Speak Truth To Power

By David Hechler

AFTER THE SCANDAL, THE BOOKS, THE MOVIE—FINALLY, IT'S judgment day in a Houston courtroom for Enron Corp.'s former chairman, Kenneth Lay, and ex–CEO, Jeffrey Skilling. Amid boatloads of details about related-party and off–balance sheet transactions, an old question is likely to resurface: "Where were the lawyers?"

The proceedings probably won't provide answers. Ten former in-house attorneys are listed as potential witnesses, but none played a major role in the scandal, and no Enron lawyer has been indicted. Instead, the trial will likely be dominated by questions about alleged accounting irregularities and insider trading. A host of interesting questions about the in-house legal team will likely go unasked and unanswered.

As the trial gets under way, ex-Enron lawyers reflect on the hard lessons they've learned.

So, four years after the company filed for bankruptcy, and not long before the trial began, we asked former Enron lawyers for their thoughts. We wanted to know their views of the energy company's controversial business methods, and if their time there changed how they do their jobs now. More important, we wondered what lessons all in-house lawyers could learn from their experiences.

When the legal department alumni discussed their post-Enron job searches, it quickly became clear that the taint of Enron hasn't washed away. Few of the in-house legal corps (once 250 strong) were willing to speak on the record, in part because they fret that they will be called to testify at the trial.

But the dozen former Enron attorneys who spoke to us ruminated long and hard about what would have made their department more effective. They fingered two culprits. The legal department was decentralized; most of the company's lawyers worked for the business units. This isn't a problem in itself, but in Enron's case the business unit executives often pressured attorneys to keep misgivings about controversial deals or accounting practices to themselves. Plus, the lawyers say, there was little central control from the company's general counsel, James Derrick. Finally, under Enron's compensation system, business executives effectively decided most lawyers' pay. This mix limited the attorneys' ability—and incentive—to play grown-up to the company's often-reckless entrepreneurs by nixing their deals.

"Laws and regulations only get you so far," says Stephen Wallace, referring to the Sarbanes-Oxley corporate governance reforms that were passed within months

PHOTOGRAPH BY F. CARTER SMITH

Stephen Wallace (left), now a GC, and Peter del Vecchio, now at a law firm, are Enron alumni who loved their jobs—but wish lawyers had asked more questions.

Former Enron GC James Derrick was called to testify at congressional hearings in March 2002.

of the Enron implosion. A member of the Enron diaspora and now general counsel of Westlake Chemical Corporation, in Houston, he says a company culture of hands-on management and strong governance is more important in promoting an ethical workplace than legislation. The story of Enron, four years later, is still a powerful reminder of that lesson.

Lesson One:
Tattooed with the Scarlet E.

A LAWYER'S REPUTATION MAY BE-come entwined with a company's—and the connection between the two can survive long after they part. Michelle Hoogendam Cash has seen this firsthand. She was an employment lawyer at Enron—in effect, the hiring partner—and now she's the managing director of the Houston office of the world's largest legal search firm, Major, Lindsey & Africa. She saw the talent the company attracted on the front end, and continues to work with Enron alums.

The energy company's lawyers were among the best the profession had to offer. "They were at the very high end," Cash says, many graduating from prestigious colleges and law schools. Quite a few were recruited from large firms. Most Enron lawyers appeared to love their jobs—and embrace the company. "I believed. I drank the Kool-Aid," says Richard Sanders, now in-house at a Houston energy company, Kinder Morgan, Inc. "It was the place to be," says Wallace.

But for many alumni, their stellar credentials were tarnished by their time at Enron; finding work over the last few years hasn't been easy. "Some people view Enron on the resume as a scarlet E," and some former Enron lawyers are turned down flat, Cash says.

"I believed. I drank the Kool-Aid," says Richard Sanders, echoing many of his former colleagues at the fallen energy company.

Some lawyers said that when they approached outside attorneys with whom they'd spoken almost every day, their contacts wouldn't return their calls. Peter del Vecchio, now a partner at the Houston office of Dallas's Gardere, Wynne & Sewell, says one former law department colleague made it through rounds of interviews at a firm before the partnership decided they couldn't hire an Enronite.

Del Vecchio had a frustrating experience of his own. In 2002, when he was still working at Enron, he discussed a job opening with a financial restructuring business that had once been a client of his when he worked at White & Case. The ex-client, he says, remembered him well and praised his qualifications, but explained that the company couldn't hire a lawyer from Enron.

Del Vecchio tells the ultimate taint story. A former Enron law department colleague was sitting at an airport bar not long after the company's collapse. He fell into conversation with the woman sitting next to him, who confided that she worked for a business that sells sex toys. "And what do you do?" she asked. "I work at Enron," came the reply. "Aren't you ashamed when you tell people that?!" she responded without missing a beat. The lawyer's analysis: "When you're looked down on by the dildo salesmen of the world, doesn't that say it all?"

Despite the stigma, Enron attorneys are finding jobs. There's no way to know precisely how many are still employed as lawyers, but Enron alums have been helped by the resurgence of the energy industry. Constellation Energy Group, Inc., has hired several of them. "We evaluated people based on their own merits. Enron recruited and attracted some of the best in the industry," says a spokeswoman for the Baltimore-based company.

Others went to work for someone they knew. Sanders's company, Kinder Morgan, is run by a former Enron president, Richard Kinder. Wallace went back to his pre-Enron employer, which offered him his old job in 2002.

"Legal recruiting and being a lawyer is a relationship game," says David Marcus, who runs his own recruitment firm

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in Houston and has helped place several Enron alums. He couldn't place any in 2002, he says. Now the tide has started to turn, he says—thanks in part to a cohesive network of ex-Enron lawyers. They've gone to bat for each other, hiring former colleagues and introducing prospective employers. "People play to the relationships they already have," Marcus says.

Lesson Two:
Beware of the Hands-Off GC.

ENRON LAWYERS WERE INSULATED in silos—the business units for which more than half of the company's lawyers worked. One lawyer likened them to "a bunch of football teams" that kept to themselves.

Not that there's anything inherently wrong with decentralization, say experts. It encourages lawyers to get close to the business and the client, which are good things, says Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware. The danger, he says, is that it can lead to erratic performance across a department. "The key is creating a tight code of conduct and tight oversight by the general counsel."

By itself, a code of conduct may have little impact on a company's ethics. Management gurus say strong leadership is more important, and a lack of direction from the top was a serious flaw in Enron's legal department. GC Derrick was disengaged from the business; lawyers interviewed for this story say they had little if any contact with their boss after they were hired. The only time Derrick consistently communicated with lawyers in the business units, they say, is when they had to hire outside counsel, which Derrick insisted on approving.

Over time, the gulf between the business units and the corporate center widened, says del Vecchio, who worked in the wholesale trading unit and later in industrial markets. Enron's law department was more than decentralized; it was "balkanized," he says. "It was

THE SAGA SO FAR

2001


Skilling

February 12 Jeffrey Skilling is named Enron CEO.

August 14 Skilling resigns for unspecified "personal reasons."

August 15 Sherron Watkins, an Enron VP, sends chairman Kenneth Lay an anonymous letter questioning Enron's accounting.

August 22 GC James Derrick hires Vinson & Elkins to conduct a preliminary investigation into the issues Watkins raised.

September 21 Lawyers from Vinson & Elkins report that the company's accounting seems sound.

October 16 Enron announces its first quarterly loss in four years. By month's end its stock is trading at $14, about half of what it was a month earlier.

October 24 CFO Andrew Fastow is fired.

October 31 Enron's board appoints a special committee, chaired by University of Texas Law School dean William Powers, to conduct a full investigation.

November 8 Enron files documents with the SEC revising financial statements from the previous five years.

November 19 Enron restates its third-quarter earnings. By month's end it's trading at 26 cents. It began the year at $80 a share.

December 2 Enron files for bankruptcy protection.

2002


Lay

January 23 Lay, who had taken over from Skilling as CEO, resigns.

February 1 The Powers Report is released. It spells out how Fastow used off-balance sheet deals to enrich himself and his friends at the company's expense.

February 20 Derrick resigns.

March 7 Enron's outside auditing firm, Arthur Andersen, is indicted.

June 15 Andersen is convicted in a jury trial.

2003

September 10 Ben Glisan, former Enron treasurer, pleads guilty to conspiracy and begins serving a five-year prison sentence—the first Enron executive behind bars.

September 17 Three former Merrill Lynch bankers are indicted for their roles in Enron's phantom sale to Merrill of Nigerian barges to boost earnings. A fourth banker is indicted soon after.

2004


Fastow

January 14 Fastow pleads guilty to conspiracy, wire, and securities fraud.

January 22 Richard Causey, Enron's former chief accounting officer, is indicted.

February 18 Skilling is indicted.

July 7 Lay is indicted.

August 5 John Forney, a former Enron trader, pleads guilty to manipulating energy prices during California's energy crisis.

November 3 Merrill Lynch bankers are convicted of conspiracy and fraud in the Nigerian barges case. Appeals are pending.

2005

May 31 U.S. Supreme Court overturns Andersen conviction on basis of vague jury instructions.

July 20 In the federal trial in Houston of five defendants who worked for Enron's broadband division, the jury acquits three of some charges but deadlocks on most counts. The prosecution says it will retry all five in 2006.

December 28 Causey pleads guilty to securities fraud.

2006

January 30 Trial of Lay and Skilling begins in Houston federal court.

Ex-Enron lawyer Jordan Mintz bucked CFO Andrew Fastow by pushing for greater transparency.

like two different legal departments." Most of the business unit lawyers reported to Mark Haedicke, who at one time was GC of at least four divisions. (Neither Derrick nor Haedicke responded to requests for comment.)

Enron alums say business managers pressured attorneys to wave through deals, with little resistance from Derrick or Haedicke. "The worst thing you could do at Enron was to be viewed as an obstructionist," says del Vecchio. He recalls one lawyer in his business unit who made the mistake of taking too seriously the risk memos they were required to write that spelled out potential problems with deals. The business side complained to Haedicke, who ordered the attorney to write another draft, which was still seen as impeding the deal. Del Vecchio was then asked to rewrite it. The lawyer wasn't fired, but the dealmakers shunned him, forcing him to move to another unit.

Exacerbating this problem was a compensation structure that allowed business managers to determine lawyers' remuneration. As del Vecchio puts it: "If your compensation is being decided by your clients, you start to get political real fast."

Under CEO Skilling's "rank and yank" system, Enron employees were ranked on the basis of how much they'd contributed (especially to the bottom line), and their bonuses reflected their rankings. That's not altogether uncommon; what was different at Enron is that the system applied to lawyers, too. Lawyers who asked pesky questions about deals often found themselves ranked at the bottom, say Enron alums.

Decentralization isn't bad per se. Citigroup Inc. has more than 1,000 lawyers—four times the number Enron had at its peak. General counsel Michael Helfer runs the corporate center himself and oversees three business units that each has its own GC. What's important, says Helfer (speaking about his own company, not Enron), is hiring top-drawer lawyers and communicating frequently. He talks to his business unit GCs "probably twice a day at least," he says. "Plus, we have formal meetings."

If lawyers spend all their time with business people, they could "go native" and okay every deal, says Citigroup GC Michael Helfer.

Another difference between Enron and Citigroup is oversight. Helfer says a general counsel has to guard against business units pressuring lawyers to be facilitators rather than gatekeepers. If three lawyers spend all their time with 20 businesspeople in Des Moines, says Helfer, the risk is that the lawyers will "go native" and green-light every deal "to make the businesspeople happy." What's more, when it comes to pay, Citigroup lawyers' bonuses are always set by more senior lawyers. Helfer encourages these attorneys to consult with the appropriate business executives when they make their decisions. The only exceptions are the unit GCs. Their bonuses are determined by the business unit heads—in consultation with Helfer, who has veto power.

The bottom line? "Lawyers should be compensated by the general counsel," says the University of Delaware's Elson. "That's where you need to have central control."

Lesson Three: Privilege Is Dead.

IN JANUARY 2002 THE EXECUTIVE committee of Enron's board passed a resolution waiving attorney-client privilege and directing its lawyers to turn over all documents requested by government investigators. The board recognized that full cooperation was the company's only hope of regaining public trust when it emerged from bankruptcy.

Enron wasn't unique in waiving the privilege. Three months earlier, the Securities and Exchange Commission praised Seaboard Corporation and refrained from penalizing the company—even though its controller had used improper accounting—partly because it turned over documents without invoking privilege. But the scope of Enron's waiver and the scale of the investigations were unprecedented.

Still, waiving privilege creates its own problems. Scandal-related shareholder lawsuits are inevitable, and waiving to the government is also waiving to private plaintiffs, says Leslie Wharton, a partner at Arnold & Porter and an expert on privilege. "There are a bunch of plaintiffs lawyers out there who now will get all that material," says Wharton, who isn't involved in Enron litigation.

Waivers can play havoc with an in-house lawyer's life. Few people are in a better position to explain how than Sanders, an Enron litigator who is now

MARK WILSON/NEWSCOM

an assistant general counsel at Kinder Morgan. In 2000 Sanders headed an investigation into the company's controversial trading strategies during the California energy crisis. When Enron's West Coast lawyers wrote up their initial findings in a memo they planned to send to Haedicke, Sanders stopped them. "No, put my name on it," he told them. He shakes his head at the memory. "In my mind, it would make it more privileged." He laughs. "That was a good call."

The result? He's been deposed four times; testified before Congress; was hauled in front of the Commodities Futures Trading Commission and the Federal Energy Regulatory Commission; and landed on the Lay trial witness list. And every e-mail Sanders wrote and received while he worked at Enron is posted on the FERC Web site—including messages to his wife. Even though he's never been accused of wrongdoing, for a while he felt like a professional witness.

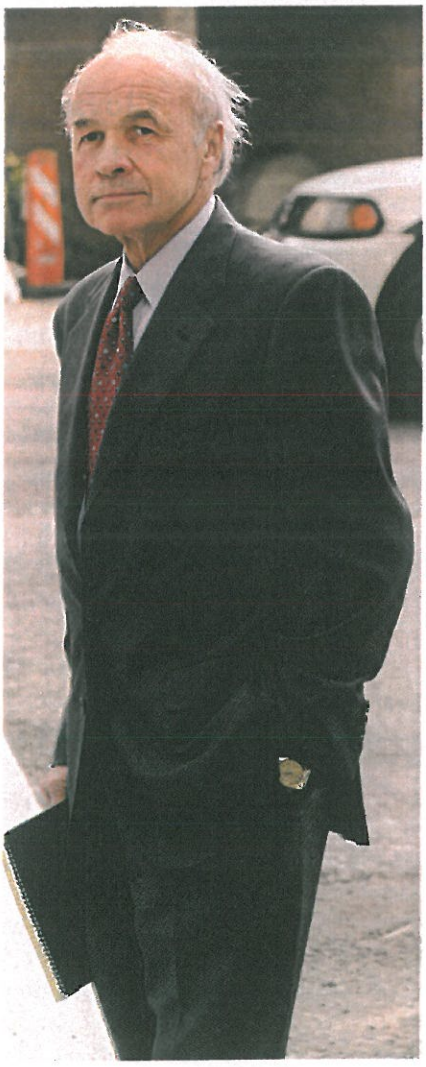
And now? When it comes to Enron's legal problems, he isn't sure whom he can talk to: "I don't know what's privileged and what's not." It's also unclear if conversations Enron employees have with outside counsel hired to defend them against market manipulation lawsuits are privileged.

Del Vecchio says his experience at Enron taught him a lesson about drafting documents. In-house lawyers should ask themselves: "How will a judge interpret these words?" Or better still, "How will an ambitious, 35-year-old assistant U.S. attorney interpret them?" In Sanders's view, however, there's only one solution: "I wouldn't put anything in writing."

Lesson Four: There's No Substitute for Hard Questions.

WHEN WESTLAKE'S STEPHEN Wallace was asked whether Sarbanes-Oxley has inoculated companies from the kind of trouble that brought down Enron, he reached into his briefcase and dropped the business section of *The New York Times* on the table. The lead story delved into alleged accounting fraud at the New York–based brokerage services firm Refco Inc. And neither Sarbanes-Oxley nor the accountants nor the lawyers prevented Refco's fall, Wallace points out. "Sarbanes-Oxley is not a cure-all," he says.

As a GC himself now, Wallace has spent a lot of time dealing with SOX. But he tries to go beyond observing laws and regulations, fine-tuning a code of conduct, and recruiting impressively credentialed directors. After all, he points out, Enron had a model code and more wizards on its board than Hogwarts. He wants his lawyers to police the business, and he communicates with them regularly—often meeting one-on-one. "People can talk more frankly without having other people around," he says.



MICHAEL STRAVATO/AP PHOTO

Enron ex-chairman Kenneth Lay is the public face of the scandal that rocked the company.

For Wallace, the value they add boils down to the questions they ask. Lawyers have to push beyond superficial explanations or a simple reliance on the work of others, he says. Though they can't review every business decision, they should carefully examine important ones. And they shouldn't be "cowed by their clients." He encourages his lawyers to listen to their intuition and speak up when an internal alarm goes off: "Lots of outside lawyers don't want to pour cold water on what clients want to do." It's up to the in-house lawyers, Wallace says, to turn on the spigot.

It's not as though that never happened at Enron. Another in-house lawyer, Jordan Mintz, pushed back against pressure from his boss, Andrew Fastow. The former CFO, who created Enron's most notorious transactions, copped a plea in 2004. Without telling Derrick or Fastow, Mintz hired Fried, Frank, Harris, Shriver & Jacobson to review the deals known as LJM, Mintz told the House Energy and Commerce Committee in February 2002. Mintz testified that he wanted to know whether Fastow's participation in these deals, known to only a few people, had to be disclosed in the company's financial filings. Days before Mintz received Fried, Frank's final memo, Fastow (under pressure from company executives) agreed to sell his interest. (Mintz, now a lawyer at Centex Corporation, the Dallas-based home builders, declined to be interviewed for this story.)

Overall, though, lawyers should have been more skeptical, say Enron alums. Del Vecchio heard rumors about LJM, and now regrets that he didn't ask questions about it. Or ask how earnings gaps got magically filled each quarter. But he says he was too intimidated: "You assumed the tax guy knew what he was talking about." If he gets another in-house job, del Vecchio vows to ask questions—no matter how dumb they sound. "What are they going to do, fire me?" he says. "It's better than working for another bankrupt company." ■