Documents Detail Bush's Role in Harken Stock Sale (Update1)

(Adds Bush saying SEC papers submitted on time in 12th paragraph from end.)

Washington, Oct. 16 (Bloomberg) -- It's a question that has dogged George W. Bush since he entered politics six years ago: What did he know about the prospects of Harken Energy Corp. in 1990 when he sold more than 212,000 shares of the Texas oil and gas company?

The answer is that Bush probably didn't know that two months later Harken shares would plunge on news that the company had a larger-than-expected $23 million loss, according to documents and interviews.

The Securities and Exchange Commission dropped an insider trading investigation into Bush's sale in 1993. Its recently released records show that as a company director, Bush knew more than he or his attorneys publicly disclosed, yet not enough to run afoul of securities laws. Bush also protected himself by getting approval in advance of the sale from company lawyers.

``It sounds like he did exactly what he was supposed to,'' said Charles Elson, a law professor at the University of Delaware.

Ten years later, the Harken stock sale remains significant. Bush has touted his private sector experience in his presidential race against Vice President Al Gore, and the transaction was a major event in his career. The $848,560 sale funded Bush's investment in the Texas Rangers, which made him a multimillionaire and helped set up his 1994 election as governor.

Campaign Issue

Bush sold his Harken stock for $4 a share on June 22, 1990. Two months later, after Harken surprised investors and analysts by reporting a $23 million loss in the second quarter, the company stock plunged to $2.38 a share.

When the stock sale became an issue in Bush's 1994 gubernatorial campaign, Bush and his attorneys said he didn't know about the size of the loss to be reported. ``I absolutely had no idea and would not have sold had I known,'' Bush told the Dallas Morning News in 1994.

Bush, referring to a potentially lucrative oil-drilling plan with Bahrain that was in the works, said he sold into ``good news.'' Bush's 1994 opponent, former Texas Governor Ann Richards, challenged that and charged that Bush knew more than he let on.

Internal company documents turned over to the SEC and obtained this year under a Freedom of Information Act request show that Bush did know about a cash flow crisis in early 1990 and that he'd been warned the company was looking at a second-quarter loss of $4 million, nearly twice the size of the first-quarter loss.

`Rosy Picture'

However, a former Harken director, an accountant and an investment banker all said it's unlikely Bush was warned that the second quarter loss would be in the neighborhood of the $23 million loss that occurred. Harken's accounting system had major troubles and management was putting a positive spin on the company's woes, the three men said.

``I don't think the full information was available to any of these directors at that stage of the game,'' said Chad Weiss, a former Smith Barney Inc. investment banker retained by Harken at the time. ``The board was given a very rosy picture of what was going on'' by Harken President Mikel Faulkner that ``wasn't very accurate,'' he said.

Faulkner, through a spokesman, declined to be interviewed or respond to questions.

Another Rescue

Bush's involvement with Harken fit a pattern in his early unsuccessful career in the oil patch. For one reason or another, Bush's independent oil ventures would require a rescue by outside investors. This was the case in September 1986 when Harken bought Bush's Spectrum 7 Energy Corp., which lost $400,000 in the six months prior to its sale.

Under the agreement, Bush joined Harken's board, received shares worth $530,130 and a consulting contract whose value ranged from $120,000 in 1989 to $44,000 in 1991.

Harken's stock, which sold for $2.38 when Bush acquired his shares, see-sawed through 1986-89 as the company embarked on several acquisitions. Then, in January 1990, Harken was awarded exclusive drilling rights off the shore of the Middle Eastern nation of Bahrain. Analysts said they were amazed such a small company could obtain such a potentially lucrative contract and Harken stock soared to a high of $5.50 on Feb. 22.

Bush, meanwhile, had become an active board member. He sat on Harken's audit committee and two special board committees, one named in March 1990 that reviewed the restructuring of $4 million in debt and another set up in May 1990 to look at whether a $40 million stock offering and restructuring would be fair to individual shareholders.

Audit Committee Role

``I certainly wouldn't consider him a weak link on the board,'' said Roland Burns, a former Arthur Andersen accountant who represented Harken during the period leading up to Bush's stock sale.

In March 1990, Arthur Andersen worked closely with Bush's audit committee when it prepared to file the company's 1989 financial results with the SEC. ``He was trying to learn as much as he could,'' said Weiss, the former Smith Barney investment banker hired by Harken to help raise capital.

While the Bahrain deal boosted its stock price, company officials grappled with a worsening financial situation. A failed bid in February 1990 for Tesoro Petroleum, an oil refiner, drained millions in cash. Harken's trading arm, which suffered a $16.6 million loss in 1989, saw its problems continue into early 1990. Bank loans were due, and Harken had to scrape for funds.

Warning From Faulkner

On April 16, Harken reported that working capital had dropped to $7 million in 1989 from $34 million in 1988 while long-term debt doubled to $94 million in 1989 from $46 million in 1988, internal records show.

``Harken and its subsidiaries suffer from high leverage and lack of liquidity,'' Harken President Faulkner said in an April 20 memo to board members.

``Equity capital is needed to reduce leverage and fund growth opportunities,'' the memo said. ``Any ideas you have with regard to potential solutions would be greatly appreciated.''

Harken was forced to scrap the proposed stock offering when the Bank of Boston refused to renegotiate loan covenants needed for the deal because of concerns about the company's financial health, according to company documents released by the SEC.

The failed stock offering ``greatly intensifies our current liquidity problem and mandates infusion of equity into the company,'' Faulkner said.

Shares Value Questioned

Faulkner's memo also suggested Harken's shares were overvalued according to a study by investment bankers Smith Barney, now a unit of CitiGroup, which was working with Harken.

``Market capitalization of Harken's 32.8 million shares at $4.625 per share equals $150 million,'' the memo said. ``The Smith Barney report valued Harken at $3.10 to $4.07 per share or $96 million to $126 million.''

Harken's Board, including Bush, met May 11 and May 17 in 1990 to discuss the company's problems, including the negotiations with Harken's banks to reduce its leverage, cash flow problems and potential violation of loan covenants, according to minutes of the meetings.

Stuart Watson, a former Harken director who served on the audit committee with Bush, said he doesn't recall getting detailed financial information from management.

Limited Information

``They kept us pretty well informed, but not about the financials,'' said Watson. ``I didn't have any information and I'm certain (Bush) didn't either on what could push up or down a stock.'' Watson refuted statements attributed to him in a 1994 newspaper article that earnings reports ``were never a surprise to us.'' ``That was not accurate,'' said Watson.

Burns, the former Arthur Andersen accountant, said Harken's operating companies ``were not getting the right information up to the corporate offices.'' And if management didn't have the financial details, it's almost certain the board didn't have them, either, he said.

On May 22, Harken appeared to head off its cash flow problems. Two major Harken shareholders had agreed to advance $40 million to Harken and its subsidiaries, with a first installment of $26 million. That was a sign of confidence in the company's long-term plans.

The shareholders were Intercontinental Mining & Resources Ltd., affiliated with Harken chairman Alan Quasha and director Jeffrey Laikind, and Phemus Corp., an affiliate of Harvard University's pension funds and affiliated with Harken director Michael Eisenson.

Corporate Restructuring

The shareholders capital infusion was part of a larger transaction that involved a corporate restructuring and a $40 million rights offering to stockholders. Harken shareholders would receive rights to buy common stock in two units, retailer Harken Marketing and natural gas producer Tejas Power Corp., which to this point weren't separately traded.

The $40 million stock rights offering wasn't without risk. Experts warned it could depress share prices and cause major changes on the company's balance sheet.

Weiss, the Smith Barney Inc. banker retained by Harken, told the board that the rights offering could reduce the company's stock price initially as traders would exploit arbitrage opportunities by dealing in the three separately traded companies. He suggested some businesses might see a decline in value when they were spun off as separate units.

Loss Projected

Meanwhile, on June 6, two weeks after the stock offering and two weeks before Bush sold his stock, Bush received an internal Harken memo that projected $4 million loss for the April-June quarter, compared to a first-quarter loss of $3.18 million.

The Harken board, including Bush, met on June 11, 1990, nine days before Bush sold his stock. At the meeting, Richard Ellis, a partner at Arthur Andersen, ``stressed the fact that there was a potential write-down that might occur in one or more of the subsidiaries'' if the offering depressed the value of the subsidiaries because of the additional shares distributed. Such an accounting write-down ``could be potentially significant but the amount is not identifiable at this time,'' according to Harken board minutes.

About this time, Bush asked Harken attorneys and management whether he could sell the stock in light of the financial report and other financial information he was privy to before the sale. They gave him the green light sometime in early June, said Bush's attorney, Robert Jordan.

Bush's Sale

On June 22, Bush sold his 212,410 Harken shares for $4 per share. That brought him a profit of $318,430 on his initial $530,130 stake, which he used that year to buy a share of the Texas Rangers. On Aug. 20, Harken reported its $23 million second-quarter loss and Harken shares plunged to $2.38.

The company blamed losses in oil trading, retail and wholesale businesses, a corporate restructuring, and an IRS audit.

Another major element was a $9.8 million special provision related to the sale of its Aloha Petroleum Ltd. retail gasoline division. Bush and Harken management said Bush hadn't been told about the Aloha write-down.

Bush didn't report the sale to the SEC until March, 1991, eight months past regulators' deadlines for such a sale. News reports say it was the late report that triggered the SEC inquiry. Bush contended the paperwork was submitted on time but was lost at the SEC.

Defending Sale

When the stock sale became a campaign issue in 1994, Bush said he sold into ``good news,'' referring to improvements in the cash-flow problem and an agreement with the Bass brothers of Fort Worth, who made billions in the oil business, to drill for oil offshore of Bahrain.

Weiss, the Smith Barney Inc. investment banker, predicted Harken's stock would rise on the news. He told Harken's board on May 11, 1990 the Bahrain agreement ``will be the primary driving force initially for the company's stock.''

Jordan, Bush's lawyer, said Weiss's remarks were influential in Bush's ``good news'' assertion.

``I think it is entirely fair to say that Bush was selling into `good news,' based on what he knew at the time,'' Jordan said. ``And in any event, no one could have had the clairvoyance necessary to predict what would happen with the stock six or eight weeks later.''

``The question the SEC asked, and one that anyone would want to ask, is what did Governor Bush believe to be the company's condition on June 20, when he sold his shares. The fact that there was concern in April doesn't mean there was concern in June. And that concern in April was tempered by future potential for the company.''

June 6 Warning

As for the June 6 warning of a $4 million loss, the SEC decided that wasn't important enough information about the company's finances to provide Bush with an important advantage over other investors, according to securities law experts and Bush's attorney.

Charles Strain, an independent oil analyst who followed Harken then, said he didn't consider a $4 million projected loss to be significant. ``I don't think so,'' he said. ``I followed it as an exploration company. It was a serious money loser at that point.''

Jordan, Bush's lawyer, also points to the fact that Bush consulted the company before selling. ``He took all necessary precautions,'' Jordan said.

Another specialist in insider trading said the new documents showing the information Bush received prior to the sale said he wasn't so sure because Bush was operating in a ``gray area.''

``I'm still not comfortable looking back 10 years and saying something is clearly material or immaterial,'' said John Coffee, professor at Columbia University in New York.

``But a director who is informed that a second quarter loss is projected to be double of the first quarter's loss is in possession of significant adverse information that the market

might want to know,'' Coffee said.
``He also received some positive information and the trade-off between them is uncertain,'' he said.

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