

Leadership failures of enron flashcard



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Many have heard of the Enron Scandal of 2001. A scandal, by definition, is an event that involves allegations of wrongdoing, disgrace, or moral outrage. In other words, a scandal is caused by shortcomings in ethics. Enron's Ken Lay, Jeffrey Skilling and Andrew Fastow each engaged in unethical practices in their various leadership positions at Enron and caused thousands of Enron employees and investors to lose their savings. (Smartest) Kenneth Lay showed all the signs of a transformational leader early in his career.

Lay began as and forever remained a staunch advocate for free markets and deregulation of markets. He had a vision of a free energy market that would be more profitable than the encumbered government-regulated market. (Jelveh; Biography) Kenneth Lay made use of considerable political clout derived from his friendship with the Bush family to further his deregulation agenda. (Smartest) Lay's vision of a deregulated market, it would seem, would cloud his ethical judgment in the future. Lay seemed to have no trouble moving up in the business world.

In 1974, he became an executive of the Florida Gas company and became president of the company in 1981. In 1982, he returned to Houston to run Transco Energy Co. , and in 1984 took the helm of Houston Natural Gas. Houston Natural Gas then merged with InterNorth in 1985, and the combined company became Enron with Lay as CEO. (Biography) The first signs of Lay's ethical shortcomings came in 1987 with what became known as the Valhalla Scandal.

Lou Borget, a trader of Enron Oil Trading, was convicted of money laundering and fraud costing Enron shareholders about sixty-four million dollars. Lay

testified that he was shocked by the illicit tactics used by his oil traders, but evidence, including the word of the former Enron Oil vice chairman Mike Muckleroy, seems to indicate that Lay understood what was happening the whole time. Auditors told Lay that his oil traders were manipulating earnings destroying records and gambling Enron money far beyond their means. Lay changed nothing after being warned by the auditors and in fact only encouraged Borget to keep making money by any means necessary.

Smartest) Lay's ethical shortcomings in this case include not being honest or trustworthy and facilitating the reckless gambling away of the shareholders' money. Much later, Lay's dishonest tendencies were brought to public attention once again in the year 2000. Lay was found to have been selling his stock in Enron from November 1 of that year. (SEC Charges Kenneth) Because of what Lay must have known about the state of Enron at the time, this is a breach of ethical conduct. Lay was selling his own stock that he knew would drastically diminish in value and at the same time encouraging employees and brokers to buy Enron stock.

(Smartest) Lay managed to sell approximately \$100 million in Enron stock before the collapse of the company. (SEC Charges Kenneth) This is inconsistent with a leader's ethical and legal obligations to be honest with stock holders. Enron's Jeffrey Skilling was, like Kenneth Lay, considered a forward-thinking executive with revolutionary ideas about how to run the Enron Corporation. Under Skilling, Enron was able to be approved for a special type of accounting called " mark to market. " This type of accounting allowed Enron to file anticipated future profits from any deal as if they were

already made. This allowed Enron to exaggerate or even outright lie about their earnings.

This is cited by many to be the catalyst to behavior that led to Enron's eventual collapse. (Smartest) Skilling's role in the scandal of Enron was unquestioned by SEC Enforcement Division Director Stephen M. Cutler, who said " In this scandal, as in others, we are by now all too familiar with executives who bask in the attention that follows the appearance of corporate success, but who then shout their ignorance when the appearance gives way to the reality of corruption. Let there be no mistake that today's enforcement action against Mr. Skilling places accountability exactly where it belongs. " (SEC Charges Jeffrey) Indeed, Skilling was indicted on 35 counts of fraud, insider trading, and other crimes related to the collapse of Enron.

Enron's Skilling) Enron's traders, under Skilling's direction and encouragement, were shown to have been manipulating the California electricity market to create false energy shortage in order to raise prices. The traders took full advantage of crises such as California's rampant forest fires burning down major transmission lines. (Enron Traders; Smartest) This is a glaring example of Enron's lack of social responsibility; Enron traders acted without regard to the people of California and made millions with these unethical tactics. Skilling was found guilty of insider trading in a way similar to how Ken Lay was.

From April 2000 to September 2001, Skilling sold over one million shares of Enron stock valued at over \$63 million with insider knowledge of Enron's inevitable bankruptcy. Skilling was also found guilty on five counts of making

false statements to auditors and twelve counts of securities fraud, which is a type fraud involving deceiving investors about company stock. (Enron's Skilling) Andrew Fastow was made CFO of Enron in 1998. Fastow is considered to be the mastermind of the fraudulent financial dealings. Fastow created the company LJM to buy Enron's failed assets. This way, any of Enron's debt could be hidden by being sold to LJM.

This significantly boosted the Enron stock under the false pretenses of making a profit when they were actually very much in debt. (Jelveh) Fastow's ability to do business with himself by acting as both CFO of Enron and CEO of LJM and other dummy corporations was a conflict of interest that should not have been allowed. However, due to his ability to make Enron debt go away with this position, he was met with complacency from other key Enron executives. (Smartest) Fastow was also involved with the company Chewco. He created Chewco in an effort to hide debt and inflate profits, much like LJM. Chewco was supposed to hide the debt incurred by the failure of Enron's Joint Energy Development Investment Limited, or "JEDI".

Enron used Chewco to report roughly \$400 million in profits which did not exist, while concealing \$600 million in debt. However, Chewco did not meet the requirements needed to be removed from Enron's accounting figures, and Enron was required to restate its earnings with Chewco's debt factored in. Enron's requirement to restate its earnings to remove this fake \$400 million profit was a primary catalyst of Enron's downfall. Fastow was the first executive of Enron to be brought to trial for his unlawful actions. Fastow was charged with fraud based on his activities with the complex transactions with his dummy corporations to defraud investors.

(Enron: After)