

Cases

Andersen: An Obstruction of Justice?

PROBLEM

Students may be familiar with **Arthur Andersen**, the CPA firm that failed to detect fraudulent financial activities in the audits of several companies including **Sunbeam**, **Waste Management**, **Enron**, and **WorldCom**. Many articles and papers have been written about the quality of these audits and how increasing the firm's revenues from both audit and nonaudit services may have supplanted audit quality as the main objective of Andersen as a firm. However, we should not lose sight of the facts that led to Andersen's demise and the findings that have occurred since Andersen ostensibly closed its doors as an audit and accounting firm.

In effect, Andersen had already received the maximum penalty even before its trial began. Once Anderson had been indicted, most of its clients had decided that an audit by a firm under indictment would be of little value even if allowed by the Securities and Exchange Commission (SEC). During the shareholder proxy season in early 2002, company after company announced it would no longer retain Andersen as its auditor. Whether the firm was able to defend itself or not, the days of Andersen as a viable audit firm had come to an end.

ANDERSEN GOES TO TRIAL

In May 2002, Arthur Andersen LLP was tried for obstruction of justice in connection with the destruction of documents during a time period prior to a formal SEC investigation of Enron, one of Andersen's largest clients. The main witness for the prosecution was David Duncan, a former Andersen partner in charge of the Enron audit, who had already pleaded guilty to obstruction of justice. The guilt or innocence of Andersen hinged on the question of corporate direction. If Duncan had acted illegally on his own in an effort to save himself from consequences resulting from an SEC investigation of Enron, then Andersen as a firm would not likely be found guilty of obstructing justice. However, if Duncan had acted illegally on the direction of Andersen's management within the scope of his position in an attempt to save Andersen from the consequences of Enron, the firm as a whole would be held liable. Therefore, the issues to be determined were (1) whether illegal acts had been committed and (2) if they had been committed on behalf of Duncan or on behalf of Andersen.

The Prosecution's Case

The chief prosecutor for the government was Samuel Buell. The main points in Buell's case follow:

- Top partners in Arthur Andersen's Chicago office had permitted Enron to use aggressive accounting practices that were very questionable given the nature of Enron's business.
- In late September through early October 2001, Andersen's legal department had begun creating a strategy designed to protect Andersen from regulators and litigants.
- A major part of the strategy was to invoke Andersen's document retention policy, which, according to prosecutors, was an obscure policy that its employees seldom read or followed on its audits. In addition, the policy had been revised in 2000 by an Andersen partner who had been disciplined by the SEC for his involvement in the Waste Management audits. According

to Buell, management had known that invoking the policy would lead to the destruction of "tons of papers and tens of thousands of computer files" that would be of interest to investigators.¹

- The prosecution presented notes from an October 9 conversation between Nancy Temple, Andersen's legal counsel, and attorneys in Andersen's legal department. This conversation indicated that Temple had believed an SEC investigation was imminent and that such an investigation could have devastating consequences for Andersen. Andersen was still operating under a court order signed in 2000 (due to a settlement of the Waste Management lawsuits) that could trigger a suspension of its license to audit publicly traded companies if it was found to have engaged in additional securities law violations.
- Duncan had admitted to destroying documents to keep them out of the investigation and that his actions were taken under direction and with the consent of Andersen management in Chicago.
- Finally, C. E. Andrews, an Andersen partner, in his testimony before Congress in January 2002, had said that Duncan had given every appearance of destroying documents in anticipation of requests for documents from federal investigators.²

Andersen's Defense

Andersen's attorneys, led by Rusty Hardin, defended Andersen against all charges brought by the government.

- The government's case had fallen short of proving Andersen's guilt or even proving that a crime had occurred.
- Duncan had shredded documents prior to any formal investigation (Andersen was not subpoenaed until November 8, 2001), and the elimination of unnecessary documents was a normal audit procedure.
- It was clearly sound business practice to consult with the corporate attorneys with regard to potential litigation and the firm's rights and obligations with regard to that investigation. In fact, Duncan, at Temple's request, had saved many documents that could have proved detrimental to Andersen.
- Hardin argued that Duncan was innocent and that the government had overstated its case against him in order to pressure him to cooperate with its investigation in exchange for a reduced sentence.
- While the prosecution focused on the part of the document retention policy that instructed auditors on the documents that could be destroyed, parts of the retention policy indicated which documentation was required to be retained in the audit files.

THE CASE GOES TO THE JURY

Although the prosecution and defense presentations were very contentious, possibly the most contentious part of the case focused on the instructions that Judge Melinda Harmon gave to the jury. The instructions hinged on the wording of the statute that makes it a crime to

knowingly use intimidation or physical force, threaten, or *corruptly persuade* another person . . . with intent to . . . cause that person to withhold documents from or alter documents for use in an official proceeding [emphasis added].³

Although both sides believed that the jury needed instructions that clarified the meaning of the statute in question, two issues were paramount in the argument concerning the instructions:

1. The phrase *knowingly* . . . *corruptly persuade* had been discussed at length. The government had contended that the word *knowingly* was not meant as a modifier of the term *corruptly persuade*. The jury had been instructed that

Even if the petitioner honestly and sincerely believed that the conduct was lawful, you may find the petitioner guilty.⁴

¹ Alexi Barrionuevo and Jonathan Weil, "High Noon: Andersen's Criminal Case Goes to the Jury," *The Wall Street Journal*, June 6, 2002, pp. C1, C20.

² *Ibid.*

³ 18 U.S.C. § 1512 (b)(2)(a) and (b).

⁴ William Rehnquist, "Flawed Instruction Led to Andersen Verdict," *Chicago Daily Law Bulletin*, June 1, 2005.

2. The government had contended that the word *corruptly* needed to be defined for the jury. Prior rulings in the 5th District Court (the same court district that was trying the Andersen case) had stated that *corruptly* was

knowingly and *dishonestly*, with specific intent to *subvert or undermine* the integrity of the proceedings [emphasis added].

The government had insisted on excluding the word *dishonestly* and adding the word *impede* to the phrase "subvert and undermine." The instruction provided to the jury had not included the word *dishonestly* and included the phrase "subvert, undermine, or impede" government fact finding.⁵

Having heard the testimony and been given these instructions, the jury convicted Andersen of obstruction of justice after deliberating for 10 days.

ROUND TWO

On May 31, 2005, in a unanimous decision, the U.S. Supreme Court overturned the Andersen conviction on the basis of flawed instructions to the jury. In writing the opinion, Chief Justice William Rehnquist cited the following arguments:

- Merely providing a person with information regarding a course of action cannot be construed as persuading *another person . . . with intent to . . . cause* that person to withhold documents.
- It is not necessarily corrupt in *persuading another person . . . with intent to . . . cause* that person to withhold documents. It may be proper for an attorney to persuade a client to withhold documents under attorney-client privilege from an investigation. In this circumstance, such persuasion would not be corrupt. Therefore, the withholding of documents from an investigation cannot by itself be presumed to be a *corrupt* action.
- Document retention policies are created to keep documents from being obtained by certain individuals and organizations, including the government. These policies are common in business, and it is not wrongful for a manager to instruct employees to abide by such a policy.
- The term *knowingly* does modify the term *corrupt* both linguistically and per the intent of the statute. The jury instructions did not convey the requisite consciousness of wrongdoing that should be required for conviction.
- Substituting the term *impede* in place of *dishonestly* in the jury instructions removed the requirement that the action be with knowledge and forethought of wrongdoing. The term *impede* has a much broader concept. Anyone who innocently persuades another to withhold information might be considered to impede an investigation. Clearly, the term *corruptly* was included in the statute to exclude such innocent behavior from being considered unlawful.
- A *knowingly corrupt persuader* cannot be someone who persuades others to shred documents under a document retention policy that was not enacted with regard to any particular proceeding in which those documents might be material. A series of events is not sufficient to indicate an intent to obstruct an investigation.

CONCLUSION

The headlines following the Supreme Court decision were telling:

"A Posthumous Victory," *USA Today*, June 1, 2005.

"Arthur Andersen's Hollow Victory," *The Economist*, June 4, 2005.

"Too Late for Andersen," *Legal Times*, June 6, 2005.

"A Bittersweet Court Victory for Andersen," *Legal Times*, June 6, 2005.

Although Arthur Andersen's verdict had been overturned because of faulty jury instructions, it was far from a vindication that what Andersen had done was correct. In addition, such a decision came much too late to provide anything but a moral victory to Andersen's former employees.

The government has chosen not to retry Andersen. First, there was little to gain in terms of either financial or other penalties. Andersen had already received the "death penalty" (and was no longer a viable entity), whether guilty or innocent. Second, if Andersen was to be retried

⁵ Ibid.

and found not guilty, the Department of Justice and the SEC would have suffered severe blows to their reputation and received a multitude of criticism from the business community. On the other hand, a retrial might have been what the government needed to fend off criticism of being overzealous and overreaching in its prosecution of Andersen. However, because the government did not retry the case, it appears that the risks outweigh the rewards. Third, the government received everything that it wanted with regard to Enron, WorldCom, and Andersen with the passage of the Sarbanes–Oxley Act. Most notably, as a result of the Andersen case, a stricter document retention policy with more severe penalties for not following that policy was enacted.

It is interesting to note that many legal experts believe that the Department of Justice and the SEC took a vastly different attitude toward the 2005 tax-shelter problems of **KPMG** because of the lessons learned from the Andersen prosecution. Clearly, in the Andersen case, there had been no winners, and the elimination of another international CPA firm caused significant harm to innocent employees and created substantial chaos in the business community.

Finally, in March 2007, a federal judge gave final approval to a \$72.5 million settlement between Andersen and investors who sued the accounting firm over its role in Enron's collapse.⁶ This finally put to rest the case of Andersen and Enron, but the repercussions may live on indefinitely.

DISCUSSION QUESTIONS

1. Look up the term *corrupt* in the dictionary. What is its definition? Was *corrupt* appropriately applied to the actions of Arthur Andersen?
2. The issues that overturned the Andersen verdict were based on faulty jury instructions, not on whether Andersen was, in fact, guilty or innocent. Based on the information in this case and other information you know, do you believe Andersen violated the law?
3. Do you believe that the Supreme Court's opinion overturning the lower court's decision was appropriate?
4. Should the SEC and the Department of Justice have tried Andersen as a firm, or should they have targeted specific individuals who had engaged in acts the two bodies believed to be unlawful?
5. Although Andersen's conviction was overturned, do you believe that its employees acted in an ethical manner?
6. Comment on the actions of David Duncan and Nancy Temple. Which of these parties do you believe was more responsible for the Andersen saga?
7. The class-action lawsuit against Andersen also named the **Canadian Imperial Bank of Commerce, JPMorgan Chase, Citigroup, Merrill Lynch, and Credit Suisse Group** as codefendants with Andersen. Why would the plaintiffs name so many entities in their lawsuit? Merrill Lynch and Credit Suisse asked a U.S. appeals court to rule that the complaint should not have been certified as a class action suit. Why would these entities make such a claim?