Felonsious Mayhem
Enron and other capitalist calamities
by PAUL M. BARRETT

A n ironclad rule of American business is that eras of great profit give rise to fantastic excess in the executive suites, and then someone gets sent to the slammer.

In June, while I was reading the book under review, we witnessed the first major indictments from the subprime mortgage fiasco: once-mighty financiers shuffled into federal court in Brooklyn in the tender grasp of deputy U.S. marshals. This particular pair from the disgraced and sold-off investment bank Bear Stearns was charged with misleading investors about the plummeting value of complex securities linked to mountains of home loans that should never have been made in the first place. Leaving the question of criminal liability to one side, it’s fair to say that Wall Street and the mortgage industry conspired to inflate a housing bubble that inevitably, and violently, exploded. As foreclosures proliferate in California and Florida, and tens of thousands are laid off on Wall Street, many ask how we didn’t realize sooner that a real-estate market that seemed too good to be true was... well, you know.

Recent decades have brought us the savings-and-loan scandal, the Michael Milken insider-trading skein, the first-generation dot-com frenzy, and a series of corporate debacles related to the Internet boom of the late 1990s. And who could forget Enron: hands down, the most byzantine saga in memory of hubris, greed, and deceit? The tale of the shiny Houston energy-trading juggernaut that crashed in late 2001 has been told so often that it has entered the realm of mythology. But Malcolm S. Salter, an authority on corporate management and Harvard, argues in his new volume that lessons from Enron’s rise and fall can guide business leaders—and the rest of us—in pondering how to regulate the great engines of capitalism in a way that will generate jobs and income without all the felonious mayhem.

As its title may suggest, Innovation Corrupted: The Origins and Legacy of Enron’s Collapse is not a brisk read; nor is it meant to be. Salter offers instead a sober case study that steers clear of narrative thrills and puckish personality portraits. His confidence that better-constructed boards of directors following common-sense principles will protect against future Enrons strikes me as overly hopeful, if not downright naive. But Salter’s heart is in the right place, and his exceedingly rational dissection of Enron will be instructive for any aficionado of big business and human frailty.

Enron had its roots in prosaic natural-gas operations that merged in 1985 and fell under the control of an amiable and eggheadish executive named Kenneth Lay, a Ph.D. economist better known for his enthusiasm for deregulating the energy business than for his managerial mastery. Lay hired Jeffrey Skilling, M.B.A. ’79, a brash and charismatic consultant from McKinsey & Company, to oversee Enron’s expanding gas-trading business. In the words of a former colleague, Skilling “could out-argue God.”

In the 1990s, Enron grew into an innovative and prosperous force in the newly deregulated natural-gas industry. It rode the Internet wave to create an on-line trading system that swiftly became the world’s biggest e-commerce site. This digital system allowed producers and users of natural gas to manage their risks more efficiently. Enron profited handsomely, as it should have.

Then Skilling and Lay let their success
An art forger’s success has less to do with "his prowess as a visual artist than with his use and misuse of history." So writes Jonathan Lopez ’91 in “A Liar’s Biography,” the introduction to his new work, The Man Who Made Vermeers: Unveiling the Legend of Master Forger Han van Meegeren (Harcourt, $26). More from the astonishing tale:

A t the end of World War II, shortly after the liberation of Amsterdam, the Dutch government threw wealthy artist Han van Meegeren into jail as a Nazi collaborator, charging that he had sold a priceless Vermeer to Hermann Goering during the German occupation. In a spectacular turn of events, Van Meegeren soon broke down and confessed that he himself had painted Goering’s Vermeer. The great masterpiece was a phony.

While he was at it, Van Meegeren also admitted to forging several other pictures, including Vermeer’s famed Supper at Emmaus, the pride of Rotterdam’s Boijmans Museum, a painting once hailed by the prominent art historian Abraham Bredius not merely as a masterpiece, but indeed “the masterpiece of Johannes Vermeer of Delft.” When the news got out, it made headlines around the world, and the forger became an instant folk hero. In widely reported interviews at the time, Van Meegeren claimed to be a misunderstood genius who had turned to forgery only late in life, seeking revenge on the critics who had scorned him early in his artistic career.

An ancient grievance redeemed; a wrong put right. It was a wildly appealing tale back in 1945, and indeed it remains quite seductive today. In the Netherlands… the story of the wily Dutchman who swindled Hermann Goering continues to raise a smile.

But the forger had one more trick up his sleeve: his version of events turns out to have been extravagantly untrue. …Van Meegeren worked for decades with a ring of shady art dealers promoting fake old masters, some of which ended up in the possession of such prominent collectors as Andrew Mellon and Baron Heinrich Thyssen. All the while, Van Meegeren cultivated a fascination with Hitler and Nazism that, when the occupation came, would provide him entrée to the highest level of Dutch collaborators.

Open Book

“A Liar’s Biography”

An early fake: The Lace Maker, a forgery in the style of Vermeer, ca. 1926. Above, Han van Meegeren, 1945

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Off the Shelf
Recent books with Harvard connections

Forgive Us Our Debts: The Intergenerational Dangers of Fiscal Irresponsibility, by Andrew L. Yarrow, M.P.A. ’94 (Yale, $25). “[D]espite centuries of distaste for debt,” the United States government will owe $10 trillion by election day—and has promised another $50 trillion or so of benefits. The unchecked debt spree threatens “night time in America,” the author suggests, and “morning in China.”

The (Un)happy Lawyer, by Monica Parker ’92, J.D. ’99 (Sourcebooks, $14.95, paper). An erstwhile lawyer herself, Parker now plies her trade as a coach for those exiting the profession. Here is her written “roadmap to finding meaningful work outside of the law” (presumably while still complying with it).

The Freedom Agenda: Why America Must Spread Democracy (Just Not the Way George Bush Did), by James Traub ’76 (Farrar, Straus and Giroux, $25). One reporter’s take on promoting democracy and why it would be good for the nation to “get caught…behaving in conformity with our deepest principles.”

City between Worlds: My Hong Kong, by Leo Ou-fan Lee, professor of Chinese literature emeritus (Harvard University Press, $29.95). An attractively illustrated history, cultural guide, and sidewalk tour of the author’s home city, where he now teaches at the Chinese University.


The Legacy of the Mastodon, by Keith Thomson ’61, Ph.D. ’63 (Yale, $35). The former director of the Oxford University Museum of Natural History traces “the golden age of fossils in America” from Thomas Jefferson (fascinated by mastodon fossils) forward—150 years of pioneering and frontier paleontology.

The Candy Bombers: The Untold Story of the Berlin Airlift and America’s Finest Hour, by Andrei Cherny ’97 (Putnam, $29.95). A huge narrative of the 1948-9 effort that brought 4.6 billion pounds of supplies into then-divided Berlin, at a time of maximum Cold War tensions. The author, an editor of the journal Democracy, tells especially about the exploits of Gail Halvorsen, the pilot who, on his own, dropped presents of candy tied to handkerchief parachutes.

How the Wise Decide, by Bryn Zeckhauser ’93, M.B.A. ’01, and Aaron Sandoski, M.B.A. ’04 (Crown, $24.95). Among other advice, leaders suggest, “Fill a room with barbarians”—to air diverse views.

Making a living in the narrow alleyways and streets of Wan Chai, in Hong Kong

Decorated Book Papers, Fourth Edition, by Rosamond B. Loring, edited by Hope Mayo, Hofer curator of printing and graphic arts, Houghton Library (Harvard College Library/Harvard University Press, $50). With 80 lush samples, from when books were beautiful.

Skilling and Lay denied any wrongdoing or even knowledge of fraud. In July 2006, 10 days after his conviction in federal court in Houston, Lay died from a heart attack. Skilling was sentenced to 24 years in prison, though his appeals continue. All told, more than 20 people were convicted in Enron-related cases, and a company that once employed 31,000 vaporized.

In painstaking analysis of the foregoing, Salter identifies three central lessons. The first is that a less drowsy board would have blown the whistle on Enron’s shenanigans and prevented disaster. He points admiringly to the typically more vigilant directors he says are installed when buyout firms collaborate with management to take public companies private. (Salter averts his gaze from the fact that so-called leveraged buyouts often result in companies crippled with debt while the private-equity boys make out like bandits, but that’s a topic for another book.) Lesson number two is that Enron executives, led by Lay and Skilling, were paid too lavishly. The reckless spewing of company stock and options—celebrated by some compensation gurus as a way to “align” management’s interests with those of the company—created an incentive for Enron’s leaders to prop up the share price at all costs. Finally, Salter calls for the institution of stringent ethical checks and balances to prevent executives from misbehaving when they operate “in the penumbra between clear rightdoing and clear wrongdoing.”

Fair enough. But as Salter’s careful exposition reveals, all the business-school theory in the world can’t cure the corruption of a devious mind. Enron had codes of ethics, but they weren’t worth the paper on which they were neatly published. (Lay, who saw himself as an academic of sorts, even contributed a chapter to a book on business ethics!) The company had a risk-analysis group stocked with quantitative geniuses who raised plenty of objections to questionable deals and dubious accounting. The objections were derided or ignored. As for what motivates the troops, Salter quotes Skilling as having this to say before everything unraveled: “I’ve thought about this a lot, and all that matters is money. You buy loyalty with money. This touchy-feely stuff isn’t as important as cash.”

Come to think of it, would even our most august schools of business adminis-
tration dispute Skilling’s blunt assessment? The fact is that money talks, and achievers in corporations and on Wall Street listen. That’s at least a big part of the reason they’ve chosen those pursuits, rather than high-school teaching.

And there’s nothing necessarily wrong with that. We all benefit, some more directly than others, when smart, competent business people invent new ways of trading natural gas or, to choose another example of more immediate interest, finance home loans. We need entrepreneurs as well as algebra instructors.

But cheaters, given a chance to bend the rules, can weaken any enterprise. Lay, Skilling, & Company were cheaters (as well as far less competent corporate strategists than they and a lot of other people thought at the time). Salter helpfully recounts an incident from as far back as 1987, when Lay discovered a rogue oil-trading team manipulating the ledgers to reap substantial bonuses. Rather than fire the miscreants, Salter notes, Lay papered over the situation. His response, widely observed at the company, “became part of Enron’s cultural lore.”

The author puts great faith in rational internal controls and company audit committees. Almost as an afterthought, he notes that what was also missing at Enron was “a deep commitment to ‘quality’ objectives—compliance with the law, the principles underlying the law, and high ethical standards—and thoughtful reflection on how best to achieve those objectives.” Well, yes. This is what tends to be missing when investigators comb the wreckage of a financial calamity. There were countless individuals within Enron who could have quit their jobs and alerted regulators to what was going on. Brave souls were in short supply.

What also tends to be missing—and what Salter might have emphasized more—is skeptical oversight from the outside. An overmatched, understated SEC was “a deep commitment to ‘quality’ objectives—compliance with the law, the principles underlying the law, and high ethical standards—and thoughtful reflection on how best to achieve those objectives.” Well, yes. This is what tends to be missing when investigators comb the wreckage of a financial calamity. There were countless individuals within Enron who could have quit their jobs and alerted regulators to what was going on. Brave souls were in short supply.

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Chapter & Verse
Correspondence on not-so-famous lost words

Thomas Engelsing would like to learn the source of the following lines: “And now hear this, my ruder truth, thou art composed of lust unchained and most vile flux.”

Royall Moore hopes that someone can provide a citation for the phrase “North northwest the path of culture” (i.e., Egypt to Mesopotamia to Greece, Rome, Europe, and the New World)—a line he heard on a radio broadcast by Robert Frost, who was reading from his poems.

Tobe Kemp seeks a provenance for his family’s longtime expression, “And I’m the dumpsy dido that can do it.”

Send inquiries and answers to “Chapter and Verse,” Harvard Magazine, 7 Ware Street, Cambridge 02138, or via e-mail to chapterandverse@harvard-mag.com.
struggles to patrol the beat to which it has been assigned. Neither Congress nor the White House—Republican or Democratic—seems inclined to strengthen the regulators. Tepid reform legislation enacted in the wake of Enron did little to deter the reckless schemes that gave us the subprime mortgage mess. Business journalists, I can confess from within that fraternity, are overly consumed with anointing corporate superstars. Too rarely do we have the fortitude to disentangle telling footnotes in securities filings when it counts—before, rather than after, the bankruptcy courts take over and shareholders are ruined.

Call me a pessimist, but my view is that human nature being what it is, we can expect more Enrons, and more perp walks. 

Paul M. Barrett ’83, an assistant managing editor at BusinessWeek, is the author, most recently, of American Islam: The Struggle for the Soul of a Religion (2006), released in a paperback version by Picador earlier this year.

B O O K S

A Tale of Two Detectives

While preparing to interview Cecile von Ziegesar, author of the wildly popular Gossip Girl series, for a London newspaper, Lauren Mechling ’99 spent a week in the “young adult” corner of a New York City Barnes & Noble. She hadn’t been in that section in a decade, by her estimate, and what she found surprised her. The moralizing tone of the books she remembered from her own teenage reading was gone. “It seemed like the books were really being written for teenagers, not for their parents to buy them,” she says. “There was something kind of ‘Wild-West’-y about it.”

Those visits prompted Mechling (pronounced meck-ling) and her friend Laura Moser to write a trilogy about a Texas girl who moves to Manhattan. Their first book, The Rise and Fall of a 10th-Grade Social Climber, has sold more than 30,000 copies since its publication in 2005. In 2006, Mechling began writing her first solo novel, Dream Girl, the story of a high-school student whose strange but predictive dreams help her slowly unravel a mystery. It was published in July.

The young-adult section of a Barnes & Noble is not a bad place for a book to be. While the rest of the industry shrinks, the Association of American Publishers estimates that sales of hardback juvenile titles, which include young-adult and children’s books, have grown 4.6 percent annually since 2002. “I guess it’s really been in the last 10 years,” says Mechling, “that the average age of young-adult authors became a lot younger, and closer to that of the readers themselves.”

Although a former reporter herself—first in Canada, and then in New York City for the Sun and Wall Street Journal (where, in her current job, she commissions essays for the paper’s Friday leisure section)—Mehling says she doesn’t approach writing for teenagers as another form of journalism. “I don’t hang out with teenaged girls,” she says. “I think it would come across as really fake and condescending if we sat down with our notebooks and watched One Tree Hill [a teen television drama] and said, ‘All right, this is what the teens are into now. Let’s write about that.’” She simply trusts that what she finds funny or touching will resonate with her readers.

Reporting and detective work both require keen powers of observation, though, so Mechling describes Claire, the heroine of her new novel, as a journalist who just doesn’t know it yet. “It’s about a girl who’s always noticing little things,” she explains. “And unlike in my life, where you notice little things and you file them away and that’s the end of it, in Claire’s case they actually end up leading her into the most fantastic adventure.”

But Claire does share one of her author’s childhood memories. While visiting grandparents in Florida, Mechling opted not to go to the beach with the rest of her family. Instead, she sneaked around the apartment building, putting an ear up against the neighbors’ doors and taking notes on what sort of deli meat they wanted on their sandwiches. She ended up caught and in trouble. So does Claire.

Claire’s adventures, like those of many young-adult heroines, will continue in a sequel, Dream Life. Mechling notes that publishers often push authors to continue writing about popular characters, but she sees another reason for creating a series as well, that gets to the heart of why young people read: “I think there’s a smaller space between their heads and the page. I think they really dive into these imaginary worlds with a greater sense of immersion and a greater sense of intensity. And I think they become personally attached to the characters they’re reading about.” She suspects that teens would rather read a dozen books by a beloved author than a book each by a dozen critically acclaimed yet unfamiliar writers.

Mechling says that writing young-adult books has been immensely rewarding. “You don’t do this for the money. You obviously don’t do it for prestige,” she explains. “I just do it because I love the satisfaction that comes from writing something that I think is very funny, or something that I think is very sweet.”

Even so, there are those who still ask her when she’s going to start her great American novel. “I definitely want to shake people when they ask that,” she says, “to just sort of guide them by the hand and show them all these great books that are coming out. If they understood, they wouldn’t say, ‘Why don’t you go write a 600-page meditation on isolation and dystopia?’” She likes her corner of the bookstore just fine.

—PAUL GLEASON

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