



MFA Reporter

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Digging for Disclosure: It's Not What They Tell You, It's What They Don't Tell You

By Ken Springer, Founder, Corporate Resolutions Inc.

Disclosure. In most of the recent corporate scandals that have received massive media attention, the problems of the CEOs under investigation are the same: disclosure. Martha Stewart did not *disclose* the reasons for her famous ImClone stock trade, Enron officers did not *disclose* all of the details regarding the company's financial status, and, of course, the investment banking houses were fined for not properly *disclosing* the actions and timing of trades and relationships between the buy and sell sides.

In the world of conducting character and integrity background investigations, non-disclosure equals dishonesty, and dishonesty is often a clue to other unethical or inappropriate behavior. Corporate Resolutions Inc. (CRI), a boutique business investigations firm headquartered in New York City, has performed thousands of inquiries supporting this statement. Whether the crimes have been glaring, shocking or routine, CRI has seen enough to know that one iota of information can truly change the way an investment appears.


Earlier this year, CRI was retained by investors of a convenience store chain who were looking to bring in an investor group to expand the chain. The investors asked CRI to look

into the youngest member of the three-person team expected to "run" the chain. Initially, CRI found nothing on this young person. His slate was clean. Nothing of a derogatory nature surfaced, other than the fact that he did not have any real experience that qualified him to even work in a convenience store, much less oversee the operations of all the stores. CRI decided to dig further. CRI discovered that the

father of the young manager had been incarcerated in a federal prison for the sale of narcotics. Further investigation determined the father had been cell mates with the third member of the "investor group," who had served time for money laundering. The facts discovered pointed towards the strong possibility that the intent of the investment was a way to launder money. Needless to say, the investors did not go

forward with the deal and saved themselves financial embarrassment and their reputation.

Theoretically someone's past is not supposed to be held against them. In most cases where you are investing your money and reputation, that theory does not apply. In fact, CRI has found that past history is often indicative of future performance.



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The convenience store tale is just one among many. Recently, CRI was hired by a hedge fund to look into an individual who was prominent in the investment community. The hedge fund had been in talks with the subject for over seven months and during the course of these conversations, the hedge fund managers seemed pleased with the abilities and prospects the subject had presented to them. Two days before the hedge fund was prepared to offer the subject a high-level position, a member of the fund had a nagging hunch. They called CRI and within hours, we discovered the subject was about to be sanctioned by the NASD for irresponsible behavior. The subject never disclosed this to his potential “partners” and presumably was just hoping the information would not leak out. He was wrong.

CRI has witnessed a variety of scenarios where disclosure has become a problematic issue. We have uncovered high-profile executives who staged insurance fraud to cover a bankruptcy filing, hedge fund managers who highlighted a degree from Yale on a resume but never received any undergraduate degree, and fund analysts who boasted 35% returns on companies that never existed. The smallest brag or the biggest abuse of power can all be indicators of a problem waiting to happen. If someone is going to lie to you about where they went to college, there is no reason to believe that he/she will not lie to you about the balance sheet of the company.

“Lawsuit lovers” are another problem CRI often identifies when conducting inquiries into officers or directors of small companies. When an executive is suing everyone that he/she does business with or used to work for, it is a behavioral pattern or clue. Again, there is no reason to believe that the next lawsuit this person files will not list you as the defendant.

Awareness is everything. If you do not know who you are dealing with, who you are about to invest in or who you are about to hire, then there are no guarantees that you will not be surprised. While not every investigation uncovers a story

that deserves headlines, it is often the behavior or activities of a person that shed light on the future of your business relationship. Interestingly, almost 40% of the background checks we conduct require further investigation – whether vetting non-disclosed business interests, clarifying facts about why suits were settled out of court or interviewing of subjects to document their version of discrepancies, law suits or personal sensitive issues.

If, for example, your hedge fund manager told you he filed for bankruptcy protection in the early 90’s and provided you with a reasonable explanation for the filing, this could be a non-issue. However, what if you did not know about the bankruptcy and the manager tried to hide it from you? Then, the non-disclosure of the event makes the weight of the bankruptcy that much heavier.

The only way to protect your investment is to do your homework. Routine background checks uncover criminal records, civil litigation, regulatory problems, resume fraud, bankruptcies, and in many instances, troublesome media attention that the individual or company may have received. However, most importantly, you must connect the dots – you don’t always find an Enron-level of scandal. You have to look for patterns of law suits, discrepancies, non-disclosure and other reputation considerations that are not always apparent. Background checks confirm what someone represents to you and determine if there are any issues that have not been properly disclosed. These inquiries give you a picture of the type of person you are doing business with, not just the image the person chooses to show. ■

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