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ENRON'S MANY STRANDS: EX-CHAIRMAN'S FINANCES; LAY SOLD SHARES FOR $100 MILLION

By FLOYD NORRIS AND DAVID BARBOZA

Kenneth L. Lay sold $100 million in Enron stock last year, the company disclosed yesterday, with a large part of that coming from selling shares back to the company after he was warned by Sherron S. Watkins that the company might collapse "in a wave of accounting scandals."

The sales, disclosed in a report filed by Mr. Lay with the Securities and Exchange Commission, included $20 million of shares sold in the three weeks after Ms. Watkins, an Enron official, sent her warning to Mr. Lay.

It is not clear how much profit Mr. Lay made on his sales, many of which came while he was encouraging Enron employees to buy shares.

In Texas, a federal judge in Houston appointed one of the most aggressive class-action law firms to lead the litigation of shareholder suits against Enron. And in Austin, a trove of correspondence released after an open-records request documented the extensive contacts between Mr. Lay and George W. Bush when the president was governor of Texas. [Page C1.]

Despite the sales, family members said yesterday that Mr. Lay, who is 59, faced serious financial difficulties as he struggled to repay loans taken out to make investments, many of which have lost value.

Mr. Lay, Enron's former chairman and chief executive, had previously disclosed selling $29.9 million in shares in public markets from January through the end of July. The new disclosures showed he took in $70.1 million from selling Enron stock back to the company from February through October.

A spokeswoman for Mr. Lay, Kelly Kimberly, said that Mr. Lay had "remained confident in Enron's stock through late 2001" and said "the vast majority" of the money he got from Enron was used to pay loans that had been secured by his stake in Enron. She said the sales were unrelated to developments at Enron, including the Watkins letter.

Ms. Kimberly added that Mr. Lay and his wife did not expect to have to file for bankruptcy. "While they are experiencing liquidity problems, they believe they will be able to work through them," she said of the Lays.

The family members, who spoke on the condition of anonymity, said no money was being hidden offshore and that Mr. Lay's wife, Linda, was being honest when she said on the NBC "Today" show last

month: "It's gone. There's nothing left. Everything we had mostly was in Enron stock."

While corporate executives are required to disclose most stock sales by the 10th day of the month after the sale, shares sold back to the company are not required to be disclosed until the next year. Thus most of Mr. Lay's sales remained unknown as Enron was collapsing last year.

Mr. Lay's sales after meeting with Ms. Watkins came during a period when he was trying to reassure investors and Enron employees that there were no problems at Enron despite a falling share price and the Aug. 14 resignation of Jeffrey K. Skilling, who had been Enron's chief executive for six months.

On Aug. 21, the same day he sold $4 million of stock to the company, Mr. Lay told employees that one of his highest priorities was to restore investor confidence, adding that that "should result in a significantly higher stock price."

On Sept. 26, in an online chat with Enron employees, Mr. Lay said the stock was a good buy and added that he had bought stock within the last two months.

Based on publicly available reports, that appeared to be true, because he had exercised stock options without reporting stock sales. But it is now clear that he had sold many more shares than he had bought during the period.

Ms. Kimberly said yesterday that Mr. Lay continued to hold some shares he had received from exercising options last summer. If so, that means he sold other shares he already owned.

On Aug. 13, the day before Mr. Lay reassumed the title of chief executive, Enron granted 90,873 shares to him, according to the filing released yesterday.

Mr. Lay's sales to the company temporarily halted after Sept. 4 but then resumed in late October after partial disclosures about partnerships run by Andrew S. Fastow, then Enron's chief financial officer, had damaged confidence in the company.

On Oct. 23, the day after Enron disclosed that the S.E.C. had begun an informal inquiry into the company's accounting, Mr. Lay resumed his sales, selling $6 million in stock to Enron over four days. On Oct. 26, the day of his final sale, he called Alan Greenspan, the Federal Reserve chairman, regarding Enron's problems, and over the next several days he called several Bush administration officials.

The Bush administration did not intervene, and on Dec. 2, after an attempted merger with Dynegy fell through, Enron filed for bankruptcy protection.

Mr. Lay's sales to Enron in 2001 began early in the year, with a $4 million sale on Feb. 1, when the share price was $78.79. He sold another $4 million in shares on April 27 and then realized $8 million in May, $24 million in June and $4 million in July. During those months he was also selling stock in the open market.

It is not clear how much money Mr. Lay made from the sales. His S.E.C. filings show that he and a Lay family partnership exercised options in 2001 for 635,334 shares, paying $12.2 million. That would reduce his net profits to $87.8 million on his sales last year, less whatever the other shares had cost him.

From 1998 through 2000, according to previous Enron reports, Mr. Lay made annual profits from exercising options of $13.1 million in 1998, $43.8 million in 1999 and $123.3 million in 2000. His

salary and bonus from 1998 to last year totaled $22.5 million.

Enron has since disclosed that its profits were overstated in all of those years, in large part because it improperly concealed losses through the partnerships run by Mr. Fastow.

All told last year, he and the family partnership sold 2,267,371 shares of Enron stock, realizing $100,027,544.87, according to his S.E.C. filings.

Mr. Lay was still left with a large holding in Enron stock when the company collapsed. His filing with the S.E.C. yesterday stated that at the end of December he owned 1,012,223 shares of Enron stock in his own account; 100,000 shares in a family partnership; 20,337 shares in his 401(k) plan; and 121 shares in an employee stock ownership plan. Enron's stock closed yesterday at 26.5 cents.

Ms. Kimberly said that Mr. Lay's sales of stock to Enron were made under a revolving credit arrangement with the company under which he was able to borrow $4 million. That appears to have been something of a formality, because he borrowed the $4 million and then repaid it with stock again and again.

Nearly everything Mr. Lay and his wife own is now up for sale, the family members said, including residential properties in Texas and Colorado, worth about $30 million. The family plans to keep a home worth about $8 million in the River Oaks area of Houston. Under Texas law, a person who files for bankruptcy can keep a home, no matter how much it is worth and no matter how large are the losses suffered by that person's creditors.

Last week, Mr. Lay sold his minority stake in the Houston Texans, an expansion National Football League team, for an undisclosed sum. He and his wife also sold one of their Aspen, Colo., properties for about $10 million, according to Joshua Saslove, Mr. Lay's real estate broker. They had bought the property in 1991 for about $1.9 million, but the property had undergone extensive renovations in 1993. Another plot of land in Colorado the family owns sold for about $2.15 million, Mr. Saslove said. There are two other Aspen properties for sale, worth $6 million apiece, he said.

Family members said that as 2001 began, 80 percent of Mr. Lay's wealth was in Enron, including his stock, options, deferred compensation plan and his 401(k) savings plan. Ms. Kimberly said with Enron virtually worthless, his net worth is down by 80 percent, but she did not give an exact figure. A family member said yesterday that Mr. Lay was worth about $400 million a year ago.

While some Enron executives were able to request and pull their deferred compensation out of Enron before it collapsed, Mr. Lay did not request or receive any of his deferred compensation, Ms. Kimberly said.

Though most of Mr. Lay's money was in Enron stock, family members and associates say Mr. Lay did have some other holdings. Because he was a director at Compaq, Eli Lilly & Company and i2 Technologies, he owned stock in those companies that is now valued at about $10 million.

In the last few years, Mr. Lay and his son Mark, 33, invested about $1 million in two privately held technology companies, EterniTV, an Internet start-up that delivers video services over the Web, and EC Outlook, a company that develops supply chain management software. Both companies are struggling.

Mr. Lay also invested nearly $20 million in Questia, a Houston company that sells access to online books. The company's work force has been cut drastically in the last year.

Asked whether Mr. Lay had a financial adviser, one close friend said: "There were no advisers. He did it all himself."

One reason, a person close to the family said, was an experience Mr. Lay had in the mid-1980's, after receiving a huge payout when he helped merge Houston Natural Gas and Internorth to create Enron. The windfall of more than $3 million was largely invested in California real estate by an adviser, he said, adding that much of that money was lost when the real estate market tumbled.

Enron-Cooper Contract

Details of the contract between the Enron Corporation and Stephen F. Cooper, whom the company's board has elected as its acting chief executive, were disclosed yesterday in a filing with federal bankruptcy court in Manhattan.

Mr. Cooper's firm, Stephen Forbes Cooper L.L.C., will be paid $1.3 million a year, payable in monthly installments of $110,000 each, along with an additional $1.2 million a year, also payable in monthly installments, for each senior executive who works on Enron's restructuring. If Enron is not liquidated and emerges from bankruptcy, Mr. Cooper's firm will also receive a fee of at least $5 million; if the company is liquidated, a fee will be agreed upon.

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Section: 3

Company Man to the End, After All

KURT EICHENWALD

Review of former Enron chairman and chief executive Kenneth L Lay's personal records and interviews with his financial advisers and other witnesses show Lay, pilloried in media for allegedly secretly unloading much of his own stake while urging employees in summer of 2001 to buy Enron stock, retained his faith in company virtually until its collapse; data seem to transform case of what appeared to be criminal insider trading into more complex mosaic of hubris and financial recklessness; Lay, forced by margin calls, sold almost $100 million worth of Enron shares in 2001, but went to great lengths to hang onto Enron shares, even as debacle unfolded; graphs; chronology of events; photos (M)

HOUSTON IT has become an indelible moment of the recent corporate scandals: Kenneth L. Lay, then chairman and chief executive of Enron, encouraging employees in the summer of 2001 to buy company stock, even as he was secretly unloading much of his own stake.

Mr. Lay's representatives have always denied that he had any ill intent, arguing that the sales resulted from margin calls on his collapsing portfolio. But his critics remain unmoved.

Enron employees accused him of betrayal. Members of Congress demanded his indictment on insider trading charges. The event even figured in a recent television movie about Enron as evidence of corruption at the company's very top.

But this story of a hypocrite unmasked suffers from one significant flaw: it appears to be untrue.

A review of previously undisclosed personal records -- including years of trading, accounting and other documents -- as well as interviews with Mr. Lay's financial advisers and other witnesses in the government's investigation indicates that Mr.

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Lay retained his faith in the company virtually until its collapse.

Ultimately, people involved in the investigation say, the records -- many of which were provided by people sympathetic to Mr. Lay -- have transformed what appeared to be an open-and-shut case of criminal insider trading into a more complex mosaic of hubris and financial recklessness. Indeed, outside experts who were told of the data said, the case seems far less likely to support charges of the type once imagined.

"This would be a case that the government would normally shy away from," said John C. Coffee Jr., a securities law expert at Columbia University.

None of this means Mr. Lay may not ultimately face criminal charges. Prosecutors may decide that he structured his selling to hide his actions improperly from the market or was aware of nonpublic information that should have led him to halt his trading. They could also conclude that he is criminally liable for some other element of Enron's collapse. But prosecutors are said to be close to a decision on whether to charge Mr. Lay, and there has been no indication that they have pursued other avenues.

With his investment blunders, Mr. Lay joined a group of chief executives -- including Bernard J. Ebbers of WorldCom and John J. Rigas of Adelphia Communications -- who structured their finances with an apparent view that their companies would never stumble. Each borrowed heavily on his stock, each left his job amidst scandal, and now -- after years of cultivating images as a brilliant corporate strategist -- each must rely on admissions of his own shortcomings to defend decisions that now seem incomprehensible.

But Mr. Lay, who declined to comment for this article, would be able to marshal reams of records to provide proof that he was caught unaware by his company's downfall.

He appears to have managed both his personal finances and Enron in much the same way: with a belief that the market would never turn sour. Both Mr. Lay and the company financed deals and investments with Enron stock, with provisions requiring the price to stay above certain levels. When those price triggers were hit, his finances and the company's began to fall apart.

Mr. Lay sold many Enron shares in 2001 -- almost $100 million worth. Often, he sold them back to the company, a mechanism that delayed disclosure.

IT is those furtive transactions -- particularly sales in late August 2001, after Sherron S. Watkins, an Enron executive, raised concerns of improprieties -- that have led to the harshest criticisms of Mr. Lay.

But the records indicate that he went to great lengths to hang onto Enron shares, even as the debacle unfolded.

They show that Mr. Lay maintained a risky -- some would say foolhardy -- trading position, pledging virtually his entire portfolio of liquid assets, dominated by his huge Enron stake, as collateral against bank and brokerage loans used to make other investments.

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Such a position can be profitable as long as the value of the pledged stock goes up, with the shares then available to pay off borrowings. But if values go down, as happened at Enron, it can result in forced sales.

Mr. Lay, with little additional collateral, made just such sales to pay down tens of millions of dollars in debt. No proceeds were used for any other purpose, the data show.

The evidence suggesting that Mr. Lay continued to believe in Enron shares in 2001 is substantial:

* When the falling stock price left him with too little collateral for his loans, he took several steps to delay selling Enron shares, like selling other investments and persuading a bank to accept an illiquid investment as collateral.

* That summer, Mr. Lay converted more than 200,000 Enron options into stock, but did not sell the shares. A result was a tax liability of several million dollars for an investment that proved worthless.

* That July 31, Mr. Lay stopped daily sales of Enron shares begun the year before under a Securities and Exchange Commission program for corporate insiders. A financial adviser said Mr. Lay believed the stock price was too low.

* In late September, before the crisis hit, Mr. Lay used a $10 million incentive payment to pay down some bank loans, essentially using cash to forestall the further forced sale of Enron shares.

* About the same time, Mr. Lay began to sell and even abandon private equity investments that required him to post additional cash -- money he could have raised by selling Enron shares.

All told, experts said, the records indicate that Mr. Lay believed what he said when he told employees the stock was a good buy in August 2001.

"That trading pattern is consistent with Ken Lay sincerely believing that Enron stock had reached a trough and had nowhere to go but up," said Kevin J. Murphy, who specializes in executive compensation at the Marshall School of Business of the University of Southern California.

That differs sharply from the story put forward early last year, after many news organizations, including The New York Times, reported that Mr. Lay had sold large numbers of shares as he urged others to buy. Many people seized on those facts as evidence of duplicity, not accounting for other possible explanations.

Still Mr. Lay was not wiped out in the collapse, though his wife, Linda, lamented in early 2002 that the family had lost everything. He retains $3.8 million in marketable investments, records show -- down from $339 million in early 2001. His retirement benefits, once valued at $68 million, now total under $2 million. He also owns tens of millions of dollars of illiquid assets, mainly real estate.

In one year, Mr. Lay has been transformed from a centimillionaire with huge stock holdings to a multimillionaire whose wealth is mostly tied up in hard-to-sell

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assets.

While the records may provide a defense against a criminal charge, it is unclear how much they may help in civil lawsuits. Shareholders have sued him, and just last month Enron creditors sued him, contending that the stock sales to the company constituted a "fraudulent conveyance" of corporate assets.

The records show that in 1997, Enron shares made up more than 90 percent of his liquid assets. Even his largest illiquid asset -- a family partnership, in which he owned an interest then valued at $47.9 million -- was largely invested in Enron.

His advisers said they pressed Mr. Lay to diversify, and in late 1999, he did so, largely with borrowed money.

Virtually all of Mr. Lay's marketable investments were pledged as collateral to back margin loans from institutions like PaineWebber, First Union and Compass Bank, a regional bank. He had multiple lines of credit at Bank of America, including a $40 million line for him and his wife, $10 million for a family partnership and $11.7 million to allow him to buy 2.5 percent of what became the Houston Texans football team.

Throughout 2000, those credit lines underwrote the purchase of new investments. Following his strategists' advice, Mr. Lay placed millions with money managers, including Goldman, Sachs; Cypress Asset Management: the TCW Group; and Fayez Sarofim & Company in Houston. Millions more went to mutual funds and other public investments.

ULTIMATELY, the strategy failed the basic tenets of diversification, because it depended on Enron's share price climbing. If it simply held even, Mr. Lay's returns would be diminished by his loan interest.

Using margin can supercharge an investment; an investor can hang onto shares while using them for other investments. But margin also allows for supercharged losses. If the pledged security falls in price, the investor's portfolio can be liquidated to pay down the debt.

That is what Mr. Lay kept trying to avoid in 2001.

According to his bank agreements and other records, the possibility of margin calls grew if the share price dropped below $80; if it fell below $60, he would almost certainly be in violation of the loan terms. The stock hit the first trigger by January 2001; by March, Enron shares traded in the high 50's.

Beginning in February, Mr. Lay started to head off margin calls and avoid having to sell Enron stock, one adviser said. First, lenders were persuaded to increase the "loan-to-value ratio," meaning that Enron shares could fall further before prompting margin calls. And one institution, Compass Bank, accepted a multimillion-dollar illiquid investment as collateral. Both negotiations, the adviser said, were viewed as a success for Mr. Lay. With Enron's stock price tumbling, though, he had to sell far more shares later.

"There was no concern, no worries that Enron was going to collapse," one adviser

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who spoke often with Mr. Lay said of that period. "Every step along the way, we felt like today is the bottom and tomorrow is going to be better."

Mr. Lay's advisers also began liquidating the non-Enron portfolio to pay down debt. (Two of his largest non-Enron holdings -- in Eli Lilly and Compaq Computer -- could not be sold at the time, because they were restricted shares granted to Mr. Lay as a director of those companies.)

By June 2001, Enron shares had fallen into the $40's, and Mr. Lay and his advisers set out to deal with his credit squeeze once and for all. They turned to Enron.

Under terms of a corporate line of credit, he could borrow up to $4 million and, if he chose, pay it back with Enron shares held at least six months. This mechanism let Mr. Lay dispose of Enron stock without immediately disclosing it; a lawyer had told him that these transactions need not be disclosed until after year-end.

Sometimes, Mr. Lay delayed repayment for days or weeks. In those instances, one adviser said, Mr. Lay believed that Enron's stock price had hit a bottom and so was betting that he could soon repay the loans with fewer shares.

Through June, Mr. Lay sold $28 million in Enron stock this way, bringing his total obligations to the banks and brokerage firms below $50 million. But he offset some sales by exercising options for 50,000 Enron shares and holding them -- another sign of faith in the stock.

On July 31, Mr. Lay sent written instructions to PaineWebber to halt his daily sales of 2,500 shares. Mr. Lay believed that he was losing money by selling too cheaply, but his advisers disagreed.

"That was another source of income to help deal with some of these margin calls and other issues," one adviser said. "It just shut off another spigot."

On Aug. 14, Jeffrey K. Skilling, then the chief executive, resigned, sending the stock plummeting anew. Almost immediately, Mr. Lay received new margin calls, just as Ms. Watkins sent him her now-famous letter asserting accounting problems.

Most attention has focused on Mr. Lay's trading after this point, and prosecutors must still decide whether Ms. Watkins's information was enough to compel Mr. Lay to stop all sales, even to the company. But Mr. Lay's records strongly suggest that his sales had nothing to do with Ms. Watkins's information.

As the stock kept sinking, he repeatedly tapped his Enron credit line -- borrowing $12 million more in August and $4 million in early September. Sometimes he repaid immediately with Enron shares; sometimes he waited weeks, apparently in hopes of a rebound.

Soon, Mr. Lay began abandoning investments that would have required cash contributions -- money he could have raised by selling Enron shares.

On Sept. 21, the same day lawyers briefed him on their investigation of Ms. Watkins's accusations, Mr. Lay used a new $10 million incentive payment to pay

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down debt. In other words, he turned over cash instead of selling Enron stock, another bet that the shares would turn around.

THEY never did. In mid-October, Enron said it was restating its earnings because of problems associated with off-the-books partnerships. The stock fell sharply, and Mr. Lay received more margin calls. Every day from Oct. 23 through Oct. 26, he borrowed on his Enron credit line to meet the demands, repaying the debt with stock.

The Oct. 26 sale, at $15.40 a share, was his last. Because of his insistence that shares be sold only to satisfy margin calls, advisers said, Mr. Lay held on to 1.2 million shares -- and some five million vested options -- as the price dove toward zero.

"He was always a bull on the stock," one adviser said, "right up to the day that the company filed for bankruptcy."

Photos: Kenneth L. Lay of Enron in his Houston office in June 2001. Stock trading and other records indicate he kept his faith in Enron virtually until its collapse months later. (Paul Howell/Dallas Morning News)(pg. 1); As part of an interview broadcast on NBC's "Today," Mr. Lay and his wife, Linda, were shown at their home in Houston in January 2002. (pg. 12)

Chart: "Meltdown"
The financial records of Kenneth L. Lay, the former chairman and chief executive of Enron, indicate that he retained his faith in the company's stock while Enron was collapsing. He apparently sold shares only to avoid, or in response to, margin calls on his heavily leveraged investment portfolio.

Graph tracks Enron's daily closing stock price from January to December 2001.

JULY 31
Mr. Lay halts daily sales of 2,500 Enron shares, upsetting advisers who wanted him to reduce his holdings.

AUG. 15
One day after Jeffrey K. Skilling resigns as chief executive, Sherron S. Watkins, an Enron vice president, writes to Mr. Lay expressing concerns about company accounting practices. A sharp drop in Enron shares leads to margin calls on Mr. Lay's portfolio on Aug. 16.

AUG. 22
Mr. Lay meets with Ms. Watkins, who tells him that Enron may be an "elaborate accounting hoax." A day earlier, Mr. Lay used Enron shares to repay a $4 million company loan he had carried for 21 days in apparent hope that the stock would rise. He also exercised 68,620 options and held onto that stock.

SEPT. 21
Mr. Lay uses a $10 million incentive payment to repay debt, rather than selling Enron shares. Five days later, in an online chat with employees, he calls Enron stock "an incredible bargain" and says that "the third quarter is looking great." Mr. Lay gets a margin call Sept. 27.

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OCT. 16
Enron reports a third-quarter loss of $618 million and reduces shareholder equity by more than $1 billion to account for transactions involving some of its partnerships.

OCT. 26
Mr. Lay calls top Washington officials to discuss Enron's problems. He also makes the last in a flurry of stock sales to satisfy margin calls.

DEC. 2
Enron files for bankruptcy protection.

Graph tracks monthly stock sales**, stock options exercised and held, margin calls* and Enron credit line drawn down through 2001.

*Does not include margin calls from brokerage firms and other financial institutions that were placed by phone.

**Does not include daily sales of 2,500 shares through July 31 under a plan filed with the Securities and Exchange Commission.

Chart: "Betting on Enron"
The bulk of Mr. Lay's net worth was tied up in Enron stock. As the stock's value soared, so did his fortune. But when Enron's stock collapsed, Mr. Lay lost much of his wealth.

MR. LAY'S LIQUID INVESTMENT PORTFOLIO
Excludes his interest in a family partnership that owned a large block of Enron stock. Mr. Lay also owns retirement benefits valued at less than $2 million and tens of millions in illiquid assets, mainly real estate.

Dec. 31, 1997: $42.94 million
Other investments: 9.5%
Enron stock and options: 90.5%

Dec. 31, 2000: $338.57 million
Other investments: 9.5%
Enron stock and options: 90.5%

Dec. 31, 2002: $3.77 million
Enron stock and options: 0.6%
Other investments: 99.4%

Following the advice of his financial advisors, Mr. Lay diversified his portfolio by taking out loans secured by his Enron stock. As Enron shares declined in value, he was forced to sell his other holdings and Enron shares to cover margin calls on the loans.

MR. LAY'S LIQUID ASSETS AND COLLATERAL, 2001
Figures in millions

Jan.

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ASSETS COLLATERALIZED: $190.35
ASSETS: $198.37

Feb.
ASSETS COLLATERALIZED: 160.25
ASSETS: 166.58

Mar.
ASSETS COLLATERALIZED: 138.00
ASSETS: 143.63

Apr.
ASSETS COLLATERALIZED: 142.47
ASSETS: 143.28

May*
ASSETS COLLATERALIZED: 119.23
ASSETS: 116.47

June
ASSETS COLLATERALIZED: 89.25
ASSETS: 86.53

July
ASSETS COLLATERALIZED: 84.80
ASSETS: 82.05

Aug.
ASSETS COLLATERALIZED: 55.41
ASSETS: 53.10

Sept.
ASSETS COLLATERALIZED: 41.24
ASSETS: 39.71

Oct.
ASSETS COLLATERALIZED: 20.24
ASSETS: 18.91

Nov.
ASSETS COLLATERALIZED: 14.97
ASSETS: 15.69

Dec.
ASSETS COLLATERALIZED: 15.17
ASSETS: 14.45

*Beginning in May, one bank accepted an illiquid investment as collateral, pushing the total value of the collateral higher than the value of the liquid assets.

(Sources: Mr. Lay's personal financial records; bank and brokerage documents)(pg. 12)

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