

Enforcement

The SEC's enforcement program seeks to promote the public interest by protecting investors and preserving the integrity and efficiency of the securities markets.

What We Did

- Obtained orders in SEC judicial and administrative proceedings requiring securities law violators to disgorge illegal profits of approximately \$1.293 billion.
- Civil penalties ordered in SEC proceedings totaled approximately \$101 million.
- Sought orders barring 126 defendants from serving as officers or directors of public companies.
- Sought emergency relief from federal courts in the form of temporary restraining orders (TROs) to halt ongoing fraudulent conduct in 48 actions, and sought asset freezes in 63 actions.
- Filed 19 actions to enforce investigative subpoenas.
- Halted trading in securities of 11 issuers about which there was inadequate public disclosure.
- In SEC-related criminal cases, prosecutors filed indictments, informations, or contempts against 259 individuals or entities.

Enforcement Actions Initiated

	<u>FY98</u>	<u>FY99</u>	<u>FY00</u>	<u>FY01</u>	<u>FY02</u>
Civil Injunctive Actions	214	198	223	205	270
Administrative Proceedings	248	298	244	248	280
Contempt Proceedings	15	29	36	31	47
Reports of Investigation	0	0	0	0	1
Total	477	525	503	484	598

Significant Enforcement Actions

Most of the SEC's enforcement actions were resolved by settlement with the defendants or respondents, who generally consented to the entry of judicial or administrative orders without admitting or denying the allegations against them. The following is a sampling of the year's significant actions.

Financial Fraud and Disclosure

- *SEC v. Dynegey Inc.*¹ The Commission filed and settled a civil action against Dynegey Inc., a Houston-based energy production, distribution, and trading company. The Commission's action arose from (1) Dynegey's improper accounting for and misleading disclosures relating to a \$300 million financing transaction, known as Project Alpha, involving special purpose entities, and (2) Dynegey's

overstatement of its energy-trading activity resulting from “round-trip” or “wash” trades--simultaneous, prearranged buy-sell trades of energy with the same counterparty, at the same price and volume, and over the same term, resulting in neither profit nor loss to either transacting party. Dynegey agreed to pay a \$3 million penalty in the civil action and, simultaneously, consented to the entry of an order in related cease-and-desist proceedings.

- *SEC v. L. Dennis Kozlowski, et al.*² The Commission filed an action against three former top executives of Tyco International Ltd., alleging that they failed to disclose the multi-million dollar, low-interest and interest-free loans they took from the company. L. Dennis Kozlowski, the former chief executive officer and chairman of Tyco’s board of directors, and Mark H. Swartz, the former chief financial officer and a director, granted themselves hundreds of millions of dollars in secret low-interest and interest-free loans from the company, and used the proceeds for personal expenses. They then covertly caused the company to forgive tens of millions of dollars of those outstanding loans, again without disclosure to investors as required by the federal securities laws. In addition, they engaged in other undisclosed related party transactions that cost shareholders hundreds of thousands, if not millions, of dollars. Mark A. Belnick, the former chief legal officer, failed to disclose the receipt of more than \$14 million of interest-free loans from the company to acquire two residences, an apartment in New York City and a \$10 million home in Park City, Utah. Kozlowski, Swartz, and Belnick also sold their shares of Tyco stock valued at millions of dollars while their self-dealing remained undisclosed.
- *SEC v. Michael J. Kopper.*³ The Commission filed and settled a civil action against Michael J. Kopper, a former high-ranking official of Enron Corp., alleging that Kopper and others used complex structures, straw men, hidden payments, and secret loans to create the appearance that certain entities that Kopper and others at Enron funded and controlled were

independent of Enron, thereby allowing Enron to move its interests in these entities off its balance sheet. Kopper agreed to an injunction and an officer and director bar, and, subject to the court's approval, to disgorge and forfeit a total of approximately \$12 million. Kopper also agreed to enter a guilty plea in related criminal proceedings filed by the U.S. Department of Justice.

- *SEC v. Adelphia Communications Corporation, et al.*⁴ The Commission filed a civil action against Adelphia Communications Corporation, its founder, John J. Rigas, his three sons, and two senior Adelphia executives. The Commission alleged that Adelphia fraudulently excluded billions of dollars in liabilities from its consolidated financial statements by hiding them in off-balance sheet affiliates; falsified operations statistics and inflated earnings to meet Wall Street's expectations; and concealed rampant self-dealing by the Rigas family, including the undisclosed use of corporate funds for the family's stock purchases and the acquisition of luxury condominiums.
- *SEC v. WorldCom, Inc.*⁵ The Commission filed a civil action charging WorldCom, Inc. with a massive accounting fraud totaling more than \$3.8 billion. The Commission's complaint alleges that WorldCom fraudulently overstated its income before interest, taxes, depreciation, and amortization by approximately \$3.055 billion in 2001 and \$797 million during the first quarter of 2002. In a related administrative proceeding, the Commission ordered WorldCom to file with the Commission, under oath, a detailed report of the circumstances and specifics of these matters.
- *SEC v. Frank M. Bergonzi, et al.*⁶ The Commission filed accounting fraud charges against three former senior executives of Rite Aid Corporation. The Commission also instituted separate settled cease-and-desist proceedings against Rite Aid and its former president and chief operating officer, Timothy J. Noonan.⁷ The Commission alleges that

the executives conducted a wide-ranging accounting fraud scheme that resulted in the significant inflation of Rite Aid's net income in every quarter from May 1997 to May 1999. After the discovery of improper and unsubstantiated accounting transactions, in July and October 2000, Rite Aid restated cumulative pretax income by a massive \$2.3 billion dollars and cumulative net income by \$1.6 billion dollars.

- *In the Matter of Microsoft Corporation.*⁸ The Commission instituted and settled administrative proceedings against Microsoft Corporation, finding that, between 1994 and 1998, Microsoft maintained between approximately \$200 million and \$900 million in unsupported and undisclosed reserves, a significant portion of which did not comply with U.S. Generally Accepted Accounting Principles (GAAP), which resulted in material inaccuracies in filings made by Microsoft with the Commission.
- *SEC v. Xerox Corporation.*⁹ The Commission filed and settled a civil action alleging that, from at least 1997 through 2000, Xerox Corporation employed a variety of undisclosed accounting actions to meet or exceed Wall Street expectations and disguise its true operating performance from investors. These actions accelerated Xerox's recognition of equipment revenue by over \$3 billion and increased its pre-tax earnings by approximately \$1.5 billion over the four-year period. In addition to an injunction, Xerox agreed to pay a \$10 million penalty, the largest ever levied in a Commission action against a public company for financial fraud.
- *SEC v. Alan K. Anderson.*¹⁰ In the action against Alan K. Anderson of Quintus Corp., the Commission alleged that the defendant personally forged contracts, e-mails, purchase orders, letters, and an audit confirmation in order to boost his company's financial results, creating three fake transactions adding up to \$13.7 million in nonexistent sales.

- *In the Matter of ACLN Limited.*¹¹ The Commission ordered a temporary suspension in the trading of ACLN Limited, a company located in Cyprus and Belgium, citing serious questions about the accuracy and completeness of the company's financial statements and disclosures. ACLN's shares were traded on the New York Stock Exchange. This was the first trading suspension of an exchange-listed company in more than 20 years.
- *SEC v. Kenneth E. Kurtzman, et al.; In the Matter of Ashford.com, Inc., et al.*¹² The Commission filed a settled civil action against the former chief executive officer and the former vice president for finance of Ashford.com; without admitting or denying the allegations in the Commission's complaint, the defendants agreed to pay civil penalties of \$60,000 and \$25,000, respectively. The Commission also filed and settled cease-and-desist proceedings against those individuals, Ashford.com, and Amazon.com, Inc. Ashford.com improperly deferred \$1.5 million in expenses under a contract with Amazon.com, causing Ashford.com to just beat analysts' pro forma earnings estimates (of a loss of \$0.31 per share) for the quarter ended March 31, 2000. The improper deferral resulted from the settlement of a dispute with Amazon.com using two separate documents prepared by Amazon.com at Ashford.com's request, only one of which was disclosed to auditors.
- *In the Matter of Kimberly-Clark Corporation, et al.*¹³ The Commission instituted settled cease-and-desist proceedings against Kimberly-Clark Corporation and its chief financial officer, alleging inaccurate annual financial statements filed by Kimberly-Clark for the years ended December 31, 1995 through December 31, 1998, and quarterly financial statements from March 31, 1996 through the quarter ended March 31, 1999. These inaccuracies arose in connection with a \$1.44 billion charge for restructuring and other unusual charges that Kimberly-Clark recorded after its merger with Scott Paper Company in December 1995. Kimberly-Clark

materially overstated this restructuring charge by accruing \$354 million of merger-related expenses (about 25 percent of the \$1.44 billion charge) that did not constitute restructuring liabilities under GAAP. In 1999, after discussions with the Commission's Division of Corporation Finance, Kimberly-Clark voluntarily restated its financial statements.

- *SEC v. Dean L. Buntrock, et al.*¹⁴ The Commission filed a complaint charging the founder and five other former top officers of Waste Management, Inc. with perpetrating a massive financial fraud, lasting more than five years, in which the company overstated its pre-tax earnings by \$1.7 billion. The Commission alleged that the defendants engaged in a systematic scheme to falsify and misrepresent Waste Management's financial results and to enrich themselves and keep their jobs. The Commission is seeking injunctions; officer and director bars; disgorgement of options, bonuses, performance-based compensation and proceeds from stock sales; and civil penalties.
- *SEC v. Roys Poyiadjis, et al.*¹⁵ The Commission filed a civil action against AremisSoft Corporation and two former officers alleging that they overstated the value of the company's contracts, revenues and recent acquisitions, and that the two former officers engaged in massive insider trading during the period of the reporting fraud. The court ordered a freeze of any funds or assets of the two officers and two relief defendants, and ordered repatriation of all such funds and assets that had been moved offshore. Upon motion of the Commission, \$175 million was frozen by the courts in the Isle of Man in connection with this matter. Subsequently, AremisSoft was permitted by the bankruptcy court to settle this case, consenting to the entry of an injunction and an administrative order revoking the registration of its common stock.

Auditor Independence

- *PricewaterhouseCoopers LLP, et al.*¹⁶ The Commission filed a settled administrative proceeding against Pricewaterhouse-Coopers LLP (PwC) and its broker-dealer affiliate for violations of the auditor independence rules. The Commission charges that PwC used prohibited contingent fee arrangements with 14 different audit clients for which its broker-dealer affiliate provided investment banking services, and that PwC participated with two other audit clients, Pinnacle Holdings, Inc. and Avon Products, Inc., in the improper accounting of costs that included PwC's own consulting fees. Because of its independence violations, the firm caused these 16 public audit clients to file false and misleading financial statements with the Commission. PwC and its affiliate agreed to pay civil penalties of \$5 million. PwC also agreed to comply with significant remedial undertakings, to cease-and-desist from violating the auditor independence rules and to be censured for engaging in improper professional conduct. In related enforcement actions, settled cease-and-desist orders were entered against Pinnacle Holdings, Inc. and Avon Products, Inc.; the financial statements of both companies were restated.¹⁷
- *In the Matter of KPMG, LLP.*¹⁸ The Commission instituted settled administrative proceedings censuring KPMG LLP based on its improper professional conduct in conducting an audit of a client in which KPMG had invested through the client's money market fund.
- *In the Matter of Moret Ernst & Young Accountants.*¹⁹ The Commission instituted settled administrative proceedings against Moret Ernst & Young Accountants, an accounting firm based in the Netherlands. Moret audited the financial statements of a major client at a time when consultants affiliated with Moret had joint business relationships with the same client, thus impairing Moret's independence as auditor. The Commission also instituted administrative proceedings against Ernst & Young LLP, alleging that Ernst & Young's

joint business relationships with PeopleSoft Inc. from 1994-2000 violated auditor independence requirements.²⁰

Foreign Payments

- *SEC v. Douglas A. Murphy, et al.*²¹ The Commission filed a civil action against two former officers of American Rice, Inc., alleging that they authorized over \$500,000 in bribery payments to Haitian customs officials to reduce American Rice's import taxes by approximately \$1.5 million.
- *In the Matter of BellSouth Corporation; SEC v. BellSouth Corporation.*²² The Commission instituted settled cease-and-desist proceedings against BellSouth Corp. and obtained an order directing it to pay a \$150,000 penalty based on its improper recordation of payments relating to its expansion into Venezuela and Nicaragua.

Regulated Entities

- *SEC v. Credit Suisse First Boston Corporation.*²³ The Commission filed a complaint against Credit Suisse First Boston Corporation (CSFB), a New York-based brokerage firm and investment bank, alleging that, in exchange for shares in "hot" initial public offerings (IPOs), CSFB wrongfully extracted from certain customers a large portion of the profits that those customers made by immediately selling their IPO stock. The profits were channeled to CSFB in the form of excessive brokerage commissions generated by the customers in unrelated securities trades that the customers effected solely to share the IPO profits with CSFB. CSFB agreed (1) to pay a total of \$100 million in the Commission's action and in a related action by the National Association of Securities Dealers Regulation, Inc., (2) to be enjoined by a federal court from future violations, and (3) to adopt extensive new policies and procedures.

- *SEC v. Frank D. Gruttadauria, et al.*²⁴ The Commission filed an action charging Frank D. Gruttadauria, formerly the branch manager for the Cleveland Ohio office of Lehman Bros. Inc., with securities fraud, alleging that over the last six years, while he worked at two different brokerage firms, Gruttadauria stole at least \$40 million in the course of defrauding more than 50 clients. The Commission promptly obtained a temporary restraining order and an asset freeze. A preliminary injunction was subsequently entered against Gruttadauria.
- *In the Matter of iCapital Markets LLC.*²⁵ The Commission instituted settled administrative proceedings against iCapital Markets LLC (formerly Datek Securities Corporation) finding that Datek had fraudulently misused the Nasdaq Stock Market's Small Order Execution System, an automatic trade execution system for small retail customer orders, by executing millions of proprietary trades, resulting in tens of millions of dollars in illegal trading profits for the firm. The firm was censured and ordered to pay a penalty of \$6.3 million.

Insider Trading

- *SEC v. Samuel D. Waksal.*²⁶ The Commission filed an insider trading action against Samuel D. Waksal, the former CEO of ImClone Systems, Inc. The Commission charges that Waksal, having received news that the Food and Drug Administration was about to reject ImClone's pending application to market a cancer treatment, tipped this information to family members who sold more than \$10 million of ImClone stock before the news became public. Waksal also tried to sell \$5 million of his own holdings of ImClone stock, and was unable to do so only because two different broker-dealers would not execute his orders. The Commission's investigation is continuing.

- *SEC v. Hugo Salvador Villa Manzo, et al.*²⁷ The Commission filed and settled an insider trading action against Hugo Salvador Villa Manzo, a Mexican businessman, and Multinvestments, Inc., a U.S. broker-dealer based in San Antonio, Texas. The Commission's complaint alleged that the defendants engaged in highly lucrative insider trading prior to the June 28, 1999 public announcement that Nalco Chemical Company would be acquired by Suez Lyonnaise des Eaux, a French company. Villa received information about the proposed acquisition from Jose Luis Ballesteros, a director of Nalco, and instructed one of his senior colleagues at Multinvestments to buy Nalco stock for Multinvestments' proprietary account. Multinvestments purchased 50,000 Nalco shares for \$2,015,625. Following the announcement of the acquisition, the defendants realized unlawful profits totaling \$558,750. Without admitting or denying the Commission's allegations, Villa and Multinvestments consented to pay a total of \$1,503,471.83, representing disgorgement of \$558,750, prejudgment interest in the amount of \$106,596.83, and a one and one-half time penalty of \$838,125.