

Enron case: Money laundering, Corruption and... Capitalism?

By Professor Bruno M. Tondini.

The verdict of guilty that fell on Kenneth Lay weeks ago (six charges of conspiracy and fraud) and Jeffrey K. Skilling (18 charges) the same way as the prosecution in November 2002 of Andrew Fastow, chief of Enron financial affairs for 78 cases of money laundering, conspiracy and obstruction of justice, thanks to the statement made by Michael Cooper, assistant of Fastow, who also pleaded guilty of money laundering and decided to testify against his former boss, for the bankruptcy in 2001 of the energy conglomerate Enron that defrauded shareholders and employees in some six thousand millions dollars, is useful to prove the insertion of the culture of corruption in the present day capitalism, as well as to know the low funds of its principal benchmark, the economy of the United States.

To really prove how genesis of the problem really was we should go back to the 90's when the "American dream" reached its peak, the participation of the shares in the savings of the family increased substantially.

The small investors obtain shares through the purchase of small parts of investment funds and through the investments made by their pension funds. The collapse of Enron and other companies liquidized the savings of many families, reduced the value of several pension funds and produced thousands of dismissals.

However, this is not an unwanted result. On the other hand, in the United States, the number of families with a wealth superior to the million dollars has practically doubled between the beginning of the decade of the eighties and the end of the nineties, to reach a total of 4,8 millions of families¹.

This phenomenon could be explained, in turn, by the policy of backward distribution of income that typifies the functioning of capitalism from some decades now. And by the creation of enormous profits in the speculation of the international financial market, which undoubtedly had to continue.

"The liquidized money" mentioned in the paragraph above, reinforced the transfer of the savings of the working classes to the upper classes by means of the financial speculation of "the pension and investment funds."

The liberal weekly newspaper *The Economist* considers that "the greatest bankruptcy of America (up to now, that of Enron) was not the mere result of bad luck in business or personal crime; the collapse was possible just because of the flaws in the way that American capitalism has worked in the last decade. Those flaws were widely known. But whereas the American economy and the stock exchange were booming, a few were interested in improving them."²

¹ Clarín Económico, 19-1-2003

² The Economist 19-1-2002.

It is worth stressing the fact that there is an important parallelism between the financial crisis of the 70s and the above-mentioned case, which inevitably turns around the recycling of surplus cash (being them petrodollars or drug dollars respectively). And that in the presence of the possibility of generating destabilization of the capitalist system, as we know it at least, provokes de disparagement of saving and its orientation to the speculative market, lessening in this way the inflationary effects following the orthodox economic logic.

It is worth noting what Carolme Atkmsn, ex vice-president of the United States treasure, said. She compares the collapse of Argentina with the Enron collapse: "the biggest canceling of superb payment has been produced in a country that no long ago was of the favorite of the markets and was praised by IMF and the world bank.

Certainly, the crisis will make other countries think before embracing open markets and global integration (...) The American enterprise (the second biggest bankruptcy in then history of the united states) was also congratulated by annalists, commentators and investors, not to mention the politicians. (...) As we know nowadays, the good times of Enron were only a mirage.³

Lay y Skilling, now facing the possibility of decades in prison, were the principal authorities of Enron that ,through out 16 years, turned the company from a small seller of oil and gas contracts into an energetic octopus that spread its tentacles all over the world.

In the year 2000, it had a 100 thousand millions dollars turnover and 1000 millions dollars earning. That wealth was virtual

The collapse followed. It has been proved in judicial headquarters after Enron accepted responsibility for the disguise of its weaknesses by means the deceitful accountability of lying to its shareholders about the real value of the wealth of the company and of speculating without limits in the financial market. Everything was carried out without reasonable state controls

It is the same type of accepted lie, Cardozo⁴ points out, that allows other energetic companies to claim like own sovereignty – and to strengthen in this way the quotation of its shares in the new York and London stock exchange -the oil and gas reserves that actually are property of the nations that concede its exploitation

Enron was the emblematic case of the crack of the so called "new Economy". The dream of prosperity without limits –and irrational –that must have been brought to the world by the strikes in the keyboard of a computer and not necessarily the production of more and better goods and services. It was the drama of the collapse of the naïve " dot.com " that had other protagonists: WorldCom, Adelphia, HealthSouth among others

Enron case in one of the best examples of the inventiveness of the financial logic and the functioning of the governmental complicity net set up to obtain huge and easy earnings and outwit the law

³ The Financial Times, 6-2-2002.

⁴ Oscar Raúl Cardozo, Clarín,26-5-2006.

In its beginning Enron bought and sold electricity and gas. It expanded with the deregulation of the electricity market and it ended up as the top seller in the field, where it negotiated sale-purchase contracts of energy. Following this trend, it turned its thoughts to the markets where those contracts are made with mere speculative reasons. Taking advantage of this experience, Enron penetrated also in the markets of other financial by-products.

The board of directors of Enron believed that due to the deregulation and pressure in the market, the companies based on big assets would give way to the small companies that exploit the potential capacities of the previous ones through the web and connected through nets and middlemen. That is why Enron was nominated as the virtual company, with few assets but able to take profit from the assets of the other companies.

An innovative character was ascribed to the lack of transparency in the figures. Especially, in the course of its activities Enron, apart from being audited by Andersen, sought advice in important law buffets and banks like King & Spalding, Chase Manhattan Bank y Bankers Trust that never objected to the legality of its procedures. This as well as other cases of great entrepreneurial frauds also shows that investment banks from the United States, in charge of describing companies and countries, cooperate with the forging of business and balances. The same happens with the big international auditing companies, European banks including the most prestigious ones; they operate in tax haven, where money coming from crime is kept and laundered and taxes are evaded.

One of Enron's favorite resources was to make transactions with companies run by its own members of the board of directors but that were shown as separate organizations and which had missing information. Those organizations were used to take responsibility for Enron debts and hide, in this way, loses and boost profits of the mother company.

Enron received financial contribution from unreal commercial and investment banks like Merrill Lynch, Morgan, and Chase Manhattan y Crédit Suisse First Boston. In the three years previous to the bankruptcy, the citigroup lent Enron 4800 millions dollars, by means of operations that made the loans appear as income.

That is to say that "without the wall street financial oil", Enron wouldn't have become the biggest energy negotiator of the United States and the seventh company of the country. In exchange, the Wall Street firms obtained hundreds of millions of dollars on commission.

Besides, to evade the payment of taxes, Enron distributed its activities in 881 subsidiaries created in tax haven, 693 of them in caiman islands. A director of the tax department stated that Enron created a special operation group that went so far as to having twenty employees whose activity was to create tax reduction strategies⁵.

The orientation was successful: between 1997 and 2000, Enron, a famous company for its success and pace of growth, did not pay income taxes in the United States. A specialist considered, for the *Washington post*, that 30 % of the earnings in 2000 (296 millions dollars) came from tax saving strategies and not from the distribution and commercialization of energy.

⁵ Clarín Económico, 26-5-2002

In 2001, came to light that Andersen had made a mistake in the assets of the parallel companies, overpricing them in millions of dollars and that he also tried to hide 380 millions in loses. In November 2001, the company had to do again the financial results and the gains started to become loses.

In December 2001 it went the bankrupt with 600 millions less in earnings than the declared ones . The price of Enron shares went down from a peak of ninety dollars to six dollars at the end of 2001. But before the downfall of the shares the top members of the board of directors sold the bonds, avoiding millionaire loses. The downfall in the price caused a collapse in the pension fund of the company employees who had invested their money in the company shares. Enron left a debt of four thousand millions in loans and thousands of millions dollars in other bank bills, amounts that the banks are trying to recover. J. P. Morgan, one of Enron's principal financiers, was trapped with loans of 2600 million dollars.

Likewise, the company had an excellent relationship with the authorities . Between 1990 and 2001, it distributed a six-million contribution in the election campaign. It also gave money to 250 members of the congress, including 71 out of the 100 senators. Its principal contribution was 623,000 dollars given to George W. Bush; Even Kenneth Lay was suggested as candidate for the post of energy secretary of the united states.

But like in all stories of conspiracy, white-collar crime and mafia, the mysterious death appeared. One of the members of the board of the company, Cliff Baxter, left Enron in 2001, just before the problems of the company, which he probably had heard of, came to light. Later, he was found dead in his black Mercedes. Apparently, it was suicide.

Considering all the above mentioned, it could be thought that the protagonists of these illegal and irregular operations are not only professional criminals, black sheep of the corrupt politics or adventurous business men. They are all those but together with member of parties of the political systems, public organizations and prestigious companies that work in the legal circuit of the international economy, in the fringes and in the center

Enron case has direct influence on the capitalist economy, even when an attempt was made that the most harmful effects were not absorbed leading to the sanction of legislation that limited the fraudulent practices of the business world. But now the business world has come back to the charges seeking the derogation of the sanction because it " imposes charges " restrain the possibilities of profit

Finally, it should also be added the in these days it seems that the stock market of the united sates is so busy with big numbers that it often thinks that loses by fraud are lethal and important for the health and trust of the investors and markets when they take place in companies that have a turn over of more than a billion dollar per year, and it forgets the risks that brings about a lessening in the demands of internal auditing on financial information for small companies, of which the number of events or irregularities can also harm the market , even though the above mentioned companies go unnoticed in the news because individually they do not seem to affect anyone.

SEC (Securities and Exchange Committee) has published a report of the Advisory Committee on Smaller Public Companies, dated 23rd April, which advises to free the small companies (smallcap y microcap) that are obliged to comply with section 404 of the Sarbanes-Oxley act.

Such article summons the companies to evaluate the design and operation of the internal audits related to the presentation of the financial information .

The proposal had initiated a debate in the business community .On the one hand, there were those who proposed such exemption claiming smaller benefits than compliance costs for the small companies. On the other hand, the market critics and stock market analysts had questioned the confusion that it would create a favorable treatment to these companies

Lets analyze two research works. The first one carried out by a well know magazine - "Compilanse Week"-where there were analyzed the 10k annual reports that the state companies in the united states presented to the SEC the 31st December 2005. The research covered around 300 cases of companies with sales that exceeded the billion dollars, to know and analyze the material weaknesses reported to the market, in the framework of Sarbanes-Oxley.act, section 404.

According to this paper, the trend has clearly shown substantially less mistakes or material weaknesses reported by the companies analyzed, in relation to the exercises above mentioned. Only 6 companies, that is 2% of the population analyzed, presented in their annual report 10k material weaknesses in the internal audit related to the financial information.

The second paper was published in march 1997 and it considered the characteristics behind 200 fraud cases ran by SEC that involved the financial state of 200 public companies between t 1987 and 1997. Such studies, even though they are not strict or wide-ranging, they are from all the companies that quote. Most of the companies that had committed fraud were relatively small in size (less than \$75 millions dollars in assets or revenue). In 83% of the cases, the CEO, CFO or both had been involved in the investigated frauds.

Finally, and we agree with Chalupowicz⁶ on that " the recent stories of financial scandal like Enron suggest that the cost of lessening the demands and internal audits on the financial information could be very high and ruin a lot of people. Although it seems that the stock markets are forgetting this quite soon when it is about companies with smaller operations", because it is mainly through the last ones from where the fraud, corruption and money laundering is channeled

⁶ Novedades Fiscales, Ámbito Financiero , 6/7/2004, Pág. 24, "A raíz de los pedidos del SEC para eliminar las exigencias de cumplimiento con la sección 404 de SOX. EE.UU. presta poca atención a las pequeñas empresas que cotizan"