

United States District Court
For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

Securities and Exchange Commission,

Plaintiff,

v.

Kenneth L. Schroeder,

Defendant.

NO. C 07-03798 JW

**ORDER DENYING PLAINTIFF'S
MOTION FOR DIRECTOR AND
OFFICER BAR**

I. INTRODUCTION

The Securities and Exchange Commission ("SEC") brought this civil enforcement action against Kenneth L. Schroeder ("Defendant") alleging, *inter alia*, violations of § 10(b) of the Securities and Exchange Act of 1934 and various SEC rules. The SEC alleges that Defendant unlawfully backdated options grants and submitted false financial statements for KLA-Tencor Corporation, ("KLA" or the "Company").

Presently before the Court is the SEC's Motion for an Order Barring Defendant from Serving as an Officer or Director of a Public Company.¹ The Court conducted a hearing on November 1, 2010. Based on the papers submitted to date and oral argument, the Court DENIES the SEC's Motion for an Order to Bar Defendant from Serving as an Officer or Director of a Public Company.

¹ (hereafter, "Motion," Docket Item No. 225.)

1 **II. BACKGROUND**

2 On July 25, 2007, the SEC filed their Complaint, alleging that Defendant had engaged in a
3 scheme to illegally backdate KLA employee stock options from mid-1999 to mid-2002, and once
4 again in 2005, in efforts to overstate KLA’s income and conceal expenses from investors.² The SEC
5 further alleged that Defendant continued to undertake this practice even after notification from KLA
6 counsel that the practice was improper, and that Defendant benefitted from the scheme, personally
7 receiving several million dollars. (Id. at 2-3.) On June 18, 2010, Defendant filed the Consent of
8 Defendant Kenneth L. Schroeder to Entry of Partial Final Judgment. (hereafter, “Consent,” Docket
9 Item No. 219.) In his Consent, Defendant consented to partial final judgment against him, without
10 admitting or denying the allegations of the Complaint, and agreed to pay a civil penalty in the
11 amount of \$275,000. (Id. at 1-2.) In the Consent, the parties dispute whether a director bar is
12 appropriate, and expressly reserve the issue for the Court to decide following the parties’ discovery.
13 (Id. at 2.) On June 25, 2010, the Court entered partial final judgment as to Defendant. (Docket Item
14 No. 221.)

15 Presently before the Court is Plaintiff’s Motion for a Director Bar.

16 **III. DISCUSSION**

17 The SEC seeks a bar prohibiting Defendant from serving as a director or officer of a public
18 company for a period of five years. (Motion at 1.)

19 A district court “may prohibit, conditionally or unconditionally, and permanently or for such
20 period of time as it shall determine,” any person engaged in securities fraud “from acting as an
21 officer or director [of a public company] if the person’s conduct demonstrates unfitness to serve as
22 an officer or director.” 15 U.S.C. § 78u(d)(2). In determining whether to order a director and
23 officer bar, a court may consider:

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² (Complaint at 1, Docket Item No. 1.)

1 (1) the “egregiousness” of the underlying securities law violation; (2) the defendant’s “repeat
2 offender” status; (3) the defendant’s “role” or position when he engaged in the fraud; (4) the
3 defendant’s degree of scienter; (5) the defendant’s economic stake in the violation; and (6)
4 the likelihood that misconduct will recur.³

5 Here, in the Consent, the parties have stipulated to reserve the determination of the
6 appropriateness of a five year director bar for the Court. (Consent at 2.) However, the extent to
7 which the parties have stipulated to relitigate the underlying factual allegations of the Complaint is
8 unclear. (*Id.* at 4.) The Consent prohibits Defendant from “denying the allegations in the complaint
9 or order for proceedings,” but further provides that “[t]his Consent shall not be binding on the
10 parties’ rights and obligations related to litigating the Court’s determination of the entry of an order
11 barring [Defendant] from serving as an officer or director” (*Id.* 4-5.) Whether “litigating the
12 Court’s determination of the [director bar]” should allow the proffering of evidence in conflict with
13 facts alleged in the Complaint is not explicitly stated in the Consent. (*Id.*) Despite the lack of
14 explicit stipulation in the Consent as to how litigation should proceed, the Court finds good cause to
15 resolve the director bar determination based on parties’ present submissions.⁴

16 Upon review,⁵ although the Court finds examples of the recurrent nature of Defendant’s
17 alleged violative conduct, there is also uncontroverted evidence showing that someone had altered
18 Defendant’s signature and the date on backdated documents. Thus, it cannot be said that the SEC

19 ³ SEC v. First Pac. Bancorp., 142 F.3d 1186, 1193 (9th Cir. 1998) (quoting 15 U.S.C. §
20 78u(d)(2)); see also SEC v. Hilsenrath, 2009 U.S. Dist. LEXIS 58930 (N.D.C.A.). In the Sarbanes-
21 Oxley Act of 2002, Congress lowered the SEC’s burden in seeking a director and officer bar from
22 showing “substantial unfitness” to serve to only showing “unfitness” to serve. SEC v. Levine, 517
23 F. Supp. 2d 121, 144-45 (D.D.C. 2007). Based on this reduced burden post-Sarbanes-Oxley, SEC
24 contends that the Court should adopt the unfitness test adopted by the D.C. district court in Levine.
25 In that test, the Court also considers the defendant’s acknowledgment of wrongdoing and credibility
26 of the defendant’s contrition as unfitness factors. See Levine, 517 F. Supp. 2d at 145-46. Since the
27 Ninth Circuit has not adopted the Levine test, and at least one court in the district has continued
28 applying First Pacific Bancorp after Sarbanes-Oxley’s removal of “substantial” from the statutory
language, the Court will only consider the First Pacific Bancorp factors here. However, the Court
finds that in this case, both tests would yield the same outcome.

⁴ At the hearing, the parties also reconfirmed that the Consent provides the Court with the
discretion to adjudicate the director bar issue.

⁵ As a preliminary matter, since the parties have filed most of the evidence for this Motion
under seal, this Order only summarizes the evidence and provides general citations to the evidence
but does not refer to any specific confidential information.


1 has demonstrated that Defendant possessed the degree of scienter sufficient to impose a five year
2 director bar. Further, because it appears that Defendant has had difficulty obtaining regular
3 employment since October 2006 when KLA made public the allegations against Defendant, the
4 Court finds that he has already been effectively barred from his profession for four years.

5 Thus, weighing Defendant's showing of alterations of his approval of certain options grants
6 and considering his effective bar over the last four years, the Court finds a director and officer bar
7 unwarranted in the present case. Accordingly, the Court DENIES the SEC's Motion for a Director
8 Bar.

9 **IV. CONCLUSION**

10 The Court DENIES Plaintiff's Motion for a Director Bar. On or before **November 29, 2010**,
11 the parties shall file a Joint Proposed Final Judgment for the Court's approval to bring this case to a
12 close.

13 Dated: November 17, 2010

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15 _____
16 JAMES WARE
17 United States District Judge

1 **THIS IS TO CERTIFY THAT COPIES OF THIS ORDER HAVE BEEN DELIVERED TO:**

- 2 Alice L. Jensen ajensen@fenwick.com
- 3 Arlena Victoria Carrozzi arlena.carrozzi@dlapiper.com
- 4 David Allen Priebe david.priebe@dlapiper.com
- 5 Elena Ro roe@sec.gov
- 6 Elliot Remsen Peters epeters@kvn.com
- 7 Flora F Vigo fvigo@omm.com
- 8 James Elliot Lyons jlyons@skadden.com
- 9 Jeffrey Bruce Coopersmith jeff.coopersmith@dlapiper.com
- 10 Jeffrey S. Facter jfactor@shearman.com
- 11 Jonathan B. Gaskin jgaskin@orrick.com
- 12 Joni L. Ostler jostler@wsgr.com
- 13 Judith L. Anderson andersonju@sec.gov
- 14 Lanelle Kay Meidan lanelle.meidan@skadden.com
- 15 Marc J. Fagel fagelm@sec.gov
- 16 Mark Philip Fickes fickesm@sec.gov
- 17 Matthew Eric Sloan Matthew.Sloan@skadden.com
- 18 Rebecca Felice Lubens rlubens@orrick.com
- 19 Richard Marmaro rmarmaro@skadden.com
- 20 Robert Adam Lauridsen alauridsen@kvn.com
- 21 Robert James Slaughter rjs@kvn.com
- 22 Shirli Fabbri Weiss shirli.weiss@dlapiper.com
- 23 Steven Keeley Taylor skt@kvn.com
- 24 Stuart L. Gasner slg@kvn.com
- 25 Susan F. LaMarca lamarcas@sec.gov
- 26 Thomas R. Green tgreen@morganlewis.com
- 27 Timothy Alan Miller tmiller@skadden.com
- 28

16 **Dated: November 17, 2010**

Richard W. Wieking, Clerk

By: /s/ JW Chambers
Elizabeth Garcia
Courtroom Deputy