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Leading and Managing Through an Existential Crisis

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Introducing Today's Presenters



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Agenda

- The Case Study
- Litigating Through a Crisis
- Lessons Learned from SEC Cases on Corporate Crises

The Case Study

RE Co.

- RE Co. is a publicly traded real estate investment and management company focusing on commercial real estate, logistics, multifamily, and single-family units.
- RE Co. manages 15 vertical funds, each structured as a limited partnership or limited liability company.
- Re Co. has:
 - \$50B AUM
 - >5,500 employees
 - >50,000 MF units
 - >12 MM square feet in logistics



Big City Fund

- Big City Fund (“BCF”) is one of RE Co.’s flagship vertical closed-end funds. BCF:
 - Formed pre-pandemic with >\$1B in cash from lenders and global investors to facilitate investments in commercial real estate (CRE) projects throughout the US.
 - During the pandemic, CRE values plummeted with skyrocketing office vacancies.
 - Post-pandemic, RTO policies failed and tenants defaulted.
 - By the end of October, 90% of BCF’s real property holdings were underwater and could not be sold.
 - Lenders refused to defend the assets or take them back.
 - BCF’s entire portfolio was in danger of being marked-to-market to \$0.



The Scheme

- RE Co.'s CEO recognized that the lender and investor situation with BCF was extremely tenuous.
- At the same time, he was wary of disclosing the full truth about BCF's precarious financial condition to RE Co.'s investors because the Fund was integral to RE Co.'s overall strategy.
- Besides, he thought, the situation could work itself out over time: He said:
 - ~“The market will rebound. I just know it!”
 - ~ “Credit will be available! Banks will have capital to lend!”
 - ~ “Investors will be patient. They get it...”
- **NONE OF THIS WAS ACCURATE.**



The Scheme

- Negotiations with the lenders dragged on for months without a clear resolution in sight.
- By the end of January 2024, RE Co.'s Controller emailed the CEO to discuss the numbers that RE Co. should disclose in its annual filings regarding BCF's performance as it did every year.
- The CEO was the sole decisionmaker and CIO for BCF, as it was RE Co.'s prized fund, and only he had access to the numbers.
- After receiving the Controller's email, the CEO turned to a secret spreadsheet saved on the local drive of his personal computer, manipulated BCF's true numbers to conceal the Fund's flagging performance, and cut and pasted the numbers into an email response back to the Controller.
- Minutes later, the CEO called his broker and directed the broker to sell 10% of his RE Co. holdings.



The Scheme

- The Controller received the CEO's reply and thought that it was odd.
- Normally, the CEO would send a spreadsheet reflecting the calculations for BCF's financial performance.
- Nonetheless, the Controller busied herself with gathering all of the relevant fiscal-year end financial information, and simply plugged in the CEO's BCF numbers into the company's financial statements without further thought.
- Two weeks later, RE Co. announced its year-end results, which included the CEO's falsified numbers, to much fanfare from its investors.



The Scheme

- One month later, BCF's talks with the lenders failed.
- The Fund marked the portfolio to \$0, which then permitted it to commence liquidation proceedings under state law without the consent of its investors.
- RE Co.'s stock price tanked by over 80%.
- Shareholder litigation and SEC/DOJ investigations ensued.



Litigating Through a Crisis

The Investigation Begins

Possible Triggers

Whistleblowers

Financial restatement

Civil litigation

Industry initiatives

News reports

Tips from competitors

Referrals from other agencies

Parallel Proceedings

Civil Complaint



Parallel Proceedings

Civil Complaint



Civil Investigation



Criminal Investigation



Regulators and Investigators



SEC



OFAC



FBI



State AG



FTC



ICE



DOJ



Antitrust



HHS

Coordinated Campaign



Coordinated Campaign



Litigating Through the Crisis

- What happened?
- What does it mean?
- What should you do about it?

Response

To-Do Checklist

- Call your lawyer
- Reports to Board and Committees?
- Consider public disclosure obligations
- Preserve information (hard copy and ESI)
- Determine whether to conduct an internal investigation

Resist or Cooperate?

Resistance

- Establish credibility
- Enhance chances of settlement
- Government may back down

Cooperation

- Establish credibility
- Establish good will
- Minimize potential scope

Internal Investigation

Key Questions



- Who is being investigated?
- Who should investigate?
- To whom should they report?
- Scope of investigation?

Internal Investigation

Considerations



- Avoid disruption
- Government may demand investigation report
- Protecting information
 - Discoverable by plaintiffs
 - Privilege considerations
 - Confidentiality agreement with government?

The Difficult Witness – Tips for Getting Through It

- **Meet people where they are.**
 - Work with what you have.
- **Different court, different authority.**
 - Often someone with power.
 - Someone else in charge.
- **New game, new rules.**
 - Tell smart, successful people how to win this game.
 - No water cooler conversation.

Public Relations

Presumption of Innocence

Timing

Message

Court presumption

Investigations take a long time

Lawyers speak legalese

Public assumes that gov't has a case

Impressions readily formed – need strategy ASAP

Everybody else speaks English

Public Relations

Some Rules

- “No Comment” is still okay (or maybe not)



Public Relations

Some Rules

- “No Comment” is still okay (or maybe not)
- Know your themes
 - PR & Legal must work together
 - Include lawyers in conversations with PR personnel



Public Relations

Some Rules

- “No Comment” is still okay (or maybe not)
- Know your themes
- Use your friends

Public Relations

Some Rules

- “No Comment” is still okay (or maybe not)
- Know your themes
- Use your friends
- Big company, but real people
 - Acknowledge that it matters
 - Show that you care

Public Relations

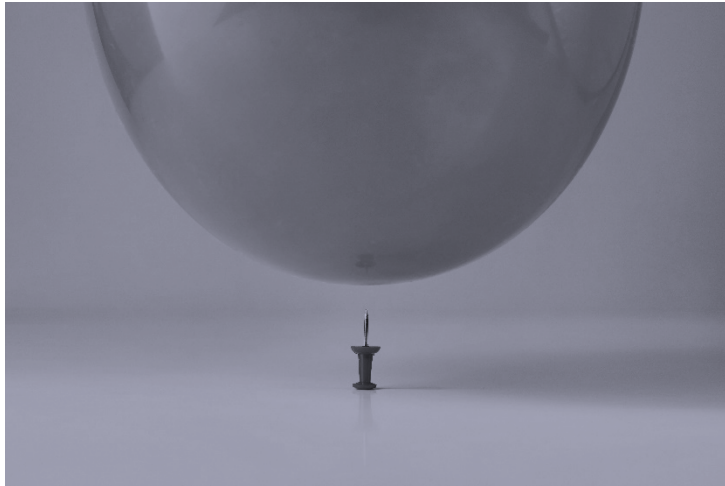
Some Rules

- “No Comment” is still okay (or maybe not)
- Know your themes
- Use your friends
- Big company, but real people
- Media (and life) are not fair
 - Beware of soundbites
 - Providing information on background

Follow-Up

Action Plan

**Assess risks and take
corrective action**



Develop strategy for PR risk



**Cultivate relationships and
credibility with agencies**



Lessons Learned From SEC Cases on Corporate Crises

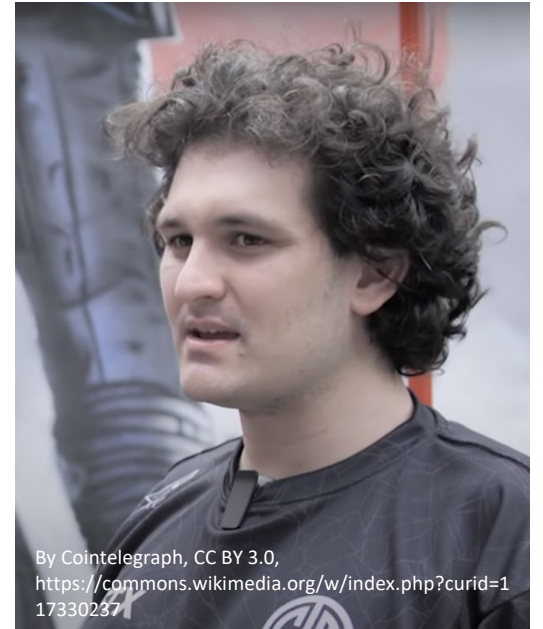
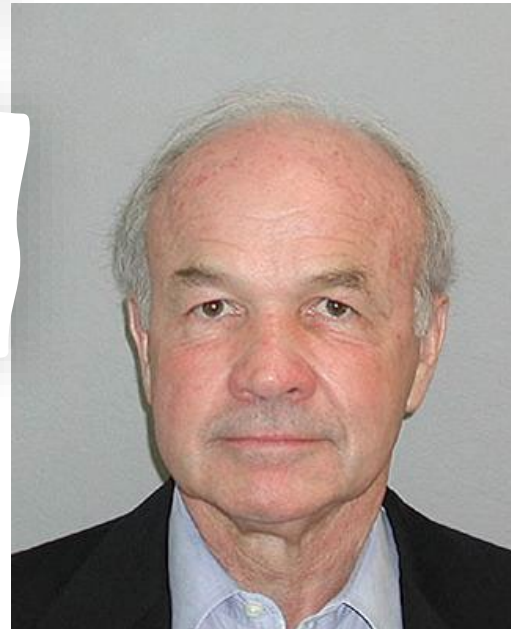
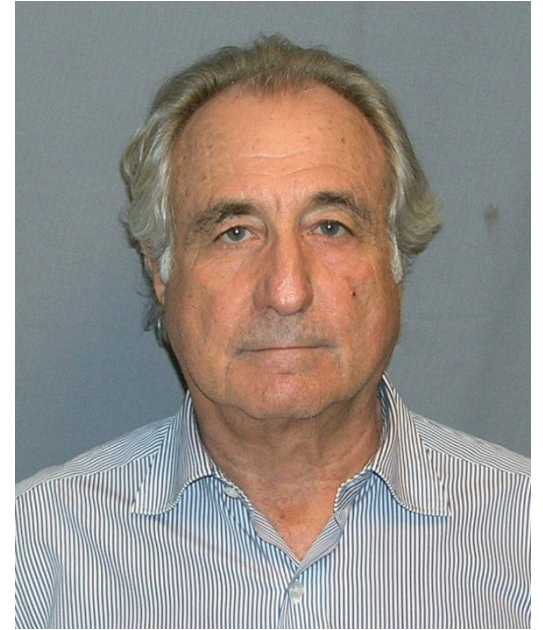
What makes an SEC case front-page news?

Rise and Fall of Theranos CEO

The Most Hated Man in NY

Bottom line: Guilty

'King of Crypto' convicted of defrauding customers



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<https://commons.wikimedia.org/w/index.php?curid=17330237>

Common Themes from SEC Fraud Cases



The Company Encounters a Challenge

Case3:14-cv-00123 Document1 Filed01/09/14 Page1 of 16

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13 SECURITIES AND EXCHANGE COMMISSION
14 Plaintiff,
15 v.
16 DIAMOND FOODS, INC.
17 Defendant

18 Plaintiff Securities
19 I. This case

20 Diamond Foods, Inc. ("Diamond")
21 Diamond's businesses include
22 retailers. As a result of a
23 fraudulently manipulate

24 Diamond reported inflated earnings for the years 2010 and 2011.

25 2. During 2010, CFO Neil faced pressure to meet or exceed the earnings estimates of
26 Wall Street stock analysts. At that time, Neil and Diamond encountered sharp increases in
27 walnut prices. Diamond's largest commodity cost was walnuts. Diamond would need to pay
28 growers higher prices for their walnuts in order to maintain the company's longstanding

SEC V. DIAMOND FOODS, INC.

1

COMPLAINT

During 2010, Neil faced **pressure to meet or exceed the earnings estimates of Wall Street stock analysts.** At that time, Neil and Diamond encountered sharp increases in walnut prices. Diamond's largest commodity cost was walnuts. Diamond would need to pay growers higher prices for their walnuts in order to maintain the company's longstanding relationships with its growers. **Yet Diamond could not increase the amounts paid to growers for walnuts without decreasing Diamond's net income as reported to the investing public.**

SEC v. Diamond Foods, Inc., Complaint ¶2

Lachwani was able to carry out his fraudulent scheme for years because he **controlled and managed all the key aspects** of HeadSpin's financials and sales operations, and he kept HeadSpin employees in those different departments isolated from each other. For instance, virtually all the information provided to HeadSpin's bookkeeper, including the supporting documentation for claimed revenue amounts, flowed through Lachwani.

SEC v. Lachwani, Complaint ¶25

From the time that Balwani joined Theranos until his departure in 2016, Theranos had **no other senior managing executives besides Holmes and Balwani**. Holmes generally focused on device innovation, board interaction, and strategic relationships, while Balwani concentrated on developing software for Theranos' technology and managing personnel and operations. Still, they collaborated closely with each other and made decisions about the company together.

SEC v. Holmes & Theranos, Complaint ¶18

Bankman-Fried remained the **ultimate decision-maker** at Alameda, even after Ellison and Trabucco became co-CEOs in or around October 2021. Bankman-Fried **directed** investment and operational decisions, frequently communicated with Alameda employees, and had **full access** to Alameda's records and databases.

SEC v. Bankman-Fried, Complaint ¶18

The CEO Takes Control – Why is This Element Necessary?

The Supreme Court’s decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011) limits liability for intentionally false statements to those who are deemed the “maker” of the statements.

“For purposes of Rule 10b–5, **the maker** of a statement is the person or entity with **ultimate authority over the statement**, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not “make” a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker.”

As a result:

- The SEC will typically look at the individual who signs or certifies a statement
- It is harder to charge individuals lower down the chain because while they may have intent, they do not have ultimate authority over the statement.

Cite as: 564 U. S. ____ (2011)

1

Opinion of the Court

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 09–525

JANUS CAPITAL GROUP, INC., ET AL., PETITIONERS
v. FIRST DERIVATIVE TRADERS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FOURTH CIRCUIT

[June 13, 2011]

JUSTICE THOMAS delivered the opinion of the Court.

This case requires us to determine whether Janus Capital Management LLC (JCM), a mutual fund investment adviser, can be held liable in a private action under Securities and Exchange Commission (SEC) Rule 10b–5 for false statements included in its client mutual funds’ prospectuses. Rule 10b–5 prohibits “mak[ing] any untrue statement of a material fact” in connection with the purchase or sale of securities. 17 CFR §240.10b–5 (2010). We conclude that JCM cannot be held liable because it did not make the statements in the prospectuses.

I

Janus Capital Group, Inc. (JCG), is a publicly traded company that created the Janus family of mutual funds. These mutual funds are organized in a Massachusetts business trust, the Janus Investment Fund. Janus Investment Fund retained JCG’s wholly owned subsidiary, JCM, to be its investment adviser and administrator. JCG and JCM are the petitioners here.

Although JCG created Janus Investment Fund, Janus Investment Fund is a separate legal entity owned entirely

Under Pressure, the CEO Turns to Fraud

From approximately July 1999 through October 2001, Enron entered into fraudulent transactions with LJM. The transactions enabled defendants and others to manipulate -Enron's reported financial results by, among other things: (a) improperly moving poorly performing **assets off-balance sheet**; (b) **concealing Enron's poor operating performance**; (c) manufacturing earnings through **sham transactions**; and (d) improperly inflating the value of Enron's investment portfolio by **backdating documents**.

SEC v. Lay, Skilling, Causey Complaint ¶122

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

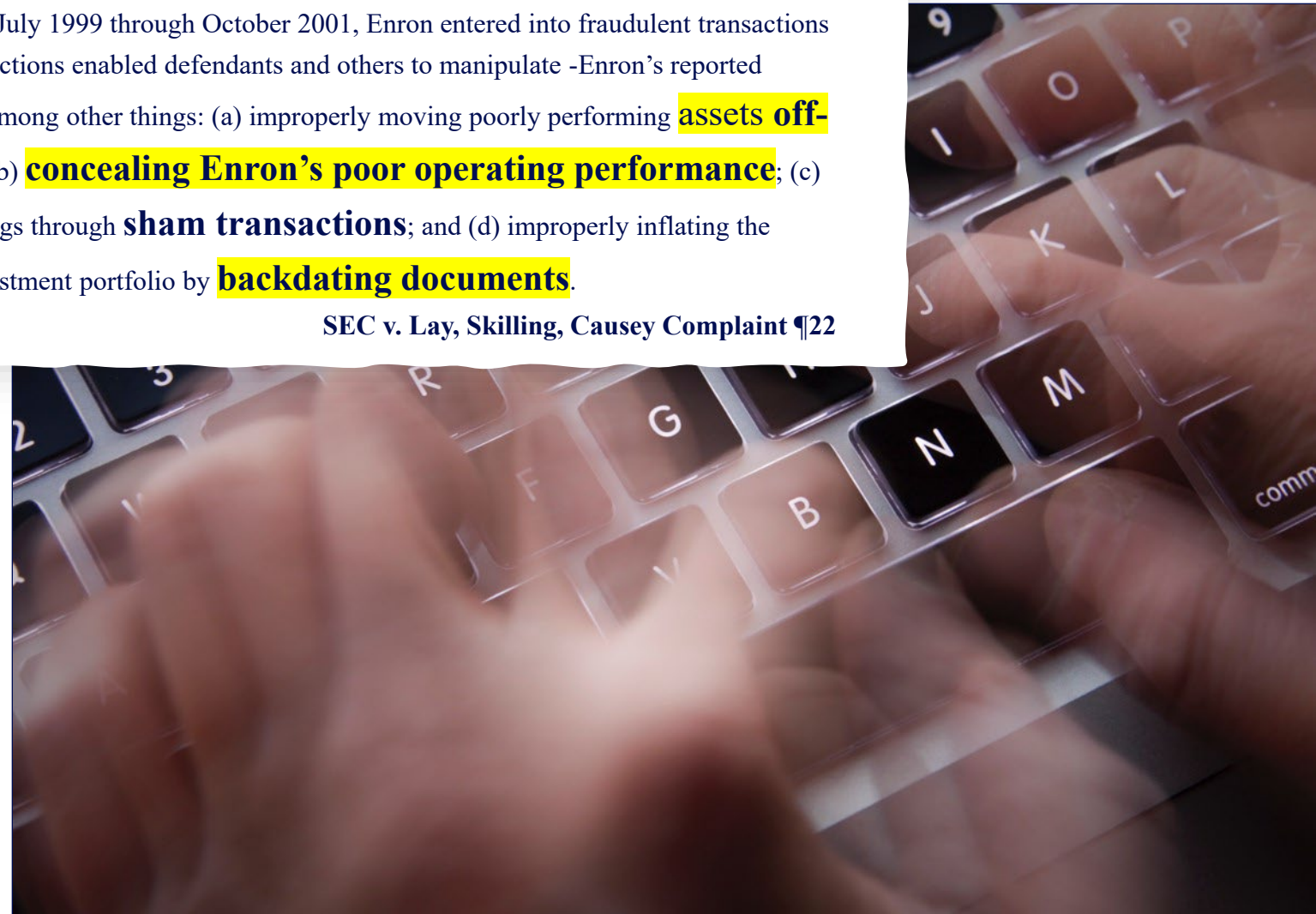
UNITED STATES SECURITIES
AND EXCHANGE COMMISSION,
Plaintiff,
v.
KENNETH L. LAY,
JEFFREY K. SKILLING,
RICHARD A. CAUSEY,
Defendants.

Civil Action No. 11-04-
SECOND AMENDED
JURY DEMANDED

Plaintiff Securities and Exchange Commission (the "Commission") for its Second Amended Complaint alleges as follows:

SUMMARY

1. Kenneth L. Lay, Jeffrey K. Skilling, and Richard A. Causey, all former senior executives of Enron, engaged in a multi-faceted scheme to defraud in violation of the federal securities laws. From at least 1999 through late 2001, Lay, Skilling, Causey, and others manipulated Enron's publicly reported financial results and made false and misleading public statements about Enron's financial condition and its actual performance. As an objective and result of their scheme to defraud, Lay, Skilling, Causey, and others made millions of dollars in the form of salary, bonuses, and the sale of Enron stock at prices they had inflated by fraudulent means. Skilling and Causey made at least \$103 million and \$23 million, respectively, in illicit gains. Lay also made millions of dollars in illicit gains, and was unjustly enriched when he



The Fraud Comes to Light, and the CEO is Exiled

Case 1:22-cv-10501 Document 1 Filed 12/13/22 Page 1 of 28

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND
EXCHANGE COMMISSION,

Plaintiff,

v.

SAMUEL BANKMAN-FRIED,

Defendant.

Civil Action No. 22-cv-10501

JURY TRIAL DEMANDED

COMPLAINT

Plaintiff Securities and Exchange Commission (the “SEC”) brings this Complaint against Defendant, Samuel Bankman-Fried (“Bankman-Fried”).

SUMMARY

1. From at least May 2019 through November 2022, Bankman-Fried orchestrated a scheme to defraud equity investors in FTX Trading Ltd. (“FTX”), a trading platform of which he was CEO and co-founder, at the same time as he was also the CEO of FTX’s platform’s customers. Bankman-Fried raised more than \$1.8 billion from U.S. investors, who bought an equity stake in FTX believing in its growth and risk management measures. Unbeknownst to those investors (and other FTX customers), Bankman-Fried was orchestrating a massive, year-long scheme to divert billions of dollars of the trading platform’s customer funds for his own personal use in his crypto empire.

2. Throughout this period, Bankman-Fried portrayed himself as a leader of the crypto community. He touted the importance of regulation



But Bankman-Fried did not stop there. Even as it was increasingly clear that Alameda and FTX could not make customers whole, Bankman-Fried continued to misappropriate FTX customer funds. Through the summer of 2022, he directed hundreds of millions more in FTX customer funds to Alameda, which he then used for additional venture investments and for “loans” to himself and other FTX executives. All the while, he continued to make misleading statements to investors about FTX’s financial condition and risk management. Even in November 2022, faced with billions of dollars in customer withdrawal demands that FTX could not fulfill, Bankman-Fried misled investors from whom he needed money to plug a multi-billion-dollar hole. His brazen, multi-year scheme **finally came to an end** when FTX, Alameda, and their tangled web of affiliated entities **filed for bankruptcy** on November 11, 2022.

Our Hypo: *SEC v. RE Co. CEO*

In 2023, **RE Co.'s CEO faced pressure to meet or exceed earnings estimates** of Wall Street analysts. By November 2023, the CEO became aware that RE Co.'s flagship fund

was **Faced with these challenges, the CEO did not disclose the fund's precarious financial condition to** investors. At the time, the CEO was the **sole decisionmaker and investment manager for the fund**, as it was RE Co.'s prized fund, and only he had access to the numbers. When prompted by RE Co.'s controller to provide the fund's numbers for RE Co.'s annual report, the CEO turned to a **secret spreadsheet** saved on the local drive of his personal computer, **manipulated the fund's true numbers** to conceal the flagging performance of the fund, and cut and pasted the numbers into an email response back to the Controller. Minutes later, the CEO **called his broker** and directed the broker to sell 10% of his RE Co. holdings.

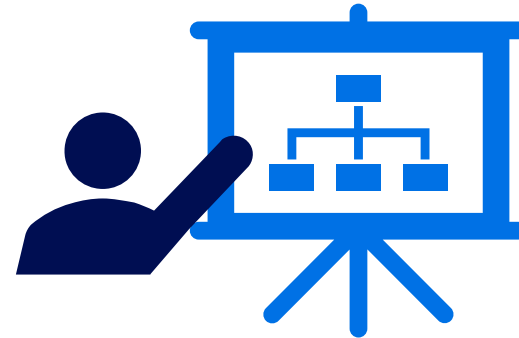
Two weeks later, RE Co. announced its year-end results, which included the CEO's falsified numbers, to much fanfare from its investors.

One month later, the fund was **forced to file for bankruptcy**. Upon this announcement, RE Co.'s stock price decreased by over 80%.

Lessons Learned: How to Avoid Being in a Headline



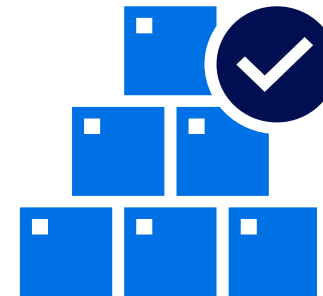
A strong corporate board



Strong controls (policies and procedures)



Effective whistleblower program



Documentation

Questions?



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