

Crash Course: For Harvard Board, Professor's Woes Pose Big Dilemma --- University Weighs Options After Shleifer Ruling On Russian Investments --- Mr. Summers Recuses Himself

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CAMBRIDGE, Mass. -- Four years ago, the U.S. government sued top Harvard University economist Andrei Shleifer for more than \$100 million, accusing him of seeking to profit from his management of a flagship foreign-aid program in Russia. Harvard, which oversaw the project throughout much of the 1990s, was also named in the civil suit.

Over the summer, a federal judge ruled that Mr. Shleifer and his former deputy conspired to defraud the government when they invested in the same financial markets they were charged with creating. The judge also found Harvard in breach of its contract. If there's no settlement, damages will be determined by a jury. Based on the suit, the university could owe the government as much as \$34 million. The liability for Mr. Shleifer and his deputy could be three times that figure.

Harvard is now faced with an unusual dilemma: Should it protect or punish one of its star professors? Mr. Shleifer has asked Harvard to pay his considerable legal bills, and in the past has suggested that it should also pay any damages.

The Corporation, Harvard's high-powered governing board, has been cool so far to Mr. Shleifer's requests. But it's in an awkward position. Not only is Mr. Shleifer one of the university's academic stars, he's also a close friend of Harvard President Lawrence Summers. The former U.S. Treasury secretary has recused himself from the deliberations, but has left no doubt where his sympathies lie.

The Corporation is also aware that its fate is in part tied to that of Mr. Shleifer. With an endowment of \$22 billion, Harvard might be willing to settle with the government to avoid further litigation, but its embarrassment won't fade unless Mr. Shleifer also settles. If Harvard agrees now to pay his legal bills, it could give the professor a stronger incentive to fight on.

In the June summary judgment, U.S. District Court Judge Douglas Woodlock detailed how Mr. Shleifer and his deputy made extensive personal investments in what was then a hot capital market, while advising Russian regulators how to create and run markets. In addition to buying stocks, the judge laid out how Mr. Shleifer, his deputy and the two men's wives used their privileged position to help open Russia's first mutual-fund company.

Mr. Shleifer declined to be interviewed. His lawyer Earl Nemser, says the judge's ruling "won't withstand review." Mr. Nemser also said that he'd be "flabbergasted" if the case hurt Mr. Shleifer's academic standing. "I don't believe his academic integrity has been questioned in any credible way in this lawsuit."

No one close to Harvard thinks the university will resort to the ultimate sanction -- taking away Mr. Shleifer's tenure. A Russian emigre and expert in financial markets, he rocketed to a full professorship at Harvard at the age of 30.

Seven years of allegations haven't held back Mr. Shleifer's academic career. In 1999, he won the John Bates Clark medal for the best economist under the age of 40, an honor widely seen as a precursor to the Nobel Prize. Three years later, Mr. Shleifer was given an endowed chair at Harvard. In 2003, New York University's business school tried to woo him away, but he decided to stay at Harvard.

The Harvard faculty and administration is betting Mr. Shleifer will easily weather any academic fallout from the judge's ruling. A senior member of Mr. Shleifer's department, who refused to be quoted by name, described the civil case as "frivolous" and "a simple contract dispute" pursued by an overzealous assistant U.S. attorney.

Colleagues also say Mr. Summers will likely protect Mr. Shleifer, his longtime protege. Mr. Shleifer won a research assistantship with Mr. Summers by citing five alleged errors in a Summers academic paper.

People familiar with the Shleifer case say that Mr. Summers recused himself at the Corporation's insistence. In a written statement, Joe Wrinn, a Harvard spokesman, says Mr. Summers and the Corporation "mutually agreed that the recusal made sense."

Mr. Summers's preferences are clear. In a 2002 deposition for the case, Mr. Summers said he had urged Harvard's former dean to make sure Mr. Shleifer remained at the university. He also noted that members of the economics department had "expressed the view that Andrei was in some way or another being s-d."

In his deposition, Mr. Summers appears dismissive of the government's allegations, saying the AID investigation and the decision to cut off funding to the Harvard project had in fact angered Russia's top reformers. "I had enough knowledge . . . to be confident that the set of issues contained in the allegations were not issues that were consequential for them; and indeed that they would have, in part, valued advisers more extensively if they were more involved in actual private-sector activities."

Harvard's Corporation, whose members include Corning Inc. Chairman and Chief Executive James Houghton and former University of Chicago President Hanna Gray, appears to be treating Mr. Shleifer more cautiously. Former Treasury Secretary Robert Rubin is also a board member and recused himself because he was in government during part of the project. The Corporation turned down Mr. Shleifer's request to present in person his case for Harvard paying his legal bills. It has deferred making a decision, preferring to see how the legal drama unfolds.

Mr. Shleifer's role in Russia dates back to the tumultuous early 1990s when the U.S. was trying to remake that country in its own image. On a trip to Moscow in 1991 he met some of Russia's best and brightest reformers and soon began shuttling between Cambridge and Moscow as an adviser. Jonathan Hay, a Russian-speaking Rhodes Scholar about to graduate from Harvard Law School, moved to Moscow to help coordinate the effort.

In a few weeks, the team drew up plans to sell off 15,000 state enterprises and give vouchers to 150 million Russians to buy shares. The U.S. Agency for International Development, or AID, awarded Harvard's Institute for International Development \$2.1 million in 1992 to support the privatization effort with Mr. Shleifer at the helm and Mr. Hay as his deputy. Over the next five years, HIID's contracts with AID grew to a total of \$57 million, as the Harvard project took on the tasks of Russian legal reform and building capital markets.

In May 1997, AID abruptly suspended the project, charging that the two men had violated government conflict-of-interest rules when they, along with Mr. Shleifer's wife and Mr. Hay's then-girlfriend and now wife, invested in Russian financial markets. The two men "abused the trust of the United States government by using personal relationships . . . for private gain," AID charged in a letter to Harvard.

Harvard fired Mr. Hay from his job with the Harvard institute. He is now an attorney in London. Mr. Shleifer was removed from the Russia project but kept his tenured position in the economics department.

The U.S. government has since spent seven years pursuing the case. "Harvard and its employees, no matter how brilliant, are still subject to the laws of the United States," the government declared in one of its filings to the court.

The U.S. attorney in Boston convened a criminal grand jury but there was no indictment. In September 2000, the government brought a civil case against the two men and their wives plus Harvard in the U.S. District Court in Boston. The judge later dropped the two women from the case.

The suit contended Messrs. Shleifer and Hay defrauded the U.S. government of more than \$30 million in AID money that was "paid to Harvard to provide impartial and unbiased advice" in Russia. Instead, the government charged, their actions undercut the purpose of U.S. reform efforts to promote "transparency [and] the rule of law" and taught the Russians the opposite lesson: that good connections were more important than fair play. The government asked for treble damages under the False Claims Act.

According to Judge Woodlock's 100-page summary judgment, Mr. Shleifer and his wife, Nancy Zimmerman, a successful hedge-fund manager, invested more than \$400,000 in Russian stocks and government bonds, registering some purchases in the name of Mr. Shleifer's father-in-law. Mr. Shleifer also invited his deputy to participate, investing part of a \$66,000 check written by Mr. Hay.

The ruling also focuses on the foursome's plans to use their connections and capital to help create Russia's first mutual fund and a share registry, a company that executes and records mutual-fund transactions. Mr. Hay's girlfriend, now wife, Elizabeth Hebert, won authorization from Russian regulators to sell the first mutual-fund shares, beating out more established competitors. Mr. Shleifer and Ms. Zimmerman loaned the company \$200,000. Meanwhile, an associate of Ms. Hebert bought the share registry from the people who set it up with a \$400,000 loan from Ms. Hebert, financed by Mr. Hay and his father.

"In the short to medium term our advantage comes from the fact that the regulator wants us to be first," Ms. Hebert wrote in a memo, revised by Mr. Hay, which was faxed to Ms. Zimmerman to help drum up investors in both mutual-fund projects.

The judge ruled that Mr. Hay violated the government's conflict-of-interest rules and found him liable on two counts of causing false claims to be filed. He also ruled that Messrs. Hay and Shleifer had engaged in a conspiracy to defraud the government, citing both men's role in launching Ms. Hebert's mutual fund and the Russian mutual-fund registry.

The judge left to a jury to decide whether Mr. Shleifer is liable for a second false-claims count based on his own investing, saying the regulations were ambiguous for U.S.-based employees of the project.

As for Harvard, the Judge found it in breach of contract because of Mr. Hay's investing and possibly that of Mr. Shleifer, if a jury rules against him. He dismissed the more serious false-claim charges against Harvard, saying the university was unaware of the men's actions.

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Mr. Shleifer's lawyer, Mr. Nemser, says the conspiracy charge requires proof of intent and "there is no conclusive evidence that Shleifer knew of the restrictions on Hay at the time of Hay's investments." He says Mr. Shleifer was never subject to the conflict-of-interest rules.

Ms. Zimmerman declined to be interviewed. In August, Ms. Zimmerman's company paid \$1.5 million to the government to settle separate civil claims that it used the Russia project's resources to promote its investments, while denying any allegations of misconduct. The company's lawyer Martin Murphy said they had settled to "avoid the expense of litigation" and said it was a "nuisance-value settlement."

Mr. Hay declined to comment. In court papers, he has argued that he never had a contractual relationship with the government, was not subject to its conflict-of-interest rules, and had disclosed his investment to Harvard and Mr. Shleifer. Ms. Hebert didn't respond to a request for an interview.

Paul Ware, an attorney with Goodwin Procter LLP in Boston, who represents Harvard, says the university is encouraged by a finding in the judge's ruling "that it had no knowledge of or participation in any fraud ... We expect that any trial on damages would not result in a judgment against the institution anywhere close to \$34 million."

A recent status report filed with the court said the government and Mr. Hay "have made significant progress toward reaching a settlement." According to people with knowledge of the cases, the government is believed to be asking for about \$25 million from Harvard and between \$5 million and \$10 million from Mr. Shleifer. If there's no settlement, the trial on Mr. Shleifer's second count will go before a jury in December. A trial to assess overall damages is unlikely to begin before next spring. There, a jury will be asked to tackle the thorny issue of whether Messrs. Shleifer and Hay helped or hindered the cause of Russian reform.

If Harvard decides to discipline Mr. Shleifer, there are few case studies it can look to for guidance. Stripping a professor of his tenure, the ultimate sanction in academia, is rare.

Jonathan Knight, an expert on tenure at the Washington-based American Association of University Professors, a professional and lobbying group, estimates that between 50 and 75 tenured professors out of 280,000 lose their position for cause each year, more typically for sexual harassment, plagiarism and fraudulent research.

There are some signs the case is starting to influence Mr. Shleifer's standing outside the academic world. A week after the judge's ruling, a New York Times columnist quoted Mr. Shleifer saying that if unethical behavior drives down costs, even ethical executives will be forced to behave unethically to stay in business. The Times later ran a note saying "the columnist was unaware of relevant background information" relating to Mr. Shleifer's legal troubles.

James Hoge, the editor of Foreign Affairs, says the policy magazine looked into the status of Mr. Shleifer's case earlier this year before publishing one of his articles on Russia. The judge's ruling has raised the bar "some," Mr. Hoge says. If Mr. Shleifer wrote for the magazine in the future, Mr. Hoge says it would likely mention the case in Mr. Shleifer's biography.

Harvard Settles Suit Over Profit In Russian Aid

By Carla Anne Robbins

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(Copyright (c) 2005, Dow Jones & Company, Inc.)

EIGHT YEARS AFTER the U.S. government accused Harvard University economist Andrei Shleifer of seeking personal profit from his management of a flagship foreign-aid program in Russia, the university and Mr. Shleifer agreed to pay nearly \$30 million to resolve civil claims.

The accusations, followed by a civil suit brought by the government in 2000, have been a long-running embarrassment for the university, made more so by the fact that Mr. Shleifer is one of its star professors and a close friend of embattled Harvard President and former U.S. Treasury Secretary Lawrence Summers.

The settlement was reached after a federal judge ruled last year that Mr. Shleifer and his former deputy conspired to defraud the U.S. government when they invested in the same financial markets they were charged with creating. The judge found Harvard in breach of its contract.

Mr. Shleifer was at the very center of U.S. efforts in the 1990s to remake Russia's socialist economy. Working with more than \$50 million in grants from the U.S. Agency for International Development, Mr. Shleifer and his deputy, Harvard-trained lawyer Jonathan Hay, helped draw up plans to sell off 15,000 state enterprises and took on the tasks of setting up transparent capital markets and teaching Russian regulators and investors the rules of fair play.

In May 1997, the U.S. government abruptly suspended the project, accusing the two men of violating conflict-of-interest rules when they -- along with Mr. Shleifer's wife and Mr. Hay's then-girlfriend, now wife -- invested in those markets. In 2000, the government filed suit against Harvard and the two men in U.S. district court in Boston for up to \$102 million.

The case has been avidly followed in Russia, where critics point to it as alleged proof that the U.S. was trying to take advantage of Russia, rather than help it.

Mr. Shleifer said in a statement that "after eight long years, I have decided to end this now -- without any admission of liability on my part. I strongly believe I would have prevailed in the end, but my lawyers told me my legal fees would exceed the amount that I will be paying the government."

Under the agreement announced yesterday, Harvard will pay \$26.5 million. Mr. Shleifer will pay \$2 million, and Mr. Hay will pay \$1 million to \$2 million, depending on his future earnings. Last year FFIA, an investment firm partially owned by Mr. Shleifer's wife, Nancy Zimmerman, agreed to pay the U.S. government \$1.5 million to settle a related claim.

The case hasn't damaged Mr. Shleifer's career. In 1999 he was awarded the John Bates Clark medal for the best U.S. economist under 40 -- widely seen as a precursor for the Nobel Prize -- and in 2002 he was given an endowed chair at Harvard.

Mr. Shleifer was apparently so certain of his standing at Harvard that last year he asked the university's governing board to pay his legal bills, which are believed to have run into the millions of dollars. In the past he had suggested Harvard also might pay any damages.

As part of yesterday's settlement, Mr. Shleifer agreed that he couldn't be indemnified by Harvard for his portion of the settlement. A person with knowledge of the discussions said that the university isn't likely to pay Mr. Shleifer's legal bills.

Had the sides not settled, a jury would have decided how much was owed the government. In theory, Harvard could have been liable for as much as \$34 million, while Mr. Shleifer and Mr. Hay could have owed three times that figure.

Mr. Hay's lawyer, Lawrence Spiegel, issued a statement yesterday saying that, "while Mr. Hay continues to believe passionately in the work that he and others performed in Russia, his fight with the U.S. government has involved considerable sacrifice. Mr. Hay has thus decided to move forward with his life and settle this dispute."

In a statement yesterday from Boston, U.S. Attorney Michael Sullivan said, "the defendants were entrusted with the important task of assisting in the creation of a post-Communist Russian open-market economy and instead took the opportunity to enrich themselves."

The government has never offered an estimate of how much profit, if any, the two men and their wives may have made. Last year's summary judgment detailed how the men invested several hundred thousand dollars in a variety of Russian instruments. The ruling also focused on the foursome's plans to use their connections and capital to help create Russia's first mutual fund.

