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Scams can Turn Governance into Malfeasance

1. Introduction

In July 2003 the market carried the news that fraud and other kinds of economic crime have struck more than a third of US companies. At the origin of this information has been a survey by PricewaterhouseCoopers, the CPA, and Wilmer Cutler & Pickering, a law firm. Of 91 companies whose executives completed the survey, some 35 percent responded that in the previous two years they had been victims of:

- asset misappropriation, usually theft or embezzlement, or
- other kinds of economic crime which inflict financial and industrial organizations.

The way it is usually defined, economic crime encompasses a range of illegal activities, including cybercrimes. A good question is who pays for it. While three out of four of US respondents to the aforementioned survey had insurance coverage, less than half obtained from their insurers recoveries for the crimes to which they were subjected. Hence, in the last analysis, the shareholders paid the bill.

It is interesting to note that the US results differed from those Pricewaterhouse Coopers obtained from companies registered in foreign countries. One of the differences is that few of the foreign firms participating in that study had some sort of insurance coverage. Also, executives in the United States were more worried about economic crimes relating to misrepresentation of corporate finances than their counterparts overseas.

No doubt, changes in American laws and regulations following the Enron, WorldCom and similar scandals accounted for a major part of the aforementioned difference. Another likely reason is greater shareholder activism in the US, particularly by pension funds, as well as a new-found vigilance by regulatory and judicial authorities.
This vigilance has so far been more pronounced in the US than in Europe. Here is an interesting example of what a European discovery process can bring to light. In September 2002, a fraud squad led by Jean-Claude Van Espen, a Belgian magistrate, raided the headquarters of Airbus, the airplane maker, in Toulouse, France. The raid’s objective was to check whether there was possible falsification of documents, bribery or other infractions as part of the sale of Airbus aircraft to Sabena, the Belgian flag airline.

The team of 20 Belgian and French investigators interviewed several Airbus employees during its three-day stay in Toulouse, and carted away boxes of documents. In the background of the investigation was the fact that in November 1997 Sabena had approved an order for 17 Airbus A320s which, by all evidence, the financially wounded airline did not need. Then, at the last minute, Sabena had doubled the order to 34 aircraft. This move, as is widely believed, helped to trigger Sabena’s collapse in 2001.

This particular scandal is a reminder that many aircraft are bought and sold in non-conventional ways. While nominally controlled by the Belgian government, Sabena was run by the parent company of Swissair, SAirGroup, which had owned a stake of 49.5 percent since 1995 and which also went bust in 2001.

Commission payments on big-budget aircraft deals increase the capital cost of the carrier, since the aircraft is subject to higher depreciation and/or operating-lease charges. Big commissions, licit and illicit, are a key reason why aircraft purchases have long been associated with controversy – with accusations ranging from mismanagement to fraud.

As will be recalled, in the 1970s, when Lockheed was still making civil jets, it was caught bribing Japanese officials to buy its L1011 wide-bodied airliner. A Japanese prime minister was later charged, and in 1983 convicted, for taking a bribe. This was neither the first nor the last case of greasing the hand of politicians to gain leverage in major sales orders.

It should also be remembered that Prince Bernard of the Netherlands was disgraced for his involvement with Lockheed. In 1977, this scandal led to Congress passing the Foreign Corrupt Practices Act (FCPA), which forbids American companies, their officers, or their representatives from bribing foreign officials. Critics, however, suggest that US firms side-step FCPA by using foreign subsidiaries and nationals to pay bribes – just like other firms from other countries are doing.

These references give a flavour of the case studies included in this chapter. These case studies have been selected to range widely in their nature and after-effect. While mismanagement and lack of internal control can be found at the root of practically all corporate scams, both the intent and impact are different in the case of malfeasance than is encountered with the plain bad management characterizing the case studies in Part Two.