

Artigos

Managerial betrayal: justifying the punishment of Enron's management

Traição gerencial: justificando a punição da direção da Enron

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Punishment for suffering wrong does not restore the wrong, because the one who suffered the unjust is still the one who suffered the wrong (THUCYDIDES).

ABSTRACT

Few interested in corporate affairs can have missed the demise of Enron. The case involved hugely complex transactions designed to appease regulators, analysts and shareholders; and corporate governance, risk management and internal control were sacrificed in favour of profitability and growth. In this paper Ten's (1987) theory is used to illustrate the benefit of a combined utilitarian and retributive model for justifying the punishment of Enron's management. Throughout, the study makes both practical and theoretical observations.

Key words: Punishment justification; Management; Enron.

Business has always had an ethical dimension, but recently the news has been full of details of executive and senior managers abusing their position and enriching themselves at the companies' behalf through dubious activities. The recent demise of Enron and WorldCom are good examples of this. Responsibility for penalising the culprits rests with the Securities and Exchange Commission and the US Department of Justice, and thousands of aggrieved employees, investors and creditors are waiting to find out what punishment will be meted out to. But in addition to the legal and economic implications there is also an ethical dimension. Punishment involves the deprivation of certain normally recognised rights, it is the consequence of an offence, it is applied against a per-

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son that has voluntarily conducted the offence, and the punishment is applied by an organ of the system that made the act an offence (ROSS, 1970, p. 618). Should the executive managers be punished, to what extent and under what conditions? Because the manager acted morally wrong? Or perhaps because punishing them provides better consequences for the company or for the industry as a whole?

The specific facts of the Enron case will not be known until the courts have pronounced thereon – if even then. Nonetheless, sufficiently is known for a principal discussion on managerial punishment. The concept of off-balance sheet partnerships is simple: balance sheet liabilities can be reduced if a firm is able to structure a borrowing arrangement in which obligation to repay is not recognised on its consolidated statements. The purpose of the Enron partnerships was to raise cash and keep debt off the balance sheet-debt that would scare investors, lower Enron's credit rating and be a hindrance to its trading operations. Partners were promised high returns backed with Enron stock. The public would see more profit and less debt and not the transaction. When Enron stock was flying high, the structure of these deals was manageable. When stock fell by more than half, as it did in 2001, deals supported by Enron stock became problematic. Moreover, Enron documents released show manipulation of power prices in California, creating artificial shortages through the use of aggressive trading tactics during the energy crisis. Enron traders exploited loopholes or market limitations to boost prices or to wring special payments out of the agencies that operated California's electricity markets. The state imposed price caps to cope with the emergency but even these offered an opportunity for traders realising that prices were not capped in neighbouring areas that were affected by the crisis. Power shortages sent prices skyrocketing in May 2000, which pushed California's two largest privately held electricity utilities to the edge of ruin, caused six days of state-wide blackouts and forced the state to buy power for more than 10 million utility customers.

Nonetheless, although the trading practices may have violated federal fraud statutes, energy experts saw the strategies as infractions of market rules that are punishable by fines or suspensions rather than criminal prosecution. Instead the class-action lawsuit filed against Enron on October 22 2002 accused Enron directors of massive insider trading while making false and misleading statements about Enron's financial performance. The lawsuit focused on the Enron leadership, specifically the 29 officers who had sold huge amounts of stock. They ranged from Ken Lay, the Enron chairman and CEO who cleared \$184 million, through Lou Pai, the Enron Energy Services executive who cashed out with more than \$350 million in Enron stock, to Wendy Gramm, whose proceeds were a more modest \$279 000. There were plenty of other winners in-between, includ-

ing over a dozen Enron officers who collected over \$10 million each. While employees were told to invest their money in the company, senior Enron managers were discreetly withdrawing their investments from the company (to a total of at least \$1.1 billion) and withholding information of the company's perilous situation. The Enron-stock meltdown wiped out \$67 billion of shareholder wealth. The losers include pension funds and mutual-fund investors that had invested in the company, and, of course, Enron's 28 000 employees.

In this paper we illustrate ways in which the punishment of Enron's management can be justified. Seeking to avoid the disadvantages of utilitarian or retributive justifications, we employ Ten's (1987) theory in the discussion of punishment. The theory combines utilitarian and retributive justifications and minimises (but not eliminates) the drawbacks of respective model.

PUNISHMENT JUSTIFICATION

Retributive or utilitarian punishment

The behaviour of many of the managers in these companies may be appalling, shocking, and at times even illegal, but is it sufficient grounds for punishment? Some see punishment as primarily retributive: it pays back the offender for the wrong he has done, although this requires a person to be punished to be guilty of a crime (to have voluntarily committed an act that is morally wrong). Others see punishment as a deterrent: its purpose is to discourage others from offending by imposing a heavy cost on so doing, making it a utilitarian justification.

In the classical version of retribution, punishment of a wrong act is obligatory and the breaking of legal regulations is a necessary and sufficient condition for justified punishment (*e.g.* Kant's uncompromising version of retributive theory). That is, if Enron's senior managers abused their positions at the expense of stockholders and employees, the managers must be punished regardless of its consequences. The justification for punishing a person is exclusively because a crime has been committed. But a person that has obeyed the law may not be punished even if this would have a good effect on him or on society at large (assuming that law-breaking equals a morally wrong conduct) (PETTIT, 1991, p. 231). The concept of crime-annulment retribution is logically similar; steps are taken to prevent violations of people's rights and violated punishment is used to annul the crime (TAMBURRINI, 1993, p. 87). To punish the senior managers at Enron, it is hence necessary that they to some degree caused employees and stockholders to loose significant, even life, savings.

Ideal retribution proposes that the suffering of offenders is intrinsically better than alternative systems in which crimes remain unpunished (TAMBURRINI, 1993, p. 95). That is, Enron's senior managers must be punished to some extent regardless of its consequences. Doing wrong must not remain unpunished. However, this does not set the form or degree of punishment. It only justifies their punishment *per se*. One advantage of such non-theological retributive theories is that there is no need to relate to other principles. For example, intrinsic retribution, where there is intrinsic good in the suffering of those guilty, does not have to take into consideration factors linking the theory to underlying reasons for the punishment. Long-term effects on people, the economy and so on can be ignored. This has the advantage of making justifications easier to apply by reducing the number of variables needed to be taken into account, although the argument is only strengthened if practical application is valued. The main drawback, however, is that the principle says nothing on form or degree of punishment. It necessitates reference to other principles, which negates the very advantage indicated earlier.

Retributive justifications of punishment may be categorised as weak in two instances. In the first instance, the retributive condition is sufficient but not necessary for justifiable punishment. Hence, avoiding Enron's collapse with its significant suffering of employees, shareholders and others by not punishing the executive management may be justifiable even if the latter are guilty. This weak version of retributive theory is here rejected because it allows for a plurality of theories justifying punishment without clarifying the hierarchy among those very theories. In the second instance of weak retribution, the retributive condition is necessary but not sufficient for justifiable punishment. Consequences for, for instance, the business sector or the individual firm may prevent punishment under certain circumstances. In allowing the legal authority to avoid punishing offenders if this has bad consequences, the weak retributive justifications must answer why the utilitarian theory is incorporated while principles on absolute rights are not. The second weak version of retributive theory treats retributive justifications as necessary but not sufficient. Punishment is only justified if the person is an offender who has voluntarily violated a legitimate law, and punishing that person is justified on utilitarian grounds. This has the advantage of preventing innocent people from being punished while thwarting punishment is cases where doing so would have disastrous consequences.

The role of retributive considerations in justifying punishment is to ensure that innocent people retain their rights. The retributive condition is based on the assumption that voluntarily committing certain acts that are perceived as violating the rights of others condemns the offender to punishment. It makes little

difference what deserts are based on. Meanwhile, utilitarian justifications base the normative dimension of punishment on expected consequences, with the general utilitarian approach looking at particular cases separately and the rule-utilitarian approach aggregating the consequences of actions as if the actions were the norm. For instance, energy traders risk a backlash unless they adopt ethical standards that prevent a recurrence of market abuses. Any punishment should hence take into account the need for a long-term behavioural change. Of course, some possible consequences will suggest tougher punishment while others support more lenient punishment.

In extreme rule-utilitarianism, no regard is taken to individual circumstances, while restricted rule-utilitarianism only uses rules as a rule of thumb, permitting reference to specific conditions (LYONS, 1984, p. 125; SMART, 1967, p. 172). In either case, the justifications are perceived as all-encompassing with no need for further considerations to other theories. Hence, the utilitarian approach is difficult to combine with another theory without having an overruling utilitarian component. In contrast, supporters of retributive justifications of punishment are divided on the overruling characteristic of retributive justification. Ten (1987, p. 65) asserts:

... on their own these theories provide inadequate justifications of punishment. For even when they succeed in showing that some form of action should be taken against offender, they do not explain why such action should take the specific form of punishment.

While perhaps a minor theoretical concern, for its application the question of guilt may be problematic. Enron's senior management had responsibility for the creation and sustenance of off-balance sheet partnerships and over the existing intra-organisational conditions, and it is primarily this aspect that is discussed here. In addition, the senior management had a supervisory role over lower-tiered managers and employees, where a combination of a strong profit need and a short-term view of company careers created a particular personality cult that placed enormous pressure on all Enron staff, employees and managers alike. There was fear among Enron's own employees and managers looking ahead to the next "rank and yank" performance review. Being innovative was the critical aspect of performance reviews. Those that were not innovative would get fired. Innovation was the key to the business and the key to advancement within the company. It was fear of mediocrity that sent 15 percent of employees out the door with pink slips every six months; fear of the financial truth that forced Enron executives to hide company debts and losses in a hideous web of partnership deals. Of course, greed among individuals also played a big role. Part of the

employment deal for employees and managers alike was a year-end bonus, paid at the beginning of the new year based on the prior year's performance. The uncapped size of the bonus often dwarfed the salary. Hence, responsibility falls on the senior management in two areas: for creating and sustaining the illegal financial arrangements and for the structural setting in which Enron conducted operations. Note that this does not entirely remove responsibility from lower level managers and employees, but that is beyond the scope of this paper.

Retributive and utilitarian punishment

With an increased understanding of factors determining peoples' actions, fewer offenders may be responsible for their actions. If so, the retributive condition is less applicable to real situations. But it is not prudent to have a theory so narrow in its applicability that it rarely can be referred to. A utilitarian justification does not make acts voluntary, but it does allow the punishment of innocent to achieve more beneficial results – something the retributive condition prevents. It also allows for the punishment of those who in the strict sense through the lack of intention (or perhaps through negligence) have not been culpable. But the most common critique of retributive principles is their lack of consideration to outcomes and allowance to punishing innocent people (HONDERICH, 1989, p. 219).

Nino (1991, p. 264) argues punishment should not be bound to one particular justification since punishment is a complex issue that demands a multitude of justifying principles. Similarly, Primoratz (1987, p. 194) reconciles the distinction between logical and ethical levels of discourse and the division of tasks of retributive and utilitarian theories through the prescription to applicability in different aspects of punishment. However, the relation between retributive and utilitarian justifications is far from unproblematic since they provide and support distinct reasons for justifying punishment. For instance, a problem facing a combined retributive and utilitarian theory is that, once the utilitarian notion of foremost seeking good consequences is accepted, as Brown (1986, p. 196) remarks:

We cannot rationally adopt ends which include, in their description, the means to them – such as deterrence by retributive punishment. For this complex end merely conceals the real function of the practice (simple deterrence) which by itself is what gives the means to it value.

Offering a solution, Ten (1987, p. 80) incorporates retributive and utilitarian conditions, stating that punishing a person is justified only if:

The offender has voluntarily violated a legitimate law, or an innocent person whose punishment will inflict much less suffering on him than the suffering that at least one other innocent person would have experienced as an additional victim of crime had there been no punishment.

Punishing him does not have serious adverse effects on others, and punishing those who have voluntarily committed similar or lesser offences is justified on utilitarian grounds.

This ensures the utilitarian condition does not overrule the retributive condition. People who have not voluntarily broken the law are not punished. Similarly, the retributive condition ensures that offenders are punished in cases where the consequences of so doing are not strong enough to prevent or support such punishment. This has several implications. Foremost, innocence is not an absolute guarantee for not being punished, nor are guilty offenders necessarily punished for their crimes. Condition (i) limits the utilitarian condition's ability to punish innocent people (and thus diminishes the importance of the retributive condition) while Condition (ii) indicates the importance of avoiding adverse effects on other people. To punish the offender and ignore negative consequences would reject the very reason for the inclusion of outcomes in the first place. As a guideline, punishment should be kept at a minimum if an innocent person suffers while ensuring the justification on utilitarian grounds. Condition (ii) constrains punishment in form and severity rather than eliminating it altogether. Note that only the necessity of punishment is stated, not the type of acts demanding punishment nor the form and severity of the punishment.

VERDICT

The importance of international business has led to discussions on international business ethics and to a reconsideration of moral and cultural relativism, which take on special significance for the universality of justifications. In this study, applicable justifying principles have been sought. The previous discussion argued that, by combining retributive and utilitarian conditions, the main criticism of respective theory is avoided. The utilitarian option of sacrificing people for the common good remains, but it is constrained.

So what is the justified punishment of Enron's senior management? Employing Ten's combined retributive and utilitarian conditions, punishing the senior Enron managers fulfils condition (i) since they realistically had both voluntarily violated existing laws and punishing the managers will inflict less suffering on others than if there had been no punishment. This for the cases where laws

where broken. But how about actions where laws were followed? After all, it is possible that some or even all laws were adhered to – technically if not in spirit. If so, is punishing the senior managers still justified on utilitarian grounds for the common good? A rule-utilitarian view opposes it, since the effects of the punishment realistically do not provide enough long term benefits to overrule the societal (and often personal) advantages of strict application of the legal system. A general utilitarian view follows a similar logic. If the management is legally innocent, then Condition (i) limits its punishment. But, since societal advantage may be gained by punishing the management to deter managers in other firms, the condition does not prohibit punishment, it only limits its extent and degree.

One may note that the managers have suffered from Enron's collapse as well. On individual level, the executives lost their jobs and have had their reputations ruined. They lost fortunes and were savaged in the press and in front of congressional committees on a daily basis. Of course, in comparison with the experience of many employees, with lost life-savings and sudden unemployment, the senior management probably suffered less in relative terms. Nonetheless, it hardly negates the suffering caused by the employees.

The study is limited to direct responsibility. It does not discuss indirect consequences on the economy and corporate behaviour at large. Nonetheless, punishing the Enron management fulfils Condition (i) even without considering the indirect impact of its actions, such as the ruin of Arthur Andersen and the contagion of scepticism that dampened the stocks of companies; reduced debt ratings of numerous other energy trading firms and financial exposure of dozens of mutual funds, banks and financial-services firms.

Regarding Condition (ii), it is satisfied since punishing the managers does not have serious adverse effects on others (excluding perhaps their close relatives and friends). Moreover, although not necessarily a formal claim by the Securities and Exchange Commission and the US Department of Justice, punishing the Enron managers is meant to be beneficial in the long run by preventing similar behaviour by managers in other firms in the future.

On the question of *who* should be punished, in terms of guilt there is little to differentiate some senior managers from the others, as the constraining conditions were weak. Little other than personal greed prevented individual managers from leaving the firm, or indirectly doing so by not participating in the various schemes and hence not performing to the expected standard. After all, personal reasons for participating, such as financial need or social capital, hardly suffice as permissible excuses. Of course, that does not mean that all the senior managers should be punished equally. Depending on the expected preventive consequence, to send a strong signal to the business community that each manager

must challenge the corporate culture and business practices, it may even be more beneficial for society at large to punish the low-level managers more severely than the senior managers. On the other hand, with a utilitarian justification, punishing the most senior managers sends a clear signal to the business community that senior managers must retain control over those working for them.

To conclude, we have presented the case of justification on retributive and utilitarian grounds. Advantages and disadvantages were presented and rejected in favour of a combined approach. This justification suggests that Enron's management ought to be punished; on utilitarian grounds if innocent, and on retributive grounds if guilty.

RESUMO

Todos os que se interessam por corporações certamente tomaram conhecimento do caso Enron, envolvendo transações de grande complexidade realizadas com o objetivo de apaziguar mediadores, analistas e acionistas, e sacrificando governança corporativa, gerenciamento de riscos e controle interno a favor da lucratividade e do crescimento. Neste artigo, a teoria de Ten (1987) é usada para ilustrar os benefícios de um modelo utilitário e retributivo combinado para justificar a punição pelo gerenciamento da Enron. Observações práticas e teóricas perpassam todo o texto.

Palavras-chave: Justificativa de punição; Gerenciamento; Enron.

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