

Los Angeles Times, March 16, 2006

Whistle Blower Recounts Enron Tale

by Thomas S. Mulligan, Times Staff Writer

HOUSTON || Former Enron Corp. Vice President Sherron S. Watkins, who gained national renown as a whistle-blower, described on the witness stand Wednesday how she had tried to warn her bosses of accounting problems that she felt threatened the energy-trading company's existence.

Watkins was the author of a now-famous memo to then-Enron Chief Executive Kenneth L. Lay warning that the company could "implode in a wave of accounting scandals."

She wrote the memo on Aug. 15, 2001, the day after Lay had reassumed the CEO's post after the surprise resignation of Jeffrey K. Skilling. It was less than four months before Enron collapsed into bankruptcy at a cost of thousands of jobs and billions of dollars of stock-market wealth.

Enron's downfall sparked a federal investigation that resulted in the multiple fraud and conspiracy charges for which Lay, 63, and Skilling, 52, are now on trial. The two face decades in prison if convicted.

Watkins' memo was anonymous, but she said she soon decided to identify herself as the author and speak with Lay. In the one-on-one meeting that followed, she said Lay "was a bit skeptical" that some deals she had spotlighted could be improper, because they had been vetted by in-house lawyers and accountants as well as Enron's external auditor, Arthur Andersen, and its law firm, Houston-based Vinson & Elkins.

Although Lay followed up by launching an investigation, Watkins said she was distressed that the job was given to Vinson & Elkins, assisted by Andersen. That amounted to the firms' "reviewing their own work," she said, calling the outcome a whitewash.

Watkins also testified that she later learned that the company had looked into the possibility of firing her, saying she was shown a memo in which Vinson attorneys discussed the ramifications of such a move.

Watkins, 46, who in recent years has made much of her living giving speeches about ethical lapses at Enron, took some blows to her own reputation Wednesday. She acknowledged that she had improperly -- if not illegally -- sold Enron shares in August and October 2001, when her position at the firm made her aware of negative information that wasn't publicly available.

She said she netted about \$47,000 in the two sets of sales. "I wish I hadn't," she testified. "I don't know whether a crime was committed."

Asked whether prosecutors considered charging Watkins, a spokeswoman for the federal Enron Task Force said the government declined to comment on such decisions.

Watkins is one of the most memorable personalities to emerge from the Enron debacle.

During a televised congressional hearing in February 2002, she verbally dueled with Skilling over the extent of Enron's financial woes and how much he knew about them. Her high-profile revelations of the company's problems earned her a spot on the cover of Time magazine's 2002 Persons of the Year issue, which honored Watkins and other whistle-blowers.

Her testimony in federal court Wednesday was largely a retelling of the story she has recounted before Congress, in media interviews and in a book. Dressed in a violet pantsuit and patterned scarf, Watkins projected self-confidence, sometimes turning to the jury of eight women and four men and gesturing as she testified.

Watkins is one of the few witnesses in the prosecution's arsenal who hasn't been charged with a crime in connection with Enron's collapse. Defense lawyers have repeatedly pointed out that cooperating witnesses hope to get lighter sentences in exchange for their testimony.

However, Skilling lawyer Ronald G. Woods implied that Watkins might have other ulterior motives. After eliciting from Watkins the information that she had given about 50 speeches at fees of \$20,000 to \$30,000 since leaving Enron, he said, "If this jury were to acquit, your source of income would dry up."

The focus of the memo Watkins wrote to Lay was a group of off-the-books partnerships created and run by former Enron Chief Financial Officer Andrew S. Fastow. The partnerships, Fastow testified a few days ago, became vehicles for enabling Enron to hide losses and improperly boost reported profit.

The partnerships were supposed to be independent entities, but Watkins said she learned that they had no money at risk in the deals with Enron and thus didn't qualify as independent under accounting rules.

She said Lay misled employees about the Vinson & Elkins investigation when he said in an October 2001 meeting that "controls and procedures" governing the Fastow partnerships "had been adhered to."

Virtually the only negative finding of the law firm's probe was that the controls had not been properly followed, she said.

In cross-examination, lawyers for Lay and Skilling portrayed Watkins as a loose cannon who had a reputation for giving pointed opinions on topics about which she lacked the facts.

In an Enron employee performance review that was entered into evidence, Watkins had been criticized for "a tendency to not listen," sometimes causing serious problems at work.

Chip B. Lewis, a lawyer for Lay, also tried to demonstrate that Lay had been highly responsive to Watkins' concerns. For example, Lay twice met with her, he launched the investigation and he transferred her out of Fastow's department at her request, Watkins acknowledged.

Stephen L. Meagher, a former federal prosecutor in San Francisco who now specializes in representing whistle-blowers in False Claims Act cases, called Watkins' testimony effective.

"My sense was that she did some damage to Lay today," he said, noting that Watkins did not come before the jury with the same "baggage" as Fastow, who pleaded guilty to two conspiracy counts.

"Her warnings to Lay are going to end up being largely indisputable," he said. "The question comes down to whether Lay's reactions were reasonable."

But Michael Perlis, a Los Angeles-based lawyer with Stroock & Stroock & Lavan, cautioned that putting a whistle-blower on the stand was not always an effective tactic for the prosecution.

"The fact that she is not tainted is helpful, but the real issue is how much direct evidence does she have to implicate" Lay and Skilling, Perlis said. "The fact she sent a memo to Lay does not necessarily mean anything, if others there were bent on deceiving him."

The trial, which has been running on a Monday-to-Thursday schedule, was recessed until Monday.

Times staff writer Marc Lifsher in Sacramento contributed to this report.

GRAPHIC: PHOTO: PROSECUTION WITNESS: Sherron Watkins leaves court with attorney Philip Hilder after testifying about events at Enron.
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