case study 3.2

Enron Boss to Turn Himself In

ENRON: THE KEY PLAYERS

To be indicted

Kenneth Lay

To be indicted overnight on charges relating to accounting fraud that drove Enron into bankruptcy.

Guilty pleas

Andrew Fastow

Pleaded guilty in January to two counts of wire fraud and conspiracy to commit wire and securities fraud. His wife Lea, a one-time director and assistant treasurer of corporate finance at Enron, faces one year in jail after pleading guilty to a single count of filing a false income tax return.

Awaiting trial

Jeffrey Skilling

Former CEO was indicted on 35 counts of securities fraud, insider trading, wire fraud and conspiracy in February. He pleaded not guilty and is free on bond.

Richard Causey

Former chief accountant was indicted in January. He faces 31 counts of fraud, conspiracy and insider trading.

The company

Enron could emerge from Chapter 11 bankruptcy protection by July 15, the deadline for when a bankruptcy judge may issue his approval of the company’s reorganisation plan. Under the plan, creditors stand to receive 20c for every dollar owed – 92 per cent in cash and the rest in equity in Prisma Energy International, which owns Enron’s foreign assets. Enron’s other assets have been sold, or are in the process of being sold.

Thirty months after the collapse of Enron shook US market capitalism to its core, former boss Ken Lay will turn himself in to the FBI today and appear in court to face criminal charges that he conspired to defraud investors.

A friend of President George W Bush and a member of Houston society, Mr Lay, 62, is expected to suffer the indignity of wearing handcuffs as he is paraded like the catch of the day for the media on his way into the courtroom.

He will plead not guilty to the long-awaited charges, which are yet to be specified but were said to include fraud and insider trading.

‘I have been advised that I have been indicted,’ Mr Lay said last night. ‘I will surrender in the morning.  
I have done nothing wrong and the indictment is not justified.’

Mr Lay became the public face of corporate greed after Enron – the energy trader he built into the seventh-largest US company by sales – filed for bankruptcy in December 2001.

Thousands lost their jobs and billions of dollars of shareholder wealth evaporated in what was then the largest bankruptcy filing in US history.

The collapse of telecommunications giant WorldCom almost two years ago dwarfed Enron in terms of assets destroyed but the Enron disaster dented America’s faith in the capital markets by revealing that some companies’ balance sheets were garbage wrapped in glossy paper.

As rumours that the indictment was imminent drew stronger in past weeks, Mr Lay broke his silence to profess his innocence, blaming underlings such as former chief financial officer Andrew Fastow for cooking up the off-balance-sheet schemes that hid Enron’s ballooning debt.

The Enron collapse brought down accounting giant Arthur Andersen and prompted Washington to enact corporate governance reforms.

Mr Lay, whose wealth was largely tied up in Enron stock, suffered along with investors. Worth more than $US400 million at the start of 2001, Mr Lay told *The New York Times* recently that of his remaining $US20 million, about $US19 million would be used for legal fees and to pay off debt.

The indictment is a huge step in a two-year investigation by the Justice Department, which has so far yielded criminal charges against 30 individuals, including Fastow and Jeffrey Skilling, who resigned as Enron chief executive in August 2001 after only six months in charge.

Skilling’s departure ended Mr Lay’s thoughts of moving on from Enron, ensuring the Texas titan, who was once rumoured to be in line for a cabinet post in the Bush administration, was at the helm when the ship went down.

Enron investigators are believed to have focused on this period, when Mr Lay made numerous public announcements expressing confidence in Enron while he was selling the stock and while whistleblowers such as Sherron Watkins – later named one of *Time* magazine’s Persons of the Year in 2002 – were sending him warning emails.

Federal prosecutors scored a coup in January when Fastow pleaded guilty to two counts of conspiracy and agreed to assist the investigation.

A similar strategy was used in the WorldCom investigation, with prosecutors waiting for CFO Scott Sullivan to agree to co-operate before they charged CEO Bernie Ebbers.

SOURCE: Rodney Dalton, New York Correspondent, ‘Enron boss to turn himself in’, *The Australian*, 9 July 2004, p. 17.

Questions

1 Briefly highlight key aspects of the Enron financial disaster.

2 Mr Lay, the CEO of Enron, is to be charged with fraud and insider trading.

(a) What is ‘insider trading’?

(b) Why does company law view ‘insider trading’ so severely?

3 The article said ‘that some companies’ balance sheets were garbage wrapped in glossy paper’.

(a) What is a balance sheet supposed to reveal about a reporting entity?

(b) What is the balance sheet equation?

(c) Why might any of the assets, liability or owners’ equity, or their balances, be incorrect?

4 What is ‘off-balance-sheet’ debt?

5 How did the collapse of Enron bring down the giant auditing firm of Arthur Andersen?

6 Is it ethical for the CEO to sell shares in the company while at the same time making ‘numerous announcements expressing confidence in Enron’?