prosecutors in U.S. Attorney's Office for S.D.N.Y.

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation

SEC Says Xerox Misled Investors By Manipulating Its Earnings

By JAMES BANDLER
And JOHN HECHINGER

In an unusually harsh rebuke of a blue-chip firm, the Securities and Exchange Commission accused Xerox Corp. of having "misled and betrayed investors" with a wide-ranging scheme over four years to manipulate its earnings and enrich top executives.

complaint, which was filed as part of the settlement agreement. Xerox neither admitted nor denied the charges.

The improper moves, which the SEC said Xerox insiders even referred to as "accounting tricks," boosted pretax profit by \$1.5 billion from 1997 through 2000, the complaint said. In 1998, 29% of Xerox's pretax earnings resulted from undisclosed accounting actions, accord-

Xerox

- Commission alleged undisclosed accounting actions that accelerated revenue recognition of equipment by over \$3 billion and increased pre-tax earnings by \$1.5 billion over a four-year period.
- Company settled to a fraud injunction and other relief.
- The Commission's investigation is continuing.

Xerox

- As part of the settlement:
 - ➔ Xerox paid a \$10 million penalty – the largest ever levied in a Commission action against a public company for financial fraud.
 - The penalty reflects the severity of the misconduct as well as the company's lack of full cooperation in the investigation.
 - ➔ Xerox was required to conduct a special review of its accounting controls and to restate its financials.
 - This ultimately led to Xerox's acknowledgment that it had misstated approximately \$6 billion of revenues.

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation – but credit meaningful cooperation.

Homestore's Ex-Execs to Settle Civil Charges

Internet: The three will plead guilty in revenue scam, pay \$4.6 million and help probe other officers and associates.

By E. SCOTT RECKARD,
JOSH MEYER
and EDMUND SANDERS
TIMES STAFF WRITERS

WASHINGTON—In addition to admitting to criminal charges in connection with a phony-revenue scam at **Homestore Inc.**, three former executives of the Internet company will pay \$4.6 million to settle related civil charges and are cooperating with investigators focusing on other former executives

and business associates, authorities said Wednesday.

U.S. Atty. Gen. John Ashcroft and officials from the Securities and Exchange Commission suggested Wednesday that others already are targets in the probe.

"Whether you are an executive at a Fortune 100 firm or an Internet start-up, if you victimize investors and employees, you will face investigation, prosecution and prison for your crimes," Ashcroft said in Washington.

In a complaint filed in federal court in Los Angeles on Wednesday against the three former executives of the Westlake Village company, prosecutors allege that a "major media company," identified by federal sources as **AOL Time**

Please see HOMESTORE, C14

Homestore

- Commission filed charges against John Giesecke Jr., Homestore's former chief operating officer; Joseph J. Shew, its former chief financial officer; and John DeSimone, its former vice president of transactions, for fraudulently inflating Homestore's revenues by causing the company to overstate its advertising revenues by \$46 million (64%) for the first three quarters of 2001.

Homestore

- Commission announced that it would not bring an enforcement action against Homestore because of its swift, extensive and extraordinary cooperation.
- Cooperation included reporting discovery of possible misconduct to the Commission immediately upon the audit committee's learning of it, conducting a thorough and independent internal investigation, sharing results of that investigation with the government, terminating responsible wrongdoers, and implementing remedial actions designed to prevent the recurrence of fraudulent conduct.

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation
5. Conduct of gatekeepers scrutinized

James A. Fitzhenry

- Fitzhenry was a Senior Vice President, General Counsel and Secretary for FLIR Systems, Inc
- Commission found that in connection with FLIR's 1998 year-end audit, Fitzhenry signed management representation letters to FLIR's auditors that he understood contained material misrepresentations regarding \$4.1 million in sales.
- In settlement, Fitzhenry agreed to:
 - ➔ Cease and desist from violating the lying-to-the-auditors rule of the Exchange Act, and
 - ➔ 5-year prohibition on appearing or practicing before the Commission under Rule 102(e).

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation
5. Conduct of gatekeepers scrutinized
6. Compliance with GAAP not always enough

Sneak Peek at Pertinent SEC Rule Under Sarbanes-Oxley Sec. 302

- Regarding Certification of Disclosure in Companies' Quarterly and Annual Reports: “We believe that Congress intended this statement to provide assurances that the financial information disclosed in a report, viewed in its entirety, meets a standard of overall material accuracy and completeness that is broader than financial reporting requirements under generally accepted accounting principles.”

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation
5. Conduct of gatekeepers scrutinized
6. Compliance with GAAP not always enough
7. Facilitating another company's reporting violations may create liability

Ashford.com/Amazon.com

- Settled cease-and-desist proceeding against Ashford.com, two of its officers, and Amazon.com involving the misstatement of Ashford.com's financial results, which allowed the company to beat analysts' pro forma earnings expectations.
 - ➡ In March 2000, Ashford.com and two of its executives improperly deferred \$1.5 million in expenses under a contract with Amazon.com, causing Ashford.com to materially understate its marketing expenses.
 - ➡ The improper deferral resulted from Ashford.com's settlement of a dispute with Amazon.com using two separate documents (prepared by Amazon.com at Ashford.com's request), one of which Ashford.com subsequently failed to disclose to its auditors.

Ashford.com/Amazon.com

- Commission found that Ashford.com and its former CEO violated and/or caused violations of antifraud, reporting, and books-and-records provisions of the securities laws, and the CFO violated and/or caused Ashford.com's violations of the reporting and books-and-records provisions.
- Commission found that Amazon.com caused Ashford.com's non-fraud violations.
- Principle: Commission will bring enforcement action against a company for its role in facilitating financial reporting violations by *another* company with which it did business.

Financial Reporting & Issuer Disclosure: Themes and Trends

1. Coordination with criminal authorities
2. Emphasis on personal accountability
3. Effort to speed up our investigations
4. Hold companies accountable for non-cooperation
5. Conduct of gatekeepers scrutinized
6. Compliance with GAAP not always enough
7. Facilitating another company's reporting violations may create liability
8. Auditor independence remains a critical element of sound financial reporting

REGULATION FAIR DISCLOSURE

First Reg FD Enforcement Actions

- Raytheon & Franklyn A. Caine
 - ➔ Cease and desist order
- Secure Computing & John McNulty
 - ➔ Cease and desist order
- Siebel Systems
 - ➔ Cease and desist order
 - ➔ \$250,000 civil penalty
- Motorola, Inc.
 - ➔ Section 21(a) report

INSIDER TRADING

Selling Ahead of Bad News

Corporate insiders are not allowed to trade on material inside information. But often they are unable to resist selling their stock ahead of bad news.



SEC Charges Former ImClone CEO Samuel Waksal With Illegal Insider Trading

FOR IMMEDIATE RELEASE
2002-87

Washington, D.C., June 12, 2002 —The Securities and Exchange Commission today [filed charges against Samuel Waksal](#), the former CEO of ImClone Systems Inc., for illegal insider trading. In its complaint, the Commission charges that Waksal received disappointing news late last December that the U.S. Food and Drug Administration would soon issue a decision rejecting for review ImClone's pending application to market its cancer treatment drug, Erbitux. The SEC further charges that Waksal told this negative information to certain family members who sold ImClone stock before the news became public and that Waksal himself tried to sell shares of ImClone before the news became public.

In its lawsuit, filed in federal court in Manhattan, the Commission seeks an order requiring that Waksal disgorge the several million dollars in losses avoided by those family members he tipped, and that he pay civil penalties and prejudgment interest. It also seeks an order permanently enjoining Waksal from violating the securities laws, and barring him from acting as an officer or director of a public company.

Specifically, the Commission's complaint alleges as follows.

- On the evening of Dec. 26, 2001, Waksal learned that on Dec. 28, 2001, the FDA would issue a Refusal to File (RTF) letter to ImClone rejecting consideration of its Biologics Licensing Application for Erbitux.



SEC v. Waksal

- SEC charged that Waksal received negative news that the FDA would soon issue a decision rejecting for review ImClone's pending application to market its cancer treatment drug, Erbitux.
- SEC complaint alleges that Waksal told this negative information to family members who sold ImClone stock before the news became public, and that Waksal tried to sell shares of ImClone before the news became public.
- SEC seeks disgorgement of the several million dollars in losses avoided by those family members Waksal tipped, and an order that he pay civil penalties and prejudgment interest.
- SEC also seeks an order permanently enjoining Waksal from violating the securities laws, and barring him from acting as an officer or director of a public company.

Trading Ahead of Good News: Mooney Sentenced for Insider Trading

- On August 21, 2002, Michael Mooney, at one time a vice-president of underwriting for United Health Care, was sentenced to 42 months in prison, 3 years supervised release, and \$150,000 in fines plus \$ 70,000 in criminal forfeiture
- Mooney had traded options of United Healthcare in 1995 based on material, non-public information regarding United's plan to acquire MetraHealth.

Mooney, cont.

- Mooney had been a member of United's due diligence team investigating the potential acquisition of MetraHealth. After the merger was announced, United's stock price rose approximately 11%. The Court found that Mooney received ill-gotten gains of \$ 274,199 as a result of his illegal trading in United.
- This was a case we filed in 1999, but our action was stayed pending resolution of the criminal trial.

Gidvani Insider Trading Judgment Affirmed

- On May 15, 2002, the U.S. Court of Appeals for the Fifth Circuit affirmed a district court grant of summary judgment for the SEC against Parvin Gidvani, a former employee of Owen Healthcare.
- The Commission had alleged that Gidvani acquired material non-public information about the impending acquisition in 1996 of Owen by Cardinal Health, Inc.

Larger Penalties in Insider Trading Litigation

- Carreker: Commission sued a senior officer of Carreker Corporation and his brother, a licensed stock broker, for trading in advance of negative earnings news. The court barred the officer from serving as an officer or director and imposed the maximum 3-time penalty available under ITSA against each defendant (\$629,820).
- John and James Panagotacos: Court ordered tipper to pay civil penalty of three times his and his tippee's profits (\$473,231), and the tippee to pay a penalty of three times his profits (\$309,000).

Larger Penalties in Insider Trading Settlements

- Nalco: Settled insider trading case against prominent Mexican national where Commission obtained 1-1/2 times penalty.
- Home Port: Settled insider trading case against an attorney and former stock broker for trading in advance of an announcement concerning an impending merger involving Home Port. Among other relief, the defendant consented to a civil penalty that is equal to two times the amount of his illegal trading profits.

