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Tobacco Probe Examines Securities Aspect

By ALIX M. FREEDMAN
And WADE LAMBERT

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As part of a criminal investigation of Philip Morris Cos., federal prosecutors in New York are pursuing an unusual theory: The tobacco company may have committed securities fraud in not disclosing all it allegedly knew about nicotine.

Under securities laws, companies are required to disclose all material information that may affect their stock price, and they are barred from releasing incomplete or inaccurate information. If prosecutors can show that Philip Morris knew more about the addictiveness of nicotine than it disclosed, they would be able to pursue criminal securities-law violations, securities lawyers said.

The nation's tobacco companies have come under fire in recent months as thousands of pages of documents from their

own files suggest that they knew far more about how nicotine affected smokers than they have disclosed. Indeed, the industry continues to dispute the notion that nicotine is addictive—even as the White House considers Food and Drug Administration proposals that would classify tobacco as a drug and introduce regulations to curb underage use.

Prosecutors appear to be considering a securities-fraud theory based on the premise that Philip Morris deliberately withheld its own findings about nicotine because such disclosures would have damaged the value of the stock by inviting Food and Drug Administration regulation and more litigation.

A person familiar with the U.S. attorney's investigation in New York said that the probe "wouldn't be limited" to one area, stressing that "This is still in the very early stages." But he said, "One avenue being pursued is whether Philip Morris committed securities fraud by failing to disclose to shareholders what it knew about nicotine, thus misleading the market."

He said prosecutors weren't probing

Philip Morris for other possible securities-law violations, such as insider trading.

"We have no idea what the U.S. attorney's investigation of Philip Morris is about," a Philip Morris spokesman said.

Asked whether the company had made adequate disclosures about nicotine, he said: "Philip Morris has expressly disclosed in 10-Ks [filed with the Securities and Exchange Commission] that the surgeon general had concluded that cigarettes were addictive. But Philip Morris's position has always been and continues to be that cigarettes and nicotine have not been proven addictive and Philip Morris has vigorously asserted that position in a variety of litigation and public policy forums."

Prosecutors, however, may be able to show that the information allegedly withheld by tobacco makers was so important that it had an effect on Philip Morris's stock price.

For instance, said Melvyn Weiss, a plaintiffs attorney at Milberg Weiss Bershad Hynes & Lerach, prosecutors could try to make the case that Philip Morris knew that cigarettes were a product that



could be regulated, as the FDA is proposing. Prosecutors could argue that the company's alleged reticence artificially bolstered its stock price.

But even if the stock price wasn't affected, Mr. Weiss said, any "materially misleading statement" could be grounds for criminal charges. Mr. Weiss's law firm has represented shareholders and smokers in suits against Philip Morris.

Although prosecutors routinely examine companies' regulatory filings for false statements, securities-law specialists say the probe is taking an innovative approach by attempting to apply the law for disclosure in such a case.

Alan M. Cohen, an attorney in the New York office of the Los Angeles-based law firm O'Melveny & Myers, explained that "a classic false-statement case . . . is when a company reported financial results but does so after having cooked the books in an effort to make its financial results look better." Mr. Cohen formerly was head of the securities and commodities fraud task force at the U.S. attorney's office in New York.

Even if the securities-law claim is just a small piece of the case, some lawyers questioned the New York prosecutors' apparent line of argument, saying it is a bit of a stretch.

Harvey Plitt, a securities lawyer at Fried, Frank, Harris, Shriver & Jacobson, which has tobacco clients, said a typical disclosure claim stems from failure to disclose adverse financial information—not bad news about a product.

"It is hard to make the case that securities law applies when what you have is a claim that relates to a product and how that product was marketed," he said. As he put it, "If Kellogg's Rice Krispies don't go snap, crackle and pop, if it just goes snap crackle, is that a securities-law violation?"

In addition to the New York investigation, Philip Morris and the rest of the \$45 billion tobacco industry are being investigated by the Justice Department's criminal division in Washington. As reported, prosecutors there are expanding what had been a preliminary inquiry into complaints by Rep. Martin Meehan (D., Mass.) and several other lawmakers that tobacco-company executives may have committed perjury in congressional testimony last year and may have broken other laws as well.

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