

Name _____

Business Management

Content Reading: Enron

Learning Target: *I can describe ethical accountability among business officers.*

Read the following and underline the important points.

Employees?

ISSUE: To what degree are CEOs Ken Lay and Jeff Skilling responsible for not preventing ethical misconduct and illegal activities within the organization?

Enron was a large energy corporation that was once considered one of the most innovative companies in America. Today, Enron is the ultimate symbol of corporate wrongdoing, associated with greed, corporate malfeasance, dishonesty, accounting fraud, and corporate governance failure. As a result of Enron's failure, thousands of people lost their jobs, and investors and banks lost billions of dollars.

Enron CEO and Chairman Ken Lay once said that he felt that one of the great successes at Enron was the creation of a corporate culture in which people could reach their full potential. He said that he wanted it to be a highly moral and ethical culture and that he tried to ensure that people honored the values of respect, integrity, and excellence. On his desk was an Enron paperweight with the slogan "Vision and Values." Despite these intentions, ethical behavior was not put into practice.

Enron was operating in an intense business environment that focused on financial results. Enron used complex computer trading models, exotic derivative products, and extreme risk-taking without considering the ethical dimensions of decision-making or the ramifications of high-risk financial instruments on stakeholders. In addition, many Enron employees were young, aggressive, and highly-educated; these managers were inventing new rules related to energy trading and distribution. Enron also did not have an effective ethics and compliance program. Top management and the board of directors were only looking at the numbers and trying to achieve earnings.

Enron collapsed in late 2001 after declaring massive financial losses. The company had inflated income for over four years, largely through off-the-balance-sheet partnerships run by Enron executives (including CFO Andrew Fastow), which kept millions of dollars of debt off of Enron's official books. Although the partnerships were legal at the time, the way Fastow created them based on Enron stock resulted in fraud. Furthermore, employees at Arthur Andersen, Enron's accounting firm, received a memo ordering them to destroy all audit materials except for basic work papers. Enron executives (including Ken Lay and former CEO Jeff Skilling) sold over \$1.1 billion of Enron stock while continuing to encourage investors to continue purchasing the stock. Ken Lay said he had no control over the sales of stock because they were triggered by bank decisions due to the decreasing price of Enron stock.

The government argued that Ken Lay, Jeff Skilling, and other employees purposely misrepresented the company's financial conditions to stakeholders to enrich themselves. Only 22 former Enron employees were indicted or convicted, most of whom were top managers close to Lay and Skilling. During the Enron trial, the judge informed the jury that they could find Lay and Skilling guilty of consciously avoiding knowledge about wrongdoing at the company. While the legal theories and facts behind Enron's failure are complex, it really came down to one issue:

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"Lay should have known what was going on and was responsible for the complete disaster." This was emphasized by Jill Ford, a member of the Enron jury, who we interviewed in February, 2007. Jill Ford seemed to like Ken Lay as a person, although she and the rest of the jury convicted him on what he should have known about Enron. She indicated that there was no direct evidence that he either participated in or knew about illegal acts that occurred at Enron. She said that when the judge stated that they could convict Lay for what he should have known, then the jury had no alternative but to convict him.

According to Lay, he was largely unaware of the ethical situation within the firm. He had relied on lawyers, accountants, and senior executives to inform him of issues such as misconduct. He felt that he had been protected from certain knowledge that would have been beneficial and would have enabled him to engage in early correction of the misconduct. Lay claims that all decisions he made related to financial transactions were approved by his law firm, Vincent & Elkins, and the Enron board of directors. Lynn Brewer, a former Enron executive, states that Ken Lay was not informed about alleged misconduct in her division. Additionally, Mike Ramsey, the lead attorney for Ken Lay's defense, claimed that Lay was not aware of most things in the indictment. The defense was informed that 130 of Enron's top management, who could have served as defense witnesses, were unindicted co-conspirators with Lay and Skilling. Therefore, the defense could not obtain witnesses from Enron's top management teams under fear that witnesses would be indicted.

Lay and Skilling were convicted of "honest services fraud" for behavior that included conspiracy, securities fraud, insider trading, and lying to auditors but did not involve bribes or kickbacks. The honest services law is used for alleged transgressions such as making false statements or depriving another person of the intangible right of honest service. Jeff Skilling was sentenced to 24 years in prison, which he has been serving in Colorado (Ken Lay died in 2006 and his conviction has been vacated). However, in June 2010 the United States Supreme Court ruled that the honest services law could not be used for convicting Jeff Skilling because the honest services law could only be used for bribes and kickbacks, not for conduct that is ambiguous or vague. The Supreme Court decision did not confirm that there was no misconduct, but that the conduct was not in violation of a criminal fraud law. The court's decision did not overturn the conviction and sent the case back to a lower court for evaluation.

Ungagged.net (The Other Side of the Enron Story) attempts to provide interviews that question the ethics of the prosecution of the Enron case. Most of those interviewed feel that it was almost impossible to obtain a fair trial for Lay and Skilling. It appears that society needs someone to blame when things go wrong in a corporate environment. Enron was clearly the biggest business scandal of its time. Officials swore that such a disaster would never occur again and passed legislation like the Sarbanes-Oxley Act to prevent future business fraud. Yet, did the business world truly learn its lesson from Enron's collapse? The answer would be a resounding no, as the 2008-2009 financial crisis attested. The crisis made the Enron scandal look small in comparison and was the worst financial crisis since the Great Depression. Like the Enron scandal, the financial crisis largely stemmed from corporate misconduct.

For additional information about this topic, please refer to Ungagged.net (The Other Side of the Enron Story), which provides interviews about the way the U.S. Department of Justice prosecuted the Enron case, especially the interview with Ken Lay's lead attorney, Mike Ramsey (<http://ungagged.net/whatitwaslike-03.php>).

There are two sides to every issue:

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Sources:

Daniel Kadlec, "Power Failure," *Time Magazine*, Dec. 02, 2001, <http://www.time.com/time/magazine/article/0,9171,1101011210-186639,00.html#ixzz0updc1QaT> (accessed July 29, 2010).

Daniel Kadlec, "Enron: Who's Accountable?" Time Magazine, Jan. 13, 2002, <http://www.time.com/time/business/article/0,8599,193520,00.html#ixzz0v0Yku2MF> (accessed July 29, 2010).

Playing the Blame Game, *Time Magazine*, Jan 20, 2002, <http://www.time.com/time/2002/enron/collapse> (accessed July 29, 2010).

O.C. Ferrell and Linda Ferrell, "The Responsibility and Accountability of CEOs: The Last Interview with Ken Lay," Working Paper, July 8, 2010. Ungagged.net: The Other Side of the Enron Story, <http://ungagged.net> (accessed July 29, 2010).

Write a paragraph, minimum five sentences, as to which side of the issue mentioned above you believe in and why.

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