Consequences of the Enron Bankruptcy

Directly Affected Parties

Officers and Directors: Criminal investigations in process (finance dept executives, top officers), over 50 class action suits filed against officers and directors.

Auditors: Andersen partners under investigation (shredding). Firm is target of numerous class action suits (probably all of the ones aimed at Enron officers and directors). It has $269 million of insurance (recent offer of between $700 and $800 million to settle with plaintiffs was reported to have been rejected) firm thought to be able to pay as much as $1 billion by capital infusions from partners and pledging future earnings of the firm.

On March 1, Andersen announced agreement to pay $217 million to settle lawsuits related to the $600 million bankruptcy of the Baptist Foundation of Arizona. Some part of this settlement is to be by a Bermuda-based insurance company owned by Andersen.

The firm is reminded of a famous case from 1970 (Continental Vending Machine) in which the judge held that compliance with GAAP was not enough (for the auditors to do in pursuit of its duties; if the result “provides a materially misleading impression in the minds of shareholders, the auditors should not certify.”

Paul Volcker is hired to form a panel of unconnected wise men (most, like him, over 70) to advise on reorganization of the firm. Volcker forms a committee that recommends discontinuance of internal consulting (Andersen already ended external consulting by the divestiture of Accenture). In mid February, Andersen reports 16 clients have defected, a number that increased to 26 by March 1 and included Merck & Co. The client defections continue to increase through the end of March.

March 6-13. Andersen seeks merger with Deloitte or other big five auditors. Merger efforts fail because of contingent liabilities attaching to Andersen.

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1 “Andersen Makes Offer to Enron Creditors,” WSJ, 2/21/02
2 Jonathan Weil, “Andersen Settles Suits Tied to Foundation,” WSJ, 3/4/02
3 Floyd Norris, “An Old Case is Returning to Haunt Auditors,” NYT, 3/01/02.
March 14. Andersen indicted by Justice Dept on single count of obstruction of justice. This action is thought to be “extraordinarily swift and severe” by some. Charges may be difficult to prove. Andersen complains that Justice is trying to put the firm out of business by indicting the “enterprise” rather than a few individuals (echoes of the Salomon Brothers affair in 1991, though Richard Breeden, chairman of SEC at the time, said there were many differences in the cases, all favoring SB). Andersen is thought to have misread depths of government’s anger, and not recognized its own pattern of failed audits. Government was highly influenced by Andersen’s history of such audits and by its apparent violation of injunction agreed to in Waste Management case, settled in 2000.

Creditors: Approx. $50 billion in debt outstanding (on and off b/s) at bankruptcy. Debt is secured, senior and subordinated. Aggregate recovery estimated at 30-50% (losses of $15-25 billion expected)

Equity investors: From date before restatement of earnings, approximately $40 billion of market value has been lost.

Insurers: D&O insurance ($350 million) has been contested by insurers; $1 billion of surety bonds unpaid because insurers claim to be been defrauded or mislead.

Pension Funds: Defined benefit plans may be under-funded to the extent of “at least $125 million” and covered by US pension insurance funds. Approx. $2 billion of defined contribution funds (401ks) had approx. 70% invested in Enron stock, so have lost $1.4 billion. [will this be a cost to the taxpayer?]

Stock analysts: “10 of 15 analysts who followed Enron were still rating the stock as a “buy” as late as Nov. 8th, weeks after SEC announced an inquiry into the company’s financial statements.” Consequences to brokers included reputation loss to their firms, and to individual analysts, and reduction in economic value added of expensive research operations at

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4 Milo Geyelin, “US Has Much to Prove in Andersen Case,” WSJ, 3/18/02
5 Kurt Eichenwald, Andersen misread depths..., “NYT, 3/18/02.
7 Kathy Chen, “Govt Pension Gty Insures Enron Plan that is Underfunder,” WSJ 2/28/02, p.A4
major investment banks. Several firms are now “reorganizing” their research efforts.

Indirectly Affected Parties

Congress:     Investigations underway at 3-5 in house and senate
SEC:         Investigating; reviewing accounting and disclosure rules
FASB:        Criticized for failure to act promptly on controversial accounting issues, contributing to confusion over vagueness of GAAP.

IASC (International Accounting Standards Committee) Claims GAAP is not a reliable a base for accounting disclosures as is IAS which give precedence to “substance over form.”

The public: As investors: confidence may be affected, perhaps temporarily, but most families are not affected.

Institutional investors: Most losses incurred by institutional investors (--% of Enron’s stockholdings at 6/30/01) and institutional creditors. These players will “punish” those upon whom they relied by denying future business or in other ways.

The capitalist system: Excesses brought about the problem, complacency and gullibility after twenty years of record wealth creator prevented detection, but in the end the “market” had affected its punishments to those responsible in approximate proportion to the level of responsibility.