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MEMORANDUM

TO: Enron File

FROM: Lisa Henriques

DATE: January 16, 2002

RE: Ken Lay Interview

On January 16, 2002, Chuck Davidow, Bill McLucas and Lisa Henriques of Wilmer, Cutler & Pickering ("WCP") and John Sullivan and Ron Forster of Deloitte & Touche (an accounting firm retained by WCP), spoke with Kenneth Lay, CEO of Enron, at Enron's Houston headquarters to gather information from him in order to allow WCP to provide legal advice to the Special Committee of Enron's Board of Directors. Dean William Powers, Chairman of the Special Committee was also present. Earl Silbert and Richard Oparil of Piper Marbury Rudnick & Wolfe LLP were present and represented Mr. Lay. Mike Ramsey, solo practitioner and Elizabeth Villar, solo practitioner, were also present. Bob Bennett and Carl Rauh of Skadden, Arps, Slate, Meagher & Flom LLP, counsel to Enron, were also present.

This memorandum has been prepared by counsel in anticipation of possible litigation arising from a Securities and Exchange Commission ("SEC") investigation and any parallel or related proceedings. This memorandum incorporates the mental impressions, analyses and opinions of counsel. As such, this memorandum is intended solely to assist counsel in providing legal representation and advice to the Special Committee of Enron's Board of Directors, and is not intended to provide a substantially verbatim recital of Lay's statements. The interview was based on WCP's understanding of the facts and review of documents as of the date of the interview. Furthermore, Lay has not reviewed this memorandum. Therefore, this memorandum may contain inaccuracies and the following discussion of certain events may be incomplete or lack context.

At the outset, Davidow explained that WCP represented the Special Committee appointed by the Board to investigate certain transactions between Enron and related parties, and we were speaking to him as part of that investigation. Davidow stated that we did not represent Enron's officers or employees, including him, that, in our view, the conversation was privileged but it was the Special Committee's (or Enron's) privilege, and that the Special Committee or Enron could decide what to do with the privilege, not him. Davidow stated that Lay should anticipate that anything he told us would be conveyed to the Special Committee, and that the information could be communicated to others, such as the Board, others associated with Enron, and the Government.

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Experience:

Lay attended the University of Missouri and received a master's degree in economics in 1965. He then accepted a position with what is now known as Exxon, as a corporate economist in the Corporate Planning Department. In May 1968, he was commissioned to the Navy and assigned to the USS Pentagon. He spent three years in the Navy and served as Technical Assistant to the Commissioner of the Federal Energy Regulatory Commission. From 1971-1974, Lay served the civilian government as a top assistant to International Regulation. From 1972-1974 Lay was the Deputy Undersecretary of the U.S. Department of Interior and focused on energy policy.

In 1974, Lay accepted a position with Florida Gas Company in Winter Park, Florida. While at Florida Gas, Lay served as Vice President Corporate Planning, Vice President of Gas Supply, President of the Pipeline and then President of Florida Gas. Lay then became Executive Vice President of Continental Group.

In 1981, Lay was President, CEO and member of the Board of Transco. In 1984, Lay became Chairman and CEO of Houston Natural Gas, which in 1985 was bought out by Internorth, a company based in Omaha, Nebraska. Four months after the buyout, in November 1985, he became CEO. This company was the predecessor to what is today known as Enron. From February 1986 through February 2001, Lay served as CEO of Enron. In February 2001, Lay stepped down as CEO and Jeff Skilling filled the position. In August 2001, Skilling resigned as CEO and the Board of Directors offered the position to Lay. Lay accepted and is currently CEO.

Accounting Knowledge:

Lay took twelve hours of accounting in college because he thought it would prepare him for business. He has a general knowledge of accounting and is able to read a balance sheet. He is familiar with the term *SPE*, and knows they are off-balance-sheet vehicles used for project financing. Lay did not understand the structure's requirements for SPEs until October 2001. He does not recall if he knew prior to October 2001 the 3% equity requirement for SPEs. He did not think the SPEs were unique. He does not recall hearing about SPEs prior to 1997.

Lay has a general knowledge of derivatives. He is familiar with puts, calls, collars and swaps from his experience with the wholesale side of the energy business.

Enron's Business Direction:

In 1995, Enron's business focused on traditional pipeline business. The business was strong, but growing at a slow rate. In the early 1990's, Enron started a wholesale business, which was the main source of growth through the mid-1990s. Enron started in the electricity business around 1996 and moved the business into Europe. In 1997, Enron launched its retail business and Enron Energy Services. At the same time, Enron was trying to expand in California but, in the end, decided not to enter the California market.

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From 1996 to 1998, approximately 60% of the earnings were generated from businesses Enron was not engaged in ten years previously, and approximately 30-40% of Enron's profit was from businesses that Enron was not engaged in five years previously.

Enron also wanted to expand to other regions of the United States and the world. In 1990, Enron had a successful natural gas business in England called Teeside. Enron also expanded to India and the Southern Cone. For example, TGSI was Argentina's biggest pipeline. Enron wanted to start its international expansion in the United Kingdom and then grow to the Nordic countries and eventually continental Europe. In India, Enron had a major pipeline that stretched from Dabhol to Mumbai. Enron also expanded to Japan and Australia.

In 1998, Enron tried to get into the water industry. Enron had the right concept but the implementation was wrong.

Enron expanded to broadband when it bought Portland General Electric ("PGE"). PGE had laid fiber in Portland and Enron expanded it from Portland to Salt Lake City, Las Vegas and back up the coast. By 2000, Enron had a nationwide backbone system of broadband fiber. The system was designed to be digital only. Enron entered into a venture with Blockbuster to deliver entertainment on demand to expand the broadband industry. Enron thought there was a real future in the idea because Sprint and Qwest were very interested in broadband.

The basic business model Enron used was to buy an asset and then expand it by either expanding into other regions of the country or the world or by building a wholesale or retail business around the asset. The model was very successful when it was applied to industries that were still rigidly regulated.

Off-Balance-Sheet Trading:

Enron utilized off-balance-sheet transactions because the company was growing quickly and the balance sheet was not large enough to handle the growth. Enron could either significantly decrease the growth rate or continue to grow rapidly by utilizing off-balance-sheet transactions. Teeside was the largest off-balance-sheet finance transaction.

There has been intense pressure from the market for earnings since 1995. Lay believes that stock purchasers want to buy stock in companies that have fast-growth price/earnings ratios, but also quality and sustainability of earnings. Therefore, companies must balance producing earnings and maintaining quality.

Jeff Skilling:

Lay was introduced to Jeff Skilling in 1985 when Skilling worked for McKinsey & Co. Skilling is a graduate of Harvard and is very bright. Skilling was on the fast track at McKinsey and ran a section of McKinsey's worldwide group at the age of 35. Lay tried to recruit Skilling to join Enron in 1988 and 1989 when Lay was working closely with Skilling on deregulation issues.

In 1990, Skilling joined Enron. Skilling was one of the driving forces behind creating a financing company for energy, which led to Enron Finance Corporation. In the late 1980s banks no longer provided financing to energy companies. A lot of good energy companies had assets, but did not have a way to finance and develop them. Enron decided to create a business that would provide financing to energy companies. Enron based its financing model off the payment model used in 1930's. In addition to financing, Enron provided its clients transportation, marketing, pools of supply in marketplaces, and long and short term plans in addition to the financing. The business was very successful.

Lay described Skilling as a strategic thinker, creative and always coming up with new ideas. He had a strong sense of finance. Lay felt that Skilling had good judgment and integrity in his business dealings. Lay never felt that Skilling was trying to manipulate him, and he always kept him well informed on Enron business.

When asked to identify any of Skilling's weaknesses, Lay said he was never able to relate well to most of the employees. The employees that worked directly with Skilling had a great deal of respect for him and were loyal, but the average employee did not always relate to Skilling. Sometimes employees felt that Skilling spoke down to them because he was so bright. Skilling also had a fast tongue, as was evidenced in a call with analysts.

When Lay stepped down as CEO, he wanted to make the transition seamless. He started to turn responsibilities over to Skilling. Skilling would take the responsibilities and run with them. After Lay stepped down as CEO, Skilling appropriately slowed the flow of information to Lay. After stepping down as CEO, Lay concentrated on other areas of Enron business, like problems in California.

Chewco:

Prior to October 2001, Lay has no specific recollection of who bought CalPERS' interest in JEDI I. He knew that CalPERS wanted to liquidate its position in JEDI I and vaguely recalls a meeting where this was discussed. He thought that there was a team that was going to work with CalPERS to facilitate the liquidation. He did not think it was an unusual transaction because CalPERS wanted to invest in JEDI II

Lay never spoke with anyone at CalPERS regarding the buyout, but vaguely remembers being introduced to CalPERS consultants. Fastow and Skilling were meeting with the CalPERS consultants and brought them to meet Lay in his office.

Chewco's buyout of CalPERS was addressed in a November 5, 1997 Executive Committee Meeting. Lay did not recall why the Executive Committee addressed the issue and not the Board. The Executive Committee has the power to act on behalf of the Board. It is possible that a decision was needed in a timely manner and therefore the Executive Committee handled the issue. There was a presentation to the Executive Committee that explained the structure and the implementation of Chewco. Lay did not recall the details of the presentation. One of the slides in the presentation makes a reference to the "Enron Guarantee Book." That term did not have any meaning to Lay. The minutes reflect that Lay joined the meeting after the Chewco presentation.

Lay does not recall learning about Chewco's buyout of CalPERS' interest prior to the meeting. Normally, Skilling and Lay would meet one to two times a week. All matters that are brought to the Board or the Executive Committee are usually discussed prior to the meetings.

Lay does not know Michael Kopper and would not recognize him. He first became aware of Kopper in October 2001 when he read an article in the Wall Street Journal. When Lay read the Wall Street Journal article, two things jumped out at him: 1) he had never heard of Chewco and 2) an Enron employee was involved. Lay thought that the only related-party transaction was Andy's involvement in LJM. Lay believed that if he had known of another party involved in related-party transactions, he would have remembered.

Lay has the authority to grant a waiver of Enron's code of conduct. No one involved in Chewco requested a waiver from Lay. Lay would expect that if Enron employees knew that someone violated the code of conduct, that person would inform Lay. Every employee at Enron must sign off that they received a copy of the code of conduct each year.

In the first quarter of 2001, Enron consolidated JEDI I. There is no indication in the Board minutes that this consolidation was ever presented to the Board. Lay did not know about the consolidation and does not recall that the consolidation was ever brought to the Board.

Lay did not recall being aware of a tax indemnification paid by Enron to Chewco involving Fastow and Skilling.

LJM:

Lay refreshed his memory about LJM by reviewing Board minutes and his calendar. Lay first heard about LJM when he returned from an international trip about ten days before a Board meeting in 1999. Fastow and Skilling met with Lay before the meeting. Lay could not recall if Kristina Mordaunt was present at the meeting. They discussed the fact that Enron had a large position in Rhythms that they wanted to hedge. The Rhythms stock had increased in value quickly and they wanted to protect the gain from future volatility. Skilling and Fastow created a proposal on how to hedge the Rhythms stock by creating a partnership, LJM. Fastow would be the general partner. The group generally discussed the potential conflict of interest. There was no proposal on how to mitigate the conflict of interest at the time. They did discuss that arm's-length negotiations were needed between the new partnership and Enron. After Lay's discussion with Skilling and Fastow he supported the idea and thought the idea should be taken to the Board.

No efforts were made to find a commercial third party because the market was moving quickly and the hedge had to be in place in a timely manner. There was no time to find a third party.

Lay never directly asked how much Fastow would make from his involvement in LJM. Lay did not think it was relevant because Fastow was concerned that if he created LJM it would impair his career at Enron. Fastow was willing to create the structure, but wanted to ensure that his career at Enron would not be affected by being involved with LJM. Another reason Lay was not curious about Fastow's compensation from LJM was because LJM was supposed to be used only once. The partnership was capable of engaging in other deals, but would only do the Rhythms hedge.

Jim Derrick, Lay and Fastow made a presentation to the Board proposing LJM. Lay generally recalls the presentation. At the Board meeting there was a lively discussion about the partnership. The Board was concerned with possible conflict of interest issues, the optics of the CFO of the company creating a partnership that transacts with the company and protecting the company. A process was created to protect the company. Rick Causey and Rick Buy were designated to review the deals and ensure that all deals were done at arm's-length. Some members of the Board had doubts about the partnership, but in the end, LJM was approved. Lay could not remember what Board members had concerns. He thought that possibly Norman Blake asked some questions because he always asked penetrating questions during Board meetings.

The proposal for LJM1 did not go to the Finance Committee because there was a timing issue. The Board has the authority to act on issues of this type without prior approval by the Finance Committee.

After the Board approved LJM, the transaction was executed. Lay had no recollection of being informed of any changes to the transaction. The people involved in the transaction are responsible for making sure that the Board's resolutions are carried out. If there are significant changes, then the Audit Committee needs to review the transaction.

Lay does not recall any discussions in Board meetings about whether the Rhythms transaction was an economically effective hedge considering the hedge was with an entity that did not have a lot of equity and was mostly funded by a loan from Enron. The discussions in the Board meetings were primarily about the related party issue. Lay did not delve into the issue whether or not the hedge was an effective economic hedge because Fastow and his team said they had scrubbed down the transaction and it was proper. Lay did not think there was a distinction between an economic hedge and an accounting hedge.

Lay did not know about the unwind of the Rhythms transaction in early 2000, and did not know why it was not brought to a Board meeting. He did not have a recollection of payments made by Enron to LJM during the unwind.

He was not aware of any payments or loans by Enron to LJM1. He also was not aware that these funds contributed to the entity that Ben Glisan and Mordaunt invested in, nor the fact that LJM1 arguably should have been paying Enron instead of receiving money.

Cuiaba:

Lay did not recall discussions about Cuiaba, but was able to refresh his memory about the deal when he reread Board minutes. Cuiaba was a large project in Brazil that encountered a number of construction problems. Lay did not recall any connection between Cuiaba and LJM. Lay had no recollection that Cuiaba was significant to the earnings in 1999, or that Enron bought back LJM's interest in Cuiaba after there were problems in that project.

LJM2:

The purpose of LJM2 was to provide an additional source of capital for investments in a timely manner. Usually, Skilling and Lay would discuss the agenda prior to the meeting, but does not recall a discussion before the Finance Committee meeting about LJM2.

When the proposal to create LJM2 was brought to the Finance Committee there was a vigorous discussion about the partnership. There was a longer and more in depth conversation about LJM2 because it was going to be a larger partnership and was going to engage in more deals with Enron. Fastow was going to be the general partner of LJM2 and, therefore, more detailed and clear policies and procedures for transacting with LJM2 were created. The Committee wanted to protect the shareholders and make sure that the transactions were done at arm's-length. The Committee discussed the issue of the optics that the CFO was going to be the GP of a partnership that was going to transact with the company. The Committee and the Board discussed what it would look like to an average person if it was known that the CFO had a partnership that transacted with the company. Once again, Fastow said he had reservations about being involved in the partnership because of possible adverse effects on his career and opportunities at Enron. Fastow said he was willing to create LJM2 because it was in the best interest of the company and the company wanted him to do it.

Lay did not know who came up with the idea of LJM because Skilling and Fastow presented the idea together. Lay does not recall any other Enron employees that were going to invest in or manage LJM.

Lay had the authority to grant waivers to the code of conduct, but in this case the Board of Directors granted Fastow the waiver. Lay said that LJM attracted a lot of attention by the Board and since LJM2 had a significant size, the Board felt it advisable to grant the waiver. Fastow also requested that the Board grant the waiver to the conflict. The Board said it would grant the waiver so long as procedures were put in place to make sure the transactions were made at arm's-length and to protect the shareholders.

Lay did not recall any discussion during the meeting about Fastow's compensation. Lay understood that Fastow would receive fees and a return on his investment. The Board discovered in October 2001 that Fastow made approximately $30 million from his interest in LJM. Lay said that he was shocked because Fastow was reluctant to create the partnerships and was only spending a few hours a week on LJM related work. These facts neutralized Lay's concerns that Fastow might be making a substantial sum of money.

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Davidow pointed out that when the Board looked at LJM1 it discussed the order of the payments to LJM, while when LJM2 was created there was no discussion of payments. Lay said that he understood that it was a private equity fund on the other side of the wall and it was not his concern how LJM distributed the funds.

There was no discussion at the time about required disclosure of Fastow's interest in LJM. There was also no discussion over minimizing the disclosure. Lay assumed that this would be disclosed like any other transaction of this nature.

Lay never heard complaints from Enron employees that Fastow was putting pressure on them to negotiate favorably with LJM. He does not recall hearing that Jeff McMahon complained to Skilling.

Lay never reached out on his own to investigate whether the controls the Board put in place to ensure arm's-length transactions were followed. Enron has a "hands off" management style. If someone identifies a problem, then Lay and people at Enron would investigate and fix the problem. Skilling was responsible for ensuring that the controls were in place. If Skilling found a problem with operations, he would talk to Lay. Also, the Audit and Finance Committees would look over the procedures at the annual meeting where they discuss the year's transactions.

Both Causey and Buy were responsible for making sure that the transactions with LJM1 and LJM2 were fair to the company and at arm's-length. Lay thought it was clear to Causey and Buy that they were supposed to look at the deal and make sure it was fair. They were supposed to look not only to see if there were independent people on each side of the deal, but also at the terms of the deal.

At the end of 1999, there were a series of transactions between Enron and LJM2. Lay did not recall that the transactions done at the end of 1999 were with LJM. It is not unusual for Enron to do a number of transactions at the end of the year.

At the May 1, 2000 Finance Committee meeting there was a presentation that gave an LJM2 update for the fourth quarter. Lay did not recall or was aware that many transactions worth a substantial amount occurred at the end of 1999, as reflected in the presentation. Enron's total earnings for 1999 were $893 million, and Lay thought $229 million was a large portion of the earnings. Lay could not recall any discussion that a significant amount of the income for Enron was from these six transactions.

Lay was unaware of previously-sold assets being bought back by Enron in 2000 and wondered what were the reasons for the buybacks.

ENA CLO:

Davidow referred Lay to a transaction that involved selling packaged loans and equity to investors. Bear Stearns marketed the investments. LJM2 bought one of the riskiest levels of investment, and the other was bought in part by LJM2 and part by TCW. Lay is a member of the

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Board of Directors for TCW. Lay does not recall hearing of the investment or that TCW was buying the investment with LJM.

Raptor:

Lay became aware of the Raptor transactions either at a Board meeting or at an agenda-review meeting prior to the meeting. He does not know who informed him of or who created the structure. The purpose of the Raptors was to hedge against P&L volatility by moving stock that increased in value into the structure. At the time the structure was presented, he does not recall if the structure was explained, but he thought that probably Skilling and Fastow made the presentation. Lay does not know the level of understanding Skilling had about the Raptor structure.

Davidow asked whose handwriting appears on the May 1, 2000 Finance Committee meeting slides. Lay believed that it was the Corporate Secretary's handwriting, but he was not a handwriting expert. On a slide entitled "Structuring Highlights" a handwritten comment states that the P&L risk is transferred, but the economic risk is not transferred. Lay stated that this was consistent with what he knows.

Another slide labeled "Vehicle Structure Slide" reflects that Raptor only had $30 million dollars, yet the structure is hedging $1 billion. Lay said that this was a good question, but he does not recall any discussion about the ability of the structure to effectively hedge. Lay said he vaguely remembers some reference to $400 million, but could not recall if it was debt or equity.

Davidow said that it seemed odd that Enron purchased a share-settled put on its own stock for $41 million and placed it in Raptor. Lay did not recall why Enron would buy a put on its own stock. Lay did not recall any conversation about Raptor's ability to pay should the price of Enron stock go down in value.

On one slide discussing Raptor in May 2000, it states that one of the risks of Raptor is accounting scrutiny. Lay does not know why accounting would be a risk. Enron trusted Andersen and Andersen knew about Raptor. He understands that Enron even discussed Raptor with Andersen's Chicago office.

The resolutions state that Glisan is authorized to approve the Raptor transaction. Glisan reported to Fastow. Davidow questioned why the Board appointed someone who worked for Fastow to be involved with the Raptor structures on Enron's behalf. Lay did not recall at the time of the resolutions this problem, but when he refreshed his memory and reviewed the Board minutes he noticed this issue. If Lay realized Glisan was going to be part of the approval process at the time, he would have known that Glisan reported to Fastow.

Lay was familiar with the name Trushar Patel, but does not recall any discussion about Patel or to whom he reported to at the time.

Lay was not aware of how the total-return swap between LJM and Raptor was priced. He also did not know if the swap took place on the date the documents reflect.

Raptor II:

Raptor II was authorized in the Executive Committee meeting on June 22, 2000. Lay could not remember why it was approved in the Executive Committee and not taken to the Board.

Raptor III:

Davidow noted that Raptor III was different from the other three Raptors because it was capitalized with The New Power Company (TNPC) stock and not Enron stock. Lay explained that Enron Energy Services pulled out of the residential market and was looking to get into a smaller retail market. The concept behind TNPC was to be the largest participant in the deregulated small retail market. In order to get into the market it formed alliances with utility companies and formed joint ventures to market to customers. In order to get TNPC together Enron approached IBM to obtain the meter billing market, AOL for the internet market and GE for capital. DLJ and other investment banks contributed to risk management and wholesale. Enron wanted to bring in wholesale natural gas. In fall 2000, there were few windows to do the IPO for TNPC. At the time of the IPO it was very successful. TNPC had its own management in offices in White Plains, NY. Enron had a significant interest in TNPC and Enron wanted to get the interest hedged.

Lay did not recall who came up with the idea to hedge TNPC stock. There is no evidence that this was ever taken to the Board for approval. Lay has a vague recollection that Enron found a way to hedge TNPC. He does not recall any particular meeting or anyone associated with the hedging of TNPC.

Lay could not recall why Enron stock was not used in Raptor III. He was not familiar with how TNPC warrants were used in the transaction. Lay did not participate in the roadshow and does not recall learning anything about the progress of the offering from his position as a director of TNPC.

In response to questions about the details of the Raptor III structure, Lay did not understand the logic of the structure. Lay did not have any reports that indicated that as TNPC stock was going down, Raptor was going underwater. Lay was not aware that in late 2000 the derivatives were in the money for Enron. In late 2000, Skilling would have been responsible for tracking how Raptor was doing and Lay believed that Skilling spent a lot of time with Enron's financials and tracked the performance of the company.

Lay did not become aware of the problems with Raptor until he became CEO again in August 2001.

On February 12, 2001, Causey made a presentation to the Audit Committee. One of the slides in Causey's presentation is entitled LJM Investment Activity. Lay did not explicitly recall the presentation, but remembers tables like this in presentations. This was the regular meeting where the Audit Committee would review the LJM structures and Lay recalls going through transactions and Causey saying that the transactions were reviewed and at arm's-length. Lay believed that Causey was properly overseeing the process. Lay does not recall Causey saying anything about Raptor or any problems.

Davidow then informed Lay that at the time, two of the Raptor structures owed Enron $175 million and did not have the capacity to pay. Lay thought that was a significant omission and said he had trusted Causey to bring information like this to the Board.

Lay said that there was no discussion prior to the third quarter of 2001 that the Raptor structures were impaired. Davidow then informed Lay that in the first quarter of 2001 there was a restructuring of Raptor. If the restructure was not done Enron would have taken a $350 million hit to its balance sheet in the first quarter. Lay said that he never heard of the restructuring in the first quarter 2001 and would have remembered a discussion of this magnitude.

In Enron's 2000 10-K, Enron stated in its related party discussion it recognized $500 million of revenue in derivatives. Davidow informed Lay that this refers to the Raptors. Lay stated that he did not recall any discussion or know the size of the revenues that Enron was recognizing in association with the Raptors. Davidow asked Lay if anyone questioned how $500 million in earnings could be from Raptor when the investment is going down. Lay said that the disclosures were signed off by Andersen and Vinson & Elkins ("V&E"), so he was confident in the 10-K.

Lay said that if the $500 million was revenue it would not be significant, but if it dropped to the bottom line then it would be material. He would expect Skilling to notify the Board that a large portion of the bottom line was coming from Raptor. Skilling was CEO in the first quarter 2001 and it was his responsibility to inform the Board.

Lay does not recall being told that there was a restructure of Raptor at the end of the first quarter. The Board minutes do not reflect that it was notified that Enron shares were transferred to Raptor.

Lay thought at the time of the restatement there was a discussion that the write-down linked back to the original Raptor and the reason Enron had to take the hit to the balance sheet was because the price of the Enron stock dropped.

Lay thought another reason for the write-off during the third quarter of 2001 was that Andersen had changed its mind on how to account for a transaction. He knew the write-down had something to do with Raptor, but not that it was undercapitalized. Lay thought that the drop in the Enron price sparked the problem. Lay said in the third quarter there was a lot of discussion on what to do with the problem. There was some discussion about recapitalizing the Raptors, but in the end Lay and Whalley decided that it was best to clean up the balance sheet and get rid of the Raptors.

Jeff Skilling's Resignation as CEO:

Lay remembers that on a Friday, after returning from a long international trip, he met with Skilling in his office. Lay informed Skilling about his trip to India and Skilling went through his list of things to discuss with Lay. At the end of the discussion, Skilling told Lay that he wanted to resign as CEO. Lay was shocked and asked Skilling why he wanted to resign. Skilling said that he wanted to spend more time with his family. Skilling has teenagers that were approaching college age and there was a family-related issue. Skilling felt that if he did not take some time with his children he would never have the opportunity. Lay pushed him a little more on the reason for his decision and Skilling said that he was under a lot of pressure and felt that Enron's stock price was dropping and he could not do anything about it. Skilling was taking Enron's stock decline personally and could not sleep at night. They spoke for about 20 to 30 minutes about it and Lay asked Skilling to reconsider his decision over the weekend. Over the weekend, Lay spoke with Pug Winokur, one of the members of the Board, about Skilling resigning as CEO. On Monday, Lay spoke with Skilling again and tried to convince him to stay at Enron. Skilling was still adamant that he wanted to resign. During the week, Lay spoke with other members of the Board to prepare them for Skilling's decision. Some of the members of the Board spoke with Skilling and tried to convince him to stay. Skilling remained adamant that he was going to resign.

Lay accepted the position of CEO after Skilling resigned. At the time Skilling decided to resign, Lay had another attractive offer to become invested in another company.

The Board of Directors met on a Monday night for a working dinner and Executive session of the Board. Skilling announced his resignation. He told the Board that he did not want the Board to mention in the press release that he was resigning for family reasons because he did not want his children to feel responsible for his decision to resign as CEO. He also would not let the Board state that he was resigning for health reasons. Skilling was emotional when he told the Board his decision to resign and went to tears a few times while he spoke to the Board. The Board tried again to convince Skilling to stay, but he was still adamant about resigning.

The day after Skilling resigned from the Board, Enron issued a press release saying that Skilling resigned because of personal reasons. The day after the resignation release went out, Skilling granted an interview with the Wall Street Journal. In the interview, Skilling said that one of the reasons he was resigning was because Enron's stock was dropping and he was under a lot of pressure. Lay felt that this undercut the company.

Davidow asked Lay if he thought that Skilling's resignation was connected with the announcement that the stock price of TNPC was dropping. Lay did not think that the two events were related because he believes Skilling told him of the resignation prior to the stock price of TNPC falling. Lay said that he would have to consult his calendar to find the exact date on which Skilling met with Lay and told him of his intention to resign. Davidow explained that the drop in the TNPC stock contributed to the Raptors being underwater and asked if this could possibly have increased the pressure on Skilling. Lay was surprised that the decline in the value of TNPC stock led to problems with the Raptors.

Greg Whalley, president of Enron, is a smart and perceptive person. Skilling said that Whalley was like a "canary in a mine." He would find problems before everyone else could detect them. Whalley came to Lay and told him about the problems with the Raptors and the possible need to unwind the deals. Lay wanted to make sure that Whalley was not exaggerating the situation. At the end of the third quarter of 2001, a decision had to be made whether to unravel the Raptors or restructure them. The team wanted to get the debt cleared from the balance sheet, even if that meant taking some hits. Lay recalls that both Causey and Fastow were at these meetings and wanted to recapitalize the Raptors.

Sherron Watkins' Letter:

Lay believes that the press may have a misunderstanding about the Watkins letter. When he received the anonymous letter it was only one page and it was not signed. The letter was thoughtfully written and alarming. The six-to-seven-page letter that has been recently referred to as the Watkins letter in the press was apparently an ongoing chronology she kept. Lay said it could not be the original because he received the one-page letter in August and part of the seven-page letter has references to actions taken by the company in October.

When Lay received the letter he sent it to the General Counsel ("GC") and told him to investigate the letter. The GC retained V&E to do an investigation. A few days after the letter was sent, Watkins went to Cindy Olson, Managing Director of Human Resources, and identified herself as the writer of the letter. Watkins expressed her concerns to Olson and Olson told her if she felt that way she should contact Lay and set up a meeting. Watkins called Lay to arrange a meeting and Lay met with Watkins on August 22, 2001. Watkins brought a stack of documents with her when she met with Lay. Lay met with Watkins for approximately one hour. Watkins went through her papers. Her major concern was with Raptor. She explained the transaction and what was wrong with it. Lay asked her if she thought that illegal conduct was taking place. Lay does not recall her answer. Lay also asked her if she shared the letter with anyone outside the company and she replied that she had not. Lay tried to determine what her motive for writing the letter was and he thought that she was honest and did not have ulterior motivations. Lay informed Watkins that an investigation was going take place.

During the investigation, Lay spoke with Causey regarding the Watkins letter. Lay wanted to keep Watkins' identity quiet. Fastow eventually found out that Watkins wrote the anonymous letter and told Lay that he was concerned that Watkins was causing problems and possibly motivated to get a severance package. Lay thought that Watkins was sincere and credible.

Watkins thought that a different accounting firm and law firm should be sought to conduct the investigation. Lay did not think that outsiders would be able to quickly understand Enron's business and transactions. Lay believed that V&E and Andersen were capable of doing a thorough review because they already understood Enron and its practices and would be able to follow Watkins' roadmap.

V&E conducted their investigation using Watkins' letter and consulting with Andersen. They reported to Lay that they could not find any problems with the transactions. Lay told V&E to speak with Watkins about the investigation and see if she had any further insights. V&E spoke with Watkins and, while she was not satisfied with the result, she was pleased that they did the investigation. During the third quarter, V&E made an oral report to the Board and then submitted a written report on its findings.

On October 31, 2001, Lay met with Watkins again. Watkins still thought there was a problem at Enron, despite V&E's investigation. Lay spoke with her about her career because she reported to Fastow. During the investigation, Lay asked Olson to take Watkins into her department and do special projects so she would not have to report to Fastow during the investigation. Lay asked her if she wanted to stay at Enron. During the investigation, Watkins was seriously considering a job with Allianz. Watkins said that she wanted to stay at Enron.

Board Discussion of Fastow's Compensation from LJM:

Lay recalls a discussion at the October 2000 Finance Committee meeting concerning a possible investigation into Fastow's compensation from LJM by the Compensation Committee. Lay does not have any knowledge that the investigation ever occurred and he does not know why it did not happen. Usually, the Corporate Secretary would put it on the other committee's agenda and set it up with the committee's chairman.

The Board discovered how much Fastow made from LJM in October 2001 when Fastow told Pug Winokur and John Duncan, members of the Board. As stories were unfolding in the Wall Street Journal and the SEC began its investigation, the Board members became more interested in what Fastow was making. Prior to the stories and the investigation, it was not a pressing issue because Fastow said he was only working about three hours a week on LJM business and the fact that he was reluctant to create the structure because he was afraid it would impede his Enron career. The Board and Lay trusted him and could not imagine that he was making a substantial sum of money from his LJM involvement. Duncan told Lay how much Fastow made prior to the Board meeting. Lay was shocked because Fastow said he only spent three hours a week on LJM business and created LJM out of an obligation to the company. Fastow made more from his involvement with LJM than he did from his position as CFO of Enron. Lay questioned whether Fastow was living up to his fiduciary duty to Enron.

Glisan's Investment in Partnerships:

The day after Fastow was put on administrative leave, Lay attended a briefing session. After the session, Glisan followed Lay back to his office and told him that he had an interest in a limited partnership. Lay told Glisan that so long as the partnership does not transact with the company, there would be no conflict. Lay thought that Glisan made his first big investment and was young and scared because of what he saw happen to Fastow. Glisan never told Lay what partnership he invested in, how much was invested or what profits he made from his investment. Lay thought Glisan was just shaken about what was going on in the company. Glisan did not offer to resign.

Lay did not know of any other employees who invested in transactions with Enron.

September 7-8, 2001 Meeting at Woodlands:

The Management Committee held a two-day, off-sight meeting in the Woodlands. This was the first off-sight meeting since Lay became CEO for the second time. Approximately 23-24 people attended the meeting. Lay wanted to get people to talk about what problems they saw at Enron and about their positions. A discussion about transactions evolved from this topic. The operating people felt that they were making money for the company and the finance people were meddling with their progress by using structured vehicles. The discussion lasted approximately one hour. Lay asked how many business people used structured vehicles, and almost everyone had used the vehicles from time to time. They said that so long as the vehicles were valid they made a lot of sense.

There were no formal minutes kept at the meeting, but some people may have kept personal notes.

Analyst Calls:

Davidow asked about an analyst call made on October 23, 2001 where Lay said that the procedures for LJM were followed. Lay based his comments on a discussion with Causey where Causey told him all the procedures were followed. Causey also participated in that analyst call and did not say anything when Lay made that statement.

Lay also said during the analyst call that there was a "Chinese Wall" in place. Lay thought there were independent people from Enron and they were walled off from Fastow and LJM. Lay did not believe that the wall could be penetrated. Now that Lay realizes that Glisan and Patel were involved in the Raptor deals for Enron and reporting to Fastow, he realizes that the wall had holes in it and he would no longer make the statement.

Sales of Enron Stock:

In 2000, Lay sold stock because he had stock options coming due. Lay received a seven-year option for renewing his employment contract. These options were going to expire in January and February of 2001. Approximately 77% of his options were associated with this transaction. Lay thought that in 2000 he exercised and held a couple thousand shares. He deferred and then exercised approximately 500,000 shares. These were cashless exercises.

In 2001, there were a couple exercises and he held about 100,000 shares. All his other options were exercised in 2001 were pursuant to scheduled sells. Lay, and others at Enron like Derrick, have written plans to sell stock. Rick Amery at First Union handles the selling of stock according to the plan for Lay. In hindsight, Lay thought that the plan did a lot of damage because the analysts viewed executives selling their shares as a problem with the company.

The options in 2001 were less than 1/6 of his total options. Lay wanted to sell the shares because he was planning on leaving Enron.

Enron puts 25% of compensation in salary and cash bonuses and the other 75% is placed in long-term incentives. He wanted to liquidate some of his stock to diversify because he had approximately 75% of his assets in Enron stock plans.

Lay never had negative information about the company at the time he sold the stock. Even when Enron took the write-off in the third quarter of 2001, Lay thought that the deals were clean and they were going to continue business as normal.

Lay also has a revolving loan with Enron as part of his compensation. He had this loan since the late 1980's and the loan ranges from $4 million to $7 million. If he draws on the loan, the company decides whether it is repaid with stock or cash. Lay made some payments for the loan toward the end of 2001.

Other employees that invested in LJM:

Lay was only aware of one other employee that was indirectly invested in LJM. Beth Tilney is a Commercial Officer at Enron and her husband Schuyler Tilney is a partner with Merrill Lynch in its private equity group. Merrill Lynch participated in LJM financing. When Merrill Lynch participates in providing private equity it offers its partners the option to buy into it. Schuyler invested in LJM2. Lay views this as a matter involving two different professionals, one at Enron and one at Merrill Lynch and this should not be a problem. Beth never had any dealing with LJM through her work at Enron to the best of Lay's knowledge.

Follow-up:

Dean Powers wanted Lay to clarify how he viewed Causey's role in overseeing the transactions. Lay thought that Causey would do more than just look at who from Enron's business unit was negotiating with LJM. The Board and Lay thought that Causey and Buy would take a more assertive role than that in overseeing the transactions. He thought that Causey would do more than just look at the accounting and then say that the deal was at arm's-length. When Causey made his presentations to the Audit Committee and the Board he believed that Causey was doing more.

Dean Powers asked Lay to look back at the Board Meetings and knowing what he knows now, did it spark any memory about the transactions and the issues raised during the Board meetings that he may have not have understood at the time, but now understands. Lay said that when he heard the word "hedge" he thought it was an effective hedge. He does not recall any discussion that the hedges were backed with Enron stock. He does not recall discussions about transferring economic risk.

Documents:

Lay was asked whether he had any documents in his office that were responsive to the SEC subpoena. Lay said he was sure that the things in his office were not responsive, but he would look.

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Follow-up:

During the interview Lay did not know the exact date Skilling told Lay he wanted to resign. After the interview, Lay's secretary called Davidow and told him that she checked Lay's calendar and Lay believes the date Skilling met with Lay and told him he was going to resign was July 13, 2001.