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REVIEW & OUTLOOK

Enron's Getaway Drivers

Enron's bankers agreed yesterday to cough up some \$300 million and change their ways, as penance for their role in helping the bankrupt energy company manipulate its financial statements. The settlement shows that there's much more to honest business ethics, or at least there should be, than the strict letter of accounting rules.

In documents revealed as part of the settlements, both the SEC and Manhattan District Attorney Robert Morgenthau show that J.P. Morgan Chase and Citigroup knowingly helped Enron disguise the full amount of its debt. They did so via elaborate financial transactions known as "structured financings," which "were really disguised loans," as Mr. Morgenthau put it.

Heretofore, Morgan Chase had been especially aggressive in claiming that it did nothing wrong. But the SEC and Morgenthau descriptions of Morgan's behavior clearly show that the bankers knew precisely what they were doing. As one Morgan executive noted in a 1998 e-mail: "Enron loves these deals as they are able to hide funded debt from their equity analysts because they (at the very least) book it as deferred rev[enue] or (better yet) bury it in their trading liabilities."

Even "in late 2001, on the eve of Enron's bankruptcy," Mr. Morgenthau continues, "one Chase executive explained to another, during a tape-recorded conversation, that Enron had used the prepaids because they did not 'appear as debt' on its balance sheet." He concludes that "Chase and Citibank knowingly structured the prepaid transactions with Enron in a way that allowed Enron to engage in fraudulent accounting and to make its financial statements less transparent."

On this evidence, the banks should consider themselves fortunate to have avoided criminal sanctions. One reason is because the law distinguishes between knowledge and intent. While the banks knew they were helping Enron cloak its books, it's more difficult to prove that they intended to commit fraud. The banks are also huge companies, with cross-cutting responsibilities, in which it is difficult to prove individual culpability beyond a reasonable doubt.

The settlement is probably therefore in the best interests of the public, assuming of course that the banks learn from the experience. On this score, Citigroup is proving to be the better citizen. The company has admitted that what it did was wrong, and even before this settlement had decided to implement internal changes to guard against hear-no-evil, see-no-evil lending. Sandy Weill's recently announced decision to retire as CEO also removes the issue of responsibility at the top.

The same can't be said about Morgan, which issued a statement yesterday that insisted it "neither admitted nor denied the SEC's allegations." So the bank's official position is that it did nothing wrong but swears not to do it again. This is hardly reassuring about the bank's sense of responsibility, especially because the settlement depends on the bank's willingness to consider its lending decisions in the light of more than the letter of the law.

If lenders know that, say, Enron's Andy Fastow is playing a game of hide the liabilities, then they have an obligation not to shut their eyes and say there's-no-one-here-but-us-bankers. It's no defense for the getaway driver to say he didn't know what those guys with the masks were doing at the teller window. Morgan's board of directors and shareholders might ask themselves what kind of message CEO William Harrison has sent to his troops with his handling of this entire Enron mess.

By the way, the Federal Reserve announced its own settlement with the two banks yesterday, but its officials declined to attend the SEC/Morgenthau press conference. We can understand if the Fed is embarrassed that its bank inspectors missed the damage done by the Enron "loans." But we hope its absence doesn't betray any lack of enthusiasm for making sure the banks live up to their end of the settlement.

The Enron collapse was a huge business and political event that undermined trust in markets. The first step to restoring that trust is getting those responsible to admit their mistakes.

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