USA TODAY
January 30, 2006 Monday
SECTION: MONEY; Pg. 4B

HEADLINE: Enron's legacy: Scandal marked turning point for business world; Impact felt in energy trading, lawsuits, corporate governance and regulations

BYLINE: Edward Iwata

As Enron's former top executives face criminal trial in Houston today, the legacy of Enron -- the most sensational corporate fraud scandal in recent history -- still ripples through the business world.

The company remains a symbol of corporate greed and hubris and one of the costliest U.S. bankruptcy reorganizations ever. Enron and other scandals spurred an unprecedented crackdown on corporate crime by prosecutors and regulators, who have nailed hundreds of defendants with fraud and other charges and hundreds of millions of dollars in penalties.

The scandals compelled Congress in 2002 to pass the Sarbanes-Oxley Act, the most sweeping anti-fraud legislation ever, and companies are paying auditors and attorneys billions of dollars in fees to keep pace with the new rules.

Among other key changes in corporate governance, company boards must disclose their auditing controls and hire more directors with auditing expertise.

The scandals shook investors' confidence and made it harder for companies to raise capital, says accounting professor Burch Kealey at the University of Nebraska-Omaha. Publicly traded companies lost $7 trillion in stock market value from 2000 through 2002 -- much of it because of the corporate scandals and the Sept. 11 attacks, say analysts, economists and scholars.

"Enron was a watershed event" that questioned "the integrity of the market and the accuracy of financial information," says Cynthia Richson, corporate governance officer at the Ohio Public Employees Retirement System pension fund, which lost $300 million from the corporate scandals.

Moreover, Enron is the biggest Chapter 11 bankruptcy in U.S. history in court-awarded fees, racking up $780 million, says UCLA law professor Lynn LoPucki. If professional fees and services not awarded by the court are added, the total surpasses $1 billion, he says.

The trial of former Enron chairman Ken Lay and former CEO Jeff Skilling will bring to a climax much of the Enron saga. They go to trial today for their alleged roles in the massive fraud that became public in 2001.

But even after the trial, Enron's impact will be felt in:

*Lawsuits. A shareholders' class-action lawsuit against Enron, 10 Wall Street investment banks and law firm Vinson & Elkins continues to wind through court.

Investors suffered $50 billion in total losses, says shareholders' attorney Bill Lerach, but securities laws allow them to collect only a portion of that. So far, lead plaintiff University of California and other investors have settled for $7.1 billion with Citigroup, JPMorgan Chase and CIBC.

"Not much that came out of Enron was hopeful," Lerach says. "But at least when these frauds occur, we're able to remedy them."

Meanwhile, 20,000 former employees and retirees in Enron's pension and 401(k) retirement plans that held Enron stock suffered $1 billion in losses, says Britt Tinglum, their Seattle attorney.

The former employees have agreed to four settlements totaling $482 million with Arthur Andersen and Enron.

The only remaining defendants are Lay, Skilling and Northern Trust, trustee of Enron's 401(k) retirement plan. A trial is set for October in Houston.

"There was an incredible breach of trust that's going to take some time to heal," Tinglum says.

*The regulatory and corporate-governance arena. Public outrage over Enron forced Congress to pass Sarbanes-Oxley, the biggest changes in securities law since the Great Depression of the 1930s, when the Securities and Exchange Commission was created.

Known as "Sarbox," Sarbanes-Oxley requires executives to certify their company finances, set up audits of internal accounting controls and disclose those controls to the SEC. Sarbanes-Oxley also created the Public Company Accounting Oversight Board, which oversees audit practices.

Stock exchanges have adopted tougher listing requirements for companies. The New York Stock Exchange and Nasdaq, for instance, now require that a majority of directors be independent.

Thousands of companies also have adopted tougher governance policies, such as adding independent directors who are less likely to ignore wrongdoing by corporate officers.

According to the National Association of Corporate Directors, companies with a majority of independent directors on their boards grew to 89% in 2005 from 61% in 2001.

"There's been a sea change in our focus on corporate ethics," says Steve Odland, Office Depot CEO and former corporate-governance chair of the Business Roundtable industry group. "We've made more progress in the last three years than the previous 30."

Large investors -- the public, corporate and union pension funds that invest trillions of dollars in retirement assets -- also have stepped up their watchdog duties.

Shareholders' advocates argue that governance rules still are too weak, and executives remain tempted to engage in questionable accounting to meet Wall Street's earnings forecasts.

Last year, for example, former SEC chairman William Donaldson failed to win enough votes from SEC commissioners on a rule that would have given shareholders more influence in directors' elections. Nor did stiffer laws stop last fall's scandal at commodities broker Refco, where former CEO Phillip Bennett has been charged with accounting fraud.

By one measure, though, the new rules appear to be working. In 2005, shareholders' lawsuits alleging accounting fraud fell 17% to 176 filings from 213 the year before, according to Stanford University law professor Joseph Grundfest and Cornerstone Research.

Some corporate boards also seem to be more alert to potential wrongdoing. During a large financial scandal last year at American International Group, directors for the insurance firm tossed longtime chairman Maurice Greenberg.

The scandals "raised the floor for what is expected of companies and boards in their governance performance," says Ann Yerger, head of the Council of Institutional Investors, which represents 140 pension funds with $3 trillion in assets.

*The corporate world. U.S. companies have shelled out hundreds of millions of dollars to comply with post-Enron rules, which some executives have slammed as an overreaction to the scandals.

In a survey of 648 large U.S. companies, accounting professors Kealey and Susan Eldridge at the University of Nebraska-Omaha found that the corporations spent an average of $2.3 million more on audit fees in 2004 than in 2003.

Businesses fear that costs of the anti-fraud rules will especially hurt small and midsize firms.

"The money helps to restore trust and faith in our system," Odland says. "But we don't want the pendulum to swing too far and stifle innovation."

*The energy-trading business. In the late 1990s, Enron and other energy traders were hailed as the high-tech future of the power industry. But after Enron collapsed, dozens of industry traders were charged with fraud, firms shed their trading units and the industry saw $90 billion in debt reduced to "junk" status.

In California, Enron traders were accused of worsening the state's power crisis in 2000 and 2001, when the state suffered blackouts and leaps in energy prices.

The Federal Energy Regulatory Commission recently issued rules that ban manipulation of the wholesale gas and electricity market. FERC also oversaw $6.3 billion in settlements between California, Enron and other energy firms accused of market manipulation.

Some think that's not enough, arguing that FERC rules and state laws must be stronger to stamp out fraudulent energy trading.

"People are more circumspect because of the criminal convictions, but we've had very few substantive reforms," says Robert McCullough of energy consulting firm McCullough Research.

Beyond the fraud, others praise Enron for revolutionizing the online and electronic trading of fuel contracts. The trading helps the power industry hedge financial risks and stabilize future fuel supplies.

"A lot of practices that flowed out of that company benefit the energy sector and the general economy," says Michelle Michot Foss, chief energy economist at the University of Texas at Austin.

In the end, Enron's legacy likely will be judged by the toughest question to assess: whether the stronger rules will wipe out wrongdoing in the corporate landscape.

The new rules "make future Enrons a little less likely to occur," says Charles Elson, a corporate-governance expert at the University of Delaware. "Sometimes it takes a disaster to create reform."

Reform only goes so far, though.

Says attorney Lerach: "If everybody was pure of heart, we'd be all right. But you're always going to have fraud in the markets."

LOAD-DATE: January 30, 2006