

Securities and Exchange Commission Historical Society
Interview with Theodore Sonde
Conducted on April 4, 2005, by Kenneth Durr

KD: This is an interview with Theodore Sonde by Kenneth Durr for the SEC Historical Society, being held on April 4, 2005, at the offices of Hogan & Hartson. I want to start off with a brief recap of your early background, your education, how you came to the SEC and what you were up to for the first couple of years.

TS: Well let's start with education. I went to City College in New York, uptown—was a Philosophy major. Went to NYU Law School; I ended up at the SEC because I had spent my last summer before my last year of law school at a large Wall Street firm and didn't find it very challenging. I had a classmate who was ahead of me in college and law school, who had gone to work at the SEC—told me what a wonderful time he was having and though I'd never taken a securities course, didn't know anything about it, and decided to go. Went down during the Kennedy Presidency, got hired just before he was assassinated, showed up when Johnson was President in the summer of 1964.

KD: And you went into corporate regulation?

TS: The Division of Corporate Regulation, which then handled what used to be called Chapter 10 proceedings where public companies went into bankruptcy. Today they're called Chapter 11 proceedings and at that time the SEC's role was more significant than it is today in typical bankruptcy proceedings of large public companies. There I met some great people, but was not particularly satisfied with the job. Paul Gonson, who

spent a long career at the Commission, and I think as a former President of the Historical Society, was my first supervisor, and Paul and I learned a little bit about appellate work and then I moved to the General Counsel's Office after about a year and a half and proceeded to spend another eight years there, moving from staff attorney to ultimately Assistant General Counsel until I moved to the Enforcement Division in 1974.

KD: And this is the point at which you start to become involved in some of these accounting cases.

TS: I had two roles in the General Counsel's Office. I started out as a young lawyer learning how to write an appellate brief and worked very closely with a great teacher and a great lawyer named Dave Ferber. Ferber was the solicitor and I spent many years with him. I also ended up working on—because I had some interest in doing trial work— a case called *Fifth Avenue Coach*, which turned out to be my first real exposure to lawyer cases and accountants cases. In that case we ended up suing one lawyer named Tom Bolan who was the name partner of a fairly prominent firm called Saxe, Bacon & Bolan and later we ended up suing his colleague.

I don't know whether to call him a partner or not because I still don't know whether he was a partner—Roy Cohn, and the two of them provided me with my first education on how some lawyers practice law. We ended up succeeding by establishing a case against

both of them and read a lot of what were then memos and interesting documents suggesting that perhaps they were into things that they shouldn't have been into.

KD: What kind of things were they doing?

TS: *Fifth Avenue Coach* was the successor of a company that used to run the bus lines in New York City. Some time, I want to say, in the late '50s, the City of New York seized the bus lines and sort of nationalized them if you want to call it that. And so the *Fifth Avenue Coach's* business stopped from being running buses and it basically had a claim for a lawsuit for damages for the assets. It turned out to be a lot of money—tens of millions of dollars, and what happened was we had discovered—not I but people in the Division of Corporate Regulation, I guess as well as Corporation Finance that—\$25 million is the number that sticks in my mind—was somehow missing.

And so we brought a case based largely on the accountant's work papers. I want to say it was Arthur Andersen at the time—who tried to account for what happened to the \$25 million and we ended up being able to account for about \$20 of it and in effect said that \$5 of the \$25 was missing, which became the center piece for a headline for the *New York Post* at the time.

Fifth Avenue Coach ended up being essentially an unregistered investment company and that was the regulatory handle that we used, to try to establish that it was an unregistered

investment company and that any form of self dealing was prohibited under the Investment Company Act. And the lawyers essentially showed the businessmen how to get around the regulatory structure in a way, which I thought was just totally wrong. There were some comical emails—not emails; there were no emails then. There were some comical memos to indicate “well I didn’t ask for your business advice” or things like that when some of the associates would say “you can’t do this” and somebody said “who asked you” or something like that. But there were a series of things that they did and various investments that they made that just didn’t make any economic sense.

KD: Now would you have started this case by going after the principals rather than the lawyer and accountant?

TS: We did not go after the accountants in the *Fifth Avenue Coach* case; we went after the businessmen as you say. But the cases came to me in the General Counsel’s Office after it had already been put together by one of the operating divisions. In this case it was the Division of Corporate Regulation and the part of it which basically dealt with mutual funds. I remember meetings and discussions that we had where they had essentially put the case together and had recommended the case be brought against two business people as well as Tom Bolan. They were going to be alleging an unregistered investment company and the General Counsel’s Office was going to be responsible for trying the case. I was the young staff attorney and had a lot of fun at it; at the same time I learned a

lot. But the case had already been packaged. I want to say Sid Mendelson was the one who originally was in charge of this enforcement function.

KD: The point that I was getting to is that this was a lawyer case, so to speak.

TS: Yes.

KD: There probably wasn't at this early date a sense of establishing the ground work for something in the way that some of the later lawyer cases would have done.

TS: I think that's true; I think that historically this case had nothing to do with the legal profession. It turned out to be a lawyer's case, if you want to call it, that because the Commission ended up suing two lawyers who were outside counsel—or allegedly outside counsel to a corporate defendant. I only identify it as a lawyer's case because it was sort of the beginning of my education into some of the legal shenanigans that I thought lawyers shouldn't be doing.

KD: Well let's move on to the next step in that education.

TS: After *Fifth Avenue Coach* there were a series of cases that were brought by the Commission against lawyers who were doing things that I don't think any respectable lawyer would think of doing. Sometimes they were simply outright securities fraud

where you would have an offering which had a minimum of say \$5 million and they would close it with \$3 and then paper over the fact that there was \$2 million missing, or they would engage in other things that were providing legal opinions where securities would be exempt from registration when there was no legal basis for it. And I ended up with a couple of those cases—the *Spectrum* case, for one, was a case that was brought out of the New York Regional Office which was pretty much a stock scam of one sort, but involved a lawyer’s opinion and it was decided that we should argue... The case was against—I’m not sure I remember his name correctly, but I want to say it was Stuart Schiff.

I don’t know whether that’s right or not. The case was argued to the 2nd Circuit about the importance of a lawyer’s opinion; there had been a case called *United States v. Benjamin* that had been decided by the 2nd Circuit that talked about how a lawyer’s opinion or an accountant’s opinion could be a tool for fraud. And the 2nd Circuit in the *Spectrum* case took off on that and expanded on that. At the same time, there were a series of—I would call them lawyers, who facilitated different kinds of crimes and frauds that got themselves involved in different kinds of activity, and the Commission decided to address more and more of that in one form or other. We had situations where, I think it was a lawyer named Kaufman had been criminally convicted of securities fraud in New York but was still practicing before the New York Bar. The Commission decided to amend its Rule 2(e) rules to try to deal with that.

I got involved in a couple of cases involving accountants, which I thought somewhat analogous to lawyers. There was a case that I worked on—an *amicus* case in the Southern District of New York, which established an important accounting principle—really a legal principle—that I thought had application to both the legal profession and the accounting profession called *Fisher v. Kletz*, where basically the court said that anyone who provides some form of identification like a lawyer or an accountant or a legal opinion to a statement that they know is no longer true has a duty to correct that. The judge relied on restatement of torts. I thought that was sort of an interesting stepping stone. It involved the bankruptcy of a company called Yale Express and the accounting firm of Peat Marwick & Mitchell at the time.

And the accounting profession, interestingly I thought, and very responsively, took that case and adopted that principle into its professional rules of conduct. I don't necessarily mean the Code of Conduct, but more on what are the standards for the profession when they learn that for example, a set of financial statements are no longer correct? And out of that case and that same principle evolved the notion that it's incumbent upon accountants to disassociate themselves from financial statements that are no longer correct . You have today the whole notion of restating financial statements which is really a spin-off of this whole notion.

At the same time, I got involved in a case involving Westek, which was the collapse of a company in the '60s involving a 2(e) case against two of what were then partners of Ernst

and Ernst, as well as the firm. I also developed a relationship with Andy Barr who was the Chief Accountant of the Commission and was sort of the gatekeeper for all accounting cases. We worked together on a number of cases and one of them was the *National Student Marketing* case as well as a couple of other cases against accountants and lawyers. We worked through the professional obligations in the *National Student Marketing* case, first against what was then Peat Marwick & Mitchell and a number of its professionals, an audit partner who ran the Washington, DC office named Tony Natelli, the audit manager on the job, and also against the law firms of White & Case and Lord, Bissell & Brook.

KD: Let's back up just a bit before we start into the *National Student Marketing* case. Andy Barr was the Chief Accountant all through this period?

TS: Well no, he...

KD: Through the sixties?

TS: Yes; I want to say even before that—he was an institution at that point but I want to say he left in 19—in the early to middle '70s, right after...

KD: Seventy-two.

TS: Oh okay; you know better than I do.

KD: A lot of stuff happened in '72 and that was one of them.

TS: Okay; but my recollection is he was on board with the *National Student Marketing* case.

KD: *Fisher v. Kletz* is not the kind of thing where he have taken notice and said let's think this through; let's look at what we're doing here?

TS: I don't remember whether he actually was consulted, but I would have thought he would have been because, as I recall, we were requested by the District Judge to provide him with an *amicus* brief and the Commission did provide an *amicus* brief. I want to say it's District Judge—then Tyler—and I know Mike Eisenberg who was the Assistant General Counsel that I worked for at the time—and I worked on the accounting position—the position that the Commission took in that case, and I don't know whether I actually remember it but I'm pretty sure that was run past Andy Barr.

KD: Okay; so *National Student Marketing*—what kind of company was this and what were the issues—just briefly?

TS: Well *National Student Marketing* was a marketing company and its claim to fame was that it claimed to have a campus-driven network of students who worked on a part-time

basis who would promote your products nationwide on college campuses. They allegedly had agreements with the Pontiac Division of General Motors; they had an agreement with American Airlines and with other companies—large companies to promote their marketing skills. They had gone from a very small company to a fairly large one in the mid to late '60s and then in the late '60s their stock collapsed. And the company was run by a fellow named Cortes Randall; Randall ended up going to jail for this among other scams. He was pretty incorrigible but he surrounded himself with good professionals.

When I got the case – 1971, I guess, because the case itself was filed in early '72—we learned that originally *National Student Marketing* had been represented by Covington and Burling here in town and Arthur Andersen and both of them had fired Cortes Randall and his company. And they were succeeded by White & Case in New York and a young partner named Jay Epley and by Peat Marwick & Mitchell here in town. They were a DC based company that had been a high-flying stock for a period of time. And the case itself had two facets; *National Student Marketing* claimed to its auditors that you could book contracts and revenue before you actually had a contract.

And so you had oral agreements to provide services hypothetically for the Pontiac Division of General Motors, and indeed there was some purported agreement. The notion was that we did most of our work in planning the marketing program and we would get a contract and by the time we got the contract we had put in most of the work;

we had the billboards ready to go out or the flyers or the promotional pieces and so all the money was earned before you actually got the contract... not a very sound notion. As I recall they fell back on a percentage of completion accounting which makes some sense in the construction industry but made no sense whatsoever in this, but somehow they convinced the auditors to do that.

In 1967 they had a sizeable profit based on these so-called oral commitments and when they brought the case to me it became apparent that the oral commitments by the time the middle of 1968 had occurred had fallen apart, and so much of this revenue was wrong. But instead of correcting the financial statements for 1967, they went on a binge to acquire a whole bunch of companies to, in effect, cover up the fact that they didn't have any income or earnings.

The criminal case against Tony Natelli largely evolved around the fact that by the time the proxy statement went out for a large \$40 million merger, they already knew the financial statements that had previously been published were wrong. Instead of admitting that they were wrong and calling for their restatement it was alleged that he caused certain adjustments to be made to hide the fact that the numbers were wrong and that was ultimately considered to be the underlying criminal offense.

What happened in 1968 was that one of the conditions for this same merger was that there was to be a comfort letter delivered which would in effect say that there were no

material adjustments required to the unaudited financial statements that were in the proxy statements. Peat Marwick, Mr. Natelli, concluded that in fact there were material adjustments and the material adjustments were such that they would wipe out all of the income in the nine-month financial statements and require a restatement. They tried to present that comfort letter to the closing where the two companies—in this case it was *National Student Marketing* and a company called *Interstate National Corporation* were merging, and this was taking place at the law offices of White & Case in New York and Peat Marwick was having trouble convincing the people in New York that they should abort the merger.

And so what evolved was a situation where Peat Marwick ended up delivering a comfort letter the following week which in effect said that the financial statements were wrong, they needed to be restated, and the stockholders needed to have new and corrected financial statements circulated to them. Well unknown to Peat Marwick for most of what was a Friday afternoon the closing proceeded without the signed comfort letter. And much to the frustration of Vic Earle, who was the General Counsel of Peat Marwick, he couldn't convince the lawyers at White & Case to abort the closing. So he added paragraphs which he thought were being delivered to the closing room, but some of which weren't until after it closed.

The Commission took the position that the two law firms had basically aided and abetted a securities fraud by allowing the closing to proceed in light of the comfort letter and

concluded that they should have aborted the closing and stopped the closing going forward. The Commission also alleged that Peat Marwick, even though it had done quite a bit, had failed in its professional obligation in that instead of following the teachings of *Fisher v. Kletz* and the accounting literature that was extant at the time, should have come to the Commission because there was literature out there that said that you have to disassociate yourself from financial statements that you know are incorrect and if you advise the client to correct it and the client refuses, you have an obligation to bring it to the attention of the proper regulatory authorities, which in the accounting literature was described as either the Stock Exchange or the SEC.

And so the Commission in the complaint basically said Peat Marwick failed in that respect. That was a small aspect of the case as it related to Peat Marwick, but it was important from a precedential point of view to make clear that the accountants had this obligation and indeed the lawyers had that obligation. As we were drafting the complaint it occurred to me that there was really no logical reason why the lawyers didn't have the same legal obligation, particularly under the then ethics rules, then called the *Code of Professional Conduct*.

KD: Was this an ABA thing?

TS: It was an ABA *Code of Professional Conduct*, which was the same as in the State of New York and in most states around the country; there were minor variations, but basically the

ABA *Code* as well as the New York *Code* required a lawyer to disassociate himself or herself from a financial fraud that the lawyer knew was being perpetrated against some person, and the way that the rules read, the lawyer was required to basically call upon the client to rectify the fraud and if failing that to report it to the affected person or tribunal. And we took it as a given that that was appropriate to apply to the lawyers as well, and so we drafted a paragraph which became a somewhat infamous paragraph saying that the lawyers had a duty to blow the whistle.

We frankly didn't spend a lot of time thinking about the revolution we were about to start, but we talked about it. I remember reviewing it with Alan Levenson; I remember reviewing it with the then General Counsel, Brad Cook; I know Dick Rowe was consulted and other people and we all thought it made sense. Of course, the legal profession didn't think it made sense and they promptly decided to change the rules and concluded that this was far beyond the call of the legal profession. Essentially there were law review articles, there were press reports, and the like about it.

And to this day I don't think they still accept the notion. It always seemed to me fairly simple that if you're a lawyer and you know that you've put together documents say for a simple real estate closing and your client tells you the morning of the closing "you don't need to come to the closing because I've gotten tickets to Brazil and I'm about to steal all the proceeds, and by the way all the documents I gave you that you based your opinion on are all forgeries and fraudulent" you have a professional obligation to call up the

lawyer on the other side and say you shouldn't go to the closing and tell him what you need to do stop that. It doesn't seem to me to be terribly earth-shattering, and when put in that light most lawyers would agree.

But put in the corporate light somehow it became startling. And it seemed to me that if you look at the language of the *National Student Marketing* complaint, you'll see that the paragraph that applies to the lawyers is parallel to the paragraph that applies to the accounting profession. It says they should have basically called upon the client to rectify the financial statements, and failing that to report to the SEC, and that was considered blasphemy.

KD: Well "revolution" was your word and clearly this did make a big splash. Can you give some sense of why this may have seemed so novel to the legal profession when you were essentially building on what had been established in the accounting profession?

TS: There were two parts of it that were novel. I think the real novelty if there was anything novel about it was that the Commission for the first time in its history was suing a major law firm for securities fraud and not only a major law firm, but a very respected firm that had an international reputation and it was claiming that it had committed securities fraud or it had facilitated securities fraud, and I think that was really the revolution if there was a revolution. The Commission drew no attention from the Bar when it sued the little old practitioner who did something stupid, the Stuart Schiffs, the Kaufman's, the Field's—

nobody cared... When it went after a partner in a major law firm, much less two law firms and three partners, two in one firm and a partner in another and charged them with securities fraud—that was the revolution.

The legal attack that they mounted or—if you want to call it—the political attack they had mounted against the legal theory was a cover, I thought. What was really unheard of and unprecedented was to go after the large professional organizations. And you have to bear in mind that at this point, there had been very few cases brought against the major accounting firms, there had been very few cases brought against the major law firms; there were no cases that I was aware of where partners of major law firms had been sued. I think there was one case that had been brought in—*The Continental Vending* case against the partner of what was then Lybrand, Ross Brothers, which is a predecessor to Coopers and Lybrand and PriceWaterhouse Coopers, and that was unprecedented. The fact that we sued Peat Marwick & Mitchell and we sued two people associated with it, I think that was unprecedented.

And the '70s brought about a series of cases like that. In addition to the *National Student Marketing* case, the Commission brought the *Vesco* case where it sued three lawyers associated with the New York law firm of Willkie, Farr, & Gallagher, a very well known firm. If my memory serves me correctly, one of the defendants who was a partner of that firm was the former director of the SEC's Division of Corporate Regulation, a fellow named Alan Conwill, and the Bar took notice of that as well. There followed a number

of other cases where major lawyers—major firms and major partners— and partners of major law firms and accounting firms were being sued. There was a case against Arthur Andersen and the *Four Seasons Case* where there was a criminal prosecution if I remember correctly. At that point, Andy Barr had left the Commission and Sandy Burton had become the Chief Accountant.

And I remember when Sandy came onboard; I went through with him the various allegations in the *National Student Marketing* case and had gone through other accounting cases. We were then beginning to start what turned out to be a long series of cases against accounting firms. We had the *Ampex* case; I think that was against Touche Ross; we had *Four Seasons*, we had the *Geotek* case which involved a case against Arthur Young and Company—there were some lawyers involved in that one, but not prominent law firms. There were three or four cases brought against Peat Marwick at that time; one was *Penn Central*, another one was *Stirling Homex*, another one's name is escaping me at the moment.

KD: There's plenty of them.

TS: Yeah.

KD: Now are you working on trying these cases through the General Counsel's Office?

TS: Well originally the General Counsel's Office would handle some, but not all, of the enforcement cases. There was no Division of Enforcement until around 1974, I think; and the General Counsel's Office was handling at that time cases like the *National Student Marketing* case which came out of the Division of Corporation Finance and the enforcement component of Corp Fin. That was handled by Dick Rowe at the time and Alan Levenson before that. The General Counsel's Office handled at that point the *Texas Gulf Sulphur* case, it handled the *Vesco* case and a number of other cases that for one reason or another were being handled there and before the Enforcement Division was created.

In 1974, I moved to the Enforcement Division and began supervising the *Penn Central* case. I want to say that moves into the early '70s because I want to say the large settlement that the Commission reached with Peat Marwick was in the mid-'70s after I had moved to the Enforcement Division.

KD: *National Student Marketing* starts early and it makes this big splash around '72 or so. But you're still involved in that for years after that?

TS: I was involved in it until it was over. It went through the usual ebbs and flows of litigation. I then learned how long it can take to get a case to trial. This particular case was particularly challenging. The judge—a wonderful judge named Barrington Parker had a terrible car accident in the middle of it and lost a leg, literally crossing Connecticut

Avenue to get a pack of cigarettes, nothing very dramatic, but it stayed with him through the end and he resumed his time on the bench after recuperation and everything else. I think he was actually disappointed when we ended up setting the *National Student Marketing* case against White and Case and had then only the trial of the innocents, as my adversary representing Lord, Bissell, & Brook talked about—actually it was Hogan & Hartson who was my adversary; that’s where I met them for the first time and where I am now.

KD: We’re moving into the ‘70s and it seems like a lot of things happened around ’72. We’re talking about lawyers and accountants. Is there a sense that—that some of these lawyer and accountant cases, something as novel as—and I’m getting the sense that it’s novel—as the *National Student Marketing* case, led to any kind of repercussions within the SEC—changes in approach, anything like that?

TS: Well I think what was happening in the early ‘70s, you have to go back to the times to some extent. You had Watergate taking place; Nixon had been President from 1968 or early ’69 forward and we had Hamer Budge originally as Chairman and then Bill Casey... and I don’t remember—let me say this, Ken: the history of the securities law, you can go back to 1930s, you’ll see that even before the ’34 Act was passed, there’s a lot written about how the legal profession essentially disserved itself and its clients by facilitating various kinds of corporate wrongdoing. There’s a lot of literature, whether you go back to Justice Douglas or other people who recognize that as corporate counsel

they had different kinds of obligations, both to the corporate owner as well as to the managers in how they carried that out and whether they facilitated improper conduct or not.

But the '70s I think gave rise to Watergate; Watergate gave rise to some of the corporate slush funds. Watergate also focused our attention on what we thought were the failures of the accounting profession to do its job which led to a bunch of the Peat Marwick cases. Clearly Sandy Burton as the SEC's Chief Accountant took it upon himself to very conscientiously look at the accounting cases on the merits. I'm not sure that Sandy Burton was unique in that but at that time he was viewed by most of the staff as being unique.

KD: A change from his predecessor?

TS: Yes. I think that Andy Barr had a different sense of how to accomplish the job and didn't see it as consistent with his view and role of the accounting profession to go after them so much as to try to teach them lessons in a different way and I think that came into disarray—disrespect at that point and people felt that more had to be done to convince the accounting profession that they had to be more stand-upish with their clients and say no when they needed to say no.

KD: At this point you're starting to head into your transition from the General Counsel's Office into Enforcement. What was the opportunity, who approached you, and what led to your decision to move?

TS: I'm not sure of the exact sequence, but I remember Stanley Sporkin had become the Director of the Division, I want to say, shortly before I went down there. Stanley had asked me to come down to the Division, I think initially to be head of the Trial Unit and take some of the cases that were in the General Counsel's Office and put them in the Trial Unit. And I can't remember the exact discussion, but it was agreed that I would become an Associate Director in charge of both the Trial Unit and the Chief Counsel's Office, and at that point both of those units reported to me. I was not involved on a day-to-day basis with any of the underlying investigations which were being handled by the other operating branches and the other Associate Directors. I was responsible more for some policy issues and also for the Trial Unit and tried to work around a group of lawyers that had some trial experience and frankly bring on some people who had a lot more experience, which we did over the years.

KD: Can you unpack that a little bit and talk specifically about the function of the Trial Unit within the Division of Enforcement?

TS: Sure. The Trial Unit's principal function was to basically handle cases in two categories. There were a group of cases that it had inherited such as the *National Student Marketing*

case, such as the *Vesco* case, and a number of other cases and it was also charged with picking up cases from the operating units that did not settle. A large percentage of the cases, Ken, settled on the filing of the lawsuit or before. A number of cases didn't settle and we were asked to try those cases and there were a whole series of cases where people in the Trial Unit were responsible for handling the case. We had—I want to say—10 or 15 experienced lawyers, some from private practice, some of them former Assistant US Attorneys, probably most of them are leading members of the Bar today of one sort or another.

Ben Greenspoon had just joined the Trial Unit before I joined it. He was then 10 years older than I. I was 34 at the time and Ben was all of 44, and I now know he's past 70 because I'm past 65. But we hired—there was a fellow there named Bob LaPrade who was the Chief Trial Attorney, a wonderful, wonderful human being. We hired Greg Glynn who was a former Assistant U.S. Attorney from the Central District of California—or Los Angeles, and he picked up the *Vesco* case, which had been handled by a fellow named Bob Kushner in the General Counsel's Office. We picked up Bob Romano and Frank Razzano who were from the New Jersey US Attorney's Office. We picked up a number of other experienced lawyers and we had a pretty good trial shop.

KD: The *Vesco* case, speaking of high profile, and we've got overlap with Nixon here; is this a lawyer and accountant case as well?

TS: It's both a lawyer and an accountant case, but it's more a regulatory case. It was basically alleged that *Vesco* had created in effect an unregistered investment company used to loot a group of mutual funds that were themselves unregistered because they were offshore and there were allegations against three lawyers from Willkie, Farr, & Gallagher, a large firm in New York, involved in that. I don't remember there being any charges against the accountants in that case.

I was not involved in the bringing of the case; I was involved and actually ended up supervising it once it came down to Enforcement in the early '70s. It of course sprang a series of other cases because it was alleged that Mr. Vesco tried to curry political favor with the Committee to Reelect the President and allegedly contributed \$250,000 in a suitcase to Maurice Stans who was then the Chairman of the Committee to Reelect the President. Efforts were made to kill the *Vesco* investigation and we discovered there was \$250,000 missing from the *Vesco* corporate entity and eventually we sent—and I shouldn't say “we” because it wasn't me—Stanley Sporkin was running the case, and they sent a subpoena to the Committee to Reelect the President, which is pretty gutsy. And the story is—and this is all public in the *Watergate* hearings—that John Dean called Bill Casey the Chairman of the SEC at the time, and told him to kill the subpoena.

Casey was smart enough to ask Sporkin what to do and Sporkin allegedly told Casey to call John Dean back and tell him to comply with the subpoena and that some day Casey would thank him. And sure enough that's what happened; and then shortly after Irv

Pollack became a Commissioner after Brad Cook resigned as Chairman and Ray Garrett became Chairman, and John Mitchell and Maurice Stans were indicted for obstruction of justice arising out of the *Vesco* case. And there's a story—I don't know, Ken, whether it's true or not, but I've heard it so many times, I'm not sure I could separate it fact from fiction: Ray Garrett had become the Chairman after Brad Cook had resigned and wanted to try to get the staff's confidence back in the integrity of the Commission.

He thought the best way to do that was to have Irv Pollack appointed as a Commissioner because everyone trusted Irv and knew that if Irv said something was the way it was that everyone believed him and still believes him. And so the story was, or is, Sporkin was up at the Commission table one day and Garrett said to Sporkin, "Would you ask Irv Pollack to come up because today the President is going to send his nomination over to the Senate to be a Commissioner, and I'd like to tell him personally that that's going to happen?" And then Sporkin said quite spontaneously, "Just like Irv, the most important day of his life—he's out working on a case;" and then he proceeded to exclaim, "Oh my God; he's working on an indictment of the Attorney General!" And Ray Garrett said, "Don't worry; we won't tell the President," and sure enough Irv was nominated to be a Commissioner and shortly thereafter, Mitchell and Stans were indicted for obstruction and that was the case that Irv was working on.

KD: That was really a close one.

TS: Yes. Well you had to sense that politics played very little real role in the Commission's business fortunately and that was a good example of it. You just kept your blinders on and just did the right thing.

KD: Others may have had their blinders off at this point because the Watergate investigations turned up all of these contributions to the Committee to Reelect the President and that's where we start to get into the questionable payments cases.

TS: Well the blinders remained on in the sense that I meant it, Ken, in that you did what you thought the law required you to do which is not to play political favorites. And Stanley and I think all of us for the most part were oblivious to politics and did what we thought made sense. Clearly all of us were riveted by the Watergate hearings and the revelations that were coming out about corporate corruption, the millions of dollars that had been contributed in one form or other by some of the best known corporations to the Committee to Reelect the President.

At one point, Vic Earle who was the General Counsel of Peat Marwick and who had become a friend at the time told me a story about how Peat Marwick had been approached to make a contribution to the Committee to Reelect the President and Vic said to me, "Politics aside, we just don't do that." He told that to the person who called him and the person who called him said, "Everybody is doing it, including the largest

corporations in the United States.” And he said, “Well everybody could be doing it, but we’re not.”

And as it turned out—and Vic and I used to chat about this—the biggest ones got it, too. And so you read about American Airlines, you read about Philips Petroleum, the case involving George Steinbrenner and others. And so there were about a handful of cases and at one point, I think Stanley was listening to the hearings, as we all were, you would go home at night and listen to the hearings or listen to the replay of the hearings that had taken place during the day, and it was clear that these contributions were being made by some of the allegedly finest corporations in America and being done through some fairly circuitous accounting devices with secret slush funds and off-the-book transactions and Swiss accounts and Bahamian accounts and other kinds of things.

And so at one point, Stanley called a meeting of a group of us - I think Alan Levenson joined the group - and we started to brainstorm about “how can they be doing this,” and someone came up with the idea that they had to be falsifying books and records and there has to be a system of accountability. And the form of accounting that the Commission required called for accounting for assets and liabilities and if you didn’t have a strict accounting for that, how could you have accurate books and records? That was a notion that was fairly alien at the time because you had the notion of books and records with registered brokers, dealers, and investment companies, but not with corporate issuers and

nobody really thought that Section 13(a) of the '34 Act could be broadly read to say that the books and records of the corporation had to be accurate.

It seemed to be a natural, logical consequence of saying that you had to file accurate corporate reports, but the notion that you had to have accurate books and records was something that was perceived of, at least initially, as something more— more a problem for the accountants who were certifying the financial statements than for SEC jurisdiction. Some of us were very skeptical about it and I include myself in that. It wasn't clear to me that we weren't piling on something that really didn't need piling on. Of course, I wasn't smart enough to know that we had struck gold and we started to make some phone calls.

We—it wasn't me making the phone calls—but people in the Enforcement Division started to make phone calls. We'd start to ask for records from the companies that had admitted that they had made bribes—a lot of them questioned our jurisdiction but provided us with information. I think Levenson deserves credit for creating this voluntarily disclosure program, which turned up literally hundreds of companies—the biggest companies in the country if not the world—with millions and millions of dollars in foreign payments, which ultimately led to the Foreign Corrupt Practices Act. I mean some of them were staggering.

There were stories about one large company, one multi-national company I won't even mention, but they initially came in as part of the voluntary program and said, we've got this slush fund in Italy. We think it's less than a half million dollars. We're following it up and get back to you. And clearly a half million dollars for this company was not material or at least not as it was conceived of. A couple weeks later we get a report that it was a couple million dollars, not a couple hundred thousand, and then it turned out to be tens of millions and then it turned out to be hundreds of millions.

KD: That's material.

TS: We started to think about materiality in a number of different ways. There was always a question about "how material was something from a numerical point of view?" and even today you can see the debate in the Commission's current releases about whether there is some threshold. I've always understood that, at the Commission, there was no mechanical rule. A lot of the accounting profession thought that a five percent rule existed and if it was less than five percent of something it wasn't material. The Commission, I thought, always consistently rejected it but it depended on where it was.

I always thought of material as going beyond that and I think Sporkin and Levenson and the rest of us thought that it was more. We talked about it in terms of how it would impact on the business of the company. For example, if you had to bribe your customers or the personnel of your customers whether it was selling aircraft engines or selling

widgets in order to market them, that was material for an investor who is going to put his money into the enterprise to know that the only reason we have so many sales is because we sell whatever it is—aircraft, television sets, or oil or whatever—abroad or we buy it abroad and the only way we do it is we do it through corrupt practices.

And so that was considered material in the sense that there was a threshold of materiality on a financial level in a numbers sense but there was also a threshold; it also went to the materiality in terms of the integrity of management, the accuracy of the books and records, the business practices and risks. If you had a sizeable amount of sales in some Latin America country that was at threat of being expropriated because the local government discovered that you have been corrupting some of their officials that was material. I got involved in the ITT case. There were questions on all sorts of shenanigans going around that case but one of them was the threat that the foreign officials would be killed if the company disclosed to us the names of the foreign officials and went through various stages of that.

I can't remember which country it was—whether it was Libya or Eastern Europe or whatever, but we were told that they couldn't give us the names or even the amounts because it would bring death and destruction to these people. I don't remember a case where we brought a case against a lawyer or an accountant for foreign corrupt payments at that time.

KD: Your discussion of what's material and what's not seems to depend on interpretation, and you're talking about interpretation that's going on within the Commission. Would the companies on the other hand say to you "well how do we know where you draw the line? We want guidelines."

TS: Ken, there was almost universal condemnation of the Commission's notion that they determined issues of materiality on an ad hoc basis. "We always want guidelines. Give us a rule; we'll follow the rule." But the fact is that we couldn't come up with a rule. We came up with so many different situations. Materiality has now been defined by the Supreme Court in a particular way out of the *TSC v. Northway* case. If you go back to the *Texas Gulf Sulphur* case, if you go back to *National Student Marketing*, everything is a question of what's material, that's the definition of the statute.

And what's material, you can talk about it as being important, you can talk about it as significant, you get into some fancy legal arguments about whether something is material or not. But clearly the securities laws don't define what a company has to say in its annual report. It simply says "describe your business"—in its simplest terms. Obviously I'm oversimplifying it but in the MD&A, the management discussion and analysis, you're supposed to describe your business. You're supposed to describe known trends and uncertainties. That's a phrase out of Regulation SK that's been there for 20—30 years if not more in one form or other.

Well, what's the uncertainty? Well if you sell products abroad in a corrupt manner, there's an uncertainty about your income stream. If you only sell power plants in the third world by bribing the President in the third world country there is uncertainty. If you're raising money from the public it doesn't take a rocket scientist to say you ought to tell them about that. If you can only open a power plant in you know wherever—that's where you ought to be doing it, so you know what's material? Well, look at the company, look at the financial statements, look at its product, and if you can only sell product through some extraordinary means it seems to me it's pretty clearly material.

KD: Moving our way through the '70s, you talked about the questionable payment issues, and you briefly mentioned the voluntarily disclosure approach which came a few years later. My understanding is part of the idea was that you were simply getting too busy to handle it yourself.

TS: Well first of all; let me back up. The Voluntary Disclosure Program came almost at the same time, at least the way I remember it, as the Watergate hearings. The Watergate hearings really started in '73. The Voluntary Disclosure Program was essentially completed by the time that the Foreign Corrupt Practices Act was enacted in 1977 and there was a report to Congress in 1976 that summarized the then status of the so-called Voluntary Disclosure Program. There's always a judgment that you make in law enforcement, particularly when you're dealing with the white collar kind of problem,

about how much you should do as opposed to how much you should encourage other people to do.

If you go back to the access theory that really was Sporkin's theory, I think, and Irv Pollack's theory about how to increase the effectiveness of the Commission's Enforcement Program. It was conceived of that you needed to create incentives to the people who were at the access points to the market—those were conceived of as the brokers/dealers of the world, the investment bankers of the world, the lawyers and the accountants—and encourage them to police themselves.

So for example, I can't think of which piece of legislation it is, but somewhere in the '70s I believe—maybe it's even in the '60s, broker-dealers were asked to accept the duty of supervision and the way that supervision worked is the Congress recognized—this was essentially Commission policy—that you couldn't police every broker/dealer, every salesman who was trying to peddle some stock. So you said to the Merrill Lynch's of the world, "it's your duty to supervise those people. If they work under your name and in your office, you have a duty to supervise them. You set up a policing mechanism that provides for supervision of Joe Q. Crook and police him, and if you discharge those responsibilities then we won't hold you responsible; we'll hold him responsible."

That's part of the duty to supervise that exists in the statute. And that relates primarily to broker/dealers. It's been extended now to most areas, but the fact is that its the same

notion: provide a financial institution, provide a law firm or an accounting firm with a duty to supervise its people, and if you do your job, we won't have to do it for you, and so you bring to us the problem children, tell us when someone has stolen money from one of your customers, someone has falsified financial statements... restate the financial statements, take corrective action.

Today, we talk, Ken, about the so-called Seaboard Release and the factors that were advertised just before the collapse of Enron which is still being used, but that wasn't new. You can argue about whether there are any new factors in it, but the Commission has always, as I think any law enforcement agency does, give people credit for doing the right thing. And so if you find a problem and we recognize that there are problems whether it's in the foreign corrupt practices area or otherwise—fix it. Tell us you fixed it; we'll give you credit for it. If we knock on your door—that is if the Government knocks on your door and tells you to fix something, you get less credit than if you find the problem and fix it on your own.

And so what the Voluntary Disclosure Program was—was to let people know, let companies know that we thought that there was a high likelihood that there was a problem in a significant number of companies. It turned out we were right about hundreds of companies, to the tens of millions or hundreds of millions of dollars. And so we said clean up your act. Clearly we had more cases than we could bring, but it clearly is better to ask the industry, whatever you want to call the industry, to correct itself rather

than—and then turn over the work product and you don't get immunity from that but if you did a responsible job you got credit for that and that credit was there and it was given out.

KD: Did that program wind down as a matter of course or were the brakes put on at some point?

TS: Probably a little of both. I don't think of anything actively happening in terms of there being brakes. The Congress passed the Foreign Corrupt Practices Act in 1977 and at that point in time I think it was universally accepted, certainly in the United States, that we should not be promoting corruption. We as a country should not be promoting corruption around the world any more than we wanted to promote corruption in Maryland or New Jersey or New York; we weren't going to promote corruption as a way to do business anywhere in the world. That was, I think, a significant step in corporate transparency and something that at first the business community was reluctant to accept but Congress made it public policy and I think most public corporations said we'll comply.

KD: How active was the SEC in some of the hearings that were going on? There was a Senate Subcommittee; there was a House Subcommittee, all moving toward this.

TS: Oh yeah; the Commission was as active as could be. I mean I wasn't actively involved in that, but it's clear from the hearings that there were various—I want to say that both

Harold Williams and Rod Hills, and I think Bill Casey to some extent, were involved in that. Casey had left by then, but I know the Commission or the staff put together a report in 1976 which pulled together the then pending cases, cataloged where they were, and supported the legislation. I want to say it was largely the result of Congressman Moss and Senator Proxmire, at least the way I remember it.

KD: Was it your sense that the SEC was out in front of this or coming up behind on this issue?

TS: I think the Commission was in front of this. There are very few situations I can think of Ken—certainly during my period—where the Congress has been ahead of the Commission. Whether you look at Sarbanes-Oxley, it's a little of carrot and stick, but at the same time, the Commission didn't create Enron or World Com; they collapsed because there were major restatements of financial statements and what created those particular ones, the Congress followed with Sarbanes-Oxley. The Foreign Corrupt Practices Act clearly was a result of the Commission being ahead of the curve and then at the same time asleep at the switch.

I mean you can argue, well, why did it take you 30 years to figure out that there was political corruption at the highest level with the largest corporations; was that unknown? And I think you have to go back to what has evolved today into a form of federal corporate governance from what was a very different climate. If you go back—I'm not sure about my dates, but when I joined the Commission in the mid-'60s, corporate issuers

weren't required to register with the Commission unless there were certain reporting obligations or they were listed on the New York Stock Exchange.

And Nasdaq didn't exist. There was something called the Over the Counter Market and it wasn't regulated very heavily and over a period of the last 40 years you have an acceptance by the Congress of the notion that these are public companies using public monies and they have an accountability that's required of them. That didn't happen just in *Sarbanes Oxley* but it was an evolution that went forward and many times people would say "oh that's state law; it's governed by state law. The SEC has no business in it." You don't hear that too often today.

KD: I've heard the '70s—somebody described that as something of a golden age for the Division of Enforcement certainly and for the SEC in some sense. I mean you are in a period where the role of the corporation in the American society is more in question probably than in any time since the '30s and the SEC is right in the middle of it as you described. From your position, you were working inside, was there a sense that this was the case and is there a sense that the Commission was leading this?

TS: I certainly think it was one of the Commission's finest moments. Whether it was the golden age as distinguished from other periods, I think of the Commission as having any number of golden ages so to speak. I think that I look at the Enforcement Program today, post-Sarbanes Oxley, and I certainly think that it has a very robust and effective

Enforcement Program and some people would say as they said when we were there, “it’s too robust and it’s too effective and it’s too harsh and it’s a lot of other things” and I might say that myself in a particular case, but I think that the Commission has historically had a very small Enforcement Program. It’s a very small agency; I remember when I started, I think it had less than 2,000 employees, which was miniscule by government standards.

I was amazed how effective 2,000 people could be and how many headlines you could grab and for what purpose. I always thought that its golden age was its political independence and its lack of involvement in the politics of the day no matter who was President. Everyone tried to influence in one way or another, but staff usually did the right thing no matter who was the President, and I don’t think that’s changed.

I think it was a golden age in the sense that this was the age when Stanley Sporkin led the Enforcement Division and led a very effective Enforcement Program—probably one of the finest Enforcement Programs that the Commission or any government agency has had. But I think that doesn’t diminish the fact that as the Commission has gone through the ‘80s and the ‘90s and now the first decade of the 21st Century, I think that it’s got equally important challenges. You can take a look at different things that have been highlights, but you think about how many billions of shares are traded now and what was considered small amounts then, the age of the computer has made it possible for us to do this all electronically. We had back office problems in the ‘60s and ‘70s; they couldn’t

handle a couple million shares a day. And I think it's a credit to the agency and its personnel that they've been able to be as responsive to it.

KD: We come back to the lawyers again with the *Carter Johnson* case, and it must have seemed different to you from some of those early cases you've discussed because by this time you've got access theory having been developed during the '70s. And so the implications of bringing action against lawyers must have seemed a little bit more than just this one-off approach.

TS: Well you know, Ken, *Carter Johnson* is not really a question of the access theory; *Carter Johnson* raises the question of what is a lawyer's role when he or she or his or her law firm finds itself in a situation where they give good advice to the client and the management chooses to ignore it by continuing to violate the securities laws? And oversimplifying *Carter Johnson* a bit, you have a series of public statements being made by management that are essentially being ignored by—I'm sorry; you have a series of public statements being made against the advice of the lawyer, and the lawyer's advice being ignored, and ultimately it being perceived of that the lawyer's role is acquiescence if you like.

And so the Commission staff came up with a theory that it was incumbent upon the lawyer to go to the Board of Directors. This came out of some of the ethical rules that were then in effect that was then called the model code and it had a provision that talked

about the lawyer having an obligation when he or she works for a public company to go to the Board of Directors and apprise them of certain things that might be viewed as injurious to the corporation, one of which in *Carter Johnson* being the violation of the securities laws by the management in the face of and in defiance of the advice of the law firm. And the staff put forth that position and litigated it and convinced an administrative law judge that indeed that was the requirement. That was appealed to the Commission; if I remember correctly, the Commission punted.

The Commission decided they weren't going to decide the issue. They decided that it was not incumbent upon them to set professional standards for the legal profession, that the case itself had brought enough attention to the issue and therefore it was not necessary for the Commission to spell out what the professional obligations of lawyers were. It was also accompanied by—I'm not sure of the sequence but there was a fairly celebrated case brought against a fellow named George Kern at the same time who was a partner of Sullivan and Cromwell that raised similar issues about what is a lawyer's role and responsibility. And the Commission there, too, decided that they would not promulgate specific rules or regulations and didn't really think it was incumbent upon them nor was it their place, recognizing that basically lawyers are licensed by the state authorities rather than by the federal government.

And the regulation of lawyers in a sense took a backseat for a number of years as different things evolved. Some of that I frankly attribute to changes in personnel. Ed

Greene, who became the General Counsel, made a speech in which he essentially said, “We’re going to leave lawyers alone.” He didn’t quite say it that way but that was the thrust of it. And there were very few lawyer cases brought. I think that Ed thought that was appropriate under the circumstances and I think he said just a few weeks ago at the SEC Speaks pretty much the same thing, although he would have phrased it differently. Certainly, the effort to go after major lawyers and partners of major firms pretty much stopped for a while.

KD: Did the Reagan Administration coming in and making some personnel changes—did that have something to do with this?

TS: I don’t think that either the Reagan Administration or the Bush Administration—either the first or the second Bush Administration. Really I don’t think that was part of their agenda. I respect Ed Greene; I think the world of him as a lawyer. I think he had a different approach. Bill Casey came in, he had three assistants who were all from Wall Street firms. And some of them I was able to convince that *National Student Marketing* made sense and some of them I wasn’t.

I worried about their putting a kibosh on it and was pleasantly surprised when they turned out to be open-minded and willing to listen to the arguments and make decisions, and I found them to be generally supportive, and I think that’s true for the most part. If anything, now, today in 2005 you have a Congressional mandate in Sarbanes-Oxley,

which calls for the Commission to regulate lawyers who practice before it - plain and simple. And now the Commission is confronted with, and remains confronted with, the issue of whether to memorialize the so-called “Blow the Whistle” concept that is embodied in the *National Student Marketing* case, which really hasn’t been accepted by the legal profession since 1972.

The accounting profession in 1995 with the enactment of the Securities Litigation Reform Act, and specifically Section 10A, was mandated to blow the whistle on its clients.

Meaning that if the accountants tried to correct a situation and couldn’t get the management to correct it and couldn’t get the Board of Directors to correct it they had an obligation to come to the Commission and report the misconduct to the Commission.

After Sarbanes-Oxley, the Commission proposed what really is the “Blow the Whistle” rule for lawyers. The Commission got a boat-load of adverse comments about it and concluded not to adopt it, but hasn’t abandoned it. It is still I think a live rule proposal that they might come to, but they probably don’t need to deal with—I think that the current climate is such that the Commission has for all practical purposes told the legal profession that that’s what they expect of them.

KD: So this is the issue, essentially, I guess, that had been dropped with *Carter Johnson*?

TS: I don’t think it was dropped with *Carter Johnson*. I think that *Carter Johnson* was an abandonment of a particular approach to the practice of law. I think that most corporate

lawyers both in *Carter Johnson*, before *Carter Johnson* and afterwards recognized that they represented the corporation and not just the management and indeed if the management decided to do something stupid they had a duty to report it. It doesn't take a lot of ethics to figure out that if you have a CEO who is stealing money from the corporation, you have a duty to report it. And even if it's your best friend and he's hired you; if he says to you, "You know I've been taking \$100,000 out of the kitty every year without any vouchers or any support," you've got an obligation to report that to someone. And you can't let that continue.

KD: Well by the time that these things were worked out, you would have left the SEC and moved onto the Federal Energy Regulatory Commission. What was behind that decision?

TS: Oh, pretty simple. Well a couple things happened; Roberta Karmel became a Commissioner. I dearly love Roberta—have known her for years; she had a style about her that was very antagonistic. I was convinced at some point that either she would leave or Stanley Sporkin would have a heart attack. I went to many Commission meetings with great frustration. We had a long trial in the *National Student Marketing* case. I thought we had won the case. The Court had bought most of our legal theories, and then I heard Roberta suggest at a Commission meeting, sometime in the late '70s, that we ought to confess error in the Court of Appeals and I thought that was a ghastly idea.

Fortunately, she was only a voice of one; the Commission didn't do that, but I could see that things were becoming very divisive. What happened is a good friend of mine, a fellow named Charlie Curtis, who had been on the staff of the Commission years and years back and had gone to the Hill, because the Chairman of FERC. He became the Chairman of FERC under the Carter Administration, and he had tried to set up an Enforcement Program at FERC. The first Enforcement Director got herself into a fair amount of trouble and Charlie said, "She's left and would you like to try to come over and help?" It sounded like a challenge; I had no idea whether Carter was going to get reelected, but it sounded like a good way to move on, and so I moved on and that was why I left. And I was afraid Stanley was going to get carried out with a heart attack from Roberta.

KD: That eventually didn't happen.

TS: No.

KD: Looking back, it looks like the idea of the lawyers and accountants cases, which is something we started at and something we ended it with, was something of a common thread. How did you see that change over the years and what would you like to have remembered for your contribution?

TS: I'd like to think that my contribution was in some small part responsible for bringing better practices to both the accounting and legal professions. I think that the fact that we continue to see regular failures by lawyers and accountants even today means that I've only made a small dent in that—if at all. I take some comfort in the fact that Congress has finally decided to give the Commission express statutory authority over both the lawyers and the accountants. At the same time, I frankly think it's a terrible idea. I mean that. I feel less so about it for the accounting profession, but as a lawyer, I find myself both in private practice and in government you are in a sense—you have an enormous amount of power, you have an opportunity to abuse it; you try to be conscientious; the people that keep you honest are the lawyers on the other side and I know that from my own experience.

I see too many cases where the government has over-reached for one reason or another; it happens today, it happened when we were there. I was horrified to find situations where cases were brought against individuals and I or somebody on my staff was responsible for trying the case, and low and behold there was no evidence. It wasn't that somebody was mean and vindictive or corrupt; it meant that somebody hadn't done a very conscientious job of going through and finding out what the evidence was against a particular individual and that was a tragedy.

KD: You were just bringing a little bit of perspective on the fact that having the government set standards for lawyers—there could be a downside to this as well as an upside.

TS: Right, right.

KD: Probably not something that you dwelled on during your time with the SEC.

TS: No, I did—a fair amount. I don't think it's changed. My job hasn't changed. I do as much, Ken, on the defense side as I did as a prosecutor, because if I'm hired by an audit committee or a public company and I've got to decide whether to fire somebody or do something worse, it doesn't change. I just think that—I'll tie it up, but the concluding thought is you see people who are still being detained in Guantanamo and haven't had a hearing, and I don't care what the politics of it are—at some point the system has got to deal with that. You still have the same problem. Is there enough evidence against them, and I don't think that the country is better off having the SEC or any other government agency regulate the conduct of lawyers because it's subject to abuse that's all.

KD: I guess we might see how it goes to some extent with Sarbanes-Oxley. Well thank you very much for talking to me.

TS: Thank you.

[End of Interview]