

**TRADING TRUTH: A REPORT ON
HARVARD'S ENRON ENTANGLEMENTS**

**A HARVARDWATCH REPORT
January 31, 2002**

ABOUT HARVARD WATCH:

HarvardWatch is a broad-based coalition of students and alumni across the University's schools concerned with corporate governance at Harvard. The independent and unaffiliated organization advocates a more transparent and accountable administration responsive to the concerns of Harvard students, alumni, and staff. HarvardWatch publicizes information about the nature of Harvard's governance system and investments in an effort to improve the functioning of the University; members of HarvardWatch want the University to be the best it can be.

The opaque, unelected seven-member Harvard Corporation is the University's highest governing body, and does not release their meeting times, places, agendas, or notes; moreover, there is no process to appeal Corporation decisions, and the Corporation refuses to meet with members of the Harvard community to explain its decisions or its decision-making process. HarvardWatch believes that reform is urgently needed and is overwhelmingly in the best interests of all of Harvard University.

SUMMARY OF FINDINGS

QUESTIONABLE FINANCIAL TRANSACTIONS AND INTERLOCKING DIRECTORATES

- Herbert "Pug" Winokur is a member of the Harvard Corporation, the university's seven-member self-selecting governing body, and a longtime member of the Board of Directors at Enron Corporation. He is currently the chair of the board's Finance Committee. In this capacity Winokur reportedly approved the creation of more than 3,000 partnerships and subsidiaries which were allegedly used by Enron to hide debt and avoid taxation. Winokur's position on the board's Finance Committee gave him unique access to Enron's financial structure and should have alerted him to the company's imminent collapse.
- During the period in which Enron executives touted the company's stock to employees, Harvard's main private investment fund — Highfields Capital — short-sold several million shares of Enron stock for an estimated profit of \$50 million. Mr. Winokur's leadership positions at Enron and Harvard raise questions regarding Highfields' massive short-selling transactions, which benefited the Harvard endowment. There has been insufficient investigation into the possibility that Highfields operated with inside information when it short-sold millions of Enron shares.
- Highfields Capital manages an estimated \$2 billion of Harvard's endowment. Jonothan Jacobson, the co-founder of Highfields Capital, previously worked under Mr. Winokur's directorship at Harvard Management Company. Highfields Capital was founded with \$500 million of Harvard's endowment.

INSTITUTIONAL CAPTURE—HOW ENRON SHAPED HARVARD'S RESEARCH AGENDA

- Through financial incentives and personal connections, Enron influenced Harvard's research agenda. Harvard's academic resources were consistently used to support Enron's unsustainable business plan.
- Robert Belfer, a director of Enron and the largest individual shareholder of the company's stock, is a major donor to Harvard, and served on the Committee on University Resources (COUR) for 9 years and on the Visiting Committee at the Kennedy School of Government (KSG). He re-endowed the Kennedy School's Belfer Center, previously called the Center for Science and International Affairs.
- Enron and board members including Winokur and Belfer have contributed millions of dollars to Harvard and have aided in the creation and funding of research centers, which have consistently advocated an agenda of deregulation in the energy industry. The research produced at Harvard's Kennedy School of Government by the Harvard Electric Policy Group (HEPG), the Environment and Natural Resources Program (ENRP), and the Belfer Center exemplify Enron's influence over Harvard's research agenda.
- These centers have collaborated with Enron and its consultants and have defended the company and other energy industry monoliths against assertions of price manipulation and other illegal activities. Academic rationales for deregulation produced at Harvard were essential cover for the short-lived success of the Enron business model.
- Enron has cultivated deep relationships with the Harvard Business School (HBS). Five HBS case studies have touted the Enron model as innovative and worthy of replication. Glowing studies of Enron were produced by HBS as recently as August of 2001, just before the company imploded.
- HBS professors have received compensation for services provided to Enron. Professors have also co-authored major works on Enron with senior company executives.
- Herbert Winokur, a director of both Enron and Harvard, has also funded several reports recommending privatization of defense services. Winokur is a leading investor in Dyncorp, a major defense contractor. The Herbert Winokur Fund at the KSG provides another example of how Winokur influenced Harvard's research agenda for corporate and personal enrichment.
- Mr. Winokur's relationship to Dyncorp has raised concerns among those investigating Enron, since Dyncorp manages e-mail and information systems for many of the leading investigative agencies, including the Department of Justice and the Federal Bureau of Investigation.

I. Introduction

This report identifies two major issues raised by Enron Corporation's extensive role at Harvard University. First, it details how Harvard may have gained millions of dollars as a result of possibly illegal and unethical insider trading involving the short-selling of Enron's stock. Harvard University appears to have benefited through its relationship to a top Enron director, Herbert "Pug" Winokur, who is also an influential member of Harvard's highest governing body.

Second, the report documents how Winokur, other Enron directors and the company itself have provided substantial funding to Harvard University and its research centers. The findings suggest a troubling pattern – that Enron used its financial resources to buy Harvard's stamp of approval for the company's deregulatory agenda. Through these entanglements with Enron Corporation, Harvard's academic reputation and credibility appear seriously compromised.

As the chair of Enron's finance committee and a member of Enron's post-bankruptcy transition team as well as a member of Harvard's supreme governing board, Herbert Winokur epitomizes the improper personal and institutional bonds between Harvard and Enron.

This proximity raises serious questions about Harvard-affiliated investments that garnered millions from the decline of Enron's stock. **According to SEC records, Highfields Capital, the firm managing approximately \$2 billion of Harvard's endowment and founded by Harvard employees with \$500 million of Harvard's money, made tens of millions of dollars by short-selling Enron stock in the months before the company's collapse.**¹ The overlapping directorates and close personal ties between the Harvard and Enron necessitate a thorough investigation of these transactions, which proved to be enormously lucrative for Harvard and Highfields.

The connections between Harvard and the Enron scandal extend beyond institutional governance and financial transactions. **To advance the cause of rapid deregulation of electricity markets, Enron funded Harvard think tanks that pursued aggressive deregulatory agendas that were pillars of Enron's business strategy.** The Enron-funded Harvard Electric Policy Working Group consistently articulated positions favorable to deregulation and Enron's interests, even after the deregulatory agenda had been called into question by the collapse of California's energy market.²

Enron's support of other programs at Harvard has yielded handsome rewards. For example, Harvard Business School has produced five glowing case studies of Enron that are advertised on the company's website.

Six of Enron's highest-ranking executives and directors are Harvard graduates, as are all three members of Enron's Special Committee, which has been charged with leading the company

¹ See Highfields Capital's 13F SEC filings dated 8/13/2001 and 11/14/2001.

² See Harvard Electric Policy Group's brochure entitled *Reshaping the Electricity Industry*, which lists Enron as a major funder. The many HEPG-affiliated pro-deregulation studies are listed at <http://www.ksg.harvard.edu/hepg/papers.htm>.

through its current crisis.³ The prevalence of Harvard alumni in the Enron drama might be dismissed as coincidence were it not for a web of alarming institutional, personal and financial connections between Harvard and Enron.

This report chronicles these intimate relationships. Its purpose is to shed light on a power network that propelled Enron's meteoric rise and helped to precipitate its tragic collapse.

The extensive connections between Harvard and Enron necessitate full disclosure on the part of the university as to all financial and educational ties between the two institutions. This final section of the report articulates specific disclosure demands that must be met to ensure the integrity of Harvard and its educational mission.

In addition, due to his pivotal role in Enron scandal, this report calls for the immediate suspension of Herbert "Pug" Winokur from the Harvard Corporation.

A broader program of institutional reform is sorely needed at Harvard. The university's secretive and highly centralized governing board exercises complete control over the allocation of \$20 billion in assets. Too often, this fortune is directed towards questionable purposes.

Similar anti-democratic practices led to Enron's disintegration. To secure Harvard's future from involvement in such practices and to better account for the University's role in broader economic matters such as the Enron scandal, Harvard must implement a more accountable corporate governance structure.

The report concludes with five major recommendations on steps to be taken to right things at Harvard. (1) Harvard should immediately initiate an investigation into Winokur's alleged role in the financial improprieties as they relate to the management of the university's endowment. (2) Winokur should be suspended pending the outcome of the investigation. (3) Harvard should initiate a comprehensive re-evaluation of corporate funding that threatens its academic integrity and reputation. (4) Harvard should immediately disclose information on its ties to the Enron Corporation, including funding received from the company. (5) The university must outline a participatory and credible process for selection of future Harvard Corporation members.

II. Financial Rewards: How Enron's Collapse Provided a Windfall for Harvard's Endowment and its Lead Investment Fund

On December 5, 2001, the Boston Globe reported that Highfields Capital had anticipated Enron's demise by short-selling millions of Enron shares before the stock collapsed.⁴ Securities and Exchange Commission filings reveal that Highfields shorted more than two million Enron shares of Enron stock.

³ Harvard graduates include Enron directors Robert Belfer, Herbert Winokur, John Mendellsohn, Paulo V. Ferraz Pereira and William Powers and former Enron International CEO Rebecca Mark. The special committee is comprised by Winokur, Powers and Pereira.

⁴ See Right on the Money, Boston Globe, 12/5/01 F1

The Globe failed to report that Highfields' profits from the Enron debacle would largely flow to Harvard University, a fact worthy of serious consideration because Harvard's board overlaps with Enron's.

Highfields was founded in 1999 by Jonothan Jacobson, formerly Harvard's lead fund manager and highest-paid employee, with \$500 million of the university's money.⁵ Since that time, Highfields has managed billions of dollars of Harvard's funds and has consistently ranked as Harvard's largest private contractor.⁶ In November of 2001, just after the Enron collapse, Harvard Magazine reported:

HMC's leading absolute-return fund manager is Highfields Capital Management, run by Jonathon S. Jacobson, M.B.A. '87, a former star at Harvard Management Company who set up shop on his own in 1998. During the past year, absolute-return funds earned 26.9 percent--the best return for any asset class, and more than 35 percentage points better than the benchmark result. Meyer called it an "extraordinary" performance.

Harvard and Highfields' profiteering from the Enron debacle might not be cause for great concern were it not for the intimate ties between Enron, Harvard and Highfields. Enron director Herbert Winokur, a member of the Committee on University Resources since 1989, has served since 1995 as a member of the board of directors of the Harvard Management Company (HMC), which oversees Harvard funds invested by Highfields. As an HMC board member, Winokur approved the transfer of endowment funds to Jacobson and Highfields in 1998. Winokur continues to exercise a fiduciary duty over Harvard funds managed by Highfields.

As noted above, Winokur is the chair of Enron's finance committee. The close proximity of Jacobson, Winokur and other members of the Harvard Corporation could have provided Highfields with the knowledge needed to profit from Enron's collapse. To avoid the perception of insider dealings, Winokur and Harvard must reveal the nature and extent of any communications between Jacobson, Winokur and other members of the Harvard Corporation in the months leading up to Enron's implosion.

It is important to note that Highfields' other major institutional backer, XL Capital, is also closely tied to Enron. XL Capital provides various types of insurance to Enron and has estimated its exposure to the Enron collapse at \$75 million.

The involvement of Winokur and other Enron directors in the life of Harvard is so extensive that it is further explored below. It appears that Enron and its directors used their far-reaching Harvard ties to their own benefit, and to the detriment of scholarship, Harvard's integrity, and defrauded Enron stockholders.

⁵ See Riches Richly Rewarded, Harvard Magazine, May 1999

⁶ See Harvard University's 990 IRS filings for the years 1999 and 2000

III. Interlocking Governance: Common Directors and Powerful Figures at Harvard and Enron

Herbert “Pug” Winokur: Harvard Corporation Member, Director of Harvard Management Company, Enron Board Member and Chair of Enron’s Finance Committee

In February of 2000, Harvard’s President Neil Rudenstine introduced Hebert “Pug” Winokur to the university community. In announcing that Winokur had been selected to assume one of the empty seats on the university’s secretive and self-regulating governing board—the Harvard Corporation—Rudenstine lauded Winokur as a “broad-gauged and highly respected business executive whose varied career has kept him in close contact with Harvard and higher education, and who has a strong sense of the nature of universities and the human dynamics of complex organizations.”

Winokur’s position on the Harvard Corporation, the University’s highest governing board, empowers him to formulate binding university policy in every realm, including investment strategy. As a Corporation member Winokur also oversees the Harvard Management Company, which invests the university’s nearly \$20 billion endowment. In addition to his governance position, Winokur has also endowed a fund for public policy research at Harvard, named in his honor.⁷

Winokur has served on the Enron board since its creation in 1985, functioning as the chair of the Enron board’s embattled finance committee.⁸ During Winokur’s tenure, Enron grew from a moderately sized owner of gas pipelines to become the largest trader of energy in the world and the seventh largest corporation in America.

Winokur was central to the short-lived success of Enron’s high-risk business model. Enron leveraged Winokur’s corporate finance expertise and government relations experience as well as his leadership position at Harvard to advance its deregulatory program. Winokur’s position among the political elite provided muster to Enron’s aggressive lobbying effort. Were it not for the Washington connections of Winokur and CEO Kenneth Lay, Enron could not have built its hollow energy empire.

As a longtime board member and chair of the board’s dysfunctional finance committee, Winokur bears much of the responsibility for the company’s unsound financial practices. According to *New York Times* accounts, Winokur, in his role as board member and finance committee chair, apparently approved and validated Enron’s problematic financial dealings.⁹ The *Times* writes that Enron’s board “reviewed the transactions involving the partnerships, according to the lawyer’s report. Both the audit committee, which was run by Robert K. Jaedicke, a former accounting professor, and included Dr. Gramm and Lord Wakeham, and the finance committee, which was headed by Mr. Winokur, reviewed the transactions last year, according to the report.”

⁷ The Harvard-administered fund is named the Herbert S. Winokur Fund for Public Policy Research

⁸ According to Enron’s annual reports, Winokur has been the chair of Enron’s finance committee since 1997.

⁹ See *The Directors: One Enron Inquiry Suggests Board Played Important Role*, NY Times, 1/19/02

As a board member, Winokur also approved the suspension of Enron's ethical guidelines. As has been reported widely, Enron's highly unorthodox financial structure included more than 3,000 subsidiaries, a large percentage of which was registered offshore.

The *Times* also reports that a company in which Winokur holds a major stake, NATCO, engaged in significant business deals with Enron, raising possible conflicts of interest.¹⁰ Winokur had received earlier criticism for his role in the financial maneuvering surrounding Azurix, an Enron subsidiary.¹¹

At present, Winokur sits on Enron's Special Committee with William Powers, a fellow Harvard graduate. Having served as an executive at Penn Central Corporation, which had weathered the largest bankruptcy in history through the 1970s, Winokur is an essential actor in Enron's attempt to survive the scandal.

Winokur and Dyncorp

As Federal investigations swirl around Winokur and other board members, doubt has been raised about the viability of independent investigation, given Enron's enormous political clout. Winokur's leading role in the company that manages information systems for many of the investigative agencies raises a special set of concerns.¹²

Winokur owes much of his wealth to his role in reconstructing Dyncorp, one of the Federal government's largest private contractors. He is a former Dyncorp chairman and remains a director of the company. At present, Dyncorp manages e-mail and information systems for the Department of Justice, the Securities and Exchange Commission and the Federal Bureau of Investigations.¹³

Investigators are reportedly concerned that Dyncorp's control of agency information systems could compromise their investigations of Winokur and Enron.

Robert Belfer: Founding director of Enron: Major Harvard patron; Member of Harvard's Committee on University Resources (COUR) and member of the Visiting Committee of Harvard's John F. Kennedy School of Government

Robert Belfer was Enron's largest individual shareholder and a member of the Enron board since 1985.

¹⁰ See Enron Board Comes Under a Storm of Criticism, NY Times, 12/16/02

¹¹ See Corporate Family Ties That Bind Right, NY Times, 11/4/01

¹² See Enron's End Run, Insight Magazine, February 4th, 2002.

¹³ See DynCorp will do \$51m upgrade of FBI network, Government and Computer News, 6/4/01; Buried Treasure, Insight Magazine, 1/14/02; and the DynCorp website at www.dyncorp.com for an extensive list of public sector clients.

At Harvard, Belfer provided \$7.5 million to endow the Belfer Center for International Affairs, which produces pro-industry strategic research on energy related subjects.¹⁴ Belfer has served on two university boards: the Committee on University Resources and the Visiting Board of the John F. Kennedy School.

The Broader Harvard-Enron Network

In addition to Winokur and Belfer, other leading figures with close ties to the two institutions include Enron CEO Jeffrey Skilling, a Harvard Business School graduate who co-authored a paper for the Harvard Electricity Policy Group; former Harvard professors Lawrence Lindsay and Robert Zoellick, both of whom currently serve in the Bush administration and formerly sat on the Enron advisory board; and Robert Rubin, the former Treasury Secretary who, in his current capacity as a Citigroup executive, attempted to obtain Federal assistance for Enron. Rubin is a former board member of the Harvard Management Company and a major figure in the life of the university. Last June, he was awarded an honorary doctorate by Harvard for his lifelong involvement in university and national affairs.

In addition to Winokur and Belfer, three other current Enron board members—John Mendellsohn, Paulo V. Ferraz Pereira and William Power—are Harvard graduates.

A more complete list of key figures in the Harvard-Enron network is listed in the appendix.

IV. Institutional Capture: Enron's Influence on Harvard's Research Agenda

Over the past decade, Enron has effectively “captured” Harvard through financial and institutional means. Harvard's Kennedy School of Government and Business School offer clear examples in which Enron was able to shape research outcomes. Enron and its leading shareholders have funded several research centers at the Kennedy School and paid consulting fees and event fees at the Business School. Both schools have provided crucial ideological support for Enron's deregulatory program.

Enron's business model relied heavily on privatization and deregulation of energy markets. Through relentless political lobbying, Enron established itself as an unregulated financial intermediary in an increasingly commodified energy sector. Between 1999 and 2000, Enron spent over \$4 million for its lobbying efforts, and it contributed \$2.4 million to federal political candidates in the 2000.¹⁵ As a result, the company relied on “intellectual production” to support its political aims, which it outsourced to academic institutions—in particular to Harvard University.

The Harvard Electricity Policy Group

¹⁴ See \$7.5 Million Gift from Belfers Will Refurbish Center for Science and International Affairs, Harvard Gazette, 5/8/97

¹⁵ Center for Responsive Politics

Enron is a major contributor to the Harvard Electricity Policy Group (HEPG), a division of the Kennedy School's Center for Business and Government. Predictably, much of the research agenda of the HEPG centers on deregulation of the electricity market.

The HEPG began convening semi-annual conferences of industry leaders in 1992, at the opening of the push for electricity deregulation and other forms of energy commodification. HEPG has convened twenty-six conferences of corporate and industry leaders at resorts around the world.

Such conferences provided ample opportunities for Enron to influence the Center's work, as evidenced by the Center's collaboration with Jeffrey Skilling, the former CEO of Enron.¹⁶ The fruits of HEPG's work on "market models" were evidenced in the creation of a dizzying array of derivative securities based on the underlying physical electricity flows. Turning electricity into a speculative market was the linchpin Enron's business plan.

The California power crisis provides an interesting glimpse into the role HEPG played in defending wholesalers and distributors as electricity prices were shooting through the roof. Between 1999 and 2000, Enron's revenue increased from \$35.5 billion to \$93.3 billion, a 163 percent increase, primarily through its energy auctions.¹⁷ Companies owning power plants were posting incredible gains as well, leading to charges of price manipulation. While federal investigations found evidence of price manipulation,¹⁸ HEPG studies defended entrenched corporate interests.

In several influential studies, William Hogan, Research Director at HEPG, argued against the notion that price manipulation had anything to do with the shortages. These pieces were collaborations with Law and Economics Consulting Group (LECG) – a private entity which receives funding from Enron.

Hogan et al consistently resisted the idea that there had been any withholding of electricity, stating that "On balance, to date the publicly available data provides no reason for the Federal Energy Regulatory Commission to change its conclusion that there is no evidence of strategic withholding nor any proof that no strategic withholding has occurred."¹⁹ However, federal investigations subsequently did find evidence of such withholding, and proceeded to penalize companies for it. Although Enron did not own physical plants, the company was likely to have withheld power through its energy auction, thereby reaping enormous profits.²⁰

Moreover, HEPG has consistently resisted price caps of any sort. HEPG's Hogan argues that "given the short supply situation, this would be just the wrong incentive."²¹ Instead, forward

¹⁶ Catherine Abbott and Jeffrey Skilling "Untitled Draft Presentation on Competitive Market Model," HEPG, 1994

¹⁷ Public Citizen, *Blind Faith: How Deregulation and Enron's Influence Over Government Looted Billions from Americans*, 2002.

¹⁸ Rebecca Smith, "California Seeks Curbs on 2 Power Firms," *The Wall Street Journal*, June 1, 2001.

¹⁹ Scott Harvey and William Hogan, "IDENTIFYING THE EXERCISE OF MARKET POWER IN CALIFORNIA," HEPG working paper

²⁰ Public Citizen, *Blind Faith: How Deregulation and Enron's Influence Over Government Looted Billions from Americans*, 2002.

²¹ John Chandley, Scott Harvey and William Hogan "Electricity Market Reform in California" HEPG working paper

contracts were stressed as a way out. “The Commission should on the other hand take steps to eliminate artificial barriers to forward contracting and ensure that competitive electricity providers are able to participate in the market and offer load management services to end users.”

Of course, price caps would hurt intermediaries like Enron and wholesale traders. And predictably, forward contracting would line their pockets further. It is worth noting that the introduction of price caps finally stabilized the California market, but led to devastating financial losses for Enron.²²

The Belfer Center

Enron’s use of Harvard University’s intellectual machinery did not stop with HEPG. Robert Belfer, a longtime board member of Enron and the largest shareholder of Enron stock, has used his financial resources and personal connections to shape Harvard research priorities.

Belfer was a member of Harvard’s Committee on University Resources (COUR) from 1982 to 1991. He also sat on the Kennedy School of Government’s Visiting Board for several years. In 1997, Belfer’s \$7.5 million donation re-endowed the Center for Science and International Affairs, subsequently renamed The Robert and Renee Belfer Center.

With Belfer’s money, the Environment and Natural Resources Program (ENRP) was spawned. Belfer and Enron have seen a good return from this investment. Funding from Belfer helped secure John Holdren’s appointment as the head of the ENRP. Holdren was recruited by the Clinton administration to head a task force on energy and climate policy—a part of the Presidential Council of Advisors on Science and Technology (PCAST). The panel was stacked with corporate insiders from the energy industry. Prominent in that roster was Bruce Stram, Vice President of Business Development at Enron Energy Services. Holdren’s Report, (presented in June 2001 at a Senate Committee hearing) urged the very policies championed by Enron. “Privatization, deregulation, and restructuring of energy industries help bring private capital into the energy sector.”²³

The report also talked about pressuring developing countries vis-à-vis multinational entities, *specifically referring to the Enron Dabhol fiasco*. “Enron Corporation’s frustrating experience in building and operating a power plant in Dabhol, India, is well known. That experience, and others like it around the world, have shown that regulatory reform in developing nations is badly needed.”

The report failed to acknowledge Enron’s shameful role in the Dabhol, where it used the state police as a paid security force to assault environmental groups and local villagers. Human Rights Watch (HRW) issued a scathing report that identified Enron’s brutal practices in Dabhol:

Human Rights Watch believes that the Dabhol Power Corporation and its parent company Enron are complicit in these human rights violations. Enron’s local entity, the Dabhol Power Corporation, benefited

²² Public Citizen, *Blind Faith: How Deregulation and Enron’s Influence Over Government Looted Billions from Americans*, 2002.

²³ “Powerful Partnerships : The Federal Role in International Cooperation on Energy Innovation” PCAST Report, June 1999

directly from an official policy of suppressing dissent through misuse of the law, harassment of anti-Enron protest leaders and prominent environmental activists, and police practices ranging from arbitrary to brutal.²⁴

While HRW was denouncing Enron's deplorable behavior in Dabhol, academics from Enron-sponsored think tanks at Harvard joined their corporate sponsors in bemoaning the "frustration" Enron experienced in its efforts to buy off and strong arm foreign governments and to repress the local populace. It is important to note that Harvard's brand name was instrumental in helping individuals like Holdren reach the upper echelons of Washington, where they served as informal lobbyists for Enron.

Harvard Business School

Harvard Business School (HBS), too, has been instrumental in promoting Enron's business plan. HBS produced five glowing studies on Enron in the past 16 months. With titles such as *Enron: Entrepreneurial Energy* and *Enron's Transformation: From Gas Pipeline to New Economy Powerhouse*, Harvard bolstered the reputation of Enron and its business model just as the company was unraveling. Enron cross-markets the five studies on its own website.²⁵

Peter Tufano, a researcher at HBS, has engaged in joint projects with Enron executives, including co-authoring a case study that has become a staple for MBA classes.²⁶ He has also written a celebrated article that valorizes the kind of financial engineering at the heart of the company's disastrous strategy; needless to say, Enron was the leading empirical example.²⁷ It is surely heartening for Enron that, to this day, Tufano continues to publicly defend the company's business model.²⁸

Harvard Business School professors, including Enron advisory board member Pankaj Ghemawat, have received extensive consulting fees from Enron. A full accounting of fees paid by Enron to all Harvard professors is needed to ensure that Harvard researchers will not be bought and sold in the future.

Winokur and Dyncorp—A Reprise

The extent of Enron board member Herbert Winokur's influence on Harvard's academic mission does not end at Enron. Winokur has contributed to programs at the Kennedy School of Government through the Herbert S. Winokur, Jr. Public Policy Fund. This fund has been a backbone of the "Preventative Defense Project," whose main publication is a book entitled

²⁴ "The Enron Corporation: Corporate Complicity in Human Rights Violations" *Human Rights Watch Report, 1999*

²⁵ See http://universityaffairs.enron.com/case_studies.asp

²⁶ Bhatnagar, Sanjay, and Peter Tufano. September 1995. *Enron Gas Services*. Harvard Business School. 9-294-076.

²⁷ Tufano, Peter. "How Financial Engineering Can Advance Corporate Strategy," *Harvard Business Review* (January-February 1996). 136-146.

²⁸ Altman, Daniel. "Could Enron's Business Actually Model Work?" *New York Times*, Jan 28, 2002

"Keeping the Edge."²⁹ One of the key recommendations of this publication is to "outsource non-core functions to the private sector."

It is perhaps more than incidental that Winokur is a former chairman and current director of Dyncorp, a major defense contractor. In addition to providing services to the US military in Colombia and other parts of Latin America, Dyncorp manages e-mail and information systems for various federal agencies. This is yet another example of how Winokur has used his formidable financial resources and personal connections to turn parts of Harvard into virtual extensions of his corporate empire.

²⁹ Carter, Ashton B., and John P. White, eds. *Keeping the Edge: Managing Defense for the Future*. Cambridge, MA: Preventive Defense Project, 2000

V. Recommendations

1. **Harvard University should initiate a credible investigation into alleged financial improprieties regarding the management of the university's endowment.** The investigation should be undertaken by a representative body that has the confidence of the entire Harvard community
2. **Pending the outcome of the investigation, Herbert Winokur should be suspended effective immediately from the Harvard Corporation.** Harvard University must send a strong and unequivocal signal to the academic community by distancing itself from the failed leadership at Enron Corporation.
3. **Harvard University should initiate a comprehensive re-evaluation of corporate funding that threatens its academic integrity and independence.** The acceptance of a narrow research agenda and tilt imposed by corporate donors such as Enron today poses a formidable threat to its academic mission.
4. **As part of its investigation, Harvard University should immediately disclose information on its ties to the Enron Corporation over the past 10 years.** This includes, but is not limited to:
 - Funding from the Enron Corporation, its executives, and its directors to Harvard University. This includes direct contributions to Harvard as well as any of its schools and centers, including the Harvard Electric Policy Group, the Belfer Center and the Harvard Business School.
 - Provision of consulting services by researchers at Harvard University and its various Centers to Enron Corporation—including the nature of such services and the compensation paid by Enron.
 - A list of all financial transactions conducted by Harvard Management, its subsidiaries, and Highfields Capital involving Enron or any of its partnerships.
 - Disclosure of any Harvard investments in private companies, partnerships or special purpose entities affiliated with Herbert Winokur.
 - A full account of any contact or communication between fund managers at Harvard Management and its officers and Highfields Capital regarding Enron or its subsidiaries.
 - A full account of contact or communication between officers of Harvard Management Company or Highfields Capital and Enron executives and officers.
 - Disclosure of the participation of Enron executives and board members at sessions at HEPG and the ENRP.

5. **Harvard University should outline a participatory process for selection of Harvard Corporation members.** This should involve all stakeholders—faculty, workers, and students.

Appendix

Relevant Biographical Information

Robert Belfer

Harvard affiliation: JD, Harvard; Patron of Harvard's Belfer Center for International and Strategic Affairs; Harvard Committee on University Resources (1982-1989); Member of Visiting Board of Harvard's John F. Kennedy School of Government

Enron affiliation: Enron's largest stockholder, Enron Director since 1985

Sanjay Bhatnagar

Harvard affiliation: MBA, Harvard

Enron affiliation: CEO of Enron India

Peter Fisher

Harvard affiliation: JD, Harvard

Enron affiliation: Undesecretary of the Treasury; implicated in Enron scandal

Citigroup Chairman Robert Rubin (see below) called Mr. Fisher to inquire about the possibility of Federal intervention in support of Enron. The New York Times reports:

It was Fisher's role as the administration's liaison to the markets that led Robert E. Rubin, the former Treasury secretary who is now chairman of the executive committee at Citigroup, one of Enron's two main lenders, to call him about the situation.

It also made Mr. Fisher a natural point of contact for Enron itself. Whether simply to keep the government informed of financial problems at the dominant player in the burgeoning business of trading energy, as Enron says it was doing, or seeking assistance as it fought to survive, as the administration has suggested twice in recent days was the case, Mr. Fisher was clearly the go-to guy.

In a government filing, Fisher recently disclosed that he owns at least 10,000 shares of Enron stock.

Pankaj Ghemawat

Harvard affiliation: Professor, Harvard Business School; MBA, Harvard

Enron affiliation: Member, Enron advisory council

William Hogan

Harvard affiliation: Professor, Kennedy School of Government; Director, Harvard Electric Policy Group (HEPG)

Enron affiliation: HEPG receives Enron funding

Jonathon Jacobson

Harvard affiliation: AB, MBA, Harvard; currently manages in excess of \$2 billion of Harvard's endowment through Highfields Capital

Enron affiliation: Highfields Capital, and Harvard in-turn, short-sold nearly 3 million Enron shares just prior to the collapse of the stock

Lawrence Lindsey

Harvard affiliation: MA and Ph.D, Harvard; former Harvard faculty, Department of Economics

Enron affiliation: Chief White House economist; Enron advisory board; Citigroup consultant

Lindsey's proximity to the president place him at the center of inquiry regarding Enron's relationship to the White House before and after the company's collapse. The New York Times reports, "Before he became the president's top economic counselor, Lawrence B. Lindsey was a paid adviser to Enron." Lindsey's position at Enron and consulting for Citigroup, Enron's banker, will continue to raise questions about the White House's relationship to the Enron scandal.

Rebecca Mark

Harvard affiliation: MBA, Harvard

Enron affiliation: Former Chairman of Enron International, Former CEO of Enron subsidiary Azurix

Once lauded by the business press, Mark took the fall for Enron's failed effort to privatize the world's water supply through its Azurix subsidiary.

Ms. Mark is named as a defendant in the most prominent lawsuit against Enron. She executed insider trades of 1.4 million shares, pocketing \$79.4 million before the company collapsed.

John Mendelsohn

Harvard affiliation: AB, MD, Harvard

Enron affiliation: Enron Director

The New York Times reports, "Also on the board is Dr. John Mendelsohn, president of the M. D. Anderson Cancer Center, one of Houston's most prestigious institutions. Enron has donated more than \$600,000 to the center in the last five years."

Mr. Mendelsohn's ability to serve as a director while receiving large donations from the company has been questioned.

Paulo V. Ferraz Pereira

Harvard affiliation: MBA, Harvard

Enron affiliation: Enron director; Former President and CEO, State Bank of Rio de Janeiro, Brazil

William C. Powers, Jr.

Harvard affiliation: JD, Harvard

Enron affiliation: Enron director

Robert Rubin

Harvard affiliation: AB, Harvard, 1966; Honorary Doctorate, 2001; former Director, Harvard Management Company;

Enron affiliation: Chairman of the Board, Citigroup (Enron's largest creditor)

John M. Seidl

Harvard affiliation: MPP and Ph.D, Harvard

Enron affiliation: Former Enron COO and director

Marc Shapiro

Harvard affiliation: AB, Harvard

Enron affiliation: Vice Chairman, Chase Manhattan Bank (major Enron creditor)

In recent profiles, both the New York Times and the Wall Street Journal have focused on Shapiro's awkward position as Chase's conduit with Enron, its major creditor.

Jeffrey Skilling

Harvard affiliation: MBA, Harvard

Enron affiliation: Former Enron CEO; former Enron Director

Perhaps the pivotal figure in the Enron scandal, Skilling is considered the architect of Enron's high-risk trading system.

The New York Times reports that Skilling, "received \$66.9 million for 1.1 million shares. Beginning in December 2000, Mr. Skilling began to sell his holdings at a pace of 10,000 shares about every seven days. He still owns about 600,000 shares and options, according to public filings."

While at McKinsey in the 1980s, Skilling reported to Harvard Corporation member and Harvard Treasurer D. Ronald Daniel.

John B. Wing

Harvard affiliation: MBA, Harvard

Enron affiliation: Former Chairman, Enron Power Group and Enron Cogeneration Co. (owner)

Herbert "Pug" Winokur

Harvard affiliation: A.B., Ph.D, Harvard; Member of Harvard Corporation; Director, Harvard Management Company

Enron affiliation: Enron Director since 1985; Chair, Enron Finance Committee; Former Chairman, Azurix Corporation (Enron subsidiary)

Robert B. Zoellick

Harvard affiliation: J.D., MPP, Harvard; former director and faculty member of Harvard's Belfer Center

Enron affiliation: U.S. Trade Representative; Enron Advisory Board; board member of Alliance Capital, major Enron shareholder

Zoellick sits precariously at the nexus of Harvard, the Bush White House and Enron. While at Harvard, Zoellick directed a pro-corporate energy research center funded by Enron's largest shareholder.

Technical Appendix: Calculating Highfields' Earnings from Put Options on Enron Stock

In general, it is difficult to decipher exactly how much Highfields netted from the transactions involving put-options on Enron from the information that is publicly available. It would require knowledge about when the options were purchased, the strike price, maturity, as well as the timing of the exercise. Since we do not know these details, we are forced to make assumptions to get some bounds on the earnings gain. Therefore, the results from the exercise below should be interpreted as educated guesses, not decisive findings.

Primarily, we will estimate gains under two scenarios. In the first scenario, the options would not have expired for a year since the time of purchase, and Highfields would have held onto the options until the stock bottomed out (at a price close to zero). This represents an upper estimate of gains. In the second scenario, we will assume that the options would expire in 3 months time, and that they were exercised half-way through the quarter following the purchase. Since this limits the possible gains from the full extent of the price drop, it should be seen as a lower estimate of gains. Within these two scenarios, we will look at different estimates based on the volatility of the underlying stock within the quarter of purchase; these should be seen as sensitivity analyses to get a 2

Exercise Price: \$0 (2nd Qtr) ; \$0 (3rd Qtr)

Estimated Price Paid for Option : 2nd Qtr - \$18.34 (High) , \$6.91 (Low)

3rd Qtr - \$ 10.20 (High) , \$3.90 (Low)

Gains from Exercising Option : \$49.00 (2nd Qtr) , \$27.00 (3rd Qtr)

Net Earnings : \$76 million (Low Estimate) , \$105 million (High Estimate)

Note that we use the assumption that Highfields bought the options “at-the-money” and that the price of the stock at time of purchase was what it was at the end of the relevant quarter. The latter assumption is a conservative one given the secular downward trend of the stock price. We are also assuming in this scenario that Highfields held onto the options until the underlying stock became worthless.

Scenario 2 – Options Held for 3 months only

To estimate the price Highfields paid for the put options, we use the following assumptions in this scenario:

Days to Expiration : 90

Volatility : 37 (low), 100 (high)

Interest Rate : 2%

Dividends Amount : 0.12 (quarterly)

Price of Stock at Purchase : \$49.00 (2nd Qtr) ; \$27.00 (3rd Qtr)

Strike Price : \$49.00 (2nd Qtr) ; \$27.00 (3rd Qtr)

Number of Options : 1.2 million (2nd Qtr) ; 2.3 million (3rd Qtr)

Exercise Price: \$35 (2nd Qtr) ; \$10 (3rd Qtr)

Estimated Price Paid for Option : 2nd Qtr - \$9.53 (High) , \$3.54 (Low)

3rd Qtr - \$5.27 (High) , \$1.97 (Low)

Gains from Exercising Option : \$14.00 (2nd Qtr) , \$17.00 (3rd Qtr)

Net Earnings : \$33 million (Low Estimate) , \$48 million (High Estimate)

Note that again we use the assumption that Highfields bought the options “at-the-money” and that the price of the stock at time of purchase was what it was at the end of the relevant quarter.

To reiterate, the latter assumption is a conservative one given the secular downward trend of the stock price. In Scenario 2, however, we are assuming that Highfields only held onto the options for no longer than 3 months. Moreover, we assume that the stock was sold midway better handle on the range of possibilities.

In both scenarios, we assume that the options were purchased at-the-money. We use the range of 37 to 100 for volatility. This is the bound on the historical and implied volatility in the period between January 2001 to October 2001 – the period in which these options were purchased. We use the Black-Scholes formula to price the options based on the assumptions detailed below. For reference, a put option is a contract which gives the owner the right but not the obligation to sell an underlying stock (Enron in this case) for a prespecified price (“strike price”) before a prespecified date (“expiration date”). We assume that these are “American” options to calculate the price, though the neither the cost nor the gains estimates are particularly sensitive to this assumption given our method.

To estimate the price Highfields paid for the put options, we use the following assumptions in this scenario:

Days to Expiration : 365

Volatility : 37 (low), 100 (high)

Interest Rate : 2%

Dividends Amount : 0.12 (quarterly)

Price of Stock at Purchase : \$49.00 (2nd Qtr) ; \$27.00 (3rd Qtr)

Strike Price : \$49.00 (2nd Qtr) ; \$27.00 (3rd Qtr)

Number of Options : 1.2 million (2nd Qtr) ; 2.3 million (3rd Qtr)

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through the quarter following purchase – and the price at the midpoint of that quarter is used to calculate the gains.

SUMMARY : As shown in the calculations above, the estimates of net earnings from these positions range from \$33 million to \$105 million. Overall, we find a \$50 million estimate to be a relatively conservative one of what Highfields earned from buying put options on Enron’s stock. Ultimately, however, it will require greater disclosure on the part of Highfields (and Harvard University) to ascertain how much the relevant parties were able to profit from the Enron fiasco.

Myth and Fact: Dispelling Misconceptions About Harvard's Enron Connections

Myth: Highfields is independent from Harvard; there's no connection.

Fact: Highfields, from its inception, has been intricately linked to Harvard. Its founder, Jonathan Jacobson, worked as Harvard's fund manager and was the university's highest-paid employee. He left Harvard in 1998 to found Highfields with \$500 million of Harvard's money. ¹ Currently, Highfields manages around two billion dollars of the Harvard endowment. According to Harvard's 1999 tax returns, Highfields was number one on the list of the top five highest-paid professional consulting services contracted by Harvard. Highfields received nearly \$30 million in fees that year alone, and was the only investment management firm to make that list.² Harvard Magazine bragged of Harvard's connection to Highfields, its "leading absolute-return fund manager." According to the magazine, "absolute-return funds earned 26.9 percent—the best return for any asset class."³ Herbert Winokur a director of the Harvard Management Company, the part of Harvard that employs Highfields and manages the endowment.

Myth: There is nothing suspicious about Highfields' trading. They probably just figured out that Enron was in trouble.

Fact: Highfields did, indeed, figure out Enron's fate before most. However, to simply assume that Highfields was just ahead of the game by virtue of their own merit is doing more than affording them the benefit of the doubt. In the quarter ending in August, Highfields had put options on only three companies, including Enron—and they owned forty-six times as much in put options on Enron than on the higher of the other two.⁴ That type of confidence is overwhelming and was extremely unique for a time when Enron stock was still very highly valued. It certainly is possible that Highfields' incredible profits on Enron's collapse was due to pure brilliance, but the circumstances make that answer look improbable. Herbert Winokur was aware of Enron's difficulties as much as four years ago.⁵ Although this doesn't amount to proof that Winokur tipped off Highfields about Enron's financial woes, it makes for a very interesting set of coincidences—one that warrants a thorough investigation. The question isn't whether Highfields was publicly suspicious, but whether that public suspicion was backed by private and illegitimate knowledge. Any potential wrongdoing should be looked into, even though nothing may have been amiss.

¹ See "Riches Richly Rewarded," Harvard Magazine, May 1999.

² See Harvard's 990 filing for 1999, dated May 14, 2001, p.7, available through www.harvardwatch.org.

³ Harvard Magazine, December 2001.

⁴ See Highfield Capital's 13F SEC filings dated 8/13/2001, available through www.harvardwatch.org.

⁵ See "Enron Directors Backed Moving Debt Off Books" in The Washington Post, 1/31/2002.

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Myth: This is perfectly acceptable behavior for a university. Research organizations sell out to corporate interests all the time.

Fact: Research organizations might sell out to corporate interests all the time, but that does not make it right. Indeed, Harvard's large role in promoting Enron's perverse business plan reveals exactly how disastrous the consequences of corporate influence in the university can be.

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research centers at Harvard played a major role in legitimating deregulation and defending energy industry monoliths against assertions of price manipulation and other illegal

activities.⁶ If Enron needs a report favoring their interests, they can write it themselves, but outsourcing it to Harvard is strategic because the Harvard emblem carries the banner of objectivity. That emblem, given its popular legitimacy, should not be for sale. If narrow corporate interests can contract out to Harvard, the university becomes a corporate propaganda machine rather than an institution engaging in true scholarship.

Myth: If Winokur knew of Enron's impending doom, and was willing to take action on it, he would have sold his own stock as well.

Fact: There's no way to know, as of yet, just how Winokur reacted to Enron's coming bankruptcy in his personal finances. However, a decent respect for Winokur's intelligence forces one to question the logic of this claim. If Winokur knew Enron was to collapse, he certainly also knew that the collapse would draw a lot of attention, and that selling his own stock would probably get him into deep trouble down the line. Tipping off Highfields casually, however, may have seemed less dangerous, as they were more removed from him and could claim to have figured it out on their own. Moreover, Winokur could simply have hedged his position at Enron by investing in funds that are taking a short position on Enron or are purchasing put-options on the company - like Highfields Capital. His ability to engage in such transactions would obviate the need to sell Enron shares directly and publicly. Again, this is not to say that Winokur did engage in these transactions, but to point out the logical fallacy of the objection.

Myth: If Winokur was warning Harvard and looking out for its interests, Harvard investors other than Highfields would have shorted Enron.

Fact: Highfields really is the end-all-be-all of Harvard investors. There simply isn't another independent firm investing as much for Harvard. The other investment management firm Harvard utilizes, Charlesbank Capital Partners, LLC, is in real estate and couldn't have done much with any information foretelling Enron's fate.⁷ Harvard itself directly invests very little in Enron—indeed, their portfolio is extremely diverse. However, should parties other than Highfields have known about Enron, they may have been too nervous about potential investigations to act on such information. Just how widely knowledge of Enron's future was spread is something Harvard should look into.

⁶For further explanation of Harvard's role in legitimating this agenda, see HarvardWatch's full report, "Trading Truth: A Report on Harvard's Enron Entanglements."

⁷Harvard's 990 filings for 1999, dated May 14, 2001.