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CONFLICTS OF INTEREST AND CORPORATE GOVERNANCE FAILURES AT UNIVERSAL BANKS DURING THE STOCK MARKET BOOM OF THE 1990s: THE CASES OF ENRON AND WORLDCOM

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INTRODUCTION

The re-entry of commercial banks into the securities business transformed U.S. financial markets during the 1990s. Beginning in the 1980s, federal regulators and courts began to open loopholes in the Glass-Steagall Act of 1933 (Glass-Steagall), which had effectively banished commercial banks from the securities industry. In 1989, the Federal Reserve Board permitted bank holding companies to establish "Section 20 subsidiaries," which could underwrite debt and equity securities to a limited extent. By 1996, Section 20 subsidiaries were able to compete effectively with securities firms as a result of the Federal Reserve's liberalization of the rules governing those subsidiaries. In 1998, the Federal Reserve took a more dramatic step by allowing Citicorp, the largest U.S. bank holding company, to merge with Travelers, a financial conglomerate that owned a major securities firm, Salomon Smith Barney (SSB). That merger produced Citigroup, the first U.S. universal bank since 1933, and it placed great pressure on Congress to repeal Glass-Steagall. In November 1999, Congress enacted the Gramm-Leach-Bliley Act (GLBA), which removed the most important Glass-Steagall barriers and allowed commercial banks to affiliate with securities firms and insurance companies by forming financial holding companies.[1]

In adopting GLBA, Congress determined that the potential benefits of combining commercial and investment banking outweighed concerns about promotional pressures and conflicts of interest that were reflected in Glass-Steagall. Congress concluded in 1999 that Glass-Steagall was obsolete and counterproductive. Congress therefore dismissed the relevance of Glass-Steagall's findings that the combination of commercial and investment banking during the 1920s had produced a wave of speculative financings, an unsustainable economic boom, and the distribution of high-risk securities that inflicted massive losses on unsophisticated investors.[2]

GLBA essentially ratified the securities powers that bank holding companies had already obtained through the Federal Reserve's Section 20 orders. By 1999, forty-five banking organizations (including all of the twenty-five largest banks) had established Section 20 subsidiaries. Three of those banks – Citigroup, J.P. Morgan Chase (Chase) and Bank of America – ranked among the top ten underwriters for U.S. securities in 1999.[3] During 1999-2000, Citigroup's investment banking fees exceeded $6.6 billion and accounted for more than a fifth of Citigroup's total revenues.[4] In 2000, Citigroup, Chase and Bank of America ranked among the top ten underwriters of global securities, along with three major foreign banks (Credit Suisse, Deutsche and UBS) and four U.S. securities firms (Goldman Sachs, Merrill Lynch, Morgan Stanley and Lehman Brothers). That group of top global underwriters remained essentially the same during 2001-05.[5]

The six domestic and foreign banks included within that group achieved their status in large part by acquiring securities firms in the United States and the United

Kingdom.[6] Leading securities firms responded to the banks' competitive challenge by acquiring FDIC-insured depository institutions. Securities firms were able to acquire these bank-like institutions by taking advantage of loopholes in the statutes governing bank and thrift holding companies. For example, Merrill Lynch acquired a thrift institution and an industrial loan company (ILC) during the 1990s. Those institutions currently hold $80 billion of deposits, and Merrill Lynch uses their deposits as the primary funding source for its commercial lending, consumer lending and bond trading activities.[7] Morgan Stanley, Lehman Brothers and Goldman Sachs also own ILCs, although each of those ILCs currently holds less than $8 billion of deposits.[8] Thus, Merrill Lynch certainly qualifies as a universal bank in terms of offering a full range of banking and securities services, and the other three major securities firms arguably fall within that category as well.

Competition between commercial banks and securities firms helped to stimulate a spectacular growth in the issuance of corporate securities during the late 1990s. Total underwritings and private placements of corporate securities in U.S. financial markets more than tripled, from $860 billion to $3.12 trillion, during 1994-2001.[9] This rapid expansion in corporate issues contributed to the stock market boom of 1994-2000, which was comparable to the great bull market of 1923-29. Unfortunately, as in the 1920s, the stock market boom of the 1990s was followed by a sharp decline during 2000-02. During that decline, the total value of all publicly traded U.S. stocks fell by 40 percent, from $17 trillion to $10 trillion, representing the worst long-term decline in stock values since 1929-32.[10]

The drop in stock prices accelerated between December 2001 and October 2002, as investors reacted to reports of accounting fraud and self-dealing at many "new economy" firms that had been viewed as "stars" during the stock market boom of the 1990s.[11] The sudden collapses of Enron and WorldCom were especially shocking to investors. With assets of $63 billion and $104 billion, Enron and WorldCom represented the largest corporate bankruptcies in U.S. history.[12] Investigations and lawsuits revealed that universal banks played central roles in financing the rapid growth of Enron and WorldCom, and in promoting the sale of their securities. Government officials penalized universal banks for their involvement with Enron and WorldCom, and officials also brought enforcement actions against universal banks for a wide range of other misconduct related to their securities activities, including (i) conflicts of interest among research analysts, resulting in the issuance of biased and misleading reports to investors, (ii) manipulative and abusive practices connected with initial public offerings (IPOs), and (iii) late trading, market timing and other abuses involving mutual funds.[13]

This chapter is part of a larger project that will examine the role of universal banks during the U.S. economy's boom-and-bust cycle of 1994-2002. In particular, I intend to consider whether the combination of commercial and investment banking activities during the 1990s created promotional pressures and conflicts of interest that (i) caused universal banks to underwrite risky securities and extend speculative loans, (ii) led universal banks to issue offering prospectuses and research reports that promoted the sale of those risky securities without proper disclosure of the investment risks, and (iii) induced universal banks to disregard legal prohibitions on deceptive practices and their own policies against abusive transactions. This chapter focuses on the involvement of universal banks with Enron and WorldCom. While many scholars have analyzed the Enron and WorldCom scandals, to my knowledge only two legal academics – James Fanto and Hillary Sale – have given substantial attention to the role of universal banks in those scandals.[14] The analysis in this chapter builds upon their important work.

The evidence presented below supports several conclusions. First, the desire for investment banking fees caused universal banks to enter into structured-finance transactions with Enron, even though bank officials recognized that that the transactions (i) were inherently deceptive, (ii) were contrary to their banks' risk management policies and (iii) exposed their banks to serious reputational risk and legal liability. Second, universal banks competed for investment banking mandates by providing extraordinary financial favors to senior corporate executives of Enron and WorldCom, notwithstanding the obvious corruption inherent in those favors. Third, universal banks distributed offering prospectuses and research reports that encouraged investors to buy Enron's and WorldCom's securities, even though bank officials knew or should have known that the promotional documents were materially misleading and failed to disclose significant investment risks. Indeed, some banks quietly arranged hedging transactions to reduce their credit exposures to Enron and WorldCom concurrently with their publication of materials encouraging investors to buy the companies' securities. Other banks fired analysts who published critical reports about Enron. Finally, universal banks repeatedly extended credit to Enron and WorldCom in order to attract investment banking business, even though bank officers had serious concerns about the financial viability of both companies.

Thus, the Enron and WorldCom episodes demonstrated an appalling failure of corporate governance safeguards at universal banks as well as their clients. The actions of universal banks with respect to Enron and WorldCom also revealed the existence of promotional pressures, conflicts of interest, speculative financing and exploitation of investors, which were similar to the perceived abuses that caused Congress to separate commercial and investment banking in 1933. Beyond the injuries suffered by investors and the broader economy, the universal banks' misconduct related to Enron and WorldCom raises troubling questions about the risks to the financial system created by the commingling of commercial and investment banking. By November 2006, universal banks had paid $15 billion, and had surrendered creditor claims of about $3 billion, in order to settle enforcement actions, civil lawsuits and bankruptcy proceedings related to Enron and WorldCom. The losses suffered by universal banks, which have not yet been fully determined, far exceed the fees they received from Enron and WorldCom. For example, Enron and WorldCom paid Citigroup about $330 million, but Citigroup has already paid nearly $5 billion to settle claims related to its work for those companies.[15] The magnitude of the foregoing losses indicates that GLBA's regulatory scheme is not adequate to control the risks posed by universal banking powers to our largest banks – the same banks that are most likely to receive "too big to fail" treatment from financial regulators.[16]

UNIVERSAL BANKS AND ENRON

The Rise and Fall of Enron

Enron was one of the most glamorous and admired companies during the stock market boom of the late 1990s. Enron's reported revenues increased from less than $10 billion in 1995 to $20 billion in 1997, $30 billion in 1998, $40 billion in 1999, and $100 billion in 2000. Enron's market capitalization reached $70 billion at its peak in August 2000. Measured by reported revenues and market capitalization, Enron was the seventh largest corporation in the United States. For five consecutive years, from 1997 through 2001, *Fortune* magazine ranked Enron as the "Most Innovative Company in America."[17]

Enron's management, led by Kenneth Lay and Jeffrey Skilling, transformed Enron from an operator of natural gas pipelines in the 1980s to a highly diversified company with four primary business segments at the end of the 1990s. Enron's major segments were (i) Transportation Services, which operated Enron's traditional natural gas pipelines and an electric utility, (ii) Wholesale Services, which operated trading markets for futures contracts and other derivative instruments based on a wide range of commodities, (iii) Energy Services, which sold energy products to commercial and retail customers, and (iv) Broadband Services, which sought to be "the world's largest marketer of bandwidth and network services [and] … the world's largest provider of premium content delivery services." Enron also made extensive "merchant investments" in a wide array of ventures, including foreign power plants, foreign water systems, and many speculative, high-technology companies.[18] By 2000, Enron's highly-publicized business units for bandwidth trading and for providing broadband services to households persuaded Wall Street that Enron deserved an "Internet-style valuation," which was far higher than Enron could have achieved as an energy company.[19]

Enron also became a de facto financial institution by the late 1990s, due to its heavy involvement in trading commodities and financial instruments. Skilling was the architect of Enron's financial services strategy, which grew out of his success in establishing a "gas bank" at Enron in the early 1990s. The "gas bank" was very profitable, and Enron became the leading supplier of futures and other derivative contracts for delivery of natural gas. Enron tried to extend Skilling's "gas bank" concept by creating trading markets and risk management products for a wide variety of commodities, including electricity, water, pulp and paper, coal, steel and broadband. Skilling believed that Enron should buy "hard assets" in targeted industries solely for the purpose of establishing a base for trading operations, and should then sell off the assets after it developed a trading capability.[20]

Skilling based his "asset light" strategy on the assumption that Enron could use its trading expertise and Internet technology to "monetize" all types of assets. Skilling was convinced that Enron had the potential to become the dominant trader for every conceivable type of commodity or contract.[21] In Enron's 2000 annual report, the company proclaimed its "unrivaled access to markets and liquidity" and also declared that "[w]hen customers do business with Enron, they get our commitment to reliably deliver their product at a predictable price, regardless of market conditions."[22]

Enron pursued three additional strategies, which contained the seeds of its destruction. First, Enron obtained permission from the Securities and Exchange Commission (SEC) to adopt the mark-to-market (MTM) accounting method for certain of Enron's trading activities. Without seeking the SEC's approval, Enron extended MTM accounting to many of its other businesses. By 2000, Enron accounted for more than a third of its assets under the MTM method. MTM accounting allowed Enron to carry those assets at "fair value" based upon publicly quoted prices or (in most cases) its own estimates of fair value. Additionally, MTM accounting enabled Enron to record in a single year all the profits that it expected to accrue over the life of a financial contract, power plant or other newly-acquired asset. Second, Enron's compensation system rewarded employees for increasing the company's quarterly earnings, thereby encouraging Enron's officers to make deals with the maximum short-term impact on profits. In combination, MTM accounting and Enron's compensation system produced an aggressive, deal-oriented corporate culture in which managers approved contracts and authorized new projects to achieve short-term earnings goals, with little or no regard for the long-term viability of those ventures.[23]

Third, as stated in its 2000 annual report, Enron pledged that it would be "laser-focused on earnings per share," and that it would maintain "investment grade status," which was "critical to the success of [Enron's] wholesale [trading] business as well as its ability to maintain adequate liquidity."[24] Enron's commitment to produce steady growth in earnings per share (EPS) and to maintain an investment-grade credit rating made the company a favorite of institutional investors. By late 2000, mutual funds, pension funds and other institutional investors held 60 percent of Enron's stock, and those investors did not begin to abandon Enron until October 2001, after the company disclosed that accounting violations would force it to write down its assets by more than $2 billion.[25]

Enron's promises ultimately created a financial trap from which it could not escape without fraud. Analysts and credit ratings agencies expected Enron to produce consistent growth in cash flow revenues and EPS. However, Enron's MTM accounting produced a mismatch between cash flow and earnings, because Enron reported MTM earnings well in advance of its receipt of actual revenues. Many of Enron's speculative ventures proved to be disappointments or outright disasters and did not produce the expected revenues. Enron therefore needed external funding sources to provide the cash flow that its internal operations failed to generate. Enron's management was unwilling to obtain the needed funds by issuing new stock, because that would dilute the company's EPS. Management was also unwilling to issue new debt, because that would undermine Enron's investment-grade credit rating.[26]

Because of its unwillingness to issue equity or debt, Enron entered into a bewildering array of structured-finance transactions. Enron's structured-finance deals were designed to achieve the following objectives: (i) to generate fictitious revenues and earnings, (ii) to obtain de facto loans while disguising Enron's obligations to repay those loans, (iii) to move poorly-performing assets off Enron's balance sheet into special-purpose entities (SPEs) controlled by Enron or its officers, and (iii) to create accounting hedges against declines in the MTM values of Enron's more volatile assets.[27] By November 2001, Enron had accumulated actual debt obligations of $38 billion, but only $13 billion appeared on its balance sheet.[28]

Enron's officers believed that the company's structured-finance transactions would provide "bridge" financing and would "maintain the impression that Enron was humming until . . . [the company] started raking in *real* profits" from the "big enchilada" projects conceived by Skilling.[29] Unfortunately, Skilling's projects failed, and the hoped-for profits did not materialize.[30] When Enron finally began to disclose the magnitude of its accounting manipulations in October 2001, the company quickly lost the confidence of its investors, creditors and trading counterparties. Enron filed for Chapter 11 bankruptcy reorganization on December 2, 2001, shortly after last-ditch merger negotiations with Dynegy failed.[31]

Universal Banks as "Enablers" of Enron's Fraud

Neal Batson, Enron's bankruptcy examiner, determined that "[t]here is sufficient evidence from which a fact-finder could conclude" that nine universal banks "had *actual knowledge* of the wrongful conduct of [Enron's] officers" and "gave *substantial assistance* to the officers by participating in the structuring and closing of the SPE transactions."[32] Similarly, Bethany McLean and Peter Elkind concluded that banks were "Enron's enablers . . . the best supporting actors of the Enron scandal – without whose zealous participation Enron's financial shenanigans would simply not have been possible."[33] Hillary Sale also agreed that "[b]anks were a significant part of what 'went wrong' at Enron. . . . Without the banks, the [SPE] transactions would not have occurred."[34]

Enron's deal-focused culture and its constant need for new sources of financing made it a favorite client of universal and investment banks. "By the late 1990's, Enron had become one of the largest payers of investment banking fees in the world" and obtained services from more than seventy banks.[35] Andrew Fastow, Enron's chief financial officer, created a tournament that forced banks to compete against each other for Enron's favor. Fastow divided Enron's banks into "Tier 1, Tier 2, and Tier 3", and a bank could earn "Tier 1" status only if it was prepared "to lead/structure complex, mission-critical deals," to "[u]nderwrite $1 billion in [a] short period of time," and to provide an "[a]ccount officer capable of delivering [the] institution" so that it would do Enron's bidding.[36] Many banks readily accepted Fastow's terms, even though Enron was a notoriously difficulty client. As one banker said, "It was hell doing business with them, but you had to because they were so big."[37]

The Enron bankruptcy examiner's reports provide detailed descriptions of the involvement of universal banks in Enron's structured-finance deals.[38] This chapter focuses on four types of transactions, which banks arranged for Enron despite their clear awareness of the deception and corruption inherent in those transactions.

First, Enron used prepaid commodity swaps ("prepays") to obtain disguised loans. In the typical prepay, the lending bank transferred funds to a bank-controlled SPE, and the SPE then "paid" those funds to Enron in exchange for Enron's "agreement" to deliver specified commodities. A series of offsetting swap agreements among the bank, the SPE and Enron effectively eliminated Enron's agreement to deliver the commodities and instead obligated Enron to pay a fixed sum of money plus interest to the lending bank. Although the prepays were functionally equivalent to loans, Enron reported the proceeds as cash flow from operating activities and recorded its payment obligations as liabilities from "price risk management activities." Thus, prepays enabled Enron to inflate its reported cash flow and to disguise its actual debt obligations.[39] Citigroup and Chase arranged more than $8.3 billion of prepay transactions for Enron between 1992 and 2001. Barclays, Credit Suisse, Royal Bank of Scotland (RBS) and Toronto Dominion Bank also participated in prepay transactions.[40] According to one Enron risk manager, "[t]he banks liked [prepays] because Enron got addicted . . . . Enron had to repay the loan[s], but the cash flow didn't materialize. So [the prepays] snowballed."[41]

"Minority interest transactions" were a second type of structured-finance device that provided disguised loans to Enron. Citigroup provided $1.75 billion of de facto loans to Enron through three "minority interest transactions" that were completed at the end of 1997, 1998 and 1999. Citigroup developed the concept for these transactions and marketed the concept as a proprietary product. In the 1999 transaction (known as Project Nahanni), Citigroup provided a $485 million loan to Nahanni, an SPE established and controlled by Citigroup. Citigroup also arranged for a group of investors to buy $15 million of equity in Nahanni in order to meet the SEC's three percent outside equity ownership requirement for avoiding consolidation of Nahanni's financial statements with those of either Enron or Citigroup. Nahanni used the funds it received from Citigroup and the investors to purchase $500 million of Treasury securities, which it then contributed as a "minority investment" in Marengo, an Enron-controlled entity. At Enron's direction, Marengo sold the Treasury bills on December 29, 1999, and Marengo sent the $500 million sale proceeds to Enron.

In January 2000, Enron caused Marengo to "repurchase" Nahanni's minority interest for $487.1 million. Nahanni used those funds to repay Citigroup's $485 million loan together with $2.1 million in imputed interest. Thus, in practical effect, Citigroup used Project Nahanni to provide a $485 million loan to Enron for a one-month period. However, Enron did not report Project Nahanni as a loan. Instead, Enron reported the $500 million of Treasury bills contributed by Nahanni as a "minority interest" on its 1999 balance sheet, which it then "repurchased" in 2000. In addition, Enron reported the sale of the Treasury bills on its 1999 income statement as $500 million of cash flow from "merchant investment" activities. Like the prepays, Project Nahanni and the other "minority interest" transactions inflated Enron's reported cash flow while disguising its actual debt.[42]

A third series of structured transactions enabled Enron to create fictitious "sales" of assets to Enron-controlled SPEs. During 2000 alone, Enron relied on asset sales to

SPEs to increase its reported operating cash flow and its reported earnings by more than 35%.[43] For example, in Project Bacchus, Enron contributed its pulp and paper trading business to an off-balance-sheet SPE named Fishtail, in exchange for 80% of Fishtail's equity. Enron asserted that it did not have to consolidate Fishtail on its balance sheet, because three percent of Fishtail's equity was held by LJM2, a purportedly independent partnership that was actually controlled by Fastow. On December 20, 2000, Enron sold its 80% interest in Fishtail for $200 million to Sonoma, another SPE. Citigroup provided Sonoma with a $194 million loan and a $6 million equity infusion, thereby enabling Sonoma to "buy" Enron's interest in Fishtail and to avoid any consolidation with Enron. Using a total return swap, Enron guaranteed repayment of Citigroup's $194 million loan, and Fastow orally committed to repurchase Citigroup's $6 million equity investment. Enron's bankruptcy examiner concluded that (i) Project Bacchus did not represent a "true sale" of Enron's pulp and paper trading business, because both Fishtail and Sonoma should have been consolidated with Enron, and (ii) Project Bacchus effectively represented a $200 million loan from Citigroup to Enron. Nevertheless, Enron reported Project Bacchus on its 2000 income statement as generating $200 million in cash flow from operations and $112 million in MTM earnings resulting from the "sale" of its pulp and paper trading business. In addition, Enron did not report its swap obligation to repay Citigroup's loan as debt on its balance sheet.[44]

Barclays, Canadian Imperial Bank of Commerce (CIBC), Credit Suisse and RBS helped Enron to make similar fictitious "sales" of assets to off-balance-sheet SPEs. CIBC's role was particularly significant, as it participated in eleven SPE transactions that enabled Enron to inflate its reported MTM earnings by nearly $600 million and its reported cash flow by more than $1.7 billion, while understating its reported debt by more than $1 billion.[45]

The most notorious of these asset "sales" was Enron's sale of Nigerian barges to an SPE established by Merrill Lynch at the end of 1999. Enron needed to sell the barges to generate earnings but could not find an arms' length buyer at the desired price. At Enron's request, Merrill Lynch established an SPE to purchase the barges and invested $7 million to capitalize the SPE. Fastow gave his oral assurance that Enron would repurchase Merrill Lynch's equity interest within six months and would also give Merrill Lynch a 15% return on its investment. Merrill Lynch's $7 million investment (together with a $21 million loan from Enron) provided the SPE with funds that were used to buy the Nigerian barges for $28 million. Enron reported the transaction on its 1999 income statement as producing $12 million in MTM earnings from the "sale" of the barges, even though the transaction did not meet the requirements for a "true sale" to an unaffiliated party. Merrill Lynch also participated in another sham transaction requested by Enron at the end of 1999 – a pair of offsetting electricity swaps that were effectively "mirror images" in their essential terms. The matched swaps had no substance, but Enron used them to report $50 million of additional earnings on its 1999 income statement.[46]

A fourth series of SPE transactions provided accounting hedges for Enron's merchant investments in speculative, high-technology companies. These hedging transactions had two primary purposes: (i) to lock in gains in the MTM values of some of Enron's merchant investments, and (ii) to protect Enron's balance sheet against future declines in the values of such investments. To create each of the desired hedges, Enron established an SPE in which either LJM1 or LJM2 – purportedly independent partnerships that were controlled by Fastow – held the required three percent equity interest. Enron then entered into a total return swap with the SPE. Under the swap, Enron agreed to pay an amount equal to any increase in the MTM value of the underlying investment and the SPE agreed to pay an amount equal to any decline in the MTM value of that investment. Thus, the SPE's payment obligation under the swap offset any MTM loss that Enron might suffer on the underlying investment. However, the hedges were illusory, because Enron capitalized the SPEs with contributions of its own stock. When Enron's stock price plummeted in 2001, the SPEs could no longer perform their payment obligations and the hedges collapsed.[47]

Credit Suisse and RBS provided the outside capital for LJM1 and received handsome returns on their investments. They also participated in transactions involving LJM1 that enabled Fastow and his associates to reap personal benefits of more than $40 million, even though officials at both banks recognized the impropriety of Fastow's self-dealing.[48] Based on LJM1's success, Fastow persuaded Enron's board to authorize LJM2 – "a big, all-purpose private equity fund" that would enable Enron to "manage its investment portfolio risk, funds flow, and financial flexibility."[49] Fastow chose Merrill Lynch to serve as the financial advisor and private placement agent for LJM2. Fastow insisted that Enron's banks must make substantial equity investments in LJM2 if they wanted to maintain "Tier 1" status for Enron's banking business. Merrill Lynch and its partners invested more than $20 million in LJM2, and Enron's other banks contributed an additional $80 million. The banks' up-front investments enabled Fastow and Merrill Lynch to recruit other institutional investors, including insurance companies and pension funds. Fastow and Merrill Lynch ultimately raised $400 million of equity capital for

LJM2, which enabled LJM2 to become "the single most powerful tool for managing Enron's earnings."[50]

In addition to the foregoing SPE deals, Enron executed a series of tax-related SPE transactions that were engineered by Deutsche Bank. Deutsche's structured transactions produced tax benefits that increased Enron's reported income by more than $400 million during 1997-2001. Enron's bankruptcy examiner concluded that these transactions "were, for the most part, artificial transactions lacking a bona fide business purpose other than the creation of accounting income for Enron."[51]

The Banks' Awareness of Enron's Fraud

Enron's bankruptcy examiner determined that the SPE transactions disguised $14 billion of debt obligations by moving those obligations off Enron's balance sheet.[52] The banks knew that Enron was using SPE transactions to inflate its reported cash flows and earnings and to hide debt obligations, thereby misleading investors, analysts and credit ratings agencies. Credit Suisse and RBS also recognized that their involvement in LJM1 enabled Fastow and his associates to receive improper self-dealing benefits. Despite this knowledge, the banks viewed Enron as a highly desirable customer, and they dismissed the financial and reputational risks created by Enron's manipulative transactions.

Bank officials plainly recognized the deceptive nature of the structured-finance deals that their banks arranged for Enron. A Chase officer remarked that "Enron loves [prepay] deals as they are able to **hide funded debt from their equity analysts**."[53] Similarly, Citibank's Capital Markets Approval Committee noted that a prepay swap requested by Enron was "effectively a loan, [but] the form of the transaction would allow [Enron] to reflect it as 'liabilities from price risk management activity' on their [sic] balance sheet and also provide a favourable [sic] impact on reported cash flow from operations."[54] Officials at Credit Suisse acknowledged that a prepay transaction the bank was structuring for Enron had "accounting driven" elements, and one officer asked, "Is it OK for us to be entering into such an 'obvious' loan transaction?"[55]

Bank officials also recognized the deceptive impact of Enron's other SPE transactions. A Merrill Lynch officer noted that his firm's "mirror image" electricity swap with Enron at the end of 1999 "clearly help[ed] them make earnings for the quarter and year (which had a great value in their stock price, not to mention personal compensation)."[56] Several banks understood that Enron was probably violating accounting rules when it excluded the assets and liabilities of various SPEs from Enron's balance sheet. As a condition of investing in those SPEs, the banks required Enron's officers to give oral assurances that Enron would repurchase the banks' three percent equity interests. Given Enron's assurances, the banks understood that their equity investments were not truly "at risk," a situation that required consolidation of the SPEs onto Enron's financial statements.[57] For example, CIBC officers described their bank's equity investments in SPEs as "trust me" transactions, because (i) "[u]nfortunately there can be no documented means of guaranteeing the equity [investment] … or the sale accounting treatment is affected," and (ii) CIBC obtained "the strongest assurance (but not guarantee) from Enron senior management that we would not incur losses. They have lived up to their word so far."[58] A Barclays official similarly reported that he had received "explicit verbal support" from Ben Glisan, Enron's treasurer, who stated that "under all circumstances" Enron would "repay in full" Barclays' equity investment in the SPE.[59]

The banks also knew that Enron was structuring deals with SPEs to inflate earnings and hide debt. A Credit Suisse officer described the Osprey Trust SPE transaction as "a vehicle enabling Enron to raise disguised debt which appears as equity on Enron's balance sheet" while "serv[ing] the added purpose for Enron of being an off balance sheet parking lot for certain assets."[60] RBS officials described Enron's SPE transactions as "21st Century Alchemy."[61] Citigroup's managers referred to Project Nahanni as "year-end window dressing" and "essentially, an insurance policy for [year-end] balancing."[62] In describing Project Bacchus, a Citigroup officer explained that "Enron's motivation in the deal now appears to be writing up the asset in question from a basis of about $100MM to as high as $250MM, thereby creating earnings."[63] Another Citigroup officer confirmed that "Bacchus is part of a program designed to ensure that Enron will meet its debt/cap targets."[64]

Several bank officials objected to Enron's SPE deals because of the transactions' deceptive nature and the potential risks they created for the banks. One Merrill Lynch officer opposed the Nigerian barge transaction because it would "aid/abet Enron income statement manipulation," and he warned that his firm would face serious "reputational risk" if a "credit meltdown" occurred at Enron.[65] Similarly, a Citigroup officer questioned the "appropriateness" of Project Bacchus in view of the "earnings dimension to this deal."[66] Citigroup's head of global risk management objected to the Sundance Industrial transaction, whose purpose was to refinance Project Nahanni, because "[t]he GAAP accounting is aggressive and a franchise risk to us if there is publicity."[67] Similarly, two Credit Suisse officers expressed serious concerns about the "significant reputational risk" created by their bank's involvement in LJM1, given Fastow's clear conflicts of interest and the personal benefits Fastow expected to receive from LJM1's dealings with Enron.[68]

In each case, however, the banks went forward with the deals because they wanted to maintain their lucrative relationships with Enron. A Merrill Lynch officer defended the Nigerian barge deal by arguing that the deal would "differentiate [Merrill Lynch] from the pack and add significant value."[69] A Citigroup officer highlighted the importance of Project Bacchus by explaining that "[f]or Enron, this transaction is 'mission critical' (their label not mine) for [year-end 2000] and a 'must' for us."[70] After Project Bacchus was approved, a Citigroup officer remarked, "Sounds like we made a lot of exceptions to our standard policies. I am sure we have gone out of our way to let them know that we are bending over backwards for them . . . let's remember to collect this iou when it really counts."[71] Credit Suisse decided to invest in LJM1 because Skilling told a Credit Suisse officer that the LJM1/Rhythms transaction was very important to Enron, and because Credit Suisse wanted to strengthen its relationship with Enron and Fastow. After completing a refinancing of LJM1 that resulted in significantly higher payments to Credit Suisse, RBS and Fastow, a Credit Suisse banker explained that that the refinancing "has provided a significant return to [Credit Suisse] and has further enhanced our relationship with Andrew Fastow." The banker's supervisor praised her for doing "an excellent job."[72]

In fact, Enron's banks had powerful financial incentives to satisfy Enron's demands. During 1997-2001, Enron's top banks received the following fees from Enron: Citigroup – $188 million; Credit Suisse – $94 million; Chase – $86 million; Deutsche – $72 million; Merrill Lynch – $63 million; RBS – $60 million; and CIBC – $30 million.[73]

Not surprisingly, the banks prized their relationships with Enron. Citigroup ranked Enron as "one of the highest revenue clients within Citigroup," Chase described Enron as "our single largest client," RBS lauded Enron as one of its "most remunerative clients," and Credit Suisse viewed Enron as "a Firm wide … priority"[74] Perhaps the most revealing comment appeared in a CIBC internal memorandum, which explained that Enron's SPE transactions were "[n]ot terribly popular with [CIBC's] risk management [group], but the returns changed their minds!"[75]

The Banks' Failure to Protect Enron's Investors

In addition to their roles in Enron's SPE transactions, universal banks served as underwriters or private placement agents for many public offerings and private placements of debt and equity securities by Enron and its affiliates. Citigroup, Merrill Lynch and Credit Suisse each participated in more than twenty public and private offerings of Enron-related securities.[76] During 1998-2001, those three banks, along with Chase, CIBC, Barclays, Lehman Brothers and Bank of America, underwrote offerings for several billions of dollars of Enron-related securities.[77] After Enron collapsed, investors filed a class action lawsuit, which alleged that the banks failed to satisfy their duties as underwriters under Section 11 of the Securities Act of 1933 (1933 Act). The lawsuit charged that the banks did not exercise due diligence and, as a consequence, the offering materials failed to disclose Enron's business and financial problems and its deceptive accounting.[78] In addition, the lawsuit claimed that the banks were liable for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 (1934 Act), because they knowingly or recklessly distributed misleading offering materials and participated in other fraudulent practices (including the SPE transactions).[79]

The class action plaintiffs further alleged that the banks committed securities fraud by causing their investment analysts to issue highly favorable research reports about Enron despite the banks' knowledge of Enron's growing problems.[80] By 1999, Enron's banks were aware of Enron's difficulties in generating operating revenues to match its reported MTM earnings, and the banks also knew that Enron was executing dozens of accounting-driven SPE transactions that generated large off-balance-sheet liabilities. By 2001, Enron's banks recognized that the company was heavily leveraged, had significant liquidity problems and depended on a continuous stream of new financings. During this period, several of the banks quietly reduced their credit exposures to Enron by entering into credit default swaps, surety agreements and other hedging transactions.[81]

Despite the banks' awareness of Enron's increasingly severe problems, their investment analysts continued to publish favorable reports about Enron until shortly before Enron's collapse. In October 2001, "all sixteen investment analysts tracked by Thomson Financial/First Call rated Enron a 'buy,' and thirteen called it a 'strong buy,'" notwithstanding a fifty percent decline in Enron's stock price and the publication of articles in the financial press that questioned the validity of Enron's financial statements.[82] In November 2001, "eleven of the thirteen analysts following Enron still recommended that the public purchase the stock, and only one recommended selling it," even though Enron had disclosed a $1.2 billion writedown in its assets as well as an SEC investigation into its accounting practices,[83] The only analyst with a "sell" recommendation in November 2001 was employed by Prudential Securities, which did not engage in investment banking activities.[84]

Indeed, universal banks placed great pressure on their investment analysts to issue only favorable comments about Enron. Merrill Lynch and Citigroup fired analysts who published critical reports about Enron during the late 1990s. Merrill Lynch and Citigroup discharged their analysts after Enron's senior management complained about their reports and warned that the analysts were undermining the banks' relationships with Enron.[85] BNP Paribas allegedly forced an analyst to resign after he (i) published a research report downgrading Enron to "neutral" in August 2001, and (ii) told his clients that Enron's securities "should be sold at all costs and sold now."[86] Also in August 2001, UBS fired a broker, Chung Wu, after he advised a number of clients – who were also Enron employees – that Enron's financial situation was "deteriorating" and they should "take some money off the table." After receiving a strongly-worded complaint from Enron, UBS terminated Wu and apologized to Enron. UBS also sent a message to Wu's clients to assure them that Enron was "likely heading higher than lower from here on out." UBS' message included a copy of UBS' most recent research report on Enron, which included a "strong buy" rating and said that "[w]e would be aggressive buyers of Enron at current levels." Like Merrill Lynch and Citigroup, UBS wanted to preserve its relationship with Enron, which included investment banking work and a lucrative appointment as administrator of Enron's employee stock option plan.[87]

Credit Suisse's research analysts faced similar conflicts of interest with respect to Enron. Two Credit Suisse analysts warned a Chase analyst to stay away from Enron's stock in October 2001, at a time when Credit Suisse's research department maintained a "strong buy" rating on Enron. In response, the Chase analyst questioned why "you're telling me one thing but [your] clients a different story??? A little shady if you ask me….

[A]fraid to lose the banking business??? [A]re you an investment banker or equity research analyst???"[88] In a subsequent email message to his colleague, one of the Credit Suisse analysts admitted that "[w]e were [Enron's] number 1 supporter so the threat of a damaging research note was zero. [T]hey needed us to publicly sell the stock almost as much as we needed them for the fees."[89]

Credit Suisse's senior managers and investment bankers pressured another analyst, Jill Sakol, not to publish critical reports about Enron in 2001.[90] At the same time, the head of Credit Suisse's research department praised Sakol for communicating her negative assessment of Enron to Credit Suisse's bond traders, who quickly sold off the bank's position in debt securities issued by an Enron SPE.[91] Thus, Credit Suisse, like other universal banks, quietly reduced its credit exposure to Enron while subordinating the interests of retail investors to the bank's own interest in maintaining its relationship with Enron.

The Banks' Losses from the Enron Debacle

Enron proved to be a very costly client for its banks. By September 2006, universal banks had paid more than $8 billion, and had surrendered about $3 billion of their creditor claims against Enron, in order to settle various claims asserted by the SEC, Enron's investors, and Enron itself. Those amounts will almost certainly increase as Enron's investors and Enron itself continue to pursue their claims against non-settling banks.

Citigroup, Chase, CIBC and Merrill Lynch paid nearly $400 million to settle Enron-related charges filed against them by the SEC.[92] Citigroup, Chase, CIBC, Lehman Brothers and Bank of America paid $6.9 billion to settle claims asserted against them in a class action lawsuit by Enron investors.[93] In September 2006, Fastow stated at his sentencing hearing that he would provide evidence to help Enron's investors litigate their class action claims against non-settling banks, including Credit Suisse, Deutsche, Merrill Lynch, Royal Bank of Canada ("RBC"), RBS and Toronto Dominion.[94] In addition, Bank of America, Barclays, Chase, CIBC, Merrill Lynch, RBC, RBS, and Toronto Dominion paid Enron $900 million and surrendered creditor claims worth about $3 billion, in order to settle claims filed by Enron itself. As of November 2006, Enron was still pursuing claims against Citigroup, Credit Suisse, Deutsche and Merrill Lynch.[95]

UNIVERSAL BANKS AND WORLDCOM

The Rise and Fall of WorldCom

The chronicle of WorldCom's rapid ascent and sudden collapse resembles Enron's story in a number of respects. Like Enron, WorldCom grew from humble beginnings to become a leading "New Economy" firm and a favorite of institutional investors during the late 1990s. Like Enron's officials, WorldCom's managers sought to pump up their company's stock price by promising to meet aggressive earnings targets set by Wall Street analysts. Like Enron, WorldCom depended on universal banks to arrange the financing the company needed for its rapid expansion. Like Enron, WorldCom resorted to accounting fraud when it could not produce the revenues and earnings it promised to Wall Street.[96] Finally, the top managers of WorldCom – like those of Enron – were unrelenting in their drive to achieve dominance in their industry. For a time, Wall Street analysts and institutional investors had complete confidence in the ability of WorldCom's managers to achieve their ambitious goals. Bernie Ebbers and Scott Sullivan (WorldCom's CEO and CFO) "were considered one of the best pairings in

American business in the late 1990s as WorldCom's stock soared, often finishing each other's sentences when talking to adoring Wall Street analysts."[97] At the end of 2001, institutional investors owned 56.5% of WorldCom's stock (just as institutional investors had owned about 60% of Enron's stock at the end of 2000).[98]

WorldCom and its predecessor, Long Distance Discount Services, Inc. ("LDDS"), aggressively pursued business opportunities created by the deregulation of the telecommunications (telecom) industry following the breakup of AT&T's telephone monopoly in 1984. LDDS began operating in 1983 as a small provider of discount long-distance telephone services to Mississippi customers. In 1985, LDDS hired Bernie Ebbers as its CEO. Ebbers was a former high school basketball coach who owned a chain of motels. He had no prior experience in the telecom business, but he had unlimited ambition and "unshakeable optimism."[99]

Between 1985 and 2001, LDDS (renamed WorldCom in 1995) acquired more than seventy companies for total consideration valued at more than $100 billion. By 2001, WorldCom was the second largest long-distance telephone company and the largest provider of Internet-based communications services in the United States.[100] The rapid growth of LDDS and WorldCom occurred in several stages. First, LDDS and WorldCom acquired a series of domestic and international providers of long-distance telephone services to exploit the deregulation of the long-distance market that began in 1984. Second, WorldCom entered the local telephone business shortly after the Telecommunications Act of 1996 removed legal barriers that had previously barred long-distance carriers from offering local calling services. In December 1996, WorldCom acquired MFS Communications, thereby securing access to local telephone networks in a number of major U.S. and European metropolitan markets. In addition, by acquiring UUNet, a subsidiary of MFS, WorldCom gained the ability to offer Internet communications services. Third, WorldCom cemented its status as a leading competitor in markets for local, long-distance and international communications when it acquired MCI Communications in 1998. Fourth, WorldCom significantly expanded its wireless communications business by purchasing Skytel Communications and two other wireless providers in 1999. WorldCom then agreed to a merger with Sprint, which would have created the largest telecom firm in the United States. However, WorldCom was forced to abandon the Sprint transaction in July 2000, after the U.S. Justice Department and the European Union opposed the deal on antitrust grounds. WorldCom's last major acquisition occurred in September 2000, when it agreed to purchase Intermedia, primarily for the purpose of acquiring the web hosting business operated by Digex (a subsidiary of Intermedia).[101]

WorldCom invested massive amounts in an effort to create a global network of fiber-optic cables, telephone lines and wireless facilities that could offer a full range of telecom, video and Internet services to commercial and residential customers. In addition to installing its own network of lines, WorldCom entered into long-term leases to use the lines of other telecom firms. Many of those leases required WorldCom to make fixed monthly payments regardless of whether WorldCom or its customers actually used the leased lines. By 2000, line costs were WorldCom's largest expense item and represented about half of its operating costs.[102]

At its peak in mid-1999, WorldCom had a market capitalization of $180 billion. WorldCom's reported revenues reached $39 billion in 2000, based on operations in 65 nations.[103] WorldCom's growth strategy depended on continuous increases in its stock price, which it used as currency to pay for acquiring other companies. Wall Street analysts and institutional investors supported a high stock price for WorldCom as long as its reported revenues grew at an annual rate of 12-15%. Through the first quarter of 2000, WorldCom met Wall Street's expectations. WorldCom inflated its reported revenues and earnings by drawing down accounting reserves, including reserves for estimated merger expenses that WorldCom had established when it acquired other companies. Analysts and investors had not questioned WorldCom's establishment of large reserves to cover merger-related costs, and WorldCom drew upon those reserves to boost its revenues and profits.[104]

The collapse of the Sprint merger in 2000 deprived WorldCom of a major source of additional revenues and also prevented it from creating new reserves for merger costs. Moreover, conditions in the telecom business became intensely competitive and WorldCom's profits fell sharply after 1999. Like WorldCom, thousands of firms had entered domestic and foreign markets for local, long-distance, Internet and wireless communications services during the 1990s. By 2000, the telecom industry was plagued by overinvestment, heavy debt burdens and excess capacity. Compounding these problems, the collapse of many "dot com" firms in 2000 caused a sharp decline in the demand for communications services.[105] Because of these adverse developments, WorldCom's operating revenues declined after the fourth quarter of 1999. From late 1999 through early.2001, Sullivan (with Ebbers' knowledge) instructed WorldCom's accounting staff to use at least $3.3 billion in reserves to absorb line costs and increase WorldCom's reported earnings, in violation of generally accepted accounting principles

("GAAP"). After WorldCom exhausted its available reserves in early 2001, Sullivan (again with Ebbers' knowledge) directed WorldCom's accounting staff to capitalize $3.8 billion of WorldCom's line costs during 2001 and the first quarter of 2002. Sullivan's capitalization of line costs reduced WorldCom's reported expenses and boosted its reported profits, once again in clear violation of GAAP.[106]

According to Sullivan's testimony at Ebbers' criminal trial, Ebbers repeatedly told Sullivan during 2000-02 that "[w]e have to hit our numbers." At the same time, Ebbers assured the public that WorldCom was achieving "very solid growth" and "there were no storms on the horizon." In February 2002, Ebbers declared during a conference call with investors and analysts that "[w]e stand by our accounting" and "[t]o question WorldCom's viability is utter nonsense."[107] Ebbers resigned as CEO at the end of April 2002. Less than two months later, WorldCom's internal auditors discovered Sullivan's illegal capitalization of line costs. On June 25, 2002, WorldCom's board of directors fired Sullivan and publicly announced a restatement that reduced its previously reported earnings by $3.8 billion. As was true at Enron, WorldCom's disclosure of its accounting violations triggered a rapid collapse of confidence among its investors and creditors. On July 21, 2002, WorldCom filed for Chapter 11 bankruptcy reorganization.[108]

At the time of its bankruptcy filing, WorldCom reported assets of $107 billion and debts of $41 billion. However, about half of WorldCom's reported assets consisted of goodwill, representing the premium above fair market value that WorldCom had paid when it acquired other companies.[109] In 2004, WorldCom (renamed MCI) issued a final restatement that reduced its previously-reported pretax earnings by $74.4 billion. Of that amount, MCI allocated $10.6 billion to accounting fraud and attributed most of the remainder to the decline in value of MCI's goodwill.[110] Less than two years later, Verizon acquired MCI's remaining assets for only $8.5 billion.[111]

The Banks' Involvement in the WorldCom Debacle

As described in the previous section, WorldCom's managers accomplished their fraud primarily by manipulating accounting entries. James Fanto has pointed out that WorldCom's fraud was different from Enron's deceptions, because WorldCom's managers did not use "SPEs and structured finance, which demand intensive investment banking involvement."[112] Consequently, universal banks did not have the same degree of direct involvement in WorldCom's fraud as they did with Enron's abuses. Nevertheless, in at least two ways, banks played a "significant" role in the WorldCom disaster.[113] First, they actively promoted WorldCom's aggressive and ultimately fatal growth strategy by persuading investors to purchase WorldCom's securities, by providing large loans to WorldCom, and by issuing analysts' reports with glowing evaluations of WorldCom's future prospects. Second, at least three banks – Citigroup, Bank of America and Chase – participated in the corruption of WorldCom's management by providing Ebbers with extraordinary financial benefits in order to win WorldCom's business.

Universal banks underwrote huge public and private offerings of debt and equity securities by WorldCom. Citigroup and its predecessors were sole lead managers for public offerings of more than $8 billion of WorldCom debt securities in 1997 and 1998. Citigroup and Chase jointly led two public offerings of WorldCom bonds – the first for $5 billion in 2000, and the second for $11.9 billion in 2001. Chase acted as sole lead manager for a $2 billion private offering of WorldCom notes in 2000.[114] Both Citigroup and Chase were also directly involved in offerings of WorldCom stock. Citigroup was the principal financial advisor for WorldCom's acquisitions of MFS and MCI, resulting in the issuance of more than $50 billion of WorldCom stock to the shareholders of MFS and MCI. Chase was the principal financial advisor for WorldCom's acquisition of Intermedia, resulting in the issuance of $5.8 billion of WorldCom stock to Intermedia's shareholders.[115] Bank of America acted as lead arranger for a $10.75 billion syndicated loan in 2000, and it was also one of five arrangers for a $2 billion trade receivable securitization program. Bank of America also participated in WorldCom's public bond offerings in 1998, 2000 and 2001.[116]

Events in 2001 confirmed the close connection between the underwriting and lending activities of WorldCom's banks. In March 2001, WorldCom asked its banks for a syndicated loan for up to $10 billion in order to refinance its existing bank debt. WorldCom told its leading banks – including Citigroup, Chase and Bank of America – that they must each provide at least $800 million of the new syndicated loan in order to secure roles as lead underwriters for WorldCom's planned $11.9 billion bond offering in May 2001. The banks agreed to provide the requested loan, even though they had increasing doubts about WorldCom's financial strength.[117] As discussed below, some of the banks quietly reduced their lending exposures to WorldCom but none of them disclosed their doubts to public investors.

Bank of America, Chase and Citigroup also provided extensive personal benefits to Ebbers to solidify their positions as WorldCom's leading bankers. Bank of America provided Ebbers with $200 million of personal loans that were secured by his WorldCom stock. Ebbers used those loans (together with more than $100 million of loans from other banks and securities brokers) to purchase a large ranch in Canada, a shipyard and yacht building business in Georgia, a trucking company, and 600,000 acres of timberland in Alabama and Mississippi. Ebbers' relationship with Bank of America became severely strained, however, when WorldCom's stock price declined sharply during 2000 and 2001. The fall in WorldCom's stock price triggered repeated margin calls on Ebbers by Bank of America. WorldCom ultimately agreed to repay all of Ebbers' loans from Bank of America in order to avoid a massive sale of WorldCom stock by the bank.[118]

In April 2001, Chase gave Ebbers a $20 million line of credit, even though Chase knew that Ebbers already had more than $300 million in outstanding personal loans secured by his WorldCom stock. Investment bankers at Chase urged their personal banking colleagues to approve the loan in order to strengthen Chase's relationship with Ebbers and WorldCom.[119]

Citigroup and its predecessors, Salomon Brothers and SSB, provided the most extraordinary favors to Ebbers. In June 1996, at a time when Salomon was seeking to establish an investment banking relationship with WorldCom, Salomon allocated to Ebbers 200,000 shares of an IPO made by McLeod Inc., a Salomon underwriting client. Salomon's allocation of McLeod stock to Ebbers was more than four times larger than any other allocation made to a retail customer. Two months after the McLeod IPO, WorldCom retained Salomon as its financial advisor for the acquisition of MFS. From 1996 through 2002, WorldCom paid Salomon/SSB and Citigroup more than $140 million of fees, including $107 million for services provided in connection with nine major transactions. During the same period, Salomon and Citigroup allocated stock to Ebbers in twenty-two IPOs or secondary offerings made by underwriting clients. Ebbers earned trading profits of $12.8 million from those allocations (including $2.16 million from the

McLeod IPO). WorldCom's bankruptcy examiner concluded that these allocations "were intended to and did influence Mr. Ebbers to award WorldCom investment banking business to Salomon/SSB. . . . Salomon/SSB came to be WorldCom's preferred investment banker on both acquisition and financings."[120]

SSB continued to provide IPO allocations to Ebbers after Travelers (SSB's parent company) acquired Salomon in 1997, even though SSB had adopted a policy that prohibited "spinning." SSB's anti-spinning policy declared that "shares may not be allocated to an executive of a corporate client or prospect as a *quid pro quo* for receiving investment banking or other business from his or her corporate employer." SSB apparently disregarded its policy and continued to give allocations to Ebbers because WorldCom was one of SSB's premier clients. In April 2003, Citigroup consented to the entry of an SEC order declaring that Salomon/SSB's allocations of IPO shares to Ebbers constituted unlawful spinning in violation of rules of the National Association of Securities Dealers and the New York Stock Exchange.[121]

Citigroup also provided huge loans to Ebbers. In 1999, Citigroup lent $63 million to Ebbers to refinance the loan on his Canadian ranch.[122] In February 2000, Travelers syndicated a $499 million loan to Joshua Timberland, a company controlled by Ebbers.[123] In October 2000, Ebbers asked Citigroup for additional credit. After an extensive review, Citigroup's senior management approved an additional personal loan in light of the "high profile/quality of Ebbers as a Citigroup client, both individually and as CEO of WorldCom." Citigroup lent Ebbers $53 million, including a refinancing of his existing loan balance of $41.7 million.[124] Citigroup had good reasons to accommodate Ebbers because (i) Citigroup knew that Ebbers resented Bank of America's margin calls, and

Citigroup wanted to replace Bank of America as the leading provider of corporate banking services to WorldCom, and (ii) Citigroup was concerned that WorldCom was developing a strong investment banking relationship with Chase. In November 2000, despite the continuing decline in WorldCom's stock price, Citigroup decided not to make a margin call on Ebbers, given "the strength of the corporate finance relationship between SSB and WorldCom." Citigroup did not make any margin calls on Ebbers until May 3, 2002, four days after he resigned as WorldCom's CEO.[125] WorldCom's bankruptcy examiner concluded that Citigroup's loans to Ebbers "constituted another form of 'spinning,' a means of obtaining and/or keeping corporate business as a result of personal financial favors provided to corporate executives."[126]

The Bank Underwriters' Failure to Protect WorldCom's Investors

In February 2001, Bank of America, Chase and Deutsche each downgraded WorldCom in their confidential internal credit ratings. The banks reduced their internal credit ratings for WorldCom due to concerns about the company's rapidly increasing debt, its lack of revenue growth, competitive pressures on its long-distance business, and its lack of a strategic plan after abandoning the proposed merger with Sprint.[127] In addition, Bank of America and Chase reduced their lending exposures to WorldCom by entering into credit default swaps and other hedging transactions, but both banks did so quietly in order to avoid offending WorldCom.[128] Notwithstanding their growing concerns about WorldCom, all three banks acted as underwriters for WorldCom's $11.9 billion public offering of bonds in May 2001. Chase acted as a joint lead manager for the bond offering along with Citigroup, and both banks participated in a "road show" in America and Europe to promote the sale of the bonds. The road show script stated that “[w]e are excited about the WorldCom credit story and this debt offering. . . . WorldCom’s financial position gives it the strongest credit profile of any of the largest broadband providers.”[129]

The offering prospectus and road show script for the 2001 bond offering did not disclose that any of the bank underwriters had previously downgraded WorldCom in their internal credit ratings or had reduced their credit exposures to WorldCom through hedging transactions. The prospectuses for the 2000 and 2001 bond offerings also did not contain a “risk factors” section describing the specific investment risks associated with the bonds. In August 2002, bond purchasers filed a class action lawsuit against the seventeen bank underwriters, alleging that the underwriters failed to exercise due diligence to ensure that the prospectus for each offering disclosed all material facts concerning the bonds’ investment risks. The purchasers alleged that the underwriters knew sufficient facts to put them on notice that WorldCom’s financial statements for 1999 and 2000 were materially misleading, particularly with respect to the treatment of line costs as capital expenditures rather than operating expenses. The purchasers also charged that the underwriters should have known that the bond offering prospectuses omitted many other material facts, including (i) the lack of specific disclosure of the “risk factors” associated with the bonds, including the deterioration of WorldCom’s long-distance business, (ii) the omission of information concerning the loans and IPO allocations Ebbers received from bank underwriters, and (iii) the absence of any information about the underwriters’ actions in reducing their internal credit ratings and hedging their credit exposures during early 2001.[130] A federal district court ruled in 2004 that federal law did not explicitly require the underwriters to disclose their internal credit ratings or hedging activities with regard to WorldCom. However, the court held that the underwriters' actions (which indicated their concerns about WorldCom) and the other omissions cited above raised legitimate issues to be resolved at trial as to whether the underwriters failed to satisfy their duties of due diligence and reasonable care under Sections 11 and 12(a)(2) of the 1933 Act.[131]

The conflicts of interest faced by the bank underwriters were further reflected in Deutsche's conduct shortly before WorldCom collapsed. On April 12, 2002, John Tierney, Deutsche's head of credit derivatives strategy, published a note stating that WorldCom was headed for bankruptcy or an involuntary merger. Tierney also warned that "recovery values for a WorldCom bankruptcy could be quite low, less than 30 percent." Five days later, Deutsche retracted Tierney's note and claimed that it had been issued by mistake.[132] As discussed below, the bank underwriters eventually settled the claims filed against them by the bond purchasers, and Chase, Bank of America and Deutsche paid the largest amounts with the exception of Citigroup.

Citigroup's Disregard for Investors' Interests

Citigroup undoubtedly played the most significant role in encouraging investors to buy WorldCom's securities. The class action filed by purchasers of WorldCom's bonds and stock alleged that Citigroup violated its duty as an underwriter under the 1933 Act and also committed securities fraud under Section 10(b) of the 1934 Act. The purchasers' allegation of securities fraud presented two major claims. First, the purchasers maintained that Citigroup and Jack Grubman (its leading telecom analyst) established "an illicit *quid pro quo* arrangement" with WorldCom's senior management and had actual knowledge about material misstatements and omissions contained in the bond offering prospectuses. Second, the purchasers charged that Grubman and Citigroup's research department knowingly issued misleading reports to investors "that touted WorldCom's value and vigorously encouraged investors" to buy WorldCom's securities, even though Citigroup knew that "the integrity and objectivity of its research department was compromised by the department's decision to serve the needs of the firm's investment bankers at the expense of providing investors with independent analysis."[133] As discussed below, Citigroup was the first bank underwriter to settle the purchasers' claims, and it paid the largest amount of any settling bank.

Grubman developed a close personal relationship with WorldCom's senior management and became a principal advisor to Ebbers and WorldCom's board. After he joined Salomon in 1994, Grubman coordinated Salomon's efforts to attract WorldCom as a client. As noted above, Salomon became WorldCom's primary investment bank after it provided an exceptionally generous allocation to Ebbers in the McLeod IPO and also helped to arrange WorldCom's acquisition of MFS (a Salomon client).[134] Grubman attended at least four WorldCom board meetings and advised WorldCom's directors on major transactions, including the merger with MCI in late 1997 and the attempted merger with Sprint in late 1999. Grubman also advised WorldCom's managers as to how they should respond to press reports about WorldCom and how they should answer anticipated questions during conference calls with investors and analysts. WorldCom's board minutes described Grubman as a "financial advisor" to the company, despite his official position as an investment analyst.[135]

Grubman saw no conflict between his status as an investment analyst and his role as a key business advisor to Ebbers and other CEOs of telecom firms. Nor did Grubman see any problem with his active role in helping Citigroup to arrange investment banking transactions for his clients. Grubman claimed credit for helping to generate over $600 million in investment banking revenues for Citigroup in 2000, and he asked Citigroup's investment banking department to reimburse his expenses for attending Ebbers' wedding.[136] In a May 2000 interview, Grubman proclaimed, "I'm sculpting the industry. . . . I get feedback from institutions and CEOs. It feeds on itself. It's a virtuous circle." Grubman dismissed critics who claimed that his close ties with telecom executives compromised his objectivity. Grubman declared, "What used to be a conflict is now a synergy . . . . [Institutional investors] know that I'm in the flow of what's going on. . . . Objective? The other word for that is uninformed."[137]

WorldCom's growth strategy dovetailed perfectly with Grubman's vision of the telecom industry's future. Grubman maintained that telecom firms must build broadband networks that would transmit a full range of voice, video and Internet services. He argued that "the demand for bandwidth is basically insatiable" because telecom services were becoming "part of the Web-centric society." Thus, in Grubman's view, the long-term survivors in the telecom industry would be firms that pursued an aggressive strategy "to marry [bandwidth] networks and customers."[138] His prediction of an inexhaustible demand for bandwidth was consistent with WorldCom's repeated claims that Internet traffic was doubling every 100 days.[139] His clients and other telecom firms rushed to build national and global fiber-optic networks, and the amount of installed fiber increased fivefold between 1998 and 2001.[140]

Grubman's status as the "king of telecom" helped Citigroup to become the top underwriter for telecom firms. During 1996-2002, Citigroup earned $1.2 billion in fees from telecom firms and underwrote $190 billion of their debt and equity securities, representing a quarter of all issuances of telecom stocks and bonds during that period.[141] Citigroup rewarded Grubman by paying him $67.5 million between 1999 and 2002.[142] In May 2000, Eduardo Mestre, Citigroup's co-head of investment banking, commented that Grubman "has had a thesis for creating value in the telecom sector that's been dead right: Build it and they will come. . . . It wasn't a foregone conclusion that the thesis would be correct."[143]

Mestre's comment soon proved to be cruelly ironic. By 2002, analysts denounced Grubman's vision of telecom's future as "wildly hyped."[144] Instead of doubling every 100 days, Internet traffic doubled only every year. Meanwhile, technological advances increased the data transmission capacity of fiber-optic lines by up to 1,000 times between 1995 and 2002. Consequently, the frenzied installation of broadband networks by Grubman's clients and their rivals produced a massive glut of transmission capacity. By September 2002, only about three percent of installed bandwidth capacity was being used, and many of Grubman's leading clients – including WorldCom, Global Crossing, McLeodUSA, Metromedia Fiber Networks, Rhythms Netconnections, Winstar and XO Communications – had filed for bankruptcy.[145]

Grubman's research reports promoted WorldCom more than any other firm. His reports described WorldCom as "our favorite stock" in August 1997 and as a "must-own" stock in November 1998. He urged investors to "load up the truck" with WorldCom stock in August 1999.[146] In response to the severe decline in WorldCom's stock price during 2000-01, Grubman argued that WorldCom's critics were mistaken, and he encouraged investors to take advantage of the company's "dirt cheap" stock price.[147] He maintained the highest "buy" rating on WorldCom's stock from January 1997 through April 2002. On February 4, 2002, Grubman published a research note in which he contended that WorldCom's stock price "has been unduly punished by a multitude of factors . . . [and] has more than corrected for any actual impacts from those issues. Therefore, we believe that [WorldCom] at this point represents a very compelling value proposition for a telecom company."[148] Also in February 2002, Grubman supported WorldCom's projection that it would generate positive free cash flow during the second quarter of 2002.[149]

Grubman did not reduce his rating on WorldCom to "neutral" until April 21, 2002, eight days before Ebbers resigned as CEO. He did not downgrade WorldCom to "underperform" (sell) until June 21, 2002, a month before WorldCom filed for bankruptcy.[150] Of course, Grubman was hardly alone in giving WorldCom strong "buy" ratings during 2000-02. Many analysts (including those employed by three major Wall Street brokerage firms) maintained such ratings on WorldCom at the end of 2001. However, other analysts disagreed with Grubman. Analysts at Wachovia Securities and BlueStone Capital (an independent research firm) posted neutral ratings on WorldCom beginning in March 2001. Analysts at Credit Suisse and Morgan Stanley also issued neutral ratings before the end of 2001.[151]

Grubman's consistently bullish investment ratings were matched by his unusually aggressive target prices for WorldCom's stock. From February 1997 through January 2002, Grubman established target prices for WorldCom's stock that were (with few exceptions) the highest quoted by any analyst. During that period, virtually all of

Grubman's target prices were at least 50% above WorldCom's actual stock price, and many of his target prices were 100% or more above the actual stock price.[152]

During an appearance before a congressional committee on July 8, 2002, Grubman testified that he did not know about any fraudulent accounting at WorldCom until it was disclosed by the company two weeks earlier. Grubman declared that "WorldCom is a company I believed in wholeheartedly for a long time" and "[a]ll my beliefs have been honestly held."[153] He also stated that he was "sorry to see investors suffer losses" based on his faulty analysis of the telecom industry, and he denied that his analysis was motivated by conflicts of interest.[154] Similarly, in his letter of resignation to Citigroup in August 2002, Grubman apologized for "failing to predict" the telecom industry's collapse, but he again insisted, "I always wrote what I believed and based my opinions on a long and sincerely held investment thesis."[155]

Despite his protestations of honesty and good faith, Grubman consented to the SEC's entry of an order on April 28, 2003, finding that (i) Grubman published fraudulent research reports in 2001 on two telecom firms (Focal Communications and Metromedia Fiber), and (ii) Grubman wanted to downgrade Focal and five other telecom providers in April 2001, but he refrained from doing so because of pressure applied by Citigroup's investment bankers. In addition, the SEC charged that Grubman raised his rating on AT&T's stock from neutral to strong buy in November 1999, at the urging of Citigroup's co-CEO, Sanford (Sandy) Weill. Weill asked Grubman take a "fresh look" at AT&T in order to help Citigroup win an underwriting mandate for AT&T's planned offering of a wireless tracking stock. In return, Grubman asked Weill to help persuade the 92nd Street Y's highly selective preschool to admit Grubman's children. Grubman's upgrade of

AT&T's stock was a crucial factor in persuading AT&T to appoint Citigroup as lead underwriter for its $10.6 billion offering of wireless tracking stock. Grubman's children were admitted to the Y's preschool after Weill spoke to a member of the Y's board and arranged for the Citigroup Foundation to make a $1 million donation to the Y.[156]

The SEC quoted internal emails sent by Grubman to colleagues in which (1) he called Focal a "pig," (2) he acknowledged that "most of our banking clients are going to zero and you know I wanted to downgrade them months ago but got huge pushback from banking," and (3) he admitted that he "upgraded [AT&T] to get . . . Sandy to get my kids into 92nd St Y pre-school (which is harder than Harvard)," and he subsequently "went back to my normal negative self on [AT&T]."[157] While Grubman did not admit or deny the SEC's allegations, he paid a $15 million penalty and consented to a lifetime ban from the securities industry.[158]

On the same date that Grubman settled with the SEC, Citigroup paid a $400 million penalty and consented to the entry of an SEC enforcement order. The SEC charged that (i) Citigroup encouraged Grubman and other investment analysts to support Citigroup's investment banking activities and allowed Grubman and other analysts to issue false and misleading reports to investors about several telecom firms, and (ii) Citigroup approved unlawful "spinning" of IPO allocations to Ebbers and other executives of existing or potential clients for the purpose of attracting additional investment banking business.[159] In May 2004, Citigroup agreed to pay $2.6 billion to settle the WorldCom investors' class action soon after the investors' counsel filed a court brief, which cited evidence indicating that "the 'most senior officers of Salomon' acknowledged privately that its investment bankers had pressured its analysts to avoid negative ratings and that 'providing accurate stock ratings conflicted with Salomon's paramount goals of securing investment banking business.'"[160]

The SEC's complaints against Grubman and Citigroup did not allege that Grubman issued false research reports with respect to WorldCom. However, the SEC's charges seriously undermined Grubman's claims of objectivity and honesty. Moreover, the WorldCom investors' class action alleged that, in early 2000, Grubman began to use a "cash earnings" model for WorldCom's operating results that departed from his previous "discounted cash flow" model. The investors charged that Grubman's new model – which he did not use for any other telecom firm – omitted capital expenditures, a central component of WorldCom's fraud. A federal district court denied motions by Citigroup and Grubman to dismiss the investors' complaint, finding that the complaint "describes strong circumstantial evidence that Grubman learned of at least the capital expenditure fraud."[161]

The Banks' Losses from the WorldCom Disaster

Like Enron, WorldCom proved to be an extremely costly client. Seventeen banks that served as underwriters for WorldCom paid more than $6 billion to settle the WorldCom investors' class action, with the largest amounts being paid by Citigroup ($2.6 billion), Chase ($2 billion), Bank of America ($460 million), and Deutsche ($325 million).[162] The same group of banks paid over $600 million to settle additional lawsuits filed by institutional investors who did not participate in the class action.[163] In announcing Citigroup's decision to settle the class action, chairman Charles Prince denied that his bank had violated any laws and said that it had chosen to buy an "insurance policy . . . against a roll of a dice in front of a jury . . . [on] a $54 billion claim."[164] However, a prominent bank analyst concluded that Citigroup had effectively "admitted guilt" in view of the extraordinary size of its settlement payment.[165]

CONCLUSION

The evidence presented above shows that universal banks aided and abetted violations of corporate governance rules and federal securities laws by officers of Enron and WorldCom. Bank officials also repeatedly disregarded risk management policies established by their own banks. In my view, the Enron and WorldCom episodes indicate that GLBA's current regulatory framework is not adequate to control the promotional pressures, conflicts of interest and risk-taking incentives that are generated by the commingling of commercial and investment banking. A comprehensive reform of the supervisory system for universal banks is urgently needed and must become a top priority for Congress and financial regulators. I intend to discuss needed supervisory reforms in a future work.

NOTES:

[1] Melanie L. Fein, *Securities Activities of Banks* §§ 1.02-1.06 and 4.03 (New York: Aspen Publishers, 3d ed. 2005); Patricia A. McCoy, *Banking Law Manual* §§ 7.01-7.03 and 7.04[1] (Newark, NJ: LexisNexis Group, 2d ed. 2004); Arthur E. Wilmarth, Jr., "The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks," 2002 *University of Illinois Law Review* 215 [hereinafter Wilmarth, "Transformation"], at 219-22, 306-07, 318-21.

[2] Arthur E. Wilmarth, Jr., "Did Universal Banks Play a Significant Role in the U.S. Economy's Boom-and-Bust Cycle of 1921-33? A Preliminary Assessment," 4 *Current Developments in Monetary and Financial Law* 559 (International Monetary Fund, 2005) [hereinafter Wilmarth, "Universal Banks"], at 560-68.

[3] Timothy J. Yeager et al., "The Financial Modernization Act: Evolution or Revolution?", Federal Reserve Bank of St. Louis Supervisory Policy Working Paper 2004-05, Dec. 2004 (available at http://ssrn.com/abstract=646261); Wilmarth, "Transformation," supra note 1, at 319-20.

[4] Complaint in *SEC v. Citigroup Global Markets Inc.,* (S.D.N.Y., April 28, 2003) (available at www.sec.gov/litigation/complaints/comp18111.htm) [hereinafter SEC Citigroup Complaint], ¶ 142.

[5] Roy C. Smith, "Strategic Directions in Investment Banking – A Retrospective Analysis," 14 *Journal of Applied Corporate Finance* No. 1, Spring 2001, at 111, 116-21; Wilmarth, "Transformation," supra note 1, at 319-23; "Year-End Review of Underwriting: 2001 Underwriting Rankings: Global Stocks and Bonds," *Wall Street Journal,* Jan. 2, 2002, at R19 (showing that the "top ten" list of global underwriters remained the same during 2000 and 2001); "Year-End Review of Markets & Finance: 2003 Underwriting Rankings: Global Stocks and Bonds," *Wall Street Journal,* Jan. 2, 2004, at R17 (same with regard to 2002 and 2003); "Year-End Review of Markets & Finance: 2005 Underwriting Rankings: Global Stocks and Bonds," *Wall Street Journal,* Jan. 3, 2006, at R10 (same with regard to 2004 and 2005, except that Barclays Capital replaced Bank of America as the tenth-ranked underwriter in 2005).

[6] Jean Dermine, "European Banking Integration: Don't Put the Cart before the Horse," 15 *Financial Markets, Institutions & Instruments* No. 2, May 2006, at 57, 69 tbl. 4.b.; Smith, supra note 5, at 116-20; Wilmarth, "Transformation," supra note 1, at 323-24.

[7] Wilmarth, "Transformation," supra note 1, at 423-24, 448-49; Statement by Douglas H. Jones, FDIC Acting General Counsel, before the House Committee on Financial Services, July 12, 2006 (available at www.fdic.gov/news/news/speeches/chairman/spjul1107.html); at 3-5, 11 (attach. 1); Matt Ackerman, "Merrill Eyes Organic Growth But May Do a Banking Deal," *American Banker,* April 19, 2006, at 9; Landon Thomas Jr., "Bond Trader at Merrill Taps the Firm's Bank to Spin Gold," *New York Times,* Aug. 8, 2003, at C1; Matthias Rieker, "Merrill's Retail Banking Strategy Seen Paying Off," *American Banker,* June 12, 2003, at 20 (reporting that bank deposits provided 51% of Merrill Lynch's funding in 2003, compared with 14% in 1998); Katherine Fraser, "Merrill Lynch Using Thrift Charter To Build Its Personal Trust Business," *American Banker,* Aug. 10, 1998, at 1.

[8] Statement by Douglas H. Jones, supra note 7, at 4-5, 11, 14 (attach. 1).

[9] Securities Industry Association, *Securities Industry Fact Book 2002*, at 12.

[10] Robert J. Gordon, "The 1920s and the 1990s in Mutual Reflection," National Bureau of Economic Research Working Paper 11778, Nov. 2005, at 5-10, 28-29; Eugene H. White, "Bubbles and Busts: The 1990s in the Mirror of the 1920s," National Bureau of Economic Research Working Paper 12138, Mar. 2006, at 2-13; Wilmarth, "Universal Banks," supra note 2, at 559.

[11] E.S. Browning & Ianthe J. Dugan, "Stocks Unwound: Aftermath of a Market Mania," *Wall Street Journal,* Dec. 16, 2002, at C1; Anthony Bianco, "The Angry Market," *Business Week,* July 29, 2002, at 32; Marcia Vickers et al., "The Betrayed Investor," *Business Week,* Feb. 25, 2002, at 104.

[12] Aigbe Akhigbe et al., "Contagion effects of the world's largest bankruptcy: the case of WorldCom," 45 *Quarterly Review of Economics and Finance* 48, 49 (2005).

[13] Wilmarth, "Universal Banks," supra note 2, at 562-563.

[14] James A. Fanto, “Subtle Hazards Revisited: The Corruption of a Financial Holding Company by a Corporate Client’s Inner Circle,” 70 *Brooklyn Law Review* 7, 18-28 (2004) (discussing Enron and WorldCom); Hillary A. Sale, “Banks: The Forgotten(?) Partners in Fraud,” 73 *University of Cincinnati Law Review* 139, 143-54, 163-69 (2004) (discussing Enron).

[15] See infra notes 92-95, 162-65 and accompanying text; see also supra note 4 and accompanying text (reporting that Citigroup earned $6.6 billion of investment banking fees from all of its clients during 1999-2000).

[16] For a general analysis concluding that current federal regulations are inadequate to control the risks posed by universal banks, see Wilmarth, “Transformation,” supra note 1, at 223-25, 300-12, 437-76.

[17] William W. Bratton, “Enron and the Dark Side of Shareholder Value,” 76 *Tulane Law Review* 1275, 1276, 1299-1300 (2002); Paul M. Healy & Krishna G. Palepu, “The Fall of Enron,” 17 *Journal of Economic Perspectives* No. 2, Spring 2003, at 3, 6 (exh. 2); Second Interim Report of Neal Batson, Court-Appointed Examiner, *In re Enron Corp.,* Case No. 01-16034 (AJG) (Bankr. S.D.N.Y., Jan. 21, 2003) [hereinafter Enron Examiner’s Second Report], at 5 & nn.8-9; Robin Sidel & Mtichell Pacelle, “J.P. Morgan Settles Enron Lawsuit,” *Wall Street Journal,* June 15, 2005, at A3.

[18] Bratton, supra note 17, at 1300-02; Healy & Palepu, supra note 17, at 5-9; Third Interim Report of Neal Batson, Court-Appointed Examiner, *In re Enron Corp.,* Case No. 01-16034 (AJG) (Bankr. S.D.N.Y., June 30, 2003) [hereinafter Enron Examiner’s Third Report], at 14-18; Final Report of Neal Batson, Court-Appointed Examiner, *In re Enron Corp.,* Case No. 01-16034 (AJG) (Bankr. S.D.N.Y., Nov. 4, 2003) [hereinafter Enron Examiner’s Final Report], at 84-86.

[19] Bethany McLean & Peter Elkind, *The Smartest Guys in the Room* 184-88, 242-45 (2003); see also Enron Examiner’s Second Report, supra note 17, App. D, at 98.

[20] Bratton, supra note 17, at 1288-92, 1320-23; Healy & Palepu, supra note 17, at 6-9; McLean & Elkind, supra note 19, at 34-39, 101-12, 212-28, 286-90; Milton C. Regan, Jr., “Teaching Enron,” 74 *Fordham Law Review* 1139, 1144-46 (2005).

[21] Bratton, supra note 17, at 1288-94; Enron Examiner’s Second Report, supra note 17, App. D, at 86-98.

[22] Quoted in Bratton, supra note 17, at 1290.

[23] Healy & Palepu, supra note 17, at 9-14; McLean & Elkind, supra note 19, at 39-42, 92-94, 121-27; Regan, supra note 20, at 1146-54; Bennett Stewart, “The *Real* Reasons Enron Failed,” 18 *Journal of Applied Corporate Finance* No. 2, Spring 2006, at 116, 116-17; Enron Examiner’s Second Report, supra note 17, at 22-26; Enron Examiner’s Final Report, supra note 18, at 85-86, 89-93.

[24] Quoted in Enron Examiner’s Final Report, supra note 18, at 84.

[25] Healy and Palepu, supra note 17, at 11-12, 16-17.

[26] McLean & Elkind, supra note 19, at 125-31, 150-51, 154; Enron Examiner's Second Report, supra note 17, at 25-26; Enron Examiner's Third Report, supra note 18, at 14-19; Enron Examiner's Final Report, supra note 18, at 83-87.

[27] McLean & Elkind, supra note 19, at 125-31, 151-70, 286-312; Enron Examiner's Second Report, supra note 17, at 15-49; Enron Examiner's Third Report 18, supra note 18, at 14-19, 25-30; Enron Examiner's Final Report, supra note 18, at 83-89.

[28] Enron Examiner's Final Report, supra note 18, at 16-17.

[29] McLean & Elkind, supra note 19, at 171.

[30] *Id.* at 284-312, 331-32, 339-41, 345-46, 362-64.

[31] *Id.* at 367-405.

[32] Enron Examiner's Third Report, supra note 18, at 4-5 (summarizing roles of Citigroup, Chase, Barclays, Deutsche, Canadian Imperial Bank of Commerce and Merrill Lynch); see also Enron Examiner's Final Report, supra note 18, at 12-13 (providing similar summary for roles of Royal Bank of Scotland, Credit Suisse and Toronto Dominion).

[33] McLean & Elkind, supra note 19, at 162, 407.

[34] Sale, supra note 14, at 139, 144.

[35] McLean & Elkind, supra note 19, at 162 (quote), 164.

[36] *Id.* at 163-65; Enron Examiner's Third Report, supra note 18, at 46 n.121 (quoting Enron Relationship Review, Mid-Year 1999, July 1999).

[37] Quoted in McLean & Elkind, supra note 19, at 165.

[38] Enron Examiner's Third Report, supra note 18, at 34-85 & App. D-I; Enron Examiner's Final Report, supra note 18, at 63-81 & App. E-G.

[39] McLean & Elkind, supra note 19, at 159-61; Enron Examiner's Second Report, supra note 17, at 58-66; *id.*, App. D (Enron's Disclosure of SPEs), at 11-19; *id.,* App. E (Prepays), at 1-45.

[40] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 45-83; *id.,* App. E (Chase), at 18-49; *id.,* App. F (Barclays), at 48-52; Enron Examiner's Final Report, supra note 18, at 72-74, 77-80.

[41] Quoted in McLean and Elkind, supra note 19, at 160-61.

[42] For discussions of Project Nahanni, see McLean & Elkind, supra note 19, at 157; Regan, supra note 20, at 1180-86; Enron Examiner's Second Report, supra note 17, App. D (Enron's Disclosure of SPEs), at 44-45, 48-49; Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 107-15.

[43] Enron Examiner's Second Report, supra note 17, at 36-39, 95-112.

[44] Sale, supra note 14, at 145-46; Enron Examiner's Second Report, supra note 17, at 95-99; Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 115-25.

[45] Enron Examiner's Third Report, supra note 18, App. F (Barclays), at 20-48; *id.* App. H (CIBC), at 2-9, 25-60; Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 1-4, 8-9, 73-78.

[46] Complaint in *SEC v. Merrill Lynch & Co.,* attached to SEC Litigation Release No. 18038, Mar. 17, 2003 (available at www.sec.gov/litigation/litreleases/lr18038.htm) [hereinafter SEC Merrill Lynch Release]; Enron Examiner's Third Report, supra note 18, App. I (Merrill Lynch), at 4-7, 23-42.

[47] Bratton, supra note 17, at 1307-10, 1316-27; McLean & Elkind, supra note 19, at 191-206, 362-64; Regan, supra note 20, at 1202-20.

[48] McLean & Elkind, supra note 19, at 191-206; Enron Examiner's Final Report, supra note 18, at 68-71, 75-76; *id.,* App. F (Credit Suisse), at 2-4, 6-7, 36-62; *id.,* App. E (RBS), at 3-4, 6-7, 29-62.

[49] McLean & Elkind, supra note 19, at 197.

[50] *Id.* at 197-206 (quote at 202); Bratton, supra note 17, at 1309-10; Enron Examiner's Third Report, supra note 18, App. I (Merrill Lynch), at 44-46.

[51] Enron Examiner's Third Report, supra note 18, at 72-76 (quote at 74); *id.,* App. G (Deutsche), at 1-4, 27-57, 71-80.

[52] Enron Examiner's Second Report, supra note 17, at 16-17.

[53] Enron Examiner's Third Report, supra note 18, App. E (Chase), at 19 (quoting memorandum from Rick Walker of Dec. 15, 1994); *id.* at 22-23 (quoting email from George Serice to Karen Simon on Nov. 25, 1998) (emphasis in original).

[54] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 70 (quoting the Committee's minutes of June 22, 1999).

[55] Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse) at 69 (quoting sworn statement by James Moran); *id.* at 68 (quoting email from Ian Emmett to Steve Wootton on Dec. 12, 2000).

[56] Enron Examiner's Third Report, supra note 18, App. I (Merrill Lynch), at 42-43 (quoting email from Schuyler Tilney to Dan Gordon of May 30, 2000).

[57] Enron Examiner's Third Report, supra note 18, at 27-29, 41-45, 57-58, 60-61, 68-71, 80-81 (quote at 80); Enron Examiner's Final Report, supra note 18, at 71-72, 77.

[58] Enron Examiner's Third Report, supra note 18, App. H (CIBC), at 55, 56 (quoting emails, each dated June 21, 2001, from Mercedes Arrango to Gerry Beauclair and from Ian Schottlaender to Arrango).

[59] Enron Examiner's Third Report, supra note 18, App. F (Barclays), at 23 (quoting Richard Williams' Transaction Comment of Nov. 14, 2000).

[60] Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 22 n.81 (quoting email from Wesley Jones to Jonathan Yellen of Sept. 16, 1999).

[61] Enron Examiner's Final Report, supra note 18, at 72 (quoting Group Credit Committee minutes of Sept. 2000).

[62] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 113 (quoting undated "Citigroup Exposure Spreadsheet" and email from James Reilly to Michael Nepveux on July 24, 2001).

[63] *Id.*, App. I (Merrill Lynch), at 120 (quoting email from Steve Baillie to William Fox on Nov. 24, 2000).

[64] *Id.* at 122, 121 (quoting emails from James Reilly to Maureen Hendricks on Nov. 28, 2000, and from James Reilly to Steven Becton on Dec. 6, 2000).

[65] Enron Examiner's Third Report, supra note 18, App. I (Merrill Lynch), at 26-27 (quoting sworn statement by James Brown).

[66] Enron Examiner's Third Report, supra note 18, App. D (Citigroup) at 120 (quoting email from Steve Baillie to William Fox of Nov. 24, 2000).

[67] *Id.* at 131 (quoting internal memorandum prepared by David Bushnell).

[68] Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 40, 46 & n. 171 (quote) (summarizing testimony by Mary Beth Mandanas and Robert Jeffe).

[69] Enron Examiner's Third Report, supra note 18, App. I (Merrill Lynch), at 25 (quoting memorandum from Robert Furst to Dan Bayly and Schuyler Tilney of Dec. 21, 1999).

[70] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 122 (quoting email from Steve Baillie to William Fox of Nov. 24, 2000).

[71] *Id.* at 124 (quoting email from Steve Wagman to Amanda Angelini of Dec. 27, 2000).

[72] Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 45-46 (summarizing testimony of Adebayo Ogunlesi and Robert Jeffe); *id.* at 56 (quoting two memoranda, each dated

Dec. 9, 1999, prepared by Mary Beth Mandanas and Richard Ivers).

[73] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 19-20; *id.*, App. E (Chase), at 10; *id.*, App. H (CIBC), at 17; *id.*, App. I (Merrill Lynch), at 16; Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 17.

[74] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 20 (quoting Citigroup interoffice memorandum of Sept. 24, 2001); *id.*, App. E (Chase), at 12 (quoting email from Todd Maclin to Richard Walker of Sept. 30, 1999); Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 49 (quoting email from David Koczan to Osmar Abib of June 17, 2001).

[75] Enron Examiner's Third Report, supra note 18, App. H (CIBC), at 18 n.51 (quoting memorandum). A CIBC officer similarly explained that the returns from one SPE transaction were "so outrageous that [CIBC's] Risk Management [group was] softened into agreeing" to the bank's involvement in the transaction. *Id.* at 18 (quoting credit application submitted by Shannon Ernst on Dec. 15, 1998).

[76] Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 16-17; *id.*, App. I (Merrill Lynch), at 15-16; Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 16-17.

[77] *In re Enron Corp. Securities, Derivative & ERISA Litigation,* 235 F. Supp. 2d 549, 640, 643-56 (S.D. Tex. 2002).

[78] *Id.* at 596-97, 612-13, 637-56, 707-08 (discussing legal standards and factual allegations related to plaintiffs' claims under § 11 of the 1933 Act).

[79] *Id.* at 570-94, 637-56, 692-704 (discussing legal standards and factual allegations related to plaintiffs' claims under § 10(b) of the 1934 Act).

[80] *Id.* at 640-41, 644-45, 648, 651, 653-56.

[81] *Id.* at 638-53; Enron Examiner's Third Report, supra note 18, App. D (Citigroup), at 21-26, 32-44; *id.*, App. E (Chase), at 12-17, 29-30; *id.*, App. F (Barclays), at 9-19; *id.,* App. H (CIBC), as 19-24, 43-44, 53-54; Enron Examiner's Final Report, supra note 18, App. E (RBS), at 20-27; *id.,* App. F (Credit Suisse), at 20-29; *id.*, App. G (Toronto Dominion), at 20-22.

[82] Jonathan Macey, "Efficient Capital Markets, Corporate Disclosure, and Enron," 89 *Cornell Law Review* 394, 403-04 (2004).

[83] *Id.* at 404; *see also id.* at n.55 (quoting Charles Hill's testimony).

[84] John C. Coffee, "What Caused Enron? A Capsule Social and Economic History of the 1990s," 89 *Cornell Law Review* 269, 286 (2004).

[85] For discussions of Merrill Lynch's decision to fire John Olson in 1998 and Citigroup's decision to terminate Don Dufresne in 1999, following complaints by Enron, see Kurt Eichenwald, *Conspiracy of Fools* 181-84, 186, 220 (2005); McLean & Elkind, supra note 19, at 230-35.

[86] Rebecca Smith, "The Analyst Who Warned About Enron," *Wall Street Journal,* Jan. 29, 2002, at C1 (discussing allegations made by Daniel Scotto).

[87] Richard J. Oppel, Jr., "The Man Who Paid the Price for Sizing Up Enron," *New York Times*, Mar. 27, 2002, at C1 (cited in Macey, supra note 82, at 404 n.56); Frank Ahrens, "Broker's Tale Probed For Link to Enron," *Washington Post*, Mar. 16, 2002, at E01 (discussing Wu's firing and stating that UBS acted as an underwriter for initial public offerings made by two Enron affiliates).

[88] Enron Examiner's Final Report, supra note 18, App. F (Credit Suisse), at 34 n.123 (quoting emails exchanged between Andy DeVries of Credit Suisse and Wade Suki of Chase on Oct. 25, 2001).

[89] *Id.* at 35 n.123 (quoting email from Brian Gibbons to Andy DeVries on Nov. 29, 2001).

[90] *Id.* at 30-33.

[91] William Battey, the head of Credit Suisse's research department, "praised [Sakol] for getting timely information to [Credit Suisse's] bond traders," but he also "reminded her of the importance of the Enron relationship for [Credit Suisse]." *Id.* at 32-33.

[92] SEC Administrative Proceedings Release No. 34-48230, July 28, 2003 (consent order requiring Citigroup to pay $101.25 million to settle Enron-related charges) (available at www.sec.gov/litigation/admin/34-48230.htm); SEC Litigation Release No. 18252, July 28, 2003 (announcing consent judgment requiring Chase to pay $135 million) (available at www.sec.gov/litigation/litreleases/lr18252.htm); SEC Litigation Release No. 18517, Dec. 22, 2003 (announcing consent judgment requiring CIBC to pay $80 million) (available at www.sec.gov/litigation/litreleases/lr18517.htm); SEC Merrill Lynch Release, supra note 46 (announcing consent judgment requiring Merrill Lynch to pay $80 million).

[93] "Class Actions: CIBC to Pay $2.4 Billion To Settle Enron Stockholder Suit," 37 *Securities Regulation & Law Report* (BNA) 1324 (Aug. 8, 2005) (reporting the following settlement payments: CIBC – $2.4 billion; Chase – $2.2 billion; Citigroup – $2 billion; Lehman – $222.5 million; Bank of America – $69 million).

[94] Carrie Johnson, "Fastow Takes Aim at Banks He Says Helped Enron," *Washington Post,* Sept. 26, 2006, at D01; Sheila McNulty & Ben White, "Fastow accuses Enron bankers," *Financial Times* (U.S. ed.), Sept. 27, 2006, at 17.

[95] "Barclays to Pay $144 Million to Settle Lawsuit with Enron," *New York Times*, Nov. 4, 2006, at C4; "Business Brief: Enron Corp., *Wall Street Journal,* Oct. 9, 2006 (reporting that Bank of America agreed to pay $20 million to settle claims by Enron); "Moving the Market: Merrill Settles Enron Claims," *Wall Street Journal,* July 7, 2006, at C3 (reporting that Merrill Lynch agreed to pay $30 million, and surrendered $74 million of creditor claims, to settle with Enron); David Enrich, "Moving the Market: Two Banks Settle Enron Lawsuit," *Wall Street Journal,* Aug. 17, 2005, at C3 (reporting that five banks had agreed to pay $735 million, and surrendered $3 billion of creditor claims, to settle with Enron); Rebecca Smith, "Executives on Trial: Trial Begins With a Tale of Two Enrons," *Wall Street Journal*, Feb. 1, 2006, at C1.

[96] For an insightful discussion of similarities among Enron, WorldCom and other well-known corporate scandals during the past three decades, see Geoffrey P. Miller, "Catastrophic Financial Failures: Enron and More," 89 *Cornell Law Review* 423 (2004).

[97] Almar Latour et al., "Held Accountable: Ebbers Is Convicted in Massive Fraud," *Wall Street Journal,* Mar. 16, 2005, at A1.

[98] Akhigbe et al., supra note 12, at 51; supra note 25 and accompanying text.

[99] Miller, supra note 96, at 436; First Interim Report of Dick Thonburgh, Bankruptcy Court Examiner, *In re WorldCom, Inc.,* Case No. 02-13533 (AJG) (Bankr. S.D.N.Y., Nov. 4, 2002) [hereinafter WorldCom Examiner's First Report], at 12-13.

[100] Akhigbe et al, supra note 12, at 49; Miller, supra note 96, at 425; Latour et al., supra note 97.

[101] WorldCom Examiner's First Report, supra note 99, at 11-20, 58-60; Fotios Harmantzis, "Inside the Telecom Crash: Bankruptcies, Fallacies and Scandals – A Closer Look at the WorldCom Case," Mar. 30, 2004 (available at http://ssrn.com/abstract=575881), at 5-8; *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 637-38 (S.D.N.Y. 2004).

[102] *United States v. Ebbers,* 458 F.3d 110, 113 (2d Cir. 2006); *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 640 (S.D.N.Y. 2004); *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 401 (S.D.N.Y. 2003).

[103] WorldCom Examiner's First Report, supra note 99, at 20-21; Latour et al., supra note 97; *United States v. Ebbers,* 458 F.3d 110, 113 (2d Cir. 2006).

[104] WorldCom Examiner's First Report, supra note 99, at 11-12, 99-108; Third and Final Report of Dick Thornburgh, Bankruptcy Court Examiner, *In re WorldCom, Inc.,* Case No. 02-13533 (AJG) (Bankr. S.D.N.Y., Jan. 26, 2004) [hereinafter WorldCom Examiner's Final Report], at 271-77; *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 400-01 (S.D.N.Y. 2003).

[105] Elise A Couper et al., "Boom and Bust in Telecommunications," 89 *Economic Quarterly* No. 4, Federal Reserve Bank of Richmond, VA, Fall 2003, at 1; Harmantzis, supra note 101, at 3-7; Jonathan McCarthy, "What Investment Patterns across Equipment and Industries Tell Us about the Recent Investment Boom and Bust," 10 *Current Issues in Economics and Finance* No. 6, Federal Reserve Bank of NY, May 2004, at 1; Dennis K. Berman, "Behind the Fiber Glut: Innovation Outpaced the Marketplace," *Wall Street Journal,* Sept. 26, 2002, at B1; Steven Rosenbush et al., "Inside the Telecom Game," *Business Week*, Aug. 5, 2002, at 34, 37-40; "Special report: The telecoms crisis: Too many debts; too few calls," *Economist,* July 20, 2002, at 59 [hereinafter *Economist* report on telecoms crisis]; WorldCom Examiner's First Report, supra note 99, at 20-21.

[106] WorldCom Examiner's First Report, supra note 99, at 102-09; WorldCom Examiner's Final Report, supra note 104, at 273-91;*United States v. Ebbers,* 458 F.3d 110, 114-16 (2d Cir. 2006); *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 640-41 (S.D.N.Y. 2004).

[107] *United States v. Ebbers,* 458 F.3d 110, 114-16 (2d Cir. 2006); *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 402 (S.D.N.Y. 2003); Ken Belson, "Witness Says Ebbers Urged

Manipulations at WorldCom," *New York Times,* Feb. 9, 2005, at C1 (summarizing Sullivan's testimony at Ebbers' criminal trial); Floyd Norris, "MCI Chief Says He Repaid Debt, Borrowing from His Company," *New York Times,* Feb. 8, 2002, at C2 (quoting "utter nonsense" statement made by Ebbers during a conference call with investors).

[108] WorldCom Examiner's First Report, supra note 99, at 23-30.

[109] *Id.* at 112-14; Deborah Solomon, "Leading the News: WorldCom's Creditors Seek to Broaden Review Prior to 1999," *Wall Street Journal,* Aug. 12, 2002, at A3; Shawn Young et al., "Leading the News: WorldCom Plans Bankruptcy Filing," *Wall Street Journal,* July 22, 2002, at A3.

[110] Jonathan Weil, "WorldCom Suit Elicits Unusual Legal Strategy," *Wall Street Journal*, Aug. 25, 2004, at C1; Shawn Young, "MCI to State Fraud Was $11 Billion," *Wall Street Journal,* Mar. 12, 2004, at A3.

[111] "Virginia: Verizon has completed its purchase of MCI," *Richmond (VA) Times Dispatch,* Jan. 7, 2006, at C-2.

[112] Fanto, supra note 14, at 26.

[113] *Id.*

[114] WorldCom Examiner's Final Report, supra note 104, at 140.

[115] *Id.* at 137-39; WorldCom Examiner's First Report, supra note 99, at 16-17, 20.

[116] *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 645-47 (quote at 647), 651-52 (S.D.N.Y. 2004).

[117] *Id.* at 651 & n.27; Gretchen Morgenson, "3 Banks Had Early Concern on WorldCom," *New York Times,* Mar. 17, 2004, at A1 [hereinafter Morgenson, "3 Banks"].

[118] WorldCom Examiner's Final Report, supra note 104, at 183-86, 220-30, 238-44.

[119] *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 639 (S.D.N.Y. 2004).

[120] WorldCom Examiner's Final Report, supra note 104, at 115-16 (quote), 118-22, 135-41, 151-77; Rosenbush et al., supra note 105, at 36 ("Jack's Inner Circle" box, stating that Citigroup earned $140.7 million of fees from WorldCom) .

[121] WorldCom Examiner's Final Report, supra note 104, at 119-21, 143-44 (quote), 173-76, 182; SEC Citigroup Complaint, supra note 4, ¶¶ 150, 158, 189-95.

[122] WorldCom Examiner's Final Report, supra note 104, at 184 n.166.

[123] Gretchen Morgenson, "When Citigroup Met WorldCom," *New York Times,* May 16, 2004, § 3, at 1; Jonathan Weil, "Citigroup Calls Ebbers Loans Proper," *Wall Street Journal,* Oct. 15, 2002, at A6.

[124] WorldCom Examiner's Final Report, supra note 104, at 183-94 (quote at 188).

[125] *Id.* at 194-202 (quote at 198).

[126] *Id.* at 183.

[127] *In re WorldCom, Inc. Securities Litigation,* 346 F. Supp. 2d 628, 650 (S.D.N.Y. 2004).

[128] *Id.* at 651-52. An internal Chase email cautioned that "if [WorldCom] gets any sense that we're laying off [credit] exposure DURING the syndication process (and wouldn't [Citigroup] love to pass that along), it would not be good news." *Id.* at 651. Similarly, a Bank of America internal memorandum warned that WorldCom would "go nuts" if it learned that the bank was reducing its credit exposure through credit default swaps or loan sales in the secondary market. *Id.* at 652 n.30.

[129] *Id.* at 654.

[130] *Id.* at 641-55, 678-87, 690-97.

[131] *Id.* at 635-37, 649-55, 662-64, 683, 695-96; see also *id.*at 656-78 (discussing legal standards governing claims under §§ 11 and 12(a)(2) of the 1933 Act); Morgenson, "3 Banks," supra note 117; Gretchen Morgenson, "Judge in WorldCom Action Sides with Plaintiffs on Issue of Due Diligence by Banks," *New York Times,* Dec. 16, 2004, at C4.

[132] Gretchen Morgenson, "Despite Access, Star Analyst Missed WorldCom Trouble Signs," *New York Times,* July 9, 2002, at C1 [hereinafter Morgenson, "Star Analyst"] (quoting Tierney's note).

[133] *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 404-05 (S.D.N.Y. 2003).

[134] WorldCom Examiner's Final Report, supra note 104, at 116-19, 134-41, 203-04 & App. 1.

[135] WorldCom Examiner's First Report, supra note 99, at 98; Gretchen Morgenson, "Analyst Coached WorldCom Chief on His Script," *New York Times,* February 27, 2003, at A1.

[136] SEC Citigroup Complaint, supra note 4, ¶¶ 19, 28; *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 405 (S.D.N.Y. 2003).

[137] Quoted in Peter Elstrom, "The Power Broker," *Business Week,* May 15, 2000, at 70.

[138] Quoted in *id.*

[139] Yochi Dreazen, "Behind the Fiber Glut: Telecom Carriers Were Driven by Wildly Optimistic Data on Internet's Growth," *Wall Street Journal,* Sept. 26, 2002, at B1 (describing claims made by WorldCom executives, and quoting Grubman's prediction in 1998 that "no matter how much bandwidth is available, it will get used").

[140] Rosenbush et al., supra note 105, at 38-40; *Economist* report on telecoms crisis, supra note 105, at 59-60.

[141] Rosenbush et al., supra note 105, at 34, 36 ("Jack's Inner Circle" box); Berman, supra note 105 (reporting that investors bought $757 billion of telecom stocks and bonds during 1996-2002); see also Gretchen Morgenson, "Bullish Analyst of Tech Stocks Quits Salomon," *New York Times,* Aug. 16, 2002, at A1 [hereinafter Morgenson, "Bullish Analyst"] (reporting that Grubman helped Citigroup earn $1billion of underwriting and merger advisory fees paid by telecom clients during 1997-2001, a figure that was 43% higher than the fees earned by Merrill Lynch, the second-ranked underwriter and merger advisor for the telecom industry); Elstrom, supra note 137 (quoting telecom executive Robert Knowling's comment that Grubman was "almost a demigod . . . the king of telecom").

[142] SEC Citigroup Complaint, supra note 4, ¶¶ 4, 41, 51.

[143] Quoted in Elston, supra note 137.

[144] Rosenbush et al., supra note 105, at 37; see also Dreazen, supra note 139; Harmantzis, supra note 101.

[145] Berman, supra note 105; Dreazen, supra note 139; Harmantzis, supra note 101, at 5-7; Morgenson, "Bullish Analyst," supra note 141; *Economist* report on telecoms crisis, supra note 105, at 59-60.

[146] WorldCom Examiner's First Report, supra note 99, at 90, 91.

[147] *Id.* at 92-94.

[148] "A Lot Was Riding on These Words," Washington Post, July 14, 2002, at B04.

[149] Morgenson, "Star Analyst," supra note 132.

[150] WorldCom Examiner's First Report, supra note 99, at 92-97; WorldCom Examiner's Final Report, supra note 104, App. 7.

[151] *Id.*; Morgenson, "Star Analyst," supra note 132.

[152] WorldCom Examiner's First Report, supra note 99, at 91-95; WorldCom Examiner's Final Report, supra note 104, App. 9.

[153] Quoted in Morgenson, "Star Analyst," supra note 132.

[154] Quoted in Rosenbush et al., supra note 105, at 37.

[155] Quoted in Charles Gasparino, "Salomon's Grubman Resigns: NASD Finds 'Spinning' at Firm," *Wall Street Journal,* Aug. 16, 2002, at A1.

[156] SEC Litigation Release No. 18111, April 28, 2003 (available at www.sec.gov/litigation/litreleases/lr18111.htm) [hereinafter SEC Citigroup/Grubman Release], at 2-4; Complaint in *SEC v. Grubman* (S.D.N.Y., April 28, 2003) [hereinafter SEC Grubman Complaint] (available at www.sec.gov/litigation/complaints/comp18111b.htm); Elstrom, supra note 137.

[157] SEC Grubman Complaint, supra note 156, ¶¶ 46-47, 39, 99. In his email of January 13, 2001, Grubman said that Weill also wanted him to upgrade AT&T's stock so that Weill could win the support of AT&T's CEO (a member of Citigroup's board) for Weill's plan to become sole CEO of Citigroup and to remove co-CEO John Reed. *Id.,* ¶ 99.

[158] SEC Citigroup/Grubman Release, supra note 156, at 1, 5 (stating that Grubman agreed to pay $15 million as disgorgement and penalties and consented to the entry of an SEC order that "permanently bars him from associating with any broker, dealer, or investment adviser").

[159] *Id.* at 1-4; SEC Citigroup Complaint, supra note 4.

[160] Gretchen Morgenson, "Citigroup Agrees to a Settlement Over WorldCom," *New York Times,* May 11, 2004, at A1 [hereinafter Morgenson, "Citigroup Settlement"] (quoting brief).

[161] *In re WorldCom, Inc. Securities Litigation,* 294 F. Supp. 2d 392, 405, 425 (quote) (S.D.N.Y. 2003).

[162] *In re WorldCom, Inc. Securities Litigation,* 388 F. Supp. 2d 319, 324, 327-29 (S.D.N.Y. 2005) (discussing amounts paid by underwriters to settle class action lawsuit); Robin Sidel, "J.P. Morgan to Pay $2 Billion as Street's Bill for Bubble Soars," *Wall Street Journal,* Mar. 17, 2005, at A1 (same).

[163] Jonathan Weil & Robin Sidel, "WorldCom Investors Settle Lawsuits," *Wall Street Journal,* Oct. 27, 2005, at A3.

[164] Robert Julavits, "For Citi, $5B Is Price of 'Moving On'," *American Banker,* May 11, 2004, at 1; Morgenson, "Citigroup Settlement," supra note 160.

[165] Timothy L. O'Brien, "Citigroup Assesses a Risk and Decides to Settle," *New York Times,* May 11, 2004, at C1 (quoting analyst Richard Bove).