Getting Tough on Corporate Crime?

Enron and a Year of Corporate Financial Scandals

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This essay is distributed by Allyn & Bacon as a supplement to Jeffrey Reiman's *The Rich Get Richer and the Poor Get Prison*. A copy of this essay with links to additional information is available as part of the companion website for the *Rich Get Richer and the Poor Get Prison*. Both are available online at http://paulsjusticepage.com .

> "Why aren't all of you in jail? And not like white-guy jail – *jail* jail. With people by the weight room going, 'Mmmmmm.'"
>
> Jon Stewart, on *The Daily Show,* discussing executives from Enron and their accounting firm, Arthur Andersen.[i]

The big crime story of 2002 was not the usual tale of murder and mayhem among the poor. Though the murder rate went up that year—reversing a downward trend in homicides that started in the mid 1990s—the year's crime story was a long and complicated saga of corporate financial shenanigans that caused a significant drop in stock market prices. Although the economic losses were widespread, *Fortune* magazine notes: "The not-so-secret dirty secret of the crash is that even as investors were losing 70%, 90%, even in some cases *all* of their holdings, top officials of many of the companies that have crashed the hardest were getting immensely, extraordinarily, obscenely wealthy."[ii]

At center stage was Enron, a multibillion dollar energy-rights trading company, which declared one of the largest bankruptcies in history on December 2, 2001, with debts of over $31 billion! Enron was subsequently accused of having perpetrated a massive "disinformation" campaign, hiding the degree of its indebtedness from investors by treating loans as revenue, hiding company losses by creating new firms with company capital and then attributing losses to them and not to Enron, and encouraging company employees to buy and hold Enron stock while its executives apparently knew of its shaky condition and were busily selling off their own shares. Enron shares had fallen from $90 in September 2000 to $25 in September 2001, and would ultimately fall below $1 each, largely wiping out the pension plans of up to 20,000 employees. As Enron shares were tanking, Ken Lay, then CEO, was emailing concerned employees advising them to hold their shares and buy new ones. Meanwhile, he himself cashed in $103 million of his own shares in the company. Jeff Skilling, Lay's successor as CEO, cashed in $68 million, and Andy Fastow, the company's chief financial officer, cashed in $32 million.[iii]

Enron turned out not to be an isolated incident and the list of companies touched by financial scandal soon included Tyco, Global Crossing, Quest, Worldcom, Xerox, Adelphia, MicroStrategy, ImClone and homemaker Martha Stuart, AOL-Time Warner, K-Mart and some major banks, such as Citigroup and J. P. Morgan Chase. Questions surfaced regarding President Bush's sale of Harkin Energy shares right before bad news caused the price to fall; and other questions arose concerning the accuracy of the earning reports of Haliburton Oil for the years when Vice President Cheney was its CEO.

Investor confidence plummeted along with stock prices, and politicians tripped over themselves trying to appear tough on corporate crime. President Bush announced what he described as strict new measures and Senator Christopher Dodd (D-Connecticut) quickly said that Bush demonstrated a lack of leadership on the issue, although the *Washington Post* pointed out that Dodd himself had "led an effort in 1995 to limit shareholders' lawsuits alleging fraud."[iv] Numerous other critics claimed that President Bush was too close to the problem to deal effectively with the wrongdoing: Enron had contributed about $2 million to Bush over the course of his political career (for a list of financial scandals matched to amounts contributed to the political parties by the suspect companies, use the link from the web-based version of this paper to go to Citizen Work's "Crookbook"). Congress passed the Sarbanes-Oxley Act, a more comprehensive bill than President Bush proposed, and one touted as the most sweeping financial reform since the Depression Era. Federal agents did the "perp walk" with several handcuffed executives before the press and American public; but, considering the number of people and the amounts of money involved, arrests and indictments have been few.

These events will not surprise readers of *The Rich Get Richer and the Poor Get Prison*, which documents a large amount of serious but unpunished (or under-punished) white-collar crime, and the even larger amount of harmful white-collar behavior that doesn't get labeled as crime though it takes more from people's pockets than the crimes on the FBI's Uniform Crime Index. Harmful acts done by the executives of big corporations and their underlings are comparable in harm and evil to the street crimes people fear (see Chapter 2's discussion with the Defender of the Present Legal Order, as well as the statistics in that chapter comparing criminal and noncriminal harms); but the criminal justice system "weeds out the wealthy" by either not including the harmful acts of businesspeople within the criminal code or, if they are made crimes, by not vigorously pursuing prosecution (see Chapter 3's section "Weeding Out the Wealthy," and the statistics in that chapter about who actually gets punished by the criminal justice system). Should we view the recent "tough-on-corporate-crime rhetoric," the new legislation, and the sight of executives in handcuffs as a sign that things are changing?

"Huff and Puff and . . . Do Little"

As we begin to answer the question about whether the U.S. is truly getting tough on corporate crime, it is necessary to note that what is at issue is not *merely* whether white-collar crimes are being punished adequately. As *The Rich Get Richer and the Poor Get Prison* argues at length and with an avalanche of statistics, great if not greater threats come from those harmful acts of corporate execs that are not technically crimes.

The so-called "questionable bookkeeping" and "misstatements" that Enron and others engaged in were not mere technical rule violations without real victims. One important consequence of the current spate of corporate crime and financial trickery is the elimination of many people's retirement nest eggs, forcing many older people to put off retirement and many retirees to go back to work: "In this age of the 401(k), when the retirement dreams of middle-class America are tied to the integrity of the stock market, crooks in the corner office are everybody's problem."[v] Other families had college tuition money tied up in stocks, along with their dreams of a more comfortable future.

The problem is twofold. There are the "unsavory" or "unethical" but not illegal practices that cause harm to many, and there are the white-collar crimes which are either not punished or, if punished, only lightly so. To be sure, the Savings & Loan scandal, as the Watergate scandal before it, did lead to some toughening of white-collar crime sentences, and some crooks responsible for the S & L scandal went to jail much as some of today's white-collar crooks will end up in jail. On the whole, however, these are few and far between, and their presence on the front page or on the nightly news should not fool us. They are the exceptions that prove the rule, and the rule is: *the rich get richer and the poor—not the rich—get prison*. As a *Fortune* magazine writer put it recently:

> Before Enronitis inflamed the public, gigantic white-collar swindles were rolling through the business world and the legal system with their customary regularity. And though they displayed the full creative range of executive thievery, they had one thing in common: Hardly anyone ever went to prison.[vi]

Even in the highly publicized S & L scandal, few executives actually went to prison in spite of the first President Bush's promise: "We aim for a simple uncompromising position. Throw the crooks in jail."[vii] And, for those who did go to prison, the average term was 36 months, compared to 56 months for burglary, 38 months for car theft and 65 months for drug offenses (see Chapter 3 of *The Rich Get Richer and the Poor Get Prison* for statistics on the treatment of S & L crooks compared to that of lower class criminals; see there also "The Savings and Loan Roster," for a list of some "outstanding" S & L criminals and their fates).

The fact is that corporate crooks have something that poor crooks lack, namely, political clout. Attempts by the U.S. Sentencing Commission to propose stiffer sentences for corporate wrongdoing in the 1990s were met with powerful and well-funded lobbying efforts, with the result that proposed penalties were significantly softened. In 1984, Congress established the U.S. Sentencing Commission to help create guidelines that would make federal sentencing more certain and uniform in criminal cases. The guidelines are in the form of a grid that judges use to plot both the severity of the offense and the nature of an offender's past record to find an appropriate range for the sentence. The first set of guidelines issued in 1987 did not address corporate crime, although the 1990 ones did. However, after a "steamroller of business lobbyists" greeted the 1990 guidelines, the Commission released a revised set of guidelines where the potential fines were "slashed," mitigating factors were given more weight and aggravating factors (such as a prior record) were removed from consideration. An offense that under the original plan carried a penalty of $64,000 carried, after lobbying, a suggested penalty of $17,500; another was revised down from $136 million to $580,000; and the maximum fine went from $374 million to $12.6 million.[viii] Then Attorney General Thornburgh, who had called fighting "crime in the suites" one of his top priorities, "withdrew the Justice Department's long-standing support for tough mandatory sentences for corporate criminals following an intense lobbying campaign by defense contractors, oil companies and other *Fortune 500* firms."[ix]

In March 2002, after the disclosure of Enron's bankruptcy, but before a wave of other frauds was revealed, *Fortune* magazine observed: "The double standard in criminal justice in this country in this country is starker and more embedded than many realize. Bob Dylan was right: Steal a little, and they put you in jail. Steal a lot, and you're likely to walk away with a lecture and a court-ordered promise not to do it again."[x]

Consequently, to know if things are really changing, we need answers to three questions: Are previously noncriminal but harmful corporate practices being made into crimes? Are existing crimes being given tougher sentences? And are the individuals convicted of corporate crimes getting the sentences that the law provides? Neither past experience nor current clues give much ground for optimism. An article in *Business Week* cautions us not to expect too much from Congress this time around. Entitled "Congress Will Huff and Puff and . . . Do Little," the article states,

> the savings-and-loan scandals produced prosecutions and a regulatory overhaul. But the S & L crisis was as much an accounting debacle as Enron is—and the accountants got off scot-free. . . . Shrugging off their profession's dismal performance, accountants successfully dodged reforms—despite a hue and cry that included televised congressional testimony by former S & L exec Charles Keating. At the end of the day, "the S & L scandal did not result in any reforms—it resulted in just the opposite, a so-called reform act that made accountability less important," notes Melvyn I. Weiss, a prominent securities lawyer representing plaintiffs.[xi]

And a recent article in the *Washington Post* notes that Congress is already losing its zeal to correct the flaws that led to the Enron debacle. Jonathan Weisman wrote in September 2002,

> The recently devastated retirement accounts of employees from Enron Corp. and WorldCom Inc. initially fueled a wave of indignation among lawmakers in Washington and solemn vows to protect their investments. But the anger that pushed tough new accounting standards past corporate opponents this summer

> has already faded [by September!], lawmakers and lobbyists say, allowing businesses to regain their strength on Capitol Hill.[xii]

Hot Deals, Looting, and Cover-ups

Even if zealous prosecution of corporate predators is unlikely, we can, at least, try to understand these recent phenomena so that we may better protect ourselves in the future. One important development, already crucial in the S & L scandal, is the advent of deregulation. Swooning from the passion of former President Ronald Reagan's love affair with free enterprise, Congress cut down a multitude of laws that held financial institutions in check. In the case of the Savings and Loans banks, this meant fewer and fewer limits on banks' lending decisions, while the Federal Deposit Insurance Corporation stood ready as always to protect the banks' customers' bank accounts. The result was a volatile combination. Riskier and riskier loans backed up by the U.S. Government and, behind it, the taxpayer. Needless to say, many bank execs simply could not resist.[xiii] The current scandal is also a product of galloping deregulation. Writes Gary Weiss in *Business Week*,

> Congress must share the blame for Enron because it chipped away at investor protections. The Private Securities Litigation Reform Act of 1995 "set the stage for all that went wrong at Enron. They removed the 'aider and abettor' rules, so the accountants and lawyers could give advice without liability," says John Lawrence Allen, a New York securities lawyer.[xiv]

The scams perpetrated by executives and companies during 2002 are a diverse collection. Some, like those of which Adelphia Communications stands accused, appear to involve relatively straightforward looting by the founding family, which allegedly used the company as its personal bank to enrich itself. Others, like Enron's, involve complicated financial transactions to inflate earnings, and thus stock prices, artificially. Martha Stewart is alleged to have benefited from insider information that allowed her to sell shares at a high price before stock prices fell dramatically on bad news. Some of these incidents are run-of-the-mill white-collar crime, with a few reflecting the increasingly casino-like economy of big finance. As the *Washington Post* reported, “Former SEC [Securities and Exchange Commission] chairman Richard Breeden warned Congress about financial fraud in early 1993; and in 1998, Arthur Levitt, who chaired the commission until last year, cited a culture of corporate gamesmanship.”[xv]

A summary of the most serious examples of alleged (and sometimes admitted) corporate wrongdoing is provided in Table 1: Scoundrel Capitalism, 2002. Because of the large amount of such wrongdoing, the table focuses on the most harmful incidents and highlights the multiple dimensions of corporate misbehavior. The status of the cases reflects developments through early October 2002; interested readers can consult the web-based version of this paper for updated information. At the moment, charges have been filed in some, but by no means all, of the troubled companies and, frequently, it is underlings in the organization who are the targets of indictments. As discussed below, massive frauds require widespread cooperation, but the indictments have been highly selective. It remains to be seen whether this narrow and selective prosecution is part of a strategy to get information to build cases against others—especially top executives—or whether the charges are meant only to give the appearance of getting tough while top executives get off unscathed.

	Table 1: Scoundrel Capitalism 2002*	
Name/Company	***Alleged Wrongdoing***	***Status***
Adelphia The 6th largest cable company declared bankruptcy soon after announcing it was responsible for $2.3 billion in off-balance-sheet loans to the founding Rigas family. Investors lost $60 billion in value when stock fell to $0.15 from a high of $66; the company has filed for bankruptcy and is restating earnings for the last several years.	The founding Rigas family used the company as their personal bank and allegedly improperly took money and loans, then created sham transactions and forged financial documents to cover it up. The SEC found "rampant self-dealing" including the use of $252 million in Adelphia funds to repay stock market losses; other company money was used to purchase $28 million in timber rights, a $12.8 million golf club, the Buffalo Sabres hockey team ($150 million), and "luxury condominiums in Colorado, Mexico, and New York City for the Rigas Family"; the family also used, without reimbursement, 3 airplanes owned by Adelphia, including for a safari vacation in Africa. At one point, Timothy Rigas grew concerned about his father's "unacceptably large" spending of company money and put him on an allowance of $1 million a month.	John Rigas, his sons, and two other executives are under criminal indictment and currently free on bail; they also face SEC fines in what an official describes as "one of the most extensive financial frauds ever to take place at a public company."
Arthur Andersen Accountants and financial consultants.	Andersen audited many companies that had to restate earnings in the current scandal and has settled with the SEC in numerous past cases involving deceptive bookkeeping: Enron; WorldCom ($8 billion restatement); Global Crossing; Qwest Communications; Baptist Foundation of Arizona ($217 million settlement); Sunbeam ($110 million settlement); Colonial Realty ($90 million settlement). The Waste Management case ($1 billion overstated earnings) led to an SEC settlement of $7 million, a $229 million shareholder settlement and an SEC "cease and desist" order on misleading accounting. Andersen officials ordered the shredding of important Enron	Andersen was convicted of obstruction of justice in June and admitted to expediting the shredding of documents. The firm will cease auditing public firms by Aug. 31, 2002, although it will continue to do financial consulting.

	documents after an SEC investigation started. To help dispose of 30 boxes of documents, Andersen called a company named Shred-it, whose motto is “Your secrets are safe with us.” Andersen also deleted large numbers of emails relating to its internal debates on Enron’s financial problems.	
Enron Described by executive Skilling as “the world’s coolest company,” Enron declared the largest corporate bankruptcy in history, Dec 2, 2001. It restated its earnings and assets downward by $1.5 billion, wiping out 4,200 jobs and $60 billion in market value lost to shareholders.	A special committee of Enron's board (The Powers Committee) concluded that partnership arrangements allowed high-level Enron executives to hide Enron's losses and liabilities, while earning tens of millions of dollars in fees for themselves. The report was based on a three month review without subpoena power or access to many documents. Nevertheless, it "found a systematic and pervasive attempt by Enron's Management to misrepresent the Company's financial condition" and that Enron employees involved in the partnerships received “tens of millions of dollars they should never have received." Investigations conclude that Enron manipulated the California power crisis for financial gain, entered into transactions presenting conflicts of interest, engaged in fraudulent transactions to book revenue, and punished whistleblowers and those who questioned the appropriateness of business transactions and practices. Enron executives and directors sold $1 billion worth of shares in the three years before the company collapsed. While executives were selling off shares just before the bankruptcy announcement, employees were locked out of selling their shares because of “administrative changes” to the stock plan. During this period, Enron stock lost 28% of its value. Ken Lay took $19 million in cash advances during this time, which he repaid with Enron stock that was rapidly losing value.	Three British bankers have been indicted because of Enron related fraudulent transactions amounting to $7.3 million (although they are still in Britain). Fastow protégé Michael Kopper pleaded guilty to conspiracy to engage in money laundering and wire fraud charges; he agreed to cooperate with prosecutors and return $12 million. On Sept 3, 2002 Lay’s lawyers feared the SEC “may soon move to freeze his assets” but it had not happened yet. Although a criminal investigation started in the US Justice Dept in Jan, no indictments have been returned against Lay or Skilling. On Oct 2, 2002, prosecutors charged Fastow with fraud.
Global Crossing Optical fiber company filed the 4th	Engaged in capacity swaps with Qwest Communications (see below) to improperly book revenue to inflate stock price. In one Congressional hearing, Rep. Billy Tauzin (R., La.), said executives "pursued sham transactions to put revenue on the	Global Crossing and Winnick’s sale of shares are the subject of investigations, but no indictments have been returned. Winnick is

largest bankruptcy under the weight of $12 billion in debt. The company is chartered in Bermuda to avoid US corporate taxes, even though it is headquartered and run out of the US, as well as enjoying all the rights and access to government contracts that US corporations enjoy	books, to mislead investors, and to prevent further drops in their stock prices." Many of these transactions were done in the last few days, sometimes the last minutes, of the financial quarter to help meet earnings expectations. CEO Casey may have misled Wall Street analysts when he denied on several occasions Global Crossing used swaps. Chairman Winnick, who works out of a replica of the Oval Office inside a gated plaza, sold more than $730 million in shares before the announcement and devaluation of the stock.	still CEO and will remain at that post through the company's reorganization. Winnick has refused to cooperate with Congressional investigations. CEO John Legere was forgiven a $10 million balance on an interest-free loan, and given a $2.75 million severance payout, even though share prices were down 90% and the bankruptcy stopped severance payments to workers who had already been laid off.
Qwest Communications The dominant local telephone company in 14 states improperly accounted for about $1 billion and may have to restate another $500 million in sales. Shares dropped to $1 each, down 89% from the start of the year and a high of $66.	Engaged in hollow trades and capacity swaps with Global Crossing and other telecoms to boost revenue and meet earnings expectations. "Investors in Global Crossing and Qwest lost billions of dollars when the truth came out about these companies' finances, while insiders walked away with billions of dollars," according to Rep. James Greenwood (R., Pa.), who chairs a Congressional committee investigating the companies. On several occasions executives asked that the details of the swaps not be put in writing to avoid scrutiny. An internal memo by the CFO Szeglia indicated Qwest would penalize anyone who questioned the company's handling of swaps and followed through by blocking business to Morgan Stanley, which publicly questioned Qwest's reliance on swaps. Qwest lays the blame with Arthur Andersen, which it says approved the accounting related to the capacity swaps. Qwest's founder and largest shareholder, Philip Anschutz, sold $213.5 million in shares prior to the restated earnings report.	Investigations by the SEC and the Dept of Justice regarding the inflated revenue reports started in March 2002, but no action has taken place. Anschutz's sale of stock is a subject of investigation, although it is a small part of the $1.6 billion in Qwest stock he sold.

Tyco This large conglomerate is chartered in Bermuda to avoid US corporate taxes, even though it is headquartered and run out of the US, as well as enjoying all the rights and access to government contracts that US corporations enjoy.	Former CEO Dennis Kozlowski and former Chief Financial Officer Mark Swartz looted company and shareholders of $600 million that went to themselves and others who helped them cover up improper secret loans that were forgiven without proper authorization. Tyco also seems to have taken losses on certain business transactions that it improperly booked as profit, which then justified bonuses for executives. The two men used the money to buy houses, art and luxury items for themselves, including a $1 million birthday party for Kozlowski's wife on the Italian island of Sardinia that included toga-clad waiters and an ice sculpture of Michelangelo's "David" with Vodka pouring from his genitals. Kozlowski also improperly bought valuable paintings by Renoir and Monet worth $13.2 million using funds borrowed from Tyco, only some of which has been repaid, and he evaded $1.1 million in New York State sales tax by falsifying documents related to the art purchases and sending empty boxes to the company's New Hampshire address.	Criminal indictments and SEC action have been announced against Kozlowski and Swartz. Both men are currently free on bail even though the Manhattan DA's office argued that the $10 million Kozlowski's wife put up for bail and the $5 in Tyco stock used by Swartz was tainted money they stole from Tyco. Even though a grand jury was investigating Swartz, he received a $45 million severance package from Tyco, which remains in effect even if he is convicted of a felony. Kozlowski's severance package is potentially worth $100 million. No action is planned on companies moving overseas to avoid taxes, but retaining full rights and government contracts.
WorldCom Telecommunications giant announced a series of restatements totaling about $7.7 billion so far, and it displaced Enron as the largest bankruptcy filing in US history. The stock price fell from a high of $64 to $0.09, reducing their total value from	Deputy Attorney General Thompson said CFO Scott Sullivan and Controller David Myers "systematically flouted rules of accounting and lied outright to investors to perpetuate the false image that WorldCom was succeeding." In response to overbuilding and excess capacity in telecommunications, business was deteriorating, and executives put pressure on numerous others to, in Myer's words, engage in accounting adjustments for which "there was no justification or documentation and were not in accordance with generally accepted accounting principles." WorldCom executives pressured whistleblowers to remain quiet and Myers warned employees who had questions not to discuss their concerns with outside auditors.	Charges of fraud have been filed against Sullivan and Myers, but none to date against former CEO Ebbers, and no move to freeze his assets, which include a 500,000 acre ranch and a yacht-building business. Sullivan faces up to 65 years if convicted on all counts of fraud, conspiracy and false statements; he is free on $10 million bond. Myers, stating he was ordered

$120 billion to about $400 million; 17,000 employees have been laid off. NY state pension plan lost $300 million because of WorldCom investments.	Co-founder and CEO Bernie Ebbers borrowed $400 million from the company just before it crashed and has yet to repay the loan, which he used to cover margin calls related to purchases of WorldCom stock. Ebbers was removed from his position when WorldCom declared bankruptcy, but he negotiated a severance package worth $1.5 million a year for life.	by superiors, pleaded guilty to three counts of wire fraud and related offenses, and faces a maximum of 20 years plus fines, which will likely be reduced for his cooperation. Accounting Director Buford Yates pleaded guilty to "assisting in a massive fraud"; he is free on $500,000 bail.

NOTE: A follow up article by the same authors is available. See Leighton and Reiman 2004, A Tale of Two Criminals: We're Tougher on Corporate Criminals, But They Still Don't Get What They Deserve. Available, http://paulsjusticepage.com > Rich Get Richer or directly at http://www.paulsjusticepage.com/RichGetRicher/fraud2004.htm

Some of the current scandals involving grossly overstated corporate earnings have their origin in reforms that were meant to correct the earlier anomaly of corporate executives drawing enormous salaries while their corporations were doing poorly. Making stock options a larger part of executive compensation, it was assumed, would give management strong motivation to run the company well, thus increasing stock prices and making their stock options more valuable. Instead, executives engaged in various questionable forms of manipulation to hide corporate losses or debts so that their shares would be artificially high (that is, higher than they would have been had the true state of the corporation's balance sheet been known to investors)—at least until they cashed in, leaving others holding large amounts of stock whose value crashed when the companies had to restate their earnings. As with the S & Ls, so the recent scenarios involve "collective endeavors in which top management ran their own institutions into the ground for personal gain"—an extraction of wealth at the expense of numerous others.[xvi]

Enron, for example, allegedly used insiders and a network of friends to create so-called "independent" firms that would enter into multi-year contracts to swap a service and give the appearance of transactions. Enron would then book the total "revenue" of the multi-year contract as income for that year while writing down the expense over many years of the contract; such firms could also be used to mask expenses or bad investments, thus reducing apparent debts and making the financial picture look rosier. Much of Enron's "revenue" came from loans (on which banks took healthy origination fees), which it then put into various partnerships (on which partners took fees) that then returned some of the money to Enron. Chief Financial Officer Andrew Fastow and former Director of Global Finance Michael Kopper, along with friends and partners, made more than $50 million in one series of "hot deals."[xvii] Rather than blowing the whistle on these transactions, some of their colleagues were heard to say, "Next time Fastow is going to run a racket, I want to be part of it."[xviii] Enron executives unloaded nearly a *billion dollars* worth of stock—while employees were locked out of selling the holdings in their pensions during much of the period in which the company's stock fell from $80 a share to $0.30. Enron investors collectively lost about $60 billion. [xix]

Other companies engaged in various "hollow swaps" that involve two companies agreeing to swap essentially the same good or service for the purpose of booking revenue and showing activity rather than filling a substantive business need. In one of many examples of these practices,

> Qwest was buying non-operating network circuits from Enron that it didn't need. Enron had agreed to buy telecommunications services from Qwest over a 25-year period at a time when its own telecom operations were collapsing. Andersen was the accountant for both companies. On the day the quarter closed, the companies finally made their deal, exchanging checks for $112 million as initial payment.[xx]

Such swaps help boost (apparent) earnings, although not all of them involve the degree of sophistication and amount of money characteristic of Enron. The SEC is investigating such practices at CMS Energy, Duke Energy, Dynergy, El Paso, Reliant Energy, Qwest Communications and telecommunications company Global Crossing. The CEO of Qwest unloaded $1.57 *billion* in stock over the years when its price was high, some at $47 a share, far more than the September 2002 trading price of about $1 a share. The CEO of Global Crossing sold $734 million in shares before the company was forced to revise downwardly its previously-inflated earning report, causing its price to fall. A host of other companies "restated" earnings that had been inflated through a variety of means, with WorldCom having misstated more than $7 billion in earnings, and Xerox having misstated $1.4 billion. The SEC charged Adelphia with fraudulently excluding $2.3 billion in debt from its earnings report. AES, AOL-Time Warner, Cedent, Haliburton, K-Mart, Lucent Technologies, MicroStrategy, Rite Aid, and Waste

Management are all said to have misstated revenues in different ways at more than $100 million in each case.

We also have been treated to a new wave of "insider trading," where people with access to significant nonpublic information use it to enrich themselves by making well-timed stock purchases or sales. Martha Stewart, for example, sold 4,000 shares of biotech company ImClone the day before the Food and Drug Administration rejected a cancer drug developed by the company. Stewart is under investigation for insider trading, obstruction of justice and possible false statements, while her friend, ImClone CEO Sam Waksal, has been arrested for tipping off family members about the impending FDA decision. Questions about insider trading also plague President Bush from his days as a director of Harkin Energy. Bush sold a substantial number of shares just days before the company released an especially poor earnings report and he apparently failed to file some required SEC reports afterwards. An investigation by the SEC during the presidency of the elder George Bush found no wrongdoing in the case of the younger Bush.

Large-scale financial trickery requires the cooperation of numerous people, including some who cover up the wrongdoing of others. The notable example here is accounting firm Arthur Andersen, which improperly shredded documents related to its dealings with Enron. Andersen is the first major accounting firm to be convicted of felony obstruction of justice. Arthur Andersen also raised investigators' eyebrows by serving as auditors for Enron while taking in millions of dollars from consulting deals with the company. This dual role of auditor and consultant created an obvious conflict of interest. Andersen auditors would surely be reluctant to bite the hand that was feeding them by letting the market know the real extent of Enron's losses and indebtedness. Andersen is, of course, quite experienced at this sort of thing, having audited such other corporate suspects as Global Crossing, Halliburton Oil, Qwest, Waste

Management and WorldCom, and before that, Charles Keating's Lincoln Savings and Loan, "which became a symbol of the nation's savings-and-loan crisis when it failed in 1989 at an eventual cost to taxpayers of $2.9 billion."[xxi]

Further, financial service firms like J.P Morgan Chase and Citigroup appear to have loaned money to corporations and helped them to hide their level of indebtedness from investors who lack an inside track. *Fortune* approvingly quoted a *Wall Street Journal* editorial that called the banks "Enron Enablers" and went further: "They appear to have behaved in a guileful way and helped their corporate clients undertake unsavory practices. And they appear to have had an entire division that, among other things, helped corporations avoid taxes and manipulate their balance sheets through something called structured finance, which is a huge profit center for each bank."[xxii] In addition, brokerage firms came under fire because their high-profile analysts enthusiastically endorsed stocks publicly that they were disparaging privately (in emails), all because their firms derived underwriting fees or other business from the troubled companies.[xxiii] Salomon Smith Barney telecoms analyst Jack Grubman admitted that "The bank supported 'pigs' [i.e., stocks in poorly performing firms] in supposedly objective research notes to ensure that [those firms] granted Salomon investment banking business." And Merrill Lynch internet analyst Henry Blodgett described some stocks as a "piece of shit" while recommending them to small investors.[xxiv]

When called before Congress, Enron executives took the Fifth, so committee members filled in the quiet time with speeches full of moral condemnation. As more and more companies were forced to revise previously inaccurate earning statements, the stock market fell dramatically and President Bush addressed the nation in an unsuccessful effort to slow the decline. Bush, our first President with an MBA, noted that widespread stock ownership creates a moral responsibility for the executives to run an honest company. He indicated that the problem was one of a few bad apples and called for a new ethic of corporate responsibility: “In the long run,” said the President, “there's no capitalism without conscience; there is no wealth without character.”[xxv] In laying out a reform agenda, Bush declared that executives should forfeit compensation gained by deception.

Response and Legislation

The President announced a new corporate fraud task force, although critics quickly pointed out the official responsible for this “financial SWAT team” was a director of a credit card company that had been forced to pay more than $400 million to settle consumer and securities fraud suits. Bush announced $100 million for the SEC, although Laura Unger, a Republican who has served as acting chairman of the SEC, commented that "$100 million is not even close to enough to really make a significant difference" in regulatory effectiveness.[xxvi] No provision was made to replace 500 FBI agents who had been transferred from white-collar crime enforcement to counter-terrorism efforts. Leon E. Panetta, a co-chairman of a New York Stock Exchange panel on corporate reforms was disappointed that Bush, as a former businessman, did not challenge his peers more earnestly “on a whole range of other issues that determine whether we really change the culture of American business . . . . It's not just the fraud we have to deal with—it's the whole get-rich-quick, boost-the-stock-price environment that invited it and encouraged it that we need to address."[xxvii]

Panetta’s comments also apply to the Sarbanes-Oxley Act, which included many of Bush’s suggestions and additional provisions. The act was signed into law on July 30, 2002. It created a new board to oversee the accounting and auditing of publicly traded companies, limited the ability of accounting firms to be both auditors and consultants of the same firms, gave shareholders five rather than three years to sue companies that misled them, and increased possible fines and jail sentences for those who violate new and existing corporate laws. (A full list of the bill's most important provisions and limitations is available through the web-based version of this paper.) Much of the law is a step in the right direction. However, political compromises in Congress led to changing the standard for holding executives liable for fraud from "reckless" (in allowing it to happen) to "knowing" (that it was happening)—the new standard requires stronger evidence and makes the case more difficult for prosecutors. Another issue involves "disgorgement," the technical term for the amount and conditions under which executives must repay money taken in fraud. Congress voted *not* to apply this to company officers and directors who knew about misconduct but were not directly involved in it.[xxviii]

As soon as the ink was dry on the legislation, the *Washington Post* reported that, "Members of Congress from both parties accused the administration of undermining or narrowing the scope of provisions covering securities fraud, whistle-blower protection and punishment for shredding documents." Critics, including the bill's authors, charged that the Justice Department drew up interpretations and prosecution guidelines that contradicted the legislative intent of the reform measure. Sen. Charles E. Grassley (R-Iowa) blasted the administration on whistleblower protection, saying "Any dummy that reads the bill knows what we meant. We couldn't have written it any clearer." And Senator Patrick Leahy, (D-Vermont), Chair of the Senate Judiciary Committee, commented: "The president said all the right things at the signing ceremony. But now given the tough law, they're basically saying, 'We're not going to use it.' "[xxix]

Further, the legislation did not address the longstanding call for a publication similar to the FBI's Uniform Crime Reports that would cover white-collar crime. (*The Rich Get Richer* is forced to base its estimates of the costs of white-collar crime on a 1974 US Chamber of Commerce report, with updates culled from a large number of disparate publications and figures adjusted annually for inflation; see Table 3-1). Indeed, as early as

> the 1940s Edwin Sutherland explained that members of the lower class were over-represented in official crime statistics because those statistics did not include economic crimes committed by high-status individuals in the course of doing business. Some fifty years later we still lack systematic information on the nature of white-collar crime, as well as official reporting and tracking procedures designed to capture its incidence or the government's response.[xxx]

Without such information, attention to the recent incidents will fade—as it did with the S & Ls—and "crime" will once again refer to the minority youth who figure in so many television crime shows. Based on these images, coupled with the FBI Uniform Crime Report's focus on the crimes of the poor as well as the lack of a credible data source on white collar crime, Americans will return to the belief that the greatest threat to them is from those lower on the economic ladder (see Chapter 4 of *The Rich Get Richer*, "To the Vanquished Belong the Spoils: Who Is Winning the Losing War Against Crime").

Conclusion

It's too early to determine whether 2002's crop of corporate wrongdoing is going to lead to stricter laws and more consistent and energetic enforcement of them. However, the early signs do not give reason for optimism. Furthermore, an adequate response to the recent corporate scandals should not stop with punishing the wrongdoing. A hard look at CEO pay, bonuses, perks and "Golden Parachute" severance packages will raise issues about the persistence and growth of economic inequality in the U.S. For example, papers filed by Tyco with the SEC detail that CEO Kozlowski used the money from Tyco to buy: a $15,000 umbrella stand shaped like a poodle; a $6,000 shower curtain, a $2,200 trash basket, and $2,900 worth of coat hangers. Part of the problem is that he improperly used Tyco money to buy such items;

the other problem is that many executives see such luxuries as part of their entitlement, even while September 2002 newspaper headlines announced: "U.S. Poverty Rate Rises, Income Drops."[xxxi] The increase in the poverty rate means that 11.7% of American families now live below the poverty line, which is set at about $18,000 for a family of four—or about what Kozlowski would spend on a poodle-shaped umbrella stand and some coat hangers.

Additional Reading

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Barak, Gregg, Jeanne Flavin, and Paul Leighton, *Class, Race, Gender and Crime* (Los Angeles: Roxbury, 2001).

Calavita, Kitty, Henry Pontell and Robert Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (Berkeley: University of California Press, 1997).

Cassidy, John, *dot.con: the greatest story ever told* (New York: HarperCollins, 2002).

Korten, David, *When Corporations Rule the World* (West Hartford: Kumarian Press and Berrett-Koehler Publishers, 1995).

Simpson, Sally, *Corporate Crime, Law and Social Control* (Cambridge: Cambridge University Press, 2002).

NOTES

[i] Quoted in Clifton Leaf, "White-Collar Criminals: They Lie, They Cheat, They Steal, and They Have Been Getting Away With It for Too Long," *Fortune* (March 18, 2002), p. 62.

[ii] Mark Gimein, "You Bought. They Sold," *Fortune* (September 2, 2002), pp. 64-65.

[iii] Peter Behr, "Chairman Told Workers Stock Was 'Bargain,'" *Washington Post* (January 19, 2002), pp. A1, A6; Daniel Altman, "Enron Had More Than One Way to Disguise Rapid Rise in Debt: Billions Were Listed as Trades Instead of Loans," *New York Times* (February 17, 2002), pp. 1, 26; Peter Behr, "Skilling to Face Senators, Accusers," *Washington Post* (February 26, 2002), pp. A1, A10; and Gimein, "You Bought. They Sold," p. 68.

[iv] Dana Milbank, "A Roaring Bull Market in Political Trading," *Washington Post* (July 10, 2002), p A8

[v] Leaf, "White Collar Criminals," p. 64.

[vi] Leaf, "White-Collar Criminals," p. 62.

[vii] Calavita, Kitty, Henry Pontell, and Robert Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (Berkeley, CA: University of California, 1997), p. 131.

[viii] Amitai Etzioni, "Going Soft on Corporate Crime," *Washington Post* (April 1, 1990), p. C3.

[ix] Michael Isikoff, "Justice Dept. Shifts on Corporate Sentencing," *Washington Post* (April 28. 1990), p. A1.

[x] Leaf, "White-Collar Criminals," p. 63.

[xi] Gary Weiss, "Congress Will Huff and Puff and . . . Do Little," *BusinessWeek* (February 25, 2002), p. 116.

[xii] Jonathan Weisman, "Efforts to Restrict Retirement Funds Lose Steam: Indignation Wanes as Congress Considers Limits on Company Stock Holdings," *Washington Post* (September 7, 2002), p. A1.

[xiii] L. William Seidman, former chair of the Resolution Trust Company, which managed S & L banks' assets during the bailout, commented: "We provided them with such perverse incentives that if I were asked how to defend the S & L gang in court, I'd use the defense of entrapment" (Calavita et al., *Big Money Crime*, p. 15).

[xiv] Weiss, "Congress Will Huff and Puff and . . . Do Little," p. 116.

[xv] Lynn Turner, "Just a Few Rotten Apples? Better Audit Those Books," *Washington Post* (July 14, 2002), p. B1. Enron is a good example, according to the *Washington Post* series, which quoted one executive as saying: "The culture at Enron is all about 'me first, I want to get paid.' I used to tell people if they don't know why people are acting a certain way, go look up their compensation deal and then you'll know. There were always people wanting to do deals that didn't make sense in order to get a bonus." Peter Behr and April Witt, Visionary's Dream Led to Risky Business, *Washington Post* July 28, 2002; Page A01

[*] The title comes from a phrase used by Simon Shama, in "The Dead and the Guilty," *The Guardian* (Sept 11, 2002), http://www.guardian.co.uk/september11/oneyearon/story/0,12361,789978,00.html. In the article, he notes that "Enron Corporation['s] implosion began the unraveling of scoundrel capitalism." Other sources include: Devin Leonard, "The Adelphia Story" *Fortune*, (August 12, 2002), http://www.fortune.com/indexw.jhtml?channel=artcol.jhtml&doc_id=208825; *CNNMoney*, "Rigas and Sons Arrested," (July 25, 2002) http://money.cnn.com/2002/07/24/news/rigas/; George Mannes, "Adelphia

Charges Up the Ante," "TheStreet.com," (July 24, 2002), http://www.thestreet.com/_yahoo/tech/georgemannes/10033900.html; Carrie Johnson and Christopher Stern, "Adelphia Founder, Sons Charged," *Washington Post* (July 25, 2002), p. A1; "Swartz Got Rich Severance Deal," *Boston Globe*, September 26, 2002, http://www.boston.com/dailyglobe2/269/business/Swartz_got_rich_severance_deal+.shtml; Peter Behr and Dan Eggen, "Enron Is Target of Criminal Probe," *Washington Post* (January 10, 2002), p. A1; Peter Behr and April Witt, "Visionary's Dream Led to Risky Business," *Washington Post* (July 28, 2002), p A1; Jonathan Krim, "Fast and Loose At WorldCom: Lack of Controls, Pressure to Grow Set Stage for Financial Deceptions," *Washington Post* (August 29, 2002), p A1; Jonathan Krim, "WorldCom Staff Told Not to Talk to Auditor, E-Mails Show," *Washington Post* (August 27, 2002), p E3; David M. Ewalt and John Kreiser, "Sidgmore Steps Down As WorldCom CEO; Ebbers May Lose Golden Parachute," *InformationWeek.com* (September 10, 2002), http://www.informationweek.com/story/IWK20020910S0007; Motley Fool, "The Motley Fool Take on Wednesday, Feb. 27, 2002," http://www.fool.com/news/take/2002/take020227.htm; Motley Fool, "The Motley Fool Take on Wednesday, June 5, 2002," http://www.fool.com/news/take/2002/take020605.htm; Robert O'Harrow, "Tyco Executives Free on Bond of $15 Million," *Washington Post* (September 28, 2002), p E1; Carrie Johnson and Ben White, "WorldCom Arrests Made," *Washington Post* (August 2, 2002), p A1; Ben White, "WorldCom Officer Pleads Guilty to Fraud," *Washington Post* (October 8, 2002), p E1; Citizen Works, "Corporate Crookbook: Corporate Scandal Sheet," http://citizenworks.org/enron/corp-scandal.php. Gimein, "You Bought. They Sold."

[xvi] Calavita, et al., *Big Money Crime,* p. 171; see also Gimein, "You Bought. They Sold," *passim.*

[xvii] Carrie Johnson, "Ex-Enron Executive Pleads Guilty," *Washington Post* (August 21, 2002), available http://www.washingtonpost.com/wp-dyn/articles/A44232-2002Aug21.html

[xviii] Peter Behr and April Witt, "Visionary's Dreams Led to Risky Business," *Washington Post* (July 28, 2002), p. A1.

[xix] Allan Sloan, "Free Lessons on Corporate Hubris, Courtesy of Enron." *Washington Post* (December 4, 2001), p. E3; see also Gimein, "You Bought. They Sold," *passim.*

[xx] Peter Behr and April Witt, Concerns Grow Amid Conflicts" *Washington Post* (July 30, 2002), p. A1.

[xxi] David Hilzenrath, "Two Failures With a Familiar Ring: Arthur Andersen Audited Foundation, S&L That Collapsed" *Washington Post* (December 6, 2001), p. A21.

[xxii] Julie Creswell, "Banks on the Hot Seat," *Fortune* (September 2, 2002), p. 80.

[xxiii] In one recent case, the National Association of Securities Dealers fined the Salomon Smith Barney Unit of Citigroup $5 million for "materially misleading research reports" on Winstar Communications. Analysts kept a $50 target price and a "buy" rating on the company until the price of a share hit $0.14. An article for TheStreet.com notes Salomon made $24 million in fees from Winstar, and Citigroup CEO Sandy Weill made $70 million a year for the last three years, plus has holdings in Citigroup worth about $960 million. "Meanwhile, the NASD trumpets that this settlement is the third largest in NASD's history. Well, if we were the NASD and we wanted to strike fear in the hearts of brokerage firms, we would keep that little statistic a secret." George Mannes, "The Five Dumbest Things on Wall Street This Week" (9/27/2002), http://www.thestreet.com/markets/dumbest/10044586.html.

[xxiv] David Teather, "The Whores or Wall Street," *Guardian* (October 2, 2002), available at http://www.guardian.co.uk/usa/story/0,12271,802926,00.html.

[xxv] The text of the speech is available through the White House Corporate Responsibility portal, http://www.whitehouse.gov/infocus/corporateresponsibility/.

[xxvi] Anitha Reddy, "$100 Million More for SEC Not Enough, Ex-Officials Say," *Washington Post* (July 10, 2002), p. E1.

[xxvii] Stephen Pearlstein, "Measures Not Likely to End Abuses," *Washington Post* (July 10, 2002), p. A1.

[xxviii] The particulars of the legislations and some of its limitations is from Citizen Works, http://citizenworks.org/enron/accountinglaw.php.

[xxix] Jonathan Weisman, "Some See Cracks In Reform Law," *Washington Post* (August 7, 2002), p E1.

[xxx] Calavita et al., *Big Money Crime*, p. 3.

[xxxi] Steven Pearlstein, *Washington Post* (September 25, 2002), p. A3.