Ken Lay

The managers of HNG deftly averted Wyatt's overtures by borrowing substantial sums of money, which made the company less financially sound. They also called in a few political favors from the state's attorney general, who sued Wyatt. The company eventually made Wyatt go away by paying $42 million for the HNG stock he owned.[3] The company survived Wyatt's bid, but the formerly financially healthy firm now had to manage the unplanned debts it incurred. The board of directors of HNG concluded that the company did indeed need a new CEO. They were very impressed by the president and chief operating officer of a competing Houston-based oil company, who agreed to serve as a white knight if needed; his name was Ken Lay. The board actively recruited Lay and then hired him as HNG's new CEO and chairman of the board.

Becoming CEO was a dream come true for Ken Lay, the ambitious forty-two-year-old son of an ordained Southern Baptist preacher. Born in 1942, Lay grew up in rural poverty as a Missouri farm boy, living without indoor plumbing until the age of eleven. His father financially supported the family with various low-paying jobs—buying and selling chickens, selling door-to-door, and working as a janitor—while spreading the word of God. At the age of twelve, Lay worked full-time during the summer driving farm tractors. The family moved to Columbia, where his older sister attended the University of Missouri on a scholarship to minimize her traveling expenses. Ken also received a university scholarship. The oldest land-grant school west of the Mississippi River fulfilled its mission by providing Lay with an inexpensive higher education that would enable him to move up the economic ladder and make the world a better place.[4]

Lay fulfilled his end of the bargain by studying hard and developing connections with influential people. Lay was very personable and earnest, and he excelled in academics and extracurricular activities despite a stuttering problem. He made a lasting impression on Pinkney Walker, his economics professor. Walker, an ardent proponent of the free market system, inspired Lay to stay in school and earn a master's degree in economics.

After graduating in 1965, Lay became a senior economist and speechwriter for the chief executive of Humble Oil and Refining in Houston. Lay attributed his quick advancement up the economic ladder to his education and enrolled in evening doctoral classes at the University of Houston. He married his college sweetheart the following year. He was of draft age as the Vietnam War heated up, and Lay enlisted in the navy and attended an officer training school. Walker pulled a few political strings and found his protégé an administrative military job at the Pentagon examining the economic impact of withdrawing from the war. Lay leveraged his Pentagon research work into a doctoral degree in economics, which he obtained in 1970.

When Richard Nixon appointed Walker to the Federal Power Commission the following year, Walker hired Lay, who completed his military service in 1971, as his chief aide. Lay quickly made a mark as a deregulation specialist and was promoted to deputy undersecretary of energy in the Department of the Interior. Although he enjoyed the prestige, Lay did not enjoy working in a bureaucratic political environment. Lay's regulatory activities brought him into contact with Jack Bowen, the CEO of Florida Gas. In 1974 Bowen hired Lay as his vice-president of governmental affairs. Bowen and Lay became good friends, and two years later Bowen promoted Lay to president.

Through hard work and the right connections, Lay advanced from a childhood of poverty, when he felt lucky for having lunchmeat to eat on Thanksgiving, to becoming president of a regulated monopoly before the age of forty, with an annual salary of $268,000, equivalent to more than $700,000 in today's money.

Then love, a force more powerful than money or status, prevented him from becoming the company's CEO. Lay had an affair with his secretary and separated from his wife.[5] Bowen had since become CEO of Transco, a Houston oil company, and was no longer available to protect his protégé from the internal corporate politics his scandalous behavior generated. Nonetheless, Bowen rescued Lay again by offering him a job as Transco's chief operating officer. Lay grabbed the opportunity, which included being groomed to succeed Bowen as CEO of Transco following his anticipated retirement in the late 1980s.

Lay returned to Houston in 1981 with his future wife and her children, and his former wife and their children, just as the price of oil collapsed from $40 to $9 a barrel. He put his abundant energies, knowledge and political skills into saving both his mentor's company and the city he admired. Lay became an industry leader by creating a spot market for the buying and selling of natural gas between producers and consumers. Lay remained at Transco until he impressed HNG's board of directors during Wyatt's unsuccessful hostile takeover attempt. After obtaining Bowen's approval, Lay left Transco to take on the duties as HNG's CEO and chairman in June 1984.

But continuous financial problems in the energy industry attracted more corporate raiders looking to enhance their wealth by purchasing other underperforming corporations. From his CEO perch, Lay's political skills would be needed to fight off a corporate raider going after an energy company operating out of Omaha, Nebraska.

Another White Knight Opportunity: 1985

In 1985, Minneapolis investor Irwin Jacobs, fresh from adding to his fortune by greenmailing the Walt Disney Corporation, set his sights on raiding Omaha's financially troubled InterNorth natural gas company. InterNorth's CEO, wanting to avoid "Irv the Liquidator," contacted Lay about a possible merger with HNG. InterNorth proposed purchasing HNG's $47 stock at $70 a share, for a total price tag of $2.4 billion.[6] A Jacobs takeover would be prevented because, even if he sold off corporate assets, Jacobs could not profitably pay off the merged company's huge debt.

The merger proposal made strategic sense for HNG. The federal government was in the process of deregulating the energy industry, and HNG would jump from being a regional company to a national one, with a network of natural gas pipelines flowing from the East Coast to the West Coast, and from Canada to Mexico. In addition, Lay could multiply his growing personal fortune by cashing in his HNG stock options at the premium price being offered by InterNorth.

But there were some potential negative ramifications for Lay to consider. The combined InterNorth/HNG entity would have a daunting $4.3 billion debt to manage and an anticipated $357 million greenmail payment for the stock Jacobs already owned. This would deplete the firm of badly needed cash.[7] Also, it would be a merger of unequal partners because InterNorth's revenue of $7.5 billion was three times larger than the revenue of HNG. Such a size disparity typically resulted in the smaller firm being taken over by the larger one. Bureaucratic redundancies would have to be eliminated to reduce costs, which would probably mean InterNorth executives gaining control of HNG's assets. Only one CEO would be needed, not two, and corporate control would transfer from Houston to Omaha.

> <u>DECISION CHOICE.</u> *If you were Ken Lay would you:*
>
> *(1) reject InterNorth's proposal in order to protect your job, to protect the job of your managers, and to keep Houston Natural Gas headquartered in Houston; or*
>
> *(2) merge with the much larger InterNorth, risk*

many executives losing their jobs due to redundancies, cash out your stock options, and begin looking for another CEO position?

Why?