

ACTION MEMORANDUM

Date: March 18, 1992

TO : The Commission

FROM : The Division of Enforcement

SUBJECT : In the Matter of Trading in the Securities of Harken Energy Corp., File No. HO-2518

RECOMMENDATION : That the Commission authorize the staff to brief orally the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce concerning the staff's investigation in the above-captioned matter.

ACTION REQUESTED BY : Seriatim Consideration

NOVEL, UNIQUE OR COMPLEX ISSUES : None

RELATED COMMISSION ACTION : None

TENTATIVE SUNSHINE ACTION STATUS : Exempt

OTHER DIVISIONS OR OFFICES CONSULTED : The Offices of Legislative Affairs and General Counsel have been provided with a copy of this memorandum.

PERSONS TO CONTACT: Bruce Hiler 272-2224
Herbert Janick 272-2985
Paul Gerlach 272-2928

I. SUMMARY

The staff has conducted an investigation of the sale by George W. Bush ("Bush") of 212,140 shares of the common stock of Harken Energy Corporation ("Harken") on June 22, 1990. Bush, who is an outside Director of Harken, made this sale prior to Harken's announcement on August 20, 1990, that it has sustained a loss for its quarter ended June 30, 1990, of \$23.2 million. As is discussed below, based upon the facts surrounding Bush's stock sale, the

staff does not intend to pursue the investigation further or to recommend any action.

Recently, there have been press reports about Bush's sale of Harken stock. See, e.g., "Article Questions Sale of Stock by Bush Son," New York Times, Monday, March 9, 1992 (reporting on article in US News & World Report on stock sale). In response to these reports, on March 11, 1992, Chairman John Dingell of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce ("the Subcommittee") requested that the staff brief the subcommittee concerning its inquiry of Bush's stock sale.

The staff seeks authority to provide the briefing requested by Chairman Dingell.

II. THE STAFF'S INVESTIGATION

On June 22, 1990, Bush sold 212,140 shares of Harken common stock at \$4 per share.^{1/} Harken is an oil and gas exploration corporation based in Texas, and its common stock was listed for trading on the New York Stock Exchange ("NYSE") in June 1990.^{2/} Bush's proceeds from this sale totalled \$848,560.

On the morning of August 20, 1990, Harken announced a loss of \$23.2 million for the quarter ended June 30, 1992. The quarterly loss announced by Harken consisted principally of: (1) operating losses for the quarter of \$6.7 million; (2) a write-down of \$7.2 million due to the impairment and restructuring of Harken's Hawaiian retail facility, Aloha Petroleum, Ltd.; (3) a write-down of \$2.5 million associated with the costs of restructuring Harken's marketing subsidiary, Harken Marketing Corp.; and (4) a \$3.9 million interest expense.

On April 5, 1991, the staff opened an informal inquiry into Bush's sale of Harken stock.^{3/} In its inquiry, the staff has reviewed documents produced by Bush and Harken, has met with Bush's attorneys, has conducted interviews of Bush's broker and Harken's in-house counsel, and has consulted with the Office of Economic Analysis ("OEA"). Based upon our investigation, it appears that Bush did not engage in illegal insider trading because it does not

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- ^{1/} At the time of this sale, Bush owned 317,152 shares of Harken common stock. ↳ ~~see case file~~
what happened to re
- ^{2/} Since March 18, 1991, the common stock of Harken has been listed for trading on the American Stock Exchange.
- ^{3/} The staff was alerted to Bush's sale when he filed late a Form 4 on March 4, 1991, reporting the June 1990 sale.

appear that he possessed material nonpublic information or that he acted with scienter when he sold the Harken stock.

The staff's inquiry has identified two difficulties with establishing that Bush possessed material nonpublic information when he sold his stock. First, the evidence establishes that Bush was not aware of the majority of the items that comprised the loss Harken announced on August 20. As is noted above, the vast majority of Harken's announced loss consisted on write-downs and expenses (items 2 through 4 above) associated with a restructuring efforts. These restructuring efforts occurred after June 22, the date of Bush's sale. The staff's investigation found a single document that Bush received prior to June 22 that related to Harken's operating losses. This document indicates that during the first week of June 1990, Bush was informed that Harken's estimated historical and projected operating losses for the second quarter were approximately \$4.2 million. This estimated loss was \$2.5 million less than the actual operating loss that Harken later announced for the quarter, and it was consistent with Harken's publicly reported trend of quarterly operating losses. 4/ In light of the market reaction to Harken's announcement of a \$23.2 million loss (which is discussed immediately below), it would be extremely difficult to establish that an announcement that Harken would loose \$4.2 million for the quarter ended June 30 (the only information Bush knew) was material information.

The staff's consultation with OEA confirms that it would be difficult to establish that Harken's August 20, 1990 announcement was material. At the request of the staff, OEA undertook an analysis to determine the materiality of Harken's second quarter earnings' announcement. The announcement occurred at 9:34 a.m. on August 20, 1990. Harken opened for trading at \$3.00 per share on August 20, 1990 and continued to trade at \$3.00 until after 12:00 p.m., when its price started to drop. Harken closed at \$2.375 per share on August 20. On August 21, Harken rebounded to close at \$3.00, its pre-announcement price. The conclusion of the OEA is that, because the price of Harken did not immediately react to the earnings announcement and there is no news that explains Harken's return to its pre-announcement price of \$3.00 on August 21, 1990, the earnings announcement did not provide investors with new material information. 5/

↳ Forbes article

The staff's investigation also indicates it would be difficult to establish that Bush acted with scienter when he sold his Harken

- 4/ Harken reported losses for its fourth quarter of 1989 and its first quarter of 1990 of \$8 million and \$2.2 million, respectively. → but b/c of seasonal changes in business, which really relevant is year-ago 2nd quarter and any estimate company
- 5/ See July 7, 1991 Memo from Lisa Meulbroek attached hereto as Attachment A.

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stock. During its investigation the staff interviewed the broker who executed Bush's stock sale and Harken's in-house counsel who advised Bush concerning his stock sale. These interviews indicated that Bush sold his stock at the urging of Ralph Smith ("Smith"), a block trader for Sutro & Co., and that, prior to doing so, he consulted with Harken's in-house counsel, Larry Cummings ("Cummings"), and Harken's CEO.

In a telephone interview, Smith told the staff that he was contacted on June 9, 1990, by an institutional client interested in purchasing a large block of Harken stock. Smith said that, in an attempt to find a seller of a block of Harken stock, he made several cold calls to individuals, including Bush, who he knew or believed owned a block of Harken stock. Smith told the staff that Bush informed him that Bush was not interested in selling his stock at that time but might be in a few weeks. According to Smith, two weeks later he placed a second call to Bush to see if Bush was ready to sell his stock. Bush said he was ready to sell his stock, and Smith began to put the deal together.

In a telephone interview, Cummings told the staff that, during the second week of June, Bush contacted Cummings and requested his advice as to whether Bush could sell his Harken stock. 6/ According to Cummings, he and Bush discussed the issues surrounding a potential sale, including whether Bush was an insider with knowledge of any information prohibiting a sale. Cummings indicated preliminarily that he thought Bush could sell his stock but Cummings wanted to consider the issue and discuss it with Harken's outside counsel. According to Cummings, Bush requested that Cummings consult with Michael Faulkner ("Faulkner"), Harken's President and Chairman, as well as Alan Quasha, another director, to determine if they had any objection to the sale or knew of any reason why Bush should not sell his stock.

Cummings told the staff that, after meeting with Bush, Cummings contacted Harken's outside counsel, Haynes and Boone, to obtain their opinion whether Bush could sell his Harken stock. Cummings said that, Haynes and Boone informed him that they would review the situation and report back to him. Thereafter, Haynes and Boone reported to Cummings that the attorneys at the firm that performed work for Harken had met internally to consider the issue and, based upon the information they had, they saw no reason why Bush could not sell his stock. Cummings also said that, as Bush requested, he conferred with Faulkner, who contacted Quasha to discuss the transaction. According to Cummings, Faulkner told Cummings that neither Faulkner nor Quasha knew of any inside information that would prevent Bush from selling his stock and neither of them objected to Bush's proposed sale.

6/ Bush and Harken waived the attorney-client privilege to allow the staff to question Harken's in-house counsel.

According to Cummings, he conveyed the results of his conversations with Haynes and Boone and Faulkner to Bush and told Bush he was free to sell his stock. Cummings said that Bush told him that he would have Smith contact Cummings to work out the mechanics of the transaction. Cummings said that Smith subsequently called Cummings to discuss the transaction and, on June 22, 1990, Bush sold 212,140 shares of Harken stock in a block sale, at the then market price of \$4.00 per share.

In light of the facts uncovered, it would be difficult to establish that, even assuming Bush possessed material nonpublic information, he acted with scienter or intent to defraud. For the reasons set forth above, the staff does not believe that an enforcement action is appropriate in this matter.

III. CHAIRMAN DINGELL'S REQUEST

In a letter dated March 11, 1992, to Chairman Breeden, a copy of which is attached as Attachment B, Chairman Dingell requested that appropriate members of the Commission staff provide a confidential briefing to the staff of the Subcommittee concerning Bush's sale of Harken stock and the federal securities laws' prohibitions on insider trading. The letter requested that this briefing be provided "at the earliest possible time."

Chairman Dingell's request for a briefing will require the staff to disclose non-public information, which requires Commission authorization. 7/ The staff requests authority to brief the Subcommittee concerning the circumstances surrounding Bush's sale of Harken stock, the staff's investigation into the sale and its conclusions concerning the basis for not recommending an enforcement action in connection with the sale.

IV. RECOMMENDATION

For the foregoing reasons, the staff recommends that the Commission authorize the staff to brief orally the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce concerning the staff's investigation in the above-captioned matter.

7/ Rule 202.5(a) of the Rules of Practice and Investigation provides that preliminary and formal investigations are nonpublic, and reports thereon are intended solely for the use of the Commission and its staff "[u]nless otherwise ordered by the Commission."