PRIVATE

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From: Brenda P. Murray
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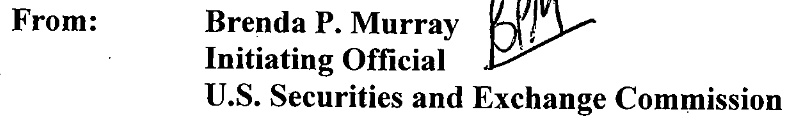
U.S. Securities and Exchange Commission



To: Diego T. Ruiz
Executive Director
U.S. Securities and Exchange Commission

Report of Initiating Official on Administrative Process for Disciplinary and Performance-Based Action Recommended by U.S. Securities and Exchange Commission Inspector General in Case No. OIG-431: Re-Investigation of Claims by Gary Aguirre of Preferential Treatment and Improper Termination

Background

On September 30, 2008, the Securities and Exchange Commission's (Commission or SEC) Inspector General (IG) delivered to Commission Chairman Christopher Cox a Report of Investigation: Case No. OIG-431 (OIG-431) that resulted from a complaint by Gary Aguirre (Aguirre) of preferential treatment and improper termination.[1] Aguirre was employed as a staff attorney in the Commission's Division of Enforcement (Enforcement) from September 7, 2004, through September 2, 2005, when he was terminated.[2] (OIG-431 at Appendix 141.) An investigation of these matters by the former IG, conducted in 2005, and an investigation and report by the U.S. Senate Committees on Finance and the Judiciary, released in August 2007, are described at OIG-431 at 1-4.

On October 21, 2008, the Commission's Executive Director appointed me as the Initiating Official with respect to the IG's recommendations that the Commission take:

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[1] I will cite to OIG-431 as "OIG-431 at __." OGI-431 is a 191-page document with an Appendix of 226 items.

[2] Excepted service employees, including Attorneys, are subject to a one-year trial period beginning on the date of their appointment. (OIG-431 at 22.) Aguirre had tendered his resignation on June 30, 2005, effective September 30, 2005, but withdrew it in an e-mail on July 27, 2005. (OIG-431 at 36, 39.) Aguirre filed a complaint with the Equal Employment Opportunity Commission against the Commission on June 24, 2004. (OIG-431 at 27 n.22 and Appendix 92.) Aguirre also filed a complaint with the Office of Special Counsel, which closed its investigation in 2007 "because [Aguirre] had filed an individual right of action (IRA) with the Merit Systems Protection Board (MSPB)." (OIG-431 at 5 n.6.)

Appropriate disciplinary and/or performance-based action against Linda Chatman Thomsen (Thomsen), a Senior Officer (SO-3) employee, who has been Director of Enforcement from May 2005 through the present;

Appropriate disciplinary and/or performance-based action, including removal of his supervisory responsibilities, against Mark Kreitman (Kreitman), an Assistant Director in Enforcement at the SK-17 level;[3] and

Appropriate disciplinary and/or performance-based action, including removal of his supervisory responsibilities, against Robert Hanson (Hanson), Aguirre's Branch Chief in Enforcement from February though September 2, 2005, at the SK-15 level.

(OIG-431 at 28-29, 191.)

The Executive Director instructed me to complete the task by November 7, 2008.

I advised Hanson and counsel for Thomsen that I would accept written statements preferably by October 29, 2008, but at any time before I finished the task. Beginning on October 22, 2008, in response to requests from Hanson and Thomsen's counsel, I asked the Inspector General to provide me with full documents, portions of which are Appendices to OIG-431. The IG refused to furnish any of the requested materials. Memorandum on Requests for Office of Inspector General Files in Connection with Reports of Investigations in Case Nos. OIG-431 and OIG-483 CONFIDENTIAL (October 28, 2008). However, he later made certain materials available to Hanson and Thomsen's counsel.

Thomsen filed a written response on October 29, 2008. (Response of Linda Chatman Thomsen to Report of Investigation, Case No. OIG-431.)

On October 31, 2008, Hanson filed pro se a written response with four exhibits: (1) Commission's Response to Appeal in Gary J. Aguirre vs. SEC, Merit Systems Protection Board (MSPB), Docket No. DC-121-07-0387-W-1 (April 10, 2007); (2) e-mail to the IG (Oct. 23, 2008); (3) Rating for Robert Hanson for Period Ending May 1, 2008; and (4) Transcript of Witness 2's testimony to IG on April 17, 2008 at 37-44.). (Response of Robert B. Hanson.) Hanson filed a Supplemental Submission on November 4, 2008, with all evaluations in his file at the Commission. (Supplemental Response of Robert B. Hanson.)

I have applied a preponderance of the evidence standard, that is whether a reasonable person, considering the contents of OIG-431, would conclude that Thomsen and Hanson have breached applicable laws, rules, and ethical standards. (MSPB Basic Procedures, Chapter 2.)

[3] On October 22, 2008, in a memorandum to the IG, I postponed these matters as to Kreitman for forty-five days based on [redacted].

OIG-431 discusses in some detail the conduct of Paul Berger (Berger), former Associate Director of Enforcement. Berger is no longer employed by the Commission, and OIG-431 makes no recommendations as to him.

Issues in OIG-431

I. Did the Commission give improper preferential treatment to John Mack (Mack) in connection with the Pequot Capital Management (Pequot) investigation and block Aguirre's efforts to take Mack's testimony because of Mack's political connections and/or prominence? (OIG-431 at 15, 32-69.)

General Electric (GE) announced that it had acquired Heller Financial (Heller) on July 30, 2001. Arthur Samberg (Samberg) was Pequot's Chairman and Chief Executive Officer (CEO). (OIG-431 at 30.) Mack had a personal relationship with Samberg and had been an investor in, and Chairman of, Pequot. (OIG-431 at 30-31.) Samberg and Mack communicated frequently prior to the public announcement. (OIG-431 at 30.) Ten days after Pequot began purchasing Heller stock, Mack became CEO of Credit Suisse First Boston (CSFB), an advisor to Heller in the acquisition. (OIG-431 at 31.) Pequot made a profit of $18.9 million on transactions in Heller and GE securities. (OIG-431 at 30.)

The IG did not find Aguirre's allegation of improper preferential treatment concerning the taking of Mack's testimony to be the basis for any personnel action. The IG concluded:

> Accordingly, the [IG] investigation did not find sufficient evidence to establish that Mack was given improper preferential treatment regarding the taking of his testimony. While there was evidence that the approach taken with respect to Mack's testimony was different than in other cases, Enforcement's explanation of why they felt it appropriate to wait to take Mack's testimony is a reasonable one and based on years of investigative experience. . . . [T]he investigation finds that this evidence [troubling aspects of the communications between Aguirre and his direct supervisor and the somewhat abrupt change in Aguirre's supervisors' views] alone is insufficient to establish that there was a direct connection between Mack's prominence or political connections and the decision not to take Mack's testimony in the summer of 2005.

(OIG-431 at 69.)

II. Did Commission senior Enforcement officials improperly provide representatives of Morgan Stanley non-public information about the Pequot investigation and, specifically, Enforcement's intentions with respect to Mack? (OIG-431 at 16, 69-87.)

On June 23, 2005, as part of its due diligence investigation of Mack, who it was considering hiring as its CEO, a high level Morgan Stanley representative began asking persons in Enforcement whether the Commission would be bringing insider trading charges against Mack in connection with the Pequot investigation. (OIG-431 at 70-74.) Morgan Stanley's previous CEO left amid considerable turmoil, and the caller from Morgan Stanley maintained it was not right

for the Commission to withhold information that Morgan Stanley needed for a hiring decision that could impact it and its shareholders. (OIG-431 at 71, 74 n.45.)

As a result of these inquiries, and the fact that it received a subpoena for Mack's e-mails, Morgan Stanley knew on or about June 24, 2005, that Enforcement "'was looking at Mr. Mack, among others, as part of [its] investigation,'" and there was an implication that Enforcement "'did not presently have evidence of any wrongdoing'" by Mack. (OIG-431 at 74 and Appendix 163.)

On June 27, 2005, Thomsen agreed that Mary Jo White (White), the lawyer conducting a six-day due diligence investigation of Mack for Morgan Stanley's Board vis-à-vis hiring Mack, could transmit directly to her Mack's subpoenaed e-mail records for review and a determination on what Thomsen could say about Mack's involvement in the Pequot investigation. (OIG-431 at 74, 76, 82.) Thomsen received the e-mails on June 28, 2005, and later personally gave them to Aguirre. (OIG-431 at 81.) It appears that Thomsen read the e-mails and talked with Berger, who told her Enforcement did not have enough information about Mack at this stage and he expected that Mack's testimony would be taken at some point. (OIG-431 at 77-78.) Thomsen did not ask Aguirre his opinion of the e-mails. (OIG-431 at 81.)

On June 28, 2005, Thomsen told White that the e-mails did not change Enforcement's opinion of Mack. (OIG-431 at Appendix 163.) It was too early in the investigation to tell whether Mack had any issues and that Enforcement was weeks from knowing more, and she could provide no more comfort. The conversation included a comment by Thomsen, "[T]here is 'smoke there' – but that there was 'surely not fire.'" (OIG-431 at 78-79 and Appendix 163.) White reported to the Morgan Stanley Board that Thomsen said it was too early for Enforcement to conclude whether Mack had any involvement in any alleged unlawful insider trading by Pequot; it seemed clear the Commission would continue the Pequot investigation aggressively, including making sure there was no misconduct by Mack; and Mack likely would be asked to testify. (OIG-431 at 79 and Appendix 163.)

> A member or employee of the Commission shall not . . . :
>
> Divulge to any unauthorized person or release in advance of authorization for its release any non-public Commission document, or any information contained in any such document or any confidential information: (A) in contravention of the rules and regulations of the Commission promulgated under 5 U.S.C. §§ 552, 552a and 552b; or (B) in circumstances where the Commission has determined to accord such information confidential treatment.

17 C.F.R. § 735-3(b)(7)(i).

> Information or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public, but the Commission approves the practice whereby officials of the Division of Enforcement at the level of Assistant Director or higher . . . may engage in and may authorize members of the Commission's staff to engage

> in discussions with persons identified in § 240.24c-1(b) of this chapter concerning information obtained in individual investigations or examinations, including formal investigations conducted pursuant to Commission order.

17 C.F.R. § 203.2.

The IG references SEC Administrative Regulations, Disclosure of Non-Public Information in Connection with Investigations, Examinations or Grants of Access, SECR19-1 (Aug. 31, 1999), which states:

> a. Various SEC rules prohibit disclosure by its officers and employees of information and documents or other non-public records of the SEC obtained in the course of any examinations or investigations, unless the SEC authorizes or approves the disclosure of such information or documents. In certain cases, however, the SEC has authorized its staff to discuss, and grant access to, materials in its examination and enforcement files and other non-public records.
>
> b. The prohibitions against use of non-public information or documents without specific authorization or approval by the SEC does not apply to the use of such materials as necessary or appropriate by members of the staff in pursuing SEC investigations, examinations, or in the discharge of other official responsibilities.

The IG found that the evidence was insufficient to establish a direct connection between Thomsen's communication with Morgan Stanley and Enforcement's decision not to take Mack's testimony in the summer of 2005. (OIG-431 at 87.) However, the IG found the contacts between Thomsen and White to be the basis for a personnel action against Thomsen for the following reasons.

The IG concluded Thomsen imparted relevant information to representatives of Morgan Stanley regarding the nature of Enforcement's evidence against Mack in connection with the Pequot investigation by indicating that "with respect to pertinent e-mails there was 'smoke' but 'surely not fire.'" (OIG-431 at 85-86.) The IG concluded Morgan Stanley used this information to decide to go forward and hire Mack as Chairman and CEO. (OIG-431 at 86.)

The IG concluded that there are serious questions about the information Thomsen provided to Morgan Stanley:

> there is a clear disconnect in Enforcement about procedures for release of non-public information;
>
> Thomsen's failure to consult with Aguirre, the lead lawyer on the investigation, could result in inaccurate information being imparted so that Enforcement might "be more reluctant to bring an action against an individual like Mack after having provided assurances about the lack of evidence." (OIG 431 at 87.);

> it could be useful to a potential target in preparing a defense to know the extent of Enforcement's evidence; and
>
> perhaps of most concern is that the information would not be available to another potential target of lesser means or reputation. (OIG-431 at 87.)

Applying the preponderance of the evidence standard, I conclude that:

Thomsen's disclosure to someone outside the Commission of the status of a pending investigation could be considered a technical violation of the non-disclosure of non-public information regulations, or it could be viewed as covered by an exception to non-disclosure set out in SECR19-1:

> The prohibitions against use of non-public information or documents without specific authorization or approval by the SEC does [sic] not apply to the use of such materials as necessary or appropriate by members of the staff in pursuing SEC investigations, examinations, or in the discharge of other official responsibilities (emphasis added).

Despite his recommendation that the Commission take disciplinary and/or performance-based action against Thomsen, the IG acknowledges:

> Thus, although Commission regulations do not define specifically in what circumstances this type of non-public information may be disclosed, . . . Thomsen may have legitimately believed that the information she provided was necessary in the discharge of her responsibilities . . . .

(OIG-431 at 86.)

The factors management should use in applying responsible judgment to where there has been a violation are set out in Douglas v. Veterans Admin., 5 MSPB 313 (1981). I will consider those criteria seriatim.

> **(1.) Nature and seriousness of the offense, and its relation to the employee's duties, position, and responsibilities including whether the offense was intentional or technical or inadvertent, or was committed maliciously or for gain, or was frequently repeated.**

Morgan Stanley knew Mack was involved in an Enforcement investigation because Enforcement had issued a subpoena for his e-mails while he was employed by Morgan Stanley. Thomsen intentionally disclosed to White that it was premature for Enforcement to determine Mack's involvement in allegations of insider trading in connection with the Pequot investigation, the investigation would continue, and Mack would likely be called to testify.

Thomsen had two, apparently brief, conversations with White. The disclosure of non-public information occurred only in the second conversation. Thomsen's uncontradicted position is that

it was not unusual for her to receive calls from persons outside the Commission about an Enforcement investigation, but generally callers did not ask about the status of an investigation, and that Morgan Stanley should have expected her to state that she could not tell them anything. (OIG-431 at 77, 80.) According to White:

> She said that again reiterated it was premature to really say anything about Mr. Mack's potential exposure, I think she had a comment on the e-mails referring to the e-mails that there was smoke but certainly not fire there on the face of the e-mails, but that it was premature to say anything about his potential exposure.
>
> I think she made a comment that because I undoubtedly reiterated the board didn't want to step into something obviously if there was a problem there and I think she made a comment the board will just have to trust him or not. Because the SEC was not going to be in a position to say anything at this juncture.

(OIG-431 Exhibit 68.)

Thomsen's explanation for disclosing information is that, after receiving the unusual request, she was concerned about the impact on Morgan Stanley and the financial markets if Morgan Stanley hired someone as CEO who Enforcement believed engaged in insider trading, and, alternatively, that Morgan Stanley might not hire a qualified individual because Enforcement indicated somehow that he was in violation of the federal securities laws. (OIG-431 at 77.) The evidence is that Thomsen believed she was faithfully carrying out her responsibilities as Enforcement Director by disclosing information that she was told was significant to an employment decision by Morgan Stanley, information which would not affect Enforcement's investigation. There are no indications that Thomsen's disclosure was committed maliciously or for gain, or was frequently repeated.

The IG places a great deal of emphasis on Thomsen's comment that there was "smoke" but "surely not fire." (OIG-431 at 85-86.) Thomsen's explanation that she was trying to convey that Mack was an actor in what Enforcement was investigating, but it did not have information to take action against him, is a reasonable interpretation. White noted the words, but there is no indication what meaning she gave to them. In the context of the conversation and surrounding circumstances, these words did not have any hidden meaning and did not disclose any more than Thomsen's other less metaphorical comments. After reviewing Mack's e-mails, Enforcement's position was unchanged; Mack remained a person of interest, but Enforcement did not have enough to prosecute at that time.

(2.) The employee's job level and type of employment, including supervisory or fiduciary role, contacts with the public, and prominence of the position.

As one of 103 Senior Officers out of a total Commission work force of 3,649 employees, Thomsen holds a front line, prominent, and public position. (Number from David Cunningham, Office of Human Resources, October 31, 2008.) Enforcement has a long standing open-door policy that encourages people to call senior Enforcement officials. (OIG-431 at 84-85.) It was not unusual for Thomsen to take a call from someone outside the Commission about an

investigation, but it was unusual for her to be asked about the status of an investigation and to receive subpoenaed materials. (OIG-431 at 80.)

The IG does not cite to any authority for his conclusion that Morgan Stanley used information Thomsen provided to go ahead and hire Mack. White testified that Thomsen did not say anything that made her feel more assured that the Board should move ahead in hiring Mack. (OIG-431 at 79.) Based on her own investigation, White, an experienced litigator, concluded that Mack had not engaged in insider trading. (OIG-431 at 74, 77, Appendix 68 at 32.)

(3.) The employee's past disciplinary record.

Thomsen has no prior disciplinary history. (David Cunningham, Human Resources, October 28, 2008.)

(4.) The employee's past work record, including length of service, performance on the job, ability to get along with fellow workers, and dependability.

Thomsen has been a Commission employee in Enforcement since 1995. She is a graduate of Smith College and Harvard Law School. She has been engaged in the practice of law for nearly thirty years. She began as Assistant Chief Litigation Counsel, moved up successively to Assistant Director, Associate Director, and Deputy Director before being appointed Director in May 2005.

(5.) The effect of the offense upon the employee's ability to perform at a satisfactory level and its effect upon the supervisor's confidence in the employee's ability to perform assigned duties.

There is no indication that this event has impacted Thomsen's ability to discharge her responsibilities. As a Senior Officer, Thomsen reports to the Commission Chairman.

(6.) The consistency of the penalty with those imposed upon other employees for the same offense in like or similar circumstances, and (7.) the consistency of the penalty with agency guidance on disciplinary actions.

Neither the Office of Human Resources nor the Office of General Counsel is aware of any similar situation.

(8.) The notoriety of the offense or its impact upon the reputation of the agency.

The publicity about this matter has not benefited the Commission.

(9.) The clarity with which the employee was on notice of any rules that were violated in committing the offense, or had been warned about the conduct in question.