

# The New York Times

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Inside the S.E.C.

STEPHEN LABATON

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## ***Chief of S.E.C. Is Set to Pursue Former Clients***

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By STEPHEN LABATON

WASHINGTON, July 17 — Harvey L. Pitt, the embattled head of the Securities and Exchange Commission, said today that with the expiration of ethics restrictions that have bound him during his first year in office, he would play a direct role in enforcement cases involving companies and accounting firms that were once his law clients.

In an interview today, Mr. Pitt — who had generally avoided questions about his intentions — said that his background as a leading securities lawyer was an asset, not the liability cited by critics who say he should continue to recuse himself from matters involving former clients.

“This will inevitably sound self-serving, but the fact is it is an enormous advantage to the public to have somebody who knows about the securities business and the securities law as I do, and it would be unthinkable to deprive people of my expertise,” he said in the interview.

The restrictions, under federal ethics rules and an agreement that Mr. Pitt made with the agency, expire in two weeks, though Mr. Pitt could have voluntarily continued to limit his role.

In recent months Mr. Pitt — who as a Wall Street lawyer represented all of the top investment houses and exchanges, all of the largest accounting firms and the accounting industry’s trade group — has come under

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*Continued on Page C6*

*Continued From Page A1*

withering criticism just for maintaining contact with former clients. Some members of Congress have been calling for his resignation — most prominently Senator John McCain, Republican of Arizona, who reiterated that view today.

"I think he is damned if he does and damned if he doesn't," Mr. McCain said in an interview. "If he doesn't recuse himself, there will be questions as to whether he should have or not, and whether he will be objective. If he does recuse himself, we have an S.E.C. without a chairman. That is why he should serve the country in another capacity."

In more than two dozen instances, including the investigation of Arthur Andersen for its role in the collapse of Enron, Mr. Pitt has recused himself. With two vacant seats on the five-member commission and two other commissioners serving without Senate confirmation, some of those decisions have presented problems for the agency.

One case involving accusations that Ernst & Young violated independence rules by maintaining a business relationship with a client has already been thrown out by a judge, because only one commissioner was able to vote on it. A large fraud case, involving senior executives at Waste Management, could encounter the same problem.

Two more nominees to the commission are to go before a Senate committee for confirmation on Thursday, and hearings for two others may be held next week. The confirmation of those nominees could take some of the political pressure off Mr. Pitt — but the ethical decisions he faces in the months ahead have the potential to be politically dangerous.

Moreover, his decision to wade into cases involving former clients is certain to fuel further criticism by some that the administration and its

appointees have been too cozy with the corporate and accounting interests at the heart of the current market crisis.

But Mr. Pitt said today that if he continued to recuse himself, he would be largely ineffective. Instead, he promised to pursue an aggressive approach in enforcement proceedings, saying that the markets and investors demand that the agency come down mercilessly on accounting firms and corporations that have misled investors.

"There is a reason for a one-year cooling-off period, a period that is used by other officials and federal judges all the time," said Mr. Pitt, who was a senior partner at the New York firm of Fried, Frank, Harris, Shriver & Jacobson before his appointment to the S.E.C. by President Bush. "At the end of that period, people should focus on the substance and not on my past."

Mr. Pitt has said it is unfair to criticize him because of clients, calling it "guilt by occupation." He emphasized that he remains beholden to none of his former clients, particularly since he has no intention of ever going back into private practice.

"I cannot carry my past with me forever," he said. "I have no intention of ever practicing law again. So all of the concern of me currying favor with my clients misperceives who I am."

Mr. Pitt said, too, that he had no intention of stepping aside. "As corny as it sounds, this is the only job I really wanted since I got steeped in securities law," he said. "To me this is the greatest job in the world. I don't even want to think about leaving."

Mr. Pitt and the other commissioners are not involved in the day-to-day handling of enforcement proceedings, which are left to career officials. But the commissioners do play crucial roles in authorizing investigations and in ultimately deciding whether the agency should bring or close a case.



Paul Hasefros/The New York Times

Harvey L. Pitt, the embattled chairman of the S.E.C., said in an interview it would be "unthinkable to deprive people of my expertise."

Senator Jon S. Corzine, Democrat of New Jersey, said that Mr. Pitt ought to participate in cases involving his former clients as the rules permit, although "he needs to be extraordinarily sensitive" to possible ethics issues and appearances.

"If you believe he should continue as S.E.C. chairman, which I do, I think he ought to follow the rules," he said. Ethics rules bar Mr. Pitt from ever participating in any matter in which he had been substantially involved when he was in private practice.

But other politicians said that the current climate of distrust in the markets — and the questions raised about Mr. Pitt's earlier meetings with former clients like Xerox and the KPMG accounting firm — obliged him to go the extra mile and extend his recusal period.

"There is no confidence that he is an independent judge of the complaints which will come before the S.E.C. regarding the accounting in-

dustry," said Representative Edward J. Markey, Democrat of Massachusetts, who has also suggested that Mr. Pitt step down. "There is a crisis of confidence, and the S.E.C. needs a leader who has the confidence of the American investor."

Alan R. Bromberg, a securities law expert at the Southern Methodist University School of Law, said that Mr. Pitt should extend his recusal period for at least another year, saying that "he is still carrying the baggage of representation of many of the people who will likely be involved in future decisions of the S.E.C."

Politically, Professor Bromberg said, it will be impossible for Mr. Pitt to vote in favor of a former client, even if the facts and law support that decision, because he will be seen as taking a dive. "If he votes against taking any action, it's bound to be thrown out that he's protecting his clients again," he added.

## ***S.E.C. Chief Seeks Promotion; Chances Look Dim***

By **STEPHEN LABATON**

WASHINGTON, July 23 — Harvey L. Pitt, who barely goes a week without new calls for him to step down as chairman of the Securities and Exchange Commission because of his handling of the crisis in the markets, is asking Congress for a raise and more respect.

Congressional aides and commission officials said today that in private discussions this week, Mr. Pitt had asked lawmakers to add a provision to the corporate and accounting bill moving swiftly through Congress that would elevate his office to the same rank as cabinet posts like sec-

retary of state and attorney general.

The plan, which was ridiculed by Democrats and disowned this evening by the White House when asked about it, stands little chance of becoming law. It proposes to catapult Mr. Pitt above his counterparts at virtually every other independent agency. It would rank him higher than the director of the Central Intelligence Agency, the administrators of the Environmental Protection Agency and the National Aeronautics and Space Administration, and all the civilian heads of the various

branches of the armed services.

While Mr. Pitt's agency is chronically pinched for cash, the change would increase his salary nearly 21 percent, to \$166,700 from \$138,200. Mr. Pitt, who for the last decade had been one of Wall Street's most successful lawyers as a senior partner at Fried, Frank, Harris, Shriver & Jacobson, earned about \$3 million in the 17 months before becoming S.E.C. chairman last summer.

Although he would have the same rank as all of the cabinet members, an elevated status would not change the independent nature of the commission or entitle Mr. Pitt automati-

*Continued on Page C13*



*Continued From Page A1*

## ***A change would give the securities regulator the same status as Greenspan.***

cally to attend cabinet meetings at the White House. Moreover, it is difficult to imagine that Mr. Pitt, who made millions of dollars a year in private practice representing many companies now facing inquiries, would have a better quality of life with the extra cash. Mr. Pitt likes to joke that even though he took a 99.9 percent pay cut to take the job, he would never want to do any other.

But in a city driven by official status, the Level 1 designation being sought by Mr. Pitt is the brass ring. Officials with that designation tend to be showered with more invitations to state dinners and choice seats at other occasions. It makes it easier to qualify for burial at Arlington National Cemetery. Outside of members of the cabinet, only Alan Greenspan, the chairman of the Federal Reserve, and Jo Anne Barnhart, the commissioner of Social Security, have the designation.

Brian Gross, the S.E.C.'s director of communications, said the rise in the agency's status had long been on Mr. Pitt's agenda, and the proposal was dusted off for the short wish list sent to Congress as the bill headed to a conference committee late last week.

"I suggested this would be a good time for us to raise the profile of the

agency," Mr. Gross said today. "The markets are a little bit flustered. The agency has been in the news."

"And the chairman said, 'Yes, let's send that up there, this is good timing,'" Mr. Gross said, adding that the proposal was important because investors are grasping for reasons to renew their confidence in the markets and this may be the most significant securities legislation to be adopted in many years.

Asked if the proposal was met with criticism, given that it comes as Mr. Pitt is defending his stewardship, Mr. Gross said, "No one has said, 'We think this is a bad idea or something we don't want to do for the S.E.C.'"

"No one to my face has rejected it," Mr. Gross added. He also said that the White House had not been consulted about the proposal.

Claire Buchan, a spokeswoman for the White House, said Mr. Pitt's proposal "could be a distraction from the real business of providing the

S.E.C. with more people, better systems and additional resources."

Democrats and Republican critics of Mr. Pitt snickered at the proposal, which they said had no chance of passage and demonstrated Mr. Pitt's political tin ear.

A small but influential group of lawmakers including the Senate majority leader, Tom Daschle, Democrat of South Dakota; Senator Joseph I. Lieberman, Democrat of Connecticut; and Senator John McCain, Republican of Arizona, have called on Mr. Pitt to step down. Aides to the three lawmakers said today that their bosses would be unavailable to comment on the proposal, with some suggesting that the proposal would do enough damage to Mr. Pitt's credibility without them piling it on.

Senator Jon S. Corzine, the New Jersey Democrat who as a former top executive at Goldman Sachs has had more experience on Wall Street than any other member of Congress, said he thought the proposed pay increase was "a diversion from the basic subject matter that needs to be dealt with."

Some critics said that even though it might be a good idea to elevate the agency's profile now that the markets are in turmoil, Mr. Pitt was the wrong person to be making the case given his political difficulties.

The proposal first surfaced last Friday. In a memo to lawmakers, the

agency asked for five items to be included in the legislation, like amendments to enable the commission to impose greater penalties on dishonest executives and a provision that would make it easier to coordinate its efforts with criminal investigators. The final item was a request to elevate the bureaucratic status of the agency, in governmentspeak, from Level 3 to Level 1, because of its importance to "our nation's financial and capital markets."

The memo said the elevation of the agency's status "would enhance our ability to attract qualified professionals at all levels." The proposed changes would elevate the pay and status of only the chairman and the four other commissioners who lead the agency. The pay of those four would rise from \$130,000 to \$150,000.

Two years ago Congress passed legislation elevating the status of Mr. Greenspan, making him the only financial regulator other than the secretary of the Treasury in the top tier.

The change was made at the urging of Representative Jim Leach, the Iowa Republican who was the chairman of the House Banking Committee, as a reward for Mr. Greenspan's service and recognition by lawmakers that he is among the most important officials in Washington.



Associated Press

William H. Webster after being named. Harvey Pitt looked on.

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## Audit Overseer Cited Problems In Previous Post

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By STEPHEN LABATON

WASHINGTON, Oct. 30 — Shortly before William H. Webster was appointed to head a new board overseeing the accounting profession by the Securities and Exchange Commission last Friday, he told the commission's chairman, Harvey L. Pitt, that he had until recently headed the auditing committee of a company that was facing fraud accusations, Mr. Webster recounted today.

Mr. Pitt chose not to tell the other four commissioners who voted on Mr. Webster's nomination that day, according to S.E.C. officials. White House officials said they, too, were not informed about the details of Mr. Webster's work for the company.

The small publicly traded company, U.S. Technologies, is now all but insolvent and it and its chief executive, C. Gregory Earls, are facing suits by investors who say they were defrauded of millions of dollars. The suits contend the misconduct occurred in late 2001 and this year. That was after the three-person audit committee, headed by Mr. Webster, had voted to dismiss the outside auditors in the summer of 2001 after those auditors raised concerns about internal financial controls.

Mr. Webster, the 78-year-old former director of the C.I.A. and F.B.I., said he told Mr. Pitt and Robert K. Herdman, the agency's chief accountant, about the investor lawsuits before he was approved last Friday.

"I told them that people are making accusations," Mr. Webster said of his conversation with Mr. Pitt

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*Continued on Page C6*

*Continued From Page A1*

before he was appointed last Friday. "I said if this is a problem, then maybe we shouldn't go forward. I raised it because I didn't want it to become an issue."

Mr. Webster said he was assured by Mr. Pitt that the staff of the commission had looked into the issue and that it would not pose a problem. Mr. Pitt had urged Mr. Webster to take the job.

But U.S. Technologies' former outside accounting firm, other members of the audit committee, company executives, and investors and their lawyers who say they were defrauded say they were never called by anyone at the commission about Mr. Webster's candidacy for the new oversight board.

Last Monday, three days after Mr. Webster was appointed, he called Mr. Pitt again to say he had heard over the weekend from another former director that a government investigation had recently begun to examine possible fraud by the chief executive of the company, Mr. Webster said. Lawyers involved in the case say the inquiry, by federal investigators in Manhattan, is actually examining whether Mr. Earls, who recruited Mr. Webster, used the company to violate criminal fraud laws. Mr. Webster is not a target of the investigation. Mr. Pitt did not tell the other commissioners about the Monday conversation either, S.E.C. officials said.

Mr. Pitt declined to discuss the selection of Mr. Webster or U.S. Technologies. Christi Harlan, a spokeswoman at the S.E.C., said that Mr. Webster informed the commission's accounting staff, headed by Mr. Herdman, about his service on the board of the company and that the staff concluded that there was nothing worthy of passing on to other commissioners or that would disqualify Mr. Webster.

"What matters is we believe Judge Webster will be a fine chairman of the Public Companies Accounting Oversight Board," Ms. Harlan said. Claire Buchan, a White House spokeswoman, referred calls about the selection of Mr. Webster to the S.E.C.

The accounting oversight board is the centerpiece of legislation approved this summer in response to the wave of scandals at companies like Enron, Arthur Andersen and WorldCom. It was created to supervise an array of professional issues, including disciplining accountants and inspecting the largest firms.

The commissioners split bitterly over the qualifications of Mr. Webster and his selection over John H. Biggs, who was considered by some in the profession to be too aggressive. In his dissent, one S.E.C. commissioner, Harvey J. Goldschmid, said the selection process had been flawed and inept and had failed to vet the candidates properly. Mr. Goldschmid declined to comment.

Mr. Webster stepped down from the board of U.S. Technologies in July after he said he was told that it could no longer provide liability in-

surance for directors and officers against claims from investors.

The company invests in young Internet companies and runs a contract labor company using prison inmates. It has had a variety of legal and regulatory difficulties. While Mr. Webster headed the audit committee, it was delisted from trading on Nasdaq for failing to make timely filings with the S.E.C.

The suits filed by investors allege that fraud occurred after the company's auditor, BDO Seidman, says it notified the auditing committee in May 2001 that U.S. Technologies had several serious weaknesses in its internal financial controls.

The company initially reported to the S.E.C. that BDO Seidman auditors had been dismissed not because of any disagreements or qualifications but only because of "an explanatory paragraph that discusses factors that raise substantial doubt" that U.S. Technologies had the "ability to continue as a going concern."

But U.S. Technologies was forced to amend its filing a few weeks later,

## ***Other commissioners and the White House were not informed by the S.E.C. chairman.***

after BDO Seidman executives sent a letter explaining that their firm had found serious accounting problems at the company.

BDO Seidman accountants wrote: "In a letter dated May 9, 2001, issued on Aug. 31, 2001, and in a telephonic audit committee meeting on July 13, 2001, BDO Seidman L.L.P. communicated a material weakness in internal control to the audit committee and management relating to financial and accounting infrastructure including lack of an experienced C.F.O., deficiencies in recording material transactions timely, and in the organization and retention of financial documents and accounting records."

Mr. Webster said the company responded by hiring a more experienced chief financial officer. He said the auditing committee did not look into the other problems mentioned by BDO Seidman accountants. He said that executives at U.S. Technologies had been concerned about the auditing bills of BDO Seidman and about the lengthy time it had taken to perform the audits.

BDO Seidman, which will be regulated by the new accounting oversight board, declined through a spokesman to comment about its work for U.S. Technologies.

Lawyers involved in the criminal investigation said there was no evidence that Mr. Webster violated any laws and he was not the target of the inquiry. But critics of his selection to the oversight board said the audit committee's decision not to investigate thoroughly and make public its

findings demonstrated that he lacked the qualifications to lead the board.

"Even if we find out that Webster was totally passive in this process, it is an indictment on his ability to run the accounting oversight board," said James D. Cox, a professor of securities and corporate law and author of a textbook on accounting who teaches at Duke. "To let something like this go shows really bad judgment, and I think is automatically disqualifying. At a minimum, the audit committee had an obligation to investigate. This is exactly the kind of situation that the accounting oversight board is supposed to change, and that the new law creating the oversight board is supposed to fix."

Mr. Webster said he did not think his experience at U.S. Technologies "would impair my ability to serve."

"But that is not for me to judge," he said. Speaking of the commission, he added: "I always made a point of telling them everything I knew. I'm sure they wouldn't have gone through with it if they didn't have confidence in me."

At the center of the investigation and the suits over U.S. Technologies is Mr. Earls, the company's chairman and chief executive, who recruited Mr. Webster and other prominent Washington figures to serve on its board and invest in the company. The board members included George Mitchell, the former Senate majority leader, and Beth Dozoretz, the former finance chairwoman of the Democratic National Committee.

Mr. Earls has recently suffered some court setbacks.

A decision two months ago in one of those cases by a Delaware judge concluded that there was significant evidence he had committed a pattern of misrepresentations "that may rise to the level of criminal conduct" in connection with USV Partners, which Mr. Earls controls and is a large investor in U.S. Technologies.

The judge also found "credible evidence" that Mr. Earls "has exhibited a pattern of defrauding investors" by using a variety of partnerships and other "special purpose entities" controlled by him.

After reciting a list of court cases against Mr. Earls, the judge, Vice Chancellor Jack Jacobs, said, "Although claims of wrongful conduct in unrelated cases certainly do not establish that Earls mismanaged USV, the ever-increasing pattern of fraud claims against Earls lends further credibility to the other evidence that does tend to establish that Earls has mismanaged USV."

In a separate civil case filed in July in federal court here, a few days after Mr. Webster resigned from the board, an investor accused Mr. Earls and U.S. Technologies of stealing for Mr. Earls's own benefit almost \$2 million last year by diverting what were supposed to be investments. Mr. Earls's lawyers have denied the accusation.

Thomas Green, a lawyer who represents Mr. Earls, said that his client violated no laws and that the company had been a victim of the downturn in the economy.

# ***Praise to Scorn: Mercurial Ride Of S.E.C. Chief***

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By STEPHEN LABATON

WASHINGTON, Nov. 9 — Two weekends ago, Harvey L. Pitt took his son and friends in a stretch limousine to a remote part of Maryland to shoot paint-ball guns.

Donning battle fatigues, Mr. Pitt traipsed in the woods with the teenagers as they pelted each other with paint shots from their weapons. A large and lumbering man, he quickly got drenched, people who were watching said. For Mr. Pitt that Saturday, playing the role of attractive target could hardly have been more fitting.

He had been unanimously confirmed just 14 months earlier to be the chairman of the Securities and Exchange Commission by a Senate whose members had hailed him as one of the nation's most brilliant lawyers, just as the agency was headed into one of its most difficult periods, a string of corporate scandals that shook investor confidence in Wall Street.

But by his final days on the job, he had become the object of derision by Democrats and political cartoonists, scorned by editorial writers of diverse philosophical persuasions, a "political piñata," as Representative Edward J. Markey, Democrat of Massachusetts, put it.

Friends and colleagues, as well as detractors, say Mr. Pitt had ultimately become a casualty of his personality, haunted by the ghost of his predecessor, and struggling to remain a loyal Republican without understanding how his partisanship at what is supposed to be an independent agency would alienate important Democrats.

On Oct. 25, the day before his faux combat, Mr. Pitt had led an unusual-

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*Continued on Page 24*



*Continued From Page 1*

ly rancorous meeting to select William H. Webster to lead a new accounting board over an alternative contender, John H. Biggs, a decision that would ultimately cost Mr. Pitt the job that he had long coveted. According to Mr. Biggs and two of the commissioners, Mr. Pitt initially promised the job to Mr. Biggs at a Sept. 11 lunch. But in early October, he told Mr. Biggs he could no longer support him.

Accounts differ as to why. Mr. Pitt has denied accusations by lawmakers that he buckled under pressure from the accounting profession, which objected to Mr. Biggs because he has been a voice for aggressive oversight of the profession. Others at the commission have said that Mr. Pitt became enraged by the campaign by Arthur Levitt, his predecessor, on behalf of Mr. Biggs, and was determined to oppose him on that basis alone.

Whatever may have happened, his supervision of the selection of the new board caused a political uproar. It grew too much for Mr. Pitt when it surfaced six days after the vote that Mr. Pitt had failed to tell the other commissioners that Mr. Webster had headed the audit committee of a virtually insolvent company that had been accused of fraud.

Mr. Pitt's mishandling of the selection of the board was the last in a series of political blunders over the last year that have baffled his many admirers.

He had offered an olive branch in a speech to his former clients in the accounting profession just before it came under harsh criticism for its role in a series of corporate collapses. Career S.E.C. officials said that he had demoralized the staff by repeatedly meeting with executives of companies under investigation.

To the consternation of Wall Street, he had only belatedly attempted to coordinate investigations with aggressive state prosecutors, like Eliot Spitzer, the attorney general of New York. He was late in seeking more money from Congress for the cash-strapped commission. And to much ridicule among Democrats and anger at the White House, he had secretly lobbied to have his status elevated to cabinet rank to put him on a level with the secretary of state and the attorney general.

### **'Larger Than Life'**

To supporters and his detractors, Mr. Pitt is the closest thing to a

modern-day Shakespearean character.

"He is larger than life on both sides," said Joel Seligman, an historian of the commission and securities law expert who has known him and followed his work closely for the last 15 years. "His talent as a litigator and writer has been profound and influential. His flaws are also larger than any chairman in the history of the commission. You're dealing with someone of extraordinary pluses and minuses."

Mr. Pitt declined to comment for this article. In a speech on Friday at the annual conference of the Securities Industry Association in Boca Raton, Fla., he suggested he was the victim of partisanship.

"Unfortunately, turmoil surrounding my chairmanship makes it very difficult for the commissioners and staff to perform critical assignments," he said. "I hope my successor isn't greeted with the same climate of attack and partisanship."

"It's easy to find fault and it's easy to criticize. In a partisan environment, criticism often devolves into attack. This doesn't help anyone. In fact, it's not just unproductive, it's counterproductive."

Lawyers on Wall Street said that Mr. Pitt's lucrative Rolodex of clients, which he built up after finishing an earlier stint at the S.E.C. to become a securities-law attorney in New York, had been the envy of other practitioners. His career gave him better training for the job than any of the 25 chairmen who preceded him, according to scholars and lawyers who follow the agency.

"We were all so excited when he got the job," recalled Stanley Sporkin, Mr. Pitt's mentor and one of the agency's most effective prosecutors. "We wanted so badly for one of our own to succeed. What has happened here has hurt all of the old career staff people, who wanted to live through Harvey."

But officials at the commission and former law partners say Mr. Pitt's personality was mercurial and he surrounded himself with aides too intimidated to openly question his judgment. They say he occasionally saw enemies where none existed and would personalize a professional disagreement.

Other commission officials say that they came to believe they could not always trust him. They say that shortly after he told Mr. Biggs that he would support his candidacy to lead the new oversight board, and that Mr. Biggs should retire early from the private sector to be ready to take the assignment, he secretly

began talks with others for the same job.

Mr. Pitt could be brilliant, S.E.C. officials recalled last week. They cited one decision he made to require senior executives to certify their financial statements and another decision to press the enforcement staff to file a securities fraud lawsuit against WorldCom only a day after it disclosed its problems. He also led a relatively collegial and unified commission on many substantive issues.

But to the staff, he could also be difficult. In closed enforcement proceedings, S.E.C. officials said, he could obsess over seemingly obscure points, driving an already overworked enforcement staff of the commission to deep distraction — much of it, in the minds of some officials, unnecessary.

S.E.C. officials said that he also tended to discount the advice of the career senior staff in favor of the political officials he had appointed. One senior career person warned him against trying to elevate the chairmanship to a cabinet level post, they recalled. But they said he dismissed that suggestion when one of his political advisers urged him to make the recommendation.

Rather than turn to the seasoned enforcement or general counsel's staff at the commission to examine the background of Mr. Webster, Mr. Pitt instead relied on his old friend, Robert K. Herdman, who had no investigative experience. Until he was hand-picked by Mr. Pitt to be the agency's chief accountant, Mr. Herdman had spent most of his career as an executive at Ernst & Young. Mr. Herdman resigned from the commission late Friday.

### **No Follower of Footsteps**

From his first days as chairman, Mr. Pitt made clear in an interview at the time, he was determined to be sharply different than his predecessor, Mr. Levitt, who in both appearance and style could not be a stronger contrast.

Both men had come from Wall Street. But Mr. Levitt had no legal background and left details to others while Mr. Pitt reveled in getting involved in the intimate details of making rules and prosecuting cases. Where Mr. Pitt would try to shut out reporters who were critical of him, Mr. Levitt would take the most critical of them to lunch to charm them. Privately, Mr. Pitt would complain to friends that Mr. Levitt's favorable press was not justified by his track record, these friends said.

If Mr. Levitt would become known for holding town meetings around the nation, Mr. Pitt was determined

## An Embattled 14 Months

A look at the tenure of Harvey L. Pitt as chairman of the Securities and Exchange Commission:

### 2001

**AUG. 1 Mr. Pitt** ▶ is unanimously confirmed as S.E.C. chairman.

**SEPT. 12** After the terrorist attacks, Mr. Pitt goes to Wall Street by train.

**SEPT. 17** The stock markets reopen.

### 2002

**JAN. 22** A five-member panel overseeing the accounting industry resigns, complain-



ing that a plan by Mr. Pitt to restructure oversight will be captive to the industry.

**MARCH 21** At a hearing, Mr. Pitt lashes out at critics of the government's response to Enron's collapse.

**APRIL 26** Mr. Pitt meets privately with the chief executive of the accounting firm KPMG, which is under investigation by the S.E.C.

**JUNE 12** Mr. Pitt proposes rules requiring executives to certify their company's results.

**JUNE 26** With unusual speed, the S.E.C. files fraud charges against WorldCom.

**LATE JULY** Mr. Pitt

proposes legislation to elevate his position to cabinet-level status with lawmakers.

**JULY 30** President Bush signs a corporate-fraud bill that creates a new accounting oversight board.

**SEPT. 11** Mr. Pitt has lunch with **John H. Biggs**, the chairman of TIAA-CREF and a strong advocate of stricter

rules for accountants. Mr. Biggs says that Mr. Pitt promised to support him to head the new oversight board.

**EARLY OCT.** Mr. Pitt tells Mr. Biggs he will no longer support him.



**OCT. 25 William H. Webster**, a former director of the C.I.A. and the F.B.I., is approved as the head of the new board by a 3-2 vote of the 5-member S.E.C.

**OCT. 30** Mr. Webster says that he told Mr. Pitt he had headed the audit committee of a company accused of fraud. Mr. Pitt did not tell the four other S.E.C. commissioners or



the White House.

**OCT. 31** Three investigations begin into the selection of Mr. Webster.

**NOV. 5** Mr. Pitt announces his resignation.

The New York Times

not to have them, he told friends. They said that if Mr. Levitt were seen as orchestrating a campaign for Mr. Biggs to head the oversight board, Mr. Pitt was determined to derail the effort.

Government officials and some of his former law partners at the Wall Street firm of Fried, Frank, Harris, Shriver & Jacobson who were interviewed last week said his fall, though tragic, was unsurprising. They noted that in 1997, the firm announced his five-year appointment as Fried, Frank's co-chairman.

But a year later, following complaints about his style, he gave up that post even though he was the firm's most profitable rainmaker.

Mr. Pitt's obsession with preventing news leaks was compared by one of his Republican allies on the commission to the self-destructive tendencies of former President Lyndon B. Johnson. Mr. Pitt was so concerned about the premature disclosure of the new accounting board that he refused to tell his fellow commissioners about his choices until the morning of the actual vote, the commissioners complained.

But he never appeared to have fully realized that the selection of the oversight board even remotely threatened his own job.

"I have not the least bit of concern about me personally," he wrote in an e-mail message in the middle of October to a former S.E.C. official who disclosed them on the condition of not being identified. "Nor do I fear for my job. Unless people are lying about it, my status is assured."

"The press coverage does not affect me or my family," he added, even as the editorial pages of virtual-

ly all of the nation's most prominent newspapers had by then called for his resignation. "Nothing the press says can worsen what has already happened. In my own heart, I know I am doing a fabulous job for the agency."

"We read the stories," he wrote, referring to himself and his wife, Saree Ruffin Pitt. "When they are negative, we say, as President Reagan did, 'There they go again.'"

There were also signs that he had changed over the last year. When he started the job in August 2001, he vowed in an interview to lower the partisanship of the commission, to not make the mistake of Mr. Levitt of making enemies of important lawmakers and to work vigorously to achieve political consensus.

But he then surrounded himself with former top aides to Phil Gramm, the Texas Republican who is widely considered to be among the Senate's most combative members.

His tone also changed markedly since his early days as chairman. "My expectation is this will be a board everyone can be proud of," Mr. Pitt said at a conference of corporate directors at Duke University a few days before Mr. Webster was selected. "Notice I didn't say everyone will be proud of. Because I've learned in Washington that's not in the cards."

### A Promising Beginning

Harvey Lloyd Pitt was born on Feb. 28, 1945, in the Crown Heights section of Brooklyn, 11 years after the creation of the Securities and Exchange Commission. His father, Morris, worked his way up from a

deli counter to the management ranks of Waldbaum's supermarkets. His mother, Sara, was a seamstress. Harvey Pitt became the first in his family to get a higher education when he enrolled in Brooklyn College.

In 1968, his last year at St. John's University School of Law in Jamaica, Queens, he argued a case in the regional finals of the national moot court competition. The case would have resonance in the current climate. It involved an investor who sued an accounting firm that had certified the financial statements of a company that had committed fraud.

Mr. Pitt lost the argument but immediately earned the respect of a lawyer from the Securities and Exchange Commission who was the judge of the competition. Even though Mr. Pitt's side lost, the S.E.C. lawyer, Meyer Eisenberg, was so impressed with his performance that he urged him to apply for a job at the commission.

Mr. Pitt did, and he rose swiftly through the ranks. Beginning as a staff attorney, he became a legal assistant to Commissioner Francis M. Wheat a year later. Then he moved to the general counsel's office, and became chief counsel of the S.E.C.'s division of market regulation.

When G. Bradford Cook resigned as the chairman of the commission because of a scandal related to Watergate — the only other time a chairman had resigned in political turmoil — President Richard M. Nixon appointed Ray Garrett Jr. to be his replacement. Mr. Pitt then became Mr. Garrett's top assistant, at

the age of 28. Former S.E.C. officials recalled the time as one of great achievement for Mr. Pitt.

"He was smart," said Mr. Sporkin, the top enforcement official at the agency at the time. "He was a hard worker. He was easy to work with. He had no ego. He was a super guy."

After the Carter administration changed the leadership of the commission, Mr. Pitt left the agency in 1978 and went to Fried, Frank.

His work habits there were legendary. Mr. Pitt worked such long hours that the firm employed three sets of secretaries to keep up with him. His most famous client was Ivan F. Boesky, the Wall Street arbitrageur who pled guilty to insider trading. He ultimately would come to represent virtually every investment bank, accounting firm and stock exchange on the Street.

### What Might Have Been

Shortly after he returned to the commission last year to become its chairman, he told a reporter that he had no intention of ever practicing law again.

Last week, one of his former partners at Fried, Frank said that Mr. Pitt's tumultuous time at the commission was unfortunate, and that he gave up an enormous amount personally to fulfill his lifelong dream of becoming chairman.

"There's a wonderful paradox," the partner said. "If Harvey had stayed at Fried, Frank through the last year, he would have had the greatest practice in the world because every troubled company from Enron down would have wanted him to represent them."





Paul Hosefros/The New York Times

Jean Nziengui, who works at the National Press Club in Washington, hangs a picture of Harvey L. Pitt on the wall.

## *S.E.C. Is Suffering From Nonbenign Neglect*

By STEPHEN LABATON

WASHINGTON, July 19 — At his debut appearance before the National Press Club today, Harvey L. Pitt proudly rattled off an impressive list of accomplishments in his first year as chairman of the Securities and Exchange Commission, from the record number of cases and temporary restraining orders to his increased efforts to throw unfit officers and directors out of corporate boardrooms. But what he did not say — instead it was

something he mused to a friend about earlier this year after the collapse of **Enron** — may be more revealing about the problems Mr. Pitt inherited at the S.E.C. Over breakfast, he expressed relief to his friend that the commission's failure to examine Enron's financial statements in the last few years was a blessing in disguise. His true nightmare, he said, would have been if the agency had actually reviewed the disclosures and never found anything wrong.

Once the star in the constellation of regulatory agencies, the Securities and Exchange Commission over the last decade has lost some of its luster. Although both

Republican and Democratic chairmen forged a series of policy initiatives on behalf of investors, the agency's vital infrastructure has been sorely neglected, starved of adequate money and manpower by politicians. That hobbled its ability to keep up with the markets at the worst possible moment — just as ordinary Americans plowed huge amounts of their savings into the markets.

"There's a corny old saying that you should be fixing the roof when the sun is shining," said Mary L. Schapiro, president

*Continued on Page 4*

*Continued From First Business Page*

of the National Association of Securities Dealers regulatory policy and oversight division, and a former commissioner of the Securities and Exchange Commission and chairwoman of the Commodity Futures Trading Commission. "There simply were not sufficient resources to make that happen."

Low morale, high turnover, meager resources and relatively weak pay hit the agency hard. Reviews like those of Enron's filings were far less frequent. Investigators said the computer system, which was supposed to make it easier for investors to get information, was virtually unusable by officials to perform even the most basic kinds of examinations.

A huge backlog grew of proposed rules for the exchange and other self-regulatory organizations. Significant delays also occurred with greater frequency for the advisory opinions and "no action" letters that were vital for companies and their lawyers seeking advice on ways to raise capital.

"The 1990's were very hard on the agency," said David Becker, who recently returned to private practice after serving as general counsel to Mr. Pitt and his predecessor, Arthur Levitt. "To some extent, the agency got hollowed out, losing lots of experienced people."

Now Congress, prompted by public outrage over heavy losses in investment and retirement accounts, is preparing to substantially enlarge the agency's budget for the first time in decades. But it is not known how quickly that money will be able to turn the tide at the tradition-bound agency.

While Enron's recent annual reports and other filings contained crucial clues for investigators — vital passages on self-dealing transactions were indecipherable and should have raised red flags — officials said commission staff members never looked at them because they had been forced to scale back reviews sharply. In the 1980's, the agency reviewed all of a single company's major filings once every three years. But by last year, the proliferation of filings during the roaring 1990's, combined with the lack of resources,

cut that back to once every seven years.

The number of corporate filings received by the agency increased 59 percent, from 61,925 in 1991 to 98,745 in 2000, according to a recent study by the General Accounting Office, an investigative arm of Congress. Over the same period, the staff of lawyers and accountants who review such filings grew by 29 percent, from 125 to 161. By 2000, a paltry 8 percent of overall filings were being reviewed.

An increasing number of regulations adopted in the name of helping investors had hardly helped. An otherwise unassailable and badly needed initiative by Mr. Levitt to require reports to be written in "plain English" had made it more difficult and tedious for the reviewers, had provoked even greater wrangling with companies and had delayed reviews even further.

Moreover, the level of experience of the typical reviewer was in deep decline. The boom market and dreadful work conditions at the agency lured many of the most valuable staff officials elsewhere, creating significantly higher turnover than at any of the other major financial regulatory agencies and leaving the reviewing staff largely in the hands of younger and less experienced lawyers and accountants. From 1998 to 2000, turnover in some divisions was as high as a third each year, and the average pay was less than half of what was being offered for comparable jobs in the private sector.

The heavily bureaucratic approach was also poorly designed, providing perverse incentives that encouraged agency examiners to review the companies with the least likelihood of having problems.

The reviews themselves were never intended to be audits or forensic searches for fraud, but efforts to assure compliance with disclosure laws and rules. Nor were they intended to discover instances where stock prices were wildly inflating the true value of a company, the role more properly in the hands of Wall Street analysts.

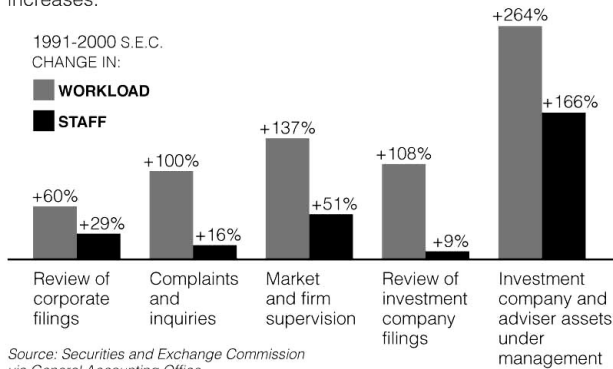
Still, the agency reviews are important for assisting enforcement officials looking for cases of wrongdoing and deception, and they are supposed to be a central feature in the multifaceted approach toward policing the markets. But since examiners had basically been given a quota to turn out reviews to satisfy Washington's number crunchers, no one looked at the quality of the reviews. Examiners say they were discouraged from taking on particularly complex filings because such work took more time.

"We have a quota of 38 a month and accountants must do 6 a month," said Michael Clampitt, a lawyer and accountant who has worked at the



## Falling Behind

Over the last decade, the demands on the Securities and Exchange Commission, in every category, have far outpaced its staffing increases.



The New York Times

agency for the last 12 years and led the successful effort to unionize the agency two years ago, after commission leaders ignored desperate pleas from the staff to fix poor work conditions.

"This is the big problem. If you have to do six filings and there are six Enrons and six companies with stable earnings, stable dividends and straightforward statements, which ones are you going to pick?"

Typical of the commission's woes is its computer system, which tried to make filings more accessible to the public, but which was never sufficiently upgraded to make it useful for officials to manipulate data in meaningful ways. As a result, the systems rival those of the Federal Bureau of Investigation for being obsolete and all but unusable for performing some vital tasks and detecting problems.

While many experts say the enforcement program has remained strong, the agency is outgunned by the private sector. It has often been characterized by a fire department's urgency, rushing from catastrophe to calamity. Stephen M. Cutler, director of the enforcement division, has told friends that his sharply limited manpower is perhaps best illustrated by the fact that one investment house alone, Merrill Lynch, has more professionals in its legal and compliance departments than he has lawyers, investigators and other professionals on his enforcement staff.

Like so many other failures of Washington, blame for the rot of the agency's infrastructure is widespread. Some Republicans in Congress, repeatedly dubious of doing anything that would make government bigger, blocked efforts to increase staff salary levels. When he served as chairman of the Energy and Commerce Committee in the late 1990's, Representative Thomas J. Bliley Jr., Republican of Virginia, was a bitter enemy of Mr. Levitt, and he single-handedly bottled up urgent pleas for more money.

Mr. Levitt said today that while he was proud of his many accomplish-

## *An agency with low morale, low pay and unusable computers.*

ments on behalf of investors during his tenure as the longest-serving chairman in the agency's history, he deeply regretted not paying more attention to the conditions of the workplace. He also regretted his political failure, despite repeated efforts, to get more money for salaries.

Some former officials recalled that like many other department heads who come to Washington to carry out policy, Mr. Levitt was largely indifferent to the plight of the staff. It was the tradition of many of the former chairmen of the agency to use a special elevator key that would enable them to get straight to their office without stops that might expose them to the rank and file.

Mr. Pitt, whose own critics within the agency say he, too, is unapproachable and relies primarily on a tight coterie of political and legal advisers, insists that he has set about to change the culture of the agency.

"In my more than two decades on the other side," Mr. Pitt said in an interview this week, "I perceived an agency that had become somewhat insular, an agency that did not always take criticism well, and an

agency that needed to constantly find new ways to do old things."

"Technology is critical here," Mr. Pitt added, "and this agency was in the era of quill pen and parchment."

Yet for the first 18 months of his administration, President Bush continued the policy of neglect. He has been slow to name commissioners; agency historians say that the commission has never gone for such a long period of time with only one official, Mr. Pitt, confirmed in office.

The failure to install commissioners has already begun to hurt the enforcement program. Earlier this month, an administrative law judge threw out the government's audit-independence case against **Ernst & Young** because only one commissioner was able to vote on it. A second major case, involving fraud accusations against top executives of **Waste Management**, faces similar problems.

Still, until just last week, when the White House proposed to add \$100 million to the S.E.C. budget, Mr. Bush's budget staff had fiercely resisted efforts to significantly enlarge its "zero growth" spending blueprint for the agency beyond its current level of \$467 million, to finance pay increases ordered by Congress, or to even provide most of the relatively modest increases sought by Mr. Pitt.

In recent years, the agency has itself become a cash cow, taking in revenue of more than \$2 billion annually. A steady stream of Republican and Democratic leaders of the agency, including Mr. Levitt and Mr. Pitt, have proposed that Congress permit it to finance itself like the Federal Reserve. But Congress, which is able to maintain some control over the independent and executive branch agencies through the power of the purse, has never taken that view seriously.

House and Senate Democrats have proposed increasing the budget to at least \$750 million, and because of the current furor, officials expect that the White House may have no choice but to support the higher spending.

# ***Bush Tries to Shrink S.E.C. Raise Intended for Corporate Cleanup***

## ***Asks Congress to Cut Budget Increase He Signed***

By STEPHEN LABATON

WASHINGTON, Oct. 18 — Less than three months ago, President Bush signed with great fanfare sweeping corporate antifraud legislation that called for a huge increase in the budget of the Securities and Exchange Commission to police corporate America and clean up Wall Street.

Now the White House is backing off the budget provision and urging Congress to provide the agency with 27 percent less money than the new law authorized.

Administration officials say their proposed increase is enough and that other budgetary needs, like the military and security against terrorism, make it impossible to afford more.

The decision has angered commission officials and Democratic lawmakers, who say that it reflects the administration's calculation that corporate scandals have begun to recede as a political issue. They say that the administration's more modest increase will not be able to pay for the expanded role of the agency,

bring salaries up to levels at other financial regulatory agencies, finance the start-up costs of an accounting oversight board and significantly expand a staff that is already overwhelmed.

Under the corporate clean-up legislation, the commission's budget — which for years has barely kept up with inflation, let alone the steep rise in stock ownership — was authorized to increase by 77 percent, to \$776 million. But as Congress wrestles with the spending measures that actually appropriate money to federal agencies, the White House is requesting \$568 million for the S.E.C., officials said, or an increase of about 30 percent over last year's budget of \$438 million.

Harvey L. Pitt, the commission's chairman, has acknowledged through a spokesman that the administration's level of financing will not allow it to undertake important initiatives.

The White House has put Mr. Pitt in the awkward position of having to choose between Congressional Democrats who want a larger budget and administration officials who want less. Brian Gross, the commission's director of communications, said that Mr. Pitt was concerned that the agency would not be able to do many of the technology and enforcement projects that he would like if the commission received only what the White House has recommended.

"It doesn't allow for a lot of new initiatives," Mr. Gross said. On the other hand, he said, Mr. Pitt appreciates that the White House has to juggle other budget issues that would prompt the administration to support the lower figure.

The commission's budget became a major political issue as the wave of corporate scandals illustrated the agency's difficulties in policing major public companies and Wall Street. Through most of the year, the administration opposed calls by Democrats for bigger increases in the agency's spending allocation. But after the collapse of WorldCom this summer, the president cited the larger spending increase when he signed the corporate overhaul, known for its prime sponsors as the Sarbanes-Oxley Act, at a ceremony in the East Room on July 30.

"Corporate misdeeds will be found and will be punished," Mr. Bush said then. "This law authorizes new fund-

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ing for investigators and technology at the Securities and Exchange Commission to uncover wrongdoing."

The commission's finances have become a casualty of political gridlock between Congress and the administration over the budget for the entire government. Congress has passed temporary spending measures set at last year's budget levels to keep the government operating at least through the end of November.

Two months ago, the commission received an increase of \$30 million over its \$438 million budget from last

***'We didn't pull the \$776 million out of a hat,' a senator says of the amount.***

year, which was widely considered inadequate, to begin hiring another 100 staff members to join its 3,100 current employees. As a result, nearly a year after those corporate scandals began with the collapse of Enron, commission officials say that they have struggled to keep up with their growing number of responsibilities and cases.

Senior agency officials say that they are still unable to open many of the investigations that they want and that, as cases near trial, they will be stretched thin. The agency's computer systems have not been updated in many years. The agency is unable to review the vast majority of corporate documents filed every day. And one investment house alone, Merrill Lynch, has more professionals in its legal and compliance departments

than the commission's entire enforcement staff.

The problems were supposed to be fixed by the Sarbanes-Oxley Act, which set a \$776 million authorized budget. But now, administration officials say Mr. Bush supports a more modest increase, of \$130 million, to \$568 million.

"The president does believe the S.E.C. has a substantial mission and we think \$568 million is sufficient to carry that out," said Amy Call, a spokeswoman for the White House Office of Management and Budget.

Administration officials say that the budget figure in the law is too high considering the other needs of the budget. They say that the agency would be able to carry out more investigations, increase staff and raise pay levels with the more modest budget proposed by the White House.

Briefing reporters aboard Air Force One, Ari Fleischer, the president's spokesman, said it was a major accomplishment that Congress recessed without increasing any spending.

"Typically, when Congress leaves, they pay an exit fee, where spending is increased above and beyond what the Congressional budget authorized, and the taxpayers are always the victims," Mr. Fleischer said. "This year, the chain was broken."

Senator Paul S. Sarbanes, the Maryland Democrat who was the principal author of the legislation, called the White House position "disheartening" and said that its proposed budget would fall far short of what is necessary for the agency to be effective.

"I can't understand why they are taking this position," he said. "We didn't pull the \$776 million out of a hat. The costs of increasing pay, hiring new staff and increasing the volume of their business presents a case for a higher budget that is overwhelming."



Agence France-Presse

President Bush on July 30, signing the Sarbanes-Oxley Act, which in part authorized an increase of the S.E.C. budget to \$776 million. Now, however, the White House has scaled that figure back to \$568 million.

The law calls for \$102 million for raises and \$108 million for better computer systems and financing for restoring the agency after the Sept. 11 attacks that destroyed its New York offices. It also proposed \$98 million to pay for 200 additional auditors, investigators and prosecutors. Budget officials estimate that the new accounting board will need from \$25 million to \$50 million to start. That money is to come from the commission's budget and be repaid later by the accounting profession.

In July, shortly before the measure was adopted, a Senate committee led by Ernest F. Hollings, Democrat of South Carolina, passed a \$750.5 million appropriations measure for the commission. The measure has since languished as Democrats and Republicans have been unable to reach agreement in the House and the Senate on the federal budget.

Democrats said that the White House position reflected the calculation that the corporate scandals have moved to the back burner, and therefore the White House does not need to honor the provision in the legislation that calls for the higher financing.

"My sense is this is a White House that is sensing some political relief that this is no longer the issue on the table so they can take a political pass on this," said Senator Christopher Dodd, the Connecticut Democrat who heads the Senate banking subcommittee on securities and investment. "They touched the critical issues last summer and now it's gone. Now the issue is Iraq all the time."

"I think they are politically mistaken and also dangerous substantively," Mr. Dodd said. "You have to have the resources and do the job. You need the right cops on the beat to get it done."

## ***Downturn and Shift in Population Feed Boom in White-Collar Crime***

By STEPHEN LABATON

WASHINGTON, June 1 — The bursting of the stock market bubble, combined with the changing face of the American population, has led to a surge in business fraud and corruption prosecutions and investigations.

Even as the rate of murder, robbery, assault and other types of violent and property crimes has declined or flattened in the last decade, there has been a marked increase in accounting and corporate infractions, fraud in health care, government procurement and bankruptcy, identity theft, illegal corporate espionage and intellectual property piracy, federal and state officials say.

With increasing frequency, white-collar corruption seems to be the crime of choice of the baby boom generation.

A week does not go by without news of investigations of blue-chip and start-up companies, the most prominent recently include Adelphia, Enron, Global Crossing, Kmart, Qwest Communications International, Schering-Plough, WorldCom and Xerox. Many of those companies' accounting firms are also facing intense scrutiny, perhaps most notably Arthur Andersen, which is in the middle of a criminal trial in Houston.

Corporate corruption cases are inevitable during the trough of the boom-bust economic cycle, when disgruntled investors and company

whistle-blowers work with prosecutors and the support of an outraged public to unveil the excesses of market euphoria. The phenomenon last occurred during the savings and loan crisis a decade ago, but it also happened after a wave of corporate scandals in the 1970's, and to a lesser extent during the Great Depression.

But this wave is different. Some statistics indicate that these fraud cases were actually on the rise during the boom cycle, and criminal law experts say that the nature and types of these crimes differ significantly from those of earlier periods.

And while the sociology of crime is imprecise, experts attribute that changing nature of crime to demographic shifts and economic forces.

"There have always been crooks,

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and Enron's chief executive hasn't gone to Sing Sing as the head of the New York Stock Exchange did in 1938," said Alfred D. Chandler Jr., the Pulitzer Prize-winning business historian at Harvard, referring to Richard Whitney, the patrician president of the exchange who went to prison wearing a three-piece suit for market abuses originated in the 1920's. "But there are critical differences between what we are seeing now and what we have seen earlier."

For one thing, technological advances like the Internet have contributed substantially to the rate of financial crime cases. Equally important, in the last decade demographic changes, like the aging and growing prosperity and education of the population, have played a role.

"What we are seeing in a variety of areas is fraud on the rise at the same time other crimes are going down," said Joseph T. Wells, a former F.B.I. agent and founder of the Association of Certified Fraud Examiners, which trains members of government, corporations and accounting firms in ferreting out fraud. "There are at least two reasons. Crime is largely a factor of age, and fraud is the crime of choice of the older perpetrator, so as the society ages, you have, and should continue to see, an increase in fraud cases."

"A second reason is that the education level of society has come up in the last 20 years, and the message is clear in the mind of the better-educated public that if you want to commit a crime, fraud is the way to go," he added. "The take is better, and the punishment generally is less."

Peter Goldmann, editor of White Collar Crime Reporter, a trade publication for lawyers and investigators, said, "White-collar crime is spinning through the roof. It's spinning new varieties daily and the incidence and amounts of money being stolen are incredible."

Some experts also point to changes in the way top executives are paid — especially the proliferation of potentially valuable stock options — that have created new and perverse incentives for senior executives to manipulate financial statements for their personal short-term gain.

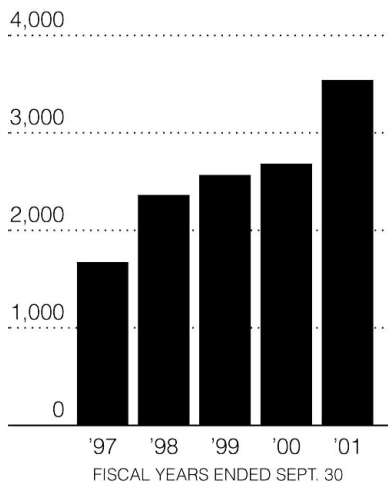
"The temptations created by stock options are much greater for earnings manipulation," said Samuel L. Hayes III, an emeritus professor of investment banking at Harvard who sits on several corporate boards. "There are greater benefits that accrue to management." By contrast, Professor Hayes said, there were few prosecutions during the 1920's

## Rising Corporate Crime

While the rate of violent crimes has been declining or flattening over the last decade, there has been a marked increase in accounting and corporate infractions, federal and state officials say.

### CIVIL CASES INVOLVING FINANCIAL VIOLATIONS

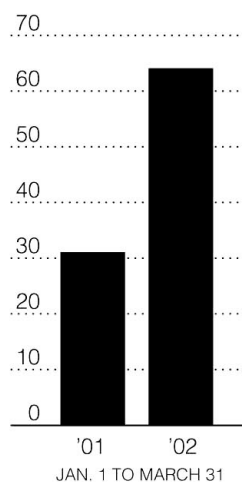
*Government and private lawsuits for securities fraud and other types of financial violations have more than doubled since 1997.*



Sources: Administrative Office of the U.S. Courts; Securities and Exchange Commission

### SECURITIES AND EXCHANGE COMMISSION INVESTIGATIONS

*The number of accounting and financial reporting cases opened.*



The New York Times

because few laws were available to prosecute the kinds of abuses that contributed to the Depression. "It was more of the Wild West," he said.

The government does not keep precise statistics on white-collar crime, primarily because there is a debate about what constitutes such crime, and general statutes prohibiting mail and wire fraud, perjury and obstruction of justice are used against corporate offenders as well as street criminals. Nonetheless, there are indicators of the trend beyond the daily drumbeat of headlines:

¶Harvey L. Pitt, the chairman of the Securities and Exchange Commission, reports that a record number of accounting and financial reporting cases have been opened in the first quarter of this year. Following the implosion of Enron last winter, the agency received a record number of tips from corporate insiders and investors about accounting and financial reporting violations at other companies. Inquiries have opened involving the large accounting firms and many of their clients, including Computer Associates International, Dynegey, Elan, Enterasys Networks, Halliburton, Kmart,

Microsoft, Nvidia and WorldCom.

¶Michael Chertoff, head of the criminal division at the Justice Department, says he has similarly seen a sharp spike in accounting and disclosure cases in recent months along with a general rise over the last few years in other kinds of white-collar cases ranging from health care fraud to theft of trade secrets.

Mr. Chertoff said that the biggest increases in investigations of possible accounting fraud have been in the telecommunications, software and energy areas and that violations appear to have been motivated by the "tremendous pressure to meet revenues and earnings projections."

Other Justice Department officials say bankruptcy fraud and whistleblower lawsuits involving government fraud, like procurement fraud, have also been on the rise.

¶Criminal cases involving white-collar crime are often accompanied by civil actions brought by the government and private parties that are tracked by the Administrative Office of the United States Courts, and they show a marked increase. While the number of federal civil lawsuits in the United States dropped from 1997

through Sept. 30, 2001 by 21,120, to 250,907, the number of government and private lawsuits for securities fraud and other types of financial violations more than doubled in the same period, rising to 3,538 from 1,669. Virtually every other type of civil lawsuit has dropped.

¶A whole new host of financial crimes has arisen with the proliferation of the Internet, from identity theft to software privacy and e-mail Ponzi schemes. Federal and state officials have responded by devoting teams of new investigators and prosecutors to combatting such abuses.

¶Private groups report significant increases in areas like accounting fraud. Beyond the well-known cases involving large publicly traded companies, they say, there has been a sharp increase in frauds related to efforts to borrow money from banks and investors.

Because not every fraud is detected, it is hard to know whether there are more instances of fraud or the enforcement level is increasing, though experts say the heavier caseload is indicative of broader trends.

"While the statistics are hard to come by, we are seeing what appears to be bigger and more frequent frauds," said W. Steve Albrecht, associate dean at the Marriott School of Management at Brigham Young University.

"People commit fraud because of three factors: financial pressure, the perception of an opportunity, and rationalizing it as O.K. This is the fraud triangle," he said. "All three of these elements have been increasing. Being at the down part of an economic cycle exacerbates the problem, but we were seeing a lot of it in the good times as well."