

OPINION

■ ENRON SCANDAL

Not too complex for a jury

By Gary J. Malone SPECIAL TO THE NATIONAL LAW JOURNAL

AS FEDERAL prosecutors investigating Enron move beyond the indictment of its auditor, Arthur Andersen, they are going to confront the task of unraveling the complex transactions at the heart of the Enron scandal.

That task is now underway according to a recent report that federal prosecutors have convened a special grand jury to focus on the off-the-books partnerships that Enron insiders used to enrich themselves.

These complex transactions have been described by the news media as so impenetrable that prosecutors and civil plaintiffs seeking to recover millions in lost investments may never be able to prove anything illegal was even done. A preview of a complexity defense could be seen in the recent Senate Commerce Committee testimony of former Enron Chief Executive Officer Jeffrey Skilling, who emphasized that he was not an accountant, and could not be expected to understand Enron's transactions, describing one partnership arrangement as "a complex, complex structure."

The "complexity" defense is not likely to be persuasive. In my two decades as a civil litigator and prosecutor of complex cases—many involving securities fraud, an area that typically requires educating juries—I have found that it is more important for juries to grasp the big picture of a complex case than to understand the mechanics of every complex transaction.

For federal prosecutors and class action lawyers suing Enron and its executives, the big picture of the Enron scandal could be quite simple to explain: Enron executives enriched themselves by structuring complex transactions that—through their very complexity—created the illusions of greater profits and value for Enron.

The transactions now being scruti-

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nized by the special grand jury have already been condemned in a report prepared for the Enron board of directors, which found that Enron insiders enriched themselves by hundreds of millions of dollars by hiding losses and inflating profits.

Enron concealed massive losses by creating the illusion that investments were hedged by agreements with off-the-books partnerships. The hedges were illusory since only Enron had a substantial economic stake in those partnerships. During the 15 months that Enron's

itself from losses by guaranteeing to pay itself money. Enron manufactured profits by selling assets to itself. Even some of its apparent trading was nothing more than Enron talking to itself.

History repeats itself

Enron's machinations remind me of a case in which I was part of the defense team for a brokerage firm that was sued by a receiver for a commodity pool that had been managed by a Ponzi scheme operator. The operator had used a variety of swindles, including a convoluted

fairly tale about the brokerage firm committing an error that caused a "locked-in-profit" in commodity futures contracts that could be cashed in only if investors first gave the Ponzi-scheme operator millions to meet a margin call. The receiver sued the brokerage firm on the basis of the Ponzi-scheme operator's testimony that the firm knew about this swindle and had aided his fraud.

While the "locked-in-profit" tale and the other swindles were convoluted, the receiver downplayed the mechanics of the fraud and focused on the big picture of the brokerage firm that profited from fraudulent trading, and the jury found the firm liable. A jury does not need to understand the detail of every fraudulent transaction if it is convinced it understands who is ultimately to blame.

Similarly, juries deciding Enron criminal cases and class actions are more likely

to focus on the big picture of who benefited from illusory transactions, rather than absorbing every detail.

The rampant complexity that Enron used to create the illusion of economic substance could actually make the Enron scandal easier to understand and prosecute. One does not have to be an accountant to grasp that the greater the number and complexity of transactions that enriched the deal-makers, the greater the likelihood that such deals were intentionally impenetrable and deceptive.

Prosecutors and civil plaintiffs in cases dealing with complex commercial transactions are greatly aided if they can explain to the jury that while the transactions might be complicated, the big picture is really simple. Ironically, the complexity and the variety of Enron's transactions may result in an easy-to-understand story of greed and deception. ■



management hid almost \$1 billion in losses, senior executives sold millions of dollars' worth of Enron stock.

Enron generated hundreds of millions of dollars in reported earnings by selling assets at inflated prices to the off-the-books partnerships, and then repurchased the assets after the reporting period. This hiding of almost \$1 billion in losses led to higher stock prices, and Enron executives were rewarded with about \$320 million in bonuses.

Enron insiders made more than \$40 million by investing in risk-free off-the-books partnerships. Andrew Fastow, Enron's former chief financial officer, turned a \$25,000 investment into a return of \$4.5 million in about two months, and other Enron employees reaped enormous windfalls.

While the mechanics of these transactions were complex, the economic reality was merely farcical. Enron protected