

SPECIAL ISSUE  
CORPORATE CORRUPTION

U.S. REPRESENTATIVE  
4TH DISTRICT • OREGON



# PETER DEFazio REPORTS

Rep. Peter A. DeFazio  
151 West 7th, #400  
Eugene, OR 97401

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## Corporate Corruption: What Happened?

It has been a difficult year for workers and investors. A group of unscrupulous corporate executives have repeatedly undermined our shared values of honesty, fairness, and trust. Our nation's faith in business and markets has been shaken to the core. Not since the excesses of the robber barons in the early 1900s has our nation been confronted with alarming corporate malfeasance on the appalling scale we've witnessed over the last several months.

There is mounting evidence that Enron, among others, manipulated power markets in the West. Memos from Enron's own files document the trading strategies used to manipulate electricity prices, which contributed to a 40 percent increase in our electric bills. Enron also escaped federal taxes by setting up more than 800 subsidiaries in tax havens like the Cayman Islands. While he was telling employees that Enron was a great investment, Enron CEO, Ken Lay, and other executives were frantically selling their own Enron stock and manipulating the books to hoodwink investors. Enron executives walked away with hundreds of millions of dollars in stock gains while thousands of employees, including those at Portland General Electric, stood by helplessly as they lost their jobs and a lifetime of savings. To add insult to injury, Lay and others were able to protect their multi-million dollar mansions, thanks to a loophole in the bankruptcy code.



Congress of the United States  
House of Representatives  
July 2002

Dear Friend:

An alarming number of executives are walking away with hundreds of millions of dollars as their companies spiral into bankruptcy, workers lose their jobs, and hard-earned pensions vanish. Accounting firms have signed off on fraudulent corporate reports to pad their profits. Market analysts tout stocks they know are worthless to gain millions from investment banking giants. The stock markets have plummeted, flushing trillions of dollars from investors down the drain. U.S. corporations are dodging taxes, shifting the burden onto small businesses and working families.

Simply scolding executives or passing loophole-ridden legislation is not enough. Congress must approve strong laws to provide regulators with the resources to become effective watchdogs.

This **special report on corporate corruption** will detail how the system got so out of control and outline some of the reforms necessary to restore confidence in Wall Street, and our economy.

If you want to contact me about this or any other issue of concern to you, please contact me at one of my offices listed on page 4.

Sincerely,  


The story is the same with other companies. WorldCom CEO Bernard Ebbers and other top executives manipulated accounting practices in order to paper over multi-billion dollar losses. Of course, prior to WorldCom's collapse, Ebbers made hundreds of millions of dollars by selling his WorldCom stock. To make matters worse, he negotiated a cushy severance package before he was fired. For running WorldCom into the ground, defrauding investors, and wiping out billions of dollars in shareholder wealth, Mr. Ebbers will get \$1.5 million a year for life.

Xerox was recently fined millions of dollars for faulty accounting. Executives at the drug company, ImClone, have

been charged with insider trading.

In order to maintain lucrative consulting contracts, accounting firms ignored fraudulent accounting.

Corporate corruption has cost tens of thousands of workers their livelihood, and millions of Americans their life savings. Fraudulent executives belong in prison. Workers and investors deserve relief.

As a long-time advocate for consumer protection and corporate accountability, I wanted to share my thoughts on how we got here and what reforms are required to restore confidence in Wall Street, U.S. business and the American economy.

# Deregulation Erodes Corporate Accountability

Contrary to the claims of so-called experts, the rash of corporate scandals was *entirely* predictable. It was the inevitable result of a failed experiment with radical deregulation plans, and massive corporate influence over Congress and the Executive Branch.

During the Carter Administration, the federal government began a grand experiment with deregulation. This unshakable devotion to deregulation continued under subsequent administrations, both Democratic and Republican. Among the industries deregulated were: aviation, trucking, telecommunications, cable television, electricity, natural gas, banking, and financial services.

Proponents of deregulation argued that government regulations hampered innovation, restricted competition and raised the cost of doing business. Consumers were promised that deregulation would lead to lower prices, more choices, and better service. Unfortunately, the exact opposite happened.

Deregulation allowed corporate executives to act with impunity—whether gouging consumers, misleading investors, or hurting workers.

In just the last decade, I voted against a series of poorly understood deregulation bills, rushed through Congress, that defanged market watchdogs and set the stage for a wave of corporate corruption:



WorldCom executive Scott Sullivan's new "home" in Florida. Current law allows unscrupulous CEOs to keep palatial homes even in cases of proven fraud.

Source: Washington Post

➤ *The 1992 Energy Policy Act* deregulated wholesale electricity, and contributed to the emergence of energy conglomerates, such as Enron, that manipulated energy markets in order to drive up prices and gouge consumers.

➤ *The 1995 Securities Reform Litigation Act* insulated accounting companies from virtually all investor lawsuits and led to an atmosphere in which companies and their auditors felt free to cook the books and mislead investors.

➤ *The 1996 Telecommunications Act* allowed a wave of corporate consolidation in the phone, cable, television, and radio industries. This legislation ushered in a corporate takeover of the media, and contributed to the collapse of telecom giants like Global Crossing and WorldCom.

➤ *The 1999 Financial Services Modernization Act* for the first time since the Great Depression, allowed the merger of insurance companies, banks, and securities dealers. This bill resulted in the scandals at Merrill Lynch and other brokerage/financial services companies, where stock analysts knowingly touted failing stocks in order

to pad the profits of the banking arm of their employers.

➤ *The 2000 Commodity Futures Modernization Act* exempted over-the-counter derivatives from regulation. The Federal Reserve arranged a multi-billion dollar bailout of Long Term Capital Management, a failed derivatives speculator. Enron's heavy derivatives trading contributed to its collapse and the run-up of West Coast electricity prices.

## Consumers Lose Out Under Deregulation

During debates about deregulation, I consistently pointed out the fallacy of proponents' arguments. A July 2002 *Consumer Reports* exposé provides additional evidence that deregulation has been a failure for consumers:

*"Deregulation should never be no regulation. Free markets are ever changing, and players are always devising new mischief. Government must remain vigilant of abuses and respond swiftly."*

- *Consumer Reports*, July 2002

### Electricity:

Electricity rates have shot up in deregulated markets (an average of 40 percent in the Northwest) and likely

won't come back down anytime soon. Previously stable electricity prices have become extremely volatile, resulting in frequent blackouts.

### Telecommunications:

The cost of local phone service has risen 50 percent and cable television prices have risen an average of 36 percent. Customer service for both has deteriorated.

### Aviation:

Most airline passengers are confronted by fewer choices, shoddy service, higher prices and security on the cheap.

### Financial Services:

Banking deregulation led to new and

higher fees and \$160 billion in taxpayer-financed bailouts.

### The Consumer Reports investigation concluded:

1. The oft-repeated claim that deregulation cut consumer prices, while regulation kept prices artificially high, is a myth.
2. The marketplace has become more adversarial toward consumers.
3. When Congress deregulated industries, it didn't just untie the hands of business. In many cases, it straight-jacketed consumers, and weakened regulators and consumer advocates.

# How Do We Fix This Mess?

## 1. Re-Regulation:

Congress must swing the pendulum away from unaccountable deregulation schemes toward common-sense, consumer-oriented regulation.

I introduced legislation (H.R. 264) to end the failed experiment with electricity deregulation and return to reliable, affordable cost-of-service-based energy, provided by suppliers with a mandate to keep the lights on.

I also introduced legislation (H.R. 4038) to regulate the widely-used and wholly unchecked practice of over-the-counter derivatives trading.

In addition, mergers between banks, insurance companies and securities dealers should be prohibited, and restrictions on concentrated and foreign ownership of media should be reimposed.






## 2. Pension Protection:

It's been heart-wrenching to hear about the families who have lost a lifetime of savings as a result of the recent corporate scandals.

Congress must approve legislation to:

- Prohibit mandated accumulation of company stock in employee 401(k) plans;
- Equalize the treatment of executives and rank-and-file workers;
- Provide employees access to quality, conflict-free investment advice;
- Mandate worker representation on retirement plan boards;
- Require executives' ill-gotten gains to be returned to employee pensions funds.

### Cut and Run

	Executive	Their Take	Fallout
	<b>Gary Winnick</b> <i>Global Crossing</i>	\$734 million	Global Crossing is bankrupt.
	<b>Dennis Kozlowski</b> <i>Tyco Intl.</i>	\$300 million	Kozlowski was charged with tax evasion. Tyco moved to Bermuda to avoid U.S. taxes.
	<b>Kenneth L. Lay</b> <i>Enron</i>	\$119 million	Lay resigned. Enron is bankrupt, and under investigation for energy market manipulation.
	<b>Charles Watson</b> <i>Dynegy</i>	\$112 million	Watson resigned. Dynegy is under investigation for market manipulation.
	<b>Bernard J. Ebbers</b> <i>WorldCom</i>	\$78 million	Ebbers was forced out. WorldCom is bankrupt, and has been charged with defrauding investors.

## 3. Taxes:

I support a number of bills to close the loopholes corporations and wealthy executives have exploited to dodge taxes.

Congress should immediately enact the following bills:

- H.R. 3884 to eliminate the ability of corporations to rent post office boxes that serve as headquarters in tax havens to avoid U.S. taxes;
- H.R. 2520 to eliminate corporate tax shelters used to hide income;
- H.R. 4993 to prevent businesses that relocate abroad to avoid taxes, from taking advantage of international tax treaties;
- H.R. 4831 to prohibit corporate tax dodgers from receiving government contracts.

## 4. Accounting Reform:

Corporate accounting has been manipulated. Stringent new rules must be enacted to restore the credibility of company books:

- Congress should repeal the liability limitations approved for huge accounting firms in 1995;
- Accounting firms should be prohibited from offering consulting services to companies they audit;
- Companies should be forced to rotate auditors every few years;
- The Securities and Exchange Commission needs more resources to conduct its own audits of the *Fortune 500*;
- Defrauding investors should be made a felony, with stiff penalties for executives;
- Stock options should be clearly accounted for in corporate books.

# Even More Remedies



## 5. Corporate Governance:

While federal regulation is important, it's just as critical to restore integrity and credibility to corporate leadership. Reforms should include:

- Requiring a shareholder vote before giving executives stock options;
- Eliminating tax breaks for exorbitant CEO salaries;
- Forfeiting executive compensation gained by defrauding investors;
- Prohibiting executives and board members from selling their company's stock until after they've resigned;
- Prohibiting executives from receiving insider loans from their company;
- Full stakeholder representation on corporate boards (including minor shareholders and workers).

## 6. Toothless Regulators:

Congress must impose strict employment restrictions to stop the revolving door between regulatory agencies and the industries they monitor. Harvey Pitt, the current Chairman of the Securities and Exchange Commission (SEC), the federal agency responsible for monitoring financial markets and accounting standards, is a prime example. In private practice, Pitt represented all of the major accounting firms. He led the opposition against accounting reforms put in place to protect investors. So as Chairman, he had to recuse himself from voting on cases before the SEC 29 times in 10 months, because of conflicts of interest. Investors and consumers don't need corporate lapdogs, they need tough corporate watchdogs.

## 7. Criminal Contractors:

The federal government is one of the largest purchasers of goods in the country. The government should use its substantial buying power to reward ethical companies and prohibit subsidies and contracts from being showered on corporate criminals. I have drafted legislation to do just that.

Similar to "three strikes" laws, my legislation would prohibit granting federal government contracts to companies with three or more civil judgments or criminal convictions for procurement fraud and related offenses like embezzlement, theft, and bribery. As scandals multiply, this legislation becomes more timely than ever.

## The Dangers of Reliance on Foreign Investors

A little-noticed, but disturbing trend, has developed in U.S. markets over the last decade—increasing reliance on foreign investors.

This trend threatens the stability of

U.S. stock markets, as well as corporate and government financing.

The trade deficit has grown from \$90 billion in 1997 to \$455 billion today. The U.S. must attract \$2 billion of capital from abroad every single day, in order to finance the trade deficit. Cumulative debt to foreigners has skyrocketed over the last decade from \$49 billion to \$1.5 trillion. That is simply not sustainable.

Today, foreigners hold 40 percent of U.S. Treasury debt, 24 percent of all U.S. corporate bonds, and 13 percent of U.S. stocks. In a classic understatement, Federal Reserve Chairman, Alan Greenspan, told Congress earlier this year, "There are ever increasing claims on the American economy by foreign investors, and that can't go on forever without some difficulty."

The "difficulty" Mr. Greenspan alludes to is that foreign investors have



*Rep. DeFazio continues to speak out against unfair trade agreements like NAFTA and WTO that force the U.S. to rely heavily on foreign investors to sustain our economy.*

begun looking at the large U.S. trade deficit, questioning whether we'll be able to pay our bills, and are now removing their money from U.S. markets. This has accelerated due to corporate scandals.

If we do not quickly restore integrity in corporate America, and overhaul our trade policies so we're not dependent on foreign investment, then we risk a financial crisis that will slow our economic recovery for years to come.

### My Offices Are Here to Serve You

2134 Rayburn HOB  
WASHINGTON, DC 20515  
(202) 225-6416

151 West 7th, #400  
EUGENE, OR 97401  
(541) 465-6732  
1-800-944-9603

125 Central, #350  
COOS BAY, OR 97420  
(541) 269-2609

612 S.E. Jackson Street, #9  
ROSEBURG, OR 97470  
(541) 440-3523

Visit My Web Site at:  
<http://www.house.gov/defazio>