



REPORT OF INVESTIGATION

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
OFFICE OF INSPECTOR GENERAL**

**Investigation into Allegations of Improper Preferential Treatment and
Special Access in Connection with the Division of Enforcement's
Investigation of Citigroup, Inc.**

Case No. OIG-559

September 27, 2011

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Table of Contents

Introduction and Summary of Results of the Investigation	1
Scope of the Investigation.....	2
Relevant Statutes, Regulations and Policies	4
Results of the Investigation.....	5
I. The Enforcement Staff Investigated Citigroup and Considered Various Charges and Settlement Options.....	5
A. The Enforcement Staff Opened an Investigation into Citigroup	5
B. Khuzami Became Director of Enforcement and Began Overseeing the Citigroup Investigation	7
C. Citigroup and the Enforcement Staff Discussed Possible Settlements.....	8
1. Citigroup Offered a Rule 13a-15 Settlement, which the Enforcement Staff Unanimously Rejected	8
2. The Enforcement Staff Held Differing Views on the Possibility of a Non-Scienter Fraud Settlement with Citigroup.....	9
3. The Enforcement Staff Accepted Citigroup's Offer to Settle to a Section 17(a) Non-Scienter Fraud Charge	10
II. The Enforcement Staff Decided to Charge Individuals.....	11
A. The Enforcement Staff Held Differing Views on (b)(5)	11
B. Trial Counsel (b)(5)	15
C. The Enforcement Staff Decided (b)(5),(b)(6),(b)(7)(C)	18
1. The Enforcement Staff Decided (b)(5),(b)(6),(b)(7)(C)	18
2. Crittenden and Tildesley Wells Submissions were (b)(5)	19
D. Citigroup, Crittenden, and Tildesley Hired Khuzami's Former Colleagues as Defense Counsel	19
E. Pomerantz E-mailed Khuzami Directly to Arrange a Meeting to Discuss Crittenden	21

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III. The Enforcement Staff Negotiated a Settlement with Tildesley, But Crittenden Refused to Settle	22
A. Tildesley Agreed to Settle to Non-Scienter Fraud	22
B. Crittenden Refused to Settle	24
C. Pomerantz Arranged a Meeting Between Khuzami and Citigroup's Chairman in an Attempt to Reach a Settlement with Crittenden	24
IV. The Enforcement Staff Reached a Settlement with Crittenden	26
A. Friestad Learned from Pedowitz that After a Call with Khuzami Pomerantz Had the Impression that the SEC Was Willing to Agree to a Non-Fraud Settlement	26
B. Khuzami and Pomerantz Recalled their June 28, 2010 Conversation	28
C. The Enforcement Staff Discussed Settling the Action Against Crittenden	29
D. Although the SEC Staff Members were (b)(5) they Continued to Seek Fraud Charges	30
E. An Enforcement Staffer Expressed Concern Regarding an (b)(5)	30
F. Khuzami Offered to (b)(5) if the Enforcement Staff Members Were Not Comfortable with the Proposed Settlement	31
G. The Enforcement Staff Decided to Change Tildesley's Settlement to Match Crittenden's Settlement	32
H. The Commission Approved the Settlements.....	33
V. The OIG Found No Evidence that Settlements Were Reached as a Favor From Khuzami to a Former Colleague	34
VI. The OIG Did Not Find that Khuzami's Conduct Violated Prior OIG Recommendations or Enforcement Manual Best Practices	36
Conclusion	40

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Introduction and Summary of Results of the Investigation

On January 11, 2011, the Securities and Exchange Commission ("SEC" or "Commission") Office of Inspector General ("OIG") opened an investigation as a result of information received in an anonymous complaint, dated January 3, 2011, alleging "serious problems with special access and preferential treatment" at the SEC. Specifically, the complaint alleged that during the SEC's investigation of Citigroup, Inc.'s ("Citigroup's") failure to disclose "more than \$50 billion" in sub-prime securities, the staff of the SEC's Division of Enforcement ("Enforcement") negotiated a settlement with one individual, which included a fraud charge, and was prepared to file contested 10(b) fraud charges against a second individual. The complaint further stated that just before the staff's recommendation was presented to the Commission, Enforcement Director Robert Khuzami had a "secret conversation" with his "good friend" and former colleague, a prominent defense counsel representing Citigroup, during which Khuzami agreed to drop the contested fraud charges against the second individual. The complaint further alleged that the Enforcement staff were "forced to drop the fraud charges that were part of the settlement with the other individual," and that both individuals were also represented by Khuzami's friends and former colleagues, creating the appearance that Khuzami's decision was "made as a special favor to them and perhaps to protect a Wall Street firm for political reasons." The complaint also alleged that Khuzami's decision had the effect of protecting Citigroup from private litigation, and that by not telling the staff about his secret conversation, Khuzami "directly violated recommendations by Inspector General Kotz in previous reports about how such special access and preferential treatment can cause serious appearance problems concerning fairness and integrity of decisions that are made by the Enforcement Division."

The OIG investigation found that on July 29, 2010, the SEC filed a settled civil action against Citigroup in the U.S. District Court for the District of Columbia. The SEC's complaint in that action alleged that during the fall of 2007, Citigroup made a series of misstatements about its investment bank's exposure to sub-prime mortgages, representing that it had \$13 billion in sub-prime exposure when, in fact, it had more than \$50 billion. On that same date, without admitting or denying the allegations in the complaint, Citigroup consented to the entry of a final judgment that (1) permanently enjoined it from violations of Section 17(a)(2) of the Securities Act of 1933, Section

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13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 12b-20 and 13a-11, and (2) ordered it to pay penalty and disgorgement of \$75,000,001.

In addition, Enforcement staff pursued charges against Citigroup's Chief Financial Officer, Gary Crittenden ("Crittenden"), and Citigroup's Head of Investor Relations, Arthur Tildesley ("Tildesley"). Crittenden and Tildesley ultimately consented to an administrative order that they cease-and-desist causing any violations of Section 13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 12b-20 and 13a-11, and undertook to pay \$100,000 and \$80,000, respectively.

The OIG investigation found that while the settlements entered into with Tildesley and Crittenden were non-fraud settlements negotiated just one month before the case was filed, and a few days after Khuzami had a telephone conversation with his former colleague from the U.S. Attorney's Office for the Southern District of New York, Mark Pomerantz, who was representing Citigroup, the evidence did not establish that those settlements were the result of a special favor. Instead, the OIG found that the settlements were part of a negotiation process that involved several members of the Enforcement staff working on the Citigroup investigation.

In addition, the OIG investigation did not find evidence that Khuzami violated prior OIG recommendations or the provisions of the Enforcement Manual applicable to all Enforcement staff regarding external communications, which were issued to address concerns raised in connection with previous OIG investigations. Although Khuzami did discuss settlement with a former colleague in a telephone call that did not include other staff members, the evidence showed Khuzami did not commit to any specific settlement in that telephone call. The evidence further demonstrated that when he understood that Pomerantz had believed such a commitment had been made, Khuzami immediately reached out to Pomerantz to disabuse him of any notion that a settlement had been reached. Moreover, Khuzami reported back to the Enforcement staff about the matter the following day and further discussions were conducted with the Enforcement staff before a final decision on the settlement was made. In addition, Khuzami informed the Enforcement staff working on the Citigroup investigation that if the Enforcement staff were not "comfortable" with the settlement, he would reject it and move forward with a contested action.

Accordingly, the OIG investigation did not substantiate the allegations in the anonymous complaint and this report is being provided for informational purposes.

Scope of the Investigation

The OIG obtained and reviewed the e-mail records of nine current SEC employees who worked on the Citigroup investigation for the period January 1, 2010, to October 31, 2010. The OIG also reviewed the entries regarding the Citigroup case in the

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SEC's case management and tracking databases known as The Hub¹ and the Name Relationship Search Index (NRSI).²

The OIG also took on-the-record, sworn testimony from the following seven witnesses who had knowledge of the facts and circumstances surrounding the SEC's Citigroup investigation:

- 1) [REDACTED] Division of Enforcement, Securities and Exchange Commission; taken on April 4, 2011 [REDACTED] Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 1.
- 2) [REDACTED] Division of Enforcement, Securities and Exchange Commission; taken on April 15, 2011 [REDACTED] Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 2.
- 3) [REDACTED] Division of Enforcement, Securities and Exchange Commission; taken on April 29, 2011 [REDACTED] Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 3.
- 4) Scott Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission; taken on May 9, 2011 ("Friestad Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 4.
- 5) Lorin Reisner, Deputy Director, Division of Enforcement, Securities and Exchange Commission; taken on May 23, 2011 ("Reisner Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 5.
- 6) Robert Khuzami, Director, Division of Enforcement, Securities and Exchange Commission; taken on June 10, 2010 ("Khuzami Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 6.
- 7) [REDACTED] Securities and Exchange Commission; taken on June 20, 2011 [REDACTED] Testimony Tr."). Excerpts of testimony transcript are attached at Exhibit 7.

In addition to the sworn testimony described above, the OIG interviewed Citigroup attorney Mark Pomerantz on July 19, 2011, and summarized that interview in a memorandum ("Pomerantz Interview Memorandum"), attached at Exhibit 8.

¹ The Hub provides electronic case management and tracking for Division of Enforcement offices nationwide.

² NRSI is used by the SEC's Enforcement staff to research whether a person or entity is involved in an open investigation.

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Relevant Statutes, Regulations and Policies

Commission Conduct Regulation

The Commission's Regulation Concerning Conduct of Members and Employees of the Commission ("Conduct Regulation"), at 17 C.F.R. §§ 200.735-1 *et seq.*, sets forth the standards of ethical conduct required of Commission members and employees. The Conduct Regulation states in part:

The Securities and Exchange Commission has been entrusted by Congress with the protection of the public interest in a highly significant area of our national economy. In view of the effect which Commission action frequently has on the general public, it is important that . . . employees . . . maintain unusually high standards of honesty, integrity, impartiality and conduct. They must be constantly aware of the need to avoid situations which might result either in actual or apparent misconduct or conflicts of interest. . . .

17 C.F.R. §§ 200.735-2(a).

Commission's Canon of Ethics

The Commission's Canon of Ethics in the Code of Federal Regulations requires the maintenance of independence and the rejection of any impressions of influence: "A member should not, by his conduct, permit the impression to prevail that any person can improperly influence him, that any person unduly enjoys his favor or *that he is affected in any way by the rank, position, prestige, or affluence of any person.*" 17 C.F.R. § 200.61 (emphasis added). *See also* 17 C.F.R. § 200.51 (requiring SEC employees to bear in mind the provisions of the Canon of Ethics).

Enforcement Manual

The Commission's Division of Enforcement Manual, dated February 8, 2011, establishes the following best practices to be applied to all situations in which senior officials (at the Associate Director level and above) engage in material communications with persons outside the SEC relating to ongoing, active investigations:

Generally, senior officials are encouraged to include other staff members on the investigative team when engaging in material external communications, and should try to avoid initiating communications without the knowledge or participation of at least one of the other staff members. However, "participation" could include either having another staff member present during the communications, or having a staff member involved in preparing the senior official for the communications. . . .

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If a senior official entertains a communication without the participation or presence of other staff members, then the senior official should indicate to the outside person that the senior official will be informing other members of the investigative team of the fact of the communication, along with any pertinent details, for their information and consideration. . . .

Within a reasonable amount of time, the senior official should document material external communications related to the investigation involving, but not limited to, potential settlements, strength of the evidence, and charging decisions. The official may take contemporaneous notes of the communication, send an e-mail to any of the assigned staff, prepare a memo to the file, or orally report details to any of the assigned staff (who may then take notes or prepare a memo to the file).

The senior official should at all times keep in mind the need to preserve the impartiality of the Division in conducting its fact-finding and information-gathering functions. Propriety, fairness, and objectivity in investigations are of the utmost importance, and the investigative team cannot carry out its responsibilities appropriately unless these principles are strictly maintained. The senior official should be particularly sensitive that an external communication may appear to be or has the potential to be an attempt to supersede the investigative team's judgment and experience.

Enforcement Manual, Section 3.1.1, February 8, 2011, (emphasis in original) at Exhibit 9.

Results of the Investigation

I. The Enforcement Staff Investigated Citigroup and Considered Various Charges and Settlement Options

A. The Enforcement Staff Opened an Investigation into Citigroup

In December 2007, the SEC opened an investigation into what it termed “[p]otentially false & misleading statements made by Citigroup and several of its senior officials . . . regarding Citigroup’s exposure to sub-prime mortgages in its investment banking unit.” See Excerpt from *The Hub*, at Exhibit 10. The Enforcement team assigned to the case consisted of ^{(b)(6),(b)(7)(C)}

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(b)(6),(b)(7)(C) 3 (b)(6),(b)(7)(C), and Associate Director Scott Friestad. *Id.*; (b)(6),(b)(7)(C) Testimony Tr. at 9-10; (b)(6),(b)(7)(C) Testimony Tr. at 8; (b)(6),(b)(7)(C) Testimony Tr. at 11; Friestad Testimony Tr. at 10.

In his OIG testimony, Friestad described the nature of the Citigroup investigation as follows:

The essence of the case is that during summer and fall of 2007, Citigroup made disclosures to its investors about the size of its exposure to subprime and subprime related securities.

In a nutshell, their disclosures were that they had a small exposure to subprime securities, and it was being reduced through the course of that year.

More specifically, they would say things to investors along the lines of we started with about \$24 billion of exposure to subprime. We have worked that down to \$13 billion. It's continuing to decrease.

Sort of implicit in that is don't worry, you know, we've got things under control, the exposure is not that great and it's declining.

In fact, their exposure to subprime securities and subprime related securities was far greater than that. It was north of \$50 billion, if you added in the two types of subprime securities that we refer to as super seniors and liquidity puts. The theory of our case was that by not disclosing the fact that the real exposure was north of \$50 billion, you are misleading investors when you are saying it's \$13 billion. The company had made misleading disclosures to its investors, and that's the gist of the case.

Friestad Testimony Tr. at 13-14.

(b)(6),(b)(7)(C) further testified that the Citigroup case "had to do with [Citigroup's] disclosure starting in July of 2007 . . . about what their subprime position was." (b)(6),(b)(7)(C) Testimony Tr. at 13 (b)(6),(b)(7)(C) stated that there were two disclosures in July 2007 and two disclosures in October 2007, and that in those disclosures Citigroup was alleged to have "misled the market to thinking that they had \$13 Billion in [subprime exposure], and they in fact had in excess of 50." *Id.* at 13-14.

3 (b)(6),(b)(7)(C) is currently a (b)(6),(b)(7)(C) in Enforcement's (b)(6),(b)(7)(C) Testimony Tr. at 8.

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(b)(6),(b)(7)(A),(b)(7)(C)

B. Khuzami Became Director of Enforcement and Began Overseeing the Citigroup Investigation

In early 2009, the Enforcement staff working on the Citigroup investigation began having internal discussions with regard to a possible settlement of the case. (b)(6),(b)(7)(C) Testimony Tr. at 13. Linda Thomsen was the Director of Enforcement at that time and participated in the initial discussions. Friestad Testimony Tr. at 15.

In March 2009, Robert Khuzami replaced Linda Thomsen as the Director of Enforcement. Khuzami Testimony Tr. at 8, 17. Prior to joining the SEC, Khuzami worked from 1990 to 2002 in the U.S. Attorney's Office for the Southern District of New York. *Id.* at 8. He was a line prosecutor for the first eight of those years, and he then became Deputy Chief and later Chief of the Securities and Commodities Task Force. *Id.* at 8. He left the U.S. Attorney's Office for a position at Deutsche Bank in 2002, where he worked until coming to the SEC as Director of Enforcement in 2009. *Id.* at 8; *see also* SEC Release 2009-31, February 19, 2009 (announcing Khuzami named SEC Director of Enforcement).⁵ In August 2009, Khuzami hired Lorin Reisner to be the Deputy Director of Enforcement. Reisner Testimony Tr. at 11; *see also* SEC Release 2009-150, July 2, 2009, (announcing Reisner will join Division of Enforcement as Deputy Director in early August).⁶ Khuzami had previously worked with Reisner at the U.S. Attorney's Office in New York where Reisner was an Assistant U.S. Attorney from 1990 to 1994. Reisner Testimony Tr. at 6; Khuzami Testimony Tr. at 15.

Khuzami recalled becoming involved in the Citigroup case in the summer of 2009. Khuzami Testimony Tr. at 16. He recalled considering the Citigroup case a priority case, (b)(7)(A) *Id.* at 21. Khuzami indicated that

⁴ Another issue raised with the OIG related to an allegation involving (b)(6) behavior toward defense counsel during the (b)(7)(A). The OIG was notified by the SEC's former General Counsel that Brad Karp, defense counsel for Citigroup in the (b)(7)(A) Matter, complained to the former General Counsel that (b)(6) had made remarks to him in a conversation prior to the SEC issuing a Wells notice that gave him the impression that any argument defense counsel made would not make a difference, and that (b)(6) had already made up (b)(6) mind about the case. The OIG investigated Karp's allegation and found insufficient evidence of any misconduct or wrongdoing on the part of (b)(6),(b)(7)(C) denied the allegation and, in fact, testified that (b)(5),(b)(6) Testimony Tr. at 101. In addition (b)(6),(b)(7)(C) and Friestad testified that they never heard of any such allegation. (b)(6),(b)(7)(C) Testimony Tr. at 112-113 (b)(6) Testimony Tr. at 111; Friestad Testimony Tr. at 152-153. Khuzami testified that although he "vaguely heard" about some allegation, he believed there was no merit to it. Khuzami Testimony Tr. at 118.

⁵ Release available at: <http://www.sec.gov/news/press/2009/2009-31.htm>.

⁶ Release available at: <http://www.sec.gov/news/press/2009/2009-150.htm>.

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at the time he initially became involved in the matter, the SEC staff were talking with Citigroup's attorneys about a possible "company disposition." *Id.* at 17.

C. Citigroup and the Enforcement Staff Discussed Possible Settlements

1. Citigroup Offered a Rule 13a-15 Settlement, which the Enforcement Staff Unanimously Rejected

In June 2009, Citigroup's counsel sent a letter to the SEC Enforcement staff, including Khuzami, attempting to convince the Enforcement staff to accept a non-fraud settlement based upon Section 13(a) and Rule 13a-15 of the Exchange Act.⁷ *See* Letter from Lawrence Pedowitz of Wachtell, Lipton, Rosen & Katz and Brad Karp of Paul, Weiss, Rifkind, Wharton & Garrison, LLP to Scott Friestad *et al.*, June 17, 2009, at Exhibit 11. The Enforcement staff rejected Citigroup's attempt to settle based upon Rule 13a-15. (b)(5) Friestad Testimony Tr. at 22-23.

(b)(5)

(b)(6) also testified (b)(6) was opposed to a Rule 13a-15 settlement when Citigroup raised the issue in 20 (b)(5) because (b)(5) Testimony Tr. at 76-77. (b)(6) said (b)(6) also thought it was (b)(5) (b)(5) *Id.* at 76.

(b)(6),(b)(7)(C) also recalled that Citigroup raised Rule 13a-15, and that the Enforcement staff rejected it (b)(5),(b)(6),(b)(7)(C) Testimony Tr. at 65-66. Likewise, (b)(6),(b)(7)(C) recalled the Enforcement staff rejecting Rule 13a-15 charges (b)(6),(b)(7)(C) (b)(6),(b)(7)(C) Testimony Tr. at 84.

Khuzami testified that he did not think the initial settlement offer from Citigroup "was appropriate," and he thought that Rule 13a-15 charges were (b)(6),(b)(7)(C) Khuzami

⁷ Rule 13a-15 of the Securities Exchange Act of 1934 imposes internal controls and procedures issuers must implement to ensure proper financial reporting. 17 C.F.R. § 240.13a-15.
⁸ (b)(6) testified that (b)(6) thought (b)(5),(b)(6),(b)(7)(C) Testimony Tr. at 76.

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(b)(5) 8-19. He further testified that he thought there was (b)(5) and that (b)(5) /t. at 19. Khuzami said that “everybody collectively said [a Rule 13a-15 settlement] was not acceptable.” *Id.* at 18.

2. The Enforcement Staff Held Differing Views on the Possibility of a Non-Scienter Fraud Settlement with Citigroup

(b)(5),(b)(6),(b)(7)(C)

⁹ Section 10(b) of the Securities Exchange Act of 1934 states, “It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C. § 78j(b).

¹⁰ Section 17(a)(2) of the Securities Act of 1933 makes it unlawful to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made, not misleading. 15 U.S.C. § 77q(a)(2).

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(b)(5),(b)(6),(b)(7)(C)



3. The Enforcement Staff Accepted Citigroup's Offer to Settle to a Section 17(a) Non-Scienter Fraud Charge

(b)(6),(b)(7)(C) memorandum and (b)(6),(b)(6),(b)(7)(C) the Enforcement staff decided to settle with Citigroup to non-scienter fraud. (b)(6),(b)(7)(C) Testimony Tr. at 14. Citigroup, through its counsel, Larry Pedowitz of the law firm of Wachtell, Lipton, Rosen & Katz and Brad Karp of Paul, Weiss, Rifkind, Wharton & Garrison, LLP made a formal settlement offer in a letter to Enforcement staff dated September 8, 2009, stating:

You have asked us to make a formal settlement offer. We are willing to settle on the basis of a Section 17(a) charge for the October 1 and 15 disclosures, with related Section 13 charges. We also will agree to pay a significant penalty.

¹¹ Friestad testified that he was not at the Citigroup witnesses' testimony, which he admitted may explain why (b)(5),(b)(6),(b)(7)(C) Friestad Testimony Tr. at 19-20.

¹² Citigroup's settlement included accepting an order under which it is permanently enjoined from violating Section 17(a)(2) of the Securities Act, Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-11, and paying a civil money penalty and disgorgement. See SEC Litigation Release No. 21605, July 29, 2010, at <http://www.sec.gov/litigation/litreleases/2010/lr21605.htm>.

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Letter to (b)(6),(b)(7)(C) and (b)(6),(b)(7)(C) from Pedowitz and Karp, September 8, 2009, at 11, at Exhibit 13.

(b)(6),(b)(7)(C) supported the settlement with Citigroup and testified that (b)(6),(b)(7)(C) ought the settlement (b)(5),(b)(6),(b)(7)(C) Testimony Tr. at 26. (b)(6),(b)(7)(C) also stated that the only thing still left to negotiate with Citigroup was the penalty amount. *Id.* at 24.

(b)(5),(b)(6),(b)(7)(C)

Khuzami testified that he had “very little involvement” in the settlement with Citigroup, but recalled a “general consensus” agreeing to the settlement. Khuzami Testimony Tr. at 19-20. Khuzami said he also remembered that (b)(5)

(b)(5)

II. The Enforcement Staff Decided to Charge Individuals

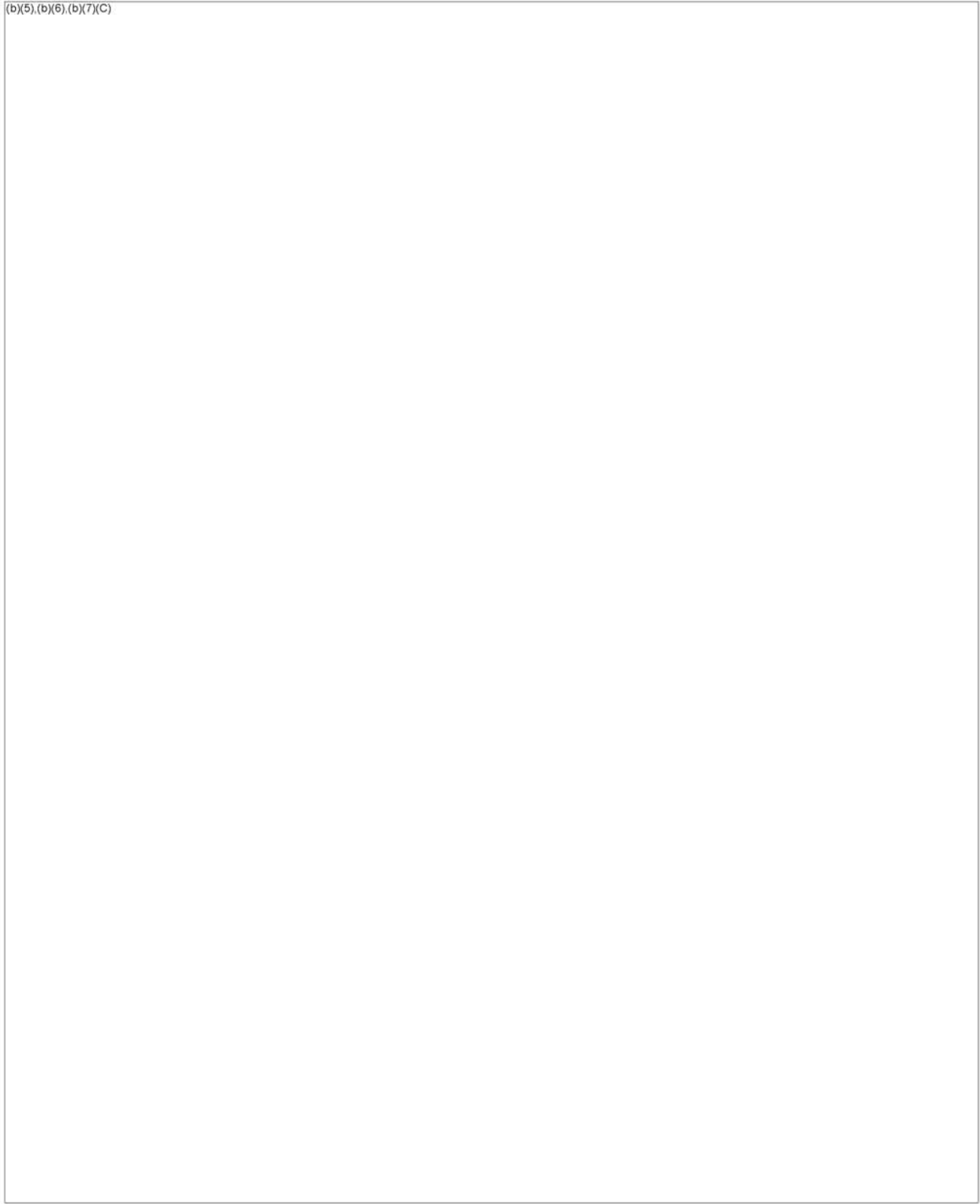
A. The Enforcement Staff Held Differing Views on (b)(5)

(b)(5),(b)(6),(b)(7)(C)

(b)(5)

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(b)(5),(b)(6),(b)(7)(C)



¹⁴ Friestad said at one point he even recommended that they bring a case against Tildesley (b)(5) (b)(5) Friestad Testimony Tr. at 48.

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(b)(5),(b)(6),(b)(7)(C)

¹⁵ The misstatements, as explained by (b)(6),(b)(7)(C) in (b)(6) testimony, related to Citigroup describing its subprime exposure as \$13 billion, rather than over \$50 billion. (b)(6) Testimony Tr. at 14. (b)(5) (b)(5), the July misstatements took place in earnings calls, and the October misstatements were in an earnings call and a press release that was incorporated into a Form 8-K. (b)(5) (b)(5)

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(b)(5),(b)(6),(b)(7)(C)

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(b)(5)

Despite Citigroup's attempt to dissuade the Enforcement staff from charging individuals, the Enforcement staff ultimately determined that it would do so and decided to issue Wells notices¹⁶ to (b)(6),(b)(7)(C)

(b)(6),(b)(7)(C)

(b)(6),(b)(7)(C)

Arthur Tildesley (Director of Investor Relations), and Gary Crittenden (Chief Financial Officer). Friestad Testimony Tr. at 29. The Enforcement staff later informed the Commission that it issued a Wells notice to (b)(5),(b)(6),(b)(7)(C)

(b)(5),(b)(6),(b)(7)(C)

(b)(5)

The Enforcement staff also informed the Commission that it issued a Wells notice to (b)(5),(b)(6),(b)(7)(C) of Crittenden's (b)(5)

(b)(5),(b)(6),(b)(7)(C)

(b)(5)

Id.

B. Trial Counsel

(b)(5)


(b)(5),(b)(6),(b)(7)(C)

¹⁶ A Wells notice provides notice to a person or entity that the staff plans to recommend that the Commission authorize an action against the person or entity for violations of the securities laws and provides an opportunity for the person or entity to submit a statement to the staff concerning this anticipated recommendation. 17 C.F.R. § 202.5(c).

¹⁷ (b)(6),(b)(7)(C) has been with the SEC since (b)(6) and in (b)(6),(b)(7)(C) transferred from the Enforcement Division's Trial Unit to the (b)(6),(b)(7)(C) Testimony Tr. at 6.

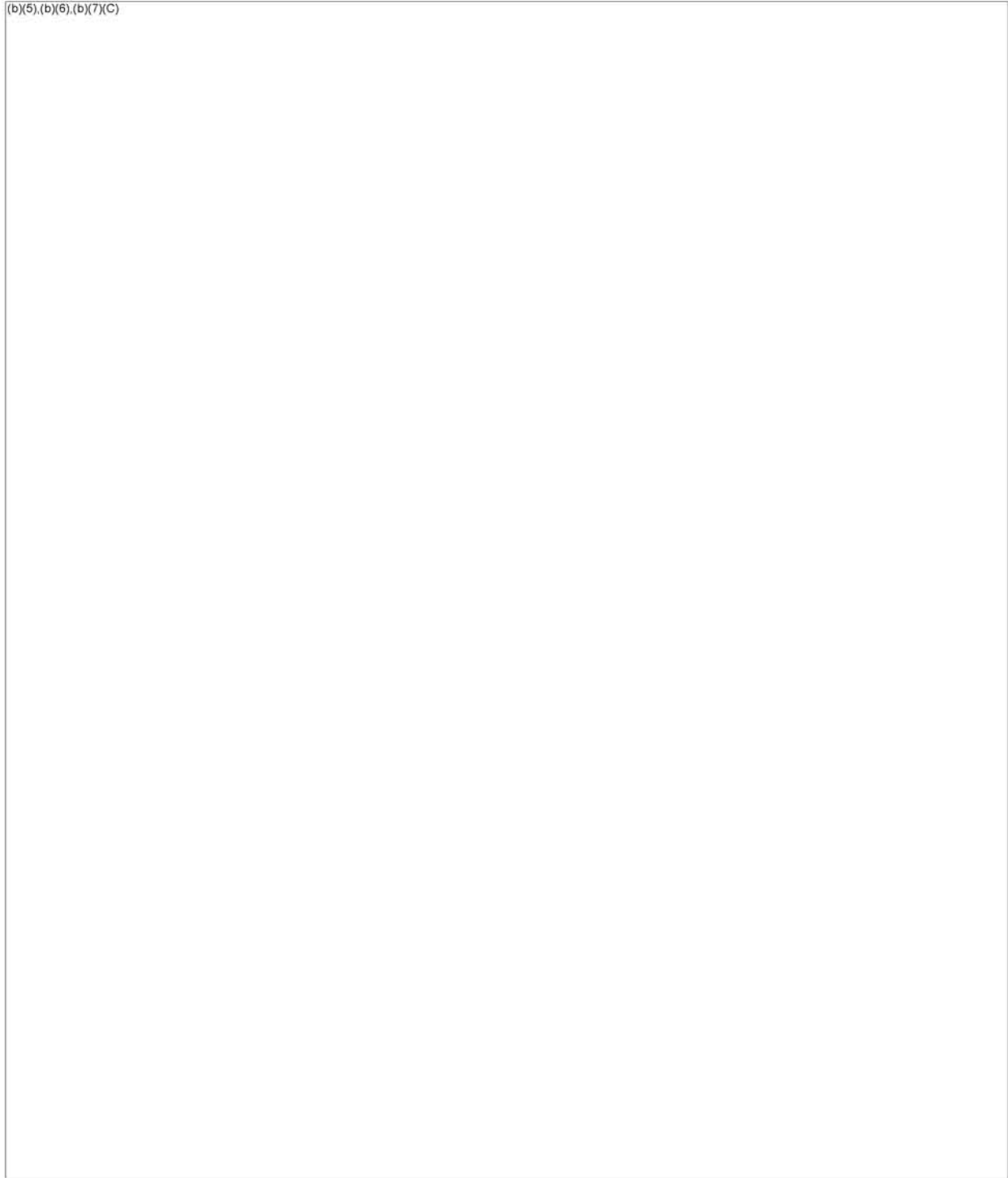
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(b)(5),(b)(6),(b)(7)(C)



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(b)(5),(b)(6),(b)(7)(C)



¹⁸ Khuzami referred to ^{(b)(6),(b)(7)(C)} memorandum several times during his OIG testimony. Khuzami Testimony Tr. at 83, 100, 101. Khuzami testified that it was ^{(b)(5)}
^{(b)(5)}
^{(b)(5)} *Id.* at 83. He further testified that ^{(b)(5)}
^{(b)(5)}
^{(b)(5)} *Id.* at 99-100. After his OIG testimony, Khuzami told the OIG that

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C. The Enforcement Staff Decided

(b)(5),(b)(6),(b)(7)(C)

(b)(5)

Against Crittenden and Tildesley

Although the Enforcement staff made the decision to

(b)(6),(b)(7)(C)

(b)(6),(b)(7)(C)

Arthur Tildesley, and Gary Crittenden,

(b)(5)

(b)(5)

ultimately recommended charges against Crittenden

and Tildesley.

1. The Enforcement Staff Decided

(b)(5),(b)(6)

(b)(6),(b)(7)(C)

(b)(5),(b)(6),(b)(7)(C)

he

(b)(5),(b)(6),(b)(7)(C)

Crittenden, and he

produced his copy of the memorandum to the OIG.

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2. **Crittenden and Tildesley Wells Submissions were**

(b)(5)

(b)(5)

(b)(5),(b)(6),(b)(7)(C)

D. Citigroup, Crittenden, and Tildesley Hired Khuzami's Former Colleagues as Defense Counsel

By the time that they filed their Wells submissions, Crittenden and Tildesley hired as their counsel John Carroll of Skadden Arps and Mark Stein of Simpson Thacher, respectively. Wells Submission of Arthur Tildesley, January 25, 2010; Submission of Gary Crittenden, January 25, 2010. In addition to Crittenden and Tildesley hiring their own counsel, Citigroup added to its defense team, hiring Mark Pomerantz, a criminal defense lawyer from Paul Weiss, in July 2009. (b)(6),(b)(7)(c) Testimony Tr. at 38. In an interview with the OIG, Mark Pomerantz explained his role in the defense efforts stating he had "more than casual involvement," and that he "spent several hundred hours on it." Pomerantz Interview Memorandum at 2.

All three of the additions to the defense team previously worked with Khuzami at the U.S. Attorney's Office in the Southern District of New York. Khuzami Testimony Tr. at 8-10; *see also* Pomerantz Interview Memorandum at 1. During Khuzami's 12

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years at the U.S. Attorney's Office for the Southern District of New York, his tenure overlapped with Pomerantz, Carroll, and Stein.¹⁹ Khuzami Testimony Tr. at 8-10. Khuzami worked directly with Stein, trying two money laundering cases with him, and Khuzami reported to Pomerantz.²⁰ Khuzami Testimony Tr. at 8-9; Pomerantz Interview Memorandum at 1. Khuzami and Carroll only briefly overlapped as Carroll left shortly after Khuzami arrived. Khuzami Testimony Tr. at 10.

Khuzami testified that he socialized with Pomerantz and Stein during the period they worked together, but generally only at office-wide functions. Khuzami Testimony Tr. at 9, 12. However, Khuzami and Pomerantz had more contact with each other after Khuzami left the U.S. Attorney's Office and joined Deutsche Bank. In fact, Khuzami retained Pomerantz, who was then with the law firm of Paul Weiss, to represent Deutsche Bank in a matter that was ongoing from 2006 to 2010. Pomerantz Interview Memorandum at 1.

Khuzami and Pomerantz both stated they did not remember getting together socially after Khuzami came to the SEC. Pomerantz Interview Memorandum at 2; Khuzami Testimony Tr. at 22-23. However, there was at least one occasion when they attempted to get together after Pomerantz was retained to represent Citigroup. According to an e-mail chain dated February 17, 2010, Pomerantz and Khuzami attempted to meet socially in New York City when Khuzami was in town for a Practising Law Institute conference. See E-mail from Khuzami to Pomerantz, February 17, 2010, at Exhibit 18. Both Khuzami and Pomerantz stated that they did not actually see each other on that occasion. Khuzami Testimony Tr. at 22; Pomerantz Interview Memorandum at 2. During his OIG testimony, Khuzami explained why it would have been appropriate for him to get together with Pomerantz as long as nothing of substance regarding the Citigroup case was discussed:

Q: Would you be concerned with the appearance question of getting together with someone who represents Citigroup in a social setting like this in the middle of a case?

A: You know, I think the fact of the matter is I have conversations or discussions with defense counsel who may be involved in cases for subject matters that are completely unrelated to the case, and those matters aren't discussed, and everyone understands that. So nothing of -- you know, nothing of substance is discussed.

¹⁹ Lorin Reisner also worked at the United States Attorneys' Office for the Southern District of New York, overlapping with Khuzami, Carroll and Stein, but not with Pomerantz. Reisner Testimony Tr. at 9-10.

²⁰ Khuzami testified that he was unsure whether he reported to Pomerantz because the reporting hierarchy was "pretty flat," but that they interacted on a more than weekly basis. Khuzami Testimony Tr. at 11-12. However, Pomerantz stated that Khuzami reported directly to him, and that it was a joint decision by Pomerantz and the U.S. Attorney, Mary Jo White, to promote Khuzami to Chief of the Securities Unit. Pomerantz Interview Memorandum at 1.

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So if the question is do I have concerns about it, I know what my obligations and ethical restrictions and approaches are, and so it doesn't trouble me. From a perception perspective, someone would look at that and suggest that there was something improper going on. I -- certainly, that's possible.

Q: So if you had gotten together with Mr. Pomerantz on some social occasion, lunch or drinks or whatever, you would have made it a point not to discuss the Citigroup case?

A: Absolutely not.

Khuzami Testimony Tr. at 23.

E. Pomerantz E-mailed Khuzami Directly to Arrange a Meeting to Discuss Crittenden

On April 6, 2010, Pomerantz sent an e-mail to Khuzami asking for a meeting to discuss "the ramifications" of a fraud charge against Citigroup's former CFO, Crittenden. E-mail from Pomerantz to Khuzami, April 6, 2010, at Exhibit 19. In the e-mail, Pomerantz stated that he wanted to "reinforce the point that a decision to charge Crittenden with securities fraud would have very large implications for Citigroup and for the settlement of charges as to Citigroup that [had] been in the works for some time." *Id.*

When asked why he was making arguments on behalf of Crittenden when he was representing Citigroup, Pomerantz explained that not only was he representing Crittenden directly in other companion litigation, but from his perspective, what happened to Crittenden was of great consequence to Citigroup as an entity because an intentional fraud charge against a former CFO would take away the benefit to Citigroup in settling to a non-scienter fraud charge. Pomerantz Interview Memorandum at 2-3.

Pomerantz stated that he sent the e-mail to Khuzami because "we wanted to prevail on [Khuzami] to pay attention to [the proposed action against Crittenden] personally." *Id.* at 2. When Pomerantz was asked why one of the other defense counsel, who was more involved in the case, did not send the e-mail, Pomerantz admitted, "We decided to send it to him because he was the Director of Enforcement and I guess because I knew him, I was the one who sent the email." *Id.* at 2.

Khuzami immediately forwarded the e-mail from Pomerantz to the Enforcement staff on the matter. *See* (forwarding date on) e-mail from Pomerantz to Khuzami, April 6, 2010. The Enforcement team testified that they generally were not concerned that Pomerantz e-mailed Khuzami directly to set up a meeting, especially because Khuzami immediately forwarded the e-mail to the staff. *See, e.g.,* (b)(6),(b)(7)(C) Testimony Tr. at 41;

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(b)(6),(b)(7)(C) Testimony Tr. at 40; (b)(6),(b)(7)(C) Testimony Tr. at 49. Khuzami testified that it is not unusual for defense counsel to contact him directly. Khuzami Testimony Tr. at 37.

(b)(6),(b)(7)(C) specifically recalled receiving the April 6, 2010 Pomerantz e-mail from Khuzami. (b)(6),(b)(7)(C) Testimony Tr. at 37 (b)(6) testified that (b)(6) thought Pomerantz's mention of the "large implications" to charging Crittenden was a reference to potential private civil litigation, and that (b)(5). *Id.* at 42-43 (b)(6),(b)(7)(C) recalled that (b)(6) discussed Pomerantz's e-mail with (b)(6),(b)(7)(C) and that they were (b)(5).²¹ *Id.* at 43 (b)(6),(b)(7)(C) testified that despite Pomerantz's comments about "large implications," (b)(5),(b)(6),(b)(7)(C)

(b)(5),(b)(6),(b)(7)(C) Testimony Tr. at 52 (b)(6) recalled that Citigroup was "trying to use whatever leverage they had . . . to get us to . . . lay off the individuals" but (b)(6) thought there was (b)(5).
(b)(5) *Id.*

Khuzami testified that he did not remember meeting with Pomerantz following his receipt of the April 6, 2010 e-mail, but that he recalled Pomerantz making the argument that charging Crittenden with fraud would cause Citigroup to face collateral civil litigation. Khuzami Testimony Tr. at 38-39. Khuzami testified that he (b)(5)

(b)(5),(b)(6)

(b)(5)

Id.

III. The Enforcement Staff Negotiated a Settlement with Tildesley, But Crittenden Refused to Settle

A. Tildesley Agreed to Settle to Non-Scienter Fraud

²¹ Citigroup's counsel continued to attempt to convince the staff not to charge Crittenden; however, the Enforcement staff (b)(5) (b)(5) Crittenden. Friestad Testimony Tr. at 33. Pomerantz concurred generally with this interpretation, although he stated that while he "didn't want to be seen as telling the staff that unless you back off of Crittenden then there will be no settlement with Citi... [t]he two were linked but not so directly." Pomerantz Interview Memorandum at 3.

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By the end of April 2010, the Enforcement staff were prepared to bring a contested action against both Crittenden and Tildesley for violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. See (b)(5) After consulting with Khuzami, the Enforcement staff informed Crittenden's and Tildesley's counsel that they intended to bring such a case, and in response, Tildesley's counsel, Mark Stein, contacted the staff and expressed an interest in settlement. Friestad Testimony Tr. at 52.

Tildesley's counsel initially offered to settle to a non-fraud, cease-and-desist proceeding with no penalty, which Friestad, in an e-mail to Khuzami, called (b)(5) (b)(5) See E-mail from Friestad to Khuzami, June 1, 2010, at Exhibit 21. *Id.* When asked to explain why (b)(5) Friestad testified, (b)(5) (b)(5) Friestad Testimony Tr. at

(b)(5)

Even during the initial meeting, which Friestad described to Khuzami in his June 1, 2010 e-mail, the staff and Tildesley's counsel had narrowed the issues to get closer to a deal that the staff would be willing to recommend to the Commission. E-mail from Friestad to Khuzami, June 1, 2010. After further negotiations, Enforcement agreed to a settlement in which Tildesley would consent to a cease-and-desist proceeding for violations of Section 17(a) of the Securities Act and an \$80,000 civil money penalty. See

(b)(5) at Exhibit 22. (b)(6),(b)(7)(C) and (b)(6),(b)(7)(C) all testified that (b)(5) Tildesley. (b)(6),(b)(7)(C) Testimony Tr. at 54. (b)(6),(b)(7)(C) Testimony Tr. at 52. (b)(6),(b)(7)(C) Testimony Tr. at 59. When asked about the fact that the settlement was for a cease-and-desist proceeding, rather than an injunction, (b)(6),(b)(7)(C) stated that (b)(5) (b)(5) 22 (b)(6),(b)(7)(C) Testimony Tr. at 54-55.

(b)(5)

(b)(5),(b)(6),(b)(7)(C)

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(b)(5)

Friestad Testimony Tr. at 56.

B. Crittenden Refused to Settle

The Enforcement staff found that Crittenden would not agree to settle to the same terms as Tildesley. *Id.* at 56-57. Friestad said that in fact Crittenden was “balking at settling on any terms, to any charges.” *Id.* at 59 (b)(6),(b)(7)(C) recalled that it (b)(5)

(b)(5) Crittenden's (b)(5) Tildesley, (b)(5) (b)(6),(b)(7)(C) Testimony Tr. at 55. However (b)(6),(b)(7)(C) said that Crittenden's counsel went (b)(5) *Id.* at 72.

Khuzami testified that Crittenden's position all along had been: “I'm not settling to any of those charges.” Khuzami Testimony Tr. at 70 (b)(6),(b)(7)(C) recalled Crittenden refusing to settle to a fraud charge because “he held some position in his church and he wouldn't be able to continue that position if he took anything that was a fraud charge.” (b)(6),(b)(7)(C) Testimony Tr. at 78. Reisner also recalled Crittenden's attorney saying to him: “I'm not optimistic about [Crittenden's] willingness to settle on any terms.” Reisner Testimony Tr. at 56.

(b)(5)

Crittenden, Friestad testified that he remembered Citigroup's counsel Pedowitz asking that the staff consider only charging Crittenden with non-scienter fraud under Section 17(a) in a contested case, rather than Section 10(b) fraud claims. *Id.* at 61. Friestad recalling wanting to speak with Khuzami before getting back to Pedowitz (b)(5)

(b)(5) Friestad Testimony Tr. at 61. Friestad said he remembered Khuzami telling him, (b)(5) (b)(5) *Id.*

C. Pomerantz Arranged a Meeting Between Khuzami and Citigroup's Chairman in an Attempt to Reach a Settlement with Crittenden

After negotiating the Tildesley settlement, the Enforcement staff were prepared to move forward (b)(5) Crittenden, but Citigroup's defense

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counsel continued to contact Khuzami to request more meetings to discuss the case.²³ On June 17, 2010, Pomerantz sent an e-mail to Khuzami requesting a meeting between Khuzami and Dick Parsons, Chairman of Citigroup's Board of Directors. E-mail from Pomerantz to Khuzami, June 17, 2010, at Exhibit 24. Khuzami immediately forwarded the e-mail to the staff, and a meeting was scheduled between Khuzami and Parsons for June 18th. *Id.*; Khuzami Testimony Tr. at 60-61.

Pomerantz explained in his OIG interview that he reached out to Khuzami to see if he would meet with Parsons in the hope that Parsons could persuade Khuzami to resolve the Crittenden matter. Pomerantz Interview Memorandum at 3. Pomerantz described the SEC staff as being "pretty unyielding in the view that Crittenden either would agree to a fraud resolution or they would bring contested 10b claims against him." *Id.* at 4. Pomerantz stated that Crittenden did not believe he committed securities fraud and was not going to say that he did. *Id.*

Initially Khuzami intended to have all the staff attend the Parsons meeting, but when Khuzami learned that Parsons might come alone, he decided to limit the number of SEC staff members to himself, Reisner, and Friestad because "having nine people here with one on the other side is just . . . not a great dynamic." Khuzami Testimony Tr. at 60-61. Khuzami testified that he granted the meeting with the thought that if this was "the last hurdle," it was "worth doing." *Id.* at 62. Pomerantz confirmed that Parsons was initially planning to attend the meeting alone, but changed his mind and asked Pomerantz to attend as well. Pomerantz Interview Memorandum at 4. Pomerantz said he recalled Khuzami, Reisner, and Friestad attending the meeting, and that the meeting "wasn't acrimonious" and stated that "the people in the room understood the points." *Id.*

Pomerantz further stated that the meeting was "a little bit different because at the meeting, Dick Parsons articulated that certainly they would understand if the staff had to charge something in light of the disclosure." *Id.* Pomerantz said, "The point of the meeting was that it shouldn't be fraud, but Parsons said he could well appreciate that the

(b)(5),(b)(6),(b)(7)(C)

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staff would have to charge Crittenden with something, but it shouldn't be securities fraud." *Id.* Pomerantz explained that this was "a different approach because all the prior submissions had said Crittenden did nothing wrong and this was the first time Parsons was saying that Crittenden did something wrong, but it wasn't securities fraud." *Id.*

Friestad recalled the Parsons meeting and that Parsons "made a personal pitch" and was (b)(5) Friestad Testimony Tr. at 75. But Friestad thought the arguments Parsons made "had already been made" and (b)(5) Crittenden (b)(5) *Id.* at 75-76. Reisner also recalled attending the Parsons meeting and that Parsons "gave us a pitch that was very similar to the pitch we had been receiving from Citigroup's counsel." Reisner Testimony Tr. at 45. Reisner also testified that he did not think (b)(5) (b)(5) *Id.* at 46.

Khuzami testified that the Parsons meeting (b)(5) Crittenden (b)(5) Khuzami Testimony Tr. at 62-63. He characterized Parsons' pitch as "the same pitch" they had heard before, which was that Crittenden (b)(5) *Id.* at 62. Khuzami stated that (b)(5) Crittenden (b)(5) Crittenden (b)(5) Crittenden and Crittenden (b)(5) *Id.* at 63.

Although the rest of the Enforcement staff working on the Citigroup investigation did not attend the Parsons meeting, the team members all knew it was taking place, understood the reasons they were not included, and were briefed immediately after the meeting (b)(6),(b)(7)(C) testified that (b)(6) was briefed "right after" the Parsons meeting, and that Khuzami seemed "uncomfortable" that the whole team could not attend. (b)(6),(b)(7)(C) Testimony Tr. at 70. (b)(6),(b)(7)(C) also testified that Khuzami briefed (b)(6) by phone after the meeting (b)(6),(b)(7)(C) Testimony Tr. at 65. (b)(6),(b)(7)(C) said Khuzami told (b)(6) that (b)(5) *Id.*

Despite the Parsons meeting, the plan at the end of June was to (b)(5) Crittenden. On June 22, 2010, the staff circulated (b)(5) Gary Crittenden, (b)(5) Citigroup and Tildesley. (b)(5)

IV. The Enforcement Staff Reached a Settlement with Crittenden

A. Friestad Learned from Pedowitz that After a Call with Khuzami Pomerantz Had the Impression that the SEC Was Willing to Agree to a Non-Fraud Settlement

On the evening of June 28, 2010, Citigroup counsel Larry Pedowitz sent Friestad an e-mail asking Friestad to call him in the morning so he could "share some perhaps useful information . . . before there is any further contact with [Crittenden's attorney]

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John Carroll.” E-mail from Pedowitz to Friestad, June 28, 2010, at Exhibit 25. Friestad testified that when he returned Pedowitz’s call on the morning of June 29, 2010, Pedowitz told him that Khuzami, in a conversation with Pomerantz, had agreed to support a non-fraud settlement with Crittenden. Friestad Testimony Tr. at 88. Friestad described his recollection of this conversation and his reaction to it as follows:

A: My recollection is that it was during this conversation with Mr. Pedowitz that I learned that Rob Khuzami had had a telephone conversation with Mark Pomerantz in which, as it was explained to me by Mr. Pedowitz, Rob Khuzami had -- had agreed to support a settlement against Mr. Crittenden that would not include any fraud charges at all.

Q: What was your reaction to learning that?

A: (b)(5)
(b)(5) And so interacting with Mr. Pedowitz, I pretended I knew what he was talking about because I did not want to convey to him that I had no idea what he was talking about.

Q: Did you have an understanding of when this conversation took place between Rob Khuzami and Mark Pomerantz?

A: No. I suspected it was the day before, but I don’t know for sure.

Id. at 88-89.

Friestad testified that Khuzami was not in the office that day, and that he spoke instead with Reisner. *Id.* at 90-91. He stated that he was (b)(5) that Reisner (b)(5) Crittenden (b)(5) *Id.* Friestad testified that it was (b)(5) he and his staff had discussed with Reisner why (b)(5) *Id.* at 91. He also stated that Reisner, (b)(5) (b)(5) *Id.* at 90.

Friestad testified that he later talked to Khuzami, who acknowledged having a conversation with Pomerantz but insisted that he did not commit to a settlement that involved dropping the fraud charge against Crittenden. *Id.* at 94. Friestad (b)(5) (b)(5) but he thought that something must have been said in that conversation because of what Pedowitz told him and because Reisner (b)(5) (b)(5)

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... [M]y own personal view was that something had been said because otherwise Larry [Pedowitz] wouldn't have communicated to me what he did -- the way he did. And, too, Lorin [Reisner]^{(b)(5)}

(b)(5)

Id. at 95.

B. Khuzami and Pomerantz Recalled their June 28, 2010 Conversation

Khuzami testified that he recalled having a conversation with Pomerantz, and that Rule 13a-15 “came up” in that conversation; however, he testified that he did not agree to anything and simply told Pomerantz to “go talk to Crittenden.” Khuzami Testimony Tr. at 73-74. Khuzami described his conversation with Pomerantz, stating, “[T]here may have been discussion about were there other alternatives that could be pursued as there were throughout this time but [there was] absolutely no agreement by me [to settle anything].” *Id.* at 72. Khuzami stated that although it was possible Rule 13a-15 was “raised amongst us,” he did not think he gave Pomerantz the impression that the SEC would consider a Rule 13a-15 settlement because all he said was, “Go talk to Crittenden.” *Id.* at 73-74. Khuzami testified that he did not know how somebody might interpret “go talk to Crittenden” as an answer to someone suggesting “what about this [approach to settling the case].” *Id.* at 74. He further maintained that “there was no such agreement, and [he] didn't agree to any such thing, and [he] couldn't agree to such a thing.” *Id.* at 72.

Pomerantz recalled that Khuzami suggested in the telephone call with him that the Enforcement staff might be willing to consider a non-fraud charge. Pomerantz Interview Memorandum at 5. He further stated, “Rob [Khuzami] suggested that maybe it would be possible to consider charging Crittenden with something other than a securities fraud charge.” *Id.* Pomerantz described Khuzami's comment as “a little crack in the door” and “a light and the light was not an upcoming train” and noted that it reflected “some willingness to consider whether the staff could entertain a non-fraud resolution as to Crittenden.” *Id.* Pomerantz thought that “quite possibly” it was Rule 13a that was the “crack in the door” in the conversation with Khuzami, and noted that his “conversation with Rob [Khuzami] was significant because it was the first indication that there were any circumstances in which the staff would recommend a non-fraud approach.” *Id.* at 6. However, Pomerantz also stated that there was no agreement made between him and Khuzami in that telephone call and that they “were not close to a resolution.” *Id.* at 5.

Pomerantz stated that after his conversation with Khuzami, he talked to John Carroll and Larry Pedowitz.²⁴ *Id.* at 6. Pomerantz stated that “then the message came back from the SEC, from the staff level, that their position had not changed and they weren't going to accept anything.” *Id.*

²⁴ Pomerantz would not discuss the substance of his conversations with Carroll and Pedowitz during his OIG interview because of the attorney-client privilege.

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Pomerantz further told the OIG that on July 1, 2010, he spoke to Khuzami again and that Khuzami was “annoyed that evidently Crittenden’s lawyer had read more into our conversation than Rob [Khuzami] had intended.” *Id.* Pomerantz said that there had “clearly been a misunderstanding” which had “led to embarrassment with the staff.” *Id.* Pomerantz said that in that July 1st call with Khuzami, he “reiterated the old points that Crittenden would not ever take securities fraud.” *Id.* Pomerantz said he told Khuzami, “There is a resolution to be had here,” and Pomerantz said that Khuzami’s response was, “if it would happen it would happen directly with Crittenden’s lawyer.” *Id.* Pomerantz said that by the end of conversation, he was “certain the state of play was that hopefully we would be back on track.” *Id.* Khuzami also remembered having a follow-up call with Pomerantz after Friestad reported to Khuzami that the defense team was under the impression that Khuzami had agreed to a resolution with Pomerantz. Khuzami Testimony Tr. at 74. Khuzami said he asked Pomerantz, “What is this kind of nonsense?” and made it clear to Pomerantz that there was “no such agreement.”²⁵ *Id.*

C. The Enforcement Staff Discussed Settling the Action Against Crittenden

(b)(5)

(b)(5) Friestad Testimony Tr. at 94. He testified that he wanted to give them a chance to express their views and, accordingly, he arranged a meeting with Reisner. *Id.* at 95. On the afternoon of June 29, 2010, (b)(6),(b)(7)(C) and Friestad met in Reisner’s office, during which meeting Reisner (b)(5) (b)(5) Mr. Crittenden, (b)(5) (b)(5),²⁶ *Id.* at 96-97. Friestad testified that the Enforcement staff expressed their views (b)(5) Reisner. *Id.* at 96.

(b)(5),(b)(6),(b)(7)(C)

After the meeting, Friestad, Reisner, and Khuzami exchanged several e-mails discussing (b)(5) See E-mails from Friestad to Reisner and Khuzami, June 29 and 30, 2010, at Exhibit 26. In the e-mails, Friestad set forth his reasons (b)(5)

²⁵ Reisner did not have a clear recollection of what occurred, but did recall that it came to his attention that Citigroup’s counsel (he thought it was John Carroll not Mark Pomerantz) had thought they were given assurances about the SEC’s position and that he talked to Khuzami who said to him, “that’s crazy . . . there were no assurances given.” Reisner Testimony Tr. at 79-80.

²⁶ Friestad said Khuzami did not attend the meeting in Reisner’s office because Khuzami was out of the office that day. Friestad Testimony Tr. at 96.

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(b)(5) *Id.*
The rest of the Enforcement team was not copied on these e-mails. *Id.*

In addition, Reisner asked (b)(6),(b)(7)(C) to research (b)(6),(b)(7)(C) and on June 30, 2010 (b)(6),(b)(7)(C) sent Reisner a memorandum summarizing (b)(6) research. (b)(6),(b)(7)(C) Testimony Tr. at 88; E-mail from (b)(6),(b)(7)(C) to Reisner, June 30, 2010, at Exhibit 27. (b)(6),(b)(7)(C) concluded in (b)(6) memorandum that (b)(5)

(b)(5)

(b)(5) Crittenden. E-mail from (b)(6),(b)(7)(C) to Reisner, June 30, 2010, at 5, at Exhibit 27.

D. Although the SEC Staff Members were (b)(5) they Continued to Seek Fraud Charges

Although the Enforcement staff were internally discussing (b)(5) (b)(5) Crittenden, the OIG found that Reisner continued to make efforts to negotiate a fraud settlement with Crittenden's counsel. Friestad testified (b)(5) isner (b)(5) Mr. Crittenden (b)(5) Friestad Testimony Tr. at 109. He (b)(5)

Mr. Crittenden, (b)(5) *Id.*
Friestad stated that (b)(5)

(b)(5)

(b)(5) Friestad and Reisner called John Carroll and conveyed to him that the SEC was still seeking fraud charges against Crittenden. *Id.* at 109-110. Carroll reacted by sending an e-mail to Friestad on July 1, 2010 saying, "Confusing day. Can we speak tomorrow?" *Id.* at 111; E-mail from Carroll to Friestad, July 1, 2010, at Exhibit 28. When Friestad called Carroll the next day, Carroll asked him "what the heck is going on" and said, "I've known you for 16 years. I don't think I've ever had a call like this in my life from you guys. What's going on?" Friestad Testimony Tr. at 113. Friestad testified that he replied to Carroll, "I hear you . . . but . . . that's our position." *Id.* at 114.

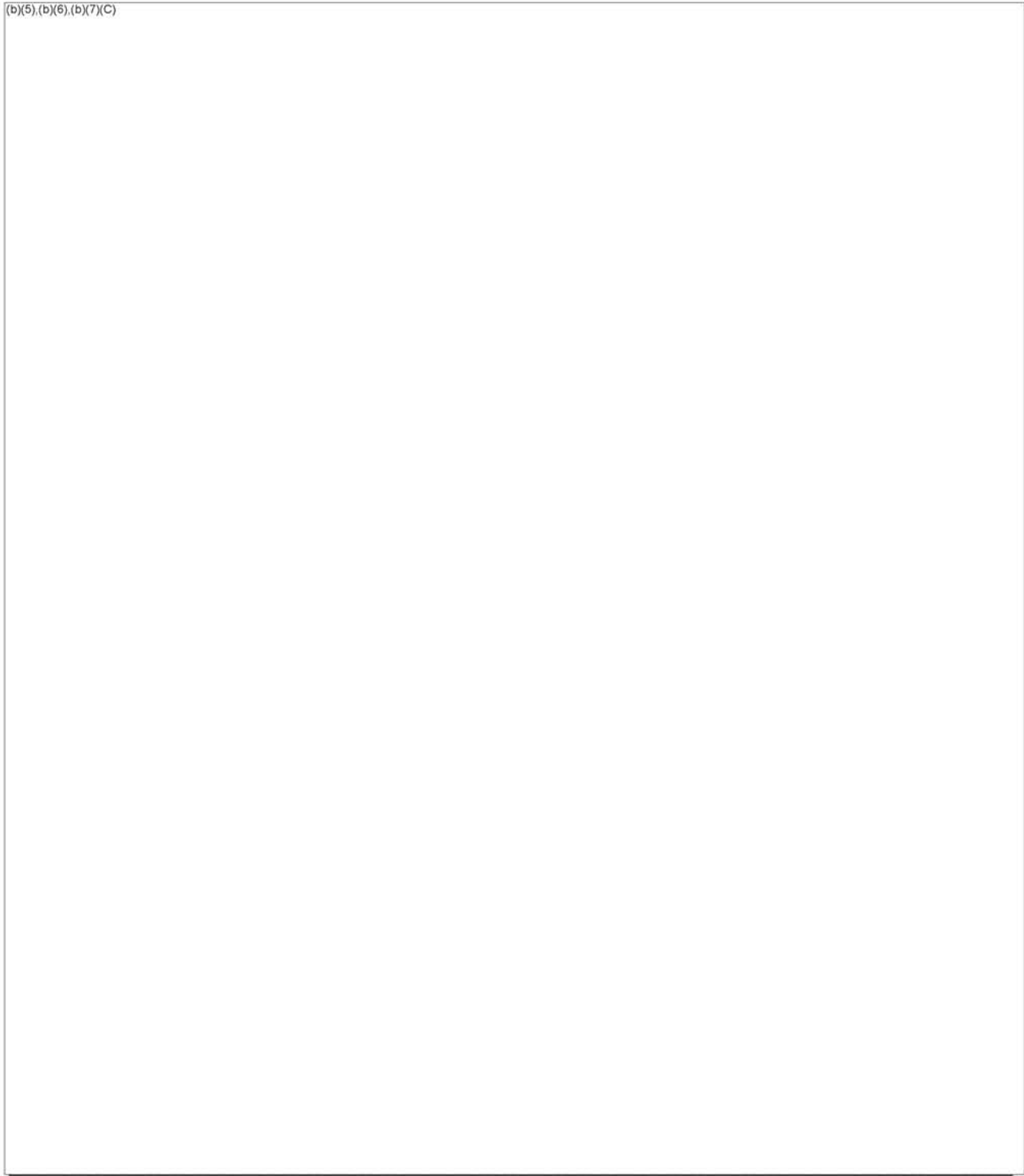
Reisner testified that (b)(5) and denied being the cause of Carroll's confusion. Reisner Testimony Tr. at 75-76. He noted that while "[he] thought (b)(5), he still "thought that we ought to (b)(5) *Id.* at 75-76.

E. An Enforcement Staffer Expressed Concern Regarding an (b)(5)

(b)(5)

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(b)(5),(b)(6),(b)(7)(C)



F. Khuzami Offered to ^{(b)(5)} if the Enforcement Staff Members Were Not Comfortable with the Proposed Settlement

The OIG investigation found that even if Khuzami was ^{(b)(5)} ^{(b)(5)} Crittenden, and even if Pomerantz had been given that impression

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in a telephone call, Khuzami was (b)(5) if the Enforcement staff insisted that was what they wanted.

On July 3, 2010, Khuzami sent an e-mail to Friestad, stating:

(b)(5)
(b)(5) – regardless of whatever miscommunications or strategy is behind what Larry or Mark told John, I'm prepared to (b)(5) (b)(5). [S]o pls confirm team is OK with this and then you should call John.

E-mail from Khuzami to Friestad, July 3, 2010, at Exhibit 30.

Friestad responded that (b)(5)
(b)(5)
(b)(5) 27 *Id.*

Khuzami described his understanding of Friestad's response in his testimony as follows:

(b)(5)

Khuzami Testimony Tr. at 105-106. Khuzami testified as to his view that (b)(5)
(b)(5)
(b)(5) *Id.*

at 106. He stated that (b)(5), and they decided to move forward with the Section 13 settlement with Crittenden. *Id.*

G. The Enforcement Staff Decided to Change Tildesley's Settlement to Match Crittenden's Settlement

(b)(5),(b)(6),(b)(7)(C)

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Once the decision was made to accept a Section 13 settlement from Crittenden, the Enforcement staff decided to modify Tildesley's settlement to reflect the same basic terms, thus dropping the Section 17(a) charges against Tildesley and replacing them with Section 13 charges. (b)(6),(b)(7)(C) testified that (b)(6)

(b)(5)
Tildesley (b)(5),(b)(6),(b)(7)(C) Testimony Tr. at 99.
(b)(6),(b)(7)(C) testified that (b)(5) Tildesley's (b)(5)
(b)(5)
Tildesley (b)(5),(b)(6),(b)(7)(C)
Testimony Tr. at 95.

Khuzami also testified that it was the general view of the Enforcement staff that (b)(5) Tildesley and Crittenden (b)(5) Khuzami
Testimony Tr. at 87. Reisner recalled that it was the Enforcement staff's (b)(5)
(b)(5) Tildesley (b)(5) Crittenden. Reisner
Testimony Tr. at 91.

(b)(5),(b)(6),(b)(7)(C)

H. The Commission Approved the Settlements

Once the new, non-fraud settlements were negotiated, the Enforcement staff (b)(5)
(b)(5) and in a session on July 28, 2010, the Enforcement staff presented the settlements to the Commission, and the Commission approved the settlements (b)(6),(b)(7)(C) Testimony Tr. at 100-101.

Under the approved settled action, the staff were authorized to file a civil injunctive action against Citigroup alleging that it violated Section 17(a)(2) of the Securities Act, Section 13(a) of the Exchange Act, and Exchange Act Rules 12b-20 and 13a-11. Minute of July 28, 2010 Commission Meeting, at Exhibit 31. The staff were also authorized to seek disgorgement of \$1 million and a \$75 million civil penalty. *Id.* In addition, the staff were authorized to institute cease-and-desist proceedings against Gary Crittenden and Arthur Tildesley for causing Citigroup's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-11, pursuant to which Tildesley and Crittenden undertook to pay \$80,000 and \$100,000 respectively. *Id.*

(b)(5),(b)(6),(b)(7)(C)

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(b)(5),(b)(6),(b)(7)(C)

V. The OIG Found No Evidence that Settlements Were Reached as a Favor From Khuzami to a Former Colleague

As noted above, approximately six months after the SEC filed the Citigroup case, the SEC's OIG received an anonymous complaint alleging that Crittenden and Tildesley's settlements were the result of a "special favor" for a former colleague. However, the OIG investigation did not find evidence to substantiate that claim.

The anonymous complaint alleged that "Robert Khuzami had a secret conversation, without telling the staff, with a prominent defense lawyer who is a good friend of Khuzami's and a fellow former SDNY alum," and that "[d]uring that secret conversation, Khuzami agreed to drop the 10(b) fraud charges against [one of the individual[s], . . . creating the appearance that his decision was made as a special favor to [the individuals] and perhaps to protect a Wall Street firm for political reasons." The complaint also alleged that the decision "had the effect of protecting the company in private litigation that it faces."

The OIG found that the conversation Khuzami had with Pomerantz did not result in any "secret" deal as the conversation was, at most, merely the beginning of further negotiations and discussions that continued for several days. In addition, the OIG found no evidence that the settlements were reached as a "special favor" for a friend.

Khuzami flatly denied the allegations in his sworn OIG testimony, stating that there was no secret conversation and calling Pomerantz "an acquaintance" rather than a good friend. Khuzami Testimony Tr. at 115. He further stated that because he does not live in New York, he does not see Pomerantz except at speaking engagements. *Id.* at 117. Khuzami maintained that "this decision was based on the evidence and the strength of the case and the risks going forward" and was not to protect a Wall Street firm for political reasons. *Id.* He added that he does not know what the part about "political reasons" even means. *Id.* The OIG did not find any evidence that Khuzami had an unusually close

²⁸ After the Citigroup case was filed, Judge Huvelle questioned the proposed settlement directing the SEC to address questions about the factual basis for the Complaint and the sufficiency of the settlements with Citigroup, Crittenden, and Tildesley, which the SEC did. Memorandum of Plaintiff Securities and Exchange Commission in Response to the Court's Order of August 17, 2010, *SEC v. Citigroup, Inc.*, No. 10-cv-01277 (D.C. filed Sept. 8, 2010), at Exhibit 32. In addition, Judge Huvelle required the parties to change Citigroup's Consent and Final Judgment to include language stating that the disgorgement and penalty funds "will" be distributed to harmed investors and that the parties agree to a mechanism to ensure that Citigroup maintains certain changes made to its disclosure policies and procedures. (b)(5)

(b)(5)

, at

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relationship with Pomerantz or that he made any decision based upon any friendship with Pomerantz. The OIG found that decisions were made after consultation with several members of the Enforcement staff working on the Citigroup investigation, and that these members of the Enforcement staff were given an opportunity to provide their perspectives.

Pomerantz also denied the allegations in the anonymous complaint during his OIG interview. Pomerantz Interview Memorandum at 7. Pomerantz said he thought the "former SDNY alum" referred to in the complaint was him because of the Southern District reference; however, Pomerantz denied that there was any secret conversation and said that he assumed his conversations with Khuzami would be shared with the staff. *Id.* Pomerantz also said that the conversations he had with Khuzami did not pertain to agreeing to drop any charges. *Id.* Pomerantz called the allegations in the complaint "ridiculous" and said the settlement was "not a special favor." *Id.* He said he believed the settlement decision was made "because there was no legal or factual basis to charge Gary [Crittenden] with fraud." *Id.*

(b)(5),(b)(6),(b)(7)(C)

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VI. The OIG Did Not Find that Khuzami's Conduct Violated Prior OIG Recommendations or Enforcement Manual Best Practices

The anonymous complaint further alleged that by not telling the Enforcement staff about his conversation with defense counsel, Khuzami "directly violated recommendations by Inspector General Kotz in previous reports about how such special access and preferential treatment can cause serious appearance problems concerning fairness and integrity of decisions made by the Enforcement Division." Although the OIG previously had issued reports concerning preferential treatment, and the Division of Enforcement distributed a manual addressing situations where outside defense counsel contacts senior SEC officials, the OIG did not find evidence that Khuzami directly violated any prior OIG recommendations or the Enforcement Manual.

In a report issued by the OIG in September 2008, the OIG found that then Enforcement Director Linda Thomson imparted non-public information to defense counsel without first conferring with Enforcement staff attorney Gary Aguirre, who had primary responsibility for the investigation, thereby creating the appearance that she was providing "preferential treatment." See OIG Report of Investigation, *Re-Investigation of Claims by Gary Aguirre of Preferential Treatment and Improper Termination*, Case No. OIG-431, September 30, 2008, at 188-189, excerpt at Exhibit 34. In that report, the OIG recommended "reassessment and clarification" of the Enforcement Division's "practice that allows outside counsel the opportunity to communicate with those above the line attorney level on behalf of their clients when they have issues or disagreements with Enforcement lawyers with whom they have been dealing to ensure such a policy does not result in the favorable treatment or the appearance thereof for prominent individuals and their counsel."²⁹ *Id.* at 191.

Prior to the issuance of the OIG report in the Aguirre matter, but after the OIG commenced its investigation, the Division of Enforcement issued a policy on external communications between senior Enforcement officials and persons outside the Commission.³⁰ Section 3.1.1 of the Enforcement Manual titled, "External communications Between Senior Enforcement Officials and Persons Outside the SEC

²⁹ The OIG report regarding Aguirre's claims also concluded that there were "serious questions about the appropriateness of the current common practice in Enforcement that allows outside counsel the opportunity to communicate with those above the line attorney level on behalf of their clients when they have issues or disagreements with the Enforcement lawyers with whom they have been dealing." *Id.* at 189. In another OIG report issued in September 2009, the OIG found that Thomson failed to confer with Enforcement staff prior to disclosing non-public information about an ongoing investigation. See OIG Report of Investigation *Allegations of Improper Disclosures and Assurances Given*, Case No. OIG-502, September 30, 2009, at <http://www.sec.gov/news/studies/2009/oig-502.pdf>. In both cases, Thomson did not have the level of knowledge or involvement in the case that Khuzami had in the Citigroup matter.

³⁰ According to OIG-502, in February 2008, after the OIG and the Senate Finance and Judiciary Committees commenced investigations, the SEC posted a new policy on external communications to Enforcement's intranet web page, and the policy was subsequently incorporated into the Enforcement Manual, which was issued to the staff on October 6, 2008.

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who are Involved in Investigations” established the following best practices to be applied to all situations in which senior officials (at the Associate Director level and above) engage in material communications with persons outside the SEC relating to ongoing, active investigations:

Generally, senior officials are encouraged to include other staff members on the investigative team when engaging in material external communications, and should try to avoid initiating communications without the knowledge or participation of at least one of the other staff members. However, “participation” could include either having another staff member present during the communications, or having a staff member involved in preparing the senior official for the communications

If a senior official entertains a communication without the participation or presence of other staff members, then the senior official should indicate to the outside person that the senior official will be informing other members of the investigative team of the fact of the communication, along with any pertinent details, for their information and consideration

Within a reasonable amount of time, the senior official should document material external communications related to the investigation involving, but not limited to, potential settlements, strength of the evidence, and charging decisions. The official may take contemporaneous notes of the communication, send an e-mail to any of the assigned staff, prepare a memo to the file, or orally report details to any of the assigned staff (who may then take notes or prepare a memo to the file).

The senior official should at all times keep in mind the need to preserve the impartiality of the Division in conducting its fact-finding and information-gathering functions. Propriety, fairness, and objectivity in investigations are of the utmost importance, and the investigative team cannot carry out its responsibilities appropriately unless these principles are strictly maintained. The senior official should be particularly sensitive that an external communication may appear to be or has the potential to be an attempt to supersede the investigative team’s judgment and experience.

Enforcement Manual, Section 3.1.1, February 8, 2011 (emphasis in original).

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(b)(6),(b)(7)(C) testified that (b)(6) was familiar with the Enforcement Manual's provisions on external communications, and stated (b)(6) felt like (b)(6) was "kept in the loop" during the Citigroup case (b)(6),(b)(7)(C) Testimony Tr. at 106. However, (b)(6),(b)(7)(C) believed there were some instances where the policy was not followed; in particular, (b)(6) pointed to "a number of phone calls with counsel that I don't remember hearing everything that went on in them." (b)(6),(b)(7)(C) Testimony Tr. at 106. (b)(6),(b)(7)(C) also acknowledged in testimony that (b)(6) thought there were situations where (b)(6) was "not kept in the loop as much as (b)(6),(b)(7)(C) could have been." (b)(6),(b)(7)(C) Testimony Tr. at 104-105. (b)(6) stated that (b)(6) would consider communications that led to the decision to settle to something other than Section 17(a) to be material communications for purposes of the guidance contained in the Enforcement Manual. *Id.* at 105.

Friestad testified that to his knowledge, Khuzami did not document the conversation he had with Pomerantz and did not orally report the substance of the conversation to the staff. Friestad Testimony Tr. at 142-143. He further testified that he would have preferred that Khuzami had told him about the Pomerantz conversation, rather than learning about it from defense counsel. *Id.* at 139. Friestad also stated that he believed there may have been other telephone calls between Khuzami and Pomerantz that he never became aware of and he suspected Khuzami had frequent phone calls with defense counsel. *Id.* at 144.

Reisner testified that he was "absolutely confident" that he "adhered to the letter and the spirit" of the Enforcement Manual's guidance on external communications. Reisner Testimony Tr. at 92. Reisner further testified:

[I]t was my practice and is my practice, uh, to either invite staff participation in calls I have with, uh, counsel or to report to the staff promptly if I have a material conversation with counsel, and I believe I did so, uh, in this case. . . .
[O]n Rob [Khuzami], there is nothing that I have seen that suggests to me that Rob [Khuzami] didn't also comply with the applicable guidance.

Id.

Khuzami testified that he did not think his communications with Pomerantz violated the Enforcement Manual because there was "nothing material about what had happened in those conversations." Khuzami Testimony Tr. at 112. He further stated, "The communication I had with Pomerantz was an agreed upon communication in advance to give our response to the Parsons meeting. And there was nothing material about the conversation I had with Mark because it was the -- it was the answer. 'Go talk to Crittenden.' That was the agreed upon response." *Id.*

Khuzami testified that he "understand[s] the reasons for the policy and generally agree[s] with them" and thinks he "complied with the policy." *Id.* at 112-113. Khuzami underscored that the documenting requirement in the Enforcement manual assumes that

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the conversations are material, and maintains that his conversations were not material. *Id.* at 113. Khuzami also noted that the conversations did not happen at the beginning of the case “where you’re doing an investigation that is confidential, and the other side doesn’t know what’s going on and you tell them some information about an investigation,” rather in this case, “we were all fully familiar on our side of the facts of the debates and the issues.” *Id.*

The OIG investigation found that throughout the Citigroup case, Khuzami made significant efforts to keep the Enforcement staff informed as to his involvement and made considerable efforts to allow them to express their views on the case. On each of the two occasions that Pomerantz e-mailed Khuzami requesting a meeting, Khuzami immediately forwarded those e-mails to the staff. *See* E-mail from Pomerantz to Khuzami, April 6, 2010, at Exhibit 19; *see also* Email from Pomerantz to Khuzami, June 17, 2010, at Exhibit 24. The OIG found that Khuzami also included at least some staff members on every meeting he had with defense counsel, and in instances where certain staff members could not attend, Khuzami made sure to brief them after the meetings. In addition, the OIG found that Khuzami held several internal meetings with the staff in which he gave the staff members ample opportunity to express their views on the Citigroup case. The Enforcement staff consistently testified to the OIG that they felt they had the opportunity to express their views throughout the Citigroup investigation.

Accordingly, the OIG investigation did not find evidence that Khuzami violated Section 3.1.1 of the Enforcement Manual. The only communication that could have potentially violated the manual was the conversation Khuzami had with Pomerantz on June 28, 2010. The staff were not included in that telephone call and not briefed immediately after; and settlement terms may have been generally discussed. However, the OIG investigation found that the evidence demonstrated that Khuzami did not commit to any specific settlement in that telephone call and when he understood that Pomerantz had believed such a commitment had been made, Khuzami immediately reached out to Pomerantz to advise him that he had not intended to agree to settle the action against Crittenden for any particular charge. Furthermore, Khuzami reported back to the Enforcement staff the following day about the matter and further discussions were conducted with the Enforcement staff before a final decision on the settlement was made. In addition, and most significantly, Khuzami in his e-mail to Friestad on July 3, 2010, gave the staff an opportunity to change his mind when he asked Friestad if the team was “comfortable” with the Rule 13a settlement and offered to stick with Section 17 if the staff felt it was important to do so.³¹

³¹ Although the OIG found that Khuzami complied with the Enforcement Manual policy, with hindsight, it may have been advisable, given Khuzami’s prior relationship with Pomerantz and the substance of what they discussed, for Khuzami to have included another staff member on his June 28, 2010 call with Pomerantz. The inclusion of another staff member would have diminished the prospect of a preferential treatment accusation as there would have been a direct witness to the conversation. Furthermore, if Khuzami had included Friestad on the call, Friestad would not have been surprised by the subsequent call from Pedowitz.

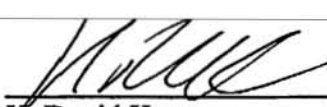
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Conclusion

The OIG investigation did not find evidence substantiating the claims in the January 3, 2011 anonymous complaint, alleging "serious problems with special access and preferential treatment" at the SEC. The OIG did not find that Enforcement Director Khuzami "forced" his staff to "drop fraud charges" against Citigroup as a "special favor" to friends and former colleagues, creating the appearance that he was trying to "protect a Wall Street firm for political reasons." Instead, the OIG found that the settlements were part of a negotiation process that involved several members of the Enforcement staff working collectively on the Citigroup investigation.

In addition, the OIG investigation did not find evidence that Khuzami violated prior OIG recommendations or Enforcement Manual provisions on external communications that were issued to address concerns raised in a previous OIG investigation.

We are providing copies of this report for informational purposes to the Deputy Chief of Staff, Office of the Chairman, Commissioner Elise Walter, Commissioner Luis Aguilar, Commissioner Troy Paredes, the General Counsel, and the Ethics Counsel.

Submitted:	<div style="border: 1px solid black; width: 300px; height: 100px; display: flex; align-items: center; justify-content: center;">(b)(6),(b)(7)(C)</div>	Date:	<u>9-27-11</u>
Concur:		Date:	<u>9/27/11</u>
Approved:	 H. David Kotz	Date:	<u>9.27.11</u>