2002


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Faith Stevelman Kahn*

Both Al Qaeda's attacks and Enron's collapse were the tragic products of antidemocratic extremism—Islamic fundamentalism in the former case and "market fundamentalism" in the latter. The U.S. government has responded to the threat posed by Islamic extremists with a military response and increased attention to heightened physical security. At a conceptual level, Al Qaeda's destruction of the self-proclaimed Centers of World Trade forces us to consider what it was that made this icon of the markets, from the terrorists' perspective, "worth" bombing? And from the perspective of American free market ideology, in contrast, what in the values and systems of organization that animate capital markets and corporate firms merits a vigorous, vehement defense?

The corporate financial accounting and white-collar crime scandals erupting onto the national landscape, seemingly continuously, in the spring and summer of 2002, have revealed a different but similarly virulent threat posed by disdain for democratic government, liberal values, and the rule of law. Since the Reagan era, a radically privatist, generally "antilaw," "greed is good" ideology has pervaded not only the culture and practices of business and Wall Street, but even government itself and legal academia. The latter is illustrated, for example, by the nearly wholesale embrace of the methodology and values of neoclassical economic science by many elite corporate legal scholars.

Enron's poses a threefold challenge to law reformers. First, this challenge encompasses crafting an appropriate legal response to the financial conflicts of interest that have broadly eroded the checks and balances intended to protect shareholders' and, ultimately, the public's interests. Second, attention must be directed to restoring the eroded architecture of federal and fiduciary antifraud protection. Finally, the profound social harm caused by corporate fraud and insider secret profit taking challenge government, legal academia, and the business community itself to reinvest corporate "governance" and the commitment to "free" markets with the democratic, egalitarian values, guarantees of opportunity, and protections against opportunism implied by the notions of "governance" and "free" markets. Corporate "disinformation" is incompatible with meritocratic values, the promise of democratic accountability, and the commitment to personal liberty that must continue to inhabit the American corporate, capitalist economy if it is to reassume its historic strength and durability. These are the values that American soldiers are fighting for in foreign lands, and the values that are being tested in the many public and private sector "corporate responsibility" initiatives being adopted and explored post-Enron.

* Professor of Law, New York Law School. I would like to thank Martha A. Fineman and Cornell's Feminist Legal Theory Workshop on Corporations and Capitalism, the Baldy Center of the University of Buffalo Law School, the Sloan Foundation, New York Law School, Terry O'Neill, Lynne Dallas, and the organizers of this Symposium for their support of this research. In addition, many thanks are due to Professor Mark Glassman, for his thoughtfulness and support of this project, Sarah Valentine and New York Law School's other expert research librarians, and Tulane Law School graduate, Thomas Owen. Having first received this Article in March 2002, the changes required to be made herein since that time would have been impossible for most law reviews to manage.
INTRODUCTION: SUDDEN DEVASTATION, TERRIBLE INJUSTICE

When Enron corporation filed for bankruptcy on December 2, 2001, it was the second titan of capitalism to crumble and collapse in the latter part of that year. Less than three months earlier, on the morning of September 11, 2001, Al Qaeda terrorists had succeeded in demolishing the twin office towers of the World Trade Center, killing thousands of workers who had begun what they believed would be an ordinary Tuesday. As part of the same incident, the terrorists also attacked and partially destroyed the Pentagon. The coincident, anti-institutionalist nature of the attack made clear that this was not merely an expression of mad rage. The terrorists had launched a direct attack...
on the American system. Their actions expressed not only disregard for human life, but also disdain for the foundations of American government, law, and our capitalist methods of production, distribution, and exchange. As such, the attacks were only partially successful; they failed to destroy their ultimate targets.

The scope of the destruction from the September 11th attacks stunned the country, bringing the work of government and commerce, the normal ebb and flow of domestic life, and even classes at my law school temporarily to a halt. For those whose families escaped immediate physical harm, the number and randomness of the casualties, the stories of survivors, and the New York Times' "Portraits in Grief" brought home the horror and sorrow caused by the attacks.

3. This Article evaluates the September 11th attacks as grotesquely violent, abhorrent but ideologically driven protests against American-led, market-based globalization and secularization. For a sweeping study of Middle Eastern and Islamic culture, providing historic background to understanding September 11th, see BERNARD LEWIS, WHAT WENT WRONG? WESTERN IMPACT AND MIDDLE EASTERN RESPONSE (2002). For critiques of globalization and the reliability of assuming the coincidence of democratic governance and market capitalism, see Amy L. Chua, Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development, 108 YALE L.J. 1 (1998); Amy L. Chua, The Paradox of Free Market Democracy: Rethinking Development Policy, 41 HARV. INT'L L.J. 287 (2000); see also BENJAMIN R. BARBER, JIHAD VS. McWORLD, HOW GLOBALISM AND TRIBALISM ARE RESHAPING THE WORLD (1996). On globalization and free trade, more generally, see ULRICH BECK, WHAT IS GLOBALIZATION? (Patrick Camiller trans., 2000); SASKIA SASSEN & K. ANTHONY APPIAH, GLOBALIZATION AND ITS DISCONTENTS (1998); GLOBAL CAPITALISM (Will Hutton & Anthony Giddens eds., 2001); and more popularly, Tina Rosenberg, The Free Trade Fix, N.Y. TIMES, Aug. 18, 2002 (Magazine), at 28. For a defense from a free marketer, see, for example, DOUGLAS A. IRWIN, FREE TRADE UNDER FIRE (2002). After years of being stalled on the matter, interestingly, in the final days of July 2002, the United States Senate and House of Representatives endorsed the Bipartisan Trade Promotion Authority Act, affording President Bush so called "fast track" trade promotion authority. See The Bipartisan Trade Promotion Authority Act, Pub. L. No. 107-210, 107th Cong. (2002).

4. Although I identify Al Qaeda's fundamentalism with antisecular, antimarket ideology, neither Al Qaeda nor the Taliban are indifferent to or uninvolved in the accumulation of material wealth. For a discussion of the Taliban's and Islamic fundamentalism's connection to the international oil business, see AHMED RASHID, TALIBAN (2000). For an analysis of Enron's questionable human rights practices in pursuit of market hegemony and profit in the international oil business, see Steven R. Ratner, Corporations and Human Rights: A Theory of Legal Responsibility, 111 YALE L.J. 443 (2001). It is interesting to conjecture the potential connection between Enron's management's noncompliance with disclosure and accounting rules and its willingness to violate international human rights laws and standards.

5. William Weinert, my neighbor and a firefighter with Ladder Company 56 in the Bronx, was one of the heroic persons undertaking rescue and clean-up efforts at Ground Zero in the days immediately after September 11th. Willie's and his wife's courage and commitment in these awful days and weeks, and those of the other firefighters and rescue workers who toiled there, demonstrate the "better angels" of the human spirit (as well as the mistake of conflating live individuals with economists' narrowly self-serving, rational actors).
People all over the world struggled to understand and explain what had occurred. What could have made the terrorists want to harm us, even to destroy our government and centers of trade and commerce?

The attacks also inflicted widespread financial devastation. Both Wall Street and main street had been performing poorly in the period prior to the attacks in comparison to the preceding years, but in the aftermath of September 11th, discussions about recession shifted from "if" to "how bad" and "for how long"? September 11th increased costs and reduced profits for both American corporations and, interestingly, foreign ones as well. Although New York City's major


6. After the mild recession of the early 1990s, the second half of the decade saw substantial increases in real property prices, strong business growth, robust consumer spending, and an astonishing escalation in stock market prices—at the same time that unemployment and inflation remained low. The NASDAQ composite index reached 5000, as large amounts of wealth were created by a technology boom and the growth of the Internet. Even in these good times, however, there were substantial increases in wealth and income inequality; according to recent census figures.


Real gross domestic product (GDP) decreased 1.3 percent in the third quarter of 2001 . . . . [T]he weakest showing for real GDP since a 2.0 percent decline in the first quarter of 1991. The decrease followed four quarters of slow growth that averaged only 1.2 percent, far below the 3.6 percent average growth rate over the first 37 quarters of the 1990s expansion.

Bureau of Economic Analysis, *Business Situation: Final Estimates for the Third Quarter of 2001*, (Jan. 2002), available at http://www.bea.doc.gov/bea/ARTICLES/2002/01January/BSF0102.pdf (last visited Aug. 25, 2002). Small increases in GDP and consumer spending were documented in the months after September 11th, but, as described in the text, a wave of significant post-Enron accounting scandals has led to massive layoffs, wage stagnation, decreases in consumer spending, widespread stock price declines, and economic instability through the period up through this Article's publication.

8. Shortly after September 11th, representatives of major U.S. airlines met with President Bush and lobbied for federal financial assistance in order to forestall an industry-wide failure. Heavy financial damage from September 11th was sustained throughout the travel, tourism, entertainment, and insurance industries, both domestically and internationally. Ironically, Houston suffered major financial damage from having both Continental Airlines and Enron headquartered there. Increased shipping, security, and insurance costs spread across economic sectors. In regard to the international economic effects of September 11th,
downtown financial firms and struggling small businesses were particularly hard hit, the financial damage was remarkably wide ranging. Stock prices fell substantially when the capital markets reopened for trading. There were substantial, widespread layoffs within the United States, even as businesses, according to Wall Street Journal reports, wondered aloud whether laying off workers under such conditions was "unpatriotic."

The focus of the federal government and federal fiscal policy shifted dramatically in the weeks after September 11th. As Congress and the Bush administration prepared to respond militarily to the terrorism, heighten domestic security, and provide economic assistance to individuals and businesses that had been victimized, a significant projected federal budget surplus slipped away. In the aftermath of September 11th, the financial collapse of Enron, and the monumental


9. Lucette Lagnado, Down Town: Around Ground Zero, An Effort to Rescue Mom-and-Pop Shops, WALL ST. J., Feb. 8, 2002, at A1. New York City's economy showed signs of weakening prior to September 11th, but it had remained stronger than the nation's as a whole. This was reversed after the attacks. Leslie Eaton, Attack Gave a Devastating Shove to the City's Tectering Economy, N.Y. TIMES, Sept. 8, 2002, at 35. By the summer of 2002 (fiscal year 2003), the city faced a $4.76 billion budget shortfall. New York State Comptroller H. Carl McCall estimated that each of the following two fiscal years would also see $5 billion shortfalls in New York City's budget as a result of its lingering budgetary problems, the aftereffects of September 11th, and the overall weakening of the national and city economy. See H. Carl McCall, After the World Trade Center Attack, Fiscal Uncertainties Facing the State and Local Governments (2001) (on file with author); William C. Thompson, Jr., One Year Later: The Fiscal Impact of 9/11 on New York City (2002) (on file with author). President Bush committed $21 billion in federal aid to New York City after September 11th. Private insurers have estimated that they would pay between $30 and $70 billion in claims related to the attacks.

10. For data from the Mass Layoff Statistics program, see www.bls.gov; see also the Bureau of the Census Web page at www.census.gov.


12. The shift in focus is dramatically evident in President Bush's State of the Union Address of January 29, 2002. Moreover, after discussing the political and security-related ramifications of September 11th in detail, President Bush alluded to the threat posed by the Enron scandal: "Through stricter accounting standards and tougher disclosure requirements, corporate America must be made more accountable to employees and shareholders and held to the highest standards of conduct." George W. Bush, State of the Union Address, available at www.whitehouse.gov/news/releases/2002/01/20020129-11.html (Jan. 29, 2002). Through the spring and summer of 2002, the President's discussions of the nation's "security" focused increasingly on the need for law reform that might stabilize investor confidence and deter the kind of corporate accounting fraud, executive self-dealing, and insider trading that suddenly appeared shockingly widespread.

corporate failures that ensued shortly thereafter, neither the President, Congress, nor the American people in general could tolerate the risks and costs of leaving the market to its own devices.\(^\text{14}\)

Like that of the Twin Towers, Enron's collapse was sudden, devastating, and horribly unjust in its effect.\(^\text{15}\) For 2000, the year prior to its bankruptcy filing, Enron ranked as the seventh largest American corporation based on the revenue criteria used by *Fortune* magazine. As reported in its year 2000 Form 10-K, Enron's annual revenues exceeded $100 billion.\(^\text{16}\) Though we now know it did so erroneously, in the same filing Enron reported net income of $979 million for 2000, $893 million for 1999, and $703 million for 1998.\(^\text{17}\) The tone of Enron's Year 2000 Annual Report to shareholders (which was submitted to the SEC and circulated to shareholders only nine months prior to the company's bankruptcy filing) was triumphant, even smug.\(^\text{18}\) An internal cover page declared "In Volatile Markets, Everything


In the nine weeks beginning a week before Memorial Day, the traditional start of summer, the major United States stock market averages have lost more than 20 percent of their value, one of the fastest falls in Wall Street history. The decline has come amid signs that some Americans are beginning to lose faith in the stock market as a sure-fire long-term investment. Money is flowing out of mutual funds at the fastest rate in years, faster even than last September, in the wake of the terrorist attacks.

*Id.* For an historically significant argument that government should modulate the rate and severity of the changes wrought by markets, see KARL POLANYI, *THE GREAT TRANSFORMATION* (1944).


\(^\text{16}\) See id. Item 6: *Selected Financial Data*. The post-bankruptcy filing coverage of Enron's financial affairs exposed the bizarrely "inflating" revenue recognition treatment the FASB had permitted for energy traders. *See id.* This revelation, and the many other extraordinary shortcomings in accounting and auditing procedures and standards that were publicized in the spring and summer of 2002, led Congress to establish an "independent" self-regulating oversight body to establish auditing standards and regulate accounting firms that audit public companies. *See* Sarbanes-Oxley Act of 2002, H.R. 3763, § 101, 107th Cong. (2002).

\(^\text{17}\) It was discovered that in several cases Enron engaged in sham asset sale transactions immediately prior to the end of a quarter, in order temporarily to alienate depreciated properties that might otherwise have impaired the company's reported profits. *See* Enron Form 10-K, *supra* note 15, Item 7: *Management Discussion and Analysis*.

Changes But Us!"¹⁹ By the conclusion of 2001, however, neither Enron's shareholders, employees, nor the American people in general felt such winsome confidence.

By the spring and summer of 2002, concern about the implications of Enron's sudden collapse had escalated into profound, nearly pervasive anxiety about the veracity of corporate reporting and the integrity of the corporate governance systems supporting it.²⁰ Markets that were already volatile and depressed became more volatile and depressed. Commentators coined the terms "Enronitis," and "the Cockroach theory"²¹ to make light of the very serious fact that confidence in the accounting, auditing, disclosure, investment banking, credit rating, and managerial oversight systems supporting the "integrity"²² of the capital markets had been grossly undermined by

¹⁹. Id. at 6.

²⁰. See, e.g., Gretchen Morgenson, Worries of More Enrons to Come Give Stock Prices a Pounding, N.Y. TIMES, Jan. 30, 2002, at C1; see Kenneth N. Gilpin, Range of Fears Pushes Stocks to Big Losses, N.Y. TIMES, July 2, 2002, at C1. The number of companies that are being required to make financial restatements has risen astoundingly in the last several years. According to the Huron Consulting Group, there were "270 restatements [in 2001], up from 233 in 2000 and just 116 in 1997." See Jonathan D. Glatzer, Recomputing Earnings with Lawbook and Eraser, N.Y. TIMES, July 2, 2002, at C8. Figures for 2002 are not yet available. As early as 1998, several prominent individuals, including Warren Buffett and Arthur Levitt Jr., then Chairman of the SEC, had publicly denounced what they regarded as worrisomely prevalent "earnings management"—a slippery slope to accounting fraud. See Arthur Levitt Jr., The Numbers Game, Speech to the NYU Center for Law and Business, available at http://accounting.rutgers.edu/raw/aaa/newserc/prl01898.htm (Sept. 28, 1998). Nevertheless, the stock market bubble had not yet burst, and prior to the Enron fiasco, neither lawmakers, regulators, or corporate or financial firms themselves were persuaded to implement substantial investor protective reforms.


²². The staying power of the term "integrity" as applied to stock prices and the functioning of the capital markets reflects, I believe, the unstated conviction that these systems rely on the moral "integrity" of the persons overseeing firms and markets, and the preciousness of our faith therein. A society's ability to sustain personal integrity, social solidarity, and the capacity for trust among its members, through both social norms and law, is a significant component of its ability to generate and sustain not only material wealth but also broader measures of well-being, as discussed infra. Indeed, this has always been the foundational premise of corporate fiduciary law. See Francis Fukuyama, Trust: The Social Virtues and the Creation of Prosperity (1995); Robert D. Putnam, Bowling Alone: The Collapse and Revival of Community (2000); Robert D. Putnam, Bowling Alone: America's Declining Social Capital, 6 J. DEMOCRACY 65 (1995); Symposium, Trust Relationships, 81 B.U. L. REV. 329 (2001); Tom R. Tyler & John M. Darley, Building a Law-Abiding Society: Taking Public Views About Morality and the Legitimacy of Legal Authorities into Account When Formulating Substantive Law, 28 HOFSTRA L. REV. 707 (2000). Corporate legal scholars have generally discussed the "integrity" of market prices in
Enron’s failure and the conduct of many of its principals and outside counselors. In the following months, both the capital markets and the relation to impersonal concepts of economic efficiency, or the relation of stock prices to the “true” or “inherent” value of a corporation. See, e.g., Lynn A. Stout, Stock Prices and Social Wealth, Harvard Discussion Paper No. 301, at 24-25, available at http://www.law.harvard.edu/programs/olin_center/papers/ (last visited Aug. 28, 2002); Marcel Kahan, Securities Laws and the Social Costs of “Inaccurate” Stock Prices” 41 DUKE L.J. 977 (1992). But there is increased scholarly attention to the importance and conditions of trust and the role of law in supporting it. See infra note 30 and accompanying text.

23. While faith in the honesty and transparency of corporate America has been hit hard, confidence in the quality and value of the services performed by “public” auditors has suffered nearly complete erosion. On June 15, 2002, a jury sitting in a federal district court in Houston found Arthur Andersen, LLP, guilty of obstruction of justice for its destruction of Enron documents subsequent to the SEC’s commencement of an investigation into Enron. David Duncan, Andersen’s former lead audit partner for Enron’s auditing work, had earlier pled guilty to obstruction of justice. Such document destruction represents a flagrant example of the kind of disrespect for the rule of law discussed herein.

Interestingly, neither Enron’s inside general counsels nor outside lawyers have suffered substantial public recrimination. The latter, Houston-based Vinson & Elkins, was active in advising Enron on many of the transactions involving the special purpose entities that ultimately fueled the destruction of the company. The absence of greater recrimination against Enron’s lawyers is suggestive of provocatively contrasting views of the role of a company’s auditors and its lawyers. See Enron May Force Reconsideration of Lawyer Ethics Rules, N.Y.L.J., Feb. 7, 2002, at 5. Although, when considered in isolation, the appropriate moral course of conduct is plain enough, the proper professional role of an attorney faced with a client’s fraudulent financial conduct has been controversial for decades. Attorneys defend the importance of their maintaining client confidentiality on the grounds that doing so facilitates their ability to promote their clients’ compliance with the law in the broader range of cases. Nevertheless, more than three quarters of the states’ professional conduct rules for lawyers currently go beyond the official position of the American Bar Association in affording lawyers substantial discretion (and in a minority of states requiring them) to disclose a client’s financial fraud in order to prevent or rectify a crime. See MODEL RULES OF PROF’L CONDUCT R. 1.6 (2000). In the summer of 2001, the House of Delegates of the ABA had rejected proposed changes recommended by the “Ethics 2000 Commission” (formally, the Commission on Evaluation of the Rules of Professional Conduct), which would have permitted lawyers to make such disclosures.

Professors Tanina Rostain of New York Law School and Austin Sarat of Amherst College have recently organized a Research Network under the aegis of the Law & Society Association focusing on “Corporate Lawyers in Transnational Practice.” The group seeks to encourage legal scholars’ and social scientists’ “empirical study of corporate lawyers and their role(s) in creating and shaping international legal regimes and markets” in such areas as the European Union, Eastern Europe, Latin America, and East Asia. Corporate lawyers’ role in facilitating compliance with the law and fostering norms of law abidingness has, of course, become far more controversial amidst revelations of ongoing frauds at so many major American companies and financial institutions. In addressing the August 2002 meeting of the American Bar Association, SEC Chairman (and former corporate lawyer) Harvey Pitt admonished the attendants that if corporate lawyers didn’t do a better job of inspiring the public’s confidence in their professionalism and integrity, they would “face the fate of the accounting profession.” Harvey Pitt, Remarks Before the Annual Meeting of the ABA’s Business Law Section, available at http://www.sec.gov/news/speech/spch579.htm (Aug. 12, 2002); see also Lawrence A. Cunningham, Sharing Accounting’s Burden: Business Lawyers in Enron’s Dark Shadows, Boston College Working Paper (Apr. 2002), available at http://papers2.ssrn.com/paper.taf?ABSTRACT_ID=307978 (last visited Aug. 28, 2002)
general economy teetered at the edge of crisis, as a wave of corporate accounting scandals, executive sweetheart deals, and allegations of insider trading broke over the financial landscape. Allegations of wrongdoing have led to investigations and/or litigation at WorldCom (which in July 2002 pushed Enron out of the number one slot as the largest bankruptcy filing in U.S. history), Qwest Communications, Global Crossing, Adelphia, Tyco International, ImClone, Merck, Xerox, AOL Time Warner, EDS, K-mart, Computer Associates International, Rite-Aid, and Lucent, and also the investment banks (Chase, JP Morgan, Merrill Lynch, Salomon Smith Barney, inter alia) and accounting firms (especially Arthur Anderson) that had served their interests. Addressing the annual meeting of the American Bar Association in August 2002, SEC Chairman Harvey Pitt warned that corporate lawyers had to work harder to avoid both actual and apparent complicity in clients' frauds or they would otherwise substantially forfeit their professional capital, as have public auditors to an unfortunate degree. Even strong proponents of the existing governance and market arrangements were estopped from arguing (at least convincingly) that Enron could be written off as an isolated case.\textsuperscript{24} Widespread support coalesced behind the need to reexamine sacred cows of the American corporate, capital market system. Remarkably, the President, Congress, the SEC, and many private sector bodies have embraced this objective and commenced the project of achieving significant legal, regulatory, and policy-based reforms.\textsuperscript{25} 

\textsuperscript{24} Enron's "exceptionality" or the "few bad apples" theory was still plausible in the early spring of 2002, and a symposium at Columbia Law School held in April focused on precisely this question. For an insightful analysis of the conceptual and practical governance shortfalls exposed by Enron's failure, see Jeffrey N. Gordon, \textit{What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections}, 69 U. Chi. L. Rev. 1233 (2002).

\textsuperscript{25} On July 8, 2002, President Bush, speaking from Wall Street, delivered a major address endorsing the need for heightened standards of corporate governance, transparency, and integrity. For a transcript of the hearings, see \textit{Transcript of President's Address Calling for New Era of Corporate Integrity}, N.Y. Times, July 10, 2002, at C4. The President signed the Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. (2002), into law on July 30, 2002; the Act has been widely hailed as the toughest federal antifraud, "corporate responsibility" legislation since the Depression-era securities laws. In the face of what threatened to be the worst bear market in a generation, Sarbanes-Oxley passed with overwhelming bipartisan support. Lawmakers, and the President himself, sensed their political vulnerability in appearing soft on business and white-collar crime in such a climate. The President also established the Corporate Fraud Task Force to coordinate enforcement by the SEC and federal criminal authorities, while the SEC considerably increased the number of
But such reforms come too late to save Enron. Enron’s precipitous decline into bankruptcy in December 2001 resulted from the sudden evisceration of multiple market participants’ faith in the accuracy of the company’s reported earnings, revenues, and liabilities figures, inter alia. Subsequent scrutiny revealed that Enron had been the corporate equivalent of a “time bomb” waiting to go off. The firm’s implosion was triggered by revelations in the fall of 2001, at the belated insistence of Arthur Andersen, Enron’s auditor, of (1) material, financial misstatements and omissions in past Enron public statements and SEC filings, (2) the existence of liabilities and losses far greater than previously had been publicly acknowledged,26 (3) sham hedging and asset sale transactions, as well as (4) potentially unlawful executive enforcement actions it was pursuing throughout the first half of 2002. On June 17, 2002, SEC Chairman Harvey Pitt announced that the Commission had succeeded in implementing all ten of the initiatives in President Bush’s March 17, 2002 “Plan to Improve Corporate Responsibility and Protect America’s Shareholders.” For a brief summary and commentary thereon, see 17 CORP. COUNSEL WKL., June 26, 2002, at 193.

In regard to private sector initiatives, the Conference Board announced the creation of the Blue Ribbon Panel on Public Trust and Private Enterprise, and the American Bar Association established a Corporate Responsibility Task Force to review corporate governance standards and lawyers’ ethics rules. The New York Stock Exchange’s Corporate Accountability and Listing Standards Committee announced a series of reform proposals in early June, as did the NASD. For the full text and a comparative analysis of the proposed NYSE reforms, see www.nyse.com/press/press.html (last visited Aug. 28, 2002); for commentary, see Holly J. Gregory & Jane G. Pollack, Raising Corporate Governance Standards: A Review of the New NYSE & NASDAQ Listing Proposals, METRO. CORP. COUNS., July 2002, at 29. The Business Roundtable, an organization of CEOs committed to “policies that foster economic growth and a dynamic global economy,” had endorsed a set of revised but comparatively conservative Principles of Corporate Governance in May 2002. The organization was subsequently persuaded, however, in July, to support the more stringent requirements and standards endorsed by President Bush and Congress. In August, the Financial Services Forum, a group of CEOs of twenty one of the world’s biggest financial companies (including Morgan Stanley, Goldman Sachs, Merrill Lynch, AIG, Bank of New York, Prudential, American Express, JP Morgan Chase & Co., and MetLife) announced that their member institutions would, in the future, expense the cost of stock options on their income statements—thereby propelling the norm of investor expectations and corporate transparency standards further in this direction. On June 5, 2002, Henry M. Paulson Jr., Chief Executive of Goldman Sachs, made a speech at the National Press Club in Washington declaring that American business faced “the greatest crisis” in his lifetime. See Patrick McGeehan, An Unlikely Clarion Calls for Change, N.Y. TIMES, June 16, 2002, at MB1.

self-dealing transactions involving scores of off-balance sheet, special purpose entities.27

Further analysis has illuminated Enron's historic reliance on dubious, and at times outrightly fraudulent, accounting and disclosure practices, including the immediate recognition of profits on long-term sales contracts of speculative, future value.28 In the fall of 2001, these

27. According to Vinson & Elkins's October 15, 2001, report to Enron's General Counsel, LJM2 (a partnership run by Enron's former Chief Financial Officer, Andrew Fastow), engaged in twenty-one transactions with Enron. Fastow earned an estimated $30 million from these transactions. The V & E report stated: “Within Enron, there appeared to be an air of secrecy regarding the LJM partnerships and suspicion that those Enron employees acting for LJM were receiving special or additional compensation.” Report of Vinson & Elkins, LLP, to James V. Derrick, Jr., Enron Executive Vice President and General Counsel, October 15, 2001, at 5, available at 2001 WL 1764266 [hereinafter V & E Report]; see, e.g., Kurt Eichenwald, Investors Lured to Enron Deals by Inside Data, N.Y. TIMES, Jan. 25, 2002, at A1. Enron's transactions with Southampton Place, L.P., in which several other Enron senior executives and directors made millions of dollars, are also described in the Powers Report. WILLIAM C. POWERS, JR. ET AL., REPORT OF THE SPECIAL INVESTIGATION COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. (2002), available at 2002 WL 198018 [hereinafter POWERS REPORT].

The duty of loyalty—the most important concept in the states' laws governing corporations—prohibits directors, officers, and other powerful corporate insiders from profiting from financial dealings with their firm unless such fiduciaries (where challenged) can demonstrate either that the transactions were "entirely fair" to the company or that the transactions were ratified by fully informed disinterested directors or stockholders. See Kahn v. Lynch Communications Sys., Inc., 669 A.2d 79 (Del. 1995); Kahn v. Lynch Communications Sys., Inc., 638 A.2d 1110 (Del. 1994). As applied by state courts in recent years, the duty of loyalty's proscription of management secret profit taking has been substantially diluted. For important commentary on the worrisome dilution of fiduciary strictures in the corporate context, see, for example, Victor Brudney, Contract and Fiduciary Duty in Corporate Law, 38 B.C. L. REV. 595 (1997); Robert C. Clark, Agency Costs Versus Fiduciary Duties, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS (John W. Pratt & Richard J. Zeckhauser eds., 1991); Tamar Frankel, Fiduciary Law, 71 CAL. L. REV. 795 (1983).

28. The precise shortfalls in Enron's accounting and disclosure practices are still coming to light at the time of this Article's publication, but certain practices immediately aroused grave concern vis-à-vis their propriety and even legality. For example, as suggested in the text, Enron had permission from the Emerging Issues Task Force, operating under the supervision of the FASB, to "mark to market" the value of its long-term contracts to deliver electricity. Enron would forecast energy prices for up to ten years (a highly speculative enterprise) and then record profits currently based on those internal models and favorable assumptions. See Alex Berenson, Ex-Workers Say Unit's Earnings Were 'Illusory,' N.Y. TIMES, Jan. 25, 2002, at A1; Floyd Norris & Kurt Eichenwald, Fuzzy Rules of Accounting and Enron, N.Y. TIMES, Jan. 30, 2002, at C1. In addition, Enron engaged in a series of financing arrangements, in which J.P. Morgan and an offshore partnership transferred capital temporarily to Enron in deals that, while functionally analogous to loans, were reflected on the company's balance sheets as assets and liabilities "from trading." The New York Times described the transactions, which were ongoing until the end of September 2001, as effectively "disguis[ing] more than $350 million in new bank loans." Kurt Eichenwald, Enron Hid Big Loans, Data Indicate, N.Y. TIMES, Feb. 27, 2002, at C1. In regard to disclosure, Enron's SEC filings described the existence of certain related party transactions
revelations gave rise to fatal doubts about the company's actual liquidity and profitability, as well as the quality and integrity of its senior management.\textsuperscript{29} Cascading uncertainty inflated the risk associated with doing business with Enron for its investors and trading partners to levels that were intolerably high, and finally, insupportable. Because a substantial portion of Enron's business involved trading in sophisticated energy and other derivatives, once there was doubt about the company's ability to perform as a counterparty on such transactions, this business, and the cash flow and profits it generated, rapidly evaporated.

Never has there been a better illustration than the Enron story of the importance of trust to the well-being of a business\textsuperscript{30}—both the

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  \item involving company senior executives, but in no way indicated the magnitude of the profits realized by such insiders thereon—surely a material omission. Enron's SEC filings also disclosed the existence of financial arrangements with certain trusts (for example, the Osprey trusts) that might entitle the trusts to receive substantial additional Enron stock; but, again, the filings failed adequately to portray the magnitude and significance of Enron's contingent, equity-based obligations. \textit{See} Enron Form 10-K, \textit{supra} note 15. In addition, there is evidence that Enron would sell deteriorated "merchant" assets to the Fastow-related, special purpose entities in the period immediately prior to the end of a quarter, and then repurchase them shortly thereafter, at substantial gains to these entities, in order to inflate the company's reported profits. \textit{See} Kurt Eichenwald, \textit{Talk of Crime Gets Big Push}, \textit{N.Y. Times}, Feb. 4, 2002, at A1; \textit{POWERS REPORT, supra} note 27. For a business savvy account of Enron's high-risk financial strategies, see Malcolm S. Salter et al., \textit{Innovation Corrupted: The Rise and Fall of Enron}, Harvard Business School Working Paper 02-102 (2002), available at http://www.hbs.edu/dor/abstracts/0102/02-102.html (last visited Sept. 12, 2002).

  \item On August 22, 2002, Michael J. Kopper, a former top finance executive at Enron, pleaded guilty to conspiracy to commit wire fraud and money laundering, based on his payment of large kickbacks to Andrew S. Fastow (Enron's former CFO). The kickbacks came out of money Kopper received for managing partnerships that were used to hide Enron's debt and increase its profits. \textit{See} Kurt Eichenwald, \textit{Ex-Enron Official Admits Payments to Finance Chief}, \textit{N.Y. Times}, Aug. 22, 2002, at A1 ("Mr. Kopper softly described how he and his friend [Andrew Fastow] had worked assiduously over many years to use a series of off-the-books partnerships to defraud Enron of millions of dollars"). The plea agreement was considered a major step in the government's potential prosecution of Mr. Fastow and other former Enron senior executives. \textit{See} Kurt Eichenwald, \textit{A Method Becomes Clearer in a Methodical Investigation}, \textit{N.Y. Times}, Aug. 22, 2002, at C1 ("Some participants in that deal [Southampton Partners]—including Ben F. Glisan Jr., the company's former treasurer—tried to reach deals with the government earlier this year, but investigators turned them away because they were dissatisfied with what the deal participants were offering."). Given Enron's financial contributions to lawmakers, and Kenneth Lay's close association with President Bush, the Enron prosecutions are the focus of tremendous popular and political interest.

  \item For an important analysis of game theory's contribution to the subject, see \textit{Robert Axelrod, The Evolution of Cooperation} (1984). As mentioned previously, corporate legal scholars are giving increased attention to the importance of trust in commercial transactions. \textit{See}, \textit{e.g.}, Margaret M. Blair & Lynn A. Stout, \textit{Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law}, 149 U. PA. L. REV. 1735 (2001); Bruce Chapman, \textit{Trust, Economic Rationality, and the Corporate Fiduciary Law}
importance of the trustworthiness of a corporation’s leaders and the dependability of the systems of accounting, auditing, and disclosure on which trust in business and the capital markets rests. Enron’s faulty systems of accounting, auditing, and disclosure breached its investors’ and employees’ rightful expectations of financial transparency. In the alternative, the opacity surrounding Enron’s business affairs and financial dealings was a true reflection of the firm’s myopic, even delusional, corruption-ridden culture.

On November 9, 2001, as mass sell-offs by spooked investors depressed Enron’s stock’s price, Moody’s lowered the company’s credit

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31. See Faith Stevelman Kahn, Transparency and Accountability: Rethinking Corporate Fiduciary Law’s Relevance to Corporate Disclosure, 34 GA. L. REV. 505 (2000) [hereinafter Kahn, Transparency]. “Transparency” is a term that has only recently come into vogue in discussions of corporation law. This piece of the discussion, more conventionally, had focused on the “when,” “what,” and “what-happens-if-not” of corporate disclosure, as governed chiefly by the federal securities laws. I define “transparency” as an organization’s systematic commitment to facilitating the intrainstitutional flow of information and promoting candor and comprehensiveness in its internal and public reporting of its financial condition, operations, and performance of its stated objectives. With respect to corporations, such transparency provides the basis of the norm of (both internal and external) accountability, as well as a basis for operationalizing this norm by measuring corporate and also managerial performance in conformity with profit driven, as well as more expansive, and potentially more socially responsive, criteria. On the latter point, see Cynthia A. Williams, The Securities and Exchange Commission and Corporate Social Transparency, 112 HARV. L. REV. 1197 (1999); see also Faith Stevelman Kahn, Pandora’s Box: Managerial Discretion and the Problem of Corporate Philanthropy, 44 UCLA L. REV. 579, 625-36 (1997) [hereinafter Kahn, Pandora’s Box] (arguing that bona fide charitable giving by corporations can only be legitimated through the democratizing effects of disclosure). In regard to the current limits on required corporate “social transparency,” as I have argued elsewhere:

[T]he limits of required corporate disclosure are more troubling for the fact that they are implicit rather than express.... Because the SEC’s disclosure requirements do not articulate the normative principles which define them (that is, the narrow and essentially economic interpretation of materiality and the limited scope of the line-item disclosure requirements), we—as investors, commentators and legislators—are less likely to “miss” what we do not see.


Transparency serves to enhance a body’s responsiveness to scrutiny and reform, and thus its adaptability and fitness. For discussion of disclosure as a corporate governance therapeutic, see Louis Lowenstein, Financial Transparency and Corporate Governance: You Manage What You Measure, 96 COLUM. L. REV. 1335 (1996). Nevertheless, “transparency” is an ideal, which, like the related concept of “democracy,” cannot, need not (and indeed sometimes should not) be attained in its absolute form in order to be meaningful. For a critical examination of the mixed utility of the latter term, see Edward L. Rubin, Getting Past Democracy, 149 U. PA. L. REV. 711 (2001). The interrelationship of the practices and norms of corporate “governance” and those of “democracy” is a theme that merits further, intensive analysis.
rating first to Baa3, its lowest investment grade, and then, on November 28, to below investment grade. This downgrading of Enron’s credit rating triggered defaults under covenants in various outstanding credit agreements;\(^{32}\) and the defaults, in turn, increased Enron’s equity obligations to investment vehicles affiliated with the off-balance sheet partnerships that had begun to arouse such grave concern.\(^{33}\) Surrounded by the fallout from what began to look like high-level corporate corruption, soon everyone just “wanted out.”\(^{34}\)

When it was made, Enron’s bankruptcy filing held the record for being the largest in U.S. history. (Again, Enron was edged out of first place in July 2002 when WorldCom’s admissions of having erroneously reported potentially in excess of $7 billion of revenue led the company to file for bankruptcy law protection.)\(^{35}\) Enron

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33. The Osprey Trust issued $2.4 billion in privately placed notes to institutional investors; the debt was backed by fifty million shares of Enron common stock. The full details regarding the equity triggers on the Osprey Notes were first made public by Jeffrey McMahon, Enron’s then-CFO, on November 14, 2001. See Gretchen Morgenson, Many May Be Surprised to Be Enron Investors, N.Y. TIMES, Jan. 25, 2002, at C1. For an account of Enron’s potential abuse of special purpose entities by an expert in structured finance, see Steven L. Schwarcz, Some Thoughts on the Enron Bankruptcy, 71 U. CIN. L. REV. (forthcoming 2002).

34. The downgrading of Enron’s debt, as well as the negative financial news first publicized in Enron’s third quarter Form 10-Q, filed on November 19, 2001, led Dynegy Corporation to cancel a planned merger with Enron on Wednesday, November 28, 2001. Enron filed a voluntary bankruptcy petition in federal bankruptcy court in the Southern District of New York the following Sunday morning. See Kurt Eichenwald & Diana B. Henriques, Enron Buffed Image to a Shine Even as It Rotted from Within, N.Y. TIMES, Feb. 10, 2002, at A1.

35. WorldCom epitomized the boom and bust of the 1990’s telecommunications craze. The company then lost a fortune as the second largest long distance carrier in the United States and Internet provider for up to a third of U.S. Internet traffic. Although its $40 billion debt load had imposed substantial cash flow pressure on the company (the assets of which were valued in excess of $100 billion through spring 2002), WorldCom’s downfall was largely due to the revelation, in June 2002, that approximately $3.85 billion in operating expenses (and later it was revealed $3.3 billion more) had not been disclosed, as well as the fact that the company’s profits were materially lower than had been reported. The company’s faulty accounting apparently involved the manipulation of reserves and the improper capitalization of current expenses. After having reached a peak of $64.50 in 1999, WorldCom’s shares traded at 9 cents per share immediately prior to its Chapter 11 filing of July 21, 2002. As the fraud came to light, WorldCom laid off in excess of 17,000 employees (twenty percent of its workforce), and the SEC, Department of Justice, and Congress undertook formal inquiries into its accounting and business affairs.

In addition, on August 1, 2002, WorldCom’s former CFO, Scott Sullivan, and its former controller, David F. Myers, surrendered at the FBI’s field offices and then, handcuffed, appeared at the Federal District Court in lower Manhattan to face criminal fraud charges. Referring to the charges in a public press conference, Attorney General John Ashcroft alerted the public to the seriousness of the government’s commitment to prosecuting corporate fraud,
sharholders are estimated to have lost in excess of $60 billion in market value in Enron stock. Tragically, thousands of Enron employees had invested substantial portions of their retirement savings in Enron stock through the company's 401(k) plan. Six states' pension funds each lost in excess of $100 million in value in Enron stock; Florida's State Board of Administration alone lost $335 million. Upon the company's bankruptcy, 4000 Houston-based employees, constituting approximately twenty percent of the firm's workforce, were immediately laid off, many without severance. And the local commercial and nonprofit economies in Houston, where


36. The concentration of Enron's employees' (and indeed any employees') retirement savings in their employers' stock runs counter to the fundamental investment principle of diversifying risk. Such excess concentration of employee funds in employer stock in 401(k) plans appears common nevertheless. This may be attributable to (1) conscious employee loyalty, (2) employer-imposed nonsaleability vis-à-vis company "matching" stock granted to the employees, (3) overconfidence/cognitive bias on the employees' part resulting from their immersion in their employers' corporate culture (as was clearly the case at Enron), and/or (4) ignorance about the danger of being insufficiently diversified. Salutary 401(k) plan reforms under consideration by Congress include requiring employers to give greater notice of the benefits and opportunities for diversification and capping total employee 401(k) investment in employers' stock. Reforms will be difficult to implement over the opposition of employers, however, because American law does not require employers to contribute to employees' retirement savings. There is, thus, a danger that "excessive" governmental intervention will result in reducing total employer-sponsored benefits.

It is significant, also, that as employers have largely stopped providing defined benefit retirement plans, the fiduciary obligations running from employers to employees vis-à-vis the management of retirement savings, as provided under the Employee Retirement and Income Security Act of 1974 (ERISA), are less widely applicable. ERISA's fiduciary obligations are generally inapplicable vis-à-vis company-sponsored 401(k) plans. For further discussion, see Susan J. Stabile, Freedom to Choose Unwisely: Congress's Misguided Decision to Leave 401(k) Plan Participants to Their Own Devices, CORNELL J.L. & PUB. POL'y 361 (2002).

37. See Leslie Wayne, The Enron Scandal Grazes Another Bush in Florida, N.Y. TIMES, Jan. 27, 2002, at 32. In the summer of 2002, as state pension fund losses mounted with the accumulating revelations of corporate financial accounting schemes, state officials from New York, California, and North Carolina organized together to pressure Wall Street firms to adopt policies limiting analysts' conflicts of interest. Their platform mirrored the reforms agreed to between Merrill Lynch and New York Attorney General Eliot Spitzer as part of the settlement of proceedings (which included Merrill Lynch's payment of a $100 million fine). See Patrick McGeehan, 3 State Pension Funds Put Pressure on Wall St., N.Y. TIMES, July 2, 2002, at C1. Provisions intended to reduce analysts' conflicts were also enacted into federal law by the Sarbanes-Oxley Act of 2002, H.R. 3763, § 201, 107th Cong. (2002).

Enron had been headquartered, experienced substantial financial shortfalls as the company entered bankruptcy.39

As Enron investors, employees (and other persons depending upon them financially) have struggled to assess their economic losses, they have also experienced serious psychological40 and social disruptions. Of course, major financial losses and/or the loss of a job occasion substantial disruption of family and community life. And the social and psychological tensions inevitably arising from such financial losses are vastly magnified where there is a perception of unfairness within the system, as opposed to the misfortune being attributed to individual "fair" although adverse outcomes. Either because these psychological and social costs are assumed, or perhaps because they are impossible to quantify and commodify (and thus fall outside of what is cognizable in a law and economics paradigm), they have been underdocumented, underanalyzed, and generally underappreciated by commentators and law reformers in assessing the "costs" of corporate fraud and the law's appropriate response thereto.41

Perhaps the most shocking aspect of the Enron story is that the scope of the inequity at Enron—the apparent greed, dishonesty, and callousness of the company's directors and officers—has so far (prior to any remediation that legal action may produce) been matched by the gross inequality in the distribution of its effects. While employees and investors incurred devastating financial losses in 2001, many senior-level insiders had already banked huge financial windfalls.42 Several


40. Social scientists are increasingly documenting the fact that people experience their social status and sense of well-being in comparative, socially embedded terms. Relatedly, they experience the loss of wealth and status—that is, downward mobility vis-à-vis their peers, as a particularly grievous injury. See, e.g., ROBERT H. FRANK, LUXURY FEVER: WHY MONEY FAILS TO SATISFY IN AN ERA OF EXCESS 104-06 (1999); RICHARD H. THALER, THE WINNER'S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE 106 (1991). This research suggests a need for reexamining the practice and notion of using stock options to align the financial incentives of (already affluent) corporate executives with the risk preference and financial best interests of "ordinary" investors.

41. As a result of the widespread press coverage of the effects on investors and employees of the losses arising from the kinds of massive corporate frauds uncovered at Enron, WorldCom, etc., and the testimony presented to Congress in 2002, the tide may have turned against legislative and judicial laissez faire. For further discussion, see infra Part VI; especially notable is the passage of Sarbanes-Oxley.

42. See Kurt Eichenwald, Enron Paid Huge Bonuses in '01; Experts See a Motive for Cheating, N.Y TIMES, Mar. 1, 2002, at A1.
Enron senior executives had exercised stock options and then sold millions, even tens of millions of dollars of company stock in the years, months, and even weeks prior to Enron's bankruptcy. Kenneth Lay, Enron's long-time Chairman and CEO, was able to effectuate lucrative sales of his Enron stock nearly continuously throughout 2001, without publicly disclosing the sales during this period.

If, instead, Lay's stock sales had been made public in a timely fashion, presumably they would have aroused greater scrutiny and concern about what was occurring at Enron. And although such concern would at least temporarily have depressed the price of the company's stock, greater transparency might also have led to management, operational, and reporting reforms that might have resolved the problems at Enron before they proved terminal. In addition, it is difficult to believe that corporate insiders at Enron (and elsewhere) would have been compensated so lavishly—through stock options, corporate "loans," and various other arrangements—if the true expense of the perquisites had been reflected in the company's financial statements and public reports.

43. See Leslie Wayne, Before Debacle, Enron Insiders Cashed In $1.1 Billion in Shares, N.Y. Times, Jan. 13, 2002, at A1. On the basis of documents filed in court and with the SEC, the New York Times calculated that top insider sellers included: (1) Lou Pai, the former chairman of an Enron subsidiary, who received $353.7 million from his Enron stock sales; (2) Kenneth Lay, who "trading almost daily," received $101.3 million from sales of his shares; (3) Rebecca Mark-Jusbasche, a director and former Enron executive, received $79.5 million for her shares; (4) Ken Harrison, a director, received $75.2 million; (5) Jeffrey Skilling, who served as CEO for seven months in 2001, received $66.9 million for his shares (after December 2000, Skilling apparently sold stock at a pace of 10,000 shares every week); and (6) Andrew Fastow, who received $30 million for his stock. Id.

44. Consistent with SEC Rule 16a-3(f), Kenneth Lay was permitted to delay the reporting of $101 million of resales of his stock to Enron (effectuated throughout 2001) until forty-five days after the end of the 2001 fiscal year. It cannot merely be fortuitous that the complex insider loan/stock resale transactions that benefited Lay were deals that largely evaded sunlight. This was part of their raison d'etre, as the savvy lawyer who structured the arrangement knew well. (One of Sarbanes-Oxley's prohibitions is a ban on many of the types of personal loans that companies had frequently extended to their directors and officers. H.R. 3763, § 402). In the alternative, the SEC's Rule 16a has generally required that corporate insiders' standard market purchases and sales of their company's stock must be reported to the SEC on Form 4 within ten days. Sarbanes-Oxley amends this deadline to the second day after the execution of the transaction. Id. § 403.

45. This is one basis for my belief that managers' concealment of unfavorable information, at least in the presence of a duty to disclose, is a violation of their fiduciary duty of loyalty. Kahn, Transparency, supra note 31; see also RESTATEMENT OF TRUSTS (SECOND) § 173 (1959) ("Duty to Furnish Information: The trustee is under a duty to the beneficiary to give him upon his request at reasonable times complete and accurate information as to the nature and amount of the trust property"); RESTATEMENT OF TRUSTS (SECOND) § 172 (1959) ("Duty to Keep and Render Accounts: The trustee is under a duty to the beneficiary to keep and render clear and accurate accounts with respect to the administration of the trust.").
Instead, in what appears in retrospect like a classic cover-up, throughout the late summer and early fall of 2001, Kenneth Lay reassured Enron employees about the positive financial prospects of the firm and even suggested that they would benefit from purchasing more Enron stock. At the same time, Lay himself was selling off much of his Enron stock and preparing to beseech President Bush's cabinet advisors for help in saving the company. 

At the board level, while Enron's directors were approving lavish compensation packages for top-level executives over the years, and...
receiving lavish stock option packages themselves,50 they either failed to inform themselves about the extraordinary, multimillion-dollar sums several executives had made from their related party transactions with Enron,51 or willfully elected to remain ignorant of them or chose to ignore their significance.52 Although corporate legal commentators have touted executive stock options' positive effects on management and corporate performance, the substantial stock option grants paid to Enron's directors (counter to the prevailing wisdom) failed to induce them to perform the kind of diligent, honest service that would genuinely have benefited the company and its shareholders. Instead, the options appear to have contributed to a gross overconcentration on near-term profit maximization at any cost.

As if to add insult to injury, two days prior to the company's bankruptcy filing, while "rank and file" employees were being laid off with little or no notice or severance pay, many senior-level executives received lucrative retention bonuses (totaling more than $55 million in value) to remain with the firm even if only through the initial phases of its bankruptcy proceedings!53 When the financial fortunes of these senior-level employees are compared to those of the workers—who in


51. The Powers Report indicates that the board was woefully ignorant on this matter. Powers Report, supra note 27. But a Senate Committee report concluded that the board knew or had the opportunity to know the material facts about insiders' overreaching and other improper conduct. Permanent Subcomm. on Investigations of the Sen. Comm. on Governmental Affairs: The Role of the Board of Directors in Enron's Collapse, S. Rep. No. 107-70, 107th Cong. (2002) [hereinafter Governmental Affairs Investigations Subcommittee Report].

52. For description of such transactions, see Powers Report, supra note 27; see also Kurt Eichenwald, Deal at Enron Gave Insiders Fast Fortunes, N.Y. Times, Feb. 5, 2002, at A1.

53. At a hearing conducted by the Senate Governmental Affairs Committee on February 5, 2002, Enron benefits managers testified that the company had paid $55 million in retention bonuses to select managers two days before its bankruptcy filing. At the same time, the company announced that it could not provide severance to 4500 workers who had been laid off. On August 28, 2002, a federal bankruptcy judge involved in the Enron proceedings approved a settlement package affording laid-off employees $28.8 million in additional severance pay and the right to attempt to recover the (then estimated to be) $80 million in executive retention bonuses the company paid out in exchange for abandoning other claims against Enron. Eduardo Porter & Mitchell Pacelle, Judge Increases Severance Pay To Former Enron Employees, WALL ST. J., Aug. 29, 2002, at A3.
many cases had their retirement savings wiped out—the tragedy and inequity is plain enough. It is highly doubtful, moreover, that litigation will even substantially level the playing field ex post.\(^{54}\) As discussed in Part IV, legal developments in the 1990s have imposed significant hurdles to plaintiffs' recoveries in securities class actions, even in meritorious cases.

For the reasons described above, the suffering experienced by those who lost significant savings and/or jobs on account of Enron’s failure has been deepened by a sense of betrayal. These individuals’ losses cannot be construed, as had initially been suggested by Paul O’Neill, the Secretary of the Treasury, as “part of the genius of capitalism.”\(^ {55}\) Neither Enron’s investors nor its employees had made the mistake of investing in buggy whips at the advent of the motor car era. Rather, on account of Enron’s directors’ and officers’ either intentional or reckless publication of erroneous financial data and other misleading disclosures, neither the company’s employees nor its investors had had the information they would have required to make rational decisions about their investment of human and financial

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54. Commentators have long recognized the shortfalls in securities class action plaintiffs’ recoveries. For citation to relevant empirical surveys and significant commentary, see James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 Ariz. L. Rev. 497 (1997). In a rare, “plaintiff-friendly” move, Congress in Sarbanes-Oxley extended the statute of limitations in private securities fraud actions, but the change applies only to those actions commenced after its enactment. Sarbanes-Oxley Act of 2002, H.R. 3763, § 804, 107th Cong. (2002). A further problem facing Enron plaintiffs, as discussed infra, is that holders of Enron equity, who purchased their securities prior to the publication of the fraudulent statements and held them until after the alleged frauds were exposed (by which time the stock had lost almost all of its market value) lack standing to bring a private cause of action under Section 10(b) and Rule 10b-5. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). This group would include many pension funds and employee 401(k) accounts, of course. In addition, the state law, fiduciary cause of action for equity holders who are defrauded by their directors or officers is presently of uncertain status. See infra note 128 and accompanying text.

55. On January 13, 2002, on the television program *Fox News Sunday*, in first publicly reacting to the news of Enron’s bankruptcy filing, Treasury Secretary Paul O’Neill described Enron’s situation as reflecting the “genius of capitalism.” O’Neill went on succinctly to state the essence of the free market, egalitarian, meritocratic ideology underlying U.S. capital market participation: “Companies come and go. Part of the genius of capitalism is that people get to make good decisions or bad decisions. And they get to pay the consequences or to enjoy the fruits of their decisions. That’s the way the system works.” Of course, this ideology and market mechanism is subverted, rendered dysfunctional when corporations publish false information. Investors deprived of accurate corporate information, by definition, are deprived of the opportunity to make and live by their own “good or bad” decisions. As allegations, investigations, and revelations of fraud at major American corporations erupted throughout the summer of 2002, O’Neill adopted a far less flippant view of the appropriate legal and governmental response to insiders’ abuse of the financial reporting system.
capital in the firm. This absence of transparency meant that when Enron failed, neither its investors nor its employees could blame their own (mis)judgments or their own bad, "dumb" luck. They had unknowingly been deprived of the information they would have required to have authorship over their choices. Instead, they had become victims of fraud and self-seeking conduct of startling dimensions.

II. FANATICISM, IDEOLOGY, AND THE STRENGTH OF AMERICAN CAPITAL MARKETS

There are many intriguing insights to be drawn from the nearly chronologically coincident events of Enron's financial collapse and Al Qaeda's fatal attack on the Twin Towers. Perhaps most fundamentally, both catastrophes can be conceived of as the product of unchecked, antidemocratic fanaticism. Al Qaeda's ideology, to the extent that it can rationally be construed, is radically anti-American, antimarket capitalist, anti-individualist, and antisecular. In the alternative, Enron's executives' ideology—as illustrated by their conduct and institutionalized in the company's vision and values statement, its public and internal documents, and corporate paraphernalia, was super-aggressively (if opportunistically or "pseudo") pro-market capitalist, radically individualist, antigovernment (even quasi-anarchistic), and messianic only in its commitment to the pursuit of corporate power and of immediate profit. Importantly, and ironically, both forms of fanaticism reflect a deep hostility to the norms and values embodied in the notion of the secular "rule of law."

The terrorists launched a violent attack on American government from outposts in distant lands. In contrast, Enron sought to quell the force of democratic government from within, either by molding the law to its advantage, through massive lobbying and campaign finance expenditures, or by evading its dictates, if necessary, through strategic maneuvers that included accounting fraud. And there is increasing evidence, moreover, that although Enron was publicly espousing the

56. Enron's filings and reports were notoriously nontransparent. However, the positive hype generated by financial analysts may have prevented many investors from gaining a clear appreciation of the significance of what they didn't see. For the discussion of analysts' potential conflicts of interest, see infra notes 93-96 and accompanying text. As they would seem less affected by the financial conflicts facing sell-side analysts, buy-side analysts' failure to steer clear of Enron is more difficult to understand. For hypotheses, see Paul M. Healy & Krishna G. Palepu, The Role of Capital Market Intermediaries in the Demise of Enron (2002) (unpublished manuscript, on file with author) (presented at Harvard Law School, May 2002).
benefits of free markets, it was using its own economic and political power during the California power crisis, if not elsewhere, to subvert the normal operation of energy and other commodities markets. In addition, the company’s role in influencing Vice President Dick Cheney’s Energy Task Force in its formulation of federal energy policy (to the company’s private advantage and the detriment, potentially, of consumers, inter alia) is a matter of ongoing controversy. In judging Enron’s corporate successes, it still remains unclear whether the company evolved truly novel, social wealth-enhancing solutions to problems of corporate organization and supply and demand, or alternatively, in large part, exploited a stock market bubble and the lack of transparency attendant to “newish,” highly complex forms of financing to cheat well, look good, and get lucky—for a while.

In any event, Enron’s financial collapse has brought attention to its and other firms’ unabashed ongoing application of large sums of money to effect favorable political and legal outcomes—outcomes that might or might not be favorable, over the longer term, to investors, employees, or consumers, but were calculated to be favorable, almost surely, to the corporate power brokers themselves. The public outcry and feared political backlash from the specter of Enron (and big business and Wall Street more generally) “getting over on” the law and lawmakers was so great that Congress was moved, finally, after years of stonewalling, to enact meaningful campaign finance reform. In this silent subversion of the proper operation and legal dictates of truly representative, democratic government, Enron posed a threat to the nation’s security and core values that was no less real than that posed by Al Qaeda.

For example, Enron’s failure illustrates the precariousness of traditional distinctions of “private” and “public,” as applied to law, social institutions (including business organizations), values, harms, costs, etc.—distinctions that feminist legal theorists and even progressive corporate legal scholars have long queried. But perhaps the most compelling lesson emerging from Enron’s fall is that the absence of fair play and “due process” in regard to the governance of corporate firms—which would mandate, for example, strict laws fostering the accurate presentation and equal availability of corporate financial information, limiting the financial conflicts of interest that

57. For a thoughtful analysis of the credibility of this proposition, see William Bratton, Enron and the Dark Side of Shareholder Value, 76 Tul. L. Rev. 1275 (2002).

may pertain to a corporation’s analysts, advisers, and principals, and corporate underwriting of the political process, not only (re)distributes losses and gains unfairly (by definition), but also produces profound, widespread disaffection, resentment, and even increased lawlessness. As sociologist David Sciulli has argued persuasively, the presence or absence of republican, democratic procedural norms in corporate governance reverberates throughout broader social structures and intermediate institutions in civil society. Social solidarity and the capacity to trust and cooperate, in turn, are essential resources for increasing wealth. At a higher level of organizational behavior, the full costs of “exit” become impossible to appraise, “voice” becomes a saving strategy.

In addition to the investors and employees immediately affected, even “bystanders” to the Enron story have felt outrage at the realization that “insider” corporate and capital market participants successfully leveraged their positional advantages (vis-à-vis information and decisional authority) to make millions of dollars of profits, while the Enron corporation, its outside investors, and its ordinary employees suffered catastrophic losses. Insider overreaching and institutionally entrenched inequality cut deeply against the core values and beliefs that have animated the paradigmatic “American dream.” These values and beliefs, this ideology, has fostered the social solidarity necessary to support corporate and capital market institutions in hardscrabble as well as happier times. Although it has been less keenly observed, ideology has always been a feature of American economic, as well as political life.

As political scientists and sociologists have observed, despite the absence of consensus in the United States regarding the substantive components of “the good life,” there is widespread consensus that
social structures, governmental processes, and the legal system must respect and foster the equal dignity of persons. This central tenet of political liberalism is the dominant public philosophy of the modern American era, the conceptual core of the country's legal and political systems. And in addition to operating in the political and legal spheres, these values have inhabited the concept of "free markets," and have operated as a crucial ingredient in making American capital markets and corporate and financial institutions effective and durable, and thus successful.

In specific form, such values are manifest in the federal and state prohibition on insider trading, in the SEC's recently enacted Regulation FD (Fair Disclosure), and, perhaps, in the SEC's Rule 14D-10 (the "all holders/best price" rule), inter alia. But they also operate, more comprehensively, in the basic architecture of corporate governance: the triad of (1) shareholder voting, (2) managerial fiduciary obligation (which rests in turn on the fundamentally political notion of shared and delegated authority), and (3) mandatory, periodic reporting (as prescribed by federal securities and state fiduciary law).

In this regard, the question of whether particular corporate and capital market rules are narrowly profit maximizing or whether individual profit motivated investors would agree to them ex ante misses a crucial piece of the socio-economic puzzle. The commitment to personal "liberty" that is integral to the concept of free markets as constructed under U.S. law requires more than the absence of governmental coercion. In this positive form, this liberty interest motivates and necessitates rules that seek to ensure that trading in capital markets, and thus the redistribution of profits and losses resulting therefrom, will occur in an environment in which accurate, intelligible, comprehensive corporate financial data is widely and equally made available to those who seek it. In this regard, corporate misrepresentation and insider secret profit taking are antithetical to the

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62. For valuable commentary, see Michael Sandel, Liberalism and the Limits of Justice (2d ed. 1999); Will Kymlicka, Contemporary Political Philosophy (1990).
65. In Rule 14d-10 (the "all holders/best price" rule), the SEC required that tender offers must be made to all holders of equity securities of the class subject to the tender offer, and that the offeror must offer the same price and type of consideration to all offerees, with limited exceptions. See Amendments to Tender Offer Rules All-Holders and Best-Price Exchange Act Release No. 6653, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016, at 88,190 (July 11, 1986).
egalitarian, democratic, ideological underpinnings of American corporate and capital market institutions.

Though harder to model in scientifically rigorous terms, ideology is as crucial to solid institutional design as is efficiency. Investor confidence is a function not only of historic objective financial criteria, but also, ultimately, moral, cultural, and ideological expectations. And for these expectations to remain robust and efficacious, they must be backed by law to a significant degree. The way that accurate information was distributed asymmetrically at Enron, that is to certain inside investors and certain upper-level employees, conflicted with fundamental liberal values and notions of personal freedom that rightly inhere in the concept and operation of free markets. The outrage that many Americans experienced in learning about the fraud and unfair dealing at Enron and WorldCom, and the other companies where frauds of various kinds have recently been alleged, has been compounded, made searing, by the simultaneously broadcast image of "ordinary" Americans risking, potentially sacrificing, their lives to defend freedom and equality against foreign terrorism. The crisis in investor confidence that clouded the summer of 2002 reflected Americans' decreased faith that liberal, democratic values have been reinforced by law in the existing systems of domestic corporate governance and capital market regulation. As analysts chart the effect of such increased investor skepticism on stock market prices, it has increasingly become evident in assessing the harms arising from corporate fraud, that "private," economic, allocative concerns and "public," ideological, and distributional ones synchronize and become inextricable.

III. ENRON AND CORPORATE GOVERNANCE: THE FAILURE OF CHECKS AND BALANCES

By early spring 2002, more than a dozen official inquiries into the conduct of Enron's directors and officers and the auditors, lawyers, investment bankers, and analysts who profited from transacting with them were ongoing. A disturbing, nearly pervasive mistrust of

66. When Enron sold partnership interests in "LJM2" it provided the offerees a chance to profit from confidential information about Enron's investment plans; thus, LJM2's investors had more accurate information about Enron's financial situation than Enron's ordinary employees and public shareholders. See, e.g., Eichenwald, supra note 27, at A1; Diana B. Henriques & Kurt Eichenwald, A Fog Over Enron, and the Legal Landscape, N.Y. Times, Jan. 27, 2002, at MB1.

67. For citation to the congressional hearings and governmental investigations, see Appendix A, infra. The operation of professional credit rating agencies has also come under
corporate America and Wall Street hung in the air. Members of Congress heard testimony regarding the highly aggressive, at times unlawful, methods by which Enron inflated its revenue and profit figures and masked its total liabilities. And before the Enron hearings had even concluded, Congress initiated hearings into the even more massive accounting fraud that had been exposed at WorldCom. It soon became apparent that the multiple corporate governance checks and balances intended to safeguard the integrity of management oversight, corporate reporting, and accounting and auditing practices—and thus, the accuracy of pricing in the capital markets as a general matter, had broken down in the case of Enron, WorldCom, and indeed several other major, seemingly successful American corporations. In Enron's case, this breakdown extended to the board's failed oversight of senior management and internal control systems, Arthur Anderson's failed auditing, and outside financial analysts' failure to recognize that much of what Enron was producing was merely hype.


68. Under current regulations, energy traders can record as revenues the total value of contracts traded, rather than merely their receipts (or losses) on trades. Enron should have made a corresponding entry for the costs of the contracts, however. According to a New York Times report, if Enron had been required to record revenues in a conventional manner analogous to a brokerage firm, its year 2000 revenues would have been $6.3 billion, instead of in excess of $100 billion. See Gretchen Morgenson, How 287 Turned Into 7: Lessons in Fuzzy Math, N.Y. TIMES, Jan. 20, 2002, at MB1.

69. See Berenson, supra note 28, at A1. The New York Times reported:

As soon as [Enron Energy Services] signed a contract, it estimated what its profits would be over the entire term, based on assumptions about future energy prices, energy use and even the speed at which different states would deregulate their electric markets.

Then Energy Services would immediately pay its sales representatives cash bonuses on those projections and report the results to investors as profits. By making its assumptions more optimistic, the division could report higher profits.

Id.

70. Prior to the restatements of fall 2001, Enron had failed to aggregate liabilities in certain off-balance sheet entities with those of the larger company. In addition, Enron engaged in transactions that functionally were loans but were accounted for as "swaps." See Eichenwald, supra note 28, at C1. These "swap" transactions "allowed something that had all the earmarks of a bank loan to be written up instead as cash assets and liabilities from the company's trading business." Id.

71. Such egregious, multiple, coincident systems failures would previously have been considered virtually impossible. This explosion of perceived security and order, with the inevitable consequence of profound, lingering ongoing popular anxiety and economic destabilization, is another parallel between the effects of Enron's collapse and Al Qaeda's successful assault.
Clearly, an important factor in these disasters was that there were too many kinds of financial conflicts of interest affecting too many of the participants. Greed, the rule of mammon, had overtaken the rule of law. Massive stock option grants to Enron’s executives, as well as its outside, theoretically “independent” directors gave them too strong a

72. I am currently working on a broader analysis of the concept of the “rule of law” and its application to corporate governance and corporate and securities law. The concept, interestingly, has rarely been invoked or analyzed in relation to corporate governance. For a basic but sweeping consideration of the concept of the “rule of law,” see ANDREW ALTMAN, ARGUING ABOUT LAW (1997); GEORGE P. FLETCHER, THE BASIC CONCEPTS OF LEGAL THOUGHT (1996) (analyzing the continued intellectual and cultural force of the rule of law concept and its influence on law reform); ANTHONY J. SEBOK, LEGAL POSITIVISM IN AMERICAN JURISPRUDENCE (1998) (assessing legal process concerns and the rule of law concept in relation to the formalism/positivism dialectic); LARRY ALEXANDER & EMILY SHERWIN, THE RULE OF RULES (2001) (analyzing the relationship of rules to the concept, authority and binding force of law); PAUL W. KAHN, THE CULTURAL STUDY OF LAW: RECONSTRUCTING LEGAL SCHOLARSHIP (1999) (arguing that dedication to the rule of law concept structures other crucial cultural beliefs and values that have too frequently been missed by legal scholars in their pursuit of particular law reforms). In relation to democratic theory, political economy, financial governance, and the other lines of inquiry pursued herein, see also JURGEN HABERMAS, BETWEEN FACTS AND NORMS: CONTRIBUTIONS TO A DISCOURSE THEORY OF LAW AND DEMOCRACY (William Rehg trans., 1996) (providing a sociologically informed analysis of the values and practices underlying democratic organization and their relationship to law and basic rights); HUGH COLLINS, MARXISM AND LAW (MARXIST INTRODUCTIONS) (1995) (applying the insights of Marxist social theory to a critique of the concept of the rule of law); THE RULE OF LAW AND ECONOMIC REFORM IN RUSSIA (Jeffrey D. Sachs & Katharina Pistor eds., 1997) (applying an interdisciplinary approach to analyzing the influence of Russia’s distinctive traditions of law “and lawlessness” to the evolution of the economic system and economic regulation in that country); DEMOCRACY, THE RULE OF LAW AND ISLAM (Eugene Cotran & Adel Omar Sherif eds., 1999); THE RULE OF LAW IN THE MIDDLE EAST AND THE ISLAMIC WORLD (Eugene Cotran & Mai Yamani eds., 2000).

73. Companies are required to disclosure the total number of options granted to their employees and directors in their Annual Reports and Proxy statements, pursuant to SEC Regulation S-K, Item 402. However, they are not currently required to “expense” them, i.e., to deduct the value of the stock options granted from the company’s annual earnings figures. This appears more anomalous because of the fact that companies are permitted to deduct the value of stock option grants as a compensation expense for federal income tax purposes.

In April 1993, the Financial Accounting Standards Board (FASB) had moved to require companies to deduct the value of the stock options granted from their reported earnings figures. See FASB, Proposed Statement of Financial Accounting Standards: Accounting for Stock-Based Compensation (Financial Accounting Series No. 127-6, 1993). Opposition from executives and the accounting industry was enormous, and the FASB dropped the proposal. See FASB Abandons Bid to Require Expensing of Employee Stock Options, 26 Sec. Reg. L. Rep. (BNA) 1725 (Dec. 23, 1994). More recently, the International Accounting Standards Board moved to adopt rules that would require the cost of stock-based compensation to be reflected in income statements. It received “harshly worded” warnings of a tough battle if it pursued the initiative. See Steve Burkholder, Battle Signaled over IASB Moves Toward Expensing of Stock Options, 33 Sec. Reg. L. Rep. (BNA) 1520 (Oct. 22, 2001).

motive to authorize overly aggressive accounting treatments, and to maintain their silence,\textsuperscript{74} and thus, the company's high-flying stock price when trouble surfaced. According to the \textit{New York Times}, Enron's directors received approximately $400,000 annually for their board service, approximately eighty-five percent of this compensation was in

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For an early legal treatment of the challenge to candor posed by financial statement driven incentive-based compensation, see \textit{Kamin v. American Express}, 383 N.Y.S.2d 807 (Sup. Ct. 1976), aff'd on opinion below, 387 N.Y.S.2d 993 (1st Dept. 1976) (holding that the board's decision to eschew an $8 million tax savings in order to bolster the firm's reported earnings numbers was to be judged under the deferential business judgment rule). As a way of addressing this conflict between "cashing in" and facilitating truthful reporting, in the summer of 2002, members of Congress evaluated the political and legal viability of requiring executives to hold the company stock they receive through option exercises throughout, or through a substantial period of, their tenure in office. \textit{See}, e.g., David Leonhardt, \textit{Slivers of Support for Shackling Corporate Pay}, \textit{N.Y. Times}, July 13, 2002, at C1.
the form of stock options (valued at the date of the annual meeting). In many, if not most cases, Enron’s “outside” directors’ objectivity was compromised also by corporate “charitable” contributions to organizations that the directors were affiliated with, as well as other remuneration unrelated to their board service. Indeed, the full extent of Enron’s contributions to nonprofit organizations affiliated with its directors cannot be ascertained because corporations are not required by any federal or state laws to disclose the size or recipients of their “charitable” donations.

Under the American model of corporate governance, consistent with state statutory law and fiduciary obligations of care, the board of directors has primary legal responsibility for decision making on nonroutine corporate affairs and primary oversight responsibility for ensuring the integrity of the firm’s essential internal controls. Most crucially, this oversight responsibility requires boards to ensure the quality and integrity of senior management by appointing, and if appropriate, dismissing the corporation’s senior executive officers. The board also has primary legal authority over and responsibility for overseeing the implementation and overall efficacy of the firm’s information-gathering and reporting systems, as these furnish the basis

75. On Sunday, July 7, 2002, the Senate Permanent Subcommittee on Investigations, which had been scrutinizing the conduct of Enron’s board over the previous six months, issued a report concluding that “much that was wrong with Enron was known to the board.” This knowledge, according to the report, extended to the aggressiveness of Enron’s accounting practices, the conflict of interest transactions, the extensive off-the-books corporate financings and transactions, and rampant excess executive compensation. The Senate Subcommittee learned that the Finance Committee of Enron’s board had been shown a chart illustrating that Enron could be forced to issue tens of millions of new shares in the event that its stock value declined, as a result of the “conflicted” off-balance sheet transactions with the Raptors. Governmental Affairs Investigations Subcommittee Report, supra note 51.

76. See Kahn, Pandora’s Box, supra note 31, at 609-24. In 2001, Enron director Lord John Wakeham received $72,000 as a consultant for Enron, in addition to his compensation as a director. Joann S. Lublin, Inside, Outside Enron Audit Panel Is Scrutinized, WALL ST. J., Feb. 1, 2002, at C1. In relation to corporate charitable contributions’ potential to impair outside directors’ objectivity, Enron directors Charles A. Lemaistre and John Mendelsohn both served as senior executives of the University of Texas M.D. Anderson Cancer Center—a hospital that received more than $600,000 in gifts from Enron since 1996. Jo Thomas & Reed Abelson, How a Top Medical Researcher Became Entangled with Enron, N.Y. TIMES, Jan. 28, 2002, at C1. The New York Times reported that Enron contributed $50,000 to the Mercatus Center at George Mason University, where Wendy L. Gramm, formerly an Enron director, was also a director. See Lublin, supra, at C1; Theo Francis, Questioning the Books: Waiver Approved for Enron Director May Cut Her Losses, WALL ST. J., Feb. 11, 2002, at A8. Enron also made significant campaign contributions to Dr. Gramm’s husband, Senator Phil Gramm. Francis, supra, at A8; Richard W. Stevenson & Jeff Gerth, Web of Safeguards Failed as Enron Fell, N.Y. TIMES, Jan. 20, 2002, at 1; Lublin, supra, at C1.
for ensuring accurate internal and external reporting and legal compliance as a general matter.\textsuperscript{77} Comprehensive, accurate information gathering and reporting is essential to keeping corporations running honestly and efficiently, of course. And the receipt of accurate, comprehensive financial data is equally essential for the board to fulfill its obligation of evaluating the competency of a firm's senior management.\textsuperscript{78}

As documented by the Powers Report and a July 2002 report of a Senate investigative committee, Enron's board failed to live up to both of these essential duties.\textsuperscript{79} Enron's directors failed to inform themselves adequately about the integrity and performance of the company's senior-most executives—especially in relation to such executives' participation in highly lucrative related party transactions, to the company's profound detriment.\textsuperscript{80}

In fact, a preliminary report authored by Vinson & Elkins, Enron's lead outside counsel, indicates that Enron's board at least twice expressly waived the company's code of conduct so that Enron executives could participate in lucrative self-dealing transactions with certain off-balance sheet entities.\textsuperscript{81} The report also suggests that the board contemplated that additional safeguards would be instituted vis-à-vis these transactions, but it does not appear that the directors ever made efforts to follow up on whether such safeguards were instituted

\textsuperscript{77} AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE § 3.02 (1994) (Functions and Powers of the Board); id. § 3.05 (Audit Committee in Large, Publicly Held Corporations); Corporate Governance and American Competitiveness: A Statement of the Business Roundtable, 46 BUS. LAW. 241 (1990) ("The board of directors has five primary functions: (1) Select, regularly evaluate, and, if necessary, replace the [CEO] ... (5) Review the adequacy of systems to comply with all applicable laws/regulations."); The Corporate Directors' Guidebook-1994 Edition, 49 BUS. LAW. 1243, 1249 (1994). The Guidebook explains that the board's oversight responsibility includes:

[E]valuating the performance of the corporation and its senior management and taking appropriate action, including removal, of management when warranted; adopting policies of corporate conduct, including compliance with applicable laws and regulations, and maintenance of accounting, financial, and other controls; reviewing the process of providing appropriate financial and operational information to decisionmakers (including board members).

\textit{Id.}

\textsuperscript{78} For discussion, see, for example, Lowenstein, supra note 31, at 1342-45.

\textsuperscript{79} POWERS REPORT, supra note 27; Governmental Affairs Investigations Subcommittee Report, supra note 51.

\textsuperscript{80} POWERS REPORT, supra note 27; Governmental Affairs Investigations Subcommittee Report, supra note 51.

\textsuperscript{81} Enron's board of directors waived the company's code of conduct to permit related party transactions between corporate insiders and the off-balance sheet entities in June and October of 1999. V & E Report, supra note 27, at 5.
or complied with; and evidently they were not. Instead, at best, the directors inappropriately, passively relied on other corporate officers and preexisting inadequate information gathering and reporting systems to protect Enron's interests. Although the states' corporate laws afford directors substantial discretion to rely on other officers' and outside advisers' advice, the exculpatory effect of such reliance is neither absolute nor uniform within the states' case law. Thus, the scope of Enron board's "justifiable" reliance on their colleagues and counselors will surely be a matter of contention in the private civil suits filed against the company under state law.

Enron's board also failed in its basic obligation to scrutinize the company's choice and implementation of accounting and disclosure systems.

82. See POWERS REPORT, supra note 27; see also Testimony of Jordan Mintz, general counsel of Enron's Global Finance Division. Mintz was sufficiently concerned about the conflict-ridden transactions with the Raptors, inter alia, as well as the underreporting of them, that in the spring of 2001 he engaged the law firm of Fried, Frank, Harris, Shriver & Jacobson to review the situation. Mintz tried and failed to raise the issue of the conflict transactions with Jeffrey Skilling, Enron's then-CEO, but he did not approach the board directly with his concerns, as is now required under the Sarbanes-Oxley Act of 2002, H.R. 3763, § 307, 107th Cong. (2002). In addition to being aired on C-Span, Mr. Mintz's testimony regarding Enron's senior officers' and board's failed responsiveness to the executives' conflicts and the perils they posed to Enron was reported extensively in the press. Eichenwald & Henriques, supra note 34, at A1 ("Questions of Conflicts-A Corporate Lawyer Raises Red Flags").

83. Directors' ability to exculpate themselves from liability based on their "justifiable" reliance on other corporate officers and outside experts and the proper functioning of corporate internal control systems is hotly contested in contemporary corporate law, notwithstanding its statutory basis. See, e.g., OR. REV. STAT. § 65.357(2) (2001); DEL. CODE ANN. tit. 8, § 141(e) (2001); N.Y. BUS. CORP. LAW § 717(a) (McKinney 2001); In re WR. Grace & Co., Exchange Act Release No. 39,156, 65 SEC Docket 1236 (Sept. 30, 1997), available at 1997 WL 600685 (holding that directors cannot passively rely on other corporate personnel and existing control systems to produce the disclosures required by law). Oregon's director reliance statute provides:

In discharging the duties of a director, a director is entitled to rely on information, opinions, reports or statements including financial statements and other financial data, if prepared or presented by:

(a) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;

(b) Legal counsel, public accountants or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or

(c) A committee of the board of which the director is not a member, if the director reasonably believes the committee merits confidence.

OR. REV. STAT. § 65.357(2). "Justifiable reliance" will surely be a principal defense put forward by Enron's directors and officers, especially vis-à-vis their auditors, Arthur Andersen, and outside lawyers, Vinson & Elkins. The specter of the various Enron participants seeking to avoid liability by casting blame on one another (i.e., pleading reliance inter se) illustrates the urgent need for further theorizing about individual versus entity-based responsibility for corporate malfeasance.
Boards’ obligations to oversee the accuracy of their companies’ public disclosures is reflected in both the corporate fiduciary case law and the SEC’s pronouncements issued under its authority to oversee the integrity of corporate reporting. This oversight responsibility is also widely acknowledged in the quasi-authoritative professional literature addressed to directors, such as the publications of the American Law Institute, the Business Roundtable, and the American Bar Association. Enron directors’ disclosure-related failures facilitated the related party transactions and failed auditing that, in conjunction with each other, weakened confidence in the company until it finally collapsed.

Investor confidence in the integrity of public accounting firms’ audits was another pillar of the corporate governance system that was

84. See POWERS REPORT, supra note 27.
87. See supra note 77 and accompanying text.
88. Members of Congress were considering affording the SEC authority, in its own right, to bar directors and officers held to be “unfit” from holding such positions with public companies in the future. Instead, as a result of Sarbanes-Oxley, the SEC may use its authority to persuade a federal court to bar service an officer or director who is “unfit”—the old standard being “substantially unfit.” H.R. 3763, § 305; see Jayne W. Barnard, The SEC’S SUSPENSION AND BAR POWERS IN PERSPECTIVE, 76 Tul. L. Rev. 1253 (2002). As a mechanism of ensuring greater accountability and accuracy in financial reporting, Sarbanes-Oxley requires that public companies’ senior-most officers (e.g., the CEO and CFO) must certify their firm’s financial statements and may face criminal penalties, including incarceration, if they “recklessly and knowingly” allow the publication of fraudulent information. See H.R. 3763, §§ 302, 906. Prior to the enactment of the Sarbanes-Oxley Act, the “books and records” provisions of the Foreign Corrupt Practices Act (FCPA), as incorporated in the Securities Exchange Act of 1934, § 13(b)(3), amended by Pub. L. No. 107-123, 115 Stat. 2390 (2002) (codified as amended at 15 U.S.C. § 78m (2001)) provided that it was a crime for corporate managers to lie to company auditors. Nevertheless, enforcement was rare and statutory penalties for violations of the FCPA were relatively minor.
severely damaged by Enron's fall. Despite former SEC chairman Arthur Levitt Jr.'s vigorous efforts to implement reform in the area of auditors' conflicts of interests, prior to Congress's enactment of the Sarbanes-Oxley Act in late July 2002, widespread financial conflicts of interest arising from the bundling of auditing and consulting services frequently would have impaired auditors' objectivity in the performance of corporate audits. Such conflicts were present in Arthur Andersen's auditing of Enron. Andersen made $27 million in 2000 from consulting services billed to Enron, in addition to the $25 million it made from auditing Enron. Until Enron fired Andersen in January 2002, Enron had been Andersen's second-largest client. Andersen's desire to retain Enron's lucrative consulting work (in addition to Enron's auditing work) would have dampened Andersen's objectivity in the audit. The handsome consulting fees may have nullified the audit partners' resolve to walk away from a client that had refused to follow sound accounting and disclosure practices.

Although the Big Five accounting firms had revolted against Arthur Levitt's proposals to prohibit individual accounting firms from performing both consulting and auditing work for the same client in 1999, the Enron-related crisis in confidence vis-à-vis the auditing profession has given rise to substantial impetus for separating auditing and consulting work in order to promote the independence, and investors' faith in the independence, of corporate auditing. Post-Enron, such change has been evolving through voluntary reforms undertaken by the major accounting firms themselves, but even more

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89. In 1999, under Arthur Levitt Jr.'s leadership, the SEC proposed a rule that would have banned an accounting firm from performing audit and (most) consulting work for the same company. The SEC's proposal provoked an intense lobbying campaign on the part of the Big Five accounting firms, and in November 2000, the SEC instead enacted standards that banned only a fraction of consulting work by auditing firms. See Revision of the Commission's Auditor Independence Requirements, SEC Release No. 7919, 73 SEC Docket 1885 (Nov. 21, 2000), available at 2000 WL 1726933. Again, Sarbanes-Oxley enacts significant new substantive limits on firms' performance of nonaudit consulting work for their audit clients. See H.R. 3763, § 201.

90. These fees are disclosed in Enron's Form 10-K, supra note 15.

91. Scott Hensley & Jonathon Weil, In Another Blow, Andersen Is Sacked as Merck’s Auditor, WALL ST. J., Mar. 4, 2002, at A10. In a July 5, 2002, SEC filing, Merck announced that it booked $12.4 billion in revenue that it never collected. For commentary, see Barbara Martinez, Merck Booked $12.4 Billion That It Never Collected, WALL ST. J., July 8, 2002, at A1. By that date, Arthur Andersen had been crushed by its conviction for obstruction of justice vis-à-vis its destruction of Enron documents. The controversiality of the Enron audit within Arthur Andersen itself is evidenced by the fact that records document disagreement between audit partners in Houston (who ran the Enron show) and those in the Chicago office (whose views were solicited but then ignored).
significantly through congressionally and SEC-mandated changes. Only time will tell whether these reforms go far enough in restoring investor confidence; whether receipt of a clean audit opinion will once again be a meaningful signifier.

Thirdly, the presence of financial conflicts of interest on the part of sell-side financial analysts may explain the curious fact that although Enron's financial statements were widely acknowledged as being chronically opaque, that opacity was not punished in the market a la Akerlof in the form of widespread "sell" recommendations (at least not prior to mid-2001). By February 2002, members of several House and Senate subcommittees had begun formal inquiries into the question of whether analysts' oddly longstanding "buy" recommendations on Enron's stock—recommendations that remained in place in many cases, until immediately prior to the company's bankruptcy filing—were influenced by the fact that their Wall Street employers had obtained (or might obtain) lucrative investment banking deals or other investment opportunities from Enron or its affiliates. And through the summer of 2002, New York attorney general Eliot Spitzer continued his broad investigation of Wall Street research department conflicts arising from their affiliation with the investment banking departments of their firms.


94. Enron's stock reached a high of $90 per share in August 2000, and, after various peaks and valleys, was still trading at $80 per share in early 2001. By the late spring it had declined below $60 per share, and continued to decline, progressively but persistently from then on. These figures are reflected in Enron's SEC filings during the period, as well as in detailed schematics published in the New York Times. See, e.g., Eichenwald, supra note 38, at A1.

95. See Leslie Wayne, Congress's Scrutiny Shifts to Wall Street and Its Enron Role, N.Y. TIMES, Feb. 19, 2002, at A1. Senator Byron L. Dorgan, Chairman of the Senate Commerce subcommittee investigating the matter, stated "We're trying to understand whether Wall Street firms had a vested interest to pump up Enron stock." Id. Merrill Lynch underwrote the sale of partnership interests and invested in certain of these interests in connection with Enron's off-balance sheet partnerships. A Merrill Lynch spokesperson testified before Congress on this conflicts issue at the end of July 2002.

96. In August 2002, AT&T announced that it had received a subpoena from Eliot Spitzer's office relating to whether Salomon Smith Barney's Jack Grubman had inflated his rating of AT&T shares in order to promote Salomon's chances of a role in a $10.6 billion offering of AT&T shares. See Seth Schiesel & Gretchen Morgenson, AT&T Is Asked for Information on Dealings with Salomon, N.Y. TIMES, Aug. 24, 2002, at C1.
IV. **ENRON AS A FORCE IN AND A PRODUCT OF A Deregulated, Legally Permissive Environment**

Through evidence offered to congressional investigators, the findings of the Powers Report, and reports by the media, it has become clear that Enron’s illicit, at times unlawful, behavior was facilitated by an excessively permissive legal environment. Indeed, the atmosphere that pervaded not only business and Wall Street, but also the political and even legal/academic establishment throughout the last two decades has been trenchantly “antilaw.” Hostility to the “costly” intrusions of law and government may have seemed like an affordable luxury prior to September 11th and the post-millennial accounting scandals, but the costs of law and the legal process can now more accurately be compared to the costs of lawlessness and the economic and social-psychological insecurity engendered thereby. In this regard, Al Qaeda’s attacks of September 11th and the fall of Enron appear to have signaled the end of a socio-political and legal era.  

By its own description, Enron was “laser-focused” on enhancing profits. This objective was achieved, in significant part, by avoiding the cost and constraints imposed by compliance with laws and regulations. In many cases, for example, in relation to the

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97. In a mid-July 2002 speech to business leaders at the University of Alabama, President Bush criticized the lack of ethical conduct, greed, and hyperconcentration on earnings that had roiled the markets:

> In order for us to have the security we all want, America must get rid of the hangover that we now have as a result of the binge, the economic binge we just went through. We were in a land of endless profit. There was no tomorrow when it came to the stock markets and corporate profits. And now we’re suffering a hangover from that binge.

Excerpts from President Bush’s Address on the Economy, N.Y. TIMES, July 16, 2002, at C5. It is fascinating to see that Bush identified the need to promote corporate transparency and ethical corporate leadership as a matter of national “security.” It is also fascinating and telling that in addressing these problems of corporate governance in his speech, Bush emphasized the need to “hold people accountable for misdeeds in the public sector... It is important for corporate America to hear this call. In order to be a responsible American, you must behave responsibly. We expect there to be full disclosure of assets and liabilities.” *Id.* (emphasis added). Corporate affairs have traditionally been shielded from regulation on the notion that they are “private,” although oversight over the accuracy of corporate disclosure has more generally been acknowledged as having “public” dimensions.

98. In the Letter to Shareholders in Enron’s 2000 Annual Report to Shareholders, Jeffrey Skilling (Enron’s President and CEO at the time) and Kenneth L. Lay (Enron’s Chairman at the time) describe Enron as “laser-focused on earnings per share.” *See ENRON, supra* note 18, at 2. In the summer of 2002, concern about the veracity of corporate earnings’ figures was substantially to blame for extraordinary market volatility. On July 16, 2002, the Dow Jones Industrial Average plunged 440 points (5%) before closing with a net loss of only 45 points. The panicked trading was compared in press reports to that following September 11th. For other data on recent stock market performance, see Appendix B, infra; see also
(non)payment of federal income taxes in four of the five years prior to its bankruptcy, Enron accomplished this by artfully structuring the legal entities, the several thousand foreign and domestic subsidiaries, through which it conducted business. A similarly formalistic, strategic (but ultimately unprofitable) approach to corporate affairs was evident in Enron's financial dependence on special purpose entities and off-balance sheet transactions. In other cases, for example, the Investment Company Act's (non)application to its foreign operations,99 Enron used its political influence to win particular exemptions from laws and regulations. The exemption from the Investment Company Act, which was granted to Enron in 1997 by the SEC after the company had extensively lobbied Congress and the Commission, was crucial to enabling Enron's expansion, and subdivision, into a nearly unfathomable multitude of foreign subsidiaries and affiliates. Again, these entities were useful in reducing or eliminating Enron's liability for federal income taxes, moving debt and depreciated property off Enron's books, and facilitating insiders' self-dealing transactions. Significantly, Enron's extensive lobbying of cabinet officials, Congress, and federal agencies fostered the deregulation of electricity and other commodities markets,100 as well as the absence of oversight and regulation in over-the-counter traded derivatives—areas that were crucially important to the company's bottom line.101 In some cases,


101. The Commodities Futures Modernization Act, Pub. L. 106-554, 114 Stat. 2763 (2000), passed by Congress in the final days of 2000, protected Enron from futures regulation and oversight of its derivatives trading business. According to the Wall Street Journal, "Enron was so forceful in pushing for energy and metals commodities to be exempted from oversight that the exemption provision was sometimes referred to by Capitol Hill staff as the 'Enron Point.'" See Schroeder & Ip, supra note 100, at A1.
Enron was simply able to leverage its financial and institutional resources to innovate more rapidly than those who might otherwise have tried to regulate it. EnronOnline, a cyberspace-based energy trading “market” launched by Enron in 1999, was immune to many of the regulations that applied to its traditional, “corporeal” counterparts, such as the New York Mercantile Exchange.\textsuperscript{102} Other regulatory oversights nearly defy explanation. Remarkably, prior to Enron’s fall 2001 financial crisis, the SEC had last reviewed the substance of the company’s filings and reports in 1997! Even as he appeared before Congress, the recently appointed SEC Chairman, Harvey Pitt, had no explanation for the hiatus.

Most contemporary practitioners and academicians in corporate law have hailed the prevailing legal “enablingism” and regulatory minimalism as promoting corporate profits and economic efficiency—and thus the broader social welfare. But the Enron story is a cautionary tale illustrating the limits of “governance through markets,” and the shortcomings of relying nearly exclusively on short-term profit maximization as the animating principle of corporate governance, laws, and market and financial regulation. In regard to the former concept, while markets may adjust ex post to colossal failures such as Enron’s, a predominantly trial and error, post-hoc approach to safeguarding the welfare of firms, investors, and employees is intolerably costly. Timing matters to the people who have “skin in the game,” and should therefore matter to the people with the power to implement reform.\textsuperscript{103} In addition, some of the salutary, ex post market response that fuels the antiregulatory argument occurs in anticipation of what is feared might be an otherwise impending, potentially more onerous legal response. This phenomenon may in fact explain the decision of certain companies and financial firms, in the summer of 2002, “voluntarily” to expense the cost of stock option grants. “Voluntary” reforms may produce superior public relations or investor response, and may, in some cases, even supplant the need for “top-down” legal or regulatory action. But such “voluntary” reforms might

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{102} According to the Wall Street Journal’s figures, EnronOnline came to control a quarter of all wholesale energy trades among U.S. utilities, independent power producers, and other market players. At its peak, Enron’s portfolio of energy and other derivatives was valued at $19 billion. See id. Because over-the-counter traded derivatives fall outside of the jurisdiction of both the SEC and the CFTC, “financial regulators had little clue what was going on inside Enron.” Id.
\item \textsuperscript{103} It would surely be intolerable to leave the regulation of air travel safety largely to post-hoc, market responses to major disasters, or national security to post-hoc responses to major terrorist attacks.
\end{enumerate}
\end{footnotesize}
never come if there were not a credible threat of legal action. Of course, laws and regulations, like markets, are imperfect in their operation—but the gravity and magnitude of the interests at stake in the American corporate governance and capital market systems mandate that perfect solutions cannot be allowed to be the fatal enemy of sound legal and regulatory reforms.

A more meaningful, activist role for law and regulation is validated, also, by the research of behavioral economists. Research findings vis-à-vis the operation of cognitive biases (the overconfidence principle, risk aversion, endowment effects, etc.) and other forms of "bounded rationality" indicate that individual investors and employees are frequently less than ideally situated to make materially welfare-enhancing choices in their dealings with firms and markets. Such biases were surely at work, for example, in Enron employees' investment decisions vis-à-vis the amount of company stock they own in their 401(k) accounts. And this pattern of excess employee concentration in employer stock is apparently widespread.

In addition, serious economic analysis no longer supports an easy equivalence between the maximization of corporate profits and the maximization of social welfare. Concerns about substantial, increasing inequality of wealth and income in the United States cannot be relegated to second order, ex post political solutions. This is true for several reasons, including the fact that these political solutions will frequently fail to materialize because of the operation of the very disparities of wealth, and the political empowerment of corporate wealth in particular, that would otherwise be the stimulus for progressive legal and regulatory reform.

In addition, ironically, while mainstream corporate legal scholars and conservative policy makers have championed market-based solutions to problems of suboptimal corporate governance (in light of its presumed detrimental effect on corporate financial performance), at least pre-Enron they frequently have opposed the adoption of more aggressive legal measures that would tend to safeguard the accuracy of the corporate disclosures that drive capital market's pricing of shares—and, thus, the market-based accountability mechanisms that purportedly supplant the need for robust legal enforcement in the area of corporate governance. The mainstream, conservative legal argument has been that entity-based penalties and fines for corporate misrepresentation are misplaced and ineffectual; whereas imposing financial damages directly on corporate directors and officers, it has been argued, is too draconian. The supposedly shareholder-friendly
argument has been that stricter laws and larger financial penalties would too commonly deter talented people from serving as part of corporate management, and especially as outside directors.

But it is difficult not to regard the deterrent-to-corporate-service argument as a cynical one in a world where Enron's outside directors, for example, received annual compensation approaching $400,000, and firemen and policemen, in comparison—including many of those who valiantly responded to the terror of September 11th, typically make no more than fifteen to twenty percent of that sum. The problem may be in the perception, the social and legal construction of what interests are at stake, what duties are involved in serving as a corporate director. In any case, from a liability perspective, if damages were capped at disgorgement of the sum of salary and bonuses/benefits received during the period in which the fraud was ongoing (as is suggested in the conclusion to this Part IV of this Article), the argument in favor of personal financial damages in cases where directors and officers have been found to have participated in or tolerated corporate fraud becomes a truly compelling one.

In the alternative, the standards for bringing and winning private suits for fraud against corporate directors and officers under both the federal securities laws and state corporate fiduciary duty law have changed substantially during Enron's lifetime—consistently in the direction of reducing or eliminating the payment of money damages by corporate defendants and their advisors. In addition, in many cases, broad federal preemption has foreclosed the possibility of pursuing securities fraud claims through state law-based class actions, as discussed infra.

After 1985 (coincidentally the year that Enron was created through a merger with the Internorth pipeline company of Nebraska),104 Delaware's legislature enacted laws permitting companies to exculpate their directors from paying monetary damages in fiduciary care suits, even where the directors' gross negligence has been proven.105 Most states have followed Delaware in statutorily sanctioning such limited director financial responsibility. Oregon—Enron is an Oregon corporation—adopted such a statutory charter exculcation provision, and consistent therewith, Enron's charter

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104. Enron was born out of Kenneth Lay's realization that in a heated takeover environment, the best mode of survival was combining with another, larger entity. In 1985, he engineered his pipeline company's merger with Internorth of Nebraska. Mitchell Pacelle, Enron Creditors to Seek Ouster of Lay, WALL ST. J., Jan. 24, 2002, at A3.

exculpates its directors for monetary damages arising from breaches of fiduciary care. 106 Consequently, Enron's directors may be proven to have been grossly negligent in failing to inform themselves about the significance of the related party transactions, the viability of the hedges in the off-balance sheet partnerships, and the "remoteness" (and thus reportability) of the liabilities therein; grossly negligent in failing to oversee the accuracy of the firm's disclosures to shareholders generally; 107 and grossly negligent in overseeing the implementation of sound accounting practices—and they would still be exonerated from monetary liability for damages accruing to Enron and its shareholders as a result of the above described negligence by virtue of the exculpatory clause in Enron's charter. It is notable in the alternative, however, such charter exculpation from liability for financial damages for breach of care does not apply either to corporate officers or corporate auditors. Indeed, under state corporation law, Arthur Andersen's auditors may be found to have aided and abetted a fiduciary breach by Enron's directors and/or officers, as described infra. 108

106. OR. REV. STAT. § 60.047(2)(d) (1993); see Enron, Revised Certificate of Incorporation, Article XVI. The article states:

A director of the Corporation shall not be held personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty . . . (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, . . . (iv) for any transaction from which the director derived an improper personal benefit.

Id.; Enron's Revised Certificate of Incorporation is available online through EDGAR, as an exhibit to Enron's Form 10-K, filed April 1, 1995. The "bad faith" and "improper benefits" limitations on exculpation may be of importance in corporate litigation against Enron's directors. As stated in the text, significantly, statutory charter exculpation is inapplicable to corporate officers, including Enron's officers.

107. In the mid-1990s, the Delaware Supreme Court held that corporations' charter exculpatory clauses may serve to insulate directors from good faith, "negligent" disclosure breaches. See, e.g., Arnold v. Soc'y for Savs. Bancorp, Inc., 650 A.2d 1270 (Del. 1994).

108. Aiding and abetting a breach of fiduciary duty remains alive as a claim under state corporate fiduciary law, although it is no longer recognized as a basis for recovery under Rule 10b-5, after the United States Supreme Court's decision in Central Bank v. First Interstate Bank, 511 U.S. 164 (1994). In Malone v. Brincat, the Delaware courts entertained an "aiding and abetting" claim against the accountants for Mercury Finance Company, based on the accountants' participation in publishing fraudulent financial reports. See 722 A.2d 5 (Del. 1998). For consideration of fiduciary law's importance as an adjunct to securities law in setting standards for directors' diligent, honest conduct vis-à-vis disclosure, see Kahn, Transparency, supra note 31. Although the Georgia Law Review piece was published after the international financial/currency crisis of 1998 (in which American regulators and politicians decried "crony capitalism" in Asia, Russia, and elsewhere) and a succession of financial accounting scandals had already engulfed several major companies including Cendant, Sunbeam, Waste Management, and Oxford Health Systems, because the economy
A pro-defendant orientation is evident also in recent United States Supreme Court decisions addressing federal remedies for corporate fraud. The Supreme Court has continued and expanded the trend, initiated in the late 1970s, of limiting the availability of Securities Exchange Act Section 10(b) and Rule 10b-5 as bases for plaintiffs to recover financial damages for fraudulent statements and materially misleading omissions. In its 1991 decision in Lampf v. Gilbertson, the Supreme Court effectively shortened the statute of limitations for bringing securities fraud claims under Rule 10b-5 to three years after the date of the fraud or one year after its discovery by the plaintiff. In regard to Enron, fraudulent financial reports dating back to 1997 and most of 1998 would be nonlitigable under this standard.

In 1994, in the case of Central Bank v. First Interstate Bank, the Supreme Court held that Rule 10b-5 cannot be used as a basis for federal suits alleging "secondary" liability for securities fraud—including, most relevantly, claims against corporate auditors for "aiding and abetting" the promulgation of fraudulent corporate reports. Thus, if Enron investors who have suffered financial losses intend to use Rule 10b-5 as a basis for recovering damages against Enron's auditors on account of their faulty auditing, they will have to demonstrate that the auditors were primary participants in the company's promulgation of fraudulent financial reports. Provocatively, the distinction between primary and secondary (aiding and abetting) liability, and thus the viability of Rule 10b-5 claims against Enron's auditors, is presently unclear. It is possible that Andersen's auditors could be adjudged primary participants in any Enron frauds that are proven as these claims make their way through the federal courts. In addition, the controversy surrounding Andersen's

and stock market remained strong, talk of increased penalties for fraud, widespread "earnings management," and lax accounting and disclosure oversight was unpopular and regarded generally as alarmist.

109. See Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (holding that deception, not merely coercion or unfairness, is required to proceed with a claim under Section 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (holding that scienter is required for claims under Section 10(b)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (holding that only purchasers and sellers of securities have standing to sue under Section 10(b) of the Securities Exchange Act).


111. This is a notable prospective change enacted by Sarbanes-Oxley. The Act mandates that the statute of limitations in federal securities lawsuits will be two years after the fraud's discovery for five years after the fraud, at a maximum. See Sarbanes-Oxley Act of 2002, H.R. 3763, § 804, 107th Cong. (2002).

112. Central Bank, 511 U.S. at 164.
failed auditing of Enron might provide the impetus for Congress to exercise its authority to reverse the effect of Central Bank.

But congressional activism has run in the opposite direction in recent, pre-Enron years. The "antiliability" orientation evident in the Supreme Court decisions described above was accelerated in 1995 by Congress's enactment (over the veto of then-President Clinton) of the Private Securities Litigation Reform Act (PSLRA).113 As part of its procedural innovations intended to curb "vexatious" fraud suits, the PSLRA raised the standard for pleading fraud in federal securities law cases.114 Many courts and commentators also found it significant that in the PSLRA Congress failed to codify that recklessness satisfies the scienter standard where scienter is required under federal securities law (as is the case for actions brought under Rule 10b-5).115 These changes and standards are proving helpful to defendants in federal courts' rulings on motions to dismiss, and may affect Enron-related litigation in requiring that plaintiffs prove that the Enron defendants acted with deliberate intent to defraud the company's investors.

The PSLRA also provides that discovery proceedings may be stayed (i.e., halted) prior to the resolution of any defendants' motions to dismiss the plaintiffs' complaints.116 In practice, the staying of discovery in such a context, where the plaintiffs must plead their claim with particularity, has frequently proven terminal to the plaintiffs' claims, as it preserves the status quo of asymmetric information in favor of the corporate defendants.

In addition, the PSLRA also eliminated joint and several liability on the part of corporate defendants in cases where deliberate intent to deceive investors is not proven.117 Thus, even if recklessness is determined to provide an adequate basis for recovery under Rule 10b-

113. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in sections of 15 U.S.C.). In addition, while Sarbanes-Oxley provides for new criminal offenses and heightens penalties where fraud is proven, other than extending the statute of limitations in securities fraud suits, it does nothing to make these claims easier to bring or plaintiffs more likely to prevail. H.R. 3763, §§ 802, 804, 906.
115. The confusion surrounding the PSLRA's effect on Section 10(b) and Rule 10-5's scienter requirement "spilled over" into the legislative history of the Securities Litigation Uniform Standards Act of 1998 (SLUSA). In testimony that was consciously made part of the SLUSA's legislative history, certain members of Congress attempted, retroactively, to validate that even after the PSLRA, "recklessness" remained sufficient to establish scienter in Rule 10b-5 litigation. The actual text of the SLUSA is silent on this point and the effect of the SLUSA's legislative history on clarifying the meaning of "recklessness" and validating that it satisfies the scienter requirement has proved inconclusive.
5, and even if Enron's auditors are determined to be primary, culpable participants in Enron's securities fraud (so as to avoid the effects of *Central Bank*), consistent with the PSLRA, Arthur Andersen's auditors cannot be held responsible for the full extent of the Enron plaintiffs' losses unless they are proven to have acted with the *intent* of deceiving Enron's investors. Because auditors are frequently the "deep pockets" in suits alleging fraudulent financial reporting (because the exposure of substantial accounting fraud on a company's part will often force it into bankruptcy, as was true in Enron's and also WorldCom's case), the PSLRA's limitation on joint and several liability was a highly significant development in limiting auditors' financial exposure for damages in securities fraud cases.

Congress subsequently reaffirmed the principal objectives of the PSLRA (reducing "unmeritorious" and "vexatious" fraud suits against American corporations), and solidified its effects by enacting the Securities Litigation Uniform Standards Act (SLUSA) in 1998. In enacting SLUSA, with limited exceptions, Congress barred private plaintiffs from proceeding with class actions under state law where fraud is alleged in relation to securities transactions involving nationally traded securities (such as Enron's common stock). Congress's reconsideration of the appropriate scope and locus of class action litigation against corporations remains ongoing, and the momentum continues to be in favor of using preemption to consolidate class action suits in the federal courts, where stringent pleading, scienter, and other pro-defendant procedural and substantive standards can be made binding and uniform—consistent with the result in the PSLRA and SLUSA.120


120. On March 13, 2002, the House of Representatives passed H.R. 2341, the so-called "Class Action Fairness Act," by a vote of 233 to 190 (a dozen Democrats supported the bill). Interestingly, the debate on H.R. 2341 appeared on C-Span intermittently with the hearings on Enron's collapse. In contrast, the Senate's version of the bill (S. 1712) was stalled in the Judiciary Committee as late as August 2002. The current perception of widespread unethical corporate conduct (which had sharper teeth in August than in March, when the House voted) would make passage of the "Class Action Fairness Act" unpopular, if not politically unfeasible. The House bill expands federal diversity jurisdiction in multistate class actions where the aggregate amount in controversy exceeds $2 million. If passed by the Senate, the legislation is expected to result in a substantial movement of mass class action tort cases to the federal courts (notwithstanding the longstanding concern about the federal courts' excessive caseload)—a move that would facilitate further regulation of these cases by
As the federal securities laws have grown increasingly significant for and also unfriendly to investors seeking recoveries for losses arising from fraudulent misstatements and omissions, state courts interpreting (state) corporate fiduciary law have also continued to resist imposing monetary liability on directors in both failure to monitor and "fiduciary misrepresentation" cases. In regard to the former, in 1996, in an important Delaware decision approving the settlement of a derivative suit, Chancellor William Allen stressed that while corporate boards bear primary responsibility for overseeing the implementation, maintenance, and effective operation of their firms' information gathering and reporting systems, "only a sustained or systematic failure... an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to [board] liability."

Thus, if Oregon's state courts follow Delaware's approach, it is highly unlikely that Enron's directors would be held financially accountable for the damages suffered by Enron shareholders as a result of the directors' failure to oversee adequate systems of information gathering, internal control, and legal compliance. This is true because inaction, in the absence of director self-dealing, has never been regarded as being an indicia of bad faith. The interesting question facing Enron's directors is, therefore, whether their failure to perceive or publicize (or implement systems that would reliably publicize) adverse corporate

the federal government. This class action "reform" legislation, unsurprisingly, has been supported by major corporations and industrial lobbying groups. Its supporters describe the proposed legislation as a vital, efficiency-enhancing response to plaintiffs' forum shopping and, more generally, a tort system run amok. Consumer advocates and organizations such as the National Conference of State Legislatures have, alternatively, denounced the legislation as reflecting unwarranted skepticism about the competence and bona fides of state court judges and inadequate respect for plaintiffs' rights to present their case in a convenient forum. In April 2002, the American Bar Association established a special task force (headed by law professor and former Tulane Law School dean Edward F. Sherman) to consider the merits of the legislation. For an overview of the broad range of mass civil tort actions that would be federalized by the legislation, see Ruth Gastel, The Liability System, INS. ISSUES UPDATE, June 2002 (available on Lexis). Although facially procedural in nature, this legislation, like the PSLRA and SLUSA, has a clear, substantive purpose—to limit "vexatious class action lawsuits" and reduce financial recoveries against American corporations (at the expense, potentially of consumers and other persons injured in their interactions with corporations). Of course, Congress's actions in enacting the PSLRA and SLUSA look vastly different in the post-Enron era, and the rush to promote corporate cost savings over consumers' rights may have stalled for a time.


information will be deemed to be a "bad faith" product of their personal interest in maintaining the company's stock price on account of their options. The outcome of such a dispute might very well rest on who is deemed to have the burden of proof, which will in turn depend on whether the court reviews Enron's board's oversight and disclosure conduct through the lens of the duty of care or the duty of loyalty. Furthermore, as described above, even if Oregon's courts were more willing than Delaware's to impose financial liability on Enron's directors for their oversight and disclosure failures, the existence of Enron's charter exculpatory clause will protect Enron's directors from having to pay financial damages so long as neither bad faith nor the receipt of illicit, private financial benefits is proven in connection therewith.

In defending such a lax approach to the enforcement of fiduciary standards, commentators have argued that the force of reputation, in lieu of law, would lead boards to adopt and observe "best practices," consistent with judicially articulated standards of conduct. Influential professors of corporation law have defended social norms as adequately, even optimally, functioning to discipline directors, at least outside of what were thought to be the very rare cases of egregious financial conflicts of interest. The lack of diligence exhibited by Enron's directors may make corporate legal academics more skeptical of the notion that directors are sufficiently mindful of their reputations so as to rise to the challenge of meaningful corporate governance. In addition, as mentioned previously, prior to Enron's collapse, insufficient attention had been focused on the fact that granting directors and officers substantial stock options has encouraged them to "look the other way," or worse, even to hinder the publicization of accurate information when signs of negative corporate

123. See, e.g., Melvin A. Eisenberg, Corporate Law and Social Norms, 99 COLUM. L. REV. 1253, 1291 (1999). For an argument about the salutary effect of social norms on corporations and corporate participants, see Edward B. Rock & Michael L. Wachter, Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation, 149 U. PA. L. REV. 1619 (2001); see also Symposium, Norms and Corporate Law, 149 U. PA. L. REV. 1607 (2001). Rock and Wachter's article, and the social norms critique within academic corporate law more generally, has been used as a rationale and justification for reduced legal enforcement—a position consistent with the 1990s enthusiasm for deregulation. Nevertheless, as of the summer of 2002, the political climate had turned radically in favor of stronger regulatory and even criminal sanctions. See, e.g., Sarbanes-Oxley Act of 2002, H.R. 3763, § 906, 107th Cong. (2002). It will be interesting to see whether the "self-regulating" corporation remains credible within academic corporate law in the post-Enron, post-WorldCom environment. In this more critical vein, see Bratton, supra note 57.

124. Rock & Wachter, supra note 123.
performance or deteriorated prospects have surfaced. In the face of widespread granting of substantial stock options to corporate directors and officers, judicial laissez faire is a dicey proposition.

Shareholder plaintiffs also face substantial impediments in using *fiduciary* law as a basis for fraud claims against corporate directors and officers. Most pertinent is the case of *Malone v. Brinca*, a promising but problematic decision in which the Delaware Supreme Court, in December 1998, overturned the Chancery Court’s grant of the director defendants’ motion to dismiss the shareholders’ complaint (with prejudice).\(^\text{125}\) Outrageously, the Chancery Court had held that even directors’ knowing, deliberate participation in promulgating false statements in SEC filings and other public disclosures would fail to constitute a breach of such directors’ fiduciary duties and corporate governance obligations.\(^\text{126}\) In overturning the lower court’s ruling, the Supreme Court took a strong, principled position—affirming that directors’ and officers’ participation in the publication of materially fraudulent statements, whether they are published directly to shareholders or to the capital market in general (which includes the company’s shareholders) is fundamentally incompatible with the directors’ basic fiduciary obligations. Thus, in *Malone*, the Supreme Court stated that *honesty*, including honesty in the publication of corporate information relevant to shareholders and the capital market in general, is a *sine qua non* of directors’ fulfillment of their basic fiduciary obligations.\(^\text{127}\)

But the Delaware Supreme Court has stopped short, in *Malone* and elsewhere, of establishing a fiduciary cause of action for alleged fraud by directors or executive officers that can be asserted by shareholders as a class action. The *Malone* Supreme Court appeared to require that any shareholder recovery on a claim of “fiduciary misrepresentation”\(^\text{128}\) would be predicated on a plaintiff proving actual reliance on the allegedly inaccurate statements—a requirement that

125. 722 A.2d 5, 14 (Del. 1998).
128. The terminology is mine. It reflects the fact that only shareholders have standing to bring a “*Malone* cause of action,” as well as the now-accepted view that corporate directors and officers owe their shareholders an affirmative duty of honesty whenever they speak to shareholders (and even to the market in general, as it includes holders of the company’s shares). In addition to requiring that a plaintiff show actual reliance, the Delaware Supreme Court’s decision in *Malone* appears to require that materiality, scienter, causation, and actual damages also need to be proven in order for a plaintiff to obtain a recovery but the precise nature of the proofs required remains uncertain.
precludes state corporate fiduciary suits for fraud (outside of mergers or other corporate level transactions) from going forward as class actions (as opposed to derivative or individual suits). It remains to be seen, however, whether courts in other states, and most intriguingly Oregon’s courts (because, again, Enron is an Oregon corporation), will follow Delaware’s precedent in imposing a requirement of actual reliance on plaintiffs’ use of fiduciary law as a mechanism for recovering financial damages against directors and officers who have perpetrated or tolerated fraudulent disclosure. If this “strict construction” prevails in regard to proving reliance, then Malone-like claims of fiduciary representation will be useful, for the most part, only in consolidated individual actions brought by larger, institutional investors (such as the many pension funds who held Enron’s stock!).

It is also significant in regard to Enron-related litigation that although SLUSA preempted a substantial body of state fraud law, it did not preempt state corporate fiduciary law suits brought by defrauded holders of corporate securities. In these respects, Enron may provide an important test case for the viability of state fiduciary law as a vehicle for shareholder recoveries against directors and officers who have allegedly participated in publishing fraudulent corporate reports. Indeed, state “fiduciary misrepresentation” claims brought by defrauded holders of Enron stock may be of particular, strategic legal significance. Consistent with the Supreme Court’s decision in Blue Chip Stamps v. Manor Drug Stores, holders of corporate equity securities (including many holders of now nearly worthless Enron common stock), as “nonpurchasers” and “nonsellers,” lack standing to bring claims under Section 10(b) and Rule 10b-5. If Enron’s many institutional investors organize themselves to bring consolidated individual state law fiduciary actions against Enron’s directors and officers alleging their lack of good faith participation in effectuating accurate disclosure, they will be litigating at the cutting edge of corporate fiduciary law.

One of the stumbling blocks facing the plaintiffs in Malone was the difficulty of calculating the appropriate measure of damages in

129. This requirement of proving actual, individual reliance is not stated expressly in the Supreme Court’s opinion, but rather suggested indirectly at the conclusion of the opinion through the court’s reference to its decision in Gaffin v. Teledyne, Inc. See Malone, 722 A.2d at 14.

instances where holders had failed to sell, allegedly, on account of the corporation's withholding of negative information.\textsuperscript{131} In responding to this challenge, state courts hearing fiduciary misrepresentation claims against directors and officers should use the disgorgement remedy invoked by the SEC in civil enforcement proceedings as a point of departure. In situations where fraudulent conduct is proven, the SEC can force the culpable parties, including corporate directors or officers, to disgorge their illicit gains, and the Commission has authority to make such recoveries available as a fund for injured parties.\textsuperscript{132}

Analogously, state courts hearing claims for fiduciary misrepresentation, at least where directors' and/or officers' deliberate fraud or reckless indifference to the publication of untruths has been proven, should require such officials to disgorge the full amount of the base and incentive compensation they received during the pendency of the frauds.\textsuperscript{133} Additionally, consistent with federal securities law standards, neither indemnification nor insurance should be available to the defendant directors and officers for damages payable on account of

\footnotesize{131. The Delaware Supreme Court in \textit{Malone} did not expressly address the nettlesome issue of how to compute damages vis-à-vis holders' claims; rather, it merely allowed the plaintiff the right to replead so as to claim either direct, actual damages to himself as a shareholder or damages to the corporation arising from the fraud through a derivative action. The quandary of computing the proper measure of damages vis-à-vis holders' claims was confronted head on by the justices sitting en banc in oral argument, and was a source of considerable consternation for them and the litigants. \textit{See} Transcript of the Rehearing en Banc, Supreme Court of Delaware, Malone v. Brincat (Apr. 16, 1998) (No. 459, 1997) ("And analogizing to torts, as Justice Holland has done, I assume your clients are going to say: But for these false disclosures, I would have sold my stock, retained my stock, purchased more stock? What? Where does this lead in terms of damages?"). In point of fact, the problem of ascertaining and awarding an "appropriate" amount and form of financial damages against corporate insiders in suits alleging fraud, apart from the most straightforward of self-dealing cases, has always been a deeply intransigent problem for the courts, both in corporate fiduciary and securities fraud cases. This conceptual difficulty has frequently provided an incentive for courts to rule against liability.

132. The SEC has authority under the Securities Exchange Act § 21(d)(3)(B) to impose penalties up to the full amount of the pecuniary gain realized by a defendant as a result of his or her violation of law. Under § 21(d)(3)(C)(i), such monies are ordinarily payable to the United States Treasury. In addition, Sarbanes-Oxley includes important new forfeiture provisions for CEOs and CFOs. \textit{See} Sarbanes-Oxley Act of 2002, H.R. 3763, § 304, 107th Cong. (2002).

133. Disgorgement provides a less draconian remedy than holding insiders financially liable for the full extent of the financial damages suffered by shareholder plaintiff, and is faithful to the bedrock principles of fiduciary law. \textit{See generally} Brudney, \textit{supra} note 27. In addition, disgorgement does not raise the kind of potentially constitutionally significant property-based problems that imposing holding periods on insiders' stock options might. In addition, providing for disgorgement as part of state law civil litigation provides a more credible deterrent than does disgorgement in SEC administrative proceedings, in light of the SEC's significantly limited enforcement resources.
breaches of their fiduciary disclosure duties, at least where recklessness or intent to deceive is proven.

This approach to the calculation of financial damages is consistent with longstanding fiduciary precedent, which holds that fiduciaries may not keep any gains achieved at the expense of their beneficiaries. On this basis, state corporate fiduciary law has required directors and officers who have profited from trading in their companies' securities on the basis of confidential corporate information to disgorge any such illicit gains. 134 In the case of Diamond v. Oreamuno, for example, a New York Court of Appeals required such disgorgement even in the absence of a showing that either the corporation or the plaintiffs were directly harmed by the insiders' trades. 135 The point of the holding was that corporate fiduciaries cannot use their privileged access to corporate information as a basis for garnering profits for themselves. 136 Because a directors' or officers' participation in corporate misrepresentation is a clear abuse of the power attendant to their offices, and thus a breach of fiduciary duty, any directors and officers who are proven to have participated in fraud (either deliberately or recklessly) should not be allowed to retain the base and bonus compensation they received in contemplation of the fulfillment of their duties.

In summary, while both state corporate fiduciary law and the federal securities laws and regulations have supported the notion that directors are responsible for overseeing the accuracy and integrity of their firms' disclosures, and also overseeing the systems of information gathering and reporting that furnish the basis for accurate disclosure, both bodies of law have been extremely reluctant to give force to these duties by imposing personal liability on corporate directors and officers. 137 As the legal developments described above

136. Id.
137. The distinction between articulated, essentially hortatory (and potentially toothless) standards of "conduct" and standards of "liability," (i.e., those upon which determinations regarding financial damages are based) is a salient one within corporate fiduciary law in the disclosure/information gathering area. See, e.g., Malone v. Brincat, 722 A.2d 5 (Del. 1998); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del Ch. 1996). In the securities law area, the gap between the SEC's expressed disappointment with directors' conduct vis-à-vis disclosure and the situations in which the SEC has imposed financial damages on individuals in relation to faulty disclosure is evident, for example, in Report of Investigation Pursuant to Section 21(A) of the Securities Exchange Act of 1934 Concerning the Conduct of Certain Former Officers and Directors of W.R. Grace & Co., Release No. 39,157, 65 SEC Docket 1240 (Sept. 30, 1997); In re Caterpillar Inc., Exchange
have individually and in the aggregate reduced the likelihood that companies and their executives will be liable for financial damages in civil fraud suits, they are likely to have contributed to the sense of “invincibility” that reportedly circulated among Enron’s corporate leaders, and, potentially, more generally, to other corporations’ and corporate actors’ willingness to view compliance with the prevailing accounting standards as optional, or from a short-term wealth maximization perspective, even sub-optimal.

Act Release No. 30532, 6 Fed. Sec. L. Rep. (CCH) ¶ 73,830 (Mar. 31, 1992). In addition, as is widely recognized, the SEC’s enforcement program has been hampered by an austerity budget and severe understaffing. For the federal courts’ reluctance to impose greater liability for disclosure shortfalls, see, for example, Virginia Bankshares, Inc. v. Sandburg, 501 U.S. 1083 (1991).

138. Many Enron employees have now publicly described the sense of limitless power and arrogance that pervaded Enron’s corporate culture. This corporate narcissism was fueled by Enron’s tremendous political clout, financed by immense lobbying and campaign finance expenditures. Enron executives had a similarly high-profile presence in the elite nonprofit world, where the company spent millions and “hung its name on skyscrapers and sports stadiums.” As mentioned previously, Enron’s collapse “left a dent of about $10 million in the 2002 budgets of local nonprofit institutions.” Morrice, supra note 39, at A23; Neela Banerjee, At Enron, Lavish Excess Often Came Before Success, N.Y. Times, Feb. 26, 2002, at C1 (“The company had set aside $1.5 million for a Christmas party at Enron Field, Houston’s sparkling new sports stadium, hoping to match the sumptuous gatherings of earlier years. Only in mid-November 2001, when a ruined Enron was heading for bankruptcy and trying to sell itself... was the celebration finally called off”).

Enron’s Jeffrey Skilling, who resigned as Enron’s president and chief executive on August 14, 2001, exemplified this arrogance in his dealings with Enron employees. When he was called to testify, it was also on display to members of Congress as well, apparently. For popular accounts, see John Schwartz, Darth Vader: Machiavelli. Skilling Set Intense Pace, N.Y. Times, Feb. 7, 2002, at C1. The New York Times reported the recollections of one of Skilling’s colleagues:

I want to get rid of these walls, [Skilling] recalled telling a person he referred to as the ‘building Gestapo.’ He wanted a big open room. ... The ‘building Gestapo,’ he said ‘didn’t get it.’ After a big struggle... he simply ‘hired contractors and had them start ripping the walls out.’ Under Mr. Skilling, the old rules no longer applied. Literally and figuratively, the walls were coming down.’ ... [Mr. Skilling] exuded an intensity, marching through [Enron’s offices] with his eyes straight ahead, his body language radiating importance and urgency and making clear that few should dare to take a moment of his time.

John Schwartz, As Enron Purged Its Ranks, Dissent Was Swept Away, N.Y. Times, Feb. 4, 2002, at C1; Richard A. Oppel, Jr. & Richard W. Stevenson, An Enron Ex-Chief Uses Defiant Tone at Senate Hearing, N.Y. Times, Feb. 27, 2002, at A1. The recent corporate corruption scandals have featured outsized, hubristic CEO types; in addition to Enron’s, there are Adelphia’s Rigases, ImClone’s Samuel Waksal, Tyco International’s Dennis Kozlowski, WorldCom’s Scott Sullivan—characters whose personae and financial maneuverings could not be outdone by Tom Wolfe’s. For an academic treatment of executive narcissism, see Jay A. Conger, The Dark Side of Leadership, ORGANIZATIONAL DYNAMICS, Fall 1990, at 44, 44-55.

139. On July 29, 2002, Qwest Communications followed in the footsteps of its accounting-challenged telecommunications peers (Adelphia, Global Crossing, WorldCom) in
The hearings and investigations into Enron’s collapse, launched by Congress, the SEC, and the Department of Justice in early 2002, were intended to address the financial conflicts of interest, breakdowns in corporate governance, shortcomings in accounting and auditing practice, and shortcomings in the law that facilitated the abusive practices and abusive outlook described above. In the areas of pension benefits, securities law, accounting and auditing practice, and corporate governance, many salutary reforms have been endorsed by members of Congress from both parties, the SEC, and private actors representing the relevant corporate and financial interests themselves. And consideration of reform proposals in these and other areas is ongoing. But Congress’s tempered “inquisition” of Enron, its principals, and their advisers has only partially been about implementing positive legal and regulatory reform.

V. REPRESENTATIONAL DEMOCRACY: THE SYMBOLIC USES OF THE ENRON HEARINGS

The congressional hearings into what transpired at Enron, WorldCom, and other major companies implicated in accounting frauds in the first half of 2002, as well as the multitude of firms that profited from financing, advising, and opining about their affairs, have served as purposeful forms of serious political theater. In particular, the Enron proceedings constituted both a public ritual of mass catharsis and also a right of political penitence on the members’ parts.

announcing “a mere” $1.1 billion of transactions that were wrongly accounted for. Simon Romero, Qwest Announces Accounting Flaws, N.Y. TIMES, July 29, 2002, at A1. Qwest’s practices had already been under investigation by the SEC and the Department of Justice at the time the company made its announcement.

140. In the final days of July 2002, the Senate Permanent Subcommittee on Investigations held hearings into whether Merrill Lynch and other major financial institutions played a substantial role in hiding Enron’s true financial condition. For an account of the scope of the inquiry and the controversy surrounding Merrill Lynch’s dealings with Enron, see Richard A. Oppel, Jr., U.S. Studying Merrill Lynch in Enron Deal, N.Y. TIMES, July 27, 2002, at C1.

141. In addition to Sarbanes-Oxley and the Bipartisan Campaign Finance Reform Act of 2002, also of relevance are (1) the Market Oversight Consolidation and OTC Derivatives Regulation Act, H.R. 4038, 107th Cong. (2002), (2) the Tax Haven and Abusive Tax Shelter Reform Act of 2002, S. 2339, 107th Cong. (2002), (3) New Proposed NASD Rule 2712 and Proposed Amendment of Rule 2710 (relating to the allocation and distribution of stock offerings), and (4) the ongoing efforts to overhaul the federal bankruptcy laws.

142. The analogy to Elizabethan court performances, such as the Masques of Ben Jonson, comes to mind. See BEN JONSON, THE COMPLETE MASQUES (Stephen Orgel ed., 1969). This Part of the Article is inspired by the sociologically oriented political theory of Murray Edelman. See MURRAY JACOB EDELMAN, THE SYMBOLIC USES OF POLITICS (2d ed. 1985); MURRAY J. EDELMAN, CONSTRUCTING THE POLITICAL SPECTACLE (1988).
In addition, at the same time, the hearings gave members of Congress a very public opportunity to attempt to reassert the authority of government and law over seemingly corrupt, lawless corporate firms and capital market participants. Indeed, it was ultimately the rule of law—and the moral, legal, and practical authority of the federal government—that was the protagonist in this drama, as challenged by rogue firms, willful and greedy corporate leaders, and amoral, highly volatile markets. As described previously, in the months after Enron's collapse, a virtual tsunami of corporate financial accounting scandals shattered the stability of the U.S. securities markets and the federal government's ability to focus on diplomatic and military affairs. Enron—and then WorldCom, Merck, Global Crossing, Qwest Communications, and others—edged Al Qaeda, for the time being, out of the *New York Times'* lead column.

The downturn in the stock markets was so severe by mid-summer 2002 that members of both parties in Congress were anxious that both the economy's and their own political survival were in question. As talk of a "double dip" recession mounted, the houses competed to pass the more stringent bills; there was talk of Democrats retaining the House of Representatives. While executives, investment types, and most mainstream corporate legal academics had long touted markets' Promethean powers of "self-correction," it seemed increasingly certain that absent a strong governmental and legal response, the crisis in investor confidence would dictate that that correction would continue for some time to be downward. As a result, on July 30, 2002, tougher criminal penalties for executives found guilty of fraud, more rigorous prohibitions on auditor conflicts of interest, new provisions regarding accounting oversight, audit committee conduct, whistle-blower protections, and requirements for CEO and CFO verification of corporate financial statements were enacted by Congress into federal law. Although he had previously advocated a milder legislative response than what was embodied in the Sarbanes-Oxley Act of 2002, President Bush ultimately endorsed the new federal law without reservation. The financial turmoil, the depth of the nation's anxiety about corporate corruption, and the widespread nature of the losses

143. Sarbanes-Oxley is based primarily on the terms of the Senate reform bill, S. 2763, introduced by Senator Paul Sarbanes, which was then reconciled in conference committee with two House bills. The primary House reform bill, passed in April, was the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 (H.R. 3763), introduced by Representative Michael Oxley. A second, more aggressive House reform bill, the Corporate Fraud Accountability Act of 2002 (H.R. 5118) was introduced by Representative James Sensenbrenner on July 15 and passed the next day.
suffered by employees and investors had persuaded the conservative, Republican President and a heretofore "states rights" friendly Congress, quite remarkably, to enact what most commentators regarded as the toughest federal corporate and financial laws since the era of the Great Depression.

Several new congressional hearings and SEC and Justice Department investigations into various forms of financial fraud and unfair dealing had commenced in the spring and summer of 2002. But the hearings and investigations into Enron continued to garner particularly intense political and popular attention. The Senate Permanent Subcommittee on Investigations inquired into Merrill Lynch's switching the analysts covering Enron—presumably to ensure that Enron would continue to receive highly favorable recommendations, which would, in turn, facilitate Merrill's participation in lucrative Enron-related investment banking deals. In addition, congressional investigators scrutinized Merrill's participation in certain transactions that obfuscated Enron's true financial situation. In fact, the Enron hearings represent a watershed—the last time that informed commentators could wonder out loud whether the problems uncovered were the function of a few "outliers," rather than the product of fundamental shortcomings in law, government, and the prevailing corporate culture.

Beginning in the early spring of 2002, the Enron hearings were aired on C-Span, on some days around the clock, and lengthy transcripts of the hearings were excerpted in the New York Times and other major national newspapers. The numerosity of the hearings and investigations was evidence of their "performative" nature: There was no practical, functional need for having a dozen congressional committees investigating Enron's conduct. Rather, the multitude of overlapping hearings allowed the public to hear from a larger cast of congressional characters. Although it at first seems counterintuitive, the Enron hearings and investigations were preeminently about what members of Congress had to say to the American people, and only secondarily about what Enron executives, auditors, analysts, and bankers had to say to members of Congress.

Again, as described further below, the Enron proceedings functioned at several dramaturgical levels at once: as a ritual of popular fealty, as an enactment of a public catharsis, and as an attempt to reestablish the perception and fact of the authority of law in the area of disclosure regulation and corporate governance.
First, in regard to the issue of fealty, the members were anxious to demonstrate that their judgment and integrity had not fundamentally been compromised by Enron's political expenditures; that is, either the funds Enron spent in lobbying the members or the funds that most of them had received as campaign contributions. In covering the Enron controversy and Congress's response thereto, reporters tallied the campaign contributions made by Enron and Arthur Andersen to members of Congress. It quickly became apparent that these campaign contributions were astonishingly large and widespread.

According to federal election records, and data amassed by Political Money Line and the Center for Responsive Politics,144 Enron had made campaign contributions to three quarters of the members of the Senate and almost half of the members of the House sitting in 2002. (A similar number of members of both houses had also received contributions from Arthur Andersen. Since 1990, the accounting industry, in the aggregate, had contributed more than $5.3 million to congressional and presidential campaigns.) Enron's contributions increased throughout the later 1990s, with an increasing share of the funds going to Republican members of Congress. The total contributions made either directly by Enron employees or through Enron's political action committee (PAC) to federal candidates and parties approximated $1 million in 1996, $1 million again in 1998, and then $2.5 million in 2000. In total, from 1989 onward, Enron is believed to have contributed a total of $5.7 million to both political parties, with Republicans receiving seventy-three percent of such contributions. Of 248 Senators and House members serving on eleven congressional committees investigating Enron in early 2002, 212 had received campaign contributions from Enron or Arthur Andersen. The top twenty Senate recipients of Arthur Andersen's contributions were all serving on at least one Enron-related investigative committee. Senator John McCain stated the issue bluntly in a CBS television interview on Face the Nation. "We are all tainted by the millions and millions of dollars that were contributed [to us] by Enron executives," he said.

The taint of Enron's outsized campaign contributions extended to the President, in fact. No company had given more money than Enron in support of George W. Bush's presidency, and no executive had been more active in funding or supporting Bush's candidacy than Enron's

chairman, Kenneth Lay. From 1993 on, donations to George W. Bush's campaigns made by Kenneth Lay and other Enron executives approximated $700,000 in total. Enron, Kenneth Lay, and Jeffrey Skilling, in addition, each gave $100,000 towards Bush's inaugural festivities, and Lay had served as a campaign "Pioneer," raising $100,000 of donations in excess of his own. In addition, Arthur Andersen's executives and its PAC contributed close to $150,000 towards George W. Bush's election, and the other major public accounting firms contributed only slightly less or more. Enron's lead outside counsel, Vinson & Elkins, and its senior partners were also major financial supporters of Bush's campaigns; three Vinson & Elkins partners were $100,000 "Pioneers" in Bush's 2000 campaign.

As the public watched the members of Congress unraveling the twisted skein of financial conflicts affecting the directors, officers, accountants, lawyers, auditors, bankers, and analysts who had been part of the Enron disaster, they would reasonably have wondered whether the objectivity and judgment of the members of Congress themselves had also been compromised by Enron's money. As they voiced their individual and collective condemnations of the conduct of Enron and its principals, members of Congress sought to distance themselves from the company's principals and advisers. They sought to signal to their constituencies, like actors in a Renaissance court masque, that their own good judgment, objectivity, and fidelity to their constituencies had not been eroded by Enron's cash. It is in this regard that the hearings should be construed as a dramatization of popular fealty. The members of Congress participating therein attempted to broadcast the message that their loyalty remained with the voting public.

Second, again, the hearings and investigations served as a "safe" forum for articulating the collective shock and anger produced by the conduct of Enron's insiders. Especially in the vituperative they launched against Enron's Jeffrey Skilling, Andrew Fastow, Kenneth Lay, and Arthur Andersen's auditors, members of Congress gave voice to the outrage that was felt so widely by Enron investors, employees, and other individuals who were suffering materially, socially, and psychologically on account of Enron's financial collapse.

145. The close affiliation between Kenneth Lay and the sitting President is part of what has brought particular public attention to bear on the hearings, as well as the Justice Department's investigations into the conduct of the company and its executives.

The formal, judgmental tenor of the proceedings and the authoritative personae of those officiating provided both a boundary and safety valve limiting the potentially aggressive, antimarket popular backlash that might otherwise have resulted from Enron's collapse. Thus, at the same time that they attempted to reestablish their identity as the faithful representatives of "the people," the members of Congress offered their own express outrage at Enron's executives as a surrogate, a mouthpiece, a synecdoche for the public's.

Finally, in the broadest sense, in the Enron hearings and the legislation that ensued therefrom, members of Congress recommenced the efforts to assert robust legal controls over markets and firms. The political commitment to deregulation and laissez faire that had predominated in the preceding twenty years had undermined the notion that business, and business executives, were bound by the rule of law. There is perhaps too fine a line between existing apart from or outside of the body of most law and regulations and being "above" them. Again, even the corporate legal academic establishment had assumed a generally "antilaw" posture based on the belief that markets and social norms provided adequate protections for employees, investors, and the public. But the fall of Enron, and the cascade of financial accounting scandals that rapidly ensued, may have undermined this faith in self-sustaining markets and self-governing firms, as they have surely altered the political environment. Congress's condemnation of the conduct of Enron, Arthur Andersen, and their senior executives can thus be regarded as a validation of the notion that capital markets and firms are not only economic, but also socio-legal institutions that must be made to operate within the bounds of law, morality, and communally legitimated values and standards.

VI. MARKETS, THE RULE OF LAW, AND THE COST OF CORPORATE FRAUD

The aftershocks of the collapse of Enron, WorldCom, and the several corporate financial scandals that ensued shortly thereafter and the attacks on the World Trade Center and the Pentagon have provoked controversial questions about the values and structures constituting and legitimating American corporate governance, market capitalism, and the globalization of markets and trade. Are these to be understood as fundamentally amoral, ideologically inert systems in which entrenched positional advantages are played out to the advantage of those who have by history, accident, or scheming become economically (and perhaps, relatedly, politically) empowered?
Congress’s enactment of Sarbanes-Oxley has occasioned some minor confusion and perhaps significant private grousing among those who will be most affected by its requirements and limits. But there has been a notable, indeed remarkable absence of vocal objection to the federal law given the political and legal climate that had prevailed only months previously. Indeed, even in the early spring of 2002, post-Enron but prior to WorldCom’s revelations of fraud, most commentators did not believe that Congress would take the legislative steps that it did, with so much resoluteness, only shortly thereafter. An adequate account of the socio-political and economic forces that propelled Sarbanes-Oxley into law is beyond the scope of this Article, but the cliche of the pendulum having swung too far seems apt.

When the stock market and the economy threatened to “bottom out” in 2002, two crucially important realizations came to the fore. The first was that there had been a devastating underestimation of both the prevalence and potential economic and social costs of corporate fraud. The stock market’s exuberance and resilience through most of the previous two decades had both facilitated and masked shady corporate accounting and disclosure practices and the socio-economic toll they would take on multiple stakeholders and the public. Not only had the costs of widespread director and officer stock option grants not been priced on corporate financial statements; their true, broader costs in terms of their affect on managerial incentives and risk preferences and standards of equity had not adequately been calculated in legislative briefs, regulatory initiatives, or in the academic writings of influential corporate legal scholars.

The fall of Arthur Andersen, Enron, and WorldCom and the distress occasioned by financial scandals at many other American companies illustrate the extraordinary financial costliness of major corporate frauds to all the parties who have invested in these firms. In addition, fear of broader corporate fraud has inflicted financial harm on investors and stakeholders in companies that have not been the object of scandal or investigation, as stock prices have broadly been pressed to astounding lows, market liquidity has been impaired, credit has been more difficult to obtain, and foreign investment in U.S. equities has diminished. In the absence of a meaningful promise of robust legal controls, oversight, and enforcement—legal controls that were significantly erased or eroded in the preceding years—major corporate frauds will flourish and destroy wealth and the capacity to generate it. Positive social norms can only do so much—especially where the law has failed to support their operation in the culture.
Also, in calculating their costs from a more comprehensive perspective, major corporate frauds disrupt the allocative efficiency of markets, and thus the justification for market-based organization. When we say that in an efficient economy capital will flow to its most highly valuing user, to positive social effect, this assumes an honest valuation.

In addition, major corporate frauds increase existing social tensions arising from income and wealth inequality. Over generations, Americans have been extraordinarily adroit at adjusting themselves to inequalities perceived to arise from the "fair" accidents of capitalism, as mentioned previously. Most workers can adjust themselves, psycho-socially, to financial losses they perceive to result from bad luck, their own miscalculations, or their "preference" for leisure—as well as gains accruing to others through good fortune or as a result of such persons' diligence or acumen. But Americans rebel against gains that accrue to insiders as a result of fraud or entrenched positional and informational advantages. This rebellion and disaffection plays itself out in families, offices, neighborhoods, and other social networks where their derivation may not be evident and their causes cannot be addressed.

And, again, there is a feedback loop alternating not only from the economic sphere to the social one, but also back again. Social harms give rise to economic costs; they are drags on a healthy economy. They inhibit productivity, cooperation, communication, and the other positive forms of social interaction that make transacting in firms and markets efficacious.

In regard to the political tensions arising from corporate fraud, the basic tenets of laissez faire—the political-economic ideology dominant since the late 1970s—are subverted where businesses can forestall or escape the rigors of competitive markets through misrepresentation. In a condition of laissez faire, government delegates its authority and responsibility to promote the overall public welfare to the operation of competitive markets. The supremacy of democratic government and the rule of law over individual economic actors and institutions is preserved, notwithstanding such delegation, by virtue of the fact that government's abstention from regulation is precisely targeted, and conditioned on the notion that the operation of free, "private" markets will benefit the overall social welfare. Where fraud and insider overreaching go unchecked in a climate of laissez faire, the political aspiration and commitment to increasing overall social welfare are surrendered. Laissez faire becomes a false justification, a naked
power grab. When corporations and corporate directors and executives commit fraud, therefore, they violate the basic ideological and economic premises that legitimate their having been afforded so much freedom.\textsuperscript{147} Like the weapons wielded by Al Qaeda, greed, corruption, and indifference to one's legal, moral, and professional responsibilities can operate as extraordinary mechanisms of mayhem and social violence.

VII. CONCLUSION: THE PROMISE OF JUSTICE AS FAIRNESS\textsuperscript{148} IN CORPORATE AND CAPITAL MARKET REGULATION

The Al Qaeda terrorists who attacked the United States on September 11th were motivated by atavistic feelings of hatred, nihilism, and religious fundamentalism to cause inexpressible harm to living persons. It seems clear also that they meant to convey a symbolic message about the inequities caused, in their view, by American-style capitalist power and secular government under the rule of law. By virtue of the enormity of the attack, the terrorists intended to spread that message and the devastation that gave birth to it all over New York's financial district, the seat of American government, and the rest of the Western World.

But irrespective of the message the terrorists intended to deliver, the crucial issue is what meaning, communally and individually, strong believers in democracy and American capitalism should take from the fallen towers of trade and the tragically truncated lives of the "soldiers of capitalism" who toiled therein. As we emerge from the dark shadows of September 11th and recommit to free trade, increased globalization, and also more extensive corporate governance and capital market rules and requirements, the attacks should remind us of the values operating within American, democratically-based capitalism, and the systems of governance that facilitate it. This is the second realization that appears to have swept the nation post-Enron and September 11th, judging from the increased expressions of

\textsuperscript{147} For an important application of Niklas Luhmann's writing on legitimation and justification, as these ideas relate to the implementation of values into policy and law in the employment area (and the analytic shortcomings of neoclassical economics as applied in law), see Mark Gould, Law and Sociology: Some Consequences for the Law of Employment Discrimination Deriving from the Sociological Reconstruction of Economic Theory, 13 CARDozo L. REV. 1517 (1992).

patriotism and wide support for corporate governance reform. In times of national crisis, economic or political, faith in the self-correcting market is insufficient. The core values of a nation become essential to rebuilding a strong economy; these are the values of freedom, meritocracy, and equal opportunity that legitimate our patriotism. In performing the autopsy of Enron, WorldCom, and Arthur Andersen, it makes sense to consider what makes a body corporate powerful or weak, moral or corrupt, responsible or exploitative? Relatedly, what can be done through law reform to promote equality and meritocracy within corporate and securities law and elsewhere in economic regulation? These are not questions commonly addressed within academic corporate law, but they are—as American-style economic institutions and legal standards are becoming ever more globally influential—questions that could not be more important or timely.

In unveiling a post-Enron agenda of law reforms intended to promote more accurate corporate reporting, greater accountability among those charged with authoring and overseeing it, and more honest, robust corporate governance, President Bush announced that it was time to get back to "basic capitalism." But the enhanced systems of safeguards, legal controls, and remedies the President proposed, and then enacted into law by signing Sarbanes-Oxley, are not part of basic capitalism. They represent, rather, an enlightened, bounded, democratically legitimated version of market capitalism and corporate governance that can only be achieved through respect for and application of the rule of law.

A crucial salutary byproduct of Enron's financial collapse is and must continue to be a keener, expanded appreciation of the scope and significance of the harms arising from corporate fraud and insider secret profit taking. As discussed above, the harms arising from these acts are both economic and extra-economic, at once social and political and economic in nature. The law's enforcement of promises of transparency, equal opportunity, and other democratic norms in the operation of corporate governance and the capital markets, these are promises that speak to the heart of the true values of American society. While it is too soon to judge whether Sarbanes-Oxley and other recently enacted federal laws and regulations meet the mark, it is clearer what is at stake; and it should remain so.

By the end of January 2002, the following congressional committees had been constituted to pursue matters relating to Enron’s bankruptcy:

1. The Senate Banking Committee—accounting and investor protection issues;
2. Senate Commerce Committee, Subcommittee on Consumer Affairs—consumer fraud questions and whether Enron’s lobbying affected deregulation of energy markets;
3. Senate Energy and Natural Resources Committee—Enron’s effect on energy markets and government oversight vis-à-vis energy trading;
4. Senate Governmental Affairs—conflicts of interest among directors, accountants, and banking firms, and whether federal regulatory agencies should have done more to avert Enron’s failure;
5. Senate Governmental Affairs Subcommittee on Investigations—Internal Enron affairs and the relationship between the executives and the IRS auditors;
6. Senate Health, Education, Labor and Pensions—Enron’s handling of its 401(k) plan;
8. House Energy and Commerce Committee—SEC oversight of Enron and accounting issues involving Arthur Andersen;

In addition, investigations into Enron are ongoing at the SEC (from which its chairman, Harvey Pitt, has recused himself, because of his former professional ties to Arthur Andersen) and by a Special Task Force of the Department of Justice (from which Attorney General John Ashcroft has recused himself, because of his receipt of $50,000 from Enron in his 1996 campaign for a Senate seat).
APPENDIX B: MARKET DATA ILLUSTRATING THE EFFECTS OF SEPTEMBER 11TH AND THE SPRING-SUMMER 2002 FINANCIAL ACCOUNTING SCANDALS

A. Dow Jones Industrial Average

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B. Standard & Poor's (S&P) 500 Index

[Graph showing stock price movements and volume for the period 02/02/01 to 10/18/02]
C. New York Stock Exchange (NYSE) Composite Index
D. **NASDAQ Composite Index**