Enron Mentions Special Edition -- 01/31/02

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The [Enron] Spillover/The Suicide
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The [Enron] Spillover
The Enron Players;
A humbling resignation and hearings in Congress for Andersen executives (with an audience cameo by The Sopranos' Lorraine Bracco) fueled last week's intrigue
First; Value Driven
You're On Your Own That Enron workers lost life savings is just another sign that the short era of economic security is over.
The [Enron] Spillover
Enron Spoils The Party;
Bush wants his State of the Union speech to drown out those stories linking the disgraced

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The [Enron] Spillover
Under The Microscope ; After Enron, investors are looking more skeptically at companies whose bookkeeping seems confusing
Nation; Global Agenda
The Incredible Shrinking Businessman Corporate titans are out. Government reforms are in. Is it the dawn of a new era?
The [Enron] Spillover/K Mart's Fall
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Special Report: The Enron Scandal: THE PARTNERSHIPS
The Man behind the Deal Machine.
As creator of iffy Enron partnerships, ousted CFO Andrew Fastow is a prime target for investigators
By Wendy Zellner in Dallas, with Mike France in Houston and Joseph Weber in Chicago
02/04/2002
BusinessWeek
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When it comes to Andrew S. Fastow, the former Enron Chief Financial Officer, there's one thing those who worked with him agree on: He never appeared anything but supremely self-confident. Early in his career at Enron, when Fastow was just another bright young executive at the energy company, he bargained relentlessly to win a concession from a banker. Afterward, Fastow thanked him and said: ''I'll remember that when I'm CFO.''
Now, some see Fastow's cockiness as one factor behind Enron's collapse into the biggest bankruptcy in U.S. history. Certainly he wasn't the only top executive at Enron with that kind of attitude; the word most people use to describe the company culture is arrogant. But Fastow was one of the few whose aggressive tactics and overconfidence had the capacity to turn dangerous for the company.
If former CEO Jeffrey K. Skilling was the architect behind Enron's transformation from stodgy pipeline to high-tech trading powerhouse, Fastow was the trusted lieutenant who created the increasingly complex and unusual off-balance-sheet financing that fueled Enron's growth. He was also key in selling the deals to banks and institutional investors--sometimes with veiled threats and sometimes with sweet talk, say those familiar with his tactics. ''He had a dual personality. He could be charming but he could also be irrationally mean,'' says one high-ranking insider.
As congressional investigators, the Securities & Exchange Commission, the Justice Dept., and shareholders' lawyers try to pin down the culprits in Enron's demise, Fastow, 40, has fast become one of the primary targets. He devised the LJM partnerships that triggered the controversy over Enron's accounting. His lawyers stress that the LJM

partnerships, which Fastow ran and had stakes in, were approved by top management and the board. They also note that Fastow had no oversight of the accounting for these deals--that was the responsibility of another Enron executive who did not report to him. Fastow spokesman Gordon G. Andrew says that ‘‘Enron senior management had full knowledge of the LJM transactions.’’ But some former and current Enron executives believe that Fastow may have hidden some aspects of the partnerships--including the involvement of other insiders--from Chairman Kenneth L. Lay and Skilling.

To many colleagues and bankers who knew him, it is easy to draw Fastow as one of the villains in this story. Insiders saw him as sometimes volatile and vindictive, determined to get to the top by pleasing Skilling. That meant putting together creative financial structures that ensured Enron could expand its business without adding too much new debt to the balance sheet or threatening its crucial credit rating. But Fastow’s desire to follow Skilling’s lead didn’t end there. To build his new home in the exclusive River Oaks section of Houston--where construction continues despite Fastow’s troubles--he hired the same architect Skilling had used, says a source familiar with the project.

Some at Enron even came to believe that Fastow named his first son, Jeffrey, after Skilling--a contention denied by Fastow’s wife through a friend. ‘‘I don’t think Andy ever did anything that Jeff didn’t tell him to do,’’ says one former co-worker. Adds another high-level insider: ‘‘He wanted to make Jeff happy.’’

Former colleagues say Fastow’s screaming, table-pounding style suited the aggressive Skilling. And Fastow’s penchant for belittling co-workers certainly didn’t hinder his climb to the top. ‘‘He loved to make people look stupid,’’ says one Enron executive. ‘‘He seemed to do it most when he was in front of a lot of people.’’ Some former co-workers say he often remembered personal slights or grudges when it came time for performance reviews; at Enron, the top managers could offer their evaluations of anyone, even those who didn’t report to them.

The aggressiveness was all in service to Skilling’s plan to transform Enron into a fast-growth, technology-oriented trading company: the company of the future. When Fastow joined Enron’s finance group in 1990, the company, and the energy industry in general, were still considered backwaters for bright young MBAs. Skilling was determined to change all that; even then he was pushing Enron to take advantage of the newly deregulated energy business. Fastow clearly sensed opportunity. And his wife Lea hailed from the wealthy Weingarten realty and grocery family in Houston, so he was eager to move to Enron’s hometown. Lea, an MBA who had also worked at Continental Illinois Bank in Chicago, joined Enron, too, in the treasury department. She left the company in early 1997.

Fastow and Skilling quickly became partners in the effort to reshape Enron, and Skilling looked to Fastow to help develop the financing that would fuel the growth of his empire.

At first, the off-balance-sheet financings created by Fastow and his group were not particularly risky, say bankers familiar with the deals. Early ones were backed by payments from oil and gas producers. But before too long, they say, Enron began using its growing clout to include in the deals a hodgepodge of assets, some of dubious quality, and a range of unusual provisions. One banker recalls a partnership that had very few restrictions on what energy assets Enron could put in; his bank eventually started turning some of the deals down. Another banker was stunned by an on-balance-sheet financing that was to be backed up by third-party receivables. The problem was that Enron also included the right to replace the receivables with its own paper, which

is now almost worthless. That deal was code-named Tammy, after Tammy Faye Bakker, and included her picture on the tombstone presented to participating bankers. As the banker recalls: ''I said, 'Is it that ugly?'''

So why did so many bankers go along? Most didn't want to miss the Enron gravy train. One Houston banker estimates that Fastow controlled some $80 million to $100 million in annual fees for a wide variety of banking and investment banking services. Reluctance to join an Enron deal or persistent questioning about the terms would lead to threats that they'd be cut out of future business, some bankers say. To help in its arm-twisting, Enron kept an internal spreadsheet listing which banks were in which deals and what they made. Fastow and his team would also sell their deals by hinting that even these off-balance-sheet structures were somehow backed up by Enron, says one former banker who did business with the company. And Fastow could also turn on the charm: He delivered flowers to the house of one banker after his son's baptism. Fastow's spokesman denies that he ever threatened bankers to get them into Enron's deals.

Fastow's hard-nosed business style doesn't square with the Andy that friends and acquaintances saw outside of the office. He was a major benefactor to the city's art museums, a fund-raiser for the local Holocaust Museum, and a co-founder of a synagogue. ''The Andy Fastow I know is one of the most thoughtful and generous people in Houston,'' says Robert E. Lapin, an attorney who is one of Fastow's closest friends. When one of Lapin's three children was diagnosed with a rare disease, Fastow was one of the first to call. ''He said, 'You just tell me when and how you need help and I'll do it,''' says Lapin. Even old chums from New Providence (N.J.) High School recall Fastow as popular and well-liked, though extremely ambitious. He was the first permanent student representative to the New Jersey State Board of Education, for instance, a post he pushed to create.

Now as friends and colleagues try to figure out how Fastow landed in the middle of one of the biggest financial scandals ever, that driving ambition is looking more and more like a liability.

RESUME: Andrew Fastow

BORN

Dec. 22, 1961, Washington

EDUCATION

BA in economics and Chinese from Tufts University, 1984; MBA, Northwestern University, 1987

POSITION

Former chief financial officer, Enron. Removed from post in October, 2001, amid controversy over off-balance-sheet partnerships that he ran and held stakes in.

CAREER TRACK

Worked in structured finance group at Continental Illinois Bank from 1984 to 1990. Joined Enron Finance in 1990 and developed close relationship with up-and-coming executive Jeffrey Skilling. Fastow became CFO in 1998 with Skilling's backing.

WHAT EVERYBODY WANTS TO KNOW

Did Fastow hide some aspects of the partnerships from Enron's top execs and board, which approved the deals?

FAMILY

Married grocery store and real estate heiress Lea Weingarten, who previously worked at Continental Illinois and Enron; they have two sons. When naming the LJM partnerships that later triggered the scandal, he used the first letters of his wife's and two sons' names.

Photograph: CONSTRUCTION HAS RESUMED ON FASTOW'S NEW HOME IN TONY RIVER OAKS PHOTOGRAPH BY PHILLIPPE DIEDERICH

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Special Report: The Enron Scandal: INVESTIGATIONS

THE SWAMP FOX ON ENRON'S TAIL Is Billy Tauzin--a longtime accounting-industry pal--the right man to lead the Hill's charge?

By Dan Carney and Laura Cohn in Washington, D.C.

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Representative W.J. ''Billy'' Tauzin, the affable Republican chairman of the House Energy & Commerce Committee, once observed of his home state of Louisiana that ''half of it is underwater. And the other half is under indictment.'' That pretty much sums up Tauzin: wickedly funny, disarmingly candid, and--given some of the politicians Louisiana has produced--painfully on the mark.

Sometimes called the Cagey Cajun or the Swamp Fox for his droll humor and deft politics, Tauzin is a master at using his committee to full effect. While he's leading just one of 10 groups looking into the Enron Corp. mess, count on him to be at the center of the action as the investigations heat up. Thanks to his early acquisition of documents and digging, much of what has come to light in recent weeks--including the letter that Enron executive Sherron S. Watkins wrote last August to CEO Kenneth L. Lay warning of the company's impending collapse--has come from his team of 15 investigators.

The Enron probe won't be the first controversy to put Tauzin in the spotlight. Many of the highest profile congressional hearings of the past 18 months have been his doing. Remember the Ford-Firestone probe? That was his. The hearings into the election-night network-TV projections in Florida? Tauzin again. The California energy crisis? He was in the middle of that investigation, too. The explanation for his frequent forays? It's partly due to his committee's jurisdiction--and partly his own desire to be the showman.

But Enron clearly puts Tauzin in an uncomfortable position. As he doggedly pursues the hottest story in business, the southern Louisiana lawyer has had to do a little backtracking of his own. Until now, he has been one of the most unabashed defenders of the accounting industry in Congress. He took $57,000 in campaign contributions from accounting firm Arthur Andersen over the past 12 years, more than any other House member. What's more, he was instrumental in defeating former Securities & Exchange Commission Chairman Arthur Levitt Jr.'s efforts to clamp down on accounting industry conflicts of interest in late 2000. ''Today,'' he says rather sheepishly, ''it's kind of hard to say there isn't evidence of a problem.Arthur Levitt was right.''

It isn't the first time that Tauzin has dramatically reversed his position. Colleagues--some admiringly, some not--call him Congress' ''ultimate political chameleon.'' Indeed, the Cagey Cajun has changed his political stripes before, with no ill consequences.

After the GOP took control of the House in 1995, he not only switched parties but
also negotiated his way into a powerful subcommittee chairmanship. In one quick move,
he managed to stay in the majority and cut in front of several lifelong Republicans
to head the panel that oversees telecommunications.
Tauzin's change of tune in the current controversy could have profound policy consequences.
Once a staunch deregulator, he now vows a thorough look at how Big Business conducts
itself. ''We're finding out that there are real problems endemic in the structure
of Corporate America that we need to deal with,'' he told BusinessWeek. ''Enron is
just the worst example.''
But can someone who has reversed positions and been closely tied to the accounting
business convince the public that he is earnest in his efforts to police it? Many
believe that while Tauzin is brilliant at political theater, he's unlikely to go to
the mat for tough new accounting rules. ''Things like this make good television,''
says Bill Allison, managing editor of publications for the consumer watchdog group
Center for Public Integrity. ''But I don't know that they're going to make good law.''
Furthermore, some critics observe that while Tauzin's talk is now tougher, he has
no intention of giving back any of the industry donations he has received.
Even so, voters back home give the congressman a lot of maneuvering room. He's adored
in his district along the Mississippi Delta for his panache and his help for local
business. As a result, he has run unopposed in most of his recent reelection races,
as a Democrat or a Republican. Besides, as former Senator J. Bennett Johnston (D-La.)
says: ''Consistency is the hobgoblin of small minds. And Tauzin does not have a small
mind.''
Indeed, he's hoping to use those smarts to prove doubters wrong. Already, committee
staffers have interviewed former Enron CEO Jeffrey K. Skilling; David B. Duncan, the
recently-fired Andersen partner who handled the Enron account; as well as that firm's
risk-management chief, Michael C. Odom. Tauzin is also negotiating to meet with former
Enron Chief Financial Officer Andrew S. Fastow, who managed and had stakes in some
of the risky partnerships that caused the company to crater.
But there is the potential for disappointment, too. He has set the stage for his own
high-profile hearings by selectively releasing some of the tens of thousands of pages
of Enron and Andersen documents his staffers have culled through, and his new challenge
will be to deliver something more than headlines. Moreover, Tauzin must also take
care not to do anything that would undercut the criminal probes undertaken by the
Justice Dept.
For now, though, Tauzin is playing it cool. While his staff was hunting through records
over the Martin Luther King Jr. holiday weekend, he was chasing deer in Alabama and
keeping in touch with his crew via BlackBerry. ''He may be hunting deer,'' one staffer
laughed, ''but he's got his dogs hunting Enron.'' After the upcoming hearings, Tauzin
may have some more headlines for his scrapbook.
Tauzin's Scorecard
His earlier hearings generated headlines, but only modest action
FORD-FIRESTONE
Televised hearings examined tire blowouts and Ford Explorer rollover problems.
RESULT: A bit of money for oversight agency and modest new tire-safety
legislation, but no sweeping reforms.
ELECTION-NIGHT COVERAGE

Headed inquiry into how cable and networks bungled vote tally.
RESULT: Nothing.
CALIFORNIA ENERGY CRISIS
Ran probe of brownouts and price spikes in 2000.
RESULT: Tauzin championed the Bush energy bill through the House, but it's now bogged down in the Senate. Meanwhile California's problems have gone away on their own.
Photograph: PAPER TRAIL: Digging through Enron papers, Tauzin staffers found documents that may prove critical PHOTOGRAPH BY WILLIAM PHILPOT/REUTERS
Photograph: BACKTRACKING: Tauzin now says SEC efforts to crack down on accounting were ''right'' PHOTOGRAPH BY ALEX WONG/GETTY IMAGES
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Special Report: The Enron Scandal
BRACING FOR A BACKLASH After Enron, business may be subjected to a new wave of regulation
By Aaron Bernstein in Washington, with Brian Grow in Atlanta, Darnell Little in Chicago, Stanley Holmes in Seattle, Diane Brady in New York and bureau reports
02/04/2002
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During the 1990s boom, Americans had mixed views about the world of business. Most applauded the bounty produced by the U.S. economy, support for deregulation was on the upswing, and many rushed to grab a slice of the pie by investing in the rising stock market. For many, business simply became cool. Yet even with the bull market and the New Economy in full swing, a backlash began to build as many also grew angry at the perceived high-handedness of big corporations: the uncaring HMOs, the lousy airline and telephone service, the price-gouging drugmakers, and the sweatshops run by shoe and garment makers.
Now the Enron Corp. scandal--coming on the heels of a sharp recession, a tumbling market, and an extended stretch during which many of the most vaunted business success stories of the late 1990s proved to be chimeras--threatens to push the anticorporate button all over again. True, two-thirds of Americans still think corporations make good products and compete well in the global economy, according to a BusinessWeek/Harris poll taken Jan. 16-21. Only a third, however, feel large companies have ethical business practices and just 26% believe they are straightforward and honest in their dealings with consumers and employees. ''The backlash is beginning,'' warned General Electric Co. Chief Executive Jeffrey R. Immelt at a talk with BusinessWeek Editor-in-Chief Stephen B. Shepard in New York on Jan. 15. ''Credibility and trust is everything [in business]. And because of the recession, because of Enron, that trust has evaporated.''
Will the public mood become increasingly at odds with big business and the culture of investing? Certainly, what's emerging is a political climate that appears much more open to government regulation than has been the case for years. A crackdown on the accounting industry seems likely. Board directors may get hit with new rules about conflict of interest, as well as new responsibilities to oversee corporate audits. Companies also could face restrictions on the ability to fund 401(k)s with their own stock. ''I worry that Enron will unleash a welter of restrictive new regulations,'' frets Steven A. Raymund, CEO of Tech Data Corp., a Clearwater (Fla.)-based computer

distributor.
Even campaign-finance reform could get a lift. After all, Enron's largesse with elected officials has left a widespread impression that it paid the cops on its beat to take a nap. ''The Enron scandal clearly shows that legislators were influenced by campaign donations and didn't live up to their watchdog duties,'' says David Clay, a veteran factory hand at Boeing Co.'s aircraft plant in Everett, Wash.
Of course, public anger and political furor often have a way of fading quickly in Washington. Gun control looked like a no-brainer after the Columbine shootings, but wound up blocked by powerful groups such as the National Rifle Assn. Corporate lobbyists are already working hard to head off Enron-related regulation. The heat also is unlikely to affect many of the broader deregulatory efforts that have brought sweeping change to industries such as banking and telecommunications.
Clearly there are signs of a growing disenchantment with business. While the BusinessWeek/Harris poll shows that a core 16% of Americans have ''a great deal of confidence'' in people running major companies--up slightly from the 15% who felt that way in 1999--the percentage who have ''hardly any'' confidence in business leaders nearly doubled to 24%, from 13% in 1999.
Although there is no concrete evidence yet that Enron is adding to that disenchantment, many fear that the sordid tale will feed suspicions about self-dealing by executives and the nexus of influence between companies and politicians. The BusinessWeek/Harris poll finds that some 79% of Americans believe corporate executives put their own personal interests ahead of workers' and shareholders', as Enron officials are alleged to have done. Other polls find similar results. For example, a Gallup Organization poll released on Jan. 16 shows that 61% of those closely following the Enron story believe its executives did something illegal. Says Governor John G. Rowland (R-Conn.), head of the Republican Governors Assn.: ''The average guy on the street sees the Enron mess and says, 'Oh, another corrupt corporation.'''
Reformers are moving to capitalize on such attitudes. Reacting to the pension losses suffered by Enron employees, for example, pension-rights and labor groups have ambitious goals to give workers more control over 401(k) plans. Limiting the amount of employer stock in such plans is only the first step. The AFL-CIO also argues that 401(k)s should be governed like union pension funds, with boards comprising employees as well as company officials. Such independent oversight could resonate widely. ''There should be outside management of retirement funds,'' says Carol Otten, an assistant vice-president in the Chicago branch of Commerzbank, a Frankfurt-based bank. ''With the CEO not involved and no company stock in the fund, there wouldn't be this question of accountability'' raised by the Enron case.
Other groups cite Enron as evidence of the need for new regulatory scrutiny of the big accounting firms. They argue that Andersen was lax because it got larger fees from consulting for Enron than from auditing the company's books. This is the rule in the industry, not an exception. In fact, the large accounting firms last year received just 28% of their aggregate fees from accounting, according to a study by the Investor Responsibility Research Center Inc., a nonprofit group in Washington that represents institutional investors.
To remedy the problem, some investors want to limit or ban auditors from consulting for the companies they audit, although the SEC appears little inclined to go along.
Others want to require corporations to change their accountants every seven years.

‘‘Enron has given investors the weapon they’ve been waiting for to really make something happen,’’ says Carol Bowie, the IRRC’s head of governance research.

In addition to reform groups, the pressure from skittish stock investors is having at least a short-term effect on some companies. For example, Kmart Corp.’s Jan. 22 bankruptcy filing was triggered in part by Enron-inspired fears. So was Tyco International Ltd.’s decision that day to split into four business units. Tyco CEO L. Dennis Kozlowski says he took the step to reassure the fast-growing conglomerate’s investors that its complex financial reporting scheme involved no risky accounting--a move that wouldn’t have been needed if the Enron meltdown hadn’t renewed investor skepticism about its bookkeeping.

The biggest political question is whether the Enron backlash will suffice to push through campaign-finance legislation. Substantial curbs on campaign contributions could have a big impact on the way Washington is run. However, that’s exactly why opponents are likely to stall any key votes until the scandal has died down.

The outcome of that battle could feed into the November elections as well. So far, there’s no evidence that close ties to Enron executives led to any unethical actions by the Bush Administration on the company’s behalf. But Democrats may try to use the opportunity to taint the President for his close association with Enron Chairman Kenneth L. Lay. More broadly, they may tap the antiregulatory mood to paint the GOP as captive supporters of unregulated corporate power. ‘‘Obviously, that’s the bigger political game here--to tie the Enron albatross around the necks of Republicans who believe that government should be less involved in markets,’’ says Jerry Taylor, an environmental expert at the Cato Institute, a free-market think tank in Washington.

Of course, 10 months is an eternity in politics. Events may simply push Enron out of the public consciousness long before autumn. Still, many average Americans were suspicious of both corporations and politicians before Enron came along. The company’s collapse, and the open question as to whether the government will take steps to guard against future corporate meltdowns, can only add to the public’s growing sense of cynicism and mistrust.

BusinessWeek/Harris Poll: A Growing Sense of Anger

Disenchantment with Corporate America is on the rise.*

Would you say you have a great deal of confidence, only some confidence, or hardly any confidence in the people running major corporations?

	A GREAT DEAL	ONLY SOME	HARDLY ANY
1999	15%	69%	13%
2002	16%	56%	24%

Enron executives have been charged with putting their own personal interests ahead of workers’ and shareholders’. Do you think this is true of many other large companies, or not?

Is True	79%
Is Not True	14%
Not Sure	6%

Enron employees had a lot of their 401(k) and retirement money in the company’s stock, so they lost most of it when the company’s stock crashed. Do you think the government should regulate companies more closely to prevent this from happening at other companies, or not?

Government should regulate 73%

Government should not regulate 23%
Not Sure 4%
Decline to Answer 1%
* Based on a survey of 886 adults conducted Jan. 16-21, 2002.
Results should be accurate within 3 percentage points.
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Finance: INSURANCE
RUNNING FOR COVERAGE Suddenly, policies to cover execs are growing scarce
By Heather Timmons in New York
02/04/2002
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Buck naked. That's how many executives and company board members facing multimillion-dollar shareholder lawsuits may feel in the post-Enron era. Fearing an explosion of litigation over alleged executive misdeeds, insurers are retreating from writing Directors & Officers (D&O) policies to cover execs against court costs and fines if they are named in suits ranging from sexual harassment to insider trading. Insurers were already jittery about the growing number of dot-bomb class actions. Now the Enron Corp. debacle is ''making everyone in the business recognize the potential severity of D&O losses,'' says John Keogh, president and COO of National Union Fire Insurance Co., American International Group Inc.'s D&O unit.
Less than a dozen companies--including AIG, Chubb, and Great American--underwrote 98% of such insurance in the U.S. in 2001. Eight insurers, including Aegis, Lloyd's of London, and St. Paul may face claims from Enron directors or officials. Aegis, as lead insurer, could be looking at $100 million alone. On Jan. 18, Enron asked the Manhattan bankruptcy judge to make its insurers advance cash to executives and directors for legal fees.
Even before Enron collapsed, all major D&O insurers in the U.S. were taking stock of the business. Lloyd's of London, the third-largest player behind AIG and Chubb Corp., has cut back its U.S. D&O operations since early 2001, competitors claim. A Lloyd's spokeswoman would only say: ''We have become extremely selective [about whom to insure].''
Premiums were slated to increase by 25% to 400% because of the jump in shareholder litigation after the Nasdaq crash, says Willis Group Holdings, a London insurance broker. And insurers were increasing deductibles. Now they're drastically scaling back the scope of policies.
Typically, companies take out D&O insurance for high-profile execs and board members. Costs vary by business size and industry. Premiums averaged $242,000 a year for utilities in 2000, reports Tillinghast-Towers Perrin, an insurance-industry consultancy, but were just $67,000 for health-services companies.
Now, just getting coverage will be hard. Companies that a few years ago could buy all the D&O insurance they needed from one insurer may have to visit 8 or 10 to get covered, says Mark Larsen, a consultant with Tillinghast-Towers Perrin. Insurers are ''being very stingy with their coverage. They're only giving a handful of policies out to their best clients.''
Enron is a worst-case scenario for D&O insurers. The pension holders and investors

who have filed suits against the company, its officials, and directors know they'll get little from Enron, which is bankrupt. Instead, plaintiffs' lawyers say, their clients hope to recoup some of their losses on the approximately $350 million in coverage that Enron had purchased for its directors and execs--which the company had increased substantially after 1999. The insurers will surely fight any claims in court, and it's far from certain that they'll lose. As a rule, D&O insurance doesn't cover instances of fraud or criminal wrongdoing.

Insurers deserve some of the blame for their rising D&O risk. After Congress passed the Private Securities Litigation Reform Act of 1995--which, among other things, gave executives a legal safe harbor when good-faith projections didn't pan out--insurers thought securities litigation would all but evaporate. They rushed headlong into the D&O market, cutting premiums and offering bonuses such as longer contracts and extra coverage to companies that upgraded their policies. Total available D&O coverage sold annually to U.S. businesses rose 70% between 1995 and 2000, to $1.5 billion.

Instead, after the Nasdaq crash in spring, 2000, shareholders went on a litigation rampage against tech companies and their investment banks. Securities class-action settlements more than doubled between 1995 and 2000, to $4.4 billion. Average damage awards jumped from $25 million per case to $200 million in that period. Much of that money ultimately came from D&O coverage.

Now that Enron makes the market look even riskier, some companies may find that they can't afford D&O insurance at all, says Fred Podolsky, CEO of executive risk practices at London's Willis Group. If that happens, top brass will have more reason than ever to make sure that their company is run well. After all, their wallets will be on the line.

Insuring the Boss after Enron

Why Directors & Officers insurance is harder to get and more expensive:

-- Shareholder class actions have more than doubled in 2001 because of the bear market of 2000, and settlements are getting bigger

-- Lloyd's of London has restricted underwriting in the U.S., Reliance Insurance filed for bankruptcy, and other major players are tightening standards

-- The spread of aggressive accounting is making insurers much pickier about which companies they will underwrite

Data: Tillinghast-Towers Perrin

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BusinessWeek Investor: The Fine Print

The Fine Print: How to Read Those Key Footnotes A new periodic series will guide you through accounting issues

By Anne Tergesen

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The sudden collapse of Enron, until recently the nation's seventh-largest corporation, took investors by surprise. But had the Wall Street analysts, mutual fund managers, journalists, and individual investors who followed the company dug a little deeper,

they could have had a heads-up that all was not quite right at the Houston energy giant long before the bad news broke in October. The source of this information? The footnotes companies are required to publish with their financial statements.

Buried in Enron's annual report for 2000, for example, are hints of the hidden debt that pushed the company into bankruptcy in December. A footnote on ''preferred stock'' indicates that if Enron's share price were to fall below $48.55--which first occurred on June 14--the company would be obliged to issue stock to a partnership called Whitewing Associates. Other footnotes reveal similar arrangements. True, Enron never put a dollar value on its potential obligations, and the footnotes did not divulge the extent of the partnerships. But enough was revealed to suggest that investors were not getting a full view of the company's finances.

As Enron's collapse illustrates, it is vital to look behind the numbers companies release in quarterly and annual financial statements. That's why BusinessWeek Investor is launching The Fine Print, a series in which we will periodically examine various sorts of footnotes you'll find in company reports.

Footnotes often list items that can greatly affect the bottom line yet are invisible on the balance sheet, the income statement, and the cash-flow statement. That's because accountants often combine several items into catch-all categories, such as ''other income'' or ''other assets.''

Take IBM. Nowhere does Big Blue's 2000 income statement credit its pension fund for boosting earnings by $824 million, or 7% of pretax income. Yet the pension fund's contribution is spelled out in a footnote. Combined with a section of the annual report called ''Management's discussion and analysis,'' the footnotes ''give you some powerful information about the story behind the numbers,'' says Lynn Turner, director of the Center for Quality Financial Reporting at Colorado State University. ''If done right, footnotes will also give you some good predictive information with respect to where the company is headed,'' he adds.

Footnotes do not make for easy reading, however, and the numbers are often difficult to decipher. In addition, there can be a long lag between the publication of earnings and the clarifying footnotes. Why? While companies generally disclose earnings in a press release shortly after the end of each quarter, they have up to 45 days to file quarterly 10-Qs and up to 90 days to release the annual 10-Ks that contain footnotes.

There's no cookie-cutter method to extract what's important from the fine print. The footnote devoted to transactions with related parties was important at Enron, for example, but it's not relevant to every company. And you can't assume that one footnote contains all a company has to say about a topic. To investigate off-balance-sheet financing, for example, you must often read several footnotes, including those that detail topics such as related party transactions, minority interests, and unconsolidated affiliates. ''You have to interrelate things,'' says Bob Olstein, portfolio manager of the Olstein Financial Alert Fund.

Finally, if after reading a set of footnotes you feel more confused than enlightened, steer clear of the stock. As Enron's fall illustrates, companies that aren't straightforward risk seeing investor confidence evaporate at the first sign of trouble.

We are inaugurating The Fine Print series by examining the footnote for pension accounting. This footnote is key because, during the bull market, income from defined-benefit pension plans became a significant source of profits for many companies. Indeed, pretax earnings were lifted by an average of 12% at the nearly one-third of the companies

in the Standard & Poor's 500-stock index that reported pension income in fiscal 2000, says Jane Adams, a pension analyst at Credit Suisse First Boston. Of course, if stock market losses persist, this trend will reverse--with falling pension assets eroding many corporate bottom lines.

When a company promises to pay pension benefits to retirees, it takes on an obligation, or liability. Attaching a figure to that obligation is an inexact science that involves estimating employees' longevity and future salary levels, among other things. To convert the pension obligation from future dollars to a current value, accountants ''discount'' it at an interest rate that assumes the company will settle its obligation by investing in high-quality bonds.

This number isn't on the balance sheet. Instead, it is offset by the value of the pension plan's investments, adjusted to smooth out some stock market volatility. Depending on whether the plan's obligation or adjusted value is greater, the company records a net pension asset or liability.

To find the pension plan's impact on net income, check the pension footnote in the annual report. For Denver-based Qwest Communications International, the note shows that the plan produced a ''net credit''--or addition--to income of $319 million in 2000 (Table 1). Despite this, Qwest lost $81 million that year.

The same table reveals that the biggest contributor to Qwest's pension windfall was $1.068 billion generated by its ''expected return on plan assets.'' Accounting rules permit the use of an expected return because relying on a day-to-day return would cause net income to jump around with the stock market. The bottom half of this table shows that Qwest expects its plan assets to gain 9.4% a year, on average. It increased that rate from an 8.8% projection in 1999. Given the stock market's doldrums, it's a good bet Qwest didn't meet that goal in 2001.

In contrast to Qwest's $1.068 billion expected return, its actual return was a $78 million loss in 2000, following a $2.5 billion gain in 1999 (Table 2). If real returns continue to trail expected returns, Qwest may build up deferred losses to the point where accounting rules require the company to put some red ink on the income statement.

Partially offsetting the $1.068 billion gain generated by ''expected returns on plan assets'' are two expenses itemized in Table 1, service cost and interest cost. Service cost represents the pension benefits employees earned during 2000. Interest cost is the annual interest cost on the pension obligation--a figure analogous to interest payments on debt.

Check the lower half of Table 1. There you'll find the ''weighted average discount rate'' used to figure the current value of these expenses, as well as the overall pension liability. When this rate--pegged to interest rates--falls, the pension obligation rises, says Janet Pegg, a Bear Stearns accounting analyst.

The footnote also indicates if a pension fund is over- or underfunded and thus potentially in need of cash infusions. In Qwest's case, the news is good. At the end of 2000, its pension plan was worth $13.6 billion (Table 2). That exceeded the $9.5 billion (Table 3) it promised to deliver in pension benefits by $4.1 billion. (This number appears under ''funded status'' in Table 4.) Because Qwest's pension fund is amply overfunded, the footnote shows no company contribution to the plan in 2000.

The days of fat pension gains may be over for Qwest. In part because the plan's actual return for 2000 was negative, the deferred gains--technically called ''unrecognized net actuarial gains''--stockpiled during the bull market fell from $4.6 billion to

$2.9 billion (Table 4).
Deferred gains can arise when actual returns exceed expected returns. Such gains are put into a pot, along with gains and losses from other pension items, such as changes in assumptions about future salaries. If the pot becomes big enough, some of it is required to spill over into net income. In 2000, Qwest recognized $58 million (Table 1) of its deferred gains--technically called ‘‘net actuarial gains.’’ But with deferred gains dwindling, less will be available to boost the bottom line in the future, says Pegg. More troublesome, if the plan’s assets continue to shrink, so will the expected returns that nearly erased Qwest’s red ink in 2000.
It’s a good bet that Qwest is not alone. So check the footnotes in those financial statements to find out whether an ugly surprise may be lurking in the form of fading pension income.
Illustration: Chart: Pension Footnotes: What to Look for: TABLE 1: Qwest’s pension plan contributed $319 million to its bottom line in 2000. The company also increased the projected return on its pension plan to 9.4%, from 8.8% in 1999.
Illustration: Chart: TABLE 2: Even though Qwest booked income from its pension plan, the plan actually lost $78 million in 2000. That helped to reduce the plan’s value to $13.6 billion.
Illustration: Chart: TABLE 3: Qwest owed its employees and retirees $9.5 billion at the end of 2000, up from $8.9 billion in 1999. Still the plan was overfunded, because it had $13.5 billion in assets.
Illustration: Chart: TABLE 4: Qwest records a net pension asset of $894 million on its balance sheet. The table also shows unrecognized gains, a source of corporate profits in the past. This declined from $4.6 billion in 1999 to $2.9 billion in 2000.
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Economic Viewpoint
ENRON: A POWERFUL BLOW TO MARKET FUNDAMENTALISTS
By Robert Kuttner
02/04/2002
BusinessWeek
20
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The deepening Enron Corp. scandal should hose away an entire world view about how capitalism is supposed to work. But will the right lessons be drawn? As a political scandal, Enron threatens the Bush Administration. No corporation was closer to the Bush family and its Republican allies. No corporation was more political in gaming the system to get the rules written in its favor. The White House damage-control machinery contends that if the President did not try to rescue Enron on the way down, his hands are clean. The real scandal, of course, is how the GOP and its broader world view helped Enron rig the rules on the way up.
The deeper scandal here is ideological. Enron epitomized an entire philosophy about the supposed self-cleansing nature of markets. Republicans are the more devout practitioners of this ideology, but both parties are implicated.
Enron, as a trading enterprise, claimed to be the quintessence of a pure free market. In practice, it was up to its ears in cronyism, influence-peddling, rigging the rules to favor insiders, and undermining the transparency on which efficient markets depend. Transparency, in turn, demands regulation in the public interest.

There is no getting around the need for regulation, since capitalism itself requires rules that govern everything from rights to financial and intellectual property to constraints on opportunistic practices that undermine the efficiency of a market system.

If you think capitalism can operate in the absence of vigorous, competent, and public-minded government, look at Moscow or Buenos Aires. And government requires politics not corrupted by bribery. For it is democratic politics that elects the officials who make and enforce efficient rules--or don't.

But for three decades now, the dominant strain of economics from the University of Chicago has been teaching gullible undergraduates and journalists that there is no such thing as the public interest. Efficient outcomes are just the aggregation of selfish private interests, and government's main job is to get out of the way. Well, after Enron, these theorists should learn some other useful trade.

Even conservatives who reject other forms of government intervention grudgingly concede the need for a Securities & Exchange Commission. Entrepreneurs and traders are not saints. Deregulation is no cure-all, because decisions about which rules to waive are every bit as politicized as the decisions to regulate. We've seen the corruption of deregulation in every imperfect-market realm from electricity to banking to copyright law to airlines, hospitals, and telecom. None of these is an absolutely efficient free market; each one requires rules. And in all of these realms, whether they are regulated or deregulated, corporations seek to game the system and rig the rules.

But Enron took the prize. It not only cooked its books. It used its extensive political influence to cook the regulatory system itself. When a public-minded chairman of the Federal Energy Regulatory Commission stood in Enron's way, Chairman Kenneth L. Lay paid a call and the offender disappeared. Wendy Gramm went from being head of the Commodity Futures Trading Corp. under Bush I to the Enron board. Her husband, Senator Phil Gramm (R-Tex.), helpfully ensured legislation allowing Enron to evade policing either from the CFTC or the SEC.

At the SEC, Arthur Levitt spent eight years trying to toughen regulation so that corporations would keep honest books and auditors would not also be retained as business strategists and spin-doctors. For this public service to capitalism, Levitt was widely vilified.

His successor, Harvey Pitt, came directly from lobbying for the accounting firms who were against Levitt's proposed rules.

The difference between the Enron scandal and the superficially similar Long-Term Capital Management affair is that LTCM essentially operated beneath everyone's radar. Enron, by contrast, worked to take out the radar stations. The Houston company systematically used its ample political connections to rig the rules--on trading, audits, disclosure, and the mechanics of energy markets. The other difference is that LTCM's dupes were ostensibly sophisticated consenting adults. In the Enron case, a lot of innocent people got badly hurt.

None of this is new--only the particulars are different. The last time we learned the broad lesson that capitalism is not self-regulating, it took a Great Depression that was followed by a reformist Democratic Administration. This time, there are no catastrophic wider effects (yet), and the incumbent Republican Administration still champions the ideology of laissez-faire and the politics of cronyism. But Enron is to the menace of market fundamentalism what September 11 was to the peril of global terror--a very costly wake-up call. Our political leaders should pay as much attention to this assault on the very heart of capitalism as they paid to the other one.

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Special Report: The Enron Scandal: COMMENTARY
A Regulator with His Own Conflicts of Interest
By Gary Weiss
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In his two decades of dedicated service to an array of corporations, Securities & Exchange Commission Chairman Harvey L. Pitt won renown as a legal scholar. But that expertise came at a price--a close identification with the interests of his clients. Controversy rages over Pitt's history of legal work for Big Five accounting firms, including Enron auditor Arthur Andersen, which threatens to undermine his leadership in formulating accounting reforms. And Pitt's conflict-of-interest nightmare may only be just beginning.
As a partner in the Washington law firm of Fried Frank Harris Shriver & Jacobson, he represented firms and individuals throughout the financial-services industry. Although most previous SEC chairmen had worked on Wall Street or were securities lawyers, Pitt's practice was unique in its sheer size and scope. Securities lawyers say that Pitt thus faces actual or apparent conflicts of interest--either can be just as troubling--on a host of issues. Another constraint is equally daunting: Legal ethics forbid him from acting on information he obtained from ex-clients. ''It's impossible to see Harvey Pitt as anything but Prometheus bound. Pitt is shackled to a rock, and the harpies are going to come and pick his guts out,'' says Bill Singer, a New York securities lawyer.
The heart of his future difficulties can be found in a single-spaced, six-page document that Pitt filed with the U.S. Office of Government Ethics on May 24, 2001, after he was nominated to the SEC. It lists Pitt's 112 clients during the preceding two years. Apart from the Big Five accounting firms, the list includes major banks, the mutual-fund and securities industry trade groups, brokerages such as Bear Stearns and Morgan Stanley Dean Witter, the New York Stock Exchange, hedge fund titan Dawson Samberg, and corporations such as media giant America Online and its Chairman Stephen M. Case.
Virtually all could be affected by SEC work in the coming years. The NYSE is vitally interested in issues affecting its heated competition with Nasdaq and electronic trading networks. Charles Schwab and Datek Online closely follow issues affecting online trading, and Nasdaq market making giant Knight/Trimark Group has pressed the SEC not to curtail payments for order-routing, and weighed in on other trading issues.
Pitt has dealt with potential conflicts by hewing strictly to the law. His spokesperson, Christi Harlan, notes that ''people can always believe that there is the appearance of a conflict of interest, but in [Pitt's] agreement with the Office of Government Ethics he has agreed not to be involved in any matter involving former clients for a year [ending in August], which is what the law requires.''
But potential conflicts won't go away just because Pitt is following the rules. If he takes action concerning former clients--even clients from years ago, not on the list--after August, lawyers say he may be seen as either favoring them or bending over backwards to do otherwise.
Either way, you ''lose the moral high ground,'' says one securities lawyer. ''You

want to avoid the appearance of a conflict as well as a real conflict,'' says Ira L. Sorkin, a former SEC regional administrator and now a New York securities lawyer. Sorkin notes that while he has confidence in Pitt's fairness, ''you don't want to create any issues that will call into question a particular decision. It's something that judges and senior people in government avoid.''

Pitt has already lost the moral high ground in the No.1 issue on the SEC's agenda. His credibility is open to serious question on many other subjects vital to the markets. And if Pitt's baggage reduces public confidence in the SEC, it may be time to consider if the price of his expertise is too high.

Possible Minefields

SEC Chairman Harvey Pitt's many former law clients could pose ethical dilemmas during future proceedings. Among them:

CORPORATIONS

America Online
Dell Computer
El Paso Natural Gas
General Instrument
Humana
Louisiana-Pacific

SECURITIES & INVESTMENT

Bear Stearns
Charles Schwab
Datek Online
Dawson-Samberg
Gruntal
Investment Company Institute
Knight/Trimark
Merrill Lynch
Montgomery Asset Management
Morgan Stanley Dean Witter
New York Stock Exchange
PaineWebber
Securities Industry Assn.
TIAA-CREF
Tiger Management

BANKS & INSURANCE

Bank of America
Bank One
Cigna
Lincoln National Life
Lloyds of London
Securities Investment Protection
Reliance Group

Data: U.S. Office of Government Ethics

Photograph: ''We are encouraging the accounting profession to take full responsibility for helping to solve this....'' -- HARVEY PITT, Chairman, SEC PHOTOGRAPH BY DANIEL ACKER/BLOOMBERG NEWS

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Finance: INVESTING
SHOULD YOU FOLLOW THE INSIDERS? Mimicking their trades in company stock is no sure road to riches
By David Henry and Timothy J. Mullaney in New York
02/04/2002
BusinessWeek
74
(Copyright 2002 McGraw-Hill, Inc.)
Most surefire tips for beating the stock market have short lives. They fizzle out as soon as people figure out that there is no magic formula for making money from stocks. But one concept has had a remarkable run: shadowing the trades of those who have the inside scoop on a company--its executives and directors. A small industry of publications and Web services has sprung up to track their required disclosures to the Securities & Exchange Commission since the late-1990s tech boom, when stock became a key part of executives' compensation. It was not lost on the market at large that many people got rich by investing in their own companies. And all the publicity about prescient selling by Enron Corp. brass before the energy company's demise has given the idea a new push.
The idea has broad currency. Many mainstream publications cover the topic, including BusinessWeek, which prints data from Vickers Weekly Insider Reports. Numerous academic studies support the view that an increase in insider buying or selling across a sector tends to point to a switch in the market's direction. Insiders at tech and scientific companies in particular seem to have a much better knack for timing the market than ordinary investors. In the months before the Nasdaq hit its March, 2000, peak, techies were selling actively. Since then, they've sold into shallow, short-lived rallies.
A study by researchers from the University of California at Los Angeles and New York University shows that a group of insider buyers, most from tech and pharmaceutical companies, beat broad market indexes by an average of 9.6% in the six months following their purchases.
But for individual companies--which is what the bird-doggers really care most about--there's little solid evidence that insider transactions convey much useful information about the near term prospects for a company's stock. A close analysis by BusinessWeek of a series of trades shows why: Many factors, from regulatory restrictions to the ebb and flow of executives' personal finances, control the timing of an insider's transactions and mask the motivations. Arguably, an executive who is buying is probably enthusiastic about his company's prospects, but a big repeat seller could be raising cash for a tuition bill at Harvard University or the downpayment on a ski lodge in Aspen, Colo.
And with companies paying an ever-larger part of compensation in stock options, insiders have more incentive to sell shares to cover expenses.
Besides, SEC filings on insider traders aren't disclosed to the public until several weeks after deals occur--when the optimum time to buy or sell may be past. In addition, brokers are increasingly helping insiders camouflage their transactions by offering them private contracts to stop losses or secretly capture gains. Or they may help them schedule trades months in advance, a tactic permitted by a recent SEC ruling.
Moreover, many companies, concerned about impressions of impropriety, limit when their execs can trade so they can't time the market.

Studies, such as the one from UCLA and NYU, that appear to support investment strategies based on insider tracking turn out on closer analysis to be less-than-rousing endorsements. For instance, the reported 9.6% six-monthly lift was skewed by outsize gains at a few companies. When researchers looked at all companies reporting insider trades, buyers only beat the market by 3.6% on average. And that average was also unrepresentative. In each case, only half of all insider buyers outperformed the market by more than a tiny margin. The study shows that investors would need to mimic hundreds of insiders' trades to lock in above-market returns, according to one of its authors, UCLA Assistant Finance Professor David Aboody. ''You would need an insider fund. An individual investor would lose his pants,'' says Aboody.

Even those in the insider-tracking business are willing to acknowledge that their data are ambiguous at best. ''You see investor services promoting that Bill Gates sold a large amount'' of Microsoft stock, says Lon Gerber, research director at Thomson Financial/Lancer Analytics. ''And it generally means nothing.''

Indeed, even when executives call their company's stock just right, it's often as much dumb luck as anything else. That became clear in interviews with a number of insiders identified by Lancer Analytics as having had astonishingly prescient trading patterns over the past 15 years, measured by returns over the six months following their trades (table).

Consider the case of David M. Kies, a director of ImClone Systems Inc., a company whose shares plunged after a much-ballyhooed cancer drug failed to pass muster with the U.S. Food & Drug Administration. Kies bought ImClone shares 19 times after joining the board in 1996, and all but once, the stock climbed in the next six months. Last October, Kies made his first sale, at $70, near the stock's high. Nearly three months later, ImClone shares fell below $20. A scared insider bailing? Hardly. Kies sold only 8% of his holdings into a $1 billion tender offer by Bristol-Myers Squibb Co. to raise tax money. ''If I didn't have the tax liability, I just would have held on,'' says Kies, adding that he's still a believer in the drug, even though ''I can't say I fully understand the science.''

The examples also show that many smart-looking buyers never sell--with unfortunate results. William A. Friedlander, a money manager who sits on the board of telecom carrier Broadwing Inc., made out fabulously for a while. After each of his 10 purchases, Broadwing shares rose an average of 23% in the following six months. The 24,000 shares he bought in July, 1999, at $21 rose 80%. Friedlander still owned those shares at $10. Why didn't he sell? He says he was mistakenly convinced that demand for broadband services would outstrip supply.

Others, like Paul A. Frame, simply got lucky. The CEO of oil services company Seitel Inc. sold shares that he had acquired earlier, mostly through options, over a decade on 16 different occasions--and in 13 cases the shares were down six months later. But, he says, he sold on a schedule determined by the company's restrictions on when he could trade, according to company spokesman Russell J. Hoffman.

Even many tech insiders get it wrong. Far from being the first to jump ship, Nortel Networks Corp.'s execs and directors bought 34 times in the months since October, 2000--a period when the stock plunged by 90%. At Gateway Computer Inc., insiders have bought a half-dozen times since mid-2001, but most did so long before Gateway released a weak sales forecast on Jan. 8, which pushed the stock down nearly 30% in one day. It has continued to fall. And Yahoo! Inc.'s ex-CEO Timothy A. Koogle sold $25 million

of Yahoo stock last year, much of it before the shares took off on a 65% rally.
The bottom line: Insider tracking is a lot of work, and it's hardly a sure-fire technique for making money. A pattern of buying or selling might give investors a hint that something's up at a company. But it's still no substitute for dogged research.

Insight or Dumb Luck?

BUYERS

COMPANY NUMBER TIMES STOCK UP PERIOD
OF BUYS SIX MONTHS LATER
BROADWING 10 7 1986-2001
William A. Friedlander, Director: He never sold as the stock soared; stock is down 64% since Jan. 1, 2001
APPLICA 15 14 1987-2000
David M. Friedson, CEO: Hasn't sold since '95, while stock tripled to $36; stock is now at $6.40
IMCLONE 19 18 1996-2001
David M. Kies, Director: Sold 8% of his stake to pay taxes before the shares fell 70%; stock is now under a cloud due to a drug approval problem
ZIXIT 10 10 1996-2000
Antonio R. Sanchez, Director, Never sold as the stock rocketed past $90; stock is now at $5.15

SELLERS

COMPANY NUMBERS TIMES STOCK DOWN PERIOD
OF SALES SIX MONTHS LATER
SEITEL 16 13 1991-2001
Paul Frame, CEO: Lucky. Sold on company-restricted schedule; stock is now a volatile market laggard
HEALTH NET 8 8 1994-2000
Roger F. Greaves, Director: Sold heavily above $29 when he lost CEO job; stock is stalled around $20
XICOR 12 11 1987-2000
Klaus G. Hendig, Senior VP: Looks smart. Big sales in $20s near stock peak; stock is now around $10
Data: Thomson Financial/Lancer Analytics; BusinessWeek

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Editorials

THE POST-ENRON WORLD

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A post-Enron era is beginning to take shape, and those chief executive officers and politicians who miss this change in the culture may find themselves suffering deeply. Enron Corp. clearly crossed the line--but it was a line that much of the country has been walking for a decade. The hyperbolic forecasts that various chief executives fed investors about their companies' prospects became sweeping deceptions by Enron officials. The accounting tricks that companies employed to boost earnings and stock prices became outright duplicity in Enron hands. And the campaign contributions spent

by many companies to ensure favorable government treatment worked only too well in Enron's case.

The Enron scandal appears to be a watershed event. Polls show a deep undercurrent of public distrust in Big Business and its influence in Washington (page 34). Investors are already demanding a new veracity and integrity from chief executives and the balance sheets they present. The next impact, however, may be on the political world as voters question the money connection between Big Business and policymaking. President George W. Bush would do well to understand the change in the nation and follow his champion Theodore Roosevelt in cleaning up the mess in political finances. As he prepares his State of the Union message, the President should seize the moment to back campaign finance reform and reassure Americans that they can trust their elected leaders.

Americans want no less from their corporate leaders. The perfidy of Enron executives contrasts sharply with the post-September 11 honesty of former New York City Mayor Rudolph W. Giuliani and Defense Secretary Donald H. Rumsfeld, who became instant public heroes for their simple and truthful appraisals of terrible crises. Compare that to what Enron Chairman Kenneth L. Lay told BusinessWeek on Aug. 20: ''There are no accounting issues, no trading issues, no reserve issues, no previously unknown problem issues. The company is probably in the strongest and best shape that it has ever been.'' Or compare that to what former Enron Chief Executive Jeffrey K. Skilling said to BusinessWeek on Aug. 23: ''People are afraid there's another shoe to drop, but it's just not the case.'' Skilling resigned on Aug. 14, the day before an Enron vice-president, Sherron S. Watkins, wrote her now-famous memo warning of an enormous ''accounting hoax.'' Enron filed for bankruptcy on Dec. 2, destroying the jobs and the retirement savings of thousands of people. Throughout this time, Lay and Skilling were selling their company's stock while advising investors and their own employees to buy it.

INVESTORS WANT HONESTY

In the immediate aftermath of the Enron fiasco, investors already have started demanding much greater clarity and honesty. Look at Tyco International Ltd., which was pressured to split itself into four companies and sell off assets because investors were uneasy about the reliability of the company's accounting methods. Even a passing grade by the Securities & Exchange Commission was not good enough to satisfy these skeptical investors. Meanwhile, the credit-rating agencies are demanding more off-balance-sheet information from companies. And stocks may well shift to a two-tier market in which investors reward companies that choose to return to conservative accounting practices and punish those that don't. The days of slippery pro forma accounting are numbered.

Washington should get behind the move toward more transparency and honesty in the country's corporate books. The ability of companies to game the entire regulatory process, as Enron did, must be prevented in the future as well. The Securities & Exchange Commission should be leading the reform effort, but it isn't. The attempt of the SEC's chairman, Harvey L. Pitt, to constrain rogue accounting firms that enable companies to distort their earnings is pitifully weak. He suggests yet another oversight committee to check procedures in a profession that already has a half-dozen such groups, none of which has stopped the many accounting scandals of recent years. Pitt's background in representing dozens of major companies, including ones in the accounting industry, in battling SEC regulation make his job all the more difficult (page 39).

THE SEC SHOULD ACT

Pitt is unquestionably a man of personal integrity, but he needs to come forth with

a far bolder reform plan. The integrity of our financial markets is at stake.
Beyond that, there is no way to ensure honesty in Washington under the current system of campaign finance. It is impossible to establish arm's-length decisions in the public interest when raising campaign money is constantly on the agenda. The Clinton Administration encouraged chief executives to fly abroad with Commerce Dept. officials to pull in overseas contracts. Their goal was laudable: to compete with Japanese and European government efforts to help their corporate ''national champions.'' At the same time, though, Clintonites were asking those same honchos flying overseas for campaign contributions. Enron's Lay flew to India with members of the Clinton Administration who helped him snag a $3 billion energy contract. He gave generously to Democrats and Republicans alike. Did he get what he paid for? We can't know for sure. Which is precisely the point.
In the post-Enron environment, Americans are revaluing their financial and political assets--and finding both severely depreciated. Investors are already betting their dollars on more trustworthy companies and CEOs. Voters may soon do the same with their political parties and elected officials. TR said in 1910 that ''our government, national and state, must be freed from the sinister influence or control of special interests.''
After Enron, President Bush should take Teddy's words to heart.
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The [Enron] Spillover/The Suicide
Enron Takes A Life
Cathy Booth Thomas/Dallas. ; With reporting by Daren Fonda/ Amityville and Joe ; Pappalardo and Jyoti Thottam/New York
02/04/2002
Time Magazine
Time Inc.
20
(Copyright 2002)
Cliff Baxter had worked hard for all the trappings of a Texas millionaire's life, but the cowboys at Enron had hog-tied his career. Sure, he had the $700,000 house in an exclusive suburb of Houston, a new 2002 Mercedes-Benz S500 sedan in the driveway and a 72-ft. yacht named Tranquility. With millions of dollars in the bank, he and his wife had established a charity to help kids with diabetes and cancer, and Baxter was even considering a new career in teaching. A smart, funny Long Islander who served five years in the Air Force and graduated first in his M.B.A. class at Columbia University in 1987, Baxter, 43, found his place with a bunch of brash Texans building the energy company of the future and rose to become vice chairman. But long before Enron went bankrupt, Baxter realized it was shady. Last week that knowledge helped drive him to suicide.
Known as a straight shooter who helped protect his employees from Enron's cutthroat culture, Baxter tried to do the right thing, at least initially. Last spring he warned then CEO Jeff Skilling about the dubious financial practices that would eventually be Enron's undoing. By speaking out, he forfeited his chance to become company president. But this was Houston, not Hollywood, and Baxter wasn't Russell Crowe in The Insider; instead of going public with his concerns, he took his millions and walked away.
Last month he was dragged into the glare. After being named in the leaked memo written by Enron whistle-blower Sherron Watkins, Baxter was subpoenaed to testify before Congress--which

meant he would have to either take the Fifth or betray friends or himself. He was
also one of 29 former and current Enron officials accused in a shareholder lawsuit
of cashing in options before prices started plummeting last fall; since 1998, he had
cashed out $35 million in stock. The pressure was getting to him--people at his yacht
club noticed that since December his hair had gone much grayer.
Late last week Baxter got into his new $80,000 Mercedes, drove to a median strip not
far from his home in Sugar Land, Texas, turned the engine off, locked the doors and
shot himself in the head with a single bullet from a .38 revolver. A suicide note
was found, reportedly pointing to the problems at Enron.
Few at the company knew as much about those problems as Baxter, who joined Enron in
1991 and rose quickly, under the tutelage of Skilling, in the marketing wing known
as Enron Capital & Trade, eventually becoming Enron’s chief of strategy. He negotiated
dozens of big deals, including the $3 billion purchase of the Oregon utility Portland
General Electric in 1997. He was also in charge of getting rid of many of Enron’s
hard assets, like power plants, around the globe--part of an effort, some insiders
think, to raise cash and help shore up the company’s ailing balance sheet. Baxter’s
onetime division, Enron North America, which sold energy on the wholesale market,
often did deals off the books with the company’s mysterious limited partnerships like
JEDI II, or Joint Energy Development Investments, which is now under investigation.
By the end of 2000, his criticism of some of those deals left him in the dead-end
job of vice chairman.
After Baxter’s death, Skilling was said to be "devastated." Watkins was
"stunned." Former Enron lobbyist Joe Allen was "in shock." Baxter’s
lawyer said his family, including his widow Carol Whalen and two children, 11 and
16, want "to mourn privately, in peace, with dignity." Friends in Amityville,
N.Y., where J. Clifford "Cliffie" Baxter grew up as one of six siblings
born to a homemaker mom and police sergeant dad, saw how appearances can deceive.
Said Jo Kenny, 66, a friend and neighbor in Amityville: "You think a person has
achieved so much, but [problems] go much deeper."
--By Cathy Booth Thomas/Dallas. With reporting by Daren Fonda/ Amityville and Joe
Pappalardo and Jyoti Thottam/New York
B/W PHOTO: AFP UNDER PRESSURE Former Enron executive Cliff Baxter took his life; Baxter’s
home in Sugar Land, Texas COLOR PHOTO: RICHARD CARSON--REUTERS [See caption above]
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The [Enron] Spillover
The Enron Players; A humbling resignation and hearings in Congress for Andersen executives
(with an audience cameo by The Sopranos’ Lorraine Bracco) fueled last week’s intrigue
Eric Roston
02/04/2002
Time Magazine
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KENNETH LAY Former Enron chairman
Had he resigned only a few months earlier, Lay might have received a "golden
parachute" in excess of $25 million. Instead, he departed in shame last week,
and must defend himself from lawsuits and hostile questions during televised congressional

hearings that start Feb. 4. Still, Lay, who helped found Enron in 1985 and became its CEO, has received about $200 million in salary, stock and other compensation from Enron since 1999. He enjoyed privileges rare even for top CEOs, such as the $7.5 million revolving credit line Enron extended him, which he reportedly used and repaid with Enron stock 15 times between last February and October. Lay will maintain his seat on Enron's Board of Directors, a perch from which, some say, he can keep an eye on the investigators probing the company.

JEFFREY SKILLING Former Enron CEO

A week after his surprise Aug. 14 resignation, the media and public, however skeptically, had digested Skilling's claim and his colleagues' swift corroboration that the CEO was leaving the company for personal reasons, after just six months on the job. Between January and August 2001, Skilling sold off about $20 million in Enron stock. He has tried to maintain a low profile--but last week's suicide by former Enron vice chairman Cliff Baxter brought reminders that, according to whistle-blower Sherron Watkins, Baxter had complained loudly to Skilling about Enron's shady bookkeeping.

DAVID DUNCAN Former Andersen partner

Duncan, who had overseen Andersen's Enron audit since 1997, was fired Jan. 15 for leading the document-shredding brigade--against company policy, according to official statements. His 15 minutes of fame, though, turned out to be less than five--that's the amount of time it took him to invoke the Fifth Amendment before a House Energy and Commerce subcommittee last Thursday. That brief appearance opened the door for the two Andersen executives, C.E. Andrews and Dorsey Baskin Jr., who claimed that they found it "appalling" that he seemed to manage the shredding "in anticipation of a government request for documents." Duncan, a 20-year Andersen veteran, initiated a rapid document-destruction campaign on Oct. 23, they said, the day after the SEC's Enron probe became public, and it lasted until Nov. 9, when Andersen received a subpoena. Duncan told House investigators that he believes officials at Andersen's Chicago headquarters tacitly encouraged shredding as early as September.

NANCY TEMPLE Andersen lawyer

After Duncan declined to answer their questions, the members of the House Committee on Energy and Commerce made quick work of Temple. Her now well-known Oct. 12 e-mail, first reported in TIME, routinely laid out the auditor's policy that explains when nonessential documents such as computer files and e-mail should be kept and when they may be destroyed. But Duncan and Andersen partner Michael Odom heard the message as a starter's pistol for what would become a 17- day document-shredding marathon. Some investigators felt they got a glimpse of Temple's state of mind in a document that emerged last week: Temple told Duncan to remove her name from a memo relating to Enron to decrease the chances she could be a witness, "which I prefer to avoid," she wrote on Oct. 16.

THOMAS WHITE Secretary of the Army

A former vice chairman of Enron Energy Services, White faced enemy fire last week for his push last year to privatize energy utilities that supply the armed forces. The activist group Public Citizen accused White of making decisions favorable to Enron soon after he officially joined the Bush Administration last June. Previously, White drew attention for his Enron holdings, more than 400,000 shares- -by far the largest among Bush Administration officials--which he sold between June and October for an estimated profit of more than $12 million. In those months, he says he had 30 strictly

personal calls or meetings with Enron employees.
SHERRON WATKINS Enron vice president
Corporate-development executives make the unlikeliest folk heroes. But Watkins wrote the prescient Aug. 15 memo to Lay that predicted Enron could "implode in a wave of accounting scandals"--a line that is already a well-worn mantra among Enron's victims.
--By Eric Roston
COLOR PHOTO: LAY: GREG SMITH--CORBIS SABA COLOR PHOTO: SKILLING: PAUL S. HOWELL--GETTY
COLOR PHOTO: DUNCAN: LARRY DOWLING--REUTERS COLOR PHOTO: TEMPLE: LARRY DOWLING--REUTERS
COLOR PHOTO: WHITE: HEESOON YIM--AP COLOR PHOTO: WATKINS: STEVE LISS FOR TIME
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First; Value Driven
You're On Your Own That Enron workers lost life savings is just another sign that the short era of economic security is over.
Geoffrey Colvin
02/04/2002
Fortune Magazine
Time Inc.
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(Copyright 2002)
The miserable fate of Enron's employees will be a landmark in business history, one of those awful events that everyone agrees must never be allowed to happen again. This urge is understandable and noble: Thousands have lost virtually all their retirement savings with the demise of Enron stock. But making sure it never happens again may not be possible, because the sudden impoverishment of those Enron workers represents something even larger than it seems. It's the latest turn in the unwinding of one of the most audacious promises of the 20th century.
The promise was assured economic security--even comfort--for essentially everyone in the developed world. With the explosion of wealth that began in the 19th century it became possible to think about a possibility no one had dared to dream before. The fear at the center of daily living since caveman days--lack of food, warmth, shelter--would at last lose its power to terrify. That remarkable promise became reality in many ways. Governments created welfare systems for anyone in need and separate programs for the elderly (Social Security in the U.S.). Labor unions promised not only better pay for workers but also pensions for retirees. Giant corporations came into being and offered the possibility--in some cases the promise--of lifetime employment plus guaranteed pensions. The cumulative effect was a fundamental change in how millions of people approached life itself, a reversal of attitude that must rank as one of the largest in human history. For millennia the average person's stance toward providing for himself had been, Ultimately I'm on my own. Now it became, Ultimately I'll be taken care of.
The early hints that this promise might be broken on a large scale came in the '80s. U.S. business had become uncompetitive globally and began restructuring massively, with huge layoffs. The trend accelerated in the '90s as the bastions of corporate

welfare faced reality. IBM ended its no-layoff policy. AT&T fired thousands, many
of whom found such a thing simply incomprehensible, and a few of whom killed themselves.
The other supposed guarantors of our economic security were also in decline. Labor-union
membership and power fell to their lowest levels in decades. President Clinton signed
a historic bill scaling back welfare. Americans realized that Social Security won't
provide social security for any of us.

A less visible but equally significant trend affected pensions. To make costs easier
to control, companies moved away from defined- benefit pension plans, which obligate
them to pay out specified amounts years in the future, to defined-contribution plans,
which specify only how much goes into the plan today. The most common type of defined-contribution
plan is the 401(k). The significance of the 401(k) is that it puts most of the responsibility
for a person's economic fate back on the employee. Within limits the employee must
decide how much goes into the plan each year and how it gets invested- -the two factors
that will determine how much it's worth when the employee retires.

Which brings us back to Enron. Those billions of dollars in vaporized retirement savings
were in employees' 401(k) accounts. That is, the employees chose how much money to
put into those accounts and then chose how to invest it. Enron matched a certain proportion
of each employee's 401(k) contribution with company stock, so everyone was going to
end up with some Enron in his or her portfolio; but that could be regarded as a freebie,
since nothing compels a company to match employee contributions at all.

At least two special features complicate the Enron case. First, some shareholders
charge top management with illegally covering up the company's problems, prompting
investors to hang on when they should have sold. Second, Enron's 401(k) accounts were
locked while the company changed plan administrators in October, when the stock was
tanking, so employees could not have bailed out if they wanted to.

But by far the largest cause of this human tragedy is that thousands of employees
were heavily overweighted in Enron stock. Many had placed 100% of their 401(k) assets
in the stock rather than in the 18 other investment options they were offered. Of
course that wasn't prudent, but it's what some of them did.

The Enron employees' retirement disaster is part of the larger trend away from guaranteed
economic security. That's why preventing such a thing from ever happening again may
be impossible. The huge attitudinal shift to I'll-be-taken-care-of took at least a
generation. The shift back may take just as long. It won't be complete until a new
generation of employees see assured economic comfort as a 20th-century quirk, and
understand not just intellectually but in their bones that, like most people in most
times and places, they're on their own.

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The [Enron] Spillover

Enron Spoils The Party; Bush wants his State of the Union speech to drown out those
stories linking the disgraced company and the White House

Michael Duffy and John F. Dickerson; With reporting by Cathy Booth Thomas/Dallas and
Karen ; Tumulty and Michael Weisskopf/Washington

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We're not going to have to tear up the speech, are we?" George W. Bush asked late last week, as his aides labored over the text of Tuesday night's State of the Union address. Bush was gently mocking the endless process--and perhaps acknowledging how many reasons there are for last-minute rewrites: a war and a recession, an anxious public, an aggressive opposition party, and above all the fast- moving story of the largest corporate bankruptcy in U.S. history--a scandal that has so far defied White House attempts to isolate it or explain it away. In the space of five days last week, the story of Enron's collapse went from the merely unusual to the truly baroque, with plot elements lifted from the pages of Robert Penn Warren and John Grisham. On Tuesday FBI agents moved in when document shredding was discovered inside Enron's Houston headquarters. On Wednesday Enron CEO Kenneth Lay, until recently the national cheerleader for a frictionless new economy and a man the President nicknamed "Kenny Boy," resigned in disgrace, forced out by a board of directors who had apparently been napping for months. One of 11 congressional investigations opened its hearings on Thursday with a tableau we might as well get used to: Enron's former outside auditor taking the Fifth Amendment. On Friday J. Clifford Baxter, 43, an executive who left Enron last May, was found dead in his Mercedes-Benz in the median of a divided highway in the fancy Houston suburb of Sugar Land- -an apparent suicide. That same day, as if on cue, the White House acknowledged that Bush's top political strategist, Karl Rove, had recommended that Enron hire a key G.O.P. consultant during the early days of Bush's presidential campaign five years ago.

It was one more intimate link between Enron and the Bush team, one more unwelcome story at a time when the President is hoping that his big speech will change the subject back to heroism and unity and patriotism, the themes that have helped make him so popular of late. But even Bush's poll numbers--playing a game that Enron accountants know so well--are beginning to tell two different stories at the same time. For a President with two wars to fight and a 77% approval rating in the new TIME/CNN poll, the Enron story has been up to now little more than a bother. The poll shows that most Americans give Bush high marks indeed for his handling of the war and the terror threat. But when it comes to domestic issues--the economy, health care, the budget deficit--his grades are middling, and Enron is reviving some of Bush's least favorite issues, such as campaign- finance reform, while stoking old questions about whose side he is on. With 45% of those surveyed predicting the recession is going to get worse, 51% said that Bush cares more about Big Business than he does about regular people--an ominous combination for the White House. And so last week Bush told about how his mother-in-law got socked by Enron's collapse. As Bush and his team know, the growing links between the Administration and the company that cooked its books and wiped out the retirement savings of thousands provide the best ground Democrats have had in months for staging fights over issues like tax cuts, the budget and pension reform--the subjects that are increasingly important to people and where Bush gets his lowest marks. No wonder nervous Bush aides reached out last week to at least one prominent Republican who had been critical of the Administration and asked him to tone it down. They called allies in the House and told them to keep it to a dull roar.

One night two weeks ago, White House Press Secretary Ari Fleischer pushed back from his desk and smiled. The evening news had just ended and, once more, all the TV stories about Enron dealt with it as an accounting debacle, not a political one. Fleischer looked over at Tom Brokaw of NBC, whose cameras had been shadowing Bush all day, and

said, "All right. Did you notice all the Enron stuff that everybody was asking about? Look what made it on the air--the business-scandal side of it."

By mid-January, Fleischer and other senior officials assumed they had put the Enron problem behind them. They were mistaken. Over the last year, the Bush team had quietly performed a host of political sacraments for the Texas company before it began to go bust, and vice versa: there was the $1.76 million in contributions that Enron executives sent to the G.O.P. during the 2000 campaign; there was the energy policy Vice President Dick Cheney drafted in 2001 after meetings with Enron officials, portions of which seem to have sprung directly from Enron's wish list; there were ex-Enron chiefs and consultants salted around the Bush Administration, from the Army Secretary Thomas White to the U.S. Trade Representative Robert Zoellick. And last summer Bush chose Pat Wood--a man strongly backed by Lay--to be his top energy-price regulator.

But when top Enron officers bombarded Washington with dire pleas for help last fall, something almost unprecedented happened: nothing. Though both sides had been in contact for months on a variety of issues, at the moment the company threw itself down at the mercy of the feds, top officials at Treasury and Commerce said, in effect, "See ya." Even Robert Rubin, the Clinton Treasury Secretary who dialed up on behalf of Enron's creditors at Citigroup, was turned away by Bush officials.

The we-did-nothing defense bought the White House time, but there were enough failures in the government's safety net of market, accounting and energy regulation to open the door to more than half a dozen congressional probes--and to give some cover to the hundreds of lawmakers from both parties (including 212 of the 248 involved in the hearings) who had taken money from Enron or its accounting firm, Arthur Andersen.

By then the White House seemed cocky. For reasons no one can explain, it went through with its plan to make one of Enron's former lobbyists, former Montana Governor Marc Racicot, the new Republican National Committee boss.

Each new development had the Democrats rubbing their hands together in anticipation. For months the opposition party had had almost nothing to say, partly because the nation was at war and partly because it was keen to align itself with a popular President. With nothing much to argue about, the Democrats had nothing with which to distinguish themselves. Worst of all, no one in the country was willing to blame the state of the economy on anyone other than Osama bin Laden. "You can only do what you can do based on the cards you have to play," said Senator John Breaux last week. "We don't have many cards."

Then Enron dealt them a fresh hand. The implosion of the huge Texas energy firm and the sudden loss of retirement funds for thousands of employees and pensioners opened up all the pathways to Scandalland that had been closed since Sept. 11. Every populist conflict in the Democratic playbook has at least a cameo role in the Enron drama: fat cats versus little guys, energy producers versus energy consumers, corporate secrets versus shareholder democracy, business-friendly Republicans against lunch-pail Democrats.

Last week, when the Congressional Budget Office found that 70% of the federal budget surpluses for this year and the next had evaporated under the weight of last year's tax cuts, the recession and lower post-Sept. 11 spending, it was only a matter of time before someone made Enron a verb. Bush, said Senate Democratic leader Tom Daschle, is "slowly Enronizing the economy. Enronizing the budget. We are taking the same approach Enron used in sapping retirement funds and providing them to those at the very top. That's exactly what Enron did. And I'd sure hate to see the U.S. do that."

Looking around for other things to Enronize, the Democrats turned next to campaign-finance reform. Last week the long-suffering backers of the Shays-Meehan bill to eliminate unregulated soft money finally attracted the 218th signature they needed to get the stalled measure onto the House floor. That doesn't mean it will pass at all, much less soon. The phrase "discharge petition" sounds encouraging but permits a vote only on certain Mondays. The House rarely, if ever, meets on Mondays. (Got that?)

Like teenagers trying to see how far they can get on a stolen credit card, Democrats then moved on to energy policy. House minority leader Dick Gephardt, gearing up for a presidential campaign, proposed a new "Apollo project" to make the U.S. energy-self- sufficient by 2010. Last week another White House hopeful, Senator John Kerry of Massachusetts, gave a similar speech, calling for Americans to produce 20% of electricity from renewable sources by 2020. Both proposals are designed to force the White House to side with energy producers and against average Americans. The White House said it is sticking with its own energy plan.

And when the first Senate hearing on Enron got under way, it felt less like an inquiry and more like a warm, ritual bath designed to soak away the stain of contributions. Senator Joe Lieberman of Connecticut, who got $2,000 from Enron and $11,500 from Arthur Andersen in the past decade, invited former SEC chairman Arthur Levitt, the nation's leading accounting hawk, to do the scrubbing and apply the rinses. That gave Senator Robert Torricelli of New Jersey, who was until recently the subject of a federal probe into his campaign finances, a chance to apologize to Levitt, who had pushed unsuccessfully for lawmakers to tighten accounting standards. "Congress did not respond," Torricelli intoned. "We were wrong. You were right."

While Senators were making their acts of contrition, Republicans on the House side--with a nervous eye on the coming midterm elections- -were trying to score points by publicly flaying some scapegoats. Arthur Andersen auditor David Duncan, who the company says ordered the shredding of Enron documents at the giant accounting firm's Houston office, took the Fifth in front of the House Energy and Commerce Committee (but not before briefing the panel's investigators behind closed doors). Then Duncan's superiors appeared before the committee and tried to pin all the blame on Duncan rather than take responsibility for a "document retention policy" that seemed to encourage shredding. Republicans got more than twice as much campaign cash from Enron employees as Democrats did in 2000--$1.7 million compared with $683,000--which may be one reason the House panel plans on more hearings next week.

None of these plot twists brought the story into the West Wing until the New York Times reported last week that conservative strategist Ralph Reed had received a $10,000-a-month consulting contract from Enron in 1997 with a little push from Rove, who was political adviser to then Governor Bush. Like so much about Enron's business practices, it is unlikely that such an arrangement would have been illegal. But the timing of Reed's Enron work had people who know about the finances of fledgling presidential campaigns clucking. A powerful force among Christian conservatives in the late 1990s, Reed was hired by Enron to bang the drum for energy deregulation in Pennsylvania at a time when the Bush team in Austin would have appreciated a low-cost, low-profile way of keeping Reed on their side, off their payroll and yet far from the crowd gathering around Steve Forbes and other conservative rivals. If Rove gave Enron a nudge about Reed--"Karl Rove gave Ralph Reed a good recommendation," said press secretary

Ari Fleischer, and Rove says he doesn't recall-- then the young Bush campaign was at least capable of the same sort of creative accounting that ultimately brought down Enron in December: finding quiet, off-the-books ways to help itself and its friends. Democrats termed the disclosure serious and promised to investigate. Reed, a political consultant in Georgia, points out that Enron tried to hire a Democrat, James Carville, for the same work in 1997--something Carville, no friend of Rove's, acknowledges. And Rove told Time that if he spoke to anyone at Enron about Reed, it might have been only after Reed was hired. An Enron official, meanwhile, who says he and two others made the decision themselves, told TIME they had no contact with Rove about the matter. But a veteran G.O.P. organizer who was in contact with Reed in 1997 said Reed told him the Bush campaign had steered business his way--something Rove doesn't deny. After a year in office, one thing is clear about Bush's political operatives: when they make a mistake, they fix it fast. When their conservative instincts lead them down a path that much of the country isn't keen on, they are awfully good at changing the subject while holding to their original course. Which is why Bush, early last week, said his mother-in-law was one of the little people who got screwed by the corporate giant. On a trip to a West Virginia machinery shop Tuesday, Bush told workers that Jenna Welch, 82, had lost almost all of her $8,000 investment in Enron last year. And he fired up his own boilers a bit, saying he was "outraged" by what happened at the Texas firm. But the Bush team didn't stop there. By late last week, it got out a few more iron shields to wedge between the White House and the mess in Texas. On Friday the Administration announced that it had ordered a government-wide review of more than $60 million in federal contracts with Enron and Andersen. Mitch Daniels, Bush's budget director, said the move was "purely a management issue." Meanwhile, the long-simmering dispute between Dick Cheney and Congress about the Vice President's energy task force started bubbling again. The General Accounting Office, which is as close as Congress comes to having an independent auditor, announced that it would file a lawsuit against the White House this week if Cheney did not fork over the details of his energy task force's private meetings with Enron officials. The GAO had postponed the suit after Sept. 11, but when it became clear Cheney had no intention of complying with its request, or even negotiating, the tiny agency decided to fight.

Congressional interest in those documents increased last week when House Democrats discovered what they think may be a subtle but significant last-minute change in Bush's energy policy, made before it was submitted to Congress. According to Rep. Henry Waxman, a California Democrat, language was added to the final energy plan that was designed to help Enron with a financially troubled power-plant project in India. Waxman obtained a copy of an earlier draft of the plan, dated March 30 and written by an interagency group. That version, sent to Cheney, included no reference to India's energy output, Waxman said. But when Cheney made his final energy plan public in May six weeks later, the proposals included a new section calling for increased energy production in India. The plan directed the secretaries of State and Energy to work with India to help that country maximize its domestic oil and natural-gas output. The provision was significant because Enron has a controversial $2.9 billion natural-gas-fired Dabhol power plant in India, but the plant's only customer, the state of Maharashtra, found Enron's prices too high and began buying power elsewhere. Enron was eager to get out of the Dabhol investment or get the facility back on line and had sought Washington's help. Cheney

met with Lay on April 17, exactly one month before the final energy proposals were unveiled. Waxman asked Cheney in a letter late last week to explain how the provision evolved and who recommended it.

Waxman's line of questioning is exactly the kind of inquiry that White House officials say the public has no patience for. Lengthy probes into the provenance of a few sentences in an already aging federal report, they add, is the sort of duck soup that turned voters off about Washington and politics for much of the Clinton era. Republicans believe this in part because they learned that lesson the hard way. The party's take-no-prisoners wing is still smarting a bit from 1998, when it did not realize until too late that its drive for Bill Clinton's scalp did as much if not more harm to their own party than it did to the President's.

However much oxygen Enron has pumped into Democrats, it doesn't change the fact that Bush has the highest sustained approval ratings in memory--and a monumental set of tasks ahead of him. That explains why, after delivering his State of the Union speech Tuesday, he planned to hit the road for two days selling his proposals to the public. Many are sure to be popular: more money for defense, intelligence gathering, homeland security and border controls and more tools for police and fire fighters. If Bush has had to shelve his plans to reform Medicare and Social Security--money is tight, and the country is in no mood to experiment with retirement benefits-- that's not an entirely unpleasant outcome. Those waters are treacherous, and many wondered why he ever thought about diving in.

Bush will try lots of little things to release the pressure building up in the Enron pipeline. He has indicated that he will sign the campaign-finance measure if it ever makes it to his desk. Aides indicated last week that he will also get behind efforts to strengthen the rules that require companies to disclose information about hidden liabilities. He will call on Congress to make sure that employees have ways to diversify their retirement savings so that other Enrons don't happen. And with unemployment rising, the former oilman is capping talk of tax cuts and boosting talk about jobs, jobs, jobs.

But the main valve Bush will open now is the one labeled "war." In that arena, the public has given him a free hand to spend whatever he wants, finish off al-Qaeda in Afghanistan, hunt down its cells around the world and build up U.S. military muscle. He is already moving into the second phase of the war, tracking terrorists in countries like the Philippines, Somalia and Sudan. Sitting at Camp David two weekends ago, he told his aides he believed that roughly 100,000 al- Qaeda-linked terrorists might still be at large around the world. "We're not going to stop short," he said.

All is fair in war and politics, but there are some battlefield tactics the combatants would rather not discuss. Democrats want to take away Bush's fatigues and drag him back to last year, to the days when his presidency lacked a clear purpose. The President wants to go in the opposite direction, wrapping the entire country--Democrats included--in a warm, unifying embrace, complete with new proposals to foster volunteerism and charity. Safe inside that hug of unity, he dares the Democrats to break the mood that faced down terrorism. A senior official predicted to TIME that voters who care about Enron and its White House ties will lose interest after the next big bombing raid. If Bush has his way, investigating the Administration's links to Enron or challenging his plans for mending the economy will seem as unpatriotic as questioning the choice of

bombing targets in Tora Bora.
--With reporting by Cathy Booth Thomas/Dallas and Karen Tumulty and Michael Weisskopf/Washington
TIME/CNN POLL
THE PUBLIC HAS QUESTIONS ABOUT ENRON...
--Do you think each of the following groups did something illegal concerning Enron?
Enron executives 55% Enron's accounting firm, Arthur Andersen 51% Members of the Bush Administration 11%
--Do you think the Bush Administration is covering up any important information about contact that Administration officials had with Enron executives?
Yes, is covering up information 43% No, is not covering up information 39% Not sure 18%
--Should Bush Administration officials, who knew of Enron's troubles before the firm's bankruptcy, have spoken out sooner about what they knew?
Yes, should have spoken out sooner 66% No, don't feel that way 20% Not sure 14%
--Do you think Enron's financial contributions to the Bush campaign and the Republican Party kept the Bush Administration from acting more aggressively to protect Enron's employees and investors from financial losses?
Yes, kept the Administration from acting more aggressively 40% No, didn't keep the Administration from acting more aggressively 40% Not sure 20%
--Do you think the Bush Administration has done enough to help Enron employees and investors who lost their savings when the firm declared bankruptcy?
Yes, done enough 27% No, not done enough 50% Not sure 23%
--Do you think George W. Bush cares more about Big Business or more about people like you?
Cares more about Big Business 51% Cares more about people like you 39%
...BUT STILL GIVES BUSH HIGH MARKS OVERALL
--President Bush's approval rating is now 77%
--How would you grade the job George W. Bush has done as President so far?
A 28% B 37% C 22% D 7% F 4%
--How would you grade the job George W. Bush has done on each of the following issues?
A B C D F
The war in Afghanistan 50% 28% 10% 5% 6% Fighting terrorism outside the U.S. 49% 29% 11% 4% 5% Homeland security 31% 33% 18% 8% 5% The economy 13% 33% 29% 12% 11% The Enron situation* 13% 23% 22% 9% 14% The environment 13% 29% 28% 12% 12% The budget deficit 12% 29% 27% 13% 13% Health care 10% 31% 29% 13% 11% Creating jobs 10% 26% 31% 14% 14%
--If George W. Bush runs for re-election, how likely are you to vote for him?
Very Somewhat Somewhat Very likely likely unlikely unlikely
Jan. 23-24, 2002 40% 23% 11% 22% May 2001 26% 17% 8% 42%
>From a telephone poll of 1,017 adult Americans taken for TIME/CNN on Jan. 23-24 by Harris Interactive. Margin of error is 3.1% . "Not sures" omitted. *19% responded "Not sure."
COLOR PHOTO: PHOTOGRAPH FROM FOUR BY FIVE INC. COVER THE ENRON MESS How Sticky Will
It Get? COLOR PHOTO: BROOKS KRAFT--GAMMA FOR TIME BUSH DENOUNCED ENRON [T of C] COLOR

PHOTO: GREGORY SMITH--AP REED GOT A PLUM JOB [T of C] B/W PHOTO: BROOKS KRAFT--GAMMA
FOR TIME ROVE WAS LINKED TO REED [T of C] COLOR PHOTO: LARRY DOWNING--REUTERS TEMPLE'S
E-MAIL TRIGGERED SHREDDING [T of C] COLOR PHOTO: LARRY DOWNING--REUTERS DUNCAN TOOK
THE FIFTH [T of C] COLOR PHOTO: KAMAL KISHORE--REUTERS LAY QUIT UNDER FIRE [T of C]
COLOR PHOTO: TYLER MALLORY--AP LEVITT SAID I TOLD YOU SO [T of C] COLOR PHOTO: REUTERS
BAXTER TOOK HIS LIFE [T of C] COLOR PHOTO: PHOTOGRAPHS FOR TIME BY BROOKS KRAFT--GAMMA
B/W PHOTO: PHOTOGRAPHS FOR TIME BY BROOKS KRAFT--GAMMA KARL ROVE helped Ralph Reed
get a lucrative Enron contract COLOR PHOTO
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The [Enron] Spillover/Karl Rove
Did W.'s Playmaker...
John F. Dickerson
02/04/2002
Time Magazine
Time Inc.
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Karl Rove loves a three-cushion shot. As the President's chief political brain, the Texan, 51, delights in crafting a message or staging a presidential visit that doesn't just score a political point but also plays to several constituencies at once. So when it was reported in the New York Times that Rove might have steered an Enron contract to Ralph Reed, a G.O.P. kingmaker whose support Rove needed, the political elite in Washington, which includes some longtime enemies, thought that just might be his kind of pool.
All the key players involved denied any funny business, but that didn't stop the chatter. It doesn't take much to get people talking about Rove. He is the architect of Bush's two gubernatorial victories in Texas as well as his presidential race. He has also been the President's tutor, feeding him histories and biographies to read. Inside the White House he is at the center of every political and domestic policy decision. He helps determine where the President spends his political capital, and in an election year when both houses of Congress are up for grabs, he is watching over hundreds of races.
Last year Rove was criticized for meeting with officials from several companies in which he owned a substantial amount of stock. Rove dumped the stocks, but there was no way his financial portfolio didn't conflict with his political one, said critics, including at least one Democratic Congressman who has called for an investigation. Those holdings included $100,000 to $250,000 of Enron shares, which already had Democrats contemplating a look into Rove's relationship with the company. Though he has never worked for Enron and the shares he owned were bought out of his own pocket, last week's disclosure that Rove recommended Reed, who was hired by the company, may move congressional

Democrats to summon him for testimony.
That would be a rare spectacle for everyone in Washington who spends time charting and discussing Rove's moves. The top political adviser to every President takes on celebrity status around town, and like those who have come before him, Rove doesn't mind encouraging the perception that he has a hand in just about every political deal that goes down. As a result, people assume that every story they hear about him is true--which is why some insiders don't believe him when he insists he didn't pull strings with Enron to help curry favor with Reed.
But some of his denials are worth believing. At the end of the 2000 presidential campaign, for example, the owlish Rove was suspected as the mastermind behind a scheme involving a stolen videotape of George W. Bush's debate preparations. Many were convinced that Rove had mailed the tape to the Gore campaign, hoping strategists there would secretly watch it. Then at just the right moment, Rove would leap out and expose them as sneaks willing to do anything to get ahead. Some in the press even published the whole yarn as if it were known to be true. But it was just hooey. A low- level former Democrat in a campaign consultant's office was prosecuted and jailed for sending the tape. Rove wasn't involved at all. It was a bum rap, but Rove probably doesn't mind. Those kinds of suspicions are the price he pays for being the President's playmaker.
--By John F. Dickerson
COLOR PHOTO: BROOKS KRAFT--GAMMA FOR TIME ROVING Central to White House politics and
policy, Rove also hopes to improve G.O.P. fortunes in November. Democrats want to tar him with Enron
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The [Enron] Spillover/Ralph Reed
...Do A Favor For A G.O.P. VIP?
Daniel Eisenberg; Reported by Michael Weisskopf/Washington
02/04/2002
Time Magazine
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If Karl Rove did land an Enron consulting job for Ralph Reed, one thing is certain: Reed didn't really need his help. Reed's choirboy looks notwithstanding, he was no neophyte trying to get into the business. By the time he stepped down as executive director of the Christian Coalition in April 1997, Reed, now 40, was considered such a shrewd political operator and grass-roots organizer that any number of FORTUNE 500 firms were knocking on his door.
Still, there is no doubt that the Bush campaign had plenty of reasons to make Reed happy. After taking over Pat Robertson's fledgling religious organization in 1989, Reed turned it into a political force, exercising something close to veto power over the Republican presidential nominee. If Reed had signed up with one of Bush's conservative rivals, Bush's White House dreams might have been threatened. But if Reed had too visible a role in the Bush campaign, his right-wing reputation might step on Bush's compassionate- conservative message.
The answer may have been to have Reed play an informal, behind- the-scenes role in the campaign while earning a tidy sum working for one of Bush's most dedicated supporters.

Late last week the White House confirmed that Rove did indeed recommend Reed to officials at Enron in 1997. Both Reed and Rove, however, vehemently deny that this was part of any kind of deal to secure Reed's backing. Reed insists he was not even aware that Rove had put in a good word for him and claims that he had pledged his support to Bush as far back as April 1997, five months before he was hired at Enron. "I was always going to be with him," Reed told TIME. "The idea this [Enron job] was an additional inducement is not only untrue, it's insulting." He also dismissed any notion that the Bush campaign had to keep him at a safe distance, citing dozens of campaign and TV appearances as evidence to the contrary.

Reed definitely paid dividends for Bush on the campaign trail. After the candidate's stunning loss to John McCain in the New Hampshire primary, Reed's firm came to the rescue in South Carolina, bombarding the state's 400,000 religious conservatives with negative phone calls and mailings about the maverick candidate from Arizona. Bush won handily.

Reed was almost as successful at Enron. He spent most of his time advising the company on how best to drum up support for energy deregulation. He made about $10,000 a month for 12 to 18 months of work, focusing initially in Pennsylvania, and Enron got much of what it wanted from the state, which deregulated its electricity market without making California's costly mistakes. But even Reed couldn't help Enron persuade the state to let it immediately compete for the customers of incumbent utility PECO Energy.

This isn't the first time Reed has been in hot water. During the 2000 presidential campaign, his firm publicly apologized for lobbying a Republican candidate on behalf of Microsoft, which was hoping to get a better hearing from a new Administration. The candidate, of course, was one of Reed's other clients at the time--Governor George W. Bush.

--By Daniel Eisenberg. Reported by Michael Weisskopf/Washington

COLOR PHOTO: STEPHEN CROWLEY--THE NEW YORK TIMES END RUN? Reed went to work for Enron
about the same time he backed Bush

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The [Enron] Spillover

Can Lawmakers Now Afford To Be Obstacles To Reform?

Mitch Frank; With reporting by Sally B. Donnelly/Washington

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Washington has its own version of the business cycle: when times are good, get rid of pesky regulations that companies complain are holding them back; when things turn sour, start crying for rules. No legislator wants to appear to be blocking reform now, especially in an election year, but previous efforts have faded away when the headlines did. Here are four areas of reform and the hurdles they face.

--By Mitch Frank. With reporting by Sally B. Donnelly/Washington

AUDITING LAWS

"We were wrong." When Senator Bob Torricelli of New Jersey said those words in a hearing last Thursday, it marked a dramatic turnaround. For years, Congress has

aided the accounting industry's efforts to avoid new auditing rules. Torricelli is one of many lawmakers (including Connecticut Senator Joe Lieberman) who have pressured the SEC several times over the past decade to back off on tougher regulations for auditors. Clinton-appointed SEC chairman Arthur Levitt tried to enact rules that would have kept firms from auditing and consulting for the same clients and forced companies to publicly disclose more liabilities, such as executive stock options. Each time Congress quashed Levitt's efforts. But that opposition was gone at last week's hearing. "Perhaps the era of self-regulation is over," said Tennessee Senator Fred Thompson. But President Bush's SEC chairman, Harvey Pitt, doesn't share Levitt's concerns. As a lawyer and lobbyist for the accounting industry for more than 20 years, Pitt led the fight against Levitt's proposals. Now he's pressing for a new industry-funded oversight board. But the current board never flunked an auditor in 25 years of peer reviews. Pitt's proposal "lacks teeth and independence," says Levitt. The Senators may be talking about stricter regulation in televised hearings, but they're not proposing many bills. Will their change of heart last long enough to result in real action?

401(K) REFORM

It's impossible to find anyone on Capitol Hill these days opposed to new protections for 401(k)s. No members of Congress want voters to think they don't care about Enron employees who watched their retirement savings disappear into a black hole of creative accounting. Talking of how his mother-in-law lost $8,000 in Enron stock, President Bush put together a Cabinet team to study the issue. Senators Barbara Boxer and Jon Corzine are pushing a bill that would limit the amount of an employer's stock in its 401(k) plan and ease restrictions on how soon employees could sell it. Boxer only had to dust off a similar bill she proposed in 1997, when Texas retailer Color Tile went bankrupt. No one is vocally opposing the Boxer- Corzine bill--yet. "There's a lot of shrapnel up here," says a Senate staff member. "People are keeping their heads down." But businesses and their lobbyists don't like the idea, arguing that the restrictions would push employers to stop offering matching contributions. They fought Boxer's 1997 bill until it quietly died in committee. One person keeping quiet is Phil Gramm, usually a leading opponent of such restrictions. Gramm's wife Wendy served on the audit committee of Enron's board, and the Texas Senator has recused himself from Enron matters. His fellow Republicans are also holding their fire, for now.

ENERGY DEREGULATION

Anyone who watched both the struggle to keep the lights on in California and the implosion of Enron might be getting cold feet about deregulation. Not Joe Barton. The Texas Congressman, who chairs the House subcommittee on energy, hopes to get a bill further deregulating public utilities to the floor by the end of next month. Barton and other proponents see Enron as an isolated example. The White House has no plans to hold off on its energy bill and proposals for drilling in the Arctic National Wildlife Refuge. Opponents are adding Enron to their arguments, though no one new is fighting the bill. But the scandal has won converts to government oversight of energy-futures trading. Enron had persuaded Washington not to monitor the trades.

CAMPAIGN FINANCE

Enron broke the logjam on the long-stalled campaign-finance bill. House sponsors obtained 218 signatures--including those of 20 Republicans--last Thursday to force the G.O.P.

leadership to take it to the floor. Charles Bass of New Hampshire provided a key Republican signature last week after failing to persuade Speaker Denny Hastert to allow debate. The bill still faces a tough vote; House majority whip Tom DeLay plans to fight it. But the 186 Representatives and 71 Senators who took Enron money may find the bill the easiest way to wash their hands. Opponents hope that Bush will veto it.
FOUR COLOR ILLUSTRATIONS: ILLUSTRATIONS FOR TIME BY PETER HOEY COLOR PHOTO: LARRY
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The [Enron] Spillover
Under The Microscope; After Enron, investors are looking more skeptically at companies whose bookkeeping seems confusing
Daniel Kadlec; With reporting by Bernard Baumohl and Unmesh Kher/New York
02/04/2002
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As questions swirled around its accounting practices, Tyco International, an industrial and services conglomerate with $36 billion in annual revenues--and a beaten-down stock price--said last week it would split into four companies in a bid to "unlock tens of billions of dollars of shareholder value." The company's combative CEO, Dennis Kozlowski, predicted the breakup would add 50% to the stock price. Going him one better, Don MacDougall of J.P. Morgan Chase said the move would make the stock worth $80 to $90 a share-- double the current price. Haven't they heard? Post Enron, any hint of questionable accounting is the functional equivalent of finding asbestos in everything a company makes. So a day that dawned with promise for Kozlowski quickly turned to loss. By week's end Tyco shares were at $45, down 3% from the day before its breakup was announced--and down 24% since fresh accounting worries surfaced at the start of this year.
Kozlowski insists that "Tyco has better disclosure in its financial statements than anybody out there." Almost two years ago, the company emerged from an informal Securities and Exchange Commission inquiry with no action against it, and in an unusual step, the SEC has put out word that no new inquiry is under way at Tyco. But while there appears to be nothing illegal about Tyco's bookkeeping, jumpy investors are suddenly setting a higher standard. They want to see clearly how a company earns, spends and invests. And Tyco--despite its planned reorganization--remains a complex conglomerate, with headquarters in tax haven Bermuda. Many investors feel it still doesn't reveal enough. Says James Chanos, president of hedge fund Kynikos Associates: "Investors just have to exercise a fair amount of diligence when looking at companies that appear confusing."
In a financial world shaking from the Enron scandal, many investors are viewing with fresh skepticism the bookkeeping methods of a range of companies, including even blue chips that are widely admired and accused of nothing illegal. Some of the companies that investors point to are American Airlines, the insurer American International

Group, Coca-Cola, Electronic Data Systems, General Electric, IBM, J.P. Morgan Chase and Xerox.
These marquee names say it all. Even companies once considered above suspicion are being subjected to increasing scrutiny. Under current accounting rules, management can essentially do whatever it pleases, says David Dreman of Dreman Asset Management, based in Jersey City, N.J. It can scatter explanations in impenetrable footnotes it is confident no one has the time or capacity to decipher. "There are enormous overstatements of earnings and understatements of expenses," he says.
Enron's unraveling can be traced to investors' first whiff of "off- balance-sheet" partnerships that hid billions of dollars of the company's liabilities. By the time Enron crashed, it was primarily a trading firm. It had relatively few hard assets to cushion its fall when business faltered and hidden debts came due. The risks aren't nearly so great at asset-rich companies like Tyco and GE. But, as with Enron, seasoned analysts have trouble determining whence, exactly, they derive their profits.
Since the Enron fiasco blew wide open, the influential Moody's Investors Service has requested additional information from some 4,000 companies that use accounting methods that Moody's believes make it harder to judge their creditworthiness. Companies are also deciding on their own that confusing books just aren't worth it. Last Wednesday, Bank of America went to great lengths to explain a $418 million gain in the fourth quarter from a subsidiary set up last year to deal with problem loans. The gain resulted from tax savings after bad loans were shifted to the subsidiary. Not wanting an Enron-like taint, the bank clearly spelled out to analysts the legal maneuver, and investors rewarded the extra disclosure by pushing the stock up 4% in a week.
K Mart, which filed for Chapter 11 bankruptcy protection last week, announced on Friday that it was looking into internal accounting issues. The company offered no details.
But the accounting getting closest scrutiny in the wake of Enron generally falls into three categories:
REVENUE RECOGNITION The SEC says its No. 1 line of inquiry is into the ways that companies book their sales. The most glaring example of revenue fraud occurred at Sunbeam five years ago. (The company's infamous former CEO, "Chainsaw" Al Dunlap, just last month settled a shareholder suit stemming from his stint at the small-appliance maker.) Sunbeam recorded the sale of gas grills and other goods well before they left the warehouse. Many of the items never did get shipped. By offering retailers deep discounts to place orders months before they normally would and by booking those sales immediately, Dunlap was able to show escalating revenue and earnings. Eventually, though, the scheme collapsed as retailers couldn't sell enough appliances even at discount prices and had to cancel orders.
The SEC warned Xerox three weeks ago about booking sales of copiers that, technically, are leased, not sold. Revenue from a lease is generally reported over the life of the lease, not up front. Xerox has said it will contest the SEC on this issue.
Some telecom companies are getting a second look, partly because more than a few use Arthur Andersen, Enron's auditor, but also because many achieved their once spectacular growth partly by immediately recognizing revenue from long-term contracts, analysts say. Qwest has received the most attention because its merger with US West opened the door to other accounting issues. Qwest has denied that it did anything wrong.
"Think about a bottle of wine," former SEC chairman Arthur Levitt said in a speech two years ago. "You wouldn't pop the cork on that wine before it was

ready. But some companies are doing this with their revenue, recognizing it before a sale is complete, before the product is delivered to a customer or at a time when the customer still has options to terminate, void or delay the sale."
MANAGED EARNINGS Critics of Tyco, which has bought hundreds of companies over the years, charge that it inflates write-downs for the costs of its acquisitions, in effect creating stored earnings it can summon at will to pump up quarterly results in a way that makes earnings growth appear to be the result of expanding sales or higher margins.
These allegations are "totally inaccurate," Kozlowski says. But those denials aren't persuasive to David Tice, who runs the Prudent Bear Fund and practices short selling, a technique that bets on a stock to fall. He has sold Tyco stock short and asserts that Tyco's core growth rate is just 7% or so a year--not the 15% to 20% that the company reports.
While investors sort that one out, they can also look at GE, famous for its steadily rising earnings and steadily rising stock price. GE is an acquisitive conglomerate known for reporting one- time gains and one-time losses in striking balance, keeping growth on a calm and steady course. The company has also benefited from earnings that flow from its overfunded pension plan. Last year, with the broad stock market down 13%, GE reported a whopping $1.7 billion of income from pension-plan investments.
How could that be? Here's one possibility cited by stock analysts: by raising the estimated rate of return on the money set aside to fund employee pensions in the future, a company can immediately cut the amount of money it sets aside and let that flow to the bottom line. But if the higher returns never materialize, there will be an earnings hit later on. GE denies that it manages its earnings. "I don't want to be painted with that brush," CEO Jeffrey Immelt told analysts last week.
Stock analysts also question the pension accounting of IBM, which two years ago assumed a 9.5% rate of return on pension investments and has upped that expected return to 10%. IBM has said the increase was based on its experience in managing the fund.
Insurance companies routinely set aside reserves for future claims. Because insurer AIG has posted steadily rising profits for years, some analysts believe the company may over-reserve in good times and use the stored earnings to pump up results in bad times. AIG has said its policy for setting aside reserves is appropriate and fully disclosed in regulatory filings.
Cisco has come under the lens, as have a slew of other tech companies, for its use of so-called pro forma earnings, which may leave out recurring expenses and are often referred to as "earnings before all the bad stuff." Last year Cisco asked investors to ignore a $2.2 billion charge for inventory loss, which most accountants consider to be a normal business expense rather than something extraordinary.
HIDING DEBT This is where Enron got into trouble. Yet hundreds of companies shift liabilities off their books without breaking any laws or accounting rules. Many, like Enron, use special-purpose entities (SPE) that, as long as the entities receive at least 3% of capital from outsiders, can be left off the consolidated books of a parent company.
There are other ways to hide debt. In the 1980s Coke divested most of its bottling operations and saddled them with most of the parent company's long-term debt. Coke kept stakes of just under 50% in the bottlers, giving it the leverage to force price increases for syrup even when the bottlers couldn't pass on those costs. Coke's large ownership interest means that it is on the hook for much of the bottling companies'

liabilities, yet the bottlers' debts do not show up on Coke's balance sheet. For that reason, some analysts consolidate the bottlers with Coke in looking at the company's financial picture.

Liabilities can also be covered over with extensive lease agreements. Both United and American airlines owe billions of dollars on long-term leases for aircraft. Those are real obligations but do not show up as debt. Data processor EDS is potentially liable for $500 million in financing costs for computers that its customers use- -an item that appears only in a footnote to a company report. And J.P. Morgan Chase has a nearly $1 billion liability as a 49% partner in an SPE called Mahonia that traded energy contracts with Enron. In accounting, there's always more than meets the eye.

--With reporting by Bernard Baumohl and Unmesh Kher/New York

OTHERS GETTING NEW SCRUTINY Here are some companies whose accounting practices have raised eyebrows among investors, analysts and regulators since Enron's collapse:

--TYCO Denies that it bolsters earnings growth by taking excessive write-downs for merger costs and using them later

--GENERAL ELECTRIC Says it doesn't smooth quarterly profits by carefully matching one-time gains and losses and by boosting income from its pension plan

--AMR The parent of American, like many airlines, owes billions of dollars in long-term lease agreements that do not show up as debt on the balance sheet but for which it is liable

--J.P. MORGAN CHASE Like other banks, it has "off-balance-sheet" partnerships (some of them traded with Enron) that have lost much of their value

--K MART Now bankrupt, the discount chain says it is investigating the possibility that improper accounting methods distorted its balance sheet

--XEROX is contesting a Securities and Exchange Commission warning not to book revenue from leased copiers as if they had been sold

--QWEST Has drawn attention for the way it accounted for its merger with US West as well as for how it books revenue. The company denies any wrongdoing

--EDS Finances clients' computers and is liable if a client cancels a contract. But EDS says it need not show this liability on its books

--IBM Says it is justified in raising estimates of returns to its pension fund--a move that instantly boosts reported revenues

--COCA-COLA Shifted billions of dollars in debt to Coke bottlers, in which it has large ownership stakes, and says it is in compliance with accounting rules

COLOR PHOTO: PETER MORGAN--REUTERS NO GAMES Kozlowski calls Tyco's accounting "vindicated"

TEN COLOR ILLUSTRATIONS

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Nation; Global Agenda

The Incredible Shrinking Businessman Corporate titans are out. Government reforms are in. Is it the dawn of a new era?

Michael Elliott

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When a rock-ribbed conservative columnist at the Wall Street Journal and the man who
was Bill Clinton's chairman of the Securities and Exchange Commission use the same
sweeping adjective to describe a situation, you know they're talking about something
serious. Testifying before the Senate Governmental Affairs Committee last week, Arthur
Levitt, former head of the SEC, identified the Enron affair with "an emerging
crisis of systemic confidence in our markets." Three days earlier, Robert L.
Bartley had written in the Journal of the "systemic failure" at the root
of the matter, one that touched "Directors suspending their ethical guidelines...
Accountants and lawyers studiously looking the other way... Wall Street analysts failing
in their principal duty."

It's the sense that Enron represents the failure of a system, not just of a Texas
oil-and-gas-and-cybertrading company, that gives the case its weight. In capitalism's
700-year history, financial scandals are two a penny. As detailed in Charles Mackay's
Extraordinary Popular Delusions and the Madness of Crowds, some of them had far more
devastating impacts than Enron's collapse ever will. John Law's Mississippi Co., for
example, bankrupted 18th century France, until Law was chased out of Paris and songs
were sung in the streets advocating "the application of all his notes to the
most ignoble use to which paper can be applied." From Credit Mobilier to Cendant,
from Jay Gould to Ivan Boesky, under Republican Presidents and Democratic ones, wherever
and whenever there is a chance to make a dishonest buck, someone will take it.

Enron stands out from this sorry list not by virtue of the company's size but because
the scandal is of such a fundamental nature. At the heart of capitalism is the act
of investment, which is nothing more than a decision by one party to lend money to
another in the hope of a return. The system can't function without trust--trust that
the money so lent will not be stolen or applied to illegal purposes, and trust that
an enterprise's accounts will accurately reflect the state of its business. Company
directors, lawyers and accountants are said to have "fiduciary" duties--the
word derives from Latin for trust--that place upon them obligations to do more than
collect fees and salaries.

Time was when investors were drawn mainly from those rich enough to look after themselves.
But those days are long past. From 1989 to 1998, the number of Americans who invested
in shares--either directly or through mutual funds, savings accounts and retirement
plans--grew from 52 million to 84 million. Enron matters because those charged with
the trust of such investors--many of them new to the markets-- let them down. A system
that has brought unimagined prosperity cannot survive if such betrayals become commonplace.

The scandal may prove to be systemic in a broader sense. For reasons that are well
understood--the years of turmoil between John Kennedy's assassination and Richard
Nixon's resignation, the end of the cold war, the absence of a sustained national
emergency that required a strong Federal Government--the authority of the American
political process has been in a long decline. At the same time, the reputation of
U.S. business leaders has grown extraordinarily. In the 1980s and '90s, Lee Iaccoca,
Sam Walton, Bill Gates, Andy Grove, Jack Welch and their ilk became our new heroes.
Businessmen seemed to combine a buccaneer's spirit with a slide-rule mind. "Washington"
(the word had to be said with a sneer) was, by comparison with the worlds of our titans,
disorganized and inefficient, quite hopeless.

Not long ago, many would have placed Enron's Ken Lay--innovative, daring--in the pantheon
of American business. That such a judgment could be made by those not otherwise known

for idiocy places our value system into question. The task of companies is to provide
returns for investors and so create jobs and spread wealth. But by the ’90s, top businessmen
had become celebrities, writing books (or having them ghostwritten), gracing covers
of magazines and preaching the wonders of American management and transparent accounting
practices to companies in other countries. After Enron, the audiences overseas for
heroes of glamour capitalism may diminish; meanwhile Americans have become appreciative
of safety and security--for themselves and their money. At such a time, it’s natural
to look to government, not institutions driven by the imperatives of the market.
The Enron affair matured into a scandal just as it began to seem that the culture
of celebrity was defunct; suddenly, we remembered that Barbra Streisand was not a
political philosopher. Neither is Jack Welch or Bill Gates or, certainly, Ken Lay.
In the ’90s, we treated businessmen as if they were film stars (and we treated film
stars like gods). But we lend stars our affections only; we lend businessmen our chance
of future prosperity. A lesson from Enron: we would be wise to entrust that responsibility
to those with their feet on the ground, not on a pedestal. Even if we built it for
them.
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The [Enron] Spillover/K Mart’s Fall
Blame Enron?
Eric Roston
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There are plenty of management shortcomings to blame for K Mart’s bankruptcy. But
the discount chain got a good shove from the Sept. 11 attacks--and from Enron. Here’s
how:
Most states require large companies like K Mart to buy commercial surety bonds, which
guarantee, among other things, worker’s compensation payments to employees hurt on
the job. During the roaring ’90s, when risk wasn’t a four-letter word, sureties were
relatively inexpensive and were used for many purposes. But as the economy slowed,
especially after Sept. 11, more and more companies defaulted, leaving insurers the
bill.
Enron, which insured future gas deliveries with surety bonds, left J.P. Morgan Chase
the task of claiming $2.5 billion from insurers that are fighting the bank in court.
Many insurers in December decided to reduce their exposure to the surety-bond market.
That helped create a supply shortfall, and insurers asked credit-starved companies
like K Mart and United Airlines to pony up cash collateral for their sureties--cash
that K Mart did not have.
Wal-Mart and Target have good credit--and no surety problems. While there is no indication
that surety will tip another company into bankruptcy--as K Mart claims--their cost
is rising and scarcity increasing.
--By Eric Roston
COLOR PHOTO: TIM BOYLE--GETTY IMAGES CLEANED OUT: Empty shelves in a Chicago K
Mart

store
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