From a Whistle-Blower to a Target

By TIM ARANGO
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On May 14, 2001, Joseph A. Ripp, the newly appointed chief financial officer of America Online, faxed a letter to the Las Vegas offices of the accounting firm Arthur Andersen with disturbing news: it appeared that an AOL business partner, and Arthur Andersen client, had forged a signature on a contract and booked several million dollars of sham revenue.

Enlarge This Image

Stephen M. Case, left, of AOL, and Gerald M. Levin, of Time Warner, before announcing a deal to merge.

AOL, via Bloomberg News

Joseph A. Ripp helped uncover fraudulent transactions between AOL and two partners.

Andrew Serban/Bloomberg News

Charles E. Johnson Jr., founder of PurchasePro, was convicted of fraud last month.

That letter set off a chain of events that culminated in the accounting scandal that followed Time Warner's merger with AOL, including huge fines and criminal convictions. Mr. Ripp, a longtime finance executive at Time Warner who had been sent to AOL's Dulles, Va., headquarters to oversee the accounting operations there, was called one of the "white hats" in the whole affair by the Justice Department.

But three weeks ago, on May 19, the Securities and Exchange Commission, after nearly six years of investigating accounting at AOL, filed a civil lawsuit against eight former executives alleging financial fraud. Seven were AOL executives before the merger; the eighth was Mr. Ripp.

Through his lawyer, Mr. Ripp declined to comment. But many of his old colleagues at Time Warner said they were flabbergasted by the turn of events.

"I think it's fair to say that everyone at Time Inc. is completely shocked by this. Joe Ripp is as far from being a crook as anyone you'll ever know," said John Huey, the editor in chief of Time Inc., who also described the complaint as "almost Kafkaesque."

Gerald M. Levin, the former chief executive of Time Warner, said of Mr. Ripp, "This is precisely the type of guy you'd want to manage your financial group."

Mr. Ripp's journey from whistle-blower to defendant is another example of the long shadow cast by the AOL-Time Warner merger, now widely regarded as one of the most disastrous corporate marriages in history. It is also a cautionary tale for corporate executives who may illuminate fraudulent conduct to one government agency but then find themselves a target of another.

"This is one of the huge challenges any corporate executive faces when the federal government comes after you," said C. Evan Stewart, a securities lawyer at Zuckerman Spaeder in Manhattan and a law professor at Brooklyn Law School and Fordham Law School. "You face this whipsaw from different competing government agencies."

How did Mr. Ripp, who successfully minded the finances of Time Inc. for 25 years and has been lauded by Justice lawyers as a pivotal figure in exposing criminal fraud at AOL, wind up in the cross hairs of the S.E.C.?

The S.E.C. claims Mr. Ripp "knowingly or recklessly engineered, oversaw and executed a scheme to artificially and materially inflate the company's reported online advertising revenue."

The S.E.C.'s complaint highlighted several well-scrutinized AOL advertising deals, most prominently a $400 million one with the German media giant Bertelsmann. That deal resulted in a Time Warner restatement of earnings in 2005 and S.E.C. wrist slaps for three executives, who were allowed to keep their jobs.

Scott W. Friestad, an associate director in the S.E.C.'s division of enforcement, said Mr. Ripp "wasn't the architect or the originator of the conduct."

"He came to the party later than the others," Mr. Friestad said. But, he added, "We don't view Mr. Ripp as an innocent bystander."

At Time Inc., Mr. Ripp had a reputation for being cautious when confronted with accounting questions. He was not even aware of Time Warner's talks with AOL leading up to the deal.

"He was the type of C.F.O. that annoyed people because he was so prissy," Mr. Huey said.

Mr. Huey's predecessor, Norman Pearlstine, now the chief content officer at Bloomberg L.P., said, "any allegations of fraud are inconsistent with the man I knew at Time Inc."

On Jan. 7, 2000, Mr. Levin assembled his top executives to inform them of the merger deal. Nina Munk, the author of "Fools Rush In," a book on the deal, wrote of that meeting: "Joe Ripp, the company's chief financial officer, was numb. Levin hadn't consulted him! A no-nonsense numbers man, Ripp had devoted his entire career to Time Inc. and then Time Warner."

After a long career tending to the books at Time Inc. — he began working with the publishing house in 1975 as an accountant at Ernst & Young — and its parent, Time Warner, Mr. Ripp found himself out of a job after the Time Warner-AOL merger because AOL's chief financial officer took on that role with the parent company. He had four years left on his contract with Time Warner. He could have simply collected a nice sum and just gone fishing. Instead he went to AOL at the urging of his bosses.

"Joe was sent in to make sure they had the kind of financial talent on the management team they needed," recalled Don Logan, the former chief executive of Time Inc., who was once Mr. Ripp's boss.

Mr. Ripp arrived in Virginia at a crucial time: the deal between Time Warner and AOL was being completed, and the Internet economy was deflating. AOL was under intense pressure to meet its financial targets to justify the price of the Time Warner deal.

In another book about the deal, "There Must Be a Pony in Here Somewhere," by Kara Swisher, Mr. Ripp recalled management problems he encountered at AOL, particularly with the chief executive at the time, Barry Schuler, "Schuler used to constantly tell me that I thought like an old media guy, and I said, 'Good, because all you new media guys are going bankrupt.' "

It was a volatile set of circumstances, and at the center was David M. Colburn, the aggressive head of AOL's business affairs unit known for his cowboy boots, permanent five o'clock shadow and tendency to dress down employees in full view of others.

Mr. Colburn's deputy and top dealmaker, Eric L. Keller, was suspended by Mr. Ripp shortly after Mr. Ripp arrived in Dulles and started an investigation into Mr. Keller's dealings with PurchasePro, a software company that had engaged in several dubious transactions with AOL. (On the day the S.E.C. filed suit against Mr. Ripp, the agency announced it had reached settlements with Mr. Colburn and Mr. Keller.)

According to several people involved with AOL at the time and documents from a criminal fraud case against PurchasePro, Mr. Ripp played a crucial role in uncovering fraudulent transactions between AOL and two business partners: PurchasePro and Homestore, an online real estate company. Those companies were central to Time Warner's settlement with the S.E.C. in 2005.

According to prosecutors, the case against PurchasePro was precipitated by the letter that Mr. Ripp wrote in 2001 — a letter that was described as a "neutron bomb" by a prosecutor in the ensuing litigation.

The letter also led to the downfall of the PurchasePro founder, Charles E. Johnson Jr. Four days before the S.E.C. complaint against Mr. Ripp was filed in United States District Court in New York for the Southern District, a federal judge in Alexandria, Va., convicted Mr. Johnson of fraud in connection with dealings years ago between PurchasePro and AOL.

Mr. Johnson was accused, among other things, of shredding and burning AOL-related documents and then spreading the ashes on the lawn of his personal assistant's suburban Las Vegas home in early 2001.

"Joe Ripp was not part of the conspiracy at AOL," Adam A. Reeves, a trial lawyer in the criminal division of the Justice Department, said in his opening statement in 2005 during a trial against another former PurchasePro executive. "He was one of the white hats in this case that helped reveal the fraud. The outside auditors, the board members, the internal investigators, all refer to the so-called Ripp letter as a bombshell."

In one of the government's exhibits in the case, a handwritten notation on one of PurchasePro's old financial statements reads, "Ripp letter killed these," next to revenue figures supposedly derived from marketing arrangements with AOL.

Mr. Ripp's lawyer, David F. Geneson, of the Washington law firm Sheppard Mullin Richter & Hampton, said recently, "Mr. Ripp is a straight shooter who consistently uncovered fraud and did not commit it. When Mr. Ripp was named C.F.O. of the AOL division, he quickly discovered serious problems. He launched an investigation and hired outside auditors and lawyers, and revealed fraud that triggered two federal prosecutions."

In the case of Homestore, Mr. Geneson said Mr. Ripp had a lieutenant draft a letter to Homestore's accountants that revealed the fraudulent nature of several transactions. A Justice Department official involved in the prosecution against Homestore, who spoke on the condition of anonymity because he did not want to been seen as criticizing another government agency, said Mr. Ripp's accounting treatment of deals between AOL and Homestore helped the government make its case and detect fraud.

Many of the dubious transactions at AOL, which led the company to inflate its advertising revenue by more than $1 billion, were so-called round trip deals with vendors. A typical example was that AOL would pay an inflated price for services or products, like computers or servers; in return, the vendor would then purchase online advertising.

Neither the PurchasePro nor Homestore cases are mentioned in the S.E.C.'s complaint against Mr. Ripp. Instead, the S.E.C. says that Mr. Ripp failed to properly account for revenue from several other deals, including a transaction with WorldCom that served to inflate AOL's revenues by more than $50 million in 2001, and the accounting for a deal in which Bertelsmann paid AOL Time Warner $400 million.

That money was improperly booked as online advertising revenue when it should have been accounted for as a reduction in the price that AOL paid for Bertelsmann's stake in AOL Europe, regulators said. It is this transaction that much of the S.E.C.'s case against Mr. Ripp seems to pivot on.

Mr. Geneson said Mr. Ripp was minimally involved with the Bertelsmann deal, which was put together and overseen by higher-ups at Time Warner headquarters in New York. Mr. Geneson added that Mr. Ripp at one point even suggested to senior executives at headquarters that they should consider additional public disclosure because it was a large deal that probably would not recur the following year.

"You would think he would get some credit for being a whistle-blower," said Mr. Stewart, the New York securities lawyer, "that someone at the S.E.C. would take this into account."

Mr. Ripp, who lives in Wilton, Conn., left Time Warner in 2004, and had a short run as president of Dendrite International, a pharmaceutical marketing company, before retiring. His professional life is in limbo as he awaits the denouement of the case.

"When he went to AOL, everyone told me he was the one exposing things that smelled bad," said Walter Isaacson, the former managing editor of Time magazine and chief executive of CNN, who has known and worked with Mr. Ripp for years. "This is a real shame. He didn't want to go there. He could have walked with a big check."

Time Warner and the executives who effected the disastrous merger with AOL have largely moved on. The company itself settled with the S.E.C. in 2005 for $300 million. Mr. Levin, the former chief executive of Time Warner, runs a spiritual retreat in California. Stephen M. Case, the founder of AOL, now has an online health care business.

But Mr. Ripp, 56, remains a captive of the merger, despite having had no role in it.

"I called him after I saw the newspaper stories and said how shocked I was and asked if there was anything I could do," said Mr. Logan. "I know Joe was always the person people depended on to know what was going on and to do the right thing."

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