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February 24, 2006

All Members of the Executive Board,
Associated Musicians of
Greater New York, Local 802
322 West 48th Street
New York, NY 10036

PRIVILEGED AND CONFIDENTIAL

Re: David Lennon's Personal Use of the Union's American Express Card

Dear Executive Board Members:

The purpose of this Memorandum is to set forth the facts, as they are understood, and the legal issues suggested by President David Lennon's personal use of the Union's American Express card. In addition, recommendations are made to protect the Union.

I. INTRODUCTION

This firm was retained, pursuant to Executive Board authorization, as Special Counsel to conduct an investigation and to research the legal issues that might be implicated. Cary Kane was charged with "review[ing] the legal issues concerning an allegation of a breach of fiduciary duty by Local President David Lennon, the interim actions taken by the Local in response to receiving the allegations, and to recommend actions, if warranted, that should now be taken by the Local."¹

Larry Cary, a principal at Cary Kane, interviewed President David Lennon, Financial Vice-President Jay Blumenthal, Recording Vice-President Bill Dennison, Former President Bill Moriarity, Former Financial Vice-President Tina Hafemeister and Controller Mathew Milne. He also spoke to the Local's accountants and to the personal attorneys for Lennon and Dennison.

The following papers and documents were reviewed: the Constitution of the American Federation of Musicians ("AFM"), Local 802's Constitution, the AFM's Expense Reimbursement Policy, the Union's Form LM-2 (Labor Organization Annual Report) for 2003

¹ Retainer Letter, dated February 7, 2006, to Harvey S. Mars, Esq. from Larry Cary, Esq., appended hereto as Exhibit "A".



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and 2004, the DOL's instructions for completing the LM-2, American Express bills and Expense Reports for Lennon from 2003 through 2005, Executive Board minutes from January 24, 2006 and January 31, 2006, various schedules prepared by the Union's Controller and various e-mails and other communications between the parties.

This report is based on the facts gleaned from the interviews and the reviewed documents. Additional information may be forthcoming from the Union's accountants who are reviewing all American Express charges from 2000 to the present for all cardholders. The legal analysis is limited to reviewing relevant portions of the Labor-Management Reporting and Disclosure Act ("LMRDA")². Tax and other statutes have not been reviewed. The Union should speak with its accountant concerning tax issues, if any. This report is intended solely for the Union's use. Only the Union and its Board may rely on the report's findings and recommendations.

Summary of Findings and Recommendations

1. Currently, there is no detailed written policy prohibiting personal use of the Union's American Express card. The Executive Board should create one.
2. During 2003, 2004 and 2005, Lennon charged more than \$10,000 in personal expenses on the Union's American Express card. He repaid these amounts, but not always on a timely basis.

² New York law also imposes a fiduciary duty on union officers. But beyond creating a state cause of action against the offending officer, NY law does not add much to the discussion of this matter. Section 722 of the New York Labor Law defines the fiduciary obligations of union officers and agents as follows:

No officer or agent of a labor organization shall, directly or indirectly

1. Have or acquire any pecuniary or personal interest which would conflict with his fiduciary obligation to such organization;
2. Engage in any business or financial transaction which conflicts with his fiduciary obligation; or
3. Act in any way which subordinates the interests of such labor organization to his own pecuniary or personal interests.



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For 13 months during 2004 and 2005, Lennon owed the Union more than \$2,000, which is the limit the law permits a union to lend an officer.

3. The LM-2 for 2005 must be accurate. It should show that Lennon used the Union's American Express card for personal reasons and that he repaid the Union \$5,925 in 2005 for American Express card charges incurred by him in 2004 and 2005. While not required by law, the LM-2 for 2004 should be refiled to show that Lennon received \$3,673.68 in personal expenses on the Union's American Express card; that he repaid the Union \$452.00 of this amount in 2004, and that he owed it \$3,221.68 as of December 31, 2004. The amended 2004 LM-2 should be filed before March 31, 2006, the date the 2005 LM-2 is due. The accountants should be consulted and they should prepare the LM-2.
4. The Union's Financial Statements for the year ended December 31, 2004 should be restated by including a note about Lennon's shortage on the American Express card. The accountants must be instructed in the future to make a note to the Financial Statements identifying any funds owed as a receivable to the Union by an officer when it is included in another, more general, category.
5. An accounting of Lennon's personal charges and repayments should be prepared by the Union's accountants, reviewed by the Financial Vice-President, and published in the Union's newspaper forthwith.
6. The process for handling the American Express bill should be changed. All three full-time officers should sign-off to approve the business purpose of expenses. The Expense Reports must be completed before the bill is paid. The American Express bill should be addressed to the Controller.
7. The Expense Report form should be redesigned to separate card charges from out-of-pocket expenses and to permit more



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detail regarding the expense, including the nature of the expense, the person(s) benefiting from the expense, and the relationship between the expense and Union business (e.g., the names of those taken to lunch and what was discussed).

8. A new subcommittee of the Executive Board should be created to review, on a quarterly basis, all card charges and Expense Reports. They must report their findings to the Executive Board.
9. The signatures of two officers should be required on all checks drawn on the Union's bank account.
10. In the event that the accountant's final review shows that Lennon has not fully repaid the charges incurred for personal expenses on the Union's American Express card, the correct amount should be demanded of Lennon. Lennon must immediately pay the demanded amount or be charged by the Executive Board under the Union's internal disciplinary procedures.
11. Lennon must acknowledge his mistake and the Executive Board should fine him one week's pay, in lieu of interest, in order to demonstrate the seriousness of his misconduct. Lennon must agree to pay the fine or be charged by the Executive Board under the Union's internal disciplinary procedures.
12. Beyond filing a correct LM-2 for 2005, the Union is not obligated to report these events to the Department of Labor. Even so, it should.
13. A discussion should immediately be held with the Union's accountants regarding whether there is the need to amend the Union's IRS filings for 2004 and whether the 2005 filing is affected by these events. The Union should follow the accountant's advice regarding how to handle it.



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14. The AFM should be informed about this matter and the actions taken by the Union in response to it. At the same time, the Executive Board should suggest that the AFM regularly hold new officers classes that cover the proper procedures for handling a local's finances.

II. FACTS

Relevant Responsibilities Of the Officers and Executive Board Under the Local's Constitution

The current three full-time officers are President Lennon, Financial Vice-President Blumenthal and Recording Vice-President Dennison. This is the first term for all three officers. The Financial Vice-President performs the treasurer's role. No special training in financial matters was provided by the AFM to the new officers. While topics concerning labor history and the challenges now faced by labor were covered at a new officers' weekend sponsored by the AFM, which was attended by some or all of the newly-elected officers, the topic of how to properly handle the Local's finances was not covered.

The three full-time officers are responsible to the Executive Board. "The Executive Board shall have general charge and supervision of the affairs of this Local, may make and enforce such orders from time to time as may be desirable in its judgment, and shall exercise all rights, powers and privileges thereof, subject to the provisions of the Constitution and Bylaws of the Local." Constitution and Bylaws of the Associated Musicians of Greater New York, Local 802, A.F. of M., hereafter denominated "Constitution", Article 1, Section 5(a).

Within this context, the Local's Constitution contemplates that all three full-time officers actively and intimately participate in the procedure for spending the Union's money. The Recording Vice-President "draws all vouchers on the treasury." Constitution, Article 1, Section 2(j). The President "countersign[s] vouchers issued by the Recording Vice-President after their approval by the Executive Board or a majority of the top officers, as the case may require." Constitution, Article 1, Section 1(c). Checks are "signed by the Financial Vice President or other persons designated by the Executive Board." Constitution, Article 1, Section 3(h). The Financial Vice-President also must submit semiannually to the Executive Board a detailed financial report of the financial condition of the Local, which report is attested to by a Certified Public Accountant. Constitution, Article 1, Section 3(c). The Financial Vice-President also



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must publish semiannually in the Union's newspaper a "detailed report of the financial condition of the Local, which report is also attested to by the CPA." Constitution, Article 1, Section 3(d).

The Local's Constitution also requires the Union to disclose to the membership the financial affairs of the officers. "Any amounts received by any elected official of this Local ... from any funds of the Local, ... shall be disclosed to the membership by listing said amounts, payees, sources, and dates of payment in the official Journal of the Local at least quarterly." Constitution, Article 1, Section 4B.

How the American Express Bill is Currently Handled

Moriarity states that the present system for processing the American Express bill was devised by former Controller Jonathan Bogert. It was designed with the intention of paying the bill on a timely basis and not delaying payment until Expense Reports were received and approved..

Currently, the American Express bill is received by Recording Vice-President Dennison. Dennison states that when he receives the bill he glances over it to look at his charges, but he does not review the entire bill. He may have, from time to time, noticed charges for Starbucks or Duane Reede on Lennon's portion of the bill, but he never reviewed Lennon's portion of the bill with an eye to discerning whether the card was being used for personal reasons. Controller Milne properly notes that the business purpose of a particular expense may or may not be readily discernable from the nature or amount of the particular expense. Some things, for example, like the rental of a tuxedo or the purchase of food may or may not be a business expense and one cannot tell simply from looking at the nature of the expense.

Either Dennison or his secretary forwards the American Express bill to the Controller's office. The Controller states he reviews the bill, not for the purpose of discerning whether people are using the card for personal reasons, but to make sure that the Union is not being double charged and that credits are being properly deducted from the bill. From time to time, according to the Controller, vendors sometimes double bill the Union for the same charge and credits are sometimes not properly reflected on the bill.

The Controller's office copies that portion of the American Express bill belonging to each cardholder and forwards it to each of them. Each cardholder is responsible for resubmitting his/her portion of the American Express bill to the Controller along with a completed monthly Expense Report.



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The Controller does not wait for the return of the Expense Reports before paying the bill. The bill must be timely paid or American Express will cancel the Union's card. Return of an Expense Report takes from two weeks to six months, according to the Controller.

The cardholder uses the Expense Report to document the business purpose of each charge. The cardholder is required to list each business related charge, describe its business purpose in short-hand form, write the date of the expense, provide a receipt and add up the total amount spent for business purposes. The cardholder also uses the same Expense Report to submit bills and receipts for cash reimbursement of out-of-pocket expenses. Receipts are attached to the Expense Report.

The cardholder is required to sign the Expense Report. He/she is also required to obtain a signature from one of the three full-time officers on the Expense Report. The second signature by the officer indicates that officer's approval of the business purpose for the items listed on the face of the Expense Report and that the necessary receipts are attached. In Lennon's case, he needs the signature of either the Recording or Financial Vice-President. In Blumenthal's case, he needs the signature of either the President or the Recording Vice-President. In Dennison's case, he needs the signature of either the President or the Financial Vice-President.

Upon receipt of the Expense Report, the Controller only checks it to see that it balances, i.e., that the amount shown on the Expense Report equals the amount of the charges allocated to that particular cardholder. The Controller does not assess whether the explanations for the charges are sufficient to justify a proper business purpose.

The check issued to pay the American Express bill is noted in a check registry prepared by the Controller's office. All three full-time officers have check signing authority. Only one signature is required on a check; that signature is generally that of the Financial Vice-President. The other two full-time officers sign the registry. On occasion, a check is issued before all three officers have signed the registry.



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Lennon's Personal Use of the American Express Card

2003

Lennon states that he first received a Union American Express card sometime after September 2000 when he was appointed an Assistant Director. This is not an elected position. He states that because he did not have a personal credit card he used the Union American Express card for personal expenses, but always paid the Union for such charges.

Lennon charged at least \$4,477 in personal expenses on the Union's American Express card during 2003,³ the first year of American Express bills given Cary to review. The Controller states the Union's records show Lennon paid for all of these personal charges in 2003. All 11 monthly bills and Expense Reports reviewed for 2003 had personal charges. The lowest monthly total was \$67.45 in March and the highest monthly total was \$965.23 in August. All 11 of the monthly Expense Reports show, in Lennon's handwriting, the amount he owed Local 802 for personal items charged that month on the card.⁴

Lennon was not an officer in 2003. All 11 of his monthly Expense Reports were approved. Former Financial Vice-President Hafemeister approved ten of them. Former President Moriarity approved one.

Former Vice-President Hafemeister states that Former President Moriarity called her into his office when he became aware of her use of the card for personal reasons. According to Hafemeister, Moriarity told her that she should not use the card for personal charges and that she could be fired for doing so. Moriarity told her AFM's Secretary-Treasurer had been forced to resign after it was discovered he had used the AFM's card for personal reasons.

Moriarity confirmed that he had this conversation with Hafemeister. Moriarity also states he told former Controller Jonathan Bogert to speak to Lennon about not using the card for personal reasons when Moriarity became aware of it happening. Moriarity states he had the Controller speak to Lennon about personal use of the card because he felt it was the appropriate way to handle it when Lennon was not an officer and only an employee. Moriarity assumes

³ The December 2003 paperwork was not included in the materials provided to Cary.

⁴ An example of a 2003 Expense Report showing Lennon's acknowledgement of moneys owed is appended hereto as Exhibit "B".



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Bogert spoke to Lennon. Lennon states he does not recall Bogert ever telling him he should not use the American Express card for personal charges.

Moriarity states that during the ten years or so that he was President, which ended in 2003, he never saw a written Local 802 policy statement prohibiting personal use of the Union's cards. He thinks there might be a law prohibiting personal use and that common sense suggests it should not occur. The current officers cannot locate any Local 802 written policy statement concerning card usage.

Hafemeister acknowledges she repeatedly approved Lennon's Expense Reports despite knowing that Lennon was continuing to use the card for personal reasons.

2004

During 2004, according to the Controller's Expense Recap⁵, Lennon charged \$3,673.68 for personal items on the Union's American Express card. During 2004, he repaid \$452.00. As of December 31, 2004, Lennon owed the Union \$3,221.68.

In some months Lennon did not use the card for personal reasons. According to the Controller's Expense Recap, the highest personal expenditure occurred in August with \$2,908.52 being charged for other than Union business. For five months during 2004, from August through December, Lennon owed the Union more than \$3,000.

A review of Lennon's Expense Reports for 2004 shows that he generally failed to indicate what he owed for personal expenditures. When asked to account for this change, Lennon states that Controller Milne who replaced Controller Bogert, told him it was not necessary to indicate what was not a business expense on the Expense Report. According to Lennon, Milne told him to indicate only the items that were business related. In three instances, Lennon also failed to obtain the signature of another officer on the Expense Report. (Because it is not possible to determine from the Expense Reports whether the Controller's Expense Recap is accurate, I have suggested that the accountant review the records.)

According to the Controller's Expense Reports Status Report⁶, as of February 2, 2006, Lennon has not obtained the signature of another officer on his expense report for four months:

⁵ A copy is appended hereto as Exhibit "C".

⁶ A copy is appended hereto as Exhibit "D".



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July, August, November and December of 2004. His Expense Reports for January, February, March and April of 2004 were signed in June 2004. His expense Reports for June, September and October 2004 were signed in January and February of 2005.

Lennon stated he was surprised that some of his Expense Reports were not signed by another officer. He stated he submitted them to Blumenthal, for him to review, approve and forward to the Controller. Alternatively, he states he gave them to Controller Milne to be forwarded to Blumenthal. He assumed this had occurred.

2005

During 2005, according to the Controller's Expense Recap, Lennon made a total of \$2,680.36 in personal charges on the Union's American Express card. Personal use of the card occurred in six months of the year. The monthly totals range from a low of \$56.26 in October to a high of \$1,950.87 in September. For five months, January, February, March, April and May, Lennon owed the Union more than \$3,000. And in three other months, June, July and September, he owed the Union more than \$2,000. Lennon made repayments in every month during 2005, and paid the Union a total of \$5,925.00 during the year.

None of the Expense Reports provided to Cary show they were approved by another officer. According to the Controller's Expense Reports Status Report, as of February 2, 2006, four reports were submitted: January, February, March and September. The earliest submission was made three months after the month for which the charges were incurred. (This inconsistency reinforces the need to have the accountant review the records.) Again, Lennon states he is surprised the Reports have not been approved by Blumenthal. He states he gave them to Blumenthal to review, approve and forward to the Controller or to Milne to be forwarded to Blumenthal. Lennon cannot offer any explanation for why Blumenthal's approval is missing.

According to the Controller, in 2005 Lennon repaid all personal charges incurred on his card in 2004 and 2005. He paid the Union a total of \$5,925 during 2005, and therefore owed nothing to the Union as of December 31, 2005.



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2006

Lennon states that he did use the American Express card in January 2006 for a personal expense and charged about \$130, which was repaid to the Union. Lennon states that he has been told by Controller Milne that as of now, he has overpaid the Union about \$418. Lennon voluntarily surrendered his American Express card in early February 2006.

Chronology of the Communications among the Officers about the Issue

According to a February 7, 2006, memo written by Dennison to the Executive Board, Dennison first became aware of Lennon's personal use of the American Express card in the spring of 2004 when he noticed several Starbucks charges on Lennon's portion of the American Express bill. Dennison writes he cautioned Lennon about personal use of the card. Dennison writes that at a summer, 2004, officers meeting, both he and Blumenthal told Lennon that personal use of the card should stop. Lennon disputes Dennison's account. Lennon states that Dennison never spoke to him about personal use of the card for Starbucks or anything else in 2004. He states that the first officers meeting about the subject occurred in 2005.

Dennison writes that in an officers meeting held in the autumn of 2004, Blumenthal complained that Lennon's monthly Expense Reports were months in arrears and he urged him to bring them up to date.

In June of 2005, according to Dennison, he again noticed Starbucks charges on Lennon's part of the American Express bill. He told Lennon he was concerned about this. Dennison writes that Lennon told him "the personal use was minor, was being promptly reimbursed to the union and would stop."

Blumenthal states in or around July of 2005, the three full-time officers met to discuss the issue of Lennon's use of the card for personal reasons. At the meeting Lennon agreed to a \$200 a week payroll deduction to repay the Union for his personal use of the card. Lennon thinks this meeting took place in June, not July. He states the major issue discussed at the meeting was the fact that he had fallen behind in doing his monthly Expense Reports. He states the Controller was keeping track of his personal charges, that the information was available to all and that he agreed to have \$200 a week deducted from his pay checks to make sure the Union was repaid what he owed. Both Dennison and Blumenthal did not think that Lennon would continue



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significant personal use of the card. Lennon also states it was not his intention to use the card for significant personal expenses following the meeting. He did.

In October of 2005, the three full-time officers again met to review the progress of Lennon's repayment. Lennon states the meeting was called by him because he had learned that Blumenthal and Dennison were concerned by the amount that was being charged by Lennon on the American Express card. At the time they met, apparently neither Dennison nor Blumenthal were aware of Lennon having made \$1,950 in personal charges in September.

Lennon states that he told the other two full-time officers that the Controller was keeping close track of his personal expenses and his repayments and that the information was available from him anytime they wanted. There was concern about the magnitude of the charges, but in many instances he was able to explain that as the President of the Local he used the card for business purposes more often than they.

At the October 2005 meeting, Lennon acknowledged that the subject of his \$1950 personal use of the card in September was not discussed. He states that in September he had an emergency where the apartment he was living in became suddenly uninhabitable and he had to go to a hotel for a while. He states he did not try to hide this charge from the other officers, but in hind-sight he thinks it would have been a better practice to have raised it with them at the meeting.

In January of 2006, Dennison wrote Blumenthal complaining about Lennon's continued personal use of the card. Dennison asked for an accounting and the back-up to satisfy himself that the moneys were properly repaid. This e-mail was copied to the Executive Board.

The Executive Board took immediate and proper interim action. The Controller was directed to review the matter and provide the Executive Board with an accounting. President Lennon was asked to voluntarily surrender the Union's American Express card. He did. The Executive Board instructed Attorney Mars to review the legality of what transpired. Mars did so, but soon recommended to the Executive Board that outside special counsel be obtained. Mars felt that because he had grown to like each of the three full-time officers it might appear that his recommendations were affected by his sentiments. Mars correctly believed he needed to avoid even the appearance of impropriety and recommended to the Executive Board that it retain outside special counsel. On February 7, 2006, the Executive Board hired Cary Kane LLP. Before completing its review, Cary Kane recommended to the Executive Board and officers that they go forward with their initial view to involve the accountant in conducting a review of the



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American Express card records. Because the LMRDA requires unions to retain financial records for five years, Cary recommended that the accountant review all American Express bills and related materials for all cardholders from 2000 to the present. The accountant's review is in the process of being completed as of the date this memorandum. At its February 7, 2006, meeting the Executive Board also passed the following resolution: "no personal use of the Local 802 credit card [shall] be made except in the case of an emergency or with the express approval of the Executive Board." This is apparently Local 802's first written policy on personal use of the American Express card.

Lennon states that he used the Union's American Express card for personal reasons because he had no personal credit card of his own, owing to a bad credit rating and because there was no rule at Local 802 against it. He says he always repaid the Union on a timely basis. He states that because of the sudden and dramatic increase in his responsibilities when he became President of the Local in the beginning of 2004, he was somewhat overwhelmed and this led to him to not timely prepare his monthly Expense Reports. He states that this led, in turn, to not focusing on how much he owed the Union and the growth of the obligation. He states it was never his intention to not repay the Union, that he never hid the issue of his personal use from anyone else. He is regretful and states he is willing to do whatever it takes to make it right.

III. DISCUSSION

It is important to note at the outset that Lennon is not accused of submitting false Expense Reports to cover-up personal use of the Union's American Express card. It is also important to note that no written policy existed against personal use of the Union's American Express card. The AFM's Expense Reimbursement Policy, which prohibits personal use of the Federation's credit card, applies only by its express terms to employees of the AFM, not officers and staff of Local 802.

While other officers spoke to Lennon about use of the Union's card for personal reasons, no law *per se* prohibits the personal use of a union's credit card by an officer or employee. It is a question mostly left by the law to each particular union to handle. Most, if not all, prohibit it.

It is also important to note at the outset that Lennon has apparently repaid Local 802 for all of his personal use of the Union's American Express card.

But having said all that, it is clearly irresponsible for a union to permit an officer to charge over \$10,000 of personal expenses during a three year period to the union's American



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Express card. It is also inappropriate, to say the least, for an officer to conduct his personal life through the union's American Express card.

LMRDA § 501

Federal law imposes fiduciary obligations on union officers and executive board members. Section 501(a) of the LMRDA imposes an obligation on each union official to "hold its [meaning the union's] money and property solely for the benefit of the organization and its members and to manage, invest, and expend the same in accordance with its constitution and bylaws and any resolutions of the governing bodies adopted thereunder"⁷

Section 501(b) of the LMRDA creates a civil enforcement mechanism for rectifying breaches of fiduciary duty by giving union members the right to go to federal court in the event the elected officers do not take steps to correct the breach by recovering any funds spent or received in violation of Section 501(a).⁸ Section 501(c) creates criminal penalties.⁹

⁷ The full text of Section 501(a) states:

Duties of officers; exculpatory provisions and resolutions void. The officers, agents, shop stewards, and other representatives of a labor organization occupy positions of trust in relation to such organization and its members as a group. It is, therefore, the duty of each such person, taking into account the special problems and functions of a labor organization, to hold its money and property solely for the benefit of the organization and its members and to manage, invest, and expend the same in accordance with its constitution and bylaws and any resolutions of the governing bodies adopted thereunder, to refrain from dealing with such organization as an adverse party or in behalf of an adverse party in any matter connected with his duties and from holding or acquiring any pecuniary or personal interest which conflicts with the interests of such organization, and to account to the organization for any profit received by him in whatever capacity in connection with transactions conducted by him or under his direction on behalf of the organization. A general exculpatory provision in the constitution and bylaws of such a labor organization or a general exculpatory resolution of a governing body purporting to relieve any such person of liability for breach of the duties declared by this section shall be void as against public policy.

29 U.S.C. § 501(a).

⁸ Section 501(b) states:



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While personal use of the American Express card is not *per se* unlawful, especially when there is no explicit constitutional or written policy in place prohibiting it, it is a question of degree. One can mistakenly use a union's card at one end of the continuum and regularly use it at the other without repaying the Union. The latter is clearly a breach of fiduciary duty because

Violation of duties; action by member after refusal or failure by labor organization to commence proceedings; jurisdiction; leave of court; counsel fees and expenses. When any officer, agent, shop steward, or representative of any labor organization is alleged to have violated the duties declared in subsection (a) and the labor organization or its governing board or officers refuse or fail to sue or recover damages or secure an accounting or other appropriate relief within a reasonable time after being requested to do so by any member of the labor organization, such member may sue such officer, agent, shop steward, or representative in any district court of the United States or in any State court of competent jurisdiction to recover damages or secure an accounting or other appropriate relief for the benefit of the labor organization. No such proceeding shall be brought except upon leave of the court obtained upon verified application and for good cause shown, which application may be made ex parte. The trial judge may allot a reasonable part of the recovery in any action under this subsection to pay the fees of counsel prosecuting the suit at the instance of the member of the labor organization and to compensate such member for any expenses necessarily paid or incurred by him in connection with the litigation.

29 U.S.C. § 501(b).

⁹ Section 501(c) states:

Embezzlement of assets; penalty. Any person who embezzles, steals, or unlawfully and willfully abstracts or converts to his own use, or the use of another, any of the moneys, funds, securities, property, or other assets of a labor organization of which he is an officer, or by which he is employed, directly or indirectly, shall be fined not more than \$10,000 or imprisoned for not more than five years, or both.

29 U.S.C. § 501(c). Personal use of a union's credit card can be a crime even where the official repays the union. See *United States v. Harmon*, 339 F.2d 354 (6th Cir. 1964). But defenses are available for negating the requisite criminal intent needed for conviction. See *United States v. Otley*, 509 F.2d 667 (2d Cir. 1975); *United States v. Silverman*, 430 F.2d 106 (2d Cir. 1970). Unlike the instant case, personal use of the card coupled with submission of false expense reports can establish the intent needed for a successful criminal prosecution. See *United States v. Dibrizzi*, 393 F.2d 642 (2d Cir. 1968). Whether President Lennon's personal use of the American Express card and his failure to timely repay the Union in 2004 and 2005 violates Section 501(c) is a matter not dealt with herein since it is beyond the scope and purview of Special Counsel's retention.



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there is no business purpose to the expenses being born by the union. See *Morrissey v. Curran*, 650 F.2d 1267, 1274 (2d Cir. 1981) (“where a union officer personally benefits from union funds, a court in a § 501(b) suit may determine whether the payment, notwithstanding its authorization, is so manifestly unreasonable as to evidence a breach of the fiduciary obligation imposed by 501(a)”). Officers who “knowingly authorize” improper payments to another officer become equally liable with the recipient for the value of the union’s funds improperly spent. *Id.* at 1283. Clearly, when officers and executive board members find out about a breach of fiduciary duty, they must take steps to call the offender to account for the funds and then recover them. Both actions have been properly taken by Financial Vice-President Blumenthal, Recording Vice-President Dennison and the Executive Board.¹⁰

The statute and the case law do not appear to impose on union officials any obligation to act beyond seeking recovery of the funds. There are no clear guidelines issued by the DOL on this “complex” subject, and in fact, the DOL has recently sought comment from the public with regard to whether it should issue guidelines. See Exhibit “E”, annexed hereto for a copy of the DOL’s Request for Comment published in the *Federal Register* on August 29, 2005.¹¹

There is no statutory obligation to report a violation of Section 501 to the DOL. Indeed, in “*LMRDA Compliance, A Guide for New Union Officers*,”¹² the DOL merely recommends that “[i]f you discover a possible misuse of union funds, contact your national or international union or the OLMS.” The OLMS is the particular office at the DOL which enforces the LMRDA.

There is no statutory obligation to press internal union disciplinary charges against an officer who is discovered to have breached his fiduciary duty but has fully repaid the union for its losses. It is necessary, however, to “take steps” as stated in the statute to recover the moneys if they haven’t been repaid. This can be accomplished by either commencing a lawsuit to recover the missing or improperly spent moneys or commencing internal union disciplinary charges, which later can be enforced in court, if the breaching officer is recalcitrant about repaying the money. See *Toussaint v. Hall*, No. 02-6403, 175 L.R.R.M. 2731, 2004 U.S. Dist. LEXIS 15332 (S.D.N.Y. Aug. 6, 2004) (decision of union’s disciplinary hearing panel requiring

¹⁰ The record demonstrates that both Blumenthal and Dennison repeatedly attempted to get Lennon to stop the personal use of the American Express card. Moreover, each insisted that the moneys be repaid and a payroll deduction was instituted to recover the funds. It was after they learned their efforts were not fully successful that they then contacted the Executive Board. The Board, in turn, took the immediate and positive actions detailed herein.

¹¹ See pages 51230 to 51231 of Exhibit E, appended hereto, for a good synopsis of what § 501 requires.

¹² A copy is appended hereto as Exhibit “F”.



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repayment of moneys reflecting personal use of union's credit card, enforced by the court). In reviewing the propriety of the punishment meted out through the internal union disciplinary actions for breach of a union's constitution, courts generally defer to the decision of the union whether or not the money is repaid and do not second-guess the severity of the punishment. *See Local 100, TWU v. TWUA*, No. 03-3512, 151 Lab. Cas. (CCH) ¶10,572, 2005 U.S. Dist. LEXIS 20012 (S.D.N.Y. Sept. 13, 2005) (decision of international union reversing local's expulsion of officer from union for personal use of union's credit card, not overturned by court).

LMRDA § 503

Besides imposing a fiduciary duty on officers to properly account for and spend the union's money, the law also restricts loans between a union and an officer. Section 503 of the LMRDA, in relevant part, provides as follows:

§ 503. Financial transactions between labor organization and officers and employees

(a) **Direct and indirect loans.** No labor organization shall make directly or indirectly any loan or loans to any officer or employee of such organization which results in a total indebtedness on the part of such officer or employee to the labor organization in excess of \$2,000.

* * * * *

(c) **Penalty for violations.** Any person who willfully violates this section shall be fined not more than \$5,000 or imprisoned for not more than one year, or both.

29 U.S.C. § 503.

Because "person" is defined in the statute to mean "one or more individuals," as well as a "labor organization," 29 U.S.C. § 402(d), both the receiver and authorizer of the improper loan, as well as the union itself, can be liable for the criminal penalties set forth in Section 503(c).

In order to be liable criminally, the individual or union must have "willfully" violated the statute. "[W]illful" conduct, for the purposes of the misdemeanor provisions of the Labor Management Reporting and Disclosure Act, is defined as conduct done with reckless disregard of the law, *i.e.*, no reasonable effort is made to determine whether the conduct would constitute a violation of the law." *United States v. Briscoe*, 65 F.3d 576, 587 (7th Cir. 1995); *see also United*



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States v. Budzanoski, 331 F. Supp. 1201, 1205 (W.D. Pa. 1971) ("In the final charge, the Court explained to the jury that the term 'willfully' included an act with evil or bad purpose, but that, more broadly, it included an act in reckless disregard for the law or the provisions of the law. The Court further explained that for an act to be willful, it need not necessarily be with evil or bad purpose; that an act found to be with careless disregard of whether or not one has the right to act is an act which is 'willful.'").

It is clear that neither the Financial or Recording Vice-Presidents nor the Union itself ever authorized Lennon to delay repayment of his personal use of the Union's American Express card. Nor do the facts suggest that they carelessly disregarded Lennon's personal use of the American Express card and the need to repay the Union. Given what they knew and when they knew it, both officers and the Executive Board acted responsibly.

Part of the problem is the current decentralization of the approval process for handling the American Express bill. Lennon could go to either Dennison or Blumenthal for approval of his Expense Reports. Neither Dennison nor Blumenthal would know that the other was not approving Lennon's Expense Reports. When it became apparent in the latter half of 2004 that Lennon was not timely completing his Expense Reports, the other officers urged him to do so. Another circumstance exacerbating the problem is that the American Express bill is paid, regardless of whether the Expense Reports have been completed and approved. Without having completed Expense Reports, the Controller cannot timely know whether personal use of the card is occurring.

Another part of the problem is how the accountants treated the American Express shortage on the Financial Statement. In the December 31, 2004 Financial Statement, Lennon's debt is classified as a receivable and included in the category of "Other accounts receivable". For 2004, "Other accounts receivable" amounted to \$40,087. This category included repayment obligations for loans which Local 807 legally and intentionally made to employees, shortages on the American Express bill (Lennon's liability), moneys due Local 802 for charges on its American Express bill that the AFM is responsible for paying, rent arrears from unrelated tenants in Local 802's building, and accrued, but not yet paid, January interest on U.S. Treasury securities. No note is included by the accountants in the Financial Statement to explain this.

When asked about it, the Union's accountant explained he knew about Lennon's American Express shortages, but did not consider the amount of the obligation to be "material" to the Financial Statement. Therefore, he did not disclose it on the statement. While the accountant is correct that the amount owed by Lennon was too small to materially affect the



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Financial Statement's fair representation of the Union's financial condition, the better practice would have been for the accountants to have included a note disclosing the amount of Lennon's American Express shortage. *See Godchaux v. Conveying Techniques, Inc.*, 846 F.2d 306 (5th Cir. 1988).

It was only after the Executive Board instructed the Union's Controller to do a report on Lennon's shortages and repayments that Blumenthal, Dennison and the Executive Board actually became aware of the full magnitude of what had occurred.

LMRDA § 439

By March 31, 2006, Local 802 must file a LM-2 for 2005 which will disclose certain material facts about this matter. In addition, an amended LM-2 for 2004 should be filed at the same time.

The law does not appear to require that amended LM-2's be filed, but the DOL often requires it after they conduct an audit. But because the 2005 filing must disclose facts clearly known to Lennon and Blumenthal, who must sign the filing, it would be prudent to expect that the DOL will conduct an investigation of this matter by subpoenaing and reviewing the Union's financial records. We recommend that the accountants complete their review of the last five years of card charges before March 31, 2006 and prepare amended LM-2 reports for filing on that day. This would, we think, increase the Local's credibility in the eyes of a government investigator. (In addition, if anyone else needs to repay the Local for their American Express shortages, they must also immediately do so.)

Section 439 of the LMRDA makes it a crime to file a false LM report. The statute states:

- (a) **Willful violations of provisions of 29 USCS §§ 431 et seq.**
Any person who willfully violates this title shall be fined not more than \$10,000 or imprisoned for not more than one year, or both
- (b) **False statements or representations of fact with knowledge of falsehood.** Any person who makes a false statement or representation of a material fact, knowing it to be false, or who knowingly fails to disclose a material fact, in any document, report, or other information required under the provisions of this



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title shall be fined not more than \$10,000 or imprisoned for not more than one year, or both.

- (c) **False entry in or willful concealment, etc., of books and records.** Any person who willfully makes a false entry in or willfully conceals, withholds, or destroys any books, records, reports, or statements required to be kept by any provision of this title shall be fined not more than \$10,000 or imprisoned for not more than one year, or both.
- (d) **Personal responsibility of individuals required to sign reports.** Each individual required to sign reports under sections 201 and 203 [29 USCS §§ 431, 433] shall be personally responsible for the filing of such reports and for any statement contained therein which he knows to be false.

29 U.S.C. § 439.

Filing an LM-2 that is inaccurate does not in and of itself subject the signatories to criminal liability under Section 439. In order to be criminally liable, the officers who sign the LM-2 must know that the LM-2 is false when they signed it. “[T]he state of mind expressly required by section [439(b)] is not willfulness but *knowledge* that the statement made in the LM-2 was false.” *United States v. Bath*, 504 F.2d 456, 460 (10th Cir. 1974) (emphasis in original). This is a high standard to prove. For example, while one’s signature on the LM-2 raises the presumption that one knows the contents of the document, where an accountant prepares the LM-2 for the union and the accountant has been given full access to the union’s book and records, reliance on the accountant is a good defense, unless the officer signing the LM-2 independently knew that there was something false in the report., *Id.* at 460. The accountants should prepare the upcoming and amended LM-2 reports and all future ones.

To the extent that Lennon had personal use of the Union’s American Express card and did not timely repay it, the Union should disclose these facts on the LM-2 Report. How it is reported on the form is open to some interpretation. It could be reported as either a loan or a shortage. Because of the criminal law penalties associated with making a loan to an officer in excess of \$2,000, and because of the facts and circumstances of the instant matter, we recommend that the matter be treated on the LM-2 as a shortage.



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LM-2's Relevant Loan Provisions

Schedule 2 of the LM-2 is used to report the existence of loans made by the Union. Pursuant to these instructions, all personal use of a union's American Express card - even if repaid by the officer after the bill is paid - are indirect loans that must be reported on the LM-2. The instructions for Schedule 2, in relevant part, state:

SCHEDULE 2 – LOANS RECEIVABLE

Report details of all direct and indirect loans (whether or not evidenced by promissory notes or secured by mortgages) owed to the labor organization at any time during the reporting period by individuals, business enterprises, benefit plans, and other entities including labor organizations. An example of an indirect loan is a disbursement by the labor organization to an educational institution for the tuition expense of an officer, employee, or member that must be repaid to the labor organization by that individual. Be sure to report all loans that were made and repaid in full during the reporting period. * * * * *

***NOTE:** Advances, including salary advances are considered loans and must be reported in Schedule 2 (Loans Receivable). However, advances to officers and employees of the labor organization for travel expenses necessary for conducting official business are not considered loans if the following conditions are met:*

The amount of an advance for a specific trip does not exceed the amount of expenses reasonable expected to be incurred for official travel in the near future, and the amount of the advance is fully repaid or fully accounted for by vouchers or paid receipts within 30 days after the completion or cancellation of the travel

Instructions for Form LM-2 Labor Organization Annual Report at 14. While the exemption covers cash advances for business-related trips, there is no exemption for personal trips or other personal expenses.



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If the Union treats the personal use of the American Express bill as a loan on the LM-2, Lennon's repayments would be disclosed in Columns (D)(1) and (D)(2) of Schedule 2.

If the unpaid personal use is considered a shortage, the existence of the shortage is reported on Item 13 of the LM-2. Lennon's repayment might then be reported on Schedule 14. Item 13 of the Report exists to show losses or shortages. The DOL's instructions for completing Item 13 of the LM-2 Report state:

13. LOSSES OR SHORTAGES

Answer "Yes" to Item 13 if the labor organization experienced a loss, shortage, or other discrepancy in its finances during the period covered. Describe the loss or shortage in detail in Item 69 (Additional Information), including such information as the amount of the loss or shortage of funds or a description of the property that was lost, how it was lost, and to what extent, if any, there has been an agreement to make restitution or any recovery by means of repayment, fidelity bond, insurance, or other means.

Instructions for Form LM-2 Labor Organization Annual Report at 10.

Lennon's repayment might then be reported on Schedule 14 or Statement B of the Report:

SCHEDULE 14 – OTHER RECEIPTS

Report the labor organization's receipts from all sources during the reporting period, other than those that must be reported elsewhere in Statement B; such as reimbursement from officers and employees for excess expense payments or travel advances not reported as loans in Schedule 2 (Loans Receivable); receipts from fundraising activities such as raffles, bingo games, and dances; funds received from a parent body, other unions or the public for strike fund assistance; and receipts from another labor organization which merged into the labor organization.

Instructions for Form LM-2 Labor Organization Annual Report at 29.



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How the issue is treated on the LM-2 must be discussed with the accountants who should prepare the filing. You should be guided by their advice, but we think the arrearage should be treated as a shortage and not a loan on the form. To treat Lennon's American Express shortage as a loan, there must have been a decision made by the Union to allow him personal use of the card and the right to carry a balance. All known facts suggest that this never happened.

In the face of then Financial Vice-President Hafemeister being told by then President Moriarity that personal use of the card was not permitted, her looking the other way should not be considered approval of the practice by the Union. The consistent efforts made by Dennison and Blumenthal to stop Lennon from using the card for personal reasons also cannot be considered approval of the practice by the Union. The fact that Dennison writes about Lennon assuring him that he would stop personal use of the card is a further indication that Lennon knew the Union had not approved of him engaging in this practice. That Dennison and Blumenthal met with Lennon in 2005 and Lennon agreed to repay the money through payroll deduction does not convert what occurred into a loan. (The instructions for reporting shortages ask the filer to report whether there have been arrangements made for repayment.) While the Controller would know about Lennon's American Express shortage, this knowledge, by itself, does not suggest approval by the Union because he is not a union officer.

Lennon as President and Blumenthal as the Financial Vice-President must sign the LM-2 for 2005 and any amended LM-2 filed for proceeding years. They should speak to the accountant and have the accountant, not the Controller, prepare the LM-2 for filing. They should only sign accurate LM-2's, lest they be faced with criminal sanctions.

IV. RECOMMENDATIONS

The American Express Bill

Either eliminate the use of a Union American Express card, which is probably not practical, or pass a detailed written policy that prohibits any personal use. If the Union's card is used inadvertently for a personal expense, the details of that use must be immediately reported to the Executive Board by the Financial Vice-President. In addition, the policy must provide for the Expense Report to be completed before the American Express bill is paid. As a general rule, the American Express bill should not be paid until all Expense Reports are received. In the event someone mistakenly uses the card for a personal or disallowed expense, payment to the Union



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must be made before the bill is paid. No exceptions to this policy can be tolerated. A violation must result in charges being brought by the Financial Vice-President or the Executive Board.

The American Express bill should be addressed to the Controller. Having it addressed to the Recording Vice-President only creates delay in the internal handling of the bill.

The policy statement should require that the Controller make an immediate written report to all three full-time officers anytime the American Express bill is paid without the Controller having all completed and approved Expense Reports. The policy statement should require the Financial Vice-President to forward a copy of any such report to the Executive Board.

The current system of having either of the two other officers sign the Expense Report to "approve" the business purpose and adequacy of the back-up is insufficient to ensuring that this problem does not happen again. When an officer submits an Expense Report, both of the other two officers must approve it. All three signatures should be on the form. In the event there is a disagreement about approving the expenses noted on the Expense Report, the cardholder should be able to quickly appeal the matter to an Executive Board subcommittee for a decision.

On a quarterly basis, a three person subcommittee of the Executive Board should be created that meets to hear appeals and to review the Expense Reports and the American Express bills to satisfy themselves that everything is proper. The subcommittee should be appointed by the Executive Board, not the President, and must not include any of the full-time officers. The subcommittee must report to the full Board the results of its review, and the minutes should reflect the subcommittee's report.

(This recommendation is modeled upon the system used by the AFM. According to Article 3, Section 8(t) of the Bylaws of the American Federation of Musicians of the United States and Canada, each quarter a subcommittee of the National Executive Board inspects and verifies the expense reports and credit card statements of the National President, the Vice-President from Canada and the Secretary-Treasurer. The membership of the subcommittee is selected by the Executive Board, it has the power to receive any documentation it requires, and it reports its findings each quarter to the Executive Board.)

The form used for the Expense Report should be revised to include the signatures of the three full-time officers and the quarterly approval of the Executive Board's subcommittee members. At least one of the three members of the subcommittee should sign the Expense Report to indicate it has been reviewed.



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The form should also be revised to physically segregate American Express charges from other items where cash reimbursement for out-of-pocket expenses is sought. This would make the form more readable. Additional space should be allocated on the form to permit a more detailed description of the business purpose of the charge. Too little description is now being submitted. For example, where a meal is charged, the names of all those who ate should be listed and a brief description included of the business discussed.

Immediate Tasks of the Subcommittee

Because it appears that no officer has signed-off on Lennon's Expense Reports for 2005 and part of 2004, technically, even the business expenses charged to the card have not been approved for those months. The subcommittee must immediately review any unapproved Expense Reports and either approve the Reports as submitted or require a resubmission as needed. In the event that the Expense Reports are disallowed in whole or in part by the subcommittee, Lennon must immediately pay the difference to the Union. He could appeal the subcommittee's decision to the entire Board, but repayment should not be significantly delayed by doing so.

Checks

Presently, only one signature is required on the Union's checks. This should be changed to require two signatures. While all three full-time officers sign the registry, it is an insufficient control device because signing the registry does not signify that the officer saw the back-up for the checks. Having only one signature on a check means that checks can be issued before a second officer has approved the expenditure.

The DOL recommends that "all checks drawn on the union's bank account have a second signature" *Internal Financial Controls*, U.S. Department of Labor, Employment Standards Administration, Office of Labor-Management Standards, January 2005. We recommend Local 802's Executive Board adopt this recommendation. The DOL also recommends that the back-up be available to the officer before signing a check. We agree, and suggest this procedure be instituted. Signing a check should indicate that the two officers understand the nature of the payment and approve it as proper.

The three full-time officers should continue to have check-signing authority. The Financial Vice-President should generally sign all checks and get the signature of one of the



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other two officers on the check. Normally, one would expect the President to be the co-signer, but in his absence the Recording Vice-President may sign.

The registry should continue to be signed by all three officers. All three have a role under the Local's Constitution in the issuance of checks. All three should continue to have an idea about how the Union's money is being spent.

Loans

Under LMRDA Section 503 a union or a union official who willfully loans either directly or indirectly more than \$2,000 to an officer or employee commits a crime punishable by up to one year in jail or a fine of \$5,000 or both. While it is not illegal to make loans for less than \$2,000 to officers and employees of the Union, it is recommended that the Executive Board examine the necessity and value of maintaining the current loan policy.

The Accountants' Review

The accountants should be reviewing the Union's records to see if there was any personal use of the American Express card beyond what this memo describes. They should make a written report to the Executive Board on such use, and when repayments, if any, were made. A discussion must be held with the accountants to make sure they know what to look for and that a written report is expected from them.

The accountants must also be told to finish their review of the American Express bills and Expense Reports in time to permit preparation and timely filing of the 2005 LM-2 Report and any amended reports, as well. Because it is likely that the DOL will conduct an audit of Local 802 as a result of becoming aware of this issue, it is important that any issues be immediately brought by the accountants to the attention of the officers and Executive Board. While we have not asked that it be done, the Executive Board should also consider at this time having the accountants review whether there were any loans made in excess of the \$2,000 limit during the past five years and whether repayment of any loans is or was delinquent. This issue is likely to be included in any DOL audit.

The Financial Vice-President should speak to the accountants about any potential IRS issues that may be present. A corrected 2005 Form 990 should be filed, if one is required, and amended returns filed for previous years if the accountants recommend it.



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Restatement of the 2004 Financial Statement

The accountants should be asked to restate the Financial Statement to include a note describing what is included in "Other accounts receivable." Whether this should be done to previous Financial Statements should be discussed with them.

The accountants should be directed to disclose in future Financial Statements any receivables on account of any officer or employee of the Union. This requirement should be included in the accountants' engagement letter.

LM-2 Reports

The 2005 LM-2 Report must accurately reflect what has transpired. It must be signed by Lennon and Blumenthal and be timely filed. The 2004 LM-2 should be amended. Previous LM-2 Reports should be reviewed with the accountants and a decision made as to whether amended Reports should be filed. If this is to be done, they should be filed at the same time the 2005 LM-2 Report is filed.

Report to the Membership

A full accounting of Lennon's personal charges and repayment should be prepared by the Union's accountants, reviewed by the Financial Vice-President, and published as required by the Union's Constitution in the Union's newspaper forthwith. In the event the accountants find that any other officers or employees also used the American Express card for personal expenses, these amounts should be disclosed as well.

The newspaper should also include a statement from the Financial Vice-President describing the steps now being taken by the Executive Board to prevent a similar occurrence of this problem in the future.

Interest and a Fine

The Executive Board is without the authority under the Union's Constitution to conduct a trial and discipline Lennon for what transpired. It could, however, demand that he pay interest. In lieu of interest, I would recommend a fine. Given the magnitude of the problem created by his actions, the interest is relatively insignificant. It would be more appropriate, in our opinion, to fine him in the amount of one week's pay, which is worth about \$1800. He could pay it through



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payroll deduction. While there was no written policy against personal use of the Union's American Express card, he failed to timely submit Expense Reports and to repay these amounts on a timely basis during the last two years. Needing more than a simple reprimand, his irresponsible behavior cries out for a serious response from the Executive Board. Should Lennon balk at voluntary payment of the fine, internal union disciplinary proceedings should be commenced against him.

In the event that Lennon agrees to payment of the fine, this should be disclosed to the membership at the same time the newspaper reports the full accounting of his use of the card. It would also be appropriate for the newspaper to also print a brief letter from Lennon taking responsibility for what happened and expressing his remorsefulness.

Report to the AFM and the DOL

These events and the steps taken by the Union to improve the situation should be reported to the AFM and the DOL. They are going to learn of it anyway from the Local's newspaper and the LM-2s. Counsel should write the DOL and an officer should write the AFM. Both letters should complement the other. The Local should also ask the AFM to sponsor an educational seminar each year on proper record keeping and financial policies for local unions. The current officers should attend in the event one is held.

V. CONCLUSION

These recommendations, if implemented, are the best hope of the Union to weather a DOL audit, which is very probable. All corrective action should be taken before March 31, 2006. A piecemeal approach will only increase the chance that the DOL will seek to initiate legal action.

We believe that Lennon never intended to defraud the Local. We also believe that Dennison and Blumenthal acted at all times out of true concern for what is best for the Union. The Executive Board has evidenced the same concern.



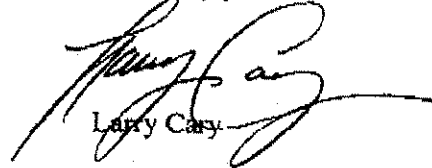
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Events of this type are extremely difficult for any union to work through. But work through them you must. The actions of a single individual, even though not intended to cause harm, cannot be allowed to jeopardize others or the Union. And, at all times, every officer and Executive Board member must appreciate the need to act responsibly in handling the Local's moneys in full conformity with the Local's Constitution and the requirements of law. At the end of the day, the Local's money is really the members' money. If one understands that, one also understands what it means to be a fiduciary.

I thank the Executive Board for retaining Cary Kane LLP. We are available, of course, to meet with the Executive Board in the afternoon of February 28th, or another time if more convenient to the Board, to answer any of your questions.

Very truly yours,



Larry Cary