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Prosecutors far from finished

By Greg Farrell, Edward Iwata and Thor Valdmanis, USA TODAY

HOUSTON — The endgame may be near for former Enron executives and others who played a role in the energy-trading giant's spectacular flameout late last year. The charges filed Wednesday against former Enron chief financial officer Andrew Fastow by the Justice Department and the Securities and Exchange Commission show clearly that the government aims to nail as many players as possible in their nearly yearlong investigation into the Enron scandal.

A handcuffed Andrew Fastow is escorted to court by an FBI agent.

Karl Stolleis, Houston Chronicle

"They're throwing the net of enforcement very broadly," says Seth Taube, a former SEC attorney at law firm McCarter & English. "They're picking off people, up and down the chain of command."

Fastow is the highest-ranking former Enron executive so far to be charged by prosecutors and SEC officials, who have been investigating Enron since its financial scandal erupted last October.

The charges come amid much public outrage over corporate crime and a nationwide federal crackdown against white-collar crooks. With a zeal reserved for drug and mob investigations, prosecutors and FBI agents are targeting former executives at Enron, Tyco, WorldCom, Adelphia Communications, Global Crossing and other companies that have lost billions of dollars in shareholder equity from alleged financial fraud.

The Justice Department and SEC filings on Wednesday accuse Fastow and others of fraud, money laundering and conspiracy in a vast scheme to defraud investors, enrich themselves and mislead Wall Street analysts and credit-rating agencies.

"The complaints transform this from a case about exotic accounting to a case about theft and fraud," says former prosecutor Steve Ryan, an attorney the Manatt Phelps & Phillips law firm. "If true, Fastow is a thief. He's painted in a horrid light."

Adds Ken Johnson, spokesman for the U.S. House Committee on Energy and Commerce, which investigated the Enron scandal earlier this year: "The pieces to the puzzle are finally coming together," says "The only question now is where do (former CEO) Jeff Skilling and (former chairman and CEO) Ken Lay fit in?"

Since the Enron scandal burst forth last fall, prosecutors have been steadily climbing the corporate ladder and aiming for Fastow and other top Enron executives, including Skilling and Lay.

Through the 1990s, the trio turned Enron from an old-style, gas-and-electricity company into a Wall Street darling, a sleek $150 billion energy firm that traded power contracts in the investment markets.

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Fastow has been characterized as the brains behind a vast web of partnerships and accounting vehicles that hid $1 billion in Enron losses and led to the firm's collapse and filing for bankruptcy protection in December.

In a 35-page criminal complaint unsealed in federal district court on Wednesday, FBI agent Omer Meisel alleges that Fastow defrauded Enron and its shareholders of millions of dollars. But beyond highlighting the charges Fastow will face, the complaint serves as a road map to where Justice Department prosecutors may strike next.

Other Enron executives

Prosecutors appear to be zeroing in on Richard Causey, Enron's former chief accounting officer, and Lay.

Noticeably absent from the criminal complaint: any reference to Skilling, who served as Enron's chief operating officer from 1997 through 2000, when he was named CEO. Nevertheless, Skilling's role as the man who championed Fastow's rise at the company and supported Fastow's efforts to keep Enron's stock price high are likely to come under government scrutiny in the future.

Lay has consistently denied any knowledge of wrongdoing. Michael Ramsey, Lay's defense attorney in Houston, said Wednesday that the government's legal filings do not show that Lay misled the Enron board about Fastow's questionable partnerships.

"Nothing in it troubles me as far as Ken Lay is concerned," Ramsey says. "There were no surprises."

It's unclear which former Enron employees may be cooperating with the government. About a dozen witnesses were confidential sources for the FBI: one current and one former Merrill Lynch staffer; eight former Enron employees; and one source who never worked at Enron, but benefited from some of the transactions Fastow engineered between secret partnerships he controlled and Enron. That individual is believed to be William Dodson, the domestic partner of former Enron finance executive Michael Kopper.

Enron's banker

Merrill Lynch also has reason for concern. Though not identified by name, the criminal complaint describes in detail how Enron executives induced the prestigious brokerage and investment banking firm to knowingly participate in a sham transaction designed to boost Enron's quarterly earnings.

The FBI affidavit signals that Merrill Lynch remains in the sights of government prosecutors over its role in the 1999 sale of a trio of electricity-generating Nigerian barges by Enron. Prosecutors claim senior Merrill executives not only knew about the now-notorious deal, but some also argued against doing it. In a statement Wednesday, Merrill continued to protest its innocence.

"If I was in Merrill's shoes, I'd be worried," says Henry Hu, a securities-law professor at the University of Texas Law School. "You have the Justice Department alleging a pattern of behavior and understanding that is starkly different from the Merrill party line."

Nevertheless, the affidavit repeatedly says that Merrill was "pressured" into doing the deal for a client that paid it $40 million in fees in 1999, adding that Fastow referred to the pressure as "bear-hugging."

"You would not want to portray someone who you planned to indict as a victim of pressure," says Jack Coffee, a securities-law professor at Columbia University. "It suggests the government is not inclined to go after Merrill. But that doesn't mean the SEC won't bring a civil case."

Repeating many of the accusations from congressional hearings in July, the affidavit describes the barge transaction as a "sham" that allowed Enron to improperly record $12 million in earnings and meet its earnings goals at the end of 1999. Merrill, referred to only as "the Financial Institution" in the affidavit, allegedly bought the barges for $28 million, $21 million of which was financed by Enron.

Prosecutors say Merrill was given an "undisclosed oral agreement" from Fastow that Merrill would be bought out in six months with a guaranteed rate of return of 15%. The energy-generating barges were sold to LJM, a private partnership controlled by Fastow, on June 29, 2000. Merrill earned a $525,000 profit.

The complaint said a senior Merrill executive held a conference call with senior Enron management "to confirm Enron's 'commitment to guarantee the takeout with six months' and that the deal needed to close by December 31, 1999," the affidavit says.

The affidavit also says Merrill entered into the barge transaction "in spite of some internal dissension, including a document expressing concern that it would be viewed as 'aiding and abetting' Enron's fraudulent manipulation of its income statement."

Merrill Lynch denies any wrongdoing and says it is cooperating with prosecutors.

"As we've previously stated, Merrill Lynch's investment was fully at risk in this transaction," the company said Wednesday. "Merrill Lynch never knowingly assisted Enron in falsifying its financial results. Had we known in 1999 what is known today about the company, we would not have done business with them."

In the meantime, former Enron workers and their attorneys were pleased with the charges against Fastow, blaming him for Enron's downfall.

"Mr. Fastow is at the center of the conspiracy," says Lynn Sarko, a former prosecutor and Seattle attorney who represents Enron-related employees and retired workers in a civil suit against the company's executives. "Workers are heartened that some of those responsible are being held accountable."

Diana Peters, a former Enron employee who showed up at the hearing to watch Fastow in his moment of peril, lumped the former CFO in with ex-CEO Skilling. "They stole," she says. "Most people who steal go to jail."

Asked about Lay, Peters wasn't so sure. "I don't feel as strongly about Lay," she says. "I think he was duped."

The complaint against Fastow comes a month-and-a-half after prosecutors filed charges against former Enron finance executive Kopper, who helped Fastow run the partnership schemes. Kopper pleaded guilty to fraud and money laundering, while agreeing to help prosecutors in Enron-related cases against Fastow and others.

The Justice Department continues to play hardball with Enron suspects and defendants. In August, its lawyers persuaded a federal magistrate to freeze $24 million in property and cash held by the Fastow family. On Wednesday, Fastow agreed to freeze $11 million more in assets.

Now that prosecutors have charged Fastow, they must secure a criminal indictment against him within 30 days. If not, the case may be dismissed. A special federal grand jury in Houston has been interviewing witnesses in the case.

If Fastow is found guilty at trial, he faces a maximum prison sentence of several decades. If he cuts a plea agreement with prosecutors, it could be reduced to 10 to 20 years.

"Fastow's criminal exposure is so immense that he has to work out a plea," says former SEC attorney Taube. "His attorneys would be nuts to try his case."

Greg Farrell reported from Houston, Edward Iwata from San Francisco and Thor Valdmanis from New York.