B. Overview of Executive Compensation Arrangements

1. In general

Overview

Enron's stated executive compensation philosophy was to provide executives with rewards that reflect their impact on Enron's total shareholder returns and creation of long-term shareholder value.[1672] As previously discussed, each year, the Compensation Committee established total compensation targets based on an assessment of external trends and market data. According to Enron employee materials, the key tenets of the executive compensation program were: (1) to tie executive compensation to the creation of shareholder value; (2) to deliver a significant portion of total compensation in a combination of short-term and long-term incentives so that executives have the opportunity to earn at the 75th percentile of the external marketplace or higher, subject to the achievement of Enron financial and nonfinancial goals and individual performance objectives; and (3) to promote teamwork and support movement of key talent to opportunities as they arise throughout the organization.[1673]

Executive compensation at Enron was generally comprised of base salary, annual incentives, and long-term incentives. Executives had the opportunity to earn at the 75th percentile or higher level, subject to obtaining performance at the 75th percentile or higher.[1674] In addition to the three principal components of executive compensation (base salary, annual incentive and long-term incentive), certain executives also participated in special compensation arrangements, such as nonqualified deferred compensation programs, split-dollar insurance arrangements, and employee loans. Individualized compensation arrangements were also used for certain executives. For example, as discussed below, as a form of compensation, Enron purchased two annuities from Kenneth L. Lay and his wife. Another executive, Mr. Lou Pai, received a fractional interest in an airplane as part of his compensation.

Base salary

Base salary levels were targeted at the 50th percentile of the external marketplace. An annual salary increase budget was set to maintain Enron's position relative to the market. Base pay was reviewed and adjusted at Enron's discretion and in relation to market conditions, but was also reflective of individual performance. Base pay was generally reviewed and adjusted on February 1 of each year, if appropriate. Base salary increases were typically approximately four percent per year.[1675]

[1672] Enron Compensation Program 2001 (employee brochure). EC2 000019710.

[1673] Enron Compensation Program 2001 (employee brochure). EC2 000019710.

[1674] Report from Compensation Committee, 2001 Enron Corp. Proxy Statement.

[1675] The minutes of the May 3, 1999, meeting of the Compensation Committee show that Messrs. Lay and Skilling requested that the Committee not increase their respective salaries for

Annual incentive awards

Annual bonuses were a major component of Enron's executive compensation structure. Annual bonuses were targeted at the 75th percentile level compared to the market and could often be larger than base salary for some employees.

According to the 2001 proxy, the primary objective of the annual incentive plan was to promote outstanding performance by Enron in absolute terms, as well as in comparison to its peer companies. The plan was funded as a percent of recurring after-tax net income as approved by the Compensation Committee each year.

Competitive annual incentive targets were established by the Compensation Committee each year based on external trends and market data.[1676] Payments were based upon Enron's performance against preestablished goals, as well as business unit and individual performance. According to the 2001 proxy, annual bonus payments were based upon Enron's performance measured against Enron's operating plan as approved by the Board of Directors. Key performance criteria such as funds flow, return on equity, debt reduction, earnings per share improvements, and other relevant factors could be considered at the option of the Committee. Proxy statements from recent years state that a Performance Review Report was presented to the Compensation Committee in January, which summarized management's view regarding whether and to what extent the key performance criteria were attained. The Performance Review Report also discussed any other significant, but unforeseen factors that positively or negatively affect Enron's performance. The Compensation Committee verified Enron's actual recurring after-tax net income, reviewed management's funding level recommendation, and approved the resulting award fund.

The Performance Review Committee process and resulting employee ranking significantly influenced the actual incentive awards paid. The Annual Incentive Plan was used for bonuses for Section 16 officers. The Annual Incentive Plan for Section 16 officers was funded as a percentage of after-tax net income, not to exceed five percent. Officers other than Section 16 officers were paid annual bonuses, but not through the Annual Incentive Plan.

Annual incentives are discussed in detail in Part III.B.2., below.

Long-term incentives

According to the 2001 proxy, Enron's long-term incentive program was designed to tie executive performance directly to the creation of shareholder wealth. The long-term incentive

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1999. The Committee reluctantly agreed to honor the request on the condition that the minutes reflect the Committee's judgment that during 1998 Messrs. Lay and Skilling had performed their respective duties superbly, that Enron's shareholders had benefited significantly from such performance, and that, in the absence of the specific request they had made, each would have received a salary increase for 1999.[1675] Joint Committee staff asked several interviewees about this and no one, including Mr. Skilling, could recall the reason for the request.

[1676] 2001 Enron Corp. Proxy Statement.

program provided for awards of nonqualified stock options and restricted stock. Awards were one-half stock options and one-half restricted stock. In the past, the Compensation Committee utilized other long-term compensation vehicles. Option grants generally vested over a five-year term. The number of options to be awarded was determined based on the approved Black-Scholes value as determined by the Compensation Committee. Restricted stock grants generally vested over four years, but could be accelerated based on Enron's performance relative to the S&P 500 index.

Participation in the long-term incentive plan was available to employees in the vice president job group and above.[1677] Long-term incentive target values were to be established by the Compensation Committee each year based on assessment of external trends and market data.[1678] Actual grants were determined each January based on the year-end performance review committee assessments and were subject to the approval by the Office of the Chairman. Award agreements providing the terms and provisions of the awards were typically presented to recipients during the first quarter of the year. Grants for section 16(b) officers required Compensation Committee approval.

Before the changes to Enron's compensation structure in 1999, some business units had their own long-term incentive programs. For example, Enron Capital & Trade Resources had its own long-term compensation program for stock options and phantom stock units, which were granted under the Enron Capital & Trade Resources Corp. Phantom Stock Unit Plan.

Long-term incentives are discussed in detail in Part III.C.2., below.

Nonqualified deferred compensation

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 tax-deferred return on deferrals. Many executives took advantage of the opportunity to defer amounts that would otherwise be included in income currently. The specific nonqualified deferred compensation plans and programs offered by Enron are discussed below in more detail.

Miscellaneous

Enron maintained a FlexPerq program for Managing Directors and above. Under the program, certain expenses were covered by an allowance rather than required to be submitted for reimbursement on an expense report. These included income tax preparation, investment counseling/estate planning, legal counseling, country club and health club membership, luncheon club membership, airline VIP club membership, car/cell phone, in-home long-distance service, and "premium" credit cards. In materials provided to executives, Enron explained that all FlexPerq allowance amounts would be reported as compensation on the participant's Form W-2.

[1677] Enron Corp. Executive Compensation Program brochure. EC 002634797.

[1678] Enron Corp. Executive Compensation Program brochure. EC 002634797.

Eligible participants would be given an annual FlexPerq allowance equal to three percent of their salary.

Top-200 most highly compensated

Appendix D shows the compensation paid to each of the top-200 highest paid employees for the years 1998, 1999, 2000, and 2001.[1679] Compensation attributable to bonus, stock options, restricted stock, deferred payout, and other compensation is separately stated. As shown in Appendix D, the top executives were extremely highly compensated, especially in the years immediately preceding Enron's bankruptcy. The range of total compensation paid to the top-200, as provided by Enron, is shown in Table 13, below.

Table 13.–Range of Total Compensation Paid to the Top-200 Most Highly Compensated Employees for 1998-2001[1680]

Year	Range of Total Compensation Paid to the Top-200
1998	$152,000 to $20,621,000
1999	$325,000 to $56,541,000
2000	$1,270,000 to $168,741,000
2001	$1,104,000 to $56,274,000[1681]

In 2000 and 2001, each one of the top-200 employees was paid over $1 million. In 2001, the year of Enron's bankruptcy, at least 15 executives were paid over $10 million. One executive was paid over $56 million.[1682] In 2000, three executives were paid over $100 million, with the top-paid executive receiving $169 million. In 2000, at least 26 executives were paid over $10 million.

Table 14, below, shows information obtained from the IRS, which is based on information provided by Enron, on the total compensation for the top-200 employees for 1998 through 2000.

[1679] This information was provided to the Joint Committee staff by Enron.

[1680] Amounts are rounded.

[1681] For 2001, $56.274 million is the highest compensation which is separately listed. There are eight separate listings for Chairman and CEO, but because names are not provided it is unclear whether compensation to some individuals is separately stated in more than one line entry.

[1682] As mentioned above, there are eight separate listings for Chairman and CEO, but because names are not provided it is unclear whether compensation paid to the most highly compensated individual is included in more than one line entry, which is likely the case.

Table 14.–Total Compensation Paid to the Top-200 Highly Compensated Employee for 1998-2000[1683]

Year	Total Compensation paid to the Top-200
1998	$193,281,000
1999	$401,863,000
2000	$1,424,442,000

As in many other cases, the information provided by the Company to the IRS does not reconcile with the information provided by Enron to the Joint Committee staff.

Executive compensation White Papers

In general

During 1986, the Compensation Committee, with the assistance of Hewitt Associates, developed the compensation philosophy, objectives, and comprehensive executive compensation program for senior Enron executives to be implemented January 1, 1987.[1684] With the merger of HNG and InterNorth, Enron needed to reconcile the different executive compensation philosophies and programs. With the help of Board members and management, Hewitt Associates developed a suggested philosophy and objectives for the compensation program. Based on these suggestions, the Management Committee developed a comprehensive executive compensation program based upon the agreed-to philosophy and objectives. The Compensation Committee approved the program (with modification), as did the full Board of Directors on December 8, 1986, subject to ongoing review and change. Approximately 60 Enron executives (less than 1 percent of the total Enron employee population) participated in the original program, including management committee members, operating company presidents, corporate officers, and selected key line and staff officers in the operating companies.

The Enron Executive Compensation Program "White Paper" provides a summary of Enron's executive compensation polices. The White Paper was periodically revised to incorporate changes agreed to by the Compensation Committee. The White Paper was distributed by management to the executives who were participants in the program. The original White Paper was dated August 1987, and was revised August 1990, May 1993, January 1996, January 1997, and January 1998. The changes between the various versions are relatively minor. In most cases, the only changes from one version to the next are the peer companies used for performance comparison and the number of executives participating in the program. The following discussion summarizes the executive compensation White Paper.

[1683] The information provided by the IRS includes some inconsistencies. In reproducing the summary data, the Joint Committee staff attempted to reconcile inconsistencies and include the data that appears to be accurate. Amounts are rounded.

[1684] EC 001934641 - EC 001934656.

Compensation philosophy and objectives

Throughout the various versions of the White Paper, Enron's stated compensation philosophy for its senior management remained the same and included the following:

- Total compensation will consist of base pay, annual bonus, long-term incentive pay, benefits, and perquisites.

- Individuals will have an opportunity to earn at the 75th percentile or higher level relative to peer companies, subject to obtaining performance at the 75th percentile or higher. Higher achievement provides higher payouts, while lesser achievement decreases total compensation. In order to assure that individual compensation is tied to performance, more dollars of total compensation will be placed at risk, tied to Enron absolute performance, and performance relative to its peers.

- Program design will promote teamwork by tying a significant portion of compensation to subsidiary and Enron Corp. performance.

White Paper Updated, January 1998

The most recent version of the White Paper appears to be January 1998,[1685] which is almost identical to all other older versions, as Enron's compensation philosophy has generally been the same since 1986. The January 1998 White Paper is included in Appendix D. The major components of the most recent White Paper, January 1998, are summarized below. Joint Committee staff asked Enron whether the White Paper had been revised since the January 1998 version. In response to this request, Enron provided an undated Enron Corp. Executive Compensation Program brochure.[1686] The brochure is summarized below and is included in Appendix D. It is unclear whether the brochure replaced the White Paper.

According to the White Paper, the executive compensation program would be reviewed biannually for market competitiveness and was reviewed periodically to determine if changes in philosophy, targets or compensation vehicles were necessary. The White Paper lists the companies that would be considered the "market" in making compensation comparisons.

Compensation Objectives.–The compensation objectives were stated as shown in Table 15 below.[1687]

[1685] EC 001934688.

[1686] EC 002634796 - EC 002634799.

[1687] This table lists the compensation objectives exactly as stated in the January 1998 White Paper. EC 001934689.

Table 15.–Enron "White Paper" Compensation Objectives

Component	Enron Target
Base Salary	50th Percentile
Target Annual Bonus for Outstanding Performance	"Gap" between Total Direct Target and Base Salary
Total Direct Compensation	Commensurate with Enron Performance - Target of 75th Percentile
Long-Term Incentive Pay	Grants at 75th Percentile - Payouts Commensurate with Enron Performance
Benefits	Same as All-Employee Benefits Target
Perquisites	50th Percentile

Participation.–According to the 1998 White Paper, approximately 78 Enron executives participated in the program. These 78 executives included management committee members, operating company presidents, corporate officers, and selected key line and staff officers in the operating companies. These 78 executives represent approximately one percent of the total Enron employee population. The participation is an increase from 60 in 1987, which at that time was less than one percent of the employee population.

Base salary.–The target for base salary was the 50th percentile of the market. The salary midpoints were set at the 50th percentile for the executive positions. The annual merit increase budget was set to maintain Enron's market position.

Annual Incentive Plan.–The primary objective of the annual incentive plan was to promote outstanding performance by Enron in absolute terms, as well as in comparison to its peer companies. The plan was funded as part of a percent of after-tax net income as approved by the Compensation Committee each year. Payouts under the program would be made in the year following the year of performance. The payout would be based upon Enron's performance against preestablished goals, as well as subsidiary and individual performances.

Long-term incentives.–Enron's long-term incentive program was designed to tie executive performance directly to the creation of stockholder wealth over a four-year period. Payout was based upon how well Enron's stock price performed absolutely and how well it performed against the stock process of its peer companies.

Each participant would be assigned a "Targeted Grant Value" coincident with selection for participation in the program and in December each year thereafter. The "Targeted Grant Value" would be determined by the results of the Hewitt Compensation Survey.

Grants were targeted at the 75th percentile. One half of the grants would be paid in nonqualified stock options to foster shareholder return. The remaining one half would be granted in the form of performance units to be paid within six weeks after the close of books for the fourth year. The Compensation Committee had the option to substitute any other long-term compensation vehicles that they deemed appropriate (e.g., restricted stock).

Enron Corp. Executive Compensation Program brochure

In general.–As discussed above, the Joint Committee staff asked Enron whether the White Paper had been revised since the January 1998 version. In response to this request, Enron provided an undated Enron Corp. Executive Compensation Program brochure.[1688] It is unclear whether the brochure replaced the White Paper. The brochure is included in Appendix D. According to the brochure, the "central philosophy of Enron's executive compensation program is to provide executives with rewards which reflect their impact on Enron's total shareholder returns and creation of long-term shareholder value. The Program is targeted at Enron's senior management team, which is approved each year by the Compensation and Management Development Committee . . . of the Enron Board of Directors."[1689] The key tenets of the program, as stated in the brochure, are:

- To deliver market competitive total compensation targets as determined through comprehensive market studies.
- To deliver a significant portion of total compensation in a combination of short-term and long-term incentives so that executives have the opportunity to earn at the 75th percentile of the external marketplace or higher, subject to the achievement of company financial and nonfinancial goals and individual performance objectives.
- To tie executive compensation to the creation of shareholder value.
- To promote teamwork and support Enron's desire for a transferable workforce.

The brochure states that the Enron Corp. Executive Compensation Program is "designed to promote excellence in both team and individual performance and to attract and retain key talent." The program is revised annually for market competitiveness. It is also reviewed periodically to determine if changes in philosophy, targets or compensation vehicles are necessary to help attract, motivate and retain executive talent."[1690]

The various components of the executive compensation program are discussed in the brochure and include base salary, annual incentives, long-term incentives, executive deferral plans, and benefits. The components of the program as explained in the brochure are discussed below. These are essentially the same as described in the White Paper for prior years.

[1688] EC 002634796 - EC 002634799.

[1689] Enron Corp. Executive Compensation Program brochure. EC 002634796.

[1690] Enron Corp. Executive Compensation Program brochure. EC 002634799.

Base salary.–Base salary was targeted at the 50th percentile of the external marketplace. An annual salary increase budget was set to maintain Enron's market position. Base pay was reviewed and adjusted on February 1 of each year.

Annual incentives.–Competitive annual incentive targets were established by the Committee each year based on an assessment of external trends and market data. Cash awards were determined each January based on company and business unit performance as determined by the Committee. Individual performance, as determined trough year-end performance review committee process had a significant influence on actual incentive awards paid.

Long-term incentives.–Long-term incentives were composed of stock options and restricted stock. Options grants provided time-based vesting. Restricted stock grants were made with a future vesting date, which could be accelerated based on Enron's performance relative to the S&P 500. The brochure describes how restricted stock vesting could be accelerated based on Enron's annual cumulative shareholder return relative to the S&P 500. Participation in the long-term incentive program was available to employees in the vice present job group and above. Actual grants were determined each January based on the year end performance review committee assessments and were subject to approval by the Enron Corp. Office of the Chairman. Awards are presented to each recipient during the first quarter of the year. Grants to Section 16 officers required Compensation Committee approval.

Executive deferral plans.–Long-term incentive plan participants were eligible to defer all of a portion of salary, bonus and long-term compensation into Enron-sponsored deferral plans.

Benefits.–Executives typically had the same benefit plans as other Enron employees.

2. Bonuses

In general

As discussed above, the components of executive compensation at Enron included base salary, annual incentive awards (cash bonus) and long-term incentive. Bonuses were targeted at the 75 percent level. There has been much media attention on the magnitude of bonuses paid to Enron executives. In many cases, bonuses were the principal compensation component. Appendix D shows the bonuses received by each of the top-200 highest paid employees for the years 1998, 1999, 2000, and 2001.[1691] Bonuses paid in 2001, the year of Enron's bankruptcy, were as high as $5 and $8 million dollars in some cases. In 2001, at least 48 executives received bonuses of $1 million or greater. Table 16, below, shows bonuses for the top-200 employees according to information obtained from the IRS.[1692] Enron's bankruptcy filing Exhibit 3b.2 shows that bonuses to 144 insiders (managing directors and above) paid during the year preceding the bankruptcy totaled approximately $97 million.

[1691] This information was provided to the Joint Committee staff by Enron.

[1692] The data is based on information provided by Enron to the IRS. As in other cases, information regarding bonuses provided by Enron to the Joint Committee staff does not reconcile with similar information provided by Enron to the Joint Committee staff and to the IRS.

Table 16.–Total bonuses for the top-200 highly compensated employees[1693]

Year	Total bonuses for the top-200
1998	$41,193,000
1999	$51,195,000
2000	$56,606,000

The Joint Committee staff asked Enron to provide the average employee bonus for employees other than the top-paid 200, for each of the years 1999 - 2001. Enron provided information on managers and above only.[1694] For such group, the average bonus paid in 2000 (earned in 1999) was $37,396, which was an average of 43.6 percent of base salary and 19.5 percent of total compensation. The average bonus paid in 2001 (earned in 2000) was $61,543, which was an average of 70.7 percent of base salary and 27.4 percent of total compensation.

According to materials provided to employees, the primary objectives of Enron's annual incentive plan were to provide cash awards aligned with Enron's achievement of preestablished financial and nonfinancial operating goals and to reward individual contributions to Enron's success.[1695] In recent years, the Annual Incentive Plan was used for bonuses for certain executives.[1696] Prior to 1999, the Annual Incentive Plan was also used for bonuses to non-executives. According to Enron, generally all employees were eligible for incentive/variable pay consideration unless excluded due to union contracts, local labor laws, etc.[1697] Payment of bonus, however, was continent on company an individual performance; therefore, less than 100 percent of employees actually received bonuses.[1698] Employees interviewed by Joint Committee staff stated that all employees, other than those receiving a performance review committee ranking of category five, received annual bonuses.

Prior to the modification of Enron's compensation structure in 1999, some business units maintained their own bonus plans. For example, the Enron International, Inc. Project Participation Plan was used for international developers. The Project Participation Plan has received a considerable amount of attention because of the large bonuses that were paid from the plan and because of the way that bonus amounts were determined. For a discussion of the Project Participation Plan, see Part III.B.3., below.

[1693] Amounts are rounded.

[1694] EC 002690459. Because Enron did not provide the specific data requested, the averages are not true indicators of typical employee bonuses.

[1695] Executive Compensation Program brochure. EC2 00019710.

[1696] Enron's bonus program is generally referred to as its "annual incentive plan," which includes the Enron Corp. Annual Incentive Plan, as approved in 1999.

[1697] EC 002679698.

[1698] EC 002679698.

Annual Incentive Awards

Annual Incentive Plan

The most recent version of the Enron Corp. Annual Incentive Plan (the "Annual Incentive Plan") was executed as of May 4, 1999, and was effective as of January 1, 1999. The Plan was "designed to recognize, motivate, and reward exceptional accomplishment toward annual corporation objectives; to attract and retain quality employees; and to be market competitive."[1699]

The Annual Incentive Plan was approved by the shareholders at the May 1999 Annual Meeting. Before the approval of the plan in 1999, an older version of the Annual Incentive Plan had been approved by the shareholders in 1994. The older version of the plan was somewhat different from the plan approved in 1999, as eligibility under the 1994 plan included all full-time and part-time employees, while eligibility under the more recent version is limited to Section 16 officers. With the change in class of eligible employees under the Plan, employees other than Section 16 officers still received annual bonuses, but not through the Annual Incentive Plan.

The Annual Incentive Plan was administered by the Compensation Committee of the Board of Directors, who had the sole discretion to interpret the plan, approve preestablished, objective, annual performance measures, certify the level to which the performance measures were attained prior to any payment under the Plan, approve the amount of awards made under the Plan, and determine who is to receive payments under the Plan.[1700]

The Annual Incentive Plan has an annual award fund of five percent of recurring after-tax net income of Enron. "Recurring after-tax net income" is after-tax net income subject to downward adjustment by the Compensation Committee in its discretion for what the Committee considered extraordinary or nonrecurring items of after-tax net income and other items or events, including, but not limited to financial impact on Enron resulting from changes in law or regulation pertaining to Federal corporate taxes. The maximum individual target award level that may be established under the Plan is one percent of the recurring after-tax net income of Enron. This is an increase from the Annual Incentive Plan in effect prior to 1999, which had a maximum individual award level of .5 percent.

According to the Plan document, at the end of each plan year, the Compensation Committee would verify the actual recurring after-tax net income of Enron, if any, and the resulting award fund (taking into consideration any downward adjustments made by the Committee). The Committee would then determine which participants would receive payments under the Plan and the amounts of the payments. Payments made under the Plan could be made in cash or other property having equivalent value, including shares of Enron Corp. common stock. Cash payments under the Plan could be deferred according to the terms of Enron's deferral plans. Eligible recipients of an Annual Incentive Plan bonus payment could defer up to 100 percent of bonus into one or more of the Enron Corp. 1994 Deferral Plan, the Enron Corp. Bonus Stock Option Program and/or the Enron Corp Bonus Phantom Stock Program.

[1699] Enron Corp. Annual Incentive Plan.

[1700] Enron Corp. Annual Incentive Plan.

Bonus determinations

Bonuses for individuals would be determined after the approval of bonus pools. Preliminary bonus pools were generally approved at the close of the current year as were preliminary funding for the following year. Exact bonus amounts would be determined and approved in the beginning of the following year. The year-end Performance Review Committee process significantly influenced the annual incentive paid to an employee.[1701]

According to the 2001 Proxy, annual bonus payments were based upon Enron's performance measured against the Enron Operating Plan as approved by the Board of Directors. Key performance criteria such as funds flow, return on equity, debt reduction, earnings per share improvements, and other relevant factors were considered at the option of the Compensation Committee.[1702] A Performance Review Report, which summarized management's view regarding whether and to what extent the key performance criteria were attained, would be presented to the Compensation Committee in January.[1703] The report also discussed other significant, but unforeseen factors that positively or negatively affected Enron's performance. The Compensation Committee would verify Enron's actual recurring after-tax net income, review management's funding level recommendation and then approve the resulting award fund.[1704]

After the Board of Directors determined the overall funding level, the Office of the Chairman determined the allocations for each operating group based on performance. Individual payouts were based on business unit performance (or corporate financial performance for corporate executives) and the employee's individual performance as determined through the Performance Review Committee process. The Compensation Committee would review the individual recommendations for key executives and the Office of the Chairman would approve the recommendations for all other participants.[1705] In an interview with Joint Committee staff, the former chairman of the Compensation Committee stated that bonuses for executives were generally proposed by management and then recommended to Compensation Committee, who would basically approve what management had proposed. According to interviews with current and former Enron employees, bonuses for nonexecutive level employees were generally determined by market data and then ultimately approved by management.

Funding

Before 2000, Enron's bonuses were funded as a percentage of each specific business unit's net income. Maintaining separate bonus funding created problems for business units,

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[1701] Executive Compensation Program brochure. EC2 00019710.

[1702] 2001 Enron Corp. Proxy Statement.

[1703] *Id.*

[1704] *Id.*

[1705] *Id.*

especially new business units, that had little or no net income, but significant total shareholder value. As discussed below, to help ensure continued employee fungibility, a single corporate-wide funding pool was established.

Before the 1999 restatement of the Annual Incentive Plan, a bonus pool for all Enron Corp. Section 16 officers and corporate staff would be determined annually. The Annual Incentive Plan as adopted in 1994 did not have a specific bonus target, but allowed the Compensation Committee to set a target based on after-tax net income. For 1996, the Annual Incentive Plan fund for Enron Corp. was 11 percent of after-tax net income. For 1997 and 1998, the Annual Incentive Plan fund for bonuses was 15 percent of after-tax net income.

At Enron's request, Towers Perrin prepared a letter, dated July 27, 1998, providing information about the percentage of after-tax net income allocated to management annual incentives.[1706] Towers Perrin commented that Enron's annual bonus spending cap of 15 percent of after-tax net income for Section 16 officers and corporate staff was relatively high.[1707] However, Towers Perrin noted that most companies are well advised to set high bonus caps because the limits exist only to preserve the tax deductibility of compensation paid to the top-five highest paid officers.[1708] Beginning in 1999, with the effectiveness of the restated Annual Incentive Plan, which limited eligibility for payments under the Plan, there was a five-percent bonus pool for Section 16 officers. Bonuses of corporate staff were not paid from the five-percent pool.

As discussed above, until 2000, Enron funded bonus pools for each business unit and for corporate staff based on market levels of incentive funding by business line.[1709] In 2000, senior management expressed concern that this bonus funding structure discouraged key commercial employees from leaving profitable units to take critical positions in less profitable units (since funding was based on a percentage of net income for each unit).[1710]

To address that concern, at the recommendation of Towers Perrin, the Compensation Committee adopted a new bonus funding scheme under which bonuses throughout Enron would be funded with one pool. At its December 11, 2000, meeting, the Compensation Committee approved a change in the compensation scheme to utilize a single corporate-wide bonus funding pool for 2000 which would be set at up to 27 percent of after-tax income. Individual employee

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[1706] EC 000104381.

[1707] The Towers Perrin survey showed that most companies pay management annual incentives from two percent to 10 percent of net income. EC 000104381.

[1708] See the discussion of the $1 million limit on deductibility of executive compensation in Part III.C.6, below.

[1709] Letter from Towers Perrin to Dr. Charles LeMaistre dated December 3, 2001. EC2 000028641. This letter is included in Appendix D.

[1710] *Id.*

bonus allocations from the pool would be made using discretion, but considering the value of the individual's position using market data and individual performance.

At the January 22, 2001, Compensation Committee meeting, the 2000 bonus pool as a percentage of after-tax net income up to 27 percent was adopted.[1711] This pool included Enron Corp. and all business units. The pool as a percentage of earnings before interest and taxes was up to 15 percent. Pursuant to the Annual Incentive Plan, the pool allocated under the Plan (for Section 16 officers) was five percent of recurring after-tax net income. Towers Perrin advised Enron that its annual incentive plan design was consistent with market 75th percentile practices for energy trading and marketing entities.[1712]

Annual bonuses for employees other than executives

As of January 1, 1999, even though payments under the Annual Inventive Plan were limited to Section 16 officers, other employees were paid annual bonuses under the general bonus pool of Enron. The bonuses were determined similar to the determination of executive bonuses and were market driven. Consulting firms, such as Towers Perrin, would be involved in determining bonuses for both executives and nonexecutives.

Bonus deferral programs

In general

Enron had two bonus deferral programs, the Bonus Stock Option Program and the Bonus Phantom Stock Deferral Program. The bonus deferral programs gave participants an opportunity to receive stock options and/or phantom stock in lieu of cash bonus payments.[1713] It appears that these programs were open to all employees receiving a cash bonus, with the exception of certain employees working outside of the United States. These programs were considered deferral programs because Federal and State income taxes associated with bonus deferrals, plus appreciation on such amounts, were not incurred until stock options were exercised or phantom shares were released. Participants were required to enroll in the programs in the year prior to the scheduled bonus payment. Participation in the programs did not guarantee that a participant would receive a bonus. The minutes of meetings of the Compensation Committee show that the Committee approved the issuance of stock options and phantom stock that Section 16 officers elected to receive pursuant to the bonus deferral programs.[1714]

[1711] The letter from Towers Perrin to Dr. Charles LeMaistre dated December 3, 2001, states that the bonus pool approved was 24.5 percent of recurring net income. The Compensation Committee minutes reflect approval of a bonus pool of 27 percent.

[1712] Letter from Towers Perrin to Dr. Charles LeMaistre dated December 3, 2001. EC2 000028641.

[1713] EC2 0000018944.

[1714] *See, e.g.*, Minutes of Compensation Committee meetings held January 24, 2000, and January 22, 2001.

Bonus Stock Option Program

The Bonus Stock Option Program provided employees with an opportunity to purchase stock at a fixed price, over a specified period of time. Under the Bonus Stock Option Program, participants could elect to defer up to 50 percent of bonus (in 5 percent increments) to purchase stock options.[1715] For every dollar deferred into the program, the participant would receive $1.50 in expected value (employees would receive a 50 percent premium). The size of the grant was determined using a Black-Scholes ratio. Before 2001, a fixed dollar value was used. Bonus stock options were fully vested immediately upon grant. Beginning with 2001 deferrals, options had a five-year term.[1716] Before 2001, options had a seven-year term. The change was meant to be in sync with an overall trend in moving toward shorter stock option grants.[1717] Company documents show that when the options were exercised, all taxes (Federal and state income taxes and FICA and Medicare) were due.

Employee materials emphasized that there is risk in choosing to receive a portion of bonus in stock options.[1718] Employees were informed that if the stock price did not appreciate to the break-even point before exercise, the participant would receive less than the amount deferred and could lose the entire deferred bonus amount if the stock price did not increase above the grant price. According to documents provided by Enron to the IRS, in 2000, approximately 1,121 employees participated in the Bonus Stock Option Program, deferring amounts ranging from $75 to $300,000.

Bonus Phantom Stock Program

The Bonus Phantom Stock Program was established in 1997 to allow Enron employees the opportunity to take a one for one exchange of cash for phantom stock for up to 50 percent of any cash bonus received.[1719] A participant electing to defer a percentage of bonus could select a holding period from one to five years and would receive a premium of five percent for each year holding the shares.[1720] Phantom stock mirrored the performance of Enron Corp. common stock and was used so that employees would not be considered to be in receipt of actual shares at the time of grant, thereby allowing deferral of taxes until the shares were released. Dividend equivalents accrued during the holding period.

[1715] Bonus Stock Option Program employee materials. EC2 000019129.

[1716] EC2 000018959.

[1717] Letter from Kim Bolton describing deferral programs dated October 12, 2000. EC2 000018424.

[1718] EC2 000018968.

[1719] EC 000104582.

[1720] Employee election form. EC2 000018971.

Beginning in 2001, Company documents show that FICA and Medicare taxes were due on the bonus shares (deferred amounts) on the bonus payment date, and would be deducted from the remaining bonus or from subsequent paychecks until fully collected.[1721] It appears that prior to 2001, FICA and Medicare taxes on the deferred bonus would be paid when the shares were released. FICA and Medicare on premium shares would be paid when the phantom shares were released. Federal and State income taxes were imposed when phantom shares are released.[1722] At the end of the holding period, shares would be sold to cover the tax liability and remaining shares would be released into the employee's brokerage account.[1723] An employee could also choose to pay withholding taxes in cash.

Information provided by Enron states that in the initial year of the Bonus Phantom Stock Program, 1998, there were approximately 620 participants.[1724] Information provided by Enron also shows that there were approximately 610 participants in 1999, 1,140 in 2000 and 681 in 2001. According to documents provided by Enron to the IRS, in 2000, approximately 1,673 employees participated in the program and deferred amounts ranging from $166 to $282,000.[1725]

Pre-bankruptcy bonuses

In general

In the weeks immediately preceding the bankruptcy, Enron implemented two bonus programs for (1) approximately 60 key traders and (2) approximately 500 employees that Enron claimed were critical for maintaining and operating Enron going forward. The combined cost of the programs was approximately $104.9 million.[1726] The minutes of the Board of Directors meetings and Compensation Committee meetings in which such payments were approved, discussed below, are included in Appendix D.

Bonuses for traders

At the November 16, 2001, meeting of the Compensation Committee, Lawrence Gregory ("Greg") Whalley reported concerns of key employees that annual bonuses either would not be

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[1721] Power-point presentation explaining the bonus deferral programs. EC2 000018950.

[1722] Power-point presentation explaining the bonus deferral programs. EC2 000018951.

[1723] Power-point presentation explaining the bonus deferral programs. EC2 000018952.

[1724] Information provided September 4, 2002. EC 001872010.

[1725] As stated previously, information provided by Enron to the Joint Committee staff and to the IRS does not reconcile in many cases.

[1726] Attachment to the December 20, 2001, Compensation Committee meeting. EC2 000028654.

awarded or, if awarded, might not be funded by Enron.[1727] Mr. Whalley reviewed the terms of a proposed grantor trust of Enron North America to fund the payment of 2001 performance bonuses to certain key personnel of Enron North America as well as Enron Energy Services and Enron Canada. The bonus trust was approved by the Compensation Committee on November 16, 2001, and was approved by the Board of Directors on November 18, 2001.[1728] Pursuant to this approval, Enron established a 2001 annual bonus pool of $50 million to be paid to up to 100 key commercial employees (referred to as traders).[1729] Towers Perrin advised that such funding equaled about 2.5 percent of Enron Americas' earnings before income taxes, which was dramatically less than market median funding of 15 percent of earnings before income taxes for energy trading units.[1730]

Originally, it was approved that payments to the traders would be made as long as the employee was actively employed on the designated payment dates of January 4, 2002, and February 5, 2002. After the payment of pre-bankruptcy bonuses to the nontrader key employee group, discussed below, Enron decided to make payments from the trust in 2001 and impose the same restrictions required for payments to the nontrader group.

Pre-bankruptcy payments to key employees

In connection with Dynegy's withdrawal from the proposed merger with Enron, Enron established a 2001 bonus pool of approximately $54 million for approximately 528 critical noncommercial staff (i.e., persons other than traders). On November 28, 2001, the Board of Directors approved the establishment and adoption of the Enron Corp. Bonus Plan for calendar year 2001.[1731] While not stated specifically in the Bonus Plan, Enron documents show that it was Enron's intent to pay 2001 bonus payments to key and critical employees as soon as

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[1727] Minutes of the Meeting of the Compensation Committee, at 1 (Nov. 16, 2001). EC2 000026922 - EC2 000026925. At the October 24, 2001, Special meeting of the Board of Directors, the Board approved the guarantee of minimum bonuses to be paid to key commercial personnel in January of 2002. EC2 000027260- EC2 000027262.

[1728] *Id.* Minutes of the Meeting of the Board of Directors, at 8 (Nov. 18, 2001). EC2 000028074 - EC2 000028081. The trust document is dated November 16, 2001. EC 001506928.

[1729] Letter from Towers Perrin to Dr. Charles LeMaistre dated December 3, 2001. EC2 000028641. The letter is included in Appendix D.

[1730] *Id.*

[1731] Minutes of the Special Meeting of the Board of Directors, at 5 (Nov. 28, 2001). EC2 000028296 - EC2 000028306; EC2 000028310 - EC2 000028314. The minutes of the November 25, 2001, meeting of the Special Committee of the Board of Directors show that the Board approved the Enron Corp. Retention Plan to retain critical and key employees through the transitional period. EC2 000027122 - EC2 000027128. The number of employees to be included in such plan was 1,350 and the value was capped at $115 million. It is unclear whether this plan was implemented or whether the Enron Corp. Retention Plan was the predecessor of the Enron Corp. Bonus Program.

practicable after approval of the Bonus Plan.[1732] The payments would be made pursuant to the new Enron Corp. Bonus Plan and the Enron Corp. Annual Incentive Plan. The new bonus plan was needed to pay bonuses to key employees who were not eligible to participate in the Enron Corp. Annual Incentive Plan.[1733] It was also contemplated that remaining eligible employees would receive bonus payments at the end of calendar year 2001. It is unclear whether additional payments were made.

The Enron Corp. Bonus Plan was executed as of November 28, 2001. The stated purpose of the Enron Corp. Bonus Plan was to recognize, motivate, and reward exceptional accomplishment of annual corporation objectives during calendar year 2001.[1734] Employees of Enron and its subsidiaries and affiliated companies who were not eligible to participate in the Enron Corp. Annual Incentive Plan, and who were designated by the Compensation Committee, were eligible to participate in the plan. Employees eligible for payments under the Performance Bonus Trust, the grantor trust established by Enron North America, discussed above, were not eligible to participate in the Enron Corp. Bonus Plan.

The Enron Corp. Bonus Plan had an award fund in the amount of not more than $60 million, subject to downward adjustment by the Compensation Committee. Payments under the plan could be made in cash or in property having equivalent value. As a condition to receive payments under the plan, participants were required to execute an agreement requiring repayment of any amounts received if the participant voluntarily terminated employment prior to the expiration of 90 days following the receipt of any payment. Additionally, the agreement under the plan required a participant who makes repayments to Enron to pay an additional 25 percent of any payment as liquidated damages for terminating employment prior to the expiration of ninety days following receipt of payment. It appears that traders who received pre-bankruptcy payments were also required to execute such agreement. Sample agreements are included in Appendix D. Enron employees interviewed by Joint Committee staff maintained that a number of employees did not want to remain with Enron for the 90-day period and did not accept the bonus payment. The Plan was unfunded (i.e., no trust was created under the Plan).

The Bonus Plan and recommended payments were presented to the Compensation Committee on November 29, 2001. A total of up to $60 million of payments pursuant to the Enron Corp Bonus Plan and the Enron Corp. Annual Incentive Plan were approved.[1735] It was also approved that management was authorized to modify the list of employees and payment amounts as deemed appropriate, and it was confirmed that any awards to employees subject to

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[1732] Attachment to the minutes of the November 28, 2001, Special Meeting of the Board of Directors. EC2 000028310. The attachment is included in Appendix D.

[1733] Payments under the Enron Corp. Annual Incentive Plan could only be made to Section 16 executives.

[1734] EC2 000019658 - EC2 000019660.

[1735] Minutes of the Compensation Committee, at 1 (Nov. 29, 2001). EC2 000026930 - EC2 000026946.

Section 16 of the Securities Exchange Act of 1934 would be presented for approval by the Committee prior to such awards being made. At the November 29, 2001, meeting, payment to one Section 16 officer was approved.

The Board of Directors was advised that Weil, Gotshal, and Manges commented that it was not a legal decision to implement this type of plan, but that it was an issue of business judgment that could be second-guessed.[1736] Weil Gotshal thought, that based on Enron's analysis of the criticality of personnel and the need to protect key personnel, it was a compensation design for which reasonable justification existed.[1737] The minutes of the November 29, 2001, Compensation Committee meeting state that Towers Perrin confirmed that the approved payments were consistent with industry practices and with the past practices of Enron to retain key employees.

According to Towers Perrin, awards were equal to about 90 percent of the bonus for the prior year.[1738] Many current and former employees interviewed by Joint Committee staff stated that payments were 100 percent of the year 2000 bonus.

Recipients of these bonus payments interviewed by Joint Committee staff stated that the bonus payments to the nontraders were made in cashier's checks (net of payroll taxes) and were paid on the Friday preceding Enron's bankruptcy filing. The comments of one individual interviewed by the Joint Committee staff indicated that there was an air of secrecy involving the payments. Other individuals who received bonuses said that it became known that the payments were forthcoming and individuals waited in the office for the payments. The Joint Committee staff asked Enron why the payments were made in cashier's checks. According to Enron, the bonuses were paid in cashier's checks "to effect the retention strategy approved by the Compensation Committee as soon as possible."[1739]

Enron's response for requests for information

The Joint Committee staff asked Enron several questions about the pre-bankruptcy payments, including how it was determined who would be entitled to the payments and the amount of the payments. Enron responded that various management team(s) of each business unit reviewed the critical efforts that would need to be maintained to increase value for creditors going forward.[1740] Enron stated that the "90 Day Payments" to certain key management and employees were based on the following criteria: the extent to which the employees' skills were

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[1736] Attachment to the minutes of the November 28, 2001, Special Meeting of the Board of Directors. EC2 000028310. The attachment is included in Appendix D.

[1737] *Id.*

[1738] Letter from Towers Perrin to Dr. Charles LeMaistre dated December 3, 2001. EC2 000028641. The letter is included in Appendix D.

[1739] EC 002679699.

[1740] Ecu000077383. Company response received January 13, 2003.

critical to business, marketable skills, trust factor with Enron, specialized skills, replaceability/cost of outside procurement (by consultants, etc.), multiskilled, and institutional knowledge.[1741] Enron provided a list of employees who received payments.[1742] See Appendix D for the list. The list included approximately 584 employees for payments totaling approximately $104.6 million. Additional information provided by Enron states that 490 employees received key employee bonuses totaling $50.404 million, which were paid from general company assets.[1743] Trader/Dynegy bonuses were paid to 67 employees totaling $46.074 million, which were made from the trust discussed above.[1744] In addition, 27 Canadian employees received bonuses totaling $8 million, which were paid by Enron Canada Corp.[1745] The payments ranged from $2,500 to $8 million. It appears that three employees terminated employment with Enron before the end of the 90-day retention period.[1746] In each of the three cases, Enron indicated that repayment of the bonus has been demanded, but the employee disputes the obligation and has not repaid.

Post-bankruptcy bonuses

Bonuses have been awarded after Enron's bankruptcy filing.[1747] With the approval of the Bankruptcy Court, Enron implemented the Key Employee Retention Program ("KERP") to provide an employment incentive for certain existing and newly hired employees deemed essential to the successful liquidation of Enron assets, divestiture of certain non-core businesses, restructuring of profitable core businesses, and management of litigation and government investigations.[1748] As approved by the court, the KERP provides for the following: retention

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[1741] Ecu000077383. Company response received January 13, 2003.

[1742] Ecu000077384 - Ecu000077395. Company response received January 13, 2003.

[1743] EC 002679698.

[1744] EC 002679698.

[1745] EC 002679698.

[1746] Ecu000077396. Company response received January 13, 2003. Information regarding individuals who terminated employment with Enron before completing the 90-day service requirement is included in Appendix D.

[1747] On December 20, 2001, the Compensation Committee ratified a retention program to be used for bankrupt companies. Minutes to the Meeting of the Compensation Committee, at 3 (Dec. 20, 2001). EC2 000028575 - EC2 000028578; EC2 000028654. The Joint Committee staff was not provided minutes of meetings held after December 2001; therefore, it is unclear whether other post-bankruptcy retention plans were considered.

[1748] Enron's motion for approval of the KERP, dated March 29, 2002, and the Bankruptcy Court's order approving the KERP, dated May 8, 2002. The motion and order also provided for indemnification of officers and directors for claims related to their post-bankruptcy-petition services, to the extent not covered by insurance, and treatment of costs related thereto as priority administrative expenses.

payments, liquidation incentive payments, and severance benefits.[1749] Employees are not permitted to participate in the retention payment program and the liquidation incentive program simultaneously. The KERP is effective March 1, 2002, through February 28, 2003.

Under the retention payment program, employees are entitled to payments of a percentage of base salary for continued employment during each quarter ending May 31, 2002, August 31, 2002, November 30, 2003, and February 28, 2003, as long as the employee neither resigns nor is involuntarily terminated for cause during the quarter. The program was expected to cover up to 1,285 employees. Payments up to a total of $40 million can be made under the program.

The liquidation incentive program is intended to correlate incentive payments to performance for employees involved in the liquidation of Enron's trading assets and certain non-core businesses between March 1, 2002, and February 28, 2003. The amount payable under the program is determined as a percentage of $1 billion increments of the cash collected from the liquidation of assets, with a threshold collection amount of $500 million. The percentage is .5 percent of collections from $500 million to $3 billion, 1 percent of collections over $3 billion up to $6 billion and 1.5 percent of collections over $6 billion up to $9 billion, for a maximum amount of $90 million. The minimum aggregate amount payable is $7.4 million.

The severance benefit program provides severance benefits for about 850 employees not eligible to participate in either of the other programs and about 700 employees eligible under the retention payment program, whose severance benefits will be offset by any retention payments received. Severance benefits consist of two weeks of base salary for each year or partial year of the employee's total service, with a minimum of $4,500 and a maximum of eight weeks of base salary. The maximum amount of severance benefits for employees not eligible for the other programs is $7 million; the maximum amount of severance benefits for employees also covered by the retention is $500,000. The KERP was later amended to reduce the amount available for severance benefits by $1.3 million in order to pay divestiture bonuses to certain employees in connection with the sale of the Enron Metals and Commodity Corporation.

[1749] In addition to approval of the KERP, the motion also requested approval to waive the right to seek recovery from 237 potential KERP participants (150 retention participants, 37 liquidation incentive participants, and 50 severance benefit participants) of payments made before the filing of Enron's bankruptcy petition, which were scheduled to vest on February 28, 2002. These payments were subject to challenge as preference payments or fraudulent transfers under bankruptcy law. Enron proposed to release any claim for disgorgement of these payments by a participant if the participant would agree to remain employed by Enron until August 31, 2002 (or an earlier termination of employment without cause).

3. Special compensation arrangements

In general

While executive compensation at Enron generally included base pay, bonus and long-term incentive, 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. The Project Participation Plan is discussed below.

Enron also had arrangements for a small number of employees or in some cases just one employee. For example, 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.[1750] A few employees received loans from Enron and had split dollar life insurance policies. These arrangements are discussed in further detail below. As discussed below in further detail, Enron purchased two annuities from Kenneth L. Lay and his wife as a part of his compensation package for 2001. Certain executives were allowed to exchange interests in plans for large cash payments or stock options and restricted stock grants.

Project Participation Plan

In general

On September 23, 1993, Enron Development Corporation adopted the Enron Development Corp. Project Participation Plan. The Project Participation Plan was used for international developers and other employees working on international projects. The Enron Development Corp. Project Participation Plan was amended and restated effective January 1, 1996; this restatement replaced the prior plan originally effective January 1, 1993.[1751] All projects were not subject to the restated plan. Generally, projects for which an incentive payment was made with respect to an event occurring on or before December 31, 1995, were not subject to the restated plan, but continued to be governed by the terms of the plan in effect prior to the January 1, 1996, restatement. The Project Participation Plan was principally used in the 1990's when Enron was competing for various international projects. According to the terms of the plan, the plan terminated as of December 31, 2000; however, payments for awards granted before 2001 could be made from the plan after such date.

One former Enron executive told the Joint Committee staff that the Project Participation Plan was terminated because it was viewed as not in the interests of the shareholders. He indicated that if someone had an interest in a project, and the project was not likely to be a good project, it was hard to move people off the project, because they had a stake in it. Every time

[1750] As part of the executive's separation from Enron, he assumed and became financially responsible for the 1/8 fractional interest in the jet aircraft Hawker 800. EC 002634790.

[1751] The Project Participation Plan was amended as of February 1, 1997, and as of January 1, 1998.

Enron wanted to move someone off a project, compensation had to be renegotiated. He said that the Project Participation Plan made staffing inflexible, time consuming, and difficult.

In the late 1990's, the name of the Project Participation Plan and all references to "Enron Development Corp." were changed to "Enron International, Inc.,"[1752] thus changing the name of the plan to the Enron International, Inc. Project Participation Plan. The stated purpose of the plan was to provide a means whereby certain selected employees could develop a sense of proprietorship and personal involvement in the development and financial success of Enron International, Inc., to attract and retain employees of outstanding competence and ability, and to encourage them to devote their best efforts to the business of Company, and to reward them for outstanding performance benefiting Enron and its stockholders.[1753]

Projects under the Project Participation Plan included:[1754]

- Bitterfeld;
- Centragas - Columbia Pipeline;
- Dabhol India - Phase I;
- Latvian Storage;
- Mostransgaz - Optical Disk Imaging;
- Severnaya Compressor Station;
- Subic Bay Power Plant;
- Yucatan (Merida);
- YPFB - Joint Venture;
- Volgograd Compressor;
- Italy - Saras;
- Poland;
- Puerto Rico;
- Panama;
- Puerto Caldera - Costa Rica;
- Sao Paulo - Brazil;
- Ecuador;
- CEMIG - Brazil;
- YPFB - Capitalization;
- CEMAT-Mato Grosso - Bolivia;
- Enersul-Mato Grosso Do Sul;
- LNG Commercial Development;

[1752] The change was executed in August 1999, to be effective February 1, 1997. By error or omission, the Board did not adopt the First Amendment on or about February 1, 1997, which would have changed the name of the plan. EC2 000019327.

[1753] Project Participation Plan document. EC 000767561.

[1754] This is not intended to be an inclusive list. Other projects may have also been under the Project Participation Plan.

- Israel Marketing;
- Mozambique - Integrated;
- Oman;
- Qatar;
- Jordan Marketing;
- E. Java - Indonesia;
- Ilijan Philippines Gas;
- China-Hainan;
- Vietnam;
- E. Kalamintan;
- Thailand IPP LPG;
- Song Yu;
- Hainan LPG Storage Terminal;
- Dong Fong Natural Gas Reserve;
- Dabhol India - Phase II;
- Multan - Pakistan;
- Dabhol India - Phase I - Implementation;
- India Marketing; and
- Dominican Republic.[1755]

All employees were eligible to be selected for participation in the Project Participation Plan. Under the plan, employees would be granted participation interests in particular projects. Participation interests would be expressed as a percentage of the value of the project. Payments with respect to a project would be triggered upon the occurrence of a plan payment date, which generally occurred upon (1) financial closure of the project, (2) operation of the project, or (3) the sale or transfer of the project. The incentive payment generated upon a payment date would be allocated among the participants who had a participation interest in the project at such time based upon the relative size of their participation interests.

Typically, awards would be paid 50 percent upon financial closure of the project and 50 percent upon operation of the project, as defined by the Project Participation Plan. The plan also included provisions which provided how participants would be compensated in the event that the particular project was sold or transferred before the achievement of financial closure or commercial operation. Under the Project Participation Plan, the total participation interests in any given projects could not exceed 10 percent. The financial closure payment would generally be five percent of the net project value; the commercial operation payment would generally be 10 percent of net project value reduced by any prior financial closure payment paid or payable. Some projects were specifically excluded from the Project Participation Plan and certain projects had special features under the plan. The plan defined how the value of the project was determined and included provisions for cases in which the value was disputed.

Payments would be made in cash, in shares of common stock, or in a combination of cash and shares. The amendment to the Project Participation Plan effective January 1, 1998, allowed

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[1755] EC 000767596 - EC 000767597.

participants in certain projects (Italy and Poland) to elect to receive payments in cash and stock options. Such options were granted under the 1994 Stock Plan.

The Project Participation Plan was administered by a committee which was charged with selecting participants in the plan and determining the participation interests to be awarded each participant. According to the plan document, the plan constituted an unfunded, unsecured obligation of Enron to make payments of incentive compensation from its general assets in accordance with the plan.

Awards under the Project Participation Plan could vary greatly. Attention has been given to the plan because of the large amounts that were awarded under the plan and because the method used to determine award amounts, a percentage of the estimated project value, could create an incentive to overstate the value of projects. Awards for top developers could be as high as $5 million or $7 million for single projects.[1756]

Former and current employees interviewed by Joint Committee staff regarding the magnitude of the payments responded that such large payments could be attributable to years of work on a particular project. While many executives greatly benefited from Project Participation Plan awards, all awards under the plan were not very large; some awards were less than $10,000.[1757]

Deferrals

The Project Participation Plan was amended effective February 1, 1997, to allow deferral of payments under the plan from the time they would otherwise be paid. A participant could elect to defer receipt of a portion of any plan payment that was to be made in cash to a date that is after the participant's termination of employment with Enron. Up to 100 percent of payments could be deferred. Payments deferred by a participant would be credited to the participant's deferral account as of the date that the participant would have received such payment under the plan had such payment not been deferred.

Deferrals were credited with Enron's mid-term cost of capital for the period. For 2001, deferrals were to earn a 7.4 percent annual rate of return.[1758] Deferral accounts would be paid to participants in the event of retirement, disability, death, or termination of employment. Payments could also be requested in the event of a hardship.

[1756] EC 000102338 (Project Puerto Rico); EC2 000032354 (Project Puerto Rico). The Joint Committee staff does not have a list of all payments, so it is not clear whether these were the highest awards.

[1757] EC2 000032354.

[1758] Participant election form for 2001 deferrals. EC2 000018648.

Documents provided by Enron show that there were 11 participants who deferred amounts under the Project Participation Plan.[1759] Enron documents show that as of December 31, 1999, there were five participants with total account balances of $450,054.[1760] As of December 31, 2000, there were 10 participants with accounts balances totaling $7.9 million.[1761] As of December 31, 2001, the Project Participation Plan had 11 participants with account balances totaling $9.4 million.[1762]

Project Participation Plan trade-outs

In 1997, Enron allowed certain participants in the Project Participation Plan to trade their interests in the plan for stock options and restricted stock, thus allowing their compensation to grow as Enron's stock price increased. On February 10, 1997, the Compensation Committee approved the trade-out of fixed interests owned by five Enron International executives in the Project Participation Plan by providing $10 million in stock options and $10 million in restricted stock. The trade-out was reported by the Board of Directors on February 11, 1997. According to IRS information, in addition to the five executives referred to above, seven other employees agreed to trade-out their participation interests in the Project Participation Plan for grants of stock options and restricted stock later in August 1997.[1763]

According to IRS documents, the value of the stock options and restricted stock conveyed to the 12 employees totaled approximately $22 million at the date of grant.[1764] Also according to IRS information, the fair market value of the options granted to two executives totaled 74 percent of the total value conveyed. Stock options were valued using the Black-Scholes valuation method. Restricted stock was assigned a value equal to the closing price of the stock on the date of the exchange.

Enron treated the stock options and restricted stock attributable to the trade-out of the Project Participation Plan interests the same as options and restricted stock are treated generally for Federal tax purposes. That is, no income was reported to employees at the time of the trade-out/grant. Rather, income was reported at the time of exercise (in the case of options) and when

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[1759] EC 000768136. This list is not all participants in the Project Participation Plan, but only those who elected to defer payments.

[1760] EC 000768234.

[1761] EC 000768234.

[1762] EC 000768234.

[1763] The additional trade-outs do not appear to be reflected in the Compensation Committee meeting minutes.

[1764] Other IRS documents state that the fair market value of the stock options and restricted stock conveyed to the 12 employees totaled approximately $26.8 million; $11.6 million on the February 10, 1997, grant date, and $15.2 million on the August 11, 1997, grant date. While these two amounts do not reconcile either amount is substantial.

the restrictions lapse (in the case of restricted stock). Similarly, Enron had a corresponding income tax deduction at such times. In the case of restricted stock, the deduction is equal to the fair market value of the stock multiplied by the number of shares with respect to which restrictions lapsed. In the case of options, the deduction is equal to the difference between the fair market value of the stock at the time of exercise and the exercise price.

Because the compensation expense was deducted when the options were exercised and the restrictions lapsed, and the stock price continued to rise, Enron's deduction was much larger than the deduction would have been if Enron had paid the awards in cash or unrestricted stock as originally contemplated by the arrangement. According to IRS documents, due to the increase in Enron stock, amounts deducted by Enron, and reported as compensation to the individuals, were about $82 million more than the value at the grant dates.[1765] According to the IRS, two individuals reported more than 90 percent of the spread.[1766] The Joint Committee staff did not discover any information indicating whether the potential increase in the deduction was a motivating factor behind the trade-outs.

4. Board of Directors compensation

In general

Nonemployee director compensation at Enron was composed of annual fees and equity grants. For the years 1999 through 2001, each nonemployee director received an annual service fee of $50,000 for serving as a director. This was an increase from the $40,000 fee paid in 1995 through 1998. In 1994 and the beginning of 1995, the annual service fee was $22,000. Additional fees for serving on committees were eliminated effective May 2, 1995. Prior to the elimination of such fees, nonemployee directors were paid $4,000 for serving on committees.

Committee chairs received an additional $10,000 annually in 1999 through 2001, which was an increase from $5,000 paid in 1995 through 1998, and $4,000 paid in prior years. Meeting fees were $1,250 for each Board of Directors and committee meetings attended. Before 1999, meeting fees for committee meetings were $1,000. Enron periodically hired compensation

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[1765] Internal IRS Memorandum regarding EDC Participation Plan Stock Trade-Out dated February 22, 2002. An earlier IRS correspondence (dated January 25, 2002) stated that the deduction could exceed $70 million.

[1766] In connection with the 1997 audit, IRS international examiners raised issues with respect to the trade-outs, including whether the grant or exercise date should be used for valuing the compensation for purposes of deductions, capitalizing costs by Enron, and determining service fee income to be reported by Enron Development Corp. The IRS concluded that there was authority for the taxpayer to use the grant date in determining the value of the trade-outs for certain purposes. The IRS also raised other issues related to the Project Participation Plan trade-outs, including whether the stock-based compensation spread was an ordinary and necessary business expense under section 83(h). For a discussion of international issues relating to the Project Participation Plan, see Part IV.D. of Part Three, above.

consultants, particularly Towers Perrin, to perform studies to determine if the level of compensation for nonemployee directors was competitive with market practices.

Directors' fees could be paid in cash, deferred under the Enron Corp. 1994 Deferral Plan, or received in a combination of phantom stock and stock options in lieu of cash under the Enron Corp. 1991 Stock Plan. As discussed below, beginning in 1997, directors were required to defer 50 percent of their annual service fee into the Phantom Stock Account of the 1994 Deferral Plan.

For 2000, total directors' fees (whether paid in cash, deferred, or paid in the form of phantom stock or stock options) were $1.1 million, or an average of $79,107 per nonemployee director. The average fee for nonemployee directors was $86,829 in 1999 and $63,500 in 1998. These averages do not include the value of stock options and phantom stock units annually granted to directors. Table 17 below shows totals fees paid in cash, deferred, or received in a combination of phantom stock units and stock options in lieu of cash for the years 1993 through 2000 for all nonemployee directors.[1767]

Table 17.–Total Directors Fees for All Nonemployee Directors 1993 - 2000
(Thousands of Dollars)

1993	1994	1995	1996	1997	1998	1999	2000
$551	$481	$601	$701	$813	$889	$1,172	$1,107

Deferrals

Beginning January 1, 1997, nonemployee directors were required to defer 50 percent of their annual service fee into the Phantom Stock Account of the 1994 Deferral Plan. Directors could elect to receive remaining fees (i.e., annual service fee has less mandatory deferrals) in cash, defer receipt of the fees to a later specified date under the 1994 Deferral Plan, or receive the fees in a combination of phantom stock units and stock options in lieu of cash under the 1991 Stock Plan.[1768] Before the mandatory deferral requirement was adopted in 1997, directors could elect to receive fees in cash, defer receipt of the fees to a later specified date under Enron's 1994 Deferral Plan, or receive the fees in a combination of phantom stock units and stock options in lieu of cash under Enron's 1991 Stock Plan. Prior to 1997, restricted stock was used instead of phantom stock units.

In some countries, deferrals into the 1994 Deferral Plan could create adverse tax consequences for the director. In August 1999, the Compensation Committee approved a change that upon notification by Enron management of the applicable international tax laws, a director could receive an award of phantom stock units under the 1991 Stock Plan in lieu of mandatory

[1767] 1994 through 2001 Enron Corp. Proxy Statements.

[1768] December 11, 2000, letter to members of the Board of Directors regarding deferral program opportunities. EC2 000018652.

deferrals into the Phantom Stock Accounts of the 1994 Deferral Plan. After such change, Lord Wakeham was allowed to receive phantom stock units in lieu of deferrals into the Phantom Stock Account.

Directors were required to annually complete election forms to make their deferral plan choices.[1769] Directors could elect to defer compensation annually in December prior to the year in which the compensation was earned and payable. Voluntary deferrals could be placed into the Flexible Deferral Account and/or the Phantom Stock Account at the director's discretion.[1770] Earnings on amounts invested in the Flexible Deferral Account or the Phantom Stock Account would be determined in the same way as all other 1994 Deferral Plan participants. Earnings on deferrals into the Flexible Deferral Account would be credited with cumulative appreciation and/or depreciation based on the market price of the chosen investments. Investments in the Phantom Stock Account were treated as if the participant purchased shares of Enron Corp. common stock at the closing price on the date of deferral. Deferral accounts would be paid as specified in the participant's election form during the first quarter of the year following the termination event (retirement, death, disability or termination).[1771] The 1994 Deferral Plan also provided an opportunity for in-service distributions.

Under the 2001 annual election form, in electing stock in lieu of fees, a director could choose a vesting period for phantom stock units between six and 60 months. Stock options (in lieu of the annual retainer fee) would be 100 percent vested on the grant date and have a ten-year term. Regular and special purpose deferrals could be elected.

Nonemployee directors were also eligible to participate in the deferral of stock options gains and deferral of restricted stock programs. The deferral of stock option gains program allowed deferrals to the 1994 Deferral Plan in lieu of receiving financial gains upon the exercise of stock options granted under an Enron Corp. stock plan. The deferral of restricted stock program allowed deferrals under the 1994 Enron Corp. Deferral Plan in lieu of the release of shares of restricted stock granted under an Enron Corp. stock plan. The programs are discussed in more detail in the nonqualified deferred compensation section of this Report.[1772]

During 2000, eight of the 13 eligible directors elected to defer fees under the 1994 Deferral Plan. In 2000, four directors elected to receive stock in lieu of fees in a combination of phantom stock units and stock options under the 1991 Stock Plan. In 1999, nine directors elected to defer fees under the 1994 Deferral Plan, while one director elected to receive stock in lieu of fees in a combination of phantom stock units and stock options according to the terms of the 1991 Stock Plan.

[1769] *Id.*

[1770] *Id.*

[1771] *Id.*

[1772] *See* Part III.C.1, below.

In prior years, Enron maintained "Directors Deferral Plans." Documents provided by Enron show that the Director Deferral Plans included HNG, InterNorth, and Enron.[1773] Documents provided by Enron show that there were approximately 29 participants in such plans. In prior years, directors also deferred into the HNG Deferral Plan and the 1985 Deferral Plan.

Directors' account balances

On December 11, 2001, Enron sent letters to the Board members advising them of the status of their nonqualified deferred compensation.[1774] Distributions to deferral plan participants who were in pay status ceased as of November 30, 2001. Enron stated that after the first phase of the bankruptcy, it would begin to explore options with its creditors to seek approval to reinstate deferral plan payments, or to somehow otherwise restore the value lost to deferral plan participants. In general, claims under the deferral plans have the same status as Enron's other unsecured general creditors, which are paid after the claims of secured creditors. Board members were informed that claims for deferral plan benefits should be made against Enron's bankruptcy estate.

Nonemployee director balances in nonqualified deferred compensation plans as of November 30, 2001, are provided in Table 18, below.[1775]

Table 18.–Nonemployee Director Balances in Nonqualified Deferred Compensation Plans (November 30, 2001) (Thousands of Dollars)

	Enron Corp. 1988 Deferral Plan	Enron Corp. 1994 Deferral Plan	Enron Directors Deferral Plan	HNG Deferred Income Plan	Total
Robert Belfer	3,894	485	1,708		6,087
Norman Blake, Jr.		250	39		288
Ronnie Chan		2*			2*
John Duncan		*			*
Wendy Gramm		686			686
Robert Jaedicke		220	1,068	175	1,463
Charles LeMaistre		92			92
John Mendelsohn		3*			3*
Paulo Pereira		4*			4*

1773 EC 000758146.

1774 It is unclear whether such letters were sent to all nonqualified deferred compensation participants or just to Board members.

1775 The information in the table was obtained from letters sent to directors by Enron informing them of their bankruptcy rights and the status of their deferred compensation. EC 000171608 - EC 000171674.

	Enron Corp. 1988 Deferral Plan	Enron Corp. 1994 Deferral Plan	Enron Directors Deferral Plan	HNG Deferred Income Plan	Total
William Powers		18			18
Frank Savage		3*			3*
Lord John Wakeham		*			*
Herbert Winokur		*			*
Joe Foy		176	484	46	706
Jerome Meyer		58			57
Total					9,411

* Denotes that balance is relatively minimal because 100% invested in the Phantom Stock Account (value of Enron common stock at $.26 per share).

Equity grants

In addition to the fees discussed above, nonemployee directors were annually granted stock options and phantom stock units. Under the Enron Corp. 1991 Stock Plan, nonemployee directors were granted shares of phantom stock units and nonqualified options to purchase stock effective the Monday following the annual meetings of the shareholders. The number of shares of phantom stock units was equal to 50 percent of the prior year's average retainer fee divided by the stock price on the date of grant rounded to the next highest increment of ten. The number of stock options was equal to four times the number of shares of phantom stock units. In some years, additional stock options were granted.[1776] For 2001, each nonemployee director was granted 460 phantom stock units and 11,175 stock options.[1777] The awards were based on an average 2000 retainer fee of $52,871 and a May 7, 2001, closing stock price of $58.04. During 2000, each nonemployee director received 360 phantom stock units and options to purchase 10,775 shares according to the terms of the 1991 and 1994 Stock Plans. Phantom stock units and options granted in 2000 and 2001 vest over a five-year period. The Senate Permanent Subcommittee on Investigations computed that for 2000, total stock/option value when granted was $250,626 per director.[1778] Table 19, below, shows the number of restricted stock shares, phantom stock units, and stock options received by directors in the years 1993 through 2001.

[1776] In most recent years (2000 and 2001), nonemployee directors were granted stock options equal to four times the number of phantom stock units plus 9,335 options.

[1777] Letter from Mary K. Joyce to Charles A. LeMaistre dated May 11, 2001, regarding May 2001 director awards. EC 000257935.

[1778] Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate, *The Role of the Board of Directors in Enron's Collapse*, May 7, 2002, Exhibit #35a.

Table 19.–Directors' Restricted Stock, Phantom Stock, and Stock Options (1993-2001)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Restricted stock shares	480	490	450						
Phantom stock units				480	510	400	560	360	460
Stock options	1,920	1,960	1,800	1,920	2,040	1,600	8,240	10,775	11,175

The 1991 Stock Plan permitted nonemployee directors whose ownership of Enron Corp. common stock would result in a materials conflict of interest for business, employee, or professional purposes, to submit an opinion of counsel of such fact to the Compensation Committee with a request that such nonemployee director not be eligible to receive further grants under the 1991 Stock Plan and to forfeit all outstanding grants made to such nonemployee director until such time as the Committee is satisfied that such conflicts have been removed or no longer apply. In December 1998, Dr. Gramm provided to the Compensation Committee a written opinion of counsel indicating that her continued participation in the 1991 Stock Plan could be considered a conflict of interest. Dr. Gramm chose not to receive further grants under the 1991 Stock Plan, and therefore, did not receive stock options or phantom stock units in 1999 or 2000. Instead, on behalf of Dr. Gramm, Enron contributed the value of phantom stock units and stock options into her Flexible Deferral Account under the 1994 Deferral Plan.

Table 20, below, represents the value of directors compensation as of August 21, 2002, and July 31, 2001, from documents provided by Enron.[1779] The top number shows the value as of August 21, 2000 (when the stock value was $86), while the bottom number shows the value as of July 31, 2001 (when the stock value was $45).

[1779] EC 000257928 - EC 000258305. The values as of August 21, 2000, were published by the Permanent Subcommittee on Investigations. Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate, *The Role of the Board of Directors in Enron's Collapse*, May 7, 2002, Exhibit #35b.

Table 20.–Value of Directors Compensation as of August 21, 2000 and July 31, 2001 (Thousands of Dollars)

	Stock Option as of 8/21/00 as of 7/31/01	**Restricted/ Phantom Stock** as of 8/21/00 as of 7/31/01	**Total Equity Value** as of 8/21/00 as of 7/31/01	**Deferral Plan Account Balance**[1780] as of 6/30/00 as of 6/30/01
Charles LeMaistre	$3,111 860	$162 72	$3,273 932	$263 242
Robert Jaedicke	3,111 860	162 72	3,273 932	1,670 1,809
Wendy Gramm	N/A	N/A	N/A	699
John Duncan	3,111 860	162 72	3,273 932	170 149
Ronnie Chan	1,295 N/A	213 N/A	1,508 N/A	357 N/A
Norman Blake	2,809 330	266 142	3,074 472	449 409
Robert Belfer	2,479 860	162 72	2,641 932	5,900 6,414
John Mendelsohn	516 61	69 49	586 110	113 141
Jerome Meyer	852 N/A (resigned)	178 N/A	1,030 N/A	247 N/A
John Urquhart	2,479 N/A	162 N/A	2,641 N/A	962 N/A
Lord Wakeham	1,472 413	208 119	1,680 532	149 115
Herbert Winokur, Jr.	2,479 860	162 72	2,641 932	170 149
Paulo V. Ferraz Pereira	140 0	53 45	193 45	39 74
Frank Savage	140 0	31 49	170 49	46 65

Miscellaneous

Liability insurance was provided to directors with a maximum indemnification of $300 million for sums that they become legally obligated to pay for claims made because of a wrongful act for which Enron does not provide reimbursement. Directors were also provided

[1780] The deferral account balances are reflected as of June 30, 2000, and June 30, 2001. The top number is the value as of June 30, 2000; the bottom number is the value as of June 30, 2001. The account balance reflects combined balances under the 1994 Deferral Plan, 1985 Deferral Plan and Director's Deferral Plans.

coverage in the case of an accident resulting in death on a company aircraft and could participate in Enron's matching gift program under which Enron would match charitable contributions by employees.