

Why Insiders Get Rich, and the Little Guy Loses

By
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This has been a tough couple of weeks for Kenneth L. Lay, chairman and chief executive officer of Enron Corp. His company's outside auditor, Andersen, reported that thousands of e-mails and documents related to Enron audits were shredded after federal regulators had launched a probe into Enron's finances. Late last week, the Enron board fired Andersen. A letter written by a company vice president warning of an accounting "implosion" was made public. Lay's private conversations seeking help from Bush Cabinet members were suddenly the talk of Washington. The Justice Department announced a criminal investigation of his company. And Enron was delisted from the New York Stock Exchange.

But this is also a story of real people, like Roy Rinard, a 54-year-old utility lineman with an Enron subsidiary, who will have to work long past when he had hoped to retire. The reason? The value of his 401(k) savings account, all invested in Enron stock, shrunk from \$472,000 to less than \$4,000 after Enron declared bankruptcy. He was helpless to stop the loss. Along with the bulk of Enron's other employees--although not its top management--Rinard was prevented by company rules from selling his retirement-plan stock. Meanwhile, Enron executives allegedly carried out a scheme that artificially inflated the price of the company's stock and then cashed out before bankruptcy was declared. All told, top Enron executives and board members sold more than \$1 billion in stock, all the while assuring their employees and shareholders that all was well at the company, according to news reports.

The federal government is investigating, but perhaps its first task should be to examine its own culpability in the matter, particularly with regard to the Private Securities Litigation Reform Act, enacted by Congress in late 1995 as part of Newt Gingrich's "contract with America."

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The Private Securities Litigation Reform Act might more accurately be labeled the "Corporate License to Steal Act." Approved by just two votes over a presidential veto, the law was written largely by and for powerful corporate interests. It gutted historic safeguards against fraud and weakened those protecting investors. It set up legal obstacles that may have enabled Enron to hide its questionable accounting practices. Under the law, victims must prove a fraud in detail without access to evidentiary documents. Damages are limited. Those collaterally responsible for a fraud like, perhaps, an accounting firm, are protected from liability.

The allegations in the Enron story echo some of the allegations in suits our law firm is currently litigating or has settled since the act was passed.

At Waste Management Inc., insiders reaped millions of dollars of profits while at the same time--it later became clear--the company was falsifying profit reports. Twice in 10 years, Waste Management had to restate previously reported earnings.

At Cisco Systems, top executives sold nearly \$600 million of their own company stock before breaking news of serious financial problems to investors. While they were rushing to sell their shares at prices as high as \$80 a share--more than four times its current value--the executives misled investors about sales, inventory and profits.

At Oracle Corp., Chairman and Chief Executive Larry Ellison dumped nearly \$900 million in stock--his first sale in five years--just weeks before the company disclosed bleak revenue and earnings news that sent stock plummeting more than 50%.

Sunbeam Corp. ultimately declared bankruptcy and its stock plummeted, but not before its chairman and chief executive, Albert J. Dunlap, who later was found to have falsified financial reports and destroyed a valuable brand name, managed to sell 100% of his holdings--for more than \$60 million. Enron's accounting firm, Andersen (then known as Arthur Andersen), was also responsible for auditing Sunbeam and recently paid \$110 million to Sunbeam shareholders to settle its liability.

These financial tragedies, while shocking, were not totally unexpected. A 1999 Fortune magazine article predicted just such events, noting that "beneath corporate America's uncannily disciplined march of profits ... lie great expanses of accounting rot, just waiting to be revealed." Since then, U.S. investors have lost trillions in shareholder value. As economist Ben Stein recently put it, "It now is clear that the worst stock market debacle in the history of post-war America did not just happen by chance or by greed of the masses, but happened in large part because of conspiracy, greed in high places, and a federal regulatory failure of unique proportions."

Which brings us back to Enron. Enron formed limited partnerships that were apparently used, among other things, to keep debt off company books. Several Enron executives, including Chief Financial Officer Andrew S. Fastow, acted as managing partners or investors in these partnerships, despite the fact the partnerships were treated as unconsolidated affiliates. Fastow--

who liquidated more than \$30 million of his own Enron shares--reportedly received an additional \$30 million in managing fees from the partnerships.

At the same time, Enron's independent accounting firm may have pushed the limits of conflict-of-interest rules. Andersen, previously in charge of insuring the accuracy of the books for Waste Management and Sunbeam, had received about \$1 million a week in fees from Enron for accounting and auditing. But the auditing never resulted in a disclosure that the partnerships existed primarily to hide debt, which meant that, on paper, Enron seemed profitable. Now Andersen has admitted to destroying Enron documents and has fired its chief Enron auditor, David B. Duncan.

We are the plaintiff attorneys for Amalgamated Bank, which, as trustee of an equity fund that invests the retirement savings of union employees, suffered losses of \$10.3 million in the Enron collapse. (This amount represents just a fraction of an estimated \$20 billion overall loss for public investors.)

Under one of the few consumer protection provisions of the 1995 reform act, institutional investors, by serving as plaintiffs in fraud litigation, can now help call corporations like Enron to answer. An increasing number, including Amalgamated Bank, have stepped up to try to recoup funds for unwitting investors.

The Enron case is a symptom of the same disease that afflicted us in the 1920s. The company is not a victim of market forces, but a motivator as old as humankind: greed. It is past time for Congress to revisit the Private Securities Litigation Reform Act and enact true reform. Otherwise, the financial well-being of millions of Americans will remain in the hands of the insiders, who can be counted on only to be faithful to the instincts of greed.

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