

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9508 / January 9, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71264 / January 9, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3526 / January 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15674

In the Matter of

MICHAEL MENDES,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933 AND SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Michael Mendes (“Mendes” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. These proceedings involve the role of Michael Mendes in Diamond Foods, Inc.'s ("Diamond") inaccurate accounting of costs related to its walnut business in 2010 and 2011. In publicly-disclosed financial statements for fiscal years ending July 31, 2010 and 2011, Diamond understated the costs associated with acquiring walnuts from growers, resulting in overstated earnings. Diamond restated its annual and periodic financial statements beginning with the quarter ended January 31, 2010 and continued through the year-ended July 31, 2011. When Diamond restated its financial results from those periods, the company's reported earnings decreased by \$10.5 million for its 2010 fiscal year, and \$23.6 million for its 2011 fiscal year.

2. As Diamond's CEO during the relevant time, Mendes had an important role in ensuring the accuracy of the financial reporting of the company, including certifying the financial statements contained in Form 10-K annual reports filed with the Commission, reviewing and approving other periodic reports and earnings releases, and signing representation letters relied on by the company's independent auditors.

3. During the relevant time period, Mendes was involved in the determination of the walnut prices that Diamond would pay walnut growers, and he was aware of reports of prices paid by other walnut purchasers to growers for their 2009 and 2010 crops which were significantly higher than prices paid by Diamond. At the same time, Mendes was involved in the decision to make two special payments to growers, paid around the same time that Diamond paid the final installment for the walnut crops delivered by its growers. These payments are described further below as the "continuity" and "momentum" payments. Mendes was also aware that these special payments were not recognized as costs associated with walnuts acquired during fiscal years 2010 and 2011, respectively.

4. Mendes acted unreasonably under the circumstances in certifying the accuracy of financial statements that Diamond included in public filings, including several filings related to offers of Diamond stock. Mendes' conduct in connection with the two special payments made to Diamond growers also caused Diamond to violate various provisions requiring accurate books and records and controls designed to ensure accurate financial reporting.

Respondent

5. Michael Mendes, age 50, is a resident of San Francisco, California. Mendes joined Diamond's International Sales and Marketing Division in 1991, and was appointed chief executive officer in 1997. Mendes joined the Diamond Board of Directors in 2005 and became its Chairman in 2010. Mendes served as Diamond's CEO and Chairman until February 2012.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Entity

6. Diamond is a Delaware corporation headquartered in San Francisco, California that markets and sells various snack foods and nuts. Diamond was founded in 1912 as a cooperative by California walnut growers, and became a public company after an initial public offering (“IPO”) in 2005. Since its IPO, Diamond has expanded into snack foods through acquisitions while maintaining its original walnut business. Diamond’s common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on NASDAQ under the ticker “DMND.”

Facts

A. Diamond Foods and its Walnut Business

7. Diamond’s stock has been publicly traded since its initial public offering in 2005. At that time, Diamond’s principal business was buying walnuts from California-based growers and reselling the walnuts through various distribution channels to the retail market. Since its 2005 IPO, Diamond has expanded into other snack food businesses and by 2010 it was a fast-growing snack food conglomerate. While no longer the sole focus of Diamond’s business, walnuts still represented Diamond’s largest commodity cost as of fiscal year 2010.

8. During the relevant time period, 2009 through 2011, Diamond acquired its walnuts through long-term supply contracts with walnut growers. These contracts generally obligated the growers to sell, and Diamond to buy, the grower’s entire crop each year, and Diamond was obligated to pay a price determined by Diamond “in good faith.”

9. Diamond’s business model focused on selling the walnuts to established retailers under annual sales contracts. These sales contracts were often negotiated in advance of the fall harvest and delivery of the walnuts to Diamond. Diamond’s growers would deliver the walnut crops each fall and Diamond would pay the growers for those walnuts in a series of payments starting with a “delivery payment” at the time of the fall harvest and culminating in a “final payment” in August of the following year.

B. Determining and Accounting for the Walnut Cost

10. Because Diamond would begin selling delivered walnuts before the final payment was made to growers, in its quarterly financial statements Diamond accounted for the costs of walnuts sold using an estimate of the total price Diamond would pay to growers for a particular crop. Once the final payment was made, in August of the year following delivery, Diamond would use the total payments made to growers for the crop as the basis for recording the cost of the walnuts sold during the fiscal year.

11. The actual prices Diamond paid growers varied by walnut variety, size of a grower’s crop, quality of the crop, and other factors, but the accounting department and management referred to an average price paid for a given crop across all growers, varieties, and qualities. For example, for fiscal year ended July 31, 2009, Diamond reported a blended total walnut cost of 71 cents per pound, though individual growers might have received more or less than that amount.

12. Diamond's contracts with its growers stated: "The Final Price will be determined in good faith, taking into account market conditions, quality, variety, and other relevant factors." Diamond also disclosed how it determined walnut prices in the "Critical Accounting Policies" section of its Forms 10-K for 2010 and 2011: "This purchase price will be a price determined by us in good faith, taking into account market conditions, crop size, quality, and nut varieties, among other relevant factors."

13. Generally accepted accounting principles ("GAAP") required Diamond to record inventory at acquisition cost in the period that the walnuts were purchased, and to record cost of sales in the period in which the inventory was sold.

14. Each quarter, Diamond's finance department would prepare a memorandum justifying the walnut price used to value walnut inventory and the cost of the walnuts sold during the quarter. This memorandum was provided to the company's independent auditors, and the auditors relied on the memorandum as a representation that the walnut price had been determined in accordance with the accounting policy disclosed in the company's Forms 10-K.

C. The Q2 2010 Walnut Cost Estimate

15. In the first quarter of the 2010 fiscal year, Diamond recorded an estimated cost for the 2009 walnut crop of 82 cents per pound. At the end of the second quarter, ending January 31, 2010, Diamond recorded an estimated walnut cost of 72 cents per pound. The recorded estimated walnut cost was adjusted by 10 cents per pound although Diamond management was aware of reports that some other walnut purchasers were paying some growers prices higher than the second quarter estimate.

16. Diamond filed a Form 10-Q with the Commission on February 25, 2010, and included financial statements that accounted for walnut costs at the adjusted estimate of 72 cents per pound. On March 1, 2010, Diamond filed a prospectus related to a proposed stock sale to pay a portion of the acquisition costs associated with Diamond's acquisition of a snack food company, and the prospectus incorporated the Form 10-Q.

D. 2010 Final Payment Includes a Special "Continuity" Payment

17. In the spring and summer of 2010, Diamond management, including Mendes, began discussing a special payment to walnut growers they termed a "continuity" payment. Some of Diamond's growers had been voicing increasing dissatisfaction with the estimated final walnut price of 71 cents per pound that had been communicated in the spring of 2010. In July 2010, with the final payment to growers for the 2009 crop just a month away, Mendes and three other senior Diamond employees visited several large growers. During these meetings, Diamond management told the growers that they would receive a competitive price for the 2009 crop they had delivered to Diamond.

18. The next month, in August 2010, Diamond made its final 2009 crop payment to its growers and included in that final payment an additional amount that Diamond described in a letter to growers as a "continuity" payment. The additional payment amount, above the average 71 cents per pound "final price" already communicated, was an additional payment of approximately 10 cents per pound. The letter to growers did not clearly explain the purpose of

the payment or inform growers that the payment was an advance payment for the 2010 crop. Mendes reviewed and approved the letter before it was sent to growers.

19. Instead, the letter stated that the August check “represents both the final payment on the 2009 crop and a continuity payment reflecting the value of the multi-year supply arrangement with our Diamond walnut growers.” The additional payment, if considered in conjunction with the previous installments and final payment amounts, would have brought Diamond closer to the walnut prices paid by some other walnut purchasers for the 2009 crop. Some growers believed that the continuity payment was an additional payment for the already-delivered 2009 crop.

20. The total amount of the “continuity” payment included in payments to Diamond’s growers was about \$20 million. Diamond’s finance department did not record the impact of the continuity payment to inventory, payables to growers, or costs of goods sold for the walnuts acquired and sold during fiscal year 2010. Diamond’s financial statements prepared for the fiscal year ending July 31, 2010, as disclosed in an earnings release attached to a Form 8-K and in Diamond’s Form 10-K, failed to recognize the continuity payment in that fiscal year.

21. Diamond’s independent auditors inquired about the additional payment included with the final payment to growers, and employees in Diamond’s finance department told the auditors that the payment was an advance for the next year’s crop. The auditors required the issue be addressed in the management representation letter prepared by Diamond’s finance department and signed by Mendes and other senior management, and the letter specifically stated that the continuity payment was for the upcoming crop and did not represent a payment for the 2009 crop.

22. In a Form S-4 registration statement filed on June 20, 2011, Diamond offered securities to be issued in connection with Diamond’s proposed acquisition of a snack food division of a large consumer products company. The registration statement incorporated the financial statements included in the Form 10-K for the fiscal year ended July 31, 2010.

23. On November 11, 2012, Diamond issued restated financial statements for the year ended July 31, 2010. The restated financial statements recognized the impact of the continuity payment and increased the reported value of inventory, payables to growers, and cost of goods sold during the fiscal year. Diamond’s 2010 restated earnings were 40 percent lower than had been originally reported.

E. 2011 Walnut Payment Is Followed By a Special “Momentum” Payment

24. In the fall of 2010, growers delivered the 2010 crop to Diamond. Based on the amount Diamond paid its growers in the initial installment of the delivery payments, some growers once again expressed concern that Diamond was paying significantly below what some other walnut purchasers were paying growers. The quarterly estimate of the walnut price was recorded as 74 cents per pound at the end of the quarter ending April 30, 2011. Diamond’s grower relations department learned of some of these grower concerns regarding Diamond’s walnut payments being significantly below prices that some other walnut purchasers were paying some growers.

25. In the spring and summer of 2011, Diamond management began discussing a special additional payment to walnut growers they termed the “momentum payment.” The growers were paid a final payment for the 2010 crop on August 31, 2011, and then two days later Diamond paid these same growers an additional amount averaging about 30 cents per pound. The additional special payments totaled about \$60 million for Diamond.

26. An August 31, 2011 letter to growers told the growers that they would be receiving two payments, a final payment and a “momentum payment.” The letter did not clearly identify the momentum payment as an advance on the next year’s crop. The letter stated that “Enclosed you will find your 2010 crop value statement summary and payment. . . . Additionally, on September 2nd we will mail a momentum payment designed to reflect the projected market environment prior to your delivery of the 2011 crop. . . . The momentum payment is independent of and incremental to your upcoming delivery payment.” Some growers were unclear about whether the momentum payment was an additional payment that should be associated with the delivered crop or as an advance on the next year’s undelivered crop.

27. Diamond’s finance department did not record the momentum payment to inventory, payables to growers, or costs of goods sold for the walnuts acquired and sold during fiscal year 2011. As such, Diamond’s annual financial statements prepared for the fiscal year ending July 31, 2011, as disclosed in an earnings release attached to a Form 8-K and in Diamond’s Form 10-K, failed to recognize the momentum payment in fiscal year 2011.

28. On September 16, 2011, Diamond filed an amendment to the Form S-4 registration statement offering securities in connection with the proposed acquisition of a snack food division of a large consumer products company, and incorporated by reference the Form 10-K filed for the year ended July 31, 2011.

29. On November 11, 2012, Diamond issued restated financial statements for the year ended July 31, 2011. The restated financial statements recognized the impact of the momentum payment as an increase to acquiring inventory, payables to growers, and cost of goods sold. Diamond’s 2011 restated earnings were 47 percent lower than had been originally reported.

F. Mendes’ Role in Diamond’s Inaccurate Financial Statements

30. As CEO, Mendes was responsible for certifying the accuracy of Diamond’s financial statements and other disclosures in Diamond’s periodic reports. Mendes supervised the company’s chief financial officer, who in turn supervised the finance department and grower relations department. The grower relations department was responsible for communicating with and making payments to growers. Mendes received reports of prices that some other walnut purchasers were paying growers for walnuts in 2010 and 2011, and in some instances Mendes met directly with Diamond growers. Mendes was also involved in determining quarterly walnut cost estimates and approved the amount of the total payment made to growers for each crop.

31. Mendes signed and certified the Form 10-K for the year ended July 31, 2010, which included financial statements that did not account for the “continuity payment” as a cost of the walnuts acquired during the fiscal year. Likewise, Mendes signed and certified the Form

10-K for the year ended July 31, 2011, which included financial statements that did not account for the “momentum payment” as a cost of the walnuts acquired during that fiscal year. Mendes also signed and certified the Forms 10-Q for the second and third quarters of 2010, and the first, second, and third quarters of 2011. All of those financial statements were subsequently restated. Mendes also signed and certified the January 1, 2010, June 20, 2011, and September 16, 2011 registration statements which incorporated the financial statements which were later restated.

32. Mendes reasonably should have known that Diamond’s Form 10-Ks for fiscal year 2010 and 2011, earnings releases for those years attached to Forms 8-K, and Diamond’s 10-Qs for the second and third quarters of 2010, and the first, second, and third quarters of 2011, all of which were subsequently restated, were inaccurate. Among other things, Mendes received reports that some walnut purchasers were paying higher walnut prices for the 2009 and 2010 crops compared with Diamond, participated in discussions regarding the continuity payment and momentum payment, and reviewed grower correspondence regarding the payments which did not clearly identify the continuity and momentum payments as advance payments. Mendes thus did not act reasonably in certifying the accuracy of Diamond’s financial statements in the fiscal years that were restated, and his conduct caused Diamond to violate various provisions requiring accurate books and records and controls designed to ensure accurate financial reporting.

33. Although he was not directly involved in discussions with Diamond’s auditors regarding the accounting treatment for the continuity payment or momentum payment, Mendes was aware of representations made to the auditors and signed a representation letter sent to the independent auditors in connection with the audit of the 2010 financial statements. That letter stated that the continuity payment was unrelated to the 2009 crop delivery, but omitted facts that Mendes knew or should have known, including that growers had expressed confusion about the purpose of the continuity payment, that some growers considered the continuity payment as a part of the final payment for the 2009 crop, and that Diamond’s recorded 2009 crop payment was significantly below the price paid by some other walnut purchasers. Because of these omissions, Mendes reasonably should have known that the statement to the auditors was incomplete.

34. Mendes received \$2.7 million in bonuses related to Diamond’s fiscal year 2010 and fiscal year 2011 results. Of this amount, approximately \$1.6 million of the bonus amounts were directly tied to earnings per share (EPS) goals, while the remaining \$1.1 million of the bonus amounts related to other management objectives. Mendes has voluntarily repaid these bonus amounts to Diamond. Mendes also forfeited claims to an additional \$1.8 million in employment benefits.

Violations

35. Section 17(a)(2) of the Securities Act makes it unlawful “in the offer or sale of any securities . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.” Section 17(a)(3) of the Securities Act makes it unlawful “in the offer or sale of any securities . . . to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.” No finding of scienter is required to establish a violation of Sections 17(a)(2) and 17(a)(3); negligent conduct is sufficient. *Aaron v. SEC*, 446 U.S. 680, 696-97

(1980). Negligence is a failure by an actor to conform conduct to the standard of “a reasonable [person] under like circumstances.” *See* Restatement (Second) of Torts §§ 282 and 283. As a result of the conduct described above, Mendes violated Sections 17(a)(2) and (a)(3) of the Securities Act.

36. Rule 13a-14 of the Exchange Act requires every principal executive of an issuer to certify reports required pursuant to Section 13(a) at the time of the filing of the report. As a result of the conduct described above, Mendes violated Exchange Act Rule 13a-14.

37. Rule 13b2-1 of the Exchange Act prohibits any person from falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act. As a result of the conduct described above, Mendes violated Exchange Act Rule 13b2-1.

38. Rule 13b2-2 of the Exchange Act prohibits any officer from either (1) making or causing to be made a materially false or misleading statement to an accountant, or (2) omitting to state, or causing another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant, in connection with any audit, review, or examination of the financial statements of an issuer subject to the reporting requirements of Section 13(a). As a result of the conduct described above, Mendes violated Rule 13b2-2 of the Exchange Act.

39. Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1, 13a-11, and 13a-13 require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate periodic reports, including annual reports on Form 10-K, current reports Form 8-K, and quarterly reports on Form 10-Q. Rule 12b-20 further requires that the required reports must contain any material information necessary to make the required statements made in the reports not misleading. As a result of the conduct described above, Mendes caused violation of these provisions by Diamond Foods.

40. Section 13(b)(2)(A) of the Exchange Act requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets. As a result of the conduct described above, Mendes caused violation of Section 13(b)(2)(A) of the Exchange Act by Diamond Foods.

41. Section 13(b)(2)(B) requires issuers of securities registered pursuant to Section 12 of the Exchange Act to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP. As a result of the conduct described above, Mendes caused violation of Section 13(b)(2)(B) of the Exchange Act by Diamond Foods.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (a)(3) of the Securities Act.

B. Pursuant to Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder.

C. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$125,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Michael Mendes as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Michael S. Dicke, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, California 94104.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalty referenced in paragraph C above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of

this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy
Secretary