

A very knowledgeable book by a veteran Wall Street reporter. Enforcement failures in the aftermath of Enron

James Comey gave Eisinger the title for his book when he took over as prosecutor for the Southern District of New York under a newly elected George W. Bush. It was composed of prosecutors who were too timid to take a case to court, especially one against individuals.

Eisinger says that the very moment Comey gave that speech may have represented the Apogee of prosecutorial zeal on the part of the financial enforcement regime. Corporations grew stronger, and court rulings made it more difficult to go after individuals. No individuals from the higher levels of the "Too Big to Fail" banks have been prosecuted.

This is a long book on the topic. I include a footnote about my own contact with Eisinger which leads me to respect his skill and tenacity.

My experience with the short sellers, and the prevalence of fraud in corporate reporting, leads me to believe that whatever ill might be said about these vultures of the capitalist world, they are essential. As Eisinger reports so well in this book, the official bodies appointed to protect the public interest simply do not do so. The investor has to look out for himself. Even sadder, there is nobody looking out for the interests of the taxpayer, who is the pidgeon of last resort, picking up the tab when the abuses that have been covered up by financial shennigans finally cause a massive collapse.

Back to my Lernout & Hauspie story. Short seller Marc Cohodes, who is still in business, challenged their accounting. He said the whole thing was a fraud. He pointed to a number of off the books financial entities and insider deals. He was very short the company.

I had been interested enough in the company to travel to Belgium for their annual meeting and to listen to their siren song about their technology. As is evidenced by this review, the technology has finally matured and works. I appeared on Cohodes' radio program, "Radio Wall Street" to offer my opinion that the stock had a future.

Marc tipped me off that an article would appear in the Wall Street Journal exposing Lernout & Hauspie's accounting frauds. Sure enough, it did, and the stock plunged accordingly. The author of the piece had been Jesse Eisinger. I was still a financial naïf at this point. The collusion between a reporter and an investor seemed improper. I wrote to the Wall Street Journal and got back a searing, nasty letter threatening to sue me to my last dime if I ever made an issue of this question. I was a young father. I backed off and shut up. I also paid attention to Lernout & Hauspie's accounting and managed to get out with a whole skin, actually continuing to receive advice from Cohodes, who may never have heard that I had contacted the Journal.

Eventually the company collapsed, Jo Lernout and Pol Hauspie had to do some penance in Belgium, though not much because they were national corporate heroes. A company called ScanSoft picked up the technology for pennies on the dollar. They later merged into Nuance Corporation which currently sells Dragon.

That's my preamble. Eisinger is a dogged reporter for whose integrity I now have more respect. He lives in a world of corrupt souls, and he knows his way around pretty well. I look forward with great interest to finishing this book and completing the review.

Chapter 1 – the Enron story

Story starts with the Enron prosecution. It was a David and Goliath effort, with the government forces underequipped and outmanned. They fought a heroic battle and won convictions against Jeffrey Skilling, Ken Lay, and Andrew Fastow.

However, corporate lawyers prevailed in a number of other fraud cases. Courts reversed the government fairly often. The defense bar and Justice Department came to look at the tactics that had worked in Enron as perhaps reckless and abusive instead of merely sufficiently aggressive. The government backed off.

The Enron prosecution had been confused, with various elements of the government – the FBI and the courts, offices in Houston, New York, and the main office in Washington, often not communicating well and even at odds with one another. There were different agendas and political ambitions. The decision was made that prosecutorial efforts needed to be harnessed into taskforces with prosecutorial powers.

Eisinger notes that this changes the incentives. There was that less zeal for prosecution, more for settlements with large financial awards.

However, the task force did pursue Enron with vigor. The case was so complex that they needed to flip people who might inform. They found an off balance sheet entity structured with the help of British bank NatWest. It was clearly improper and they managed to flip for some NatWest participants to give evidence against Fastow of Enron.

Also significant was that they pursued Arthur Anderson, the big eight accounting firm which had enabled a lot of the fraud at Enron. The word got out that banks and other financial institutions that had aided the fraud could also be targeted.

The team got a plea bargain involving a three year prison term from British banker coppers and they parlayed that into a plea bargain from Andrew Fastow, which gave them the material they needed to eventually go after Ken Lay and Jeff Skilling.

The Enron/Anderson account is masterfully done and takes the first quarter of the book. Eisinger's conclusion is that "the Enron prosecutions led to a weaker Justice Department. After the Enron prosecutions came a backlash against aggressive government action, led by corporations and the defense bar. The courts overturned several Enron verdicts. The Justice Department began to lose the institutional knowledge necessary to bring such complicated corporate cases. The DOJ would turn against taskforces, forgetting the Enron successes."

And lastly "the most unfortunate lesson learned from the Enron task force experience came from its first success. The team's first victory in court was its most consequential. The business lobby, the defense bar, and even today is Justice Department came to believe that the government had made a grave mistake. It had convicted Arthur Anderson."

Chapter 2 addresses the Anderson prosecution, which grew out of Enron.

There was debate about the wisdom of indicting Anderson. They could put the firm out of business, as Drexel Burnham Lambert had been put out of business in the Michael Milken days.

Anderson had been chastised before for covering up for clients, among them Waste Management. In meeting with the government, some prosecutors felt that Anderson was almost daring them to indict. Michael Chertoff, lead prosecutor, told him that he could not simply let them walk away. He would bring them to trial.

Anderson had evolved from an accounting firm into an accounting/consulting firm, with the latter being the more lucrative and hence the more powerful. They often competed for government

business against Booz Allen Hamilton when I was employed there in 1980. The big eight accounting firms had dwindled to the big five by the time of the Enron scandal.

Eisinger contends that although all five major accounting firms had problem clients, Arthur Anderson was in a class by itself. They had Sunbeam, Waste Management, Quest, Global Crossings and a host of other clients that went bankrupt and/or had to seriously restate their earnings. More than that, many Anderson partners had been reprimanded for having enabled accounting fraud.

A total of 86 individuals migrated from Arthur Anderson into Enron. It was no longer an arm's length relationship; it was friends dealing with each other. Some Anderson accountants told their top management about their concerns with the dealings with Enron, but Anderson top management ignored them. Enron was a lucrative client.

Anderson's new CEO, Bernardino, attempted to downplay and explain away the problems with Enron accounting. Anderson spent a fortune on public relations to try to downplay the problem. Bernardino accepted interviews on TV, such as with Meet the Press. He didn't do too well. The company knew it was in trouble.

Billy Tauzin, representative from Louisiana, sicced Congress on them, with some new disclosure every day.

Chief Anderson lawyer Fiske made the mistake of nonchalantly observing to Michael Chertoff of DOJ that clients and investors "don't care about the SEC." The SEC was unlikely to bring about any meaningful change; they simply levied fines and business went on as usual.

Eisinger reports that Chertoff was enraged, mainly because Fiske was right. Chertoff was seething: "If you are telling me that we cannot indict Arthur Anderson because it is too big, well, in this building that dog don't hunt." That Dog Don't Hunt is Eisinger's chapter title.

Although Anderson and the DOJ continued to negotiate, the DOJ was adamant that Anderson had to admit guilt. They refused.

The government got David Duncan, the Anderson partner in charge of the Enron relationship, to sign on as a government witness. Arthur Anderson had dared the government to make a hard decision, and they could not afford to be cowards.

The government won its case against Arthur Anderson. Congress took up the issue. Republicans were upset that capitalism was getting a bad name. The Democrats wanted strong measures. The result was the Sarbanes-Oxley act of 2002 which set up the Public Company Accounting Oversight Board.

The moribund Arthur Anderson prevailed in the PR war. They convinced the public that government prosecutors had gone overboard in prosecuting white-collar criminals.

Arthur Anderson had hemorrhaged clients during this period of prosecution and was subjected to innumerable lawsuits from people alleging that they had lost money on account of improper Anderson accounting. Anderson folded because it was no longer able to hold clients.

Since the time of the Enron/Anderson cases the government has been increasingly reluctant to prosecute. Eisinger's last sentence is "Anderson had to die so that all other big corporations might live, free of prosecution."