Greed is Good Gone Bad

Mother Merrill and the Robber Barons of the Big Board

By Chandra Niles Folsom

When Gordon Gekko uttered the infamous phrase, "Greed is good" to stockholders in the 1987 film *Wall Street*, the white collars were paying close attention. Over the next 15 years, CEOs and stockbrokers alike enjoyed what appeared to be a free ride at the expense of the rest of us. But taking it all ended up costing a bundle for those who thought the rule of law and code of ethics did not apply to them.

When the Wheel of Karma finally rolled down Easy Street the pavement shook, with reverberations felt from the boardrooms of some of the nation's top corporations to the trading floor of the New York Stock Exchange. Behind the wheel was New York State Attorney General Eliot Spitzer and foremost in his cross-hairs, the financial world's thousand-pound gorilla, Merrill Lynch.

The Scandals

The scandals, which included Connecticut players, were many and varied—from the careless collapse of energy giant Enron to the rotten stock tips doled out by Merrill's golden boy Henry Blodget, to the convictions of domestic diva Martha Stewart and eager broker Peter Bacanovic, the brokerage house once affectionately known as Mother Merrill had skidded off the straight and narrow path lovingly paved by Charlie Merrill back in the days when a handshake sealed a deal.

Nobody felt that disillusionment more than former financial consultant Keith Schooley, the hopeful Oklahoma native who came to the firm in search of a better future for his family, only to end up as the Merrill Lynch whistleblower.

"As the public has so clearly learned in recent years, there are many problems within the securities industry and investors are the ones being victimized," said Schooley, who worked at Merrill's Private Client Group from July 1991, until his controversial dismissal in September 1992. "I think it's safe to say that if Merrill Lynch has problems, it stands to reason that the rest of Wall Street has problems, too. Frankly, this is a sad commentary on the industry."

In his recent book *Merrill Lynch: The Cost Could Be Fatal, My War Against Wall Street's Giant* (Lakepointe Publishing), Schooley provides a detailed account of his struggle to expose internal misconduct and cover-ups at the firm, and his wrongful termination lawsuit that went all the way to the Oklahoma Supreme Court.

Although Schooley's David vs. Goliath crusade did not reward him with the justice he sought, an inquiry pursued by Spitzer brought the battle to a more level playing field. Following a 10 month investigation, evidence revealed Merrill's investment analysts had intentionally deceived clients into buying stock in failing corporations in order to support the firm's investment banking interests. The smoking gun—Merrill's top internet analyst Henry Blodget, was found to have written a series of damning emails publicly endorsing stocks he privately mocked. The discovery resulted in an unprecedented $100 million settlement to the State of New York, in May 2002. As part of the settlement, Merrill agreed to enact a series of reforms to insulate securities research analysts from undue influence in its investment banking division,

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expand disclosure requirements on all research, and sever every link between analysts' pay and investment banking revenue.

According to an internal memo, Blodget's team had negotiated 52 transactions from December 1999 to November 2000, earning the company $115 million. Following the windfall, Blodget's pay package soared from $3 million to $12 million.

For his part in the deception of investors, Blodget was fined $4 million and barred from the securities industry.

Following further SEC investigations, Merrill Lynch was fined an additional $100 million.

Spitzer said he thought the number of investors hurt could range in the hundreds of thousands if not millions.

"In essence, individual investors who depended on Merrill Lynch's stock analysis and overall investment advice were misled," Spitzer (now governor of New York) stated at a news conference following the settlement. "It simply cannot be said that this was a result of a rogue analyst or two—this was the way things worked at Merrill Lynch."

The Plot Thickens

New York State's Wall Street probe resulted in a $1.4 billion settlement between financial regulators and nine other Wall Street firms by the end of 2002.

Its aftermath led to some high-profile lawsuits against Merrill Lynch, including at least 50 class-action suits with 23 cases related to its research coverage of internet companies netting settlements of $164 million—ranking them on Russell Mokhiber's *Corporate Crime Reporter* as one of the 10 Worst Corporations of 2003, alongside Diebold and Halliburton.

Not everyone was satisfied with those results.

"I was disappointed with the outcome of Attorney General Spitzer's case against Merrill Lynch concerning the conflicts with investment analysts' research opinions," said Schooley, whose initial grievance with the firm stemmed from his witnessing widespread wrongdoing, ranging from brokers to senior management. "If Spitzer had the case he claimed to have, I think he should have gone much further. Instead, Spitzer allowed the firm to do what it is so good at doing—that is, buying its way out of a problem. A firm with $38 billion in revenue paying a fine of $100 million would be the same as an individual with annual income of $100,000 paying a fine of $263 to avoid testifying in public hearings and possible criminal indictments."

The Women of Merrill

Merrill's old boy network found other ways to misbehave—most evident in the way it treated female employees.

In April 2004, the firm was ordered by arbitrators in Federal District Court in San Antonio, Texas to pay damages of $2.2 million to E. Hydie Sumner, a broker employed by Merrill from 1991 to 1997. The panel found that the brokerage house had violated Title VII of the Civil Rights Act of 1964, the federal Equal Pay Act and Texas labor law. It was the first legal ruling to find a Wall Street firm had engaged in systematic bias, ruling that Merrill had willfully discriminated against Sumner, consistently paid women brokers less than men, and blocked them from promotion.

Merrill had already doled out more than $100 million in settlements to hundreds of other women who joined a class-action case against the firm in 1998. It all began in 1994 when broker Mary-Beth Cremin was booted when she became pregnant. When Merrill failed to act on her complaint, she sued. Then, other women came forward, some contending they had been subjected to sexual harassment in a hostile work environment. An extensive class-action suit was filed in 1997 and snowballed until Merrill faced nearly 1,000 lawsuits.

The uprising crossed the Pond in 2004, when the largest sexual discrimination claim ever filed in the UK was leveled against Merrill there.

The scandals, which included Connecticut players, were many and varied

White-collar crime began snatching headlines with Ivan Boesky in the 1980s, yet the audacity of its players seemed to escalate following the Bush 43 appointment of Harvey Pitt to head the SEC—evidenced in cases including the Tyco and WorldCom fiascos and, arguably the most heinous case of corporate malfeasance, Enron. Its founder, the now deceased Kenneth Lay and former CEO Jeffrey Skilling were both convicted earlier last year of conspiracy to commit securities and wire fraud in duping investors—including naïve employees, into purchasing shares in the crumbling corporation in order to line their pockets with sales from inflated stock.

The Connecticut Connection

In October 2002, Attorney General Richard Blumenthal launched three major lawsuits. The first, filed on behalf of the Connecticut Resources Recovery Authority, was aimed directly at Enron for a deal that appeared like a complicated energy sale, yet was actually a sham loan of $220 million obtained to pump up its stock price.

The claim was settled for $111 million, in February 2005.

The second action was a legal malpractice suit against CRRA's former law firms, which crafted the illegal transaction. In December 2006, one of the firms named in the suit, Hawkins, Delafield & Wood LLP, settled for $21 million, and agreed to cooperate in other litigation regarding the Enron transaction.

"The third so-called global action, in a Houston federal district court, was against dozens of parties who helped create Enron's false financial picture," said Blumenthal. "The defendants included Enron's former investment banks, among them Merrill Lynch."

The AG's office conducted aggressive discovery in the global action—the role of Enron's former investment banks being central to the inquiry. It specifically contained substantial findings related to Merrill's key role in creating Enron's facade.

But on March 19, in a 53-page ruling, a federal appeals panel in New Orleans wrote that the Houston judge improperly granted class-action status—a big victory for Merrill Lynch.

The case, considered to be the largest securities class action in U.S. history, was slated for a jury trial on April 16. According to Shearman & Sterling LLP, who is representing Merrill in the Enron litigation, trial has been stayed pending plaintiffs' attempt to seek review of the court's decision in the United States Supreme Court.

Governor John Rowland's 2004 resignation was linked in part to a $3,600 hot tub gifted to him by a lawyer arranging the deal approved a year before Enron collapsed.

A Merrill Lynching

A separate Senate subcommittee probe alleged that Merrill Lynch investment bankers aided Enron through a murky Nigerian barge deal and that 96 Merrill employees had invested in a partnership with Enron's Andrew Fastow, who pleaded guilty to two counts of conspiracy. The former CFO happily accepted a reduced sentence of six years last September and said in court that Merrill, along with other investment banks, aided in his deception.

In November 2004, four former Merrill executives were convicted on conspiracy and fraud in Enron's 1999 bogus sale of three power barges to Merrill to falsely boost its year-end numbers to the tune of $12 million. Merrill slipped the noose and settled civil allegations, forking over $80 million to the SEC.

Two Darien residents—Daniel Bayly, Merrill's former head of investment banking and James A. Brown, former head of Merrill's asset lease and financial group, were among those convicted and sentenced in the scheme that earned them the dubious distinction of becoming the first bankers to be jailed in the Enron scandal.

In July 2005, Bayly began serving a 30 month sentence at Petersburg Federal Prison in Virginia, plus six months of supervised release and $295,000 in fines—convicted on conspiracy to commit wire fraud, falsifying Enron's books and records, and wire fraud.

In August 2005, Brown was sentenced to 46 months in a Fort Dix, New Jersey federal prison, plus a year of supervision, on conspiracy to commit wire fraud, falsifying books and records, wire fraud and abetting, perjury and obstruction of justice.

Yet late last summer, a split-decision by a three-judge panel at the 5th US Circuit Court of Appeals reversed the conspiracy and fraud convictions for the four executives on legal grounds that one of the three theories of fraud in the indictment was flawed. The charge in question—Honest-services was what GOP lobbyist Jack Abramoff and Republican Congressman Duke Cunningham pled guilty to in 2006. However, the court concluded that the barge deal was in fact a sham transaction as the government had alleged.

The panel also upheld Brown's perjury and obstruction charges that stemmed from a secret oral guarantee, given by Fastow to Bayly, that Merrill never really owned the barges but had merely loaned Enron money, which it fraudulently booked as earnings.

"Brown anticipates filing a petition for writ of certiorari in the United States Supreme Court to seek reversal of the perjury and obstruction charges remaining against him," said Brown's attorney, Sidney Powell. "Brown did not commit any crime, or intend to commit any crime. The Fifth Circuit's decision conflicts with Supreme Court precedent and deepens an acknowledged circuit split in this area of the law. Brown's testimony constituted neither perjury nor obstruction."

The government appealed the reversed opinion to the entire 5th Circuit Court of Appeals but in October the 5th Circuit declined allowing the entire circuit to hear the case—essentially denying all rehearing petitions. So the government had two choices—to appeal the case to the

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Supreme Court, or retry the case before a jury on a slightly different legal theory.

The bottom line for Bayly and Brown is that this case is far from over. On April 4, a judge in Houston announced that Bayly and Brown will be retried in January. Robert Furst, the third Merrill executive who was caught and released, will also be retried. The fourth, William Fuhs, had his convictions thrown out and cannot be retried.

It's a Bad Thing

Meanwhile in Westport, trouble was brewing for Martha Stewart. The self-made billionaire who created an empire by branding her own image had taken a wrong turn off greed's slippery slope onto the route of all evil.

In 2001, with the assistance of her Merrill Lynch broker, Peter Bacanovic, Stewart avoided a loss of $45,673 by selling all 3,928 shares of her ImClone stock, days before a regulatory setback sent the pharmaceutical company's shares into a tailspin.

In 2002, Stewart was charged with conspiracy, obstruction of justice, and making false statements. Although she staunchly proclaimed her innocence, Stewart was found guilty on all counts in a New York courtroom. The charge of securities fraud was tossed out by the judge.

The image of Stewart ringing the opening bell at the Exchange quickly faded as she accepted the prison sentence handed to her in 2004 and served five-months at Virginia's Alderson Federal Prison Camp, with an additional five-months of home supervision.

Bacanovic was found guilty on four of the five counts charged and served a five-month sentence.

Upon news of her demise, shares of Martha Stewart Omnimedia fell faster than a vault dropped out a window by thieves in the night. Advertising spots were pulled from her magazines, her syndicated television show was ditched and she was forced to step down as CEO and chairwoman of her company. Stewart also resigned her position as a board member for Revlon and the New York Stock Exchange.

Merrill's old boy network found many ways to misbehave

In January 2006, a federal appeals court upheld the convictions of Stewart and Bacanovic and last August, the SEC settled insider-trading charges against the duo. Stewart paid the maximum penalty of $195,000 and in November agreed to pony-up another $5 million as part of a $30 million class-action suit. MSO chipped in $15 million more and her company's insurers picked up the remaining $10 million—a high price to pay for a $45,000 swindle. Stewart was also barred for five years from various aspects of public company involvement and prohibited from participating in other financial facets of the business world.

But once the bar is lifted, in 2011, it is anticipated that Martha Stewart will return to her throne at MSO.

Has anything changed since the Robber Barons of the Big Board were brought to justice?

"The corporate culture when I was there encouraged dishonesty in pursuit of the almighty dollar and it appears that culture has not changed," said Schooley. "Merrill Lynch can thrive only if it has the trust of its clients and shareholders. In my opinion the firm can't win back that trust without taking strong steps to reform the corporate culture." •

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