

With the end of the school year upon us, it seem slike the appropriate time to grade your performnce since the beginning of your tenure as Chairman. To be blunt, you are failing. You are getting an F. There are two reasons. First, you have been acting dishonestly and without integrity, probably due to a lack of political courage. Second, you have not fired David Kotz.

Let me give you some examples. The recent Washington Post article was chock full of lies and half-truths. You WERE involved with the decision to send senior staff -- including Andy Vollmer and Linda Thompson -- to the hearing with out authorizing them to talk about the Madoff matter. In fact, as you know, the only way they could have talked about the details of the prior investigation -- without breaking the law -- is if you and the rest of the Commission had voted to authorize such disclosure. That did not happen. Obviously, the decision backfired, and it was appropriate for you to promise better responsiveness going forward. But for you to now try to spin that episode to pretend that you had nothing to do with it -- and lay all the blame at the feet of the staff -- is shameful.

Equally shameful is the way you handled the replacement of the former Director of Enforcement. Why in the world would you leak to the Washington Post that you were looking to replace Linda Thompson when she had already told you that she would be announcing her resignation within the next few days? (And when I say "you" -- everyone knows that you had Elisse Walter do your dirty work for you -- it wouldn't have happened without your authorization.) Linda responded by handling the situation with dignity and grace. You were classless and gutless.

Speaking of gutless, you should stop telling people that your decision not to promote Andy Calamari to head the NYRO was based on your fear that you would be criticized if you picked him, due to his connection to the prior Madoff investigation. You should do what's right, regardless of whether it's politically expedient. Andy was the best person for the position. End of story.

Along those lines, it seems as if you think there's some PR advantage to you in announcing that you're hiring "former prosecutors" to key Enforcement positions. Just so you know, prosecutors are usually less aggressive than the SEC's Enforcement staff. Where are the criminal charges against Stanford and Muzillo? Look back to see who walked away without criminal prosecution while Khuzami and Canellos worked at the SDNY -- "Chainsaw" Al Dunlap of Sunbeam, Michael Saylor of Microstrategy, the executives responsible for the massive Xerox fraud, among others. The SEC brought major cases against those individuals. The "former prosecutors" did not.

I hope that you turn out to be a strong supporter of the Enforcement Division, but I am concerned that you are just talking tough now because it seems like that's the way the political winds are blowing. I read an article this past week saying that fines and penalties were down more than 70% at FINRA last year -- on your watch. Prior to that, who can forget that you were among the first to embrace "principles based regulation" (again, while you were at FINRA) when that was in vogue in certain political circles. Will you stop talking and acting tough a year from now, after the economy has recovered and things have settled down? Your decision to cave in to political pressure with respect to mark-to-market accounting is not encouraging.

Back to the Post story, you need to be careful not to say things that are demonstrably false. For example, saying that you "began [your] career as an enforcement lawyer at the SEC" is a flat-out lie. I have been told that you never worked in the Enforcement Division at the SEC. Hopefully, that was a mistake by the reporter and not resume fraud by you.

Your attempt to take credit for the Reserve Primary Fund case in another head-scratcher. According to you, the investigation would have dragged on for years without your intervention. Nothing could be further from the truth. The matter had been identified as a high priority matter by people you have thrown under the bus (Thompson and Calamari), and Wells calls were made in December, long before you arrived on the scene. Apparently, the only contribution you actually made was to show up for the closed meeting and vote to approve the staff's recommendation. What are you going to claim next -- that you personally took Angelo Mozillo's deposition testimony?

As long as you're telling tales, why didn't you tell the Post about the times when you've asked the staff whether they can "just sue someone" -- without any investigation or evidence -- because they have a "gut feeling" that the person did something wrong? I know the NYAG does business that way, primarily for PR reasons, so I was glad to hear that the Enforcement staff told you that it was a bad idea, because the Commission has traditionally held itself to a higher standard.

I was also shocked when I heard that you've been telling people that you believe you can announce major changes and then ask people not to judge you for a year or two -- when you'll be long gone, just like you did when you were at the CFTC. In this respect, your push to hire more "specialists" is a transparent political ploy. Everyone knows you're doing it because of the backlash that followed the House hearing on Madoff and Markopolos. Well, let me tell you something -- Markopolos is

a crack-pot. That should be obvious to anybody who watched him ramble on about the Russian mob and his fear that Madoff would have him killed. But you're acting as if he's speaking the Gospel truth. At most, he dealt with 5-6 staff members over the years, so what basis does he have to judge 3,600 people? And why are you acting as if he's right in assuming that they are all a bunch of incompetent idiots? You're quick to label the matter a "failure," without knowing all the facts. Why? Do you know something that nobody else does, or are you just acting like all the other morons out there (Ackerman) and judging what happened several years ago through today's lens? Don't you want to hear the staff's side of the story.

To be fair to you, I hear that the Enforcement staff appreciates the two policy changes that you initiated -- allowing formal orders to be approved by duty officer and eliminating the pilot penalty program -- and you have received a lot of positive press for taking these steps, which goes to show that you don't need to do anything radical to have a positive impact (after all, as everyone knows, all you did is roll back the clock and allow the Enforcement Division to do business the way they used to). The Enforcement Division can be improved, and Khuzami deserves credit for taking that on, but hiring specialists is not the way to do it.

I'm sorry if it sounds like I'm being tough on you, but it's for your own good. You have the ability to be a good Chairman. If you concentrate on doing what's right, and stop worrying what Congress and the press are going to do or say, everything will be fine.

The same cannot be said for David Kotz. He is incompetent and corrupt and should be fired immediately.

I understand that serious EEO allegations have been made against him -- stemming from an affair that he's been having with a woman who he later promoted, which has led to the creation of a hostile work environment. I further understand that several members of the IG's staff have complained to Diego R. and Jeff R. about Kotz's behavior and requested transfers. Apparently, Kotz is abusive and vindictive, and has in several instances doctored reports to include findings that he wanted, over the objections of his staff. What are you doing about that? Shouldn't he be placed on leave until these allegations are resolved?

In addition to possible disciplinary action for these transgressions, you need to appoint someone to evaluate his actual job performance. As I said before, he is incompetent and corrupt. Talk to management and ask how much time is being wasted fixing things that he gets wrong. To do that, you'll need to get copies of his draft audit reports and

compare them to the final versions that are publicly released. The recent report on waivers is a perfect example. I understand that Enforcement staff throughout the country spent hundreds, if not thousands, of hours fixing his mistakes (if you compare the final version with the draft, you will see that Kotz had an error rate of approximately 90%). Maybe you want your Enforcement staff spending their time that way, but I do not. It scares me to think what might have been missed while these thousands of hours were being spent cleaning up Kotz's mess. Another Madoff? Let's all pray that is not the case.

His March 2009 report on NSS complaints also has serious flaws. In it, he blames Enforcement for failing to adequately respond to some 5,000 complaints about NSS. However, the truth demonstrates how Kotz is corrupt -- he doesn't view the facts impartially; he has a pre-determined outcome that he wants to reach and then spins, distorts or omits facts that are inconsistent with his thesis, in order to achieve his desired outcome. For example, Kotz knew from talking to the staff that approximately 2,600 of the 5,000 complaints were from a single individual and that nearly 3,000 complaints were about a single issuer (which WAS being investigated). His intentional omission of those relevant facts from the final report demonstrate his bias for a particular outcome.

Kotz's shabby work is not limited to Enforcement matters. His report on the CSE program suffers from similar flaws. Despite T&M's best efforts during the review process to correct factual errors and unsupported conclusions, Kotz issued his report condemning the Commission and its staff -- which was his pre-determined goal -- without any effort to be fair or objective. Management's response to the report says it all: "We believe the OIG Report is fundamentally flawed in its process, premises, analysis and key findings.... [T]he Division's calls to correct mistakes, misunderstandings and misrepresentations have had limited effect on the final document. It is our view that the resulting OIG Report starts from incorrect assumptions and reaches inaccurate, unrealistic, and impracticable conclusions."

Wow!! What more do you need to get rid of this guy? I know you think he's teflon because of the Madoff matter, but how much longer can you allow his incompetence and corruption to tarnish the reputation of the Commission and its staff? (By the way, here's some friendly advice: you aren't doing yourself any favors with the staff by issuing press statements like the one you did last week, after Kotz issued his semi-annual report.)

The audit reports are just the tip of the iceberg. You also need to focus on the bias, corruption and ineptitude that's reflected in his investigative reports -- the ones where he recommends criminal and disciplinary actions be taken against the staff.

To begin with, you need to take steps to change the process, because it is fundamentally unfair as it currently exists. Do you know that nobody -- not even the employees who are the subject of the reports -- has a chance to review or comment on the reports until after they have been issued (and, typically, leaked to the press)? What kind of system is that? Criminals in SEC enforcement investigations get more due process than the Commission's own staff -- why is that? The system is not only broken, it's McCarthy-esque, so shame on you if you don't take steps to fix it immediately.

Before getting to some specific examples of how Kotz has abused the process, there's something else you should know about his character. Kotz has been banned from coaching in a youth soccer league, due to frequent obnoxious and unsportsmanlike conduct towards coaches, parents and/or children. Children!!

While cheating on your wife and being a poor sport are not, alone, grounds for dismissal, they are relevant considerations in evaluating someone who sits in judgment of others, as an IG does. In my view, they lead to one inescapable conclusion -- that Kotz does not have the judgment, discretion, temperament or maturity to be an inspector general. His recent work bears that out.

As I'm sure you know, ALJ Murray, who is widely respected, recently reviewed two of Kotz's reports and found that none of his recommended actions was supported by the record. Even more troubling was her finding in one of the reports that the "IG's Report of Investigation does not support his conclusions." In other words, he had no evidence and was simply making things up. If that wasn't bad enough, when the ALJ asked Kotz to provide information to support his claims, he refused (presumably because he had been caught red-handed). How can you stand by and allow that to happen? People's lives and reputations are being ruined. Don't you care?

And why are you allowing these reports to be sent to Grassley before the people affected by them have a chance to respond? His judgment and discretion are just as bad as Kotz. If anything, according to hallway rumors, Grassley and his staff should be investigated for their attempts to pressure the Enforcement staff to pursue baseless allegations against a regulated entity, in an effort to help a relative extort money from

the firm (through litigation filed by the relative after he was terminated for cause).

It's hard to rank Kotz's numerous lies, distortions and other transgressions, but arguably none of them are worse than the recent report in which he concluded that two employees' securities transactions "raise suspicions of insider trading." Hardly anybody has seen an unredacted version of the report, but word on the street is that Kotz has, once again, distorted the facts to suit his warped view of the world (and to generate headlines and television appearances for himself, which he apparently believes is part of his mission).

One of Kotz's "smoking guns" is a trade that's reported to involve a sale of 50-100 shares on United Health stock approximately two months before an investigation was opened. The investigation was opened in response to a WSJ story that day, so it was impossible for the trade two months earlier to be connected to it in any way. What is Kotz thinking? Have you asked him to explain how that raises concerns about insider trading? To me, it's a bright neon sign that demonstrates for all the world to see that he's incompetent, biased and vindictive.

The other trading that Kotz finds troubling is the purchase of 10-20 shares of Schlumberger stock after an investigation was opened. Has Kotz explained to you why this trade deserved to be referred for potential criminal prosecution? Anybody with half a brain could immediately see that the employee got the trade backwards if they were indeed trading on material, non-public information.

I don't know why Kotz labled the trades as suspicious of insider trading, but there are only two logical explanantions -- he's driven to manufacture headlines (in which case, he's corrupt) or he's a buffoon. Either way, he deserves to be fired.

A recent article captures the problems with Kotz and the report perfectly: "This 'case' would never have made the first cut had it been reviewed by someone who knows anything about how you go about putting together a viable insider trading case.... IG Kotz should never have referred the matter to the U.S. Attorney's Office, as he announced. He should have followed through on the investigation and, presumably, gathered the necessary evidence to either close it himself or present a real criminal case to the DOJ.... The SEC should also review the allegations itself, or appoint a special counsael to do so, and move quickly to either sanction these employees, or clear them."

Which raises the question -- what are you going to do about this? We've

seen your initial, panicked response -- proposing that virtually all trading by SEC employees be banned. But now that you've had time to gather information and reflect on things, everyone's watching to see if you will do the right thing. This is going to be a serious test of your leadership. Nothing else that you're doing right now (whistleblower statute, custody rules, etc.) will matter if you don't get rid of Kotz.

This is not an academic point either. In addition to the problems highlighted above (which are by no means exhaustive), I don't see how anyone can reasonably expect that the impending IG reports relating to Bear Stearns and Madoff will be any better than the biased, incompetent and corrupt work that Kotz has produced so far.

Do the right thing. Fire Kotz immediately. Fail not at your peril.