Buffet, Sokol and Reporting to the SEC

In the post on Tuesday we wrote and discussed several points about Warren Buffet, Berkshire Hathaway and David Sokol. One of the issues was disclosure to the Securities and Exchange Commission (SEC) of any possible securities violations. Another issue was the support provided by Warren Buffet at the time of the resignation of David Sokol in March. Writing in the DealB%K column of the New York Times on May 2, Andrew Ross Sorkin, said that one of Warren Buffet's mantras is "Lose money for the firm and I will be understanding; lose a shred of reputation for the firm and I will be ruthless."

The public support given by Buffet to Sokol after his resignation certainly appeared at odds with this mantra. As quoted in the Wall Street Journal, when company executive David Sokol resigned 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 his employer, Berkshire-Hathaway, purchase. However, is his article, Sorkin said that he had come to another understanding. Sorkin quoted an unnamed friend of Buffet who said, "Warren knew that the second that press release hit the wires, Sokol's professional career was over…If you worked at Berkshire-Hathaway, you got the message loud and clear."

It may still seem that Buffet's public pronouncement of support is inconsistent with the stated 'understanding' of Berkshire-Hathaway employees. Indeed Buffet's partner Charlie Munger said, "I think we can concede that that press release was not the cleverest press release in the history of the world." He went on to say "The facts were complicated, and we didn't foresee appropriately the natural reaction." One might suppose the natural reaction to which Munger is referring is that if you publicly support an ex-employee, it is not a sign of criticism.

Tempering all of this, as reported by Sorkin, is that even when making this public pronouncement of support, Buffet was notifying the SEC about Sokol's conduct. Sorkin reported that "the day he issued the release, Berkshire called the Securities and Exchange Commission and briefed them on Mr. Sokol's trades, which Mr. Buffett described to me as "pretty damning evidence." "Calling the head of the enforcement division of the S.E.C. and laying out a pattern of trading that you know is going to result in something — Dave [Sokol] probably thought it was pretty harsh," Mr. Buffett told me. The SEC. is now investigating the matter, people briefed on the inquiry said. In a statement after the Berkshire meeting, a lawyer for Mr. Sokol issued a statement, saying "the stock trades did not violate the law or Berkshire policy."

Sorkin also reported that "As for Berkshire's compliance programs, which are not nearly as tough as those at most investment firms, Mr. Buffett clearly believes that he must run his company based on a modicum of trust. "We can have all the records in the world and if somebody wants to trade outside them or something, you know, they're not going to tell us they're trading in their cousin's name," Mr. Buffett said. Mr. Munger added. "I think your best compliance cultures are the ones which have this attitude of trust and some of the ones with the biggest compliance departments, like Wall Street, have the most scandals."

We certainly applaud the fact that Buffet timely notified the SEC. However, to publicly praise someone for conduct which may have violated securities law and led to that employee's resignation and expect such praise to send a signal of reproach still leaves us, as it did initially with Andrew Ross Sorkin, "scratching my head about his reaction."