CHAPTER 1

Fraud's Feeding Frenzy

EXECUTIVE SUMMARY

In the first decade of this century, the ongoing "feeding frenzy" of corporate fraud proves that we fail to learn from history. Respected and trusted corporate executives have been revealed to be morally corrupt fraudsters. They became rogue employees: too busy stealing from the corporate "piggy bank" to think of the consequences for their employees, shareholders, customers, or themselves. Corporate powerhouses such as Enron and WorldCom and their executives were swept up in fraudulent financial accounting and a multitude of other frauds. The government reacted strongly in response to the public outcry after billions of dollars in investments evaporated. The President promoted the need for corporate responsibility and promised to arrest any corporate executive with a hand in the corporate coffers. Some indicted CEOs tried to use the "Chutzpah Defense," claiming they were deaf, dumb, and blind when the frauds were going on at their companies. The outcome has been indictments, followed by "perp walks" as well as convictions, and a change in how the government views corporate fraud prevention. Yet, fraud still rears its ugly head.

FRAUD'S FEEDING FRENZY STILL GOING STRONG

In the late 1980s, a federal agent investigated a $95 million swindle in New York City involving mail fraud, bank fraud, money laundering, and a host of other crimes. He and his team made arrest after arrest of the many fraudsters involved in this massive scheme. After the arrest of yet another major player in the fraud, this federal agent commented on the defendants' criminal behavior. He likened it to hungry sharks feeding on their helpless prey and called it a "feeding frenzy of fraud." Through the years, the expression has often been used to describe various fraud schemes that made the headlines. This snappy, off-the-cuff description of fraud and the people who commit it tells volumes about the damaging effect it can have. Like unrelenting sharks constantly searching for their next meals, fraudsters never stop their search for new opportunities to commit fraud and economic crime.

Fraud has always been a thorn in the side of honest citizens and businesses. The enactment of strong laws and the empowerment of enforcement agents are helpful but certainly do not guarantee an end to fraud, a crime of opportunity that has been with us through the ages. Uninformed people who think that the corporate wrongdoings in recent years comprised the first such instances of large-scale fraud have much to learn. "Thus, all through the country, thousands of innocent and unsophisticated people, knowing nothing about the ways of these city thieves and robbers, are continuously fleeced and robbed."[1] Does this sound like a description of the many victims of Enron, WorldCom, and other corporate frauds? It was said by a congressional sponsor of the United States Mail Fraud Statute[2] well over a century ago. The Mail Fraud Statute, the nation's oldest and premier fraud-fighting mandate, was enacted in 1872 after an epidemic of consumer mail-order frauds. Today, consumer frauds of all types are still prosecuted with the Mail Fraud Statute, as are many corporate frauds, large and small. The Mail Fraud Statute is a weapon of choice in prosecuting fraud because it covers any scheme or artifice to defraud as long as the mails are used in some way to further the crime. If e-mail, social media or other electronic communications are used to perpetuate the scam, the Wire Fraud Statute is available.

WHAT A DIFFERENCE A FEW YEARS MAKE

Fraud has had a tremendous impact on the corporate landscape of the early 21st century. Enron, WorldCom, Tyco, Adelphia, HealthSouth, and other companies dominated the headlines with allegations of accounting and other financial crimes. Chief executives were convicted after high-profile trials and sent to prison. Millions of investors lost billions of dollars, millions more lost confidence in Wall Street, and corporate crime remains in the news. In 2002, the government created the Corporate Fraud Task Force "to hold wrongdoers responsible and to restore an atmosphere of accountability and integrity within corporations across the country."[3] Besides prosecuting corporations and their executives for accounting fraud, the task force brought charges for options backdating, insider trading, securities fraud, market manipulation, revenue and earnings management schemes, Foreign Corrupt Practices Act violations, and hedge fund and tax shelter frauds. The Corporate Fraud Task Force has been successful because it brings the full weight of the federal government down on corporate fraudsters by combining "the talents and experience of thousands of investigators, attorneys, accountants, and regulatory experts" from across ten departments.[4]

The many corporate executives who have faced criminal prosecutions worked for both well-known and lesser known companies. Although the major players have dominated the headlines, defendants came from all types and sizes of business (e.g., a bagel business in New Jersey that created fake sales to fraudulently inflate revenue).[5] When it comes to corporate fraud, anyone can be a player. Exhibit 1.1 lists some of the many corporate defendants prosecuted by the Corporate Fraud Task Force.

PERSONAL PIGGY BANK CONCEPT OF LEADERSHIP

The corporate scandals in recent years had a common recipe: corporate executives with no integrity, total arrogance, and huge greed, combined with weak boards and accounting firms that failed to fulfill their responsibility for independent auditing. Executives showed

EXHIBIT 1.1 Significant Criminal Cases Prosecuted by the Corporate Fraud Task Force

Adelphia
Allfirst
Allou Healthcare
American Tissue
Arthur Andersen
Biocontrol
Cendant
Charter Communications
Computer Associates
Comverse Technology
Credit Suisse First Boston
Dynegy
eConnect
Enron
Financial Advisory Consultants
GenesisIntermedia, Inc.
Golden Bear Golf
HealthSouth
Homestore
ImClone
Informix
Just for Feet
Katun Corporation
L90, Inc.
Leslie Fay
Manhattan Bagel
McKesson
Merrill Lynch
MonsterWorldwide
Network Associates
NextCard, Inc.
Nicor Energy
Peregrine Systems
PurchasePro
Quintus
Qwest
Refco
Reliant Energy Services, Inc.
Rite Aid
SafeNet
Symbol Technologies
Targus Group
U.S. Technologies
Vari-L Company, Inc.
Waste Management
WorldCom
Zurich Payroll

Source: U.S. Department of Justice, Corporate Fraud Task Force, *Significant Criminal Cases and Charging Documents*, www.justice.gov/archive/dag/cftf/cases.htm.

complete disregard for shareholders with a belief they could steal huge amounts of money from their respective companies. In the case of former Tyco CEO Dennis Kozlowski, there were multiple reports of his excessive spending of corporate funds for extravagant parties and personal purchases.[6] Kozlowski received from Tyco a $19 million no-interest loan and $11 million for art, antiques, and furniture for his New York City apartment, including the now infamous $6,000 floral patterned shower curtain. To top it off, Tyco paid half the cost for a $2.1 million junket for friends and family to the Italian island of Sardinia to celebrate the birthday of Kozlowski's wife.[7] Because Kozlowski was the CEO, it was easy for him to take as much money out of the company as he wanted. However, he did not escape justice and was subsequently convicted and sent to prison for his criminal behavior.

Kozlowski was not the only corporate titan to take freely from the corporate coffers. Those executives who allow greed to overcome them can easily abuse the power that comes from absolute control. It is a given that former Adelphia CEO John Rigas never thought he would be arrested and convicted for stealing from the corporate piggy bank. Rigas and other Adelphia executives were accused of looting the company of more than $1 billion. They didn't care that the company's assets belonged to shareholders. Even though they felt they were accountable to no one, their accounting fraud was discovered, and federal authorities arrested them.

Former WorldCom CFO Scott Sullivan also thought he had a personal piggy bank to freely tap. This once well-respected CFO of a telecom powerhouse never believed he would be paraded before the media like a common criminal, but there he was doing the "perp walk" with FBI agents in Manhattan following his arrest for a massive accounting fraud. Soon after, he was helping the government prosecute and convict his boss, former WorldCom CEO Bernard Ebbers.

A culture of noncompliance combined with a lack of accountability and transparency contributed to the wholesale looting of once respected companies by their fraudster CEOs, CFOs, and others. People who commit fraud never think about the consequences, or they believe there will be no consequences because they are above the law. They think the piggy bank is theirs to crack open and spend, not caring or understanding that shareholders are the true owners of the funds. These executives forgot who they really worked for.

EXECUTIVE INSIGHT 1.1: A MILLIONAIRE CEO GETS GREEDY

Rocky Aoki was the founder of the successful Benihana Asian restaurant chain. Aoki started the company in 1964 by introducing the Japanese steakhouse experience with entertaining chefs preparing meals in front of the dining guests. He created outlets all over the United States, and eventually Benihana became a publicly traded company on the NASDAQ, with Aoki as both CEO and Chairman of the Board. The company's slogan of "An Experience at Every Table" says it all about dining at Benihana.[i]

Unfortunately, Aoki had another kind of experience that was anything but positive. In 1993, Aoki participated in an insider trading scheme that would eventually result in his indictment and conviction.[ii] Aoki received insider information from a stock promoter who was also a public relations consultant for Spectrum Information Technologies. Spectrum was a publicly held corporation in Manhasset, New York.[iii] Spectrum and its corporate officers would later make the headlines with other issues including allegations of "defrauding investors by artificially boosting its stock price" and other frauds.[iv] The Spectrum case is further profiled in Executive Insight 13.1 in Chapter 13.

According to the June 1998 federal indictment of Aoki, in September and October 1993, Spectrum held secret negotiations with John Sculley, former CEO and Chairman of the Board of Apple Computer, to get him to join Spectrum in a similar executive capacity. During this period, Aoki solicited and received "non-public information concerning Spectrum's negotiations" with Sculley. On October 18, 1993, Spectrum publicly announced that Sculley had accepted the executive positions and would be joining the company. As expected, Spectrum's stock rose from $7.63 to $11.13, a 46 percent jump. Between September 29 and October 15, 1993, Aoki purchased 200,000 shares of Spectrum through three different brokerage accounts. On November 2, 1993, Aoki sold the 200,000 shares for a profit of approximately $590,000.[v]

Aoki then opened a brokerage account for the tipster on or about November 8, 1993, and instructed that 1,000 shares of

P1: TIX/b P2: c/d QC: e/f T1: g
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Spectrum be purchased for that account. Shortly thereafter, Aoki instructed his personal brokerage account to transfer $10,000 to the tipster's account to pay for the 1,000 shares purchased. The tipster then sold the stock.[vi] After the investigation of Aoki became public in May 1998, he resigned as chairman and CEO in the hopes that the impact on Benihana would be lessened by his departure.[vii]

Postal Inspectors on Long Island, New York, conducted the investigation that resulted in the June 1998 federal indictment of Aoki for one count of conspiracy and five counts of trading with insider information.[viii] In announcing the indictment, Zachary Carter, then United States Attorney for the Eastern District of New York, stated that "insider trading undermines the public's confidence in the fair operation of our nation's securities markets."[ix]

Although Aoki made a major transgression affecting his life and his company, he realized the error of his ways and took responsibility. He pled guilty on August 23, 1999, to four counts of insider trading and on March 8, 2000, was sentenced to three years of probation and a $500,000 fine.[x] The judge was lenient on Aoki because the plea agreement had mandated a $1 million fine and eight months of home detention.[xi]

John McDermott, the Postal Inspector who conducted the investigation, commented that Aoki could not resist making a relatively small amount of money compared with his probable net worth. Aoki used the insider information but got caught because he foolishly paid the tipster by wire transfer of the funds from his brokerage account. The wire transfer led right back to Aoki.

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[i] Benihana, Inc., www.benihana.com.
[ii] Alan Wax and Patricia Hurtado, "Benihana Founder Gets Probation, Reduced Fine," *Newsday*, March 8, 2000, A54.
[iii] *United States v. Rocky Aoki*, Indictment, United States District Court, Eastern District of New York, CR 98–593.
[iv] James Bernstein, "Feds Charge 3 in Spectrum Fraud, SEC Says Execs Artificially Boosted Stock Price," *Newsday*, December 5, 1997, A77.
[v] *United States v. Rocky Aoki*, Indictment.
[vi] Ibid.

[vii] Combined news services, "Benihana Founder Resigns," *Newsday*, May 20, 1998, A47.
[viii] Robert E. Kessler, "Aoki Indicted in Stock Deal, Benihana Founder Allegedly Paid for Insider Information about Spectrum Development," *Newsday*, June 10, 1998, A51.
[ix] Ibid.
[x] Wax and Hurtado, "Benihana Founder Gets Probation, Reduced Fine."
[xi] Ibid.

THE ROGUE EMPLOYEE

A "rogue employee" is any employee, no matter the level, who deviates from hired duties and perpetrates fraud by attacking the company from within, causing financial and reputational damage.[8] Rogue employees have their own agendas, and their interests are not aligned with those of their employers. In fact, they are not really employees of the company. True employees are committed to the company's mission and are part of the team in helping the company to grow to even greater heights and results. Rogue employees are not out for the common good and betterment of the business. They are out to steal, defraud, and line their pockets to the detriment of their employers. The rogue employee typically portrayed in the media has been the CEO, CFO, or other senior executive. Although these positions attract the most media attention, rogue employees can be anywhere in the organization. In many cases, a long-time, lower level employee who stays "below the radar screen" is the culprit. No matter where the rogue employee may be in a company, greater attention to internal controls and fraud prevention is essential in lessening the damaging effects of employee fraud.

THE CEO'S CHUTZPAH DEFENSE

The significant corporate frauds and resulting prosecutions of responsible corporate executives have provided a new defense posture appropriately named the "Chutzpah Defense." *Chutzpah* is a Yiddish term meaning unbelievable gall, audacity, arrogance, or utter

nerve. Corporate executives are taking this word to a new level and it can be applied to their criminal defense strategies as they attempt to escape criminal convictions and lengthy prison time. You can call this defense what you like—The Deaf, Dumb, and Blind Defense; The Dog Ate My Homework Defense; The Hey, I'm Just the CEO, What Do I Know about What's Going On? Defense—but the Chutzpah Defense is the best description. This troubling defense strategy is a last-ditch effort to extricate the corporate fraudster from appropriate punishment.

As former federal agents in the pursuit of justice, the authors know full well what capable, professional defense attorneys are obliged to do when representing clients facing criminal charges. However, it is hardly believable that CEOs, CFOs, or other high-level corporate officers would not know what is going on at their companies. If they are so unaware of what is happening, they should not be in those roles. Boiler room scam artists are fond of saying "put some lipstick on this pig and sell it" when trying to push fraudulent securities on unsuspecting investors. That is what some indicted corporate defendants are trying to do with this Chutzpah Defense. Although the deception may work on some, it is generally not working on juries. Recent experience has shown that juries will just not accept the Chutzpah Defense. Corporate executives on trial who have tried this approach to avoid conviction have lost.[9] Juries will just not believe the CEO who claims ignorance of large-scale fraud occurring right under their nose. Pigs, even with lots of lipstick, don't fly.

Bernard Ebbers tried the Chutzpah Defense and lost. During closing arguments, the prosecutor called it the "Aw Shucks Defense": Ebbers claimed he had no expert knowledge of accounting and no idea that any fraud was going on at WorldCom. He was just a "good ol' boy," a cheerleader for the company, who left the details to others. Justice prevailed because pleading ignorance about massive fraud when one is the CEO or CFO just does not work. The basic principles of the changes in corporate governance are all about accountability, especially for the corporate executive.

Although it can be argued that acceptance of responsibility for one's actions is on a societal decline of late, judging from the lawsuits filed against McDonald's Corporation blaming their burgers for weight-related problems or their hot coffee for burns, at least there have been changes for the better. Sarbanes-Oxley and improved

corporate governance have increased corporate responsibility and accountability. A word to the wise: "The Buck Stops Here" should be written in big letters and displayed on every corporate executive's desk as a reminder to all that the Chutzpah Defense is not an option.

A SAMPLING OF CORPORATE FRAUDS

Enron's collapse was the first of many publicized corporate scandals and started Congress on the path to enact legislation intended to stop corporate fraud. More transgressions and revelations followed. The biotech firm ImClone Systems was probed by congressional investigators for failing to tell investors that one of its drugs had not been approved by the Food and Drug Administration. Adelphia failed to disclose that it paid billions of dollars in secret loans to its CEO and his family. Arthur Andersen was indicted and convicted on charges of obstruction of justice in the Enron investigation. In May 2005, the U.S. Supreme Court overturned the conviction on improper jury instructions, but the damage was done as the company went out of business. Merrill Lynch agreed to pay a $100 million fine to settle charges that the firm's stock research misled investors. These disclosures and others that followed forced Congress to take a new look at corporate reform. There are many similarities in the lessons that can be learned from the fall of these major corporations.

Enron

More than any other company facing scandal in recent years, Enron stands out as the poster child for corporate greed and fraud. Beginning with Enron's reporting of $638 million in losses on October 16, 2001, the revelations of fraud were nonstop. The resignation of former CEO Jeffrey Skilling in August 2001 was probably more than a coincidence and a harbinger of things to come. As stated in Skilling's indictment of February 18, 2004, the resignation came with "no forewarning to the public."[10] The reading of the criminal charges tells why he would

want to leave as quickly as possible. The indictment of Skilling and other co-conspirators details the feeding frenzy of fraud at Enron. In describing the scheme to defraud, the indictment stated that:

> *From 1999 through late 2001, defendants Jeffrey K. Skilling and Richard A. Causey (former Enron Chief Accounting Officer and Executive Vice-President) and their co-conspirators engaged in a wide-ranging scheme to deceive the investing public, the SEC, credit rating agencies, and others about the true performance of Enron's businesses by (1) manipulating Enron's finances so that Enron's publicly reported financial results would falsely appear to meet or exceed analysts' expectations; and (2) making public statements and representations about Enron's financial performance and results that were false and misleading in that they did not fairly and accurately in all material aspects represent Enron's actual financial condition and performance, and omitted to disclose facts necessary to make those statements and representations truthful and accurate.*[11]

Early on, there was much criticism of the Enron Task Force for not moving faster in bringing the company's corporate crooks to justice. There was a constant complaint that the prosecutors were dragging their feet and getting nowhere fast. How wrong the critics were. Complex white-collar crime investigations can often take many months and even years to complete before any indictments are brought. A slow and steady but exhaustive collection of evidence cannot be confused with inactivity. Corporate executives need to remember that federal investigators and prosecutors are working behind the scenes interviewing witnesses, subpoenaing documents, quietly "flipping" targets into cooperators, corroborating information, and building a case. This is what happened with the Enron investigation. As then U.S. Assistant Attorney General Christopher Wray said at the time of Skilling's indictment, "the indictment of Enron's CEO shows that we will follow the evidence wherever it leads—even to the top of the corporate ladder."[12]

The late Kenneth Lay, former Enron Chairman and CEO, subscribed to the Chutzpah Defense by using his own variation, the "Mr. Magoo Defense." Mr. Magoo is the bumbling and nearsighted cartoon character who has no clue what is happening around him. Comedian and television commentator Dennis Miller made a joke

about Ken Lay, who was telling everyone who would listen how he was a corporate and financial genius with the ear of presidents—that is, until "the feds" started investigating Enron. Suddenly he became a bumbling Mr. Magoo, who had no idea what was going on inside his own company. He was blind beyond belief to the massive fraud permeating the company he led as founder, chairman, and CEO. Lay repeatedly appeared on television to defend himself and said he knew nothing of Enron's "cooking the books" or other frauds at the company. While the company was heading for bankruptcy, he was publicly encouraging his employees to buy more stock in Enron, claiming it was a great value at the beaten-down price. Although convicted after jury trial, Lay died before sentencing so his conviction was set aside.

Creating a culture of compliance is a common theme of this book. Truly great leaders inspire and mentor their employees to higher standards of accomplishment and integrity. That was clearly missing at Enron. More than two dozen company executives were eventually charged with numerous financial crimes including Skilling, Lay, and former CFO Andrew Fastow. There is no doubt that the "tone at the top" was one of noncompliance and lawlessness that fostered an environment of fraud and corruption at all levels of the company.

Tyco

Dennis Kozlowski, Tyco's former CEO, was accused with other Tyco executives of looting $600 million from the company and defrauding investors through unauthorized loans and bonuses, loans improperly forgiven, and sales of stock that were inflated by fraudulent corporate accounting. Kozlowski joined Tyco in 1975 and rose through the ranks to President, Chief Operating Officer, and then CEO. Over time, he came to typify the corporate lifestyle of excess at every turn. It all came tumbling down when in late May 2002, he learned he was about to be indicted by the Manhattan District Attorney's Office. Kozlowski resigned from Tyco on June 3, 2002, and on June 4, he was arrested.

Tyco's new management commissioned an internal accounting and corporate governance review of the allegations of fraud and

abuse by Kozlowski and other former Tyco executives. The review was conducted by New York attorney David Boies with assistance from numerous forensic accountants. The scope of the internal accounting review included 1999 to 2002 reported revenues, profits, cash flow, internal auditing, control procedures (or lack of them), the use of corporate assets to pay personal expenses, employee loans and loan forgiveness, and other corporate governance issues. The subsequent report found the company "engaged in a pattern of aggressive accounting which, even when in accordance with Generally Accepted Accounting Principles (GAAP), was intended to increase reported earnings above what they would have been if more conservative accounting had been employed."[13]

Tyco was successful to a degree in playing the numbers through accounting manipulations. For one, it abused goodwill. *Goodwill* in accounting terms is a financial advantage that a business gains from the purchase price over fair market value of assets acquired. When a company is purchased, goodwill is the difference between the amount paid over the net asset value. Tyco had a "staggering $26 billion worth of goodwill on its balance sheet."[14] This maneuver greatly increased earnings and cash flow because it allowed Tyco to book additional revenue without associated costs of acquisition. Tyco also did not report acquisitions that it stated were small enough to be considered "immaterial" under GAAP. "From 1991 through 2001, Tyco spent $8 billion on more than 700 acquisitions that it said were not material. But taken as a group, these 700 deals clearly had a huge impact on Tyco's results."[15] There is no doubt that these accounting moves had a material impact on the revenue and expenses of the company and should have been disclosed.

An important lesson to remember is that no matter how strong the evidence appears to be in a case, there is no such thing as a guaranteed conviction. Dennis Kozlowski's first trial in state court in Manhattan in April 2004 ended in a mistrial. The evidence seemed to be overwhelming, but still the jury could not come to a decision after 12 days of deliberations. After the mistrial, one of the jurors called the case against the defendants "a slam dunk" and stated, "Those guys [Kozlowski and Mark Schwartz, Tyco's former CFO] are never going to get acquitted, no matter what they do. The best they can hope for is a hung jury."[16] Despite this juror's view, the jury could not come to an agreement to convict, forcing a retrial of the defendants. At the

second trial in June 2005, Kozlowski and Schwartz were found guilty of looting $600 million from the company. They were each sentenced to between $8^1/_2$ and 25 years in prison and immediately began serving their sentences. Kozlowski and Schwartz were also hit with fines and restitution totaling $239 million. It was one of the biggest wins for prosecutors fighting corporate fraud.

WorldCom

WorldCom was once the second largest long-distance telecommunications company. It was a Wall Street darling that in reality had a culture of noncompliance and criminality at the highest levels of leadership. Former CEO Bernard Ebbers was convicted after trial in March 2005. Former CFO Scott Sullivan pled guilty, as did several other executives who agreed to cooperate against Ebbers. The downfall began in March 2002, when then Vice-President of Internal Audit Cynthia Cooper went to Sullivan with her concerns about the company's accounting. He angrily told her to mind her own business and that everything was fine. Her instincts told her there were big problems, and she kept digging. Ebbers resigned in April 2002 amid questions regarding $408 million in personal loans. A $7.2 billion accounting fraud eventually became a $107 billion bankruptcy filing, the largest in corporate history.

In late May 2002, Cooper and her staff uncovered $500 million in fraudulent computer expenses. Arthur Andersen, WorldCom's auditors, refused to respond to some of Cooper's questions about the auditing. On June 20, 2002, Cooper told WorldCom's Audit Committee that the company was falsifying its accounting. The Audit Committee and Board of Directors are credited with acting quickly. A few days later Sullivan was fired, and WorldCom admitted it hid $3.85 billion in expenses, allowing it to post a profit in 2001 instead of a loss. In 1998, *CFO* magazine named Sullivan one of the country's best CFOs. What the magazine did not know was that Sullivan had instructed his people to cook the books. WorldCom hid billions of dollars in expenses by transferring them throughout the company's capital expenditures accounts. Cooper exposed this massive fraud and became a famous whistleblower, recognized as one of *Time* magazine's Persons of the Year for 2002.

Federal prosecutors moved swiftly to prosecute Sullivan and former controller David Myers on 17 criminal counts including conspiracy to commit securities fraud. They were arrested on August 1, 2002, just two days after President Bush signed the Sarbanes-Oxley Act into law. At a Washington, D.C., news conference after the arrests, then Attorney General John Ashcroft stated, "With each arrest, indictment and prosecution, we send this clear, unmistakable message: corrupt corporate executives are no better than common thieves."[17]

The subsequent federal indictment issued by a Grand Jury in the Southern District of New York alleged that Sullivan and his co-conspirators "engaged in an illegal scheme to inflate artificially WorldCom's publicly reported earnings by falsely and fraudulently reducing reported line cost expenses."[18] Furthermore, the indictment stated that the "co-conspirators made these false and fraudulent journal entries in WorldCom's general ledger knowing, and intending (1) that such journal entries would ultimately be reflected in WorldCom's financial statements and public filings with the SEC; (2) that WorldCom's financial statements and public filings would falsely overstate WorldCom's earnings; and (3) that the investing public would rely upon such overstated earnings."[19] As often happens, federal prosecutors convinced Sullivan, Myers, and several other executives to testify against an even bigger catch, CEO Ebbers. Ebbers, who steadfastly maintained his innocence and demanded a jury trial, got his wish.

Sullivan was the star government witness against Ebbers at trial. The jury spent eight exhausting days deliberating. It came back on March 15, 2005, with a conviction on all counts, including conspiracy to commit fraud by falsifying WorldCom's financial results; securities fraud by misleading investors and the public about WorldCom's true financial condition; and making false filings that misrepresented WorldCom's financial state with the SEC. Although Ebbers took the stand and claimed he was unaware of the fraud and that Sullivan alone was the mastermind behind it, the jury did not believe him. Leslie Caldwell, the former head of the Enron Task Force, who is knowledgeable about the CEO ignorance defense, stated after the conviction, "There's inherently a lot of suspicion when a highly paid CEO says there were significant things he wasn't aware of. There's a certain cynicism among jurors, who ask, 'How'd you get to be CEO?'" On July 13, 2005, Ebbers was sentenced to 25 years in prison for masterminding the fraud at WorldCom. The trial judge

rejected his plea for leniency and gave him the harshest sentence yet for corporate fraud.

Adelphia

John Rigas had it all. At 78 years of age, he was the founder of one of the nation's largest cable companies. He was a son of Greek immigrants who became an entrepreneur and eventually got into the cable subscription business by starting Adelphia Communications Corporation. He built it from the ground up into a public company worth billions of dollars. His two sons were executives in the company. Rigas and his family lived the good life that mega millions in corporate earnings can provide. They had mansions, their own personal golf course, a fleet of luxury cars, and power. Unfortunately, Rigas had a secret that would soon be exposed. He was a corporate fraudster, and Adelphia had become his personal piggy bank.

All came crashing down for Rigas on July 24, 2002, when United States Postal Inspectors arrested Rigas, his two sons, and two other Adelphia executives and charged them with multiple counts of conspiracy to commit mail fraud, wire fraud, bank fraud, and securities fraud. Rigas and his sons did their obligatory "perp walk" in Manhattan just days before the Sarbanes-Oxley Act was signed into law. Rigas and his sons knew they were about to be arrested and offered to surrender, to avoid the perp walk. The government refused because they wanted the spectacle of a very public arrest to send a strong message to other corporate crooks. As stated in the criminal complaint, "the defendants and their co-conspirators perpetrated an elaborate and multifaceted scheme to defraud stockholders and creditors of Adelphia, and the public." Another statement found in the criminal complaint describing the defendants' behavior was unusual: "The investigation has revealed probable cause to believe that John J. Rigas, the defendant, together with members of his family, has looted Adelphia on a massive scale, using the company as the Rigas family's *personal piggy bank* [emphasis added], at the expense of public investors and creditors."[20] The United States Attorney for the Southern District of New York called the crime "one of the most elaborate and extensive frauds ever."

The scheme ran from 1999 through May 2002, but the criminal investigation only began in March 2002, resulting in prosecution by July 2002. When Adelphia filed for bankruptcy protection on June 25, 2002, it listed $18.6 billion in debt. The investigation found that Rigas and his sons had looted the company of more than $1 billion. Among the many financial transgressions they were alleged to have committed are the following:

- Received a million dollars a month in secret cash payments
- Built a $13 million private golf course using Adelphia funds that were not disclosed to the non-Rigas family members of the board of directors or to the public
- Borrowed $2.3 billion from banks with Adelphia guaranteeing loans that were not recorded in the company's books
- Used $252 million to pay margin calls against loans that the family received from various brokerage firms
- Personal use of corporate aircraft and New York City apartments by Rigas family members (Adelphia employees were allegedly instructed not to record personal use of the aircraft in the usage logs.)

Rigas, his sons, and one other co-defendant went to trial in New York on March 1, 2004. On July 8, 2004, Rigas and one son, Timothy Rigas, were convicted on all 15 counts. The jury deadlocked on another son, Michael Rigas, who later pled guilty to making a false entry in a company record to avoid a retrial. A fourth defendant, Adelphia's assistant treasurer, was acquitted. One of the government's star witnesses at trial was cooperating defendant James R. Brown, once Adelphia's Vice-President of Finance. He testified that Adelphia developed a culture of lies. They had kept two sets of books for more than 10 years. One book contained the falsified numbers, and one had the actual numbers, so they would know which ones they had manipulated and by how much. As Brown testified, "We don't want to fool ourselves."[21] Brown was a critical insider witness for the government, and although he spent 18 years at the company and was a loyal employee, the threat of a long prison term turned him into a government cooperator. There are no bonds of loyalty when prison is a reality.

At his sentencing hearing on June 20, 2005, Rigas told the judge, "In my heart and in my conscience, I'll go to my grave really and truly believing that I did nothing but try to improve the conditions of my employees."[22] The judge did not buy Rigas' story and sentenced him to a "life sentence" of 15 years in prison since Rigas was 80 years old when originally sentenced. Rigas' son, Timothy, received 20 years in prison.[23] In 2008, a federal judge reduced the elder Rigas' sentence by three years and his new release date is scheduled for 2018.

THE DRIVE FOR CORPORATE RESPONSIBILITY

In 2002, President George W. Bush saw corporate fraud as such an enormous problem that he made corporate responsibility a core element of his administration, along with the war on terrorism. Early on in the emerging corporate scandals, President Bush set out an aggressive agenda to fight corporate fraud including:

- Exposing and punishing acts of corruption
- Holding corporate officers and directors accountable
- Protecting small investors, pension holders, and workers
- Moving corporate accounting out of the shadows
- Developing a stronger, more independent corporate audit system
- Providing better information to investors[24]

On March 7, 2002, the President announced his "Ten-Point Plan to Improve Corporate Responsibility and Protect America's Shareholders." It was based on three principles: information accuracy and accessibility, management accountability, and auditor independence. The Ten-Point Plan declared that:

1. Each investor should have quarterly access to the information needed to judge a firm's financial performance, condition, and risks.
2. Each investor should have prompt access to critical information.
3. CEOs should personally vouch for the veracity, timeliness, and fairness of their companies' disclosures, including their financial statements.

4. CEOs or other officers should not be allowed to profit from erroneous financial statements.
5. CEOs or other officers who clearly abuse their power should lose their right to serve in any corporate leadership positions.
6. Corporate leaders should be required to tell the public promptly whenever they buy or sell company stock for personal gain.
7. Investors should have complete confidence in the independence and integrity of companies' auditors.
8. An independent regulatory board should ensure that the accounting profession is held to the highest ethical standards.
9. The authors of accounting standards must be responsive to the needs of investors.
10. Firms' accounting systems should be compared with best practices, not simply against the minimum standards.[25]

These tenets were to form the basis of the Sarbanes-Oxley Act of 2002.

President Bush went further to demonstrate to the investing public that he meant business. On July 6, 2002, he called on Congress to legislate new powers and statutes to stop corporate fraud and bring to justice those wrongdoers who violated the public and corporate trust. On the same date, he created the Corporate Fraud Task Force, headed by then Deputy Attorney General Larry Thompson, to coordinate the investigation and prosecution of financial accounting fraud and other corporate frauds. The full force of federal law enforcement would be brought to bear on corporate wrongdoers. Although some may argue that it should not have taken massive corporate implosions and billions of dollars in losses to get the government to act, "better late than never" was the refrain of the day.

Congress and the President did act. On July 30, 2002, President Bush signed the Sarbanes-Oxley Act into law. This law has had significant implications for public companies. Sarbanes-Oxley will not make fraud disappear, but its strong language and stiff penalties could deter corporate executives who are tempted to stray. Sarbanes-Oxley has become a household name with corporate America, accounting firms, and government prosecutors and regulators. In corporate suites and boardrooms of public companies, Sarbanes-Oxley and its requirements, safeguards, and sanctions are discussed daily. Sarbanes-Oxley has had a major impact on corporate

crooks and enhanced corporate compliance and governance in the process.

In November 2009, President Barack Obama established the Financial Fraud Enforcement Task Force to replace the Corporate Fraud Task Force. The new task force builds upon the work of the Corporate Fraud Task Force with an added emphasis on financial fraud that resulted in the financial crisis of 2008 and those economic recovery efforts that came in its wake. "The task force's mission," according to U.S. Attorney General Eric Holder, "is not to just hold accountable those who helped bring about the last financial meltdown, but to prevent another meltdown from happening."[26] The task force investigates a variety of frauds, including bank, mortgage, loan and lending fraud, securities and commodities fraud, retirement plan fraud, mail and wire fraud, tax crimes, money laundering, False Claims Act violations, and other financial crimes.

FIGHTING FRAUD IS GUARANTEED EMPLOYMENT

Investigators beginning a career or assignment in fraud detection are commonly told never to worry about being out of a job because investigating fraud provides job security. The message is that fraud is an evil that will always be present in our society and that anyone smart enough to enter the field of fraud detection and prevention will find full and long-term employment. Sad as it may seem, fraud will always occur wherever there is opportunity. The feeding frenzy of fraud will not abate unless fraud prevention is embraced and instituted at all levels of a company, especially in the executive suite.

NOTES

1. Attributed to an unnamed Congressional sponsor of the *Mail Fraud Statute*, enacted in 1872.
2. *Mail Fraud Statute,* U.S. Code Title 18, Section 1341.
3. U.S. Department of Justice Archives, *The President's Corporate Fraud Task Force*, www.justice.gov/archive/dag/cftf/.

4. Ibid.
5. *United States v. Allan Boren and Eric Cano*, First Superseding Indictment filed February 2001, Cr. No. 01–730(A)-GAF, United States District Court for the Central District of California, 5–6.
6. Mark Maremont and Colleen DeBaise, "Prosecutor Says Two Executives Used Tyco as 'Piggy Bank,'" *Wall Street Journal*, March 17, 2004, C1.
7. Colleen DeBaise, "Newest 'Tyco Gone Wild' Video Is Out, and Jurors See $6,000 Shower Curtain," *Wall Street Journal*, November 26, 2003, C1.
8. Timothy L. Mohr, "Employee Fraud and Rogue Employees-Prevention and Detection," a professional project submitted to the faculty of Utica College, Utica, N.Y., December 2002.
9. The acquittal of former HealthSouth CEO Richard Scrushy in June 2005 is an exception. Although the evidence against Scrushy appeared to be formidable, the jury felt otherwise. There are some who attribute the acquittal to the "homefield advantage" of having the case tried in Birmingham, AL, where Scrushy was very popular, as well as the excellent work of the defense team in impeaching many of the prosecution witnesses.
10. *United States v. Jeffrey K. Skilling and Richard A. Causey*, Superseding Indictment filed February 18, 2004, Cr. No. H-04–25, United States District Court, Southern District of Texas, Houston Division at 3.
11. Ibid., 5.
12. "Ex-Enron CEO Named in 42-Count Indictment," *MSNBC .com*, February 19, 2004, www.msnbc.msn.com/id/4311642.
13. Summary of Findings of Accounting and Governance Review prepared for Tyco International, Ltd. by Boies, Schiller & Flexner, December 30, 2002.
14. Anthony Bianco, William Symonds, Nanette Byrnes, and David Polek, "The Rise and Fall of Dennis Kozlowski," *BusinessWeek*, December 23, 2002, 64–77.
15. Ibid.
16. Christopher Mumma and Thomas Becker, "Jurors Expect Conviction in Tyco Retrial," *Seattle Times*, April 7, 2004, E4.
17. Carrie Johnson and Ben White, "WorldCom Arrests Made," *Washington Post*, August 2, 2002, A1.

18. *United States v. Scott D. Sullivan*, First Superseding Indictment, S1 02 Cr. 114 (BSJ), United States District Court for the Southern District of New York, 9.
19. Ibid., 10.
20. *United States v. John J. Rigas, Timothy J. Rigas, Michael J. Rigas, James R. Brown, and Michael C. Mulcahey*, criminal complaint unsealed on July 24, 2002, United States District Court, Southern District of New York, sworn to by United States Postal Inspector Thomas F.X. Feeney.
21. Peter Grant, "Adelphia Insider Tells of Culture of Lies at Firm," *Wall Street Journal*, May 19, 2003, C1.
22. "Adelphia Founder Gets 15-Year Term; Son Gets 20," *MSNBC .com*, June 20, 2005, www.msnbc.msn.com/id/8291040/.
23. Ibid.
24. The White House, "The President's Leadership in Combating Corporate Fraud," *Corporate Responsibility*, http://georgewbush-whitehouse.archives.gov/infocus/corporateresponsibility/.
25. Ibid.
26. U.S. Securities and Exchange Commission, "President Obama Establishes Interagency Financial Fraud Enforcement Task Force," press release (November 17, 2009), www.sec.gov/news/press/2009/2009–249.htm.