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Trends, Tips and Lessons Learned

November 2005

As we reflect upon the start of our 15th year in business we have come to recognize that our strengths are found within our background checks and corporate investigations. As you know, things are not always black and white, as such we pride ourselves in assisting clients in resolving the grey areas. This issue of Trends, Tips and Lessons Learned provides some illustrations of how we have done that.

Kenneth S. Springer, President
Corporate Resolutions Inc.

Bayou Group ... "A recipe full of shoulda, coulda, woulda's"

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CRI Trends & News

Litigation Trends

More and more, attorneys are seeing the benefits of our pre-deposition fact-finding inquiries. Oftentimes, the facts identified in these inquiries serve as a road map when questioning a witness and a barometer as to their truthfulness.

CRI Milestones

On August 22, 2005 we started our 15th year in business.

Our London office has been in operation since 1994.

A scandal laced with "shoulda, coulda, woulda's" for investors. Newspapers, journals and magazines have repeatedly cited the effects of the Bayou Group debacle: fraud in almost every form possible.

Not only did Samuel Israel III and his Bayou Group hedge fund defraud investors of over \$300 million, but, to make the pain worse, the entire situation could have been potentially avoided. Ouch.

What happened to the investors of Bayou Group has happened many times before, though the scale of the fraud usually varies. No one wants to harp on the past. Investors, managers and lenders need to look forward and start to understand what can be done to protect

themselves in the future.

Background investigations are the first and most obvious step. The investigations are, more often than not, prolific in their findings. The public records that are searched, the data analysis that is performed and the results that are provided can help anyone get a better understanding of a person(s) and/or a company.

Most of the things we now know about Mr. Israel and his sordid past were in the public domain. His checkered employment history, lawsuits, problematic trading patterns and general untrustworthy behavior would have surfaced in a due diligence investiga-

tion conducted by Corporate Resolutions, Inc. in New York City. This same investigation would have also identified his conflicts of interest and those of his suicidal CFO, Daniel Marino.

In most due diligence inquiries, Corporate Resolutions (CRI) reviews civil and criminal lawsuits filed by/against the subject, on the state and federal level, as well as bankruptcy filings. CRI also seeks to identify any corporate affiliations held by the subject and/or the subject's known company and reviews thousands of publications to find any media attention received by the subject. In addition, we search regulatory filings (SEC (continued on page 3)

Whistleblower Hotline

"Eyes and ears for board members, lenders and investors"

Needless to say that when the Sarbanes-Oxley Act passed in 2002 following the Enron scandal it introduced a new era of accountability for corporate management. Specifically, Section 301 of the

Act mandates that audit committees of public companies establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding account-

ing, internal accounting controls, or auditing matters. The Act goes on to state that "the reporting mechanism must enable employees to remain anonymous when making (continued on page 3)

Violations of Non-Compete Agreements “What you can do”

An article in the June 2005 Miami-Dade Daily Business Review indicated that labor and employment attorneys have noticed a spike in the use of non-competes by companies and an increased willingness on the part of those companies to enforce them. It seems that employees of all kinds and in various industries are being asked to sign these agreements as companies are using them to protect themselves when employees leave their company and attempt to work for a competitor. They are doing so to protect trade secrets, which employees might provide to their new employer, and to keep customers from following the ex-employee to their new company. Florida has become one of the nation's strictest states in enforcing non-competes. California and Georgia are commonly seen as states with laws that make it the most difficult for employers to enforce non-competes.

CRI has recently investigated several cases for companies looking to enforce non-competes signed by former partners and senior executives. The individuals had signed these agreements as part of a buyout resulting from a recap. New management was brought in by

the investment group and it was thought by all accounts that the former management team was going off to enjoy their “new found wealth”. That was not the case however, as we determined that although the former managers had signed agreements stating that they could not work in this specific industry for a period of 18-24 months after leaving the company, they had actually planned to set up a competing business as early as six months prior to leaving the company. It was determined through our interviews of employees, former employees and outside contractors that one of the individuals had set up a shell corporation immediately upon leaving the company. A computer forensic review of that former executive's company-owned computer identified deleted files and emails indicating that a corporate logo was also being designed for the new company, six months prior to the shell corporation being formed. This information was helpful to our client's attorneys in their re-negotiations with the former executives.

In another instance, a client suspected that a top-performing salesman might be getting ready to join a competitor. Our client also indi-

cated that the employee had signed a non-competes agreement several years earlier that prohibited him from working in the same industry for a one-year period, if he left the company. After speaking with the client regarding the reasons for their concern, it was decided that CRI would conduct a limited surveillance of the salesman. During the first few days of the surveillance it was determined that the salesman visited the corporate offices of a competitor on one occasion. On the second occasion we contacted the client who then called the salesman on his cellular telephone inquiring where he was and when he would be returning to the office. The salesman lied and said he was meeting with a client who was located in a completely different area of town than where he actually was. Our surveillance video recorded the employee exiting the competitor's offices a short time later. The employee was confronted with the facts and admitted he was actually working for the competitor at the same time he was working for our client. The employee was terminated and legal action was taken against the employee.

What we include that others Don't

In conducting our due diligence investigations we access over 75 international regulatory data sources including OFAC. We also access another data source which contains over 37,000 arbitration awards from the NASD, NYSE, NFA, CBOE, Amex, MRSR, PHLX, and PCS dating back to 1989.

Bayou Group ... "A recipe full of shoulda, coulda, woulda's" (Cont'd)

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and others), make other discreet queries with trusted investigative sources to gain a clear understanding of the subject, and, of course, confirm whatever is presented on the subject's CV.

On September 18, 2005, Gretchen Morgenson put it rather succinctly in The New York Times: "What you don't know about your hedge fund manager, it turns out, can really hurt you." Morgenson's article detailed the numerous inflations and omissions on Mr. Israel's resume.

Throughout his resume, Mr. Israel either overstated his responsibilities or, at times, completely falsified and excluded key facts.

Although honorable people often neglect to detail every aspect of their career on a CV, a pattern of falsification and fraud is often a clue as to the type of person that is running a company or, in this case, a hedge fund. The information that is now known about Mr. Israel is primarily of public record. A prudent due diligence investigation would have saved investors over \$300 million.

Conducting background investigations should never be considered a supplemental service -- it is a necessity. No one wants to be involved in another Bayou Group. For 15 years, Corporate Resolutions Inc. has been protecting the interests of investors, venture capitalists, banks and lenders. There is an easy way to protect yourself and your investment. Call us.

If you would like to read the results of the review that CRI conducted on this, much of which has not yet surfaced in the media, please contact us.

Whistleblower Hotline

"Eyes and ears for board members, lenders and investors" (Cont'd)

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such a complaint." As a result, many public organizations have implemented anonymous employee hotlines, which have proven to be a valuable tool for fraud detection.

Whistleblower hotlines have proven to be effective for publicly traded companies, and we believe they can play an important role for privately held companies as well. *The private equity community and their lenders would greatly benefit from implementing such whistleblower hotlines at their portfolio companies, and corporate investors in hedge funds could require such a mechanism prior to initiating their investment.* A hotline could also serve as an effective mechanism for reporting other significant issues that could adversely affect a company or a fund such as allegations of fraud or mismanagement, sexual harassment, conflicts of interest, drug usage, workplace violence, violations of non-compete agreements and

similar type matters.

Many privately-held firms do not have the internal resources and/or know how to fully investigate and review complaints regarding these matters. The challenge for them is to determine how to handle an anonymous complaint and how to go about investigating its validity. The retention of an experienced independent third party to receive and monitor the hotline complaints and to investigate the allegation is a viable solution to this problem. It is better to hear bad news first hand and take corrective action than it is to do nothing and learn about it later in the newspapers.

Since the early 1980's, hotlines have proven to be a valuable tool for fraud detection. The most effective are independent hotlines that offer 24-hour a day, 365-day access to trained interviewers with bilingual capabilities. Simplified communications along with a single vehicle for reporting all workplace issues have historically

provided the best results. Hotline incident reports can then be quickly disseminated to the company's designated parties, such as their legal counsel, human resources manager, and the board of directors. *The Association of Certified Fraud Examiners reported in their 2004 Report to the Nation that over 39% of fraud incidents reported were initially discovered through a tip by an employee, contractor, vendor or anonymous source, compared to 24% through internal audit and 21% through accidental discovery.*

When Sarbanes-Oxley was signed into law it only pertained to publicly traded companies; however, a number of states are considering the imposition of those same guidelines on private companies. If that is the case, the CEO's of those companies will be held accountable, for the same issues as are their counterparts at publicly traded companies.

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We wish to also point out that U.S. Federal Sentencing Guidelines, which apply to all companies public and private, requires employers to offer a mechanism for reporting illegal behavior as well as ethics training for all employees.

CRI is expert at helping our clients resolve these issues, and can provide assistance in the implementation of a hotline and related training at your company. Please contact us for more information about this.

“I cannot tell a lie!”

We have all heard and probably used this great quote from the founding father of our country George Washington, as did one recent CFO candidate. As our client was providing us with identifying information for the background investigation we were about to conduct of the prospective CFO, they wanted us to know that the candidate had been “extremely honest” with them during his interviews, having stated that he had declared personal

bankruptcy several years ago. He told them that he was very embarrassed by the situation, which he said was directly attributable to the extraordinary medical expenses his wife incurred as a result of an automobile accident. The client made sure to tell us not to spend much time on the bankruptcy matter as they had already made a decision to hire the candidate, assuming everything else checked out.

As our investigation progressed the bankruptcy case was

identified during our litigation search and our media review verified the automobile accident. On the surface, the information substantiated what our client had been told by their candidate. Our analysis of the facts however, determined that the bankruptcy actually occurred 6 months prior to the accident and appeared to be a result of an extravagant life style. To quote another former President Ronald Reagan, “Trust but verify”.

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About Corporate Resolutions

Corporate Resolutions Inc. (CRI) is a worldwide business investigations and consulting firm, providing a wide range of services to leading financial institutions, the private equity and alternative asset communities, law firms, insurance companies, healthcare organizations and global corporations. CRI, established in 1991, has offices in New York City, Boston and London. Visit us on the web at www.corporateresolutions.com.