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Board was told of risks before Bush stock sale

Harken memo went to SEC after probe

By Michael Kranish and Beth Healy, Globe Staff, 10/30/2002

WASHINGTON - One week before George W. Bush's now-famous sale of stock in Harken Energy Corp. in 1990, Harken was warned by its lawyers that Bush and other members of the troubled oil company's board faced possible insider trading risks if they unloaded their shares.

The warning from Harken's lawyers came in a legal memorandum whose existence has been little noted until now, despite the many years of scrutiny of the Bush transaction. The memo was not received by the Securities and Exchange Commission until the day after the agency decided not to bring insider-trading charges against Bush, documents show.

The memo, a copy of which was obtained by the Globe, does not say directly whether Bush would face legal problems if he sold his stock. But it does lay out the potential for insider-trading violations by Bush and other members of the Harken board, and its existence raises questions about how thoroughly the SEC investigated Bush's unloading of \$848,000 of his Harken stake to a buyer whose name has not been made public.

The SEC cleared Bush after looking into whether he had insider knowledge of an upcoming quarterly loss at Harken. But the SEC investigation apparently never examined a key issue raised in the memo: whether Bush's insider knowledge of a plan to rescue the company from financial collapse by spinning off two troubled units was a factor in his decision to sell.

The plan engineered by one of the company's largest shareholders, the endowment fund of Harvard University, raised uncertainty about the value of Harken after the breakup. The question is, did Bush sell believing that the stock might soon dip?

"It would certainly have raised a question in the mind of a reasonable investigator," said Theresa Gabaldon, a professor at George Washington University and author of the textbook "Securities Regulation."

Gabaldon, who reviewed the documents at the request of the Globe, also examined company minutes related to the move to split up Harken through what is called a "rights offering" and concluded that they would have been worthy of further examination by securities regulators. But, she said, "I don't think [the SEC investigators] were looking at the rights offering at all."

The Globe contacted four former SEC officials who worked on the Bush case; none of them recalled seeing the memo in question. None would speak about the case on the record, but a July 1991 memo from the SEC investigators to their boss reveals that they were having difficulty securing documents from Bush, who was holding many items back, saying they were private correspondence between him and his lawyer.

"Bush has produced a small amount of additional documents, which provide little insight as to what Harken nonpublic information he knew and when he knew it," the memo said.

The SEC nevertheless cleared Bush on Aug. 21, 1991. One day later Bush's lawyer - Robert Jordan, now the US ambassador to Saudi Arabia - turned over the legal memorandum outlining concerns about insider trading. The nine-page memo, dated June 15, 1990, was titled "Liability for Insider Trading and Short-Term Swing Profits" and addressed the possibility that Harken board members might know more about the spinoff plan, which included a stock rights offering, than the general public did.

The memo, did not instruct the board members whether to sell. One week after the memo was written, Bush sold his stock. In the following six months, the stock price dropped from \$4 per share to \$1.25 per share, although the price later recovered.

White House spokesman Dan Bartlett said the memo does not suggest that Bush refrain from selling the stock. Bartlett also said that the memo was sent to the Harken board, of which Bush was a member, but did not mention Bush by name.

"This is a general memo that goes through the perfunctory guidelines of a rights offering," Bartlett said. "It was not specific to the transaction that the president was contemplating."

SEC reports on the case make it clear, however, that the memo was written in response to Bush asking Harken executives whether he could sell his shares. Bartlett said he did not believe that Bush had seen the memo, but instead thought that Bush was told about the advice by a company lawyer.

The memo raised a specific concern about the insiders' knowledge of the rights offering, which split Harken into three entities. The plan was recommended by Harken board member Michael Eisenson, the Harvard Management executive in charge of the university's Harken investment. Eisenson was trying to save the company from bankruptcy, according to board meeting minutes. Eisenson has declined to be interviewed.

In 1990, Harken, a small, Texas-based energy company, was Harvard Management's seventh-largest stock holding. The investment, made in 1986, had been part of an ill-timed plunge by the university endowment into the energy sector. There has been speculation that Bush's presence on the Harken board attracted Harvard to the company. But former Harvard executives and others with knowledge of the Harken investment said Bush had nothing to do with the fund's investment.

The crucial question is whether Bush was motivated to sell when he did by information he learned at the special meeting of Harken directors on May 17, five weeks before he sold his stock. The meeting was held at a moment of crisis for the company, which was expected to

run out of cash within three days, according to internal documents. One Harken memo related to the rights offering says the company had "no other source of immediate financing" if the deal was not completed. Indeed, the offering was necessary to get leniency from Harken's two lenders, the former Bank of Boston (now part of FleetBoston Financial) and First City Bank of Texas. The major shareholders, led by Harvard, had to put up financial guarantees to seal the bargain.

Meanwhile, Bush was pondering the sale of most of his own Harken holding, which he came into in 1986 when Harken bought out his interest in another failing oil venture, called Spectrum 7. Bush has said that a Los Angeles stockbroker, Ralph Smith, called him in early June 1990 to ask if he would sell his Harken shares to one of Smith's clients. Bush said no, but said he might be interested in selling "in a few weeks," according to the SEC memo.

Shortly after the Smith call, Bush asked Harken's general counsel for advice. The counsel, in turn, asked Harken's law firm, Haynes and Boone, whose advice included this warning: "The act of trading, particularly if close in time to the receipt of the inside information, is strong evidence that the insider's investment decision was based on the inside information. ... Unless the favorable facts clearly are more important than the unfavorable, the insider should be advised not to sell."

The memo notes that in Harken's May 22 announcement, it "does not disclose the purchase price for which the rights will be offered and expressly states that `additional terms of the proposed rights offering are currently being formulated.'"

The price would not be announced until Oct. 3; that's when investors would know how much they would have to pay to buy shares in spun-off companies. The Globe could not determine when Bush and other board members learned what the price would be.

One week after the memo was written, Bush sold his shares on June 22 via the broker, Smith. Smith could not be reached for comment, but has been quoted as saying the buyer was an institution that he would never reveal.

Nearly a year would go by before the SEC investigated the transaction, a delay caused in large measure because Bush was late in notifying the agency of his insider sale.

During the SEC investigation, Bush's lawyer was asked by the SEC what advice was given to Bush about selling. The Bush lawyer told the SEC that no objection to the sale was made by Harken's law firm. "Haynes and Boone informed [Bush] that they had met internally to consider the issue and, based upon the information they had, they saw no reason why Bush could not sell his shares," the SEC report said.

The summary was released a day before the agency received the legal memo in which Harken and Boone offered much more cautious advice to Bush and the board. Jordan could not be reached to discuss the apparent conflict. The SEC investigators also declined to comment.

Harken remains financially troubled, with its stock trading at 22 cents a share. It is currently in the middle of another effort to raise capital.

As for Bush, he has often said that he could not be faulted for insider trading because he was

selling into good news; the prior January Harken had entered into a deal to drill for oil in the Persian Gulf nation of Bahrain.

Michael Aguirre, a California securities lawyer who filed the original Freedom of Information request that led to the release of some of the documents, said he is astonished that the SEC did not investigate the rights offering.

"It was something they either overlooked or consciously avoided," he said. "It appears that Mr. Bush had insider information, that he was told that such insider information could be considered material, [and] was given express warnings about what the consequences could be."

Thus, Aguirre said, it is "imperative" that Bush allow the buyer of his stock to be identified because that would clarify whether Bush knew the buyer and conveyed inside information to the buyer.

Michael Kranish can be reached at kranish@globe.com.

Beth Healy can be reached at bhealy@globe.com.

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