

## BERKSHIRE HATHAWAY INC.

**TO:** The Board of Directors  
**FROM:** The Audit Committee  
**DATE:** April 26, 2011  
**RE:** Trading in Lubrizol Corporation Shares by David L. Sokol

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### **A. Summary.**

Berkshire Hathaway's top priority is to maintain the highest standards of business ethics. Company policies require the employees of Berkshire Hathaway and its subsidiaries to uphold those standards. The Audit Committee has considered<sup>1</sup> the conduct of David Sokol in connection with his trading in the shares of Lubrizol, and has determined that it violated those standards. In particular:

- His purchases of Lubrizol shares while serving as a representative of Berkshire Hathaway in connection with a possible business combination with Lubrizol violated company policies, including Berkshire Hathaway's Code of Business Conduct and Ethics and its Insider Trading Policies and Procedures.

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<sup>1</sup> This report is the product of the Committee's deliberations at its meetings of April 6, April 21 and April 26, 2011, as well as discussions during the meeting of the full Board of Directors on March 30, 2011 and communications on other dates between the Chair of the Audit Committee and Company management and legal counsel.

- His misleadingly incomplete disclosures to Berkshire Hathaway senior management concerning those purchases violated the duty of candor he owed the Company.
- These events should serve as an opportunity to reinforce to all officers, directors and employees of Berkshire Hathaway and its subsidiaries the importance of adhering to those policies and avoiding conduct that comes close to, or strays over, the line of propriety. To that end, we authorize Warren Buffett to release this report.

**B. Facts.**

In 2010, David Sokol was encouraged to scout for, and to bring to the attention of Warren Buffett, potential acquisition opportunities for Berkshire Hathaway. Mr. Sokol was not authorized to make acquisition decisions for Berkshire Hathaway; that power remained with Mr. Buffett in consultation with Charles Munger, subject to ratification by the Board.

That fall, Mr. Sokol met with investment bankers at Citi, discussed Berkshire's acquisition criteria, and suggested that Citi send him information about companies in the chemicals industry that might meet Berkshire Hathaway's acquisition criteria. In October, Citi sent Mr. Sokol a list of 18 companies in the chemicals industry. In November, Citi sent Mr. Sokol additional information concerning three of those companies, including Lubrizol, that were identified by

Mr. Sokol. Citi's data concerning Lubrizol and the other companies were derived from publicly available sources.

On Monday, December 13, 2010, Mr. Sokol met with Citi investment bankers to discuss the list. Mr. Sokol said the only company on Citi's list he found interesting was Lubrizol. A Citi representative said Citi had an investment banking relationship with Lubrizol and its CEO, James Hambrick. Mr. Sokol asked Citi to ask Mr. Hambrick if he was willing to speak with Mr. Sokol concerning Berkshire Hathaway and Lubrizol. Mr. Sokol added that Berkshire Hathaway does not do hostile transactions, and that if Mr. Hambrick met him and nothing came of their meeting, it would remain confidential.

On Tuesday, December 14, Mr. Sokol bought 2,300 shares of Lubrizol, a partial fill of a 50,000 share limit order.

On Friday, December 17, Citi reported the substance of the December 13 meeting to Mr. Hambrick. Mr. Hambrick told Citi he would inform the Lubrizol Board of Berkshire Hathaway's possible interest, and a Citi representative reported that fact to Mr. Sokol.

On Tuesday, December 21, Mr. Sokol sold the 2,300 shares of Lubrizol.

On January 5, 6 and 7, 2011, Mr. Sokol bought 96,060 shares of Lubrizol, a partial fill of a 100,000 limit order.

On January 10 or 11, a Citi banker told Mr. Sokol to expect a call from Mr. Hambrick.

On January 14, Mr. Hambrick phoned Mr. Sokol and they agreed to meet.

On January 14 or 15, Mr. Sokol proposed to Mr. Buffett the idea for purchasing Lubrizol, and told Mr. Buffett that he had an opportunity to meet with Lubrizol's CEO. Mr. Buffett was initially unimpressed with Lubrizol as a potential acquisition, but told Mr. Sokol to let him know what he learned at the meeting. He also told Mr. Sokol that he was unfamiliar with the lubricants and additives part of the chemicals industry. During the conversation, Mr. Buffett asked Mr. Sokol how he had become familiar with Lubrizol. Mr. Sokol mentioned that he owned the stock. He did not disclose:

- the amounts and timing of his purchases;
- the fact that he bought the shares after discussing Lubrizol with Citi and after Mr. Sokol had narrowed the bankers' initial list of 18 chemicals companies to one, namely Lubrizol;
- the fact that Mr. Sokol had bought shares after Mr. Sokol (acting as a senior representative of Berkshire Hathaway scouting acquisition candidates) had asked for Citi's help arranging a meeting with Lubrizol's CEO to discuss Lubrizol and Berkshire; and

- the fact that Mr. Sokol bought shares after learning that Citi had discussed his request for a meeting with Lubrizol's CEO, who told Citi that he would discuss Berkshire Hathaway's possible interest in a transaction with the Lubrizol board.

It did not cross Mr. Buffett's mind at that time that Mr. Sokol might have bought Lubrizol shares after seeking through investment bankers to initiate discussions with Lubrizol concerning a possible Berkshire Hathaway acquisition of Lubrizol. Because Mr. Sokol's comment about owning the shares was in response to Mr. Buffett's question how Mr. Sokol had come to know the company, it implied that Mr. Sokol had been following Lubrizol as an owner of its shares, and in that way came to think of Lubrizol as a possible Berkshire Hathaway acquisition.

Mr. Buffett remained skeptical concerning Lubrizol as an acquisition candidate through January 25. On January 25, Mr. Sokol met with Mr. Hambrick, and he briefed Mr. Buffett on that meeting the following day. Mr. Buffett began to warm to the idea of the acquisition of Lubrizol. On January 27, Mr. Buffett phoned Roger Altman of Evercore (an investment banker for Lubrizol), and Mr. Buffett met with Mr. Hambrick on February 8. Mr. Buffett, not Mr. Sokol, handled the negotiation of the terms of the transaction, including price.

On the morning of March 14, Berkshire Hathaway and Lubrizol announced the signing of the merger agreement. A Citi representative with whom Berkshire Hathaway did business congratulated Mr. Buffett on the merger agreement, and told Mr. Buffett that Citi's investment bankers had brought Lubrizol to Mr. Sokol's attention. This was the first time Mr. Buffett heard that investment bankers played any role in introducing Lubrizol to Mr. Sokol, and did not square with Mr. Sokol's remark in January that he had come to know Lubrizol by owning the stock.

At Mr. Buffett's request, Berkshire Hathaway CFO Marc Hamburg phoned Mr. Sokol on March 15. Mr. Hamburg asked Mr. Sokol for the details of his Lubrizol stockholdings. Mr. Sokol provided the dates and amounts of his Lubrizol purchases. Mr. Hamburg also asked about Citi's role in introducing Mr. Sokol to Lubrizol. Mr. Sokol answered that he thought he had called a banker he knew at Citi to get Mr. Hambrick's phone number. When Mr. Hamburg commented that it sounded as if the banker must have exaggerated his role when he spoke with his colleagues, Mr. Sokol did not contradict him.

In the period March 17-25, as Berkshire Hathaway collaborated with Lubrizol on the preparation of Lubrizol's preliminary proxy statement. Berkshire Hathaway learned more about the role of Citi, and learned that Mr. Sokol's Lubrizol purchases took place after Citi had presented him information about

Lubrizol responsive to his request for information about chemicals companies that might be acquisition candidates for Berkshire Hathaway, and after he had asked Citi to ask Mr. Hambrick for a meeting to discuss Berkshire and Lubrizol.

Mr. Buffett returned from an Asian trip on Saturday, March 26. Late in the day on Monday, March 28, he received Mr. Sokol's letter of resignation. Mr. Buffett accepted Mr. Sokol's resignation, and in a call he had with Mr. Sokol, Mr. Sokol reiterated that his resignation was for the reason stated in his letter, namely to build wealth for his family and philanthropic activities.

On March 29, Mr. Buffett provided Mr. Sokol an opportunity to review for accuracy a draft Mr. Buffett had prepared of a press release announcing Mr. Sokol's resignation and disclosing Mr. Sokol's Lubrizol trades. At Mr. Sokol's request, Mr. Buffett deleted from the release the one passage Mr. Sokol said was inaccurate: a passage that implied that Mr. Sokol had resigned because he must have known the Lubrizol trades would likely hurt his chances of being Mr. Buffett's successor. Mr. Sokol told Mr. Buffett that he had not hoped to be Mr. Buffett's successor, and was resigning for reasons unrelated to those trades. Except for that deletion, Mr. Sokol concurred in the accuracy of the press release. For example, Mr. Sokol left unchanged the statement that when Mr. Sokol made his purchases, he "did not know what Lubrizol's reaction would be" if Mr. Buffett

developed an interest in a transaction. Mr. Sokol also left unchanged Mr. Buffett's statement that he had "held back nothing in this press release."

Lubrizol's revised preliminary proxy statement was filed on April 11, 2011. Based on information provided to Lubrizol by Citi, the revised preliminary proxy statement disclosed that on December 17, 2010, Citi informed Mr. Sokol that Mr. Hambrick had said he would discuss Berkshire Hathaway's possible interest with the Lubrizol Board. This information had not been disclosed by Mr. Sokol to Berkshire Hathaway.

**C. Mr. Sokol's Trading Violated Company Policies.**

**1. Insider Trading Policies and Procedures.**

Key officers and employees ("Covered Employees") of Berkshire Hathaway and its subsidiaries are required to certify their familiarity with, and adherence to, the company's Insider Trading Policies and Procedures (the "Trading Policy"). Mr. Sokol signed such a certification in May 2010. The Trading Policy expressly forbids the trading of securities of any public companies while the trader is in possession of material nonpublic information relevant to those companies. Consistent with Berkshire Hathaway's aversion to conduct that might be considered close to the line, the Trading Policy identifies several specific categories of information that must be considered material *for purposes of the*

*policy*--even if the information might not be material as insider trading law defines materiality. These include:

- “All actual and *anticipated* securities transactions of Berkshire and its subsidiaries that have not been publicly disclosed should be considered material.”
- “Other public companies to which this prohibition is applicable include those that *may be* involved in a significant transaction with Berkshire. . . .”
- “If a . . . Covered Employee is aware that Berkshire has taken or altered a position in a public company’s securities or that Berkshire is *actively considering* such action, trading in any securities of such public company . . . [trading in the securities] is expressly prohibited prior to the public disclosure by Berkshire of its actions . . . (or until the [employee] becomes aware that Berkshire did not take and is no longer actively considering such action).”<sup>2</sup>

Mr. Sokol should have considered Lubrizol a “company that may be involved in a significant transaction with Berkshire” from the day he selected it from Citi’s list of chemicals companies and asked Citi to ask Lubrizol’s CEO for a

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<sup>2</sup> Italics have been added in this report to quotations from internal policies to emphasize words and phrases particularly relevant to the Committee’s discussion.

meeting, and even more so from the day Citi told him that they had delivered his message and that the CEO would discuss Berkshire's possible interest with his board. Mr. Sokol should have treated a possible Lubrizol transaction as "anticipated" or under active consideration, and should have refrained from trading until a transaction was announced or he became aware that Berkshire was no longer actively considering such an action.

We appreciate that at the time Mr. Sokol traded, he did not know whether Mr. Buffett would support, or reject, the idea of an acquisition of Lubrizol. We also recognize that Mr. Sokol did not know how Lubrizol would respond to an acquisition proposal if Berkshire Hathaway were to make one. We recognize the view that those uncertainties might have kept Mr. Sokol's information below the level of probability required to support a finding of materiality for purposes of finding a violation of federal insider trading law. But the Trading Policy requires a higher standard of conduct than what is required to avoid being charged with a federal securities violation.

The words "may be involved," "anticipated," and "actively considering," as used in the Trading Policy, should be read to prohibit a key employee from trading the securities of another company while in possession of information that includes the employee's own efforts to initiate merger talks between that company and

Berkshire Hathaway. Particularly in light of the often-repeated Berkshire Hathaway policy that employees should conduct themselves as if any act they contemplate would be reported in their local paper, the Committee does not believe the words “may be involved,” “anticipated,” and “considering” should be read so narrowly that the prohibition on trading would apply only to transactions involving companies whose acquisition has already earned the endorsement of Mr. Buffett, or only when an acquisition is being actively considered by Mr. Buffett. Mr. Sokol’s trades violated that prohibition.

## **2. Code of Business Conduct and Ethics.**

Berkshire Hathaway’s Code of Business Conduct and Ethics (the “Code”) applies to all directors, officers and employees (“Covered Parties”) of Berkshire Hathaway and its subsidiaries. It provides:

- “Covered Parties who have access to confidential information are *not permitted to use or share that information for stock trading purposes or for any other purpose except the conduct of the Company’s business.*”

When Mr. Sokol bought Lubrizol stock, he knew that it was the one company he had selected (while scouting for acquisitions on behalf of Berkshire Hathaway) from Citi’s list of 18 companies in the chemicals industry; he knew that he had asked Citi (which said it had an investment banking relationship with

Lubrizol) to ask Mr. Hambrick whether he would meet with Mr. Sokol to discuss Berkshire Hathaway and Lubrizol; and by the time of his January purchases he knew that his message had been delivered and that Mr. Hambrick had told Citi he would discuss Berkshire Hathaway's possible interest with the Lubrizol Board. Even if this information was not material, it was indisputably confidential. The Code prohibited him from trading on it.

- “Covered Parties are prohibited from taking for themselves *opportunities that are discovered through the use of corporate property, information or position* without the consent of the Board of Directors of the Company.”

In his position as a representative of Berkshire Hathaway, Mr. Sokol identified acquisition criteria, reviewed materials presented by Citi concerning possible specialty chemicals companies that might be acquisition candidates for Berkshire Hathaway, narrowed the companies to Lubrizol, and set in motion communications between Berkshire Hathaway and Lubrizol that eventually culminated in the proposed acquisition at a considerable premium above the recent trading price of its shares. Any opportunity to profit from the possibility of such an event belonged to Berkshire Hathaway, not Mr. Sokol. This violates the Code.

In the Committee's view, it is no excuse that Berkshire Hathaway did not make open-market purchases of Lubrizol before it negotiated the merger

agreement, and that Mr. Sokol's purchases did not deprive Berkshire Hathaway of the opportunity to trade had it chosen to do so. Berkshire Hathaway had the opportunity and the right *not* to trade the shares of a company it is considering acquiring, and there are good reasons why it might elect not to trade (e.g., to enhance its reputation for not making hostile acquisitions). If its representatives were to trade ahead of potential mergers in which they represented Berkshire Hathaway, they could undermine the trust that Berkshire Hathaway strives to earn from its potential merger partners.

### **3. Biennial Letter to Berkshire Hathaway CEOs.**

Every two years, Mr. Buffett writes to the CEOs of all Berkshire Hathaway companies "to reemphasize Berkshire's top priority": "to zealously guard Berkshire's reputation." The letter instructs the CEOs: "If it's questionable whether some action is too close to the line, just assume it is outside and forget about it."

Even if it were assumed that Mr. Sokol's trading could be reconciled with the precise language of the provisions of the Trading Policy and the Code discussed above, it could not be reconciled with the obligation to stay well within the lines. By engaging in such questionable conduct, Mr. Sokol threatened Berkshire Hathaway's reputation--or would have done so had he remained with the Company.

**D. Mr. Sokol Failed To Fulfill His Duty of Full Disclosure to the Company.**

Inherent in all the Company policies discussed above is the expectation that employees, and particularly those entrusted with great responsibility, will fully disclose to those to whom they report all the facts they need. Thus, the Code instructs:

- “Confronted with ethically ambiguous situations, the Covered Parties should remember the Company’s commitment to the highest ethical standards and seek advice from supervisors, managers or other appropriate personnel to ensure that all actions they take on behalf of the Company honor this commitment.”

The expectation of full disclosure is particularly crucial when the facts relate to a potential conflict of interest:

- “A conflict of interest exists when a person’s private interest interferes in any way with the interests of the Company. A conflict can arise when a Covered Party takes actions or has interests that may make it difficult to perform his or her work for the Company objectively or effectively. . . . All directors and executive officers of the Company, and the chief executive officers and chief financial officers of Berkshire Hathaway’s subsidiaries, shall disclose any material transaction or relationship that reasonably could

be expected to give rise to such a conflict to the Chairman of the Company's Audit Committee. No action may be taken with respect to such transaction or party unless and until such action has been approved by the Audit Committee."

And the biennial letter to CEOs reminds them that candor is especially important concerning "significant bad news" or anything whose propriety or legality is doubtful.

All of these internal policies are underscored by the law of Delaware, where Berkshire Hathaway is incorporated. Under Delaware law, corporate representatives owe their company a duty of loyalty. The duty of loyalty includes a duty of candor, which requires them to disclose to the corporation all material facts concerning corporate decisions, especially decisions from which they might derive a personal benefit. Mr. Sokol's actions did not satisfy the duty of full disclosure inherent in the Berkshire Hathaway policies and mandated by state law. His remark to Mr. Buffett in January, revealing only that he owned some Lubrizol stock, did not tell Mr. Buffett what he needed to know. In the context of Mr. Buffett's question how Mr. Sokol came to know Lubrizol, its effect was to mislead: it implied that Mr. Sokol owned the stock before he began considering Lubrizol as an acquisition candidate, when the truth was the reverse. A candid

disclosure would have revealed the timing and size of the purchases, and the communications with Citi concerning obtaining a meeting to mutually explore interest in a potential acquisition that had preceded them. Knowledge of those facts would likely have prompted further questions by Mr. Buffett and could have allowed Berkshire Hathaway to evaluate measures that could have been taken to alleviate the problem before negotiations proceeded with Lubrizol.

Mr. Sokol's answer to Berkshire Hathaway's CFO, Mr. Hamburg, concerning the investment bankers similarly fell short of the degree of candor required of a corporate fiduciary, and suggests his answer to Mr. Buffett's earlier inquiry noted above was intended to deceive.

Because Mr. Sokol bought shares of Lubrizol stock worth approximately \$10 million when he was attempting to communicate with Lubrizol about a potential transaction with Berkshire Hathaway, he should also have treated his intention to trade as a transaction involving a material potential conflict of interest, which the Code required him, as a senior executive, to disclose in advance to the Chair of the Audit Committee. The Committee does not believe that, in fact, Mr. Sokol's opinion that it was in Berkshire Hathaway's interest to consider the acquisition of Lubrizol was anything but sincere, nor is it aware of any evidence that Mr. Sokol lobbied for Berkshire Hathaway to offer a higher price. But it was not for Mr. Sokol to decide whether buying \$10 million worth of Lubrizol stock

might distort his judgment as a representative of Berkshire Hathaway. That was a decision for the Audit Committee to make. By not disclosing in advance his intention to trade, Mr. Sokol took that decision away from the Audit Committee.

**E. Remedies.**

Violations of the Code are punishable by employment-related disciplinary action “up to and including removal from office or dismissal.” Failure to adhere to the Trading Policy can also “result in dismissal by Berkshire for cause. . . .” Mr. Sokol has voluntarily resigned from all the positions he held with Berkshire Hathaway companies. His voluntary resignation had the effect of preventing him from receiving any severance-related benefit substantially different from those to which he would have been entitled if he were terminated for cause on the same effective date. He has thus suffered a severe consequence from his violations of Company policy.

The Audit Committee authorizes Mr. Buffett to release this report. Such a public statement will demonstrate to all who work for Berkshire Hathaway, as well as the other constituencies Berkshire Hathaway serves, that the Company takes its policies very seriously, and that its instruction to all its representatives to play in the middle of the court is Company policy, not public relations. We expect this report to send a loud message that those policies are designed to be read broadly,

and to deter anyone who may be contemplating a violation of the spirit or letter of those policies in the future.

This is not the end of the Audit Committee's work. Still under way are:

- Work with Company management and legal counsel to identify and implement lessons learned from these events, including possible enhancements to its procedures.
- Cooperation with any government investigations relating to this matter, and monitoring any developments that may emerge from them.
- Consideration by the Board, or the Audit Committee, or such other committee as the Board may think appropriate, of possible legal action against Mr. Sokol to recover any damage the Company has sustained, or his trading profits, or both, and of whether the Company is obligated to advance Mr. Sokol's legal fees associated with proceedings in which he is named.