“Corporate Fraud and Abuse Taxes” Cost the Public Billions

The U.S. Chamber of Commerce is running TV ads in five states claiming that “excessive litigation” costs Americans $136 billion each year in what it has termed the “lawsuit abuse tax.” This phony claim is a smokescreen designed to promote a corporate agenda aimed at taking away consumers’ legal rights needed to hold companies accountable for fraud.

The numbers behind the so-called “lawsuit abuse tax” are as reliable as an Enron balance sheet and the use of them to fool the public can be just as dangerous and costly as the bankrupt energy company’s lies. But while the Chamber uses millions of dollars to perpetuate the fraudulent claim of a “lawsuit abuse tax,” you will never hear the business group address the “corporate fraud and abuse taxes” that drain the pocketbooks of employees, taxpayers and consumers.

The “corporate fraud and abuse tax” reaches hundreds of billions of dollars each year and the public is left to pick up the tab. Three examples of corporate crime and government handouts to corporations are discussed below. They highlight only a few of the most glaring examples of corporate fraud, waste and mismanagement that business associations truly concerned about added consumer costs should attempt to combat.

The Price Tag of Recent Corporate Fraud: Up to $236 Billion

Employees, stockholders and pension plans saw hundreds of billions of dollars in stock value evaporate after business scandals and charges of corporate malfeasance rocked Wall Street and the country in recent months.

Public Citizen’s examination of 20 companies under investigation by the Securities and Exchange Commission and/or the Department of Justice found that the total shareholder value of these corporations has been eroded by nearly $236 billion since government investigations were announced or when a company admitted financial mismanagement (see attached analysis).

While all $236 billion in stockholder losses is not solely due to corporate fraud (some portion is due to the overall decline in the stock market), our analysis suggests that a substantial portion is due to corporate malfeasance – either because many of these companies saw large losses shortly after it became public that they were under investigation by the federal government or restated their earnings and because some of the problems of some of these companies helped fuel the overall decline in stock values, particularly in their industrial sector (see discussion in the methodology section in the attached analysis).

The corporate crime blotter includes businesses under government investigation for many reasons: accounting inconsistencies, overstating profits (and understating losses), booking sales that never materialized and incomplete disclosure of shareholder risk concerning mergers.

Shareholder value in 14 of these companies was diminished by more than $1 billion, and at least $25 billion in shareholder value was lost in four different companies. The share prices of five companies fell by more than 90 percent – and the value of 13 company stocks has been cut by half – since the public learned about investigations into fraud or abuse. The median stock value lost by the 20 companies is 52 percent.

The biggest losses came to stockholders in Tyco ($84.2 billion), Lucent ($55.5 billion), WorldCom ($26.9 billion), Enron ($25 billion), Xerox ($9.8 billion) and Qwest ($9.8 billion). The $211 billion in shareholder value lost by these six corporations represents about 90 percent of the total losses in the 20 companies that Public Citizen examined.

The Price Tag of Federal Corporate Welfare: $125 Billion

The concept of "aid for dependent corporations" is alive and well in the federal budget. Through corporate welfare programs the government helps businesses by providing lucrative tax loopholes; paying to advertise their products; training workers; building new factories; supporting research and development that boosts companies' bottom lines at the expense of taxpayers who pay once for the research and again for the product. In fact, even settlements with government regulators (like the SEC) for corporate crime can be turned into corporate welfare tax deductions because companies can write off these "ordinary and necessary" expenses.[1]

It is called "economic incentives" but a clever euphemism does not change the fact that the cost of federal corporate welfare is equal to all the income tax paid by 60 million individuals and families, according to an 18-month investigation by TIME Magazine.[2] Reporters Donald Barlett and James Steele found that "the federal government alone shells out $125 billion a year in corporate welfare."[3]

An April 17, 2002 analysis by Citizens for Tax Justice determined that recent tax breaks included in the economic stimulus package approved by Congress in 2001 (P.L. 107-147) will mean that American taxpayers will pay more than $170 billion in corporate tax breaks during each of the next two years.[4] "In fact, for the first time since the early eighties, corporate tax loopholes will actually cost more than companies pay in income taxes in fiscal 2002 and 2003," states the Citizens for Tax Justice report. A look at a few major companies analyzed by Citizens for Tax Justice showcases this abuse:

- Microsoft paid no tax at all in 1999, but reported $12.3 billion in U.S. profits.
- General Electric paid just 11.5 percent of profits in taxes during the last five years – a savings to the company of $12 billion.
- WorldCom paid no taxes in two of the last three years while reporting $15.5 billion in profits.

The problem of corporate welfare is so immense that key members of Congress are proposing a Corporate Welfare Subsidy Reform Commission.[5] Its purpose: To eliminate government handouts to big businesses. "There are more than 100 corporate subsidy programs in the federal budget today," said Sen. John McCain (R-Ariz.), a cosponsor of the legislation.[6]

The Price Tag of the S&L Bailout Scandal: At Least $341 Billion

The savings and loan (S&L) industry began incurring huge losses during the 1980s because financial institutions made risky real estate investments that relied on continued inflation for profits; government regulators eased financial reporting standards; and the heads of some "thrifts" raided assets while the government stalled plans to close insolvent S&Ls.

This left a multi-billion dollar mess that the public was forced to pay to clean up. The final cost to taxpayers for bailing out failed S&Ls: $341 billion over 30 years, according to the General Accounting Office (GAO).[7]

The first wave of public monies used to bailout the failed S&Ls came in 1987 when Congress created the Financing Corporation to help out the Federal Savings and Loan Insurance Corporation (FSLIC) by floating bonds totaling $7.5 billion. But that was not nearly enough. So Congress passed the Financial Institutions Reform, Recovery and Enforcement Act in 1989 that abolished the FSLIC and transferred its assets to the newly created Resolution Fund. The Resolution Trust Corporation, created to help manage the assets of failed S&Ls, received $50 billion but, again, not enough. Congress came to the rescue again and made another $105 billion available.

The total costs of bailing out failed S&Ls includes $132 billion appropriated by Congress that was funded directly by taxpayers and interest payments on 30-year bonds that the GAO estimates will reach $209 billion.[8] Others have estimated that interest payments will put the total cost between $500 billion and more than $1 trillion, based on changing interest rates, and require $32 billion from taxpayers every year.[9]

Endnotes

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[5] "Gephardt Announces Plan to Cut Corporate Welfare with Sen. McCain," Office of Rep. Richard Gephardt Press Release, April 17, 2002.
[6] "McCain Introduces Corporate Subsidy Reform Commission Act," Office of Sen. John McCain Press Release, April 17, 2002.
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$236 Billion in Shareholder Losses in 20 Corporations Under Government Investigation

This examination of companies under investigation by the Securities and Exchange Commission, Department of Justice or Federal Energy Regulatory Commission found that the total shareholder value in 20 corporations has been eroded by a total of $236 billion since government investigations became public or companies admitted financial mismanagement through restatements or announcements of internal probes.

Company	Date Public Learned About Fraud or Investigation	Reason Selected and Investigation Information	Share Price on Column 2 Date	Share Price on Sept. 3, 2002	Share Loss	Outstanding Shares (Millions)	Value Lost (Millions)
Adelphia	27-Mar-02	Adelphia announced $2.3 billion in off balance sheet debt; SEC began investigation in April 2002 into allegations that the company overstated results by inflating capital expenses and hiding debt. [1]	$20.89	$0.16	$20.73	186	$3,856
CMS Energy	10-May-02	CMS Energy announced SEC inquiry into "round trip" energy swap practices after an internal review found that CMS had artificially inflated its revenues and expenses by more than $4.4 billion from May 2000 through mid-January 2002. [2]	$19.97	$10.18	$9.79	133	$1,302
Duke Energy	7-Jun-02	Duke announced SEC probe into $1 billion of "round-trip" energy trades to boost revenues. [3]	$22.80	$20.08	$2.72	31	$84
Dynegy	08-May-02	Dynegy announced formal SEC investigation into accounting of energy trades. [4]	$10.60	$2.17	$8.43	272	$2,293
El Paso	07-Jun-02	El Paso announced SEC investigation into "round trip" energy trades. [5]	$22.10	$15.78	$6.32	584	$3,691
Enron	16-Oct-01	Enron reported a $618 million third-quarter loss and disclosed a $1.2 billion reduction in shareholder equity, partly related to partnerships run by CFO Andrew Fastow. [6]	$33.84	$0.19	$33.65	743	$25,002

Company	Date Public Learned About Fraud or Investigation	Reason Selected and Investigation Information	Share Price on Column 2 Date	Share Price on Sept. 3, 2002	Share Loss	Outstanding Shares (Millions)	Value Lost (Millions)
Global Crossing	08-Feb-02	Global Crossing announced it is subject of SEC probe into accounting practices; company allegedly engaged in network capacity “swaps” with other carriers to inflate revenue. [7]	$0.07	$0.059	$.01	888	$10.6
Halliburton	28-May-02	Halliburton announced SEC investigation into whether company booked $100 million in annual construction cost overruns before customers agreed to pay for them. [8]	$19.50	$13.71	$5.79	436	$2,524
Hanover Compressor	26-Feb-02	Hannover restated $37.7 million in revenues and $7.5 in net income and announced SEC request for information. [9]	$13.25	$10.38	$2.87	79	$227
Homestore	21-Dec-01	Homestore announced internal investigation into accounting practices. SEC investigating if company inflated sales by improperly booking some transactions as revenues. [10]	$3.30	$0.53	$2.77	117	$324
Kmart	25-Jan-02	Kmart announced internal and SEC investigations into accounting practices to determine if financial statements were intended to mislead investors. [11]	$0.87	$0.63	$0.24	502	$120
Lucent Technologies	21-Nov-00	Lucent announced internal probe in accounting practices; it filed restatement that reduced 2001 revenues by nearly $700 million in December 2000. [12]	$18.00	$1.83	16.17	3,430	$55,463
Network Associates	26-Mar-02	Network Associates announced a massive revenue and profit shortfall and it changed how it recognized some revenues; three top executives resigned. [13]	$20.70	$13.00	$7.70	148	$1,140
Peregrine Systems	01-May-02	Peregrine delayed fiscal year reporting; announced internal investigation into accounting irregularities; CEO Stephen Gardner and CFO Matthew Gless resigned; said it would restate results for the last three years and reduce reported revenue by about $250 million. [14]	$3.45	$0.27	$3.18	193	$614

Company	Date Public Learned About Fraud or Investigation	Reason Selected and Investigation Information	Share Price on Column 2 Date	Share Price on Sept. 3, 2002	Share Loss	Outstanding Shares (Millions)	Value Lost (Millions)
PNC Bank	28-Jan-02	PNC restated 4th quarter financial results, cutting 2001 income by $155 million. SEC found that PNC improperly transferred $762 million in loans and assets. [15]	$62.25	$44.33	$17.92	284	$5,089
Qwest Communic-ations	11-Feb-02	Qwest announced SEC subpoena related to inflated revenue created by network capacity "swaps"; SEC also looking at accounting for long-term deals. [16]	$9.00	$3.18	$5.82	1,676	$9,754
Reliant Energy	05-Apr-02	Reliant announced informal SEC investigation into earnings restatement; SEC investigating "round trip" energy trades. [17]	$24.90	$11.85	$13.05	304	$3,967
Tyco	02-Jan-02	Media reports of investigation into company accounting; SEC investigating merger accounting and CEO Dennis Kozlowski's use of company funds. [18]	$57.25	$15.03	$42.22	1,995	$84,229
WorldCom	11-Mar-02	WorldCom announced SEC inquiry into accounting policies; SEC later alleges that cash flow was overstated by booking $3.8 billion in operating expenses as capital expenses. [19]	$9.18	$0.11	$9.07	2,962	$26,865
Xerox	29-Jun-00	Xerox announced SEC investigation into its Mexico operations accounting; SEC also filed civil suit in April 2002 against Xerox for misstating four years worth of profits totaling $3 billion. [20]	$20.00	$6.53	$13.47	730	$9,833
Totals							**$236,389**

Methodology

The total value erased cannot be entirely attributed to corporate fraud or a lack of investor confidence due to charges of corporate malfeasance. Indeed, many stocks were in a downward spiral because of worsening economic conditions or the stock market "bubble."

At the same time, the figures represent conservative estimates in that they do not cover the time when fraud was actually occurring. For example, the date chosen as when the public first learned of corporate crime at Enron is October 16, 2001, the date it posted a $618 million third-quarter loss and disclosed a $1.2 billion reduction in shareholder equity, partly related to partnerships run by CFO Andrew Fastow. Even though it is alleged that Enron cooked the books for years prior, which helped the stocks reach levels as high as $90 per share, the public was unaware of the mismanagement and these early dates (and high stock prices) were not used in the analysis.

In fact, the dates chosen to begin calculating the cost of corporate fraud in terms of shareholder value lost represent the time when the public was first made aware of allegations of mismanagement or outright fraud. This was compiled from company press releases, media reports and SEC filings.

Overall, the companies in this study lost a collective $254 billion from their 52-week high to the time when the public first learned about possible corporate fraud. And while the Dow has lost 17.5 percent of its value and NASDAQ is down 38.7 percent since the start of 2002, the share prices of five companies fell by more than 90 percent – and the value of 13 company stocks has been cut by half – since the public learned about investigations into fraud or abuse. The median stock value lost by the 20 companies is 52 percent.

The total shareholder value erased was calculated by using a company's stock price on the date that a government investigation was announced or when a company admitted that mismanagement occurred and then using the current price (on September 3, 2002) to compute the change in stock value. This amount was multiplied by the number of outstanding shares to establish the total shareholder value lost. The amount of shareholder value lost since 2001 was determined by finding the difference between a company's stock price on January 2, 2001 (the start of trading) and the stock price on September 3, 2002. This value also was multiplied by the number of outstanding shares.

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