# STATEMENT

## "The Role of the Board of Directors in Enron's Collapse"

## Chairman Joe Lieberman

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Thank you, and thanks to the Permanent Subcommittee on Investigations for holding this important hearing, which initiates the next phase of the Senate Governmental Affairs Committee's investigation of the scandalous collapse of the Enron Corporation.

Over the past six months, we've all heard many reports about who failed Enron's shareholders and employees leading up to the company's fall—obviously the company's management has been cited, Arthur Andersen, government watchdogs, stock analysts, rating agencies. There were bad decisions, breakdowns, and betrayals at several links in the oversight chain. Today we focus on another group that deserves some of the blame for failing to uncover the crookedness in the company's behavior books, and that is the company's board of directors.

Textbooks tell students that the board of directors is the group of individuals elected by the shareholders to watch over the management of a corporation on behalf of the shareholders. Board members are, in essence, like trustees or guardians for the shareholders and, in a larger sense, for the integrity and reliability of our economic system.

In fact, because of their essential role, directors by law owe special duties to the corporation and particularly its shareholders: duties called "loyalty" and "care." Loyalty, meaning freedom from conflicts of interest—in other words, serving shareholders and only shareholders with independence and undivided attention. Care meaning doing your work responsibly, thoroughly, and in good faith.

By all appearances, Enron's board of directors failed their shareholders on both these counts.

Even though a majority of Enron's board was made up of "outside" directors—meaning directors not in Enron's management—a stunning 10 of the 15 most recent outside directors had conflicts of interest including contracts with Enron, common bonds to charities, and memberships on the boards of other companies doing business with Enron.

Some examples: charities close to some of the directors were supported heavily by Enron and its officers. Two directors had earned more than $6.5 million in consulting fees from Enron since 1991. One director served on the board of a company that in 1999 signed a $1 billion energy management agreement with an Enron affiliate.

Arrangements like this can divide, or even redirect, a director's loyalties to the hand that feeds them—management—and away from their single-minded responsibility to the shareholders. Consulting contracts or large donations to favored charities whittle away the objectivity directors must bring to every decision they make, and leave shareholders without the protectors they need.

Second, let's talk about the directors' duty to take care and be diligent in overseeing the management of the company.

The more we look, the more evidence we find of inadequate oversight. In 1999, the board went so far as to suspend Enron's code of ethics—on two separate occasions—to allow the company's chief financial officer, Andrew Fastow, to run partnerships that would make deals with Enron. That to me was extraordinary and extraordinarily irresponsible: rather than raising a red flag, the board gave a green light to Mr. Fastow to, as Sherron Watkins put it in her testimony before the Senate Commerce Committee, "put his hands in the Enron candy jar."

As the shareholders' elected representatives, the board of directors have an affirmative obligation to ask questions and get answers. We're talking about qualified individuals who had a professional understanding of the industry and impressive credentials.

Let me read a few of those credentials:

Former Chairman of the Executive Committee of Gulf & Western Industries… Former Chairman of the U.S. Commodity Futures Trading Commission… Former United Kingdom Secretary of State for Energy… Professor of Accounting and former Dean of Stanford Business School…

The question is, why all that experience, and so much more, accomplished so little for shareholders of Enron.

To me, the directors' lack of diligence is even more troubling in light of the fact that they profited so much from their positions as board members. In stock sales alone, some made hundreds of thousands, and a few made more than a million dollars.

The Board of Directors didn't just fiddle while Enron burned. They toasted marshmallows over the flames. Even as those flames shook our economy and engulfed the dreams of thousands of dedicated Enron employees who lost not only their jobs but their retirement security.

The flagrant failure of Enron's board of directors is a warning we must heed. The more than 100 million people whom we call the new investor class, those middle-class Americans who entered the market in the 1990s, are shaken. They're asking: if the distinguished Enron board failed so utterly in this case, how many other boards might be negligent?

After all, investment capital is the lifeblood of our free market economy. So the belief that directors are failing their shareholders is a threat to the health of our economic system. We cannot let it grow or go untreated. We all must work together now to restore shareholder's confidence.

There are many proposals of potential reforms that have been made to strengthen directors' accountability. I believe called for giving the SEC new powers to remove negligent directors from their boards and ban them from future service on the boards of any other public company. I'm also very interested by proposals to ban or limit company stock sales by directors for the duration of their terms and to impose mandatory term limits on directors.

And I strongly support the call to the stock exchanges to adopt listing requirements that would require companies to limit the number of insiders

who can serve on boards, and to restrict directors from serving on more than a given number of boards, and to prohibit behavior that amounts to conflicts of interest.

As usual, self-regulation by the companies and by the stock exchanges would be the most direct and effective path to reform. But if there is inadequate self-regulation, there is no question some government action will be necessary to prevent the most egregious abuses of responsibility by boards of directors.

About 100 years ago, the satirist Ambrose Bierce defined a corporation as, “An ingenious device for obtaining individual profit without individual responsibility.” Let us work together now to make sure that cynical joke does not become a prophesy. Let’s make sure that directors are accountable and vigilant, and shareholders’ first line of defense against corporate negligence, mismanagement, or corruption, and that they give investors the confidence our economy needs to grow as robustly as we all want it to.

Thank you.