Merrill Lynch: corporate apologia and business fraud

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Abstract

In April 2001, New York Attorney General Eliot Spitzer accused Merrill Lynch of fraud, creating a public relations crisis for the investment firm. The crisis was caused by the disclosure of damaging emails in which analysts referred to stocks that they were selling as “a piece of junk” or “trash.” Consequently, this monograph examines the apologetic crisis management discourse proffered by Merrill Lynch to restore its reputation. It argues that since companies are unwilling to admit responsibility due to liability concerns, in contemporary discourse compensation should be read as an argot that functions as an admission of culpability.

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According to CBS News, Americans are $7 trillion poorer now than they were at the height of the internet bubble when the collective stock markets bid technology or so-called "dot.com companies" like Pets.com to staggering heights of valuation even though they had no income, earnings, or positive cash flow (The sheriff of Wall Street, 2002). With the tremendous sense of financial loss, and the fact that the bursting of the bubble led the economy into a recession in early 2002, it follows that the need for scapegoats would abound, among them Arthur Andersen, Enron, Tyco, and even America’s principal domestic doyenne, Martha Stewart. Each revelation of accounting gimmicks and insider trading has brought about the realization by many investors that the markets were “rigged” and designed to enrich

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insiders, while individual investors and holders of 401Ks were perennially on the outside—and easy targets for abuse.

Eventually, the revelations of wrongdoing reached to the heart of Wall Street. In April 2001, Eliot Spitzer, Attorney General of New York, using his authority under the Martin Act, announced he had opened an investigation of fraud at Merrill Lynch, one of Wall Street’s oldest and most venerable firms. In it, he accused the firm of recommending the purchase of poorly performing stocks to individual investors which enabled Merrill Lynch to win or retain lucrative investment banking fees for those same companies—thus dramatically increasing the impact on the firm’s bottom line (White, 2002).

The investigation plunged the organization into a public relations crisis. As it continued and the ongoing revelations continued to dog the firm, Merrill Lynch chose to settle rather than fight the allegations any longer. In May 2002, Attorney General Spitzer announced a settlement: Merrill Lynch would apologize for the wrongdoing, pay a $100 million fine, as well as change the way that analysts are compensated (White, 2002).

It is our position that this case is paradigmatic of the problems inherent in modern apologetic speech in that, when presented with clear evidence of wrongdoing, the Wall Street giant initially responded with a denial and counter-attack; and once it became clear that the allegations would not go away, it then completed a settlement with its accusers in which it offered a weak statement of regret followed by the paying of a large fine. Specifically, we argue that Merrill Lynch’s communicative choices reflect efforts to appear apologetic to public constituencies while at the same time avoiding legal liability. To support this claim, we first review the research on corporate apologia; second, we survey the narrative that constituted the crisis; third, we offer analysis that considers the multiple strategies utilized by the firm to account for its wrongdoing; and finally, we draw a number of conclusions as to the role of apologia as used by financial firms.

1. Apologia: an institutional perspective

The study of apologia has a long and varied tradition. Originally conceived as a defensive form of speech, the study of apologia now focuses on how corporations in the midst of public relations crises respond to criticism in the defense of their carefully crafted images in order to deal with the problem of guilt (Benoit, 1995; Hearit, 1995, 2001).

Prototypically, past research on apologia has shown that corporate apologists deal with the problem of guilt by assuming one of three dissociational stances (Hearit, 1995, 1999; Perelman & Olbrechts-Tyteca, 1969). The first way is through a denial stance. Here guilt is rejected, or at minimum an apologist denies that it is the responsible party. This denial is accompanied by an opinion/knowledge dissociation in which a company argues that there is a false perception that it is guilty of the transgression and that, upon closer examination, the “true facts” of the case reveal that the organization is indeed a law-abiding corporate citizen.

A second way to address the problem of guilt is to achieve absolution by transferring it to another. In terms of apologetic speech, organizations guilty of wrongdoing often find scapegoating a compelling vehicle by which to deal with the problem of their guilt. These apologists shift the blame through the application of an individual/group dissociation. The dissociation occurs when the company is able to locate guilt, not in the company qua company, but in the actions of a few individuals.

The final prototypical stance in which apologists handle their guilt is through acceptance of guilt by engaging in a process of self-mortification, often accompanied by a strategy of corrective action. Here
the guilt is accepted, and the guilty party deals with its guilt by seeking forgiveness. Communicatively, this form of guilt is handled through an act/essence dissociation which argues that while an act was committed, it was not representative of the essential nature of the organization. Such was the position that Merrill Lynch found itself in after disclosures of financial mismanagement and fraud.

2. Eliot Spitzer, Merrill Lynch and allegations of wrongdoing

Merrill Lynch, one of the nation’s most prominent Wall Street brokerage firms, was the subject of an investigation begun in April 2001 by Eliot Spitzer, New York State Attorney General, into the question as to whether the firm provided misleading information to its investors. Spitzer began by subpoenaing approximately 30,000 internal emails in an almost year-long investigation (Disinformation on Wall Street, 2002).

The allegations came to the fore on April 8th, 2002, when Spitzer took action against Merrill Lynch by labeling any investment advice the firm had to offer as “tainted” and acquired a court order that forced the company to make changes in how it issued its equities information (McGeehan, 2002a, p. C1). In discussing the case, Spitzer stated that Merrill Lynch’s behavior “jeopardizes the integrity of the marketplace. This was an outrageous betrayal of their trust and a shocking abuse of the system, perverted to produce greater revenues . . .” (McGeehan, 2002a, p. C1). The firm, conversely, denied the allegations and claimed that they revealed that Spitzer did not understand how research works in securities firms (McGeehan).

What was unique about the allegations was that Spitzer also provided additional proof for his contentions in the form of email messages that were acquired from his earlier subpoena. The allegations were that Merrill Lynch publicly recommended to individual investors that they buy stocks that its own research concluded were poor values, due to the fact that the firm did not want those same companies to take their lucrative investment banking business elsewhere (Cohen, 2002). Some of the correspondence was particularly telling; analysts referred to stocks as a “powder keg,” and a “piece of junk” yet did not downgrade buy recommendations (Disinformation on Wall Street, 2002, p. A32). Still others described stocks as: “crap,” a “dog,” a “disaster,” (White, 2002, p. 5A) and a “piece of [expletive]” (Cohen, 2002, pp. 4–7).

To tighten the screws against Merrill Lynch, on April 23rd state securities and federal regulators formed a joint task force to investigate the firm. Reports revealed that the Department of Justice’s head of criminal investigation was scrutinizing the inherent conflict of interest in how securities firms operate (McGeehan, 2002c). The next day Harvey Pitt, then chairman of the Securities and Exchange Commission, joined the task force investigating Merrill Lynch, a move which signaled that any settlement would likely have policy implications for all Wall Street firms (McGeehan, 2002d).

Part of the delay in coming to a settlement was the degree to which Merrill Lynch would have to apologize and accept responsibility, for accepting responsibility would incur huge liability concerns. The cause for concern for Merrill Lynch was that unlike a settlement with the S.E.C., an agreement with the State of New York would be admissible in lawsuits from disgruntled investors—a concern that could cost the firm millions if not billions of dollars (McGeehan, 2002g).

After many delays in court and consultations with Attorney General Spitzer, on May 21st, 2002, Merrill Lynch finally agreed to settle the case; in the agreement the firm agreed to pay a $100 million fine, change how its analysts were compensated, restructure the research department to make it more independent, and
offer an expression of regret for its actions (McGeehan, 2002b; Merrill Lynch’s Deal, 2002). In so doing, it was able to avoid a firm destroying indictment. The day after the settlement, Merrill Lynch began an advertising campaign to shore up its damaged reputation (Merrill weighs a Giuliani role, 2002). Yet with the settlement, the firm’s problems were not over; it faced 37 class action lawsuits from investors.

It should be noted that corporate fraud, inflated recommendations and intentionally misleading investors was not the sole province of Merrill Lynch. Indeed, many observers have spoken of this issue as an industry-wide problem. On December 19th, 2002, Attorney General Eliot Spitzer along with most of the leading Wall Street firms announced a $1 billion settlement in which they paid fines and restructured how they made securities recommendations and published their research (Morgenson & McGeehan, 2002). As part of the agreement, the firms did not admit any wrongdoing.

3. We’re guilty but not responsible: Merrill Lynch’s apologia

Merrill Lynch utilized all three dissociational stances in its journey from denial to conciliation in a progressive attempt to resolve its public relations crisis and deal with the problem of its guilt.

3.1. Denial and counter-attack

Merrill Lynch first responded to the allegations of wrongdoing from the Attorney General with a strategy of denial:

There is no basis for the allegations made today by the New York Attorney General. His conclusions are just plain wrong. We are outraged that we were not given the opportunity to contest these allegations in court. (McGeehan, 2002a, p. C1)

The company coupled its initial stance of denial with a counter-attack against Spitzer:

The allegations reveal a fundamental lack of understanding of how securities research works within overall capital-raising process. They cite a limited number of employee emails, taken out of context, as “proof” that investment banking had undue influence in determining research ratings. In fact, these emails prove nothing of the sort. (McGeehan, 2002a)

In effect, Merrill Lynch chose a dissociational strategy in which it sought to differentiate itself from allegations of wrongdoing by denying them, and claimed a “lack of understanding” by the attorney general of how financial services companies operate.

Such a strategy did not work. Spitzer continued his effort to force changes in the industry through his desire to make the research function of brokerage independent:

That would help us get to the point where we get structural relief industrywide. I think there’s a fair recognition that something more than just beefing up compliance departments has to be done. (McGeehan, 2002b, p. C10)

While still denying that the firm had done anything wrong, Merrill Lynch continued to work toward a settlement with Spitzer. In particular, the firm agreed to make full disclosure to its investors as to which firms the company had investment business with. Spitzer agreed that such a move was a step forward (Morgenson, 2002).
3.2. Initial scapegoating

The next step in managing the crisis by Merrill Lynch occurred by strategically transferring guilt from the firm to selected individuals—an individual/group dissociation. Of course, the biggest departure among the analysts who left was Henry Blodget, who reached a joint decision with Merrill Lynch to leave the firm while the investigation was still ongoing, late in November 2001 (McGeehan, 2001). Then, in its initial attempts to reach a settlement in 2002, Merrill Lynch announced another offering on April 26th: it had fired Phua Young, a well-liked analyst for misconduct (McGeehan, 2002e). He was not the only one to leave or be let go. On May 2nd, Merrill Lynch announced that Thomas Davis, who headed the research department, would leave the firm in the next six months. He was the last holdover of the previous management team (McGeehan, 2002f).

3.3. Mortification and corrective action

While the exit of key participants in the controversy helped its case, the departures did not resolve it, and it was only with the heat turned up against the firm by all the investigations that Merrill Lynch began to take a more conciliatory approach. On April 26th, 2002, at the company’s annual meeting, the firm issued its first apology by corporate officials; Chairman and Chief Executive David Komansky said: “The emails that have come to light are very distressing and disappointing to us. They fall far short of our professional standards and some are inconsistent with our policies” (McGeehan, 2002e, p. C1). He continued: “We regret that and we further regret that the perception of our research integrity has clearly been affected. We have failed to live up to the high standards that are our tradition” (p. C1).

These apologies appeared to be less interested in the repair of a relationship than an attempt to dissociate the firm from a few vaguely identified actions during an unpleasant period. Furthermore, Komansky promised that the firm would “take meaningful and significant actions to restore investor confidence” but refused to outline what the specific steps were (p. C1). In the minds of investors who heard the hollow tone, however, the apology was less than meaningful. Hence, this round of mortification was too weak to be satisfactory for investors.

The conciliatory approach, however, seemed to work with investigators. Three weeks later, the Attorney General and Merrill Lynch announced that it had reached a final settlement which included a $100 million fine. As part of the settlement, Merrill Lynch was forced to apologize for the wrongdoing and offer a second round of mortification. The firm intoned that it was sorry.

for the inappropriate communications brought to light. We sincerely regret that there were instances in which certain of our Internet sector analysts expressed views that at certain points may have appeared inconsistent with Merrill Lynch’s published recommendations. (McGeehan, 2002h, p. A1)

Again, the company went through great semantic gyrations to sound apologetic while being careful not to assume any culpability for its actions, with its strongest admission being that some analysts’ views were “inconsistent” (p. A1).

Regarding the weak apology offered by Merrill Lynch, The New York Times in an editorial responded that the firm should apologize for “fantastical stock recommendations” not because boorish emails came to light (Merrill Lynch’s Deal, 2002, p. A26). Instead, the Times suggested that Spitzer’s real motive was “to force Wall Street to change its ways, and he may prove more successful than have federal regulators” (Merrill Lynch’s Deal, 2002, p. A26).
3.4. Final scapegoating

To further differentiate the firm from the misconduct and complete the individual/group dissociations, on June 3rd, 2002, stories surfaced that seemed to suggest that David Komansky, who negotiated the deal with Spitzer, would leave the firm before his scheduled retirement two years later, to be replaced by Stanley O’Neal. It was O’Neal’s perspective that Komansky was responsible for doing the deal-making with Spitzer because it was on his watch that the abuses occurred (McGeehan, 2002i). One unnamed Merrill Lynch executive described it more directly: “Stan was glad to have Dave here to stand up and take that bullet” (p. A1). By July 22nd, the stories proved to be true when Merrill Lynch announced that Komansky would step down as chief executive to O’Neal on December 2nd and as chairman the following April 28th (McGeehan, 2002j).

4. Conclusions: guilt, apology, liability, and restitution

“Successful” apologia function to bring absolution on two levels. First is the understanding that the apologist has to justify his or her behavior; in other words, articulate his or her association to the alleged offense and deliver an apologia. Second is the recognition that the apologia is more than words: the apologist must show “proper regard for the process of correction” (Goffman, 1971, p. 100). By doing so, critics are able to judge the degree to which the apologist respects and pays attention to the symbolic and ritualistic dimensions of justificatory discourse.

Yet when one considers the apologistic discourse offered by the senior officials in charge of Merrill Lynch, it follows that such efforts at apology were failures on both counts. First, Merrill Lynch officials’ explanations were woefully inadequate and serve as clear examples of corporate doublespeak. When presented with incontrovertible evidence in the form of very embarrassing emails, the firm nevertheless proceeded with a denial, claiming the emails were misunderstood and that the Attorney General did not understand how the securities business worked. When the company finally did issue an apologia it did so in a manner in which it assumed little if any responsibility for its actions: It appeared to be sorry that the emails were brought to light instead of sorry for the deception. The New York Times called the substance of Merrill Lynch’s defense “silly” (Merrill Lynch’s Deal, 2002, p. A26).

Second, Merrill Lynch showed little regard for the process of correction. The firm did not care about repairing relationships with its investors. Indeed, it appears as if the apologetic process, which came only through news accounts and not through a published apologia as is the apologetic norm (Hearit, 2001), seemed designed to be overlooked. Furthermore, the apologia was delivered by a chief executive who was soon to exit the firm, thus providing a scapegoat on which to heap any outstanding guilt.

The apparent reason for such a weak apology by the brokerage firm is the concerns about liability the firm would face if it directly assumed responsibility for the wrongdoing. The role of liability in contemporary apologetic discourse as studied by organizational critics is, like the proverbial crazy aunt who lives in the basement, ever present but seldom discussed. Tyler (1997), in an insightful study, has concluded that while it is the personal impulse of corporate officials to respond to public and media pressure to come clean and apologize, it is their fear of exposing their companies to liability concerns that prohibits them from doing so. The manner in which such executives extricate themselves from such a position typically results in the use of equivocal communication in which a company denies having committed a wrong, but promises never to do it again (Tyler).
Yet, if Merrill Lynch only expressed regret that misunderstood yet damaging emails had come to the fore and that people had unfortunately lost huge sums of money in the technology sector, the question follows as to why the company was forced by the Attorney General to pay a $100 million fine. Such a point brings us to the primary conclusion of this paper. Due to liability concerns, modern corporate officers only offer weak statements of regret for what happened without assuming responsibility (Hearit, 1995).

The assumption of responsibility occurs when organizations offer compensation to victims or assent to pay fines or restitution. Said another way, due to liability concerns, in its current form in contemporary apologetic speech, the acknowledgement of wrongdoing lies not in the apology but in the compensation. This is what the Attorney General meant when he said “You don’t pay a $100 million fine if you didn’t do anything wrong” (McGeehan, 2002b, p. A1). While compensation is a way in which a company pays for a problem to “go away” (Benoit, 1995), it also functions as a form of “proportional humiliation” which is strikingly similar to the humbling process through which one has to go through when apologizing (Courtright & Hearit, 2002).

This study has examined the apologetic efforts of Merrill Lynch after New York State Attorney General Eliot Spitzer accused the large Wall Street firm of fraud. In so doing, it argues that the apologetic exchange featured an attempt to appear apologetic for public relations purposes while avoiding legal liability. Yet it should be noted that the biggest loser in the hyping of buy recommendations was the individual investor. While said individuals were the Attorney’s General reason for investigating Merrill Lynch—serving their interest and by extension the public interest, it was the small, individual investor who was left out of the settlement—for the $100 million fine went to the treasury of the State of New York and other states who were party to the agreements, leaving individual investors with the impression, once again, that the game was rigged.

References


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