

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 6-102
By *JMV* NARS, Date *5/2/2012*

GC-34-02

ACTION MEMORANDUM

May 3, 2002

TO: The Commission
FROM: Office of the General Counsel *MC*
RE: United States v. Arthur Andersen, LLP,
Criminal Case No. H-02-121 (S.D. Texas)

RECOMMENDATION: That the Commission authorize Thomas C. Newkirk, Associate Director, Division of Enforcement, and Spencer C. Barasch, Associate District Administrator, Fort Worth District Office, to testify as lay witnesses in the above-captioned criminal prosecution for obstruction of justice.

ACTION
REQUESTED BY: May 6, 2002

NOVEL, IMPORTANT
OR COMPLEX ISSUES: Whether a Commission Associate Director of Enforcement should testify in a criminal trial concerning active, on-going Commission investigations or litigation.

OTHER OFFICES
CONSULTED: Stephen Cutler, Division of Enforcement, concurs.

PERSONS TO
CONTACT: Office of the General Counsel
Richard M. Humes 942-0940
Samuel M. Forstein 942-0871
Wm. Smith Greig 942-0916

Division of Enforcement
Stephen Cutler 942-4540
Thomas Newkirk 942-4550

DETERMINED TO BE AN
 ADMINISTRATIVE MARKING
 E.O. 12065, Section 6-102
 By JMV NARS, Date 5/2/2012

INTRODUCTION

On Monday, May 6, 2002, the trial is scheduled to begin in United States v. Arthur Andersen, LLP, Criminal Case No. H-02-121 (S.D. Tex.). Arthur Andersen, LLP ("Andersen") is charged with one count of obstruction of justice (18 U.S.C. 1512(b)(2)) for its destruction of documents and computer files relating to its audits of Enron Corp. ("Enron"). To prosecute the case, the Department of Justice has created the Enron Task Force, naming Leslie R. Caldwell as Task Force Director and appointing Joshua R. Hochberg as Acting United States Attorney for the Southern District of Texas. Serving as one of the Special Attorneys on the Task Force is Samuel W. Buell.

The Task Force / United States Attorney's Office ("USAO") has requested that the Commission authorize Thomas C. Newkirk, Associate Director, Division of Enforcement, to appear as the first witness at trial to testify on the Commission's structure and operations generally, on the functions and oversight of the accounting profession, on the work of the Division of Enforcement in particular, and on the evidentiary basis of two active Commission enforcement matters (Sunbeam and Waste Management). A list of these areas of possible testimony (the "Testimony List"), which was prepared by OGC attorneys, is attached. Specifically, as to Waste Management and Sunbeam, he wants Mr. Newkirk to testify that Andersen, which was the auditor of these two entities, knew from its involvement in Waste Management and Sunbeam investigations that the documents it destroyed would be material to the Commission's Enron investigation. The USAO intends to call as its second witness Spencer C. Barasch, Associate District Administrator in the Fort Worth District Office, to offer lay testimony on the limited subject of the FWDO's October 17, 2001 letter to Enron regarding its Related Party transactions.

The Commission has previously granted a Department of Justice access request in this matter, and the USAO has reviewed and copied Commission documents that it considers relevant to its case against Andersen. When the Commission grants access, there is generally no requirement of specific Commission approval for staff fact or lay testimony. See Office of the General Counsel's 1979 memorandum on access requests. Because Mr. Newkirk's testimony presents the possibility that certain privileged Commission documents and communications regarding Sunbeam and Waste Management will be revealed, we are seeking Commission approval for Messrs. Newkirk and Barasch to provide lay testimony. If the Commission approves the recommendation, attorneys from OGC will accompany them to trial to help ensure that any limitations imposed by the Commission are respected and that Commission privileges are protected as much as possible under the circumstances.

While we believe it important that the Commission support the USAO in prosecuting this obstruction case by permitting Mr. Newkirk to testify (if for no other reason than that it involves obstruction of the Commission's inquiry), doing so presents certain difficulties. Specifically, authorizing Mr. Newkirk to testify about active Commission proceedings presents the risk that he will be cross-examined about privileged matters and that by permitting his testimony, the Commission will be deemed to have waived its privileges, thereby opening up the Commission and staff to discovery regarding privileged documents and communications in Commission cases

DETERMINED TO BE AN
 ADMINISTRATIVE MARKING
 E.O. 12065, Section 6-102
 By JMV NARS, Date 5/2/2012

involving the same or similar issues. In balancing the risks to the Commission against the benefit to the prosecution from Mr. Newkirk's testimony, we believe it appropriate for the Commission to authorize Mr. Newkirk to testify. We do not believe Mr. Barasch's limited factual testimony presents such risks.

BACKGROUND

A. The Obstruction of Justice Charge

The case stems from Andersen's involvement as auditor and consultant for Enron, which declared bankruptcy in December 2001. The criminal indictment asserts that in the summer and fall of 2001, Andersen began to foresee imminent civil litigation against, and government investigations of, it and Enron. The indictment further alleges that in October 2001, Andersen, after being alerted by Enron that the Securities and Exchange Commission had begun to investigate Enron, engaged in the "wholesale destruction" of Enron-related documents and computer files at Andersen's Houston office. The indictment further asserts that Andersen personnel in Andersen's offices in Portland, Oregon, Chicago, Illinois, and London, England were instructed to destroy Enron-related documents, and that Andersen partners in London and Chicago engaged in the destruction of Enron-related documents. The indictment concludes that Andersen, through its partners and others, knowingly and intentionally persuaded and attempted to persuade its employees to withhold records, documents, and other objects from regulatory and criminal proceedings and investigations and to destroy and conceal evidence.

Under the obstruction of justice statute, 18 U.S.C. 1512(b), the USAO must prove that Andersen: i) knowingly, ii) engaged in corrupt persuasion and attempts at corrupt persuasion toward another person, iii) with the intent to withhold a record, document, or other object, iv) from a regulatory or criminal proceeding. Obstruction of justice under 18 U.S.C. 1512 is a specific intent crime, so the USAO must establish that Andersen knew the documents and computer records it was destroying were useful in a Commission investigation and that Andersen intended to impair their availability in the investigation. See United States v. Kellington, 217 F.3d 1084, 1098 (9th Cir. 2000) (obstruction of justice is a specific intent crime).

B. The Testimony Sought by AUSA Buell

In its initial contacts with Mr. Newkirk, the USAO indicated that it sought his testimony on the general importance of documents to the Commission's investigation and prosecution of cases of accounting fraud. The USAO was aware of the declarations that Mr. Newkirk had executed in support of amicus briefs the Commission filed in private securities litigation involving Waste Management, Inc. ("Waste Management") on the importance of documentary evidence in establishing certain cases. Those declarations state, among other things, that analysis of audit work papers can be very important to the Commission staff in conducting an investigation of accounting irregularities.

The USAO now seeks Mr. Newkirk's detailed testimony on a much wider range of

DETERMINED TO BE AN
 ADMINISTRATIVE MARKING
 E.O. 12065, Section 6-102
 By JMV NARS, Date 5/2/2012

subjects, including the Commission's history, structure, operations, authority, and certain of its regulations (see Testimony List items 1-7); auditors and accountants, including their functions and methods; the standards and principles included in GAAP and GAAS; the role of FASB and the AICPA (see Testimony List items 8-19); and the definition and purpose of forms 10-K, 10-Q, and 8-K (see Testimony List items 20 and 21). AUSA Buell also seeks Mr. Newkirk's testimony regarding the number of Enforcement actions the Commission brings against Big 5 engagement partners in a typical year (Testimony List item 24).

Of particular concern are questions the USAO seeks to ask regarding active on-going Commission investigations and litigation. Specifically, the USAO wants Mr. Newkirk to testify regarding the importance of Andersen's working papers and other documents in the Commission's investigations of and litigation involving Waste Management (Testimony List item 22) and Sunbeam Corp. ("Sunbeam") (Testimony List item 23).¹

As to Waste Management, in SEC v. Buntrock, No. 02-CV-2180 (N.D. Ill.), the Commission recently sued the founder and five other former top officers of Waste Management for financial fraud. Mr. Newkirk signed the Commission's Complaint in this matter. Defendants' answers to the Commission's complaint are due on May 31, 2002. The parties are currently engaged in discussions regarding the scope of discovery. In June 2001, the Commission settled a civil action and related administrative proceedings arising from Andersen's audits of Waste Management's financial statements from 1992 through 1996.² Mr. Newkirk participated in the preparation of the action memoranda seeking authorization to commence a formal investigation

-
- 1 On April 30, 2002, AUSA Buell, acknowledging a significant change in tactics, informed us that he will not seek any testimony from Mr. Newkirk regarding Enron. Thus, Testimony List items concerning Mr. Newkirk's opinions on Enron are no longer relevant. Mr. Newkirk has no direct involvement in the Commission's continuing investigation of Enron.
- 2 The civil injunctive action against Andersen and three of its partners charged violations of the antifraud provisions, and the five related administrative proceedings, brought under Rule 102(e), were against Andersen, the three partners named in the civil action, and a fourth Andersen partner. The civil action against Andersen and related administrative proceedings were:
- Securities and Exchange Commission v. Arthur Andersen LLP, Robert E. Allgyer, Walter Cercavschi, and Edward G. Maier, Civil Action No. 1:01CV01348 (J.R.) (D.D.C. June 19, 2001);
- In the Matter of Arthur Andersen LLP, Administrative Proceeding File No. 3-10513;
- In the Matter of Robert E. Allgyer, CPA, Administrative Proceeding File No. 3-10515;
- In the Matter of Edward G. Maier, CPA, Administrative Proceeding File No. 3-10514;
- In the Matter of Walter Cercavschi, CPA, Administrative Proceeding File No. 3-10516;
- and
- In the Matter of Robert G. Kutsenda, CPA, Administrative Proceeding File No. 3-10517.

DETERMINED TO BE AN
 ADMINISTRATIVE MARKING
 E.O. 12065, Section 6-102
 By JMV NARS, Date 5/2/2012

of Waste Management, to file suit, and to enter into the settlement agreement.

As to Sunbeam, on July 11, 2001, the Commission filed an amended complaint in SEC v. Albert J. Dunlap, et al., Case No. 01-8437-Civ. (S.D. Fla.), charging five former officers of Sunbeam, as well as an Andersen partner, with fraudulent accounting practices. Mr. Newkirk signed the original complaint, his name appears on the amended complaint, and he reviewed the action memorandum, the settlement documents, and the formal orders of the Commission. The action is on-going.

In a conversation with OGC attorneys, AUSA Buell stated that Mr. Newkirk's testimony regarding Waste Management and Sunbeam would help to establish that Andersen, which was the auditor for those companies, knew that its audit and other documents would be highly relevant to a Commission investigation (the knowledge element of the obstruction of justice charge) and that Andersen therefore had a motive to destroy them (the intent element). Under FED. R. EVID. 404(b), evidence of Andersen's prior acts may be admitted as proof of motive, plan, intent, knowledge, or absence of mistake or accident. AUSA Buell regards this testimony as highly important to the prosecution's case.

On cross-examination, Mr. Newkirk may face questions concerning the bases of his testimony regarding Commission investigations or litigation, including regarding privileged conversations and documents. Thus there is a specific risk to the Commission's on-going actions involving Waste Management and Sunbeam. In these enforcement actions, for example, the court may declare that Mr. Newkirk's testimony constituted a waiver of any Commission privileges for internal Commission documents and communications regarding those cases and allow discovery against the Commission and staff that would involve communications normally deemed privileged.³

The Division of Enforcement believes that if privileged information were to be revealed, it would not unduly harm the Commission. Specifically, while Enforcement is of the view that it would be not be good for the Commission and staff to be subjected to such discovery, they do not believe that such discovery would result in derailing the Commission's cases. Given Mr. Newkirk's position and experience, and the potential breadth of his testimony, there is also a general risk to other Commission matters that may have informed Mr. Newkirk's testimony. It is not inconceivable that Mr. Newkirk may be cross-examined about other Commission investigations and litigation involving accounting irregularities on which he has worked. This could lead to questioning regarding privileged matters from those inquiries.

³ Internal staff memoranda are normally protected by the work product, deliberative process, and law enforcement privileges; memoranda from the staff to the Commission are in addition protected by the attorney-client privilege. See 8 Charles A. Wright & Arthur R. Miller, FEDERAL PRACTICE AND PROCEDURE § 2016.2 (2d ed.) ("When a party puts privileged matter in issue as evidence in a case, it thereby waives the privilege as to all related privileged matters on the same subject," citing United States v. Pierre, 132 F.2d 837, 839-40 (2nd Cir. 1942) (Hand, J.)).

DETERMINED TO BE AN
 ADMINISTRATIVE MARKING
 E.O. 12065, Section 6-102
 By *Jmi* NARS, Date *5/2/2012*

DISCUSSION

Where, as here, the Commission has previously granted a Department of Justice access request in a matter, there is generally no requirement of specific Commission approval for staff fact or lay testimony. See Office of the General Counsel's 1979 memorandum on access requests. The potential risks to privileged Commission materials, however, as well as the importance and prominence of the case against Andersen, lead us to seek Commission approval for Messrs. Newkirk and Barasch to provide lay testimony.

The USAO's desire for helpful testimony from Messrs. Barasch and Newkirk must be balanced against the Commission's interests in its on-going matters. Having analyzed this balance of interests, we believe that the Commission should authorize Mr. Newkirk to testify to the extent he is able to do so regarding the general history, structure and operations of the Commission; the responsibilities, functions and oversight of the accounting profession; and the required filings of 10-Q's, 10-K's, and 8-K's. Mr. Newkirk's testimony on these general matters appears to hold minimal risk, provided that no reference is made in the questions or the testimony to active Commission matters.⁴ Similarly, Mr. Barasch's proposed testimony regarding the FWDO's October 17, 2001, letter to Enron appears to present little risk.

With greater difficulty, we conclude that Mr. Newkirk should also be authorized to testify regarding the importance of the documentary evidence he obtained in the Waste Management and Sunbeam cases, and regarding cases brought against Big 5 engagement partners in general.

In balancing the interests of the USAO and the Commission in this matter, we first examine the benefits to the prosecution, as they are considerable. Mr. Newkirk's testimony regarding the importance of documentary evidence in prior Commission cases involving Andersen will directly support prosecution arguments that Andersen knew that documents related to its Enron audits would be relevant to a Commission investigation and therefore had a motive to destroy them. As noted, AUSA Buell regards Mr. Newkirk's testimony as highly important to the prosecution's case and believes that Mr. Newkirk's knowledge, experience and credibility will be accorded considerable weight by the jury. Moreover, it behooves the Commission to assist the prosecution of obstruction of justice related to its own investigations.

On the other hand, the risks to the Commission are considerable. Although the Commission and the USAO can likely reach agreement on the questions to be put to Mr. Newkirk on direct examination, the USAO cannot control what the defense asks him on cross examination. Even as a lay witness, if on direct examination Mr. Newkirk testifies regarding

⁴ We explored with AUSA Buell whether he has considered having an academic testify on these general issues rather than Mr. Newkirk, and we offered to identify some potential academic experts. AUSA Buell responded that the trial date was too near for the USAO to attempt to engage a suitable academic expert, and that in any case, as the Commission "stands in the shoes of investors," a Commission witness would have a greater impact.

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 6-102
By JMV NARS, Date 5/2/2012

specific Commission investigations and litigation, he may face cross-examination regarding these matters. Thus there is a risk to the Commission's on-going actions involving Waste Management and Sunbeam, particularly given Mr. Newkirk's involvement in preparing or reviewing action memoranda and other privileged internal documents. In addition, given Mr. Newkirk's experience and position, he could be queried as to any matters that informed his testimony, thus extending the risk beyond the Waste Management and Sunbeam matters. (As to the current criminal charge against Andersen, Mr. Newkirk has stated that he is not qualified to testify and that he has no personal knowledge of nor has he authored or edited any memoranda pertaining to the facts.)

In a criminal case, the defendant is generally entitled only to the limited discovery allowed by FED. R. CRIM. P. 16; verbatim written statements discoverable under the Jencks Act, 18 U.S.C. 3500; and exculpatory materials as mandated by the Supreme Court in Brady v. Maryland, 373 U.S. 83 (1963). It seems unlikely that the court would grant a motion for a continuance to take discovery, as the trial is set for Monday, May 6, and the court recently denied Andersen's request for a postponement of that date. Nevertheless, under FED. R. CRIM. P. 17(f), it is theoretically possible that defense counsel could seek to depose Mr. Newkirk once his name appears on the USAO's witness list.

CONCLUSION

We recommend that the Commission approve Mr. Barasch's proposed testimony regarding the FWDO's October 17, 2001, letter to Enron and Mr. Newkirk's proposed testimony as to general questions concerning the Commission, the accounting profession, and required filings. We also recommend that the Commission approve Mr. Newkirk's proposed testimony as to the Waste Management and Sunbeam investigations and litigation.

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 8-102
By JMV NARS, Date 5/2/2012

United States v. Arthur Andersen, LLP
Criminal Case No. H-02-121 (S.D. Tex.)

**Areas of Possible Testimony of Thomas Newkirk and Spencer Barasch
Outlined by AUSA Samuel Buell**

The Commission Generally

1. The history of the Commission, including the Crash of '29, the study leading to the formation of the Commission, the Securities Act of 1933, and the Securities Exchange Act of 1934.
2. The structure and operations of the Commission.
3. What the Commission does to protect investors; more specifically, what the Divisions of Enforcement and of Corporate Finance do.
4. Whether the Commission has the authority to promulgate its own accounting rules.
5. Whether the Commission requires quarterly reviews by auditors.
6. The purpose of a Commission "Accounting Letter" (possibly referring to a letter issued by Corporate Finance).
7. Whether the Commission requires auditors and accountants to adhere to certain document-retention policies.

Auditors

8. The work and responsibilities of auditors, including the role of the Big 5 and the importance of auditors in providing information to markets.
9. The definition and importance of an auditing restatement.
10. Whether Andersen would be automatically barred from practice if it were convicted of a felony.
11. The role of analysts on the buy side and on the sell side.
12. The legal context of the powers exercised by FASB, i.e. from whence the powers of FASB derive.
13. The responsibilities of auditors to make disclosures in financial statements where information provided requires additional explanation in order to be complete.
14. The role of the Quality Control Inquiry Committee of the AICPA.
15. The consequences of an AICPA sanction.
16. Whether GAAS or GAAP contain document retention policies.
17. What is the universe of "working papers" in an audit.
18. Whether GAAS requires an auditor to maintain documents reflecting internal disagreements over the course and conclusions of its audit.

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 8-103
By JMV NARS, Date 5/2/2012

19. The obligations of auditors under Section 10A of the '34 Act to report illegal acts.

Forms and Filings

20. The definition and purpose of 10-K's and 10-Q's and the requirements relating thereto, including whether they must be filed by all companies listed on the NYSE.
21. The definition and purpose of 8-K's.

Active Commission Matters

22. The Commission's investigation of and litigation against Waste Management, Inc., with an emphasis on the Andersen documents.
23. The Commission's investigation of and litigation against Sunbeam, with an emphasis on the Andersen documents.
24. The number of cases the Commission brings against Big 5 engagement partners in a typical year.
25. The impetus for the Commission's opening of its investigation into Enron and the Commission's October 17, 2001, letter to Enron.
26. Enron's place in the Fortune 500 in recent years, and the basis for Fortune's rankings (total revenue).
27. Whether in its investigations the Commission generally requires accounting firms to produce their e-mails.
28. Discussion of charts relating stock prices of Sunbeam and Enron to specific events.

Miscellaneous

29. The substance of an article by Chairman Pitt in which he referred to document-retention policies vis-à-vis investigatory subpoenas.