

# Trial of top Enron officials begins in Houston

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The trial of Enron executives Kenneth Lay and Jeffrey Skilling began last week in Houston, Texas, the home of the now bankrupt former energy giant. Lay was Enron's chairman and CEO, while Skilling was the long-time president and chief operating officer, who also served briefly as CEO in 2001. Both are charged with various counts of securities and wire fraud, and Skilling is also charged with insider trading.

Enron's history is the most well-known example of the corporate fraud and accounting manipulations that have come to characterize much of American business. Its bankruptcy in December 2001 led to thousands of layoffs, the collapse of the company's stock price, and the loss of billions of dollars on the part of investors, including many of the company's own employees.

The charges of fraud relate to allegations that Lay and Skilling deliberately sought to deceive investors, employees and the government about the true financial state of the company as it began to implode. The company unraveled in 2001, as the stock market boom deflated and it became increasingly difficult for the company to hide its underlying woes. Throughout the year, however, Skilling, Lay and other executives sought to boost the company at analyst and employee meetings, while overseeing various accounting manipulations to improve financial reports. At the same time, they were selling their own stock options and making millions of dollars.

The prosecution is relying on the testimony of 15 lower-level executives, who have already pleaded guilty to various charges, agreeing to testify for the government in exchange for lighter sentences. These include former chief financial officer Andrew Fastow, former chief accountant Richard Causey and former treasurer Ben Glisan. These executives have admitted guilt and are expected to testify that both Lay and Skilling knew and approved of their crimes. Fastow was most closely associated with the various off-balance sheet entities used by Enron to hide debt and boost earnings reports.

Not only is the defense arguing that Lay and Skilling did not willingly commit fraud, it maintains that no major fraud was committed at all. Indeed, the defendants' claim is that most of the witnesses the government will call to the stand are in fact guilty of no crimes, and that they agreed to plea deals only to escape the costs of trial and the threat of more extensive punishments.

In his opening statement, Skilling's defense attorney Daniel Petrocelli declared, "This is not a case of hear no evil, see no evil. This is a case of there was no evil." Later he made the claim, "Enron was no house of cards...It was a wonderful company, a shining star." Outside of some theft from the company committed by Andrew Fastow, the defense will argue, nothing was really wrong with Enron and all the rosy statements made by Skilling and Lay were therefore actually true. The company collapsed not through any fault of its own, but rather as a result of a financial panic on Wall Street, due in part to the deliberate attempts by short sellers (investors betting that the stock

price would fall) to bring the company down.

Given the extensive nature of Enron's fraud, combined with what is now a generally well-documented understanding of the true sickness and rot of the company throughout the late 1990s and into 2000 and 2001, this will be a very difficult position to maintain. The defense is apparently hoping that at least some members of the jury will be confused enough about the company's accounting details and the way American business operates to accept the argument. The alternative position that the defense might hold—that Lay and Skilling were simply duped by the lower-level executives into thinking everything was going fine, even amidst massive corruption—is perhaps even more difficult to sell.

As its first witness, the government called Mark Koenig, Enron's former chief of investor relations, who is expected to finish testimony this week. Koenig's job was to oversee interactions with Wall Street analysts, and therefore he would be closely involved in any attempts to manipulate Enron's earnings figures.

Koenig's testimony has focused on two units of Enron, Enron Broadband Services (EBS) and Enron Energy Services (EES). EBS was Enron's bid to capitalize on the telecommunications stock bubble. It was supposed to develop a market in trading Internet bandwidth in a manner similar to Enron's earlier creation of a market for trading energy contracts. Shortly after EBS was formed in the late 1990s, Enron's stock shot up 25 percent. Even though EBS never really got off the ground, and one of its main potential sources of revenue—a deal with Blockbuster Video—fell through without any results, it was trumpeted by Lay, Skilling and others as potentially a hugely profitable enterprise.

Koenig recounted how at one point Skilling informed employees that EBS was suffering, requiring that hundreds of workers be shifted to other operations. However, a week later he told an analysts' conference that EBS was doing well.

According to Koenig, Skilling also deliberately mislead investors about the extent to which EBS's revenues were based on the sale of fiber optic cable—that is, the liquidation of assets—rather than any profitable operations. In July 2000, Skilling told an analyst that only \$50 million had been made through the sale of the cables, though the real figure was \$152 million, accounting for all of EBS's revenue.

"We were all on the same page of attempting to portray EBS as self-thriving and just fine," Koenig testified. To admit that EBS was in fact floundering would have led to a steep drop in Enron's stock price.

Lay and Skilling also sought to misrepresent the health of EES, the prosecution contends. Koenig testified that in the first quarter of 2001, Enron made a last-minute decision to shift over \$200 million in losses onto another division of the company, Enron Wholesale, in order to hide EES's problems. Skilling then told Wall Street analysts that the division was healthy. In its opening statements, the government said that Lay made similar fraudulent statements about EES, claiming at

one point that the unit had made a \$40 million profit instead of a \$500 million loss. If the real state of EES had been known, “it would have been a disaster with investors,” Koenig said.

At the time, Enron Wholesale was very profitable, due in large part to the enormous revenues the company was pulling in as a result of the California energy crisis. Indeed, Enron was seeking to downplay the amount of profit it was getting from the soaring gas prices in that state, both because these profits would not be seen as stable sources of revenue by Wall Street and for fear of a public backlash over Enron’s price gouging.

In addition to the particular attempts to shift losses between the different units of Enron, Lay and Skilling sought throughout 2001 to present to investors, employees and the public a picture of a thriving company. They knew this was false, according to the government and Koenig.

A video of a February 2001 employees meeting was shown at the trial. It included statements by Lay and Skilling that the company had never been more healthy, and that in five years it could be the world’s leading company, rather than just the leading energy company. In August 2001, only a few months before Enron declared bankruptcy and shortly after Skilling unexpectedly resigned as CEO, Lay told a meeting of analysts, “I can honestly say that the company is probably in the strongest and best shape it’s ever been.”

In September 2001, Koenig said that he and another executive at the company raised some questions about Enron’s increasingly “aggressive” accounting practices at a meeting that included Lay, Skilling and other top officials. He said that Fastow and Causey pointed out that the accounting might be aggressive, “but it benefited a lot of the people around the table,” an apparent reference to the vast sums of money top executives were receiving through the sale of stock options.

Koenig’s testimony is only the beginning of a trial that will likely last months. The next witness scheduled is Kenneth Rice, who worked closely with Skilling. Many of the more egregious accounting manipulations will likely come up later in the trial, particularly with the testimony of Fastow.

Lay and Skilling certainly deserve to be punished for whatever crimes they have committed, which had devastating consequences for workers, small investors and—particularly in the case of the California energy crisis—broad sections of the population. However, the phenomenon of Enron was not simply the story of a handful of executives who succeeded in deceiving Wall Street analysts.

Enron epitomized the turn by broad sections of the ruling elite toward fraud and criminality in the vast accumulation of wealth over the past several decades, and particularly since the mid-90s.

Skilling, Lay and the others were products of certain general trends in American capitalism: the obsessive focus on stock prices and short-term profit calculations, the linkage of executive compensation to these stock values through the use of stock options, the decline of American manufacturing and the increasing turn toward financial speculation and market manipulations to transfer wealth into the hands of a tiny layer of executives and large investors.

For these services, Enron was touted by financial publications and analysts as a highly innovative model company, a prime example of the “new economy.” To the extent that analysts on Wall Street were deceived by Enron, it was because they did not bother to probe Enron’s claims. So long as the stock was soaring, Wall Street was perfectly willing to let Enron do what it was doing, no questions asked. They all had a stake in the continued success of Enron. Enron

was hardly unique in this regard, as the subsequent scandals at WorldCom, Tyco, Kmart and other major US companies demonstrated.

Many of the analysts were employed by banks that were heavily invested in Enron, and worked actively to help the company cover up its losses. This fact came out in the civil suit brought against banking giants Citigroup and JP Morgan Chase in 2003. The banks were charged with helping Enron cover up its cash flow problems by disguising loans as revenue.

Enron was, moreover, a company with the most extensive political connections, particularly to George W. Bush, both during his tenure as Texas governor and in his initial period in the White House. Enron officials were appointed by Bush to top positions, and the company played a key role in formulating the administration’s early energy policy. Lay was Bush’s close personal friend and a top contributor to his campaign. The Bush administration’s Justice Department has, of course, refrained from examining any of these questions, and they have been almost entirely dropped by the media and the Democratic Party as well.

Ever since Enron set off a wave of accounting scandals in 2001, the American ruling class has worked consciously to obscure these broader issues, for they call into question the basic foundation of the American economy. This attitude was expressed most recently in a February 8 *Wall Street Journal* editorial. The essential lesson of Enron, the *Journal* declared, is that the class of corrupt businesses is “pretty small.”

“The trial that began in Houston last week is not, or at least should not be, about the existence of a culture of corporate malfeasance,” the *Journal* opined. “Rather, it concerns the question of whether the two men at the top of Enron knew about and participated in the fraud that allegedly brought the company down.”

From a strictly legal standpoint, this may be true, but the attempt to present the trial of Lay and Skilling as the final stage in the Enron saga is intended to forestall any consideration of the deeper processes at work. Indeed, even as Lay and Skilling sit in the dock, the basic social conditions that produced and encouraged them continue unimpeded.



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