

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

REPORT OF INVESTIGATION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL

Case No. OIG-529

Investigation of Alleged Misconduct by the Atlanta Regional Office in its Investigation of Krispy Kreme Doughnuts, LLC

Introduction and Summary of Investigation

On May 22, 2008, the Office of Inspector General ("OIG") of the Securities and Exchange Commission ("SEC" or "Commission") opened an investigation prompted by a February 26, 2008 complaint to the SEC OIG hotline, alleging investigative misconduct by the Atlanta Regional Office ("ARO") Division of Enforcement ("Enforcement"). The anonymous complaint alleged that the SEC Enforcement investigation of Krispy Kreme Doughnuts, Inc. ("KKD") was "botched" for a number of reasons, including that "... no one was charged with intentional fraud despite there being evidence that fraud was committed," "ill-gotten profits" by a KKD officer were not disgorged, and "reports from Special Investigators" were not followed up on appropriately. The complaint further alleged that key testimony in the ARO investigation was never taken or taken too late, certain auditor work papers "were not reviewed," and the ARO's investigation's excessive delay was incorrectly blamed on the U.S. Attorney's Office for the Southern District of New York ("USAO"). Finally, the complaint claimed that four Enforcement staff were improperly "taken off the case" by (b)(7)(C) because they advocated a more aggressive prosecution of fraud in the matter.

The OIG investigation did not find evidence that the ARO staff investigation into securities violations and other wrongdoing by the officers of KKD was negligent or "botched," despite a pronounced delay in obtaining testimony and concluding the investigation. The OIG also did not find evidence that the decision not to pursue fraud charges was unsupportable in light of the litigation risks expressed. Further, the OIG concluded that the ARO penalties assessed for the ill-gotten gains of the KKD officers' fraudulent activities were supported by analysis from the SEC Office of Economic Analysis ("OEA"). However, the OIG investigation did find that certain delays in the investigation were excessive. The OIG further determined that some potential evidence may have been unexamined, likely the result of poor communication among the ARO staff, and this issue also affected other aspects of the investigation. Finally, while the OIG found that there was considerable turnover in the staffing of the investigation, the OIG did not uncover evidence substantiating the claim that (b)(7)(C) removed staff from the investigation in order to negate these staff efforts to conduct a more aggressive

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

investigation. Accordingly, we are referring the matter to SEC Management for informational purposes.

Scope of Investigation

In its investigation, the OIG reviewed numerous documents, including various drafts of the Enforcement staff Action Memorandum, and Supplemental Action Memorandum in this matter.¹ Further, we reviewed comments to the Action Memoranda by the SEC's Office of Chief Counsel ("OCC"), the Office of the Chief Accountant ("OCA"), the Division of Corporation Finance, and the OEA.

We reviewed nearly 1,000 e-mails and related attachments from the various staff attorneys assigned to the KKD investigation as well as from the other Divisions and Offices who commented on drafts of the Action Memoranda. We also reviewed e-mails and meeting notes submitted by a witness in this matter.

The OIG also took the sworn testimony of the following (b)(7)(C) (b)(7)(C) (b)(7)(C) between 2004 and 2009:

- (a) (b)(7)(C) taken on June 3, 2009;
- (b) (b)(7)(C) taken on June 3, 2009;
- (c) (b)(7)(C) taken on June 3, 2009;
- (d) (b)(7)(C), taken on June 3, 2009; and,
- (d) (b)(7)(C) taken on June 4, 2009.

Relevant Legal Standard

The SEC's Enforcement staff has the obligation to continuously and diligently investigate instances of securities fraud, as set forth in the Commission Canon of Ethics in the Code of Federal Regulations. The Policy of the Canon recognizes that "[i]t is

¹ The purpose of the Action Memorandum was to advise the Commission on the details and findings of its investigation and recommend what securities violation charges, if any, should be brought as a result. See February 12, 2009 Action Memorandum in the matter of Krispy Kreme Doughnuts, Inc., attached as Exhibit 1. See February 19, 2009 Supplemental Action Memorandum in the matter of Krispy Kreme Doughnuts, Inc., attached as Exhibit 2.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

characteristic of the administrative process that the Members of the Commission and their place in public opinion are affected by the advice and conduct of the staff, particularly the professional and executive employees.”² Hence, “it shall be the policy of the Commission to require that employees bear in mind the principles specified in the Canons.”³ The Preamble of the Canon clearly indicates the serious duty placed upon members of the Commission and the staff, as follows:

Members of the Securities and Exchange Commission are entrusted by various enactments of the Congress with powers and duties of great social and economic significance to the American people. It is their task to regulate varied aspects of the American economy, within the limits prescribed by Congress, to insure that our private enterprise system serves the welfare of all citizens. Their success in this endeavor is a bulwark against possible abuses and injustice which, if left unchecked, might jeopardize the strength of our economic institutions.⁴

The Canon further provides: “In administering the law, members of this Commission should vigorously enforce compliance with the law by all persons affected thereby.”⁵ The Canon also affirms that: “Members should recognize that their obligation to preserve the sanctity of the laws administered by them requires that they pursue and prosecute, vigorously and diligently but at the same time fairly and impartially and with dignity, all matters which they or others take to the courts for judicial review.”⁶

Results of Investigation

I. Allegation of Failure to Bring 10(b) Fraud Charges Despite Evidence to the Contrary

The complaint to the OIG alleged that in the SEC Enforcement investigation of KKD, “no one was charged with intentional fraud despite there being evidence that fraud was committed” (b)(5)

(b)(5),(b)(7)(C)

The Enforcement investigation of KKD and its officers for possible financial fraud and disclosure issues (b)(5)

² 17 C.F.R. § 200.51 (2009).

³ *Id.*

⁴ 17 C.F.R. § 200.53 (2009).

⁵ 17 C.F.R. § 200.55 (2009).

⁶ 17 C.F.R. § 200.64 (2009).

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5)

(b)(5)

(b)(5)

(b)(5)

Additionally, the OIG found that several staff who worked on the KKD (b)(5) (b)(5),(b)(7)(C) According to Neal A. (b)(7)(C) the Staff Accountant assigned to the KKD investigation, "By the time I was being taken off the case, (b)(5)

⁷ Exhibit I at 1.

⁸ *Id.*

⁹ *Id.* Concurrently, the Board of Directors of KKD convened a Special Committee to conduct an inquiry into these issues and other possible wrongdoing. The Committee hired outside counsel to do independent investigations which are noted in Section IV(E) of this Report of Investigation. In April 2006, as a result of these investigations, KKD restated their financial statements for 2003 and 2004 and the first three quarters of fiscal year 2005. These investigations also found fault with or forced the resignations of Livengood, Casstevens, Tate, and Polansky. *Id.* at 2-3.

¹⁰ Draft Action Memorandum dated May 16, 2006 attached to May 16, 2006 e-mail from (b)(7)(C) to (b)(7) (b)(7) among others, attached as Exhibit 3. Distributed to staff for comment, this draft only contained the Table of Contents and Summary sections of the memorandum.

¹¹ January 22, 2008 Draft Action Memorandum in the matter of Krispy Kreme Doughnuts, Inc., at 1, attached as Exhibit 4.

¹² June 24, 2008 Draft Action Memorandum in the matter of Krispy Kreme Doughnuts, Inc., at 34, attached as Exhibit 5.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5) [redacted] ¹³ (b)(7)(C) further stated that he

(b)(5) [redacted]

(b)(5) [redacted] ¹⁴

(b)(5), (b)(7)(C) [redacted]

(b)(5), (b)(7)(C) [redacted]

(b)(5), (b)(7)(C) [redacted]

¹³ Transcript of June 3, 2009 Testimony of (b)(7)(C) [redacted] (6/03/09 Tr.) at 40, attached as Exhibit 6.

¹⁴ *Id.* at 23-24.

¹⁵ Transcript of June 3, 2009 Testimony of (b)(7)(C) [redacted] (6/03/09 Tr.) at 26, attached as Exhibit 7.

¹⁶ (b)(7)(C) [redacted] (6/03/09 Tr.) at 13.

¹⁷ *Id.*

¹⁸ *Id.* at 15.

¹⁹ Transcript of June 4, 2009 Testimony of (b)(7)(C) [redacted] (6/04/09 Tr.) at 21, attached as Exhibit 8.

²⁰ *Id.* at 18.

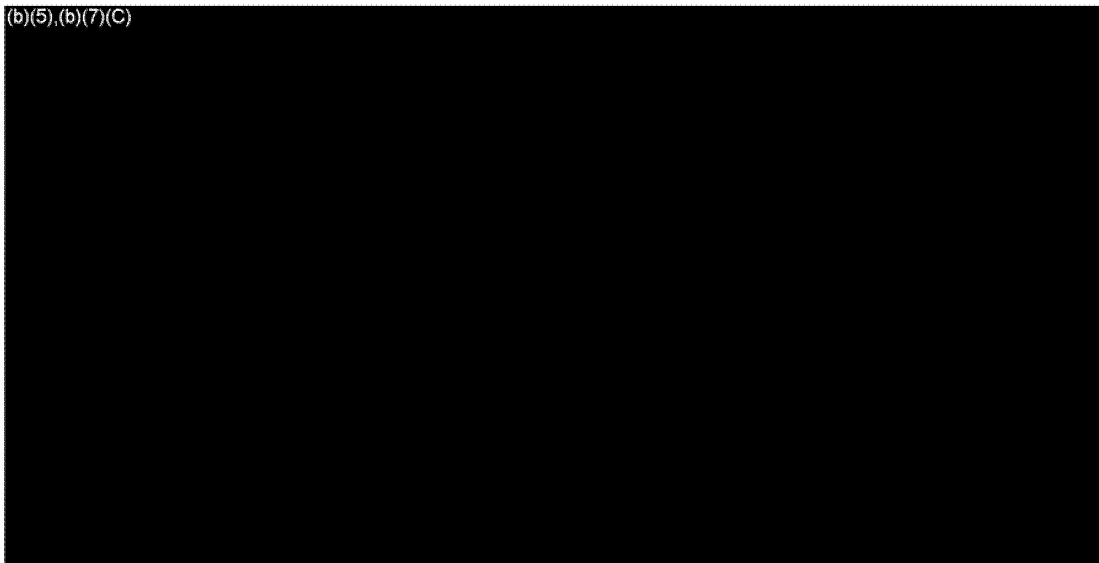
²¹ *Id.*

²² E-mail from (b)(7)(C) [redacted] (December 1, 2008), attached as Exhibit 9.


²³ The term *scienter* refers to having the requisite knowledge of the wrongness/illegality of an act or conduct; *i.e.*, knowing the impropriety/illegality associated with doing certain acts. This is often an

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

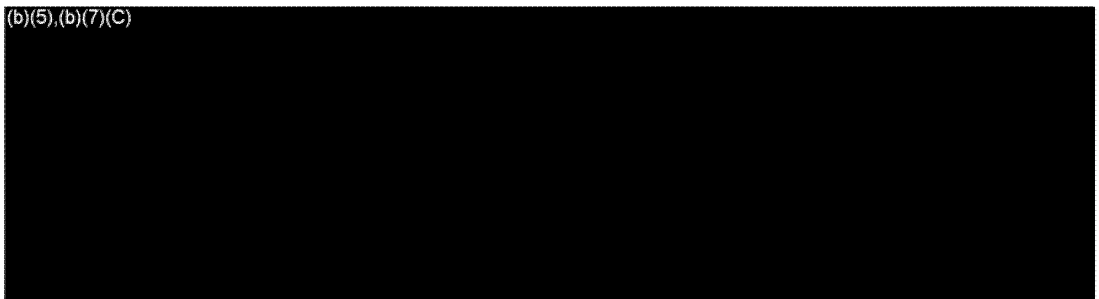
(b)(5),(b)(7)(C)




(b)(5),(b)(7)(C)



(b)(5),(b)(7)(C)




(b)(5),(b)(7)(C)




element of liability or guilt that must be proven before a judgment or conviction can be obtained in civil or criminal cases. West's Encyclopedia of American Law. The Gale Group, Inc., 1998.

²⁴ (b)(5),(b)(7)(C)



(b)(5),(b)(7)(C)



²⁵ Exhibit 1 at 1.

²⁶ *Id.* at 38.

²⁷ *Id.* at 30.

²⁸ *Id.* at 42.

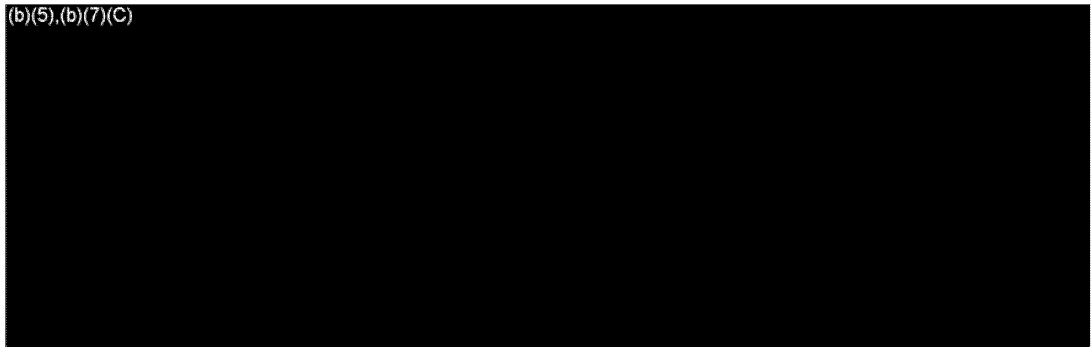
²⁹ Exhibit 1 at 26.

³⁰ *Id.* at 40.


³¹ *Id.* at 42-43.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

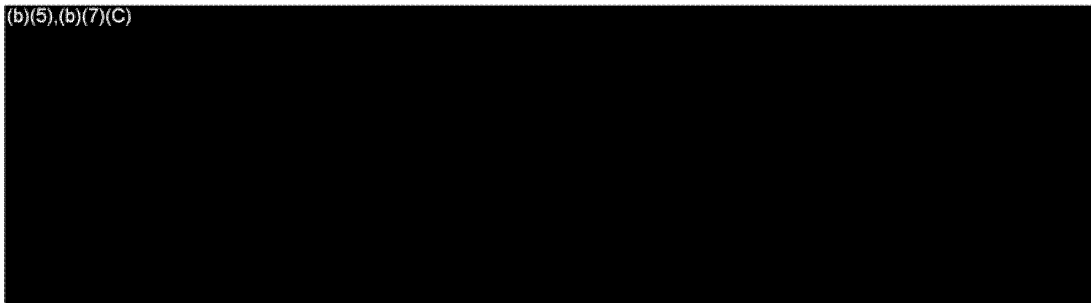
(b)(5),(b)(7)(C)



(b)(5),(b)(7)(C)



(b)(5),(b)(7)(C)

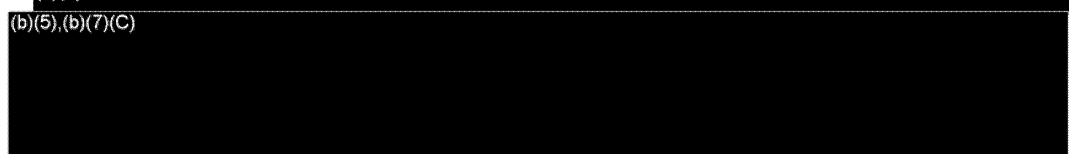


(b)(5)



³² (b)(5)

(b)(5),(b)(7)(C)



³³ Exhibit 2 at 3.

³⁴ *Id.*

³⁵ *Id.* at 3-4.

³⁶ *Id.* at 4.

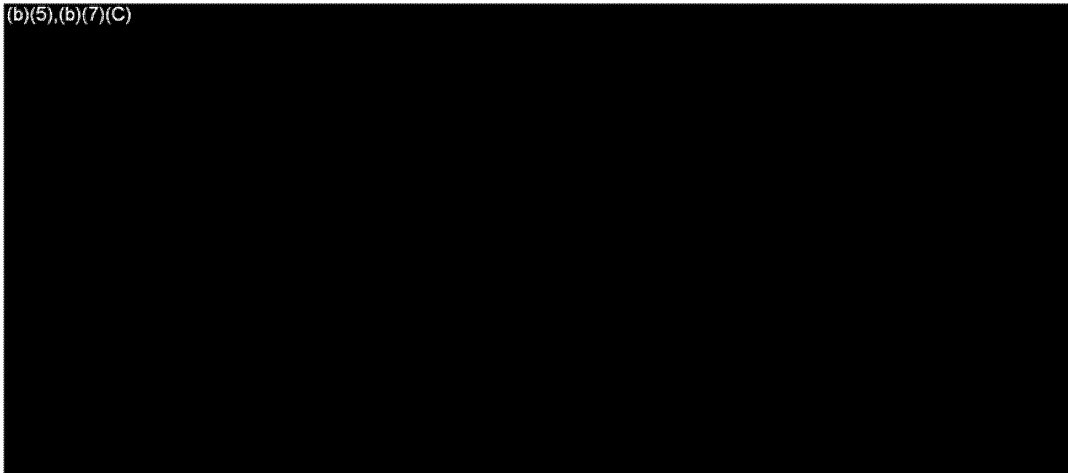
³⁷ *Id.*

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

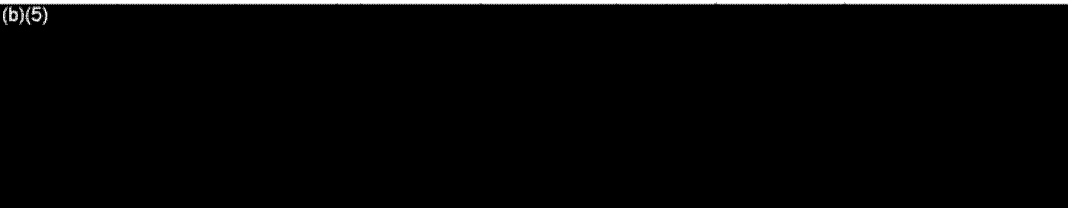
II. Allegation that KKD Officer Was Improperly Not Ordered to Relinquish \$10 Million in Ill-gotten Gains

The complaint to the OIG further alleged that “(b)(7)(C) made a profit of approximately 10 Million dollars [illegally]” which was not “taken away”³⁸ This claim apparently references the \$10,018,005 profit made by Livengood in his August 25, 2003 stock sales following the misrepresentation of KKD’s financial results which inflated the stock price.³⁹

(b)(5),(b)(7)(C)



(b)(5)



³⁸ The OIG concluded that the complaint misstated the party that is the subject of this claim. The complainant refers to “(b)(7)(C) (b)(7)(C)” as the recipient of the approximately \$10 million in ill-gotten gains. However, the context of the allegation only makes sense if it refers to former KKD CEO Scott Livengood, who profited in this amount from his stock sale on August 25, 2003 (per the ARO Memorandum of Action dated February 12, 2009). Our conclusion about this error is further supported by a second incorrect reference to (b)(7)(C) in which the complainant uses the name (b)(7)(C) instead of Livengood, as the witness whose testimony took four years to obtain.

³⁹ Exhibit 1 at 21-22.

⁴⁰ *Id.* at 31.

⁴¹ Exhibit 2 at 1.

⁴² *Id.* at 4.

⁴³ *Id.*

⁴⁴ Exhibit 1 at 22.

⁴⁵ *Id.*

⁴⁶ Exhibit 1 at 1.

⁴⁷ Exhibit 2 at 4. A detailed breakdown of the KKD Restatement’s nineteen elements was contained in Appendix A of the ARO Action Memorandum for Krispy Kreme Doughnuts, Inc. (b)(7)(C) Exhibit 1.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5)

(b)(5),(b)(7)(C)

III. Allegation of Improper Removal of Key Staff Members

The complaint received by the OIG also identified (b)(7)(C) ARO staff members who were allegedly removed from the case because they favored a more vigorous investigation of fraud charges against the KKD officers than did their supervisor, ARO (b)(7)(C). The OIG found that (b)(7)(C) staff members were removed and there was considerable staff turnover in the investigation, but did not find evidence substantiating the claim that the reason for the staff members' removal was because they disagreed with (b)(7)(C) prosecution strategy, or was otherwise improper.

The OIG found that by the fall of 2006, approximately eighteen months into the ARO investigation of KKD, (b)(7)(C) of the original assigned staff, Staff Attorneys (b)(7)(C) (b)(7)(C) and (b)(7)(C), were no longer actively working on the KKD case.⁵⁰ (b)(7)(C) and (b)(7)(C) involvement remained nominal after this point, while (b)(7)(C) was brought back in periodically, from late 2007 until its closure, for accounting analysis.⁵¹ Conversely, (b)(7)(C) (b)(7)(C) of the

⁴⁸ (b)(6),(b)(7)(C)

(b)(5),(b)(7)(C)

⁴⁹ *Id.*

⁵⁰ While the claim in the complaint specifically stated that (b)(7)(C) removed the following (b)(7)(C) staff members from the case, (b)(7)(C) and (b)(7)(C) there is no evidence that (b)(7)(C) was ever assigned to the case. Therefore, our discussion relates only to the others named.

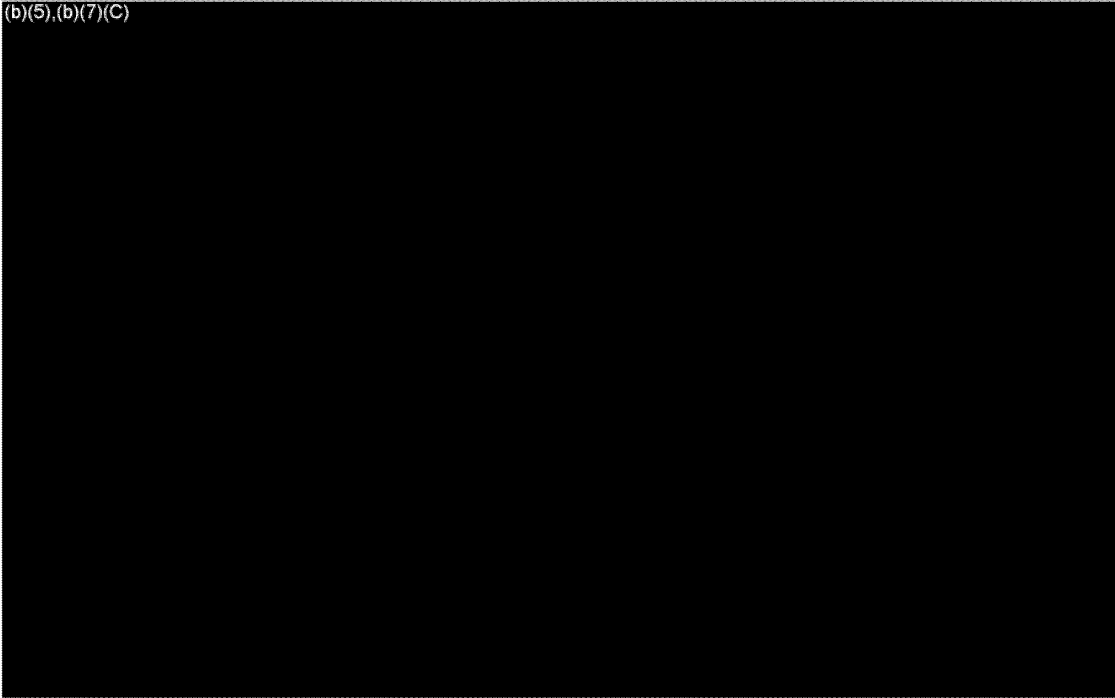
⁵¹ (b)(7) testified about conversations he had with both (b)(7)(C) his supervisor and the Regional (b)(7)(C) about his reluctance to be associated with the case findings that

(b)(5),(b)(7)(C)

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

investigation from November 2004 onward⁵² continued to be very involved, as did (b)(7)(C) a Staff Attorney and Certified Public Accountant (CPA), who by his own account, began working on the matter in "early 2005."⁵³

(b)(5),(b)(7)(C)



⁵² Transcript of June 3, 2009 Testimony of (b)(7)(C) (6/03/09 Tr.") at 6, attached as Exhibit 11. (b)(7)(C) began working at the ARO on (b)(7)(C) approximately 6 months after the investigation was opened.

⁵³ Transcript of June 3, 2009 Testimony of (b)(7)(C) at 6, attached as Exhibit 12. Additionally, the shift in staffing on this case is reflected in the various drafts of the ARO Action Memoranda. While a December 2005 partial draft Memorandum, a May 2006 Draft Memorandum and the January 2008 Draft Memorandum list (b)(7)(C) (b)(7)(C) as contacts, the later June 2008 draft, the final Action Memorandum of February 12, 2009 and the Supplemental to Action Memoranda of February 19, 2009 and February 25, 2009 omit reference to them. Unlike (b)(7) who, as previously noted, requested that his name be taken off the memorandum, (b)(7)(C)

(b)(7)(C)



⁵⁴ (b)(7)(C) 6/05/09 Tr. at 50.

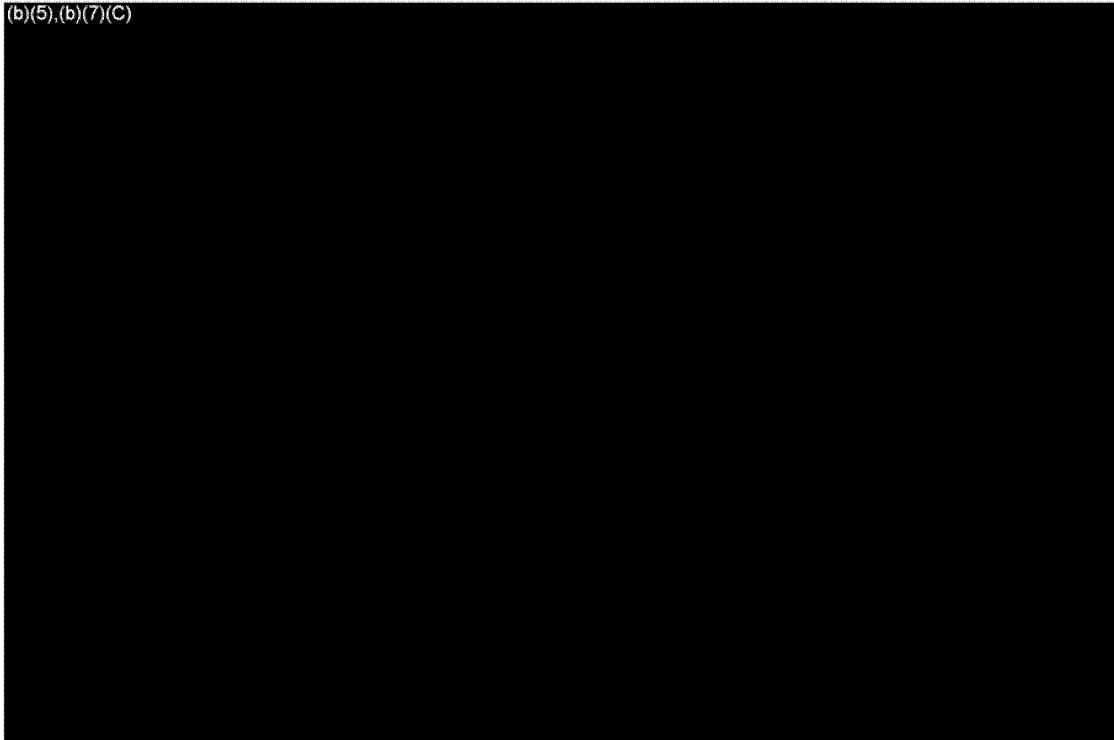
⁵⁵ *Id.* at 29.

⁵⁶ *Id.* at 50.

⁵⁷ *Id.* at 49.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C)



Toward the end of the OIG's testimony session with (b)(7)(C) asked to amend the response above, concerning whether he was taken off the investigation in 2006.⁶⁴ He stated the following:

(b)(7)(C)



⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* at 51. (b)(5),(b)(7)(C)

(b)(5),(b)(7)(C)

⁶¹ (b)(7)(C)

(b)(7)(C)

⁶² (b)(7)(C)


(b)(7)(C)

⁶³ (b)(7)(C) 5/5/09 Tr. at 31.

⁶⁴ *Id.* at 35.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C)



While (b)(7)(C) accounting expertise was solicited in the final stages of compiling the Action Memorandum, he, too, felt that he was removed from the substance of the case in the spring of 2006.⁶⁷ It was then that his focus was redirected from charges against individual KKD officers to the auditor files.⁶⁸ In his testimony, (b)(7)(C) noted, (b)(7)(C) (b)(7)(C) I'm not really sure why."⁶⁹ He further testified, "Actually, it was just a bunch of us that kind of got one by one, and I don't remember the order, kind of removed from the case or pushed off the case."⁷⁰

(b)(7)(C) also recalled that his role in the investigation changed after a specific case meeting with (b)(7)(C) and other ARO staff "somewhere in the Spring of '06, March, April or something," - presumably the same March 2006 meeting that (b)(7)(C) referred to in his testimony.⁷¹ (b)(7)(C) stated the following:

(b)(7)(C)



⁶⁵ *Id.* at 36.

⁶⁶ *Id.* at 37.

⁶⁷ (b)(7)(C) 6/03/09 Tr. at 43.

⁶⁸ *Id.*

⁶⁹ *Id.* at 9.

⁷⁰ *Id.* at 12. Later in his testimony, he identified (b)(7)(C) as the (b)(7)(C) other ARO staffers "taken off the case." *Id.* at 39.

⁷¹ *Id.* at 42.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

and giving the auditors, or being assigned to look at the auditors.⁷²

The OIG found evidence that (b)(7)(C) input was solicited again from mid-2007 to the case's conclusion, primarily regarding accounting questions. However, when (b)(7)(C) was asked by (b)(7)(C) review Action Memorandum language in August 2007,⁷³ he thought it was an odd request given his lack of familiarity with the main subject matter.⁷⁴ When asked again in February 2008 to discuss the January 22, 2008 Draft Memorandum, he balked, stating in an e-mail to "... please keep in mind I remember very little about the case."⁷⁵

(b)(7)(C) testified to the OIG that he did assume greater responsibility for drafting the Enforcement recommendation as the investigation progressed, relying less on certain staff who had earlier worked on the case, because he needed to synthesize the staff's investigative data.⁷⁶ He testified as to his rationale in managing the case this way as follows:

People were assigned to different areas to focus on. So (b)(7)(C) was looking at certain stuff, (b)(7)(C) was looking at certain stuff (b)(7)(C) he became involved and he was looking at stuff, (b)(7)(C) was looking at stuff. . . .

And at a certain point . . . you've got to . . . bring it together into one or two people who can then make some judgment calls as to, you know, how do we present to the client, what's the story. . . . Everyone knows their issue. They don't necessarily know their neighbor's issue. They're not understanding necessarily how their issue fits with their neighbor's issue or how there might be common themes. There's got to be somebody.⁷⁷

⁷² *Id.* at 42-43.

⁷³ E-mail from (b)(7)(C) to (b)(7)(C) (August 27, 2007), attached as Exhibit 14.

⁷⁴ (b)(7)(C) 6/03/09 Tr. at 14. See also E-mail from (b)(7)(C) to (b)(7)(C) (August 27, 2007), attached as Exhibit 15 stating:

(b)(7)(C)

In this same e-mail exchange, he also requested to be taken off the staff contact list for the ARO Memorandum, discussed *infra* in Section IV(D) of this report and *supra* in footnote 51.


⁷⁵ E-mail from (b)(7)(C) to (b)(7)(C) (b)(7)(C) (February 21, 2008), attached as Exhibit 16. The subject ARO Draft Action Memorandum for Krispy Kreme Doughnuts, Inc. (January 18, 2008) is referred to *supra*, attached as Exhibit 4.

⁷⁶ (b)(7)(C) 5/03/09 Tr. at 59-61.

⁷⁷ *Id.*

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C)




While all the employees removed from the investigation expressed frustration with the lack of communication from management in the KKD matter, none of them specifically stated that they believed the decision to remove them was related to their taking a more aggressive posture in the investigation. When directly asked in testimony why he was removed from the investigation, (b)(7)(C) did not state that he believed he was removed because he favored a more rigorous investigation than his superiors. In fact, (b)(7)(C) replied "I'm not quite sure why" but noted that he did not believe that it was because he was so tied up with another matter at that time, as someone during the investigation had suggested.⁸⁰ Moreover, (b)(7)(C) stated that he recalled discussing with the other removed staff why they had been removed, and noted, "I never remember anybody having an answer of why."⁸¹


In summation, there was no testimony or documentary evidence to substantiate the claim that these changes in personnel were the result of any divergent views with respect to the investigation. Nor was there evidence to suggest that these (b)(7)(C) individuals were removed because they refused to conduct the investigation in the manner recommended by their supervisor. However, although acting within managerial purview in removing original staff from the KKD investigation, we did find evidence that management failed to communicate to these individuals the reasons why they were taken off the case, causing a strained working environment and some uncertainty among the removed staff.

⁷⁸ *Id.* at 61.

⁷⁹ (b)(7)(C)



(b)(5),(b)(7)(C)



⁸⁰ (b)(7)(C) 6/03/09 Tr. at 12.

⁸¹ *Id.* at 39.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

IV. Allegation of Failure to Conduct Adequate Investigation

A. Allegations in Complaint to OIG

The complaint to the OIG alleged generally that the KKD investigation was “botched” by a lack of due diligence. The complaint noted that, “The SEC staff took four years to take the testimony” of KKD Chief Financial Officer Scott Livengood⁸² and “Chief Operating Officer [John] Tate also refused to testify in the case and was never made to.” The complaint stated that the ARO inappropriately blamed the USAO for the lengthy delays in the ARO’s investigation and submission of recommendations for action. The complaint also alleged that audit workpapers were never reviewed as part of the investigation.

B. Case Stalled for a Significant Period of Time

The OIG investigation found that while initially active, the KKD investigation, opened in May 2004, stalled for several years, shortly after the ARO staff had prepared various drafts of an Action Memorandum to the Commission. The OIG learned that by June 27, 2005, at least portions of an Action Memorandum detailing the evidence in the case had already been drafted by the ARO Enforcement staff.⁸³

(b)(5)



The OIG found evidence of little activity in the KKD investigation during the second half of 2006 and the majority of 2007. Following up on his testimony, ARO (b)(7)(C) e-mailed the OIG in June 2009 and decried the length of the investigation as follows:

⁸² While the complaint actually named (b)(7)(C) as the party whose interview was delayed for four years, the context of the allegation and, indeed, the rest of the complaint, indicate that the source meant Scott Livengood former CEO of KKD, rather than (b)(7)(C) who was the SEC ARO supervisor of the investigation. This misstatement (or transliteration error) was likely caused by the fact that (b)(7)(C) was mentioned, or the subject of, other allegations in the complaint.

⁸³ E-mail from (b)(7)(C) to (b)(7)(C) (and others) with attachment entitled “(b)(7)(C) First Insert to Action Memo Dated June 27, 2005.doc.” (June 27, 2005), attached as Exhibit 17.

⁸⁴ Attachment to e-mail from (b)(7)(C) to (b)(7)(C) among others (May 16, 2006) entitled “KKD Action Draft Memo Circulated for Comment 5-16-06,” attached as Exhibit 18. This draft, distributed for ARO staff review, contained the Table of Contents and Summary sections of the draft memorandum and, per (b)(7)(C) contained the “overall structure of the argument.” *Id.*

⁸⁵ (b)(7)(C) 6/03/09 Tr. at 39.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

At various times, I did discuss with other staff members my opinion on how long it would take for the action memo to get out of this office and go to the home office – if it ever got out at all. The failure to finalize the action memo was a running joke in the office . . . [and] no one could understand why it was taking so long to complete the case, although there was much speculation as to why.⁸⁶

The OIG also reviewed a timeline of (b)(7)(C) activity in the case from May 2004 to February 2008 which indicated inactivity from May 2006 to August 2007, with the exception of attending one meeting about the case with other ARO staff.⁸⁷ Further, the OIG did not detect evidence of other significant activity during this period other than CFO Livengood submitting a response to a Wells notice in May 2007.

In fact, the OIG investigation found that key testimony in the KKD investigation was significantly delayed. We found that the primary witness, KKD CFO Scott Livengood, did not testify until 2008, four years after the investigation was opened.⁸⁸ Further, our investigation verified that testimony from CEO John Tate was never taken.⁸⁹

(b)(5)
(b)(5)
(b)(7)(C) (b)(5)
(b)(5)⁹¹ (b)(7)(C) said Tate and Livengood ignored the initial subpoenas⁹² based upon the defense that they could be used against them in a criminal investigation.⁹³

(b)(5),(b)(7)(C)

⁸⁶ June 12, 2009 e-mail with timeline attachment, from (b)(7)(C) to OIG Investigator (b)(7)(C) attached as Exhibit 19.

⁸⁷ *Id.*
⁸⁸ (b)(7)(C) 6/03/09 Tr. at 37. See also (b)(7)(C) 6/03/09 Tr. at 25.

⁸⁹ (b)(7)(C) in his interview stated unequivocally, "At the end of the day we did not take his testimony."
(b)(7)(C) 6/03/09 Tr. at 52. See also other ARO staff testimony concurring as follows: (b)(7)(C) 6/03/09 Tr. at 37, (b)(7)(C) 6/04/09 Tr. at 29, (b)(7)(C) 6/03/09 Tr. at 26, (b)(7)(C) 6/03/09 Tr. at 10. Additionally, Tate did not respond to a Wells notice until August 5, 2008 and did so in the form of a "Talking Point Memoranda." Exhibit 1 at v.

⁹⁰ (b)(7)(C) 6/03/09 Tr. at 24.


⁹¹ (b)(7)(C) 6/03/09 Tr. at 41.

⁹² *Id.* at 52.

⁹³ (b)(7)(C) 6/04/09 Tr. at 26.

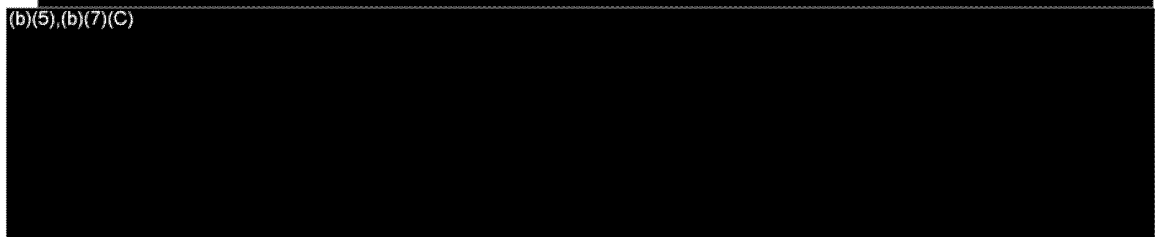
This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5), (b)(7)(C)



94 (b)(5)

(b)(5), (b)(7)(C)



95 (b)(7)(C) 6/03/09 Tr. at 55.

96 *Id.* at 56.

97 *Id.* at 55.

98 (b)(7) 6/03/09 Tr. at 22.

99 *Id.*

100 (b)(7)(C) 6/04/09 Tr. at 39.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C)

(b)(5),(b)(7)(C)

Accordingly, the OIG concluded that there were unusual delays in the conduct of the KKD investigation, even factoring in the impact of the ongoing criminal proceeding. We found that almost five years elapsed from the onset of the ARO enforcement investigation into KKD and its officers to the submission of the final Supplemental Action Memorandum closing out the case. The investigation appeared dormant for much of 2006 and 2007. (b)(5)

(b)(5)

C. Failure to Examine Audit Work Papers

The OIG investigation also found that despite the length of the investigation, the ARO did not examine other potential sources of information. The OIG investigation found evidence to substantiate the claim in the complaint that some audit workpapers were never reviewed by the ARO staff in the course of their investigation. Each ARO staff member who testified in the OIG investigation acknowledged this to be correct.

¹⁰¹ *Id.* at 37.

¹⁰² (b)(7)(C)

(b)(5),(b)(7)(C)

¹⁰³ (b)(7)(C) 6/03/09 Tr. at 44.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(7)(C) stated that he had reviewed about five boxes of audit work papers, but that "there were just at least 100, maybe 200 [boxes]" that may not have been reviewed.¹⁰⁴ He explained that in June 2005, he was detailed to the SEC DC trial unit to work on another investigation and "... really didn't have the time to [review the work papers.]"¹⁰⁵ (b)(7)(C) also stated he asked that another accountant be assigned to do the bulk of the review in his absence.¹⁰⁶ He recalled that, afterward, ARO attorneys (b)(7)(C) were assigned to look at the audit files (b)(7)(C),(b)(8)

The OIG investigation found that in a January 10, 2006 e-mail, (b)(7)(C) responded to a query from (b)(7)(C) about which audit work papers the ARO possessed, stating, "I believe (b)(7)(C) is the one who is keeping track of this info."¹⁰⁹ (b)(7)(C) noted in the same e-mail that there were still many "series" of papers to review.¹¹⁰ However, (b)(7)(C) a non-accountant, (b)(7)(C)

In response to (b)(7)(C) e-mail referenced above, (b)(7)(C) on the same day, asked (b)(7)(C) (who was also a trained accountant) to "make sure that we have all of the necessary audit work papers, etc. and to schedule some time with (b)(7)(C) and go through in detail what we have."¹¹² However, the OIG found no evidence that this review and assessment occurred.

(b)(7)(C) request to get another person involved while he was detailed to the trial unit in Washington DC, but did not get the impression that it was a priority.¹¹³ (b)(7)(C)

¹⁰⁴ *Id.* at 35-38.

¹⁰⁵ *Id.* at 9.

¹⁰⁶ *Id.* at 35-37.

¹⁰⁷ *Id.* at 38.

¹⁰⁸ *Id.*

¹⁰⁹ E-mail from (b)(7)(C) to (b)(7)(C) (January 10, 2006) attached as Exhibit 20.

¹¹⁰ *Id.*

¹¹¹ (b)(7)(C) 6/04/09 Tr. at 30.

¹¹² E-mail from (b)(7)(C) (January 10, 2006) attached as Exhibit 21.

¹¹³ (b)(7)(C) 6/04/09 Tr. at 45.

¹¹⁴ *Id.* at 46.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 47.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C),(b)(8)



In conclusion, the OIG found that a significant number of audit files, which could potentially have contained useful evidence, were not reviewed during the course of the ARO investigation.

D. Improper Blaming of the U.S. Attorney's Office for Delay in Investigation

The complaint alleged that the ARO inappropriately blamed the USAO for the lengthy delays in the ARO's investigation and submission of recommendations for action. The OIG investigation found evidence that the Action Memorandum overstated the role of the USAO's office and understated the role of the ARO in causing delays.

(b)(5)



117 *Id.*

118 *Id.*

119 (b)(7)(C) 03/09 Tr. at 58.

120 6/03/09 Tr. at 27.

121 Exhibit I at 2.

122 *Id.*

123 *Id.*

124 *Id.*

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(5),(b)(7)(C)



125 (b)(7)(C) 6/03/09 Tr. at 45.

126 *Id.* at 45-47.

127 (b)(7)(C) 6/03/09 Tr. at 17.

128 04/09 Tr. at 22.

129 /03/09 Tr. at 46.

130 /03/09 Tr. at 41.

131 *See also* Section I(C).

132 (b)(7)(C) 6/04/09 Tr. at 29-30.

133 6/03/09 Tr. at 41.

134 6/04/09 Tr. at 31.

135 *Id.* at 32.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

(b)(7)(C) strenuously objected to the ARO placing blame on the USAO for the delay, and also disputes (b)(7)(C) testimony. (b)(7)(C) testified that he recalled that the (b)(5)

(b)(5) ¹³⁶ (b)(7)(C) misgivings about the footnote in the Action Memorandum blaming the USAO were serious enough to spur his August 27, 2007 request to remove his name from the report. ¹³⁷ He stated as follows:

(b)(7)(C)

In summation, the OIG found evidence to support the contention that the ARO Action Memorandum incorrectly attributed so much delay to the USAO.

E. Other Claims of Inadequate Investigation

Finally, the OIG considered two additional issues alleged in the complaint, and found them both unsubstantiated, and meriting only brief comment. ¹³⁹ First, the OIG found that the claim that the "special investigation reports" about KKD were not utilized by the ARO staff to be without merit. Testimony from each witness was unequivocal that the ARO staff carefully reviewed the two reports prepared by firms hired by KKD, found the authors of the reports to be very cooperative and held several meetings with them. ¹⁴⁰

¹³⁶ (b)(7) 6/03/09 Tr. at 26-27.

¹³⁷ *Id.* at 13-15. See also Exhibits 14-15, comprising an e-mail chain between (b)(7) and (b)(7)(C) beginning August 27 2008 and ending August 28 2008, concerning (b)(7)(C) request for his name to be removed from the Action Memorandum.

¹³⁸ (b)(7) 6/03/09 Tr. at 15.

¹³⁹ Details of our findings on these two claims are contained in the following two footnotes, 140 and 141, respectively.

¹⁴⁰ Testimony supporting the OIG's conclusion that this claim was unfounded include the following: (b)(7)(C) was able to recount both reports provided to the ARO. He termed the (b)(5) report "complete crap" and the (b)(5) "very good" and "pretty detailed" but laughed when recalling the (b)(7)(C) summary because it did not conclude "that anything was like fraudulent That was like really weird." (b)(7)(C) 6/03/09 Tr. at 33-34. (b)(7)(C) also expressed familiarity with the investigative reports and recalled having "a lot of contact" with (b)(7)(C) 6/03/09 Tr. at 21-23. (b)(7)(C) testified that there was SEC follow-up on these investigative reports stating about one "it essentially confirmed our suspicions, revealed some things that we did not know" (b)(7)(C) 6/3/09 Tr. at 23-24. (b)(7)(C) testified that in addition to follow up after the report's issuance, the ARO had "telephone conference calls where they [investigators] would apprise us during their investigation of what they found out." (b)(7)(C) 6/04/09 Tr. at 35. He termed the ARO coordination with them "the most cooperation I've ever seen from opposing counsel." (b)(5), (b)(7)(C)

(b)(5), (b)(7)(C)

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

Second, we did not substantiate the claim in the complaint that “[redacted]” is settling with Livengood although there is no admissible evidence.”¹⁴¹

Conclusion

The OIG investigation found that while certain claims made in the complaint were substantiated, there was insufficient evidence that the investigation was “botched” or could be considered negligent. [redacted]

[redacted]

However, the OIG did conclude that the ARO investigation was excessively delayed. We found that in July 2005, ARO staff had already drafted portions of an Action Memorandum detailing the evidence in the case. In May 2006, the staff had revised the summary “facts” section of the draft Action Memorandum laying out the case for filing SEC enforcement actions against [redacted] individuals. However, we found that the KKD investigation languished soon after, and found evidence of little activity in the KKD investigation during the second half of 2006 and the majority of 2007. We also found that key testimony in the KKD investigation was significantly delayed, and, in fact, the primary witness did not testify until 2008, four years after the investigation was opened. Further, testimony from another key witness was never taken.

While the OIG investigation did verify that an ongoing criminal prosecution factored into the delays, the ARO’s decision not to compel testimony exacerbated the problem. [redacted]

[redacted]

[redacted]

¹⁴¹ The settlement with Livengood, recommended for SEC approval in the February 19, 2009 Supplemental Action Memorandum is discussed, *supra*, in this Report. Evidence of this officer’s participation in financial fraud and other violations of SEC rules is indisputable, documented in the Supplemental Memorandum and the earlier full Action Memorandum, and admitted by Livengood in his plea agreement. Possibly, the complainant meant something else along the lines that there was no “evidence” for the ARO to settle with Livengood. But that assertion, too, would be found by the OIG to be without merit. Therefore, the OIG refrains from speculating what the allegation means, or further commenting on it.

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

Accordingly, we are referring this matter to the Deputy Chief of Staff and the Director of Enforcement for review of this report and informational purposes.

Submitted: (b)(7)(C) Date: 6/08/10

Concur: (b)(7)(C) e: 6/08/10

Approved:  Date: 6/08/10
H. David Kotz

This document is subject to the provisions of the Privacy Act of 1974, and may require redaction before disclosure to third parties. No redaction has been performed by the Office of Inspector General. Recipients of this report should not disseminate or copy it without the Inspector General's approval.

REPORT OF INVESTIGATION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION OFFICE OF INSPECTOR GENERAL

Case No. OIG-529

Investigation of Alleged Misconduct by the Atlanta Regional Office in its Investigation of Krispy Kreme Doughnuts, LLC

Introduction and Summary of Investigation

On May 22, 2008, the Office of Inspector General ("OIG") of the Securities and Exchange Commission ("SEC" or "Commission") opened an investigation prompted by a February 26, 2008 complaint to the SEC OIG hotline, alleging investigative misconduct by the Atlanta Regional Office ("ARO") Division of Enforcement ("Enforcement"). The anonymous complaint alleged that the SEC Enforcement investigation of Krispy Kreme Doughnuts, Inc. ("KKD") was "botched" for a number of reasons, including that "... no one was charged with intentional fraud despite there being evidence that fraud was committed," "ill-gotten profits" by a KKD officer were not disgorged, and "reports from Special Investigators" were not followed up on appropriately. The complaint further alleged that key testimony in the ARO investigation was never taken or taken too late, certain auditor work papers "were not reviewed," and the ARO's investigation's excessive delay was incorrectly blamed on the U.S. Attorney's Office for the Southern District of New York ("USAO"). Finally, the complaint claimed that four Enforcement staff were improperly "taken off the case" by Steven E. Donahue ("Donahue"), Assistant Regional Director, because they advocated a more aggressive prosecution of fraud in the matter.

The OIG investigation did not find evidence that the ARO staff investigation into securities violations and other wrongdoing by the officers of KKD was negligent or "botched," despite a pronounced delay in obtaining testimony and concluding the investigation. The OIG also did not find evidence that the decision not to pursue fraud charges was unsupportable in light of the litigation risks expressed. Further, the OIG concluded that the ARO penalties assessed for the ill-gotten gains of the KKD officers' fraudulent activities were supported by analysis from the SEC Office of Economic Analysis ("OEA"). However, the OIG investigation did find that certain delays in the investigation were excessive. The OIG further determined that some potential evidence may have been unexamined, likely the result of poor communication among the ARO staff, and this issue also affected other aspects of the investigation. Finally, while the OIG found that there was considerable turnover in the staffing of the investigation, the OIG did not uncover evidence substantiating the claim that Donahue removed staff from the investigation in order to negate these staff efforts to conduct a more aggressive