


Environment

A brief history of Bush, Harken and the SEC

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WASHINGTON, October 16, 2002 — In 1976, George W. Bush was a freshly minted graduate of the Harvard Business School looking for a job.

He had \$20,000 left over from his education trust fund, a well-known last name and some great connections. He decided to follow in his father's footsteps by getting into the oil business, and moved back to his childhood home of Midland, Texas.

The early years

In 1977, Bush organized his first company, Arbusto Energy Inc. (Spanish for bush), an oil exploration venture. After an unsuccessful 1978 run for the House of Representatives, Bush returned to the oil business, attempting to take Arbusto public in 1982 with disappointing results. Bush changed the name of the company to Bush Exploration that same year and struggled on.

Ivy League Underwriter: When Harken was in financial trouble in August 1990, its largest investor helped the company stave off disaster. Aeneas Venture Corp., the venture capital arm of Harvard Management Company, entered into a joint venture with Harken. Harvard Management invests Harvard University's huge endowment. Read the full report. By 1984, Bush Exploration was in dire need of capital. It stepped Spectrum 7 Energy Corp. of Ohio, owned by William DeWitt Jr. The two companies merged and Bush was made CEO with a \$75,000 salary. As part of the deal, he received 1.1 million shares of stock, or 16.3 percent of the company.

An April 1986 *New York Times* story described Spectrum 7 as less concerned with recovering oil than in creating tax shelters. The company specialized in selling limited partnerships, which generated generous write-offs before the tax laws were revised in 1986.

Spectrum 7 did not fare much better than Bush Exploration in the 1980s, with the end of the Arab oil embargoes, a flood of cheap, imported crude oil drove many small, domestic producers out of business. Bush was at the helm of another struggling company seeking a bailout. Spectrum 7 was teetering on the brink of bankruptcy, and this time the white knight was Harken Oil.

Harken was a small concern, but poised to become much bigger. In 1983, a young New York lawyer named Alan G. Quasha, a man with no experience in the oil business, but with financial connections to Compagnie Financière Richemont AG, a Swiss-based investment company, took over the firm.

The company's biggest backer was fund manager George Soros[^]. In late 1984, Harken was appointed exclusive agent and manager of Soros Oil Inc., a privately held corporation formed to invest in oil and gas properties. The deal allowed Soros shareholders to exchange their interest for shares of Harken stock.

On September 22, 1986, Harken announced it had bought Spectrum 7, and Bush joined the board of directors. He was given an \$80,000-a-year consulting contract (which was raised to \$120,000 in 1989), \$500,000 in Harken stock, and options valued at \$131,250.

Once Bush joined the firm, Harken began a tremendous period of growth. Barely a month after Bush came aboard, the company received a huge capital infusion from Harvard Management Company, which manages Harvard University's vast endowment. Aeneas Venture Corp., the venture capital investment arm of Harvard Management, agreed to invest \$20 million in Harken and buy \$2 million in newly issued Harken stock.

By November, Harken began trading on the NASDAQ exchange. In December, the company made its biggest acquisition, buying E-Z Serve Inc., a chain of 900 rural convenience store/gas stations. Included in the purchase was Aloha Petroleum, a Hawaii gasoline retail chain.

That same month, under Harken's Non-qualified Incentive Plan, Bush acquired options for 80,000 shares of the company's stock at a cost of \$96,000, or \$1.20 a share.

Chronology: The Center started posting documents related to Harken Corp. on July 3, 2002. See all the documents we posted since then. Backed by Harvard and two other large institutional investors, Harken continued to expand. Total revenue in 1986 had been \$4 million – by 1989, it had eclipsed \$1.1 billion.

Still in politics

In June, 1987, Bush went to work full time for his father's campaign for the presidency in his Washington, DC office. According to Harken's proxy statement from the period, the company continued to pay Bush his consulting fee while he worked full time for his father. He regularly flew back to Texas or to New York to attend Harken board meetings; the trips were paid for by his father's campaign, and reimbursed by Harken, according to

documents.

In December 1988, after his father won the election, Harken's board gave Bush an option to buy 25,000 shares of Harken stock. Bush exercised the option immediately with the help of a low interest loan from the company. (Such loans were criticized in 2002 when the Bush administration launched its plan to reform corporate governance.)

The next year proved to be a financial turning point for Harken. The company had a petroleum commodities trading subsidiary and in 1989, suffered \$17 million in losses, according to one report.

The same year, Soros, who owned a 20 percent stake in Harken, sold back his 6.9 million shares in the company for nearly full market value and persuaded Harken to sell him its 42 percent stake in Crystal Oil Co. at a discount, according to *BusinessWeek*.

The double-whammy put Harken in a cash-poor position.

According to internal documents, one of the company's trading partners in the commodities market was another Texas-based company Enron. A **June 20, 1990 Harken memo** referenced Enron and a \$363,000 letter of credit. (The Center was the first to report Enron as Bush's No. 1 career patron in *The Buying of the President 2000*.)

In an effort to raise money to offset the trading losses, Harken decided to sell 80 percent of its Aloha Petroleum subsidiary, bought as part of the E-Z Serve acquisition in 1986. Aloha was to be sold to an undisclosed company according to a *Wall Street Journal* article published at the time.

Later reports indicated the sale, for \$12 million, was to a group of Harken insiders called International Marketing & Resources. Of the purchase price, \$11 million was financed through a loan from Harken itself. IMR was actually controlled by two Harken directors. The company announced the deal in a July 10, 1989, news release, reporting that the sale was to an international partner.

The deal was investigated by the SEC in 1991; its structure and terms bore a resemblance to the transactions without economic substance that sank Enron in 2001. In August 1989, the company counted the sale of Aloha as a \$7.9 million gain. It also reached another financial milestone it began trading on the New York Stock Exchange.

Good news, bad news

In January 1990, the company announced more good news. Despite never

having drilled an oil well overseas, Harken penned an agreement with the Bahraini government to explore and develop petroleum offshore. The tiny Persian Gulf country is surrounded by some of the world's richest oil deposits. (Rumors swirled that the Bahraini government hired the firm because of its connections, via Bush, to his father, who was then President, though no proof has ever been offered.)

Meanwhile, Harken's actual financial condition worsened. A planned public offering intended to raise capital for the company collapsed when Bank of Boston refused to grant waivers to allow it to proceed. The crisis was made clear in an April 20 letter, posted by the Center earlier this year, from Harken president Mikel D. Faulkner to the company's board, warning of a liquidity crisis. Other internal documents refer to a severe cash crisis and critically tight cash flow.

In the memo, Faulkner blamed the problems primarily on two events: losses from trading and the company's repurchase of Soros' shares.

By May, Harken's banks began to put pressure on the company. Bank of Boston determined Harken had violated terms of a \$115 million loan package. Fortunately for the company, another bank stepped in, but for a price. The new financing agreement featured a higher interest rate, less credit for acquisitions, a \$750,000 fee and requirements by some major stockholders to guarantee \$22.5 million in debt.

While the new finance agreement was a big help, the company was still in need of cash. The board decided on a major restructuring of the company and planned a rights offering to raise in excess of \$40 million. The deal involved spinning off two subsidiaries, Harken Marketing and Tejas Power Corp.

Bush sells

By this time, Bush had become general partner of a group that would eventually buy the Texas Rangers Major League Baseball team. To help pay off a loan used to invest in the team, he decided to sell some of his Harken stock.

On June 8, 1990, Ralph Smith, a trader for Sutro & Co., called Bush on behalf of an institutional client interested in buying a large block of Harken stock. Smith asked Bush if he was interested in selling. Bush said no, but added that he might be interested in about two weeks.

On June 15, 1990, lawyers from the firm of Haynes & Boone, which worked for Harken, sent a warning about selling on insider information. The memo to Harken staffers had the subject line Liability for insider trading and short swing profits. (The information was revealed in an SEC memo, which also reported Bush's late filing of insider trading forms on four different

occasions.)

A week later, Bush contacted Smith, and sold 212,140 Harken shares for \$4 per share, netting \$848,560. Despite having been put on notice by the company lawyer of the importance of filing timely insider reports only a few months before, Bush waited eight months before filing the required forms on the sale with the SEC.

A month later, on July 23, 1990, the company released some good news. Bass Enterprises Production Company, owned by the billionaire Bass brothers, had entered into an agreement to fund initial exploratory drilling off Bahrain for \$25 million. Unfortunately for Harken, Iraq invaded Kuwait 10 days later, which destabilized the region and complicated its plans to develop the Bahrain oil fields.

Nevertheless, Harken seemed, to all outward appearances, to be a sound company with prospects for future growth. The company was even featured in a largely upbeat story in Forbes magazine. But the day the piece came out, Harken announced stunning and unexpected news: the company had a loss of \$23.2 million for the second quarter. The announcement drove the share price of the stock down 20 percent.

The reporting of the loss raised questions about the timing of Bush's stock sale. Bush was a member of the board's audit committee, although it was the executive committee of which Bush was not a member that had access to most of Harken's financial information.

According to SEC documents, investigators concluded that neither Bush nor the rest of the company's hierarchy were aware of the magnitude of the loss at the time Bush sold his stock. The investigation was criticized on several grounds, including the fact that the subject of the inquiry, Bush, was never interviewed by the SEC.

Another blow

In January 1991, Harken was dealt another setback. The SEC had been reviewing the company's sale of its Aloha subsidiary two years previous, and decided Harken incorrectly accounted for the sale. Harken agreed to issue corrected financial statements for the 1989 fiscal year and for the nine months ending September 30, 1990. The end result in 1989, rather than the \$3.3 million loss the company originally reported, it had to admit actual losses of \$12.6 million.

Shortly thereafter, on March 4, 1991, the SEC received notice of Bush's June 1990 stock sale. At the time, Bush blamed the delay on the SEC, saying they lost it. Recently, White House spokesman Ari Fleischer said it was a mix-up

by Harken's lawyers. When asked again at a press conference, Bush said I still haven't figured it out completely.

The SEC opened an investigation on April 5, 1991.

On Oct. 18, 1993, an SEC memo declared the investigation has been terminated as to the conduct of Mr. Bush, and that, at this time, no enforcement action is contemplated with respect to him. The letter also stated that the investigation's termination must in no way be construed as indicating that the party has been exonerated or that no action may ultimately result from the investigation.

In November 1993, Bush resigned from Harken's board and as a consultant. The following year, Bush ran his second political campaign, this time for governor of Texas, and defeated incumbent Ann Richards.

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