

# Fact Sheet

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**U.S. Department of Labor**

**Employee Benefits Security Administration**

**June 26, 2003**

## **Secretary of Labor Chao's Lawsuit Involving Enron Corporation Retirement Plans**

### **Secretary's Lawsuit**

The Secretary of Labor brought *Chao v. Enron* under the Employee Retirement Income Security Act of 1974 (ERISA), the federal law that regulates retirement plans and plan fiduciaries. The Secretary filed the lawsuit in the federal district court in Houston, Texas. She seeks to recover the losses suffered by two Enron retirement plans that had large investments in Enron stock:

- Enron Corporation Savings Plan (the "Savings Plan"), a defined contribution plan that covered 20,000 Enron employees, retirees, and their beneficiaries, and
- Enron Corporation Employee Stock Ownership Plan (the "ESOP"), a defined contribution plan that covered 7,600 Enron employees, retirees, and their beneficiaries.

The Secretary's action also seeks to bar all of the defendants from acting as fiduciaries or holding positions of responsibility with respect to any employee benefit plan in the future.

### **Background**

By the beginning of 2001, the two plans were among the largest investors in Enron stock, owning over 25 million shares of Enron stock. In early 2001, more than half of the Savings Plan's assets and essentially all of the ESOP's assets consisted of Enron stock.

The Secretary's complaint alleges that the plans' fiduciaries never seriously considered the prudence of the plans' investments in Enron stock or took appropriate action to protect the plans' participants from the losses that they incurred as a result of the investment. The defendants include:

- (1) The members of the plans' Administrative Committee (James S. Prentice, Roderick J. Hayslett, Tod A. Lindholm, Cindy K. Olson, Sheila D. Armsworth and Paula Reiker). Under the terms of the plans and ERISA, the committee had the duty to prudently oversee the plans' investments and to act solely in the interests of the plans' participants. Enron, Kenneth Lay, and Jeff Skilling were responsible for the selection of members of the Administrative Committee.
- (2) Enron Corporation. Enron Corporation is an Oregon corporation with its principal place of business in Houston, Texas. At the time it filed for bankruptcy on December 2, 2001, it was considered the seventh largest publicly traded corporation in the United States. Under the

terms of the plans, Enron Corporation was responsible for selecting the members of the Administrative Committee and was a named fiduciary.

- (3) Kenneth Lay and Jeff Skilling. Kenneth Lay was the Chairman of Enron's Board of Directors, and Jeff Skilling was Enron's Chief Executive Officer until he resigned in August 2001, when Kenneth Lay became Chief Executive Officer. Jeff Skilling and Kenneth Lay both exercised authority over the selection of Administrative Committee members. Kenneth Lay resigned as Enron's Chairman and Chief Executive Officer in January 2002.
- (4) Enron's Board of Directors. Under the terms of the ESOP, Enron's board of directors was responsible for the selection of the ESOP's trustee, a plan fiduciary with responsibility for overseeing the plan's investment in Enron stock.

The Inside Directors (Directors who were also officers or employees of Enron) were Kenneth L. Lay and Jeffrey K. Skilling.

The Outside Directors (Directors who were not also officers or employees of Enron) were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Wendy L. Gramm, Ken L. Harrison, Robert K. Jaedicke, Charles A. LeMaistre, John Mendelsohn, Paulo V. Ferraz Pereira, Frank Savage, John Wakeham, and Herbert S. Winokur, Jr.

- (5) The ESOP and Savings Plan. The plans are named as defendants for technical legal reasons, and not because of any allegation of misconduct by the plans. They are necessary as parties to ensure that the court can give complete relief to everybody affected.

### **What Did the Administrative Committee Do Wrong?**

Despite numerous warning signs that the plans' investments in Enron stock posed a risk to the plans' participants, the Administrative Committee did little or nothing to protect the participants' interests with respect to the stock. Even as the stock dropped in value throughout 2001, the committee's members:

- Never monitored, reviewed, analyzed, questioned, altered, slowed or stopped the plans' investments in Enron stock;
- Never considered the significance of the large number of warning signs in 2001 which should have caused the committee to question the plans' extensive holdings of Enron stock (many of these warning signs are set out in paragraphs 29-60 of the Secretary's complaint);
- Never considered the prudence of the plans' investment of most of their assets in Enron stock;
- Never considered the prudence of spending Enron's matching contributions on anything other than Enron stock;
- Never considered freezing or removing Enron stock as an investment option under the Savings Plan; and
- Never considered whether it would be prudent to sell some or all of the plans' Enron stock.

Further, two members of the Administrative Committee, Cindy Olson and Tod Lindholm, also breached their fiduciary duties to the plans by ignoring specific evidence in their own possession

which directly indicated significant financial mismanagement at Enron:

- Cindy Olson ignored Sherron Watkins' August 2001 warnings of accounting and financial misconduct. Watkins had given Olson a draft of her memorandum warning of grave accounting improprieties even before providing it to Kenneth Lay. Instead of acting to protect participants, Olson assisted Lay in isolating Watkins and denying her further access to Enron's financial information. Olson even helped Andrew Fastow, Enron's Chief Financial Officer, to confiscate the lap top computer Watkins had used to draft her memorandum.

Cindy Olson knew by the fall of 2001 that Kenneth Lay was making misstatements about Enron to participants. Even so, she failed to bring this information to the attention of the plans' other fiduciaries or to take any action to protect the plans and their participants from the misrepresentations made by Lay.

- Tod Lindholm analyzed and approved the accounting treatment for at least one of the transactions between Enron and Fastow's LJM partnership. The transaction permitted Fastow to reap significant profits at the expense of Enron, the company he was hired to serve. As a result of his participation in the transaction, from as early as June 2000, Lindholm knew or should have known that Enron was engaging in transactions which permitted insiders to take huge profits at the expense of the company and its shareholders.

### **What Did Enron Do Wrong?**

Although Enron Corporation was responsible for appointing and overseeing the Administrative Committee and was a named fiduciary:

- Enron never monitored the Administrative Committee in the performance of its duties;
- Enron never supplied the Administrative Committee with critical adverse information known to it about Enron's true financial condition;
- Enron never sought to remove Committee members for failing to discharge their obligations at any time before the bankruptcy;
- Enron never corrected misstatements made by Kenneth Lay to participants regarding Enron's financial condition.

### **What Did Kenneth Lay and Jeff Skilling Do Wrong?**

Although Lay and Skilling exercised authority over the selection of Administrative Committee members:

- Lay and Skilling never monitored the Administrative Committee in the performance of its duties;
- Lay and Skilling never supplied the Administrative Committee with critical adverse information known to them about Enron's true financial condition; and
- Lay misled participants about Enron's financial condition, encouraged them to invest in Enron stock, and suggested that Enron's financial transactions had the complete support of the company's internal officers, external auditor, and counsel, even though Sherron Watkins had advised him that Enron could implode in a wave of accounting scandals and he was fully aware that Enron had asked outside counsel to investigate Enron's financial activities.

## **What Did the Board of Directors Do Wrong?**

Although the documents governing the ESOP gave Enron's Board of Directors responsibility to appoint a trustee for the ESOP, and ERISA requires that all plan assets be held in trust by a trustee:

- The Board of Directors failed to appoint a trustee to manage the ESOP's holding in Enron stock;
- The Board of Directors deprived the ESOP of a trustee, and did not undertake to perform the trustee's duties themselves or to safeguard the interests of the ESOP.

## **What Else Has the Secretary Done to Protect the Plans' Participants?**

On November 16, 2001, the Secretary opened one of the first investigations into the financial improprieties at Enron. Since then, investigators for the Secretary have questioned over a hundred witnesses and subpoenaed over two and a half million pages of documents.

Shortly after opening her investigation, it became clear to the Secretary that the plans' Administrative Committee was not acting in the plans' best interests and that it should be removed. At the Secretary's insistence, Enron agreed to remove the plans' fiduciaries and, in April of 2002, the Administrative Committee was replaced by an independent fiduciary selected by the Secretary: State Street Bank.

The Secretary's investigation of Enron continued through the rest of 2002. While the investigation was proceeding, a private class action was brought on behalf of the plans' participants in the United States District Court in Houston. In response to motions by the defendants in that action to have the court summarily dismiss the participants' claims, on August 30, 2002, the Secretary filed an amicus brief in support of the plans' participants in the private litigation. The District Court has not yet ruled on those motions.

The Secretary has now determined that she has sufficient information to file her own action. In her complaint, she asks that the defendant fiduciaries be held jointly responsible for the monetary losses that they have caused to the plans. The Secretary also asks the court to bar all of the defendants from managing or providing services to any employee benefit plan in the future.

## **Contact Information**

More information about the lawsuit may be obtained on the department's website at [www.dol.gov](http://www.dol.gov).