



Former Nortel Officials Including Dunn Sued for Fraud (Update6)

By David Scheer and Chris Fournier

March 12 (Bloomberg) -- North American securities regulators sued former Nortel Networks Corp. officials including ex-Chief Executive Officer Frank Dunn for allegedly manipulating earnings to meet financial targets.

The executives engaged in accounting fraud from 2000 to 2004, the U.S. Securities and Exchange Commission and the Ontario Securities Commission alleged in civil complaints today. The complaints also target former finance chief Douglas C. Beatty and former Controller Michael J. Gollogly.

Nortel restated earnings going back to 1999 after probes by regulators in 2004 indicated executives incorrectly booked revenue, inflating sales figures by \$3.4 billion. Nortel fired Dunn, Beatty and Gollogly after the investigations.

"The SEC's allegations suggest bold, knowing conduct," former SEC enforcement lawyer Jacob Frenkel said in an interview. "It will be interesting to see whether there are any more cases, civil or criminal." Frenkel, who is now in private practice in Rockville, Maryland, isn't involved in the proceedings.

In the Canadian suit, Dunn and the others can face fines of up to C\$1 million (\$860,000) under the Ontario Securities Act. The SEC, which filed its suit in U.S. District Court in Manhattan, asked the court to force the defendants to forfeit gains from their conduct and pay unspecified fines.

"The fraudulent conduct at issue here was egregious and long-running," Linda Thomsen, the SEC's enforcement chief, said in a statement. "Each of the defendants betrayed Nortel's investors and their misconduct gave rise to billions of dollars in shareholder losses."

Dunn 'Disappointed'

Dunn said he "welcomes the announcement today" that the OSC will hold a hearing into the circumstances of the restatements, according to a statement.

"I am disappointed that, after three years, the United States Securities and Exchange Commission has brought charges on the same day" as the OSC, Dunn said. "I think it would have been appropriate, under the circumstances, if the authorities in the United States had deferred to the Ontario Securities Commission in what is really a Canadian matter."

The SEC's suit also targets MaryAnne E. Pahapill, who served as both assistant controller and controller at Nortel during periods between 1999 and 2005.

Dunn, Beatty and Pahapill altered Nortel's practices for booking revenue to meet forecasts in 2000 and 2001, the SEC alleged in its complaint. In 2002 and 2003, Dunn, Beatty and Gollogly manipulated reserve funds to meet earnings targets and pay bonuses, the regulator said.

Possible Ban

Both the OSC and SEC will seek to bar the former executives from working as officers or directors at publicly traded companies.

Nortel shares rose 9 cents to \$28.17 at 4 p.m. in New York Stock Exchange composite trading. They lost 99 percent of their value between July 2000 and Sept. 2002.

"Investors haven't forgotten what's happened but we don't think this increases the negativity around the shares," Tim Daubenspeck, an analyst at Portland, Oregon-based Pacific Crest Securities. "It doesn't make things worse." Daubenspeck rates the shares "sector perform" and doesn't own any.

Attorneys for Beatty and Gollogly didn't immediately return phone calls. Pahapill, who the SEC says is representing herself, also didn't respond to a request for comment.

Bonuses Paid

After he became CEO, Dunn manipulated Nortel's reserves to "manage Nortel's publicly reported earnings, create the false appearance that his leadership and business acumen was responsible for Nortel's profitability and to pay bonuses" to Nortel executives, according to SEC documents.

The inflated results helped Dunn collect \$3.64 million in bonuses in 2003, while Beatty and Gollogly got \$1.31 million and \$3.53 million, the SEC said. Altogether, the company paid \$19 million to its top 43 managers that year.

"We can't comment on the proceedings," Jay Barta, a spokesman for Toronto-based Nortel, said in a phone interview. "We'll do whatever we can to cooperate with the SEC."

This month Nortel announced a fourth restatement of results in as many years, this time to fix errors from third-party calculations for liabilities on employee benefit plans and timing mistakes on how the company recognized sales.

"The house is still not in order," said David Rea, chairman of Davis-Rea Ltd. Investment, which manages about \$380 million in Toronto. "This company was out of control for years and we didn't know about it or understand the extent of it." Rea sold his Nortel shares "years ago."

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