

Enron, Ethics and Finance - Spring 2009 – Course Syllabus

University of Houston MBA Program – FINA 7397
Stephen V. Arbogast, Executive Professor of Finance

This course aims to use the lessons of Enron to teach a practical approach to corporate ethics. Students can expect to be trained both to identify important ethical issues and in how to handle such issues within a corporate structure. Considerable attention is given to the development of tactical plans that allow ethics issues to be raised with the greatest probability of an ethical outcome.

The course is case study-based, with a special focus on financial matters. Guest speakers from Enron will share their insights into the ethical dilemmas they faced.

The first two thirds of the course will follow the trajectory of Enron's ethical decomposition. Beginning with case studies from 1987, students will follow Enron through its downgrading of internal financial control, the adoption and abuse of mark-to-market accounting, its steadily more aggressive use of off-balance sheet financing via Special Purpose Entities, and the entry of outright corruption in the form of related party transactions. Then students will examine the plight of Enron's resisters, such as Sherron Watkins, Jordan Mintz and Vince Kaminski, who struggled to raise ethical issues within a deeply compromised management structure.

The last third of the course will examine ethical issues surrounding financial transactions outside the Enron context. Special attention here will be given to tax matters, leasing, and remittance strategies from economically troubled emerging market countries.

Specific areas of instruction will include:

- How tactics for raising and working ethics issues vary with a firm's "Stage of Ethical Decomposition"
- How to develop a tactical game plan for working an ethics issue inside a corporation
- What constitutes the line between creativity and deception in such areas as:
 - "Managing " reported accounting results
 - Announcing material disclosures and analyzing results for market analysts
 - Leasing and other off-balance sheet financing
 - Tax structures motivated by tax avoidance
 - Developing financial transactions to work around foreign exchange controls in developing countries
- Fundamentals of sound Financial Control and the economic rationale for investing in good controls
- The conflict in-house legal counsels face between responsibility to the client and to the law, and the special capacities attorneys possess to resist unethical practices

- When it is both ethical and effective for resisters to take their concerns outside the company management structure

Classes will generally consist of two case studies each week, supplemented by brief lectures. Guest speakers will join specific classes to critique presentations of cases in which they were involved. It is anticipated that Sherron Watkins and Jordan Mintz will be among the guest speakers.

Students should expect to participate in teams that organize and present at least two case studies during the course of the semester. Grades will be apportioned 60% to the case study presentations, 30% to a final exam and 10% for class participation. The final exam will likely be a take-home case study.

Reading assignments and case studies will primarily be found in ***Resisting Corporate Corruption, Lessons in Practical Ethics from the Enron Wreckage (CCR)***, Stephen V. Arbogast, M & M Scrivener Press. ***The Smartest Guys in the Room (SMGR)***, McClain and Elkind, will be used to provide background material on Enron. CCR has been ordered and is available in the bookstore. SMGR can be purchased in paperback from Amazon.com. These readings will be supplemented by case studies and articles provided by the instructor.

All students should read the first case study, Enron Oil Trading I, prior to the first class. For convenience sake, this case (and this case only) will be posted on WebCt at least a week in advance of the first class.

The Professor's office is 220-D in Melcher Hall and office hours are Monday and Wednesday from 4:30-6:00 PM. The Professor may also be contacted by e-mail at svarbogast@uh.edu or svarbogast@comcast.net.

At the conclusion of the course, students should have an enhanced awareness of the ethical issues that arise in business, of the tactical options available to address such issues, and of the signal importance of sound financial control in maintaining an ethical business culture.

Good Luck and Enjoy the Course

Module 1: Causes & Nature of Corporate Corruption

| Date | Topic | Case Studies | Assignments |
|-------------|--|--|---|
| January 21 | Course Introduction, Why Finance? Why Enron? Roots of Wall Street's Ethical Crisis Insider Trading Scandal, 1986-88 The Complexity of Ethics Issues How to do an Ethics Case CEO's and Ethics: Ken Lay's Dilemmas w/ Enron Oil Trading | | CCR: Preface SMGR, pp. 10-19 |
| January 28 | Fundamentals of Financial Control Economic Rationale for Financial Control Role of Internal Audit Pressures on Audit; The Politics Of maintaining Audit's Role | Enron Oil Trading (A, B & C) | CCR: Essay 3 SMGR, pp. 19-26 |
| February 4 | Market Pressures & Ethics Compensation Systems & Ethics Ethics and "Creative" Accounting Enron's version of 'Mark-to-Market' Neutering Corporate Gatekeepers Ethics and the Aggressive Client <i>Enron's "Gas Bank"</i> | Enter Mark-to- Market (A & B) | CCR: Essay 2 SMGR: 27-43 |
| February 11 | Efficient/Transparent Markets And Ethics <i>Commodities Trading under MtM</i> Spread of questionable practices when controls are impaired Position and role of the resister Facing the boss/'dominant function' Role of CFO in protecting or impairing an ethical culture | Enter Mark-to- Market (C) Adjusting the Forward Curve in the Back Room (A) | SMGR: 85-92, 114-118 |
| February 18 | Off-balance sheet finance & Ethics <i>Cactus, JEDI, Whitewing & Chewco</i> Use of Special Purpose Entities And "Off-Balance Sheet" Financing Tactics of a corruption agent Stopping a flawed transaction at the last minute Ethics and transaction details | Adjusting the Forward Curve in the Back Room (B) An SPE Too Far? | SMGR: 66-68, 132-140, 143-149, 155-161, 165-170 |

Module 2: Resisting Corporate Corruption

| Date | Topic | Case Studies | Assignment |
|-------------|---|---|---|
| February 25 | Roots of the “Agency Problem” <i>LJM & Related-Party Transactions</i> Conflict of Interest Policy Standard Related-Party Controls “Going to the Top” with an Ethics Issue Managing a Follow-up Investigation | Jeff Skilling and LJM (A) & (B) | SMGR: 208-211 |
| March 4 | Encountering/Assessing the “Agent” <i>LJM Hedging MtM gains</i> Resisting as an In-house attorney Choosing the issue for resistance Positioning the issue for Management Managing career risks | <i>Guest: Jordan Mintz</i> New Counsel for Andy Fastow (A) & (B) | SMGR: 189-193, 327-330 |
| March 11 | “Studying” what’s in Denial <i>Company-wide Risk Study</i> <i>Total Return Swaps</i> Bring forward a ‘Disaster Scenario’ Working inside/outside the firm (1) The ethics of Anonymous outside Disclosure | <i>Guest: Vince Kaminski</i> No Where to Go with the Probability of Ruin | SMGR: 304-312 |
| March 25 | Deciding to become an Inside/ Outside Whistleblower <i>LJM Raptor Transactions</i> <i>Whistleblowers, Risks & Legal Status</i> Managing Earnings vs. Accounting Fraud Tactics for Whistleblowers | <i>Guest: Sherron Watkins</i> “Whistleblowing” before Imploding in Accounting Scandals | SMGR: 342-343, 354-357, 358- 359 |
| April 1 | ‘New CEO’ in Bad Situation <i>CEOs and Public Company</i> <i>Disclosure Laws</i> <i>Saving Enron after Skilling</i> Business fundamentals and damaging disclosures | Lay Back, and Say What? | CCR: Ethical Lessons from the Enron File SMGR: 330-335, 342-351 357- 358 |
| April 8 | Law Firm conflict of interest ‘Clever/Technical’ Legal advice vs. Ethical advice | Investigating Accounting Improprieties at Jayen Corporation | |
| April 15 | No Class | | |

Module 3: Distinguishing Financial Creativity from Ethics Issues

| Date | Topic | Case Studies |
|-------------|---|---|
| April 22 | <i>Tax Avoidance & Ethics</i> <i>The M&A “Mixing Bowl”</i> Examples of ‘Over the Line’ Tax Avoidance Structures Ethical gray zones & boundaries | <i>Guest: Eric Herpin, Chief Tax Counsel</i> <i>ExxonMobil Chemical</i> Newco |
| April 29 | <i>Financial Leasing</i> Financial motives & effects Accounting motives & effects Ethical gray zones & boundaries | The Coronet Leases |
| May 5 | <i>Blocked Funds Remittance Strategies</i> <i>Blocked Funds Exposure to Loss and</i> <i>Conventional Hedging</i> Full Disclosure to Host Governments Ethical gray zones & boundaries The Foreign Corrupt Practices Act Course Summary and Review for Take-Home Final Case Study | Trapped by the San Jose Convenio |

Final Words:

Academic Honesty:

The University of Houston Academic Honesty Policy is strictly enforced by the C. T. Bauer College of Business. No violations of this policy will be tolerated in this course. A discussion of the policy is included in the University of Houston Student Handbook, <http://www.uh.edu/dos/hdbk/acad/achonpol.html>. Students are expected to be familiar with this policy.

Accommodations for Students with Disabilities:

The C. T. Bauer College of Business would like to help students who have disabilities achieve their highest potential. To this end, in order to receive academic accommodations, students must register with the Center for Students with Disabilities (CSD) (telephone 713-743-5400), and present approved accommodation documentation to their instructors in a timely manner.