

Warren Buffet, Berkshire Hathaway and the End of Armageddon-Some Lessons Learned

We have previously written about the importance of getting your investigation right before publicly announcing the results. In other words, do not allow your CEO, as Renault did, to go on national television and decree that three (former) executives had foreign bank accounts filled with money from the sale of company trade secrets, unless you have such facts in your possession. This lesson has been recently driven home here in the US by the Oracle of Omaha, Warren Buffet with his remarks at the time of the resignation of company executive David Sokol.

As quoted in today's Wall Street Journal, on when company executive David Sokol resigned back on March 30, Buffet said that he thought Sokol's actions were not "in any way unlawful" when Sokol purchased stock in a company, Lubrizol, that he later recommended that his employer, Berkshire-Hathaway, purchase. However, the WSJ reported that this past Saturday, Buffet said that Sokol's purchases violated the company's insider trading rules and its own Code of Conduct. Further, Buffet was quoted as saying the company had found some "very damning evidence, in my view" about the trades and had turned this over to the Securities and Exchange Commission (SEC). According to today's New York Times, Sokol's lawyer denied this claim and was quoted as saying, "At no time did Mr. Sokol violate any law or any Berkshire policy."

What caused Buffet to change his view on this matter? As reported in the New York Times, on April 27, the Board of Directors "released a scathing report accusing Mr. Sokol of misleading Berkshire about his Lubrizol trades and violating the company's ethics and insider trading policies." In other words, it appears that Buffet's initial statement back in March was made before the facts had been fully investigated. Sound familiar?

So how does all of this relate to the compliance world? We believe that there are at least three lessons to be learned from this matter.

1. Aim Before You Fire Off

As with *L'Affaire Renault*, we believe that a company needs to get the best handle on the facts that it can before going public or disclosing to the SEC any allegation of violations of US Securities Laws. Any allegation of conduct by any senior management official, which violates US laws, must be taken seriously but a thorough investigation must occur. Just as Renault fired off too early by proclaiming facts that have never been found to exist, here Buffet claimed there was nothing to be concerned about less than one month before his own company's Board came to the opposite conclusion after an investigation.

2. Process and Procedure Apply to Everyone

As also noted in today's New York Times, this matter "reveals a lack of appropriate corporate governance and controls nonetheless." My friend Francine McKenna has written an excellent

piece on this matter which is entitled, “*Slippery People: Corporate Governance at Berkshire Hathaway.*” One of her points is that with the decentralized governance and control structure present at Berkshire Hathaway, the company operates “at low levels of internal controls.” In any *best practices* compliance program, internal controls are a key mechanism to detect violations. Even if a company’s business model is successful due to lack of internal controls, it may fail a compliance examination if there is no oversight of senior executives.

3. What Did You Do When You Found Out?

Fairly early on in my compliance career I heard Paul McNulty speak and provide his thoughts on how the Department of Justice (DOJ) looks at Foreign Corrupt Practices Act (FCPA) issues. His remarks have stuck with me. He gave his perspective on the three general areas of inquiry the DOJ would assess regarding an enforcement action. First: “*What did you do to stay out of trouble?*” Second: “*What did you do when you found out?*” and Third: “*What remedial action did you take?*”

So what did Buffet and by extension, his company Berkshire Hathaway, do when they found out. Initially, they announced Sokol was resigning and Buffet made the statements of support. This is certainly not what the DOJ or SEC expect. If there is evidence of misconduct which could violate Securities Law, they expect that the company would self-report the incident and there would be company sanctions against the employee.

This second point is also critical in setting the “Tone at the Top”. Buffet is viewed by many literally as the “Oracle of Omaha” but the message he sent in his supportive statements in March may well have sent the wrong message to company employees. This message may have been corrected by the release of the Board report last week and by the actions of the company going forward. However the damage may have been done. Berkshire Hathaway may have to work very hard to remedy the company’s own internal perception now.

We can only hope that all of this will drive home to all company’s the need for rigorous enforcement of its own Code of Conduct as a first line defense against FCPA violations. However, this episode shows the vital role that internal controls plays in an overall compliance program. I am always reminded of then President Reagan’s words to General Secretary Gorbachev regarding the agreement to reduce and dismantle each country’s nuclear arsenal, “Trust – but verify.”

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