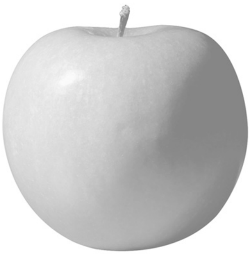
Introduction: The Stories



Reality is a collection of stories. Theory contemplates those stories, turns them this way and that, looking for trails of truth that lead through all of them, trails that connect them in some way that makes sense. The stories that we contemplate in this brief reflection are about fabulously wealthy businessmen who held responsible positions as executives (for the most part chief executives) in leading companies in the United States in the last decade of the twentieth century, extending into the twenty-first. A second Gay Nineties, a second Gilded Age, came abruptly to an end with their exposure as criminals (or close to it), their fall from power, and their richly deserved subsequent disgrace. As I write this short book, the scandals are by no means over (much of the ill-gotten wealth is still in the hands of those who made off with it), and the high-flying executives are only beginning to come to justice. Appeals will follow. But we know enough to get started on the contemplating, and given that the ill-gotten money was (eventually) ours, we ought to be interested in finding out why we lost it. Just maybe, we can find ways to protect ourselves from the thieves in the next generation, and possibly find a way to educate our children that will make them less likely to become those thieves. Those are two different tasks, note.

First we have to know the stories. I cannot tell any of them in any detail, but then, I don't have to; each of them has been given loving attention by the enthusiastic corps of business journalists, and an appended reading list for the aficionado (see the Bibliography) will provide hours of fun for anyone interested in pursuing them. But we have to have some idea of the central tale and cast of characters for at least the major stories, so that we may refer to them in what follows.

Enron, first and most famous, started as a humble pipeline company; it owned pipes and it transported natural gas. Kenneth Lay became CEO of Houston Natural Gas, one of the predecessor companies, and rapidly parlayed several good friendships in the Republican administration of Ronald Reagan into a relaxation of the regulations that had kept the energy industry from profitable innovations. He named the company Enron in 1985, at the merger of HNG and Internorth. Starting with energy contracts – electricity, gas, and the infrastructure to support them – Enron rapidly expanded into foreign gambles in India and Africa, highly profitable risk management derivatives, including weather derivatives, and discovered new and original ways to conceal company losses (when the gambles failed) by creating "special purpose entities" (SPEs), offshore partnerships, most of which were not quite legal. When the whole structure fell apart, investors lost about $70 billion. (The notorious "Nigerian Barges" scam alone cost them $13.7 million.) The CFO, Andrew Fastow, went to jail, as did his wife (she was released in June 2005); at this writing Kenneth Lay has been indicted but not yet tried. Enron investors promptly sued to get their money back; they did not sue Enron, which had no money, but all the banks that had lent Enron money, on the theory that if the banks had been paying attention, the whole debacle would not have happened. (The lawsuits clearly work; on June 14, 2005, J. P. Morgan Chase agreed to pay the investors $2.2 billion in compensation, following an agreement by Citigroup to pay them $2 billion.[1] On August 2 of that year, Canadian Imperial Bank of Commerce agreed to pay $2.4 billion, setting some kind of record, to settle claims that it helped hide losses at the Enron Corporation, raising to $7.1 billion the settlements to compensate investors.[2] It's a start.)

Enron exemplifies one of the major lingering problems in the entire corporate scandal. When Enron stock was at its peak, shortly before the final decline and fall, Lou Pai, an Enron executive, sold his shares for $350 million and retired from Enron to move to Hawaii where, as far as I know, he still lives, at peace with himself, his neighbors, and the law. After the final collapse, most Enron employees, some of whom had been with the company or its predecessors for many years, discovered that their comfortable retirements had evaporated in the Houston heat, and that they were left with nothing to show for lifetimes of work. On the model enforced by the courts on Bernard Ebbers (see WorldCom, below) it may be possible to extract some reparations for the employees from the personal wealth of Andrew Fastow and (possibly) Kenneth Lay – always excluding Fastow's enormous mansion, which is protected from bankruptcy proceedings by Texas's

[1] Julie Creswell, "J. P. Morgan Chase to Pay Enron Investors $2.2 Billion," *The New York Times*, June 15, 2005, first Business Page.

[2] Jeff Bailey, "CIBC Pays to Settle Enron Case: An Agreement for $2.4 Billion," *The New York Times*, August 3, 2005.

Homestead law. But is there any principle on which we can approach Lou Pai, and ask him to give up, maybe, $200 million of the money he got from his Enron holdings, to divide among the employees that Enron cheated out of their savings? We want to think about that.

Arthur Andersen came down with Enron. As the accounting firm that had signed off on all those marvelous deals, those SPEs with shadowed ownership, Andersen had clearly violated the high standard of integrity set for it by its founder, who had assured the Securities and Exchange Commission that the personal integrity of the accountants would be enough to guarantee the integrity of the auditing enterprise. For 60 years, personal integrity had indeed been enough, and Andersen was known as the most unflinchingly upright in the business. But it failed in the Enron case.

A look at the pressures on Andersen, after it had collapsed, revealed the reason for its failure in the Enron era. Since 1929 (and before) independent accounting firms like Andersen have audited the financial reports of all major companies, making sure that they did the addition right, put entries on the proper line, and above all accounted for every dollar in profit, loss, debt, or investment. The auditor's job, essentially, was to rain on your parade if you were trying little schemes to avoid taxes or conceal losses from investors, and to certify you clean and virtuous if you were not. But times had changed; in addition to the essential, unglamorous, and ill-rewarded work of auditing, the major accounting companies had taken on the lucrative work of consulting (mostly on taxes and accounting regulations) with the companies they were auditing. Andersen had just suffered a devastating split: its consultants had announced that they were no longer interested in sharing their stipends throughout the firm (the custom in accounting companies), so went off on their own, leaving Andersen, alone among the Big Five, dependent on auditing income alone. The auditors tasked their new CEO, Joe Berardino, with building up a new consulting business, and he did that, but relied heavily on one major consulting client, Enron, who was also, of course, a very major accounting client. Now, any auditor nastiness, any attempts to rain on Enron's parade, on the permissibility of those SPE deals, might result in the loss of the consulting client, and there goes the business. So Andersen, dependent upon Enron for its consulting trade, was nice about the deals.

In a fit of nervousness, probably about its previous niceness, Andersen's Houston office, the one that ministered to Enron, decided that its Enron records were best not seen by anyone, so it shredded them, bag after bag, over one weekend, handing out huge plastic bags to its employees to take home for guinea pig litter. Possibly the Andersen employees never intended to destroy evidence for the case that was building against Enron and would surely involve Andersen before it was through. Possibly. But everyone on the scene drew the obvious conclusions, and Andersen ended up convicted of conspiracy. The company went out of business immediately. (The conviction was later reversed, but too late to save the company.[3])

The **WorldCom** scandal is a tale of two companies: **MCI**, which had been part of the deregulatory push that broke up the old AT&T telephone monopoly, and became one of the leading communications companies in the United States, and WorldCom itself, a long-distance communications carrier (essentially, an outgrowth of the same AT&T breakup). At one point WorldCom was the United States's second largest long distance carrier,

[3] Charles Lane, "Justices Overturn Andersen Conviction," *Washington Post*, June 1, 2005, p. A1.

AT&T remaining the largest. At this point it has officially disappeared from the books; it went into bankruptcy in July 2002, after finding about $11 billion in accounting fraud on its books. It abandoned its CEO, Bernard Ebbers, to the clutches of the law, and emerged from bankruptcy in April 2003 as **MCI**, the company that it had purchased for $37 billion in 1997. On March 15, 2005, Ebbers was convicted of conspiracy, securities fraud, and false regulatory filings. On July 13, 2005, he was sentenced to 25 years in prison, the longest sentence so far.[4] The huge wealth of the corporation provides no stability in the titanic battles of wealth; someone is convinced that there is even more money out there to be made, and financial maneuvers can keep a company "in play" indefinitely.

One element of the justice question was settled in the Ebbers case, possibly to become a model for the others: on June 30, 2005, Ebbers agreed to give over ("cough up," in the language of the day) all his assets, now about $40 million, to spread among the victims of his frauds. The list of assets to be put at the court's disposal is enlightening: a multimillion dollar income tax refund, assorted properties in Mississippi: 300,000 acres of timber property, a sawmill and lumber concern, KLLM Transport Services in Richland, Sunset Marina in Jackson, Marriott Courtyard in Tupelo, the Brookhaven Country Club in Brookhaven, and 800 acres in Pine Ridge, including his home. There was also a 28,000 acre farm in Louisiana.[5] At one point Ebbers had been worth almost $1 billion; it's a shame the fraud could not have been discovered then.

4 Ken Belson, "WorldCom Head Is Given 25 Years For Huge Fraud," *The New York Times*, July 14, 2005, A1, C4.

5 Gretchen Morgenson, "Ebbers Set to Shed His Assets: $40 Million to Go To Fraud Victims," *The New York Times*, July 1, 2005, C1, C6.

Adelphia Communications was the sixth largest cable company in America at one point, but not all of its wealth was real; in 2002 it too went bankrupt. On June 20, 2005, Adelphia's CEO John Rigas was convicted of looting the company of hundreds of millions of dollars and perpetrating a major fraud on the investors; he was sentenced to 15 years in prison. His son, Timothy Rigas, CFO of the company, was sentenced to 20 years; the father got off more lightly because he is 80 years old and suffering from cancer. (Another son, Michael, will be tried later for an associated securities fraud.) Apparently the Rigases had adopted an accounting system so complicated that no one could understand what they were doing, and behind the screen created by the system, they looted the company of up to $2.3 billion.[6]

Tyco was started in 1960 as a laboratory operating on government contracts. By 1964 the company had gone public and developed an appetite for other companies; by the year 1999 it had 260,000 employees and was a highly diversified manufacturing company. Like many companies, it began in that year to report earnings more optimistically than the law allows, to keep up the price of its stock. Investigations began to find out just why it had hyped its results; the stock fell and matters appeared grave. But in 2000, under the leadership of Dennis Kozlowski, it beat back the SEC, acquired 40 more companies for a total of $9 billion, and earned very high profits. It became one of the darlings of Wall Street, with flattering profiles of its CEO appearing in *Business Week*, among other places. But all that money turned out to be irresistible; Kozlowski was caught raiding the company coffers ("grand larceny and enterprise corruption") for personal

[6] Roben Farzad, "Jail Terms For 2 at Top of Adelphia," *The New York Times*, June 21, 2005, C1.

use – buying very expensive French masterpieces for his home (having them shipped to New Hampshire in order to avoid paying taxes on them), complementing the art with a $6,000 shower curtain for his bathroom, and finally throwing his wife a birthday bash largely at company expense on the island of Sardinia (replete with a statue of David in ice, spraying vodka from its penis) – to the tune of $600 million. Along with his CFO, Mark Swartz, he was convicted of misuse of company funds on June 17, 2005. On September 19, 2005, they were sentenced to 8 and one-third to 25 years in prison for the fraud.[7] Asked to comment, most of their peers said they got off easy.[8]

HealthSouth was at one point the country's largest provider of outpatient surgery, rehabilitation services, and diagnostic services, in over 1,800 facilities not only located in all 50 states but in Puerto Rico, Great Britain, Australia, and even Saudi Arabia. It was something of a byword in health care provision: in an industry where patient demands and expectations keep rising, Medicare and Medicaid reimbursement continues to contract, and employers are continually sifting through the competition to get the lowest costs for their medical insurance, Richard Scrushy and HealthSouth just seemed to be able to keep the costs down and post a profit quarter after quarter. The business press adored Scrushy, Newt Gingrich at one point wanted him to run for Congress, others thought he'd make a good governor of Alabama. In 1997 Scrushy took home $106 million, and he was only 45 years old.

[7] Andrew Ross Sorkin, "Ex-Tyco Officers Get 8 to 25 Years: 2 Sentenced in Crackdown on White-Collar Crime," *The New York Times*, September 20, 2005, A1, C4.

[8] Floyd Norris, "Why His Peers Say Kozlowski Got Off Easy," *The New York Times*, September 23, 2005, C1.

But it all turned out not to be true. It seems the popular CEO had overstated earnings and assets, year by year from 1999 on, in order to keep the price of the stock high enough to meet Wall Street expectations. He had cheated the investors, and the SEC launched an investigation. Worse, from the taxpayer's perspective, HealthSouth had apparently submitted claims, some estimated hundreds of thousands of claims, to Medicare and Medicaid for services that just weren't performed, or not as the claim said they had been performed. Worse yet, from the patient's perspective, the patients were not getting all the treatments they were supposed to get. If HealthSouth's medical quality matched its accounting quality, the patients were probably not harmed by the failure – at least the doctors didn't get a chance to make them worse – but it was still fraud. Pressured from three angles – investors, government insurers, and customers – HealthSouth had defrauded them all. On June 9, 2005, HealthSouth agreed to pay $100 million over a 2-year period to settle shareholder claims.

Scrushy was widely accused of personally directing the fraud, instructing subordinates to "fix" the numbers. He was put on trial in the same month the settlement was agreed upon, and prosecutors hoped for a resounding message-sending verdict. But on June 28, 2005, an Alabaman jury found him not guilty, sending shock waves through the entire prosecutorial effort.[9] What had happened? Recall the parable of the dishonest steward, told in the Gospel according to Luke, chapter 16: knowing he was about to be fired for dishonesty, the steward used his remaining time and power to forgive all manner of debts owed to his master, in this

9 Simon Romero and Kyle Whitmire, "Former Chief of HealthSouth Acquitted in $2.7 Billion Fraud," *The New York Times*, June 29, 2005, A1, C3.

way buying favor all through the community for when he needed help, which would be soon. We sometimes forget that rich men have many opportunities to endear themselves to the people who will sit on a local jury; Scrushy was very good at it. When he went on trial, he was the local boy who had made good, and who now led TV Bible classes. The jury chose to believe him rather than his (admittedly sleazy) associates, who had testified against him.[10] Annoyed, the shareholders took him to court on civil charges, and managed to wring $47.8 million out of his overstuffed bank accounts.[11] (The SEC had threatened as much, and may still act on its own.)[12] The controversy continues as I write.

There were many others. Why?

Choosing a Path in the Woods

We may start the reflection right here: What trails can we discern linking these stories? Where do they seem to go? Can we discern their origins, and project their further courses, in some way that will be profitable to us in our efforts to make sure that this *never happens again*?

A difficulty besets our discernment, which I choose to turn into an advantage: we can find *many* trails that thread through the woods of confusion in these cases, all of which carry promise

10 Kyle Whitmire, "Jurors Doubted Scrushy's Colleagues," *The New York Times*, July 2, 2005, C5.

11 Kyle Whitmire, "Judge Orders Ex-HealthSouth Chief to Repay Nearly $48 Million," *The New York Times*, January 4, 2006, C3.

12 "S.E.C. Set to Press Civil Case Against Scrushy," *The New York Times*, July 6, 2005, C5.

of enlightenment if followed. My problem is worse than that faced by Robert Frost, who found that "two paths diverged in a wood," and ended by taking the path "less traveled by." For I have many paths, charging off in different directions. I have a choice. I can try to do justice to all of them, mapping all the trails, completing (in the year 2075) a work the size of the Encyclopedia Britannica, or I can choose to be what some of my colleagues would call "simplistic": picking the explanation I think fits the stories best and arguing for it, and for the remedies it suggests, ignoring the complexities introduced by all the other considerations. If I do that, I will have to leave most of the paths to "another day," as Frost hoped, or more likely to other people, and choose only one of them to follow. *Unless* I do that, we will be here in this text for the rest of our lives. Fortunately, as above, many of the trails have been energetically trampled clear by enthusiastic hikers other than myself, many of whom will be found in the Bibliography; I am free to follow that path less traveled by, the path of personal growth, personal character, and personal decision, the proper province of the ethicist.

For a quick peek at the last page, let me summarize where my single simple trail will lead: I believe the fundamental error was made when our culture, the culture of the West, embraced Liberalism. "Liberalism" has meant many things in recent history, the most accepted meaning encompassing all of the protective measures for the poor that have always been associated with the extended family of tribal society – an odd closing of the circle of time. I choose to use the traditional meaning of Liberalism, arising from the Enlightenment in Western Europe. Liberalism, on my very traditional reading, rests on the thesis that in general, adults should be allowed to follow their desires wherever they lead, including the desire for accumulation of wealth beyond all reason, without limit and without social sanction. This notion of Liberalism, no other, grounds the entirety of the Free Market economy and the entirety of the political structure of legally guaranteed liberties and protections. Soon enshrined in law as a plague of "rights," the liberties so granted excluded almost every prohibition except those against personal assault and theft of property. The liberal creed read that Liberty should protect every act of every person, just so long as the act hurt no one else – that is, hurt no one in violation of law.

Economic hurt, for example, the harm that results if your business fails and you are left with debts, or if your job is terminated and you have no work to do, is excluded from the list of punishable hurts. Such hurts proceed from the ordinary workings of the free market (like the hurt that proceeds from the consumers deciding that they like the products offered for sale in the shop next to you more than they like yours), therefore it is not harm, so no one should be held responsible for it, unless some breach of duty can be found; and now you know why our courts of law are so terribly crowded – we can only treat the breach of duty, we cannot treat the hurt. Liberalism ultimately destroyed what I will call the Village: the natural human community that placed limits on human vice by the simple mechanism of transparency and moral consistency, and that destruction precipitated the scandals we live with today. I will argue that when we embraced Liberalism (represented by John Locke, Adam Smith, and the Utilitarians, over the strenuous objections of Conservatives like Edmund Burke), we adopted the ideal of a life without limits; and that loss of a sense of limit, of proportion, of natural ends, natural boundaries in human life, is the nerve of the vice that undermines our economics, our politics, and every one of our enterprises, public and private. In that embrace, we abandoned our communities, renounced our plain duty to care for each other and for the earth, and set our societies on the road to perdition. The abuses briefly chronicled above, which will forever go by the name of "Enron," follow immediately from that abandonment. That is the trail I will follow.

Before we go that way, though, let's take a very brief look at the others, for they all have something to contribute to the general discussion, you might want to follow them up yourself, and it will save time later if I don't have to explain why I am not following up this or that lead. We will consider the trails according to the occupational descriptions of their devoted guides – not a standard classification, to be sure, but useful in this case.

Business analysts (and the teachers of business students) have had a field day with the unhappy results of the latest round of corruption in the board room. (The best example of this literature is Kurt Eichenwald's *Conspiracy of Fools*, an account of the Enron debacle, and there are many others.) Everywhere they see mistakes, careless miscalculations, and ignorance of the fundamental truths of business enterprise. This direction, at least, is clear: if incompetence is the origin, and more of the same is the direction, then we have a solution: we need more and better technical education, primarily in our business schools, for business competence, for more thorough mastery of the fundamentals of business. I appreciate the force of this analysis; there was a good deal of sheer incompetence, and Enron's businesses (for example) never really made money.

But there was so much of it! How, in the late twentieth century, in administrations as favorable to business as we have ever had, could we get this positive epidemic of incompetence – from the best educated corporate officers in the world – amounting to systematic forgetfulness of the fundamentals of their trade, as

Eichenwald would have it? Can we reduce all this malfeasance to stupidity compounded by panic? But if that's our conclusion, where are we going to find "better educated" businessmen than these graduates of Wharton and Harvard? There has to be something more here, something more fundamental, that the business analysts, convinced that the market must always work if we will just follow the rules of rational self-interest, just cannot see. Part of the problem, I will argue, lies in the Enlightenment assumption that rational self-interest is rational, or generally represents the real interests of the individual or the society. We will have to take a better look at that assumption.

Social philosophers of Marxist background, with a consciousness of the problems of the market system honed from European schools of economics, have incorporated what they take to be the sad lessons of Enron into their social and political philosophy classes. For those of a socialist turn, these collapses indicate the faults of the market system, and the poison of the popular adoration of the false gods of capital, "free enterprise," and "liberty to accumulate wealth." When the market is allowed to run wild, this is the result: ordinary citizens are cheated out of their savings while the capitalists take home millions, as the value of their shares rises. Wall Street insists that profits must go up every year, every quarter. If they do not, investment analysts will downgrade your stock, it will decline in value, and you will be vulnerable to takeover. Wall Street and the Market are to blame; reappropriation of the resources of the country by the people is the answer; we need a fundamental restructuring of law and economy to reflect real needs and interests of the people. Enron and all the others are good arguments to abandon the "free market" altogether, but failing that, to reestablish very firm controls on its profit-seeking activities.

There is much that is appealing in this approach – certainly the spectacles that crowd our courts and our newspapers cause "the market" to give off such a stench that we might be forgiven for thinking it dead. But again, the social philosophers have picked as their target a framework constructed of human decisions and actions, while the source and grounds of those decisions and acts are precisely the problem. It is possible to be an honest business person; it is possible to run a company honestly, and fairly, taking into account the interests of all the stakeholders. The Market does not have to die. Business is not by definition exploitive and dishonest. Under what conditions can it run well?

Between the social philosophers and the defenders of the free market are the **regulators**, who value the free market but understand that it cannot function honestly without strict government oversight. When they say that business really needs regulatory oversight, they have a theoretical argument in their favor as well as a (very well confirmed) practical observation. For the obligation of a corporation, publicly owned, is to increase shareholder wealth; that part seems to be well understood. It need not do so in a dishonest way, but whatever means will increase wealth within the law, the law in force at any time, the corporation will adopt. Then if there are profitable actions that we do not wish the corporation to take, we *must* pass a law forbidding them, for whatever is not *forbidden*, in this field, is not *permitted* (the usual opposition), but *obligatory*. It's our job as a public to construct a rigid framework of law that will restrain all businesses from all evil. And when we find corruption, the regulators are convinced that just a few more good laws are needed, and repair immediately to the legislature, whence issues **Sarbanes-Oxley**, for instance.

It is surely true that in a complex economy, the free market at its best and most honest cannot operate well without regulation; but when it is far from its best, as in the current cases, using legislation to stem this tide of criminality is like trying to contain the rupture of a major water main by putting little dikes in front of the main streams. First of all, we're not getting at the source of the problem, so it will continue, requiring ever more dikes, and second, even the dikes we have will not work: the water, and the criminals, will simply find their way around them. They're much smarter than we are. Laws only work when the people are law-abiding; laws to regulate large corporations only work when the managers of those corporations are law-abiding, and these just were not. There is also the possibility, which we will revive at the end, that really good people don't need every action dictated by law to be good. We may hold that out as a hope.

We are brought back to the individuals, the people who made these decisions, and must surely have known, at some level, that they were wrong. For philosophers of a more reflective turn, **ethicists** who meditate on all human conduct, Enron represents a serious failure of fundamental morality. It is not that their companies did not, officially, adhere to the highest ethical values. Enron's Code of Ethics, over 60 pages in length, was a model of its kind; Tyco International avows itself committed to the highest standards of integrity. Somehow, the individuals who were bound by those standards simply failed to meet them. Yet they did not seem to be, at the beginning, truly bad people by nature, and they had had every educational advantage. Surely they understood the standards they were expected to meet. What made them "go bad," what made them indulge in astoundingly greedy and criminal behavior? Are there ways that such going bad can be prevented, or stopped before it reaches these terrible ends? Will this trail, the trail of personal ethics and character, yield any solution at all? No wonder the others have avoided it; we will pursue it.

For I think the general public deserves better than it has got out of these scandals. Besides being the dupe, the mark for these con men, the ultimate losers, as their pension funds are compromised and their share of the tax burden increased by the cheating of the very wealthy, the public is left with only a media circus to cover a massive fraud with few means of understanding it. For the public, there is only titillation, and wonder, and, if the public is at all thoughtful, despair. Here were the most privileged creatures on the face of the earth, born into solid families in the wealthiest country in the world, with the best college and graduate educations, fortunate to work for unbelievably high salaries for some of the best companies on the globe, philanthropists, the company names on community projects, exactly the men and women that we would have expected to be our leaders in the new century – and look, they were up to their armpits in filth, lying, cheating, and stealing. What motivation could possibly have led them to risk their great good fortune for so little more money and the risk of lifelong disgrace? What depth of moral corruption explains the betrayal of the nation's trust by those who profited most from the system that grounds that trust?

In what follows, we will try to put the scandals in a larger context – in fact, in the largest context possible, the entirety of human nature. For it is not just business enterprise that has wandered off its moral tracks. Education, church, statecraft, and God's green earth itself are equally at risk, threatened by neglect, by chicanery, by exploitation and diversion from mission by powerful and greedy agencies.

We were put on this earth to take care of the earth and to take care of each other, and frankly, we're doing a very bad job of both.

We will have to rediscover the responsibilities of our stewardship before the mess will be cleaned up, and those responsibilities extend well beyond economics. In order to do that, we are going to have to recreate the context of morality in which our race came to moral consciousness. Ultimately, the answer to that "why" question, with regard to Enron and all the others, is that in the development of our advanced economies we have put some human beings into contexts where humans have little practice working, and where normal controls are gone, and the results that we have seen are grimly predictable. Let us see how that might be so.