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**Sphex Club**  
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**“We Have No Cash - Was We Robbed?”**

“We have no cash,” Jeff McMahon told Greg Whaley on October 14, 2001. Whaley was the newly appointed president of Enron, and he was shocked; he had no clue; he had only been president for a few months after Jeff Skilling unexpectedly resigned in August. Enron’s commercial bankers had finally pulled the plug; they refused to roll over Enron’s commercial paper, a portfolio of unsecured short-term loans that all big companies need to fund their day-to-day operations. Normally the renewal is a routine matter since exposure is generally about 24 hours; nothing to worry about unless Enron was “going down the tubes.” Out of cash; it could not pay its janitors much less pay its general creditors of which there were more than any one executive realized. Enron was desperate. It tried to call in its political IOU’s. Frantic calls were made to Alan Greenspan with a plea for a government bailout. Greenspan turns his back. Enron next tried to resuscitate itself by negotiating a merger with its major competitor, Dynegy, but the merger collapsed when Enron had to restate its earnings for the third time in a month to the tune of about \$664 million dollars.

On December 2, 2001, Enron filed for bankruptcy. The lives of thousands of its employees were devastated; their retirement wiped out; its stockholders victimized by Wall Street myopia; its high rolling and high flying executives brutally grounded, with some headed to jail; and its bankers, lawyers and accountants dragged down into the swirling vortex of a corporate catastrophe.

What happened to Enron, the darling of Wall Street? How did a company that had multi-million dollar earnings over ten years all of sudden collapse and descend into bankruptcy within a three month period? How did the smartest guys in the room, as authors Bethany McLean and Peter Elkin dub them in their book of the same name, not have the smarts and business acumen to see that their business practices were gluttonous recipes for financial disaster.

The rise and fall of Enron is an intriguing and fascinating story involving fatally flawed projects, accounting chicanery, greed, stupidity, arrogance, sexual escapades, and probably most of all, a loss of moral and ethical direction from its management. Tonight we will review the founding of Enron, its major executives who were “the smartest guys in the room,” or at least they thought so, its business plans and practices, its extensive political influence. I ask you to reflect upon the Enron ethos and what its collapse has to say about big business in America in the

21<sup>st</sup> century. Was Enron, its stockholders, and its employees robbed? I want to hear your opinion.

### **History/Ken Lay**

In 1925, Texas oil tycoons formed the Houston Natural Gas Company (HNG). Over the next several decades, HNG provided gas to the city of Houston. The region's population was doubling every 20 years, and by the mid-1970's it had 2 million customers and owned over 300 gas wells, 97 oil wells in Texas, Oklahoma, New Mexico, West Virginia and Wyoming. By 1980 HNG was one of the most profitable companies in Houston with over \$3.7 billion in assets, revenue's topping \$2 billion and profits were over \$120 million.

In the early 1980's, HNG fought off a hostile takeover from a corporate villain who was likened to J. R. Ewing, the duplicitous villain of the TV series, Dallas. It cost HNG a bundle to win this battle, and its Board became dissatisfied with its CEO. They felt they needed a more dynamic executive; the man they hired for the job was Ken Lay. Lay was an experienced pipeline executive, son of a Baptist minister, a Phi Beta Kappa graduate in economics from the University of Missouri, a PhD, and a divorcee who had dumped his wife and married his secretary – not an unusual scenario in the Enron culture.

Within a few months after Lay took over at HNG, it merged with an Omaha-based pipeline company, Internet North, that owned one of the best pipelines in America, connecting gas fields in Texas and Oklahoma with cities in the mid-West and northward into Canada. The merged company had over 370,000 miles of pipelines that stretched from coast to coast and border to border.

Within several months of the merger in May of 1985, squabbling between the executives of the merged companies led to a takeover by Lay and his lieutenants. He masterminded a move of the headquarters from Omaha to Houston, and changed the company name to Enron.

Over the next fifteen years, Enron expanded its existing gas and oil business and embraced new markets. Enron transported about 15% of all the natural gas burned in the United States; it entered into power generation; it built power plants all over the world and made money in delivering or trading gas and electricity; it bought water companies and sold water; it traded in metals and agricultural products; it had a love affair with broadband – the high flying internet bonanza; and Enron traded everything imaginable in the financial world: stock options, stock swaps, derivatives, name a financial machination and Enron traded it. Enron traders were its

glamour men and women; well educated, hard charging, fast acting, intimidating, and they made huge amounts of money. They were smarter than everybody else.

Lay and his new wife, Linda, became part of the rich and famous people in Houston.

They moved to River Oaks, the right place to live in Houston. One of Lay's neighbors was the billionaire oil tycoon H. L. Hunt. Ken and Linda Lay belonged; they attended the right parties, hobnobbed with diplomats, and the right politicians, particularly with a family that had Bush as its last name; a good friend was a rising politician and businessman named Dick Chaney.

Yet, there were near disasters in its formative years that nearly sunk Enron. In the spring of 1987, a group of greedy and unsupervised Enron traders in Valhalla, New York, had exceeded their trading limits and had entered into contracts that required Enron to deliver millions of barrels of crude oil - oil that Enron did not have, could not afford, and could not deliver. Enron was short 87,000,000 barrels of oil; to put this in perspective, this was equivalent to the entire output of the United Kingdom's North Seas' oil fields for three months. Lay had been warned months before not to trust these traders and their financial reporting. After the scam was discovered by Enron auditor, Arthur Anderson, Lay could not bring himself to fire the traders and proclaimed his own innocence. Enron escaped by buying oil on the spot market and

bluffing its customers. This was a scenario that would be replayed in almost identical fashion some 14 years later with devastating consequences.

### **Jeff Skilling**

On August 1, 1990, the smartest guy in the room became chairman and chief executive officer of a newly created Enron subsidiary, Enron Finance Corp. Jeff Skilling was an MBA superstar graduate from the Harvard Business School; he had been a rising star in the internationally-known consulting firm of McKinsey and Company. In the early 1980's, Skilling developed a strong interest in energy issues. He had advised Enron on the best way to integrate HNG and Internet North. Skilling kept coming up with ideas that Ken Lay simply could not afford to ignore, and he became an Enron employee in the mid-1980's.

Skilling conceived a brilliant idea that took him to the pinnacle of power in corporate America. It was named the "Gas Bank."

In the early 1980's, Ronald Reagan pushed for the deregulation of the gas pipeline industry. Skilling realized that there was plenty of gas available from producers who were now freed from federal price controls. He also understood that there was plenty of demand from utilities that wanted to burn gas to make electricity; Skilling saw a void to be filled. There was

no intermediary that could aggregate and balance the gas supplies coming from the producers with the demand coming from the consumers. Skilling created a mechanism that allowed the producer and the consumer to hook up. The gas bank. It was a brilliant idea. Producers liked the idea because Enron could give them long term contracts for their gas, and consumers liked it because they would be able to predict fuel costs over multi-year terms. Enron guaranteed delivery to gas consumers over long periods of time, as many as 15 years. Enron made its profit on the contracts by pocketing the spread between the cost of gas and the selling price.

With the gas bank going great guns, Skilling conceived the idea that Enron provide financing to oil and gas producers, and in return, the producer agreed to sell its production to Enron at an agreed upon price. Enron's profits proliferated. Skilling learned that he could pull off monster deals, and he became infatuated with his brilliance and success— some observers liken it to becoming hooked on cocaine. But he initiated a change in Enron's accounting that, in my opinion and the opinion of many observers of Enron, lead to Enron's demise: mark to market accounting.

## Mark to Market

As Skilling managed the tremendous growth in Enron in the trading business, he became convinced that Enron's accounting had to be changed. He brought to bear tremendous pressure on Lay, the SEC, and Enron's accountants for Enron to adopt an unorthodox method of accounting.

What is mark to market accounting? When Enron books an asset and liability, for instance, a 10-year contract to supply natural gas to a utility, under conventional accounting the value on Enron's books continues to reflect its initial assumption over the life of the deal. A company's books profits as the cash from the contract is received. However, using mark-to-market, Enron adjusted the value of the contract on its balance sheet on a regular basis to reflect fluctuations in market price or anything else that might change the value of the contract. Enron invariably always made adjustments upward, not downward.

The second difference, and the most important one: when a business uses conventional accounting it books the revenues and profits that flow from the contract as the profits come through the door. But under the mark-to-market method, Enron booked the entire estimated value of a ten year contract for the entire 10 years on the day Enron signed the contract. This

meant that Enron could declare the entire projected profits from the moment it signed a 10-year contract even though it may not have a cent in hand. Thus under mark-to-market accounting, there is a large discrepancy between the profits Enron was reporting to its shareholders and the public and the cash Enron actually had on hand to run the business. What made matters worse: Enron paid high bonuses to its traders and managers when the deal was closed, even though Enron had received no cash.

Another danger of mark-to-market accounting involves growth. When a contract is made and all the potential profits are immediately booked, under mark-to-market accounting Enron appeared to be growing rapidly. Wall Street loved it. However, how does Enron continue the growth? When Enron received the cash from the contracts over time, it could not count the cash in its profits because it had already booked the profit. Enron had to begin every quarter fresh. If Enron did one deal last quarter, in order to show growth, it must have two deals the next quarter, then four the quarter after that and eight after that quarter and on and on. Enron was promising Wall Street that its earnings would increase 15% annually. Enron had mounted a treadmill that became faster, steeper and ultimately out of control.

## **Co-Generation (John Wing)**

In 1992, Enron entered the co-generation business. Under the leadership of another Harvard MBA, John Wing, Enron built a co-generation plant at Tee-Side in northeastern England. Co-generation uses the heat from the combustion of natural gas to create electricity and steam; it is more efficient than older methods of producing power. The electricity is sold to big industrial users like utilities and the steam is sold for use in industrial processing or space heating. True to Enron's big is better philosophy, Tee-Side was the biggest co-generation plant on earth providing about 3% of Britain's electricity. Wing was a brilliant financier; Enron owned 50% of Tee-Side by acting as the general contractor. Enron laid out almost no cash, but it owned half of the plant value at \$1.6 billion. But with the profits, there came a price. Enron had to negotiate with a group of North Sea producers of gas to build a pipeline to supply the plant, and then Enron had to agree to take the natural gas whether Enron could use it or not. This arrangement is called a take or pay contract. In the 1980's Enron had similar contracts with producers, and had to spend tens of millions of dollars to get out of dozens of expensive take or pay contracts in the United States. Wing and his cohorts should have known better.

Tee-Side set another precedent, one that would drive Enron's international projects for the next decade. Wing was granted a small ownership interest in Tee-Side at no cost to Wing. When the project was completed, Enron paid Wing for his interest in the plant, approximately \$11,000,000. Wing's paycheck at Tee-Side became the standard by which future international projects were measured. It was an example of Enron's extravagancies in rewarding deal-makers before Enron ever received any profit whatsoever. A good deal for Wing, a bad deal for Enron and its stockholders. Enron was a goose that was laying golden eggs, and soon every Enron big shot was standing at the door to get the golden egg.

### **Rebecca Mark**

A Wing protégé, and his lover, Rebecca Mark wanted to make a name for herself in Enron's international business. She was gorgeous, earthy, smart, and used her sexuality on more than one occasions to enhance her business career. She was Enron's rock star. It is an acknowledged fact that she used both her brains and her backside to enhance her career at Enron.

She had begun her career in 1985, left to go to Harvard Business School on Enron's ticket, and returned in 1988. She had experience with the Tee-Side Project in England. When Enron created Enron Development Corporation in 1991, Mark was named the CEO. She worked

on projects from South America to the Middle East. But the crown jewel of her career at Enron, her passion, and ultimately her downfall, was the construction of a power plant in a remote part of India that was one of the legendary stopping points for Sinbad the Sailor, a place called Dabhol.

India is a very risky country for foreign investors. The government is unstable. Politics are in constant turmoil. There is no assurance that if India nationalized business of a foreign investor that its investment would be returned. India had a long history of despising foreign investors and not honoring contracts. Unfortunately, Enron's excursions into India proved that India's attitude and treatment of foreign investors was well deserved.

The project was going to cost \$2.9 billion, and it was going to be constructed in two phases. Initially, the Indian government was excited about the Enron project; the government visualized that upon completion it would provide a reliable source of power that would attract new foreign investments to the western coast of India.

There were two key questions that Mark never fully addressed: did India really need the power, the answer to which was yes; the second, and most importantly, could India pay for it? The answer was probably not. Mark forged ahead despite no concrete answers to these troubling

questions. In December 1993, the Indian government signed a contract that required it to pay Enron \$1.3 billion per year or about \$26,000,000,000 over the life of a 20-year contract. It was the largest contract ever signed anywhere on the globe. The deal was really too good to be true, and in fact, ultimately it soured and was, in fact, too good to be true.

Phase 1 of the project started in December 1993, but before it generated a dollars worth of power, a new Indian government took office, and it refused to honor its contract with Enron. Undeterred, Mark pushed forward, and with the help of her friends in the Clinton Administration in 1996, the Indians approved the construction of Phase II before the completion of Phase I, all of which earned Mark a total compensation of \$25.7 million and made her a famous international business woman. She considered herself a candidate to succeed Lay as CEO. But it was not to be. She lost out to Skilling, her arch rival. By July 2001, the Indians had stopped paying Enron for the electricity from Dabhol. Mark was to make one last splash as CEO of an Enron venture, Azuric, a company organized to buy water companies and sell water. This venture also turned sour; another disaster. More about Mark and Azuric later.

### **Enron's Friends**

In 1993. Enron announced it was hiring James A. Baker, the former secretary of state under George the First's Administration, and Robert Mosbacher, the former secretary of commerce. Just several months after he left office, Baker tried to sell Kuwait on the merits of a 400 mega-watt power plant for Enron to build near the city of Kuwait. In addition, Baker pushed for Enron projects in Turkey, Qatar and Turkmenistan. When asked about the propriety of hiring former members of the Bush administration who had been involved with the war in Kuwait, Lay answered, "Is there any reason American companies should not profit from the war in Kuwait. What's wrong with hiring former American officials to encourage investments anywhere in the world? Jim Baker has given us some very helpful advise to be more competitive in the world. I ask you, what in the hell is wrong with that?"

But Lay did not back off from criticism. Within five weeks after the end of her tenure on the Commodity Futures Trading Commission, Enron hired Wendy Lee Graham, the wife of the Texas senator. Lay announced her hiring by saying, "Experience in financial and commodities market will prove extremely valuable to Enron." What Lay did not say was that Wendy Graham had nursed passage through the FTC of a federal rule that exempted energy derivative contracts

from federal regulations - an area that was rapidly becoming one of Enron's most profitable businesses.

Enron donated \$2 million to President Bush's 2000 campaign; and strongly encouraged its employees to support Bush financially. Karl Rove was a stockholder. He sold his interest for \$250,000 in early 2001.

### **Derivatives**

Sparing everyone the details, in layman's terms derivatives are like stock options: known as puts and calls. A call is an option to buy at a fixed price, and a put is an option to sell at a fixed price. It is a common practice in the stock market. In Enron's derivative business, Enron sold puts and calls to its industrial customers. For example, a utility company could buy a call option from Enron that allowed the utility to buy 1,000,000 cubic feet of gas per day for a period of one year at a fixed price. With the option, the utility could make a more accurate forecast about its revenues and cash flow. In other words, the utility was hedging its price risk. The utility was spending a little money for an option from Enron that protected it in case natural gas prices soared.

Enron entered a myriad of other derivatives; Forward Contracts, Futures, Energy Swaps; Interest Rate Swaps; even derivatives to protect against inclement weather. Enron could buy and sell these complex contracts in competition with the big boys like City Bank, and Morgan-Stanley. But unlike Wall Street firms, Enron did not have to get a securities license, thanks to Wendy Graham. In essence, Enron operated its own derivative exchange. But unlike exchanges such as the New York Mercantile Exchange or the Chicago Board of Trade, both of which have collateral requirements, Enron could set its own standards, a fact that would allow it to become one of the key players in the burgeoning multi-trillion dollar over-the-counter derivative market. But like so many of its other projects and businesses, its derivative business went sour, and this risky business was one of the most significant factors in Enron's down fall.

### **Rich Kinder**

During the 1990's, under the leadership of Rich Kinder, a no-nonsense doctor of discipline in both finances and project management, Enron grew steadily. Revenues climbed from \$5.3 billion in 1990 to \$5.7 billion in 1991. By 1996, Enron had almost \$13.3 billion in assets. Profits rose each year, and by 1996 profits were \$584,000,000.

Kinder held each business unit to exacting standards. If a pipeline president said he would achieve a 17% profit, Kinder demanded that the target be met. Kinder hired top notch, expert managers in their field.

Enron's cash cow was its pipeline business. These were run by an experienced pipeliners. They made real profits. Enron had a booming business trading oil and gas; it explored and produced natural gas; it was building cogeneration plants like Tee Side. Kinder appeared to be Lay's successor. But Kinder had a zipper problem like so many of the Enron executives. He was engaged in an affair with Ken Lay's executive assistant, Nancy McNeil. The strain of this affair caused a rift between Kinder and Lay and with Enron's Board. In 1996 he was given his walking papers, but Kinder did not need to go to a halfway house. His severance included vacation pay of \$100,000, \$1.1 million in severance, \$3.8 million in loan forgiveness, and over \$30,000,000.00 in stock options.

### **Skilling Becomes COO**

Kinder's departure was to prove to be the beginning of the undoing of Enron. Kinder was probably the best operations' man in the energy business. Now Lay was forced to move Jeff Skilling out of Enron trading, a position in which he thrived, and into the position of the chief

operating officer. Lay was out of the day-to-day management of Enron; he was busy rubbing elbows with the Bushs, the Clintons, and European politicians. With Skilling at the helm, the discipline associated with Kinder was replaced with unbridled aggression and profligate spending. Skilling traders became the heroes, and the old pipeliners were considered dinosaurs. New hotshots with MBA's from Ivy League schools replaced the old employees who knew how to get gas through the pipelines. By the end of 1997, Skilling's first year as COO, Enron's cash position was wretched, and it would get worse. Skilling spent money he did not have; he had an unlimited budget; and he spared no expense: \$2,000,000 on flowers, company planes, plus first-class airfare, first-class hotels, limousines, new computers, palm pilots, art, and new employees by the boatload. When Kinder left in 1996, there were 7,500 employees; by the end of 1997 Enron had over 15,000 employees. There was no way that Enron's cash position was going to improve under Skilling's mark-to-market accounting. Every time an Enron trader booked a big power plant deal or gas trade, Enron booked a huge profit, very little of which was cash and paid a gigantic bonus. One auditor later said the excess was obscene. "We were just pissing away money."

From the day Skilling took office, cash flow from operations was negative. By the end of 1997, Skilling's first year as COO, Enron had a negative cash flow of a whopping \$5.88 million. Cash flow was also negatively impacted by the implosion of bad business deals. For example, Enron was engaged in lawsuits involving the Tee-Side contract. Enron was ordered to pay \$440,000,000 to the North Sea Oil Companies for violation of the take-or-pay contracts that were negotiated by Wing and Mark.

### **Andy Fastow**

In 1997, Skilling realized he had to do something to shore up Enron's cash shortage and profit position. He needed to get debt off of Enron's books. He turned to a young, cocky, financial wizard, Andy Fastow. Fastow realized the easiest way to keep debt off Enron's books was to put the debt on somebody else's books. Fastow turned to tax shelters known as a special purpose entity (SPE), taking the form of joint ventures and limited partnerships of various kinds.

Under accounting rules a SPE qualifies as wholly independent of Enron if it satisfied three simple tests: (1) at least 3% of the SPE equity would come from outside (that is non-Enron investors); (2) the SPE could not be controlled by Enron; (3) Enron was not liable for any loans or other liabilities of the SPE.

Employing this concept time after time, Fastow constructed extraordinarily complex and convoluted series of transactions designed to remove debts from its balance sheet, but at the same time exposed Enron to financial ruin.

Fastow's first use of the SPE arose from a joint venture with the California Public Employees Retirement System (Calpers). Calpers wanted out of the joint venture with Enron, a demand that exposed Enron to hundreds of millions of dollars in payments to Calpers. Skilling panicked, but Fastow came to his rescue. He created CHEWCO to take out Calpers from the joint venture, and at the same time kept this obligation off Enron's balance sheets. The transaction is much too complicated to include in this paper, but I have attached a diagram of the CHEWCO transaction. You can take this home and study it yourself at your leisure. The CHEWCO transaction was presented to the Board, and with a favorable opinion from its law firm, Davis and Elkins, the Board approved the deal. No member of the Board understood CHEWCO either.

When the CHEWCO deal was approved by the Board, Skilling and Fastow were off to the races without a bridle. Fastow constructed a myriad of off balance sheet deals with names like LJM, Osprey, Whitewings, and Rapture. Fastow had started Enron down a slippery slope,

but no one in authority, Lays, Skilling or the Board, seemed to care, or at least were oblivious to the dire financial consequences of SPE. Why should they, Enron's stock was ascending faster than a dove and everybody was making lots of money.

By mid-1999, Skilling and Fastow had set up several SPE's that functioned as parking lots for Enron where it could stow and retrieve assets. The assets and debts of the SPE were hidden from Wall Street because the SPE's would not be owned by Enron; and their debts and assets would not be shown on Enron's balance sheet. In many instances, Fastow and the Enron Board ignored the basic accounting rules so that the SPE did not qualify as independent of Enron – nobody cared or was concerned.

An example: LJM-1. It was controlled by Fastow, and he managed all its investments. This violated the accounting principle that the SPE could not be controlled by Enron. Yet, Lay brought Fastow's proposal to the Enron Board of Directors and after a short debate, the Board agreed to waive Enron's ethics' policies which prohibited Enron's officers from doing deals directly with the company. The Board approved the LJM deal. This approval gave Fastow the green light to continue his shenanigans. Each SPE moved debt and risky investment off Enron's balance sheets. Fastow's chicanery was never challenged by Wall Street analysts. Enron stock

in September 2000 reached an all time high of \$96.00 a share. Better yet for Fastow, he pocketed a huge bonus; (some have estimated Fastow's total compensation over this period at about \$100 million). Not surprisingly, he represented the seller, Enron, and the buyer, the SPE, that he had formed, and he determined the price of the sale of Enron's assets to the SPE, and he profited on both sides of the deal.

A common thread in all of Enron's SPE would be another contributing factor to its collapse. In each transaction, Enron guaranteed that if any of its assets transferred to a SPE were sold at a loss, Enron would make up the shortfall to the SPE by the issuance of shares of its common stock. This pledge looked great when Enron's stock was at 96; however, this guarantee became a disaster when Enron's stock began to fall and eventually lost its value in the marketplace.

Enron began buying and selling derivatives that were based on the value of its own stock. Derivatives are risky, but trading derivatives that are predicated on the value of your own stock is like playing Russian roulette. These transactions are too complex for me to understand, much less explain. (I don't feel bad because most Wall Street bankers did not understand them either.) I have included another chart which you may study at your leisure.

LJM-2 followed LJM-1. Unbelievably, the Enron Board approved what was essentially an open-ended transaction with which Fastow could do multiple transactions with Enron's assets. Fastow was the general partner of LJM-2; LJM-2 raised over \$200,000,000 from limited partners who would agree to invest in Enron's assets. In effect, Enron was selling its assets to LJM-2 at a price that was negotiated by Fastow as representative of both the seller – Enron, and the buyer of the assets – LJM-2.

Enron's Board approved the LJM-2 on the theory that there would be controls to harness Fastow's inherent conflict of interest – all deals between Enron and LJM-2 would have to be approved by Rick Causey, Enron's chief accounting officer, and Rick Buy, the company's chief risk officer. The rationale for approval by Board was that LJM-2 would be a potential ready purchaser of Enron's businesses and assets, and it would provide liquidity, risk management and other financial benefits to Enron. Over the next two years, Fastow made huge profits in compensation when Enron sold assets to LJM-2 and as a general partner of LJM-2. This was the ultimate win-win situation for Andy Fastow. Enron's Board never asked any questions until it was too late. They had no idea of the amount of money Fastow was profiting from these transactions until it was too late.

## Azuric

Another Enron venture proved to be a disaster. To get Rebecca Mark away from her arch rival, Jeff Skilling (they hated each other), Enron formed a company called Azuric. The initial public offering was \$695,000,000. It was organized to buy water companies and provide water all over the world. The water business was far more difficult than Rebecca Mark ever imagined. It was another money-losing project for Enron from the beginning. Competition, particularly from old time French companies, was stiff, and its competition had more experience in the business. Mark had convinced Lay that Enron could capture water contracts in Europe, Latin and Asia that would compliment their existing energy business. It was not to be. Water is a different story than oil and gas. It has different political and social sensibilities than gas and electricity. Water has religious, nationalistic, and political overtones in every region of the world. And unlike gas and power, people are not willing to pay high prices for it. Water is viewed as a birthright, not a luxury. Towns, cities and countries are willing to hire activists, lawyers and even armies to protect what they view as their water. As Mark Twain wrote, “Whiskey’s for drinking, water’s for fighting.” By 2000, Azurix losses became a geyser. In August, 2000, Mark resigned as chairman and CEO of Azurix and gave up her seat on the Enron

Board of Directors. But do not feel sorry for her. She sold 104,000 of Enron's shares that brought her total stock sale proceeds to \$82.5 million. She left Enron rich, still gorgeous and comfortably settled in River Oaks with a new husband.

### **Broadband/Ken Rice ✓**

Enron saw a great opportunity to enter the broadband business. Again, another disaster.

Basically, broadband is the trading of time and space on the internet through fiber optics.

Skilling and Lay, the smartest guys in the room, thought Enron would change the fundamentals of the internet business. Their competition would be run out of business. It was not to happen.

Lay's old friend, Ken Rice, was appointed President of Enron Broadband Services in 2000. Rice was already rich, and he did not work very hard at this business. He spent most of his time racing Ferrari cars and going on vacations. Within a year, Enron Broadband was insolvent.

### **The Trading Game and a September High**

Yet in 2000, Skilling was going strong, and Enron was the darling of Wall Street. Enron was no longer the stogie slow-going pipeline business entity that transported gas and generated a lot of electricity. Enron had become a trading company, a fast paced trading culture in which

deals were the driving force behind Enron's business. But there was one big problem. Enron was making no money from the trading business. And it generally generated no cash flow.

Here was the problem. Enron was the principle in every transaction; this made it very expensive to Enron. Here's how it worked. If a seller of natural gas agreed on Enron's price, that seller could sell the gas immediately to Enron. Enron would then take title to the gas and then try and sell it to another party. With \$7,000,000,000 of trades everyday, and being the middle man in every transaction, Enron necessarily would have to hold some of the gas for days and even weeks before it could get the price it wanted to resell the gas. That meant that Enron had to have billions of dollars in cash and required lots of credits from its bankers. And everyday that Enron held onto a big position in a commodity such as gas it had to pay interest on the money it borrowed to take the position. In the first six months of 2000, Enron borrowed \$3.4 billion to finance its operations. However, Enron's cash flow from operation was a negative \$547,000,000. Enron was losing money, real money, and interest expenses were eating them alive. By the end of June 2000, Enron was paying about \$2,000,000 per day in interest to banks and other lenders. Fortunately, Skilling was able to make Enron's revenue look great with surging revenue due to the illusion of mark-to-market accounting. For the first six months of the

year 2000, Enron's revenues totaled \$30 billion, but it had a negative cash flow. But Skilling never worried about costs; he was only concerned about revenue.

Enron's stock hit an all-time high of over \$96.00 per share in the fall of 2000. Wall Street was happy, and the banks were falling over themselves to lend money. In return, Wall Street investment bankers expected to provide Enron with investment banking services which carried huge fees and commissions. The word was out on Wall Street, "if you wanted to do investment banking with Enron, your analyst had to have a strong buy rating on the stock."

Arthur Anderson was in Enron's pocket. In 1999, Anderson billed Enron over \$46,000,000 for auditing, consulting and tax work. By 2000, that figure had risen to \$52,000,000. Enron knew it could control, Anderson, and it did.

In 2000, seven percent of Enron's total revenue, \$7.2 billion, came from its derivative business. Of the \$65 billion in assets Enron claimed on its balance sheet, nearly one-third of the assets - \$21 billion were financial derivatives. In 1996, when Rich Kinder was the CEO, Enron had just \$2.7 billion in assets from derivatives.

How was it possible for Enron to grow its assets from derivatives?

Well, the answer is simple, Enron made it up. There are no government set rules for reporting derivatives, thanks, in part, to Enron's good friend, Wendy Graham. Enron could do whatever they wanted to in calculating the value of derivatives. Enron could create billions of dollars in revenue by simply changing a few assumptions about the value of its derivative contracts. If Enron needed more revenue to prop up its financial statements, it simply adjusted the price on some of its contracts.

There was only one check on this derivative craziness; Arthur Anderson. But as one top Enron executive put it: "Anderson was a rubber stamp."

Enron reported \$101 billion in revenue in 2000, up from \$40 billion in 1996. Wall Street obsessed with revenue growth, not profits, was both impressed and gideously excited; what was good for Enron, was good for Wall Street.

### **Cracks in the Wall**

In 2001, while most of Wall Street was catering to Enron, because they wanted their investment banking business, several analysts began to question whether Enron's stock was headed towards \$125.00 per share, as predicted by Skilling. Other reports raised questions whether Enron was worth the \$73.00 per share, its price as of February 1, 2001.

Skilling became CEO of Enron in February 2001, and he became primarily responsible for conducting the regular conference calls with Wall Street bankers. On a conference call on April 17, 2001, while most bankers were prefacing their questions with congratulatory remarks about Enron revenues that had escalated to \$50.1 billion, a doubting Thomas, Richard Grubman, asked Skilling why Enron did not provide the analysts with more information prior to the conference call. When Skilling replied that Enron had never provided cash flow statements before a conference call, Grubman was not satisfied. "You're the only financial institution that can not produce a balance sheet or a cash flow statement with their earnings"

Skilling replied, "Why thank you, we appreciate that, asshole."

The analysts were stunned. Corporate bosses did not call analysts an asshole. It was a tip to the analysts that they should be paying more attention to Enron's constant predictions of ever increasing revenues. It was the beginning of the end for Skilling. On May 29, 2001, Enron's closing price: \$53.00. There was growing concern among analysts and energy watchers that Enron's stock was inflated, and that its financial reports could not be relied upon.

July 13, 2001, Enron's closing price was \$48.00. The day before Enron had reported that its broadband business had lost \$102,000,000 on revenues of just \$16,000,000. Unfazed,

Enron's managers predicted that Enron was going to rule the world of broadband. It was a ridiculous statement, but this attitude reflected the culture at Enron. No matter what may be occurring in the real world, Enron was going to continue to grow. But the facts revealed the truth. The Dabhol project had collapsed. The Indians had stopped paying. Its water company, Azuric, had failed, costing Enron \$325 million. The broadband venture had gone belly-up. It was now worthless. To support its trading business, Enron had had spent millions of dollars buying paper mills that were now useless in Enron's trading business; and their many other ventures had gone sour.

Enron was also running out of the ability to manufacture cash from deals known as prepays. Prepays were complicated - a way to hide debt. In simple terms, Enron would sell long-term commodity contracts, such as gas, that it signed with customers to investment bankers. In turn, investment bankers would immediately give Enron cash for these contracts. The only problem was that Enron was obligated to repurchase the gas from the investment bankers. It was nothing more than a concealed loan, but it allowed Enron to raise cash without adding debt to its balance sheet.

## Skilling Resigns

Unexpectedly, on July 13, 2001, Skilling resigned. Lay was shocked, “why resign,” he asked. It is about my family, the children. Bull.

Skilling realized that Enron’s falling stock prices spelled disaster for Enron. Enron was in its worst cash crisis ever. By the end of June, Enron’s cash flow from operations was a negative \$1.3 billion, and it had to borrow \$1.7 billion just to keep the doors open. Enron was paying \$2.3 million per day in interest.

Skilling also knew that two of its SPE’s, Whitewing and Osprey, were going to have a dramatic effect on Enron’s stock value. Again, these were complicated transactions, but the problem was that Enron was on the hook for the debts of Whitewing and Osprey if their assets (really Enron’s assets) fell in value. Not only did Enron have to issue additional shares of its stock if the SPE sold assets at a loss, Enron was required to distribute extra Enron stock to the investors in these SPE’s if Enron’s stock fell below \$48.55. If Enron had to issue stock to prop up Whitewing and Osprey’s entities, the additional stock would further dilute the value of existing stockholders, leading inevitably to further decreases in Enron’s stock. In turn, the stock analysts would downgrade Enron; no more buy recommendation. Enron stock would be

hammered; Enron's financial house of cards that Skilling and Fastow had built in order to hide debt and pump up Enron's profits was crumbling; Skilling saw it, and he wanted out before the "shit" hit the fan.

Lay must have realized what was happening too. Lay had been selling Enron stock on a regular basis through 2001. In the two weeks prior to his meeting with Skilling, Lay sold 31,500 shares of Enron.

On July 13, the day Skilling resigned, he sold another 3,500 shares and pocketed over \$104,000.00. Lay continued selling 3,500 share a day for the next few days. On July 20, he sold a total of 78,500 shares for a one day gain of over \$2.1 million. Skilling was also bailing out to the tune of approximately \$100 million, and this was before Lay or Skilling had heard of a woman named Sherron Watkins.

### **Sherron Watkins**

Skilling's resignation was made public on August 15, 2001. Enron's stock price was \$40.25, but his explanation that he was leaving to spend more time with his family did not make sense. He was divorced, and he had never been considered much of a family man. He was

walking away from a \$10 million pay package. Stock analysts were puzzled. With the announcement of Skilling's resignation, Enron's stock price fell another six percent.

Sharon Watkins did not believe any of Skilling's explanations. Watkins was an eight year veteran of Enron, and a typical employee - smart, aggressive, and not timid about speaking her mind. She worked for Andy Fastow, and she had many questions about Enron's weird accounting procedures.

The day Skilling quit, Watkins sent to Lay an anonymous one page letter. She told Lay that Skilling knew that his accounting tricks were going to kill Enron, and he would rather abandon ship now than resign in shame in two years. She expressed concern about one particular SPE known as Raptures. She concluded by saying "I am incredibly nervous that we will implode in a wave of accounting scandals." What a prophetic statement.

On August 22, Lay met with Watkins. Before this meeting, she had written another longer memo that was both prescient and concise. She laid out the problems with the off balance sheet entities. Watkins addressed Fastow's bastard financing head on. "Is there any way our accounting guru can unwind these deals now. I have thought and thought about a way to do this, but I keep bumping into one big problem. We booked the Condor and Rapture deals in 1999 and

2000; we enjoyed a wonderfully high stock price; we then tried to reverse and fix the deals of 2001. It is a bit like robbing the bank one year and trying to pay it back two years later. Nice try, but investors were hurt; they bought at \$70 and \$80 a share looking for \$120 a share and now they are at \$38.00 or worse. We are under too much scrutiny, and there are probably one or two disgruntled employees who know enough about the funny accounting to get us in trouble.”

Watkins’ letter to Lay proved to be a pivotal event in the collapse of Enron. She had exposed Andy Fastow and his partnerships; ones that were designed to make Fastow rich while hiding Enron’s debts and bad deals.

When Fastow heard about Watkins’ meeting with Lay, he went berserk. He stormed into Watkins’ work area and told her immediate supervisor: “I want that bitch out of her tonight.”

Lay made a half-hearted attempt to investigate Watkins’ allegations. Although Watkins advised Lay to hire an independent law firm, Lay contacted Enron’s long time law firm, Davis & Elkins, to look into Watkins’ charges. After a few weeks, Davis & Elkins assured Lay that the off balance sheet matters were not a problem. This was not a surprise because Davis & Elkins had helped Enron set up many of the partnerships.

Lay continued to cash out. On August 21, the day before he met Watkins, Lay emailed all company employees: “as I mentioned at an employee meeting, one of my biggest priorities is to restore investor confidence at Enron. This should result in significantly higher stock price.” That same day, Lay sold over 60,000 shares of Enron netting himself over \$1 million; the day before he had sold 25,000 shares, pocketing about \$387,000.

### **Raptors – Back to the Beginning**

October 16, 2001, Enron was out of cash, and it was desperate. On this day, Lay stunned Wall Street by announcing Enron had lost \$618,000,000 in the third quarter, a result of Enron’s decision to write off over \$1 billion in bad investments (Dabhol, Azuric, etc.) There was more. Lay casually dropped another bombshell: Enron was taking a \$1.2 billion reduction in stockholder equity. A SPE known as Raptors was totally insolvent. Enron had pledged about a billion dollars worth of its stock to Raptors. Raptors used Enron stock to hedge against possible decline in the assets Raptors had bought from Enron. In return, Raptors had given Enron a promissory note of \$1,000,000,000 to repay a \$1,000,000,000 stock loan from Enron. But Enron’s accountants made a big mistake by banking the Raptors note as an addition to Enron’s shareholder equity. The lending of Enron stock to Raptors was not an asset; it was a liability,

and the promissory note should have been a reduction to Enron's equity. Still, an Enron lackey told the Wall Streeters that the loss of equity was "just a balance sheet issue."

The credit rating agencies didn't buy it. They were closely scrutinizing Enron's finances, and it was only a matter of time before they were going to downgrade Enron's long range debt.

Enron's final death spiral had begun, and this time there was no way to go but down.

On October 17, Enron froze all the assets in the Enron Corporation's savings plan, telling employees that it was freezing the assets because it was changing the administrators of the retirement plan. In December, 2000, the plan contained \$2.1 billion in assets, 62% of which was invested in Enron stock. By November 19, 2000, the value of Enron stock had fallen to \$9.06 and thousands of the company's employees had lost the bulk of their life savings.

On October 19, 2001, the Wall Street Journal reported that Fastow had realized more than \$11 million from management fees and capital appreciation of his special purpose entities. Lay didn't know what to do about the bad publicity. The Board met but took no action against Fastow. Enron's inaction coupled with its silence about the bad publicity drove Enron stock to \$26.05.

On October 23, 2001, Enron announced that the SEC had begun an investigation of Enron and Fastow's partnerships. Enron's stock price fell 21% to \$20.65. The same day, Milberg Weiss, one of the most aggressive plaintiff's class action law firms sued Enron alleging that Lay, Fastow and others had failed to disclose material information to its stockholders. But on this same day in a meeting with Enron's sixty top managers, Lay assured them that everything was going to be fine, and reconfirmed his support for Fastow saying he had done nothing wrong. But Lay's sales pitch didn't work. Many of Enron's top managers said Fastow had to go. An Enron inside accountant, Vince Kaminski, who never bought into mark to market accounting, called Fastow's deals, "terminally stupid."

Lay was adrift. Skilling had gone, and the new president, Whaley, was inexperienced and could offer him no good advice. Lay scheduled another conference call with Wall Street for the morning of October 23 to defend Fastow and insure that no conflicts existed between Fastow's dual roles inside the Enron company. It didn't work. One analyst, a longtime friend, told Lay, "There is an appearance that you are hiding something." Lay continued to defend Fastow, ended the meeting by telling the analyst, "I and Enron's Board of Directors continue to have the highest faith and confidence in Andy and think he's doing an outstanding job as CFO."

But the analysts did not let up. They wanted more information about these special SPE's, naming Whitewing, Osprey and Marlin. Each SPE had different price trigger points which required Enron to issue more stock to cover any losses incurred by the limited partners in the SPE if Enron stock fell below a certain price. Enron's chief antagonist was Skilling's good friend, Richard "Asshole" Grubman. From Grubman's research, Enron would have to find about \$1,000,000,000 to pay off debts of one special purpose entity known as Marlin. Lay denied it, and said Grubman's figures were wrong. Grubman's figures were not wrong.

On October 24, 2001, two Enron Board members asked Fastow how much money he had made from LJM-1 and LJM-2. "About \$45,000,000," Fastow replied. They were stunned. They had no idea that in two years Fastow had amassed such a fortune: Fastow's total take from Enron over three years from salary, bonuses, commissions, and stock options was about \$100 million.

These directors told Lay about this incredible fortune that Fastow has amassed. Lay didn't call a conference call of Wall Street analysts. Instead, on October 24, he issued a six-paragraph press release saying that Fastow was taking a leave of absence, and he would be replaced by Jeff McMahon as the Enron CFO. Fortunes Magazine "CFO of the Year" in 2000

was now a displaced person in corporate finance. On October 29, Moody's cut Enron's credit rating 2 notches above junk status. Enron's stock fell to \$13.81.

Ken Lay was desperate. He tried to call in political IOU's for a government bailout.

Greenspan would not go along. Lay approached Dynergy to try a merger, Enron's last hope for survival. In the proposed deal, Dynergy was going to buy Enron for about \$9 billion in stock.

The merger was announced to Wall Street on November 8, 2001. This same date that Enron

announced that it had overstated its profits by a total of nearly \$6,000,000 since 1997. In 1997,

Skilling's first year, Enron made \$9,000,000, but reported \$105,000,000. In 1998, the off

balance sheet deals had allowed Enron to overstate its profits by \$113,000,000; the 1999 profits

were too high by \$250,000,000, and the 2000 profits by \$132,000,000. Believe it or not, Wall

Street liked the restatement because it was accompanied that the news that Dynergy was going to

buy the company for \$9,000,000,000. In fact as a result, on November 14, Enron's stock closed

at \$10 a share, its highest level since November 5.

Then came the killer. On November 19, Enron had to restate its profits once more. Its

financial reports filed with the SEC showed that Enron was restating its third quarter financial

results for the second time in 11 days. It admitted that it had lost \$618,000,000 in the third

quarter of 2001. It also disclosed that on November 12, Standard & Poore had downgraded its debt to a notch below junk status. It in turn caused an Enron note in the amount of \$690,000,000 to become a demand obligation on November 27. This meant that if Enron could not come up with \$690,000,000 in cash by November 27, the owner of the promissory note (Enron never said who it was) could go in and seize Enron's assets.

The November 9 filing with the SEC stunned Chuck Watson, the head of Dynergy. The Dynergy deal fell through, and on December 2, 2001, Enron filed for bankruptcy – sadly it had \$16 billion in debt and \$2 billion in cash – it was the largest corporate bankruptcy in American history.

What does the collapse of Enron have to say about American business in the 21 century?

Enron is not an isolated corporate debacle. World Com's bankruptcy in 2002 was larger than Enron's. Who can an investor or stockholder trust? Do corporate executives go blind to their fiduciary duty (and what is right or wrong) from gigantic salaries, stock options, and bonuses.

Where were the directors? What responsibility do they bear? Are corporate executives of multinational corporations the EVERY MAN OF THE 21 CENTURY. You may recall the medieval morality play Every Man: it begins as follows: the Lord God looks down on Every Man from on

high. He sees that Every Man in his seeking for riches and pleasures has forgotten God and He is much displeased. He calls his messenger, Death, and bids him take to Every Man the message that he must go on a long journey; that he must prepare to make his accounting before the Almighty God.

Every Man is loathed to leave this Earth. He pleads that he is not ready and offers Death a thousand pounds if Death will reprieve him. Death refuses saying that all the riches in the world might be his if he were open to such bribes. Every Man next inquires if he will be allowed to return after he has rendered his account to Almighty God. Death assures him that from the place to which he is going there is no returning.

**KEY PLAYERS**

**FINANCIAL PLAYERS | POLITICAL PLAYERS**

**Kenneth L. Lay, former Enron Chairman and CEO (resigned Jan. 23, 2002)**

Lay and Enron poured millions of dollars into both political parties, cultivating access and using the entree to lobby Congress, the White House and regulatory agencies for action that was critical to the energy company's spectacular growth. In addition to being one of the single largest financial backers of President George W. Bush's political career, Lay is also one of the president's friends.



With the exception of a six-month period in 2001 when he relinquished the CEO title to his successor, Jeffrey Skilling, Lay held the top two positions in the company since February 1986 until January 2002. Lay was named to the position of CEO in February 1986, following the merger of Houston Natural Gas and InterNorth, Inc. in July 1985.



**Andrew Fastow, former Enron Chief Financial Officer (ousted Oct. 24, 2001)**

Fastow was removed as Enron's CFO on Oct. 24, 2001 as the SEC began a probe into conflicts of interest in two partnerships he created and managed. Those partnerships earned him around \$30 million in management fees from the deals in addition to his Enron salary. In October 2002, Fastow was charged and indicted on 78 counts of securities, wire and mail fraud, money laundering and conspiring to inflate Enron's profit.

Fastow was named CFO in March 1998. Prior to that he was senior vice president of finance.

**Michael J. Kopper, former Enron director in global finance unit**

Kopper served as a right-hand man to Fastow and was the architect of many of the off-balance-sheet partnerships that concealed millions in Enron debt. Fastow and Kopper allegedly helped three British bankers defraud their employer, National Westminster Bank PLC, of more than \$7 million in connection with a stake in an Enron-related partnership in 2000.

Kopper and his domestic partner, William D. Dodson, reaped \$10.5 million based on a \$125,000 investment in a partnership called Chewco, according to an investigative report issued by Enron's board of directors.

Kopper left the company in June 2001 and separately collected hundreds of thousands of dollars in salary and bonuses during his seven-year tenure at Enron - as well as six-figure annual fees for managing the partnerships.

In August 2002, Kopper pleaded guilty to financial wrongdoing and agreed to surrender \$12 million in the first criminal case against a company official.

Kopper, 37, is a native of New York's Long Island who attended Duke University and the London School of Economics.

**Greg Whalley, former Enron President and Chief Operating Officer (resigned Jan. 28, 2002)**

The Treasury Department disclosed that Enron President Lawrence "Greg" Whalley had "six to eight" conversations last fall with Treasury Undersecretary Peter Fisher, including one in which he asked Fisher to call Enron's lenders as they decided whether to extend credit to the company.

Whalley was president and chief operating officer of Enron Wholesale Services. He joined Enron in 1992. Whalley holds a bachelor's degree from The United States Military Academy and an MBA from the Stanford Graduate School of Business.

**Jeffrey Skilling, former Enron Chief Executive Officer (resigned Aug. 14, 2001)**

Senior Enron executives criticized former CEO Skilling about possible conflicts of interest in two partnerships he created with former Chief Financial Officer Andrew Fastow. Jeffrey McMahon, then Enron's treasurer, was "highly vexed" about the conflicts, "complained mightily" and suggested a list of remedies.



Skilling served as the CEO of Enron for six months in 2001 before resigning for personal reasons. He joined Enron in 1990 after leading McKinsey & Company's energy and chemical consulting practices. He became president and COO in December 1996 and served on the company's board of directors

**J. Clifford Baxter, former Enron Vice Chairman (resigned May 2, 2001)**

Baxter's complaints about secret partnerships were cited in a letter to then-Chairman Kenneth L. Lay in August of 2001, by former Vice President Sherron Watkins.



Baxter was one of 29 former and current Enron executives and board members named as defendants in a federal lawsuit, after he sold 577,436 shares of Enron for \$35.2 million before Enron's collapse.

Baxter resigned as vice chairman on May 2, 2001 and at the time was credited for helping build Enron's wholesale business. He was found shot to death in a car Jan. 15, 2002, in an apparent suicide.

**Wendy L. Gramm, Enron Director**

Gramm is on Enron's Board of Directors, serving on its audit committee, a key place where accounting problems could have been aired. Gramm is married to U.S. Sen. Phil Gramm (R-Tex.)



Before joining the Mercatus Center at George Mason University as the director of regulatory studies, Gramm served as chairman of the U.S. Commodity Futures Trading Commission from 1988-1993. She was administrator for information and regulatory affairs at the Office of Management and Budget from 1985-1988, the executive director of the Presidential Task Force on Regulatory Relief, and director of the Federal Trade Commission's Bureau of Economics.

**Sherron Watkins, former Enron Vice President for Corporate Development**

According to congressional investigators Watkins is the internal whistleblower who in August of 2001, more than two months before Enron disclosed it had overstated its profits and understated its debts, warned Kenneth L. Lay that the company might "implode in a wave of accounting scandals." Shortly after Enron Chief Executive Officer Jeffrey Skilling suddenly resigned. Watkins described "a veil of secrecy" around partnerships involving the energy-trading company's former chief financial officer, Andrew Fastow. [Related Article](#)



**Arthur Andersen**

The job of Arthur Andersen, one of the nation's largest accounting firms, was to make sure investors could rely on Enron's financial statements. But Andersen also was a major business partner-soliciting and selling millions in consulting services to Enron. Andersen was also responsible for some of Enron's internal bookkeeping, and some Andersen executives ended up taking jobs at Enron.

Arthur Andersen questioned Enron about debt transferred to partnerships.

Arthur Andersen fired lead Enron auditor David Duncan after learning that he ordered the shredding of documents related to the audit. An attorney for a former employee has alleged that Enron workers continued shredding documents as recently as the second week of January.

Led by then-chief executive Joseph F. Berardino, Arthur Andersen took its case public, saying it would take "all appropriate steps" to defend its integrity. Berardino also suggested that the company might stop selling consulting services to firms it audits. Berardino has since resigned from the firm.

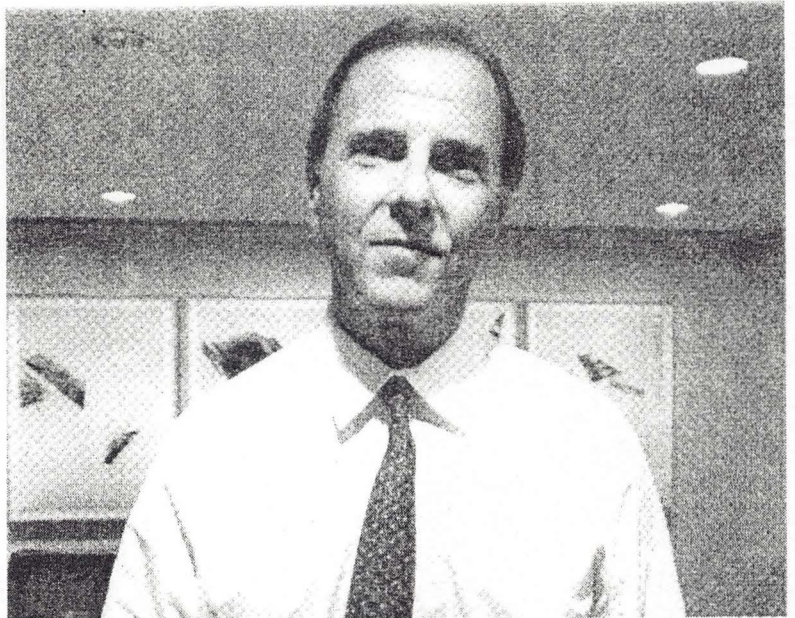
**FINANCIAL PLAYERS | POLITICAL PLAYERS**



Ken Lay in late December 2000, when Enron was on top of the world and Lay was widely viewed as a business visionary. (*Pam Francis, Sipa Press*)



Andy Fastow, the mastermind behind the financial schemes that helped bring the company down, made more than \$60 million from the two private funds he ran. *(Gamma)*

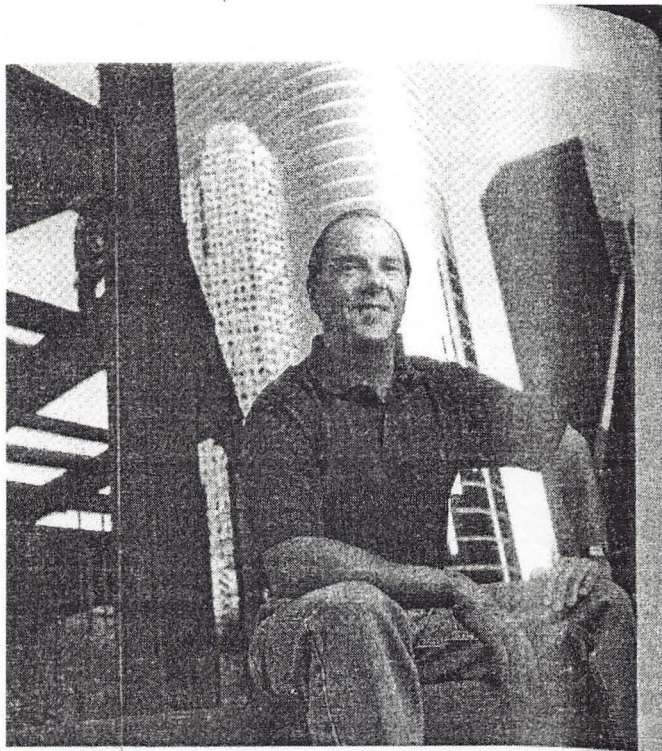


Jeff Skilling, the ruthless McKinsey & Co. consultant who became Enron's president, and later, its CEO, never doubted his own genius. After a speech to a group of analysts, Skilling said they "didn't get it. I was brilliant." *(Paul Hosefars/New York Times)*



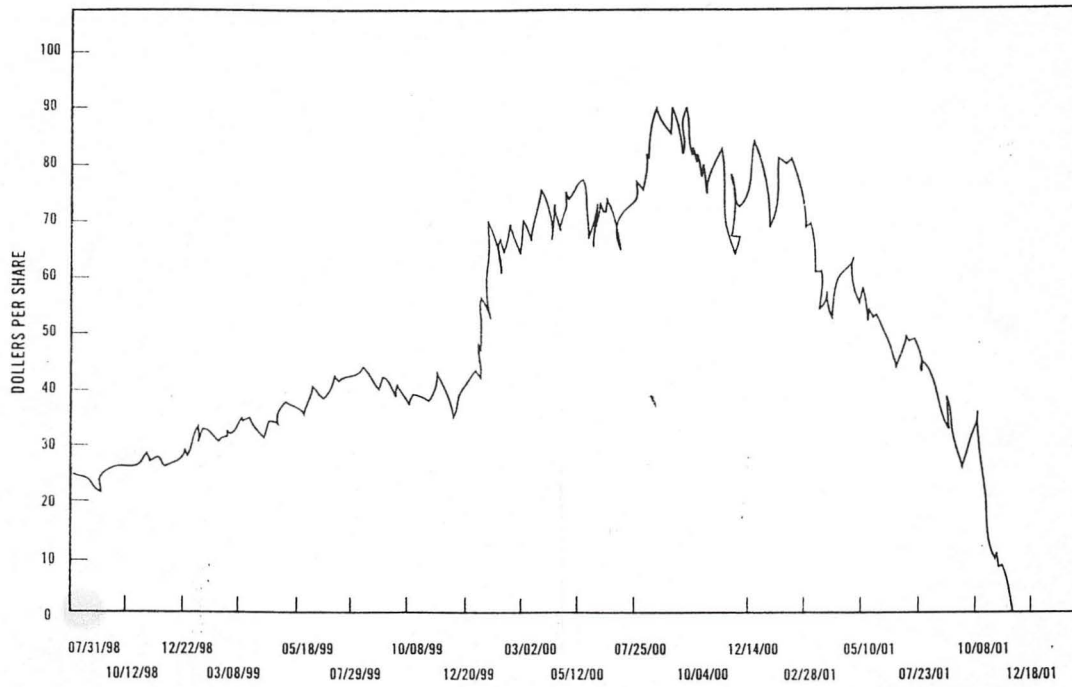
Rich Kinder, Enron's president and chief operating officer from 1990 to 1996, went on to become one of Houston's truly Big Rich.

Jeff Skilling at the height of his power and fame, outside Enron's gleaming headquarters in downtown Houston.  
*(Wyatt McSpadden)*



Rebecca Mark was Enron's most glamorous executive—and Skilling's fiercest rival.  
*(Barron Claiborne, CORBIS—Outline)*

### THE ROLLER COASTER: ENRON STOCK PRICE 1998-2001



Stock price chart

## ENRON CAST OF CHARACTERS AND THEIR STOCK SALES\*

| Name               | Position at Enron                        | Shares Sold | Gross Proceeds  |
|--------------------|--|-------------|-----------------|
| J. Clifford Baxter | Vice-Chairman                            | 619,898     | \$34,734,854    |
| Robert Belfer      | Member of Board of Directors             | 2,065,137   | \$111,941,200   |
| Norman Blake       | Member of Board of Directors             | 21,200      | \$1,705,328     |
| Rick Buy           | Chief Risk Officer                       | 140,234     | \$10,656,595    |
| Rick Causey        | Chief Accounting Officer                 | 208,940     | \$13,386,896    |
| Ronnie Chan        | Member of Board of Directors             | 8,000       | \$337,200       |
| James Derrick      | General Counsel                          | 230,660     | \$12,563,928    |
| John Duncan        | Member of Board of Directors             | 35,000      | \$2,009,700     |
| Andy Fastow        | Chief Financial Officer                  | 687,445     | \$33,675,004    |
| Joe Foy            | Member of Board of Directors             | 38,160      | \$1,639,590     |
| Mark Frevert       | Chief Executive Officer, Enron Europe    | 986,898     | \$54,831,220    |
| Wendy Gramm        | Member of Board of Directors             | 10,328      | \$278,892       |
| Kevin Hannon       | President, Enron Broadband Services      | Unknown     | Unknown         |
| Ken Harrison       | Member of Board of Directors             | 1,011,436   | \$75,416,636    |
| Joe Hirko          | CEO, Enron Communications                | 473,837     | \$35,168,721    |
| Stan Horton        | CEO, Enron Transportation                | 830,444     | \$47,371,361    |
| Robert Jaedicke    | Member of Board of Directors             | 13,360      | \$841,438       |
| Steve Kean         | Executive Vice President, Chief of Staff | 64,932      | \$5,166,414     |
| Mark Koenig        | Executive Vice President                 | 129,153     | \$9,110,466     |
| Ken Lay            | Chairman, Enron Corp.                    | 4,002,259   | \$184,494,426   |
| Charles LeMaistre  | Member of Board of Directors             | 17,344      | \$841,768       |
| Rebecca Mark       | Chief Executive Officer, Azurix          | 1,895,631   | \$82,536,737    |
| Michael McConnell  | Executive Vice President                 | 32,960      | \$2,506,311     |
| Jeff McMahan       | Treasurer                                | 39,630      | \$2,739,226     |
| Cindy Olson        | Executive Vice President                 | 83,183      | \$6,505,870     |
| Lou Pai            | CEO, Enron Energy Services               | 3,912,205   | \$270,276,065   |
| Ken Rice           | CEO, Enron Broadband Services            | 1,234,009   | \$76,825,145    |
| Jeffrey Skilling   | Chief Executive Officer, Enron Corp.     | 1,307,678   | \$70,687,199    |
| Joe Sutton         | Vice-Chairman                            | 688,996     | \$42,231,283    |
| Greg Whalley       | Chief Operating Officer, Enron Corp.     | Unknown     | Unknown         |
| TOTALS             |  | 20,788,957  | \$1,190,479,472 |

\*All listed sales occurred between October 19, 1998 and November 27, 2001. The number shown under gross proceeds indicates the number of shares times the price of Enron stock on the day the shares were sold. It does not reflect any costs the Enron officials incurred in exercising the sale of the stock. Therefore, the net proceeds to the listed individuals is likely less than the amount shown.

SOURCES: Mark Newby, et al. vs. Enron Corp., et al., Securities and Exchange Commission filings, Congressional testimony, Enron Corp. press releases.

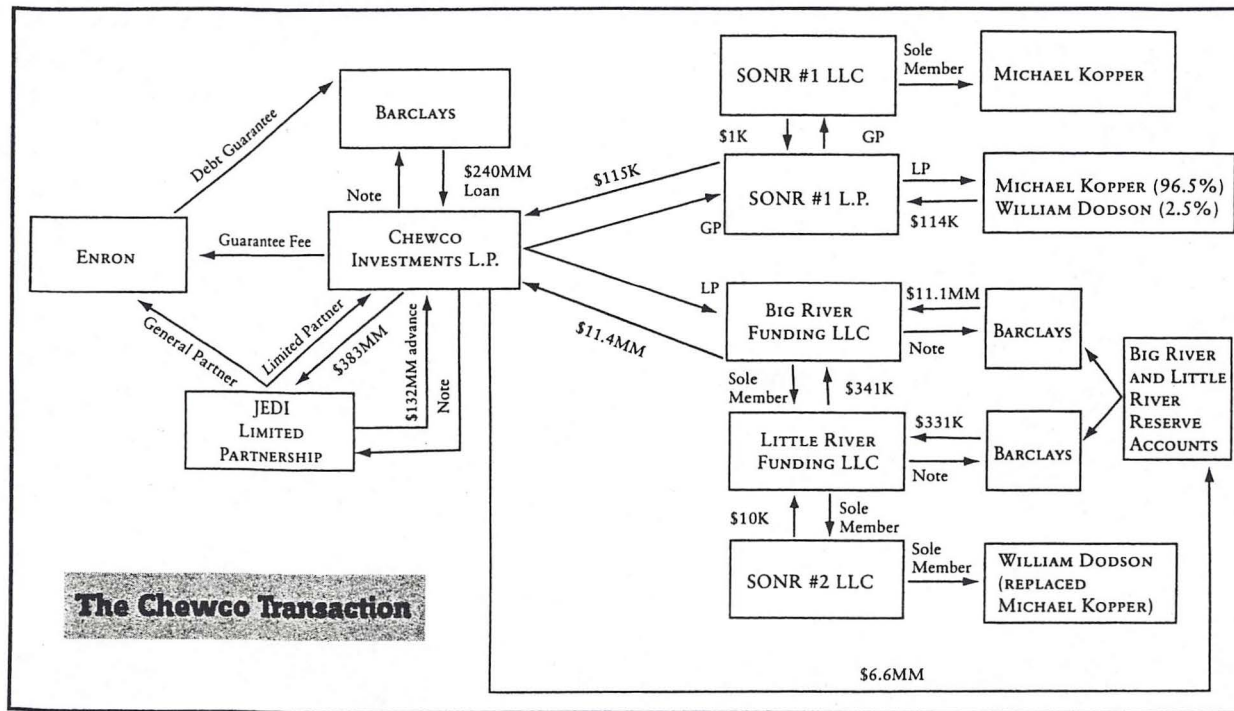


Diagram of Chewco Transaction (graph from p. 51 of the Powers Report)

SOURCE: William C. Powers, Raymond S. Troubh, Herbert S. Winokur, Jr., "Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.," Enron Corporation, February 1, 2002 (the Powers report).

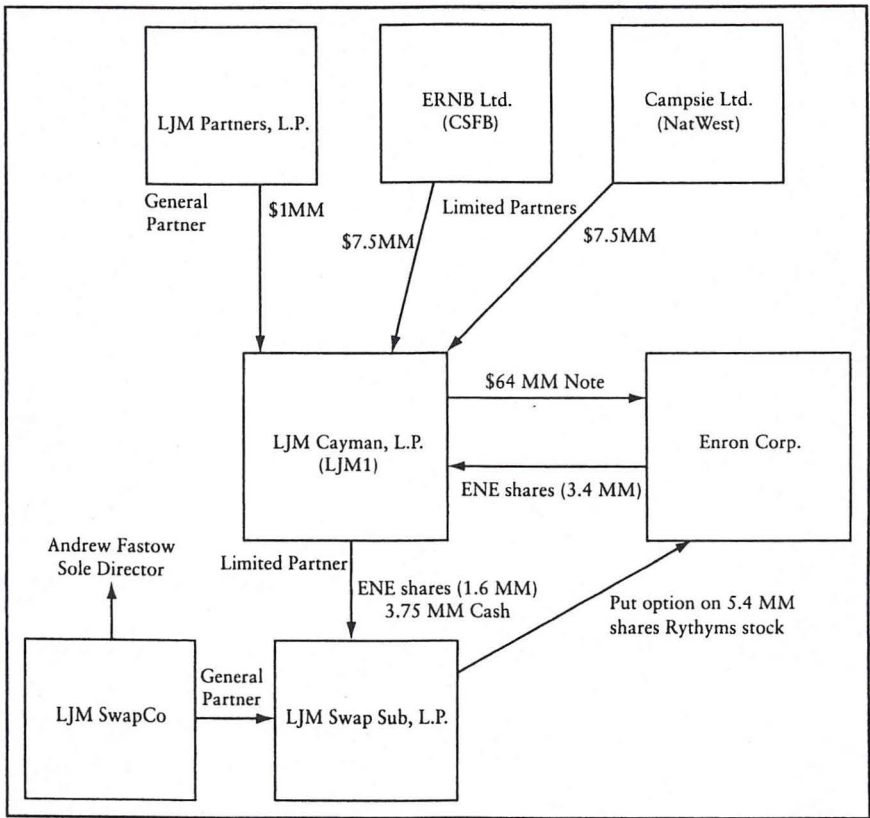


Chart from p. 81 of the Powers Report

## Fastow Plea Deal May Boost Cases Against Enron's Ex-CEOs

The guilty plea and cooperation agreement by former Enron Corp. executive Andrew Fastow gives prosecutors a potentially powerful new weapon in their investigation of the fallen energy giant, apparently bringing them closer to filing criminal charges against other top executives, including former Enron President and Chief Executive Jeffrey Skilling.

Still, even with the inside glimpse Mr. Fastow gives prosecutors, they face barriers

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*By John R. Emshwiler in Los Angeles  
and Thaddeus Herrick in Houston*

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in bringing Mr. Skilling and other top Enron executives to trial. Prosecutors likely need corroborating evidence to support any claims by Mr. Fastow concerning wrongdoing by others. The government has reached plea agreements with other lower-level Enron officials. Any of those potential witnesses also likely would face challenges from defense attorneys that they were making allegations to reduce their own penalties.

The case against former chairman and longtime chief executive Kenneth Lay appears to be more uncertain than that against Mr. Skilling, who within a matter of weeks could face criminal charges involving illegally manipulating Enron's financial statements, according to people familiar with the matter. Though Mr. Lay was chief executive for far longer than Mr. Skilling, the latter was widely viewed as the person most responsible for transforming Enron into a high-profile global energy trader.

Messrs. Skilling and Lay have consistently and strongly denied taking part in any wrongdoing. Mr. Skilling, for instance, has told people that if he is charged criminally he would fight vociferously to clear his name. An attorney for Mr. Skilling didn't return a phone call yesterday.

As part of his agreement with the Justice Department, Mr. Fastow, 42 years old, pleaded guilty to two criminal counts and agreed to a 10-year sentence in return for his cooperation. He also agreed to forfeit more than \$29 million to authorities. The plea resolved a pending a 98-count indictment that could

have put Mr. Fastow in prison for more than 25 years if he had been convicted at trial. Also yesterday, Mr. Fastow's wife, Lea, pleaded guilty to a single criminal tax charge in a related indictment and faces at least five months in prison.

In a statement, Mr. Fastow said he "and other members of Enron's senior management fraudulently manipulated Enron's publicly reported financial results. Our purpose was to mislead investors and others about the true financial position and Enron and, consequently, to inflate artificially the price of Enron stock and maintain fraudulently Enron's credit rating."

He added, "I also engaged in schemes to enrich myself and others at the expense of Enron's shareholders and in violation of my duty of honest services to those shareholders."

Mr. Fastow is the highest-ranking former Enron executive to admit to crimes at the company. Leslie Caldwell, chief of the Justice Department's Enron Task Force, said Mr. Fastow's "cooperation gives us a window into Enron's executive suites. Whatever knowledge that he has of who did what and who knew what at Enron will now be our knowledge."

Mr. Fastow might also be able to provide information about alleged illegal activities involving off-balance-sheet entities, which Enron used to mask losses on various business ventures.

The most immediate impact of Mr. Fastow's cooperation likely will be on Enron's former chief accounting officer, Richard Causey. People familiar with the federal inquiry said that prosecutors are expected to file a criminal complaint against Mr. Causey within the next few days, based partly on information provided by Mr. Fastow. Mr. Causey's attorneys have said their client did nothing wrong.



*Andrew Fastow*

## Enron Justice

After yesterday's guilty plea from former Enron CFO Andrew Fastow, no one can say that business scandal culprits are getting off easy. The eye-popping 10-year prison term, plus the forfeiture of more than \$29 million, is among the harshest ever handed down for a white-collar crime.

The plea, which includes a pledge of cooperation in the probe of Enron higher-ups, is a huge break for the government's case. Mr. Fastow was the architect of Enron's "special-purpose entities," the arcane investment vehicles that he now admits were at the heart of a "conspiracy" to commit fraud. If there is any evidence to be had about the complicity of former Enron CEO Jeffrey Skilling and Chairman Kenneth Lay, the 42-year-old Mr. Fastow is likely to have it.

But the larger lesson here is about individual accountability under the law. When the news about Enron and other corporate scandals first broke, the political and media instinct was to indict business as a class and fret about the immorality of capitalism.

The Bush Justice Department itself fed this interpretation with its prosecution of the entire firm of Arthur Andersen, Enron's auditor. That may have been gratifying as a political demonstration but it let the individual culprits off the hook. The Andersen partners who created the culture that closed its eyes to fraud at Enron and elsewhere have merely moved on to other lucrative accounting lives.

To function properly, free markets require an underpinning of honesty and the rule of law. But that means that when executives violate

the law, they have to be held *individually* accountable for specific crimes. The deterrent effect of seeing Mr. Fastow severely punished is likely to be far more bracing for everyone in business than one more proscription out of Congress or the SEC.

So much for the fat cats getting off easy.

It's especially notable that Mr. Fastow agreed to such a long sentence as part of his

plea, rather than trust his fate to a jury. He had after all been pleading his innocence for two years. One incentive may have been to reduce the risks to his wife, Lea, who was an Enron assistant treasurer and will plead as part of the deal to a tax charge and also serve time in prison. At least one of the parents will now be able to raise their young children while the other is behind bars.

But perhaps Mr. Fastow also concluded that just about any jury of his peers was likely to find him guilty. Enron was hardly a victimless crime, since it prompted what at the time was the largest bankruptcy in American history. Thousands of people lost their jobs, their life savings, or both. As Mr. Fastow admitted as part of his plea, "I also engaged in schemes to enrich myself and others at the expense of Enron's shareholders and in violation of my duty of honest services to those shareholders."

The next few weeks will see many of those accused in the corporate scandals go to trial. The biggest misfire so far has been the Frank Quattrone mistrial, and the Martha Stewart prosecution looks like another overreach. On the other hand, prosecutors may have gone too easy on the Tyco case, especially the auditors.

As for Enron, 26 individuals have been charged so far, including 19 former company executives. Seven have been convicted, including Mr. Fastow. All in all the system seems to be working, even for the once high and mighty.



Andrew Fastow

# Enron exec's wife strikes plea bargain

## Fastow could be next

HOUSTON (AP) — The wife of former Enron finance chief Andrew Fastow struck a bargain with prosecutors Thursday for a five-month prison sentence — a deal that could lead to a guilty plea from her husband and crack the scandal wide open.

Under the plea bargain, Lea Fastow's term would not overlap her husband's, so that at least one of them could raise their two children. That was a major concern of the couple.

U.S. District Judge David Hittner gave his tentative approval to the deal but said he would await a background investigation to make sure the sentence for the 42-year-old former Enron assistant treasurer is appropriate.

Sources close to the case said Andrew Fastow, 42, was negotiating a deal with that could send him to prison for 10 years and force him to pay \$20 million. A source speaking on condition of anonymity said any plea bargain with Fastow would be contingent on a deal for his wife.

Plea bargains with the Fastows would represent a significant break in the Enron

investigation, bringing prosecutors closer to Enron's former top executives, Kenneth Lay and Jeffrey Skilling. Neither has been charged and both maintain their innocence.

Prosecutors say Fastow was a central figure in a scandal that wiped out billions of dollars in investor and employee savings and resulted in thousands of layoffs at the one-time energy giant. It was the first in a series of scandals to rock corporate America in the past two years.

Fastow allegedly masterminded a complex web of off-the-books deals that hid Enron's losses and allowed him to skim millions for himself, his family and friends. Prosecutors say he reaped an estimated \$30 million.

Lea Fastow is charged with six counts of conspiracy and filing false tax forms for allegedly participating in some of her hus-

## Enron-related trials set for 2004

Two years into the Justice Department's investigation of what led to Enron Corp.'s 2001 collapse, 26 people have been charged. Five Enron-related trials are scheduled this year, involving former executives of the bankrupt energy company and Merrill Lynch & Co.

### Planned trial date, former title and a summary of charges

|                 |   |   |
|-----------------|---|---|
| Feb. 10         | <b>Lea Fastow</b><br>Enron executive                                | Six charges; conspiracy and filing false tax forms.   |
| April 20        | <b>Andrew Fastow</b><br>Enron finance chief                         | Nearly 100 counts; money laundering, fraud, insider trading, and other charges.                                   |
| June 14         | <b>Six former executives</b><br>Two at Enron, four at Merrill Lynch | Conspiracy charges related to a deal in which a loan was disguised as a sale to meet targeted earnings.           |
| Oct. 4          | <b>Seven former executives</b><br>Enron Broadband                   | 223-count indictment including fraud, insider trading, money laundering, conspiracy and other charges.            |
| Oct. 12         | <b>John Forney</b><br>Top Enron trader                              | Charges include manipulation of Western markets during California's power crisis of 2000 and 2001.                |
| Pleading guilty | <b>David Duncan</b><br>of Arthur Andersen LLP, Enron auditor        | Former top Enron auditor pleaded guilty to various charges. Six former Enron executives have also pleaded guilty. |

SOURCE: Associated Press

AP

band's deals. A full pre-sentencing investigation by probation authorities could take two months.

Andrew Fastow is charged with fraud, money laundering, insider trading and other offenses. He is free on \$5 million bail while he awaits trial in April.

Attorneys have not said whether he is willing to cooperate in making a case against Lay and Skilling. When Fastow was indicted in October 2002, his lawyers said Skilling and Lay approved his work.

Husband, wife plea bargains

# Former Enron official to serve 10-year sentence

By Kristen Hays

The Associated Press

HOUSTON — Andrew Fastow, chief architect of the shady, off-the-books deals that brought down Enron, pleaded guilty along with his wife Wednesday in an agreement that could take prosecutors to the top of the corporate ladder at the scandal-ridden company.

The plea bargains represent the biggest breakthrough yet in the two-year investigation into a scandal that led to the energy giant's collapse and rocked Wall Street and Washington alike.

Fastow, Enron's former finance chief, agreed to a 10-year prison sentence that will make him the highest-ranking executive to do time in the case. He also agreed to forfeit \$23.8 million and help the government build a

case against the executives who once occupied Enron's most opulent top-floor office suites: former chairman Kenneth Lay and former CEO Jeffrey Skilling.

"I and other members of Enron senior management fraudulently manipulated Enron's publicly reported financial results," Fastow, 42, said in a statement filed with the plea agreement, adding that the purpose was to mislead investors and inflate the company's stock price and credit rating. He did not read the statement in court.

Fastow's wife, Lea, pleaded guilty to filing false tax returns related to Enron's ill-gotten gains. Lea Fastow, also 42, was Enron's assistant treasurer.



Andrew Fastow



Lea Fastow

Andrew Fastow, clad in a gray suit, showed no emotion during the proceeding but flashed a smile afterward as he prepared to leave with his attorneys. He did not speak to reporters. His wife was not seen in the courtroom, though his parents and brother sat in the packed gallery.

Without a plea, he would have gone to trial on 98 counts of fraud, money laundering, insider trading and other charges.

Prosecutors say Fastow masterminded a sea of partnerships and tangled financing deals that hid Enron debt and inflated company profits while funneling millions of dollars to him, his family and selected friends. The partnerships had names like LJM (the first initials of Fastow's wife and two sons) and Chewco (after the "Star Wars" character Chewbacca).

He pleaded guilty to two counts of conspiracy to commit fraud — one covering the LJM partnership, the other involving transactions that Fastow used to pocket an estimated \$45 million.

"I also engaged in schemes to enrich myself and others at the expense of Enron's shareholders and in violation of my duty of honest services to those shareholders," Fastow said.

Lea Fastow's deal calls for a five-month prison sentence and a year of supervised release, including five months of house arrest. But U.S. District Judge David Hittner will decide later whether to accept the sentencing deal. She still has the right to withdraw the plea.

The plea negotiations had stalled last week after Hittner refused to guarantee her a five-month prison sentence — a condition that Fastow's attorneys did not like.

The final deal calls for the same prison time, and Hittner still has the right to alter Lea Fastow's sentence, which the family insisted on to

ensure that their two young sons have at least one parent at home.

"There really is life after Enron for all of us, we believe, and we're trying to get through this process the best we can," said Lea Fastow's lawyer, Mike DeGeurin.

Some experts believe Andrew Fastow's plea could break open the case against Lay and Skilling.

"Unquestionably, this is the breakthrough that the government has been pursuing," said Robert Mintz, a former federal prosecutor and an expert in white-collar crime. "There is nobody besides Fastow who can make this case for the government and that's why they have been pursuing him for so long and so aggressively."

When asked if prosecutors expected more indictments, Leslie Caldwell, head of the Justice Department unit investigating the company's downfall, did not answer directly.

"The investigation is very active and this is a significant development which I expect will yield results," Caldwell said.

"This is very significant to the Enron Task Force because whatever Andrew Fastow knows about what went on the 50th floor, the Enron Task Force will now know as well," she said.

Lay and Skilling have steadfastly maintained their innocence. Lay's attorney, Michael Ramsey, said Wednesday that Lay has no worries if Fastow tells the truth.

Bruce Hiler, Skilling's attorney, said his client had done nothing to merit charges. "We understand the pressure to enter a plea rather than stand trial in the poisoned atmosphere that has been created around Enron, but that doesn't change the truth as to my client," he said.

Enron declared bankruptcy in December 2001 amid mass layoffs, leaving investors and retirees stuck with worthless stock. In the following months, WorldCom, Global Crossing, Adelphia Communications and others suffered a similar fate as investigators uncovered a raft of accounting failures across corporate America.

Enron was the nation's seventh-biggest company in 2001, and its bankruptcy was the largest such filing in U.S. history at the time. Its stock once traded at above \$90, but sank to mere pennies amid the collapse.

# Skilling arrested

Lay now the only former executive not charged

## 28 Enron indictments later

The indictment of former Enron chief executive Jeffrey Skilling on Thursday marks the 28th individual charged with a crime since the Justice Department confirmed its investigation into the

energy giant on Jan. 9, 2002. So far, Skilling, who is charged with 35 counts of fraud and other crimes, is the highest ranking Enron executive to be charged.

**H**OUSTON (AP) — Former Enron Corp. chief executive Jeffrey Skilling was brought to court in handcuffs Thursday, charged with fraud, insider trading and other crimes in the highest-reaching indictment yet stemming from the energy trader's colossal collapse.

Skilling is accused of participating in widespread schemes to mislead government regulators and investors about the company's earnings. He pleaded not guilty to all 35 federal counts against him, and posted his \$5 million bond with a cashier's check.

Skilling's indictment leaves former chairman Kenneth Lay as the only major Enron executive not charged. It's unclear whether the latest charges make an indictment against Lay more likely; many close to the Enron case doubt Skilling would agree to cooperate with an investigation into Lay or anyone else in exchange for leniency.

"Skilling's been a pretty cool customer. I don't think so," said James Finberg, an attorney who represents former Enron shareholders.

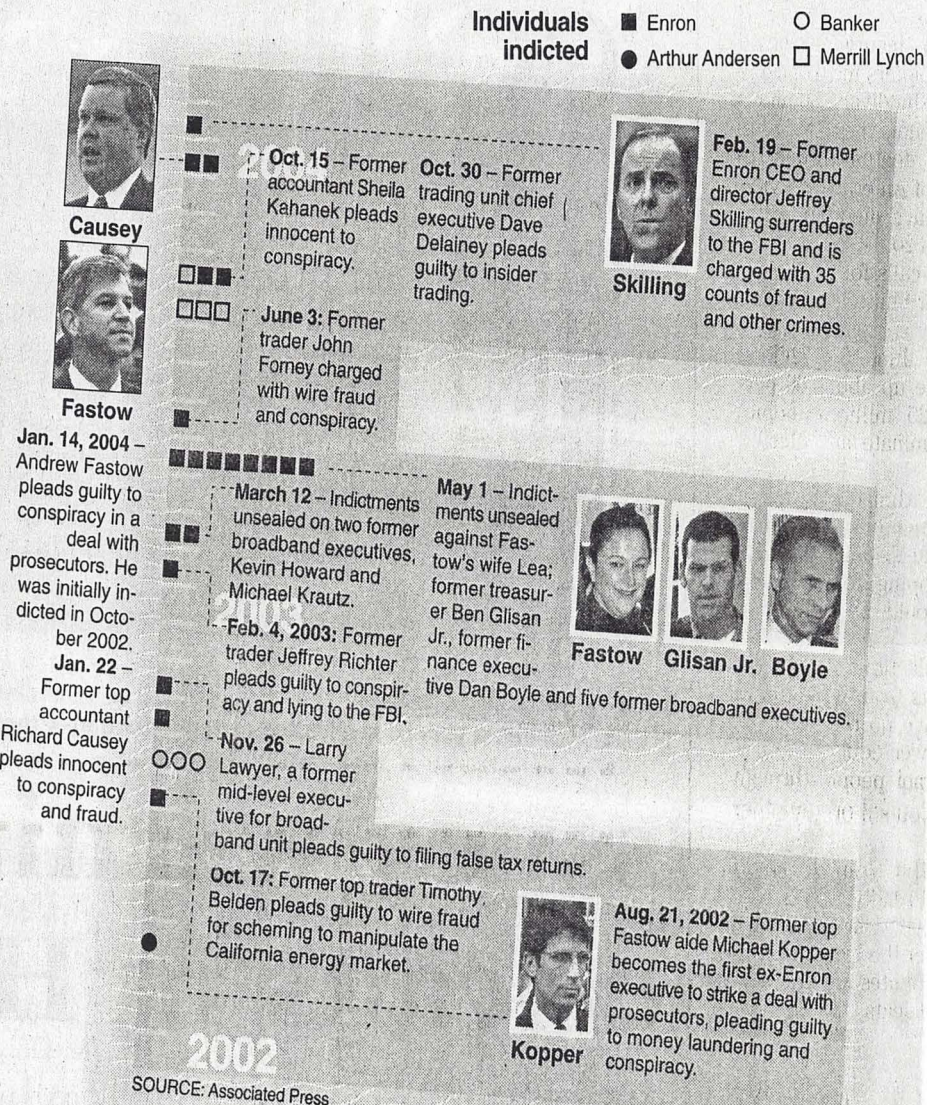
The indictment, handed up Wednesday and unsealed Thursday, accuses Skilling, 50, and Richard Causey, Enron's former chief accounting officer, of taking part in the schemes to mislead regulators and investors. Causey, 44, was first indicted a month ago and is free on \$500,000 bond.

Ten of the counts accuse Skilling of insider trading that generated \$62.6 million from stock sold from April 2000 through September 2001, about a month after he quit Houston-based Enron. According to the indictment, shares of Enron fell from \$87 in September 2000 to \$31 a year later.

Skilling, flanked by a pair of attorneys, turned himself in at the Houston FBI offices just before daybreak. About 15 minutes later, his hands behind him in cuffs, he was placed in a car for the trip to the federal courthouse.

The charges against Skilling were among the most anticipated in the Justice Department's investigation, which passed its two-year mark last month.

"The indictment of Enron's CEO shows



NOTE: The first criminal charges to be filed in the investigation were against Arthur Andersen LLP on March 7, 2002. The following month, David Duncan became the only individual from the company to be indicted.

that we will follow the evidence wherever it leads — even to the top of the corporate ladder," Assistant Attorney General Christopher Wray said.

Skilling's lawyer Dan Petrocelli said prosecutors "were making a grave mistake."

"Jeff Skilling has nothing to hide," Petrocelli said. "He did not steal. He did not lie. He did not take anyone's money, and in the 60 pages of charges filed by the United States government, they don't even accuse him of these things and it's not from lack of trying."

Deputy Attorney General James Comey, who heads the Justice Department's corporate fraud task force, said Skilling and other executives were responsible for a "massive, complex scheme to give shareholders and the investing public the false appearance of financial strength and security at a time when Enron was, in fact, failing."

Ex-Enron officials mentioned in the

indictment include former chief financial officer Andrew Fastow, who pleaded guilty and is cooperating with federal prosecutors, and former treasurer Ben Glisan, who pleaded guilty to conspiracy in September and became the first former Enron executive put behind bars.

The indictment mentions Lay twice but only by title: Skilling reported directly to Enron's CEO and chairman; and the CEO and chairman briefly mentioned a \$1.2 billion writedown in shareholder equity during a conference call with analysts the same day Enron announced massive third-quarter losses in mid-October 2001.

Lay, who served as CEO before Skilling, has maintained his innocence of any wrongdoing related to Enron's failure.

Petrocelli said Skilling — unlike other former Enron executives who invoked their Fifth Amendment rights before Congress — had cooperated fully with investigators and government panels investigating the company's collapse.

# U.S. Prosecutors File Indictment Against Skilling

## *Though Expected, Action Involving 42 Counts Marks Key Moment in Enron Saga*

Capping a two-year investigation into the inner workings of Enron Corp., federal prosecutors yesterday reached the highest level of the fallen energy giant with the filing of a 42-count indictment against former company president and chief executive Jeffrey Skilling.

Though the charges against the 50-year-old Mr. Skilling had been expected for weeks, the filing of the case in

*By John R. Emswiller in Los Angeles  
and Alexei Barrionuevo in Houston*

Houston federal court marks a signal moment in one of history's biggest business scandals. The indictment sets the stage for what could be an intense courtroom battle. Mr. Skilling has consistently denied any wrongdoing and has assembled a high-powered legal team to fight the indictment.

Mr. Skilling's indictment leaves former chairman Kenneth Lay, 61, as the most important Enron figure that hasn't been charged with criminal wrongdoing. While Mr. Lay was Enron's chief executive for far longer than Mr. Skilling, the latter was widely viewed as a much more important figure in operating the company during the years, starting in the late 1990s, when much of the alleged wrongdoing took place. As reported, prosecutors continue to investigate Mr. Lay, who has denied any wrongdoing.



*Jeffrey Skilling*

Yesterday, escorted by federal agents, Mr. Skilling arrived at the Houston courthouse in handcuffs and a tweed blazer. He had chosen to wear neither a tie nor a belt because he didn't want to give government agents the satisfaction of removing those articles when they took him into custody, a person close to the case said. Just prior to the start of the hearing, Mr. Skilling could be seen reading the indictment and shaking his head.

In the packed courtroom, he stood  
*Please Turn to Page A13, Column 4*

near Mr. Skilling's power and prominence within Enron or in the wider business world. Mr. Skilling joined Enron in 1990 after having been a standout student at the Harvard Business School and a fast-rising star at the consulting giant McKinsey & Co. When Mr. Skilling arrived, Enron was still a relatively staid natural-gas pipeline company.

During the 1990s, Mr. Skilling led the transformation of Enron into a global trading colossus that trafficked in everything from energy products and metals to space on the information superhighway and insurance against inclement weather. Along the way, he assembled a team of like-minded, aggressive young executives, which included Messrs. Fastow and Causey, who ascended the Enron corporate ladder alongside their patron.

In 1997, Mr. Skilling became president, chief operating officer and heir apparent to Mr. Lay, the longtime chairman and chief executive. Mr. Skilling's rise to the chief executive post in February 2001 seemed to many at the time to be a confirmation of the critical role he had played in building Enron into a Wall Street and media favorite and an entity with reported annual revenues of \$100 billion. At 47, Mr. Skilling seemed to be poised to lead Enron through at least another decade of success and growth.

Instead, Mr. Skilling shocked his Enron colleagues and many outside the company by abruptly resigning six months later, in August 2001. Though he and Mr. Lay, who resumed the chief executive post, insisted that the resignation was for strictly personal reasons, suspicions began to arise that something might be amiss inside the company.

While looking into Mr. Skilling's departure, The Wall Street Journal came across references in Enron's SEC filings to two suspicious-looking entities, which came to be known as the LJM partnerships. These entities did transactions with Enron involving hundreds of millions of dollars, despite the fact that the company's own chief financial officer, Mr. Fastow, ran and partly owned the partnerships. Subsequent disclosures about those partnerships contributed to a massive loss of investor confidence in Enron that pushed the company into filing for bankruptcy-law protection in December 2001.

Many of the ensuing investigations of Enron have concluded that the LJM arrangement was merely the tip of a large and ugly iceberg that consisted of a complex array of financial maneuvers, including the use of off-balance-sheet entities to improperly create income and hide debt. This alleged broad scheme of wrongdoing is at the heart of the criminal case against Mr. Skilling and his co-defendant, Mr. Causey. Many of the specific alleged acts of wrongdoing by the two have been included in prior federal criminal filings in the Enron probe. However, with the inclusion of Mr. Skilling, prosecutors believe that they have reached the top rung of the conspiracy, said one person familiar with the probe.

Among other things, yesterday's indictment alleges that Messrs. Skilling, Causey and others manipulated Enron's reported earnings through the improper use of reserve accounts. Mr. Skilling also allegedly took part in a scheme to guarantee one of the LJM partnerships a profit in return for its help in manipulating Enron's financial results.



FILE PHOTOS BY TIM JOHNSON—REUTERS AND JACQUELINE LARMA—ASSOCIATED PRESS

**Is turmoil for CEOs changing our corporate culture? Enron president and chief executive officer Jeffrey Skilling is escorted from a Houston courthouse. Below, Disney shareholders wait in line to cast their votes on the fate of Disney imperial CEO, Michael Eisner.**

# Crimes of Others Wrecked Enron, Ex-Chief Says

By KURT EICHENWALD

HOUSTON, Tex. — There was a time when Kenneth L. Lay's close relationship with President Bush brought him power and influence in Washington that was virtually unparalleled among his colleagues in corporate America.

Now, Mr. Lay, the former chairman and chief executive of Enron, fears those ties may only serve to bring him criminal charges.

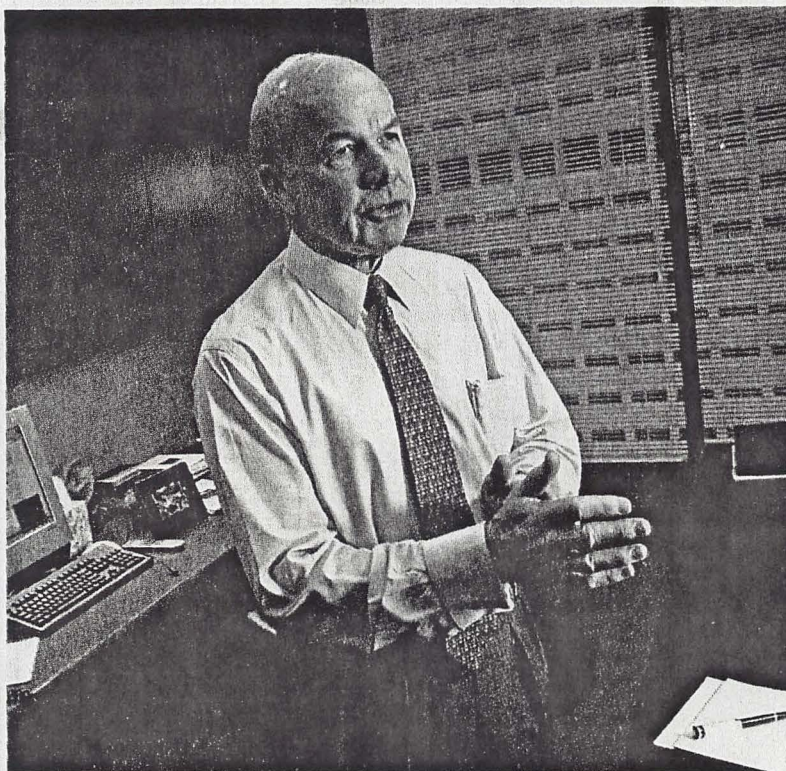
"If anything, being friends with the Bush family, including the President, has made my situation more difficult," Mr. Lay said in a recent interview, "because it's probably a tougher decision not to indict me than to indict me."

For more than two years, he has been the nation's silent pariah.

Now, on the eve of what may be the government's final decision on whether to charge him with a crime, Mr. Lay is talking for the first time about the company's collapse in 2001 and the scandal that enveloped it. In more than six hours of interviews with The New York Times, Mr. Lay remained steadfast in his expressions of innocence, even as he acknowledged, as head of the company, responsibility for the debacle rests rightfully with him.

"I take full responsibility for what happened at Enron," said Mr. Lay, 62. "But saying that, I know in my mind that I did nothing criminal."

As Mr. Lay describes it, the Enron collapse was the outgrowth of the wrong-headed and criminal acts of the company's finance organization, and specifically its chief financial officer, Andrew S. Fastow. He says that both he and the board were misled by Mr. Fastow about the activities and true nature of a series of off-the-books partnerships that played the decisive role in the com-



Michael Stravato for The New York Times

Kenneth L. Lay said he accepted responsibility for Enron's failure.

pany's collapse. Yet, Mr. Lay still argues that some of the company's most controversial decisions — including some that set up financial conflicts of interest for Mr. Fastow that could well be unprecedented in corporate America — had good reasons to be done, and can only be seen as mistakes in hindsight.

The years since the Enron collapse have transformed Mr. Lay, a man

once celebrated in business and political circles. Today, he is widely vilified as bearing significant responsibility for Enron's downfall, a debacle which cost thousands of employees their jobs, millions of investors their savings, and, for a time, forced a nation to question the capital markets system. He is often portrayed as a man who bailed out of his company as it was sinking, selling millions of shares even while telling investors and employees that he believed in the company's future.

However, he conceded: "What

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Continued on Page 15

# guilty

## First Enron exec also convicted in trial over '99 loan

By Greg Farrell  
USA TODAY

In a warning shot for Wall Street investment banks, a Houston jury convicted four former Merrill Lynch executives and a former Enron executive Wednesday on charges of conspiracy and fraud stemming from a 1999 loan disguised to look like a business transaction.

In the transaction, Merrill agreed to "buy" three power plants mounted on barges off the coast of Nigeria for \$7 million, only to have Enron's chief financial officer, Andrew Fastow, buy them back six months later for \$7.5 million. Enron used the transaction to book \$12 million in pretax profit for the year, helping it meet its targets.

Prosecutors produced evidence indicating Merrill entered into the deal only after receiving verbal guarantees that Enron would reverse the transaction within six months, giving Merrill a profit.

After 21 hours of deliberations, the jury convicted Daniel Bayly, Merrill's former head of global investment banking; James Brown, former head of Merrill's asset lease and finance group; William Fuhs, a vice president who reported to Brown; and Robert Furst, who managed Merrill's relationship with Enron. A fifth defendant, Dan Boyle, became the first former Enron executive to be convicted at trial. More than a dozen Enron executives have pleaded guilty in the past two years.

The jury acquitted one former Enron executive, Sheila Kahanek, an accountant who testified that she opposed the verbal guarantees that surrounded the transaction.

"This is a conviction that should send some shudders across Wall Street," said John Coffee, an expert in securities law at Columbia University. "This is not limited to Merrill Lynch and Enron. Many other financial institutions have engaged in these kinds of transactions."

In a statement, Merrill said it would be "inappropriate" to comment on the "trial of several individuals" and that the firm had "put this case behind it more than a year ago when it resolved all issues with the government."

But Thomas Ajamie, a Houston attorney who has followed the case, said the verdict could cost Merrill dearly in the civil lawsuits it faces over its business transactions with Enron. "This will have a devastating effect on Merrill's defense of the class-action lawsuits by shareholders and bondholders," he said.

Ajamie also noted that after winning its obstruction of justice trial against Arthur Andersen two years ago, Wednesday's courtroom victory gives the Enron Task Force "momentum" going into the trials of former Enron CEO Jeff Skilling and former chairman Ken Lay.

"This doesn't bode well for anyone or any company caught up in the Enron morass," he said.

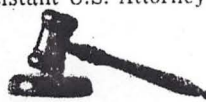
Merrill said the verdict would have "little or no impact" on the civil lawsuits it faces, because the 1999 barge deal "did not cause significant shareholder losses."

# Ebbers Trial Gets Under Way

By ALMAR LATOUR  
And SHAWN YOUNG

**N**EARLY THREE YEARS after WorldCom Inc. disclosed the largest accounting fraud in U.S. history, opening arguments in the trial of Bernard Ebbers started in a New York City courtroom as prosecutors laid out what could be a difficult case against the former chief executive. The prosecutors told jurors that his relentless push to meet Wall Street's expectations and keep the stock high were instructions to commit fraud.

"When he said hit the numbers, it was a command to commit fraud," Assistant U.S. Attorney David Anders told the newly selected jurors. By telling investors that WorldCom was strong as his employees were "cooking the books," "Bernie Ebbers lied not once, not twice, but again and again and again," Mr. Anders said. "He made sure that the people who worked for him, lied for him."



## EXECUTIVES ON TRIAL

Inside: The Scrusby case begins; Both's will today. Page C4

Mr. Ebbers's attorney, Reid Weingarten, shot back by attacking the credibility of the government's star witness, Scott Sullivan, who pleaded guilty last year to orchestrating the \$11 billion fraud. Mr. Weingarten said Mr. Sullivan, WorldCom's former chief financial officer, is "very capable of deception, that is, he's a liar."

Mr. Weingarten also said Mr. Ebbers didn't act like someone who was in a conspiracy. Mr. Ebbers didn't sell stock and in fact bought more shares in WorldCom (now called MCI Inc.) after he left the company. "There are a zillion documents in this case and there ain't one smoking gun," Mr. Weingarten told the jurors.

The opening arguments were among the first salvos in a new round of criminal trials as prosecutors work their way up the corporate ladder to take on executives who headed companies that symbolized an era of unprecedented corporate fraud.

In a nearby courthouse, jury selection was completed in the retrial of L. Dennis Kozlowski, the former chief executive of Tyco International Ltd., and another executive accused of looting that company of \$600 million. In Birmingham, Ala., lawyers for former HealthSouth Corp. CEO Richard Scrusby argued that the company's \$2.7 billion fraud was the work of a tightly knit group of executives.

Mr. Ebbers, 63, is accused of conspiring with several other WorldCom executives to conceal the deteriorating financial condition of his company. He faces at least 30 years in jail if convicted, an effective life sentence. Charged in March of last year, he has pleaded not guilty. The trial is expected to last six to eight weeks.

The prosecutors, led by Mr. Anders, told the jury that Mr. Ebbers repeatedly lied to investors in order to hide the telecom giant's disappointing financial results over a period of roughly two years. Mr. Anders argued that Mr. Ebbers did so because he wanted to keep WorldCom's stock from dropping.

Mr. Anders added that Mr. Ebbers had a per-

Continued From Page C1

sonal motive to lie: The executive had pledged WorldCom stock as collateral for about \$400 million in personal loans he used to buy a yacht, a timber business and other assets. As the stock price of WorldCom fell, Mr. Ebbers came under pressure from banks to provide more collateral, while such pressure would ease if the stock price would stay high, Mr. Anders told jurors.

Mr. Ebbers was at crossroads in October 2000, when he had to update investors about WorldCom's financial performance, which had deteriorated and didn't meet Wall Street's expectations, Mr. Anders told the jury. Instead, Mr. Anders said, Mr. Ebbers "chose to lie" and painted a rosier picture than there really was.

Mr. Anders said several witnesses who have pleaded guilty to fraud in the WorldCom case are scheduled to testify that Mr. Ebbers was involved in the accounting scheme.

Mr. Anders said Mr. Sullivan, the former financial chief who pleaded guilty last March on the eve of his own trial, sat near Mr. Ebbers and talked to Mr. Ebbers sometimes as often as "20 times a day." Mr. Sullivan will testify, Mr. Anders said, that he told Mr. Ebbers about certain methods to lower telecommunications-line costs and artificially increase revenues and that Mr. Ebbers responded by saying WorldCom would simply have to meet its growth and profit projections.

In his opening statement, Mr. Weingarten, Mr. Ebbers's chief lawyer, portrayed his client as a former basketball coach who knew little about corporate finance but was a star at managing his sales force and seeing opportunities.

Mr. Weingarten told the jury that his client had lived an "only in America" story, in which he rose from being a milkman and a bouncer to becoming a hotel owner and, later, the chief executive officer of one of America's largest telecom companies. "He managed WorldCom the way he ran hotels," Mr. Weingarten said.

Mr. Weingarten said Mr. Sullivan essentially ran day-to-day operations and had total control over all accounting decisions and frequently disregarded Mr. Ebbers's opinions and advice. Mr. Sullivan referred to Mr. Ebbers with insulting nicknames such as "the milkman," according to Mr. Weingarten.

Mr. Weingarten made it clear that Mr.



AP Photo/Gregory Bull

**Date at Court:** Ex-WorldCom chief executive **Bernard Ebbers** (left) walks toward the federal courthouse yesterday with his lawyer **Reid Weingarten**.

Sullivan's integrity will come under attack and said there are "aspects of his personal life" where he wasn't the person he appeared to be. Last week, Judge Barbara Jones said Mr. Sullivan could be questioned about "marital infidelities," and Mr. Weingarten's remarks suggest that he will be.

Mr. Weingarten emphasized that Mr. Ebbers relied on Mr. Sullivan to manage financial issues. Mr. Weingarten also said Mr. Ebbers considered leaving WorldCom in 2000 and that he suffered from a heart condition that required attention. Mr. Ebbers ultimately decided to stay on, but handed effective daily control to Mr. Sullivan and the chief operating officer, Ron Beaumont.

The jury, consisting of 12 jurors and four alternates, is predominantly working class. Of the jury pool, six are men and 10 are women. The pool includes seven African-Americans, several Hispanics and one white male.

WorldCom went into bankruptcy protection in July 2002 on the heels of its accounting fraud, wiping out a stock that had been worth more than \$180 billion at its peak in 1999. The company emerged from Chapter 11 protection last April under the name MCI.

# Scrushy Blames Fraud on Underlings

## HealthSouth's Ex-Chief Denies Knowing of Scheme As Trial Gets Under Way

By DAN MORSE  
And EVELINA SHMUKLER

BIRMINGHAM, Ala.--Lawyers for former HealthSouth Corp. Chairman and Chief Executive Richard M. Scrushy blamed the \$2.7 billion accounting fraud at the company on more than 10 trusted lieutenants, contending they took extraordinary steps to hide the scheme from him.

In opening arguments at Mr. Scrushy's trial, the defense team launched a fierce attack against a string of former HealthSouth executives who have pleaded guilty and are expected to testify against Mr. Scrushy. Jurors were told they wouldn't see any evidence that proves Mr. Scrushy knew of a conspiracy to inflate the rehabilitative and surgical-care provider's bottom line.

"There's not one single memo, not one single document, not one single note, not one single e-mail with Richard Scrushy's fingerprints on it," said James Parkman, one of Mr. Scrushy's attorneys.

The sharp rhetoric from defense lawyers and prosecutors was the strongest indication yet that both sides expect testimony from at least three former HealthSouth chief financial officers to be crucial to determining Mr. Scrushy's fate. U.S. Attorney Alice Martin told jurors they would hear that Mr. Scrushy in 1996 instructed

William Owens and Aaron Beam, two high-ranking finance executives, to alter financial statements to meet profit targets. "If you ever get caught, you're on your own," Mr. Scrushy said at the time, according to Ms. Martin.

Mr. Scrushy's trial, expected to last more than two months, is one of the first major tests of the Sarbanes-Oxley Act, passed after a wave of corporate scandals. The case already has captivated HealthSouth's hometown of Birmingham, where Mr. Scrushy makes regular appearances on an early-morning Bible study program on local television. Mr. Scrushy faces more than 40 criminal charges and the possibility of life in prison.

Opening arguments from both sides pointed to the central role Mr. Owens is likely to have in the trial. In 2003, he wore an undercover recording device to try to gather incriminating statements from Mr. Scrushy.

But Mr. Parkman, an attorney for Mr. Scrushy, argued that Mr. Owens orchestrated the fraud at HealthSouth because "he needed the money ... more than anybody else," adding that "his spending was out of control." Mr. Owens couldn't be reached, and his attorney, Frederick Helmsing, declined to comment, citing an order by U.S. District Judge Karon Bowdre limiting lawyers from discussing the case.

Mr. Scrushy's lawyers contended that the recordings obtained in 2003 through Mr. Owens will show that Mr. Scrushy didn't know about the fraud. "We expect you will find that the very tapes that the government will submit ... will serve as the very basis for your reasonable doubt in

this case," said Arthur W. Leach, one of Mr. Scrushy's attorneys, adding that references to fraud in the recordings were "cryptic."

Prosecutors ended their opening argument by flashing a blown-up image cataloging personal items purchased by Mr. Scrushy, with Ms. Martin rattling off a list that included "boats, armored vehicles ... a Rolls-Royce, antique rugs, more boats" and a \$3.2 million airplane.

Several minutes later, after conferring with lawyers on both sides, Judge Bowdre told jurors that Mr. Scrushy's wealth isn't on trial. "This case is about whether Mr. Scrushy knowingly participated in the fraud at HealthSouth," she said.

Prosecutors called their first witnesses in the case yesterday afternoon. The first two were designed to show the jury that victims of the alleged securities fraud relied on HealthSouth's falsely inflated earnings to buy stock and hold on to stock. The first witness was an 83-year-old woman who said she helped invent the household cleaner Formula 409. The woman, who described herself as a longtime HealthSouth investor, said that she had relied on the company's annual statements as well as Mr. Scrushy's reputation as a hands-on CEO.

"I was really, really impressed," she said, "because he was so interested in what was happening in his company."



**Journal Link:** *WSJ.com subscribers can see a graphic tracking several corporate-fraud cases, at [WSJ.com/JournalLinks](http://WSJ.com/JournalLinks).*

# Crimes of Others Wrecked Enron, Its Former Chief Executive Says in Interview

## In the Eyes of a Storm

Now, according to witnesses who have testified before the grand jury and other people involved in the investigation, prosecutors are focusing almost exclusively on Mr. Lay's actions and statements in the months preceding bankruptcy, in an effort to determine if he deceived investors about the true state of Enron before its demise even as he was selling his own stock.

However, a review of Mr. Lay's financial and trading data shows that the facts are much murkier than is generally believed, with the sales being forced by lenders as he took numerous actions that would only be done by someone trying to minimize their stock sales.

To date, numerous executives who worked for or advised Enron have pleaded guilty to crimes or been charged with wrongdoing. Virtually the entire senior management has faced legal proceedings its treasurer, chief financial officer, primary outside accountant, corporate secretary and even a division head have all pleaded guilty to crimes. Others, including Jeffrey K. Skilling, another former chief executive, and Richard A. Causey, the former chief accounting officer, have been charged with fraud.

Mr. Lay himself has remained under investigation that entire time, and — at what he said was his legal team's insistence — invoked his Fifth Amendment right against self-incrimination in testifying before Congress.

In his first unrestricted interview since the collapse, Mr. Lay discussed the issues that have swirled around him, including his role in the events leading up to the collapse, the rationale behind the off-books partnerships that crippled the company, and how his life and personal finances have changed.

The changes in his financial status are perhaps the most stunning. At the beginning of 2001, Mr. Lay said, he had a net worth in excess of \$400 million — almost all of it in Enron stock. Today, his worth is below \$20 million, and his total available cash not earmarked for legal fees or repayment of debt is less than \$1 million.

The interview was conducted in Mr. Lay's office in downtown Houston. There, a picture window frames the old Enron skyscraper across town, a sight he said he rarely contemplates during his days working as a consultant for two start-up companies.

Mr. Lay said that he had remained silent on the advice of lawyers, but is coming forward now to explain his views of a story that he says has become infused with myths. While not saying so explicitly, he suggested that was motivated by a desire to tell his side both to the prosecutors on the Justice Department's Enron Task Force who have been investigating him and the citizens of Houston who may well sit in judgment on him.

Throughout the interview, Mr. Lay was calm and subdued, an edge appearing in his voice only when he discussed former Enron executives he said had lied to him, what he perceived as misperceptions about what happened at the company, and the government's decision to investigate him with three successive groups of prosecutors, each going over the same ground again.

## Pointing Fingers

In the end, Mr. Lay said, the Enron story is one of corrupt executives in a finance organization led by Andrew S. Fastow, the former chief financial officer, who took advantage of the company for their own personal benefit and ultimately destroyed it.

"At our core, regrettably, we had a chief financial officer and a few other people who in fact mismanaged the company's balance sheet and finances and enriched themselves in a way that once we got into a stressful environment in the marketplace, the company collapsed," he said. "But by

the same token, most and I mean 98 percent of the people who worked at Enron were good, honest, hardworking individuals. They were not crooks."

Still, Mr. Lay said he clinged to a belief that the outcomes of certain corporate decisions that ultimately proved devastating to the company could not have been anticipated. The use of such partnerships was widespread throughout the business world, as corporations attempted to use a technique authorized under the accounting rules to pretty up their reported financial picture. But Enron took those efforts much further, adopting policies that were unheard of, such as allowing Mr. Fastow to operate an off-books investment fund that did business with the company and provided financing for some of the partnerships.

Mr. Lay labels criticisms of that set-up as 20-20 hindsight, created only because the world now knows that Mr. Fastow used the vehicles to manipulate Enron's earnings and loot the company all, Mr. Lay said, without his knowledge.

"At the time it seemed the appropriate thing to do," he said. "And I had no reason to doubt or distrust Fastow."

But legal experts dismiss the entire venture as foolhardy from inception. "It's just not common sense thinking," said John J. Fahy, a former federal prosecutor now with Fahy Choi in Rutherford, N. J. "Your C.F.O. cannot be put in a position where he is in conflict with the company. He is simply too important. The idea is just crazy."

While he has been subjected in recent years to withering personal criticism on Capitol Hill, by the media,

on late night talk shows and across the Internet, Mr. Lay said that in his hometown many longtime friends and associates remained supportive, and he continued to serve on multiple charitable boards in town.

## In 'The Twilight Zone'

Still, Mr. Lay said, the event took a toll, disheartening him and his wife, Linda.

"Linda kind of likened it not too long ago to being in the show, 'The Twilight Zone,' where you live your whole life" trying to be ethical and straightforward, Mr. Lay said, "to almost overnight being referred to in the national media and elsewhere as a kind of pariah on society. And that's not any fun."

By the summer of 2001, Mr. Lay said, he had turned the chief executive's job over to his hand-picked successor, Mr. Skilling, who built Enron's energy trading business. By the end of that year, Mr. Lay expected to relinquish his title of chairman as well, and take a position with a New York merchant bank.

Then, Mr. Skilling told Mr. Lay he wanted to resign. With no one in the wings, Mr. Lay informed the merchant bank in August that he could not work there, and returned to Enron as chief executive. His return was greeted with employees expressing concerns about the way the company was running. Mr. Lay commissioned surveys of employees, and invited them to come speak with him or one of his top executives about any concerns.

The appeals brought in responses from throughout the company, pointing up problems that ranged serious challenges to significant dangers. Sherron Watkins, an executive who

had just sent an anonymous letter to Mr. Lay criticizing some of the off-books entities as improper, came forward to meet with him. Other e-mail messages arrived from current and former executives lambasting and praising the company. Some of those e-mails Mr. Lay said he saw; others, he said, were never shown to him.

Those e-mail messages, including one from a former employee named Margaret Ceconi, which Mr. Lay said he never saw until long after Enron's collapse, have been examined by the grand jury, according to witnesses who were questioned. Her memo raised claims of a host of problems including accounting issues in one of the company's divisions. Prosecutors are apparently trying to prove that the e-mails gave Mr. Lay notice of deep problems at the company.

One of the e-mails questioned by the government, from a senior executive named Steven Kean, said the company was perceived as being involved in aggressive accounting and the hyping of new businesses. But the message simultaneously praised Enron's accounting staff and expressed high expectations for future growth.

Mr. Lay said he was impressed by Ms. Watkins, who criticized certain off-books entities particularly a quartet of entities known as the Raptors — for utilizing what she said was improper accounting intended to bolster Enron's profits in 1999 and 2000. "I thought she seemed very credible, very smart," he said.

But, "you just don't read one letter coming from a person in middle management and decide, 'Well, we have a serious problem here,'" he said.

Mr. Lay instructed his legal team to bring in Vinson & Elkins, a Houston law firm to investigate; the lawyers concluded there were no significant problems. However, Vinson & Elkins did legal work on the entities under investigation, and Mr. Lay has been sharply criticized for seeking advice from a conflicted party. But Mr. Lay said, given the gravity of the accusations, he wanted a fast answer, which he thought Vinson & Elkins could provide because of its familiarity with the issues. Indeed, Mr. Lay said, a subsequent review by independent lawyers and accountants, which found serious flaws in the structures, took three months to conclude.

"If we'd started that report back in August," he said, "We would have been bankrupt before we got the report back."

But at the same time negative news was coming in, Mr. Lay was hearing positive information about the company. In a September meeting, Mr. Fastow announced that the company balance sheet was stronger than ever. Ben F. Glisan Jr., the treasurer, said Enron's credit rating was likely to be raised in a matter of months. When criticisms of some ac-

counting approaches were raised at that meeting, Mr. Causey, the chief accounting officer, gave a red-faced, hand-slapping defense, saying every transaction was vetted by him and by Arthur Andersen, Enron's outside accountants.

Both Mr. Fastow and Mr. Glisan have pleaded guilty to felonies. Mr. Causey has been indicted on multiple counts of fraud.

Meanwhile, Mr. Lay said, reports from his biggest operating divisions were uniformly positive.

### Personal Stock Sales

Other information gave him reason to believe Enron's stock price would recover, Mr. Lay said. For example, in mid-September, Goldman Sachs informed him that Enron was at risk of a hostile takeover because its stock price had fallen below its true value. Board records show that, in the second week of October, Goldman made a full presentation on the dangers from the low stock price, and presented defenses Enron should have at the ready to ward off unwanted suitors.

Mr. Lay maintains his stock sales throughout 2001 were not an effort to bail out of the company; rather, he says, he was making every effort to hold on to every share he could.

For more than a decade, Mr. Lay kept almost all of his holdings in Enron stock. Prior to 2001, his financial advisers persuaded him to diversify. But he refused to sell his shares to raise the cash for other investments. So instead, he borrowed about \$100 million, using a large chunk of his Enron stock as collateral. Most of that money went into hard-to-sell assets, like investment properties and private equity deals.

"I wanted to hold on to the Enron stock," he said, "So I used the Enron stock as collateral to borrow the money and then reinvest."

Such a strategy would only work, of course, if the Enron stock held steady or rose. But Mr. Lay said he simply did not think the price would fall. "That was not something I thought very hard about in 2000," he said.

Once the stock price did start falling, however, Mr. Lay received demands for more cash from the banks. He had few assets he could readily sell to meet those demands, and many of those were disposed of in the face of the financial pressure.



Stephen Crowley/The New York Times

Kenneth Lay, center, leaves a Senate Commerce Committee hearing in 2002 after refusing to testify.

In consultation with his financial advisers, Mr. Lay said, he decided to increase his gamble on Enron stock. He borrowed money from a corporate line of credit, to the limit of \$4 million, and used that to meet his margin calls. Then, he would wait, hoping for the price to go up. If another margin call arrived, he would repay the corporate line with Enron shares, and borrow again to meet the new obligation from the banks.

Under the contracts with the banks, Mr. Lay had no right to refuse payment, and no means of paying outside the corporate credit line and the Enron shares. If he failed to meet his margin loans, the banks would sell his shares for him, in the open market. Under the contract, the bank could sell as much of the stock as it wanted.

"Knowing bankers, I thought if they did that, they would make sure they met the margin call, and maybe sell a little more to build up a cushion," he said. "From my standpoint, I was trying to sell as few shares as I could."

There are independent signs that is true. That summer, Mr. Lay converted more than 200,000 options into stock, but did not sell the shares, incurring a tax liability on an investment that proved worthless. More telling, in late September, he received a cash bonus of \$10 million for rejoining the company, and used all of it to pay down his bank debt — using cash to forestall the further forced sale of Enron shares.

Through August and September of that year, Mr. Lay was forced by margin calls to sell more than 550,000 Enron shares. At the same time, he was awarded or purchased almost 185,000 shares. This has become the areas of investigation by prosecutors because, during a September 26 online meeting with employees, Mr. Lay responded to a question by commenting that he had purchased shares. But in the aggregate, he was a net seller.

Securities law experts said that because of the difference between forced sales and voluntary purchases, it was difficult to call Mr. Lay's statements a fraud.

"You aren't able to aggregate all of the transactions over the prior month, particularly when those are explained by economic necessity rather than volitional decision," said John C. Coffee Jr., a professor with Columbia University Law School. "I am dubious that you can call that a fraud."

But still, in the interview, Mr. Lay was asked whether he believed he owed employees a fuller response, and an explanation that he was selling shares, forced or not.

"Let me put it this way, it just didn't cross my mind," he said. "I was doing my best to hang on to as much as I could because I was convinced that the fundamentals of the company were so strong."

Despite the rumblings that criminal charges against him could well be imminent, Mr. Lay says he is sanguine, believing that cooler heads will prevail and he will emerge from these events without being forced to trial.

"I know in my mind I did nothing wrong and nothing criminal," he said. "But I'd say if it does happen, it's a great miscarriage of justice."

But, if faced with indictment, would Mr. Lay consider pleading guilty?

"Absolutely not."



# An accounting for corporate thieves

Top executives at the nation's scandal-ridden corporations are beginning to pay for their misdeeds. And they are paying big time, as they should.

Front and center among the corporate raiders last week were the Fastows, Andrew and his wife, Lea, who pleaded guilty in an agreement that could allow prosecutors to get right to the top of those involved in the scandal that reduced Enron from the nation's seventh biggest company in 2001 to a bankrupt failure today.

Andrew Fastow, 42, Enron's former finance chief, agreed in federal court in Houston to a 10-year prison sentence that will make him the highest ranking executive in the case to do time. He also agreed to forfeit \$23.8 million in ill-gotten gains and to help the government build a case against the executives who once occupied Enron's gilded top-floor office suites — former chairman Kenneth Lay and former CEO Jeffrey Skilling.

Those two former executives have to be squirming as a result of the statements Andrew Fastow released relating to the case. "I and other members of Enron senior management fraudulently manipulated Enron's publicly reported financial results," Fastow confessed. He added that the purpose was to mislead investors and inflate the company's stock price and credit rating.

Without the plea bargain, Fastow would have gone to trial on 98 counts of fraud, money laundering, insider trading and other charges. Conviction on those charges could have led to far more than 10 years in prison.

Lea Fastow, Enron's assistant treasurer, pleaded guilty to filing false tax returns related to Enron's ill-gotten gains. Her deal calls for a five-month prison sentence and a year of supervised release, including five months of house arrest.

It's pitiful that one of the considerations the judge had to make in accepting the plea bargains from this high-flying corporate couple was to ensure that their two young sons would have at least one parent at home to care for them. They obviously weren't thinking about their sons as they fleeced the now defunct firm's

shareholders and employees of their investments and retirement accounts.

Prosecutors say Fastow masterminded the partnerships and tangled financial deals that hid the energy giant's debt and inflated company profits. Those same deals funneled millions of dollars to him, his family and selected friends.

In pleading guilty to two counts of conspiracy to commit fraud — one involving transactions that Fastow used to pocket an estimated \$35 million — he said, "I also engaged in schemes to enrich myself and others at the expense of Enron's shareholders and in violation of my duty of honest services to those shareholders."

Some observers of the Enron investigation believe that Andrew Fastow's plea could break open the case against Lay and Skilling.

Robert Mintz, a former federal prosecutor and expert on white-collar crime, said, "There is nobody beside Fastow who can make this case for the government and that's why they have been pursuing him for so long and so aggressively."

Fastow's greedy financial behavior, along with that of other executives at such firms as WorldCom, Global Crossing and Adelphia Communications, helped Wall Street and the Congress focus attention on the ways big business had manipulated its books for several years when the red-hot stock market was doing nothing but going up. Their shenanigans combined with a downturn in the economy, helped burst that stock market bubble resulting in huge losses for stockholders at virtually every level.

With new rules and regulations in place, let's hope that such greedy activity in the boardrooms and in the still opulent inner sanctums of America's largest corporations is a thing of the past. The prison terms of Andrew and Lea Fastow and those who follow (as they surely will) should be a daily reminder for at least the next decade or so that those guilty of white-collar crime at the highest levels will be treated like the common criminals they have proven themselves to be.

# The morality of business

**Samuel Gregg**

Gregg is director of research at the Acton Institute for the Study of Religion and Liberty, based in Grand Rapids, Mich. Knight Ridder/Tribune

The indictment of former Enron Chairman and CEO Kenneth Lay and the sentencing of home decorating maven Martha Stewart have once again drawn attention to the numerous business scandals that have tarnished the image of free enterprise.

With such megacorporations as Ahold of the Netherlands, Parmalat of Italy, Santander Central Hispano of Spain and Skandia of Sweden, this is not a uniquely American phenomenon.

Even before the scandals, many people considered unscrupulous behavior the norm in the business world, with captains of industry seen following only one commandment: "Thou shalt not get caught."

But suppose one inverts this viewpoint. Suppose one argues that free enterprise, economic liberty and their accompanying institutional and legal framework promote the moral health of society.

## MORALITY: Free enterprise and its captains are innately moral

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Such a position is likely to shock some people: those who consider free enterprise inherently disreputable; those who support free enterprise, but claim the material prosperity generated by business is sufficiently moral in and of itself; and those who believe that free enterprise can only prove its moral worth by giving money to politically correct causes.

The idea that free enterprise can itself be moral is hardly new. "Trade is the natural enemy of all violent passions," 19th-century French social philosopher Alexis de Tocqueville wrote in his much-quoted work, "Democracy in America."

"Trade loves moderation, delights in compromise, and is most careful to avoid anger. It is patient, supple, and insinuating... it leads them to want to manage their own affairs and teaches them how to succeed therein. Hence it makes them inclined to liberty but disinclined to revolution."

This is true for commercial relationships outside a country as well. It is no coincidence that peace tends to prevail between nations that trade with one another.

Free enterprise shows its inherent morality in another significant way: By its very existence, it makes it difficult

See MORALITY, 4

for government to unreasonably restrict our choices.

St. Thomas Aquinas once wrote that the power of households to manage their own economic affairs — a power that depends on the assurances that come with property ownership — makes it possible for individuals to keep the state's rulers from overstepping their powers. It is surely no coincidence that wherever commercial societies emerge, governments lose their capacity to behave tyrannically.

Even something as fundamental to free enterprise as legally enforceable contracts contributes to society's moral health. When people enter into a contract, they engage in a recognized legal practice.

Contracts are really no more than promises. They encourage our willingness to be truthful and keep our word. They require us to act in a manner that is practical and reasonable — and often, therefore, more moral. In short, we commit ourselves to perform certain actions. Contracts would be null and void without such commitments.

This is not to say that free enterprise and free markets are all a society needs to be morally healthy. Clearly, they are not. Other institutions of civil society, such as churches, schools, and local community associations, play an indispensable role in forming the moral culture in which we live.

Yet we ought to remember that being involved in business per se provides people with opportunities to develop virtuous habits. Every successful entrepreneur knows that habits such as prudent risk-taking, thrift, honesty and industriousness

are essential for success. Even exercising creative insight, as business executives are required to do daily, can be a morally enriching activity.

It's important for the American people to understand the valuable contributions free enterprise makes to the moral, as well as the economic, health of our country.

It's also critically important to remind people in these troubled times that the business world isn't the natural province of robber barons and petty crooks, but a crucial element of a free society — and an institution that significantly strengthens society's moral fiber.