

### **III. PENSION AND COMPENSATION OBSERVATIONS, FINDINGS, AND RECOMMENDATIONS**

#### **A. General Observations with Respect to Pensions and Compensation**

Enron's stated philosophy was a pay for performance approach to compensation; those who performed well were paid well. Enron implemented this approach with a broad array of compensation arrangements for its executives that included base pay, bonuses, and long-term incentive payments. In 2000, total compensation for the 200 highest paid employees of Enron was \$1.4 billion dollars (\$1.2 billion of which was attributable to stock options and restricted stock). In the same year, Enron reported \$975 million of financial statement net earnings.

Enron's approval of compensation packages for its executives rested almost entirely with internal management. Although the Compensation Committee of the Board of Directors formally approved both the total amount of compensation paid to executives and the form of such compensation, the Committee's approval generally was a rubber stamp of recommendations made by Enron's management. Missing was an objective assessment of the value added by top executives; compensation was typically deemed to be justified if it appeared to be consistent with what other companies paid executives. Targets for compensation were sometimes set, but in practice the total amount paid frequently exceeded the targets. The Compensation Committee went through the motions of satisfying its role as objective evaluator of reasonable pay by commissioning "independent" studies with respect to Enron's compensation arrangements; in some cases, the studies appeared to be designed to justify whatever compensation arrangement management wanted to adopt.

The lack of scrutiny of compensation was particularly prevalent with respect to Enron's top executives, who essentially wrote their own compensation packages. In some cases, although going through the formalities of reviewing arrangements, the Compensation Committee merely rubber stamped what was presented. In other cases, the Compensation Committee either never reviewed certain arrangements for executives, or performed such a cursory review that they were not fully aware of what they were approving. For example, a former chairman of the Compensation Committee could not remember an arrangement under which an Enron executive was awarded a fractional interest in an airplane as a form of compensation.

There was no indication that Enron's Compensation Committee ever rejected a special executive compensation arrangement brought to them. Indeed, the Compensation Committee used studies, sometimes commissioned after the fact, to justify the compensation arrangements for top executives. As a result, Enron's top executives earned enormous amounts of money and even used the company as an unsecured lender. For example, from 1997 through 2001, Mr. Lay borrowed over \$106 million from Enron through a special unsecured line of credit with the company.

Enron did not appear to maintain consistent or centralized recordkeeping with respect to compensation arrangements in general and executive compensation in particular. Enron could not provide documentation relating to many of Enron's special compensation arrangements for its top executives. When asked about compensation arrangements in interviews, current and

former Enron employees with responsibility for such matters had no knowledge of certain aspects of executives' compensation, particularly in the case of special arrangements. Although Enron represented that it properly reported income with respect to employee compensation arrangements, the lack of recordkeeping made it impossible to verify whether this was true.

Enron's heavy reliance on stock-based compensation, both with respect to executives and with respect to rank and file employees, caused significant financial loss when Enron's stock price collapsed. As part of a philosophy that a large portion of executive compensation should depend on shareholder return, Enron rewarded executives with huge amounts of stock options, restricted stock, and bonuses tied to financial earnings. In addition, a strong company culture encouraging stock ownership by all employees led to high investments in Enron stock made by employees through the Enron Corp. Savings Plan (the "401(k)" plan). In the end, when Enron's stock price plummeted, Enron's employees and executives lost millions of dollars in retirement benefits under Enron's qualified plans and nonqualified deferred compensation arrangements and through the loss of value of stock that had been received as compensation for services. Although some executives suffered losses that appear stunning in amount, many executives also reaped substantial gains from their compensation arrangements. Enron's rank and file employees in many cases lost virtually all of their retirement savings because they believed statements made by Enron's top executives up to the very end that Enron was viable and that Enron's stock price would turn around.