



Perspectives on Compliance Programs

The Enron Verdict

By Andrew Weissmann

In 1964, 38 people in New York City listened to Kitty Genovese's blood-curdling cries for help as she was being stabbed to death. They failed to take action, wrongly believing that others would do so. As the celebrated 1964 Genovese case reminds us, failing to act when one witnesses misbehavior is a very human phenomenon that goes far beyond the confines of big city streets. Indeed, the lesson from that case is particularly worth keeping in mind when considering recent national corporate scandals.

IS ENRON AN ANOMALY?

The crimes at Enron may have been different in degree and even in kind than at other institutions. But those who write off Enron as an anomaly, with no lessons to offer corporate America, are wearing rose-colored glasses. Hundreds of individuals at Enron — as well as institutions like WorldCom, Tyco, and Computer Associates — failed to raise questions about ques-

tionable transactions. The ability to ignore potentially problematic corporate transactions is of course far easier than ignoring a victim's cries for help. There are numerous ways to rationalize inaction. For instance, employees can assume they are unaware of all the terms of the questionable transaction, or that experts inside and outside the company examined and blessed the transaction. And, unlike the apathetic citizens in the Genovese case, corporate employees may not want to jeopardize their jobs by raising what they believe to be unwelcome questions.

Seeing the consequences of inaction — the spectacular implosion of Enron in a matter of weeks or the hemorrhaging of auditing clients as a result of the discovery of massive shredding of documents at Andersen — has prompted us into an age of more responsible corporate citizenship. The growth in internal compliance programs post-Enron seeks to address the seemingly intractable problem illustrated by the Kitty Genovese case by encouraging people to come forward, without fear of retribution, to report wrongdoing. Self-reporting by employees within a corporation goes to the heart of the problem.

In the wake of the convictions of

Enron leaders, including Jeff Skilling, the late Ken Lay and Andy Fastow, there has been a strong temptation to view this iconic case as a bookend to the extraordinary spate of high-profile corporate scandals that emerged following the energy company's unexpected demise in 2001. This temptation is almost irresistible, given the Enron timeline: the first case of major corporate malfeasance to command government and public attention and the last such case to go to trial. But that analysis misses the point of Enron's indelible impact and does a disservice to the true Enron legacy.

Long before the verdicts against Skilling and Lay were rendered, the case produced a critical — and historic — outcome. Enron's unintended commentary on the state of corporate governance produced an important cultural paradigm shift and led to fundamental changes in the way business is done in this country.

CORPORATE GOVERNANCE

In the shadow of Enron, not a single major American corporation can afford to ignore implementation of serious internal compliance systems to detect and deter corruption. In the past, companies that undertook half-hearted compliance efforts or, even worse,

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implemented mere paper programs would not necessarily stand out as aberrational. Not so today. Virtually every major public corporation in America, usually with direction from top management and the board of directors, has espoused true commitment to searching ethics and compliance programs, backed by expenditure of substantial financial resources to put their money where their mouths are.

At most major corporations there are freshly minted chief ethics and compliance officers, reporting directly to CEOs, general counsels and audit committees of boards of directors. These compliance officers are no longer relegated to the so-called back office and underpaid. Their ranks now routinely include former partners at major law firms, and former federal prosecutors trained in fraud detection. Millions of dollars are spent annually by American corporations on fraud detection and prevention, and employee training. Equally important, with the notoriety of e-mails at Andersen and CSFB seemingly soliciting destruction of documents at seemingly less than opportune times, companies have devoted millions of dollars on creating and enforcing document policies that properly “hold” documents in anticipation of litigation. And boards of directors that often served no more of a check on corporate malfeasance than a grand jury does on the overzealous prosecutor are newly emboldened to display true oversight and backbone. The days of directors participating concurrently on multiple boards — euphemistically termed “overboarding” — have virtually vanished along with Enron.

The government can certainly take some credit for this phenomenon. A series of internal compliance

measures were mandated by Congress as a result of the Sarbanes-Oxley Act (SOX) and that statute’s new obstruction crimes set clearer standards for when and what documents must be retained by companies. And Larry Thompson, the former Department of Justice Deputy Assistant Attorney General, as well officials at the Securities and Exchange Commission and U.S. Sentencing Commission, provided inducements to taking compliance seriously. They all implemented policies — the Thompson Memorandum, the Seaboard Report, and Chapter 8 of the Sentencing Guidelines, respectively — that give credit in charging and sentencing determinations to those corporations that implement reasonably effective internal controls. Of course, prosecution of individual employees, including mid-level executives as well as more notorious CEOs, also served a strong deterrent to those who might otherwise stray.

A LESSON LEARNED

But the real impetus for corporate reform was the Enron scandal itself and the myriad corporate fiascos that came in its wake. No company wants to be the next Enron. If pure altruism were not inducement enough, good business dictates good compliance. Even the hint of scandal can send the price of a company’s stock plummeting. Academic reports are showing a correlation between compliance and stock price: Corporations that perform effective checks on their internal controls actually outperform those with weak internal systems. Moreover, an effective ethics and compliance system is the best means to prevent a scandal from occurring in the first place. As a board member observed at a recent ethics and governance training session I conducted, the

lesson he learned was that “managing” a major corporate scandal is an oxymoron, and consequently the best solution is preventing it from ever happening.

Corporate America has heeded the Enron lesson. This is good news for the public. Government regulators and prosecutors cannot be everywhere to detect breaches of the law and prosecute all violations. Moreover, by the time they act, the damage has been done to innumerable investors, much of it irreparable. The Enron shareholders and other victims — no matter how successful the civil and criminal cases — will see pennies on the dollars. Self-policing to ensure adherence to societal norms is required. Serious internal compliance programs serve to encourage employees to speak truth to power — to report conduct that they believe may have crossed the line.

Will crime within corporations still exist? Of course, as it will elsewhere. But when it does, the question will be whether the conduct was discovered as a result of compliance measures within the corporation, which detected the conduct as a result of effective self-policing. Was the crime aberrational or, as with Enron, emblematic? The answers to those questions will be the true verdict of the Enron scandal.



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