C. Pension and Compensation Arrangements

1. Overview

Enron's compensation arrangements received considerable media attention in the aftermath of the Enron bankruptcy. Some of this attention has focused on the broad-based retirement plans maintained by Enron that receive special tax benefits ("qualified retirement plans"). For many Enron employees, the benefits provided under these plans were the primary source of retirement income. Attention has also focused on the overall compensation arrangements of Enron, particularly the compensation provided to executives. The Report addresses both aspects of Enron's compensation arrangements.

2. Enron's qualified retirement plans

Overview of Enron qualified plans

Enron maintained three main qualified retirement plans: the Enron Employee Stock Ownership Plan ("ESOP"); the Enron Retirement Plan, which was modified and renamed the Enron Cash Balance Plan; and the Enron Savings Plan.

The Enron ESOP was invested primarily in Enron stock.

The Enron Retirement Plan provided a benefit based on a participant's compensation and years of service. The Enron ESOP and Enron Retirement Plan were designed as a floor-offset arrangement, under which benefits earned by a participant under the Enron Retirement Plan were reduced or "offset" by the benefits received by the participant under the Enron ESOP.

The floor-offset arrangement was frozen after 1994 and was phased out over the period 1996 through 2000. During that period, the value of the account balance in the ESOP was locked in, and an offset for benefits accrued under the Enron Retirement Plan during 1987 through 1994 was set permanently based on Enron stock prices at specified times. As a result of the locking in of the offset and the subsequent decline in the value of Enron stock, many plan participants did not receive the same level of benefits they would have received if the offset feature had remained unchanged. The locking in of the offset is currently under review by the IRS.

In 1996, the Enron Retirement Plan was renamed the Enron Cash Balance Plan and the traditional defined benefit plan formula was replaced with a cash balance formula. The Enron Cash Balance Plan has been under review by the IRS National Office since 2000, pursuant to a 1999 directive that all cash balance plan conversions be referred to the IRS National Office pending clarification of applicable rules.

The Enron Savings Plan is a 401(k) plan. Participants could make elective deferrals and after-tax contributions to the Enron Savings Plan, and had a range of investment choices available for their contributions, including Enron stock. In addition, Enron made matching contributions based on employee elective deferrals. The matching contributions were invested in Enron stock pursuant to the plan terms; participants could elect to invest the matching contributions in another investment after attaining age 50.

Many Enron Savings Plan participants lost considerable amounts of retirement savings due to the high level of investment in Enron stock. Significant amounts of plan assets were invested in Enron stock even though the Enron Savings Plan offered approximately 20 investment options other than Enron stock, consisting of a broad range of alternatives offering various risk and return characteristics.

Employee investment in Enron stock was generally encouraged by Enron. Even as the price of Enron stock declined during 2001, management told employees of a bright future for Enron. For example, Kenneth L. Lay was consistently optimistic in his predictions for the future of Enron stock, even when an employee specifically asked about Enron stock in the context of the Enron Savings Plan.

The decline of Enron's stock price and Enron's subsequent bankruptcy has affected the benefits that Enron employees are or may be entitled to under the Enron qualified plans. Most of the media attention regarding the effect of the bankruptcy on employees' benefits related to the significant plan holdings in Enron stock, particularly in the Enron ESOP and the Enron Savings Plan.

Issues reviewed with respect to Enron qualified plans

The Joint Committee staff reviewed in detail certain issues relating to the Enron qualified plans, including: (1) the locking in of the value of the ESOP offset under the Enron Retirement Plan; (2) the conversion of the Enron Retirement Plan into the Enron Cash Balance Plan; (3) investment of the Enron ESOP in Enron stock; (4) a change in recordkeepers under the Enron Savings Plan that resulted in a "blackout" period in October and November 2001 during which plan participants could not make investment changes while the price of Enron stock was falling; (5) the reasons behind the level of investment of Enron Savings Plan assets in Enron stock; and (6) allegations made in early 2002 by Ms. Robin Hosea, a former Enron contract and full-time employee, that payments were made from Enron's employee benefit funds for purposes unrelated to employee benefits. The Report also discusses the issue of whether plan fiduciaries of the Enron ESOP should have acted to remove Enron stock as an investment under the ESOP, despite plan provisions directing such investment.

3. Other compensation arrangements

In general

In addition to the attention given to the Enron qualified retirement plan issues, attention has been focused on the various compensation arrangements of Enron, particularly those of officers and other executives. This focus has been both on the magnitude of compensation paid to certain executives and on the various forms of compensation used by Enron.

Enron had a pay-for-performance compensation philosophy. Employees who performed well were compensated well. Enron's compensation costs for all employees, and especially for executives, increased significantly over the years immediately preceding the bankruptcy.

Enron's executives were paid substantial amounts. In 2000, total compensation for the 200 highest paid employees of Enron was $1.4 billion. This consisted of $56.6 million of bonuses, $1.06 billion attributable to stock options, $131.7 million attributable to restricted stock, and $172.6 million of other income, including base salary.

Overview of Enron's executive compensation arrangements

Executive compensation at Enron was generally comprised of base salary, annual incentives, and long-term incentives. Enron's long-term incentive program was designed to tie executive performance directly to the creation of shareholder wealth. The long-term incentive program provided for awards of nonqualified stock options and restricted stock. Certain executives were eligible to participate in nonqualified deferred compensation arrangements.

Nonqualified deferred compensation plans

Certain executives were given the opportunity to participate in nonqualified deferred compensation arrangements. Participants were eligible to defer all or a portion of salary, bonus, and long-term compensation into Enron-sponsored deferral plans. The plans provided an opportunity to delay payment of Federal and State income taxes and earn a tax-deferred return on deferrals. Many executives took advantage of the opportunity to defer amounts that would otherwise have been included in income currently.

Nonqualified deferred compensation was a major component of executive compensation for Enron. In 1998, the 200 highest paid employees at Enron employees deferred $13.3 million. By 2000, that amount had risen to $70 million. For the years 1998 through 2001, a total of $154 million in compensation was deferred. According to documents provided by Enron, Mr. Lay deferred $32 million under one of Enron's nonqualified deferred compensation plans.

In late 2001, prior to Enron's bankruptcy filing, early distributions were made to certain participants from two of Enron's nonqualified deferred compensation plans. These distributions totaled more than $53 million.

Stock-based compensation

Enron used stock-based compensation as a principal form of compensation for executives. Enron's stock-based compensation programs included nonqualified stock options, restricted stock, and phantom stock. Enron's deduction for compensation attributable to the exercise of nonqualified stock options increased by more than 1,000 percent from 1998 to 2000. Enron's directors were also compensated partially in Enron stock.

Pre-bankruptcy bonuses

In the weeks immediately preceding the bankruptcy, Enron implemented bonus programs; one for approximately 60 key traders and one for approximately 500 employees that Enron claimed were critical for maintaining and operating Enron going forward. In order to receive a bonus under one of these programs, the employee had to agree to repay the bonus, plus an additional 25 percent, if the employee did not remain with Enron for 90 days. The combined cost of the programs was approximately $105 million.

Special compensation arrangements

Enron had certain compensation arrangements for limited groups of people or for specific individuals. For example, Enron had a Project Participation Plan for employees in its international business unit.

Enron also had arrangements for a small number of employees or in some cases just one employee. One executive, Mr. Lou Pai, received the use of a 1/8 fractional interest in a jet aircraft Hawker 800 as part of his compensation. A few employees received loans (or lines of credit) from Enron or split-dollar life insurance arrangements. Enron purchased two annuities from Mr. Lay and his wife as part of a compensation package for 2001. Certain executives were allowed to exchange interests in plans for large cash payments or stock options and restricted stock grants.

Employee loans

From time to time, Enron extended loans to a few executives. Information provided to the Joint Committee staff indicates that loans were made to at least eight Enron employees, including Mr. Lay and Mr. Jeffrey Skilling. Mr. Lay was provided with a $7.5 million line of credit with the company. The aggregate amount withdrawn pursuant to his line of credit from 1997 through 2001 was over $106 million. In 2001 alone, Mr. Lay engaged in a series of 25 transactions involving withdrawals under the line of credit totaling $77.5 million, of which all but $7.5 million was repaid. Mr. Skilling was loaned $4 million by Enron in 1997. Half of the loan was repaid in 1999 and the other half in 2001.

Purchase and reconveyance of Mr. Lay's annuity contracts

In September of 2001, the Compensation Committee of the Enron Board of Directors agreed to an "insurance swap transaction" under which Enron agreed to purchase two annuity contracts from Mr. and Mrs. Lay for $10 million and also agreed to reconvey the annuity contracts back to Mr. Lay if he remained employed with Enron through December 31, 2005. If Mr. Lay left Enron prior to that date, the reconveyance would still take place in four events: (1) retirement with the consent of the Board; (2) disability; (3) involuntary termination (other than termination for cause); or (4) termination for "good reason." Mr. Lay's counsel indicated in a letter to the Joint Committee staff that they could not give a legal opinion about the current status of the annuity contracts and indicated their understanding that the characterization of Mr. Lay's termination with Enron for purposes of severance benefits was still under review.

Split dollar insurance arrangements

Enron entered into split-dollar life insurance arrangements with Mr. Lay ($30 million and $11.9 million), Mr. Skilling ($8 million), and Mr. Clifford Baxter ($5 million).