Sokol Acted Unethically, Warren, Just Say It

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In announcing the resignation of David Sokol, Berkshire Hathaway executive and possible successor, Warren Buffett said on March 30th, "Neither Dave nor I feel his Lubrizol purchases were in any way unlawful."

Buffett should have gone on to say, "I do, however, think David Sokol acted unethically." But he didn't, and a firestorm of questions about Buffett, Sokol, and Berkshire governance has ensued.

As every business-savvy reader now knows, the "Lubrizol purchases" involved Sokol's acquisition of about $10 million of Lubrizol shares on January 5-7, 2011; his recommendation to Buffett that Berkshire buy the company on about January 14th and then again on January 25th; and Berkshire's decision to buy Lubrizol announced in mid-March with a resulting increase of $3 million in Sokol's Lubrizol holdings.

According to Buffett's March 30th statement, "In our first talk about Lubrizol, Dave mentioned that he owned stock in the company. It was a passing remark and I did not ask him about the date of his purchase or the extent of his holdings."

There has been an outpouring of writing about whether Sokol's purchases were, in fact, legal or were violations of insider trading rules; whether Buffett should have asked more questions of Sokol in mid-January; and whether, on March 30th, he should have said Sokol's actions were legal.

All well and good. But, in my view, while the questions about "what was legal" have to be sorted out, one key question about "what was right" does not.

When he was urging the Lubrizol deal in mid-January, David Sokol had an ethical obligation to tell Warren Buffett that he had just bought company shares worth $10 million. (Buffett's failure to ask hard questions does not excuse Sokol.) This is probably required under Berkshire's insider trading policy (barring trades in public companies "that may be involved in significant transactions with Berkshire...in which Berkshire has invested or may in the future invest"). But it is surely required as a matter of simple ethics. You tell the chairman that you just bought a significant amount of stock in a target you are recommending and that you may benefit if the deal goes through.

So, there are lots of open questions. But, the core of the matter as we know it today is straightforward: Sokol acted unethically in January by not disclosing the details about
his Lubrizol holdings to Buffett, and Buffett should have said, in his March 30th announcement, that Sokol acted unethically.

Despite his iconic status as a business leader of great integrity, Warren Buffett seems just as prone to poor judgment as other leaders faced with troubles inside their companies: circle the wagons and, initially, admit no fault on the part of anyone.

David Sokol may have been an excellent business leader, but he acted unethically in a one-on-one with his boss.

The boss, especially one with such a fine sense of impropriety, should have said so.

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