

Enron's Legacy

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INTRODUCTION

Corporation, *n.* An ingenious device for obtaining individual profit without individual responsibility.¹

October 16, 2003, marked the second anniversary of the Enron scandal. The energy giant's implosion was the first in a series of massive corporate financial frauds that caused billions of dollars in stockholder losses and cost tens of thousands of jobs.² The frauds also resulted in record corporate bankruptcies,³ huge earnings restatements,⁴ and lost confidence in the integrity of the nation's financial markets.⁵

Apart from these very tangible harms, the fraud scandals also contributed to fundamental changes in public attitudes about corporations and their executives. In a 2003 survey on the outlook of jurors, sixty-three percent of the respondents said that over the past year their opinion of large corporations had changed for the worse.⁶ Seventy-eight percent believed that it was not uncommon for companies to destroy documents to cover up wrongdoing,

1. Ambrose Bierce, *The Devil's Dictionary* 29 (1999).

2. John A. Byrne, Fall from Grace, *Bus. Wk.*, Aug. 12, 2002, at 51.

3. When Enron filed for bankruptcy in December of 2001, it was the largest corporate bankruptcy on record. The record was eclipsed when WorldCom filed for bankruptcy the following year. Jon Van, *WorldCom Files for Bankruptcy: Company Vows to Survive America's Biggest Insolvency*, *Chi. Trib.*, July 22, 2002, News Sec. at 1.

4. WorldCom, for example, restated its profits by \$74.4 billion for the years 2000 and 2001. *WorldCom Restates Profits by \$74.4 Billion for 2 Years*, *N.Y. Times*, Mar. 13, 2004, at B14.

5. Richard W. Stevenson, *Corporate Conduct: News Analysis; Old Business in New Light*, *N.Y. Times*, July 9, 2002, at A1.

6. Ed Aro, Dan Shea, & Amy Nafziger, *How Juries and Judges Are Reexamining Duties of Directors, Officers in Wake of Corporate Scandals*, *U.S.L.W. (BNA)* 2459 (Feb. 10, 2004) [hereinafter *How Juries and Judges Are Reexamining*]. In the 2002 survey, seventy-five percent thought that corporate executives "often try to cover up the harm they do." *Id.*

In a different 2003 corporate reputation survey by another group, about seventy-five percent of the respondents ranked the reputations of large corporations as "not good" or "terrible." Ronald Alsop, *Corporate Scandals Hit Home: Reputations of Big Companies Tumble in a Consumer Survey; 'Money Can Rob the Goodness,' Wall St. J.*, Feb. 19, 2004, at B1.

and more than half said that in a lawsuit in which a large corporation was a defendant, the witnesses most likely to lie or withhold the truth on the stand were senior corporate executives.⁷ In a similar vein, a potential juror in the retrial of Wall Street analyst Frank Quattrone was excused after saying she was “predisposed to assume” that corporate executives who are accused of committing crimes are guilty.⁸

It seems we have entered the age of cynicism, and it's no small wonder that we have. The accounting and financial fraud scandals of the last few years reflect systemic failures of corporate governance mechanisms. That being true, it is not surprising that Congress called for major structural reforms to restore corporate integrity as well as public trust. Nor is it surprising that regulators and prosecutors substantially reordered enforcement priorities as they devised new strategies to address pervasive corporate fraud.

Many of the governance reforms are now in place, and the post-Enron enforcement record is impressive—both in the level of enforcement activity and in demonstrable rates of success. Yet some observers are skeptical about the pace and focus of recent criminal enforcement efforts. Have prosecutors moved quickly enough to bring cases directed at core, complex financial fraud? Or does their success rate reflect a preference for bringing peripheral charges that are far easier to prove? Why was Martha Stewart on trial when poster CEOs Ebbers, Skilling, and Lay had yet to be charged? Simply put, have federal prosecutors set their sights too low?

This article provides a context for examining these and related concerns. Part I sets the stage by reviewing eight corporate fraud scandals that rocked the financial community in the past few years. These scandals alone involved frauds that, in the aggregate, exceeded \$14 billion and produced the two largest bankruptcy filings in United States history.

7. How Juries and Judges Are Reexamining, *supra* note 6.

8. Kara Scannell & Randall Smith, Quattrone Judge Bars Divulging Juror Names, *Wall St. J.*, Apr. 14, 2004, at C1.

Part II considers important structural reforms designed to fill regulatory and enforcement gaps that allowed Enron and its progeny to slip through the cracks. They include the Sarbanes-Oxley Act of 2002, the Enron Task Force, the Corporate Fraud Task Force, amendments to the federal sentencing guidelines, new and revised Justice Department and SEC enforcement criteria, and adequate funding for the SEC. Collectively, these reforms provide greater transparency and accountability in corporate governance matters, improve coordination and cooperation among prosecutors and other members of the enforcement community, increase the severity of penalties for high-end fraud, and restore the SEC to sound financial footing.

Part III turns to the post-Enron enforcement environment and examines how the Justice Department and the SEC have responded to the corporate fraud crisis. Its analysis of major criminal prosecutions brought in response to the scandals, the role that “real-time” enforcement plays in criminal fraud prosecutions, and how and where SEC civil enforcement fits into the grand scheme of things, reveals that prosecutors and the SEC have achieved significant criminal and civil enforcement success in a relatively brief period of time.

Part IV provides a critique of the criminal enforcement record and challenges several assumptions that underlie criticisms of the current fraud investigations. It begins by posing a series of questions about the pace and focus of the investigations. Then, drawing on the enforcement analysis provided in part III, part IV exposes serious flaws in critics’ assumptions about prosecutorial priorities. By exploring how the government builds major corporate fraud cases, why it commonly uses the approach that it does, and the impact its strategy has on the timing and sequence of prosecutions, part IV shows that common complaints about the pace and direction of corporate fraud prosecutions are largely ill-informed.

Part IV shows that, contrary to conventional wisdom, the vast majority of post-Enron corporate fraud prosecutions neither focus on peripheral issues nor settle

for charging mid-level executive scapegoats. Virtually all of the major fraud prosecutions brought in the last two years directly address core, underlying issues of fraud, and the government has pursued a demonstrably effective strategy for imposing responsibility squarely where it belongs—at the top of the corporate ladder.

I. THE CORPORATE FRAUD SCANDALS

In the wake of Enron's implosion, federal regulators opened dozens of corporate fraud investigations and initiated countless civil enforcement actions and criminal prosecutions. The following brief synopses of eight major financial accounting scandals—Enron, WorldCom, Adelphia, Rite Aid, Symbol Technologies, Qwest, Dynegy, and HealthSouth—provide a context for considering the legal aftermath of this era of massive corporate fraud.

- **Enron:** In October of 2001, the Houston-based energy titan announced a \$618 million third quarter loss and a reduction of \$1.2 billion in shareholder equity. Through the use of special purpose entities, Enron inflated its reported earnings by shifting debt off the books and hiding corporate losses. Two months after disclosing that its financial statements were riddled with errors, Enron filed for Chapter 11 bankruptcy protection.⁹ In the aftermath of the scandal, 6,500 Enron employees lost their jobs and pensions while Enron executives awarded themselves more than \$55 million in cash bonuses the day before the bankruptcy filing.¹⁰
- **WorldCom:** In February of 2002, WorldCom—one of the nation's largest providers of telecommunications services—cut earnings projections and announced a

9. In re Enron Corp., No. 01-16034 (AJG), Voluntary Petition (Bankr. S.D.N.Y. Dec. 2, 2001) (on file with the author).

10. Robert Bryce, *Pipe Dreams: Greed, Ego, and the Death of Enron* 339-40 (2002).

multi-billion dollar second-quarter charge to write down some of its acquired operations.¹¹ In June, the company unmasked a colossal corporate fraud, showing \$3.8 billion in ordinary expenses that were improperly booked as capital expenditures.¹² At the time the fraud was recognized, it was regarded as the largest corporate fraud in American history. In July, the company sought Chapter 11 protection in the largest bankruptcy filing in U.S. history.¹³

- **Adelphia Communications:** In March of 2002, Adelphia—the nation’s sixth largest provider of cable services—disclosed that corporate assets had been used as collateral for \$2.3 billion in secret loans to company executives.¹⁴ Because the loans were not properly accounted for, Adelphia’s financial statements greatly inflated earnings and hid billions of dollars of debt.¹⁵ Prosecutors accused the executives of looting the company by treating it as their “private piggy bank.”¹⁶ Adelphia filed for Chapter 11 bankruptcy protection in June of 2002.¹⁷
- **Rite Aid:** In July of 2000, accounting irregularities forced the national drug store chain to announce that it was increasing its losses for the late 1990s by \$1.6 billion.¹⁸ At the time of the announcement, the

11. Floyd Norris, *MCI Chief Says He Repaid Debt, Borrowing from His Company*, N.Y. Times, Feb. 8, 2002, at C2.

12. By November 2002, the company acknowledged that its false profits could top \$9 billion.

13. *In re WorldCom, Inc.*, No. 02-13533 (AJG), Third and Final Report of Dick Thornburgh, Bankruptcy Court Examiner, at 1 (Bankr. S.D.N.Y. Jan. 26, 2004) (on file with the author).

14. Jared Sandberg & Joann Lublin, *Questioning the Books: Adelphia Draws Market Criticism Over Debt, Loans*, Wall St. J., Mar. 29, 2002, at A4.

15. *Id.*

16. *Prosecutors Says Rigases Stole from Adelphia*, Wall St. J., Mar. 2, 2004, at C4.

17. Sally Beatty, *Adelphia Details Creditors in Filing for Bankruptcy*, Wall St. J., June 22, 2002, at B8.

18. *Rite Aid’s Former President Pleads Guilty*, Wall St. J., July 11, 2002, at B4.

restatement was by far the largest ever recorded by a U.S. company.¹⁹

- **Symbol Technologies:** In April of 2001, the SEC received an anonymous letter reporting fraudulent revenue transactions at Symbol Technologies, a leading manufacturer of bar-code scanners. The writer claimed the transactions were “just the tip of the iceberg.”²⁰ Subsequent investigations revealed widespread accounting manipulation that had vastly inflated the company’s revenues. Investigators also found that Symbol had falsely claimed it had met or exceeded analysts’ expectations for thirty-two consecutive quarters. Symbol ultimately restated its sales and profits, reducing its revenues by \$234 million and its net income by \$325 million.²¹
- **Qwest Communications:** After a month of denying that it was under investigation, Qwest—the dominant provider of local telephone service in fourteen Western states—announced in July of 2002 that it had incorrectly accounted for over \$1.1 billion in transactions between 1999 and 2001.²² In February of 2003, Qwest disclosed that \$2.2 billion of revenue had been improperly accounted for between 2000 and 2002, and cautioned that the

19. Rite Aid Case Gives First View of Wave of Fraud on Trial, Wall St. J., June 10, 2003, at A1.

20. Press Release, United States Attorney’s Office for the Eastern District of New York, Former Senior Executives at Symbol Technologies Indicted in Massive Corporate Fraud Scheme—Corporation Has Purged Executives Responsible for the Fraud, Implemented Significant Corporate Reforms, Agreed to Cooperate with the Government’s Investigation and Pay \$139 Million (June 3, 2004) (on file with the author).

21. Steve Lohr, Day 2: I Learn the Books Are Cooked: William Nuti Knew Symbol Had Trouble, but Not How Much, N.Y. Times, June 21, 2004, at C1.

22. Simon Romero, Qwest Says It Incorrectly Accounted for \$1.1 Billion, N.Y. Times, July 29, 2002, at A11.

amount could be even higher after its new auditor reviewed its books.²³

- **Dynergy:** Executives at the Houston-based energy trading company engineered a complex “round trip” trading scheme.²⁴ Although the round trip transactions created the appearance of active trading, in reality they were merely shams.²⁵ The company restated its earnings in January of 2003, recognizing \$341 million of loss in the final quarter of 2002.²⁶
- **HealthSouth:** In March of 2003, executives at the nation’s largest operator of rehabilitation hospitals and surgery centers disclosed a massive accounting fraud that misled lenders and inflated earnings and assets by as much as \$2.5 billion to meet Wall Street analysts’ forecasts.²⁷ By January of 2004, the estimated loss had risen to between \$3.8 and \$4.6 billion.²⁸ HealthSouth narrowly avoided bankruptcy.²⁹

II. STRUCTURAL REFORMS

The recent spate of financial and accounting scandals prompted a broad array of legislative and regulatory responses. The most significant initiatives include creation of the Corporate Fraud Task Force and the Enron Task Force within the Justice Department, enactment of the Sarbanes-

23. Barnaby J. Feder, U.S. Takes Dual Actions in Qwest Case, *N.Y. Times*, Feb. 26, 2003, at C1.

24. Rebecca Smith, Fraud Charged Against Former Dynergy Employees, *Wall St. J.*, June 13, 2003, at B2.

25. Simon Romero, Former Employees of Dynergy Face Charges of Fraud, *N.Y. Times*, June 13, 2003, at C1.

26. Dynergy Restates Some Earnings, *N.Y. Times*, Feb. 1, 2003, at B2.

27. Fifth Chief Financial Officer at HealthSouth to Admit Fraud, *N.Y. Times*, Apr. 25, 2003, at C13.

28. HealthSouth Audit Finds as Much as \$4.6 Billion in Fraud, *N.Y. Times*, Jan. 21, 2004, at C2.

29. Reed Abelson, HealthSouth’s Bondholders Await Ruling, *N.Y. Times*, Mar. 31, 2004, at C1.

Oxley Act, amendments to the United States Sentencing Guidelines, revisions to the Justice Department's Corporate Prosecution Guidance, publication of SEC enforcement criteria, and significant increases in SEC funding.

A. The Corporate Fraud Task Force

The Corporate Fraud Task Force (CFTF) was one of the earliest initiatives undertaken in response to the corporate fraud crisis. Created by Executive Order in July of 2002, its charge includes coordinating and directing the investigation and prosecution of major financial crimes, recommending how resources can best be allocated to combat major fraud, facilitating interagency cooperation in the investigation and prosecution of financial crimes, and recommending regulatory and legislative reforms relating to financial fraud.³⁰ The Task Force is chaired by the Deputy Attorney General and includes the Director of the FBI, two Assistant Attorneys General,³¹ and seven United States Attorneys.³² In addition to the Justice Department group, an interagency group of officials from other executive departments³³ works with Justice Department

30. Exec. Order. No. 13271, 67 FR 46091 (July 11, 2002).

31. They are the Assistant Attorney General Criminal Division and the Assistant Attorney General Tax Division. *Id.*

32. They are the United States Attorneys for the Central and Northern Districts of California, the Northern District of Illinois, the Eastern and Southern Districts of New York, the Eastern District of Pennsylvania, and the Southern District of Texas. The Executive Order authorizes the Deputy Attorney General to designate other Department of Justice officials as members of the Task Force as well.

33. The Executive Order creating the Task Force designates the Secretary of the Treasury and the Chairmen of the SEC, the Commodities Futures Trading Commission, the Federal Energy Regulatory Commission, and the FCC as members of the interagency group, in addition to other executive officials the Deputy Attorney General deems appropriate. As of the date of this writing, the interagency group also includes the Secretary of Labor, the Chief Inspector of the Postal Inspection Service, and the Director of the Office of Federal Housing Enterprise Oversight. Office of the Deputy Attorney General, Members of the President's Corporate Fraud Task Force, available at <http://www.usdoj.gov/dag/cftf/membership.htm>.

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members to promote interagency cooperation and joint enforcement efforts throughout the federal government.³⁴

In its first year of operation, the Corporate Fraud Task Force was involved in more than three hundred criminal fraud investigations.³⁵ As it neared the end of that year, criminal fraud charges were pending against more than 350 defendants, and 250 individuals had either been convicted of or pled guilty to committing fraud. The Task Force was also involved in parallel civil enforcement actions brought by the SEC, the Federal Energy Regulatory Commission, the Commodities Futures Trading Commission, and the Department of Labor.³⁶

B. The Enron Task Force

In an even earlier response to the financial and accounting fraud scandals, the Justice Department established the Enron Task Force in January of 2002, to investigate and prosecute criminal matters related to Enron's collapse.³⁷ Members of the Enron Task Force include experienced prosecutors and FBI and IRS agents with expertise in white collar crime cases. In addition to coordinating Enron-related investigations and prosecutions in the Southern District of Texas and the Northern District of California, the Enron Task Force assists the SEC, the National Association of Securities Dealers, and other regulatory agencies in civil investigations of Enron matters.³⁸

34. Corporate Fraud Task Force, First Year Report to the President 1.2-1.3 (July 22, 2003) [hereinafter First Year Report].

35. *Id.* at iii.

36. *Id.* at 2.2-2.3.

37. *Id.* at 2.3. Task Force lawyers filled a void created when the Justice Department ruled that the entire Houston United States Attorneys Office was conflicted out of the Enron cases because many of the prosecutors had friends or relatives who had worked for Enron.

38. *Id.* at 2.3.

C. The Sarbanes-Oxley Act

In July of 2002, Congress enacted the Sarbanes-Oxley Act,³⁹ a sweeping corporate governance reform bill that gave regulators broad powers to impose new accountability rules on corporate executives,⁴⁰ to ensure accuracy in financial reports issued by publicly held corporations,⁴¹ to strengthen rules regarding auditor independence,⁴² and to improve public accounting oversight mechanisms.⁴³ Sarbanes-Oxley also provided prosecutors new statutory tools to use in financial fraud cases. The Act adds the first securities fraud crime to be codified in the federal criminal code,⁴⁴ criminalizes premature destruction of corporate audit records,⁴⁵ requires chief executive officers and chief financial officers to certify their company's financial statements,⁴⁶ imposes severe punishment for false certification of financial statements,⁴⁷ punishes retaliatory firing of whistleblowers who report criminal wrongdoing to federal authorities,⁴⁸ adds a new prohibition against document destruction to the panoply of obstruction of justice crimes,⁴⁹ and significantly increases criminal penalties for fraud and conspiracy to defraud.⁵⁰

39. The Sarbanes-Oxley Act of 2002, Pub. L. 107-204 (July 30, 2002).

40. See, e.g., 15 U.S.C.A. §§ 7243-7244 (West Supp. 2003).

41. See, e.g., 15 U.S.C.A. § 7241 (West Supp. 2003).

42. See, e.g., 15 U.S.C.A. § 78j-1(I)-(m), § 7231 (West Supp. 2003).

43. See 15 U.S.C.A. § 7211 (West Supp. 2003).

44. 18 U.S.C.A. § 1348 (West Supp. 2003). Section 1348, which is modeled on the mail fraud statute, is the only provision in the federal criminal code that specifically punishes securities fraud. Other provisions proscribing securities fraud are found in title 15 of the United States Code. See, e.g., 15 U.S.C.A. § 78ff (West 1997 & Supp. 2003).

45. 18 U.S.C.A. § 1519 (West Supp. 2003). Section 1519 requires accountants who audit public companies to retain audit workpapers for a period of five years.

46. 18 U.S.C.A. § 1350(a), (b) (West Supp. 2003).

47. 18 U.S.C.A. § 1350(c) (West Supp. 2003). The maximum punishment for willfully certifying a false financial statement is twenty years imprisonment and/or a \$5 million fine.

48. 18 U.S.C.A. § 1513(e) (West 2000 & Supp. 2003).

49. 18 U.S.C.A. § 1512(c) (West 2000 & Supp. 2003).

50. See, e.g., 15 U.S.C.A. § 78ff(a) (West 1997 & Supp. 2003) (increasing the maximum penalty for securities fraud to twenty years in prison and/or a maximum fine of \$25 million); 18 U.S.C.A. § 1341 (West 2000 & Supp. 2003)

D. Revised Sentencing Guidelines

Sarbanes-Oxley directed the United States Sentencing Commission to review existing sentencing guidelines applicable to high-end fraud, obstruction of justice, and other white collar crimes, with the expectation that the Commission would require longer sentences than in the past.⁵¹ Although critics predicted that Sarbanes-Oxley's enhanced penalties were unlikely to increase the length of sentences actually imposed,⁵² the revised guidelines require substantially longer prison time in several categories of cases. The guidelines amendments increase the minimum sentence for large-scale frauds by about 25 percent⁵³ and triple the sentence for Enron-like frauds that endanger the solvency or financial security of a substantial number of victims or a publicly traded company.⁵⁴ The amendments also increase sentences imposed on corporate officers and directors who are convicted of securities fraud by about 50 percent solely because they are corporate executives,⁵⁵ and

(increasing the maximum penalty for mail fraud to twenty years in prison and to thirty years if the fraud affects a financial institution). For a comparison of current and former penalties for fraud and conspiracy, see Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 *Wash. U. L.Q.* 357, 378 (table 1), 379 (table 2) (2003) [hereinafter Brickey, *From Enron to WorldCom*].

51. Congress gave the Commission emergency authority to promulgate temporary guideline amendments and imposed a six-month deadline for the Commission to act. The temporary amendments were in effect from January 25, 2003 until November 1, 2003, when permanent amendments became effective. See U.S. Sentencing Commission, *Amendments to the Sentencing Guidelines, Part B: Submitted to Congress May 1, 2003*.

52. See, e.g., Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 *St. John's L. Rev.* 671, 685 (2002); Mary Kreiner Ramirez, *Just in Crime: Guiding Economic Crime Reform After the Sarbanes-Oxley Act of 2002*, 34 *Loy. U. Chi. L.J.* 359, 387 (2003).

53. U.S. Sentencing Guidelines Manual § 2B1.1(b)(2) (2003 ed.). This increase applies to frauds that affect 250 or more victims.

54. *Id.* § 2B1.1(b)(12)(B).

55. *Id.* § 2B1.1(b)(14). This enhancement applies only to officers and directors of publicly traded companies.

increase by more than five years the minimum sentence for crimes that cause economic loss of more than \$400 million.⁵⁶

Sarbanes-Oxley also directed the Commission to review the organizational sentencing guidelines to ensure that authorized sentences are adequate to deter and punish institutional wrongdoing.⁵⁷ After conducting a two-year review, the Commission adopted the first amendments to the organizational sentencing guidelines since they became law in 1991.⁵⁸ Reflecting norms embedded in Sarbanes-Oxley, the amendments are designed to foster a culture of compliance.

The organizational guidelines require the sentencing court to consider a series of aggravating and mitigating factors in determining the appropriate sentence. If the corporation has an effective compliance program to prevent and detect criminal conduct, that will mitigate the sentence imposed. The Sarbanes-Oxley amendments retain this basic approach but adopt more rigorous criteria for evaluating what constitutes an effective compliance program.

First, in addition to requiring the exercise of due diligence to prevent and detect criminal wrongdoing, the amended guidelines broaden the stated objectives of corporate compliance programs to include promoting an institutional culture that “encourages *ethical* conduct” as well as a commitment to legal compliance.⁵⁹ Toward that end, the amended guidelines set minimum standards and procedures

56. Id. § 2B1.1(b)(1). A substantial increase in the sentence will also occur if the fraud involves more than \$200 million but does not cross the \$400 million threshold. At the end of its 2003 term, the Supreme Court cast considerable constitutional doubt on the validity of guidelines enhancements like these because they rely heavily on judicial factfinding. See *Blakely v. Washington*, 124 S. Ct. 2531 (2004).

57. The Sarbanes-Oxley Act of 2002, Pub. L. 107-204, § 805(a)(2)(5) (July 30, 2002).

58. See U.S. Sentencing Commission, Amendments to the Sentencing Guidelines, Submitted to Congress April 30, 2004 [hereinafter 2004 Guidelines Amendments]; News Release, U.S. Sentencing Commission, Commission Tightens Requirements for Corporate Compliance and Ethics Programs (May 3, 2004). The amendments became effective November 1, 2004. 28 U.S.C.A. § 994(p) (West 1993).

59. 2004 Guidelines Amendments, *supra* note 58, § 8B2.1(a)(2) (emphasis added).

for devising, implementing, and enforcing the organization's compliance program. Second, the amendments broaden the role of senior management and the board of directors in implementing and monitoring compliance programs⁶⁰ and disqualify the corporation from receiving a mitigated sentence based on its compliance program if high-level executives either participated in, condoned, or were willfully ignorant of the wrongdoing.⁶¹ And third, the amendments provide that periodic risk assessment is crucial to an effective compliance program.⁶²

E. Justice Department Corporate Prosecution Guidance

Corporate prosecutions constitute a small minority of federal criminal cases. But as the government's prosecution of Arthur Andersen for obstruction of justice attests, federal prosecutors will charge business entities in cases they believe are truly egregious.

In 1999, the Justice Department issued non-binding guidelines to provide United States Attorneys offices a framework for deciding whether to bring charges against a corporation. Called Federal Prosecution of Corporations,⁶³ the guidance identified eight factors that would generally be relevant to the charging decision: (1) the nature and seriousness of the crime, including potential harm to the public; (2) the pervasiveness of wrongdoing within the company; (3) the company's prior history of similar misconduct; (4) the company's timely and voluntary disclosure of the wrongdoing and the degree of its cooperation in identifying responsible individuals and providing evidence; (5) the effectiveness of the company's compliance program in preventing and detecting wrongdoing; (6) remedial measures the company took upon discovery of the wrongdoing; (7) potential collateral consequences of a corporate conviction,

60. Id. § 8B2.1(b).

61. Id. § 8B2.2.5(f)(3).

62. Id. § 8B2.1(c).

63. U.S. Dept. of Justice, Federal Prosecution of Corporations (June 16, 1999) (on file with the author).

including adverse effects on third parties; and (8) the adequacy of available non-criminal remedies as an alternative to criminal prosecution.

The guidance recommended that when prosecutors decide to indict a corporation they should bring the most serious sustainable charge,⁶⁴ and cautioned that it is generally inappropriate to condition corporate plea agreements on the government's promise to forgo prosecuting culpable individuals.⁶⁵

1. Corporate Cooperation

In January of 2003, the Justice Department issued revised corporate prosecution principles that respond to the corporate fraud scandals. Now called Principles of Federal Prosecution of Business Organizations,⁶⁶ the revised guidance retains the same analytical framework but calls for "increased emphasis on and scrutiny of the authenticity of a corporation's cooperation" with the investigation.⁶⁷ Like the original guidance on cooperation, the revised principles take into account the company's willingness to disclose the results of its internal investigation, to identify culpable

64. *Id.* at XI, General Principle. The guidance also recommends that corporate plea agreements should, where possible, require that the corporation plead to the most serious and readily provable charge. *Id.* at XII, General Principle.

65. *Id.* at XII, General Principle. This is in keeping with the premise that a corporate prosecution should not serve as a proxy for prosecuting individual officers and employees. *Id.* at I, Comment.

66. U.S. Dept. of Justice, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003) [hereinafter Principles of Prosecution] (on file with the author).

67. Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Department Components, United States Attorneys, Re: Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003) [hereinafter Thompson Memorandum] (on file with the author).

Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing. The revisions make clear that such conduct should weigh in favor of a corporate prosecution.

Id. As Deputy Attorney General, Mr. Thompson also chaired the Corporate Fraud Task Force at that time.

individuals, to make witnesses available and assist in locating evidence, and to waive attorney-client and work product protections. But the revised principles emphasize the importance of scrutinizing whether the corporation is really cooperating or whether it is merely going through the motions while actually impeding the investigation.⁶⁸ Examples of conduct that impedes include:

overly broad assertions of corporate representation of employees or former employees; inappropriate directions to employees or their counsel, such as directions not to cooperate openly and fully with the investigation including, for example, the direction to decline to be interviewed; making presentations or submissions that contain misleading assertions or omissions; incomplete or delayed production of records; and failure to promptly disclose illegal conduct known to the corporation.⁶⁹

The clear import is that conduct that impedes prompt and full exposure of wrongdoing should weigh in favor of prosecuting the corporation.⁷⁰

Conversely, exemplary corporate cooperation can reap handsome rewards. Homestore, the largest online provider of real estate listings, is an illustrative case in point. Homestore executives enriched themselves through a series of fraudulent transactions that inflated the company's revenue. As soon as its audit committee learned of the

68. *Id.*

69. *Principles of Prosecution*, *supra* note 66, at VI, Comment.

70. Thompson Memorandum, *supra* note 67. This shift in focus echoes remarks Attorney General John Ashcroft made at a conference on corporate fraud and responsibility. While recognizing the potentially grave consequences of indicting a corporation or other business entity, he made it unmistakably clear that "where corporate corruption extends to a corporate cover-up," the Justice Department won't hesitate to prosecute the entity. *Enforcing the Law, Restoring Trust, Defending Freedom*, Prepared Remarks of Attorney General John Ashcroft, Corporate Fraud/Responsibility Conference (Sept. 27, 2002) (on file with the author). He observed that firms like Arthur Andersen that "den[y] themselves the benefit of cooperation" by obstructing an investigation "sometimes invit[e] their own demise." *Id.* See Kathleen F. Brickey, *Andersen's Fall From Grace*, 81 *Wash. U. L.Q.* 917 (2004).

fraud, Homestore promptly reported it to the SEC.⁷¹ Homestore also hired outside counsel to conduct an internal investigation, provided the investigative report to the government, and waived attorney-client and work product protections applicable to materials it supplied to the SEC. Homestore also fired the responsible individuals and implemented remedial measures to prevent the fraud from recurring.⁷²

As of the date of this writing, the government's investigation has resulted in the filing of criminal charges against seven Homestore executives and managers,⁷³ including the COO, the CFO, and the Vice President of Planning.⁷⁴ As is often the case, the SEC simultaneously sued the top executives.

In view of the company's extensive cooperation, it is not surprising that Homestore was not criminally charged. But its assistance in the investigation also apparently induced the SEC to forgo filing a civil enforcement action against the corporation as well.⁷⁵

2. Corporate Compliance Programs

A second substantive change in the guidance relates to evaluating the effectiveness of corporate compliance policies and procedures to ensure that they are not "mere paper programs."⁷⁶ The new emphasis here is on scrutinizing the role of the board of directors.⁷⁷ Did the

71. First Year Report, *supra* note 34, at 2.5.

72. *Id.* at 2.5-2.6.

73. See *United States v. Giesecke*, (information filed in United States District Court for the Central District of California) (C.D. Cal. Sept. 25, 2002) (charging Homestore COO, CFO, and Vice President of Planning) (on file with the author); Press Release, Securities and Exchange Commission, SEC and United States Attorney Charge Former Homestore Executives with Scheme to Inflate Advertising Revenue (Sept. 18, 2003) (on file with the author).

74. All of the defendants pled guilty, and most of them became cooperating witnesses.

75. First Year Report, *supra* note 34, at 2.6.

76. Thompson Memorandum, *supra* note 67.

77. Corporate boards have received bad report cards in the wake of the corporate scandals. See, e.g., *The Role of the Board of Directors in Enron's*

board independently review management's proposals, or did it serve as a rubber stamp? Did management provide sufficient information to enable the board to exercise independent judgment? Were the company's internal audit controls adequate to ensure independence and accuracy? Did the directors establish an information and reporting system designed to facilitate informed decision making by management and the board on corporate legal matters?⁷⁸ These questions probe not only whether the design of the compliance program is adequate, but also whether management has conscientiously enforced it.

Collapse, S. Rep. 107-70, at 11-59 (2002) (finding that Enron's Board must assume significant responsibility for the company's collapse; the board abdicated its fiduciary responsibilities by tolerating high risk accounting practices and transactions with blatant conflicts of interest, by failing to address extensive undisclosed off-books transactions, by awarding excessive executive compensation, by failing to curb abusive use of a personal multi-million dollar credit line by CEO Ken Lay, and by allowing its own independence to be compromised); Richard C. Breeden, *Restoring Trust: Report to The Hon. Jed S. Rakoff, The United States District Court for the Southern District of New York, on Corporate Governance for the Future of MCI, Inc.*, 1-2, 5-6, 45-76 (Aug. 2003) [hereinafter Breeden Report] (report by court-appointed corporate monitor criticizing WorldCom board's lack of independence and cronyism, and providing a blueprint for reform) (on file with the author); Dennis R. Beresford, Nicholas deB. Katzenbach, & C.B. Rogers, Jr., *Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc.*, 29-35, 264-337 (Mar. 31, 2003) [hereinafter Report by WorldCom Special Investigative Committee] (criticizing WorldCom board for relinquishing too much power to CEO Bernard Ebbers and exercising too little restraint over him, and detailing an almost complete breakdown of corporate governance mechanisms) (on file with the author); First Interim Report of Dick Thornburgh, Bankruptcy Court Examiner, *In re: WorldCom, Inc.*, Case No. 02-15533 (AJG), 6-7, 37-43 (Bankr. S.D.N.Y. Nov. 4, 2002) [hereinafter First Interim Report of Dick Thornburgh] (making preliminary findings that WorldCom's Board and its audit and compensation committees virtually abdicated their responsibilities to CEO Ebbers) (on file with the author); Second Interim Report of Dick Thornburgh, Bankruptcy Court Examiner, *In re: WorldCom, Inc.*, Case No. 02-15533 (AJG), 114-15 (Bankr. S.D.N.Y. June 9, 2003) (finding "significant and troubling questions" about WorldCom board's due diligence in making hundreds of millions of dollars in loans to CEO Bernard Ebbers) (on file with the author); Westar Energy, Inc., *Report of the Special Committee to the Board of Directors*, 81-82 (Apr. 29, 2003) (faulting Westar board for failing to curb abusive use of company airplanes for personal use) (on file with the author).

78. Principles of Prosecution, *supra* note 66, at VII, Comment (citing *In re Caremark Int'l*, 698 A.2d 959 (Del. Ch. 1996)).

The corporate compliance criteria in the guidance also complement corporate governance reforms, imposed by Sarbanes-Oxley, that subject corporate boards to increased scrutiny. Thus, for example, Sarbanes-Oxley relieves senior management of the responsibility for hiring, compensating, and monitoring outside auditors and assigns it to the board's audit committee.⁷⁹ Sarbanes-Oxley also endeavors to eliminate financial conflicts of interest from the audit oversight function by requiring directors who serve on audit committees to satisfy statutory financial independence criteria. Under the new standards, audit committee members may not receive fees or compensation from the corporation other than their compensation as board members. Nor may they be affiliated with the corporation or its subsidiaries in any capacity other than as members of the board.⁸⁰ And to help ensure informed decision making, Sarbanes-Oxley requires that at least one member of the audit committee qualify as a "financial expert."⁸¹ Sarbanes-Oxley also assigns the audit committee the responsibility of establishing procedures for receiving internal and external complaints relating to financial and audit matters.⁸²

79. 15 U.S.C.A. § 78j-1(m)(2) (West Supp. 2003).

80. *Id.* § 78j-1(m)(3).

81. 15 U.S.C.A. § 7265 (West Supp. 2003). The term "financial expert" means someone knowledgeable about accounting, auditing, and internal controls that are appropriate to public companies. If no financial experts serve on the audit committee, the corporation must explain why.

82. 15 U.S.C.A. § 78j-1(m)(4) (West Supp. 2003). The procedures must allow employees to submit complaints anonymously and confidentially. *Id.* See also Standards Relating to Listed Company Audit Committees, 68 Fed. Reg. 18,788 (Apr. 16, 2003) (rejecting a "one size fits all" approach by giving audit committees discretion to adopt procedures that are appropriate to the individual circumstances and needs of the company) (codified at 17 C.F.R. §§ 228.10 through 228.702, 229.10 through 229.1016, 240.10A-3, 240.14a-101, 249.220(f), 249.240(f), 249.331, 274.128 (2004)).

Sarbanes-Oxley forbids publicly traded companies from discharging, demoting, or otherwise discriminating against an employee in retaliation for the employee's internally reporting fraud to a supervisor or any corporate employee with authority to investigate or terminate misconduct, for reporting externally to federal regulators or investigators or to members of Congress, or for participating in or assisting fraud proceedings. 15 U.S.C.A. § 1514A(a), (b) (West Supp. 2003). It also provides civil remedies for whistleblowers whom the corporation has retaliated against, *id.* § 1514A(c), (d), and imposes criminal liability for retaliating

Thus, prosecutors may look to corporate governance requirements imposed by Sarbanes-Oxley to assist their evaluation of a company's compliance program as they assess the merits of charging the corporation. Indeed, while corporate prosecutions are likely to remain the exception rather than the rule,⁸³ the revised guidance sends a clear message that the Justice Department believes the threat of criminal prosecution can serve as a catalyst for positive change in a corporation's culture.⁸⁴

F. SEC Enforcement Criteria

Unlike the Justice Department, the SEC has no criminal enforcement powers. It does, however, have a broad array of civil enforcement tools to address corporate fraud. Like the Justice Department, the SEC follows a set of nonexclusive and non-binding criteria in determining whether to bring an enforcement action against a corporation. And like the Justice Department, the SEC's principal focus is on the nature and degree of the company's "self-policing, self-reporting, remediation and cooperation."⁸⁵

against whistleblowers who report information relating to a possible federal crime to federal investigators. 18 U.S.C.A. § 1513(e) (West Supp. 2003). In the criminal context, "retaliation" includes inflicting any harm, including interference with another's lawful employment or livelihood. See Brickey, *From Enron to WorldCom*, supra note 50, at 360-70.

83. See Thompson Memorandum, supra note 67 (stating that although prosecutors should consider the merits of prosecuting the business entity itself, corporations will be charged in only a minority of cases).

84. See Principles of Prosecution, supra note 66, at I.

85. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969, [2001-2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,985, at 63195 (Oct. 23, 2001) [hereinafter Section 21(a) Report]. This report was issued in conjunction with the settlement of an action against the controller of a corporate subsidiary. The controller was found responsible for inaccuracies in the parent company's books and records, for misstatements in the company's periodic reports, and for covering the falsehoods up. *Id.* at 5. Although the report does not identify the company, SEC officials refer to it as the Seaboard 21(a) Report because the investigation involved financial accounting irregularities at the Seaboard Corporation. Barry W. Rashkover, *Reforming Corporations Through Prosecution: Perspectives From an SEC Enforcement Lawyer*, 89 Cornell L. Rev. 535, 539 (2004).

The SEC criteria are remarkably similar to the factors the Justice Department considers. The SEC criteria include: (1) the nature of the misconduct, including the level of culpability and whether the company's auditors were misled;⁸⁶ (2) why the misconduct occurred (e.g., pressure from senior management), what compliance measures were in place, and how and why they failed;⁸⁷ (3) the organizational level where the misconduct occurred, the duration of the wrongdoing, and whether the behavior was systemic;⁸⁸ (4) the degree of harm to investors and other outside parties;⁸⁹ (5) the length of time between discovery of the wrongdoing and an effective organizational response—including disciplining wrongdoers, prompt disclosure to regulators and the public, and full cooperation with law enforcement authorities;⁹⁰ (6) whether the company conducted a thorough review, who conducted it, and whether the audit committee and the board were fully informed;⁹¹ (7) the degree of the company's cooperation, including whether it voluntarily disclosed the results of its review to the SEC and whether it made its employees available to assist in the investigation;⁹² and (8) the likelihood that the wrongdoing will recur.⁹³

The agency published these criteria to “further encourage self-policing efforts and . . . promote more self-reporting, remediation and cooperation” in SEC

The SEC took no action against the corporation because of its prompt and effective responses and full cooperation. The corporation's internal auditors conducted a prompt review and notified management, which then informed the audit committee. After the full board was informed, it advised the company to retain an outside law firm to conduct an internal review. Shortly after that, the company dismissed the wrongdoer and two of her supervisors and publicly disclosed that it would restate its financial statements. The corporation provided the SEC all relevant information, including the details of its internal investigation, and did not invoke attorney-client or work product protections. Section 21(a) Report, *supra*, at 1-2.

86. *Id.* at 5.

87. *Id.* at 5-6.

88. *Id.* at 6.

89. *Id.*

90. *Id.* at 6-7.

91. *Id.* at 7-8.

92. *Id.* at 8.

93. *Id.* at 9.

investigations.⁹⁴ Thus, in the eyes of both the Justice Department and the SEC, criminal and civil enforcement actions against business entities are legitimate tools of corporate governance reform.⁹⁵

G. SEC Funding

Through much of the last decade, the SEC was an agency under siege. As congressional zeal for deregulation reached its peak in the mid-1990s, growth in the SEC's workload greatly outpaced growth in agency resources.⁹⁶ Between 1995 and 2002, for example, the number of mutual funds subject to SEC inspection rose from just over 5,700 to more than 8,200, but the number of SEC inspectors remained the same.⁹⁷ Between 1991 and 2001,

94. *Id.* at 9.

The importance of cooperation is underscored by several recent developments. Just days after imposing a record \$10 million fine against Bank of America for failure to comply with repeated requests for documents relating to its trading practice, the SEC staff proposed levying a \$25 million fine against Lucent Technologies based on the company's lack of cooperation in the SEC's investigation of Lucent's improper recognition of \$679 million in revenue. Lucent was notified of the proposed fine a year after it had reached an agreement in principle that would have settled the case without payment of a fine. Shawn Young & Dennis K. Berman, SEC Staff Recommends Penalty Against Lucent of \$25 Million, *Wall St. J.*, Mar. 18, 2004, at B5. And early in March, SEC Enforcement Director Stephen Cutler said the Commission would soon announce "a very important [document] case" that it would segment from a broader inquiry into other underlying misconduct because of the entity's "slow and uncooperative" approach to document production. *Corporate Accountability Rep. (BNA)*, Mar. 12, 2004, at 281. Cutler said the SEC would not wait until the end of the investigation to file the document charges because the broader investigation had been impeded by the company's lack of cooperation, and he suggested that the Commission expects to follow this approach more often in the future. *Id.*

95. Compare John S. Baker, Jr., *Reforming Corporations Through Threats of Federal Prosecution*, 89 *Cornell L. Rev.* 310 (2004) (arguing that corporate reform, if needed, is the province of state, not federal, regulators) with Rashkover, *supra* note 85 (defending the use of SEC enforcement powers as well as criminal prosecutions to encourage responsible corporate citizenship).

96. See Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* 630-39 (3d ed. 2003).

97. Mark Maremont & Deborah Solomon, *Behind SEC's Failings; Caution, Tight Budget, '90s Exuberance*, *Wall St. J.*, Dec. 24, 2003, at A1 [hereinafter *Behind SEC's Failings*]. The Division was staffed by about 370 employees during

the number of cases the Enforcement Division opened rose sixty-five percent, but the Division's staff grew by only twenty-seven percent.⁹⁸ Overall, from fiscal years 1993 through 2000, the SEC's budget grew modestly from \$253.2 million to \$382.4 million.⁹⁹

Although this was a period of urgent need for new resources to handle the burgeoning workload, Congress proposed to further hobble the SEC by freezing its budget for five years, reducing the number of Commissioners from five to three, and requiring the SEC to justify the cost of any change in its regulatory requirements.¹⁰⁰ While these onerous initiatives never became law, Congress imposed a freeze on SEC staff positions for four consecutive years.¹⁰¹

The scarcity of financial and human resources led to significant delays in performing core oversight and regulatory functions, observance of selective enforcement policies, and less frequent and less thorough reviews of some key filings.¹⁰² Thus, for example, although the Corporate Finance Division's goal was to review every company's annual report at least every three years, as of 2002 it had been five years since the Division conducted its last partial review of Enron's annual 10-K report. It had not conducted a full review of an Enron annual report since 1991.¹⁰³

Needless to say, growing imbalance between the SEC's workload and its resources resulted in low staff morale, which in turn translated into significant turnover

this period.

98. *Id.*

99. Seligman, *supra* note 96, at 630.

100. *Id.*

101. *Id.* at 635.

102. *Id.* at 637.

103. Staff Rep. to Senate Comm. on Gov't. Affairs, Financial Oversight of Enron: The SEC and Private Sector Watchdogs II (Oct. 8, 2002), at 31-32. In 2001, the Division conducted a full review of only sixteen percent of the 14,600 annual 10-K reports that were filed—a record that fell far short of its goal. *Id.* at 13.

problems¹⁰⁴ and a decisive vote to unionize non-managerial positions held by lawyers, accountants, and support staff.¹⁰⁵

In one sense, Sarbanes-Oxley exacerbated existing problems by creating new regulatory requirements and imposing short deadlines for SEC rule makings to implement them. But Sarbanes-Oxley also provided “welcome new enforcement tools” for combating financial fraud¹⁰⁶ and, significantly, addressed the agency’s need for additional resources to accomplish its goals. Sarbanes-Oxley authorized the appropriation of \$776 million—a seventy-seven percent increase—for the SEC for fiscal year 2003¹⁰⁷ and authorized use of the funds to achieve pay parity with other financial regulators, to improve technology and security, and to add at least 200 new professionals to the agency’s staff. But the provision authorizing additional resources for the SEC did just that—it *authorized* the appropriation of more funds, but did not actually provide them.

In his remarks at the Sarbanes-Oxley signing ceremony, President Bush lauded Congress for enacting sweeping reforms that included “new funding for investigators and technology at the Securities and Exchange Commission to uncover wrongdoing,” and he promised to use the Act’s new enforcement tools “to the fullest.”¹⁰⁸ But just eighty days later, the administration proposed an SEC budget of only

104. In 1997, for example, sixteen percent of the SEC’s lawyers, twelve percent of its accountants, and nearly eleven percent of its examiners left the agency. In 1998-1999, the SEC lost twenty-five percent of its lawyers, accountants, and examiners. This turnover rate was double the average government-wide departure rate for white collar employees. Seligman, *supra* note 96, at 635-36. The rapid turnover rate and the inability to hire qualified replacements fast enough left about two-hundred fifty positions unfilled in September of 2001. *Id.* at 637.

105. Seligman, *supra* note 96, at 636. About 1,800 positions were unionized.

106. U.S. Securities and Exchange Commission, Testimony Concerning Implementation of the Sarbanes-Oxley Act of 2002, Statement of William H. Donaldson, Chairman, at 2, 7-8 (Sept. 9, 2003) [hereinafter Donaldson Testimony].

107. The Sarbanes-Oxley Act of 2002, Pub. L. 107-204, § 601 (July 30, 2002); Seligman, *supra* note 96, at 740.

108. Remarks by the President at Signing of H.R. 3763, the Sarbanes-Oxley Act of 2002 (July 30, 2002); Press Release, Office of the White House Press Secretary, President Bush Signs Corporate Corruption Bill (July 30, 2002).

\$568 million—some \$200 million less than Sarbanes-Oxley authorized.¹⁰⁹ Although Congress ultimately passed, and the President signed, an appropriations bill allocating \$716.4 million to the SEC for fiscal year 2003, the agency's efforts to rapidly hire new staff were impeded by delayed enactment of the bill and cumbersome civil service rules. By the time Congress waived the hiring rules, it was too late to spend the full amount before the end of the fiscal year, and the SEC returned \$130 million of its 2003 appropriation to the Treasury.¹¹⁰ During the next budget appropriations cycle, the President proposed an \$841.5 million SEC budget for fiscal year 2004. But this time Congress reduced the appropriation by \$30 million because the SEC had not yet reached its goal of hiring more than eight hundred new staff.¹¹¹ For the 2005 fiscal year, the President proposed to increase the SEC budget by ten percent to \$893 million.¹¹²

In view of the continued political tug of war over resources, it remains to be seen what amount Congress will ultimately appropriate, but it does seem clear that among its other virtues, Sarbanes-Oxley was a positive step toward restoring the SEC's financial footing.

H. Observations on Post-Enron Reforms

The post-Enron structural reforms considered in part II have provided regulators and members of the

109. Joseph A. Grundfest, Give the SEC Its Due: More Money, *Wall St. J.*, Oct. 29, 2002, at A22.

110. Behind SEC's Failings, *supra* note 97.

111. Cut Proposed for SEC Budget; Hiring Delays Are Cited for the Reduction: The Agency Would Still Get More Than in Fiscal 2003, *L.A. Times*, Dec. 2, 2003, at C4 (reporting that the SEC had achieved seventy percent of its goal of filling 850 new staff positions); Donaldson Testimony, *supra* note 106, at 18 (stating the goal of hiring 847 new staff in fiscal year 2003). But cf. Government Accountability Office, Securities and Exchange Commission: Review of Fiscal Year 2003 and 2004 Budget Allocations (July 27, 2004) (noting that the SEC's hiring initiatives were consistent with Sarbanes-Oxley's directive but criticizing the agency for spending its increased allocations without first adopting an updated strategic plan).

112. Office of Management and Budget, Executive Office of the President, Budget of the United States Government, Fiscal Year 2005—Appendix, at 1181.

enforcement community significant resources to address systemic failures in corporate governance. In addition to increasing transparency and accountability in corporate governance matters, the reforms give regulators and prosecutors potent new enforcement tools, enhance interagency coordination and cooperation, and provide the financial support essential for the SEC to effectively perform its core regulatory functions.

III. ENFORCEMENT ENVIRONMENT

Unprecedented marshaling of federal regulatory and law enforcement resources has contributed to significant criminal enforcement levels in the post-Enron era.

A. Major Prosecutions

Between March 2002 and July 2004, federal prosecutors filed criminal charges relating to nineteen major corporate fraud scandals I have systematically tracked. The charges were filed in sixty-nine separate but often related prosecutions naming more than a hundred twenty-five defendants (table 1). During the same time frame, prosecutors successfully concluded cases against two-thirds of the defendants.¹¹³ With the exception of four acquittals and two dismissals,¹¹⁴ all of the dispositions reported in table 1 are either guilty pleas or jury convictions.

113. The remaining third are either in or awaiting trial. See *infra* table 6.

114. Juries acquitted one Adelphia defendant, one NewCom defendant, and two Qwest defendants. Charges against both Kmart defendants were dismissed at the close of the government's case. A breakdown of dispositions by type appears *infra* in table 6.

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Table 1
Major Corporate Fraud Prosecutions
Filed March, 2002 - July, 2004

INVESTIGATION	CRIMINAL CASES ¹¹⁵	TOTAL DEFENDANTS	TOTAL DISPOSITIONS ¹¹⁶
ADELPHIA	2	6	5
CENDANT	4	5	3
CHARTER COMMUNICATIONS	1	4	1
CREDIT SUISSE FIRST BOSTON	1	1	1
DYNEGY	3	8	7
ENRON ¹¹⁷	16	33	13
HEALTHSOUTH ¹¹⁸	16	20	17
HOMESTORE	3	7	7
IMCLONE	4	5	4
KMART	1	2	2
MCKESSON	4	7	4
NEWCOM	2	4	4
NEXTCARD	2	2	1
PURCHASEPRO	2	2	2
QWEST	1	4	3
RITE AID	3	6	6
SYMBOL TECHNOLOGIES	3	10	2
TYCO ¹¹⁹	1	1	0
WORLDCOM ¹²⁰	5	6	5

Thus, it can readily be seen that there has been an extraordinary amount of criminal enforcement activity

115. Federal prosecutions.

116. Includes guilty pleas, jury convictions, acquittals, and dismissals through July, 2004. Excludes mistrials. See *infra* table 6.

117. Includes related cases involving Enron energy trading, Enron broadband services, Enron bankers and investment bankers, and Arthur Andersen. For subsequent developments in the main Enron investigation, see *infra* notes 206-224 and accompanying text.

118. For subsequent developments, see *infra* notes 178-183 and accompanying text.

119. Table 1 excludes state criminal charges against three Tyco executives, a Tyco outside director, and an art gallery.

120. Table 1 excludes state criminal charges against WorldCom and five of its executives. See *infra* note 184. For subsequent developments in the federal investigation, see *infra* notes 184-204 and accompanying text.

focused on corporate fraud since Enron's collapse and that federal prosecutors have achieved a high degree of success.

B. Real-Time Enforcement

To encourage decisive action, the Corporate Fraud Task Force directed member investigators and prosecutors to adopt a "real-time" enforcement approach.¹²¹ Real-time enforcement translates into filing criminal charges as quickly as possible, preferably within weeks or months after an investigation begins. To accomplish this in the context of large or complex fraud investigations, cases are segmented into discrete components involving readily provable crimes.¹²²

WorldCom provides a case in point. On June 25, 2002, WorldCom announced that a massive accounting fraud had inflated the corporation's revenue by \$3.8 billion.¹²³ The day after the announcement, the SEC initiated an investigation, filed a civil complaint,¹²⁴ and simultaneously sought and obtained an injunction prohibiting WorldCom from altering or destroying records relating to the fraud.¹²⁵ The SEC also sought a court-appointed monitor to preserve WorldCom assets and maintain the status quo during the pendency of the suit.¹²⁶

121. First Year Report, *supra* note 34, at 2.5. The SEC is also emphasizing real-time enforcement in major cases. *Behind SEC's Failings*, *supra* note 97.

122. *Id.* at 2.5.

123. Simon Romero & Alex Berenson, *WorldCom Says It Hid Expenses, Inflating Cash Flow \$3.8 Billion*, *N.Y. Times*, June 26, 2002, at A1; Jared Sandberg, Rebecca Blumenstein & Shawn Young, *Accounting Fraud at WorldCom Tops \$3.8 Billion*, *Wall St. J.*, June 26, 2002, at A1.

124. *SEC v. WorldCom, Inc.*, 02-CV-4963 (JSR) (S.D.N.Y. June 26, 2002) [hereinafter *WorldCom Complaint*] (on file with the author).

125. Michael Schroeder, *SEC Files Civil Suit Against WorldCom*, *Wall St. J.*, June 27, 2002, at A3; Judge Bars WorldCom, Andersen, from Destroying Documents, *HoustonChronicle.Com*, June 28, 2002 (on file with the author).

126. Kurt Eichenwald & Simon Romero, *Inquiry Finds Effort at Delay at WorldCom*, *N.Y. Times*, July 4, 2002, at C1. In addition to having concerns about potential document destruction, the SEC believed a monitor was needed to ensure that WorldCom did not make extraordinary payments to current or former officers, directors, and employees. The court appointed former SEC Chairman Richard Breeden to serve as special monitor. *Id.*

At the same time, the FBI and prosecutors from the United States Attorney's Office for the Southern District of New York launched a parallel criminal investigation.¹²⁷ Notwithstanding that the accounting fraud at WorldCom was vast, on August 1, 2002—just five weeks after the fraud was revealed—prosecutors filed a sealed complaint against WorldCom's CFO and its Director of General Accounting.¹²⁸ A grand jury indicted the two officials toward the end of September,¹²⁹ and two weeks later prosecutors filed charges against WorldCom's Senior Vice President and Controller and two WorldCom accountants.¹³⁰ Shortly after that, four of the five defendants pled guilty and became cooperating witnesses.¹³¹

These cases moved swiftly partly because they focused on a discrete aspect of a sprawling fraud. Although it was clear early in the investigation that the accounting irregularities permeated many aspects of WorldCom's financial reporting, prosecutors and investigators decided

127. The criminal investigation is discussed more fully *infra* at text accompanying notes 184-205.

128. Sealed Complaint, *United States v. Sullivan* (complaint filed in United States District Court for the Southern District of New York) (S.D.N.Y. Aug. 1, 2002) (on file with the author).

129. See Indictment, *United States v. Sullivan* (indictment filed in United States District Court for the Southern District of New York) (S.D.N.Y. Aug. 28, 2002) (charging Scott Sullivan, WorldCom's CFO, and Buford Yates, WorldCom's Director of General Accounting, with conspiracy, securities fraud, and making false SEC filings) (on file with the author).

130. See Information, *United States v. Myers*, 02-CR-1261 (S.D.N.Y. Sept. 25, 2002) (charging WorldCom Senior Vice President and Controller David Myers with conspiracy, securities fraud, and making false SEC filings); Information, *United States v. Vinson*, 02-CR-1349 (S.D.N.Y. Oct. 10, 2002) (charging WorldCom accountant with conspiracy and securities fraud); Information, *United States v. Normand* (information filed in United States District Court for the Southern District of New York) (S.D.N.Y. Oct. 10, 2002) (charging WorldCom accountant with conspiracy and securities fraud) (all on file with the author).

131. See Litigation Release No. 17842, S.E.C., *Myers and Yates, Two Former WorldCom Executives, Are Personally Enjoined from Committing Securities Fraud and Other Violations, and Barred from Acting as Officers or Directors of a Public Company*, [2001-2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,180, at 63,592 (Nov. 15, 2002); Litigation Release No. 17883, S.E.C., *Vinson and Normand, Two Former WorldCom Accounting Managers, Are Permanently Enjoined from Committing Securities Fraud and Other Violations*, [2001-2003 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,198, at 63,622 (Dec. 6, 2002).

to limit their initial investigation to the improper recording of ordinary operating costs.¹³² By keeping the investigation sharply focused, they were able to bring a key part of this complex case to a quick resolution.

The HealthSouth investigation is another example of successful use of real-time prosecutions. Although the initial investigation centered on possible insider trading by the corporation and its Chairman and CEO Richard Scrushy,¹³³ the focus of the investigation changed sharply after Weston Smith, a former HealthSouth CFO, informed prosecutors that he and other senior officials had participated in a scheme to falsify the company's earnings over a substantial period of time.

Roughly two months after prosecutors learned of the fraud, eleven HealthSouth executives—including all five former CFOs—had pled guilty and agreed to cooperate in the ongoing investigation.¹³⁴ Before the year was up, four more financial and accounting officers pled guilty and became cooperating witnesses, and CEO Richard Scrushy was under indictment.¹³⁵ “We’re moving as swiftly as could be expected,” the lead prosecutor told reporters.¹³⁶

The rapid filing and resolution of so many cases was facilitated by a strategic decision to limit the scope of the investigation. Rather than trying to trace HealthSouth's entire financial history, prosecutors limited the period under investigation to 1997-2003, when the fraud contributed to the overstatement of HealthSouth's earnings by at least \$2.5

132. First Year Report, *supra* note 34, at 2.5. By recording ordinary expenses as capital expenditures, WorldCom disguised a \$662 million loss as a \$2.4 billion profit. Amanda Ripley, *The Night Detective*, *Time*, Dec. 30, 2002/Jan. 6, 2003, 44, at 46-47.

133. Patti Bond, *A Fraud Squad Dream; HealthSouth Case to Test New Law*, *Atlanta Journal-Constitution*, May 11, 2003, *Bus. Sec.* at 1Q [hereinafter *Fraud Squad Dream*].

134. *Former Executive at HealthSouth Pleads Guilty*, *N.Y. Times*, May 6, 2003, at C8.

135. Scrushy and three of the CFOs were charged with violating Sarbanes-Oxley's prohibition against certifying false financial information. See 18 U.S.C.A. § 1350 (West Supp. 2003).

136. Simon Romero & Riva D. Atlas, *New Charges Are Expected at HealthSouth*, *N.Y. Times*, Mar. 25, 2003, at C2 [hereinafter *New Charges Expected*].

billion. Prosecutors felt no need to probe the company's finances farther back in time "because there's plenty to go on in [the 1997-2003] time frame."¹³⁷ This decision shortened what could have easily been an investigation that dragged on for years, and criminal charges were filed with lightning speed.¹³⁸

A third example of real-time enforcement occurred in the eConnect case in Los Angeles. In eConnect, coordinated efforts between federal prosecutors, the FBI, and the SEC resulted in the filing of civil and criminal fraud charges within a few weeks after the company's CEO issued press releases that misrepresented the company's business operations and profitability.¹³⁹

C. SEC Enforcement

The SEC's Enforcement Division employs a broad array of civil and administrative tools to combat fraud. Its enforcement powers include investigating securities law violations, bringing civil actions in federal court, bringing actions within the agency before an administrative law judge, recommending action by the Commission, and negotiating settlements on the Commission's behalf. Remedies the Division can pursue include injunctive relief, disgorgement of ill-gotten gains, civil monetary penalties, asset freezes, and barring individuals from serving as corporate officers and directors. As shown in table 2, the Enron implosion marked the beginning of a steady increase in the number of actions filed by the Enforcement Division.

137. Fraud Squad Dream, *supra* note 133 (quoting Alice Martin, the U.S. Attorney in Birmingham and lead prosecutor in the HealthSouth cases).

138. The investigation took a sharp turn with the indictment of two HealthSouth vice presidents for using corporate assets to pay kickbacks to a Saudi Arabian official to secure a contract to manage a Saudi hospital. Information, *United States v. Carman*, (information filed in the United States District Court for the Northern District of Alabama) (N.D. Ala. Mar. 2, 2004) (on file with the author); Information, *United States v. Nico*, (information filed in the United States District Court for the Northern District of Alabama) (N.D. Ala. Mar. 2, 2004) (on file with the author). Both men agreed to plead guilty.

139. First Year Report, *supra* note 34, at 3.11.

Table 2
SEC Enforcement Actions Filed
Fiscal Years 2000-2003

DATE OF FILING	FINANCIAL FRAUD AND ISSUER REPORTING ACTIONS	TOTAL ENFORCEMENT ACTIONS
FY 2000	103	503
FY 2001	112	484
FY 2002	163	598
FY 2003	199	679

Although the SEC does not have criminal enforcement powers, the Enforcement Division often works closely with criminal investigators and prosecutors to assist in developing a criminal case. Indeed, it is not uncommon for the SEC and the Justice Department to conduct parallel civil and criminal investigations of the same matter. Thus, for example, the SEC has brought enforcement actions that parallel criminal investigations relating to Adelphia, Enron, WorldCom, Tyco, HealthSouth, Kmart, Dynegy, Qwest, and Merrill Lynch.¹⁴⁰

To illustrate, a high percentage of SEC civil enforcement actions filed in Enron-related cases have been brought against individuals who are criminally charged. More than half of the individuals who have been prosecuted for Enron-related fraud¹⁴¹ have been named as defendants in SEC enforcement actions, and all but five of the twenty-three individuals who have been the subject of SEC enforcement actions have been criminally charged (table 3).

If a parallel investigation results in the filing of criminal charges, the SEC will often initiate a civil or administrative enforcement action at or about the same time the criminal charges are filed. And when the criminal investigation results in a negotiated guilty plea and cooperation agreement, it is not uncommon for the SEC and the Justice Department to announce a global settlement of all civil and criminal charges at or about the same time.

140. See *id.* at 3.25-3.29.

141. This figure excludes the prosecutions of Arthur Andersen and David Duncan, Andersen's Enron engagement partner, on obstruction of justice charges.

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Table 3
Enron-Related
Parallel Civil and Criminal Proceedings

DEFENDANT	CIVIL FILING	CIVIL SETTLEMENT	CRIMINAL FILING	GUILTY PLEA
LAY	July 8, 2004		July 8, 2004	
RIEKER	May 19, 2004	May 19, 2004	May 19, 2004	May 19, 2004
SKILLING	Feb. 19, 2004		Feb. 19, 2004	
CAUSEY	Jan. 22, 2004		Jan. 22, 2004 ¹⁴²	
FASTOW	Oct. 2, 2002	Jan. 14, 2004	Oct. 1, 2002 ¹⁴³	Jan. 14, 2004
DELAINEY	Oct. 30, 2003		Oct. 29, 2003	
COLWELL	Oct. 9, 2003		None	
GLISAN	Sept. 10, 2003	Sept. 10, 2003	Apr. 30, 2003	Sept. 10, 2003
RICE	May 1, 2003		Apr. 29, 2003	
HIRKO	May 1, 2003		Apr. 29, 2003	
HANNON	May 1, 2003		Apr. 29, 2003	
SHELBY	May 1, 2003		Apr. 29, 2003	
YEAGER	May 1, 2003		Apr. 29, 2003	
HOWARD	May 1, 2003 ¹⁴⁴		Apr. 29, 2003 ¹⁴⁵	
KRAUTZ	May 1, 2003 ¹⁴⁶		Apr. 29, 2003 ¹⁴⁷	
MERRILL LYNCH	Mar. 17, 2003	Mar. 17, 2003	None	
FURST	Mar. 17, 2003		Oct. 14, 2003 ¹⁴⁸	
TILNEY	Mar. 17, 2003		None	
BAYLY	Mar. 17, 2003		Oct. 14, 2003 ¹⁴⁹	
DAVIS	Mar. 17, 2003		None	
GORDON	Dec. 19, 2003	Dec. 19, 2003	Dec. 19, 2003	Dec. 19, 2003
CIBC	Dec. 22, 2003	Dec. 22, 2003	Dec. 22, 2003 ¹⁵⁰	Dec. 22, 2003 ¹⁵¹

142. Original indictment. Superseding indictments filed Feb. 19, 2004 and July 8, 2004.

143. Criminal Complaint filed on this date was followed by an indictment filed on October 31, 2002, a superseding indictment filed on April 30, 2003, and a second superseding indictment filed on July 8, 2004.

144. Amended complaint. Original complaint filed Mar. 12, 2003.

145. Superseding indictment. Original indictment filed Mar. 26, 2003.

146. Amended complaint. Original complaint filed Mar. 12, 2003.

147. Superseding indictment. Original indictment filed Mar. 26, 2003.

148. Superseding indictment. Original indictment filed Sept. 16, 2003.

149. Superseding indictment. Original indictment filed Sept. 16, 2003.

150. Deferred prosecution agreement announced. No criminal charges have been filed.

151. As a condition of deferred prosecution agreement, CIBC agreed to accept

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JOHN DOE # 1	Dec. 22, 2003		None	
JOHN DOE # 2	Dec. 22, 2003		None	
JOHN DOE # 3	Dec. 22, 2003		None	
J.P. MORGAN CHASE	July 28, 2003	July 28, 2003	None	
CITIGROUP	July 28, 2003	July 28, 2003	None	
KOPPER	Aug. 21, 2002	Aug. 21, 2002	Aug. 21, 2002	Aug. 21, 2002

D. Observations on Post-Enron Enforcement

The Justice Department has aggressively prosecuted major corporate fraud cases since Enron's collapse. Assisted by a real-time enforcement strategy, prosecutors succeeded in rapidly filing—and in many instances resolving—criminal charges against more than one hundred twenty-five corporate officers, executives, and advisers for involvement in fraudulent schemes at nineteen major corporations.

These enforcement initiatives also demonstrate tangible benefits that are derived from increased cooperation between the Justice Department and the SEC in major fraud investigations. Cooperative civil and criminal enforcement efforts facilitated the SEC's immediate response to the WorldCom scandal while criminal investigators simultaneously sought evidence of criminal fraud. Coordinated parallel proceedings have also facilitated global settlements of matters pending against executives who were criminally prosecuted and were also charged with civil violations of SEC rules and regulations. Simply put, the Justice Department and the SEC have compiled impressive post-Enron enforcement records.

IV. CRITIQUE

In the aftermath of Enron, prosecutors have moved aggressively to investigate and bring criminal charges, and the SEC has filed dozens of parallel civil cases. Yet despite

responsibility for criminal wrongdoing by its employees.

the government's considerable post-Enron enforcement success, some commentators remain skeptical about the pace and focus of the investigations and prosecutions.

A. The Pace and Focus of the Investigations

Why was Martha Stewart on trial but not Ken Lay? Why were no charges filed against any of the three most visible top executives—Enron CEOs Ken Lay and Jeff Skilling and WorldCom CEO Bernie Ebbers—during the first two years of the financial fraud investigations? Although all three have now been indicted, why did it take so long to build cases against them? Why was the government content to focus on mid-level executives instead of imposing responsibility where it belongs—at the top of the corporate ladder?

These “foot dragging” issues have dogged prosecutors throughout the post-Enron investigations. One underlying assumption is that prosecutors have been giving priority to catching relatively small fish. But a look at the record shows the opposite is true. Well before Enron's Skilling and Lay were indicted, prosecutors had charged many high-ranking company officials, including Enron's Executive Vice President and CFO, its Treasurer, and the top executives at Enron Broadband Services (table 4). And before WorldCom's CEO Ebbers was charged, prosecutors had filed cases against the company's Chief Financial Officer, its Senior Vice President and Controller, and its Director of General Accounting.

In nine of the major financial fraud investigations I systematically tracked,¹⁵² nineteen corporate CEOs, Chief Operating Officers, and/or Presidents have been criminally charged.¹⁵³ In fourteen of the investigations, the CFO, Chief

152. See *infra* note 167.

153. They are chief executives of companies in the following investigations: Adelphia (President and Chairman of the Board); Cendant (Chairman of the Board and CEO; International President and Chief Operating Officer); Dynegy (Nicor Energy President and CEO); Enron (President and CEO; Enron Energy Services and Enron North America CEO; Enron Broadband Services Chairman

Accounting Officer, and/or Vice President for Finance have been criminally charged.¹⁵⁴ That is in addition to countless executive vice presidents, accounting directors and officials, and other mid- to high level managers and directors.¹⁵⁵

Thus, it is clear that these are not low level prosecutions and that top executives have not received a free pass. Prosecutors routinely charge high ranking officials and mid-level executives and managers in post-Enron fraud prosecutions. Their priority is to charge responsible high-level participants in the fraud, and there is no evidence of “scapegoating” for the sake of expediency.

and CEO; Enron Broadband Services President and CEO; Enron Broadband Services COO); HealthSouth (CEO and Chairman of the Board; President and COO); Homestore (Chief Operating Officer); ImClone (President and CEO; Chairman of the Board and CEO of Martha Stewart Living OmniMedia); McKesson (CEO; Chairman of the Board); NewCom (President, CEO, and Chairman of the Board); Rite Aid (President; two Co-Chairmen and CEOs); Symbol Technologies (President and CEO); and WorldCom (CEO). This list excludes state court charges against Tyco CEO Dennis Kozlowski.

My database of fraud prosecutions also includes indicted chief executives of Ahold (U.S. Foodservices CEO), eConnect (CEO), Informix (Chairman and CEO), and Westar (CEO).

The Corporate Fraud Task Force reported that in its first year, criminal charges were brought against CEOs in at least fourteen other corporate fraud investigations. Prosecutors charged the chief executives of American Tissue, Anicom, Commercial Financial Services, Biocontrol Technology, Lason, Network Technologies, U.S. Technologies, MCA Financial, Surgilite, L90, Manhattan Bagel, Media Vision, First Merchants Acceptance Corporation, and Sharp International. First Year Report, *supra* note 34, at 3.2, 3.10, 3.11, 3.13, 3.14, 3.16.

154. They are the key financial officers of Adelphia (CFO; CAO; Treasurer; and Chairman of Board's Audit Committee); Cendant (CFO); Charter Communications (Chief Accounting Officer; CFO); Dynegy (Vice President of Finance); Enron (Executive Vice President and CFO; Chief Accounting Officer; Enron Broadband Services Vice President of Finance; Treasurer; Managing Director in Enron Global Finance; Enron Vice President in Global Finance); HealthSouth (all five former CFOs); Homestore (CFO); McKesson (CFO; Senior Vice President for Finance); NewCom (CFO); PurchasePro (Senior Vice President of Finance); Rite Aid (Executive Vice President and CFO); Qwest (Global Business Unit CFO); Symbol Technologies (Chief Accounting Officer; Senior Vice President and CFO; Senior Vice President of Finance; Vice President of Finance; Director of Finance; Senior Vice President of Worldwide Sales and Finance; Vice President of Worldwide Sales and Finance); Tyco (Executive Vice President and CFO); and WorldCom (CFO; Senior Vice President and Controller).

155. See Brickey, *From Enron to WorldCom and Beyond*, *supra* note 50, at 382-401, appendix A.

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Table 4
Criminal Defendants in Enron-Related Prosecutions

PROSECUTION¹⁵⁶	DEFENDANT
UNITED STATES V. ARTHUR ANDERSEN, LLP	Partnership
UNITED STATES V. DUNCAN	Andersen Global Managing Partner, Enron Engagement Team
UNITED STATES V. KOPPER	Enron Managing Director in Enron Global Finance
UNITED STATES V. FASTOW (ANDREW)	Enron Executive Vice President and CFO
B. Glisan	Enron Treasurer and Former Andersen Accountant
D. Boyle	Enron Vice President in Global Finance
UNITED STATES V. BELDEN	Enron Vice President and Managing Director of West Power Trading Division
UNITED STATES V. LAWYER	Enron Finance Executive
UNITED STATES V. RICHTER	Enron Trading Division Manager
UNITED STATES V. FORNEY	Enron Senior Trader, West Power Trading Division
UNITED STATES V. BIRMINGHAM	NatWest London Banker
G. Darby	NatWest London Banker
G. Mulgrew	NatWest London Banker
UNITED STATES V. FASTOW (LEA)	Enron Former Assistant Treasurer and Wife of Enron CFO
UNITED STATES V. RICE	Enron Broadband Services Chairman and CEO
J. Hirko	Enron Broadband Services President and CEO
K. Hannon	Enron Broadband Services COO

156. In chronological order by lead defendant through July, 2004.

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R. Shelby	Enron Broadband Services Senior Vice President of Engineering Operations
S. Yaeger	Enron Broadband Services Senior Vice President of Strategic Development
K. Howard	Enron Broadband Services Vice President of Finance
M. Krautz	Enron Broadband Services Senior Director of Transactional Accounting
UNITED STATES V. BAYLY	Merrill Lynch Head of Global Investment Banking Division
J. Brown	Merrill Lynch Head of Strategic Asset Lease and Finance Group
R. Furst	Merrill Lynch Enron Relationship Manager, Investment Banking Division
S. Kahaneck	Enron Accountant and Senior Director in APACHI Division
W. Fuhs	Merrill Lynch Vice President
UNITED STATES V. DELAINEY	Enron Energy Services and Enron North America CEO
UNITED STATES V. CAUSEY	Enron Chief Accounting Officer
J. Skilling	Enron President and CEO
K. Lay	Enron CEO and Chairman
UNITED STATES V. RIEKER ¹⁵⁷	Enron Vice President for Investor Relations

Another set of concerns about the fraud prosecutions relates to which cases prosecutors have chosen to pursue. Some commentators suggest that prosecutors may be bypassing the complex frauds at the core of the financial scandals and are charging, instead, crimes like obstruction of justice that are easy to prove.¹⁵⁸ The Arthur Andersen,

157. Rieker was indicted after Causey and Skilling but before Ken Lay.

158. Andrew Ross Sorkin, Wall St. Banker Is Found Guilty of Obstruction: Retrial Victory for U.S.; Star of Technology Boom in '90's Suggested Staff 'Clean Up Files,' N.Y. Times, May 4, 2004, at A1 [hereinafter Wall St. Banker Guilty of

Martha Stewart, and Frank Quattrone prosecutions illustrate the point.

- Arthur Andersen was charged with obstruction of justice in connection with its destruction of thousands of Enron-related documents shortly after learning the SEC had opened an investigation into Enron's financial accounting. After a six week trial, a jury found Andersen guilty. Critics of the prosecution contend that this was a case of scapegoating that did little to root out the fraud at the core of the Enron scandal.¹⁵⁹
- Martha Stewart and her stockbroker, Peter Bacanovic, were prosecuted primarily for concealing why Stewart sold all of her ImClone stock the day before the FDA announced its rejection of an important ImClone drug. Bacanovic and Stewart were charged with conspiracy, obstruction of justice, lying to the government and—in Stewart's case—

Obstruction] (quoting a former federal prosecutor who viewed the conviction of Frank Quattrone as evidence of the government's success in convincing the public that obstructing an investigation is as serious a crime as the underlying fraud and who cited the Martha Stewart and Quattrone prosecutions as examples of the government "successfully employing the tactic of side-stepping a complex financial fraud prosecution in favor [of] a far more simplistic obstruction case") (also quoting a venture capital firm partner who viewed the Quattrone prosecution as a waste of "a lot of time and effort over something that's not very significant"); Mary Flood, *The Fall of Enron: Snowball Effect in Enron Case?*, *Andersen Indictment May Pay Many Dividends to Prosecutors*, *Hous. Chron.*, Mar. 19, 2002, at A1 [hereinafter *The Fall of Enron*] (stating that prosecutors like to bring obstruction and perjury charges because they are simpler to investigate and easier to prove).

159. *The Fall of Enron*, supra note 158 (quoting Arthur Andersen defense lawyer as stating that Andersen was "the first scapegoat in the batch" of post-Enron investigations and prosecutions); *Readers Deserve Better Than Simple Conjecture*, *Columbus Dispatch (Ohio)*, Mar. 31, 2002, Editorial & Comment at 02D (calling Andersen the "transparent scapegoat" that prosecutors used to conveniently deflect attention away from Enron); *Accountants on Trial*, *N.Y. Times*, June 19, 2002, at A22 (observing that the Senate Banking Committee's approval of a bill creating an accounting oversight body made it clear that Andersen would not be the sole scapegoat for the failures of the accounting industry).

securities fraud. Judge Cedarbaum—who seemed skeptical from the outset—ultimately dismissed the lone securities fraud count. But after hearing a brief case for the defense, the jury found Stewart and Bacanovic guilty of all but one of the remaining charges. Critics of the prosecution contend that there was no real fraud and that the two were singled out for covering up a crime Stewart was never charged with committing.¹⁶⁰

- Frank Quattrone, the head of Credit Suisse First Boston's Global Technologies Group (CSFB), became ensnared in an investigation into how CSFB allocated shares in hot initial public offerings. He was charged with obstruction of justice and witness tampering for sending an e-mail urging subordinates to "clean up their files" by destroying relevant documents. His first trial ended with a hung jury, but on retrial the jury convicted him on all three counts.¹⁶¹ The government was criticized for making Quattrone a "scapegoat" by filing a "peripheral" case based on "flimsy" evidence.¹⁶²

Regardless of how these three prosecutions are explained, they are clearly not typical of the corporate fraud cases the government has filed since Enron collapsed.

160. Allan Sloan, *She's a Criminal? Give Me a Break.*, Newsweek, Mar. 15, 2004, at 37. See also Jonathan D. Glater, *On Wall Street Today, A Break From the Past: In Recent Cases, It's the Cover-Up, Not the Crime*, N.Y. Times, May 4, 2004, at C1 (quoting a former federal prosecutor who found the conviction of investment banker Frank Quattrone "another ironic and tragic example of people being held responsible for interfering with an investigation in which ultimately they were not culpable. . . . This isn't an example of the cover-up being worse than the crime. There was no crime.").

161. *Wall St. Banker Guilty of Obstruction*, supra note 158.

162. Erin McClam, *Quattrone Prosecutors Looking at Intent*, Newsday (New York), Nov. 9, 2003, Bus. Sec. at A40; Randall Smith & Kara Scannell, *Prosecutors Weigh Options for Retrial In Quattrone Case*, Wall St. J., Nov. 4, 2003, at C1; Anne Grimes, *Quattrone Case Aired '90s Excesses: Picture of Silicon Valley That Emerged in Courtroom Exposed 'Cowboy Culture.'* Wall St. J., Oct. 27, 2003, at C7.

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Although conspiracy is by far the most frequently charged offense (table 5), the significance of the conspiracy charges is far more than numerical. The stated conspiratorial objectives almost invariably include some species of fraud or deceit. The criminal objectives identified in all of the Enron conspiracy charges¹⁶³ included wire fraud and/or securities fraud. Similarly, the criminal objectives identified in conspiracy charges brought against all but two of the HealthSouth defendants¹⁶⁴ included wire fraud and/or securities fraud,¹⁶⁵ and all of the WorldCom conspiracy charges included securities fraud as a criminal objective.¹⁶⁶

163. Twenty-eight Enron defendants have been charged with conspiracy.

164. Seventeen HealthSouth defendants have been charged with conspiracy.

165. The conspiratorial objectives in the other four cases were to deceive auditors, to falsify corporate books and records, and to bribe foreign officials.

166. All six WorldCom defendants have been charged with conspiracy.

Table 5
Federal Offenses Charged
In Corporate Fraud Prosecutions¹⁶⁷
March, 2003 - July, 2004

OFFENSE	NUMBER OF DEFENDANTS CHARGED
CONSPIRACY	94
SECURITIES FRAUD ¹⁶⁸	68
WIRE FRAUD	58
FALSE BOOKS, RECORDS, REPORTS, OR FILINGS ¹⁶⁹	30
FALSE STATEMENTS ¹⁷⁰	26
MAIL FRAUD	20
OBSTRUCTION OF JUSTICE ¹⁷¹	13
INSIDER TRADING	13
MONEY LAUNDERING	11
TAX FRAUD ¹⁷²	10
BANK FRAUD	8
CIRCUMVENTING INTERNAL ACCOUNTING CONTROLS	5
PERJURY	3
WITHHOLDING INFORMATION	2
TRAVEL ACT VIOLATION	2

Significantly, securities fraud charges are next in line. More than half of the defendants in the investigations I systematically tracked have been charged with securities fraud,¹⁷³ and wire fraud charges are not far behind. Falsifying books, records, reports or filings—principally

167. Table 4 includes criminal charges filed in the following investigations: Adelphia, Cendant, Charter Communications, Credit Suisse First Boston, Dynegy, Enron, HealthSouth, Homestore, ImClone, Kmart, McKesson HBOC, NewCom, NextCard, PurchasePro, Qwest, Rite Aid, Symbol Technologies, Tyco (federal charge only), and WorldCom (federal charges only).

168. Includes title 15 and title 18 (Sarbanes-Oxley) securities fraud charges; excludes insider trading charges.

169. Includes certification and transmission of false reports.

170. Includes false statements to auditors and regulators.

171. Includes witness tampering, Sarbanes-Oxley obstruction charges, and obstructing investigation of a financial institution.

172. Includes filing false returns and tax evasion.

173. Excludes insider trading charges. Some, but not all, of the thirteen defendants charged with insider trading were also charged with committing other species of securities fraud.

SEC documents—in violation of securities laws and making false statements are the next most frequently charged crimes. As seen in table 5, obstruction of justice charges are at the low end of the scale.

But table 5 actually understates the case. When the fraud charges are disaggregated, about seventy-five percent of the defendants have been charged with at least one substantive fraud offense. And that figure still understates the full extent of fraud allegations, because it does not take into account defendants who have been charged with conspiracy to defraud—but not with fraud itself. Thus, for example, in the Enron prosecutions seventy percent of the defendants have been charged with substantive fraud. Of those who have not, all but two have been charged with conspiracy to defraud. Similarly, about seventy-five percent of the HealthSouth defendants were charged with substantive fraud offenses or conspiracy to defraud, and all of the WorldCom defendants were charged with securities fraud.

Stated simply, these prosecutions target fraud, not fluff. Their focus is not on peripheral or tangential crimes but is, instead, on securities law violations. To be sure, those who impede financial fraud investigations will be charged with cover-up crimes. But it is the hindrance of the investigation that triggers obstruction of justice charges. Obstruction charges are rarely filed in lieu of fraud allegations and merely add another dimension to the prosecution.

B. Building a Complex Case

There have been remarkably few criminal trials to resolve federal charges to date. Apart from the “media genic” Arthur Andersen, Frank Quattrone, and Martha Stewart trials, little of the action has been in the federal courtroom. That does not mean that few criminal cases have been resolved, however. Indeed, nearly two-thirds of the defendants charged in these prosecutions have pled guilty, and most of them have become cooperating witnesses in the continuing investigations (table 6).

Table 6
Disposition of Charges
in Federal Corporate Fraud Prosecutions
By Type¹⁷⁴
March, 2002 - July, 2004

GUILTY PLEA	CONVICTION ¹⁷⁵	ACQUITTAL	HUNG JURY	DISMISSAL	AWAITING TRIAL ¹⁷⁶
73	8	4	2	2	43

Guilty pleas play a crucial role in corporate fraud prosecutions. Apart from the frequency with which criminal charges are resolved without going to trial, plea agreements are a key factor in how the government builds its cases. Indeed, all but four of the seventy-three defendants who have pled guilty to date have also become cooperating witnesses.¹⁷⁷

1. HealthSouth

Perhaps the most stunning example is a series of prosecutions in the HealthSouth investigation. In the span of two short months, the prosecutor's pursuit of real-time enforcement led to eleven guilty pleas by HealthSouth executives—including all five former CFOs.¹⁷⁸ Three of the CFO prosecutions are notable because they involved the filing of the first Sarbanes-Oxley charges for certifying a

174. Table 6 reports disposition of charges filed in the following investigations: Adelphia, Cendant, Charter Communications, Credit Suisse First Boston, Dynegy, Enron, HealthSouth, Homestore, ImClone, Kmart, McKesson HBOC, NewCom, NextCard, PurchasePro, Qwest, Rite Aid, Symbol Technologies, Tyco (federal charge only), and WorldCom (federal charges only).

175. Includes one conviction on retrial.

176. Includes two defendants awaiting retrial and two defendants who were in trial when this article went to press.

177. The defendants who pled guilty but did not enter into cooperation agreements are ImClone President and CEO Sam Waksal, Enron Treasurer Ben Glisan, and two top NewCom executives. Enron's Glisan, who is serving a five year term, is reportedly cooperating from prison. Mary Flood, *The Fall of Enron: Prisoner Goes to See Grand Jury*; Enron Ex-Official Likely Cooperating, *Hous. Chron.*, Mar. 5, 2004, Bus. Sec. at 1.

178. Former Executive at HealthSouth Pleads Guilty, *N.Y. Times*, May 6, 2003, at C8.

false financial statement.¹⁷⁹ Within the next four months, the total number of HealthSouth executives who had pled guilty rose to fifteen.¹⁸⁰ Significantly, all of them entered into cooperation agreements to assist in the continuing investigation. Within a month after the last guilty plea was entered, HealthSouth CEO and Chairman of the Board Richard Scrushy was charged in an eighty-five count indictment¹⁸¹ with conspiracy, securities fraud, mail and wire fraud, money laundering, and three Sarbanes-Oxley crimes—including certifying or attempting to certify false financial statements¹⁸² and violating Sarbanes-Oxley's title 18 securities fraud statute.¹⁸³ There can be no doubt that the cooperation of former CFOs and Senior and Executive Vice Presidents in the accounting and finance departments provided an invaluable roadmap up the corporate chain of command.

179. 18 U.S.C.A. § 1350 (West Supp. 2003).

180. Ex-HealthSouth Official Agrees to Plea Deal in Massive Fraud, Wall St. J. Online, Sept. 26, 2003 (on file with the author); Another Guilty Plea in HealthSouth Case, N.Y. Times, Aug. 29, 2003, at C2; HealthSouth Executive Admits to Falsifying Taxes, N.Y. Times, Aug. 28, 2003, at C7.

181. Fifteen of the counts in the indictment were forfeiture counts.

182. 18 U.S.C.A. § 1349 (West Supp. 2003). Section 1349 applies to attempts to violate other provisions included in the mail fraud chapter of title 18. There is no attempt statute of general applicability in the federal criminal code.

Section 1349 also includes a new conspiracy provision that applies only to conspiracies to violate other provisions codified in the mail fraud chapter. Unlike the general federal conspiracy statute, 18 U.S.C. § 371 (West 2000), the authorized punishment for conspiracies charged under section 1349 is keyed to the punishment for the object offense. This can mean an enormous difference—in one case a difference of twenty-five years—in the maximum authorized sentence. For a comparison of the authorized penalties under the two conspiracy provisions, see Brickey, *From Enron to WorldCom and Beyond*, supra note 50, at 379, table 2.

183. Indictment, *United States v. Scrushy*, CR-03-BE-0530-S (N.D. Ala. Oct. 29, 2003) (on file with the author). The Sarbanes-Oxley securities fraud provision, 18 U.S.C.A. § 1348 (West Supp. 2003), is modeled on the mail fraud statute. It is “more general and less technical” than the anti-fraud provisions in the securities laws and “should not be read to require proof of technical elements from the securities laws.” 148 Cong. Rec. S7421 (daily ed. July 26, 2002). Section 1348 authorizes longer sentences than are provided in its title 15 securities fraud counterpart. See Brickey, *From Enron to WorldCom and Beyond*, supra note 50, at 378, table 1.

2. WorldCom

Cooperating witnesses have also been enormously important in the WorldCom and Enron prosecutions. The story of the WorldCom cases began with the filing of a sealed complaint in early July of 2002.¹⁸⁴ The seven count complaint named WorldCom CFO Scott Sullivan and WorldCom's Senior Vice President and Controller David Myers as defendants.¹⁸⁵ The complaint alleged that Sullivan and Myers conspired to commit securities fraud, to make false filings with the SEC, to mislead auditors, and to falsify books and records. In addition, the two were charged with securities fraud and making false filings with the SEC. The conspiracy count charged that Sullivan and Myers conspired with "others known and not known,"¹⁸⁶ but did not identify any unindicted co-conspirators by name.

It was not until the end of August that an indictment was filed, but by then the cast of characters had changed. The indictment charged Sullivan and Buford Yates, WorldCom's Director of General Accounting, but not David Myers.¹⁸⁷ Like the complaint, the indictment charged Sullivan and Yates with conspiracy, securities fraud, and making false filings with the SEC. Although the indictment did not charge additional defendants, it did name Betty

184. State criminal charges relating to the WorldCom fraud were subsequently filed in two jurisdictions. Senior Vice President and Controller David Myers was indicted for securities fraud in Mississippi state court and pled guilty. The Oklahoma Attorney General later filed charges against WorldCom, its CEO Bernie Ebbers, CFO Scott Sullivan, Myers, and two WorldCom accountants. WorldCom settled the case against it under an unusual agreement to create 1,600 new jobs in Oklahoma over ten years, with average salaries of \$35,000, and to cooperate in the continuing state investigation. News Release, W.A. Drew Edmonson, Attorney General, State to Gain 1,600 Jobs From WorldCom Agreement (Mar. 12, 2004) (on file with the author). The charges against Ebbers were temporarily dismissed at the urging of federal prosecutors. Charges against the other defendants are pending.

185. Sealed Complaint, *United States v. Sullivan*, 02 Mag 1511 (S.D.N.Y. July 3, 2002) (on file with the author).

186. *Id.* at 1.

187. Indictment, *United States v. Sullivan* (indictment filed in United States District Court for the Southern District of New York) (Aug. 28, 2002) (on file with the author).

Vinson and Troy Normand—WorldCom accounting officials who served, respectively, as Director of Management Reporting (DMR) and Director of Legal Entity Accounting—as unindicted co-conspirators.¹⁸⁸ And while the conspiracy count implicated Myers as a participant in the scheme with Sullivan,¹⁸⁹ it did not name him as an unindicted co-conspirator.

It can only be surmised that Myers was dropped as Sullivan's co-defendant because he had begun to negotiate a plea. As it turns out, the inference is supported by subsequent events. A month after the Sullivan indictment was filed, Myers was charged in a three count information¹⁹⁰ with conspiracy, securities fraud, and making false filings with the SEC.¹⁹¹ The conspiracy count identified Sullivan, Yates, Vinson, and Normand as co-conspirators. Myers pled guilty the day the charges were filed and became a cooperating witness.

Six weeks later, Vinson and Normand were charged—in separate informations—with conspiracy and securities fraud.¹⁹² As might be expected, the conspiracy charges identified all five as members of the conspiracy. Like Myers, both Vinson and Normand pled guilty the day the charges were filed and became cooperating witnesses.¹⁹³ At separate plea hearings, Myers, Vinson, and Normand all said they were acting on orders from senior management. Vinson and Normand specifically named Scott Sullivan.¹⁹⁴

188. *Id.* at 2.

189. *Id.* at 7-13.

190. It is relatively common to charge cooperating witnesses in an information rather than an indictment. The filing of a criminal information is a less formal way to proceed than presenting the case to a grand jury and seeking the return of an indictment. In federal court, the Constitution prohibits bringing a defendant to trial for a felony offense without an indictment unless the defendant waives the right to a grand jury proceeding. U.S. Const. amend. V.

191. Information, United States v. Myers, 02-CR-1261 (S.D.N.Y. Aug. 25, 2002) (on file with the author).

192. Information, United States v. Vinson, 02-CR-1349 (S.D.N.Y. Oct. 10, 2002); Information, United States v. Normand (information filed in United States District Court for the Southern District of New York) (S.D.N.Y. Oct. 10, 2002) (both on file with the author).

193. 2 Ex-Officials of WorldCom Plead Guilty, *N.Y. Times*, Oct. 11, 2002, at C10.

194. Former Controller of WorldCom Pleads Guilty to Fraud Charges, *N.Y.*

Shortly before Vinson and Normand entered their pleas, Sullivan's remaining co-defendant, Buford Yates, also pled guilty and became a cooperating witness. Like Myers, Vinson, and Normand before him, Yates said at his plea hearing that he participated in the fraud on orders from the "highest levels" of management.¹⁹⁵

Notably, this turn of events left Sullivan slowly twisting in the wind. Each of the charging documents identified him as a co-conspirator, and the clear implication was that the cooperating witnesses would testify against him. It was bad enough that four of his colleagues had turned state's evidence. But in the interim, two outside reports—one prepared by a special investigative committee of the WorldCom board of directors,¹⁹⁶ the other by WorldCom's bankruptcy examiner¹⁹⁷—provided detailed blueprints of Sullivan's role in the decision to treat ordinary expenses as capital expenditures, his rationale for deciding to do so, and his participation in implementing the accounting scheme.

Understandably, all of this put enormous pressure on Sullivan.¹⁹⁸ Indeed, there were unconfirmed rumors that Sullivan had been engaged in serious plea negotiations that broke down because prosecutors insisted that he serve a prison term of at least ten years.¹⁹⁹ Later reports suggested that negotiations might have resumed, but by and large nothing notable happened until a few months before he was scheduled to go to trial. Amid reports that he had already

Times, Sept. 27, 2002, at C2; Deborah Solomon, WorldCom's Ex-Controller Pleads Guilty to Fraud, Wall St. J., Sept. 27, 2002, at A3; 2 Ex-Officials of WorldCom Plead Guilty, N.Y. Times, Oct. 11, 2002, at C10.

195. Robert F. Worth, Ex-Official Of WorldCom Pleads Guilty To Fraud, N.Y. Times, Oct. 8, 2002, at C9; Jerry Markon, WorldCom's Yates Pleads Guilty, Wall St. J., Oct. 8, 2002, at A3.

196. See generally Report by WorldCom Special Investigative Committee, *supra* note 77.

197. See generally First Interim Report of Dick Thornburgh, *supra* note 77.

198. Deborah Solomon, WorldCom's Ex-Controller Pleads Guilty to Fraud, Wall St. J., Sept. 27, 2002, at A3.

199. Deborah Solomon, Jerry Markon & Susan Pulliam, Sullivan Indictment May Be Near, Wall St. J., Aug. 28, 2002, at A3; Mike Claffey, Feds Indict WorldCom Executive, N.Y. Daily News, Aug. 29, 2002, News Sec. at 9.

spent \$14 million in legal fees, Sullivan struck a deal with the prosecutors eight months after he was first criminally charged. He pled guilty to conspiracy, securities fraud, and making false filings with the SEC and agreed to become a cooperating witness.²⁰⁰

Enter Bernie Ebbers—until then WorldCom's elusive CEO—who was indicted on the day Sullivan entered his plea.²⁰¹ Without Sullivan's cooperation, prosecutors had been stymied in their efforts to connect the dots to the top, and the Ebbers indictment was a major break in the case.

The indictment is instructive in several respects. First, it portrays Ebbers and Sullivan as virtually joined at the hip on the key accounting issues.²⁰² The indictment alleges that they both regularly monitored the company's operating performance and financial results, that they regularly met to discuss the revenue reports, and that Ebbers "carefully scrutinized" the reports, which were printed on special paper to facilitate his review. The indictment also alleges that Ebbers and Sullivan reviewed documents summarizing anticipated events that would affect WorldCom's revenues and jointly devised means to artificially inflate earnings to meet analysts' expectations. Thus, the indictment portrays Ebbers as playing a central role in the fraud.

Equally important, the indictment reveals substantial cooperation on Sullivan's part and provides a tantalizing glimpse at what his testimony is likely to be. In addition to specific allegations about a close working relationship between the two, the conspiracy count quotes statements—

200. Prepared Remarks of Attorney General John Ashcroft, Indictment of Bernard J. Ebbers & Scott D. Sullivan (Mar. 2, 2004) (on file with the author); Dennis K. Berman, Sullivan Gives In, Pleads Guilty: Ex-WorldCom Executive, Faced 165 Years in Jail; Cooperates Against CEO, *Wall St. J.*, Mar. 3, 2004, at A12. The Sullivan plea agreement is presently not a public document. Voice Mail Message to Mark Kloempken, Assistant Librarian—Reference/Public Services, Washington University School of Law, from Irvin B. Nathan, Partner, Arnold & Porter (Mar. 19, 2004) (transcription on file with the author).

201. Indictment, *United States v. Ebbers*, S2-02-CR-1144 (BSJ) (S.D.N.Y. Mar. 2, 2004) [hereinafter *Ebbers Indictment*] (on file with the author).

202. The Ebbers indictment names Sullivan as a co-defendant.

alleged to be materially false—that Ebbers made during conference calls with analysts. The statements attributed to Ebbers largely relate to misleading claims about significant revenue growth and WorldCom’s robust financial condition.²⁰³ Sullivan, of course, was in on the calls. The indictment also quotes a voicemail message Sullivan left Ebbers that painted Ebbers with personal knowledge of the accounting irregularities. The message states that the monthly revenue reports were getting “worse and worse,” that the reports had “accounting fluff” and “junk” in them, and that the numbers in the reports were way off.²⁰⁴ Suffice it to say, Sullivan’s decision to cooperate was an enormous boost to the government.

But why was he so crucial to the case against Ebbers? Several factors, including Ebbers’ management style, made it difficult to connect him to the fraud. Ebbers was reputedly not a hands-on manager. Instead, he was said to delegate everything that he could. He met primarily with high-level executives like Sullivan, and no minutes or records were kept. He never took notes, rarely used a computer, and did not use e-mail.²⁰⁵ Simply put, his management style left no paper trail for investigators to follow. That being true, it would take the knowledge of a relatively high ranking insider to guide the government to the skeletons—if skeletons there be—in Bernie Ebbers’s closet.

3. Enron

The government also achieved a major breakthrough in its enormously complex Enron investigation when CFO Andy Fastow agreed to plead guilty and cooperate with

203. Ebbers Indictment, *supra* note 201, at 20-21.

204. *Id.* at 27.

205. In the words of one executive, “[i]f people had questions for him, they’d fax them to his secretary and he’d call them back or scribble a reply.” Jessica Hall, *Ebbers Left Little Evidence; WorldCom CEO Always Low-Tech*, *Hous. Chron.*, Oct. 15, 2002, at Bus. Sec. at 1.

prosecutors.²⁰⁶ Fastow's plea negotiations turned into an elaborate dance in which he and his wife Lea—a former Enron Assistant Treasurer who was separately indicted on tax-related charges²⁰⁷—worked to obtain a commitment that she would complete a short sentence before he went to prison so at least one parent could care for the children. Mrs. Fastow ultimately reached an agreement under which she would plead guilty to a misdemeanor tax offense and serve a maximum of one year in prison.²⁰⁸ Her husband's plea agreement called for him to serve at least ten years in prison and to cooperate fully.

Andy Fastow's cooperation agreement bore fruit a week after he entered his plea with the indictment of Rick Causey—Enron's Chief Accounting Officer and Fastow's boss—on charges of conspiracy and securities fraud.²⁰⁹ A month after that, the government filed an indictment charging Enron President and CEO Jeff Skilling with securities fraud, wire fraud, false statements, insider trading, and conspiracy.²¹⁰ Several more months of

206. Plea Agreement, *United States v. Fastow* [Andrew], CRH-02-0665 (S.D. Tex. Jan. 14, 2004) (on file with the author).

207. Indictment, *United States v. Fastow* [Lea], CRH-03-150 (S.D. Tex. Apr. 30, 2003).

208. Her original plea agreement called for her to plead guilty to one felony count and to serve a split sentence of five months in prison and five months of home confinement. Plea Agreement, *United States v. Fastow* [Lea], CRH-03-150 (S.D. Tex. Jan. 14, 2004) (on file with the author). The presentencing report recommended a somewhat longer prison term, which the judge was free to impose. The terms of Mrs. Fastow's plea agreement allowed her to withdraw her guilty plea if the judge rejected its terms. *Id.* at 3. Mrs. Fastow withdrew her plea after the judge announced that he would not feel bound by the ten month split sentence recommended in the plea agreement. Kurt Eichenwald, *Lea Fastow Withdraws Plea in Tax Case*, N.Y. Times, Apr. 4, 2004, at C4. The judge then set a June 2004 trial date, *The Fall of Enron*, supra note 158, but renewed plea negotiations resulted in a new deal under which she agreed to plead guilty to one tax misdemeanor charge carrying a maximum sentence of twelve months in prison. *New Plea Bargain for Lea Fastow in Enron Case*, N.Y. Times, Apr. 30, 2004, at C13. The new plea agreement was filed under seal. Judge Hittner accepted her misdemeanor plea and sentenced her to serve one year in prison followed by a year of supervised release. John R. Emshwiller, *Lea Fastow Receives Sentence in Enron Tax Case*, Wall St. J., May 7, 2004, at C3.

209. Indictment, *United States v. Causey*, CRH-04-25 (S.D. Tex. Jan. 21, 2004) (on file with the author).

210. Superseding Indictment, *United States v. Skilling*, CRH-04-25 (S.D. Tex.

intensified investigation²¹¹ culminated in the indictment of Enron CEO and Chairman Ken Lay, who was charged with securities fraud, wire fraud, bank fraud, and conspiracy.²¹² Thus, all of the top Enron officers now have been charged.

Why did it take so long to get to the top? One reason is that the fraud was so complex. To unravel all of the strands required the assistance of knowledgeable insiders to guide investigators through hundreds of thousands of documents.²¹³ In consequence, prosecutors have, of necessity, used a building-block approach in putting these cases together.

But several other factors may have contributed to the delay in reaching the top. First, Ken Lay was said to be relatively disengaged as a manager. His principal role seemed to be that of goodwill ambassador, community booster, and philanthropist.²¹⁴ Indeed, until the scandal broke, it was rumored that he planned to retire and run for political office.²¹⁵ Was he in or out of the loop?²¹⁶

Feb. 18, 2004) (on file with the author). The superseding indictment consolidated the Skilling and Causey prosecutions and charged Causey with additional crimes.

211. See John R. Emshwiller, *Case Against Lea Fastow is Revised*, *Wall St. J.*, Apr. 30, 2004, at B2; Deborah Solomon, *Former Enron Official is Likely to Settle Charges: Rieker is Expected to Help U.S. Prosecutors in Case Against Other Executives*, *Wall St. J.*, May 5, 2004, at A6.

212. *Superseding Indictment, United States v. Causey*, CRH-04-25 (S-2) (July 7, 2004) (on file with the author). The second superseding indictment consolidated the Skilling, Causey, and Lay prosecutions.

213. To date, more than thirty people associated with the Enron fraud have been criminally charged.

214. Bethany McLean & Peter Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron* 3, 86 (2003) [hereinafter *The Smartest Guys in the Room*]. Lay joined Enron as its CEO in 1984. Peter C. Fusaro & Ross M. Miller, *What Went Wrong at Enron* 1 (2002) [hereinafter *What Went Wrong*]. He stepped down in February of 2001 when Skilling assumed the post, but Lay remained Chairman of the Board. *Id.* at 174. After Skilling's abrupt resignation after just six months on the job, Lay assumed the CEO post again. *Id.* at 176. Lay resigned on January 23, 2002. By then, Enron had filed for bankruptcy and had sold its energy trading business for a song, and the Department of Justice had begun a criminal investigation of Enron's accounting practices. *Id.* at 178.

215. *The Smartest Guys in The Room*, supra note 214, at 342. It was rumored that he wanted to become Mayor of Houston. *Id.*

216. Sherron Watkins, the whistleblower who brought the fraud to his attention, thought Lay and the board had been "dupe[d]" by Skilling and Fastow, and that he should not bear full responsibility for the accounting mess. The

Investigators' efforts to examine evidence that could point to what he did or did not know were hindered by nearly two years of legal stonewalling. On January 2, 2002, the SEC issued a subpoena to Lay, who was then Enron's Chairman and CEO.²¹⁷ The subpoena ordered him to produce documents relating to Enron on January 9 and to testify on January 23. The SEC later allowed him to produce the documents on a rolling basis beyond the January 9 date. Despite repeated requests that he comply, he withheld subpoenaed records—including copies of Enron memoranda, letters, and speeches—on Fifth Amendment grounds.²¹⁸

His claim was problematic in several significant respects. The documents were corporate records, and a corporation has no Fifth Amendment privilege against self-incrimination.²¹⁹ Thus, to withhold the records on Fifth Amendment grounds, Lay would have to assert a privilege that was personal to him. But under well-settled law, the custodian of corporate records cannot assert his personal Fifth Amendment privilege to resist producing them.²²⁰ Thus, a successful claim of privilege to withhold the Enron documents would necessarily hinge on the collateral claim that they were his personal records, not those of the corporation.

Here, that argument necessarily founders because his employment agreement provided that all business-related

Financial Collapse of Enron—Part 3: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 107th Cong. 21 (2003) (testimony of Sherron Watkins) At a congressional hearing into the Enron scandal, Watkins testified that even after she informed Lay of the special purpose entity problem, she believed he did not fully understand the seriousness of the issue. *Id.* at 23.

217. SEC v. Lay, Memorandum of the Securities and Exchange Commission in Support of its Application for Orders to Show Cause, for an *In Camera* Review, and Requiring Obedience to Subpoena (D.D.C. Sept. 29, 2003) [hereinafter SEC Memorandum] (on file with the author).

218. *Id.* at 5.

219. *Bellis v. United States*, 417 U.S. 85, 87-94 (1974).

220. *Braswell v. United States*, 487 U.S. 99, 102 (1988). Because corporate officials hold corporate records in a representative capacity, they cannot assert a personal Fifth Amendment privilege even if the documents would incriminate them personally. *Id.* at 109-110.

documents generated while he worked for Enron were Enron's "sole and exclusive property."²²¹ Because the subpoenaed documents related to Enron business, the agreement precluded his claim that they were personal records, even if they bore his handwritten notes and annotations. Moreover, the agreement required him to return all Enron-related business documents when he left the company. Yet he continued to withhold them from investigators long after he resigned from his Enron posts on January 23, 2002²²²—just two weeks after the subpoena was served.

After more than a year of legal wrangling, the SEC sought a court order compelling him to produce the documents.²²³ A month or so later, the SEC and Lay reached an agreement that required him to surrender the records within a week and allowed the SEC to use them in any criminal or civil action later brought against him.²²⁴ Thus, in view of this protracted evidentiary dispute, it is not surprising that his indictment came so late.

C. Observations on Building Complex Cases

Part IV's examination of the HealthSouth, WorldCom, and Enron investigations illustrates that building a complex corporate fraud case often takes time, patience, and ingenuity. Sometimes, as with HealthSouth, luck is on the prosecutor's side. With more than a dozen key company officials—including all five former CFOs—quickly pleading guilty and agreeing to cooperate, the route up the chain of command was relatively fast and direct. CEO Richard Scrushy was indicted just six months after the first criminal charges were filed against financial and

221. SEC Memorandum, *supra* note 217, at 3-4.

222. *Id.* at 4.

223. *United States v. Lay*, Application of the Securities and Exchange Commission for Orders to Show Cause, For an *In Camera* Review and Requiring Obedience to Subpoena (D.D.C. Sept. 29, 2003) (on file with the author).

224. Former Enron Chief Agrees to Give Documents to SEC, *Wall St. J. Online*, Nov. 7, 2003 (on file with the author). The agreement was approved by the judge in the case. *Id.*

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accounting executives who admitted their participation in the fraud.

With Enron and WorldCom, the route to the top was unavoidably more time-consuming and circuitous. Because key witnesses were less willing to cooperate, the government's building-block approach involved painstaking work that required time and strategic coordination. But it was work that paid off handsomely and may yet bear more fruit. WorldCom CEO Ebbers was charged a little more than a year after the fraud was exposed. Enron CEOs Skilling and Lay were indicted nearly two and a half years after Enron's collapse, and the investigation is still ongoing.

Contrary to what skeptical observers often say, these cases do not reflect prosecutorial footdragging. They demonstrate the complexity of the work required to build a solid case against top executives of corporations that engaged in elaborately concealed, long-term schemes to defraud. But developing the evidence needed to charge the CEOs first required building solid cases against other key executives who were privy to what their superiors knew and when their superiors knew it. Simply put, cooperation up the chain of command was critical to reaching the top.

CONCLUSION

Enron was a bleak moment in modern corporate history. Once renowned as the most successful corporation in the United States, "Enron" is now synonymous with fraud and failure. Enron left a legacy of distrust, reforms, and heightened regulation.

Enron's legacy also includes a sea change in the enforcement environment. Aggressive civil and criminal initiatives over the past few years have resulted in the filing and successful resolution of unprecedented numbers of major fraud cases in a record period of time. Criticisms that the government has set its sights too low—by largely sidestepping the complex financial frauds that are the core of

the corporate scandals, or being content to prosecute mostly mid-level operatives—are fundamentally misinformed.

As part IV clearly shows, fraud is the principal focus of these post-Enron prosecutions. The defendants are typically charged with securities fraud, wire fraud, or conspiracy to defraud—along with other kindred crimes. Although prosecutors will not hesitate to charge anyone who obstructs or impedes an investigation with cover-up crimes, the occasional filing of collateral obstruction of justice charges does not change the reality that these are, at bottom, securities fraud prosecutions.

It is also clear that these prosecutions are directed at pinning responsibility on all culpable parties—from those who actually cook the books to high-ranking executives who play more indirect roles. This building-block approach serves the ultimate goal of working up the corporate hierarchy to charge the highest blameworthy executives. As the recent indictments of CEOs Ebbers, Skilling, and Lay confirm, the prosecutorial objective is to connect the dots to the top.

Yet notwithstanding considerable enforcement success, it remains to be seen whether we are nearing the end of the road. Although it would be reassuring to think that we are, the widening circle of revelations about large-scale accounting irregularities, corporate cronyism, executive excess, and Wall Street complicity suggests that the opposite may be true. Or, as the inimitable Yogi Berra might have put it: “It ain’t over ‘till it’s over.”