Carleton, Norman

From:

Lori.Santamorena@bpd.treas.gov

Sent:

Thursday, December 27, 2001 8:13

To:

Norman, Carleton@do.treas.gov

Subject: Re:

interesting, OPIC and Ex Im Bank at one time issued instruments that were TT&L eligible,

Norman.Carleton@do.treas.gov

To: Jill.Cetina@do.tress.gov, Anne.Salladin@do.treas.gov, Shella.Bair@do.treas.gov, Steve.Berardi@do.treas.gov, Timothy.Bitsberger@do.treas.gov, Matthew.Eichner@do.treas.gov, Jose.Gabilondo@do.treas.gov, Jared.Gross@do.treas.gov, Viva.Hammer@do.treas.gov, Isantamorena@bpd.treas.gov, Peter.Nickoloff@do.treas.gov, Michael.Novey@do.treas.gov, Fred.Piotrangeli@do.treas.gov, Jean.Whaley@do.treas.gov, Jean.Whaley@do.treas.gov,

Mark.Wiedman@do.treas.gov

cc: Subject:

December 20, 2001

12/20/01 05:35 PM

Enron, GB, Bechtel Claim US Insurance On India Project

Dow Jones Newswires

WASHINGTON -- Enron Corp. (ENE), General Electric Co. (GE) and Bechtel Corp. (X.BTL) have filed a total of nearly \$200 million in insurance claims with the U.S. government for investment losses in India.

Since last week the three companies have individually filed applications with the Overseas Private Investment Corp. for "expropriation compensation" on their investments in Dabhol Power Co., OPIC spokesman Larry Spinelli said Thursday.

Dabhol Power is a \$2.9 billion power plant and liquefied natural gas, or LNG, import terminal near Bombay in western India. It's considered the largest foreign direct investment in India's history.

"We obviously regard this as a very serious development," Spinelli said of the insurance claims. "And we are looking to the Indian government for constructive involvement to settle these issues."

OPIC is a government agency that finances U.S. companies' overseas investments through insurance and losss. In addition to OPIC financing, the U.S. government is owed 8202.5 million for a losn the Export-Import Bank made to Dabhol Power.

Work on the 2,184-megawatt Dahbol power plant stopped this year after its sole customer, the Maharashtra State Electricity Board, declined to pay earlier-agreed power prices.

Faced with nonpayment, Enron said in August it would consider buyers for its controlling 65% interest in the project. Officials from the bankrupt Houston-based company met last week with Indian lenders and government officials to discuss ways of disposing of its stake.

GE and Bechtel each hold a 10% interest in the project. The Maharashtra State Electricity Board holds the remaining 15%.

Two Indian companies, Tata Power Co. (P.TPW) and BSES Ltd. (P.BSX), have shown interest in bidding for the Dabhol power plant. Royal Dutch/Shell (RD) and BG Group Plc (BRG) have shown interest in the Dabhol LMG import terminal.

-By Campion Walsh, Dow Jones Newswires; 202-862-9291; 1/17/02

Campion.Walsh@dowjones.com

Campaign Gifts, Lobbying Built Enron's Power in Washington

By Dan Morgan and Juliet Eilperin Washington Post Staff Writers Tuesday, December 25, 2001; Page A01

During the administration of the first President George Bush, a new party fundraiser named Kenneth L. Lay was invited to spend the night at the White House. The sleepover was an early coup for the chairman of Enron Corp. and a harbinger of things to come.

Over the following decade, Lay and Enron poured millions of dollars into U.S. politics, cultivating unequaled access and using the entree to lobby Congress, the White House and regulatory agencies for action that was critical to the energy company's spectacular growth. Now, with Enron's sudden bankruptcy, public attention has turned not only to the financial practices that brought the company down, but to what its far-flung political operations say about the country's campaign finance system.

Some Democrats in Congress are spoiling for an opportunity to use Lay and Enron to embarrass the Republican Party, which received most of the company's largess over the years. They want to look into such things as Enron's relationship with Phil Gramm (R-Tex.), ranking minority member on the Senate Banking Committee and chairman of the committee at a time when his wife, Wendy L. Gramm, was serving on Enron's board. Last year, Gramm's committee approved legislation that included a key provision exempting parts of Enron's massive energy trading operation from federal oversight.

"I think the Enron story is going to turn out to be an enormous political story," said Rep. Henry A. Waxman (D-Calif.), ranking minority member on the House Energy and Commerce Committee.

The ties of Lay to the White House and GOP leaders, he added, were so multilayered that Republicans are likely to be reluctant to pursue them. But he made clear that he intends to do so and expects the Democratic-controlled Senate to follow suit.

Enron also cultivated relationships with Democrats, however. Lay played golf in Vail, Colo., with President Bill Clinton, and Enron gave hundreds of thousands of dollars to Democratic campaign committees and Democrats in the House and Senate, including Sen. Charles E. Schumer (N.Y.) and Rep. Martin Frost (Tex.), the ranking minority member on the House Rules Committee.

A Routine Cost for Some

Advocates of campaign finance reform say the Enron case vividly illustrates the ties between politics and big money, though it's unclear that the company's political operations were radically different from others for whom political contributions have become a routine cost of doing business.

"There are aspects of [the Enron case] that remind us of the savings and icon spandal, in the sense that a powerful institution used big money to buy influence and protect itself while ordinary citizens ended up losing their life savings," said Fred Wertheimer, president of Democracy 21, a Washington interest group, referring to a banking controversy in the 1980s. Enron's ties to Republicans and the present Bush administration were especially close. Lay raised large sums for George W. Bush's campaign.

Enron, Lay and its employees have contributed \$572,350 to him over his career, far more than any other company, according to the Center for Public Integrity in Washington.

Several top administration officials have been Enron advisers or stockholders. Enron, Lay and other senior executives contributed \$1.7 million in soft-money donations to politicians in the 2000 election cycle, two-thirds of it to Republicans, according to the Center for Responsive Politics.

Republicans clearly are sensitive to the potential political dangers. The National Republican Senatorial Committee recently returned a \$100,000 check collected from Enron in November, after deciding that "it was appropriate to give it back," spokesman Dan Allen said. The Republican Governors Association last week returned an Enron donation of \$60,000. What was unique about Enron, competitors and allies agree, was a brash and sometimes counterproductive political style.

Stories of Enron's hardball style are legion. In October 1999, for example, Jeffrey K. Skilling, then Enron's president, expressed his displeasure at Rep. Joe Barton's position on a deregulation bill pending in the energy subcommittee Barton chairs.

The meeting grew "heated and awful," said one person who was present, until Barton (R-Tex.), a usually mild-mannered man who keeps a Bible on his desk, exploded. "Jeffrey Skilling, I may not have your millions of dollars, but I am not an idiot," one witness recalled Barton saying. The meeting ended without Enron getting the changes it wanted. "Skilling did not get Washington," the source added.

"In their lobbying, they acted like the 800-pound gorilla they were," said Christopher Horner, a Washington lawyer who briefly directed Enron's government relations in 1997. Lay and Skilling declined interview requests, but Enron officials say they have no regrets about their use of money. "It got us name recognition," company spokesman Mark Palmer said. "Given the aggregation of our foes, we had to make sure that people knew what our argument was."

Jump-Starting Deregulation

Almost from its start in 1985 as a gas pipeline company, Enron needed help in Washington, and it got it in a series of actions by Congress and the Federal Energy Regulatory Commission (FERC) that undermined the traditional monopoly of utility companies over power plants and transmission lines.

Enron lobbied for several of the initial actions that set the stage for the era of a deregulated wholesale electricity market.

It supported the 1942 Thergy Policy Act, which encued the utility con punited vire, to electricity merchants such as Enron. It also worked with the Commodity Futures Trading Commission — then chaired by Wendy Gramm — for a regulatory exemption for futures trading in energy derivatives, which later became Enron's most lucrative business. Soon after Gramm stepped

down in 1993, she was appointed to Enron's board.

Independent sources knowledgeable about these dealings, however, said Enron was not the main interested party. They said the lead was taken by several major oil companies, including British Petroleum Co. and Phillips Petroleum Co., which were concerned about the effect of CFTC regulation on their offshore trading in crude oil contracts. Wendy Gramm, an apostle of free markets, needed little convincing, the sources said.

That same year, Lay served as chairman of the committee organizing the Republican National Convention in Houston. Hedging its bets, Enron made a major contribution to a "street fair" in honor of Sen. John Breaux (D-La.), a key energy policymaker, at the Democratic convention. Key orders by FERC in 1996 also supported Enron's transformation into a freewheeling trader of gas, electricity and more exotic products, such as telecommunications services and sulfur-dioxide emissions credits.

The new rules ensured that Enron and other merchant companies could buy electricity from independent power plants and sell it to distant customers, using transmission lines borrowed from utility companies.

Even Enron's harshest critics credit Lay with putting new issues -- such as electricity deregulation -- on the Washington agenda. Lay, a former Interior Department official with a PhD in economics, became "the ambassador" for deregulation, one former employee said.

Throughout the 1990s, Enron's agenda was opposed by coal-burning utilities, especially ones in the Southeast, which viewed the emerging wholesale electricity market as a threat to their turf. Many of these, such as Atlanta-based Southern Co., had impressive political funding and connections of their own.

But with the explosive growth of Enron and the GOP takeover of Congress in 1995, the company's soft-money donations -- unregulated and unlimited gifts to political parties and organizations -- jumped sharply. They went from about \$136,000 in the 1993-94 election cycle. to \$687,000 in 1996 and \$1.7 million in 2000, according to the Center for Responsive Politics.

Frustrated by Washington

For all its connections, sources say, Enron often found Washington frustratingly slowand unreliable.

The company placed a substantial bet on federal support for limits on the greenhouse gases causing global warming. Enron officials hoped to exploit a new market in industry for carbon-emissions credits, similar to the one that developed for sulphur credits after clean-air legislation was enacted in 1990.

Lay joined the Union of Concerned Scients's and environmental groups in calling for carbs on carbon in the atmosphere. The Clinton administration was supportive, but this year the Bush administration reneged on a campaign pledge to impose limits on greenhouse gas emissions from coal-burning power plants.

A multimillion-dollar lobbying campaign in Congress to secure legislation requiring states to institute retail electricity deregulation fared even worse.

Enron hired former New York representative Bill Paxon, a leading conservative, to run Americans for Affordable Electricity, which commissioned studies and recruited business support for deregulation. But the legislation never made it out of a congressional subcommittee. At the same time, Enron was growing restive over the slow pace of deregulation in the wholesale electricity market, the core of its business. Large parts of the country, especially the Southeast, were still monopolized by regulated utilities that limited the opportunity for trading gas, electricity and energy derivatives.

Political Pragmatism

Enron's political pragmatism was demonstrated in the 1998 New York Senate election, when it dropped its support of the Republican incumbent, Alfonse M. D'Amato, after Democrat Schumer endorsed Enron's goal of wholesale deregulation, sources said. Lay reciprocated by hosting several fundraisers for Schumer, and Enron's political action committee contributed \$7,500 to the Schumer campaign.

The company's lobbying team expanded along with its political spending. It outgrew the twoperson operation that existed in 1989 and began to reflect Enron's interest in everything from pipeline safety and derivatives trading to Overseas Private Investment Corp. loan guarantees. By last year, its lobbying expenses exceeded \$2 million a year and covered a raft of big-name consultants, such as former Montana governor Marc F. Racicot, the new Republican National Committee chairman, and former top aides to House Majority Leader Richard K. Armey (R-Tex.) and House Majority Whip Tom DeLay (R-Tex.)

The hazards of Enron's efforts to connect with both parties were evident last year, when shortly before the November election, the company picked a Clinton administration Treasury official, Linda Robertson, to run its Washington office.

A perturbed DeLay, whose campaign and related funds had received more than \$100,000 from Enron and Lay, briefly "excommunicated" Enron, a House source said. Robertson was not invited to a series of meetings of electricity lobbyists held in DeLay's office last July, though an Enron official did finally attend the sessions.

Enron had more success when Congress overwhelmingly approved legislation last year containing a provision precluding the Commodity Futures Trading Commission (CFTC) from regulating Enron's trading in energy derivatives. These instruments are traded largely between electricity dealers and big wholesale consumers, which use them to hedge against price swings that could adversely affect their businesses.

The exemption, nucleal into broader legislation that established the legislaty of enregulated derivatives trading by banks, was not supported by a Clinton administration working group, largely because of opposition from the CFTC. Since the departure of Wendy Gramm, some in the agency had lobbied for tighter control over the exploding energy derivatives market. The legislation passed through the Senate Banking Committee, then chaired by Phil Gramm, who has received \$97,350 from Enron employees and its political action committee since 1989. A Gramm spokesman said the senator does not recall talking to his wife, an Enron director, about the energy provision and played "no role" in negotiating it. Wendy Gramm did not return phone calls seeking comment.

Enron was a primary player, with Koch Industries Inc., a large, privately held oil and gas company based in Wichita, in pushing for the exemption, a source said. But the company's main effort was focused on the House Agriculture Committee, where the legislation originated. Its chairman and ranking Democrat, Texas Reps. Larry Combest (R) and Charles W. Stenholm (D), respectively, were among the top recipients of Enron campaign donations in the House since 1989.

The CFTC objected strenuously to the initial draft marked up by the committee, but the Texas congressmen helped work out a compromise between Enron and the agency. The compromise was then offered by Rep. Jerry Moran (R-Kan.), the home-state congressman of Koch Industries and a recipient of campaign donations from Enron and Koch in the last election cycle. Moran did not return a phone call seeking a comment.

Early this year, Lay seemed to be at the height of his political power, getting a private meeting with Vice President Cheney to discuss the administration's energy policy proposals and weighing in on key nominations to FERC.

Curtis Hebert Jr., FERC's chairman at the time, has reported that Lay called him and implied that Enron would urge the newly installed Bush administration to keep him in the job -- if he changed his views to support Enron's position for faster electricity deregulation. Lay contended that Hebert called him to ask for support.

Hebert was not reappointed. He was replaced by Texas lawyer Pat Wood III, a strong advocate of deregulation who had the backing of Lay and Enron.

Ironically, since Enron's fall, both FERC and Congress seem to be moving in the direction of the deregulated markets Lay and Enron lobbyists had pushed for.

© 2001 The Washington Post Company

CORRECTION

Wednesday, December 26, 2001; Page A02

A Dec. 25 article incorrectly reported the action taken by the Senate Banking Committee, chaired by Phil Gramm (R-Tex.), on a bill that exempted much of Enron Corp.'s trading activities from federal regulation. The legislation was approved by the Senate Agriculture Committee.

© 2001 The Washington Post Company

Enron Executives Face Subpoenas

Senate Panel Also Orders Testimony of Directors By Peter Behr and Dan Morgan Washington Post Staff Writers Thursday, January 3, 2002; Page E01

A Senate committee announced yesterday that it is subpoenaing top executives and directors of the bankrupt Enron Corp. to determine their roles in the Houston company's epic collapse.

Three other congressional committees already are digging into the Enron failure, but the subpoenas announced yesterday are believed to be the first of the congressional probes. Among the likely recipients is Wendy Gramm, an Enron director who is the wife of Sen. Phil Gramm (R-Tex.).

Sen. Carl M. Levin (D-Mich.), chairman of the Governmental Affairs Committee's permanent subcommittee on investigations, said the panel also will subpoen financial and trading records from Enron and audit documents from its accountant, Arthur Andersen LLP.

Enron's attorney, Robert Bennett, called the subpoenas "totally unnecessary" and said "we are fully cooperating with Congress."

100

Although Enron Chairman Kenneth L. Lay did not show up for two earlier congressional hearings on Enron's bankruptcy, he has agreed to testify next month before the Senate Commerce Committee, Bennett said.

Enron has turned over nearly three dozen boxes of documents to the House Energy and Commerce Committee, Bennett said. "I don't question the legitimacy of an inquiry [into Enron's failure], but it's not a measured approach is have a half-dozen different committees doing this at the same time," he said. "It can lead to a circus atmosphere and a lot of wasted time and effort." The full Governmental Affairs Committee has scheduled a hearing for Jan. 24 on Enron's use of a large number of partnerships that kept billions of dollars of corporate debt off the company's books. The hearing will also examine whether federal regulators missed warning signs of the company's trouble.

Accounting errors involving the private partnerships caused Enron to overstate its earnings by half a billion dollars over the past four years. Enron's disclosure of the overstatement, in November, triggered a final plunge in the company's stock price and the company's bankruptcy filing Dec. 2.

Sen. Joseph I. Lieberman (D-Conn.), chairman of the full committee, said, "The focus is, how did this corporation collapse, and what can we do to make sure that something like this never happens again?"

Lieberman's committee joins an already crowded field of Enron inquiries. The House Energy and Commerce Committee has sent investigators to interview Enron officials in Houston.

Subcommittees of the House Financial Services Committee and the Senate Commerce Committee have already held hearings.

But Lieberman's panel is the top investigative committee of the Senate. Under Republican leadership during the Clinton administration, then-chairman Fred D. Thompson (R-Tenn.) headed an investigation of Bill Clinton's 1996 presidential campaign fundraising.

Levin and Lieberman said they intend to look into the close ties between Lay and President Bush, a connection that some Democratic Party officials say they hope to take advantage of in this year's congressional election campaigns.

Levin said he wants to know what advice Lay, who was a large contributor to the Bush campaign, gave to officials of the new administration as it formulated energy policy a year ago. Enron "also had close relationships with some Democrats, it's fair to say," Lieberman acknowledged. He said he expected the inquiry to be bipartisan and to have Thompson's support. "We are going to work together," Lieberman said.

Lieberman said the committee also wants to learn whether federal regulators have the authority to adequately oversee the complex commodity trading and financial transactions that were the foundation of Enron's rapid growth over the past three years.

Lieberman noted that much of Enron's trading in energy derivatives was exempt from regulation by the Commodity Futures Trading Commission, and he said a focus of the inquiry would be whether this allowed the company to hide some transactions.

Enron was an active player in lobbying for the exemption beginning in the early 1990s, according to sources. The exclusion was initially approved by the CFTC in 1992, and in 2000 Congress endorsed it as part of the Commodity Futures Modernization Act, despite concerns of some senior regulators.

At a joint hearing on the legislation by the Senate Banking and Agriculture committees in June 2000, then-CFTC chairman William J. Rainer spelled out his "reservations" about the exclusion and said that "the case for it has not been made" with regard to energy derivatives.

© 2002 The Washington Post Company

Senator Eyes End To Enron-Type Special-Purpose Entities

Dow Jones Newswires

WASHINGTON -- U.S. Senate Commerce Committee Chairman Fritz Hollings, D-S.C., pledged Tuesday to introduce legislation to eliminate the sorts of financial accounting that led to the financial collapse of Enron Corp. (ENE).

At a committee hearing on the Enron debacle, Hollings called for legislation to eliminate the use of special-purpose entities, which are partnerships or trusts through which companies keep their debt off the books and, in Enron's case, overstate earnings.

Hollings said such off-the-balance-sheet transactions should end in order to protect investors. Hollings also was highly critical of the amount of insider stock selling by top Enron officials. He noted that Enron Chairman Kenneth Lay and former Chief Executive Jeffrey Skilling each sold shares in recent months for more than \$60 million, while members of Enron's board sold shares worth more than \$160 million.

"The selling of Enron was prolific," Hollings said, calling the insider selling "a screaming red flag."

If Enron officials felt the stock was undervalued, as they publicly attested, "why were they cashing in?" Hollings said.

Hollings also said there was plenty of blame for the "shenanigans" associated with Enron's collapse, which he likened to a "cancer." He cited Enron's role in persuading the Commodity Futures Trading Commission against the Clinton administration's call for regulation of energy derivatives, and subsequent congressional action to exempt from regulation the highly complex energy derivatives Enron's special-purpose entities engaged in.

"We are all guilty for letting it happen," Hollings said of Enron's collapse.

Sen. Byron Dorgan, D-N.D., chairman of the committee's consumer affairs panel, described Tuesday's hearings as the first of several that will delve into the roles in Enron's financial collapse played by: Enron officials; Arthur Andersen, Enron's outside auditor; Wall Street analysts, and regulators.

"This is about an energy company that morphed into a trading company involved in hedge funds and derivatives. It took on substantial risks, created secret off-the-books partnerships and, in effect, cooked the books under the nose of their accountants and investors," Dorgan said.

Dorgan noted that Lay, Enron's chairman and chief executive, has agreed to testify at a future hearing. Dorgan also said the committee will invite Skilling, Enron's former chief executive, and Andrew Fastow, Enron's former chief financial officer, to testify at the same hearing.

"Was this just bad luck, incompetence and greed, or were there some criminal or illegal actions, as has been suggested by the accounting firm that reviewed Enron's books?" Dorgan said.

Page 1 of 2

WSJ.com



November 30, 2001

Review & Outlook

Investigating Enron

You can cut the Schadenfreude with a machete these days as Enron careens toward failure. Like any fast-rising, innovative business, the energy trader made enemies, some with a fair grievance and some not. We hope the inevitable (and necessary) investigations keep in mind the difference.

Enron was a forthright advocate of competition, as every obituary of the past few days has noted. Some see the firm's collapse as discrediting the market economics it championed, though the opposite is closer to the truth.

It strikes us that Enron was partly a victim of its own success. Its revenues quadrupled in a year, thanks to the fillip that California's troubles provided to the wholesale power market. But profits were up much less — i.e., Enron was earning thinner margins in the energy-trading business it pioneered. The new industry quickly became too competitive and transparent to afford any windfalls, just as deregulation admirers would have predicted.

Enron does not own U.S. power plants and generally did not seem to make outsized profits on power for resale in, say, California. But that didn't stop California's eccentric attorney general, Bill Lockyer, from blaming Enron CEO Ken Lay for that state's electricity mismanagement. Last summer he told a Wall Street Journal reporter that, "I would love to personally escort Lay to an 8x10 cell that he could share with a tattooed dude who says, 'Hi my name is Spike, honey." Consider that an unfair grievance.

Accounting matters are more troubling. The struggle for a century has been to make sure corporate managers don't pursue their own agendas at the expense of owners. The emergence of special partnerships, controlled and owned by Enron's own senior officers, with which the company did some of its murkiest deals, would cause even libertarians to wonder what's been going on. Clearly Mr. Lay didn't fully understand what former Enron CEO Jeffrey Skilling was up to, and shareholders weren't told either.

At the same time, Enron officers had a large amount of personal wealth tied up in Enron stock, which has fallen from \$90 to 61 cents. So the mere existence of these partnership deals does not automatically indicate corrupt intent. Only a detailed investigation can resolve whether these deals were honestly motivated, and whether Enron's (and Arthur Andersen's) interpretation of accounting rules was defensible. In any case, trial lawyers will descend to squeeze every penny out of Enron's troubles for themselves (and for shareholders or employees who held Enron stock in their 401(k)s).

As for the investigations, we hope they won't be influenced one way or another by long connections between Mr. Lay and President Bush. Even the hint of special treatment would be a political disaster, especially for an Administration that promised to clean up after Bill Clinton.

While tradition has been not to make criminal matters out of accounting scandals, exceptions have arisen recently. Federal prosecutors in Nev York have gone after Walter Forbes, who sold his company to Cendant, giving rise to what before Enron was the nation's most costly stock meltdown due to bad accounting. San Francisco prosecutors recently extracted guilty pleas from executives of Aurora Foods

02246

http://interactive.wsj.com/archive/tetrieve.egi?id=SB1007085116787679680.djm&tempade-... 11/50/01

Page 2 of 2

over their treatment of trade promotion expenses for their portfolio of "orphan" brands as capital expenditures.

Enron is an opportunity for the Bush team to show it can police similar financial chicanery, if some is found. Sorting the capitalists from the crooks is one way of protecting capitalism.

URL for this Article:

http://interactive.wsj.com/archive/retr-ave.cgi?id=SB1007086116767679680.djm

Copyright © ::001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this material is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



de



Spensored By:



November 30, 2001

Dow_Jones Newswires

White House: No Objection To Congress Probe Of Enron

Dow Jones Newswires

WASHINGTON — The Bush administration Friday said it had no objection to calls in Congress to launch hearings into the collapse of Enron and said such a move is well within Congress's jurisdiction in providing oversight.

"The president understands that at all times Congress should exercise its proper oversight role and that includes anything, in a case like this...an investigation into the collapse of a company," White House spokesman Ari Fleischer said.

Fleischer said that other parts of the federal government have already launched their own investigations and the Treasury Department is monitoring these.

-By Alex Keto, Dow Jones Newsy fres; 202-862-9256; Alex.Keto@dowjones.com

URL for this Article:

http://interactive.wsj.com/archive/retr-ave.cgl?id=DI-CO-20011130-004645.djm

Copyright © 2001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this reaterial is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



للشيانا وجريون ريه



November 30, 2001

Major Business News

U.S. Attorneys Inform Regulators They Want to Monitor Enron Probe

By Michael Schroeder Staff Reporter of THE WALL STREET JOUI NAL

WASHINGTON -- Federal prosecutors in two states have told the Securities and Exchange Commission that they are interested in monitoring the agency's investigation into possible accounting fraud at Enron Corp., as a possible precursor to a separate criminal probe, according to a person with knowledge of the situation.

Meanwhile, members of Congress announced new inquiries into the company's activities.

Enron stock's spectacular plunge the past few weeks has attracted the interest of officials in New York and Texas, including the U.S. atto neys' offices in Manhattan and Houston, this person said. Spokesmen for the U.S. attorneys' offices declined to comment.

In late October, Enron disclosed that the SEC had undertaken a formal investigation into the Houston energy company's financial dealings with partnerships headed by its former chief financial officer, Andrew Fastow.

A formal investigation involves the SEC's enforcement branch going to the five-member commission and obtaining formal subpoena power to pursue its inquiry. A person familiar with the SEC probe said the agency felt it needed subpoens power to compel the release of information by parties that have done business with Enron.

Enron's stock price has collapsed from about \$60 a share early in the year to under \$1 amid financial restatements due to improper accounting and a failed merger with crosstown rival Dynegy Inc. Shareholder and Enron employee etirement account values have been devastated by the meltdown. Criminal authorities are interested to learn if the SEC finds that malfeasance contributed to the shareprice declines.

In 4 p.m. composite trading Thurs tay on the New York Stock Exchange, Enron was at 36 cents, down 25 cents, or 41%.

If a criminal probe were undertaken, it would be handled by one office, mostly likely in Houston. Enron's hometown. But federal prisecutors in Manhattan, who have experience in securities-fraud cases, could assert jurisdiction because I'uron's stock trades on the New York Stock Exchange.

Early this year, Enron came under attack from California politicians and regulators for profiting from spiking energy prices in that state.

One reason authorities haven't begun their own investigations is the fear that a criminal probe might cause witnesses "to clam up." said the person with knowledge of the situation. 02249

http://interactive.wsj.com/archive.retrieve.cgi?id=SB1007087266825656840.djm&template=... 11/30/01

Enron officials have said they are looperating fully with the SEC, which has only been investigating Enron for about five weeks and hain't had enough time to assess possible liability of Enron executives. SEC civil allegations could lead to fines and sanctions.

SEC Chairman Harvey Pitt, who has taken some heat for some policies viewed being too soft on business, has made the Enron investigation a top priority to show he will be a tough enforcer. In remarks Thursday to the Consumer Federa ion of America, Mr. Pitt said promised a thorough and swift probe of Enron. The SEC has a team of a h lf-dozen enforcement attorneys and accountants working the case.

Gregory Bruch, a former SEC enforcement attorney who has litigated complicated accounting fraud investigations, said Enron's involvement with partnerships and extensive energy derivatives trading likely would take a year for the SEC unravel. He said the SEC would have to "cut corners" to bring a case more quickly, meaning the regulator would name fewer defendants than it might in a broader, more time-consuming case.

On Capitol Hill, the House Energy and Commerce Committee said it would investigate Enron's accounting practices and Senate Commerce Committee announced it would assess the impact on U.S. patural gas and electricity markets

Write to Michael Schroeder at mi-(e.schroeder@wsj.com)

URL for this Article:

http://interactive.wsj.com/archive/retr.ave.cgi?id=SB1007087266825656840.djm

Hyperlinks in this Article:

maitto:mike.schroeder@wsj.com

Copyright S :: 001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this reaterial is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



€017:023



icensored 9



December 2, 2001

Dow Jones Newswires

Chronology Of Enron Corp.'s History

HOUSTON (AP)--A look at the h. story of Enron Corp. (ENE):

July 1985 -Houston Natural Gas merges with InterNorth, a natural gas company based in Omaha, Neb., to form the modern-day Enron, an interstate and intrastate natural gas pipeline company with approximately 37,000 miles of pig e.

1989 -Enron begins trading nature: gas commodities. Over the years, the company becomes the largest natural gas merchant in North America and the United Kingdom.

June 1994 -Enron North America rades its first electron. Enron goes on to become the largest marketer of electricity in the U.S.

August 1997 -Enron announces it: first commodity transaction using weather derivative products. Enron goes on to market coal, pulp, paper, plastics, metals and bandwidth.

April 1999 -Enron agrees to pay \$100 million over 30 years for the naming rights to Houston's new ballpark, Enron Field. The Astros also sign a 30-year facilities management contract Enron Energy Services.

November 1999 -Enron launches inronOnline, the first global Web-based commodity trading site.

December 2000 -Erron announce: that president and chief operating officer Jeffrey Skilling will take over as chief executive in Februar:. Kenneth Lay will remain as chairman. Shares hit 52-week high of \$84.87 on Dec. 28.

August 2001 - Skilling resigns after running the company for just six months; Lay becomes CEO again.

October 16, 2001 -Enron reports a \$638 million third-quarter loss and discloses a \$1.2 billion reduction in shareholder equity, partly related to partnerships run by chief financial officer Andrew Fastow.

Oct. 22, 2001 -Enron acknowledges Securities and Exchange Commission inquiry into a possible conflict of interest related to the company's dealings with those partnerships.

Oct. 24, 2001 -Enron ousts Fastov:.

Oct. 31, 2001 -Enron announces the SEC inquiry has been upgraded to a formal investigation. Enron creates special committee headed by University of Texas law school dean William Powers to respond to the investigation.

02251

http://interactive.wsj.com/archive.jetriave.cgi?id=BT-CO-20011202-000301.djml&template=... 12/3/01

Page 2 of 2

WSJ:com

Nov. 6, 2001 -Enron's stock price dreps below \$10 a share after reports the financially troubled energy trader was seeking additional financial to shore up confidence.

Nov. 8, 2001 -Enron files document: with SEC revising its financial statements for past five years to account for \$586 million in losses.

Nov. 9, 2001 -Dynegy Inc.(DYN) ar nounces an agreement to buy its much larger rival Enron for more than \$8 billion in stock.

Nov. 14, 2001 -Enron announces it is trying to raise an additional \$500 million to \$1 billion in new private equity to shore up customer and market confidence.

Nov. 19, 2001 -Enron restates its thi d-quarter earnings and discloses it is trying to restructure a \$690 million obligation that could come due Nov. 27.

Nov. 20, 2001 -Concerns about Enren's ability to weather its spiraling financial problems send the company's stock down nearly 23% to its lowest level in nearly 10 years. Officials from both Enron and Dynegy say the merger was not in trouble.

Nov. 21, 2001 -Enron reaches critical agreement to extend \$690 million debt payment.

Nov. 26, 2001 -Enron shares fall another 15% as investors continued to doubt that the deal will completed. Shares finish day at \$4.01.

Nov. 28, 2001 -Dynegy backs out of deal after Enron's credit rating is downgraded to junk bond status; analysts say a bankruptcy filing is littely. Enron shares plunge below \$1 amid the heaviest single-day trading volume ever for a NYSE or Nasdaq-listed stock.

Dec. 2, 2001 -Enron files for Chapter 11 bankruptcy protection; sues Dynegy for wrongful termination of merger.

URL for this Article:

http://interactive.wsj.com/archive/retrieve.cgi?id=BT-CO-20011202-000301.djm

Copyright © 2011 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this material is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



Page | of 5



December 2, 2001

Dow Jones Newswires

Enrop Files For Chapter 11 Bankruptcy

HOUSTON, Dec. 2 /PRNewswire/ -- Enron Corp. (NYSE: ENE) announced today that it along with certain of its subsidiaries have filed roluntary petitions for Chapter 11 reorganization with the U.S. Bankruptcy Court for the Southern Listrict of New York. As part of the reorganization process. Enron also filed suit against Dynegy Inc. (FYSE: DYN) in the same court, alleging breach of contract in connection with Dynegy's wrongful ermination of its proposed merger with Enron and seeking damages of at least \$10 billion. Enron's lawsuit also seeks the court's declaration that Dynegy is not entitled to exercise its option to acquire an Enron subsidiery that indirectly owns Northern Natural Gas Pipeline. Proceeds from the lawsuit would be: afit Enron's creditors.

In a related development sixed at preserving value in its North American wholesale energy trading business. Enror said that it is in active discussions with various leading "financial institutions to provide credit support for recapitalize and revitablize that business under a new ownership structure. It is auticapated that Enron would provide the new entity with traders, back office capabilities and technology from Enron's North American wholesale energy business, and that the new entity would conduct counterparty transactions through EnronDuline, the company's existing energy training platform. Any such arrangement would be subject to the approval of the Bankruptoy Court.

02253

In connection with the company's Chapter 11 filings, Enron is in active discussions with leading financial institutions for debtor-in-pussession (DIP) financing and expects to complete these discussions shortly. Upon the completion and court approval of these arrangements, the new funding will be available immediately on an interim basis to supplement Enron's existing capital and help the company fulfill obligations associated with operating its business, including its employee payroll and payments to vendors for goods and services provided on or after today's filing.

Filings for Chapter 11 reorganization have been made for a total of 14 affiliated entities, including Enron Corp.; Enron North America Torp., the company's wholesale energy trading business; Enron Energy Services, the company's retail energy marketing operations: Enron Transportation Services, the holding company for Enron's pipeline operations; Enron Broadband Services, the company's bandwidth trading operation; and Enron Metals & Commodity Corp.

Enron-related entities not included in the Chapter 11 filing are not affected by the filing. These nonfiling entities include Northern Natural Gas Pipeline, Transwestern Pipeline, Florida Gas Transmission. EOTT, Portland General Electric and numerous other Enron international entities.

To conserve capital, Enron will implement a comprehensive cost-saving program that will include substantial workforce reductions. These workforce reductions primarily will affect the company's

http://interactive.wsj.com/archiverterrieve.egi?id=DI-CO-20011202-000436.djml&template=;... 12/3/01

Page 2 of 5 -WSJ.com

operations in Houston, whale Entry , currently employs approximately 7,500 people, in addition, the company will continue its accelers of program to divest or wind down non-core assets and operations. Details of the units to be affected will be communicated shortly.

The Dynegy Lawsuit

In its lawsuit filed today in U.S. Bankruptcy Court in New York, Enron alleges, among other things, that Dynegy breached its Merger Agreement with Enron by terminating the agreement when it had no contractual right to do so; and that Dynegy has no right to exercise its option to acquire the entity that indirectly owns the Northern Natural Gas pipeline because that option can only be triggered by a valid termination of the Merger Agreem int.

The Chapter 11 Filings

In conjunction with today's petitions for Chapter 11 reorganization. Enron will ask the Bankruptcy Court to consider a variety of "first day ruotions" to support its employees, vendors, trading counterparties, customers and other constituents. These include motions seeking court permission to continue payments for employee payroll and health benefits; obtain interim financing authority and maintain cash management programs; and retain legal, financial and other professionals to support the company's reorganization actions. In accordance with applicable law and court orders, vendors and suppliers who provided goods or services to Enre n Corp. or the subsidiaries that have filed for Chapter 11 protection before today's filing may have pre-petition claims, which will be frozen pending court authorization of payment or consummation of a plan of reorganization.

The Wholesale Energy Trading Business

The discussions currently underwry with various leading financial institutions are aimed at obtaining credit support for, recapitalizing and revitalizing Enron's North American wholesale energy trading operations under a new ownership structure in which Erron would continue to have a significant ownership interest.

"If these discussions are successful, they could result in the creation of a new trading entity with a strong and unencumbered balance sheet, the industry's finest trading team, and its leading technology platform. all backed by one or more of the v orld's leading financial institutions," said Greg Whalley, Enron president and chief operating officer. "We understand that it may take time for counterparties to resume normal trading levels with this entity, but we are confident that this business can be put back on a solid footing. Obviously, our potential partners share our confidence or they would not be at the table with us. We intend to take steps to retain employees who are key to the future success of our wholesale energy trading business and to regain the support and confidence of its trading counterparties."

Comment by Ken Lay

02254

"From an operational standpoint, our energy businesses-including our pipelines and utilities-are conducting normal operations and will continue to do so, " said Kenneth L. Lay, chairman and CEO of Enron, "While uncertainty during the past few weeks has severely impacted the market's confidence in Enron and its trading operations, we are taking the steps announced today to help preserve capital. stabilize our businesses, restore the confidence of our trading counterparties, and enhance our ability to pay our creditors." Enron's principal legal advisor with regard to the proposed merger with Dynegy, Enron's Chapter 11 filings, the Dynegy lawsuit, and related matters is Weil, Gotshal & Manges LLP. Enron's principal financial adviso with regard to its financial restructuring is The Blackstone Group.

http://interactive.wsj.com/archive/retrieve.ogi?jd=DI-CO-20011202-000436.djml&tzmplate=j.... 12-3/01

Page 3 of 5

About Erron Corp.

Enron Corp. markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is www.enron.com.

Forward-looking Statements

This press release contains statements that are forward-looking within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Investors are cautioned that any such forward-locking statements are not guarantees of future performance and that actual results could differ materially as a result of known and unknown risks and uncertainties, including: various regulatory issues, the outcome of the Chapter 11 process, the outcome of the discussions referred to above, gene all economic conditions, future trends, and other risks, uncertainties and factors disclosed in the Company's most recent reports on Forms 10-K. 10-Q and 8-K filed with the Securities and Exchange Commission. SOURCE Enron Corp.

"CONTACT: Mark Palmer, -1-713-853-4738, or Karen Denne, -1-715-853-9757, both of Euron.

.Web site: http://www.enron.com/

(ENE DYN)

NEW YORK -- Enron Corp. (ENE announced Sunday that it and some of its subsidiaries have filed voluntary petitions for Chapter 11 reorganization with the U.S. Bankruptcy Court for the Southern District of New York.

The company said that it had also fied suit against Dynegy Inc. (DYN) in the same court, alleging breach of contract in connection with Dynegy's wrongful termination of its proposed merger with Enron and seeking damages of at least S10 billion.

Enron's lawsuit also seeks the court's declaration that Dynegy is not entitled to exercise its option to acquire an Enron subsidiary that incirectly owns Northern Natural Gas Pipeline.

Enron said the proceeds from the lawsuit would benefit its creditors.

Enron said that it is in "active discussions" with financial institutions to recapitalize and provide credit support for its North American ene gy trading business under a new ownership structure.

Enron said in a statement that "it is anticipated" that the company would provide the new entity with traders, back office capabilities and technology. The new entity would conduct counterparty transactions through EnronOnline, the company's existing energy trading platform. Any such arrangement would be subject to the approval of the Bank: uptey Court, Enron said in the statement.

To conserve capital, Enron will implement a comprehensive cost-saving program that will include substantial workforce reductions.

These cuts will primarily affect the company's operations in Houston, where Enron currently employs approximately 7,500 people.

02255

http://interactive.wsj.com/archive.retrieve.egi?id=DI-CO-20011202-000436.djmi&template=p... 12/3/01

-WSLcom Page 4 of 5

In addition, the company will continue its accelerated program to divest or wind down non-core assets and operations.

Details of the units to be affected will be communicated shortly, the company said in its sustement.

Enron said Chapter 11 filings were made for 14 affiliated entities, including Enron Corp.: Enron North America Corp., the company's whole sale energy trading business; Enron Energy Services, the retail energy marketing business; Enron Transportation Services, the holding company for Enron's pipeline operations: Enron Broadband Services, a bandwidth trading operation; and Enron Metals & Commedity Corp.

Enron-related entities not included in the bankruptcy filing are not affected by the filing, Enron said. These non-filing entities include Northern Natural Ges Pipeline, Transwestern Pipeline, Florida Gas Transmission. EGTT, Portland Gent at Electric and numerous other Enron international entities.

Enron said that "from an operational standpoint, our energy businesses-including our pipelines and utilities-are conducting normal operations and will continue to do so."

The company said that although "un-ertainty during the past few weeks has severely impacted the market's confidence in Enron and its trading operations," Enron intends to "help preserve capital, stabilize our businesses, restore the confidence of our trading counterparties, and enhance our ability to pay our creditors."

In connection with Enron's Chapter 1 fillings, the company is in "active discussions with leading financial institutions" for debtor-in-1 assession financing and expects to complete these discussions shortly.

Upon the completion and court approval of these arrangements, the new funding will be available immediately on an interim basis to supplement Enron's existing capital and help fulfill obligations including payroll and payments to vindors. Enron said.

Enron will ask the bankruptcy court to consider a variety of "first day motions" to support its employees, vendors, trading counterparties, cust there and other constituents. These include motions seeking permission to continue payments for employee payroll and health benefits; obtain interim financing authority and maintain cash management programs; and retain legal, financial and other professionals.

The company said its legal adviser for the lawsuit and proposed merger with Dynegy and Enron's Chapter 11 filing is Weil Gotshal & Manges LLP. Enrop's principal financial adviser for its financial restructuring is The Blackstone Group.

Enron, which hopes to have a "significant ownership interest" in the proposed new entity that owns its North American wholesale energy triding operations, said "we understand that it may take time for counterparties to resume normal tracing levels with this entity, but we are confident that this business can be put back on a solid footing."

Dynegy terminated its plan to acquire Enron on Wednesday after credit-rating agencies downgraded a major portion of Enron's debt to "jurk" status. Enron's energy trading ground almost to a halt because trading partners became worried about Enron's finances.

Bankers involved in Enron's restruct tring discussions estimate that liabilities total \$40 billion, including

02256

http://interactive.wsj.com/sychive.re/rieve.egi?id=DI-CO-20011202-000436.djm/&temptate=j... 12.5-01

Page 5 of 5

\$13 billion in debt on its balance shellt. The Wali Street Journal reported.

Enron shares closed Friday at 26 cents, down 70 cents. The stock reached as high as \$40 little over a year age.

Company Web site http://www.care.uemn

u 7.1, den esta Arcibie: http://nemative.com/grammeran nemative ningif.p=D+OD-4.ppnn203-603428 gj=

Cognification of a Laboratory & Company, and All Rights Reserved.

Promiting, Clariford, in more was of their more than I gas exped by your fail experience and expendent and expendent and expendent

File at the material of successfully given in segrif sequence

O Date Windswift

a.

02257

http://interactive.wsj.com/archive.rs/ideve.cgi?id=DI-CO-20011202-000436.djml&template=j... 12/3/01



November 29, 2001

Major Business News

Enron CEO's Political Connections Run Silent During Company's Crisis

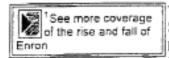
By BG's DAVIS Staff Reporter of THE WALL STREET JOURNAL

For years, Enron Corp. Chairman Kenneth Lay has been George W. Bush's best friend in the board rooms of America's top corporations.

Since 1993, Mr. Lay and Enron have donated nearly \$2 million to Mr. Bush's political career, making them Mr. Bush's biggest backers. When Mr. Bush was Texas governor, Mr. Lay, a Houston resident, helped him win passage of a state education-reform plan that brought Mr. Bush national acclaim. During that fight, Mr. Lay got to know aides who became power players in the Bush White House.

Mr. Lay was confident enough of his friendship with Mr. Bush that he even needled him for needing arthroscopic surgery to repair a jogging injury. "I want you to know that at least one jogger [me] got past 50 without that surgery," Mr. Lay scribbled in a note to then governor in 1997.

Still, as Enron faces its greatest critis, Mr. Lay's influence and personal relationships with the administration have amounted to little. There appears to be no effort by the White House or Congress to bail Enron out of its difficulties, which are widely seen as self-inflicted. The White House had no comment on Mr. Lay's predicament, a spokeswoman said. Indeed, short of an actual bailout to help Enron meet its obligations — such as an aid package approved by Congress or organized by government officials from private sources, similar to the rescue of the Long Term Capital Management hedge fund—there is little Washington can do at this stage to help the company. Nor is there likely to be a bailout, since Enron has burned many bridges on Capital Hill with its history of strong-arm lobbying tactics, some congressional aides say.



That may reassure a cynical public, says Robert Mosbacher, Commerce Secretary in the first Bush administration and a longtime friend of the current president as well as Mr. Lay. "I don't see anybody being let off the hook," he said

Mr. Mosbacher says he introduced Mr. Lay to the Bush family around 1987, when he persuaded Mr. Lay to help raise money for George H.W. Bush's successful presidential bid in 1988. Mr. Lay contributed \$461,000 to the younger Mr. Bush's two successful gubernatorial campaigns. He also made Enron's fleet of corporate jets available to Mr. Bush and won his help in lobbying officials in other states considering Enron projects.

His influence with then-Gov. Bust, was based on more than money. Mr. Lay was one of the state's leading business executives and deeply involved in Texas politics. Under Mr. Bush's predecessor, Democrat Ann Richards, Mr. Lay headed the Governor's Business Council, a state advisory board. Mr. Bush asked him to stay on the job o help develop an educational reform plan and sell it to the Texas Legislature.

Page 2 of 2

wSJ.com

In that capacity. Mr. Lay became close to several Bush aides, including political guru Karl Rove and communications adviser Karen Hughes, who have taken positions at the White House. He also got to know another leading Texas busines, man: Dick Cheney, then CEO of Dallas oil concern Halliburton Co., who would become Mr. Bush's pick for vice president.

Against this backdrop, Mr. Lay was widely considered a top candidate for Treasury Secretary in the younger Bush's administration. Ultin ately though, he was disqualified, Bush insiders say, as too closely identified with Mr. Bush, Mr. Cheney and others who worked in the Texas energy business for an administration that wanted to show it wasn't in the pocket of big oil companies.

Early on, Mr. Lay had unrivaled access to the administration. When the president's advisers debated a new energy policy in the spring, Mr. Lay was the only energy executive to be invited for a one-on-one session with Mr. Cheney, who led the effort. Mr. Lay also worked with Mr. Rove and others to successfully push for appointments to the Federal Energy Regulatory Commission, which oversees much of Enron's business.

As Enron's problems multiplied and its fortunes plummeted, however, the White House was silent. During a several-hour long interview in the spring, Mr. Lay mused that his Bush connections could be be be be been someday. "It could hurt, from the standpoint that, at some point, they lean in the other direction to make sure they don't fac: criticism," he said.

Write to Bob Davis at bob.davis@wisj.com2

URL for this Article:

http://interactive.wsj.com/archive/retrieve.cgi?id=SB1006987787276109720.djm

Hyperlinks in this Article:

- (1) http://interactive.wsj.com/pages/enrc npage.htm
- (2) mailto:bob.davis@wsj.com

Copyright © 2001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this material is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



Page 2 of 2

Enron officials have said they are looperating fully with the SEC, which has only been investigating Enron for about five weeks and hain't had enough time to assess possible liability of Enron executives. SEC civil allegations could lead to fines and sanctions.

SEC Chairman Harvey Pitt, who has taken some heat for some policies viewed being too soft on business, has made the Enron investigation a top priority to show he will be a tough enforcer. In remarks Thursday to the Consumer Federation of America, Mr. Pitt said promised a thorough and swift probe of Enron. The SEC has a team of a half-dozen enforcement attorneys and accountants working the case.

Gregory Bruch, a former SEC enforcement attorney who has litigated complicated accounting fraud investigations, said Enron's involvement with partnerships and extensive energy derivatives trading likely would take a year for the SEC unravel. He said the SEC would have to "cut corners" to bring a case more quickly, meaning the regulator would name fewer defendants than it might in a broader, more time-consuming case.

On Capitol Hill, the House Energy and Commerce Committee said it would investigate Enron's accounting practices and Senate Commerce Committee announced it would assess the impact on U.S. natural gas and electricity markets

Write to Michael Schroeder at mi-ce.schroeder@wsj.com1

URL for this Article:

http://interactive.wsj.com/archive/retr.ave.cgi?id=SB1007087266825656840.djm

Hyperlinks in this Article:

mailto:mike.schroeder@wsj.com

Copyright © ::001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this material is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com





Spansored B

DOCUMENT OUTFUT SOLUTIONS

December 2, 2001

Dow Jones Newswires

Chronology Of Enron Corp.'s History

HOUSTON (AP) -- A look at the history of Enron Corp. (ENE):

July 1985 -Houston Natural Gas merges with InterNorth, a natural gas company based in Omaha, Neb., to form the modern-day Enron, an interstate and intrastate natural gas pipeline company with approximately 37,000 miles of pipe.

1989 -Enron begins trading natural gas commodities. Over the years, the company becomes the largest natural gas merchant in North America and the United Kingdom.

June 1994 -Enron North America rades its first electron. Enron goes on to become the largest marketer of electricity in the U.S.

August 1997 -Enron announces it: first commodity transaction using weather derivative products. Enrongoes on to market coal, pulp, paper, plastics, metals and bandwidth.

April 1999 -Enron agrees to pay \$100 million over 30 years for the naming rights to Houston's new ballpark, Enron Field. The Astros also sign a 30-year facilities management contract Enron Energy Services.

November 1999 -Enron launches EnronOnline, the first global Web-based commodity trading site.

December 2000 -Enron announce: that president and chief operating officer Jeffrey Skilling will take over as chief executive in February. Kenneth Lay will remain as chairman. Shares hit 52-week high of \$84.87 on Dec. 28.

August 2001 - Skilling resigns after running the company for just six months; Lay becomes CEO again.

October 16, 2001 -Enron reports: \$638 million third-quarter loss and discloses a \$1.2 billion reduction in shareholder equity, partly related to partnerships run by chief financial officer Andrew Fastow.

Oct. 22, 2001 -Enron acknowledges Securities and Exchange Commission inquiry into a possible conflict of interest related to the company's dealings with those partnerships.

Oct. 24, 2001 -Enron ousts Fastov:

Oct. 31, 2001 -Enron announces the SEC inquiry has been upgraded to a formal investigation. Enron creates special committee headed by University of Texas law school dean William Powers to respond to the investigation.

02261

http://interactive.wsj.com/archive.tetrieve.egi?id=BT-CO-20011202-000301.djml&template=... 12/3/01

Page 2 of 2

Nov. 6, 2001 -Enron's stock price dreps below \$10 a share after reports the financially troubled energy trader was seeking additional financial to shore up confidence.

Nov. 8, 2001 -Enron files document: with SEC revising its financial statements for past five years to account for \$586 million in losses.

Nov. 9, 2001 -Dynegy Inc.(DYN) ar nounces an agreement to buy its much larger rival Enron for more than S8 billion in stock.

Nov. 14, 2001 -Enron announces it is trying to raise an additional \$500 million to \$1 billion in new private equity to shore up customer and market confidence.

Nov. 19, 2001 -Enron restates its thi d-quarter earnings and discloses it is trying to restructure a \$690 million obligation that could come due Nov. 27.

Nov. 20, 2001 -Concerns about Enr. a's ability to weather its spiraling financial problems send the company's stock down nearly 23% to its lowest level in nearly 10 years. Officials from both Enron and Dynegy say the merger was not in trouble.

Nov. 21, 2001 -Enron reaches critical agreement to extend \$690 million debt payment.

Nov. 26, 2001 -Enron shares fall another 15% as investors continued to doubt that the deal will completed. Shares finish day at \$4.01.

Nov. 28, 2001 -Dynegy backs out of deal after Enron's credit rating is downgraded to junk bond status; analysts say a bankruptcy filing is littely. Enron shares plunge below \$1 amid the heaviest single-day trading volume ever for a NYSE or Nasdaq-listed stock.

Dec. 2, 2001 -Enron files for Chapter 11 bankruptcy protection; sues Dynegy for wrongful termination of merger.

URL for this Article:

http://interactive.wsj.com/archive/retrieve.cgi?id=BT-CO-20011202-000301.djm

Copyright © 2001 Dow Jones & Company, Inc. All Rights Reserved.

Printing, distribution, and use of this material is governed by your Subscription Agreement and copyright laws.

For information about subscribing, go to http://wsj.com



02262

http://interactive.wsj.com/archive/t/trieve.egi?id=BT-CO-20011202-000301.djml&template=... 12/3/01



December 2, 2001

Dow Jones Newswires

Enrop Files For Chapter 11 Bankruptcy

HOUSTON, Dec. 2 /PRNewswire/ -- Enron Corp. (NYSE: ENE) announced today that it along with certain of its subsidiaries have filed coluntary petitions for Chapter 11 reorganization with the U.S. Bankruptcy Court for the Southern District of New York. As part of the reorganization process, Enron also filed suit against Dynegy Inc. (PYSE: DYN) in the same court, alleging breach of contract in connection with Dynegy's wrongful termination of its proposed merger with Enron and seeking damages of at least \$10 billion. Enron's lawsuit also seeks the court's declaration that Dynegy is not entitled to exercise its option to acquire an Enron subsidiary that indirectly owns Northern Natural Gas Pipeline. Proceeds from the lawsuit would be: efit Enron's creditors.

In a related development simed at preserving value in its North American wholesale energy trading business. Enron said that it is in active discussions with various leading financial institutions to provide credit support for, recapitalize and revitabline that business under a new ownership structure. It is auticipated that Enron would provide the new entity with traders, back office capabilities and technology from Inron's North American wholesale energy business, and that the new entity would conduct counterparty transactions through EnronOnline, the company's existing energy trading platform. Any such arrangement would be subject to the approval of the Sankruptcy Court.

02263

In connection with the company's Chapter 11 filings, Enron is in active discussions with leading financial institutions for debtor-in-phasession (DIP) financing and expects to complete these discussions shortly. Upon the completion and court approval of these arrangements, the new funding will be available immediately on an interim basis to supplement Enron's existing capital and help the company fulfill obligations associated with operating its business, including its employee payroll and payments to vendors for goods and services provided on or after today's filing.

Filings for Chapter 11 reorganization have been made for a total of 14 affiliated entities, including Enron Corp.; Enron North America Corp., the company's wholesale energy trading business; Enron Energy Services, the company's retail energy marketing operations; Enron Transportation Services, the holding company for Enron's pipelir e operations; Enron Broadband Services, the company's bandwidth trading operation; and Enron Metals & Commodity Corp.

Enron-related entities not included in the Chapter 11 filing are not affected by the filing. These non-filing entities include Northern Natural Gas Pipeline, Transwestern Pipeline, Florida Gas Transmission. EOTT, Portland General Electric and numerous other Enron international entities.

To conserve capital, Euron will implement a comprehensive cost-saving program that will include substantial workforce reductions. These workforce reductions primarily will affect the company's

http://interactive.wsj.com/archive/re-rieve.egi?id=DI-CO-20011202-000436.djml&template=j... 12/3/01

Page 2 of 5

-WSJ.com

operations in Houston, where Enrol currently employs approximately 7.500 people. In addition, the company will continue its accelerated program to divest or wind down non-core assets and operations. Details of the units to be affected will be communicated shortly.

The Dynegy Lawsuit

In its lawsuit filed today in U.S. Benkruptcy Court in New York, Enron alleges, among other things, that Dynegy breached its Merger Agreement with Enron by terminating the agreement when it had no contractual right to do so; and that Dynegy has no right to exercise its option to acquire the entity that indirectly owns the Northern Natural Gas pipeline because that option can only be triggered by a valid termination of the Merger Agreement.

The Chapter 11 Filings

In conjunction with today's petitions for Chapter 11 reorganization, Enron will ask the Bankruptcy Court to consider a variety of "first day motions" to support its employees, vendors, trading counterparties, customers and other constituents. These include motions seeking court permission to continue payments for employee payroll and health benefits; obtain interim financing authority and maintain cash management programs; and retain legal, financial and other professionals to support the company's reorganization actions. In accordance with applicable law and court orders, vendors and suppliers who provided goods or services to Enron Corp. or the subsidiaries that have filed for Chapter 11 protection before today's filing may have pre-petition claims, which will be frozen pending court authorization of payment or consummation of a plan of reorganization.

The Wholesale Energy Trading Business

The discussions currently underway with various leading financial institutions are aimed at obtaining credit support for, recapitalizing a id revitalizing Enron's North American wholesale energy trading operations under a new ownership structure in which Enron would continue to have a significant ownership interest.

"If these discussions are successful, they could result in the creation of a new trading entity with a strong and unencumbered balance sheet, the industry's finest trading team, and its leading technology platform, all backed by one or more of the world's leading financial institutions," said Greg Whalley. Enron president and chief operating officer. "We understand that it may take time for counterparties to resume normal trading levels with this entity, but we are confident that this business can be put back on a solid footing. Obviously, our potential partners share our confidence or they would not be at the table with us. We intend to take steps to retain employees who are key to the future success of our wholesale energy trading business and to regain the support and confidence of its trading counterparties."

Comment by Ken Lay

02264

"From an operational standpoint, our energy businesses-including our pipelines and utilities-are conducting normal operations and will continue to do so, " said Kenneth L. Lay, chairman and CEO of Enron. "While uncertainty during the past few weeks has severely impacted the market's confidence in Enron and its trading operations, we are taking the steps announced today to help preserve capital, stabilize our businesses, restore the confidence of our trading counterparties, and enhance our ability to pay our creditors." Enron's principal legal advisor with regard to the proposed merger with Dynegy, Enron's Chapter 11 filings, the Dynegy lawsuit, and related matters is Weil, Gotshal & Manges LLP. Enron's principal financial advisor with regard to its financial restructuring is The Blackstone Group.

Page 3 of 5

About Enrop Corp.

Enron Corp. markets electricity and natural gas, delivers energy and other physical commodities, and provides financial and risk management services to customers around the world. Enron's Internet address is www.enron.com.

Forward-looking Statements

This press release contains statements that are forward-looking within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and that actual results could differ materiall; as a result of known and unknown risks and uncertainties, including: various regulatory issues, the outcome of the Chapter 11 process, the outcome of the discussions referred to above, general economic conditions, future trends, and other risks, uncertainties and factors disclosed in the Company's most recent reports on Forms 10-K. 10-Q and 8-K filed with the Securities and Exchange Commission. SOURCE Euron Corp.

CONTACT: Mark Palmer. -1-713-853-4738, or Karen Denne. --1-713-853-9757, both of Enron.

Web site: http://www.enron.com/

(ENE DYN)

NEW YORK -- Enron Corp. (ENE announced Sunday that it and some of its subsidiaries have filed voluntary petitions for Chapter 11 reorganization with the U.S. Bankruptcy Court for the Southern District of New York.

The company said that it had also fied suit against Dynegy Inc. (DYN) in the same court, alleging breach of contract in connection with Dynegy's wrongful termination of its proposed merger with Enron and seeking damages of at least S10 billion.

Enron's lawsuit also seeks the court's declaration that Dynegy is not entitled to exercise its option to acquire an Enron subsidiary that incirectly owns Northern Natural Gas Pipeline.

Enron said the proceeds from the lawsuit would benefit its creditors.

Enron said that it is in "active discussions" with financial institutions to recapitalize and provide credit support for its North American energy trading business under a new ownership structure.

Enron said in a statement that "it is anticipated" that the company would provide the new entity with traders, back office capabilities and technology. The new entity would conduct counterparty transactions through EnronOnline, the company's existing energy trading platform. Any such arrangement would be subject to the approval of the Bank uptcy Court, Enron said in the statement.

To conserve capital, Enron will implement a comprehensive cost-saving program that will include substantial workforce reductions.

These cuts will primarily affect the company's operations in Houston, where Enron currently employs approximately 7,500 people.

02265

http://interactive.wsj.com/archive.retrieve.egi?id=DI-CO-20011202-000436.djml&template=j... 12/3/01

Page 4 of 5

In addition, the company will continue its accelerated program to divest or wind down non-core assets and operations.

Details of the units to be affected will be communicated shortly, the company said in its statement.

Enron said Chapter 11 filings were n ade for 14 affiliated entities, including Enron Corp.; Enron North America Corp., the company's whole sale energy trading business; Enron Energy Services, the retail energy marketing business; Enron T: ansportation Services, the holding company for Enron's pipeline operations; Enron Broadband Services, a bandwidth trading operation; and Enron Metals & Commodity Corp.

Enron-related entities not included in the bankruptcy filing are not affected by the filing, Enron said. These non-filing entities include Northern Natural Gas Pipeline, Transwestern Pipeline, Florida Gas Transmission. EOTT, Portland General Electric and numerous other Enron international entities.

Enron said that "from an operational standpoint, our energy businesses-including our pipelines and utilities-are conducting normal operations and will continue to do so."

The company said that although "une ertainty during the past few weeks has severely impacted the market's confidence in Enron and its trading operations," Enron intends to "help preserve capital, stabilize our businesses, restore the confidence of our trading counterparties, and enhance our ability to pay our creditors."

In connection with Enron's Chapter 1 fillings, the company is in "active discussions with leading financial institutions" for debtor-in-possession financing and expects to complete these discussions shortly.

Upon the completion and court approval of these arrangements, the new funding will be available immediately on an interim basis to supplement Enron's existing capital and help fulfill obligations including payroll and payments to vandors, Enron said.

Enron will ask the bankruptcy court to consider a variety of "first day motions" to support its employees, vendors, trading counterparties, cust imers and other constituents. These include motions seeking permission to continue payments for employee payroll and health benefits; obtain interim financing authority and maintain cash management programs; and retain legal, financial and other professionals.

The company said its legal adviser for the lawsuit and proposed merger with Dynegy and Enron's Chapter 11 filing is Weil Gotshal & Manges LLP. Enron's principal financial adviser for its financial restructuring is The Blackstone Group.

Erron, which hopes to have a "significant ownership interest" in the proposed new entity that owns its North American wholesale energy trading operations, said "we understand that it may take time for counterparties to resume normal tracing levels with this entity, but we are confident that this business can be put back on a solid footing."

Dynegy terminated its plan to acquite Enron on Wednesday after credit-rating agencies downgraded a major portion of Enron's debt to "jurk" status. Enron's energy trading ground almost to a halt because trading partners became worried about Enron's finances.

Bankers involved in Enron's restructuring discussions estimate that liabilities total \$40 billion, including

02266

http://interactive.wsj.com/archive/retrieve.egi?id=DI-CO-20011202-000436.djml&tempfate=j... 12/3/01

Page 5 of 5

\$13 billion in debt on its balance she t. The Wall Street Journal reported.

Enron shares closed Friday at 16 cen s, down 10 cents. The stock reached as high as 590 little over a year age.

Company Web site: http://www.east/u.com

UFILI demokis Arciolas http://nitercotyes.co.j.com.Zrod.ne restres - pg/htte/Dr-200-30011203/000428 bjm

Copy Figur 3.2 — Bow follow & Company, Inc. All Regard Reserved.

Princing dustribution and one visual met sixt, governed by your Subscription Agreement and capacity laws.

ð.

For information of our subscribery, golds, styri wyjane:

Colse Hindaws

10

Carleton, Norman

From:

Nickoloff, Peter

Sent:

Thursday, December 27, 2001 4:10 PM

To:

Carleton, Norman; 'Alexander M. Brill (E-mail)'; 'ddow@cftc.gov'; Novey, Michael; Hammer, Viva; Eichner, Matthew; Gabilondo, Jose; Sutton, Gary; Ellett, Martha; Schultheiss, Heidilynne; 'Amy Mitchell (E-mail)'; 'Annette Nazareth (E-mail)'; 'Belinda Blaine (E-mail)'; 'Bob Colby (Email)'; 'David Wall'; 'Diane Virzera'; Eichner, Matthew; 'Elizabeth Fox (E-mail)'; 'Eric Hirschhorn (E-mail)': Hammer, Viva; 'John Polise (E-mail)'; 'Joyce Hansen'; 'Kathryn Dick (E-mail)'; 'Kurt Wilhelm (E-mail)"; "Lori Sanatamorena (E-mail)"; "Miguel Browne"; Novey, Michael; 'Pat

Parkinson (E-mail)'; 'Pat White'; 'k. philippa_malmgren@opd.eop.gov';

'dombalagiano@sec.gov'

Roseboro, Brian; Bitsberger, Timothy; Gross, Jared; Stokes, Veronica; Barbour, Gaylen;

Smith, Amy, Holahan, Betsy, Wiedman, Mark, Bair, Shella, Bradshaw, Tara

Subject:

Cc:

Joint Report on Retail Swaps



The transmittal letters were signed and dated vesterday, December 26, 2001. They were delivered, along with the report, to the offices of the Speaker and the President of the Senate this afternoon. Additional copies of the report will be forwarded to members and selected staff of the House Financial Services Committee and the Senate Banking Committee later today and tomorrow.

We will put copies for your agencies in the mail tomorrow. In the meantime, the report (sans signatures) is available today on Treasury's website at http://www.treas.gov/press/today.htm. Later it should be available at http://www.treas.gov/press/releases/01report.htm. Also, I have attached a copy of the report to this message.

Thanks to all of you for your work on this report.

Happy New Year,

Peter Nickoloff Office of Federal Finance Policy Analysis U.S. Department of the Treasury Room 5011 MT Washington, D.C. 20220

202/622-1692 f. 202/622-0974

peter.nickoloff@do.treas.gov e.

Carleton, Norman

From:

Nickoloff, Peter

Sent: To: Tuesday, December 04, 2001 12:02 PM Carleton, Norman; Schultheiss, Heidilynne

Subject:

Some EnronOnline stories from Internetweek.com

In no particular order...

Friday, November 30, 2001, 5:52 PM ET.

UPDATE: EnronOnline Still Trading

By Jade Boyd

While a bankruptcy filing by troubled energy trader Enron Corp. is widely expected, the company says it continues to trade more than 400 products at its online trading exchange, EnronOnline.

An Enron spokesman said Enron traders are still actively making trades via EnronOnline in 472 products. Most trades are in core energy products like natural gas and electricity, but Enron also continues to trade paper and forest products, said company spokesman Eric Thode.

Enron averaged about 5,000 trades per day on its site prior to November. The company conducted about 1,000 trades Thursday, when only 62 products were sold online, Thode said.

Analysts say traders from other companies aren't establishing new positions with Enron, so virtually all of Enron's current trade volume represents trades by people who are closing out existing positions to limit exposure to Enron.

Since Enron did a huge volume of trade online -- about \$600 billion since EnronOnline went live in November 1999 -- it may take weeks for trading to wind down completely, said Peter Fusaro, president of the energy consulting firm Global Change Associates.

The bigger question is how long Enron can finance its trading operation. Fusaro said a bankruptcy filing might make it easier for Enron to raise the cash it needs to fund trading operations, but that won't restore trader confidence in the company.

Since Enron is a party to every trade on its site, either as buyer or seller, it's vital that trading partners have confidence in Enron's ability to stand behind the deals it makes. Analysts say that confidence is lacking, and an infusion of cash won't be enough to restore it.

Wednesday, November 28, 2001, 4:15 PM ET.

UPDATE: Enron-Dynegy Deal Collapses; EnronOnline Temporarily Halts Trading

By Jade Boyd

Dynegy Inc. has cancelled its proposed \$8 billion merger offer for fellow energy trader Enron Corp. Trading on Enron's pioneering exchange, EnronOnline, was halted temporarily today in response to

the news.

The future of Enron is now in question as credit-rating agencies today downgraded the company's bonds to junk status, triggering the payment of more than \$3 billion in outstanding debts.

Enron spokesman Eric Thode said all trading was halted on EnronOnline this morning in the wake of the Dynegy announcement, but trading of core energy products, such as natural gas, resumed this afternoon. At no time was telephone trading suspended, he said.

Enron's online business model is different from most independent exchanges, which link buyers and sellers. Enron is a party to all transactions at its site, acting as either the buyer or seller. Enron makes its profits by buying low and selling high, and employs an army of analysts to compile information that could affect future prices on natural gas, electricity and the 1,500 other commodities it trades online.

Thode declined to comment on reports this week that Enron traders were working to help valued customers by brokering deals between buyers and sellers.

"We're still in the market, and we're still conducting transactions that make commercial sense," said Thode.

Even before halting trading today, activity on Enron's Web-based exchange, EnronOnline, has reportedly fallen steeply in recent weeks as trading partners abandon the site in favor of deals with more stable firms. Dynegy and a number of other energy traders do business online, but none in volumes approaching EnronOnline, which pioneered the field and once saw trade volumes in excess of \$4 billion per day.

Enron's Thode, however, said that trade volumes on EnronOnline have not declined signficantly in recent weeks.

Over the past 30 days, the site has averaged about 5,300 trades per day, with a total value of \$2.7 billion, Thode said. That's well within the average volumes seen on the site during any 30-day period this year, Thode said.

The New York Stock Exchange halted trading of Enron shares ahead of the Dynegy announcement, but Enron's stock had already lost \$2.95, or 71.3 percent of its value on rumors of the dissolution. Trading was halted at \$1.19. Enron's stock traded at more than \$90 last August.

Dynegy cancelled the deal citing "breaches of representations, warranties, covenants and agreements in the merger agreement."

Dynegy had sought to renegotiate the terms of the merger after Enron's stock price continued to plummet in the wake of the Nov. 9 merger announcement.

Dynegy's announcement came as Standard & Poor's, Moody's Investors Service and Fitch, Inc. downgraded Enron's long-term debt to below investment-grade status. The loss of investment-grade credit means that more than \$3 billion in debts to off-balance sheet partnerships are due immediately.

In a prepared statement, Enron said it is "taking actions designed to preserve value in the company's core trading and other energy businesses." Enron said it is temporarily suspending all payments other than those necessary to maintain core operations.

"With Dynegy's termination of the merger and the ratings agency downgrades, we are evaluating and exploring other options to protect our core energy businesses," Enron Chairman and CEO Kenneth L. Lay said in the prepared statement. "To do this, we will work to retain the employees necessary to

2

the continuing operations of our trading and other core energy businesses."

In canceling the proposed merger, Dynegy said it would exercise its option to buy Enron's Northern Natural Gas Pipeline, something it was entitled to because Dynegy's partner, ChevronTexaco, pumped \$1.5 billion cash into Enron when the Nov. 9 merger agreement was struck.

Many in the industry believe Enron will be forced to file bankruptcy as a result of the Dynegy pull-out.

Enron would not comment on whether a bankruptcy filing is in the works, but the company says it is reviewing its option to repay Dynegy the \$1.5 billion cash, which would allow it to retain Northern Natural Gas Pipeline.

Should Enron file for bankruptcy protection, it would be the largest corporate bankruptcy in U.S. history. Enron's third quarter balance sheet lists \$61.8 billion in total assets, which eclipses the \$35.9 billion worth of assets Texaco Inc. listed when it filed for bankruptcy in 1987.

November 26, 2001

Reload

October 30, 2000 www.internetweek.com/transformation2000/coverstory/enron.htm www.internetweek.com/transformation2000/coverstory/enron.htm

Enron's Web Retreat

Many of Enron Corp.'s online businesses may not make the cut as the company, exposed to billions of dollars in debt from off-balance-sheet deals, prepares to be acquired.

Enron's pioneering moves in online trading earned the company the cover of InternetWeek's Transformation Of The Enterprise issue in October 2000. At its apex last year, Enron had a market value of around \$80 billion, as it posted \$100 billion in revenue.

But Enron's stock plunged over the last month amid revelations that company executives had created limited partnerships which reportedly left Enron exposed to \$3.3 billion in outstanding notes. With its market value and image decimated, Enron this month accepted an \$8 billion buyout offer from rival Dynegy Inc., which has agreed to inject \$1.5 billion to keep Enron's trading desk afloat.

Enron pioneered Web trading of energy commodities with EnronOnline, where the company buys and sells futures on up to 1,500 products, doing more than \$4 billion in daily transactions. Most of that trading is still in energy products, though Enron had diversified into bandwidth, paper, steel, freight storage and other commodities. With the Dynegy deal, however, Enron plans to focus on "core" energy activities and dump other assets.

The first casualty is Enron Broadband Services, which owns about 15,000 miles of optical fiber and 25 network interconnection facilities in the United States. EBS envisioned buying and selling bandwidth as a pure commodity like natural gas, but bandwidth trading volumes never approached the level needed for a liquid market. Enron is looking to sell EBS, a spokesman says.

Enron has yet to make a decision on its other online trading businesses, including Net Works, the incubator that developed most of the technology that underpins EnronOnline. Each business will be reviewed "based on their capital requirements and near-term growth prospects," the spokesman

November 30, 2001

The Internet Didn't Kill Enron

By ROBERT PRESTON <MAILTO:rpreston@cmp.com>

"We have a fundamentally better business model."

That's how Jeffrey Skilling, then president of Enron Corp., summarized his company's startling ascendancy a year ago, as Enron's revenues were soaring on the wings of its Internet-based trading model.

It was hard to find fault with Enron's strategy of brokering energy and other commodities over the Internet rather than commanding the means of production and distribution. EnronOnline, its year-old commodity-trading site, already was handling more than \$1 billion a day in transactions and yielding the bulk of the company's profits. At its peak, Enron sported a market cap of \$80 billion, bigger than all its competitors combined.

See Also

Forum: Enron E-Biz Meltdown: What Went Wrong? http://www.internetweek.com/forum/enron More Enron Stories http://www.internetweek.com/enron.htm

Today, Enron has filed for bankruptcy, the status of EnronOnline is touch and go, ENE is a penny stock and Skilling is out of a job. Last year's Fortune 7 wunderkind, hailed by InternetWeek and others as one of the most innovative companies in America, overextended itself to the point of insolvency.

So was Enron's "better business model" fundamentally flawed? With the benefit of 20/20 hindsight, what can Internet-inspired companies in every industry learn from Enron's demise?

For one thing, complex Internet marketplaces of the kind Enron assembled are fragile. Enron prospered on the Net not so much because it had good technology -- though the proprietary EnronOnline platform is considered leading-edge -- but because online customers trusted the company to meet its price and delivery promises.

As Skilling told *InternetWeek* a year ago, "certainty of execution and certainty of fulfillment are the two things people worry about with commodity products." Enron, by virtue of its expertise, networked relationships and reputation, could guarantee those things.

Once it came to light, however, that Enron was playing fast with its financials -- doing off-balance sheet deals and engaging in other tactics to inflate earnings -- customers (as well as investors and partners) lost confidence in the company. And Enron came tumbling down.

Furthermore, advantages conferred by superior technology and information-gathering are fleeting. Competitors learn and mimic and catch up. Barriers to market entry evaporate. Profit margins narrow.

Enron, short of incessant innovation, could never hope to corner Internet market-making, especially in industries, like telecommunications and paper, that it didn't really understand. In its core energy

market, perhaps Enron was too quick to eschew refineries and pipelines for the volatile, informationbased business of trading.

But it wasn't Internet that killed the beast; it was management's insatiable appetite for expansion and, by all accounts, personal enrichment.

It's too easy to kick Enron now that it's down. It did a lot right. The competition and deregulation and vertical "de-integration" Enron drove are the future of all industries, even energy. Enron was making markets on the Internet well before its competitors knew what hit them.

Was Enron on to a better business model? You bet it was. But like any business model, it wasn't impervious to rules of conduct and principles of economics.

June 11, 2001

Services

Trader Reaps Benefits Of E-Market Leadership

'Liquidity' is the key to Enron's position at the center of online value chains

By JADE BOYD <MAILTO:jcboyd@cmp.com>

ENRON Headquarters: Houston Line of business: Energy production and marketing; online exchange operator 2000 Revenue: \$100.79 billion 2000 Net Income: \$979 million Percentage of revenue from e-business activity: N/A CEO: Jeffrey K. Skilling Top e-business executive: Philippe Bibi, president and CEO, Enron Net Works E-business highlights: EnronOnline conducted its millionth transaction in May; total trade volumes on the commodity-trading site have exceeded \$550 billion since it was established in November 1999. Enron Broadband Services conducted 580 online transactions in the first quarter, compared with 321 for all of 2000 E-business challenges: Re-creating its success in online energy trading in dozens of other commodity businesses including bandwidth, data storage, forest products, metals, coal and freight logistics Top e-business accomplishment: With EnronOnline, Enron brought immediate and transparent pricing to energy markets; the site is one of the world's leading e-commerce platforms, with daily trade volumes in excess of \$4 billion Services: Industry Leaders http://www.internetweek.com/100-01/serv.htm ONLINE EXTRA--Reporter's Notebook On Enron http://www.internetweek.com/100-01/serv.htm ONLINE EXTRA--Reporter's Notebook On Enron

Uncertainty has debilitated many e-businesses, with staffers and managers alike wondering when things will pick up. But optimism is still in the air at Enron Net Works, the e-business arm of Fortune 7 energy company Enron Corp., which continues to expand its electronic trading model into all manner of commodity markets.

Net Works oversees EnronOnline, where Enron buys and sells more than \$4 billion a day of mostly natural gas and electric power, plus steel, coal, telecom bandwidth, data storage, freight services and 1,500 other products.

Net Works is also a new-business incubator, repackaging applications Enron originally developed for internal use into revenue-generating online services. For example, EnronCredit.com http://www.EnronCredit.com, an offshoot of software Enron created to help its traders manage credit risk, offers a service to some 10,000 companies to quickly determine the cost of extending credit to their own trading partners. EnronCredit.com, which broke even in its first year, is expected to turn a profit this year.

Net Works is part software development house and part IT department, responsible for routine tasks, such as desktop support, and critical functions, such as keeping Enron's e-business infrastructure running. The group, with 1,500 employees, grew some 30 percent in the past year, occupying more than four floors of Enron's downtown Houston headquarters.

"Our job is in two parts," says Net Works COO Greg Piper. "Help Enron expand horizontally in markets for

new commodities like forest products and freight services, and build a business around the tools that helped to transform Enron."

E-Commerce Apex

While Enron's e-business gains have been spotty in some areas—it has struggled to create liquid Web markets in bandwidth and on paper, for instance—EnronOnline is one of the most successful e-marketplaces. It conducted its millionth transaction late last month, and the total value of trades on the site exceeds \$590 billion. Online trading now accounts for almost 75 percent of Enron's energy transactions in North America, the company says.

Enron counts both purchases and sales in its volume numbers—unlike e-marketplaces that simply take a cut of transactions on their sites—because the company is a "counterparty" to every trade on EnronOnline. Enron makes its money on the spread between what it pays for commodities and what it sells them for.

When a customer clicks to buy gas, electricity, steel or any other commodity, Enron guarantees price and delivery time. The key for Enron isn't to own massive amounts of physical product or storage and delivery capacity, but to arrange for third-party supply and logistics electronically. Enron stays informed about the vast array of factors that can influence price and delivery on a minute-by-minute basis by employing thousands of researchers, analysts, weather forecasters and other market specialists.

Enron isn't just moving physical product on the site. Much of its online deal-making is in financial derivatives and risk management.

For example, Enron is now in the market for DRAM chips. But it doesn't buy and sell the chips; it sells financial instruments that let companies lock in a price for DRAMs for a set period. Ultimately, Enron hopes to buy and sell the chips itself, just as it buys and sells gas, electric-ity and other commodities.

Energy Trading Redone

Enron is reticent about disclosing exact volume figures for the different commodities traded on its sites. The large majority of trades are still conducted in natural gas and electricity.

The Internet is transforming energy trading from something of an art form, dominated by person-to-person deals negotiated over the telephone, to an automated science. By openly displaying its "bid" and "ask" prices--and the spread between them--Enron drove trade volumes through the roof in 2000. Forrester Research estimates that the "notional value" of online energy trades grew 750 percent in 2000, with EnronOnline accounting for most of them.

But competing energy firms are banding together to form online marketplaces of their own. American Electric Power, Aquila, BP Amoco, Duke Energy and others joined with Goldman Sachs and other financial firms to form Intercontinental Exchange, while Axia Energy, Coral, Dominion TXU and Williams have formed TradeSpark.

While these consortia may view each other as competitors, they see EnronOnline as complementary, says Forrester analyst Jim Walker. "Everyone loves to have Enron trade on its site because Enron brings the most valuable thing to the market, which is liquidity," Walker says.

Enron has purchased physical assets to ensure its own supply in several key markets, such as pulp and paper and metals, Piper says. Metals trading, he says, is up to about 1,000 transactions daily, representing about 25,000 metric tons of steel.

Enron conducted 580 bandwidth trades in the first quarter, compared with 321 in the past year, and it expects to handle more than 2,200 trades in 2001.

However, Enron's total online trading volume represents everything from storage services to long-haul circuits to dark fiber to IP services. None of the bandwidth commodities has achieved liquidity yet, notes Kevin

Hannon, president of Enron Broadband Services, which completed an 18,000-mile fiber optic network in 2000 and built 25 "pooling points" to tie in with other provider networks.

A Helping Hand

Enron has plowed ahead so aggressively online that some trading partners that haven't invested in back-office automation simply can't keep up, Piper admits. Enron is responding with CommodityLogic, software modules designed to help trading partners streamline the fulfillment process and reduce data re-entry errors.

Enron will create and maintain a centralized database of information pertaining to trades. Partners access that information with CommodityLogic software modules designed for such tasks as quality assurance, scheduling and invoicing. The three modules in tests are InvoiceLogic; ConfirmLogic, an order confirmation system; and NomLogic, which handles delivery scheduling for natural gas trades.

"Scheduling that natural gas would typically involve three to 10 phone calls and two to three faxes, and for a deal done over the course of a 30-day month, you might have had to repeat that every business day," says Tom Gros, the Net Works vice president in charge of CommodityLogic. "With NomLogic, that process now takes seconds. I enter it on the screen and automatically, if it's a month-long deal, the previous day's data appears for me so I don't have the chance to create an error."

The business model for developing CommodityLogic is the same one Enron used for EnronCredit.com and its other online initiatives: Net Works develops an application to save time or improve efficiency internally and then repackages the app for external use. The software for EnronCredit.com's Cost of Credit service, for instance, was originally developed to help Enron's own traders manage credit risk.

Much of Cost of Credit information is free with registration to EnronCredit.com, but Enron charges a fee to download information or get e-mail alerts of significant changes to the credit risk of companies in a prespecified portfolio. But the main way Enron makes money from the site is by selling "bankruptcy swaps" to enterprises that want a hedge against the possibility that a partner will go out of business.

Whereas EnronCredit.com grew out of software Net Works developed for Enron's commodity trading business, Enron's latest ASP offering, DealBench, came out of software designed to make it easier and faster for Enron to negotiate large structured deals for complex assets, such as power plants.

Enron's procurement department has used the auction functions in DealBench to buy more than \$1 billion of goods, everything from broadband networking gear to carpeting for the new 40-story skyscraper Enron is building across the street from its 50-story headquarters in downtown Houston.

DealBench's collaboration tools manage the complex communications that are part of any large structured deal. Features include secure two-way messaging and the ability to deliver multimedia presentations and give participants varying levels of access to sensitive information.

Last month, Enron added Data Room, a document management system that lets companies set up "virtual data rooms" to streamline the bidding process for complex physical assets, such as refineries and manufacturing plants. Normally, companies selling these types of assets have to staff a physical room hosting lawyers and engineers from every potential bidder, each of whom require several days to pore over hundreds of thousands of pages of technical documents. Enron has used Deal Room to syndicate some \$3 billion of its own credit to more than \$1 financial institutions and sell more than \$240 million in assets.

With all DealBench services, companies can host any number of potential bidders simultaneously, giving each participant the exact level of access necessary. Bidders download a piece of client software that decodes encrypted documents on the site, so even if sensitive documents are sent to unauthorized users, they can't be opened, says Jeffrey Bartlett, a principal at DealBench.

Rather than take a percentage of the overall deal, Enron sells DealBench licenses to the deal managers and hosts

the platform. Enron wouldn't reveal specifics about pricing, which varies based on the length of contract, number and size of prospective deals and the number of potential bidders.

Centerpiece Of E-biz

For the time being, energy trading--and trading in financial products related to those trades--will remain the centerpiece of Enron's online business. Forrester estimates that notional trading for U.S. natural gas futures and options contracts amounted to about 3.6 times the total quantity of physical trades and 12 times the amount of physical delivery in 2000.

"Electricity in the U.S. is a \$300 billion market, but the velocity at which that \$300 million is being turned over is increasing," says Bob Christensen, an energy industry analyst with First Albany Corp. "The same power--and all the fuels related to it--can churn and change hands a dozen times a day."

As other companies convert their trading systems to online models, Enron hopes to sell its expertise in this area. (Enron says its own online-enabled back-end systems reduced its marginal cost per transaction by 75 percent in 2000.)

Enron stands to gain twice: first, by providing the services itself, and second, by further increasing online trade volumes in a market where it has a clear ownership stake.

Opening Statement Chairman Michael G. Oxley Committee on Financial Services

Subcommittee on Oversight and Investigations Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"The Enron Collapse: Impact on Investors and Financial Markets"

December 12, 2001

Good morning and thank you, Subcommittee Chairs Baker and Kelly, for holding this important hearing. Today we will begin the Committee's investigation of the facts and circumstances surrounding the largest corporate failure in history. Today we will hear about the dramatic collapse of Enron Corporation, the seventh largest company in the United States. Riding high as recently as six months ago, the company has since lost more than 99% of its market capitalization, and now trades below \$1.

Until all the facts are known, it is prudent for this Committee to avoid reaching sweeping conclusions about the causes and persons responsible for Enron's collapse. But that does not mean we should refrain from asking the difficult questions that demand answers.

We will ask the difficult questions. We will delve thoroughly into the facts and circumstances surrounding Enron's collapse. And we will get answers.

This Committee, and the Subcommittees on Capital Markets and Oversight, will vigorously pursue this matter to ensure that the Congress, and the American public, know who to hold accountable.

We need to learn whether millions of investors were intentionally misled by Enron's financial engineering and reluctance to disclose information.

We need to learn why financial statements that provided less than a complete picture of Enron's financial situation were certified.

We need to learn why almost all of the securities analysts following Enron failed to warn investors, and why exactly half of them continued to rate the company a "buy" or "strong buy", even after it had plunged below one dollar.

We need to learn whether the current reporting and financial disclosure system needs to be overhauled.

We need to learn why the accounting rules permit companies to keep important information off their balance sheets.

Above all, we need to reduce the likelihood that this will happen again.

The effects have been devastating - as one might expect when a \$75 billion company files for bankruptcy. Hit hardest by the meltdown, of course, were Enron's employees. Thousands have already lost their jobs, and more will undoubtedly follow. And the 11,000 employees who participated in the company's 401(k) plan have seen their retirement savings practically eliminated.

In addition, beyond the impact on Enron employees themselves, Enron's collapse has drained the investment savings of investors across the country who put their retirement and other investments into mutual funds, pension funds, and other vehicles that invested in Enron. Thankfully, at this point there does not seem to be a systemic threat to the financial markets as a result of Enron's collapse, but the damage the collapse has done to the financial position of thousands of Americans will be very difficult to quantify.

Some may use Enron's bankruptcy as a vehicle to make big-government arguments against electricity markets. But it wasn't the electricity consumer who was hurt by Enron's fall, it was the workers and investors.

Furthermore, Congress must pass the netting provisions of the bankruptcy reform legislation. Enron and its subsidiaries were party to tens if not hundreds of thousands of different financial contracts. The identification of these contracts and verification that they are eligible for netting will require vast expenditures of time and money and divert the attention of Enron and the court from the task of reorganizing. Meanwhile, creditors will remain uncertain as to the enforceability of their contracts and the ultimate status of their claims against Enron. Let's eliminate the uncertainty, the waste of valuable court time and estate funds, and allow institutions to eliminate exposure more efficiently.

We are pleased to welcome the distinguished Chief Accountant of the Securities and Exchange Commission, Bob Herdman, to the Committee to discuss the reporting and financial disclosure system mandated by the Federal securities laws. I am particularly pleased that Mr. Herdman is here today, as the central issues that the Enron collapse raises are issues of investor protection and accounting rules, about which there are few better experts than the Chief Accountant of the Commission on which to opine.

I would like to remind the members of the Committee that Enron, as well as Andersen, are the subjects of a formal investigation by the SEC, so Mr. Herdman

will not be able to provide any specific information about those investigations. Please phrase your questions accordingly.

On the third panel, we will hear from the chief executive of Arthur Andersen, which serves as Enron's auditor. We welcome back Chuck Hill to the Committee, to discuss the performance of Wall Street research analysts in this matter. And finally, we will hear from the AFL-CIO on the impact to investors.

Unfortunately, Enron's CEO, Kenneth Lay, was not able to testify before the Committee here today. I want to assure the members of the Committee, as well as the public, that I am confident that Mr. Lay, and Enron, will provide answers to us and to the public as the Committee continues its investigation into this matter.

I look forward to the testimony.

###

TESTIMONY OF ROBERT K. HERDMAN CHIEF ACCOUNTANT

U.S. SECURITIES AND EXCHANGE COMMISSION RECENT EVENTS RELATING TO ENRON CORPORATION

Before the Subcommittee on Capital Markets, Insurance and Government
Sponsored Enterprises and the Subcommittee on Oversight and Investigation,
Committee on Financial Services
U.S. House of Representatives
December 12, 2001

Chairman Baker, Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of the Subcommittees:

I am pleased to appear before you on behalf of the Securities and Exchange Commission ("SEC" or "Commission") to testify concerning the recent events relating to Enron Corporation ("Enron"). I appreciate the opportunity to discuss the importance of transparent financial reporting to investors and our capital markets and several accounting issues raised by Enron's recent filings with the Commission.

Overview of the Effects of Enron on our System of Capital Markets

The SEC shares the Subcommittees' concern about the recent events surrounding Enron. The bankruptcy filing of a Fortune 10 company gives pause to all of us who care about financial reporting—and, more importantly, about its customers—the investing public. As Enron has disclosed in its public filings with the Commission, the SEC is investigating the Enron matter. Any further information relating to that investigation is nonpublic at this point and, accordingly, my statement will be confined to the public record. The Commission requests that the Subcommittees respect the confidential nature of the Commission's investigation and the Commission's reluctance to address in this public forum specific issues related to Enron's compliance with the federal securities laws.

Enron's announcement of its intention to restate its financial statements comes on the heels of several other widely publicized restatements. We share your concern that such restatements may shake investors' confidence in our system of financial reporting and our capital markets. We also recognize the devastating impact that such events can have on employees whose retirement funds are invested in the company's securities. In the coming weeks and months, we will all learn more about what transpired at Enron, as many of the details are unknown at this time. However, today I will discuss for the Subcommittees what has been announced publicly as well as some of the related disclosure and financial reporting issues.

In some of the staff's discussions with congressional staff, it has been suggested that a chronology of the public events as reflected in Enron's filings with the Commission might be useful to the Subcommittees. An understanding of these public events also may assist in understanding the company's accounting issues. A chronology, therefore, is attached to my testimony as Appendix A.

Transparent Financial Reporting Protects the Financial Markets

A primary goal of the federal securities laws is to promote honest and efficient markets and informed investment decisions through full and fair disclosure. Transparency in financial reporting – that is, the extent to which financial information about a company is visible and understandable to investors and other market participants—

The information contained in this statement concerning the events surrounding the bankruptcy filing of Enron Corporation is based upon publicly available information. The Commission is currently conducting an investigation into a number of aspects of these events and has not made any findings or reached any conclusions related to these events. This statement does not discuss nonpublic matters relating to that investigation or that may become the subject of actions by the Commission or by other authorities.

plays a fundamental role in making our markets the most efficient, liquid, and resilient in the world.

Transparency enables investors, creditors, and the market to evaluate an entity. In addition to helping investors make better decisions, transparency increases confidence in the fairness of the markets. Further, transparency is important to corporate governance because it enables boards of directors to evaluate management's effectiveness, and to take early corrective actions, when necessary, to address deterioration in the financial condition of companies. Therefore, it is critical that all public companies provide an understandable, comprehensive and reliable portrayal of their financial condition and performance. If the information in financial reports is transparent, then investors and other users of the information are not surprised by unknown transactions or events.

Investors and creditors expect clear, reliable, consistent, comparable, and transparent reporting of events as they occur. Accounting standards provide a framework that is intended to present financial information in a way that facilitates informed judgments. For financial statements to provide the information that investors and other decision-makers require, meaningful and consistent accounting standards and comparable practices are necessary. Companies in like circumstances must apply such standards and practices in a like manner if the information is to be comparable.

The SEC Relies on an Independent Private Sector Standards-Setting Process that Is Thorough, Open, and Deliberative

While the Commission has the statutory authority to set accounting principles, ² for over 60 years it has looked to the private sector for leadership in establishing and improving accounting standards.³ The quality of our accounting standards can be attributed in large part to the private sector standards-setting process, as overseen by the

See, e.g., section 19(a) of the Securities Act of 1933, L5USC 77s(a), and section 13(b)(1) of the Securities Exchange Act of 1934, 15 USC 78m(b)(1).

Accounting Series Release (ASR) No. 4 (April 1938) and ASR No. 150 (December 1972).

SEC. The primary private sector standards-setter is the Financial Accounting Standards Board (the "FASB"), which was established in 1972. An oversight body that represents its core constituency of investors, business people, and accountants appoints the members of the FASB. The FASB's standards are designated as the primary level of generally accepted accounting principles ("GAAP"), which is the framework for accounting. FASB standards set forth recognition, measurement, and disclosure principles to be used in preparing financial statements.

In setting standards, the FASB follows a thorough, open, and deliberative process. For major projects, that process can include: (i) wide distribution of discussion memoranda; (ii) public hearings; (iii) publication of exposure drafts; (iv) solicitation of comment letters; (v) public deliberation on comment letters; and (vi) use of field tests to test standards before their adoption.

The SEC oversees the FASB and its accounting standards-setting process. Specifically, the SEC staff evaluates each project and proposed standard to make sure that the FASB standard-setting process is being administered in an open, fair, and impartial manner, and that each standard adopted is within an acceptable range of alternatives that serve the public interest and protect investors. The SEC staff: (i) monitors the FASB's project developments; (ii) meets with the FASB and its staff on a regular basis to discuss pending FASB projects; (iii) reviews comment letters received by the FASB on its projects; and (iv) after a standard is adopted, continues to consult with the FASB, its staff, and its interpretative body, the Emerging Issues Task Force ("EITF"), on implementation issues.

The Self-Regulatory Processes Administered by the American Institute of Certified Public Accountants ("AICPA")

The EITF is a committee of accounting practitioners that assists the FASB in providing timely guidance on emerging issues and the implementation of existing standards. If the EITF reaches a consensus solution to an emerging or implementation issue, Commission or FASB action may not be considered necessary. The SEC Chief Accountant participates as an observer at EITF meetings.

The SEC staff also monitors the activities of the standard setting functions of the AICPA's Auditing Standards Board ("ASB") and the AICPA's self-regulatory programs, designed to enhance public confidence in the audit process.

Regarding the ASB, the SEC staff attends many of the ASB's public meetings, reviews exposure drafts of proposed auditing standards and selected comment letters responding to those exposure drafts, and periodically meets with representatives of the ASB to discuss current and future projects and other matters of mutual concern. Recently, the ASB was placed under the oversight of the Public Oversight Board ("POB"), which is chaired by former Comptroller General of the United States, Charles A. Bowsher.⁵

The POB was created in 1977 to oversee and report on the self-regulatory programs of the AICPA's SEC Practice Section, which until recently consisted principally of the AICPA's peer review and quality assurance programs. Under the peer review program, accountants from outside the member firm assess the firm's quality control systems over its accounting and auditing practice and test compliance with those systems. Under the quality control inquiry process, a committee of professionals reviews allegations of audit failure contained in litigation filed against a member firm for indications of needed improvements in the firm's quality control systems.

Starting in 2001, the POB's responsibilities have been expanded to include not only oversight of the peer review, quality control inquiry, and auditing standards setting functions, but also to improve the communication and coordination among the various bodies that make up the self-regulatory process and to conduct oversight reviews and other projects that are deemed to be appropriate to protect the public interest.

Other members of the POB include former FASB Chairman, Donald Kirk; the Chairman of the Executive Committee for Lockheed and former Under Secretary of the Army, Norman Augustine; former Counselor to the President and former Secretary of Defense, Melvin Laird; and former SEC Commissioner, Aulana Peters.

An example of the POB's projects that benefit the public interest occurred in 2000 when the POB, at the SEC staff's request, sponsored the Panel on Audit Effectiveness ("Panel"). Although the Panel found that the audit process is fundamentally sound, the Panel's report contained approximately 200 recommendations for the accounting profession, standard setters, audit committees and regulators. The AICPA and others are working to implement those recommendations, including: revising the auditing standards for detecting material misstatements in financial statements that may be due to fraud, enhancing the peer review process, and strengthening the AICPA's disciplinary processes.

In this regard, the AICPA recently amended its self-regulatory processes to require member firms to have specific quality controls related to maintaining their independence from audit clients, to provide for "continuous" peer reviews of the largest accounting firms (which provides for the performance of certain peer review procedures in the two years between the firm's triennial peer reviews), and, in the event of litigation alleging deficiencies in the audit of a public company, in certain situations to terminate, remove from audits of public companies, or subject to additional oversight the individual involved.

As shown by these recent changes, the self-regulatory process can, and does, change over time in response to the needs of investors. In view of the events surrounding Enron, the profession and the Commission are considering what further improvements should be made.

For example, last week the managing partners of the five largest accounting firms issued a joint statement that they intend to work with the SEC and others to evaluate and improve the profession's self-regulatory process, and to enhance disclosures and audit procedures concerning related party transactions, special-purpose entities, and issues related to market risks, including those related to energy contracts.⁶ They also indicated

See, "Statement From Big Five CEOs," dated December 4, 2001.

their support for the modernization of the financial reporting system, as previously announced by Chairman Pitt. Similarly, AICPA Chairman James Castellano stated that the AICPA is committed to working with the SEC and accounting firms to make needed changes to the self-regulatory process and to provide improved guidance to auditors and to modernize the financial reporting system.

Role of the SEC in Reviewing Filings

As noted above, the Commission is responsible for administering the federal securities laws. These laws are designed to protect investors by requiring full and fair disclosure of all material information about publicly traded securities. Full disclosure ultimately benefits both investors and the capital markets. By enhancing investors' confidence in the completeness and accuracy of information about public companies, these full disclosure requirements encourage investor participation in the capital markets.

The Commission does not have authority to approve or disapprove a security or a transaction on its merits. If a transaction appears to involve a high degree of risk to investors or if a company involved in a transaction is experiencing financial difficulty, we do not, and we cannot, stop the transaction from proceeding on that basis. Rather, the Commission's job is to ensure that the company fully discloses these risks and fully informs investors of its financial condition so that investors can make informed investment decisions. This system is designed to maintain market transparency. It allows market forces rather than regulatory controls to determine what transactions will proceed and at what prices a company's securities will trade. In this way, even small companies and companies with financial difficulties may have access to the public capital markets on an equal footing with larger or more financially secure companies. Full and

See, e.g., Remarks by SEC Chairman Harvey L. Pitt at the Fall Meeting of the ABA's Committee on Federal Regulation of Securities, dated November 16, 2001.

[&]quot;AICPA Statement of James G. Castellano, AICPA Chair, Barry Melancon, AICPA President and CEO," dated December 4, 2001.

fair disclosure allows markets to assign an appropriate value for the securities of all public companies.

Under the securities laws, public companies file registration statements, periodic reports and other disclosure documents with the Commission. The Commission's Division of Corporation Finance ("DCF") has primary responsibility for overseeing disclosures by issuers of securities. The SEC, however, does not have sufficient resources to review all registration statements and other filings that are made with the Commission. Therefore, in 1980, the SEC implemented a "selective review" program by which the DCF reviews some, but not all, of the filings that are made with the Commission. When a filing is made, it is routed to the appropriate industry group within the DCF and it is then "screened" to determine if it will be subjected to a full financial and legal review, a partial review for specific issues only, or no review. In order to preserve the integrity of the selective review process, the Commission does not publicly disclose its screening criteria for filing reviews.

The SEC does not audit public companies. If the DCF has significant concerns or becomes aware of information that suggests that a company may have violated the securities laws, the DCF may refer the matter to the Commission's Division of Enforcement. The SEC has broad authority to investigate possible violations of the securities laws and may bring actions against a company if information in its registration statement or other filings proves to have been materially false or misleading, including actions to stop the sale of securities.

As Chief Accountant, I am the principal advisor to the Commission on accounting and auditing matters arising from the administration of the federal securities laws. My

All registration statements potentially are subject to review by the staff of the DCF. Given the volume of filings each year, we fulfill this obligation by selectively reviewing registration statements and other documents that companies file with the Commission when they engage in public offerings and other transactions in publicly traded securities. We also selectively review periodic reports, such as those on Forms 10-K and Forms 10-Q, which public companies are required to file with the Commission, and current reports on Forms 8-K. These reports are designed to keep investors apprised of the companies' financial condition and results of operations on a periodic basis.

staff also works closely with domestic and international private sector accounting and auditing standards-setting bodies, consults with registrants, auditors, and other Commission staff, such as the staff in the DCF and the Division of Enforcement, regarding the application of accounting standards and financial disclosure requirements, and assists in addressing problems that may warrant enforcement actions.

Having now reviewed the role of the SEC and the FASB in the financial reporting process, I would like to discuss three accounting issues that were raised by Enron in its November 8, 2001 Form 8-K filing: (1) restating previously issued financial statements, (2) accounting for special-purpose entities, and (3) the reduction in Enron's shareholders' equity in connection with the receipt of notes receivables. Finally, as requested by some members of the Subcommittees, I will give a brief overview of a subject that is not mentioned in Enron's filing – mark to market accounting as it applies to nonderivative energy-trading contracts.

Restating Previously Issued Financial Statements

ΙĐ

In its November 8, 2001 Form 8-K filing, Enron announced its intention to restate previously issued financial statements dating back to 1997. Various groups have reported increases in the number of companies restating their financial statements over the last several years, with one study citing 233 restatements in 2000.¹⁰ Let me briefly explain the accounting and auditing literature regarding restatements.

Management is responsible for the preparation and presentation of financial statements in conformity with GAAP. If management discovers an error in previously issued financial statements, it should account for the error in accordance with Accounting Principles Board Opinion No. 20 (APB 20), Accounting Changes. APB 20 concludes that correction of an error related to a prior period discovered after the issuance of financial statements for that period should be reported as a prior period adjustment.

Two separate studies by Financial Executives International and Arthur Andersen indicate increases in the number of restatements by public companies over the past four years.

Pursuant to Generally Accepted Auditing Standards ("GAAS"), an auditor has responsibilities when an error is discovered regardless of whether the auditor or its client discovers the error. Statement of Auditing Standards No. I, which is part of GAAS, sets forth the procedures an auditor should follow when, subsequent to the date of the audit report, the auditor becomes aware that facts may have existed at the date of the report that might have affected his or her report. When subsequently discovered information is found both to be reliable and to have existed at the date of the audit report, the auditor should advise the client to make appropriate disclosure of the newly discovered facts and their impact upon the financial statements in cases where the auditor believes: (a) the audit report would have been effected if the information had been known at the date of the report, and (b) there are persons currently relying upon the financial statements who would attach importance to the information.

Our capital markets are much more efficient if, instead of correcting information in restatements, the original financial statements reflect appropriate accounting policies and contain appropriate disclosures the first time. To that end, the staff of the SEC wants to work together with the corporate community, the accounting profession, and private sector standard-setting bodies to advance, not just protect, the interests of investors by helping companies to get financial reporting right the first time.

Accounting for Special-Purpose Entities

Enron's Form 8-K filing discloses that three previously unconsolidated specialpurpose entities ("SPEs") should have been included in Enron's consolidated financial
statements. An SPE is an entity created by a sponsor to carry out a specified purpose or
activity, such as to consummate a specific transaction or series of transactions with a
narrowly defined purpose. SPEs are commonly used as financing vehicles in which
assets are sold to a trust or similar entity in exchange for cash or other assets funded by
debt issued by the trust. In many cases SPEs are used in a structured transaction or series
of transactions to achieve off-balance sheet treatment. In addition, use of SPEs can
provide a lower cost of financing and can create tax advantages. An SPE, however, is

expensive to set up and maintain. Therefore, SPE activities usually occur on a large scale so the impact of the reduced interest rate more than offsets the costs.

To illustrate, here is an example of how an SPE might work. A third party investor unrelated to a transferor may set up an SPE for the benefit of a transferor, which is the company that transfers or contributes the assets to the SPE. The investor will control the activities of the SPE and retain the substantive risks and rewards like common stockholders in a "normal" corporation. The SPE will hold assets and finance them through debt and equity issued to institutional investors or public shareholders. To reduce the interest rate paid on the debt, the SPE will obtain credit enhancements (for example, guarantees or similar derivative arrangements) often from the transferor and or other third parties. This spreading of the risk through the credit enhancements, coupled with the fact that the SPE's securities are usually liquid and easily traded, generally reduces the cost of the borrowing to a level below what it would have been had the transferor directly borrowed money from a bank or the market.

Most SPE transactions are off-balance sheet. This means that financial information about the SPE, including its assets and liabilities, does not appear in the financial statements of the transferor.

The accounting literature regarding SPE consolidation is found in materials issued by the EITF. In order to achieve off-balance sheet treatment of an SPE pursuant to GAAP, two conditions must be met. First, the assets must be sold to the SPE (be legally isolated from the transferor) and, second, an independent third party owner that has made a substantive capital investment (which amounts to at least 3% of the SPE's total capitalization) must both control the SPE and possess the substantive risks and rewards of owning the SPE's assets. If executed properly, the legal isolation and the control by a third party reduce the risk of the creditor, as discussed above. Thus, off-balance sheet

See: EITF Issue No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions; EITF Issue No. 96-21, Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities; and EITF Topic No. D-14, Transactions involving Special-Purpose Entities.

treatment of an SPE involves more than just sufficient third-party equity. This equity must be "at risk" from the investor's perspective. If the investor's return is guaranteed or not "at risk," the transferor would be required to consolidate the SPE in its financial statements.

As noted in the Form 8-K filing, Enron has concluded that three previously unconsolidated SPEs did not qualify for nonconsolidation pursuant to GAAP. Thus, Enron plans to restate its financial statements to reflect these entities in the consolidated statements of financial position and results of operations.

The SEC, as noted in its Annual Report to Congress for 2000, has urged the FASB to continue their efforts to provide consolidation guidance concerning SPEs. The FASB has announced its intention to concentrate on developing guidance for dealing with several consolidation issues that would resolve many problems encountered in present practice, including issues related to special-purpose entities. We will continue to urge the FASB to address SPE consolidation issues to increase financial statement transparency.

Reduction in Shareholders' Equity

Part of Enron's announced restatement includes a \$1.2 billion reduction in shareholders' equity. Enron created four SPEs in 2000 and, as part of their initial capitalization and a series of ongoing transactions, issued its own common stock in exchange for notes receivable. At the time, Enron increased notes receivable and shareholders' equity to reflect these transactions. However, in announcing its restatement Enron disclosed that it had concluded that pursuant to GAAP¹² these notes receivable should have been presented as a reduction of shareholders' equity. GAAP generally requires that notes receivable arising from transactions involving a company's capital stock be presented as deductions from stockholders' equity and not as assets. Enron has

EITF Issue No. 85-1, Classifying Notes Received for Capital Stock, and SEC Staff Accounting Bulletin No. 40, Topic 4-E, Receivables from Sale of Stock.

indicated that they overstated both total assets and shareholders' equity by \$172 million due to a transaction first reported in the financial statements for the quarter ended June 30, 2000, and by an additional \$828 million due to a transaction first reported in the quarter ended March 31, 2001. As a result, Enron has announced it intends to restate the financial statements for the second and third quarters in 2000 and its annual financial statements for 2000 for \$172 million. The aggregate restatement for the first and second quarters for 2001 will be \$1.0 billion

Enron also has disclosed that in the third quarter of 2001, it purchased a limited partnership's equity interest in an SPE, and that transaction resulted in a further reduction of shareholders' equity by \$200 million. Enron also disclosed, without further explanation, that the \$200 million related to the excess of the fair value of contracts deliverable by Enron over its notes receivable.

Mark-to-Market Accounting

Some members of the Subcommittees have requested that I also discuss mark-tomarket accounting issues as applied to energy contracts. It should be noted, however, that Enron has not indicated that it intends to restate its financial statements due to markto-market accounting issues.

Entities commonly enter into contracts for the purchase and sale of energy commodities. Historically, most energy contracts were settled by physical delivery. However, in recent years companies have entered into energy contracts, at rapidly increasing rates, to speculate on market movements, to conduct hedging transactions, or otherwise to generate gains from market price differences.

To determine the proper accounting for these contracts pursuant to GAAP, a multi-step process must be undertaken. The first step is to evaluate whether a contract is a derivative¹³ in its entirety (as defined by GAAP). If the contract is not a derivative, then the company would determine if the contract is an energy-trading contract. ¹⁴

If the contract is determined to be an energy-trading contract, then GAAP requires that the nonderivative energy-trading contract be marked to market with gains and losses included in earnings and separately disclosed in the financial statements or footnotes thereto. GAAP provides a set of indicators to consider when determining whether an operation's energy contracts are entered into for trading purposes.

Consistent with GAAP for financial instruments such as debt and equity securities and derivatives, GAAP does not specify how to compute fair value for energy trading contracts, other than that it should be done on an individual contract basis. Instead, GAAP provides a general principle, stating that fair value is the amount at which a contract could be bought or sold in a current transaction with willing parties, that is, other than in a forced or liquidation sale.

Pursuant to GAAP, a quoted market price in active markets is considered the best evidence of fair value and shall be used as the basis for the measurement, when available. If a quoted market price is not available, GAAP requires companies to estimate fair value based on the best information available in the circumstances. As quoted market prices may not exist for many energy trading contracts, companies must consider prices for similar energy contracts and the results of valuation techniques to the extent available in the circumstances. When valuation techniques or models are used, the best information for companies to consider includes recent spot prices and forward prices. An energy price curve is constructed by compiling forward prices of what the energy commodity is expected to be one to five years in the future. Specifically, observable forward prices are

A derivative is an instrument whose value is derived, in part, by reference to a stated index or other means. Derivative instruments are defined in Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities.

EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities. These criteria require an analysis of many factors including capacity, customers, volume, internal controls and the contracts themselves.

generally available up to three years into the future. In addition, broker-dealer prices are often available four to five years into the future. As a result, similar energy contracts with similar durations of five years or less have observable fair values within a narrow range.

However, a wide range of fair value estimates may result as the duration of an energy contract exceeds five years. Forward prices beyond the fifth year must be estimated, so the assumed rate of volatility has an important role in the assignment of fair value. Generally, prices are less volatile in the long run than in the short run. However, the current accounting guidance is not specific as to the application of fair value methods, so the assumed volatility of energy prices may vary, potentially leading to a wider range of assessed fair values.

Enron applies mark-to-market accounting for its energy trading activities. Enron has disclosed that the market prices it used to value its energy trading contracts reflect "its best estimate considering various factors including closing exchange and over-the-counter quotations, time value and volatility factors underlying the commitments."

Enron disclosed that it engages in price risk management activities for both trading and non-trading purposes. Enron's net assets from price risk management activities were approximately \$1,088 million and \$300 million at December 31, 2000 and 1999, respectively. While Enron discloses that it reports changes in its market values as part of other revenues (total other revenues were \$7.2 billion for the year ended December 31, 2000), it is unclear from its public filings what portion of its revenues comes from the changes in values. In its statement of cash flows, however, Enron notes that approximately \$763 and \$395 million of income was recognized from price risk management activities that did not result in the receipt of cash in 2000 and 1999, respectively.

Improving the Disclosure and Regulatory System

In an "Op Ed Discussion" in the December 11, 2001 issue of The Wall Street Journal, Chairman Pitt has enumerated many initiatives for improving and modernizing the current disclosure and regulatory systems. A copy of the article is attached as Appendix B. Chairman Pitt, with significant input from those inside and outside the Commission, began development of these initiatives prior to the announcements by Enron. These initiatives, not yet adopted by the Commission, include:

- More current disclosure, including "real-time" disclosure of unquestionably material information,
- · Disclosure of significant trend data and more "evaluative" data,
- Financial statements that are more clear and informative for investors,
- Disclosure of the accounting principles that are most critical to the company's financial status and that involve complex or subjective decisions by management,
- Private sector standard setting that is more responsive to the current and immediate needs of investors.
- A regulatory environment that continues, as always has been the case, to
 encourage public companies and the auditors of their financial statements to seek
 the advice of the SEC staff on new or unusual accounting questions so that they
 may "get it right the first time" and avoid restatements and the possibility of
 enforcement proceedings,
- A comprehensive and effective self-regulatory process for the accounting profession, as discussed above, with effective oversight by the Commission and its staff,
- More involvement by audit committees with management and the auditors regarding the selection and application of accounting principles used by the company, and
- Analysts not expressing views or recommendations when they do not have an adequate data foundation or when confused by company presentations.

As noted above, the accounting profession has announced its intention to assist the Commission in these efforts.

Conclusion

While the Commission's work relating to the Enron matter is just beginning, it is clear that with losses this sudden and deep to one of our largest reporting companies, we must look carefully at the adequacy of the current system of financial reporting. You can rest assured that the Commission and its staff are approaching this inquiry with an open mind and a firm intention to find out exactly what occurred and to deter, where possible, similar occurrences in the future. Should we conclude that any legislative solutions seem appropriate or helpful, we will seek the assistance of this Committee and your Subcommittees. We very much appreciate your prompt action and interest in having scheduled this hearing today and inviting us to participate.

> يم. المجار

Chronology of the Public Events Surrounding Enron

Enron, based in Houston, Texas, describes itself as a provider of products and services related to natural gas, electricity, and communications to wholesale and retail customers.

In 1999, a series of private investment limited partnerships, LJM Cayman, L.P. ("LJM1") and LJM2 Co-Investment, L.P. ("LJM2"), were created with Enron's then Executive Vice President and Chief Financial Officer serving as the managing member of the general partners. The CFO operated these partnerships as the managing member of the general partners while at the same time serving as an Enron senior executive.

In July 2001, the CFO relinquished his operating position in LJM1 and LJM2 and sold his interests to a non-executive officer of an Enron division who had previously reported to the CFO. This individual resigned from Enron immediately before purchasing the CFO's interests in the partnerships.

In August 2001, the President and CEO of Enron resigned citing personal reasons while acknowledging the pressure associated with the decline in the price of Enron's common stock during his six-month tenure as CEO. The current Chairman and former CEO reassumed the CEO title.

On October 16, 2001, Enron announced that it had recorded a \$1.01 billion after-tax charge to its third-quarter earnings to recognize asset impairments, restructuring costs, and losses associated with certain investments. Enron subsequently disclosed that \$35 million of this charge was related to transactions with LJM2.

In a conference call on October 16, 2001, Enron disclosed that shareholders' equity was reduced in the third quarter by \$1.2 billion related to the company's repurchase of its common stock, which previously had been issued as part of a series of transactions involving special-purpose entities associated with LJM2. In subsequent disclosures, Enron has characterized the reduction in shareholders' equity as the correction of accounting errors.

On October 24, 2001, Enron replaced the CFO. He subsequently was terminated.

On November 8, 2001, Enron filed a Form 8-K with the Commission. In the Form 8-K, Enron announced, among other matters, the following:

- Its intention to voluntarily restate its financial statements for the years ended
 December 31, 1997 through 2000 and the quarters ended March 31 and June 30,
 2001 reducing previously reported net income for the last four and one-half years
 by \$569 million, or 16% of reported net income for those four and one-half years.
 In connection with that announcement, Enron alerted investors not to rely upon
 the previously issued financial statements for these periods, including the audit
 reports of Arthur Andersen LLP covering the year-end financial statements for
 1997 to 2000.
- Its intention to file a restatement recording: (1) a previously announced \$1.2 billion reduction to shareholders' equity reported by Enron; (2) various income statement and balance sheet adjustments as the result of a determination by Enron and its auditors that three unconsolidated entities should have been consolidated in the financial statements pursuant to generally accepted accounting principles ("GAAP"); and (3) prior-year proposed audit adjustments and reclassifications (that were previously not recorded because they were determined to be immaterial in the year originally proposed and therefore never recorded).
- A Special Committee of the Board of Directors had been formed to investigate the matters disclosed in the Form 8-K and the Committee's investigation might result in additional or different information.

The restated financial statements that Enron indicated it would file have not yet been filed with the Commission. On November 9, 2001, Dynegy Inc. announced its intention to acquire Enron for approximately \$9 billion in Dynegy Inc. stock and the assumption of \$13 billion in debt.

On November 19, 2001, Enron filed its Form 10-Q for the quarter ended September 30, 2001. The company updated some of the disclosures made in its November 8, 2001 Form 8-K and disclosed that it had initiated an action plan for the restructuring of its business that would negatively impact its fourth quarter earnings. Enron also disclosed that a note payable in the amount of \$690 million related to a limited partnership had been accelerated due to a downgrade in Enron's debt rating. In addition, Enron disclosed additional debt amounts that would be accelerated if the company's debt rating fell below investment grade. The filing noted that the auditor of Enron's financial statements was unable to finalize its required review of the quarterly financial statements prior to filing with the Commission due to an ongoing investigation by the Special Committee.

On November 28, 2001, several rating agencies lowered Enron's long-term debt to below investment grade. Shortly after the downgrade, Dynegy terminated the merger agreement, citing breaches of representations, warranties, covenants and agreements in the merger agreement including a material adverse change provision.

On December 2, 2001, Enron filed for Chapter 11 bankruptcy protection and simultaneously sued Dynegy for \$10 billion alleging breach of contract in connection with Dynegy's wrongful termination of its proposed merger.

As noted previously, the Commission's investigation into these matters is continuing.

APPENDIX B

How to Prevent Future Enrons By Harvey L. Pitt

12/11/2001
The Wall Street Journal
Page A18
(Copyright (c) 2001, Dow Jones & Company, Inc.)

The Securities and Exchange Commission is investigating Enron's meltdown and its tragic consequences. Until all the facts are known, there is nothing that can or should be said about who may be responsible for this terrible failure. The public can be confident, however, that we will deal with any wrongdoing and wrongdoers swiftly and completely, to ensure full protection of investor interests.

Even before the Enron situation, we were working to improve and modernize our disclosure system -- to make disclosures more meaningful, and intelligible, to average investors. Our immediate concern in the wake of this tragedy should be to understand how to prevent more events like this. Of course, those with intent and creativity can override any system of checks or restraints. Believing that we can create a foolproof system is both illusory and dangerous. But investors are entitled to the best regulatory system possible, and we can achieve more than we presently do if we focus attention on finding solutions instead of scapegoats.

Our current reporting and financial disclosure system has needed improvement and modernization for quite some time. Disclosures to investors are now required only quarterly or annually, and even then are issued long after the quarter or year has ended. This creates the potential for a financial "perfect storm." Information investors receive can be stale on arrival and mandated financial statements are often arcane and impenetrable.

To reassure investors and restore their confidence, the public and private sectors must partner to produce a sensible and workable approach that includes, in addition to our existing after-the-fact enforcement actions:

- A system of "current" disclosure. Investors need current information, not just periodic disclosures, along with clear requirements for public companies to make affirmative disclosures of, and to provide updates to, unquestionably material information in real time.
- Public company disclosure of significant current "trend" and "evaluative" data. Providing current trend and evaluative data, as well as historical information, would enable investors to assess a company's financial posture as it evolves and changes. It would also preclude "wooden" approaches to disclosure, and encourage evaluative disclosures that begin where line-item and Generally Accepted Accounting Principles disclosures end. This information, upon which corporate executives and bankers already base critical decisions, can be presented without confusing or misleading investors, prejudicing legitimate corporate interests, or exposing companies to unfair assertions of liability.
- Financial statements that are clear and informative. Investors and employees concerned with preserving and increasing their retirement funds deserve comprehensive financial reports they can easily interpret and understand.
- Conscientious identification and assessment by public companies and their auditors of critical accounting principles. Public companies and their advisers should identify the three, four or five most critical accounting principles upon which a company's financial status depends, and which

21

involve the most complex, subjective or ambiguous decisions or assessments. Investors should be told, concisely and clearly, how these principles are applied, as well as information about the range of possible effects in differing applications of these principles.

- Private-sector standard setting that responds expeditiously, concisely and clearly to current and immediate needs. A lengthy agenda that achieves its goals too slowly, or not at all, like good intentions, paves a road to the wrong locale.
- An environment that encourages public companies and auditors to seek our guidance in advance. The SEC must be, and must appear to be, a constructive resource and hospitable sounding board for difficult and complex accounting issues before mistakes are made. We will always need, and utilize, after-the-fact enforcement, and we can, and will, improve our review of financial reports. But by now it is painfully clear that preventing problems is infinitely superior, and far less damaging, than acting after investor funds, retirement accounts or life savings are dissipated.
- An effective and transparent system of self-regulation for the accounting profession, subject to our rigorous, but non-duplicative, oversight. As the major accounting firm CEOs and the American Institute of Certified Public Accountants recently proposed, the profession, in concert with us, must provide assurances of comprehensive and effective self-regulation, including monitoring adherence to professional and ethical standards, and meaningfully disciplining firms or individuals falling short of those standards. Such a system has costs, but those who benefit from the system should help absorb them.
- More meaningful investor protection by audit committees. Audit committees must be proactive, not merely reactive, to ensure the quality and integrity of corporate financial reports. Especially critical is the need to improve interaction between audit committee members and senior management and outside auditors. Audit committees must understand why critical accounting principles were chosen, how they were applied, and have a basis for believing the end result fairly presents their company's actual status.
- Analyst recommendations predicated on financial data they have deciphered and interpreted.
 Analysts and their employers should eschew expressing views without an adequate data foundation, or when confused by company presentations.

Our system can be improved and modernized. In a crisis, some seek easy answers to difficult problems by pointing fingers. But true reform requires rigorous analysis, respect for competing views, and compromise and statesmanship by all concerned. We are up to the task, but only if we are able to tap our best minds to produce our most creative solutions, and only if we are able to discuss these issues openly and honestly. We are committed to that end, and we seek participation from everyone with an interest in our capital markets. Together, in partnership, we can make a difference. That is our vision, and our mission.

Mr. Pitt is chairman of the Securities and Exchange Commission.

Copyright © 2000 Dow Jones & Company, Inc. All Rights Reserved.

Remarks of Joseph F. Berardino Managing Partner – Chief Executive Officer, Andersen

U.S. House of Representatives Committee on Financial Services December 12, 2001

Chairman Oxley, Congressman LaFalce, Chairman Baker, Congressman Kanjorski, Chairwoman Kelly, Congressman Gutierrez, Members of the Committee.

I am here today because faith in our firm and in the integrity of the capital market system has been shaken. There is some explaining to do.

What happened at Enron is a tragedy on many levels. We are acutely aware of the impact this has had on investors. We also recognize the pain this business failure has caused for Enron's employees and others.

Many questions about Enron's failure need to be answered, and some involve accounting and auditing matters. I will do my best today to address those.

I ask that you keep in mind that the relevant auditing and accounting issues are extraordinarily complex and part of a much bigger picture. None of us here yet knows all the facts. Today's hearing is an important step in enlightening all of us. I am certain that together we will get to the facts.

If there is one thing you take away from my testimony, I hope it is this: Andersen will not hide from its responsibilities. That's why I'm here today. The public's confidence is of paramount importance. If my firm has made errors in judgment, we will acknowledge them. We will make the changes needed to restore confidence.

Today, I want to address two issues that go to the heart of concerns about our role as Enron's auditor.

First, did we do our job? I want to explain what we knew and when we knew it on several key issues, keeping in mind that our own review – like yours – is still under way.

Second, did we act with integrity? I want to discuss the \$52 million in fees we received and respond to concerns that have been raised.

I also want to talk about what I believe are some of the lessons we can already learn from Enron

– for our firm, for the accounting profession, and for all participants in the financial reporting
system.

Let me start by telling you what we know about three particular accounting and reporting issues:

- the restatements caused by the consolidation of two Special Purpose Entities, known as SPEs, and the recording of previously "passed" adjustments as a required byproduct of the restatement;
- a \$1.2 billion reclassification in the presentation of shareholders' equity during 2001 of which \$172 million was misclassified in the audited 2000 financial statement, and:
- the company's disclosures about its off-balance-sheet transactions and related financial activities.

I want to emphasize that my remarks are based on the information that is currently available. We have made our best efforts to be complete and accurate in describing what we know. But our review, like the work of the SEC, this Committee, Enron's board, and others, is not yet complete. It is always possible that new information could be developed that would change current understanding of events or uncover new events.

Consolidation of Special Purpose Entities

Let me begin with the Special Purpose Entities. SPEs are financing vehicles that permit companies, like Enron, to, among other things, access capital or to increase leverage without adding debt to their balance sheet. Wall Street has helped companies raise billions of dollars with these structured financings, which are well known to analysts and sophisticated investors.

Two SPEs were involved in Enron's recent restatement announcement. On one, the smaller of them, we made a professional judgment about the appropriate accounting treatment that turned out to be wrong. On the one with the larger impact, it would appear that our audit team was not provided critical information. We are trying to determine what happened and why.

Let's begin with the larger SPE, an entity called Chewco. What happened with Chewco accounted for about 80 percent of the SPE-related restatement.

In 1993, Enron and the California Pubic Employees Retirement System (Calpers) formed a 50/50 partnership they called Joint Energy Development Investments Limited, or JEDI for short. Among other factors, the fact that Enron did not control more than 50 percent of JEDI meant that

2

that partnership's financial statements could not be consolidated with Enron's financial statements under the accounting rules. In 1997, Chewco bought out Calpers' interest in JEDI. Enron sponsored Chewco's creation as an SPE and had investments in Chewco.

The rules behind what happened are complex, but can be boiled down to this. The accounting rules dictate, among other things, that unrelated parties must have residual equity equal to at least 3 percent of the fair value of an SPE's assets in order for the SPE to qualify for non-consolidation. However, there is no prohibition against company employees also being involved as investors, provided that various tests were met, including the 3 percent test.

In 1997, we performed audit procedures on the Chewco transaction. The information provided to our auditors showed that approximately \$11.4 million in Chewco had come from a large international financial institution unrelated to Enron. That equity met the 3 percent residual equity test. However, we recently learned that Enron had arranged a separate agreement with that institution under which cash collateral was provided for half of the residual equity.

What happened?

Very significantly, at the time of our 1997 procedures, the company did not reveal that it had this agreement with the financial institution. With this separate agreement, the bank had only one-half of the necessary equity at risk. As a result, Chewco's financial statements since 1997 were required to be consolidated with JEDI's which, in a domino effect, then had to be consolidated in Enron's financial statements.

It is not clear why the relevant information was not provided to us. We are still looking into that. On November 2, 2001, we notified Enron's audit committee of possible illegal acts within the company, as required under Section 10A of the Securities and Exchange Act.

Now, about the second SPE structure; specifically, a subsidiary of the entity known as LJM1. This transaction was responsible for about 20 percent -- or \$100 million -- of Enron's recent SPE-related restatement.

In retrospect, we believe LJM1's subsidiary should have been consolidated. I am here today to tell you candidly that this was the result of an error in judgment. Essentially, this is what happened:

After our initial review of LJM1 in 1999, Enron decided to create a subsidiary within LJM1, informally referred to as Swap Sub. As a result of this change, the 3 percent test for residual equity had to be met not only by LJM1, but also by LJM1's subsidiary, Swap Sub.

3

In evaluating the 3 percent residual equity level required to qualify for non-consolidation, there were some complex issues concerning the valuation of various assets and liabilities. When we reviewed this transaction again in October 2001, we determined that our team's initial judgment that the 3 percent test was met was in error. We promptly told Enron to correct it.

We are still looking into the facts. But given what we know now, this appears to have been the result of a reasonable effort, made in good faith.

Adjustments previously not made to Enron's 1997 financial statement

As a result of the restatement for the SPEs, Enron was required to address proposed adjustments to its financial statements that were not made during the periods subject to restatement. Questions have been raised about certain of these "passed adjustments." Let me address that issue next.

As part of the audit process, the auditor proposes adjustments to the company's financial statements based on its interpretation of Generally Accepted Accounting Principles (GAAP). A company's decision to decline to make proposed adjustments does not mean that there has been an intentional effort to misstate. If the auditor believes that the company's actions result in either an intentional error or a material misstatement, it may not sign the audit opinion.

Often, there is a timing issue to consider. These adjustments typically are proposed by the auditor at the conclusion of the audit work – usually one or two months after the close of the year-end. Some companies, like Enron, choose to book those adjustments in the year after the auditor identifies them, when they are immaterial.

Questions have been raised about \$51 million in adjustments not made in 1997 when Enron reported net income totaling \$105 million. Some have asked how adjustments representing almost half of reported net income could have been deemed to be immaterial.

Auditing standards and SEC guidance say both qualitative and quantitative factors need to be considered in determining whether something is material. The Supreme Court has described this approach as the "total mix" of information that auditors must consider.

In 1997, Enron had taken large nonrecurring charges. When the company decided to pass these proposed adjustments, our audit team had to determine whether the company's decision had a material impact on the financial statements. The question was whether the team should only use reported income of \$105 million, or should it also consider adjusted earnings before items that affect comparability – what accountants call "normalized" income?

4

We looked at "the total mix" and, in our judgment, on a quantitative basis, the passed adjustments were deemed not to be material, amounting to less than 8 percent of normalized earnings. Normalized income was deemed appropriate in light of the fact that the company had reported net income of \$584 million one year earlier, in 1996, \$520 million in 1995 and \$453 million in 1994.

It is also important to remind you that the restatement analysis presented in Enron's recent 8-K filing was not audited. When Enron's audited restatement is issued, the \$51 million in adjustments presented in 1997 will be reduced for the effect of adjustments proposed in 1996, which were recorded in 1997.

Reclassification of \$1.2 billion of shareholders' equity

Now let me turn to the issue of shareholders' equity. Shareholders' equity was incorrectly presented on Enron's balance sheet last year and in two unaudited quarters this year.

Auditors do not test every transaction and they are not expected to. To do so would be impractical and would be prohibitively expensive. EnronOnline alone handled over 500,000 transactions last year.

Auditing standards require an audit scope sufficient to provide reasonable – not absolute —
assurance that any material errors will be identified. This testing is based on a cost-effective and
proven technique known as sampling. If appropriate accounting is found in a properly chosen
sample, this generally provides reasonable assurance that the accounting for the whole
population of transactions has been done in accordance with GAAP and is free of material
misstatement.

Shareholders' equity was initially overstated last year for a transaction with a balance sheet effect of \$172 million. This amount was recorded as an asset, but should have been presented as a reduction in shareholders' equity. That amount, \$172 million, was less than one third of one percent of Enron's total assets and approximately 1.5 percent of shareholders' equity of \$11.5 billion. It was a very small item relative to total assets and equity and had no impact on earnings or cash flow. Accordingly, the transaction fell below the scope of our audit.

In the first quarter of this year, Enron accounted for several more transactions in a similar way, increasing the size of the incorrect presentation of shareholders' equity by about \$828 million.

The quarterly financial statements of public companies are not subject to an audit, and we did not conduct an audit of Enron's quarterly reports. Consistent with the applicable standards, our work primarily was a limited review of the company's unaudited financial statements.

5

In the third quarter, Enron closed out the transactions that included the \$172 million and the \$828 million equity amounts, and we and Enron reviewed the associated accounting. This review included third-quarter impacts on the profit and loss statement and on the balance sheet. This is when the erroneous presentation of shareholders' equity came into focus.

We had discussed the proper accounting treatment for similar types of transactions with Enron's accounting staff, and therefore, the scope of our work on the year 2000 audit and this year's quarterly reviews did not anticipate this sort of error. When we informed the company of the error, the company made the necessary changes in its financial statements.

Questions about disclosure

Questions have been raised about the sufficiency of Enron's disclosures, especially about unconsolidated entities. I ask you to keep in mind that the company disclosed in its financial statements that it was using a number of unconsolidated structured financing vehicles. Unconsolidated means, by definition, that the assets and liabilities of these entities were not recorded in Enron's financial statements. However, in certain circumstances, footnote disclosures are required.

With that disclaimer, let me offer one man's view of what investors were told. Enron had hundreds of structured finance transactions. Some were simple; others, very complex. The company did not disclose the details of every transaction, which is acceptable under GAAP, but it did disclose those involving related parties and unconsolidated equity affiliates.

- JEDI and other entities are listed in footnote nine of Enron's 2000 annual report.
- LJM1 and LJM2, involving the company's former CFO, both were described in the 1999 and 2000 annual reports and described more fully in its annual proxy statements.

In footnote 11 to the 2000 annual report, Enron also disclosed under the heading "Derivative Instruments" that it had derivative instruments on 12 million shares of its common stock with JEDI and 22.5 million with related parties.

Some people say we should have required the company to make more disclosures about contingencies, such as accelerated debt payments, associated with a possible decline in the value of Enron's stock or changes in the company's credit rating.

I ask you to keep in mind that the company's shares were coming off near record levels when we completed our audit for 2000. No one could have anticipated the sudden, rapid decline we

6

witnessed in this stock and its credit ratings, and accounting rules don't require a company to disclose remote contingencies.

That said, we continue to believe investors would be better served if our accounting rules were changed to reflect the risks and rewards of transactions such as SPEs, not just who controls them. Putting more of the assets and liabilities that are at risk on the balance sheet would do more than additional disclosure ever could. We have advocated changes in these accounting rules since 1982.

I offer an additional observation about Enron's disclosures. Press reports indicate that some who analyzed the company's public disclosures came to the conclusion that perceptions about the company – and thus the market's valuation of Enron – were not supported by what was in the company's public filings.

Fees paid to Andersen

Some are questioning whether the size of our fees, \$52 million, and the fact that we were paid \$27 million for services other than the Enron audit, may have compromised our independence at Enron. I understand that the size of fees might raise questions, and I think our profession must be sensitive to that perception.

With that in mind, I think it would be helpful for the Committee to have a deeper understanding of the nature of the work we did for Enron, and how the fees for that work were reported.

As a starting point, it is important to recognize that Enron was a big, complex company. Enron had \$100 billion in sales last year. It operated 25,000 miles of interstate pipeline and an 18,000-mile global fiber optic network. Enron did business in many countries. Its EnronOnline trading system was the world's largest web-based eCommerce system and handled more than half a million transactions last year – for 1,200 products. Enron was the seventh largest company on the Fortune 500.

This was not a simple company. It was not a simple company to audit. In addition to its operations and trading, Enron, as we know, engaged in sophisticated financial transactions. Not a few, but hundreds. Assets worldwide totaled \$65 billion, both before and after Enron adjusted for the restatements

Given this complexity, it should not surprise anyone that the fees paid to our firm for Enron's audit were substantial. The \$25 million we were paid for Enron's audit last year is comparable to the amounts that General Electric and Citigroup, two sophisticated financial services providers,

7

paid for their audits. It is slightly more than the audit fees paid by two others -- JPMorgan Chase and Merrill Lynch.

Because of the way the fee categories for new proxy statement disclosures on auditor fees were defined, many services traditionally provided by auditors – and in many cases *only* provided by auditors – now are classified as "Other." Regrettably, without knowledge of the underlying facts, this leads some to believe that such fees are for "consulting" services.

In fact, \$2.4 million of the \$27 million in "Other" fees reported by Enron last year related to work we did on registration statements and comfort letters. This is work only a company's audit firm can do.

Another \$3.5 million was for tax work, which has never even been mentioned as a conflict with audit work. Audit firms almost always do tax work for clients.

Another \$3.2 million of the "Other" fees Enron paid us last year related to a review of the controls associated with a new accounting system – a service highly relevant to the auditor's understanding of the company's financial reporting system. Another Big Five firm installed that financial accounting system – for about \$30 million.

Finally, \$4 million of the fees listed as having been paid to Andersen were, in fact, paid to Andersen Consulting, now known as Accenture. As most of you know, our firms formally separated last August and had been operating as independent businesses for some time. Nevertheless, the rules said Enron had to report any fees it paid to Andersen Consulting as having been paid to its audit firm.

If you take all these factors into account, the total fees that Arthur Andersen received from Enron last year amounted to \$47.5 million. And of this, about \$34.2 million, or 72 percent, was audit-related and tax work. Total fees for other services paid to our firm amounted to \$13.3 million. This was for several projects, none of which was for systems implementation or for more than \$3 million.

Some may still assert that even \$13 million of consulting work is too much – that it weakens the backbone of the auditor. There is a fundamental issue here. Whether it's consulting work or audit work, the reality is that auditors are paid by their clients. For our system to work, you and the investing public must have confidence that the fees we are paid, regardless of the nature of our work, will not weaken our willingness to do what is right and in the best interest of the investors as represented by the audit committee and the board.

I do not believe the fees we received compromised our independence. Obviously, some will disagree. And I have to deal with the reality of that perception. I am acutely aware that our firm must restore the public's trust. I do not have all the answers today. But I can assure you that we are carefully assessing this issue and will take the steps necessary to reassure you and the public that our backbone is firm and our judgment is clear.

Lessons for the Future

When a calamity happens, it is absolutely appropriate to ask what everyone involved could have done to prevent it. By asking the other witnesses and me to testify today, the committee is working hard, in good faith, to understand the issues involved and to help prevent a recurrence with another company.

I believe that there is a crisis of confidence in my profession. This is deeply troubling to me, as I believe it is a concern for all of the profession's leaders and, indeed, all of our professionals. Real change will be required to regain the public's trust.

Andersen will have to change, and we are working hard to identify the changes that we should make.

The accounting profession will have to reform itself. Our system of regulation and discipline will have to be improved. I discussed some of the issues that the profession faces in an op-ed in the Wall Street Journal last week, which is attached to my testimony.

Other participants in the financial reporting system will have to do things differently as well - companies, boards, audit committees, analysts, investment bankers, credit analysts, and others.

We all must work together to give investors more meaningful, relevant and timely, information.

But our work starts with our firm. We are committed to making the changes needed to restore confidence.

A day does not go by without new information being made available, and I would observe that all of us here today -- and many others who are not here -- have a responsibility to seek out and evaluate the facts and take needed action. My firm, and I personally as its CEO, will continue to do our part. I hope that my participation today has been helpful to your efforts.

Thank you.

Testimony of
Charles L. Hill
Director of Research
Thomson Financial / First Call
before the joint session of
the House Subcommittee on

Capital Markets, Insurance, and Government Sponsored Enterprises and

the House Subcommittee on Oversight and Investigations 12 October 2001

BROKER ANALYST'S ANALYSIS OF ENRON

Prologue

I welcome the opportunity to again testify in front of the House Financial Services Committee. I believe this committee has been addressing substantive issues that are important not only to the future health of the investment community, but important to the general public's perception of and confidence in the overall capitalist system.

The excesses associated with, Enron that led to its bankruptcy are more far reaching than just their impact on Enron.

There is plenty of blame to go around in the mistakes made in the Enron situation. I am here today to focus on the role of the broker analysts in this debacle.

In my previous testimony before this committee, I did not tread lightly on what I thought were some serious problems in analyst behavior that needed to be remedied.

I am here this morning, however, to say that the analysts to some degree were more victims rather than culprits in the Enron situation. Not that they were without blame, particularly in the late stages of the Enron collapse, but they were not the underlying cause of the excessive rise in Enron's stock that later proved to be irrational.

The performance of the analysts should be judged on two fronts. The first is their analysis of Enron's fundamentals, particularly in regard to earnings. The second is their valuation assessment and recommendations of Enron stock.

Analysis of Enron Fundamentals by Broker Analysts

The thing that stands out most visibly about the analyst's analyses of Enron, is that over the three years up to October 2001, their estimates at the beginning of each year for that year had minimal changes. The few changes that did occur were always upward and usually followed the guidance given by the company when they reported quarterly earnings. The narrowness of the spread of estimates among analysts was remarkable, especially for an energy company. The coefficient of variance for Enron estimates was consistently below the average for the S&P500 during the same period.

This pattern is highly suggestive that the analysts were being spoon fed as to what Enron expected earnings to be. The analysts might have been willing to accept company guidance, be it overt or inferred, as long as the company kept meeting expectations each quarter. Since at least the beginning of 1998, Enron has met or exceeded analyst estimates every quarter.

One reason that analysts may have been more willing than normal to accept company guidance for Enron was that it was becoming increasingly difficult to understand how Enron was achieving its revenue growth and profitability. Extensive use of derivatives, particularly when the company is using mark-to-market accounting is extremely difficult in the best of situations. We now know that a big additional reason for the difficulties in analyzing Enron's financials was that there were significant parts of Enron's business that were hidden from the balance sheet.

Often the way out for analysts when faced with difficult to analyze situations like Enron is to drop coverage. Why take the risk when there are plenty of companies that are transparent enough to do meaningful analysis with confidence? The problem with dropping Enron was that it had become the giant in the industry. If you were an analyst covering that industry, you essentially had to cover Enron. That was further reinforced if your firm was one of Enron's investment bankers or investment banker wannabe.

The real problem though was having sufficient information about the off balance sheet items. Whether the accounting for each of these items was within FASB rules or not is not yet clear, although the announced restatement of prior periods earnings is a strong signal that at least not all was kosher. But what is clear is that Enron was not providing what could even be considered minimum transparency in its financials and that the analysts did not have all the tools necessary to make a reasonable analysis.

Valuation of Enron Stock by Broker Analysts

In evaluating analyst performance on recommending Enron stock, one first has to understand how the brokerage community's recommendation really

works. As I have testified before to this committee, the investor needs a two level decoder.

The first level of the decoder gets all the brokers on a common recommendation scale. The most common scale is a five tiered one, where the top category is a strong buy, the second is a buy, the third is hold, the fourth is sell, and the fifth is strong sell. Most brokers have a five tier scale, some have a four tier one, and a few have a three tier scale. In addition, many have very different terminology. The term "buy" may be the term used for the top category at some brokers, or for the second best category at many brokers, or, in at least one case, for the middle category. There are more than a dozen different terms used for each of the top three categories, and almost as many for the bottom two.

Unfortunately, getting all the firms on a common scale is not the end of the decoding. Analysts are overly biased on the positive side in their recommendations. The typical distribution is about 33% of all recommendations are in the top or strong buy category, about 33% in the second or buy category, about 33% in the middle or hold category, and only about 1% in the remaining sell and strong sell categories combined.

If the recommendations are put in numeric terms where 1 is a strong buy (or whatever the broker's term is for their top category), 2 is a buy, 3 is a hold, 4 is a sell, and 5 is a strong sell. Using this numerical scale, consensus recommendations can be calculated for each company. Most of the time the average consensus recommendation for either the companies in the S&P500, or for the roughly 5000 companies that analysts cover, is a 2.1. Occasionally, the average may be a 2.0 or a 2.2.

Therefore, the second level of the decoder would move the recommendations into three more meaningful categories. Those in the 1 or strong buy category would really be saying buy, at least in relative terms. Those in the 2 or buy category would really be saying they were neutral on the stock, and those in the 3 or hold, the 4 or sell, and the 5 or strong sell categories all would be saying sell the stock.

For Enron, the consensus recommendation, as shown on the accompanying graph, was about a 1.5 from May 2000 until the end of September 2001. Even if we had our decoder to compensate for analyst optimism, it is clear that the analyst covering Enron were very positive with their recommendations.

But during that same period, the analysts had similar or higher consensus recommendations on competitors like Calpine and Dynegy. While the consensus recommendation for Enron was much better than the average for S&P500 companies, there enthusiasm was not limited to Enron.

In early October 2001, the consensus recommendation spiked up from a 1.5 to a 1.3 as several analysts raised their recommendations ahead of Enron reporting its 3Q01 earnings on 16 October. On the day of the earnings announcement one analyst raised their recommendation, pushing the

consensus to a remarkable 1.2. But as the Enron story began to unravel over the next few days, the recommendation downgrades exploded, plus six of the seventeen analysts dropped coverage.

Conclusions

In these kind of situations, it is easy to point a finger at the analysts for mistakes made. In my prior testimony, and in other forums, I have taken the analysts to task for not performing to an acceptable standard in certain situations. While the analysts are certainly not without blame on Enron, they are not the real culprits in this situation.

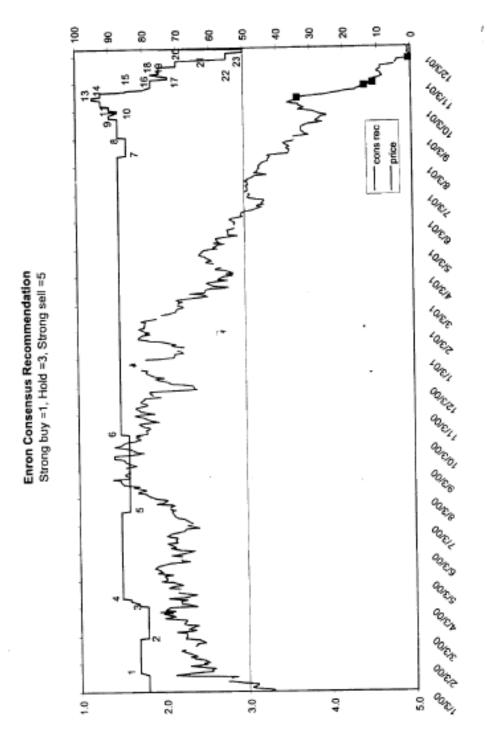
I am not an expert in doing the actual accounting at a company, or in auditing a company's accounting, but having been an analyst for 22 years, as well as closely observing analyst behavior at First Call for the last ten, I can say without reservation that this was a situation where either the company or its auditors or both were at fault in not providing investors, especially including the analysts, with the tools necessary to understand Enron's business.

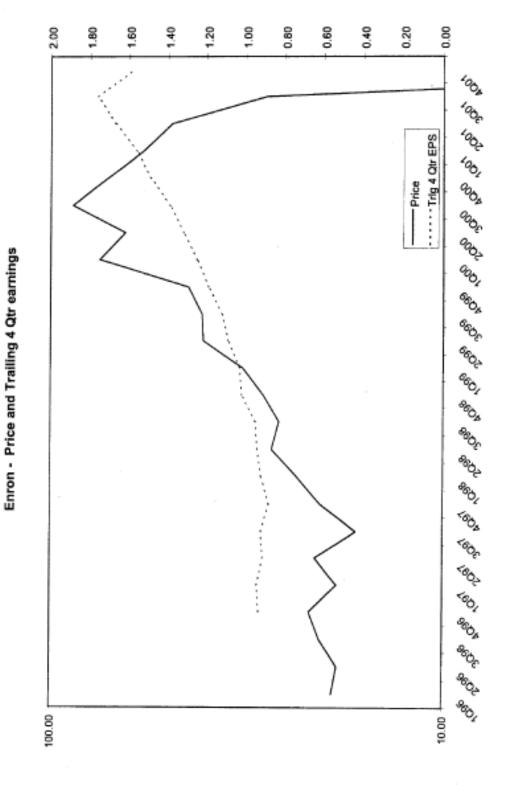
Whether the letter of the accounting rules were met or not, it is patently obvious that the spirit of the rules was violated in that Enron's financial statements did not fairly convey enough information for investors to reasonably analyze the company's operations.

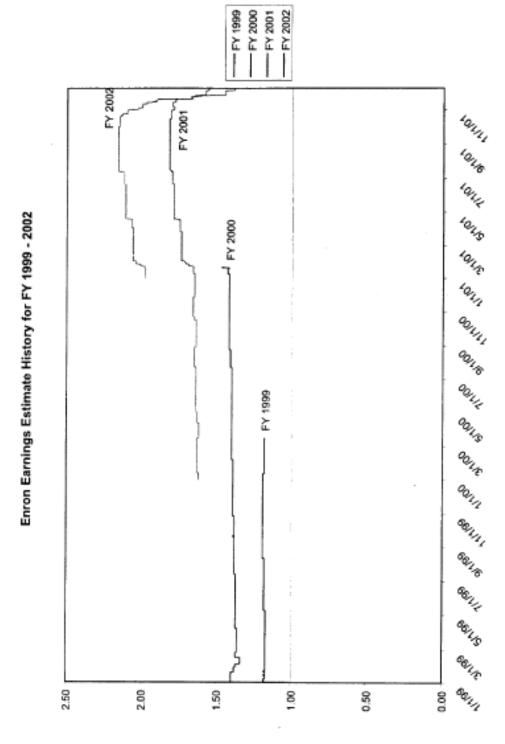
In that climate, it is hard to be too critical of the analysts' optimism. Enron had a long history of showing consistent and substantive earnings growth. If it had been up to me if I was in that situation, I would have dropped coverage long before October 2001. The financial reports and details of operations had become more and more inscrutable well before then. But as I mentioned earlier, most, if not all, analysts did not have that operation. All things considered, they probably did as well as could be expected until October 2001, although in hindsight it is easy to say that they could have at least tempered their bullish recommendations to some degree.

However, once the issues of the off balance sheet items became an unexplained issue on the 16 October 2001 conference call on 3Q01 results, it does seem that the analysts could have moved quicker to either suspend their recommendation or dramatically drop the level of their recommendation. The unexplained \$1.2 billion balance sheet writedown was not a caution flag, it was a red flag.

But Enron is not the situation on which to challenge analyst performance. There are far more significant situations were analyst conflicts and performance are at issue. The lessons to be learned here is how to insure that company's and their auditors can be relied on to openly provide the necessary tools for investors to meaningfully analyze the company's business.







TESTIMONY OF RICHARD L. TRUMKA
SECRETARY-TREASURER, AFL-CIO
BEFORE THE SUBCOMMITTEES ON CAPITAL
MARKETS, INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES AND THE
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS

DECEMBER 11, 2001

Good morning Chairman Baker. My name is Richard Trumka, and I am the SecretaryTreasurer of the AFL-CIO. On behalf of the AFL-CIO and our unions' 13 million
members, I am grateful to the Financial Services Committee for affording us the
opportunity to express our views on the implications of the collapse of Enron. In
particular I would like at the outset to commend this Committee and Chairman Baker in
particular for his leadership in calling this hearing and his foresight in looking at the issue
of analyst independence last summer. As I will describe below, that issue is a significant
part of what went wrong at Enron.

My purpose in appearing here today is threefold. First I would like to give the committee some sense of the impact the collapse of Enron has had on workers trying to invest for their retirement, and on unions and employers trying to help workers achieve retirement security. Second, I would like to take a moment or two to talk about why Enron collapsed, and the links between Enron's collapse and the issues that were already facing this Congress on the day the Enron disclosures began. Finally, and perhaps most importantly, there is a clear regulatory agenda that the Securities and Exchange Commission and the Department of Labor must take up. Today the AFL-CIO has sent rulemaking petitions to the SEC embodying this agenda of auditor independence and Board integrity. With this Congress' support, the relevant regulatory agencies could take a series of initiatives that would go a long way toward protecting workers' retirement security and the investing public from the conflicts of interest that led to the collapse of Enron.

We are here today because Enron's bankruptcy was of a size and speed not experienced since some of the famous debacles that followed the Great Crash of 1929. And we must begin by recognizing that its collapse has had a real impact not just on big Wall Street firms, but on millions of working people and their pension funds.

This is a catastrophe rich in irony. Enron was a company that talked about a future of transparent markets, but whose CFO openly bragged to the financial press that its own accounting was a black box, saying "We don't want anyone to know what's on those books. We don't want to tell anyone where we're making money."

This was a company that complained about the costs of corruption in the global economy, but made campaign contributions an integral part of its business strategy; a company whose own governance was a web of conflicts of interest that completely stymied the protections our legal system provides investors. And finally this was a company whose mantra was deregulation and privatization, but which has ultimately become an advertisement for why workers need both defined benefit pension plans and a Social Security system safe from the conflicts of interest rampant in the capital markets.

We must, however, begin with those who have been hurt worst and most unconscionably by the conduct of the Board and officers at Enron--the employees of Enron, more that 5,000 of whom have already lost their jobs, and more than 12,000 of whom participated

in Enron's 401(k) plan.² Enron's contribution to these employees' retirement security was to donate stock to their accounts and to encourage employees to put their own savings into company stock as well. They appear to have done this without even giving their employees a prospectus, as required under current law.³ The result was that on the eve of the collapse over half of the assets of Enron's 401(k) were invested in the company's stock, and many individual workers had all of their 401(k) assets in company stock.

Then on October 17, 2001, the same day that the Securities and Exchange Commission announced it was investigating Enron, the company chose to implement a plan to switch 401(k) administrators, knowing that their decision would freeze employees' accounts, leaving them unable to get out as the stock price went into freefall.⁴ Meanwhile the insiders continued their insider selling, selling that netted a handful of people over \$1 billion.⁵ The blackout continued for three weeks, two weeks longer than the industry standard for such a change, according to Plan Sponsor magazine.⁶ Then at the end of November when the market price of Enron's stock was under \$1, Enron placed shares of stock it had purchased earlier this year into the frozen accounts and charged employees' accounts \$61 per share. The final insult was that as Enron laid off thousands of employees, management tried to extort waivers of 401-k claims by threatening to withhold portions of worker severance payments.⁷ Now Enron employees' only hope of recovering the retirement money they entrusted to their own company lies in the hands of the courts. And frankly, there does not appear to be sufficient assets available to come anywhere near close to the claims against the company.

Ironically, Congress passed the Employee Retirement Income Security Act (ERISA) to prevent situations in which corporate bankruptcies meant workers lost their jobs and their pensions, just like what happened to thousands of workers at Studebaker in the 1960s. Decades later, thousands of Enron employees find themselves in the same position.

I focus particularly on these workers because, unlike most other investors in the company, by and large Enron workers did not have diversified portfolios. The bulk of their retirement savings was in Enron stock. Many of the 1,000 members of the International Brotherhood of Electrical Workers at Enron's subsidiary Portland General Electric have suffered catastrophic losses, members like Roy Rinard, who watched helplessly, his accounts frozen, as his twenty two years of retirement savings dwindled from \$472,000 to less than \$3,500. Ken Kahloni, a former information and technology manager at Enron, lost \$75,000 in his 401(k). He said, "I took a pay cut to work there two years ago, because I wanted to work for the 'best company."

But the harm Enron's collapse has caused America's working families by no means stops there. Workers' retirement funds have lost tens of billions of dollars in the collapse of Enron. Earlier this year, Enron was the 7th largest company in America measured by revenue.⁸ Enron's equity at its peak was worth about \$63 billion, and its bonds another \$6 billion more. There was almost twice as much money invested in Enron stock than in General Motors stock.⁹ Most pension funds and institutional investors held some Enron

Page 5

stock or bonds. If any person in this room has an S&P 500 index fund in your 401(k) or your mutual fund portfolio, you lost money in Enron-- probably about half a percent of your total assets in that fund. And this is if you invested in index funds-- in a strategy that is designed to cheaply mitigate the risks of investing in any single company.

Let me give you some examples of the monies lost by pension funds. The Amalgamated Bank of New York, a major index fund manager for union and public pension funds, has filed court papers stating index funds it sponsored lost approximately \$10 million in Enron equity and debt. The Georgia State Board of Investment has said in court that it has the largest losses. Filings by major commercial money managers with tens of billions of dollars of worker retirement money under management such as Alliance, Janus and Fidelity suggest each has losses in the hundreds of millions of dollars. Most of this money is being invested to fund pension benefits for working families—for the public employees we are counting on to protect us during this period of national crisis, for the pensions of the iron workers who are as we speak clearing the rubble at Ground Zero, for the firefighters who today, as on September 11, stand ready to give their lives to save ours. Because of the way that our retirement system has become increasingly interwoven with the capital markets, practically every American fortunate enough to be able to save for retirement in any form was hurt by the collapse of Enron.

In part, the moral of this story is that conflicts of interest in the capital markets can do a lot of damage to America's working families. Currently, Congress is considering

Testimony of Richard L. Trumka House Financial Services Committee

December 12, 2001

Page 6

legislation sponsored by Rep. Boehner that would remove the ban on conflicts of interest

in the provision of investment advice to 401(k) participants.12 Mr.Boehner's bill would

leave 401(k) participants prey to the same conflicts that have so distorted the analysis of

individual stocks, and as Enron shows, conflicts of interest can truly harm 401(k)

participants' retirement savings. Similarly, consider how much worse this situation

would be for Enron employees if their Social Security benefits had been invested in

Enron, as they would if the privatization advocates had had their way.

Now some may ask, don't people gain and lose money in the markets every day-- isn't the

Enron story just a particularly dramatic example of the dynamics of risk and return. Our

answer, as stewards of worker capital, is emphatically no-- this is not how the financial

markets should work. This is not a story of risk or of ignorance. It is a story of conflicts

of interest, of duties breached and duties ignored, of loyalty betrayed. This is a story of

vital information whose disclosure might have saved the company being withheld until it

was too late. It is a story of people so shameless and greedy that literally as the

bankruptcy papers were being drawn up they were still passing what remained of the

firm's cash out to themselves-\$55 million on the last working day before they filed for

Chapter 11.13

Now obviously a lot of people have sued in court alleging some of these things. In the

end the facts, many of which today are murky, will be sorted out. But even today certain

things are clear.

02371

Though Enron began as a utility and pipeline company, and its hard assets remain just that, Enron had become a new kind of financial intermediary. Enron brokered a huge number of contracts allocating price risk and other kinds of risk in an increasingly bewildering array of commodities—from natural gas and electricity to Internet services to the weather. In that kind of business, a company's most valuable asset is trust—trust that you are telling all your constituencies the truth, trust that you are a market maker and not merely a gambler. And what seems to have fundamentally happened to Enron is that the company's management abused that trust and ultimately destroyed it. Almost overnight Enron turned from a market colossus with an enterprise value of well over \$70 billion to a mere collection of pipes and computer terminals worth considerably less than its debts.

The story of Enron's unraveling begins with self-dealing—with transferring business out of the company into the hands of related entities that were in large part owned by Enron executives. These transactions were approved by the Board of Directors, the auditors and the lawyers. According to the chairman of the Compensation Committee, Charles Le Maistre, the partnership arrangements served in part to retain executives, saying "We try to make sure that all executives at Enron are sufficiently well-paid to meet what the market would offer." But there was no mention of these transactions anywhere in Enron's extensive disclosure of its already extremely generous executive compensation practices. And the company funds that were put into these partnerships were accounted for as investments, not as payments to executives. These partnerships then went on to

Page 8

lose Enron and its shareholders over \$1 billion.¹⁵ The disclosures around these partnerships and the loss that suddenly appeared on Enron's balance sheet in October was the first of a series of increasingly devastating revelations that both recast the company's historic performance and completely destroyed the credibility of Enron's management.

How was this allowed to happen? Let's begin with the first line of defense when management goes bad— the Board of Directors. At Enron most of the Board was independent of the company according to the SEC's requirements. But look another layer deeper, as we did after the initial revelations, and you find the majority of the supposedly independent directors were dependent on Enron or its executives— dependent on them for political support, dependent on them for investment opportunities—and were ultimately unsuited to sit on the Audit Committee or the Compensation Committee.

Some of these "independent" directors were actually investing in Enron-sponsored limited partnerships. Is it any wonde, that when the crisis began and shareholders needed desperately to hear from outside directors, all they got was silence?

Then there were the auditors. Arthur Andersen was the company's long-time auditor.

And until its division into a consulting company and an accounting firm, Andersen had been receiving millions of dollars per year in consulting fees. But even on the accounting side, Andersen marketed a variety of consulting services to Enron, including, many believe, advising Enron on the structure of the special purpose vehicles. So you had an audit firm that was dependent on Enron management for higher margin consulting

Testimony of Richard L. Trumka House Financial Services Committee

December 12, 2001

Page 9

services, purporting to provide independent review on behalf of investors of transactions

some of which they themselves, may have designed and charged a fee for.

On the subject of auditors, some have suggested that auditors are not able to detect a

carefully hidden fraud, one where the truth is completely hidden by management. And

that may very well be true, but that was not what happened at Enron. The financial

statements themselves contain the proof that the auditors were aware of each of the

transactions that led this company to grief-the self-dealing with the CFO, creating

partnerships to trade in the company's own stock, other partnerships whose purpose

seemed to be to generate dubious revenues, hide liabilities and otherwise bookable

derivatives positions from the investing public. 17 While none of these were disclosed in a

way to make them transparent to the investing public or to Enron's employees, there was

more than enough information in those statements alone to sound warning bells among

the auditors that signed off on them.

Then finally there were the Wall Street analysts. Ultimately investors look to the expert

analyst community to interpret the numbers released by the companies they invest in.

And here we saw again the spectacle of conflict of interest triumphing over duties to

investors. Enron was such a large firm doing so much business in the financial markets

that practically every Wall Street firm and post-Glass-Steagall commercial bank had an

interest in courting the company. And in the eyes of their analysts, Enron was always a

good buy. Of course, if you knew enough to seek out independent analysts, many of

02374

Page 10

whose advice comes with a price tag beyond that of the average 401(k) participant, you would have heard a different story.

As late as October, Salomon Smith Barney, whose parent Citigroup is one of the largest creditors of Enron and a provider of investment banking services, rated Enron a "buy" until October 26, then it went to "neutral" where it remained until the company filed Chapter 11.18 Lehman Brothers, who stood to earn a large advisory fee if the Dynegy deal closed, rated Enron as a strong buy right through to the end; Lehman Brothers then abruptly dropped coverage of Enron after it filed Chapter 11, stating that the "filing had complicated [the] outlook for [Enron] stock."19 Out of thirteen analysts that covered Enron in October, according to Forbes Magazine, eleven were bullish.20 But among eight independent investment newsletters tracked by Forbes, by August, when Enron CEO Skilling mysteriously resigned, four were already bearish and two more went bearish by October.21

Finally, the last link that failed was the active money managers. And here again investors faced conflicts of interest, including the same conflicts that compromised analysts. But the most glaring apparent conflict is the case of Alliance Capital, a major manager of worker pension fund assets and its link to Enron through Enron board member Frank Savage, a former senior executive and board member of Alliance. In the second quarter of 2001, while Mr. Savage was an executive of Alliance, Alliance Capital increased its Enron holdings by 71 percent to become the largest Enron shareholder.

Testimony of Richard L. Trumka

House Financial Services Committee

December 12, 2001

Page 11

while other large investment managers reduced their stake in the former energy giant

during the same time period.22

The result was that for years the marketplace set the price of Enron's stock artificially

based on fictitious accounting, passed on by a conflicted Board and conflicted auditors,

and hyped by conflicted analysts. And both sophisticated institutions and the average

investor, following the advice of experts, bought at that price. And at least some of us

were buying from insiders, who all this past year were unloading stock at an astounding

rate.

Of course I have just described what happened before the attempted Dynegy acquisition.

In the weeks that followed the announcement, the same dynamics that appear to have

prompted the crisis led to the creation of a new myth-- that the problems at Enron were

manageable. Many people had an interest in that myth-- most importantly Enron

executives, the investment bankers who stood to reap large fees if the deal went through

and the commercial lenders whose ability to avoid an Enron bankruptcy depended on

steering the company into the Dynegy safe harbor. No one wanted to disclose what the

real state of Enron's finances was, clearly because some very scary things were hidden

there. But what this secrecy did was make certain that once the news of the extent of the

problems began to leak, no one could stop the collapse.

The AFL-CIO and worker pension funds took several steps during the collapse of Enron to try and reform corporate governance and disclosure, and then as the situation worsened to protect workers' investments in the courts. Initially, the AFL-CIO and the Amalgamated Bank, a large index manager of union pension fund assets, reached out to outside directors. We wrote to Enron's Board asking that a special committee of the Board that had been set up and chaired by Thomas Power, Dean of the University of Texas Law School, broaden its agenda from merely investigating specific past transactions to reforming both the company's executive compensation and its audit policies.23

When the Dynegy transaction was announced, we again wrote to the Enron Board, pointing out that the markets continued to be in turmoil due to incomplete disclosure and that investors more than anything needed enhanced disclosure both to stabilize prices and to enable investors to evaluate the Dynegy transaction. We suggested the company immediately recruit people with credibility in the capital markets to its Board. We offered to meet with the Board and discuss possible candidates, but never received a substantive reply. Given what we all know now about the lack of independence of the Board, this is no surprise.24 Copies of our letters are attached.

As the situation deteriorated the AFL-CIO, together with other large institutions, contemplated a state court action to obtain Enron's books and records to be able to evaluate the Dynegy deal. But before we could begin that process the deal collapsed. In

Page 13

the wake of Enron's bankruptcy, the Amalgamated Bank took the last step remaining open to investors, bringing suit in federal district court in Houston on behalf of Enron's shareholders against both Arthur Andersen and Enron's Board and officers.25

The most important lesson to be learned from the collapse of Enron and from our unsuccessful efforts to protect workers' investments is how hard it is to repair the damage done by rampant conflicts of interest aided by regulatory loopholes. We have to get the regulatory system right in the first place. And though the Securities and Exchange Commission has made great efforts in recent years to strengthen investors' regulatory protections, the truth is that too often steps that were necessary have not been taken due to resistance by a variety of entrenched interests. Union pension funds have tried through corporate governance efforts like the building trades funds' support of independent auditors to strengthen these protections firm by firm, but we cannot do it alone.

Therefore, the AFL-CIO is today submitting two rulemaking petitions to the Commission aimed at addressing the structural problems in our securities laws that gave rise to the Enron fiasco, which are attached to our testimony. We ask in these petitions that the Commission act to tighten the definition of who is an independent director, and require the disclosure of the full range of ties that can exist between directors and the corporate officers they oversee. In the accounting area, our proposals address most of the practices I have discussed. Our proposals include a prohibition on accountants reviewing transactions they themselves structured, direct audit committee approval of any auditor

Page 14

consulting arrangement and the audit engagement itself, and a variety of steps designed to ensure that public auditors are always looking at the firms they audit with a reasonably fresh eye. In addition, I would call your attention to testimony the AFL-CIO has previously submitted to this Committee on the subject of analyst independence and the regulatory changes that could improve that situation that contributed so significantly to the debacle at Enron.²⁶

While we do not believe legislation is necessary, the fact is that without Congressional support for these kinds of regulatory changes, the interests that profit from the loopholes that brought us Enron will prevail again, as they so often did in the regulatory fights of the 1990's. We hope very much that Chairman Harvey Pitt takes up the agenda embodied in our rulemaking, but frankly we know he cannot do so successfully without the support of this Committee and your counterparts in the Senate.

I urge this Committee and this Congress to support both the Administration's enforcement actions against Enron and its Board and executives, and to urge the SEC and the Department of Labor to step forward and act against the rampant conflicts of interest and the defects in our disclosure system that gave us the Enron debacle. Our funds will fight as hard as we can to get our money back. But the truth is only strong government action can ensure that investors are not victimized again in this way. The AFL-CIO looks forward to working with you in the coming days on these important tasks. Thank you.

- 1 "Is Enron Overpriced?", by Bethany McLean. Fortune, March 5, 2001, Pg. 122.
- ² "Enron: Let Us Count the Culprits." Business Week, December 17, 2001, pg. 154
- ³ Roy E. Rinard and Steve Lacey, v. Enron Corp. and the Northern Trust Company, Class Action Compliant Filed in the United States District Court Southern District Of Texas.
- ⁴ "Enron Faces Suits by 401 (k) Plan Participants," by Theo Francis and Ellen Schultz. The Wall Street Journal, November 23, 2001
- ⁵ Amlagamated Bank et. al. v. Kennath L. Lay et. al. Cass Action Complaint Filed in the United States District Court Southern District Of Texas.
- 6 "Recordkeepers: Blackouts can be Shorter," PlanSponsor.com, December 10, 2001.
- 7 "Enron asks Staff to Drop 401 (K) Suits for Severance," Wall Street Journal, Nov 29, 2001, page C13.
- 8 "Power Failure: As Enron crashes, angry workers and shareholders ask, Where were the firm's directors? The regulators? The stock analysts?," by Daniel Kadlec. *Time Magazine*, December 10, 2001, Pg. 68.
- 9 As measured by market capitalization on December 29, 2000.
- ¹⁰ Amlagamated Bank et. al. v. Kennath L. Lay et. al. Cass Action Complaint Filed in the United States District Court Southern District Of Texas.
- Alliance, Janus and Fidelity Investments were among Enron's five largest shareholders as of September 1, 2001, as reported in "Enron: Running On Empty As The Collapsed Energy Giant Seems Headed For Liquidation, Many Losers Count Their Losses," by Peter Coy et al. Business Week, December 10, 2001, pg. 80.
- ¹² The Retirement Security Advice Act of 2001 (H.R. 2269).
- ¹³ "Enron Made Payments in Bid To Hold Top Energy Traders", by Richard A. Oppel Jr. New York Times, December 10, 2001, pg. C2.
- "Enron Jolt: Investments, Assets Generate Big Loss --- Part of Charge Tied To 2 Partnerships Interests Wall Street," by John Emshwiller and Rebecca Smith. Wall Street Journal, October 17, 2001, pg. C1.
- ¹⁵ Enron Corp.'s Form 10-Q for the quarter ending September 30, 2001 filed with the U.S. Securities and Exchange Commission on November 19, 2001.

- ¹⁶ In 2000 Arthur Andersen received \$27 million in other consulting fees and only \$25 million in auditing fees. Enron Corp.'s Proxy Statement for 2001 Annual Meeting of Shareholders filed with the U.S. Securities and Exchange Commission on March 27, 2001.
- Enron Corp.'s Form 10-K for the year ending December 31, 2000 filed with the U.S. Securities and Exchange Commission on April 2, 2001.
- ¹⁸ Salomon Smith Barney analyst reports dated July 13, 2001, October 5, 2001 and October 26, 2001.
- ¹⁹ Lehman Brothers analyst reports dated October 23, October 24, November 12, November 28 and December 7, 2001.
- ²⁰ "While Enron Burned, Wall Street Fiddled", by Dan Ackman. Forbes.com, November 29, 2001.
- ²¹ "Enron: An Unreported Triumph For Investment Letters." Forbes.com, December 7, 2001.
- AXA Financial, Inc., Form 13-F, September 30, 2001, file with the Securities and Exchange Commission, November 13, 2001.
- ²³ Letter dated November 2, 2001 to William Powers, Jr., Chairman of Enron Special Committee, and Kenneth Lay, Enron Chairman of the Board and Chief Executive Officer, from Richard L. Trumka, Secretary-Treasurer of the AFL-CIO, and Gabriel P. Caprio, President and CEO of Amalgamated Bank.
- ²⁴ Letter dated November 9, 2001 to William Powers, Jr., Chairman of Enron Special Committee, and Kenneth Lay, Enron Chairman of the Board and Chief Executive Officer, from Richard L. Trumka, Secretary-Treasurer of the AFL-CIO, and Gabriel P. Caprio, President and CEO of Amalgamated Bank.
- ²⁵ Amiagamated Bank et. al. v. Kennath L. Lay et. al. Cass Action Complaint Filed in the United States District Court Southern District Of Texas.
- ²⁶ Testimony of Damon A. Silvers, Associate General Counsel, AFL-CIO, before the House Subcommittee On Capital Markets, Insurance, And Government Sponsored Enterprise on "Analyzing the Analysts—Are Investors Getting Unbiased Research From Wall Street", June 14, 2001.

December 11, 2001

Jonathan G. Katz Secretary U.S. Securities and Exchange Commission 450 Fifth Street, N.W. Washington, DC 20549

Re: Petition for rulemaking

Dear Mr. Katz,

The American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO") hereby petitions the Securities and Exchange Commission (the "Commission") to undertake a rulemaking proceeding to amend the rules governing auditor independence to revise the definition of an independent auditor and limit the services accounting firms may provide to their audit clients. We also ask the Commission to require additional proxy statement disclosure regarding the role of the audit committee in approving both audit engagements and non-audit consulting agreements with the audit firm. As shown by the scandal currently unfolding at Enron Corporation, investor confidence in the U.S. capital markets requires that auditors be, and be perceived as, truly independent from their clients.

The AFL-CIO is a federation of trade unions that represent 13 million working men and women who participate in the capital markets as investors through defined benefit and defined contribution plans as well as through mutual funds and individual accounts. Our member unions sponsor benefit plans with over \$400 billion in assets, and our members are participants in public employee and collectively bargained single-employer plans with over \$5 trillion in assets. Our union-sponsored funds alone are the beneficial owners of approximately 3.1 million shares of Enron stock, through both actively-managed and passive (or indexed) portfolios.

Background

Independent auditors occupy a central position in promoting confidence in the integrity of the financial reporting system and U.S. capital markets. Because the Commission requires that financial information filed with it be certified or audited by independent auditors, auditors are, as the Commission recently stated, the "gatekeepers" to the public securities markets. Auditors work not only for their clients, but also for the investing public.

The role of the independent auditor is once again in the spotlight, as it was following relevations of accounting fraud at Sunbeam, Cendant and Waste Management. Now, the stunningly rapid failure of Enron Corporation, where there is evidence that Enron's auditor, Arthur Andersen, knew about and identified accounting errors but did not insist on their timely correction, focuses attention on the factors that might lead a company's auditor to sign off on misleading financial statements. Foremost among these is a dependence on a company and its management that can serve to undermine an auditor's objectivity.

Independence can be compromised in various ways. The provision of certain kinds of non-audit consulting services to audit clients may create economic incentives that can lead a firm to devalue the audit services and focus on retaining the client, even at the cost of making inappropriate audit judgments. In 2000, Arthur Andersen received more non-audit fees than audit fees from Enron. A "mutuality of interest" not conducive to independence may develop from the provision of certain kinds of non-audit services or from the employment by an audit client of former employees of the auditor. Certain services result in the auditor acting as management or an employee of the client. Finally, auditors may not be able to audit objectively work performed by the audit firm itself under a consulting agreement.

Over the past several decades, the proportion of audit firms revenues derived from non-audit services, such as internal audit, information technology, financial advisory and appraisal and valuation services, has grown steadily. At the five largest public accounting firms, revenues derived from non-audit services grew from 13% of total revenues in 1981 to half of total revenues in 2000.²

The 2000 Commission Rulemaking

Citing these threats to independence and their potential effect on capital formation, as well as the increased pressure on companies to make or surpass analyst earnings estimates, the Commission undertook last year to revise its rules governing auditor independence. With respect to the provision of non-audit services to audit clients,

Revision of the Commission's Auditor Independence Requirements, Exchange Act Release No. 43602 (Nov. 21, 2000) (adopting release).

Revision of the Commission's Auditor Independence Requirements, Exchange Act Release No. 42994 (June 30, 2000) (proposing release).

the Commission solicited comment on three alternative approaches: banning the provision of such services altogether, imposing limits on the provision of those non-audit services deemed most likely to impair independence, and requiring only additional disclosure.³

Although a number of commenters and those testifying at the Commission's public hearings favored a ban on non-audit services, there was also significant opposition, mainly from the accounting profession, to any substantive reform. As a result, the final regulations reflected a compromise in which auditors could provide those non-audit services that posed a danger to independence, but only under certain circumstances. (The proposed limitation on providing expert testimony were dropped in its entirety.) A compromise was also reached regarding the additional disclosure required of registrants regarding the non-audit services provided by their auditors and the involvement of their audit committees with respect to auditor independence issues.

In light of subsequent developments, however, we ask the Commission to revisit some of the issues raised in the 2000 rulemaking, and to consider some new reforms, in order to strengthen its auditor independence safeguards. As discussed more fully below, both substantive reform and additional disclosure are necessary to preserve confidence in our capital markets.

The Rules on the Provision of Non-Audit Services Should be Strengthened

We believe that the Commission's final rules give too much flexibility to audit firms to provide non-audit services that could compromise the firms' objectivity and create economic incentives that may undermine the effectiveness of audits. A December 5, 2001 Washington Post article highlighted the pressures on individual auditors to "cross-sell" non-audit services to audit clients, recounting a case in which a Coopers & Lybrand accountant's performance review varied according to the amount of such services he was able to sell. That case involved Phar-Mor, which later filed for bankruptcy protection following revelations of accounting fraud; a jury found that Coopers, Phar-Mor's auditor, had committed fraud.

We believe that in some cases the sheer amount of the consulting services may create perverse incentives. During testimony in connection with the 2000 rulemaking, much was heard about the "loss leader" phenomenon, in which firms submitted artificially low bids, not consistent with providing high quality audit services, as a way to establish a relationship with a client and sell audit services. The audit then makes up an even smaller proportion of the total revenue stream from the client. And here, the danger not only lies in the auditor's impaired judgment. Anecdotal evidence suggests that executives of some companies encourage audit firms to undertake non-audit consulting as a way of obtaining leverage for the company over the audit process.

³ See id.

Certain non-audit services pose a more significant threat to an auditor's independence than others. The Commission recognized this in the 2000 rulemaking, when it prohibited firms from providing certain services, like bookeeping services. However, the Commission determined that audit firms could continue to sell information technology and internal audit consulting services to audit clients, as long as certain requirements, designed to lodge ultimate responsibility for the systems with the client, are satisfied. We believe this was a mistake.

The provision of information technology and internal audit services raise several serious problems. First, in cases where an information technology project is unsuccessful, a company may not be permitted to capitalize the costs of the project on the balance sheet (thereby creating an asset), but rather is required to expense them, thus reducing income. An accounting firm that botched the consulting job will be less likely, we think, to be assertive with management about the need to expense the item.

Similarly, if the auditor discovers, during the course of an audit, a theretofore undiscovered problem with software or an internal audit system the auditor designed and installed, the auditor is in the uncomfortable position of having to inform the client about the audit firm's own error. Finally, in a real sense the audit firm is auditing it own work because assessing the reliability of the numbers generated by an information technology or internal audit system is a part of the audit function.

We believe that the conditions imposed on audit firms in connection with information technology and internal audit consulting services are easily manipulated and do not mitigate the danger that the auditor and client will come to view the auditor as an extension of management and that the auditor will experience difficulty in vigorously auditing its own work.

Attention should be focused on another kind of consulting service, one that was not raised in the 2000 rulemaking but that has been brought to the fore by the Enron debacle. Enron's restatement of several years' worth of financial statements stemmed in part from the acknowledgment by Enron that the financial results of off-balance-sheet special purpose entities ("SPEs") set up by Enron—and in some cases managed by Enron officers—should have been consolidated with Enron's own results. In one case, Enron conceded that consolidation was necessary because the SPE had been inadequately capitalized when it was established.

Enron paid Arthur Anderson \$27 million in 2000 for non-audit consulting services, including fees for "business process and risk management consulting." We are concerned that this category may include consulting regarding the transactions pursuant to which one or more of the erroneously non-consolidated SPEs were established. Such an arrangement would, we think, create an unacceptable conflict of interest, requiring Arthur Andersen's audit personnel to question the judgment of its consultants on a matter which could—and eventually did—have a major impact on Enron's financial results. We urge the Commission to consider amending Rule 2-01 of Regulation S-X to provide that

an independent auditor may not design and/or structure a transaction the audit firm must pass on in connection with the audit.

Auditors Should be Rotated

Currently, audit firms must rotate the audit engagement partner every seven years, in order to remove the risk of over-familiarity with the client. However, the engagement partner may remain in a relationship management position with respect to the client, which mitigates the effect of partner rotation.

We believe a more sensible approach is to require mandatory rotation of audit firms every seven years. Such rotation would provide a number of important benefits. First, a new audit firm would bring to bear a skepticism and fresh perspective that a long-term auditor may lack. Second, auditors tend to rely excessively on prior years' working papers, including prior tests of the client's internal control structure, particularly if fees are a concern.⁴ Relatedly, longtime auditors may come to believe they understand the totality of the client's issues, and may look for those issues in the next audit rather than staying open to other possibilities. Finally, an auditor may place less emphasis on retaining a client relationship even at the cost of a compromised audit if it knows the engagement will end after several years.

In our opinion, the benefits to shareholders, lenders and the investing public from requiring rotation of auditors outweighs the additional cost that may be entailed in connection with a new auditor becoming familiar with the client. We urge the Commission to consider revising Rule 2-01 of Regulation S-X to provide for mandatory auditor rotation.

Additional Disclosure Should be Required

We also think that additional disclosure regarding the involvement of the audit committee in entering into the audit engagement and pre-approving non-audit consulting arrangements would enhance the effectiveness of audit committees and provide valuable information to investors. The Commission originally proposed in 2000 to require disclosure of whether the audit committee, before any disclosed non-audit service was rendered, approved and considered the effect on independence of such service. Only the latter disclosure was included in the final rule.

Requiring disclosure about the audit committee's role with respect to both the audit engagement and non-audit consulting contracts would advance important goals. Disclosing whether the audit committee, rather than the registrant, entered into the audit engagement would give investors information about whom the auditor views as its audit

See Richard G. Brody & Stephen A. Moscove, "Mandatory Audit Rotation," The National Public Accountant 32 (May 1998).

client. Commentators have noted that an auditor that views a registrant's management as its client is less likely to challenge that management in the context of an audit.

Similarly, investors would be better informed about the extent of the audit committee's involvement if the Commission required disclosure regarding audit committee pre-approval of consulting arrangements. The Panel on Audit Effectiveness organized by the Public Oversight Board, which was convened on the request of the Commission and issued its report last year, recommended that audit committees pre-approve non-audit services that exceed a threshold arrived at by the committee.

Disclosure will assist investors in determining whether a registrant has implemented that recommendation.⁵

We urge the Commission to consider taking the steps proposed herein as soon as practicable. It is vital, we think, in light of recent events, to assure the investing public of the integrity and reliability of the audited financial statements of U.S. public companies. We believe that the reforms we propose to the auditor independence and audit committee disclosure rules can be an important step in that direction.

If you have any questions regarding this petition, please do not hesitate to contact Damon Silvers at 202-637-3953. We look forward to discussing this with you further.

Very truly yours,

Richard Trumka Secretary-Treasurer

⁵ The Panel on Audit Effectiveness Report and Recommendations, sec. 5.30 (Aug. 31, 2000).

December 11, 2001

Jonathan G. Katz Secretary U.S. Securities and Exchange Commission 450 Fifth Street, N.W. Washington, DC 20549

Re: Petition for rulemaking

Dear Mr. Katz,

The American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO") hereby petitions the Securities and Exchange Commission (the "Commission") to undertake a rulemaking proceeding to amend Items 401 and 404 of Regulation S-K to require more proxy statement disclosure regarding conflicts of interest on the part of directors and director nominees. We believe that recent events at Enron Corporation have made plain that the existing disclosures are simply inadequate to ensure that shareholders are informed of all relevant information about director conflicts of interest.

Background

Our system of corporate governance relies heavily on independent directors to act as vigorous monitors of management behavior and to represent shareholder interests. For example, a committee of independent directors is often constituted to evaluate potential transactions or litigation involving a company. Similarly, the tax code requires that incentive compensation in excess of the \$1 million cap on deductibility be awarded by a compensation committee composed of independent directors. Many institutional investors, following on that requirement, take compensation committee independence into account when voting on pay packages and deciding whether to withhold votes from director candidates.

One of the most important functions entrusted to independent directors is oversight of the financial reporting process, which is of vital importance both to a company's shareholders and the markets in general. To that end, listing standards of both the New York

Stock Exchange and the Nasdaq market require listed companies of a certain size to maintain audit committees composed of independent directors, and the Commission requires companies to disclose information regarding the mandate, membership and functioning of the audit committee.

Current Disclosure Requirements

The Commission's rules also, in essence, define independence by requiring disclosure in the proxy statement of certain relationships between directors (or director nominees) and the registrant (and in some cases its executive officers) that could compromise the director's objectivity. These requirements focus on employment, family, and business relationships. Currently, the following relationships involving directors and director nominees must be disclosed:¹

- 1. Current or past employment by the registrant;
- Family relationships between the director or nominee and the registrant's executive officers;
- Transactions with the registrant or any subsidiary in which the amount involved exceeds \$60,000 and in which the director or nominee has a direct or indirect material interest;
- Indebtedness to the registrant or any subsidiary in an amount in excess of \$60,000;
- 5. The ownership of certain equity interests in, or service as an executive officer of, a business or professional entity (a) that is a significant customer of the registrant, (b) that is a significant supplier of the registrant, or (c) to which the registrant is indebted in an amount exceeding a threshold;
- Status as a member of, or of counsel to, a law firm that the registrant has retained during the last fiscal year or proposes to retain during the current fiscal year, subject to a minimum threshold;
- 7. Status as a partner or executive officer of an investment banking firm that has performed certain kinds of services for the registrant during the last fiscal year or that the registrant proposes to have perform services during the current fiscal year, subject to a minimum threshold; and
- Any other relationship similar in scope and nature to the relationships listed above.

These disclosure requirements are set forth in Items 401 and 404 of Regulation S-K.

Enron Corporation

As you are no doubt aware, Enron Corporation recently filed the largest bankruptcy case in U.S. history, precipitated by a massive crisis of investor and customer confidence. Enron has already announced plans to lay off or put on leave 7,500 workers, and the value of Enron stock held in employees' 401(k) retirement accounts has declined by \$1.3 billion since the beginning of 2001. The market capitalization of Enron, which was the seventh largest company in the Fortune 500, plunged from over \$60 billion at its peak last year to under \$1 billion last week. Enron's inclusion in the S&P 500 index until shortly before the bankruptcy filing means that the broader market and the many investors who index their equity holdings are also suffering as a result of Enron's failure.

The AFL-CIO is a federation of trade unions that represent 13 million working men and women who participate in the capital markets as investors through defined benefit and defined contribution plans as well as through mutual funds and individual accounts. Our member unions sponsor benefit plans with over \$400 billion in assets, and our members are participants in public employee and collectively bargained single-employer plans with over \$5 trillion in assets. Our union-sponsored funds alone are the beneficial owners of approximately 3.1 million shares of Enron stock, through both actively-managed and passive (or indexed) portfolios.

Enron's meltdown was caused by a number of factors, among them a cavalier attitude toward disclosure, inadequate internal controls and an approach to accounting that at best can be characterized as careless and at worst constituted a conscious effort to mislead investors and the public about the profitability of Enron's operations. These problems point to an abject failure by Enron's board, especially its finance and audit and compliance committees, in the discharge of its monitoring duties. We believe that the lack of independence on Enron's board and key committees contributed to this failure.

At first glance, Enron's board and key committees appear to be composed primarily of independent directors. According to Enron's 2001 proxy statement, of the 14 directors nominated for reelection at the 2001 annual meeting, eight, or nearly two-thirds, lacked disclosable relationships with Enron. Of members of the audit and compliance committee, which was responsible for reviewing the effectiveness of internal controls and the application of accounting principles, only one, John Wakeham, has disclosable ties to Enron, in the form of a \$72,000 per year consulting arrangement. A majority of members of the finance committee, which oversaw Enron's risk management activities, are similarly independent.

However, further research reveals that several of the eight ostensibly independent directors, including two who serve on the audit and compliance committee and one who serves on the finance committee, actually have relationships with Enron or its senior

One of those directors, then-CEO Jeffrey Skilling, resigned from both his executive and director positions in August 2001.

executives that could interfere with those directors' ability to be objective and to challenge company decisions and policies.³

- Audit committee member John Mendelsohn is the president of the University of
 Texas M.D. Anderson Cancer Center. The Cancer Center has received
 contributions from Enron, and Enron chairman and CEO Kenneth Lay was part of
 what the <u>Houston Chronicle</u> characterized as a "coalition" to lobby the Texas
 legislature for \$20 million worth of infrastructure improvements to support the
 development of the Southeast Texas BioTechnology Park, which will be built on
 University of Texas land and house the Cancer Center's Life Sciences Center.
 Compensation committee chairman Charles LeMaistre is the Cancer Center's
 president emeritus and serves on its Board of Visitors.
- According to Enron's 2001 proxy statement, directors Norman Blake and John
 Duncan own common units of EOTT Energy Partners, L.P. ("EOTT"), a limited
 partnership whose general partner is a wholly-owned subsidiary of Enron. Enron
 thus exercises significant control over EOTT, which could affect the economic
 return available to Messrs. Blake and Duncan. Mr. Blake serves on Enron's finance
 committee: Mr. Duncan is a member of the audit and compliance committee.
- Wendy Gramm, a member of the audit and compliance committee, is director of the Mercatus Center at George Mason University. According to a December 10, 2001 article in <u>Time</u> magazine, Enron contributed \$50,000 to the Mercatus Center.

Uncovering the relationships described above was neither easy nor inexpensive. An investor thus cannot evaluate the independence of the board and key committees at all or even a substantial number of the companies in its portfolio without expending significant funds. Because of the economics involved in undertaking such research, even proxy voting and research services such as the Investor Responsibility Research Center—which exploit economies of scale in assembling corporate governance data—rely solely on the disclosures set forth in the proxy statement when evaluating boards and key committees. Accordingly, we believe that additional proxy statement disclosure regarding relationships between directors and director nominees, on the one hand, and registrants and their senior executives, on the other, is vital in enabling investors to select investments wisely, monitor companies in which they have invested and cast informed votes in director elections.

Specifically, we urge the Commission to amend the rules to require disclosure of:

 Relationships between the registrant or any executive officer of the registrant and any not-for-profit organization on whose board a director⁴ or immediate family member⁵ serves or of which a director or immediate family member serves as an officer or in a similar

We raised these concerns in a letter to Enron's special committee, which is attached to this petition.

For the sake of simplicity and readability, "director" also refers to director nominees.

^{5 &}quot;Immediate family member" should be defined to include a person's spouse, parents, children, siblings, inlaws and first cousins.

capacity. Disclosable relationships should be defined to include contributions to the organization in excess of \$10,000 made by the registrant or any executive officer in the last five years and any other activity undertaken by the registrant or any executive officer that provides a material benefit to the organization. "Material benefit" should be defined to include lobbying efforts such as those engaged in by Mr. Lay on behalf of the M.D. Anderson Cancer Center as well as fundraising activities undertaken by the registrant or any executive officer on the organization's behalf.

2. Relationships in which the registrant or any executive officer exercises significant control over an entity in which a director or immediate family member owns an equity interest or to which a director or immediate family member has extended credit. Significant control should be defined with reference to the contractual and governance arrangements between the registrant or executive officer, as the case may be, and the entity. For example, in most cases, a general partner exercises significant control over a partnership, while a limited partner may exercise significant control depending on the terms of the partnership agreement.

It may be necessary to provide that the existence of significant control may depend, in part, on the overall ownership structure of the entity and not just the stake held by the registrant or executive officer. For example, the owner of less than a majority of a corporation's stock may nonetheless exercise significant control if the other stockholders are numerous and fragmented.

- Joint ownership by a registrant or executive officer and a director or immediate family member of any real or personal property.
- 4. The provision of any professional services, including legal, financial advisory or medical services, by a director or immediate family member to any executive officer of the registrant in the last five years.

We understand that in 1998 the Council of Institutional Investors ("CII") filed a petition for rulemaking relating to disclosure of director conflicts of interest and that the Commission has not responded to that request. Although CII's proposed language is more general, we believe that our request covers many if not all of the conflicts that were of concern to CII.

We urge the Commission to take up these important issues immediately. Investor confidence in the United States capital markets depends in large measure on their transparency. Full disclosure of director conflicts of interest will improve transparency and enable investors to assess more accurately the quality of companies' governance structures.

If you have any questions regarding this petition, please do not hesitate to contact Damon Silvers on 202-637-3953. We look forward to discussing this with you further.

Very truly yours,

Richard Trumka Secretary-Treasurer

Testimony of
Charles L. Hill
Director of Research
Thomson Financial / First Call
before the joint session of
the House Subcommittee on

Capital Markets, Insurance, and Government Sponsored Enterprises and

the House Subcommittee on Oversight and Investigations 12 October 2001

BROKER ANALYST'S ANALYSIS OF ENRON

Prologue

I welcome the opportunity to again testify in front of the House Financial Services Committee. I believe this committee has been addressing substantive issues that are important not only to the future health of the investment community, but important to the general public's perception of and confidence in the overall capitalist system.

The excesses associated with Enron that led to its bankruptcy are more far reaching than just their impact on Enron.

There is plenty of blame to go around in the mistakes made in the Enron situation. I am here today to focus on the role of the broker analysts in this debacle.

In my previous testimony before this committee, I did not tread lightly on what I thought were some serious problems in analyst behavior that needed to be remedied.

I am here this morning, however, to say that the analysts to some degree were more victims rather than culprits in the Enron situation. Not that they were without blame, particularly in the late stages of the Enron collapse, but they were not the underlying cause of the excessive rise in Enron's stock that later proved to be irrational.

The performance of the analysts should be judged on two fronts. The first is their analysis of Enron's fundamentals, particularly in regard to earnings. The second is their valuation assessment and recommendations of Enron stock.

Analysis of Enron Fundamentals by Broker Analysts

The thing that stands out most visibly about the analyst's analyses of Enron, is that over the three years up to October 2001, their estimates at the beginning of each year for that year had minimal changes. The few changes that did occur were always upward and usually followed the guidance given by the company when they reported quarterly earnings. The narrowness of the spread of estimates among analysts was remarkable, especially for an energy company. The coefficient of variance for Enron estimates was consistently below the average for the S&P500 during the same period.

This pattern is highly suggestive that the analysts were being spoon fed as to what Enron expected earnings to be. The analysts might have been willing to accept company guidance, be it overt or inferred, as long as the company kept meeting expectations each quarter. Since at least the beginning of 1998, Enron has met or exceeded analyst estimates every quarter.

One reason that analysts may have been more willing than normal to accept company guidance for Enron was that it was becoming increasingly difficult to understand how Enron was achieving its revenue growth and profitability. Extensive use of derivatives, particularly when the company is using mark-to-market accounting is extremely difficult in the best of situations. We now know that a big additional reason for the difficulties in analyzing Enron's financials was that there were significant parts of Enron's business that were hidden from the balance sheet.

Often the way out for analysts when faced with difficult to analyze situations like Enron is to drop coverage. Why take the risk when there are plenty of companies that are transparent enough to do meaningful analysis with confidence? The problem with dropping Enron was that it had become the giant in the industry. If you were an analyst covering that industry, you essentially had to cover Enron. That was further reinforced if your firm was one of Enron's investment bankers or investment banker wannabe.

The real problem though was having sufficient information about the off balance sheet items. Whether the accounting for each of these items was within FASB rules or not is not yet clear, although the announced restatement of prior periods earnings is a strong signal that at least not all was kosher. But what is clear is that Enron was not providing what could even be considered minimum transparency in its financials and that the analysts did not have all the tools necessary to make a reasonable analysis.

Valuation of Enron Stock by Broker Analysts

In evaluating analyst performance on recommending Enron stock, one first has to understand how the brokerage community's recommendation really

works. As I have testified before to this committee, the investor needs a two level decoder.

The first level of the decoder gets all the brokers on a common recommendation scale. The most common scale is a five tiered one, where the top category is a strong buy, the second is a buy, the third is hold, the fourth is sell, and the fifth is strong sell. Most brokers have a five tier scale, some have a four tier one, and a few have a three tier scale. In addition, many have very different terminology. The term "buy" may be the term used for the top category at some brokers, or for the second best category at many brokers, or, in at least one case, for the middle category. There are more than a dozen different terms used for each of the top three categories, and almost as many for the bottom two.

Unfortunately, getting all the firms on a common scale is not the end of the decoding. Analysts are overly biased on the positive side in their recommendations. The typical distribution is about 33% of all recommendations are in the top or strong buy category, about 33% in the second or buy category, about 33% in the middle or hold category, and only about 1% in the remaining sell and strong sell categories combined.

If the recommendations are put in numeric terms where 1 is a strong buy (or whatever the broker's term is for their top category), 2 is a buy, 3 is a hold, 4 is a sell, and 5 is a strong sell. Using this numerical scale, consensus recommendations can be calculated for each company. Most of the time the average consensus recommendation for either the companies in the S&P500, or for the roughly 5000 companies that analysts cover, is a 2.1. Occasionally, the average may be a 2.0 or a 2.2.

Therefore, the second level of the decoder would move the recommendations into three more meaningful categories. Those in the 1 or strong buy category would really be saying buy, at least in relative terms. Those in the 2 or buy category would really be saying they were neutral on the stock, and those in the 3 or hold, the 4 or sell, and the 5 or strong sell categories all would be saying sell the stock.

For Enron, the consensus recommendation, as shown on the accompanying graph, was about a 1.5 from May 2000 until the end of September 2001. Even if we had our decoder to compensate for analyst optimism, it is clear that the analyst covering Enron were very positive with their recommendations.

But during that same period, the analysts had similar or higher consensus recommendations on competitors like Calpine and Dynegy. While the consensus recommendation for Enron was much better than the average for S&P500 companies, there enthusiasm was not limited to Enron.

In early October 2001, the consensus recommendation spiked up from a 1.5 to a 1.3 as several analysts raised their recommendations ahead of Enron reporting its 3Q01 earnings on 16 October. On the day of the earnings announcement one analyst raised their recommendation, pushing the

consensus to a remarkable 1.2. But as the Enron story began to unravel over the next few days, the recommendation downgrades exploded, plus six of the seventeen analysts dropped coverage.

Conclusions

In these kind of situations, it is easy to point a finger at the analysts for mistakes made. In my prior testimony, and in other forums, I have taken the analysts to task for not performing to an acceptable standard in certain situations. While the analysts are certainly not without blame on Enron, they are not the real culprits in this situation.

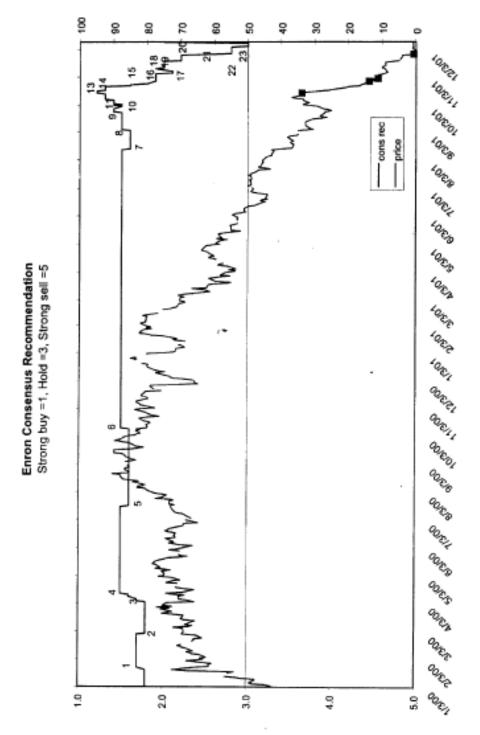
I am not an expert in doing the actual accounting at a company, or in auditing a company's accounting, but having been an analyst for 22 years, as well as closely observing analyst behavior at First Call for the last ten, I can say without reservation that this was a situation where either the company or its auditors or both were at fault in not providing investors, especially including the analysts, with the tools necessary to understand Enron's business.

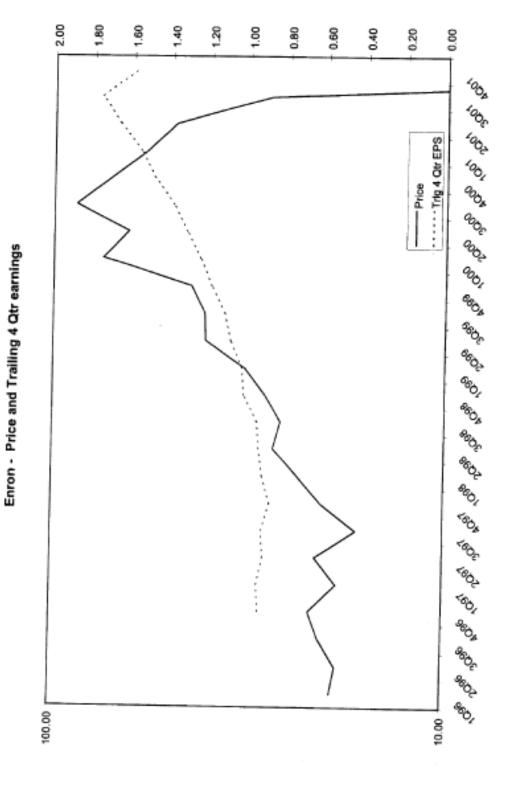
Whether the letter of the accounting rules were met or not, it is patently obvious that the spirit of the rules was violated in that Enron's financial statements did not fairly convey enough information for investors to reasonably analyze the company's operations.

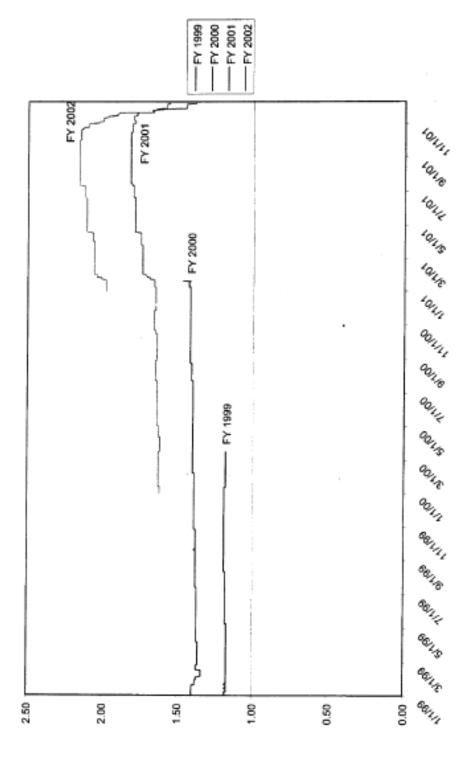
In that climate, it is hard to be too critical of the analysts' optimism. Enron had a long history of showing consistent and substantive earnings growth. If it had been up to me if I was in that situation, I would have dropped coverage long before October 2001. The financial reports and details of operations had become more and more inscrutable well before then. But as I mentioned earlier, most, if not all, analysts did not have that operation. All things considered, they probably did as well as could be expected until October 2001, although in hindsight it is easy to say that they could have at least tempered their bullish recommendations to some degree.

However, once the issues of the off balance sheet items became an unexplained issue on the 16 October 2001 conference call on 3Q01 results, it does seem that the analysts could have moved quicker to either suspend their recommendation or dramatically drop the level of their recommendation. The unexplained \$1.2 billion balance sheet writedown was not a caution flag, it was a red flag.

But Enron is not the situation on which to challenge analyst performance. There are far more significant situations were analyst conflicts and performance are at issue. The lessons to be learned here is how to insure that company's and their auditors can be relied on to openly provide the necessary tools for investors to meaningfully analyze the company's business.







TESTIMONY OF RICHARD L. TRUMKA

SECRETARY-TREASURER, AFL-CIO

BEFORE THE SUBCOMMITTEES ON CAPITAL

MARKETS, INSURANCE, AND GOVERNMENT

SPONSORED ENTERPRISES AND THE

SUBCOMMITTEE ON OVERSIGHT

AND INVESTIGATIONS

DECEMBER 11, 2001

Good morning Chairman Baker. My name is Richard Trumka, and I am the SecretaryTreasurer of the AFL-CIO. On behalf of the AFL-CIO and our unions' 13 million
members, I am grateful to the Financial Services Committee for affording us the
opportunity to express our views on the implications of the collapse of Enron. In
particular I would like at the outset to commend this Committee and Chairman Baker in
particular for his leadership in calling this hearing and his foresight in looking at the issue
of analyst independence last summer. As I will describe below, that issue is a significant
part of what went wrong at Enron.

My purpose in appearing here today is threefold. First I would like to give the committee some sense of the impact the collapse of Enron has had on workers trying to invest for their retirement, and on unions and employers trying to help workers achieve retirement security. Second, I would like to take a moment or two to talk about why Enron collapsed, and the links between Enron's collapse and the issues that were already facing this Congress on the day the Enron disclosures began. Finally, and perhaps most importantly, there is a clear regulatory agenda that the Securities and Exchange Commission and the Department of Labor must take up. Today the AFL-CIO has sent rulemaking petitions to the SEC embodying this agenda of auditor independence and Board integrity. With this Congress' support, the relevant regulatory agencies could take a series of initiatives that would go a long way toward protecting workers' retirement security and the investing public from the conflicts of interest that led to the collapse of Enron.

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001 Page 2

We are here today because Enron's bankruptcy was of a size and speed not experienced since some of the famous debacles that followed the Great Crash of 1929. And we must begin by recognizing that its collapse has had a real impact not just on big Wall Street firms, but on millions of working people and their pension funds.

This is a catastrophe rich in irony. Enron was a company that talked about a future of transparent markets, but whose CFO openly bragged to the financial press that its own accounting was a black box, saying "We don't want anyone to know what's on those books. We don't want to tell anyone where we're making money."

This was a company that complained about the costs of corruption in the global economy, but made campaign contributions an integral part of its business strategy; a company whose own governance was a web of conflicts of interest that completely stymied the protections our legal system provides investors. And finally this was a company whose mantra was deregulation and privatization, but which has ultimately become an advertisement for why workers need both defined benefit pension plans and a Social Security system safe from the conflicts of interest rampant in the capital markets.

We must, however, begin with those who have been hurt worst and most unconscionably by the conduct of the Board and officers at Enron--the employees of Enron, more that 5,000 of whom have already lost their jobs, and more than 12,000 of whom participated

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001

in Enron's 401(k) plan.² Enron's contribution to these employees' retirement security was to donate stock to their accounts and to encourage employees to put their own savings into company stock as well. They appear to have done this without even giving their employees a prospectus, as required under current law.³ The result was that on the eve of the collapse over half of the assets of Enron's 401(k) were invested in the company's stock, and many individual workers had all of their 401(k) assets in company stock.

Then on October 17, 2001, the same day that the Securities and Exchange Commission announced it was investigating Enron, the company chose to implement a plan to switch 401(k) administrators, knowing that their decision would freeze employees' accounts, leaving them unable to get out as the stock price went into freefall. Meanwhile the insiders continued their insider selling, selling that netted a handful of people over \$1 billion. The blackout continued for three weeks, two weeks longer than the industry standard for such a change, according to Plan Sponsor magazine. Then at the end of November when the market price of Enron's stock was under \$1, Enron placed shares of stock it had purchased earlier this year into the frozen accounts and charged employees' accounts \$61 per share. The final insult was that as Enron laid off thousands of employees, management tried to extort waivers of 401-k claims by threatening to withhold portions of worker severance payments. Now Enron employees' only hope of recovering the retirement money they entrusted to their own company lies in the hands of the courts. And frankly, there does not appear to be sufficient assets available to come anywhere near close to the claims against the company.

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001 Page 4

Ironically, Congress passed the Employee Retirement Income Security Act (ERISA) to prevent situations in which corporate bankruptcies meant workers lost their jobs and their pensions, just like what happened to thousands of workers at Studebaker in the 1960s. Decades later, thousands of Enron employees find themselves in the same position.

I focus particularly on these workers because, unlike most other investors in the company, by and large Enron workers did not have diversified portfolios. The bulk of their retirement savings was in Enron stock. Many of the 1,000 members of the International Brotherhood of Electrical Workers at Enron's subsidiary Portland General Electric have suffered catastrophic losses, members like Roy Rinard, who watched helplessly, his accounts frozen, as his twenty two years of retirement savings dwindled from \$472,000 to less than \$3,500. Ken Kahloni, a former information and technology manager at Enron, lost \$75,000 in his 401(k). He said, "I took a pay cut to work there two years ago, because I wanted to work for the 'best company."

But the harm Enron's collapse has caused America's working families by no means stops there. Workers' retirement funds have lost tens of billions of dollars in the collapse of Enron. Earlier this year, Enron was the 7th largest company in America measured by revenue. Enron's equity at its peak was worth about \$63 billion, and its bonds another \$6 billion more. There was almost twice as much money invested in Enron stock than in General Motors stock. Most pension funds and institutional investors held some Enron

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001

stock or bonds. If any person in this room has an S&P 500 index fund in your 401(k) or your mutual fund portfolio, you lost money in Enron- probably about half a percent of your total assets in that fund. And this is if you invested in index funds-- in a strategy that is designed to cheaply mitigate the risks of investing in any single company.

Let me give you some examples of the monies lost by pension funds. The Amalgamated Bank of New York, a major index fund manager for union and public pension funds, has filed court papers stating index funds it sponsored lost approximately \$10 million in Enron equity and debt.10 The Georgia State Board of Investment has said in court that it has the largest losses. Filings by major commercial money managers with tens of billions of dollars of worker retirement money under management such as Alliance, Janus and Fidelity suggest each has losses in the hundreds of millions of dollars. 11 Most of this money is being invested to fund pension benefits for working families -- for the public employees we are counting on to protect us during this period of national crisis, for the pensions of the iron workers who are as we speak clearing the rubble at Ground Zero, for the firefighters who today, as on September 11, stand ready to give their lives to save ours. Because of the way that our retirement system has become increasingly interwoven with the capital markets, practically every American fortunate enough to be able to save for retirement in any form was hurt by the collapse of Enron.

In part, the moral of this story is that conflicts of interest in the capital markets can do a lot of damage to America's working families. Currently, Congress is considering

Testimony of Richard L. Trumka House Financial Services Committee

December 12, 2001

Page 6

legislation sponsored by Rep. Boehner that would remove the ban on conflicts of interest in the provision of investment advice to 401(k) participants. Mr. Boehner's bill would leave 401(k) participants prey to the same conflicts that have so distorted the analysis of individual stocks, and as Enron shows, conflicts of interest can truly harm 401(k) participants' retirement savings. Similarly, consider how much worse this situation would be for Enron employees if their Social Security benefits had been invested in

Enron, as they would if the privatization advocates had had their way.

Now some may ask, don't people gain and lose money in the markets every day-- isn't the Enron story just a particularly dramatic example of the dynamics of risk and return. Our answer, as stewards of worker capital, is emphatically no-- this is not how the financial markets should work. This is not a story of risk or of ignorance. It is a story of conflicts of interest, of duties breached and duties ignored, of loyalty betrayed. This is a story of vital information whose disclosure might have saved the company being withheld until it was too late. It is a story of people so shameless and greedy that literally as the bankruptcy papers were being drawn up they were still passing what remained of the firm's cash out to themselves--\$55 million on the last working day before they filed for Chapter 11.13

Now obviously a lot of people have sued in court alleging some of these things. In the end the facts, many of which today are murky, will be sorted out. But even today certain things are clear.

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001 Page 7

Though Enron began as a utility and pipeline company, and its hard assets remain just that, Enron had become a new kind of financial intermediary. Enron brokered a huge number of contracts allocating price risk and other kinds of risk in an increasingly bewildering array of commodities—from natural gas and electricity to Internet services to the weather. In that kind of business, a company's most valuable asset is trust—trust that you are telling all your constituencies the truth, trust that you are a market maker and not merely a gambler. And what seems to have fundamentally happened to Enron is that the company's management abused that trust and ultimately destroyed it. Almost overnight Enron turned from a market colossus with an enterprise value of well over \$70 billion to a mere collection of pipes and computer terminals worth considerably less than its debts.

The story of Enron's unraveling begins with self-dealing—with transferring business out of the company into the hands of related entities that were in large part owned by Enron executives. These transactions were approved by the Board of Directors, the auditors and the lawyers. According to the chairman of the Compensation Committee, Charles Le Maistre, the partnership arrangements served in part to retain executives, saying "We try to make sure that all executives at Enron are sufficiently well-paid to meet what the market would offer." But there was no mention of these transactions anywhere in Enron's extensive disclosure of its already extremely generous executive compensation practices. And the company funds that were put into these partnerships were accounted for as investments, not as payments to executives. These partnerships then went on to

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001

Page 8

lose Enron and its shareholders over \$1 billion. 15 The disclosures around these partnerships and the loss that suddenly appeared on Enron's balance sheet in October was the first of a series of increasingly devastating revelations that both recast the company's historic performance and completely destroyed the credibility of Enron's management.

How was this allowed to happen? Let's begin with the first line of defense when management goes bad—the Board of Directors. At Enron most of the Board was independent of the company according to the SEC's requirements. But look another layer deeper, as we did after the initial revelations, and you find the majority of the supposedly independent directors were dependent on Enron or its executives—dependent on them for political support, dependent on them for investment opportunities—and were ultimately unsuited to sit on the Audit Committee or the Compensation Committee.

Some of these "independent" directors were actually investing in Enron-sponsored limited partnerships. Is it any wonder that when the crisis began and shareholders needed desperately to hear from outside directors, all they got was silence?

Then there were the auditors. Arthur Andersen was the company's long-time auditor.

And until its division into a consulting company and an accounting firm, Andersen had been receiving millions of dollars per year in consulting fees. ¹⁶ But even on the accounting side, Andersen marketed a variety of consulting services to Enron, including, many believe, advising Enron on the structure of the special purpose vehicles. So you had an audit firm that was dependent on Enron management for higher margin consulting

Testimony of Richard L. Trumka House Financial Services Committee

December 12, 2001

Page 9

services, purporting to provide independent review on behalf of investors of transactions

some of which they themselves, may have designed and charged a fee for.

On the subject of auditors, some have suggested that auditors are not able to detect a

carefully hidden fraud, one where the truth is completely hidden by management. And

that may very well be true, but that was not what happened at Enron. The financial

statements themselves contain the proof that the auditors were aware of each of the

transactions that led this company to grief-the self-dealing with the CFO, creating

partnerships to trade in the company's own stock, other partnerships whose purpose

seemed to be to generate dubious revenues, hide liabilities and otherwise bookable

derivatives positions from the investing public.17 While none of these were disclosed in a

way to make them transparent to the investing public or to Enron's employees, there was

more than enough information in those statements alone to sound warning bells among

the auditors that signed off on them.

Then finally there were the Wall Street analysts. Ultimately investors look to the expert

analyst community to interpret the numbers released by the companies they invest in.

And here we saw again the spectacle of conflict of interest triumphing over duties to

investors. Enron was such a large firm doing so much business in the financial markets

that practically every Wall Street firm and post-Glass-Steagall commercial bank had an

interest in courting the company. And in the eyes of their analysts, Enron was always a

good buy. Of course, if you knew enough to seek out independent analysts, many of

02411

Testimony of Richard L. Trumka House Financial Services Committee December 12, 2001

Page 10

whose advice comes with a price tag beyond that of the average 401(k) participant, you would have heard a different story.

As late as October, Salomon Smith Barney, whose parent Citigroup is one of the largest creditors of Enron and a provider of investment banking services, rated Enron a "buy" until October 26, then it went to "neutral" where it remained until the company filed Chapter 11. Lehman Brothers, who stood to earn a large advisory fee if the Dynegy deal closed, rated Enron as a strong buy right through to the end; Lehman Brothers then abruptly dropped coverage of Enron after it filed Chapter 11, stating that the "filing had complicated [the] outlook for [Enron] stock." 19 Out of thirteen analysts that covered Enron in October, according to Forbes Magazine, eleven were bullish. 20 But among eight independent investment fiewsletters tracked by Forbes, by August, when Enron CEO Skilling mysteriously resigned, four were already bearish and two more went bearish by October. 21

Finally, the last link that failed was the active money managers. And here again investors faced conflicts of interest, including the same conflicts that compromised analysts. But the most glaring apparent conflict is the case of Alliance Capital, a major manager of worker pension fund assets and its link to Enron through Enron board member Frank Savage, a former senior executive and board member of Alliance. In the second quarter of 2001, while Mr. Savage was an executive of Alliance, Alliance Capital increased its Enron holdings by 71 percent to become the largest Enron shareholder,

Testimony of Richard L. Trumka

House Financial Services Committee

December 12, 2001

Page 11

while other large investment managers reduced their stake in the former energy giant

during the same time period.22

The result was that for years the marketplace set the price of Enron's stock artificially

based on fictitious accounting, passed on by a conflicted Board and conflicted auditors,

and hyped by conflicted analysts. And both sophisticated institutions and the average

investor, following the advice of experts, bought at that price. And at least some of us

were buying from insiders, who all this past year were unloading stock at an astounding

rate.

Of course I have just described what happened before the attempted Dynegy acquisition.

In the weeks that followed the announcement, the same dynamics that appear to have

prompted the crisis led to the creation of a new myth-- that the problems at Enron were

manageable. Many people had an interest in that myth-- most importantly Enron

executives, the investment bankers who stood to reap large fees if the deal went through

and the commercial lenders whose ability to avoid an Enron bankruptcy depended on

steering the company into the Dynegy safe harbor. No one wanted to disclose what the

real state of Enron's finances was, clearly because some very scary things were hidden

there. But what this secrecy did was make certain that once the news of the extent of the

problems began to leak, no one could stop the collapse.

02413

Carleton, Norman

From: Sent:

Schultheiss, Heidilynne

To: Cc:

Tuesday, January 02, 2001 2:23 PM Squitieri, Ray; Sachs, Lee; Paulus, Michael; Greene, Michelle; Gross, Jared

Carleton, Norman; Nickoloff, Peter; Soares, Chris; Cetina, Jill

Subject:

SF Chronicle Article on Cal Energy Situation

This was sent to me by a former DoE employee who now works for an private-sector energy company in Houston. It's a good, comprehensive background piece. Unfortunately I don't have it in electronic form, and the hardcopy (margin) format is a bit strange.

> December 31, 2000 (SF Chronicle) > Genesis Of State's Energy Fiasco/String of bad decisions on deregulation > could end up costing consumers \$40 billion > Christian Berthelsen Next month, about 10 million Californians may begin paying as much as > 30 percent more for electricity, in a maddening coda to one of the most > costly public policy mistakes ever made. > When the state's leaders started moving the energy system toward > deregulation six years ago, they envisioned a brand new day in which > utility companies' long-standing monopoly would be broken and rates would > decline by as much as 25 percent. > Instead, when it is over, it may cost customers of the state's > investor-owned utilities \$40 billion, perhaps more. In the coming year, it could > harm the world's sixth-largest economy and send a ripple effect throughout > the globe for those dependent on California's continued prosperity. This is the story of what went wrong with deregulation, and how > planning lapses, serious policy blunders -- and warnings that came too late -- set > California's two main utilities, Pacific Gas & Electric Co. and Southern > California Edison, toward a train wreck. Power plant construction lagged while demand expanded. Leaders > misjudged how much competition there would be to supply California with juice. And > flawed deregulation laws left utilities and their customers at the mercy > of power companies, extracting the highest price for electricity. "There was a blind adherence to free-market ideology that couldn't > possibly work," said Eugene Coyle, a former utility securities analyst, > economist and early opponent of deregulation. "There were poorly > thought-out specifics." In the early 1990s, businesses were fleeing the state amid the worst > economic times since the Great Depression. Energy rates were 50 percent > higher than they were on average across the nation, because of commitments > to more expensive, environmentally friendly power and cost overruns for > nuclear power plant construction. Large customers such as steel makers, mining concerns and cement > makers, for which electricity costs make up 25 percent of their overhead, saw that > independent power producers were offering power much more cheaply. They > began to insist on change. The United States had deregulated long-distance telephone service, > airlines and a host of other industries, often with resulting competition > that was a boon to consumers. Why not do the same for electricity? So California embarked on a ploneering experiment. In 1993 and 1994, > the California Public Utilities Commission began to draft such a policy. It > allowed large users to buy power directly from independent producers and > froze customer rates at artificially high levels so utilities could > recover their investments in costly plants. The utilities sought to have the terms codified in law, and in early > 1996, a number of bills were introduced in the Legislature to do so. Some observers say that what happened next contributed to the overall > plan's flaws. Months passed while the discussion meandered and faltered, > and at one point it even appeared that no law would be passed. That's when state Sen. Steve Peace took the reins and tried to make > something happen. The San Diego legislator already had won the respect of his colleagues > for his work on another complex piece of legislation, reform of the workers'

> compensation system. During a hurried two-week conference in August -- dubbed the "Steve > Peace death march" for his propensity to keep negotiators at the table late into > the night -- the fine points of the energy law were hashed out. Legislators entrusted their judgment to Peace and the few colleagues > who worked on the bill. There was an abiding sense by a number of participants > that few members of either house knew what was in the bill or even > understood it. It was passed by both houses of the Legislature unanimously > and signed into law the following month. "People were grateful to Peace and (former Sen. Diane) Martinez for > taking it on, " said Debra Bowen, D-Los Angeles, the current chair of the Senate > energy committee. "Historically, utilities were a pretty boring topic, and > I think term limits factored into it." The law was to end the monopolistic control that utilities held over > both power production and supply by requiring them to sell off their > generators. It set rates artificially high so they could recover money > from bad investments. And it gave them nearly two years to prepare for > competition. Moreover, residential customers would be granted an immediate 10 > percent rate cut. The system took effect April 1, 1998, and, at first, things seemed to > work well. Soon, though, there were warning signs. It turned out the residential rate cut was actually going to be > financed with \$7.5 billion in bonds that customers had to pay off. So the reduction > in real terms was closer to only 3 percent, not 10 percent. Then in early 1999, the California Energy Commission, which tracks the > state's supply and demand, was warning of coming supply shortfalls. Demand was skyrocketing, the agency pointed out in a Senate energy > committee hearing, and no new significant generation had been built in a > decade. Without more power, California was going to run out. But > construction of new power plants takes at least two years from start to > finish, and the state was already running behind in accommodating the > growth. Back in the early 1990s, however, the energy commission had painted a > far different picture. At that time, California had an oversupply of power, perhaps as much as 30 percent more than it needed. There was so much that when the utilities commission set up an auction > for the construction of new facilities in the early 1990s, Edison and San > Diego Gas and Electric Co. appealed to the Federal Energy Regulatory > Commission to halt the auction, arguing there was already too much > generation in California. The FERC obliged. "If anybody had told us in 1996, or even in 1998, that we would > experience (such) load increases, we would have said, 'You're crazy,' " said D.J. > Smith, a lobbyist for the California Large Energy Consumers Association > and one of the top advocates of deregulation. "Nobody had ever seen load > go up like that in a mature situation." Still, production figures from Edison Electric Institute, which provide > a crude indicator of demand, show consumption grew by 4 percent in 1996, 3.4 percent in 1997, nearly 5 percent in 1999, and a whopping 10 percent this > year. And surrounding states, including Arizona, Nevada, Oregon and > Washington, began to experience the same demand growth. Since California imported as > much as 25 percent of its power from those states, the amount available > was suddenly reduced by as much as half. But considering the long time it takes to build plants, in part because > of public opposition, the warnings were too little, too late. In fact, the situation remained far off the radar screen of consumers, since most were > still insulated from price spikes by a rate freeze. Then this summer, things started to spiral out of control. San Diego was the first region to meet the conditions necessary for full deregulation, and as hot summer months added to demand, customers' bills > suddenly tripled. The debt load of PG&E and Edison began to balloon -- to what will be an > estimated \$11 billion by the end of 2000 -- as they borrowed to pay for > power while being barred from passing that cost on to consumers. Suddenly, the glow of deregulation had lost its luster. It immediately became clear that California's failure to build power > plants as its rapidly growing economy pushed demand upward was a serious > problem. Increasingly, the state's growing technology economy depended on > electricity, and new home construction concentrated in hot areas like > Riverside and San Bernardino counties, where air conditioning is a must.

And for all the talk of competition, there was a serious flaw that made > the market singularly uncompetitive. In order to encourage generators to create as much power as possible, > deregulation guaranteed the highest price for wholesale electricity. > Through a practice known as the "market clearing price," the last bidders > -- who are invariably the most expensive -- set the price everyone would > receive. In other words, if the first generator bids \$30 for a certain amount of > megawatts but the last bids \$100, those two bidders and everyone in > between receive \$100. As the wholesale price of electricity skyrocketed to > \$1,500 per megawatt hour this month from \$30 before the storm, the high > cost has been compounded by the fact that everyone receives that amount. Further, the law had encouraged utilities to sell their generators and > existing electricity supply without guaranteeing access to affordable > power. Rather than arranging to buy power on long-term contracts that could > have saved money, they were put in the position of having to buy their power on > a market where profit was the ultimate goal, and they and their consumers > had to pay the price. Perhaps in the biggest misjudgment, policymakers neglected the huge > amount of money it takes to run power companies and attract customers. Thus, they > overestimated how much competition would flourish in the market Running power companies is so costly -- \$500 million to build a new > plant -- that only a handful of companies bought into the market. And once they > were here, the marketing cost of signing up new customers was > astronomical. Indeed, since choice has become available to California, less than 1 percent of residential customers has changed electricity providers. > The same goes for just 15 percent to 20 percent of industrial customers -- the > class that advocated deregulation in the first place. At the end of the day, this experiment in deregulation has come at a staggering cost: \$40 billion. That includes the \$23 billion already paid > by customers when rates were frozen at artificially high levels, and the > \$7.5 billion in bonds financing consumers' own rate reduction. Now a new tab is running -- whatever share of the \$11 billion in debt > that state utility regulators decide customers should pay. The state's leaders are now casting around desperately for solutions to > put Humpty Dumpty back together again. The FERC is encouraging the utilities to enter long-term contracts with > suppliers, and market clearing pricing is under review. The state's > utilities commission will decide Jan. 4 how much of a rate increase to > grant to PG&E and Edison. And a dozen or so power plants are under > construction. Meanwhile, consumer advocates are backing a state ballot measure that > would not only re-regulate utilities but essentially make energy supply a > government function. And they are challenging the utilities' efforts to > pass on their debts to consumers, noting they have also reaped windfall > profits from selling electricity. For example, in the quarter covering the summer months when power costs > first went haywire, PG&E's profits amounted to \$225 million, a 22 percent > increase over the same period in the previous year. In the short term, the state is considering ways to encourage energy > conservation the same way it did with water. And the question now being > asked is whether a commodity as central to the well-being of the economy > should ever have been placed almost entirely under the control of free "There's a discussion on how much we want to rely on market forces > alone when it comes to electricity, " Bowen said. "Do we want to subject > ourselves to times when rates are really low and really high?" POWER DEREGULATION CHRONOLOGY ---April 1994: California Public UtilitiesCommission indicates it favors deregulation. -October 1995: Framework of deregulation laid out in memorandums between large users, energy providers and utilities. -January 1996: Bills introduced in legislature to codify deregulation plan. ---August 1996: The "Steve Peace death march" hashes out fine points of law. It passes both houses unanimously. ---Sept. 23, 1996: Gov. Pete Wilson signs the deregulation bill. ---April 1, 1998: After a four-month delay, deregulation begins. ---June 2000: San Diego has satisfied conditions for deregulation, and the rate cap there is

```
lifted. Shortages drive prices up 300 percent in some cases. --
-September 2000: The utilities begin to warn of billions in mounting debt and seek an end
to the rate cap that has prevented them from passing costs on to customers. --
-November, December 2000: More shortages put energy system in state of perpetual crisis, despite fall being a season of traditional low demand; state regulators consider
utilities' requests for rate increases. A decision is expected Jan. 4.
> ----- PLAYERS IN THE DEREGULATION DRAMA --
-Steve Peace;
     Took control of the legislative process while a state senator and drove
> deregulation into law. --
-D.J. Smith:
     Lobbyist for large, industrial electricity customers and an early
advocate of deregulation. --
-Diane Martinez:
    As state senator, helped with the deregulation legislation. --
-Greg Conlan:
     Sympathetic to industrial consumers with high bills while serving on
the California Public Utilities Commission. --
-Pete Wilson:
     Saw deregulation as an answer to California's then-ailing economy. --
-Kenneth Lay:
     Noted in 1997, as chief executive of Enron Corp. in Houston, that
little competition had emerged. "It's like California announced a party but
nobody's showing up, " he said. --
-Gordon Smith:
     As chief executive of PG&E, supported deregulation, at one point noting
there had been a "ceiling on our profits" under the old system.
     E-mail Christian Berthelsen at cberthelsen@sfchronicle.com.
```

> Copyright 2000 SF Chronicle

Carleton, Norman

From:

Sent: To: Subject: Schultheiss, Heidilynne Monday, February 26, 2001 9:52 AM Carleton, Norman; Nickoloff, Peter Fortune: Is Enron Overpriced?

There are three parts to this interesting article on Enron; you have to click to load parts 2 and 3.

http://www.fortune.com/fortune/2001/03/05/enr.html

Carleton, Norman

Lori.Santamorena@bpd.treas.gov From:

Monday, December 10, 2001 2:47 PM Sent:

norman.carleton@do.treas.gov; peter.nickoloff@do.treas.gov To:

Subject: 1BN) Enron Records at SEC Sought by House Energy and

---- Forwarded by Lori Santamorena/BPD on 12/10/01 02:45 PM ----

"PUBLIC DEBT, US DEPT OF TREASURY" <GSRS@bloomberg.net>

Too LSANTAMORENA@BPD.TREAS.GOV

co:

Subject: 1BN) Enron Records at SEC Sought by House Energy and Comme

12/10/01 02:34 PM

Enron Records at SBC Sought by House Energy and Commerce Panel 2001-12-10 13:15 (New York)

Enron Records at SEC Sought by House Energy and Commerce Panel

Washington, Dec. 10 (Bloomberg) -- The U.S. House Energy and Commerce Committee asked the Securities and Exchange Commission to produce by next Monday all reviews and reports it has done on Enron Corp. since 1997.

Consittee chairman Representative Billy Tauzin and James Greenwood, chairman of the panel's oversight and investigations subcommittee, made the request in a Dec. 7 letter to SEC Chairman Harvey Pitt released by Tauzin's office today.

The apparent collapse of the company has resulted in the loss of substantially all of the equity value in Enron, and the loss by many participants of sizeable portions of their retirement savings, '' said Tauzin of Louisiana and Greenwood of Penneylvania, "'It also highlighted the lack of transparency both Republicans. in Enron's derivative positions in the energy market.

Tauzin and Greenwood requested SBC reviews of all Enron quarterly and annual filings with the egency beginning January 1997 up to the date the SEC launched its own formal probe into Enree. Tauxin and Greenwood also want all proposed adjustments to Enron filings submitted to the SEC by Enron auditors.

-- Vicky Stamas in Washington (202) 624-1958, or vetamas@bloomberg.net /ba

Story Illustration: To compare Enron's stock performance with warket indexes, type {ENE US «Equity» COMP «GO»}.

Company news: ENE US <equity> CN

NI Codes:

MI CMG

NI NEG

MI TX NI GOV

NI COS

MI US

NI DC MI CMD

NI GA

MI OIL MI BLC

NI UTI

NI SEC NI ACC

NI NYSE

MI BCY

1/15/02

ი2534

NI GAS

\$<7991>\$

-0- (BM) Dec/10/2001 18:15 GMT

Carleton, Norman

From:

Lori.Santamorena@bpd.treas.gov

Sent:

Friday, December 07, 2001 1:47 PM

To:

norman.carleton@do.treas.gov

Subject: 1BN) Derivatives Dealers Fret as Bankruptcy Overhaul

you may have already seen this ...

---- Forwarded by Lori Santamorena/BPD on 12/07/01 01:47 PM ----

"PUBLIC DEBT, US DEPT OF TREASURY" <GSRS@bloomberg.net>

12/07/01 01:42 PM

LSANTAMORENA@BPD.TREAS.GOV Too

1BN) Derivatives Dealers Fret as Bankruptcy Overhaul Lags Subject

Derivatives Dealers Fret as Bankruptcy Overhaul Lags (Updatel) 2001-12-07 13:03 [New York]

Derivatives Dealers Fret as Bankruptcy Overhaul Lags (Updatel)

(Adds Enron comment in 12th paragraph.)

Washington, Dec. 7 (Bloomberg) -- J.P. Morgan Chase & Co., Merrill Lynch & Co. and other securities firms are trying to persuade Congress that failure to change bankruptcy rules by year's end will disrupt the market for the products companies use to hedge against fluctuations in interest rates and currencies.

The banks want Congress to require that a company's holdings of derivatives be considered as a whole if it goes broke. That way, bankruptcy trustees can't cash in some derivatives that settle in the company's favor and void others on which the company owes the bank. Federal Reserve Board Chairman Alan Greenspan and Treasury Secretary Paul O'Neill support the concept.

The change is something derivatives dealers have wanted for years. They say the need is more pressing now because the economy's slump has driven record numbers of companies into bankruptcy. Otherwise, banks will hesitate to deal in derivatives without the guarantee that they'll be paid, thus denying businesses of all kinds a key tool to pin down future costs.

"We are fearful that in the current negative economic climate, these products are going to be tested in a way that they have not been tested." swid Stacy Carey, a lobbyist for the International Swaps and Derivatives Association.

Legislation requiring derivatives to be dealt with as a net asset is tucked into a larger bankruptcy overhaul bill, the thrust of which would make it harder for consumers to escape all of their credit card and other unsecured debt when filing for bankruptcy.

"Cherry-Picking'

Action on the bankruptcy measure has stalled for a fourth consecutive year over disputes unrelated to the derivatives 'netting'' provisions, which have drawn no opposition. Dealers want Congress to move the derivatives proposal as separate legislation.

Derivatives are designed to protect from wild swings in prices or interest rates; a company buys contracts that will produce gains if other assets yield losses. Almost inevitably, a large holding of derivatives will contain winners and losers.

Under bankruptcy law, bankrupt companies may cancel obligations and contracts that are onerous to them and cash those with favorable returns to pay creditors. Canceling losing contracts and keeping winning ones is unfair, dealers say.

Carleton, Norman

From:

Nickoloff, Peter

Sent: To: Subject: Tuesday, December 04, 2001 12:02 PM Carleton, Norman; Schultheiss, Heidilynne

Some EnronOnline stories from Internetweek.com

In no particular order...

Friday, November 30, 2001, 5:52 PM ET.

UPDATE: EnronOnline Still Trading

By Jade Boyd

While a bankruptcy filing by troubled energy trader Enron Corp. is widely expected, the company says it continues to trade more than 400 products at its online trading exchange, EnronOnline.

An Enron spokesman said Enron traders are still actively making trades via EnronOnline in 472 products. Most trades are in core energy products like natural gas and electricity, but Enron also continues to trade paper and forest products, said company spokesman Eric Thode.

Enron averaged about 5,000 trades per day on its site prior to November. The company conducted about 1,000 trades Thursday, when only 62 products were sold online, Thode said.

Analysts say traders from other companies aren't establishing new positions with Enron, so virtually all of Enron's current trade volume represents trades by people who are closing out existing positions to limit exposure to Enron.

Since Enron did a huge volume of trade online -- about \$600 billion since EnronOnline went live in November 1999 -- it may take weeks for trading to wind down completely, said Peter Fusaro, president of the energy consulting firm Global Change Associates.

The bigger question is how long Enron can finance its trading operation. Fusaro said a bankruptcy filing might make it easier for Enron to raise the cash it needs to fund trading operations, but that won't restore trader confidence in the company.

Since Enron is a party to every trade on its site, either as buyer or seller, it's vital that trading partners have confidence in Enron's ability to stand behind the deals it makes. Analysts say that confidence is lacking, and an infusion of cash won't be enough to restore it.

Wednesday, November 28, 2001, 4:15 PM ET.

UPDATE: Enron-Dynegy Deal Collapses; EnronOnline Temporarily Halts Trading

By Jade Boyd

Dynegy Inc. has cancelled its proposed \$8 billion merger offer for fellow energy trader Enron Corp. Trading on Enron's pioneering exchange, EnronOnline, was halted temporarily today in response to

the news.

The future of Enron is now in question as credit-rating agencies today downgraded the company's bonds to junk status, triggering the payment of more than \$3 billion in outstanding debts.

Enron spokesman Eric Thode said all trading was halted on EnronOnline this morning in the wake of the Dynegy announcement, but trading of core energy products, such as natural gas, resumed this afternoon. At no time was telephone trading suspended, he said.

Enron's online business model is different from most independent exchanges, which link buyers and sellers. Enron is a party to all transactions at its site, acting as either the buyer or seller. Enron makes its profits by buying low and selling high, and employs an army of analysts to compile information that could affect future prices on natural gas, electricity and the 1,500 other commodities it trades online.

Thode declined to comment on reports this week that Enron traders were working to help valued customers by brokering deals between buyers and sellers.

"We're still in the market, and we're still conducting transactions that make commercial sense," said Thode.

Even before halting trading today, activity on Enron's Web-based exchange, EnronOnline, has reportedly fallen steeply in recent weeks as trading partners abandon the site in favor of deals with more stable firms. Dynegy and a number of other energy traders do business online, but none in volumes approaching EnronOnline, which pioneered the field and once saw trade volumes in excess of \$4 billion per day.

Enron's Thode, however, said that trade volumes on EnronOnline have not declined signficantly in recent weeks.

Over the past 30 days, the site has averaged about 5,300 trades per day, with a total value of \$2.7 billion, Thode said. That's well within the average volumes seen on the site during any 30-day period this year, Thode said.

The New York Stock Exchange halted trading of Enron shares ahead of the Dynegy announcement, but Enron's stock had already lost \$2.95, or 71.3 percent of its value on rumors of the dissolution. Trading was halted at \$1.19. Enron's stock traded at more than \$90 last August.

Dynegy cancelled the deal citing "breaches of representations, warranties, covenants and agreements in the merger agreement."

Dynegy had sought to renegotiate the terms of the merger after Enron's stock price continued to plummet in the wake of the Nov. 9 merger announcement.

Dynegy's announcement came as Standard & Poor's, Moody's Investors Service and Fitch, Inc. downgraded Enron's long-term debt to below investment-grade status. The loss of investment-grade credit means that more than \$3 billion in debts to off-balance sheet partnerships are due immediately.

In a prepared statement, Enron said it is "taking actions designed to preserve value in the company's core trading and other energy businesses." Enron said it is temporarily suspending all payments other than those necessary to maintain core operations.

"With Dynegy's termination of the merger and the ratings agency downgrades, we are evaluating and exploring other options to protect our core energy businesses," Enron Chairman and CEO Kenneth L. Lay said in the prepared statement. "To do this, we will work to retain the employees necessary to

the continuing operations of our trading and other core energy businesses."

In canceling the proposed merger, Dynegy said it would exercise its option to buy Enron's Northern Natural Gas Pipeline, something it was entitled to because Dynegy's partner, ChevronTexaco, pumped \$1.5 billion cash into Enron when the Nov. 9 merger agreement was struck.

Many in the industry believe Enron will be forced to file bankruptcy as a result of the Dynegy pull-out.

Enron would not comment on whether a bankruptcy filing is in the works, but the company says it is reviewing its option to repay Dynegy the \$1.5 billion cash, which would allow it to retain Northern Natural Gas Pipeline.

Should Enron file for bankruptcy protection, it would be the largest corporate bankruptcy in U.S. history. Enron's third quarter balance sheet lists \$61.8 billion in total assets, which eclipses the \$35.9 billion worth of assets Texaco Inc. listed when it filed for bankruptcy in 1987.

November 26, 2001

Reload

October 30, 2000
www.internetweek.com/transformation2000/coverstory/enron.htm
<http://www.internetweek.com/transformation2000/coverstory/enron.htm>

Enron's Web Retreat

Many of Enron Corp 's online businesses may not make the cut as the company, exposed to billions of dollars in debt from off-balance-sheet deals, prepares to be acquired.

Enron's pioneering moves in online trading earned the company the cover of InternetWeek's Transformation Of The Enterprise issue in October 2000. At its apex last year, Enron had a market value of around \$80 billion, as it posted \$100 billion in revenue.

But Enron's stock plunged over the last month amid revelations that company executives had created limited partnerships which reportedly left Enron exposed to \$3.3 billion in outstanding notes. With its market value and image decimated, Enron this month accepted an \$8 billion buyout offer from rival Dynegy Inc., which has agreed to inject \$1.5 billion to keep Enron's trading desk afloat.

Enron pioneered Web trading of energy commodities with EnronOnline, where the company buys and sells futures on up to 1,500 products, doing more than \$4 billion in daily transactions. Most of that trading is still in energy products, though Enron had diversified into bandwidth, paper, steel, freight storage and other commodities. With the Dynegy deal, however, Enron plans to focus on "core" energy activities and dump other assets.

The first casualty is Enron Broadband Services, which owns about 15,000 miles of optical fiber and 25 network interconnection facilities in the United States. EBS envisioned buying and selling bandwidth as a pure commodity like natural gas, but bandwidth trading volumes never approached the level needed for a liquid market. Enron is looking to sell EBS, a spokesman says.

Enron has yet to make a decision on its other online trading businesses, including Net Works, the incubator that developed most of the technology that underpins EnronOnline. Each business will be reviewed "based on their capital requirements and near-term growth prospects," the spokesman

November 30, 2001

The Internet Didn't Kill Enron

By ROBERT PRESTON < MAILTO:rpreston@cmp.com>

"We have a fundamentally better business model."

That's how Jeffrey Skilling, then president of Enron Corp., summarized his company's startling ascendancy a year ago, as Enron's revenues were soaring on the wings of its Internet-based trading model.

It was hard to find fault with Enron's strategy of brokering energy and other commodities over the Internet rather than commanding the means of production and distribution. EnronOnline, its year-old commodity-trading site, already was handling more than \$1 billion a day in transactions and yielding the bulk of the company's profits. At its peak, Enron sported a market cap of \$80 billion, bigger than all its competitors combined.

Forum: Enron E-Biz Meltdown: What Went Wrong? http://www.internetweek.com/forum/enron More Enron Stories http://www.internetweek.com/enron.htm

Today, Enron has filed for bankruptcy, the status of EnronOnline is touch and go, ENE is a penny stock and Skilling is out of a job. Last year's Fortune 7 wunderkind, hailed by InternetWeek and others as one of the most innovative companies in America, overextended itself to the point of insolvency.

So was Enron's "better business model" fundamentally flawed? With the benefit of 20/20 hindsight, what can Internet-inspired companies in every industry learn from Enron's demise?

For one thing, complex Internet marketplaces of the kind Enron assembled are fragile. Enron prospered on the Net not so much because it had good technology -- though the proprietary EnronOnline platform is considered leading-edge -- but because online customers trusted the company to meet its price and delivery promises.

As Skilling told InternetWeek a year ago, "certainty of execution and certainty of fulfillment are the two things people worry about with commodity products." Enron, by virtue of its expertise, networked relationships and reputation, could guarantee those things.

Once it came to light, however, that Enron was playing fast with its financials -- doing off-balance sheet deals and engaging in other tactics to inflate earnings -- customers (as well as investors and partners) lost confidence in the company. And Enron came tumbling down.

Furthermore, advantages conferred by superior technology and information-gathering are fleeting. Competitors learn and mimic and catch up. Barriers to market entry evaporate. Profit margins narrow.

Enron, short of incessant innovation, could never hope to corner Internet market-making, especially in industries, like telecommunications and paper, that it didn't really understand. In its core energy

market, perhaps Enron was too quick to eschew refineries and pipelines for the volatile, informationbased business of trading.

But it wasn't Internet that killed the beast; it was management's insatiable appetite for expansion and, by all accounts, personal enrichment.

It's too easy to kick Enron now that it's down. It did a lot right. The competition and deregulation and vertical "de-integration" Enron drove are the future of all industries, even energy. Enron was making markets on the Internet well before its competitors knew what hit them.

Was Enron on to a better business model? You bet it was. But like any business model, it wasn't impervious to rules of conduct and principles of economics.

une , 200 Services

Trader Reaps Benefits Of E-Market Leadership

'Liquidity' is the key to Enron's position at the center of online value chains

By JADE BOYD <MAILTO:jcboyd@cmp.com>

ENRON Headquarters:Houston Line of business: Energy production and marketing; online exchange operator 2000 Revenue: \$100.79 billion 2000 Net Income: \$979 million Percentage of revenue from e-business activity: N/A CEO: Jeffrey K. Skilling Top e-business executive: Philippe Bibi, president and CEO, Enron Net Works E-business highlights:EnronOnline conducted its millionth transaction in May; total trade volumes on the commodity-trading site have exceeded \$550 billion since it was established in November 1999. Enron Broadband Services conducted 580 online transactions in the first quarter, compared with 321 for all of 2000 E-business challenges:Re-creating its success in online energy trading in dozens of other commodity businesses including bandwidth, data storage, forest products, metals, coal and freight logistics Top e-business accomplishment:With EnronOnline, Enron brought immediate and transparent pricing to energy markets; the site is one of the world's leading e-commerce platforms, with daily trade volumes in excess of \$4 billion Services: Industry Leaders http://www.internetweek.com/100-01/serv.htm ONLINE EXTRA—Reporter's Notebook On Enron http://www.internetweek.com/100-01/serv.htm ONLINE EXTRA—Reporter's Notebook On Enron

Uncertainty has debilitated many e-businesses, with staffers and managers alike wondering when things will pick up. But optimism is still in the air at Enron Net Works, the e-business arm of Fortune 7 energy company Enron Corp., which continues to expand its electronic trading model into all manner of commodity markets.

Net Works oversees EnronOnline, where Enron buys and sells more than \$4 billion a day of mostly natural gas and electric power, plus steel, coal, telecom bandwidth, data storage, freight services and 1,500 other products.

Net Works is also a new-business incubator, repackaging applications Enron originally developed for internal use into revenue-generating online services. For example, <a href="EnronCredit.com <a href="EnronCredit.com <a href="EnronCredit.com, an offshoot of software Enron created to help its traders manage credit risk, offers a service to some 10,000 companies to quickly determine the cost of extending credit to their own trading partners. EnronCredit.com, which broke even in its first year, is expected to turn a profit this year.

Net Works is part software development house and part IT department, responsible for routine tasks, such as desktop support, and critical functions, such as keeping Enron's e-business infrastructure running. The group, with 1,500 employees, grew some 30 percent in the past year, occupying more than four floors of Enron's downtown Houston headquarters.

"Our job is in two parts," says Net Works COO Greg Piper. "Help Enron expand horizontally in markets for new commodities like forest products and freight services, and build a business around the tools that helped to transform Enron."

E-Commerce Apex

While Enron's e-business gains have been spotty in some areas--it has struggled to create liquid Web markets in bandwidth and on paper, for instance--EnronOnline is one of the most successful e-marketplaces. It conducted its millionth transaction late last month, and the total value of trades on the site exceeds \$590 billion. Online trading now accounts for almost 75 percent of Enron's energy transactions in North America, the company says.

Enron counts both purchases and sales in its volume numbers--unlike e-marketplaces that simply take a cut of transactions on their sites--because the company is a "counterparty" to every trade on EnronOnline. Enron makes its money on the spread between what it pays for commodities and what it sells them for.

When a customer clicks to buy gas, electricity, steel or any other commodity, Enron guarantees price and delivery time. The key for Enron isn't to own massive amounts of physical product or storage and delivery capacity, but to arrange for third-party supply and logistics electronically. Enron stays informed about the vast array of factors that can influence price and delivery on a minute-by-minute basis by employing thousands of researchers, analysts, weather forecasters and other market specialists.

Enron isn't just moving physical product on the site. Much of its online deal-making is in financial derivatives and risk management.

For example, Enron is now in the market for DRAM chips. But it doesn't buy and sell the chips; it sells financial instruments that let companies lock in a price for DRAMs for a set period. Ultimately, Enron hopes to buy and sell the chips itself, just as it buys and sells gas, electric-ity and other commodities.

Energy Trading Redone

Enron is reticent about disclosing exact volume figures for the different commodities traded on its sites. The large majority of trades are still conducted in natural gas and electricity.

The Internet is transforming energy trading from something of an art form, dominated by person-to-person deals negotiated over the telephone, to an automated science. By openly displaying its "bid" and "ask" prices -- and the spread between them--Enron drove trade volumes through the roof in 2000. Forrester Research estimates that the "notional value" of online energy trades grew 750 percent in 2000, with EnronOnline accounting for most of them.

But competing energy firms are banding together to form online marketplaces of their own. American Electric Power, Aquila, BP Amoco, Duke Energy and others joined with Goldman Sachs and other financial firms to form Intercontinental Exchange, while Axia Energy, Coral, Dominion TXU and Williams have formed TradeSpark.

While these consortia may view each other as competitors, they see EnronOnline as complementary, says Forrester analyst Jim Walker. "Everyone loves to have Enron trade on its site because Enron brings the most valuable thing to the market, which is liquidity," Walker says.

Enron has purchased physical assets to ensure its own supply in several key markets, such as pulp and paper and metals, Piper says. Metals trading, he says, is up to about 1,000 transactions daily, representing about 25,000 metric tons of steel.

Enron conducted 580 bandwidth trades in the first quarter, compared with 321 in the past year, and it expects to handle more than 2,200 trades in 2001.

However, Enron's total online trading volume represents everything from storage services to long-haul circuits to dark fiber to IP services. None of the bandwidth commodities has achieved liquidity yet, notes Kevin Hannon, president of Enron Broadband Services, which completed an 18,000-mile fiber optic network in 2000 and built 25 "pooling points" to tie in with other provider networks.

A Helping Hand

Enron has plowed ahead so aggressively online that some trading partners that haven't invested in back-office automation simply can't keep up, Piper admits. Enron is responding with CommodityLogic, software modules designed to help trading partners streamline the fulfillment process and reduce data re-entry errors.

Enron will create and maintain a centralized database of information pertaining to trades. Partners access that

information with CommodityLogic software modules designed for such tasks as quality assurance, scheduling and invoicing. The three modules in tests are InvoiceLogic; ConfirmLogic, an order confirmation system; and NomLogic, which handles delivery scheduling for natural gas trades.

"Scheduling that natural gas would typically involve three to 10 phone calls and two to three faxes, and for a deal done over the course of a 30-day month, you might have had to repeat that every business day," says Tom Gros, the Net Works vice president in charge of CommodityLogic. "With NomLogic, that process now takes seconds. I enter it on the screen and automatically, if it's a month-long deal, the previous day's data appears for me so I don't have the chance to create an error."

The business model for developing CommodityLogic is the same one Enron used for EnronCredit.com and its other online initiatives: Net Works develops an application to save time or improve efficiency internally and then repackages the app for external use. The software for EnronCredit.com's Cost of Credit service, for instance, was originally developed to help Enron's own traders manage credit risk.

Much of Cost of Credit information is free with registration to EnronCredit.com, but Enron charges a fee to download information or get e-mail alerts of significant changes to the credit risk of companies in a prespecified portfolio. But the main way Enron makes money from the site is by selling "bankruptcy swaps" to enterprises that want a hedge against the possibility that a partner will go out of business.

Whereas EnronCredit.com grew out of software Net Works developed for Enron's commodity trading business, Enron's latest ASP offering, DealBench, came out of software designed to make it easier and faster for Enron to negotiate large structured deals for complex assets, such as power plants.

Enron's procurement department has used the auction functions in DealBench to buy more than \$1 billion of goods, everything from broadband networking gear to carpeting for the new 40-story skyscraper Enron is building across the street from its 50-story headquarters in downtown Houston.

DealBench's collaboration tools manage the complex communications that are part of any large structured deal. Features include secure two-way messaging and the ability to deliver multimedia presentations and give participants varying levels of access to sensitive information.

Last month, Enron added Data Room, a document management system that lets companies set up "virtual data rooms" to streamline the bidding process for complex physical assets, such as refineries and manufacturing plants. Normally, companies selling these types of assets have to staff a physical room hosting lawyers and engineers from every potential bidder, each of whom require several days to pore over hundreds of thousands of pages of technical documents. Enron has used Deal Room to syndicate some \$3 billion of its own credit to more than \$1 financial institutions and sell more than \$240 million in assets.

With all DealBench services, companies can host any number of potential bidders simultaneously, giving each participant the exact level of access necessary. Bidders download a piece of client software that decodes encrypted documents on the site, so even if sensitive documents are sent to unauthorized users, they can't be opened, says Jeffrey Bartlett, a principal at DealBench.

Rather than take a percentage of the overall deal, Enron sells DealBench licenses to the deal managers and hosts the platform. Enron wouldn't reveal specifics about pricing, which varies based on the length of contract, number and size of prospective deals and the number of potential bidders.

Centerpiece Of E-biz

For the time being, energy trading--and trading in financial products related to those trades--will remain the centerpiece of Enron's online business. Forrester estimates that notional trading for U.S. natural gas futures and options contracts amounted to about 3.6 times the total quantity of physical trades and 12 times the amount of physical delivery in 2000.

"Electricity in the U.S. is a \$300 billion market, but the velocity at which that \$300 million is being turned over is increasing," says Bob Christensen, an energy industry analyst with First Albany Corp. "The same power--and all the fuels related to it--can churn and change hands a dozen times a day."

As other companies convert their trading systems to online models, Enron hopes to sell its expertise in this area. (Enron says its own online-enabled back-end systems reduced its marginal cost per transaction by 75 percent in

2000.)

Enron stands to gain twice: first, by providing the services itself, and second, by further increasing online trade volumes in a market where it has a clear ownership stake.

From: Cetina, Jill

Sent: Thursday, November 29, 2001 8:36 AM

To: Gross, Jared; Malvey, Paul; Carleton, Norman; Bitsberger, Timothy; Roseboro, Brian; Sobel, Mark; Byrne, Kathleen;

Sharer, James; Quinn, Lois; Dulaney, Tim

Subject: Interesting piece in today's NY Times that pins recent spike in vol in Eurodollars & UST market on Enron

Had heard participants speculate that something might up with Enron's Eurodollar portfolio but no one I talked to had seen the flow.

Enron's Woes Exacerbate Turmoil

By GRETCHEN MORGENSON

02577

he swift downfall of Enron (news/quote) has contributed to extreme turbulence in the United States Treasury market in recent weeks, causing violent swings in interest rates not seen since Russia defaulted on its debt and the Long-Term Capital Management hedge fund nearly collapsed in late 1998.

Even though the exact makeup of Enron's large trading portfolio remains a mystery, traders said that the energy company had bet that interest rates would continue to decline because of continuing weakness in the economy.

Then two weeks ago, the economy began to show signs of revival. As investors decided that the days of Federal Reserve rate cuts were over, rates began to rise and prices on Treasury securities fell. The move out of Treasuries crushed traders who still expected the weak economy to push interest rates lower. Scrambling to cut their losses, those traders sold even more, depressing prices and pushing up rates further.

The sense among many market participants is that Enron's woes made a bad market excruciating. "I think the Street in general lost half of its year or more in the last week or two," said Stan Jonas, managing director at Fimat USA, a broker dealer. "Everyone was long the bond market, thinking the economy was going to be bad. Then everything shifted, and Enron drove it to extremes."

How extreme? In the two weeks beginning Nov. 12, two-year Treasury notes plummeted in price, pushing their yields up to 3.18 percent, from 2.41 percent. In the same period, yields on Treasuries with five-year maturities went to 4.4 percent, from 3.62 percent.

The trade that appears to have gone awry for Enron, market participants say, involved the sale of hundreds of thousands of Eurodollar futures, some of which matured in two or three years. Such contracts are frequently used to bet on the direction of interest rates. Enron could also have used the Eurodollar contracts to hedge against fluctuations in oil prices. In a weak economy, oil prices usually fall. But so do interest rates, so a bet on lower rates would produce gains to help offset the decline in oil prices. When data showed signs of life in the economy, traders surmised that Enron began to sell its Eurodollars and started an avalanche of selling among other traders.

There were huge Eurodollar positions being liquidated, said Gemma Wright, director of market strategy at Barclays Capital. "We don't know for certain who it was, but the amount of the loss was high." (V)

Enron Collapses as Suitor Cancels Plans for Merger (November 29, 2001)

Market Place: A Big Fall Evoking Nasty Old Memories of a Run on a Bank (November 29, 2001)

--The Chief Executive: Foundation Gives Way on Chief's Big Dream (November 29, 2001)

The Last Resort: A Bankruptcy Filing Might Be the Best Remaining Choice (November 29, 2001)

The Lenders: Citigroup and J.

One reason that traders suspect Enron may have been forced out of such a position was that the company had neither the cash flow nor the bank credit to meet calls for additional cash from traders at other firms. Typically, companies have cash reserves to meet such calls or have access to temporary lines of credit to cover shortfalls. Enron appears to have neither. Yesterday, the company said it was suspending all payments except for those "necessary to maintain core operations."

In addition to the recent interest rate spike, Enron has had to contend with falling oil prices. The price of crude oil has dropped 28 percent since the end of October.

Caught in a vise, Enron has almost certainly been selling securities to raise cash. Treasury securities and Eurodollar contracts, because their markets are large, are among the easiest to sell. In both cases, Enron was probably selling into a falling market.

Adding to the turmoil in the bond market, traders said, was less participation by Wall Street firms, which were unwilling to take on big new trading positions near the end of their fiscal year. Several firms end their years on Nov. 30.

Some traders say Enron's problems started with comments on Tuesday by Laurence H. Meyer, a governor of the Federal Reserve. Mr. Meyer suggested that additional rate cuts might be coming, and that remark helped stabilize prices of Treasury securities. "It's my view that there are no coincidences," Mr. Jonas said. "Laurence Meyer is a big hawk on interest rates, and he basically talked a 180. That was their big gun. The only bigger gun would have been Greenspan."

P. Morgan Are Left With Exposure to Loans (November 29, 2001)

The Rating Agencies: Debt Rankings Finally Fizzle, but the Deal Fizzled First (November 29, 2001)

The Derivatives: Market That Deals in Risks Faces a Novel One (November 29, 2001)

(J		
×		
×		

Newsletters Subscribe to DealBook

opening bell

× Get your free daily briefing with the latest and most comprehensive news about the deal-making industry, delivered by e-mail before the market's

		г
U.S. Marke	Company Research ets Int. Markets nds Bank Rates	
Commodit	ics & Currencies	

Click here to order Reprints or Permissions of this Article

From:

Hammer, Viva

Sent: To:

Wednesday, November 21, 2001 10:08 AM

Carleton, Norman

Subject:

RE: Dow Jones Newswires: Energy Cos Limit Business With Enron After 10Q -Traders

I missed the meeting as you know because of a lyons meeting. How did it go?

-----Original Message-----

From:

Carleton, Norman

Sent:

Tuesday, November 20, 2001 5:06 PM

To:

Roseboro, Brian; Bair, Shella; Wiedman, Mark; Gross, Jared; Cetina, Jill; Sharer, James; Nickoloff, Peter; Schultheiss, Heidilynne; Berardi, Steve; Pietrangeli, Fred; Whaley, Jean; Lori Sanatamorena (E-mail); Novey, Michael; Hammer, Viva; Eichner,

Matthew; Gabilondo, Jose

Subject:

Dow Jones Newswires: Energy Cos Limit Business With Enron After 10Q -Traders

November 20, 2001

Energy Cos Limit Business With Enron After 10Q -Traders

Dow Jones Newswires

By Mark Golden OF DOW JONES NEWSWIRES

NEW YORK -- Many energy trading companies were unwilling to sell power and natural gas for next day delivery to Enron Corp. (ENE) Tuesday morning, a result of heightened credit concerns following the release of Enron's quarterly financial report Monday, traders and other sources said.

For weeks, companies have limited both buying and selling with Enron for future deliveries. But for the first time since Enron's troubles began a month ago, energy companies weren't selling to Enron in the spot markets for fear that Enron might not be able to pay its bills as soon as next month.

"It's pretty well accepted in the industry that people are staying away for now," said Charlie Sanchez, energy market manager for Gelber & Associates in Houston.

Traders at all of the major companies contacted said they couldn't sell to Enron Tuesday morning. Several spokespeople for energy companies confirmed the situation, but declined to say so on the record.

"Nobody will take Enron," one western electricity broker said. After struggling, however, that broker eventually found a utility that was willing to sell to Enron Tuesday morning.

Calpine, a prominent independent power producer and trader, said it was willing to sell power to Enron.

"We continue to sell power to Enron and are monitoring the situation closely," spokeswoman Catherine Potter said.

The situation Tuesday morning was fluid. One utility that refused to sell to Enron in the morning was willing to do so in the afternoon, a person at the company said. That company's trading, however, was still limited to the spot markets.

Credit concerns about the once-dominant energy trading company were heightened with Enron's filing of its third quarter annual report Monday evening with the U.S. Securities Exchange Commission.

Enron may have to pay \$690 million on a note that became a demand obligation with the company's most recent credit-rating downgrade, Enron said in Monday's filing. The company also warned that its profits in the fourth quarter could be hurt by credit concerns, a decline in asset values and reduced trading activity.

"The 10Q in and by itself is a document that could raise concerns," Fitch analyst Ralph Pellecchia said. "We have a lot of questions outstanding relative to disclosures that were new to us and their strategies of how they are going to manage the situation."

Companies are willing to buy from **Enron** in the spot gas and power markets, because taking delivery on commodity and paying for it a month later poses no credit risk for the buyer

An Enron spokesman didn't respond to a request for comment.

Reliant Resources (RRI) and the Bonneville Power Administration, the federal government's western power marketer, both said their organizations are continuing to "do business" with Enron. But when asked specifically if they were selling spot power or gas to Enron, spokesmen for both declined to comment.

"We're watching the situation very carefully," said Reliant spokesman Richard Wheatley. "There is a lot of speculation because of the filing yesterday."

Energy companies began shying away from **Enron** over the past month, as concerns about its finances precipitated a 75% drop in its stock price and left its bonds trading at levels typically associated with junk-rated debt.

Traders and their companies have said consistently that until Enron's credit ratings improve, they will continue to watch their exposure to **Enron** carefully, with trades limited to short-term deals.

Moody's Investors Service, Standard & Poor's and Fitch all rate **Enron** one notch above speculative grade. Moody's has Enron's ratings on review for a downgrade, and S&P has **Enron** on negative credit watch. Fitch calls Enron's credit rating "evolving." Enron's ability to do business in the energy markets depends on its maintaining investment-grade ratings.

The manager of one hedge fund that follows **Enron** closely said Tuesday that several trading companies expressed strong concerns about Enron's financial viability. But the manager thought those concerns weren't proportionate to Enron's position.

"They have nine days to work out the \$690 million debt payment, and if they can't work it out, they have the cash to make the payment," the manager said.

Dynegy Inc. (DYN), which has agreed to buy **Enron** in a stock-swap currently worth about \$10 billion, injected \$1.5 billion into **Enron** last week. **Enron** has also closed on \$1 billion worth of revolving credit lines with J.P. Morgan Chase & Co. (JPM) and Citigroup (C) in the past week, with \$450 million of that amount closed Monday.

Developments with **Enron**, however, have raised enough concerns that energy companies aren't willing to extend themselves into positions that have even the appearance of vulnerability, Sanchez of Gelber & Associates said.

"The industry has been shell-shocked by their recent announcements, and they're not ready to go back to trading with them," said Sanchez of Gelber & Associates.

Some traders wondered why Dynegy hasn't stepped in to buy energy from sellers and then sell that product to Enron. Such a move, known as "sleeving" in energy markets, serves as an ad hoc

form of credit guarantee one transaction at a time.

Dynegy didn't return phone calls on the matter.

-By Mark Golden, Dow Jones Newswires; 201-938-4604; mark.golden@dowjones.com

(John Edmiston in Houston, Kristen McNamara in New York and Jon Kamp in Chicago contributed to this article.)

Reached later, Dynegy made clear it wouldn't take any extraordinary measures to support Enron in the market.

"We will operate as two separate companies until the merger is completed," Dynegy spokesman John Sousa said. "We have to act independently."

Mirant Corp. (MIR), a major trader of North American power and gas, has trimmed its business with Enron.

"We're trading on a very limited basis," said spokesman Chuck Griffin, who wouldn't be more specific.

Cinergy Corp. (CIN), a mid-sized energy trading company, said it is buying and selling gas and power with **Enron**.

-By Mark Golden, Dow Jones Newswires; 201-938-4604; mark.golden@dowjones.com

(John Edmiston in Houston, Kristen McNamara in New York and Jon Kamp in Chicago contributed to this article.)

From: Sent: Nickoloff, Peter

Sent: To: Subject: Friday, November 23, 2001 12:08 PM Carleton, Norman; Schultheiss, Heidilynne

Enron and risk management

From ERisk.com

Walking On Air

Rob Jameson, ERisk <mailto:rjameson@erisk.com>

November 20, 2001

There's a much-loved moment in the world of cartoons when the heroes and villains chase each other way beyond the edge of a cliff or high building, sustained by their momentum. It's only when they notice the drop beneath them that their confidence fails, their legs stop moving and they plummet like a stone.

It's no surprise that the economic boom of the 1990s, followed by the sharp slowdown and geo-political turbulence of the past 12 months, have given rise to a few moments like that in the corporate world. It's more worrying that institutions whose principal skills are to identify and manage risk have also managed to 'walk on air' for an extended period.

The latest air walker to come to grief seems to be international energy glant Enron, which after a difficult few months
http://www.chron.com/cs/CDA/story.hts/business/1138683 is preparing to be swallowed up by Dynegy in an act that will rather resemble a shark being eaten by a goldfish. Commentators began to point.out.

http://globalarchive.ft.com/globalarchive/article.html?id=011120000978&query=enron this week that though the deal will probably go through, it's not yet a certainty. It depends upon no adverse material changes becoming apparent with regard to the SEC enquiries, Enron's balance sheet, litigation and so on.

It's too early to be sure at any forensic level what went wrong with Enron. But even more vertiginous drops have happened this year across a spectrum of industries that has, at its heart, the competent management of financial risk. Some headline examples are the collapse of the UK's Independent Insurance, the liquidation of Australia's <u>HIH Insurance</u>. http://www.erisk.com/reference/case/ref_case_hih.asp and the fall of Superior Bank in the US.

The link between these diverse debacles is a failure in corporate reporting. In a firm that manages risks this is important for two distinct reasons. The first is that most risk management companies - and not just banks, as Enron is discovering - depend heavily upon market confidence in their creditworthiness in order to raise and preserve funding, and to make transactions in the markets that are their lifeblood. When that confidence disappears, a vicious spiral of rising funding costs, asset deterioration, counterparty worries and liquidity risk begins to suck a company down. (The mechanism is discussed in thitp://www.erisk.com/news/features/liquidity.pdf ERisk feature.)

The second distinct reason is that the way in which companies report risk in internal and external accounts is critical in companies that are, in essence, portfolios of intangible risky assets and liabilities. Last week Ellen Seidman, retiring head of the US Office of Thrift Supervision, used her swansong speech to make.that.point. make.that.point. make.that.point. make.that.point. make.that.point. make.that.point. make.that.point. http://www.erisk.com/news/daily_news_daily_news_daily_sm.asp?NE=ambanker_2001_11_15_news_0000-0002-KEYWORD.Missing.xml successful to the embarrassing failure of Superior Bank. She said that the approval of Superior's accounts, despite the bank's optimistic valuation of a highly volatile subprime lending portfolio, points to a larger problem with bank accounting.

Across the risk management industries, risk-based transactions and portfolios are becoming more complex, valuations are increasingly based on models and estimates, and in turn risk estimates are increasingly used to justify complex risk retention or risk transfer strategies. Without a framework of sophisticated risk reporting and corporate governance, the books of a firm can prove a world of smoke and mirrors, held together by a collective act of faith in the executives or boards that rule the corporation.

Occasionally, that faith proves unjustified. And when that happens, history shows that equity investors have often walked hand-in-hand with executives to the edge of the cliff.

Investors, unlike other stakeholders, are often happy that a company becomes more risky so long as its prophecies of future rewards are growing even faster. Executives know that leveraging a firm's future risk/reward profile can be achieved by various means: increasing market share at thin risk-adjusted margins; incurring difficult-to-measure long-tail liabilities; shaping a firm's cashflows and liabilities using reinsurance contracts and options; or investing heavily in potentially lucrative but increasingly risky ventures.

There's nothing wrong with any of these, providing a business succeeds in clearly communicating its risk position to

investors, has limited stakeholders other than shareholders and does not depend on external perceptions of its soundness to remain in business. Most risk management firms fail on one or all of these caveats, and when things go wrong, analysts suddenly find themselves shifting from a plausible tale of profits to one of losses that don't have a verifiable floor. They begin to suspect they will discover the real answer not in the next conference call, but years later in the dry transcripts of courts, liquidators, regulators and commissions. (The Royal Commission on Australia's HIH Insurance begins sitting next week and will report in mid-2002.)

One answer to the problem of air walking is to strengthen the connection between risk reporting, company statements and the specific duties of boards of directors. A research paper

http://www.newyorkfed.org/rmaghome/econ_poi/2001/801jmac.html recently published by the Economic Policy Review of the Federal Reserve Bank of New York points out that to become liable for a bank failure in the US, directors have to fail utterly to establish a reporting system for risk. The authors of the paper argue that this is too soft, given the increasingly critical nature of such systems and the variety of stakeholders in a bank. They recommend instead: "In order to avoid liability, directors of banks have a continuing obligation to develop and maintain a detailed and elaborate system for monitoring and oversight."

Elsewhere, the international accounting authorities and the regulators of both the banking and insurance industry are moving to tighten up best practice in company accounts and the reporting of risk. Away from the field of regulatory capital reform, the Basle Committee's accounting task force issued a report http://www.bis.org/publ/bcbs84.htm in August on the internal audit function in banks. Among other recommendations, it stressed that a bank's internal audit group should regularly carry out an independent review of the risk management system developed to set the bank's capital levels. The same committee is currently preparing a survey of how internal audit works in practice.

But these are long-term efforts, and to be effective they will have to cross many professional and industry boundaries. Meanwhile, risk officers might ask themselves a simpler question. If a rumour circulates tomorrow that their firm is in trouble, could they convince an outsider that the cogs in their financial reporting, risk reporting and corporate governance systems are all meshed together?

From: Sent: Nickoloff, Peter

To: Subject: Friday, November 09, 2001 1:20 PM Carleton, Norman; Schultheiss, Heidilynne Interview with Enron's Chief Risk Officer

From Erisk.com

CRO Profile: Rick Buy - Enron Corporation

Asked about the biggest challenge he faces, Enron's chief risk officer could never be accused of aiming low: Rick Buy aims to condense all the risks of Enron Corporation into a single metric. This would comprise operational, market and credit risk and incorporate risk- adjusted return on capital (RAROC), value-at-risk (VaR) and extreme value theory into what Buy calls a single "pseudo capital-at-risk figure" that can be shown to the Enron board of directors.

It's a daunting task for the CRO of a company that encompasses business lines as diverse as running a vast natural gas pipeline network, wholesale power marketing, energy trading, project financing and consulting, as well as engineering and construction. That's without taking into account new ventures such as Enron's entry into the UK water business through Azurix; its involvement with weather derivatives through the launch of temperature-linked bonds; its launch of a B2B exchange for trading bandwidth; and its foray into online credit risk management for third parties, Enron Credit.

Ranked 18th in the Fortune 500 index, with revenues of \$100 billion in 2000 (compared with \$40 billion in 1999) Houston-based Enron is seeing its list of counterparties growing towards the 20,000 mark, a rise that Buy attributes partly to the development of the Enron Online e-trading platform – which has reputedly turned Enron into the world's biggest e-commerce company since its launch last year.

The size and complexity of Enron's diverse business lines and counterparty list makes the idea of a single risk measurement for the whole firm seem almost incredible. Buy admits that one of his other goals – of achieving enterprise risk management (ERM) across the whole group – is only about 30 per cent complete so far, but says a lot of progress has been made in aggregating risk across the company: "We understand that, for example, credit exposure to Shell in London has to be added to Shell elsewhere, and we routinely assess how exposed we are in this kind of way"

Buy joined Enron from Bankers Trust in 1994, and as CRO now reports directly to president Jeffrey Skilling as well as to the board. He is on Enron's executive committee and heads the risk assessment and controls (RAC) group. Enron's separate risk committee was disbanded a year ago, and the risk function now comprises Buy and his RAC group, the board and senior management. The board sets the firm's appetite for risk, while the RAC group measures and reports on risk throughout the company.

"The board tends to be vague on the details of risk positions, "says Buy. "I try to ascertain their comfort levels with certain market moods and P&L swings. We then try to set our limits structure to accommodate that risk appetite. You have to read between the lines of the board's views to some extent – they know that we need to take on risk, but also they take the view that we're not a pure trading house." Individual transactions to the value of \$750,000 and above get referred directly to Buy's RAC group, while anything above the value of \$75 million has to be approved by the board.

From:

Nickoloff, Peter

Sent: To: Subject: Friday, November 02, 2001 1:16 PM Carleton, Norman; Schultheiss, Heidilynne

Another Enron story

The New York Times

November 2, 2001

The Rise and Fall of Enron

Earlier this year, most companies would have loved to have Enron's problems. Californians resented the energy trading company's huge profits during their energy crisis, and Democrats in Washington raised questions about Enron's influence within the White House and about the cozy relationship between Enron's chairman, Kenneth Lay, and Vice President Dick Cheney. Nobody seemed better positioned to thrive during the Bush presidency than this Houston-based apostle of deregulation.

Wall Street was impressed with Enron's strategy of swooping into formerly regulated markets to broker contracts for natural gas, electricity or unused telecom bandwidth. The company was celebrated as a paragon of American ingenuity, a stodgy gas pipeline company that had reinvented itself as a high-tech clearinghouse in an ever-expanding roster of markets. Enron's push to force utilities into the Internet age with its online trading systems, at a seemingly handsome profit, became an epic tale of the dot-com revolution.

It now appears that Enron's tale may be more cautionary than epic. Enron envy has crashed, along with the company's stock price, as serious questions emerge about its bookkeeping. Enron disclosed earlier this month that \$1.2 billion in market value had vanished as a result of a controversial deal it entered into with private partnerships run by its chief financial officer, Andrew Fastow.

Most alarming was Enron's reluctance to shed light on management's wheeling and dealing. "Related-party transactions," as the accountants call them, are fraught with conflicts of interest. Though much remains to be learned about these transactions, their scope and lack of transparency suggest that Enron may have in effect created its own private hedge fund to assume some of the risk and mask the losses of its complex trading. The extent to which company insiders profited from the partnerships is not yet clear.

Enron has scrambled to dampen Wall Street's concerns, acknowledging its credibility problem while insisting on the health of its core businesses. On Wednesday it brought in William Powers, the dean of the University of Texas School of Law, to review the transactions. The Securities and Exchange Commission has launched its own formal investigation. Mr. Fastow was forced to resign, following Jeffrey Skilling, the man credited with driving Enron into new cutting-edge businesses, out the door.

Enron's former admirers on Wall Street, mindful of recent scandals involving high-profile companies doctoring their earnings, and of the spectacular collapse of the Long-Term Capital Management hedge fund in 1998, are alarmed. Carole Coale of Prudential Securities summed up the prevailing sentiment when she told The Times: "The bottom line is, it's really difficult to recommend an investment when management does not disclose facts." Analysts, as well as the media, are not entirely blameless. Enron did mention, albeit in passing, the troubling related-party deals as early as March 2000. But few analysts bothered to raise questions at a time when the company's revenues, profits and stock price were soaring.

Harvey Pitt, the new Securities and Exchange Commissioner, must pursue the Enron inquiry aggressively in order to assure investors that he will be as vigilant as his predecessor, Arthur Levitt, when it comes to protecting the integrity of financial markets. Indeed, even if Enron is cleared of any wrongdoing and regains some of its past luster, as it well might, the company that preaches the merits of self-regulating marketplaces has reminded us all of the need for a strong regulator on Wall Street.

From:

Nickoloff, Peter

Sent: To: Subject: Thursday, November 08, 2001 10:46 AM Carleton, Norman; Schultheiss, Heidilynne

Enron to be acquired

From the New York Times:

November 8, 2001

Dynegy Is Said to Be Near to Acquiring Enron for \$8 Billion

By RICHARD A. OPPEL Jr. and ANDREW ROSS SORKIN

The board of Dynegy Inc. (news/quote </redirect/marketwatch/redirect.ctx?) MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=DYN>) tentatively approved a deal last night to acquire the Enron Corporation (news/quote </redirect/marketwatch/redirect.ctx? MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=ENE>), the oncemighty energy-trading company laid low by a financial crisis and government investigation, executives close to the transaction said.

A deal would enable Dynegy to buy the much bigger Enron at a fire-sale price - about \$8 billion in stock, or roughly \$10 a share, for a company that less than a year ago had a market value of nearly \$70 billion. But with stock and bond investors fleeing, some of its trading partners refusing to do business with it, Enron had few choices but to talk to Dynegy.

As part of the deal, Chevron (news/quote </redirect/marketwatch/redirect.ctx? MW=http://custom.marketwatch.com/custom/nyt-com/html-companyprofile.asp&symb=CHV>) Texaco (news/quote </redirect/marketwatch/redirect.ctx?MW=http://custom.marketwatch.com/custom/nyt-com/htmlcompanyprofile.asp&symb=TX>), which owns a 27 percent stake in Dynegy, would give Enron a cash infusion of at least \$1.5 billion up front and an additional \$1 billion when the deal closed.

The executives said the companies hope to finalize the details and announce the deal today.

If completed, a takeover by Dynegy, a company only about one-quarter its size in revenue, would represent a remarkable humbling of Enron, the nation's biggest buyer and seller of natural gas and electricity. Enron had \$139.7 billion in revenue for the first nine months of the year.

As recently as last spring Enron was lionized by investors as an innovator that had in many ways created and cleverly dominated the nation's deregulated energy markets. It would also vindicate not only Dynegy, which took a more measured approach to doing business in those markets, but also critics uncomfortable with energy deregulation who said Enron's energy trading was ruthless, its finances murky and its power and influence too extensive.

The company's chairman and chief executive, Kenneth L. Lay, is a close friend of President Bush. He has been one of Mr. Bush's largest campaign contributors, and no other energy company gave more money to Republican causes last year than Enron. Mr. Lay would be on the board of the combined companies, the executives said, but it was unclear if he would have an operational role.

Enron's problems came to light last month when the company disclosed \$1 billion in write-downs and an unusual \$1.2 billion reduction in shareholder equity. The reduction in equity arose from transactions with investment partnerships involving Andrew Fastow, the chief financial officer, who was forced to resign on Oct. The Securities and Exchange Commission is investigating those transactions.

Enron is expected today to send the S.E.C. answers to questions the agency has posed in its investigation. The answers have been reviewed by Dynegy officials, the executives said, and are expected to be released publicly.

Enron is scheduled to meet its creditors tomorrow about the company's continuing crisis - and about the merger

deal, if there is one.

People close to the deal say the company hopes that a deal with Dynegy, and the release of the answers to the S.E.C., will calm the crisis that has engulfed the company and led other energy companies that trade with Enron to curtail their credit exposure to the company.

Besides worries about the huge losses and the S.E.C. investigation, investors and creditors are nervously watching Enron's credit rating. Moody's Investors Service and Standard and Poor's have already cut the rating to two notches above junk status, and on Monday, Fitch Inc. cut it to one notch above junk.

As part of the acquisition, Dynegy would be taking on Enron's \$12.8 billion debt load - a number that does not include billions of dollars of other debt, accumulated off the balance sheet, that has played a major role in Enron's current problems. The executives said they expected the deal would lead to the sale of some Enron assets to pay down the \$12.8 billion debt.

Should Enron lose its investment grade rating, other energy trading companies could curtail their business with the company even further, and Enron could be forced to issue tens of millions of shares of stock to cover offbalance sheet debts that it has guaranteed.

Early Wednesday, shares of Enron plunged 28 percent, to about \$7, on fears that the company was unable to line up new investors.

But the stock took back most of its losses in the afternoon after CNBC reported the talks with Dynegy. Shares of Enron closed at \$9.05, off 62 cents. Dynegy shares closed at \$33, down \$3.

In addition to both companies' very large presence in energy trading, Enron owns the Portland General Electric Company (news/quote </redirect/marketwatch/redirect.ctx?MW=http://custom.marketwatch.com/custom/nytcom/html-companyprofile.asp&symb=PGB>), a utility in Oregon it had already agreed to sell, and Dynegy owns the Illinova Corporation, a retail electricity and natural gas utility in Illinois.

Regulators may take a hard look at those utilities in reviewing a merger deal, said Jeff Dietert, an analyst with Simmons & Company in Houston. "Then you've got concerns about market power," he said. "It's just a lot of

different issues to deal with before we get too excited that this deal is going to get done."

The acquisition would combine Enron, which dominates United States trading of electricity and natural gas and has been shedding its hard assets, with Dynegy, a company that has pursued a much different strategy of using trading to maximize earnings from its power plants.

Enron has always concentrated on sophisticated financial trading strategies, a senior executive at a rival energytrading firm, said. "Dynegy has always been more of a logistical player of physical assets," he said. "Those are very different cultures and very different mentalities." The executive noted that there had been an immense talent drain from Enron in the last two weeks. "It has become a frenzy," he said.

From: Schultheiss, Heidilynne

Sent: Thursday, November 08, 2001 5:05 PM

To: 'weini@sec.gov'; 'dutth@sec.gov'; 'judy.ringle@ssa.gov'; 'mpenick@cftc.gov'; Carleton, Norman; Nickoloff,

Subject: FW: Derivatives Study Center in the Press

Randall is up to the same old tactics again. And I would hardly characterize him as "free market"; I think he would be offended at the label!

----Original Message-----

From: Randall Dodd [mailto:rdodd@econstrat.org]
Sent: Thursday, November 08, 2001 5:02 PM

To: Randall Dodd

Subject: Derivatives Study Center in the Press

Derivatives Study Center

Randall Dodd 560 Director 202 326 8555 1401 H Street, NW, Suite

Washington, D.C. 20006 rdodd@econstrat.org

Dear Colleagues:

I thought it would be worthwhile to take a moment to write and let you know that the Derivatives Study Center has been in the news quite a bit in the last couple of months. This has given me the opportunity to discuss some of the suspicious sxtock trades that preceded the terrorist attacks on September 11th, to explain some of problems in tracking these transactions through tax haven countries, to comment on the various proposals for an economic stimulus package, and even to talk about the possible issuance of War Bonds in the wake of the September 11th attacks. This includes appearances on CNN's Money Line (September 7th), CBS Evening News (see transcript below) and radio appearances on WTOP, Wisconsin Public Radio, WBUR in Boston (discussing the tracking of terrorist finances) and WAMU's syndicated "Talk of the Nation" (discussing War Bonds). You can listen to either of the latter two of these radio broadcasts through links below. In addition to broadcast news, I have copied in below some examples of on-line and print articles – including the Congressional Quarterly, San Francisco Chronicle and Miami Herald – where these comments have been quoted.

Regarding current events, the Derivatives Study Center is closely following the implosion of Enron Corporation and any impact it is having on energy and other derivatives markets, and the Center is also following the recent disclosure that the Treasury Department bungled its announcement of plans to cease new auctions of the 30-year Treasury bond so that the news was leaked early to some market participants. So look for the Center to show up in articles linked to these events.

> Yours, Randall Dodd

Thursday, September 11, 2001

Taxing Issues
Washington Wants to Trim Capital Gains Tax to Spur Growth
Experts Say It Won't Work
ABCNEWS.COM

02596

1/15/02

Derivatives Study Center

Page 2 of 14

By M. Corev Goldman

N E W Y O R K, Sept. 11 -- The U.S. economy is not well. And Washington lawmakers are desperately searching for whatever remedy they can find to cure it.

Already they've spooned out some \$38 billion worth of rebate checks to weary consumers, part of a \$1.35 trillion 10-year tax-out package meant to stimulate growth. And Republicans and Democrats alike have been bantering of late about another tax out they hope will revive the sluggish economy: A reduction in the capital gains taxation rate to 15 percent from 20 percent.

Dubbed the "rich man's" tax because it tends to affect only those with very high incomes and assets, the capital gains tax was initially implemented to bring revenue into the government's coffers from those who made money on well-heeled investments. The rate was as high as 28 percent before the former Clinton administration lowered it to 20 percent with the 1997 Taxpayer Relief Act.

With the economy looking sicklier by the day, lawmakers in Washington are now exploring a further reduction in the capital gains tax as a way to stimulate economic growth — a move they hope will restore consumer confidence and get the economy back on its feet. The problem is, not everyone agrees that a reduction or outright elimination of a well-heeled tax will really do all that much to help the struggling economy.

"It's an honest debate and one that certainly has its merits, but there is a big question mark as to whether a reduction in the capital gains rate would have any effect at all," said Stanford University economics professor Warren Bailey. "Any talk of a tax cut is going to seem positive, but there really is no way to tell what the impact might be."

Minimal Market Gains

Currently, anyone who makes a capital gain — whether by selling stock at a profit or selling real estate in excess of \$500,000 — is required to pay a 20 percent tax. For small gains in an IRA portfolio, that's not too bad; for larger gains, such as buying a \$1 million country home and selling it for \$4.5 million, the implications of the tax become much more palpable.

According to research compiled by the Congressional Research Service's government and finance division, only 1.8 percent of the taxpaying population earns more than \$200,000 and pays approximately 79 percent of capital gains taxes. The tax itself accounts for roughly 4.5 percent of total federal income, payroll and excise taxes; it accounts for 14 percent of total taxes for the highest-income taxpayers.

In theory, a reduction in the rate would add to the government's revenues like this: Anyone currently sitting on the fence as to whether or not to sell their investments might be encouraged to do so if the tax rate were less. That would then increase tax revenue and help Congress deal with the shrinking budget surplus, which has been declining in a weaker economy and Bush's already current tax cut, and avoid dipping into Social Security.

In practice, many economists and market-watchers don't believe a five-point reduction in the capital gains tax will have any effect whatsoever. The only effect it might have, experts say, is to keep long-term interest rates high as longer-term revenues the government would have been receiving dwindle away.

After all, at the end of the day, the government will be taking in 5 percent less.

"The vast majority of capital goes go to very rich people, and right now there aren"t any capital gains anyway," said Randall Dodd, a director with the Economic Strategy Institute in Washington, "If you want to stimulate the economy, that is not a very effective way to do it."

Tried and True

And that small percentage of American wealth has a very tried-and-true way of doing business.

"If you think a reduction in the capital gains rate is going to stimulate the economy, you have to think that those high-income people are going to something other than what they've been doing with their money," said Iris Lav, a senior analyst with the Center on Budget and Policy Priorities in Washington. "That tax is for very wealthy people, and those people are not likely to change their spending patterns."

To be sure, some analysts have suggested that, if another tax cut is something Washington decides it absolutely must do, then it should be a different kind of tax cut, such as a reduction in the 15.3 percent payroll tax that comes out of most working Americans' paychecks.

Rolling back a portion of the payroll tax that goes to Social Security and Medicare would give a tax cut to more than 30 million workers most earning less than \$44,000 a year who were left out of this year's \$40 billion in tax rebate checks because they didn't have enough taxable income to qualify.

All the same, others believe the government should simply cut income tax rates across the board, providing broad-based tax relief for lower- and middle-income individuals and families that might bring less cash into the Treasury, but would create more economic activity as disposable incomes rise.

"During a downturn economy a government probably should cut taxes, and a government should probably run a deficit — that's what a

1/15/02

Derivatives Study Center

Page 3 of 14

government is supposed to do," said Cornell's Bailey. "But the tax cut also has to be something that will genuinely encourage people to spend. If it's too exclusive, it's not going provide much relief to the economy in the long term."

Wednesday, September 19, 2001

Newscast: Terrorists may have attempted to profit from a drop in airline stocks after the four hijackings

09/20/2001

CBS News: Morning News

(c) Copyright 2001, CBS Worldwide Inc. All Rights Reserved.

SUSAN McGINNIS, anchor: Federal investigators are following a money trail, trying to find out if terrorists profited from stock swings blamed on the suicide attacks. Sharyl Attkisson reports.

SHARYL ATTKISSON reporting:

Sources tell CBS News that the afternoon before the attack, alarm bells were sounding over unusual trading in the US stock options market, an extraordinary number of trades betting that American Airlines' stock price would fall. The trades are called 'puts,' and they involved at least 450,000 shares of American. But what raised the red flag is more than 80 percent of the orders were puts, far outnumbering call options, those betting the stock would rise. Sources say they've never seen that kind of imbalance before. Normally, the numbers are fairly even.

After the terrorist attacks, American Airlines' stock price obviously did fall,, and according to our sources, that translated into well over \$5 million total profit for the person or persons who bet the stock would fall. Sources tell "60 Minutes" that the initial options were bought through at least two brokerage firms including, including NFS, a subsidiary of Fidelity, and TD Waterhouse, a discount firm. At least one Wall Street firm reported suspicions about this activity to the Securities and Exchange Commission shortly after the attack.

The same thing happened with United Airlines on the Chicago Board Options Exchange four days before the attack. An extremely imbalanced number of trades betting United's stock price would fall also transformed into huge profits.

Mr. RANDALL DODD (Economic Strategy Institute): We can directly work backwards from the trade on the floor of the Chicago Boards Option Exchange. That trader is linked to a brokerage firm. That brokerage firm received the order to buy that put option from either someone within their own brokerage firm speculating or from one of their customers.

ATTKISSON: Now US investigators want to know whether Osama bin Laden was the ultimate inside trader, profiting from a tragedy he's suspected of masterminding to finance his operation. Authorities are also investigating possibly suspicious trading in Germany, Switzerland, Italy and Japan.

The stock trail could stop at the water's edge if the money came from banks in places that don't cooperate with the US. But insider trading is always motivated by greed, and a senior Wall Street executive noted it would be ironic if the terrorists' greed ended up providing one of the best leads investigators have. Sharyl Attkisson, CBS News, Washington.

Saturday, September 22, 2001

CQ WEEKLY - THE ECONOMIC INITIATIVE

Sept. 22, 2001, Page 2200

A Cautious Start for Stimulus

By Julie Hirschfeld Davis, CQ Staff

The cusp of a war, a swoon in the securities markets and the destruction at the nation's financial epicenter have jolted both parties in Congress and President Bush into rethinking how the federal government should stimulate an already weak economy.

Greenspan, at right, was among the economists urging the 107th Congress to take a "go slow" approach to writing legislation designed to stimulate the economy. He and Securities and Exchange Commission Chairman Harvey Pitt 1/15/02

greeted Phil Gramm, R-Texas, far left, and Paul S. Sarbanes, D-Md., left center, before a Sept. 20 hearing of the Senate Banking Committee.

No longer bickering over whether more spending will threaten Social Security, all of them say the nation can afford a substantial defense build-up, the rebuilding in New York City, a bailout for the airline industry and perhaps more tax cuts without jeopardizing the nation's long-term fiscal health. (Airlines, p. 2206)

Members of the House Ways and Means and Senate Finance committees will be continuing a series of bipartisan discussions in the coming weeks about what the congressional role should be in trying to stimulate the economy -- all the while seeking to avoid public battles over tax policy at a time when lawmakers are determined to show unity.

But through the week of Sept. 17 -- both in private and in public -- many economists cautioned Congress to move slowly on any additional stimulus package.

"Nobody has the capacity to fathom fully how the tragedy of Sept. 11 will play out," the nation's most influential economist, Federal Reserve Chairman Alan Greenspan, told the Senate Banking Committee on Sept. 20. "But in the weeks ahead, as the shock wears off, we should be able to better gauge how the ongoing dynamics of these events are shaping the immediate economic outlook.

"It's far more important to be right than quick," Greenspan added.

Republican and Democratic leaders say they are planning to meet again the week of Sept. 24 with Greenspan, as well as with top White House economic adviser Lawrence Lindsey and former Clinton administration Treasury Secretary Robert E. Rubin, before they decide on a package.

"We need to get a better assessment of the overall impact," House Majority Leader Dick Armey, R-Texas, said after the meeting Sept. 19. "The nation's had a terrible jolt and, quite frankly, the jolt is more widespread, both in terms of the physical performance of different markets and in terms of the national psyche, than what we've been able to measure."

The administration has signaled an openness to additional tax cuts this year, but has not endorsed any of the ideas being floated. In discussing other stimulus options, Treasury Secretary Paul H. O'Neill has suggested the administration is not now planning to endorse federal aid for industries other than the airlines, such as insurance firms. And federal regulators say they have adequate powers over the financial markets. (Markets, p. 2202; insurance, p. 2203)

"There is a sense we ought to do something, and I think there is a sense that we ought to wait a week or so to see what that is," said Rob Portman of Ohio, a Ways and Means member and a conduit between the White House and House GOP leaders. "That's about as much consensus as I've seen." 'Enough to Get America Going'

One week after the deadliest foreign attack on American soil, the government's budget picture has brightened considerably, judging by the

1/15/02

shift in political rhetoric on Capitol Hill. Republicans and Democrats -who were hurling accusations of fiscal mismanagement at each other until the
moment the airliners struck the World Trade Center and Pentagon -- have cast
that rhetoric aside.

"The definition of how much is: enough to get America going again," the president declared Sept. 19, when he was asked how much he was willing to spend of the surplus revenue once dedicated to the Social Security trust funds -- the so-called lockbox. (Background, CQ Weekly, pp. 2126, 2050) "The leaders from the Congress are very reasonable, and they are mindful about government money as well as anybody else," Bush said, with the top Republicans and Democrats from the House and Senate seated beside him in the Oval Office. "But we are dedicated -- we are dedicated to saying to the American people, this is an emergency the likes of which we have not seen in a long time in this country, and this government will come together and deal with it."

The next day, after members of the House Ways and Means Committee met in private with several economists to discuss options for economic stimulus legislation, Chairman Bill Thomas, R-Calif., said "one of the things that there was general agreement on was the fact that the budget constraints are probably not a major obstacle in the current environment."

What Can Congress Do?

Participants in the week's discussions said one reason for the lack of consensus about what taxes to cut next is that there is no clear understanding yet about the scope of the attacks' consequences for consumer confidence, the stock markets and the gross domestic product.

"It's open because there are so many unknowns," Senate Finance Committee Chairman Max Baucus, D-Mont., said after a Sept. 21 meeting with O'Neill, Thomas, Finance ranking Republican Charles E. Grassley of Iowa and Ways and Means ranking Democrat Charles B. Rangel of New York.

But the talks nonetheless illustrated the new framework for the federal budget debate: It is no longer about which party is a more studious guardian of the shrinking surplus. It is about how best to spend the surplus to stimulate the economy. That is a change many economists say was a long time in coming.

"If the economy is slowing down, you want to lean in the direction of deficits, and until Tuesday, this was clearly not understood on either side of the aisle," Frank C. Wykoff, a professor of economics at California's Pomona College, said in describing the Sept. 11 attack. "Up until now this bipartisan agreement on Social Security has essentially been Hoover economics, and now they finally woke up and realized you have to stimulate the economy."

In the Ways and Means meeting -- to which each party invited three economists to share their views of the current economic situation and how to improve it -- participants were said to be split on three key questions:

Should Congress even try to legislate an economic stimulus? If so, should the package's provisions be permanent or temporary? And should its emphasis be on long-term or short-term concerns?

In a Sept. 17 report, the Congressional Research Service noted that many

1/15/02

economists doubt that congressional moves to alter fiscal policy can counter a recession because of the difficulty of enacting a stimulus quickly enough to stop a flagging economy. Some suggest the government's options for spurring investment and retail spending will be inadequate to countermand the loss in consumer confidence expected to flow from the attacks. Others say the possible tax law changes would take effect too late to counter a downturn that may have begun before Sept. 11 and that seems sure to get worse, at least in the near term.

"These investment stimuli tend to reinforce an expansion, but they're not going to turn things around, because firms are going to be constrained on the demand side by the market," Wykoff said. "You can't really juice up investment if investors aren't ready to invest."

But some lawmakers say it is important for Congress to respond in some way, if only to demonstrate solidarity and a resolve to keep the U.S. economy on firm footing. "Sometimes we need to take action just to give ourselves a psychological boost," said Ways and Means Democrat Robert T. Matsui of California, although he added, "I don't have a lot of confidence in these microeconomic measures having a great macroeconomic effect."

And while many Democrats want to ensure that any stimulative tax relief is temporary — with an eye toward controlling the loss of revenue to the Treasury and thereby keeping long-term interest rates in check — several Republicans maintain that the package should make permanent changes in tax law, in the belief that promised continuity of the tax code would help boost economic activity.

Bang for the Buck

Not surprisingly, large differences separate Republicans and Democrats on the question of what those measures should be. While lobbyists and lawmakers acknowledge that any stimulus package would need to be a bipartisan product in order to become law, talk of additional tax cuts already has revived long-running debates.

Eager to assert his prerogative as the House's chief tax writer, just three days after the attack Thomas recommended an ambitious tax package including a capital gains rate cut, an increase in small-business expense deductions and a reinstatement of the investment tax credit. He also proposed a short-term acceleration in the business depreciation schedule. (CQ Weekly, p. 2132)

Business groups have quietly expressed support for many of those proposals, most of which have been on their own wish list for some time, and they began pushing for additional tax breaks as well. This led some Democrats to begin criticizing the GOP and the business community for political opportunism in the heat of a national crisis. As a result, it took some personal appeals from Rangel to get fellow Democrats to attend a Sept. 17 meeting with Thomas to talk about stimulus options.

The situation led to some awkward positioning as business groups sought to balance their desires for tax relief against their reluctance to look selfish. On Sept. 17, U.S. Chamber of Commerce President Thomas Donohue downplayed his group's zeal for immediate additional tax cuts, saying "We'll have some discussion of a stimulus package in the future." But later in the

week, the Chamber's top lobbyist, Bruce Josten, said business groups were indeed pushing for quick action on items like eradication of the alternative minimum tax for corporations and the revival of the investment credit. Also, a coalition of business groups sent Bush and congressional leaders a letter urging them to move promptly.

Democrats signaled that they are loath to consider a cut in the capital gains rate. The GOP says the move might raise revenue in the short term by encouraging people to sell their assets to take advantage of the lower rate. Democrats say the new rate would do little to bolster new investments and would disproportionately benefit the wealthy.

Similarly, some Republicans have said they are against a leading Democratic idea: cutting payroll taxes for lower-income workers. "We're worrying about ensuring the future of Social Security and Medicare, and if we cut the payroll taxes now, that could cause problems for us later," said Jill Gerber, a spokeswoman for Grassley.

Republicans also are unlikely to submit to demands to revisit the tax cuts between 2005 and 2010 under the \$1.35 trillion tax cut law (PL 107-16) enacted in June. Many Democrats say this is necessary to control interest rates in the long run considering the explosion in federal spending that is sure to follow the attacks. (CQ Weekly, p. 1304)

Even before Sept. 11, Rubin had been counseling Democrats to press to reopen the debate on the tax cuts for the second half of the decade, arguing that the lost revenue would cause long-term rates to rise and hurt the current economy. "Maintaining our fiscal discipline going forward will be key to economic well-being," he told the U.S. Hispanic Chamber of Commerce on Sept. 21.

Keeping Focused

But both Republicans and Democrats were sounding a conciliatory note at the end of the week of Sept. 17.

"I don't think we ought to emphasize poison pills, but if we search for common ground, we'll find the poison pills," Sander M. Levin of Michigan, the ranking Democrat on the Ways and Means Trade Subcommittee, said Sept. 20 in declining to say what proposals would be non-starters in his party's eyes. "I think we all have a choice, including the president: to search for common ground, or to try to shove through our agenda. And I think the answer should be searching for common ground."

And while Thomas emphasized the need for investment stimuli, he said it also might be appropriate to "do a bit of a demand side" -- for instance, he said, by providing tax relief similar to Bush's tax cut for those who do not pay income taxes. Such a cut has been anathema to the GOP in the past. In the absence of bipartisan agreement on how to proceed, economists have counseled lawmakers not to cobble together a stimulus package in the image of most tax relief measures that move through Congress, which frequently turn into "Christmas trees" littered with special provisions to satisfy important constituencies.

"You don't do a little bit of this and a little bit of that in creating a

1/15/02

political package which, though it might have broad appeal from a lot of pieces in it, would have virtually no impact if you're trying to influence economic decision-making," Thomas said. "It would be better if we sat down and tried to come to a bipartisan agreement on a package that had a sufficient focus to make a difference."

Other Stimuli

Beyond tax cuts, lawmakers are considering other ways to help boost the economy in the wake of the terrorist attacks. One proposal under discussion would be to assist laid-off workers in paying their share of temporary medical insurance available to them after they are no longer employed. Republicans also have resumed their push for legislation that would once again empower the president to negotiate trade agreements that Congress would have to accept or reject quickly and without amendment. Longstanding partisan disagreement on such a measure will make it difficult to schedule quick action but Republican leaders say granting Bush such "fast track" power would give businesses confidence in their international futures - as well as building a coalition of nations committed to eradicating terrorism. (Diplomacy, p. 2191)

Regardless of what the elements of the package are, some economists believe Congress cannot wait too long to act. "There's not enough appreciation of what's been lost here in terms of momentum," said Randall Dodd of the Economic Strategy Institute, a think tank that advocates free-market policies. "We were in this box two weeks ago, but now we have an excuse to take actions that might otherwise have seemed rash."

Still, that excuse may not last long. David C. Colander, professor of public finance and macroeconomics at Princeton University, said the nature of the coming military conflict will determine how long the current dynamic remains. "If it's actual wartime, everything is forgotten about balancing budgets, and the total focus goes elsewhere," Colander said.

However, if it turns out to be a war of sporadic, small-scale engagements rather than a focused, massive assault, the public's attention could drift back to domestic concerns, he said, and Washington could return to its old ways of fighting over budget priorities in the context of surpluses and deficits. "This clearly is not war as we know it," Colander said.

Monday, September 24, 2001

WBUR - Boston University and National Public Radio Frozen Assets: The Financial Battle Begins

President Bush issued an executive order today to freeze the U.S. assets of 27 groups and individuals suspected to support terrorism. Calling the order a "strike on the financial foundation" of terrorists, the President called on financial institutions around the world to follow suit. If foreign banks did not take similar action, Bush warned that those banks may have their U.S. assets frozen.

A financial assault is seen by many as an important component of the war against terrorism. Jeffrey Robinson, author a two books on money laundering, says the financial war will be difficult, because funding for terrorism does not come from a rich ex-Saudi millionaire as most people thing -- but from criminal activity and charities.

You can listen to the show, using Real Player, by clicking on the hyperlink Listen below.

02603

1/15/02

Listen

Guests:

Randall Dodd, Professor of Economics at American University Jeffrey Robinson, author of "The Laundrymen: Inside Money Laundering, the World's Third-Largest Business"

Wednesday, September 25, 2001

Bush goes after terrorists' funds / President freezes assets in U.S., pressures foreign banks to aid in financial crackdown

Carolyn Lochhead

Chronicle Washington Bureau

09/25/2001 The San Francisco Chronicle FINAL A.1

President Bush threatened yesterday to freeze the U.S. operations of foreign banks that do not cooperate in a financial crackdown on 27 suspected terrorists and terrorist groups.

"Money is the lifeblood of terrorist operations," Bush said. "Today we're asking the world to stop payment."

The executive order requires U.S. financial institutions to immediately freeze the assets of groups on the list and prohibits any U.S. citizen or business from doing business with anyone on the list.

The administration has no authority to force foreign banks to do likewise, but the threat to shut down their U.S. operations could prove powerful leverage, given the dominating role the United States plays in global finance.

The order goes well beyond the freeze of assets imposed by President Bill Clinton in 1998 against Osama bin Laden, the government's chief suspect in the Sept. 11 attacks on New York City and the Pentagon. That freeze had little effect.

Bush called the move "a major thrust of our war on terrorism," making the announcement in the Rose Garden accompanied by Secretary of State Colin Powell and Treasury Secretary Paul O'Neill.

Conceding that most terrorist assets probably are located overseas, Bush said the administration had created "the international financial equivalent of law enforcement's 'Most Wanted' list."

"It puts the financial world on notice," Bush said. "If you do business with terrorists, if you support or sponsor them, you will not do business with the United States of America."

The threat could affect such famous bank havens

as Switzerland, Grand Cayman and Dubai.

Bush said the administration will work with the governments of foreign banks that might be harboring assets of groups or individuals on the list and "ask them to freeze or block terrorists' ability to access funds in foreign accounts. If they fail to help us, . . . the Department of the Treasury now has the authority to freeze their banks' assets and transactions in the United States."

The administration list targets bin Laden and his al Qaeda network, but also includes Egypt's Al-Jihad, the Libyan Islamic Fighting Group, and the Islamic Movement of Uzbekistan, a group said to number as many as 3,000 fighters trying to create an Islamic state within three nations just north of Afghanistan. The list also includes suspected individual terrorists.

In an attempt to shut down what is believed to be bin Laden's large fund-raising network, the administration included two nonprofit groups, Wafa Humanitarian Organization and Al Rashid Trust.

Bank analysts generally praised the move but said cutting off terrorist money is no easy task. Many are believed to use informal money networks that skirt financial institutions altogether. Moreover, the amounts involved are sometimes small; some estimate the cost of mounting the Sept. 11 hijackings and terrorist attacks was about \$200,000.

Because the United States has cut its economic ties to several nations that could be most helpful, the government also lacks vital financial information.

"The groups that are named are only the ones we suspect," said Bruce Zagaris, a partner in the Washington law firm, Berliner, Corcoran & Rowe. "The U.S. doesn't even have relations -- and hasn't for many, many years -- with a number of countries that are the biggest and most important countries in the Middle East, such as Iraq, Iran and Libya."

As a result, Zagaris said, "We have very few resources on the ground to know anything about what's going on in these countries. We necessarily are having to rely on other countries or entities for normal intelligence that we would have had if we had an embassy and all kinds of other private-sector contacts."

COOPERATION VITAL

The effectiveness of the crackdown will hinge in part on getting other countries and institutions throughout the Middle East to add names to the

Monitoring and enforcement is another problem. Former Yugoslavian President Slobodan Milosevic hid his assets for years, Zagaris noted.

"It was only last week that the Greek central bank finally ordered a number of Greek banks where Milosevic's money was thought to exist to cooperate," Zagaris said. "For all those years, the money was first in Cypress, and it took a while to convince Cypress to crack down. By the time that was enforced, the money had been moved to Greek branches of Cypriot banks. Only now are we catching up with the assets."

Randall Dodd, director of the nonprofit Derivatives Study Center, praised the administration's moves.

Dodd said terrorists could also be using offshore tax havens in the Caribbean such as Grand Cayman, Barbados and Antigua, where banking fees are a major source of revenue.

COMPENSATION MAY BE NEEDED

The administration's threat to shut off economic relations with those nations could prove a powerful weapon, Dodd said, but might require some kind of compensation in return. The Organization for Economic Cooperation and Development, a group of industrialized nations, tried to harmonize banking laws in the Caribbean but met resistance from some islands that feared a substantial loss of

The United States itself has not joined several international money-laundering agreements, including the 1990 Council of Europe's Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, ratified by 47 nations, including Russia.

Bush called on the Senate yesterday to ratify the United Nations Convention on Suppression of Terrorist Financing.

International cooperation could prove effective, Dodd said, noting that within minutes of the Sept. 11 attacks, U.S. law enforcement was able to track credit-card receipts across the country, resulting in immediate arrests.

"That's the difference between having record-keeping and reporting in place, versus starting after the fact," Dodd said. "It's a good idea. I don't know why it took them this long to do it."

Wednesday, September 26, 2001

Miami Herald

If terrorists manipulated markets, money may be gone MIMI WHITEFIELD

(2) Knight-Ridder Tribune Business News

Federal Securities Agency Hot on Trail of Possibly Attack-Related Profits

1/15/02

If terrorists or their associates tried to manipulate securities markets in the days before the Sept. 11 attacks and profited as stocks affected by the disaster plummeted, analysts say the money they made has probably already been moved out o the country.

The Securities and Exchange Commission is investigating whether some investors were aware of the attacks ahead of time and used that knowledge to profit in the stock options market, or by short-selling stocks — selling borrowed shares and buying them back later at much lower prices.

The SEC declined to comment Tuesday on the progress of the investigation, referring to a statement issued last week that said: "We are vigorously pursuing all credible leads but, at this time, we have drawn no conclusion."

SEC Chairman Harvey I. Pitt is scheduled to testify before the House Financial Services Committee today, however, and may be questioned about links between those responsible for the terrorist attacks and securities market fluctuations.

The Chicago Board Options Exchange, the world's largest options market, also is investigating.

Leo Guzman, who heads Guzman & Co., an investment banking and brokerage firm in Miami, says at first he was skeptical there was any connection between the terrorist attacks and market activity.

But after analyzing unusual options trading involving airline stocks and the stocks of two companies devastated in the World Trade Center attack, he says the link seems to be more than coincidental.

"There is enough evidence to be very suspicious," he said. "The options leave a huge trail." The case that terrorists may have sold stocks short, however, is not nearly as convincing, he said.

In the week before two American Airlines and two United Airlines jets were hijacked and crashed into the Pentagon and the twin towers of the World Trade Center, traders on the options markets in Philadelphia and Chicago noticed a sudden surge in the purchase of stock-options contracts that would have gained value if the price of AMR Corp. and UAL Corp., the parent companies of the two airlines, declined.

Essentially, the terrorists would have been betting on the negative impact of an event only they knew was going to occur on stock prices.

Traders' suspicions prompted the SEC probe, which was announced last Wednesday -- two days after the markets reopened following a four-day hiatus in the wake of the attacks.

By that time, however, terrorists or their associates could have liquidated their positions and wired their profits offshore, analysts said.

"My suspicion is the money has already left the country," said Randall Dodd, an economics professor at American University and head of its Derivatives Study Center.

If there was manipulation of so-called put options — contracts that give the holder the right to sell a security at a specified price (the strike price) by a certain date — regulators should be able to trace the options trades to the brokers who placed the orders and ultimately to the customers who submitted them.

But if it turns out an order was submitted by an offshore company or a front company the trail may stop there, says Dodd. "The bright light of the audit trail can stop quite quickly and disappear into the shadows, especially if one of these tax haven countries is involved," he says.

Absolute banking secrecy that makes the true owners of offshore accounts difficult if not impossible to trace has been the chief competitive advantage of offshore banking centers. Recently, in the face of international pressure, some

offshore banking centers have lifted the veil of secrecy in an effort to combat money laundering. Others, however, have balked.

If terrorists did indeed profiteer from put options, said Guzman, they could have reaped their profits on Sept. 17 -selling their puts the day the markets reopened. "It was a good time to do it because the market was crashing," he said.

Because options are settled overnight, profiteers could have wired their money offshore the next day, Guzman said.

His theory is that if manipulation of put options did occur, the investors knew their trades would be traceable but gambled that by the time they were tracked, they would have been paid. "Maybe the trail doesn't matter, if the payoff is big enough," Guzman said.

He said the case for that scenario is the most dramatic for American Airlines stock. If, for example, an investor bought an option at \$2.20 on Sept. 10 -- the day before the attacks, that investor would have been able to sell it on Sept. 17 for \$10.80.

On both those days, there are huge spikes in the volume of put options traded. During August, around 150 American Airlines put options traded each day. During the first week of September the volume was even lower than that. Then on Sept. 10, the trading volume shot up to 1,535 put contracts, each representing 100 shares. On Sept. 17, the volume was 1,219 contracts, before falling off sharply in subsequent days.

Guzman said he found a similar, though not as dramatic, spike in trading volume on Sept. 10 for Marsh & McClennan Cos., an insurance firm with offices in the World Trade Center, and Morgan Stanley Dean Witter, whose WTC offices also were destroyed. The big upsurge in UAL options trading came on Sept. 6.

"The interesting thing is that this (pattern) happened to several companies in different industries," Guzman said.

If there was put option manipulation, said Dodd, and the money is already offshore, it should serve as a lesson for the future.

While the United States has a regulatory environment that permits transactions to be readily traced, he said that's not always the case with offshore banking centers, where record-keeping and regulations may be lax.

"The long-term solution is to establish multilateral financial regulatory agreements with other countries," Dodd said. "In order to bring these transactions into the light, the U.S. needs to support efforts such as the OECD (Organization for Economic Cooperation and Development) initiative on tax havens that will create proper record-keeping and reporting requirements."

Wednesday, September 26, 2001

Watchdogs probe unusually high volumes of pre-attack trades on hotel, airlines stocks Brock N. Meeks MSNBC

02607

WASHINGTON, Sept. 26 - More evidence of suspicious options trading in the airline and hotel sectors prior to the Sept. 11 attacks has emerged in a report from an options analysis newsletter. The Chicago Board Options Exchange is investigating the unusual activity, a CBOE spokesperson confirmed.

THE SECURITIES and Exchange Commission and New York Stock Exchange are also investigating the suspicious trading activity, according to sources familiar with those investigations. The SEC and NYSE have declined to confirm 1/15/02

"We are vigorously pursuing all credible leads, but at this time we have drawn no conclusions," the SEC said in a or deny any such investigations. statement last week. "We are working closely with other federal law enforcement authorities, as well as the selfregulatory organizations and our foreign regulatory counterparts, to provide all possible assistance."

Short selling and activity in so-called "put" options on airlines and hotel stocks soared to "levels we have not seen in years," according to Phil Erlanger, a former senior technical analyst at Fidelity Investments.

"Puts" are essentially bets that a particular stock or other security is going to fall in value.

Erlanger, who now tracks shorts and options via his Web site www.erlangersqueezeplay.com, has just released new data on option and short trading prior to the attack, gleaned from the New York Stock Exchange.

"I saw these charts, and I said, 'This is not normal activity,'" Erlanger said. In his technical analysis of the charts created from the options data, Erlanger said the "footprint for taking advantage of prior knowledge [of the attacks] is definitely there."

Erlanger has turned his data over to the NYSE and SEC.

"It's up to the agencies to find the shoe that fits the footprint to see whether this was indeed action taken with prior knowledge," Erlanger said.

Although not a sure sign of illegal activity, the activity in put options is only seen "under extraordinary circumstances," Erlanger said, such as when the country is at war. To have seen the activity in the airlines and hotels balloon right before the attack is highly suspicious, he said. "It doesn't prove that XYZ terrorists or associates of terrorists or even a country or government of a terrorist did these trades or someone with prior knowledge did these trades," Erlanger said. However, he said with a heavy sigh, "it's so out of the ordinary that it's walking like a duck and quacking like a duck."

For example, United Airlines saw a 40 percent jump in shorts — some 4.4 million shares — compared with a month earlier. And American Airlines saw 4,078 put options sold on Sept. 10, compared with an average of 200. According to Erlanger's calculation, if one person carried out that transaction on the 4,000 AMR puts, he would have netted a profit of \$4.8 million.

"The potential is for hundreds of millions of dollars (to have been made here)," Erlanger said of all the combined activity on Sept. 10.

In an apparent act of trader hubris, Erlanger says some investors were also making huge speculative bets in American Airlines doing "naked call selling" in which an investor pledges to sell stock he or she doesn't own. Normally, in selling "calls" the investor actually owns the underlying security. If a naked call sell goes sour, the losses could be huge.

But in the wake of American Airlines stock tumbling, making money on the naked calls "was a layup, it was easy money," Erlanger said.

Although such trades leave a well-documented paper trail, actually finding those involved or freezing any illegal GREEN AND GONE assets may be moot.

"My suspicion is that if they had a U.S. account I'm sure they took the cash out and split," said Randall Dodd, of the Washington-based Economic Strategy Institute and head of its Derivatives Study Center. "These guys don't appear to be stupid," Dodd said, "and they could have taken their money out shortly after the exchange re-opened."

Making matters tougher on U.S. investigators would be if the deals and profits were funneled through a network of offshore accounts and murky banking franchises whose dealings help lubricate the impoverished economies of countries known for their status as secretive tax havens.

"More likely they didn't work in cash and had the funds transferred to an overseas account that I can only suspect was in a country that wasn't as cooperative (with U.S. banking investigations)," Dodd said. "A clear audit trail can quickly disappear" once it has gone overseas, he said.

Indeed, other countries also have been looking into suspicious trades but have so far come up empty or have declared nothing out of the ordinary occurred.

However, Bundesbank President Ernst Welteke said in Liege, Belgium, on Saturday there were "ever clearer signs that there were activities on international financial markets which must have been carried out with the necessary expert knowledge" that the tragic events in New York and Washington were about to take place.

If the profits are still inside U.S. banks, the SEC can take some action to at least keep the money from being spent or disappearing into the world's shadow financial networks of money laundering and coded accounts.

02608 1/15/02

There is no set of guidelines telling the SEC how or when to freeze accounts under investigation, said John Hiney, an agency spokesman. "It depends on the situation," Hiney said. "We can go to court to freeze an account, and that would be a matter of public record," he said. "We don't generally talk about investigations, although there will generally be announcements put out about court action of one sort or another and will close with the word that the commission's investigation continues."

Friday, September 28, 2001

Over half a century ago, during World War II, War Bonds boosted both the US economy and the morale of the country. In the wake of September 11, some are suggesting special government bonds be reintroduced to help rebuild New York and finance our new war against terrorism. A look at the economic, political, and social impact of War Bonds.

Sen. Mitch McConnell (R-KY), United States Senate

Randall Dodd, Director of Derivatives Study Center, Economic Strategy Institute; also Professor of Economics,

John Steele Gordon, author The Business of America (Walker & Co.); columnist with American Heritage American University

Larry Samuel, author of Pledging Allegiance: American Identity and the Bond Drive of World War II (Smithsonian Institution Press

You can listen to the show by clicking on the following icon.

Listen in RealAudio!

From: Schultheiss, Heidilynne

Sent: Thursday, November 08, 2001 5:05 PM

To: 'weini@sec.gov'; 'dutth@sec.gov'; 'judy.ringle@ssa.gov'; 'mpenick@cftc.gov'; Carleton, Norman; Nickoloff,

Subject: FW: Derivatives Study Center in the Press

Randall is up to the same old tactics again. And I would hardly characterize him as "free market"; I think he would be offended at the label!

----Original Message----

From: Randall Dodd [mailto:rdodd@econstrat.org] Sent: Thursday, November 08, 2001 5:02 PM

To: Randall Dodd

Subject: Derivatives Study Center in the Press

Derivatives Study Center

Randall Dodd 560 Director 202 326 8555 1401 H Street, NW, Suite

Washington, D.C. 20006 rdodd@econstrat.org

Dear Colleagues:

I thought it would be worthwhile to take a moment to write and let you know that the Derivatives Study Center has been in the news quite a bit in the last couple of months. This has given me the opportunity to discuss some of the suspicious sxtock trades that preceded the terrorist attacks on September 11th, to explain some of problems in tracking these transactions through tax haven countries, to comment on the various proposals for an economic stimulus package, and even to talk about the possible issuance of War Bonds in the wake of the September 11th attacks. This includes appearances on CNN's Money Line (September 7th), CBS Evening News (see transcript below) and radio appearances on WTOP, Wisconsin Public Radio, WBUR in Boston (discussing the tracking of terrorist finances) and WAMU's syndicated "Talk of the Nation" (discussing War Bonds). You can listen to either of the latter two of these radio broadcasts through links below. In addition to broadcast news, I have copied in below some examples of on-line and print articles – including the Congressional Quarterly, San Francisco Chronicle and Miami Herald – where these comments have been quoted.

Regarding current events, the Derivatives Study Center is closely following the implosion of Enron Corporation and any impact it is having on energy and other derivatives markets, and the Center is also following the recent disclosure that the Treasury Department bungled its announcement of plans to cease new auctions of the 30-year Treasury bond so that the news was leaked early to some market participants. So look for the Center to show up in articles linked to these events.

Yours, Randall Dodd

Thursday, September 11, 2001

Taxing Issues
Washington Wants to Trim Capital Gains Tax to Spur Growth
Experts Say It Won't Work
ABCNEWS.COM

02610

1/15/02

By M. Corey Goldman

NEW YORK, Sept. 11 — The U.S. economy is not well. And Washington lawmakers are desperately searching for whatever remedy they can find to cure it.

Already they've spooned out some \$38 billion worth of rebate checks to weary consumers, part of a \$1.35 trillion 10-year tax-cut package meant to stimulate growth. And Republicans and Democrats alike have been bantering of late about another tax cut they hope will revive the sluggish economy: A reduction in the capital gains taxation rate to 15 percent from 20 percent.

Dubbed the "rich man's" tax because it tends to affect only those with very high incomes and assets, the capital gains tax was initially implemented to bring revenue into the government's coffers from those who made money on well-heeled investments. The rate was as high as 28 percent before the former Clinton administration lowered it to 20 percent with the 1997 Taxpayer Relief Act.

With the economy looking sicklier by the day, lawmakers in Washington are now exploring a further reduction in the capital gains tax as a way to stimulate economic growth — a move they hope will restore consumer confidence and get the economy back on its feet. The problem is, not everyone agrees that a reduction or outright elimination of a well-heeled tax will really do all that much to help the struggling economy.

"It's an honest debate and one that certainly has its merits, but there is a big question mark as to whether a reduction in the capital gains rate would have any effect at all," said Stanford University economics professor Warren Bailey. "Any talk of a tax cut is going to seem positive, but there really is no way to tell what the impact might be."

Minimal Market Gains

Currently, anyone who makes a capital gain — whether by selling stock at a profit or selling real estate in excess of \$500,000 — is required to pay a 20 percent tax. For small gains in an IRA portfolio, that's not too bad; for larger gains, such as buying a \$1 million country home and selling it for \$4.5 million, the implications of the tax become much more palpable.

According to research compiled by the Congressional Research Service's government and finance division, only 1.8 percent of the taxpaying population earns more than \$200,000 and pays approximately 79 percent of capital gains taxes. The tax itself accounts for roughly 4.5 percent of total federal income, payroll and excise taxes; it accounts for 14 percent of total taxes for the highest-income taxpayers.

In theory, a reduction in the rate would add to the government's revenues like this: Anyone currently sitting on the fence as to whether or not to sell their investments might be encouraged to do so if the tax rate were less. That would then increase tax revenue and help Congress deal with the shrinking budget surplus, which has been declining in a weaker economy and Bush's already current tax cut, and avoid dipping into Social Security.

In practice, many economists and market-watchers don't believe a five-point reduction in the capital gains tax will have any effect whatsoever. The only effect it might have, experts say, is to keep long-term interest rates high as longer-term revenues the government would have been receiving dwindle away.

After all, at the end of the day, the government will be taking in 5 percent less.

"The vast majority of capital goes go to very rich people, and right now there aren't any capital gains anyway," said Randall Dodd, a director with the Economic Strategy Institute in Washington. "If you want to stimulate the economy, that is not a very effective way to do it."

Tried and True

And that small percentage of American wealth has a very tried-and-true way of doing business.

"If you think a reduction in the capital gains rate is going to stimulate the economy, you have to think that those high-income people are going to something other than what they've been doing with their money," said Iris Lav, a senior analyst with the Center on Budget and Policy Priorities in Washington. "That tax is for very wealthy people, and those people are not likely to change their spending patterns."

To be sure, some analysts have suggested that, if another tax cut is something Washington decides it absolutely must do, then it should be a different kind of tax cut, such as a reduction in the 15.3 percent payroll tax that comes out of most working Americans' paychecks.

Rolling back a portion of the payroll tax that goes to Social Security and Medicare would give a tax cut to more than 30 million workers most earning less than \$44,000 a year who were left out of this year's \$40 billion in tax rebate checks because they didn't have enough taxable income to qualify.

All the same, others believe the government should simply cut income tax rates across the board, providing broad-based tax rates for lower- and middle-income individuals and families that might bring less cash into the Treasury, but would create more economic activity as disposable incomes rise.

"During a downturn economy a government probably should cut taxes, and a government should probably run a deficit — that's what a

1/15/02

government is supposed to do," said Cornell's Bailey. "But the tax cut also has to be something that will genuinely encourage people to spend. If it's too exclusive, it's not going provide much relief to the economy in the long term."

Wednesday, September 19, 2001

Newscast: Terrorists may have attempted to profit from a drop in airline stocks after the four hijackings

09/20/2001

CBS News: Morning News

(c) Copyright 2001, CBS Worldwide Inc. All Rights Reserved.

SUSAN McGINNIS, anchor: Federal investigators are following a money trail, trying to find out if terrorists profited from stock swings blamed on the suicide attacks. Sharyl Attkisson reports.

SHARYL ATTKISSON reporting:

Sources tell CBS News that the afternoon before the attack, alarm bells were sounding over unusual trading in the US stock options market, an extraordinary number of trades betting that American Airlines' stock price would fall. The trades are called 'puts,' and they involved at least 450,000 shares of American. But what raised the red flag is more than 80 percent of the orders were puts, far outnumbering call options, those betting the stock would rise. Sources say they've never seen that kind of imbalance before. Normally, the numbers are fairly even.

After the terrorist attacks, American Airlines' stock price obviously did fall,, and according to our sources, that translated into well over \$5 million total profit for the person or persons who bet the stock would fall. Sources tell "60 Minutes" that the initial options were bought through at least two brokerage firms including, including NFS, a subsidiary of Fidelity, and TD Waterhouse, a discount firm. At least one Wall Street firm reported suspicions about this activity to the Securities and Exchange Commission shortly after the attack.

The same thing happened with United Airlines on the Chicago Board Options Exchange four days before the attack. An extremely imbalanced number of trades betting United's stock price would fall also transformed into huge profits.

Mr. RANDALL DODD (Economic Strategy Institute): We can directly work backwards from the trade on the floor of the Chicago Boards
Option Exchange. That trader is linked to a brokerage firm. That brokerage firm received the order to buy that put option from either someone
within their own brokerage firm speculating or from one of their customers.

ATTKISSON: Now US investigators want to know whether Osama bin Laden was the ultimate inside trader, profiting from a tragedy he's suspected of masterminding to finance his operation. Authorities are also investigating possibly suspicious trading in Germany, Switzerland, Italy and Japan.

The stock trail could stop at the water's edge if the money came from banks in places that don't cooperate with the US. But insider trading is always motivated by greed, and a senior Wall Street executive noted it would be ironic if the terrorists' greed ended up providing one of the best leads investigators have. Sharyl Attkisson, CBS News, Washington.

Saturday, September 22, 2001

CQ WEEKLY - THE ECONOMIC INITIATIVE

Sept. 22, 2001, Page 2200

A Cautious Start for Stimulus

By Julie Hirschfeld Davis, CQ Staff

The cusp of a war, a swoon in the securities markets and the destruction at the nation's financial epicenter have jolted both parties in Congress and President Bush into rethinking how the federal government should stimulate an already weak economy.

Greenspan, at right, was among the economists urging the 107th Congress to take a "go slow" approach to writing legislation designed to stimulate the economy. He and Securities and Exchange Commission Chairman Harvey Pitt 1/15/02

greeted Phil Gramm, R-Texas, far left, and Paul S. Sarbanes, D-Md., left center, before a Sept. 20 hearing of the Senate Banking Committee.

No longer bickering over whether more spending will threaten Social Security, all of them say the nation can afford a substantial defense build-up, the rebuilding in New York City, a bailout for the airline industry and perhaps more tax cuts without jeopardizing the nation's long-term fiscal health. (Airlines, p. 2206)

Members of the House Ways and Means and Senate Finance committees will be continuing a series of bipartisan discussions in the coming weeks about what the congressional role should be in trying to stimulate the economy -- all the while seeking to avoid public battles over tax policy at a time when lawmakers are determined to show unity.

But through the week of Sept. 17 -- both in private and in public -- many economists cautioned Congress to move slowly on any additional stimulus package.

"Nobody has the capacity to fathom fully how the tragedy of Sept. 11 will play out," the nation's most influential economist, Federal Reserve Chairman Alan Greenspan, told the Senate Banking Committee on Sept. 20. "But in the weeks ahead, as the shock wears off, we should be able to better gauge how the ongoing dynamics of these events are shaping the immediate economic outlook.

"It's far more important to be right than quick," Greenspan added.

Republican and Democratic leaders say they are planning to meet again the week of Sept. 24 with Greenspan, as well as with top White House economic adviser Lawrence Lindsey and former Clinton administration Treasury Secretary Robert E. Rubin, before they decide on a package.

"We need to get a better assessment of the overall impact," House Majority Leader Dick Armey, R-Texas, said after the meeting Sept. 19. "The nation's had a terrible jolt and, quite frankly, the jolt is more widespread, both in terms of the physical performance of different markets and in terms of the national psyche, than what we've been able to measure."

The administration has signaled an openness to additional tax cuts this year, but has not endorsed any of the ideas being floated. In discussing other stimulus options, Treasury Secretary Paul H. O'Neill has suggested the administration is not now planning to endorse federal aid for industries other than the airlines, such as insurance firms. And federal regulators say they have adequate powers over the financial markets. (Markets, p. 2202; insurance, p. 2203)

"There is a sense we ought to do something, and I think there is a sense that we ought to wait a week or so to see what that is," said Rob Portman of Ohio, a Ways and Means member and a conduit between the White House and House GOP leaders. "That's about as much consensus as I've seen." 'Enough to Get America Going'

One week after the deadliest foreign attack on American soil, the government's budget picture has brightened considerably, judging by the

1/15/02

shift in political rhetoric on Capitol Hill. Republicans and Democrats -who were hurling accusations of fiscal mismanagement at each other until the
moment the airliners struck the World Trade Center and Pentagon -- have cast
that rhetoric aside.

"The definition of how much is: enough to get America going again," the president declared Sept. 19, when he was asked how much he was willing to spend of the surplus revenue once dedicated to the Social Security trust funds -- the so-called lockbox. (Background, CQ Weekly, pp. 2126, 2050) "The leaders from the Congress are very reasonable, and they are mindful about government money as well as anybody else," Bush said, with the top Republicans and Democrats from the House and Senate seated beside him in the Oval Office. "But we are dedicated -- we are dedicated to saying to the American people, this is an emergency the likes of which we have not seen in a long time in this country, and this government will come together and deal with it."

The next day, after members of the House Ways and Means Committee met in private with several economists to discuss options for economic stimulus legislation, Chairman Bill Thomas, R-Calif., said "one of the things that there was general agreement on was the fact that the budget constraints are probably not a major obstacle in the current environment."

What Can Congress Do?

Participants in the week's discussions said one reason for the lack of consensus about what taxes to cut next is that there is no clear understanding yet about the scope of the attacks' consequences for consumer confidence, the stock markets and the gross domestic product.

"It's open because there are so many unknowns," Senate Finance Committee Chairman Max Baucus, D-Mont., said after a Sept. 21 meeting with O'Neill, Thomas, Finance ranking Republican Charles E. Grassley of Iowa and Ways and Means ranking Democrat Charles B. Rangel of New York.

But the talks nonetheless illustrated the new framework for the federal budget debate: It is no longer about which party is a more studious guardian of the shrinking surplus. It is about how best to spend the surplus to stimulate the economy. That is a change many economists say was a long time in coming.

"If the economy is slowing down, you want to lean in the direction of deficits, and until Tuesday, this was clearly not understood on either side of the aisle," Frank C. Wykoff, a professor of economics at California's Pomona College, said in describing the Sept. 11 attack. "Up until now this bipartisan agreement on Social Security has essentially been Hoover economics, and now they finally woke up and realized you have to stimulate the economy."

In the Ways and Means meeting -- to which each party invited three economists to share their views of the current economic situation and how to improve it -- participants were said to be split on three key questions:

Should Congress even try to legislate an economic stimulus? If so, should the package's provisions be permanent or temporary? And should its emphasis be on long-term or short-term concerns?

In a Sept. 17 report, the Congressional Research Service noted that many

1/15/02

economists doubt that congressional moves to alter fiscal policy can counter a recession because of the difficulty of enacting a stimulus quickly enough to stop a flagging economy. Some suggest the government's options for spurring investment and retail spending will be inadequate to countermand the loss in consumer confidence expected to flow from the attacks. Others say the possible tax law changes would take effect too late to counter a downturn that may have begun before Sept. 11 and that seems sure to get worse, at least in the near term.

"These investment stimuli tend to reinforce an expansion, but they're not going to turn things around, because firms are going to be constrained on the demand side by the market," Wykoff said. "You can't really juice up investment if investors aren't ready to invest."

But some lawmakers say it is important for Congress to respond in some way, if only to demonstrate solidarity and a resolve to keep the U.S. economy on firm footing. "Sometimes we need to take action just to give ourselves a psychological boost," said Ways and Means Democrat Robert T. Matsui of California, although he added, "I don't have a lot of confidence in these microeconomic measures having a great macroeconomic effect."

And while many Democrats want to ensure that any stimulative tax relief is temporary -- with an eye toward controlling the loss of revenue to the Treasury and thereby keeping long-term interest rates in check -- several Republicans maintain that the package should make permanent changes in tax law, in the belief that promised continuity of the tax code would help boost economic activity.

Bang for the Buck

Not surprisingly, large differences separate Republicans and Democrats on the question of what those measures should be. While lobbyists and lawmakers acknowledge that any stimulus package would need to be a bipartisan product in order to become law, talk of additional tax cuts already has revived long-running debates.

Eager to assert his prerogative as the House's chief tax writer, just three days after the attack Thomas recommended an ambitious tax package including a capital gains rate cut, an increase in small-business expense deductions and a reinstatement of the investment tax credit. He also proposed a short-term acceleration in the business depreciation schedule. (CQ Weekly, p. 2132)

Business groups have quietly expressed support for many of those proposals, most of which have been on their own wish list for some time, and they began pushing for additional tax breaks as well. This led some Democrats to begin criticizing the GOP and the business community for political opportunism in the heat of a national crisis. As a result, it took some personal appeals from Rangel to get fellow Democrats to attend a Sept. 17 meeting with Thomas to talk about stimulus options.

The situation led to some awkward positioning as business groups sought to balance their desires for tax relief against their reluctance to look selfish. On Sept. 17, U.S. Chamber of Commerce President Thomas Donohue downplayed his group's zeal for immediate additional tax cuts, saying "We'll have some discussion of a stimulus package in the future." But later in the

1/15/02

week, the Chamber's top lobbyist, Bruce Josten, said business groups were indeed pushing for quick action on items like eradication of the alternative minimum tax for corporations and the revival of the investment credit. Also, a coalition of business groups sent Bush and congressional leaders a letter urging them to move promptly.

Democrats signaled that they are loath to consider a cut in the capital gains rate. The GOP says the move might raise revenue in the short term by encouraging people to sell their assets to take advantage of the lower rate. Democrats say the new rate would do little to bolster new investments and would disproportionately benefit the wealthy.

Similarly, some Republicans have said they are against a leading Democratic idea: cutting payroll taxes for lower-income workers. "We're worrying about ensuring the future of Social Security and Medicare, and if we cut the payroll taxes now, that could cause problems for us later," said Jill Gerber, a spokeswoman for Grassley.

Republicans also are unlikely to submit to demands to revisit the tax cuts between 2005 and 2010 under the \$1.35 trillion tax cut law (PL 107-16) enacted in June. Many Democrats say this is necessary to control interest rates in the long run considering the explosion in federal spending that is sure to follow the attacks. (CQ Weekly, p. 1304)

Even before Sept. 11, Rubin had been counseling Democrats to press to reopen the debate on the tax cuts for the second half of the decade, arguing that the lost revenue would cause long-term rates to rise and hurt the current economy. "Maintaining our fiscal discipline going forward will be key to economic well-being," he told the U.S. Hispanic Chamber of Commerce on Sept. 21.

Keeping Focused

But both Republicans and Democrats were sounding a conciliatory note at the end of the week of Sept. 17.

"I don't think we ought to emphasize poison pills, but if we search for common ground, we'll find the poison pills," Sander M. Levin of Michigan, the ranking Democrat on the Ways and Means Trade Subcommittee, said Sept. 20 in declining to say what proposals would be non-starters in his party's eyes. "I think we all have a choice, including the president: to search for common ground, or to try to shove through our agenda. And I think the answer should be searching for common ground."

And while Thomas emphasized the need for investment stimuli, he said it also might be appropriate to "do a bit of a demand side" -- for instance, he said, by providing tax relief similar to Bush's tax cut for those who do not pay income taxes. Such a cut has been anathema to the GOP in the past. In the absence of bipartisan agreement on how to proceed, economists have counseled lawmakers not to cobble together a stimulus package in the image of most tax relief measures that move through Congress, which frequently turn into "Christmas trees" littered with special provisions to satisfy important constituencies.

"You don't do a little bit of this and a little bit of that in creating a

1/15/02

political package which, though it might have broad appeal from a lot of pieces in it, would have virtually no impact if you're trying to influence economic decision-making," Thomas said. "It would be better if we sat down and tried to come to a bipartisan agreement on a package that had a sufficient focus to make a difference."

Other Stimuli

Beyond tax cuts, lawmakers are considering other ways to help boost the economy in the wake of the terrorist attacks. One proposal under discussion would be to assist laid-off workers in paying their share of temporary medical insurance available to them after they are no longer employed. Republicans also have resumed their push for legislation that would once again empower the president to negotiate trade agreements that Congress would have to accept or reject quickly and without amendment. Longstanding partisan disagreement on such a measure will make it difficult to schedule quick action but Republican leaders say granting Bush such "fast track" power would give businesses confidence in their international futures -- as well as building a coalition of nations committed to eradicating terrorism. (Diplomacy, p. 2191)

Regardless of what the elements of the package are, some economists believe Congress cannot wait too long to act. "There's not enough appreciation of what's been lost here in terms of momentum," said Randall Dodd of the Economic Strategy Institute, a think tank that advocates free-market policies. "We were in this box two weeks ago, but now we have an excuse to take actions that might otherwise have seemed rash."

Still, that excuse may not last long. David C. Colander, professor of public finance and macroeconomics at Princeton University, said the nature of the coming military conflict will determine how long the current dynamic remains. "If it's actual wartime, everything is forgotten about balancing budgets, and the total focus goes elsewhere," Colander said.

However, if it turns out to be a war of sporadic, small-scale engagements rather than a focused, massive assault, the public's attention could drift back to domestic concerns, he said, and Washington could return to its old ways of fighting over budget priorities in the context of surpluses and deficits. "This clearly is not war as we know it," Colander said.

Monday, September 24, 2001

WBUR – Boston University and National Public Radio Frozen Assets: The Financial Battle Begins

President Bush issued an executive order today to freeze the U.S. assets of 27 groups and individuals suspected to support terrorism. Calling the order a "strike on the financial foundation" of terrorists, the President called on financial institutions around the world to follow suit. If foreign banks did not take similar action, Bush warned that those banks may have their U.S. assets frozen.

A financial assault is seen by many as an important component of the war against terrorism. Jeffrey Robinson, author a two books on money laundering, says the financial war will be difficult, because funding for terrorism does not come from a rich ex-Saudi millionaire as most people thing -- but from criminal activity and charities.

You can listen to the show, using Real Player, by clicking on the hyperlink <u>Listen</u> below. 1/15/02

Listen

Guests:

Randall Dodd, Professor of Economics at American University

Jeffrey Robinson, author of "The Laundrymen: Inside Money Laundering, the World's Third-Largest Business"

Wednesday, September 25, 2001

Bush goes after terrorists' funds / President freezes assets in U.S., pressures foreign banks to aid in financial crackdown

Carolyn Lochhead

Chronicle Washington Bureau

09/25/2001 The San Francisco Chronicle FINAL A.1

President Bush threatened yesterday to freeze the U.S. operations of foreign banks that do not cooperate in a financial crackdown on 27 suspected terrorists and terrorist groups.

"Money is the lifeblood of terrorist operations," Bush said. "Today we're asking the world to stop payment."

The executive order requires U.S. financial institutions to immediately freeze the assets of groups on the list and prohibits any U.S. citizen or business from doing business with anyone on the list.

The administration has no authority to force foreign banks to do likewise, but the threat to shut down their U.S. operations could prove powerful leverage, given the dominating role the United States plays in global finance.

The order goes well beyond the freeze of assets imposed by President Bill Clinton in 1998 against Osama bin Laden, the government's chief suspect in the Sept. 11 attacks on New York City and the Pentagon. That freeze had little effect.

Bush called the move "a major thrust of our war on terrorism," making the announcement in the Rose Garden accompanied by Secretary of State Colin Powell and Treasury Secretary Paul O'Neill.

Conceding that most terrorist assets probably are located overseas, Bush said the administration had created "the international financial equivalent of law enforcement's 'Most Wanted' list."

"It puts the financial world on notice," Bush said. "If you do business with terrorists, if you support or sponsor them, you will not do business with the United States of America."

The threat could affect such famous bank havens

as Switzerland, Grand Cayman and Dubai.

Bush said the administration will work with the governments of foreign banks that might be harboring assets of groups or individuals on the list and "ask them to freeze or block terrorists' ability to access funds in foreign accounts. If they fail to help us, . . . the Department of the Treasury now has the authority to freeze their banks' assets and transactions in the United States."

The administration list targets bin Laden and his al Qaeda network, but also includes Egypt's Al-Jihad, the Libyan Islamic Fighting Group, and the Islamic Movement of Uzbekistan, a group said to number as many as 3,000 fighters trying to create an Islamic state within three nations just north of Afghanistan. The list also includes suspected individual terrorists.

In an attempt to shut down what is believed to be bin Laden's large fund-raising network, the administration included two nonprofit groups, Wafa Humanitarian Organization and Al Rashid Trust.

02618

1/15/02

Derivatives Study Center Page 10 of 14

Bank analysts generally praised the move but said cutting off terrorist money is no easy task. Many are believed to use informal money networks that skirt financial institutions altogether. Moreover, the amounts involved are sometimes small; some estimate the cost of mounting the Sept. 11 hijackings and terrorist attacks was about \$200,000.

Because the United States has cut its economic ties to several nations that could be most helpful, the government also lacks vital financial information.

"The groups that are named are only the ones we suspect," said Bruce Zagaris, a partner in the Washington law firm, Berliner, Corcoran & Rowe. "The U.S. doesn't even have relations -- and hasn't for many, many years -- with a number of countries that are the biggest and most important countries in the Middle East, such as Iraq, Iran and Libya."

As a result, Zagaris said, "We have very few resources on the ground to know anything about what's going on in these countries. We necessarily are having to rely on other countries or entities for normal intelligence that we would have had if we had an embassy and all kinds of other private-sector contacts."

COOPERATION VITAL

The effectiveness of the crackdown will hinge in part on getting other countries and institutions throughout the Middle East to add names to the list.

Monitoring and enforcement is another problem. Former Yugoslavian President Slobodan Milosevic hid his assets for years, Zagaris noted.

"It was only last week that the Greek central bank finally ordered a number of Greek banks where Milosevic's money was thought to exist to cooperate," Zagaris said. "For all those years, the money was first in Cypress, and it took a while to convince Cypress to crack down. By the time that was enforced, the money had been moved to Greek branches of Cypriot banks. Only now are we catching up with the assets."

Randall Dodd, director of the nonprofit Derivatives Study Center, praised the administration's moves.

Dodd said terrorists could also be using offshore tax havens in the Caribbean such as Grand Cayman, Barbados and Antigua, where banking fees are a major source of revenue.

COMPENSATION MAY BE NEEDED

The administration's threat to shut off economic relations with those nations could prove a powerful weapon, Dodd said, but might require some kind of compensation in return. The Organization for Economic Cooperation and Development, a group of industrialized nations, tried to harmonize banking laws in the Caribbean but met resistance from some islands that feared a substantial loss of

The United States itself has not joined several international money-laundering agreements, including the 1990 Council of Europe's Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, ratified by 47 nations, including Russia.

Bush called on the Senate yesterday to ratify the United Nations Convention on Suppression of Terrorist Financing.

International cooperation could prove effective, Dodd said, noting that within minutes of the Sept. 11 attacks, U.S. law enforcement was able to track credit-card receipts across the country, resulting in immediate arrests.

"That's the difference between having record-keeping and reporting in place, versus starting after the fact," Dodd said. "It's a good idea. I don't know why it took them this long to do it."

Wednesday, September 26, 2001

Miami Herald

If terrorists manipulated markets, money may be gone MIMI WHITEFIELD

(2) Knight-Ridder Tribune Business News

Federal Securities Agency Hot on Trail of Possibly Attack-Related Profits

1/15/02

Mimi Whitefield

If terrorists or their associates tried to manipulate securities markets in the days before the Sept. 11 attacks and profited as stocks affected by the disaster plummeted, analysts say the money they made has probably already been moved out o the country.

The Securities and Exchange Commission is investigating whether some investors were aware of the attacks ahead of time and used that knowledge to profit in the stock options market, or by short-selling stocks -- selling borrowed shares and buying them back later at much lower prices.

The SEC declined to comment Tuesday on the progress of the investigation, referring to a statement issued last week that said: "We are vigorously pursuing all credible leads but, at this time, we have drawn no conclusion."

SEC Chairman Harvey I. Pitt is scheduled to testify before the House Financial Services Committee today, however, and may be questioned about links between those responsible for the terrorist attacks and securities market fluctuations.

The Chicago Board Options Exchange, the world's largest options market, also is investigating.

Leo Guzman, who heads Guzman & Co., an investment banking and brokerage firm in Miami, says at first he was skeptical there was any connection between the terrorist attacks and market activity.

But after analyzing unusual options trading involving airline stocks and the stocks of two companies devastated in the World Trade Center attack, he says the link seems to be more than coincidental.

"There is enough evidence to be very suspicious," he said. "The options leave a huge trail." The case that terrorists may have sold stocks short, however, is not nearly as convincing, he said.

In the week before two American Airlines and two United Airlines jets were hijacked and crashed into the Pentagon and the twin towers of the World Trade Center, traders on the options markets in Philadelphia and Chicago noticed a sudden surge in the purchase of stock-options contracts that would have gained value if the price of AMR Corp. and UAL Corp., the parent companies of the two airlines, declined.

Essentially, the terrorists would have been betting on the negative impact of an event only they knew was going to occur on stock prices.

Traders' suspicions prompted the SEC probe, which was announced last Wednesday -- two days after the markets reopened following a four-day hiatus in the wake of the attacks.

By that time, however, terrorists or their associates could have liquidated their positions and wired their profits offshore, analysts said.

"My suspicion is the money has already left the country," said Randall Dodd, an economics professor at American University and head of its Derivatives Study Center.

If there was manipulation of so-called put options -- contracts that give the holder the right to sell a security at a specified price (the strike price) by a certain date -- regulators should be able to trace the options trades to the brokers who placed the orders and ultimately to the customers who submitted them.

But if it turns out an order was submitted by an offshore company or a front company the trail may stop there, says Dodd. "The bright light of the audit trail can stop quite quickly and disappear into the shadows, especially if one of these tax haven countries is involved," he says.

Absolute banking secrecy that makes the true owners of offshore accounts difficult if not impossible to trace has been the chief competitive advantage of offshore banking centers. Recently, in the face of international pressure, some

1/15/02

Derivatives Study Center

Page 12 of 14

offshore banking centers have lifted the veil of secrecy in an effort to combat money laundering. Others, however, have balked.

If terrorists did indeed profiteer from put options, said Guzman, they could have reaped their profits on Sept. 17 -- selling their puts the day the markets reopened. "It was a good time to do it because the market was crashing," he said.

Because options are settled overnight, profiteers could have wired their money offshore the next day, Guzman said.

His theory is that if manipulation of put options did occur, the investors knew their trades would be traceable but gambled that by the time they were tracked, they would have been paid. "Maybe the trail doesn't matter, if the payoff is big enough," Guzman said.

He said the case for that scenario is the most dramatic for American Airlines stock. If, for example, an investor bought an option at \$2.20 on Sept. 10 — the day before the attacks, that investor would have been able to sell it on Sept. 17 for \$10.80.

On both those days, there are huge spikes in the volume of put options traded. During August, around 150 American Airlines put options traded each day. During the first week of September the volume was even lower than that. Then on Sept. 10, the trading volume shot up to 1,535 put contracts, each representing 100 shares. On Sept. 17, the volume was 1,219 contracts, before falling off sharply in subsequent days.

Guzman said he found a similar, though not as dramatic, spike in trading volume on Sept. 10 for Marsh & McClennan Cos., an insurance firm with offices in the World Trade Center, and Morgan Stanley Dean Witter, whose WTC offices also were destroyed. The big upsurge in UAL options trading came on Sept. 6.

"The interesting thing is that this (pattern) happened to several companies in different industries," Guzman said.

If there was put option manipulation, said Dodd, and the money is already offshore, it should serve as a lesson for the future.

While the United States has a regulatory environment that permits transactions to be readily traced, he said that's not always the case with offshore banking centers, where record-keeping and regulations may be lax.

"The long-term solution is to establish multilateral financial regulatory agreements with other countries," Dodd said. "In order to bring these transactions into the light, the U.S. needs to support efforts such as the OECD (Organization for Economic Cooperation and Development) initiative on tax havens that will create proper record-keeping and reporting requirements."

Wednesday, September 26, 2001

Watchdogs probe unusually high volumes of pre-attack trades on hotel, airlines stocks Brock N. Meeks MSNBC

02621

WASHINGTON, Sept. 26 — More evidence of suspicious options trading in the airline and hotel sectors prior to the Sept. 11 attacks has emerged in a report from an options analysis newsletter. The Chicago Board Options Exchange is investigating the unusual activity, a CBOE spokesperson confirmed.

THE SECURITIES and Exchange Commission and New York Stock Exchange are also investigating the suspicious trading activity, according to sources familiar with those investigations. The SEC and NYSE have declined to confirm 1/15/02

or deny any such investigations.

"We are vigorously pursuing all credible leads, but at this time we have drawn no conclusions," the SEC said in a statement last week. "We are working closely with other federal law enforcement authorities, as well as the selfregulatory organizations and our foreign regulatory counterparts, to provide all possible assistance."

Short selling and activity in so-called "put" options on airlines and hotel stocks soared to "levels we have not seen in years," according to Phil Erlanger, a former senior technical analyst at Fidelity Investments.

"Puts" are essentially bets that a particular stock or other security is going to fall in value.

Erlanger, who now tracks shorts and options via his Web site www.erlangersqueezeplay.com, has just released new data on option and short trading prior to the attack, gleaned from the New York Stock Exchange. "I saw these charts, and I said, 'This is not normal activity,'" Erlanger said.

In his technical analysis of the charts created from the options data, Erlanger said the "footprint for taking advantage of prior knowledge [of the attacks] is definitely there."

Erlanger has turned his data over to the NYSE and SEC.

"It's up to the agencies to find the shoe that fits the footprint to see whether this was indeed action taken with prior knowledge," Erlanger said.

Although not a sure sign of illegal activity, the activity in put options is only seen "under extraordinary circumstances," Erlanger said, such as when the country is at war. To have seen the activity in the airlines and hotels balloon right before the attack is highly suspicious, he said. "It doesn't prove that XYZ terrorists or associates of terrorists or even a country or government of a terrorist did these trades or someone with prior knowledge did these trades," Erlanger said. However, he said with a heavy sigh, "it's so out of the ordinary that it's walking like a duck and quacking like a duck."

For example, United Airlines saw a 40 percent jump in shorts — some 4.4 million shares — compared with a month earlier. And American Airlines saw 4,078 put options sold on Sept. 10, compared with an average of 200. According to Erlanger's calculation, if one person carried out that transaction on the 4,000 AMR puts, he would have netted a profit of \$4.8 million.

"The potential is for hundreds of millions of dollars (to have been made here)," Erlanger said of all the combined activity on Sept. 10.

In an apparent act of trader hubris, Erlanger says some investors were also making huge speculative bets in American Airlines doing "naked call selling" in which an investor pledges to sell stock he or she doesn't own. Normally, in selling "calls" the investor actually owns the underlying security. If a naked call sell goes sour, the losses could be huge.

But in the wake of American Airlines stock tumbling, making money on the naked calls "was a layup, it was easy money," Erlanger said.

GREEN AND GONE

Although such trades leave a well-documented paper trail, actually finding those involved or freezing any illegal assets may be moot.

"My suspicion is that if they had a U.S. account I'm sure they took the cash out and split," said Randall Dodd, of the Washington-based Economic Strategy Institute and head of its Derivatives Study Center. "These guys don't appear to be stupid," Dodd said, "and they could have taken their money out shortly after the exchange re-opened."

Making matters tougher on U.S. investigators would be if the deals and profits were funneled through a network of offshore accounts and murky banking franchises whose dealings help lubricate the impoverished economies of countries known for their status as secretive tax havens.

"More likely they didn't work in cash and had the funds transferred to an overseas account that I can only suspect was in a country that wasn't as cooperative (with U.S. banking investigations)," Dodd said. "A clear audit trail can quickly disappear" once it has gone overseas, he said.

Indeed, other countries also have been looking into suspicious trades but have so far come up empty or have declared nothing out of the ordinary occurred.

However, Bundesbank President Ernst Welteke said in Liege, Belgium, on Saturday there were "ever clearer signs that there were activities on international financial markets which must have been carried out with the necessary expert knowledge" that the tragic events in New York and Washington were about to take place.

If the profits are still inside U.S. banks, the SEC can take some action to at least keep the money from being spent or disappearing into the world's shadow financial networks of money laundering and coded accounts.

02622

Derivatives Study Center

There is no set of guidelines telling the SEC how or when to freeze accounts under investigation, said John Hiney, an agency spokesman. "It depends on the situation," Hiney said. "We can go to court to freeze an account, and that would be a matter of public record," he said. "We don't generally talk about investigations, although there will generally be announcements put out about court action of one sort or another and will close with the word that the commission's investigation continues."

Friday, September 28, 2001

War Bonds

Over half a century ago, during World War II, War Bonds boosted both the US economy and the morale of the country. In the wake of September 11, some are suggesting special government bonds be reintroduced to help rebuild New York and finance our new war against terrorism. A look at the economic, political, and social impact of War Bonds.

Sen. Mitch McConnell (R-KY), United States Senate

Randall Dodd, Director of Derivatives Study Center, Economic Strategy Institute; also Professor of Economics, American University

John Steele Gordon, author The Business of America (Walker & Co.); columnist with American Heritage Magazine

Larry Samuel, author of Pledging Allegiance: American Identity and the Bond Drive of World War II (Smithsonian Institution Press

You can listen to the show by clicking on the following icon.

Listen in RealAudio!

From: Wiedman, Mark

Sent: Friday, January 11, 2002 6:10 PM

To: Carleton, Norman

Subject: RE: 1BN) Treasury's O'Neill Comments on Enron Calls,

I haven't heard from Sheila on the e-mails, though I've checked. In any case e-mails like this are EXTREMELY useful. Thanks.

----Original Message-----From: Carleton, Norman

Sent: Friday, January 11, 2002 9:47 AM

To: Cetina, Jill; Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian;

Schultheiss, Heidilynne; Whaley, Jean; Wiedman, Mark

Subject: FW: 1BN) Treasury's O'Neill Comments on Enron Calls, Disclosur

----Original Message----

From: Lori.Santamorena@bpd.treas.gov [mailto:Lori.Santamorena@bpd.treas.gov]

Sent: Friday, January 11, 2002 8:40 AM To: norman.carleton@do.treas.gov

Subject: 1BN) Treasury's O'Neill Comments on Enron Calls, Disclosur

---- Forwarded by Lori Santamorena/BPD on 01/11/02 08:39 AM ----

"PUBLIC DEBT, US DEPT OF TREASURY" <GSRS@bloomberg.net>

To:

realistic section interest realistic sections

Subject: 1BN) Treasury's O'Neill Comments on Enron Calls, Disclosur

Isantamorena@bpd.treas.gov

01/11/02 08:17 AM

Treasury's O'Neill Comments on Enron Calls, Disclosure Rules 2002-01-10 19:35 (New York)

Mashington, Jan. 10 (Bloomberg) -- The following are comments from U.S. Treasury Secretary Paul O'Meill on his conversations with Earon Corp.'s chairman Ken Lay prior to Enron's bankruptcy and a review by government regulators of the adequacy of corporate disclosure rules. O'Neill spoke during interviews on Cable News Network and CNBC.

"My first call from Ken Lay was for him to give me a headsup that they were struggling and to offer the president of his company to speak with the Undersecretary of Domestic Finance (Peter Fisher) to understand the positions they had so we could make sure that we were taking care of our responsibility, which is to make sure that the U.S. capital markets work," O'Neill told CNN.

"That was the purpose of Ken's call to me, to let me know we were welcome to have access to information so we could understand what they were doing and the possible exposure to the world's capital markets.

"The second call, Ken called we to tell me they were in discussions with Dynergy and it was an information-only call. Subsequently, (Commerce Secretary) Don Evans called me to say he'd

had a call and that Ken had told him that rating agencies were looking at them and there was real concern if the rating agencies downgraded them that that could effectively scupper the deal with Dynergy, " he said.

on what he did following the call:

"I subsequently asked (Fisher) to speak with the Enron people, which he did, so that we could satisfy ourselves that the Enron affairs were not going to have a negative impact on U.S. capital markets, '' O'Neill told CNBC.

On whether he thinks ethics rules were broken: I thought it was business as usual," he told CNGC, "I get calls every day from the big players in the world. Enron was the

biggest trader of energy in the world. So I was not surprised at all that I would get a call saying we've got a problem over here and you should know about it."

On whether he was he asked by Ken Lay for a government bailout: "Absolutely not," he told CNBC. "One of things I enjoy about Treasury is I don't have a lot of giveaway programs so if he wanted a givesway from the government he sure wouldn't have called me. I don't know if one were inclined to make ballouts why there would be a bailout for a company that's gotten itself into trouble. If you want to look at recent Chapter 11 filings or Chapter seven filings you can look at Bethlehem Steel and Sunbeam and they don't call the government for a bailout. I ran a Fortune 50 company, it never would have occurred to me to call the government for a bailout if I got my company in trouble.'

On what President George W. Bush has asked him to do today: "The president tasked me to one, head a committee that includes Don Evans and (Labor Secretary) Elsine Chao to look at the Enron case and other bankruptcy cases to pay special attention to the question of whether we need to smend the rules that govern pension plans and 401k plans to provide a greater deal of assurance to individuals who have a stake in pension plans and 401k plans." be told CNN. "That is driven by the president's concern about the individual employees. The president said to me we need to see if there is something we need to do so that we learn from this. If there is a weakness in our rules let's fix the

rules.''

And the second committee the president asked me to convene

The president's economic is one that's a standing committee, the president's economic committee. That includes myself and Alan Greenspan, the head of (the Commodities Putures Trading Commission) and Marvey Pitt of the SEC. The charge the president's given us is to look at the Enron case and other cases and see if we need to adjust the disclosure rules so that shareholders and employees have all the information they need to make intelligent decisions. This is not about Enron, this is about making sure the rules that govern the way our economic system works are worthy of the conditions that we're dealing with these days to assure that individuals are not hurt because of a weakness in our rules."

-- Simon Kennedy in the Washington newsroom (202) 624-1834, or at skennedy@bloomberg.net /jo

Story illustration: For graph of Enron's stock price, type: [HNE US < Equity > GPO D < GO > }

ENE US «Equity» CN

MI TRE

NI SEC

MI SCR NI LAM

NI ACC

NI CNG

NI FIN NI GOV

MI US

MI TX

NI NY NI NASD

MI OIL

MI PIP

MI NEG

NI GAS

NI ERN

NI EXE NI CNG NI LAW NI RULES NI VOICES

#<40533>#

-0- (BN) Jan/11/2002 0:35 GMT

From:

Carleton, Norman

Sent:

Wednesday, August 22, 2001 10:12 AM

To:

Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Enron article

Tracking: Recipient

Delivery

Read

Nickoloff, Peter

Delivered: 8/22/01 10:12 AM Read: 8/22/01 10:13 AM

Schultheiss, Heldilynne Delivered: 8/22/01 10:12 AM Read: 8/28/01 8:54 AM

----Original Message-----

From: Norman Carleton [mailto:Norman.Carleton@worldnet.att.net]

Sent: Thursday, August 16, 2001 11:39 PM

To: Norman Carleton; norman.carleton@do.treas.gov

Subject: Enron article



AUG 15, 2001

Enron's Chief Executive Quits After Only 6 Months in Job

By RICHARD A. OPPEL Jr. with ALEX BERENSON

■ D ALLAS, Aug. 14 — Jeffrey Skilling, the chief executive of the Enron Corporation (news/quote), stunned Wall Street today by announcing that he would quit after just six months in the job, calling the move a "purely personal decision."

But the abruptness of the departure left many analysts questioning whether a series of setbacks the company has suffered played a part in the decision.

Kenneth Lay, Enron's 59-year-old chairman, will step back into the position he left early this year after 15 years as chief executive.

Mr. Lay, who originally recruited Mr. Skilling to Enron, said tonight that he had agreed to stay on through the end of 2005 to "make sure we've got plenty of time to work out an orderly succession."

Mr. Skilling, 47, had been at the heart of the transformation of Enron from an old-line natural gas pipeline company to the biggest and most aggressive of the new breed of unregulated energy traders that buy and sell billions of dollars of electricity and other commodities daily.

That strategy helped Enron's stock price soar during the last decade. But this year the company's shares have fallen sharply, as Enron has suffered from problems with its new broadband telecommunications trading unit, its investment in a large power plant in India, and criticism from officials in California, who blame Enron and other energy companies fo the collapse of the state's electricity market.

A former energy consultant at McKinsey & Company who joined Enron in 1990, Mr. Skilling built its energy-trading operations into the company's most profitable unit, accounting for nearly \$1.7 billion - or 85 percent - of operating income last year. He became president and chief operating officer in 1997, and in February of this year became chief executive.

1/15/02

On a conference call, Mr. Skilling said he could not "stress enough that this has nothing to do with Enron." He added that "the reasons for leaving the business are personal, but I'd just as soon keep that private."

Mr. Skilling, who is divorced, has joint custody of three teenage children — a daughter, 17, and two sons, 14 and 11 — with his ex-wife. Mr. Skilling, who will leave the board but will serve as a consultant to the company, will not receive any severance package because his departure is voluntary, Mr. Lay said.

Since May 2000, Mr. Skilling has sold at least 450,000 Enron shares worth at least \$33 million, according to Securities and Exchange Commission filings. He still owns about 1.1 million shares, the filings show.

"Absolutely no accounting issue," Mr. Lay told analysts, "no trading issue, no reserve issue, no previously unknown problem issues" are behind the departure. There will be "no change in the performance or outlook of the company going forward," he added.

He also said the company was on track to meet analysts' earnings expectations, which are about \$1.80 a share this year and \$2.15 next year.

On the call, Mr. Skilling said that "in general there have been a lot of issues" that have buffeted the company this year, but he said that he believed Enron had already surmounted most of them. "Now is the time" to step down, he said, "because I think we've got a lot of these things behind us."

Nonetheless, the move jolted analysts, who, despite the stock's recent slide and the company's other problems, saw Mr. Skilling as the unquestioned leader to follow Mr. Lay.

In after-hours trading, shares of Enron fell about 8 percent, to \$39.55. That fall follows a plunge of almost 50 percent since January in the stock, which had closed in regular trading at \$42.93, up 78 cents. The news of the executive changes came after the market closed.

"I'm surprised and I'm stunned," said Philip K. Verleger, an energy economist with the Brattle Group, a consulting firm in Cambridge, Mass. "Skilling was the guy who executed the growth in the trading business."

Investors have become increasingly concerned that a surge in new power plant construction will lead to a glut of electricity within a few years and lower the value of Enron's role as a middleman between plant owners and electricity users. In addition, the company's efforts to enter the water business have fared poorly, and its broadband trading operation has become a cash drain.

Mr. Skilling's promotion early this year came after several crucial Enron executives resigned. These included Rebecca Mark, who at one time was considered a rival for the top job.

Ms. Mark became chief executive of the Azurix Corporation (news/quote) in 1999 after Enron spun off the company, its global water business. But its financial performance was disappointing, and Ms. Mark left the company last year. Enron later agreed to buy back Azurix stock for less than half what public shareholders had paid.

Nickoloff, Peter

From:

Carleton, Norman

Sent:

Friday, December 21, 2001 10:37 AM

To:

Cetina, Jill; Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean; Wiedman, Mark; Bieger, Peter; DeMarco, Edward; Dorsey, Karen; Ellett, Martha; Ellis, Dina; Huffman, Lucy; Hughes, Gerry; McGivern, Tom; McInerney, Roberta; Salladin, Anne; Smith, Amy;

Sutton, Gary; Tishuk, Brian

Subject:

DJ: US Congress Fails To Pass Contract Netting Bill

December 21, 2001

US Congress Fails To Pass Contract Netting Bill

Dow Jones Newswires

(This article was originally published Thursday.)

WASHINGTON -- Despite an eleventh-hour appeal from Federal Reserve Chairman Alan Greenspan and pressure from Wall Street, lawmakers again failed to enact legislation that clarifies corporate bankruptcy laws by allowing companies to quickly settle outstanding derivatives contracts in the event of an insolvency.

The once-obscure financial issue gained new prominence and urgency on Capitol Hill as lawmakers struggled to understand the high-finance finagling that lead to the recent Chapter 11 bankruptcy filing of energy giant Enron Corp. (ENE).

The measure allows institutions to quickly close outstanding derivatives contracts with bankrupt trading partners by **netting** all the losses and gains of individual contracts into one deal.

"Enron underscores the importance of it," said Peggy Peterson, spokeswoman for the House Financial Services Committee. "The other factor is the recessionary economic climate - the **netting** provisions would lower market risk."

Greenspan recently met with committee Chairman Michael Oxley, R-Ohio, and House Judiciary Chairman James Sensenbrenner, R-Wis., after Oxley held a bruising hearing on financial improprieties leading to Enron's demise.

Pressure to pass the measure was already building since the Sept. 11 terrorist attacks shut down U.S. financial markets and destroyed the Manhattan offices of many Wall Street brokerage houses.

"Congress should not fail to enact **netting** legislation this year," Greenspan and Treasury Secretary Paul O'Neill wrote House lawmakers a few weeks after the attacks. "Further delays would unnecessarily place the financial system at greater risk."

But Sensenbrenner rebuffed requests from Greenspan, Oxley and House leaders to pass the legislation apart from the larger bankruptcy bill it was attached.

Complicated, off-balance sheet transactions were Enron's undoing. Its stock collapsed after a Nov. 8 announcement that the firm had overstated its net income by \$569 million over four years.

Creditors are now lining up to collect on the approximately \$40 billion in debt owed by Enron.

Of that, roughly \$22 billion is on the balance sheet in the form of bank debt, commodity-transaction financing, bonds and other public securities. The remainder is made up of roughly \$7 billion in bonds and bank debt linked to other assets in special partnerships, as well as an additional \$10.7 billion in "project finance," a term that typically refers to money lent to build power plants or oil refineries.

-By Dawn Kopecki, Dow Jones Newswires; 202-862-6637; Dawn.Kopecki@dowjones.com

From: Sent:

Carleton, Norman

Thursday, January 10, 2002 5:54 PM

To:

Abdelrazek, Rawan

Subject:

FW: DJ: Arthur Andersen Says It Destroyed Documents Related to Enron Account

----Original Message--

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 4:50 PM

Cetina, Jill; Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject:

DJ: Arthur Andersen Says It Destroyed Documents Related to Enron Account

January 10, 2002

Major Business News

Arthur Andersen Says It Destroyed **Documents Related to Enron Account**

By Judith Burns

Dow Jones Newswires

WASHINGTON -- Arthur Andersen LLP, already under fire for its audits of Enron Corp., said it has destroyed documents sought by federal law enforcement officials investigating the Enron debacle.

In a statement issued Thursday, Andersen said it notified the U.S. Justice Department and the Securities and Exchange Commission that individuals at the firm "disposed of a significant but undetermined amount" of documents relating to its work for Enron. The Houston energy company declared bankruptcy in December after announcing it had overstated four-and-a-half years worth of

The document destruction includes paper documents and e-mail correspondence.

Andersen said it has instructed employees to retain all existing documents "until further notice."

In addition, the Chicago-based Big Five accounting firm said it has asked former Sen. John Danforth (R., Mo.) to conduct "an immediate and comprehensive review" of the firm's policies on document handling and recommend improvements.

Andersen said destruction of Enron documents occurred "in recent months" by individual employees involved in auditing the energy company.

Michael Donovan, a Philadelphia attorney with Donovan Searles, LLC, which has filed a class-action lawsuit against Andersen on behalf of Enron shareholders, said document destruction by an audit firm is shocking.

"Auditors save everything," including all work papers for audit clients, Mr. Donovan commented.

Enron was one of Andersen's largest clients, generating \$25 million a year in audit fees and \$27

million of fees for consulting. Enron, a high-flying energy company which last year ranked No. 7 on the Fortune 500 list, announced big losses last October in off-balance-sheet partnerships run by former Chief Financial Officer Andrew Fastow. In early November, Enron acknowledged it had overstated earnings by \$569 million over a four-and-a-half year period and said investors could not rely on its past financial statements.

The SEC launched a formal investigation into Enron's accounting on Oct. 31.

Write to Judith Burns at judith.burns@dowjones.com1

Tracking:

Recipient

Abdelrazek, Rawan

Delivery

Delivered: 1/10/02 5:54 PM

Read

Read: 1/11/02 2:26 PM

From: Carleton, Norman

Sent: Thursday, January 10, 2002 5:54 PM

To: Abdelrazek, Rawan

Subject: FW: Bloomberg: Attorney General Ashcroft Recuses Himself From Enron Probe

-----Original Message-----

From: Carleton, Norman

Sent: Thursday, January 10, 2002 2:54 PM

To: Cetina, Jil; Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject: Bloomberg: Attorney General Ashcroft Recuses Himself From Enron Probe

01/10 14:35

Attorney General Ashcroft Recuses Himself From Enron Probe

By Anna Marie Stolley

Washington, Jan. 10, (Bloomberg) -- U.S. Attorney General John Ashcroft said he won't participate in the Justice Department's investigation into Enron Corp.'s collapse due to his "relationship" with the company.

The announcement followed a call to step aside by U.S. Representative Henry Waxman. The California Democrat pointed to political contributions that Enron and its Chief Executive Officer Kenneth Lay made to Ashcroft's unsuccessful 2000 Senate campaign.

The Justice Department said yesterday that it is creating a task force in Washington to investigate the events that led to the biggest corporate bankruptcy.

Ashcroft announced today that he and his chief of staff, David Ayres, have recused themselves from anything to do with the Enron investigation "due to the totality of the circumstances of the relationship between Enron and the attorney general."

"The attorney general has not been involved in any aspect of initiating or conducting any investigation involving Enron," the Justice Department said in a statement.

rac in :

Reci lent

eli ery

Rea

Abdelra ek, Rawan

Delivered 1 10 02 M

Read 1 11 02 2 2 M

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 5:54 PM

To:

Abdelrazek, Rawan

Subject:

FW: DJ: White House Says Enron Sought Help, Was Rebuffed

----Original Message-----

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 2:47 PM

To: Cetin

Cetina, Jill; Bair, Shella; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject:

DJ: White House Says Enron Sought Help, Was Rebuffed

January 10, 2002

White House Says Enron Sought Help, Was Rebuffed

Dow Jones Newswires

WASHINGTON -- The Bush administration confirmed Thursday that Enron's (ENE) chief executive, Kenneth Lay, contacted two top officials last autumn and warned his company was headed toward bankruptcy. White House spokesman Ari Fleischer said.

However, Fleischer said that Lay's appeal for help from the government was rebuffed. In his appeal, Lay compared **Enron** to Long-Term Capital, a hedge fund that collapsed in the 1990s and sparked fears that its collapse could cause a shock to the financial system.

"What was told to me this morning was (Treasury) Secretary Paul O'Neill said that he had been contacted by Mr. Lay in the fall of last year and Mr. Lay brought to the secretary's attention his concerns about whether or not **Enron** would be able to meet its obligations. And he expressed his concern about the experience that Long Term Capital went through when Long Term Capital went bankrupt," Fleischer said.

"Secretary O'Neill then contacted (Treasury) Undersecretary (Peter) Fisher to ask him to evaluate whether the comparison was apt, and the Department of Treasury was advised that it was not apt as a result of Secretary Fisher's review," Fleischer said.

Interest in the administration's ties to **Enron** have been high because **Enron** was a major donor to President George W. Bush's political campaigns.

Democrats on Capitol Hill have begun hearings to see to if there was any impropriety in Enron's ties to the White House.

Further complicating the situation is that fact that many **Enron** employees held company stock in their 401K plans. **Enron** prevented the employees from selling their shares while the company collapsed, wiping out their savings in some cases.

Fleischer also said that Lay talked to Commerce Secretary Don Evans and expressed concerns about Enron's credit rating as the company experienced financial troubles.

Earlier in the day, Bush announced that two government working groups would begin reviewing the

country's 401K regulations and corporate disclosure rules as a result of Enron's bankruptcy. On Wednesday, the Justice Department announced it would launch a criminal investigation into Enron's collapse, the largest bankruptcy in the nation's history.

However, Bush said he didn't meet with Lay personally and he said a full investigation into Enron was warranted and would take place.

Fleischer maintained that Bush was never involved in the discussions about whether to extend government assistance to **Enron**.

Asked if O'Neill or Evans approached Bush about the Enron matter, Fleischer said. "They did not."

Fleischer also said the two secretaries didn't tell Bush that **Enron** had approached them until Thursday morning. He called the fact that Enron's Lay approached the two secretaries nothing unusual.

"I think it should surprise no one that people in the administration receive phone calls from people who are either in business or at unions. It happens everyday. I mean, it's not uncommon for people to receive phone calls from business leaders across the country, from union officials across the country. That happens as a common occurrence has always taken place," Fleischer said.

"I want to remind you that, communication is not a wrongdoing. What took place here was, they received phone calls and took no action. The charge has been, did the government take any action? And the answer form these two officials is no," Fleischer said.

Fleischer warned Democrats against seeking to reap political hay from Enron's woes and its ties to the White House. He called such efforts a "fishing trip" and said it was the sort of investigation the country tired of in the 1990s.

-By Alex Keto, Dow Jones Newswires; 202-862-9256; Alex.Keto@dowjones.com

Tracking:

Recipient

Abdelrazek, Rawan

Delivery

Delivered: 1/10/02 5:54 PM

Read

Read: 1/11/02 10:07 AM

From: Sent: To:

Carleton, Norman

Tuesday, June 19, 2001 2:42 PM

Annette Nazareth (E-mail); Belinda Blaine (E-mail); Bob Colby (E-mail); Bob Zwirb (E-mail); 'David Wall'; 'Diane Virzera'; Eichner, Matthew; Elizabeth Fox (E-mail); Eric Hirschhorn (E-mail); Hammer, Viva; John Polise (E-mail); 'Joyce Hansen'; Kathryn Dick (E-mail); Kevin Erickson (E-mail); Kurt Wilhelm (E-mail); Lori Sanatamorena (E-mail); 'Miguel Browne'; Nickoloff, Peter; Novey, Michael; Pat Parkinson (E-mail); 'Pat White'; Schultheiss, Heidilynne Gross, Jared; Ellett, Martha; Sutton, Gary; Gabilondo, Jose; DeMarco, Edward; Hughes,

Subject:

Cc:

Gerry FW: Suggested Interviewees

----Original Message----

From: Zwirb, Robert S. [mailto:bzwirb@CFTC.gov]

Sent: Tuesday, June 19, 2001 2:35 PM To: 'Norman.Carleton@do.treas.gov' Subject: Suggested Interviewees

Here is our list of organizations/individuals that we propose to interview for the retail swaps study:

National Grain Trade Council Enron FIA Managed Funds Assn Refco

Bob MacKay (former chief of staff at CFTC)

Pecinient

_						
т	March.	~	Ыi	12		
	ra	С	ĸ.	п	u	

Recipient	Delivery	rceau
Annette Nazareth (E-mail)		
Belinda Blaine (E-mail)		
Bob Colby (E-mail)		
Bob Zwirb (E-mail)		
'David Wall'		
'Diane Virzera'		
Eichner, Matthew	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 4:06 PM
Elizabeth Fox (E-mail)		
Eric Hirschhorn (E-mail)		
Hammer, Viva	Delivered: 6/19/01 2:42 PM	Read: 6/20/01 1:54 PM
John Polise (E-mail)		
'Joyce Hansen'		
Kathryn Dick (E-mail)		
Kevin Erickson (E-mail)		
Kurt Wilhelm (E-mail)		
Lori Sanatamorena (E-mail)		
'Miguel Browne'		
Nickoloff, Peter	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 2:45 PM
Novey, Michael	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 5:04 PM
Pat Parkinson (E-mail)		
'Pat White'		
Schultheiss, Heidilynne	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 2:42 PM
Gross, Jared	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 2:42 PM
Ellett, Martha	Delivered: 6/19/01 2:42 PM	Read: 6/21/01 9:34 AM
Sutton, Gary	Delivered: 6/19/01 2:42 PM	Read: 7/2/01 9:04 AM
Gabilondo, Jose	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 3:00 PM
DeMarco, Edward	Delivered: 6/19/01 2:42 PM	Read: 6/19/01 4:10 PM
Hughes, Gerry	Delivered: 6/19/01 2:42 PM	

Delivery

02979

Read

From: Carleton, Norman

Sent: Tuesday, August 28, 2001 9:58

To: Belinda Blaine (E-mail) Subject: FW: Enron article (2)

-----Original Message-----From: Carleton, Norman

Sent: Wednesday, August 22, 2001 10:13 AM To: Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Enron article (2)

-----Original Message-----

From: Norman Carleton [mailto:Norman.Carleton@worldnet.att.net]

Sent: Thursday, August 16, 2001 11:43 PM

To: Norman Carleton; norman.carleton@do.treas.gov

Subject: Enron article (2)



AUG 16, 2001

Enron Head Seeks to Reassure Staff

By REUTERS

Filed at 4:48 p.m. ET

HOUSTON (Reuters) - The chairman of Enron Corp. (news/quote) (ENE.N) on Thursday sought to reassure employees that the energy giant's business was on firm footing as its stock faced a second day of brutal pressure on Wall Street, following a top executive's shock resignation.

Kenneth Lay told employees at a companywide meeting that Enron's business was strong, despite the extended pressure on its stock and heir apparent Jeff Skilling's unexpected resignation as president and chief executive officer.

Lay, who was met with a standing ovation when he took the podium, touched on a wide variety of topics during the 90-minute meeting during which he took questions and presented financial data he said proves the company is strong.

"We've got a lot of great stuff going on and we're not getting much credit for it in the marketplace, but we will," Lay said. "I do think the next several months and few years are going to be great for Enron."

His comments came as Enron's stock saw its worst day in 19 months, closing down \$3.40 or 8.5 percent at \$36.85 on the New York Stock Exchange. That brings its losses to roughly 13 percent since Skilling announced his resignation after the market's close Tuesday.

Lay said he believed the energy giant's stock can sustain a price-to-earnings (P-E) multiple of 25-30 going forward. It is about 20 right now, based on Wednesday's close.

1/16/02

"I think the current business model can easily justify a 25-30 P-E, with the current business model and in the current market," Lay said. "We can't get that 40-50 P-E back until we get our return on capital investment up."

Enron enjoyed the higher multiples as recently as March, but then the stock began an extended slump that saw it lose about half its value.

WHO REPLACES SKILLING?

Though Lay took Skilling's duties over, he told employees that he expected to fill the void Skilling left in the office of the chairman in the next few days. Skilling, 47, was chief operating officer before Lay handed him the CEO reins in February, and the COO position has remained unfilled since then.

The executive or executives who assume the operational role Skilling had will largely be seen as the new heir or heirs apparent to Lay, 59. Enron earlier said it would increase the office of the chairman, which previously was occupied by Lay and Skilling, to include Lay and two understudies.

"Certainly, there is a hole in the office of the chairman, and we will be addressing that very soon. I think I told some people yesterday that we were looking to do something probably in the next couple of days," Lay said.

Lay reiterated that the succession will be internal, but did not elaborate on which executives he would choose.

MANY GLOBAL ASSETS TO GO

The best way to return Enron's stock to its headier levels will be to get a higher return on capital investment, he said. Enron hopes to glean billions from a sale of low-yield global assets, which it will then pour into highreturn businesses, Lay said.

``The quickest way to do that is to monetize some of these assets," Lay said. ``That doesn't mean we're going to monetize all of them."

He said Enron will still be very active in Europe, Japan, Australia and other countries, and may start working in developing countries at some point in the future.

Lay took more than a dozen questions from the audience, with topics ranging from work-a-day issues like how close cubicles will be spaced in Enron's new office building to the issue of what recourse there is for employees who have stock options that are priced in the \$80 range.

While he rebuffed a re-pricing of those options because "stockholders hate that," he did say all employees would be issued a new round of options that are priced at current levels.

Touching on another recent issue, Lay said Enron was in advanced talks to sell Oregon utility subsidiary Portland General, which was to be sold to utility Sierra Pacificfor \$3.1 billion until regulatory issues scuttled the deal.

"We have another transaction that is pretty far advanced and it might be a transaction where we would even maintain some ownership interest in that business for some time. But it's not far enough advanced to talk about right now," Lay said, not revealing the name of the potential buyer.

Asked if Enron's broadband arm would suffer more layoffs if was not successful by year's end, Lay said he thought ``the odds of that are very, very small." Lay said 500 people were taken out of Enron's broadband operation, with about half being laid off and the rest being redeployed within the company.

1/16/02

The underperformance of the broadband business, which coincided with the broad collapse of the telecommunications market, is among several problems that have dogged Enron lately.

They include a costly payment fight with the Indian government over the \$3 billion Dabhol power plant, the vilification of Enron by California politicians who blame Texas companies for their power crisis, and the breakup of a marquee video on-demand broadband Internet deal with Blockbuster Inc. (news/quote) (BBI.N).

Answering an employee question, Lay said there was no truth to a rumor that Royal Dutch/Shell RD.AS (SHEL.L) was planning a hostile takeover of Enron because of the stock's recent weakness.

From:

Carleton, Norman

Sent:

Tuesday, August 28, 2001 9:58

To:

Belinda Blaine (E-mail)

Subject: FW: Enron article

----Original Message----From: Carleton, Norman

Sent: Wednesday, August 22, 2001 10:12 AM To: Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Enron article

-----Original Message-----

From: Norman Carleton [mailto:Norman.Carleton@worldnet.att.net]

Sent: Thursday, August 16, 2001 11:39 PM

To: Norman Carleton; norman.carleton@do.treas.gov

Subject: Enron article



AUG 15, 2001

Enron's Chief Executive Quits After Only 6 Months in Job

02987

By RICHARD A. OPPEL Jr. with ALEX BERENSON

ALLAS, Aug. 14 — Jeffrey Skilling, the chief executive of the Enron Corporation (news/quote), stunned Wall Street today by announcing that he would quit after just six months in the job, calling the move a "purely personal decision."

But the abruptness of the departure left many analysts questioning whether a series of setbacks the company has suffered played a part in the decision.

Kenneth Lay, Enron's 59-year-old chairman, will step back into the position he left early this year after 15 years as chief executive.

Mr. Lay, who originally recruited Mr. Skilling to Enron, said tonight that he had agreed to stay on through the end of 2005 to "make sure we've got plenty of time to work out an orderly succession."

Mr. Skilling, 47, had been at the heart of the transformation of Enron from an old-line natural gas pipeline company to the biggest and most aggressive of the new breed of unregulated energy traders that buy and sell billions of dollars of electricity and other commodities daily.

That strategy helped Enron's stock price soar during the last decade. But this year the company's shares have fallen sharply, as Enron has suffered from problems with its new broadband telecommunications trading unit, its investment in a large power plant in India, and criticism from officials in California, who blame Enron and other energy companies fo the collapse of the state's electricity market.

A former energy consultant at McKinsey & Company who joined Enron in 1990, Mr. Skilling built its energy-trading operations into the company's most profitable unit, accounting for nearly \$1.7 billion — or 85 percent — of operating income last year. He became president and chief operating officer in 1997, and in February of this year became chief 1/16/02

executive.

On a conference call, Mr. Skilling said he could not "stress enough that this has nothing to do with Enron." He added that "the reasons for leaving the business are personal, but I'd just as soon keep that private."

Mr. Skilling, who is divorced, has joint custody of three teenage children — a daughter, 17, and two sons, 14 and 11 — with his ex-wife. Mr. Skilling, who will leave the board but will serve as a consultant to the company, will not receive any severance package because his departure is voluntary, Mr. Lay said.

Since May 2000, Mr. Skilling has sold at least 450,000 Enron shares worth at least \$33 million, according to Securities and Exchange Commission filings. He still owns about 1.1 million shares, the filings show.

"Absolutely no accounting issue," Mr. Lay told analysts, "no trading issue, no reserve issue, no previously unknown problem issues" are behind the departure. There will be "no change in the performance or outlook of the company going forward," he added.

He also said the company was on track to meet analysts' earnings expectations, which are about \$1.80 a share this year and \$2.15 next year.

On the call, Mr. Skilling said that "in general there have been a lot of issues" that have buffeted the company this year, but he said that he believed Enron had already surmounted most of them. "Now is the time" to step down, he said, "because I think we've got a lot of these things behind us."

Nonetheless, the move jolted analysts, who, despite the stock's recent slide and the company's other problems, saw Mr. Skilling as the unquestioned leader to follow Mr. Lay.

In after-hours trading, shares of Enron fell about 8 percent, to \$39.55. That fall follows a plunge of almost 50 percent since January in the stock, which had closed in regular trading at \$42.93, up 78 cents. The news of the executive changes came after the market closed.

"I'm surprised and I'm stunned," said Philip K. Verleger, an energy economist with the Brattle Group, a consulting firm in Cambridge, Mass. "Skilling was the guy who executed the growth in the trading business."

Investors have become increasingly concerned that a surge in new power plant construction will lead to a glut of electricity within a few years and lower the value of Enron's role as a middleman between plant owners and electricity users. In addition, the company's efforts to enter the water business have fared poorly, and its broadband trading operation has become a cash drain.

Mr. Skilling's promotion early this year came after several crucial Enron executives resigned. These included Rebecca Mark, who at one time was considered a rival for the top job.

Ms. Mark became chief executive of the Azurix Corporation (news/quote) in 1999 after Enron spun off the company, its global water business. But its financial performance was disappointing, and Ms. Mark left the company last year. Enron later agreed to buy back Azurix stock for less than half what public shareholders had paid.

From: Carleton, Norman

Sent: Thursday, January 10, 2002 12:16 PM

To: Cetina, Jill

Subject: FW: Bloomberg Column: Enron Broadband Trading Losses Grew as Company Touted

Success

----Original Message----

From: Carleton, Norman

Sent: Thursday, January 10, 2002 12:14 PM

To: Bair, Sheila: Berardi, Steve: Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schulthelss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject: Bloomberg Column: Enron Broadband Trading Losses Grew as Company Touted Success

01/10 10:31

Enron Broadband Trading Losses Grew as Company Touted Success

By Loren Steffy

Houston, Jan. 10 (Bloomberg) — Dixie Yeck landed Enron Corp.'s first contract to trade space on high-speed phone lines, a milestone in the company's plan to turn fiber-optic bandwidth into a commodity to be bought and sold like electricity and natural gas.

Her bosses told Yeck her December 1999 agreement with Global Crossing Ltd. was a step toward realizing Enron's goal of dominating a market that company executives projected would grow to \$500 billion in 2005 because of the explosion of the Internet.

"Enron wanted to be the biggest buyer and seller of bandwidth," said Yeck, 36, who was in charge of finding telecommunications companies in the midwestern U.S. that wanted to sell network capacity and businesses that wanted to buy it. "They got you so pumped up, you just had to believe them."

Yeck's dream faded in less than a year as Internet companies went out of business and those that remained had more fiber-optic network space than they needed. Yeck said many of her 1,500 co- workers at Enron Broadband Services had so little to do that they spent hours each day surfing the Internet.

"The whole market had started to dry up," Yeck said. "I knew EBS was going under."

Yeck said she listened in disbelief in January 2001 to an Internet broadcast in which Enron executives told investors the company's broadband business was booming. Chairman Kenneth Lay said the division had reached the "critical mass" it needed. Then-President Jeffrey Skilling touted "enormous growth prospects" for the business. The broadband division, he said in an interview two months later, was worth \$36 billion, or \$40 a share, at a time when Enron's stock traded at \$70.

"My experience did not match what was being presented," said Yeck, who quit her job in October, less than two months before Enron filed the largest Chapter 11 bankruptcy in U.S. history.

Suspect Profits

Even as market prices for bandwidth tumbled in 2000, Enron Broadband recorded gains on its income statement from equity investments in other companies, derivative instruments and sales of fiber-optic cable among Enron-affiliated partnerships. Gains from those sales accounted for 20 percent of the division's pretax profit last year.

"There's something not right about that," said Ron Banaszek, director of bandwidth trading for Tradition Financial Services, an over-the-counter commodities broker in Stamford, Connecticut. "Prices have been eroding. If there was that kind of money to be made, I think other (broadband) companies would be making a lot of money right now."

Surge of Losses

When Enron restated earnings for the past four and a half years in November, the extent of the financial distortions became clear. The broadband division's \$60 million year-end loss ballooned to \$357 million by the third quarter of 2001,

and restructuring a derivative investment resulted in negative revenue of \$125 million, according to statements filed with the U.S. Securities and Exchange Commission.

"The broadband deal was the beginning of the end," said Ogan Kose, a crude-oil trader who was one of 4,500 Houston employees Enron fired in December. "Instead of writing it off, they continued to carry it."

Enron entered the 1990s as a Houston-based pipeline operator and transformed itself into the dominant trader of natural gas futures, controlling as much as 30 percent of the gas futures contracts traded on the New York Mercantile Exchange. The company repeated that success in markets for trading electricity and weather derivatives.

Skilling promised investors, including those at the meeting last January, that Enron would deliver 20 percent to 30 percent profit growth annually by applying the same strategy to new markets. Enron began trading in metals, lumber and broadband and set up companies such as New Power Holdings Corp. and Azurix Corp. to tap deregulated electricity markets and buy and sell water.

Toll of Failures

None of the ventures generated the profits that flowed from Enron's early trading businesses. By the third quarter of 2001, gas, power and weather trading generated \$717 million in pretax profit. Losses from other operations topped \$1.4 billion.

"We made millions, and they just kept putting it into the next business hoping it would be the next big thing," said Tom Donohoe, an Enron natural gas trader who was fired in December. "Azurix was a flop. Broadband was a flop. Any one of them we probably could've absorbed, but it was just one after the other."

For a while, Enron endured the losses by shifting debt and assets off its books using partnerships capitalized by the company's shares, which rose 87 percent last year. Many of the partnerships were set up by former Chief Financial Officer Andrew Fastow, who made \$30 million running them, according to SEC filings.

Chain Reaction

When Enron's shares began falling, the company became liable for off-balance-sheet debt. That set off a chain reaction that cut the company's credit rating, scared off customers and drove Enron's shares as low as 26 cents. The stock's decline wiped out the savings of thousands of employees who'd loaded their 401(k) retirement plans with Enron shares. The SEC, the Justice Department and Congress are investigating.

Lay, Skilling and Fastow declined interview requests. They are named as defendants in more than 40 lawsuits filed by shareholders and employees and are among Enron insiders who sold more than \$1 billion of company stock during the past three years.

Broadband Strategy

Enron set up its broadband unit as Internet growth was peaking and thousands of companies were creating retail Web sites, electronic exchanges and inventory management systems that needed to move data over high-speed lines. Enron planned to make a market in access to the lines, serving as a middleman between companies that wanted to sell transmission capacity and those that wanted to buy it.

Enron also began building a fiber-optic network, spending \$436 million in 2000 alone on 18,000 miles of cable that it planned to connect to transmission equipment and lease to users.

In its first contract, the one Yeck signed with Global Crossing, a telephone and data network operator, Enron agreed to buy bandwidth capable of moving data and streaming video between New York and Los Angeles. Enron planned to resell the bandwidth at a profit.

"This is "Day One" of a potentially enormous market," Skilling said in a news release on Dec. 2, 1999. "The market structure for bandwidth is currently inefficient and expensive. We are demonstrating that bandwidth can be traded under flexible, market-based contract structures."

Enron began transferring hundreds of employees from other divisions, eventually assigning 1,500 to its broadband trading unit. That was more than three times the number of employees Williams Communications Group Inc. hired for its broadband business, which had 33,000 miles of fiber, almost twice as much as Enron.

Spending Plans

At a Houston investor conference in September 2000, Lay said Enron had completed 90 bandwidth trades. He announced a plan to spend as much as \$1.95 billion to beef up Enron's fiber network and trading operations in two to three years.

"When tech was in favor, all of Wall Street was pushing them to increase their exposure in broadband," said Tim Ghriskey, manager of Ghriskey Capital Partners. As a fund manager for Dreyfus Corp. in late 2000, Ghriskey sold 1.55 million Enron shares.

Trading bandwidth proved more difficult than trading natural gas. For starters, Enron faced stiffer competition. When the company began trading gas futures in 1991, it took years for rivals to follow its lead.

Action by Rivals

Two months after Enron completed its first bandwidth trade, Williams Communications announced it was forming a unit to trade broadband. By the end of 2000, rivals such as Koch Industries Inc. and Dynegy Inc. had set up units to trade bandwidth.

"When Enron revolutionized the gas industry, they were ahead of the game and they made a lot of money," said Kyle Vann, chief executive of Entergy-Koch LP, a joint venture between Koch and New Orleans utility Entergy Corp. "Then they took it to the power industry, and they made a lot of money. With bandwidth, once Enron went that way, there were a lot of other people who did, too."

Even as more companies began selling bandwidth, consumers and businesses began ordering fewer telecommunications services. Industry experts estimate that about 20 percent of the world's fiber is being used.

"You have such an incredible surplus of capacity, that there's really not a lot of trading leverage there," Vann said. "It's just a big old huge excess."

In March, Enron lost one of its biggest customers. Blockbuster Inc., the world's largest video-store chain, canceled a 20year contract to deliver movies-on-demand over Enron's network. Blockbuster spokeswoman Karen Raskopf said at the time that the company "decided there were plenty of other carriers out there that were more sophisticated technically."

New Counting Method

With contracts drying up, Enron developed a new method for measuring trading volume. At the January investor conference, Lay said Enron completed 300 "intermediation transactions" the previous year. He never defined the term, and Yeck had never heard it before. It was a measure that broke broadband contracts down to their smallest components to create a larger number, Yeck said.

"It made it look like a lot more was happening than there was," she said. "It's like a personal computer maker saying 'we sold a million bytes." That's not much, but it sounds like it -- a million, wow."

Banaszek of Traditional Financial Services and other broadband traders and consultants said they aren't familiar with the term, either.

"It was always very difficult with these guys to get any specifics in terms of their businesses," said Ghriskey, the former Dreyfus fund manager. "That's one of the reasons we sold all our stock."

Few Broadband Trades

At a Houston court hearing on Dec. 7, William Lerach, an attorney for Amalgamated Bank, an Enron shareholder that wants to freeze profits Enron executives made from stock sales, said his investigation found Enron's broadband unit never did more than 20 "legitimate" transactions.

Most of Enron's broadband trades were so-called daisy chain deals, with related affiliates, Lerach said.

Enror spokesman Mark Palmer said he has no way to find out how many contracts the broadband division had. He said he thinks intermediation transactions represented "deals where we were either the buyer or seller of some type of bandwidth commitment in the future."

Yeck and Kose said they knew of Enron buying and selling broadband contracts at no profit to increase trading volume, Palmer dismissed such claims as the "talk of disgruntled former employees."

Sales to Partnerships

Enron's financial statements show the division was in decline since late 2000. Revenue of \$162 million in the third quarter of that year slipped to \$83 million by the first quarter of 2001 and \$16 million by the second quarter. At the same time, pretax losses rose from \$20 million in the third quarter of 2000 to \$102 million by the second quarter of 2001.

Much of the revenue came from sources other than trading. Enron derived some of it from investments in companies such as Rhythms Netconnections Inc., a provider of local high-speed networks whose shares rose more than fourfold in the month after it went public in April 1999. The company filed for bankruptcy in August.

Enron generated about 20 percent of the \$318 million gross profit reported for 2000 from selling a block of fiber to partnerships controlled by Fastow, the former CFO.

Recording a Gain

In June 2000, the partnership, known as LJM2, paid \$100 million -- \$30 million in cash and \$70 million in an interestbearing note -- for some of Enron's fiber, according to SEC filings. Enron booked a \$67 million pretax profit from the sale and received \$20 million for operating, maintaining and marketing the fiber.

Enron's profit from the transaction depended on LJM2's ability to find a buyer willing to pay a higher price for the fiber. In December 2000, it found two. LJM2 sold part of the fiber to unnamed ``industry participants" for \$40 million and set up a ``special purpose entity" that bought the rest of the fiber for \$113 million, according to SEC filings.

In six months' time, the value of the fiber, based on Enron's accounting, rose by \$53 million. Banaszek said even the initial \$67 million profit seems unlikely because fiber prices fell during most of 2000.

Yeck decided to quit in October, after being transferred to the trading desk. She said "there was nothing to do" and the staff battled over trades in the hope of winning performance bonuses that made up most of their compensation.

"It was like a piece of meat in a pack of wolves," Yeck said. "They would claw and scratch and do whatever it took to get it."

Broadband Fails

Many of Enron's competitors had already given up on broadband. Koch, which set up a bandwidth trading business in September 2000 under its Koch Investment Group unit, had three employees devoted to broadband. After signing one contract, Koch stopped trading in the market because of lack of demand.

The amount that broadband cost Enron became clear in November, after the company restated earnings to reduce them by \$586 million over the past 4 1/2 years.

The unit took \$277 million in charges for restructuring, soured equity investments, writing down excess network equipment and adjusting the value of a derivative investment. Enron didn't provide details on the derivative, which resulted in negative revenue of \$125 million for the quarter, according to statements filed with the SEC.

With bankruptcy looming, Enron said it would sell its broadband operation, along with other assets. During a conference call on Nov. 14 to discuss the sale, Skilling's replacement, Greg Whalley, told analysts what Dixie Yeck had suspected a year earlier: "The return for these investments and businesses is dismal."

Trac ing:

ecipient Cetina, Jill e i ery

Delivered: 1/10/02 12:16 PM

ead

Deleted: 1/14/02 1:36 PM

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 12:16 PM Cetina, Jill

To:

Subject:

FW: Bloomberg: Bush Task Force to Study Disclosure Rules After Enron

-----Original Message-----

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 12:07 PM

To:

Bair, Shella; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject:

Bloomberg: Bush Task Force to Study Disclosure Rules After Enron

01/10 11:16

Bush Task Force to Study Disclosure Rules After Enron (Update2)

By David Morris

Washington, Jan. 10 (Bloomberg) -- President George W. Bush said he ordered Treasury Secretary Paul O'Neill and other officials to review the adequacy of corporate disclosure rules after Enron Corp.'s bankruptcy.

"In light of the most recent bankruptcy, Enron, there needs to be a full review of disclosure rules to make sure the American stockholder, or any stockholder, is protected," Bush said.

The review marks Bush's first official public act in response to Enron's financial collapse. Multiple investigations of Houston-based Enron, including a criminal probe by the Justice Department, carry political risks for the president who was close to Enron Chairman Kenneth Lay, a large contributor to Bush's political campaigns.

The White House released a letter Tuesday saying Enron representatives met with Vice President Dick Cheney's energy task force six times in seven months last year to talk about energy policy.

Bush, the former Texas governor, said he hasn't talked with Lay about Enron's financial troubles and most recently saw the Enron chief last spring at a literacy fundraiser held by the president's mother, former First Lady Barbara Bush.

Nest Eggs

The disclosure-rule task force, including O'Neill and Commerce Secretary Donald Evans, should look into ways to protect pensioners from losing their nest eggs if their employer goes out of business, Bush said.

Enron, which was the biggest energy trader, said on Nov. 8 that profits had been inflated by \$585 million since 1997 because of accounting errors. After the restatement, Enron shares plunged about 99 percent, to as little as 25 cents, before the company on Dec. 2 filed the biggest U.S. bankruptcy case ever.

Enron's restatement involved transactions with partnerships and affiliates, some of which were set up by Enron officials. The Securities and Exchange Commission is investigating whether Enron adequately disclosed information about partnerships and affiliates, and whether its auditor, Arthur Andersen, acted properly in its reviews of Enron's books.

The Justice Department yesterday said it had established a task force of prosecutors to conduct a criminal investigation of the events surrounding Enron's collapse. Six congressional committees are conducting investigations of Enron's fall and the impact on 401(k) retirement accounts, which held much of employees' retirement savings in Enron stock.

Former CEO

Some of the investigative focus is on what former Enron Chief Executive Officer Jeffrey Skilling knew about partnerships that allowed Enron to shift debt off the company books. Skilling has denied having detailed knowledge of the partnerships.

Skilling's spokeswoman Judy Leon said today the former Enron CEO would cooperate fully with the Justice Department probe and "welcomes any inquiry aimed at clearing the air and finding out what really happened at Enron."

Leon said Skilling already had cooperated with inquiries by the SEC and Congress. "When the facts are in, we expect he will be vindicated," Leon said.

SEC Chairman Harvey Pitt, who has been in office about five months, already has promised a comprehensive review of rules about corporate disclosures of financial information. Pitt has said he wants to establish a system where companies make more-frequent disclosures to investors and describe more clearly important factors for their business prospects.

Enron stock, which traded for as much \$90.75 in August 2000, fell 10 cents to 69 cents in late morning trading.

Trackin:

Recipient Cetina, Jil Deli ery

Delivered 1 10 02 12 16 PM

Read

Deleted 1 14 02 1 6 PM

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 12:15 PM

To:

Cetina, Jill

Subject:

FW: AP: Bush Orders Treasury To Eye Pension, 401K Rules - Sources

-----Original Message-----

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 11:57 AM

To:

Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangell, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject:

AP: Bush Orders Treasury To Eye Pension, 401K Rules - Sources

January 10, 2002

Bush Orders Treasury To Eye Pension, 401K Rules - Sources

WASHINGTON (AP)--U.S. President George W. Bush, in a follow-up to the criminal investigation of Enron Corp. (ENE), has ordered the **Treasury** Department to review rules regulating company pension and 401(k) plans, The Associated Press has learned.

Administration sources, speaking on condition of anonymity, said Bush would announce the action Thursday in the Oval Office, in part to inoculate himself politically from the bankruptcy of the Texasbased energy company that has ties to Bush and administration officials.

The Justice Department announced Wednesday it has begun a criminal investigation of the bankrupt energy company, whose collapse caused many employees to lose their life's savings.

The Justice Department is forming a national task force to look into the company's dealings. The group will be headed by lawyers at the department's criminal division and include prosecutors in Houston, San Francisco, New York and several other cities, said a Justice Department official, speaking on condition of anonymity.

As a follow-up, **Treasury** Secretary Paul O'Neill will head a review of laws and regulations to determine if they can be tightened to protect worker pension plans. A senior official involved in discussions on the issue said the Justice Department will determine whether Enron broke any laws and the **Treasury** Department will study whether Enron's conduct, although potentially legal, exposed loopholes in the system.

Enron's chairman and chief executive, Kenneth L. Lay, is a political ally of Bush's. He and other Enron officials met six times with Vice President Dick Cheney or his aides last year, before and after the release of the administration's energy plan.

Lay and his company have been leading contributors to Bush as well as to a long list of Democratic and Republican candidates.

The Center for Public Integrity, a nonpartisan watchdog agency in Washington, says Enron's executives contributed nearly \$800,000 to Bush, members of Congress and the two national political parties from 1999 to 2001.

A senior Bush adviser said the president wants to protect workers' pensions. His political team, the adviser said, is worried that the administration could face intense criticism for its association with Lay and Enron as hearings heat up on Capitol Hill.

Tracking:

Recipient

Cetina, Jill

Delivery

Delivered: 1/10/02 12:15 PM

Read

Deleted: 1/14/02 1:36 PM

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 12:15 PM

To:

Subject:

FW: DJ: Bush: Worried By Lost Pensions In Bankruptcies

-----Original Message---

From:

Carleton, Norman

Sent:

Thursday, January 10, 2002 11:55 AM

To:

Bair, Shella; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean;

Wiedman, Mark

Subject:

DJ: Bush: Worried By Lost Pensions In Bankruptcies

January 10, 2002

Bush: Worried By Lost Pensions In Bankruptcies

WASHINGTON -- President George W. Bush said Thursday that he wants to see a thorough investigation into the sudden collapse of Enron (ENE) and has ordered a review of the U.S. laws governing pensions.

On other matters, Bush also warned Iran not to thwart U.S. efforts in the war on terrorism and he specifically warned Tehran not to harbor "al-Qaida murderers."

Speaking in a hastily arranged event in the Oval Office, the president made his comments as the political heat mounted over Enron's collapse. The company and its head, Kenneth Lay, have a record of making large political contributions to Bush. Bush acknowledged this by calling Lay "a supporter"

Enron has also backed Democratic candidates.

Flanked by some of his top economic advisers, Bush said, "One of the things that we are deeply concerned about is that there has been a wave of bankruptcies that have caused workers to lose their pensions and that is deeply troubling to me."

"So I have asked the secretary of treasury, secretary of labor, secretary of commerce to convene a working group to analyze pension rules and regulations to look into the effects of the current law on hard-working Americans," Bush said.

Specifically, Bush said the group will look at ways to prevent workers from losing their life savings if their companies go belly up.

On top of this, Bush said he was asking the Treasury, the Federal Reserve, the Securities and Exchange Commission and the Commodities Futures and Trading Commission to convene a working group look at corporate disclosure rules and regulations.

Bush said he was ordering these actions "in light of the most recent bankruptcy, Enron."

"There needs to be a full review" of the events at Enron, Bush added.

Bush said he was particulary disturbed by reports that workers at Enron who held Enron stock in their 401K plans were prevented from selling their shares as the company collapsed.

1

White House spokesman Ari Fleischer called the collapse of Enron a "wake-up call."

Bush said the two working groups would complement the criminal investigation into Enron's dealings that have been started by the Justice Department.

Bush said he hadn't met with Enron's Lay personally but Lay did come to the White House early in Bush's term as part of a delegation of businessmen who discussed the economy. Bush said former Texas Governor Ann Richards, a Democrat, named Lay the head of Texas's Governor's Business Council and Bush allowed him to stay on in that position.

Despite the political backing Lay gave to Bush, the president said he wanted to see the government "fully investigate issues such as the Enron bankruptcy."

On Iran, Bush reacted to reports that Iran may be sheltering small groups of al-Qaida fighters in Afghanistan's lawless western provinces with a warning.

"First of all, Iran must be a contributor in the war on terror," Bush said.

He vowed once again to uphold his doctrine "either you are with us or against us."

"Any nation that thwarts our ability to fight terror will be held to account one way or another. We had some positive signals early in our war on terror. We would hope that they would continue to be a positive force in helping us bring people to justice. We would hope, for example, they wouldn't allow al-Qaida murderers to hide in their country. We would hope that if that would be the case, if someone tries to flee into Iran, they would hand them over to us," Bush said.

Bush also warned Iran against trying to undermine the authority of the newly formed Afghan government in Kabul and urged Tehran to cooperate with Kabul.

"If they try in any way shape or form, try to destabilize the government, the coalition will deal with them, you know, in diplomatic ways, initially," Bush said.

Bush expressed the view that a stable Afghanistan was in Tehran's interests in any case.

On a related issue, Bush said that he suspected a shipload of weapons that was intercepted by Israeli commandos likely had been bound for the Palestinian Authority. Bush said it was time for Palestinian leader Yasser Arafat to prove he is a man of peace and to renounce terrorism once and for all.

-By Alex Keto, Dow Jones Newswires; 202-862-9256; Alex.Keto@dowjones.com

Tracking:

Recipient Cetina, Jill Delivery

Delivered: 1/10/02 12:15 PM

Read

Deleted: 1/14/02 1:36 PM

From:

Carleton, Norman

Sent:

Tuesday, December 18, 2001 12:13 PM

To:

Cetina, Jill

Subject:

FW: Bloomberg: Enron Enriched Wall Street Firms, Analysts Ignored Warnings (long story)

-----Original Message-----

From:

Carleton, Norman

Sent:

Tuesday, December 18, 2001 12:12 PM

To:

Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva; Lori

Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidlynne; Whaley, Jean;

Wiedman, Mark

Subject:

Bloomberg: Enron Enriched Wall Street Firms, Analysts Ignored Warnings (long story)

12/18 02:43

Enron Enriched Wall Street Firms, Analysts Ignored Warnings

By Adam Levy

Houston, Dec. 18 (Bloomberg) -- On Tuesday, Oct. 16, Enron Corp. Chief Executive Kenneth Lay delivered a shocker. Late in a conference call that followed the release of the company's third-quarter results, Lay said Enron would terminate one of its several limited partnerships -- and thereby wipe out \$1.2 billion of shareholder equity.

"I shuddered when I heard that," says Gregory Phelps, who invests \$1.1 billion in energy and utility stocks at John Hancock Advisers Inc. and has long avoided Enron. "But it didn't seem to make much of an impression on part of the investment community."

Over the next few days, reports began piling up on Phelps's desk from the Wall Street analysts who track Enron. Merrill Lynch & Co., UBS Warburg LLC, Credit Suisse First Boston and Goldman Sachs Group Inc. still rated Enron a "buy."

Prudential Securities Inc. analyst Carol Coale wrote that she was "dismayed" by management's "disguise" of the \$1.2 billion equity reduction, yet she kept intact her "buy" rating and \$55 price target on Enron stock, which was then trading at \$33.17.

'Strong Buy'

Richard Gross of Lehman Brothers Holdings Inc. maintained his "strong buy" rating. "The end of the world is not at hand," Gross said. "We think investors should rustle up a little courage and aggressively buy the stock."

Phelps and other investors say the analysts' reactions were just another sign of Wall Street's gullibility about Enron.

For more than a year, they say, analysts had ignored red flags ranging from inflated business valuations to large insider stock sales, to the abrupt resignation of Jeffrey Skilling in August 2001 -- just six months into his tenure as CEO.

As recently as September, Enron was the second most highly rated stock in the Standard & Poor's 500 Index, behind Tyco International Ltd., according to Thomson Financial/First Call.

"Enron is uniquely positioned to be the GE of the new economy," Donato Eassey, Merrill Lynch's energy stock analyst, told Bloomberg News in February 2001. "This isn't a management team to bet against." Eassey resigned from Merrill in December.

Support is Obvious

One of the main reasons for all of the support is obvious, say investors: Until the week before its third- quarter earnings report in October, Enron was a deal machine that enriched dozens of Wall Street firms through lucrative underwriting contracts, mergers and acquisitions assignments and derivatives trades.

"You'd be hard-pressed to find a house on the Street that didn't do business with Enron," says Don Coxe, chairman and chief executive of Harris Investment Management Inc., which in early December held 78,000 Enron shares in the Harris

Insight Equity Fund. "They spread a ton of business around the Street, so it's no wonder these analysts were behind the stock."

Enron says it didn't have a quid pro quo relationship with anyone. "At no time has Enron ever required any financial firm to endorse our stock as a prerequisite for doing business with the firm," says spokesman Vance Meyer.

'Taps on Shoulders'

Some Wall Street veterans say they don't find that denial persuasive. "Even if there were no spoken agreements, you can bet analysts often got taps on the shoulders from the investment bankers making sure that they were reminded to keep 'buy' ratings intact," says Phelps. "That's just the way Wall Street works."

Enron spread the wealth across many Wall Street firms. In May 2001, Enron used six banks -- A. G. Edwards & Sons Inc., Banc of America Securities, Dain Rauscher Wessels, First Union Securities Inc., Salomon Smith Barney Inc. and UBS Warburg -- to manage a \$151 million unit offering for Northern Border Partners LP, one of scores of Enron-controlled partnerships.

Usually, no more than four underwriters are involved in deals that small, investment bankers say.

CSFB advised Erron on a pending \$2.9 billion sale of Portland General Electric Co. in October — one of 41 separate mergers and acquisitions transactions Erron initiated since January 1999, according to Bloomberg data.

Enron Activity Dwarfs Rivals

That dwarfs the number of deals over that span announced by rivals Dynegy Inc., which struck 15 corporate combinations, and Kinder Morgan Inc., which did a dozen deals.

Error further cemented its relationship with Wall Street by borrowing from banks, obtaining letters of credit and trading in derivatives -- financial instruments such as futures and options whose value is based on other assets.

When Enron filed for bankruptcy in December, its list of creditors was 54 pages long and included Citigroup Inc., CSFB's London branch, J. P. Morgan Chase & Co. and UBS.

Goldman Sachs is a dealer for Enron's \$4 billion commercial paper program and has arranged six of the company's 15 preferred share sales.

In June 1999, Merrill Lynch managed the \$695 million initial public offering of Azurix Corp., Enron's water business. Run by Enron's former Vice Chairman Rebecca Mark, who resigned in August 2000, Azurix failed in its strategy to buy water companies and win large projects. It lost a bid to acquire a 49 percent stake in Berlin's water utility, for example.

Enron Buys Back Stock

Enron bought back the stock in 2001, after it had fallen more than 55 percent during the company's 18 months as a public entity.

In October, J. P. Morgan and Citigroup's Citibank unit provided Enron with \$1 billion in credit lines to help it pay down debt and meet day-to-day costs. Those loans came just in time for the two firms to win the business of advising Enron on its planned acquisition by Dynegy.

J. P. Morgan and Citigroup's Salomon were set to charge \$90 million -- \$45 million each -- for that advice, according to people familiar with the arrangement.

Dynegy was set to pay \$15 million in advisory fees to Lehman Brothers. That would have been Lehman's biggest such transaction in 2001.

Dynegy Deal Falls Through

In December, after the Dynegy deal fell through, Enron obtained as much as \$1.5 billion in new financing from J. P. Morgan and Citigroup. On December 11, J. P. Morgan filed a lawsuit in Enron's bankruptcy case, seeking \$2.1 billion — funds the bank said aren't part of the energy trader's assets shielded from creditors by the Chapter 11 filing.

Enron traded derivatives in energy, broadband and weather with a host of investment firms, and at the time it filed for

bankruptcy, it owed some of them hundreds of millions of dollars.

According to its bankruptcy filing, Enron owed \$185 million to two offices of Chase Manhattan Bank, a subsidiary of J. P. Morgan Chase; \$74 million to UBS; and \$71 million to CSFB. Bear Stearns Cos. said it stood to lose \$69 million from the collapse of the energy trader; Commerzbank AG said it would lose slightly less than \$45 million.

Schmoozing Wall Street

Enron's multiple business dealings with Wall Street caused firms to look favorably on the company's new ventures, say investors.

In late January 2001, for example, Enron's senior management hosted a meeting for 170 analysts and investors. Skilling told the crowd that Enron's biggest immediate opportunity was its plan to trade broadband capacity: space on the fiber-optic networks that zip voices, data and images around the planet.

Skilling said that based on his analysis, Enron's broadband business was worth \$36 billion, or \$40 a share. Enron stock was then trading at \$82. The business had lost \$60 million on \$408 million in revenue in 2000.

"The numbers never added up, but Wall Street didn't challenge them," says Harris Investment's Coxe.

Ronald Barone, an analyst at UBS Warburg, wrote after the January meeting that he was "brain drained, having digested scores of detailed presentations." He also wrote that he was "enamored" with Enron's broadband business, even though it wouldn't generate earnings for at least a year because it would take that long to generate enough trades.

\$25 a Share

He estimated the business was worth \$25 a share, or \$22.5 billion. He kept his "strong buy" rating on the stock and, in a January 25 report, raised his 12-month target on Enron stock to \$102 from \$100. The stock was trading at \$82 at the time. Barone declines to comment on his recommendations.

Lehman's Gross raised his 12-month target price on Enron to \$100 from \$90 after the company's analysts' conference. He said he viewed Enron's foray into broadband as no different from any of its other endeavors.

"Given the track record that has been displayed over the past 36 months, we have no reason to doubt the success of their efforts," Gross wrote a week after the conference in a report dated Feb. 1. Enron stock was then trading at \$78. "We continue to recommend Enron as a core holding," he wrote. Gross declines to comment.

\$180 Million Charge

Enron's fiber-optic business collapsed this past summer. In its third-quarter earnings release, Enron said it had taken a \$180 million charge to restructure the business, including severance payments to 500 fired workers and a reduction in the value of its operations.

As Enron's stock was rising on Wall Street, analysts often said they were in the dark about the company: how it made money and booked sales and what was behind dozens of off-balance-sheet partnerships.

Their lack of knowledge didn't stop them from promoting Enron stock. Goldman Sachs analyst David Fleischer said in March that Enron's "lack of disclosure and transparency is a long-standing hallmark."

Enron had been a fixture on Goldman's "recommended list" of a couple hundred favored stocks since 1993, when analyst Fleischer joined the firm.

"Extraordinary Franchises"

"Enron has built unique and, in our view, extraordinary franchises in several business units," Fleischer said in March.

On March 14, Commerzbank Capital Markets analyst Andre Meade raised his long-standing rating on Enron to "accumulate" from "hold" because the stock had dropped 30 percent in the previous three months -- even though, he said, he couldn't construct accurate earnings models. "Enron keeps a lot of facts close to the vest," he said.

"Saying they don't understand it but still recommend it is a slap in the face to remind us how useless analysts are," says Robert Olstein, a 35-year Wall Street veteran who runs the \$890 million Olstein Financial Alert Fund.

After the market closed for trading on Aug. 14, Skilling, 48, abruptly resigned, citing personal reasons and raising concerns among investors that dire financial news might be forthcoming.

Falling Stock

Enron stock dropped as much as \$6, or 13 percent, the following day, ending the week at \$36.67.

Analysts insisted nothing was awry. "There is nothing wrong with the company," UBS's Barone said after meeting with Lay, who had once again become Enron's CEO. "There is no other shoe to fall — and no charges to be taken." He kept his "buy" rating on the stock.

Lehman's Gross also met with Lay and other senior managers on the night of Aug. 16. "The Enron machine is in top shape and continues to roll along," Gross wrote to investors the next day.

He didn't see a short-term catalyst to boost the stock — then trading at \$36.85 a share — yet he urged investors to get more shares, maintaining his "strong buy" recommendation and a 12-month price target of \$72.

CSFB analyst Curt Launer wrote a brief note to clients after what he described as ``intensive meetings" with management. He said there was ``no truth to any of the speculations" and kept his 12-month target of \$84 and his `'buy" recommendation.

Enron a 'Buy'

Of the 22 analysts who covered Enron, 19 rated the stock a "buy" as of mid-October 2001. That's when, one after another, disclosures spilled out of the Houston-based company: Enron's partnerships had hidden billions of dollars in debt; years of profits had been exaggerated; and the U.S. Securities and Exchange Commission was investigating Enron's partnerships with affiliates.

The disclosures dashed Enron's credibility with lenders and drove it to bankruptcy.

On Nov. 21, with Enron stock at less than \$7 -- down more than 90 percent from its high in August 2000 -- Goldman's Fleischer downgraded Enron to ``market perform," Wall Street parlance for ``hold." He didn't respond to several phone calls.

Easier Decision

Investors say Fleischer's decision to downgrade the stock was made easier by his firm's failure to win a role advising Enron on its planned sale to Dynegy. "I wouldn't doubt at all that being dropped from the 'recommended list' had something to do with not winning the advisory business," says Phelps.

Fleischer and Goldman spokespeople didn't return phone calls.

To many investors, there were signals that should have tipped off analysts that something was amiss. In December 2000 and January 2001, 10 top Enron executives sold more than \$73 million in stock. Lay and Skilling together sold stock valued at more than \$17.6 million, according to the Washington Service, which tracks insider stock sales and purchases.

Insider sales are often a strong sign to investors that something's wrong. Timothy Ghriskey, who at the time was a fund manager at Dreyfus Corp., sold about 1.55 million Enron shares in late 2000. "It wasn't much of an endorsement that they were bailing out too," he says. "I didn't see much upside in the stock and figured that with the valuation so high, there was a lot of downside if they failed to deliver."

Wake-Up Call for Analysts

Coxe and other investors say Enron's failure should provide a wake-up call for analysts, who pay too little attention to company balance sheets. "I pay the Street lots of commission dollars and expect that analysts are reading the footnotes and kicking tires," Coxe says.

Several Wall Street firms took steps last year to defuse criticism that conflicts of interest taint analysts' research. In July, Merrill Lynch announced that its analysts could no longer own shares in the companies they cover. CSFB soon followed with similar announcements.

As of Dec. 17, with Enron a penny stock, fetching 57 cents a share, 7 of 17 Wall Street analysts rated the stock a "hold" and 5 offered a "sell" recommendation.

Five other analysts advised their clients that the company at the center of the biggest bankruptcy filing in U.S. history was still a "buy."

rac ing:

eci ient Cetina, Jili

nt

eli ery

Delivered: 12/18/01 12:13 PM

ead

Deleted: 1/3/02 10:55 AM

From: Sent:

Carleton, Norman

Tuesday, December 18, 2001 9:55 AM

To: Subject: Cetina, Jiil

FW: ENRON ADMITS IT'S REALLY ARGENTINA

----Original Message----

From: Wiedman, Mark

Sent: Tuesday, December 18, 2001 7:52 AM

To: Roseboro, Brian; Carleton, Norman; Nickoloff, Peter; Schultheiss,

Heidilynne

Subject: FW: ENRON ADMITS IT'S REALLY ARGENTINA

----Original Message----

From: Jon Gross <jgross@projectgrad.org>

To: Mark Wiedman <Mark.Wiedman@do.treas.gov>; Mike Grunwald <grunwaldmr@washpost.com>;

Anuj Gupta <agupta@mba1998.hbs.edu>; Eddy Daniels <eddy.daniels@enron.com>

Sent: Mon Dec 17 23:20:54 2001

Subject: FW: ENRON ADMITS IT'S REALLY ARGENTINA

----Original Message----

From: jmgross [mailto:jmgross@icademy.com] Sent: Thursday, December 13, 2001 5:48 PM

To: Robert Vincent; Catherine Markman; Jonathan Gross

Subject: Fw: ENRON ADMITS IT'S REALLY ARGENTINA

Too funny, on the slight chance you haven't already received this.

ENRON ADMITS IT'S REALLY ARGENTINA Now Massive Ineptitude, Corruption Make More Sense, Analysts Say

Houston, Texas - Collapsed due to gross mismanagement and insurmountable debt, energy company Enron today confessed to what many observers had long suspected: it is actually Argentina.

Congressional leaders, who have called for an investigation into the biggest corporate failure in U.S. history, immediately dismissed Enron's claim, but Argentinians weren't so sure. "The shady deals. The crazy debt. I knew there was something familiar about those guys," said Banco del Argentina director Ernesto Caballo.

Enron chairman and CEO Kenneth Lay, speaking through an interpreter via phone from Buenos Aires, apologized for any confusion the subterfuge may have caused, and noted that as a sovereign nation, the company was immune from U.S. prosecution. Lay also insisted that he had not "fled" to Argentina, but had returned home to the capital to visit "mi familia."

While not directly stating it, Lay also hinted that he might in fact be Argentinian President Fernando de la Rua. Reached in Buenos Aires, de la Rua admitted he couldn't rule that out. "Things are pretty crazy around here. Who can say?"

But Enron creditors, clients, and shareholders, who stand to lose billions over their exposure to the company, weren't buying any of it.

"While they may act like it, they are not a South American country, and Ken Lay is not the President of Argentina," declared J.P. Morgan Chase spokesman Alex Firtilly. "They are a malfeasant U.S. corporation that has potentially caused us to lose \$500 million. And Ken Lay is from Missouri."

"¿Como?," Lay replied. "No hablo Ingles."

Recently ranked as high as No. 7 on the Fortune 500 list of the largest U.S. companies, Enron literally ran itself into the ground by fudging its books, making secretive deals that enriched company insiders, and relying too heavily on debt. Though it was formed in 1986 with the merger of Houston Natural Gas and InterNorth, Enron became Argentina only recently, said Lay, "on the advice of our attorneys."

That counsel came none too soon. As a South American state, all pending U.S. and European lawsuits are rendered harmless. And the company escapes what had been a daily fusillade of scorn from its former home.

Indeed, much as the French were baffled by America's obsession with President Clinton's sexual affairs, many South Americans say they don't understand why Enron and its leaders have been vilified. As former Colombian President Ernesto Samper explained: "In the United States, you look at corruption as an abomination We look at it as an art."

EXTRADITION DENIED

The U.S. State Department has refused to recognize Enron as Argentina, and a spokesman said the Bush administration has officially requested the extradition of Lay and the officers who allegedly fled with him. Argentina, however, denied the request, explaining that an entire country cannot be extradited. And besides, they added, Lay had pledged to help pay off the nation's \$132 billion debt.

Asked where the bankrupt Enron got such a sum, Lay explained that after proclaiming its nationhood status, the company had received an emergency IMF loan. An IMF spokesman later confirmed the payment.

"From what we knew of their fiduciary practices, Enron appeared to have all the hallmarks of a typical IMF fundee," said IMF communications director Nestor Svingen. "At first, we did balk when they asked for \$232 billion, but when they explained that some of the money would go to repay overdue IMF loans, we thought, 'Oh, that's all right then.'"

"Not that we actually expect to see any money from anyone," Svingen added. "It's just this little game we all play. Great fun if you like numbers. Do you enjoy quadratic equations? I could do them all day."

Asked what Enron/Argentina had pledged to do with the extra \$100 billion it requested, Svingen said the application had specified funding for "civic infrastructure improvements."

"That usually means the president is going to build a palace," Svingen explained.

Tracking:

Recipient

Cetina, Jill

Delivery

Delivered: 12/18/01 9:55 AM

Read

Read: 12/18/01 9:56 AM

From:

Carleton, Norman

Sent:

Wednesday, December 05, 2001 7:18 PM

To:

Cetina, Jill; Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Eichner, Matthew; Gabilondo, Jose: Gross, Jared; Hammer, Viva; Lori Sanatamorena (E-mail); Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Whaley, Jean; Wiedman,

Subject:

FT: Enron probe will examine industry-wide impact

Enron probe will examine industry-wide impact

By Gwen Robinson in Washington and Andrew Hill in New York

Published: December 5 2001 19:22 | Last Updated: December 6 2001 00:03

US lawmakers signalled on Wednesday that investigations into the Enron case would go beyond the collapse of the energy trader and dig deep into the implications for companies, markets and the accountancy profession.

Investigators from the House of Representatives energy and commerce committee - one of the most powerful congressional panels - will meet Enron officials on Thursday in Texas as part of their probe into the company, which filed for bankruptcy protection on Sunday.

Billy Tauzin, the Louisiana Republican who chairs the committee, said his investigators "intend to be very aggressive" and would begin hearings next month.

"This is just the beginning," said an official involved with the hearings. "These issues go way beyond Enron to securities law and financial markets regulation - and the role of auditors."

"Too many people were hurt by this," Mr Tauzin said, adding that he wanted to know how Enron manipulated accounting procedures and would examine the impact of the company's failure on energy markets.

Although Mr Tauzin said he could not say right away whether Congress needed to take action, an official involved with the probe predicted that "at the very least" it would lead to tighter regulation of accountants and ensure more transparency in commodities trading.

The "Big Five" accountancy firms including Andersen, Enron's auditor, issued a joint statement on Wednesday that responded to growing criticism over the the quality and objectivity of Andersen's audits and promised to react to the implications of the Enron collapse.

The energy committee, which conducted a comprehensive investigation into last year's controversy over defective Firestone tyres on Ford Explorer vehicles, is promising an equally thorough inquiry into Enron.

The committee's investigators met on Wednesday with the Financial Accounting Standards Board and senior executives of Andersen. Wednesday's talks with Enron in Texas will centre on the company's accounting procedures and its relationship with Andersen. The committee this week asked Enron and the SEC to hand over documents on the company's accounts and the SEC's investigation.

Michael Oxley, the Republican chairman of the House financial services committee, said on Tuesday that two of its subcommittees would "move past the headlines and get the facts on Enron" in their joint hearings planned for next Wednesday.

Meanwhile, Enron continues to hive off non-core operations. PwC, which is acting as the administrator for Enron Europe, said it intended to sell the group's European metals, commodity trading and credit derivatives business, having agreed the sale of Enron Direct, the UK-based gas

and power supplier, on Tuesday.

At the same time, the parent company is trying to salvage its stricken core north American trading business. UBS, the Swiss banking group and JP Morgan Chase have both registered an interest in forming a joint venture.

The latest of at least two dozen lawsuits was filed on Wednesday against Enron executives and board members, together with a request for an order to freeze their assets.

Bill Lerach, lead attorney for the new suit said: "Our investigation is revealing to us the fraud thus far disclosed was the tip of the iceberg."

Additional reporting by Elizabeth Wine and Sheila McNulty

_						
т	ra	•	k i	n	n	

Recipient	Delivery	Read
Cetina, Jill	Delivered: 12/5/01 7:18 PM	Deleted: 1/3/02 10:55 AM
Bair, Sheila	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 6:41 PM
Berardi, Steve	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 8:04 AM
Bitsberger, Timothy	Delivered: 12/5/01 7:18 PM	Deleted: 12/12/01 8:28 AM
Eichner, Matthew	Delivered: 12/5/01 7:18 PM	Read: 12/5/01 10:07 PM
Gabilondo, Jose	Delivered: 12/5/01 7:18 PM	Read: 12/7/01 8:57 AM
Gross, Jared	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 8:07 AM
Hammer, Viva	Delivered: 12/5/01 7:18 PM	
Lori Sanatamorena (E-mail)		
Nickoloff, Peter	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 9:50 AM
Novey, Michael	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 10:18 AM
Pietrangeli, Fred	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 8:16 AM
Roseboro, Brian	Delivered: 12/5/01 7:18 PM	Read: 12/6/01 9:17 AM
Schultheiss, Heidilynne	Delivered: 12/5/01 7:18 PM	Read: 12/10/01 1:55 PM
Whaley, Jean	Delivered: 12/5/01 7:18 PM	Read: 12/11/01 10:18 AM
Wiedman, Mark	Delivered: 12/5/01 7:18 PM	

The New York Eimes

January 10, 2002

Enron Chairman Gave Warning to Bush Officials on Company's Collapse

By THE ASSOCIATED PRESS

Filed at 12:57 p.m. ET

WASHINGTON (AP) — Enron (news/quote) Chairman Kenneth L. Lay reached out to two of President Bush's Cabinet officers when the energy company was collapsing, the White House disclosed Thursday as the Justice Department opened a criminal investigation of Enron's bankruptcy.

Bush, who received significant campaign contributions from Lay and other Enron executives, said he himself has never discussed Enron's financial problems with its embattled corporate chairman. The president said he last saw Lay in Texas at spring fund-raiser for former first lady Barbara Bush's literacy foundation.

Lay also was among a group of some 20 business leaders who came to the White House early in the Bush administration to discuss the state of the economy, Bush said.

Many Enron employees lost their life savings when the company filed for bankruptcy Dec. 2.

"What anybody's going to find out is that this administration will fully investigate issues such as the Enron bankruptcy, to make sure we can learn from the past and make sure workers are protected," Bush said.

But Lay did seek the ear of other top-level administration officials last fall.

According to White House press secretary Ari Fleischer, Lay telephoned Treasury Secretary Paul O'Neill amid Enron's collapse ``to advise him about his concern about the obligations of Enron and whether they would be able to meet those obligations."

Lay also told O'Neill that Enron "was heading to bankruptcy," Fleischer said.

O'Neill received calls from Lay on Oct. 28 and Nov. 8, said Treasury spokeswoman Michele Davis. It was on Oct. 16 that Enron made its stunning disclosure of a \$638 million third-quarter loss.

In a separate phone call to Commerce Secretary Don Evans, Lay similarly worried that the company might have to default on its obligations. He brought to the secretary's attention "that he was having problems with his bond rating and he was worried about its impact on the energy sector," Fleischer said.

After that conversation, Evans spoke to O'Neill ``and they both agreed no action should be taken to intervene with their bond holders," Fleischer said.

TECHNOSCOUT TECHNOLOGY UPDATES How to make your car

How to make your car invisible to radar and laser

Natural de-icer means you'll have to shovel less this winter

Carry 20 GB of data in your shirt pocket

A floor lamp that spreads sunshine all over a room

Easily change from TV to VCR to DVD to Video Games with the touch of a button

Digital camera, webcam and camcorder all in the size of a pen

It's time to put all of your photos onto your computer

Time zone to time zone never set your watch again

Click for the complete story

Advertisement

Enron Chairman Gave Warning to Bush Officials on Company's Collapse

The spokesman had said Wednesday he did not know of anyone in the White House who discussed Enron's financial situation.

Fleischer also brushed aside talk of any conflict in the Justice Department investigation and said there was no reason to turn the probe over to a special counsel.

Lay gave \$25,000 to a leadership committee headed by then-senator and now Attorney General John Ashcroft, according to the Center for Public Integrity.

An attorney for Enron welcomed Ashcroft's inquiry, the latest in a series of governmental probes into the company's demise, saying the investigation would `bring light to the facts."

"We want to get to the bottom of this too," said Robert Bennett, a Washington attorney representing the Houston-based company. "A lot of decent and honorable people work at Enron and we should wait until the facts are out."

Bush ordered a separate review Thursday of pension and corporate disclosure rules that could jeopardize workers' savings. "There has been a wave of bankruptcies that have caused many workers to lose their pensions and that is deeply troubling to me," Bush said.

The Justice Department is forming a national task force to look into the company's dealings. The group will be headed by lawyers at the department's criminal division and include prosecutors in Houston, San Francisco, New York and several other cities, said a Justice Department official, speaking on condition of anonymity.

The official declined to say when the investigation began. Enron faces civil investigations by the Labor Department and the Securities and Exchange Commission and subpoenas from congressional committees.

All are looking into the energy trading company's collapse, the largest bankruptcy filing in U.S. history.

The failure hit employees and investors hard. Workers were prohibited from selling company stock from their Enron-heavy 401(k) retirement accounts as the company's stock plummeted. Many lost their life's savings.

Enron executives cashed out more than \$1 billion in stock when it was near its peak.

Former Enron chief executive Jeffrey Skilling, who left the helm nearly two months before the company's swift descent, welcomes the investigation, said spokeswoman Judy Leon. Skilling has said he had no idea, despite Enron's falling stock values, that the company was on the brink of failure.

Formed in 1985, Enron had 20,000 employees and was once the world's top buyer and seller of natural gas and the largest electricity marketer in the United States. It also marketed coal, pulp, paper, plastics, metals and fiber-optic bandwidth.

One likely focus of the Justice Department investigation is possible fraud based on Enron's heavy reliance on off-balance-sheet partnerships which took on Enron debt. The partnerships masked Enron's financial problems and left its credit ratings healthy so it could obtain the cash and credit crucial to running its trading business.

The Houston-based company went bankrupt after its credit collapsed and its main rival,

file://C:\WINDOWS\Temporary%20Internet%20Files\OLK3031\Enron%20Chairman%20Gave%20Warning... 1/16/02

Enron Chairman Gave Warning to Bush Officials on Company's Collapse

Dynegy Inc. (news/quote), backed out of an \$8.4 billion buyout plan late last year.

Just a year ago, stock of Enron, the nation's largest buyer and seller of natural gas, traded at \$85 per share. Today it is less than \$1.

Lay has close ties to Bush and his father, the former president. Lay was a top contributor to the younger Bush's 2000 presidential campaign.

The company played a key role earlier this year when a White House task force met with business executives and other interests to fashion a national energy policy. The task force was headed by Vice President Dick Cheney.

^-----

On the Net:

http://www.enron.com

http://usdoj.gov

Copyright 2002 The Associated Press | Privacy Information

From:

Carleton, Norman

Sent:

Wednesday, November 21, 2001 1:23 PM

To:

Gabilondo, Jose

Subject:

FW: Bloomberg: Enron Gets Extension on \$690 Mln Note Due Next Week (Update1)

-----Original Message-----

From:

Carleton, Norman

Sent:

Wednesday, November 21, 2001 1:14 PM

To:

Roseboro, Brian; Bair, Sheila; Gross, Jared; Wiedman, Mark; Cetina, Jil; Sharer, James; Pietrangeli, Fred; Berardi, Steve; Whaley,

Jean; Nickoloff, Peter; Schultheiss, Heidilynne; Novey, Michael; Hammer, Viva; Eichner, Matthew; Bitsberger, Timothy

Subject:

Bloomberg: Enron Gets Extension on \$690 Min Note Due Next Week (Update1)

11/21 12:38

Enron Gets Extension on \$690 Mln Note Due Next Week (Update1)

By Mark Johnson

Houston, Nov. 21 (Bloomberg) -- Enron Corp., whose shares had dropped 92 percent this year amid a financial crisis, said lenders extended to mid-December the payment date on a \$690 million note due next week.

Enron, which agreed to be bought out by rival energy trader Dynegy Inc. in a transaction now valued at more than \$23 billion, said earlier this week a drop in its credit rating may force it to repay the \$690 million note. The repayment would strain cash reserves Enron needs to back its trading operations, investors and analysts said.

The Houston-based company didn't say in its release who holds the note, which is owed by an affiliated partnership that owns Brazilian natural-gas assets and was backed by Enron.

The note is held by a group of banks led by the Citibank unit of Citigroup Inc., Standard & Poor's said in a press release yesterday.

Enron also is in discussions with other lenders on a restructuring of its debt, the company said in a statement distributed by PR Newswire.

"We believe the interests of Chase and Enron's other primary lenders are aligned in this restructuring effort," James Lee, vice president of JP Morgan Chase & Co., said in the Enron statement. "We will work with Enron and its other primary lenders to develop a plan to strengthen Enron's financial position up to and through its merger with Dynegy." Morgan has been advising Enron on its merger with Dynegy.

Enron said yesterday it may have to pay \$9.15 billion in debt due by 2003, suggesting the company may run out of cash before the merger closes. Dynegy has said the merger should close before the end of the third quarter of 2002.

Enron said in a regulatory filing that it has less than \$2 billion in cash or credit lines.

Shares of Enron, the most active stock in U.S. trading, fell \$1.79, or 23 percent, to \$5.20 in midday trading. Before the announcement that it had renegotiated the \$690 million note, its shares had fallen as much as 42.78 percent, the lowest level in more than a decade.

Dynegy fell \$2.50, or 6 percent, to \$39.20. Shares of ChevronTexaco Corp., which owns 26 percent of Dynegy, rose 49 cents to \$87.02

ra kin :

e ipient

Deli er

ead

abilondo, Jose

Delivered 11 21 01 1 23 PM

Read 11 23 01 9 46 M

From:

Carleton, Norman

Sent:

Tuesday, November 20, 2001 4:44 PM

To:

Gross, Jared

Subject:

FW: Bloomberg: Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

----Original Message-

From:

Carleton, Norman

Sent:

Tuesday, November 20, 2001 4:41 PM

To:

Roseboro, Brian; Bair, Sheila; Bitsberger, Timothy

Subject:

Bioomberg: Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

11/20 16:05

Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

By Stacie Babula

Houston, Nov. 20 (Bloomberg) -- Enron Corp. shares and bonds dropped after the energy trader disclosed it may have to pay \$9.15 billion in debt due by 2003, suggesting the company may run out of cash before its takeover by Dynegy Inc. can be completed.

Shares of Enron fell \$2.05, or 23 percent, to \$7.01. Earlier they touched \$6.55, the lowest price in more than a decade. Enron's 6.4 percent notes due in July 2006 were bid as low as 69 cents on \$1 of face value and offered at 73 cents, down more than 13 percent in light trading, traders said.

Enron, whose dealings with affiliated partnerships led to earnings restatements, credit-rating cuts, a federal investigation and a management shakeup, said in a regulatory filing that it has less than \$2 billion in cash or credit lines. Dynegy plans to complete its buyout by October, and Enron may have to ask lenders to restructure payment schedules to survive.

"This filing shows that Enron is in a precarious financial situation," said Commerzbank Securities analyst Andre Meade, who rates Enron shares "hold" and doesn't own them. "They have to stay afloat for the Dynegy deal to go through, and that now looks difficult."

Enron and Dynegy wouldn't comment on the stock drop today. Standard & Poor's Investors Service said that Enron's credit rating remained on negative watch, indicating it would not immediately downgrade the company's debt.

\$690 Million Surprise

"Enron's near-term liquidity position is. . . expected to be sufficient to carry the company through the completion of its proposed merger with Dynegy," S&P said in a report.

Investors were concerned the debt, including a \$690 million note that Enron disclosed it may have to pay off next week, would lead to a cut in Enron's credit rating, analysts said.

The filing was a "distraction" that will not threaten the merger, said Todd Shipman, a director at S&P who follows Enron.

"Our approach to this has been on the basis that the Dynegy deal is a good thing for credit quality," Shipman said.

Moody's Investors Service, which didn't issue a statement on Enron's debt today, kept the company's credit rating at investment grade on Nov. 9, the day Dynegy announced it would buy Enron in a deal now valued at \$25 billion.

The ruling came after executives from Lehman Brothers Holding Inc., J.P. Morgan Chase & Co. and Citigroup Inc.'s Salomon Smith Barney lobbied the credit-rating company, people familiar with the situation said.

Avoiding Junk

A junk rating would have led Dynegy to abandon the acquisition, Dynegy Chief Executive Officer Charles Watson said. It would also have triggered debt repayment of at least \$3.9 billion, Enron said in a Securities & Exchange Commission filing vesterday.

Enron shares are selling for almost 32 percent less than the value of Dynegy's offer, showing investors have doubts the deal will be completed. Dynegy shares fell \$1.90 to \$41.70 today.

"It's become more clear that the chances of this deal going through aren't 90 percent, but much closer to fifty-fifty," said Edward Paik, who helps manage the Liberty Utilities Fund, with 1.6 million Enron shares. "There's just so much information that is unknowable" about Enron's financial position, he said.

Most of the \$9.15 billion in debt is due before the end of the third quarter, when the Dynegy buyout is scheduled to close, Enron said yesterday in a third-quarter filing with the SEC.

Asset Sales Planned

Last week, Enron Chief Operating Officer Greg Whalley said the company will sell assets of "non-core businesses" to raise money. It has \$8 billion invested in the businesses, including broadband telecommunications and the Dabhol power plant in India. Enron expects to get "billions" from the sales, Whalley said, without being more specific.

Enron reported yesterday that its U.S. operations had \$1.2 billion in cash left. It has added at least \$5 billion since Sept. 30 from credit lines, loans and a \$1.5 billion investment from ChevronTexaco, part owner of Dynegy.

Enron used \$1.9 billion of the money it raised to retire commercial paper, which is short-term debt. It gave no details on how it spent the remaining \$3.1 billion.

Enron Chief Financial Officer Jeffrey McMahon said last week that the company also was looking to get another \$500 million to \$1 billion from private investors.

Asset sales valued at about \$800 million are expected to close by the end of this year, according to the SEC filing. Enron spokeswoman Karen Denne wouldn't comment on whether it could sell assets fast enough to keep current on its debts.

Dynegy will have to help Enron sell assets, said Mitchell Stapley, who manages \$3.5 billion in fixed-income assets including Enron bonds for Fifth Third Investment Advisors Inc.

Dynegy and ChevronTexaco Corp., which owns 26 percent of Dynegy, also will have to help Enron negotiate with its lenders, said Kathleen Vuchetich, who helps manage the \$1.4 billion Strong American Utilities Fund, which is 5 percent Dynegy shares.

Debt Questioned

"I never dreamt (the \$9.15 billion) would be that large, coming due all at once," Vuchetich said. "It calls into question their decision to schedule it that way in the first place."

ChevronTexaco, the second-largest U.S. oil company, is providing \$2.5 billion in cash as part of the Enron buyout. It provided the first \$1.5 billion a week ago.

Shares of ChevronTexaco, based in San Francisco, rose \$3.62 to \$86.53.

Enron yesterday reduced third-quarter results by 3 cents a share, bringing the period's loss to 87 cents, or \$664 million. On Nov. 8, Enron lowered earnings back to 1997 by \$586 million to reflect losses by affiliated partnerships that were wrongly kept off the books. That included a third-quarter reduction of \$17 million.

A drop in Enron's senior unsecured debt rating to "BBB-" by Standard & Poor's on Nov. 12 may force Enron to pay off a \$690 million note by Nov. 27 if it doesn't find collateral to guarantee the debt taken on by an affiliated partnership that owns Brazilian natural-gas assets, the filing said.

Without repayment or collateral, investors can begin to liquidate the partnership's assets, Enron said. The company said it's working with lenders to come up with an acceptable agreement on the debt.

Making good on debt owed by its Whitewing affiliated partnership may cut Enron's fourth-quarter earnings, Enron said. Enron is obligated to back Whitewing by issuing junior convertible preferred stock. Because Enron's stock has plunged, it may have to write down its assets by \$700 million, the filing said.

©2001 Bloomberg L.P. All rights reserved. <u>Terms of Service http://www.bloomberg.com/tos.html, <u>Privacy Policy http://www.bloomberg.com/trademarks.html</u>, and <u>Trademarks http://www.bloomberg.com/trademarks.html.</u></u>

Trac ing:

ecipient Gross, Jared

De

Deli ery

Delivered: 11/20/01 4:44 PM

ead

ead: 11/20/01 4:53 PM

From:

Carleton, Norman

Sent:

Wednesday, November 21, 2001 1:23 PM

To:

Lori Sanatamorena (E-mail)

Subject:

FW: Dow Jones Newswires: Enron Closes On \$450M Secured Credit Line

----Original Message---

From:

Carleton, Norman

Sent:

Wednesday, November 21, 2001 1:22 PM

To:

Bair, Sheila; Berardi, Steve; Bitsberger, Timothy; Cetina, Jill; Eichner, Matthew; Gabilondo, Jose; Gross, Jared; Hammer, Viva;

Nickoloff, Peter; Novey, Michael; Pietrangeli, Fred; Roseboro, Brian; Schultheiss, Heidilynne; Sharer, James; Whaley, Jean;

Wiedman, Mark

Subject:

Dow Jones Newswires: Enron Closes On \$450M Secured Credit Line

November 21, 2001

Enron Closes On \$450M Secured Credit Line

HOUSTON -- Enron Co. (ENE) closed on the remaining \$450 million of a previously announced \$1 billion in secured credit lines and said it is in active discussions to restructure its debt to improve liquidity.

In a press release Wednesday, Enron said the \$450 million credit facility is secured by the assets of Enron's Northern Natural Gas Co.

A \$550 million credit facility, secured by the assets of Enron's Transwestern Pipeline Co., closed Nov. 16. The proceeds are being used to supplement short-term liquidity and to refinance maturing obligations.

The company said the maturity on its \$690 million note payable obligation will be extended to mid-December.

Dow Jones Corporate Filings Alert reported Monday that Enron is currently preparing a restructuring plan aimed at taking aggressive steps to rationalize the company's existing cost structure, accelerating the process of divesting noncore businesses and assets and restructuring scheduled maturities of debt and other obligations.

Enron's credit lines are from J.P. Morgan, the investment-banking arm of J.P. Morgan Chase & Co. (JPM), and Salomon Smith Barney, the investment-banking arm of Citigroup Inc. (C).

Enron also reaffirmed its commitment to the merger with Dynegy Inc. (DYN). On Nov. 9, Enron and Dynegy signed a definitive merger agreement that would give Enron shareholders 0.2685 share of a Dynegy share. The merger is expected to close by the end of the third quarter of 2002.

On Monday, Enron filed its Form 10-Q for the third quarter, which reflected a wider loss by 3 cents a share. The energy company previously reported a loss of \$618 million, or 84 cents a share, on revenue of \$47.6 billion for the third guarter ended Sept. 30.

Stephen Lee; Dow Jones Newswires; 201-938-5400

From: Carleton, Norman

Sent: Wednesday, November 21, 2001 1:22 PM

To: Lori Sanatamorena (E-mail)

Subject: FW: Bloomberg: Enron Gels Extension on \$690 Min Note Due Next Week (Update1)

----Original Message----

From: Carleton, Norman

Sent: Wednesday, November 21, 2001 1:14 PM

To: Roseboro, Brian; Bair, Sheila; Gross, Jared; Wiedman, Mark; Cetina, Jill; Sharer, James; Pietrangeli, Fred; Berardi, Steve; Whaley,

Jean; Nickoloff, Peter; Schultheiss, Heidilynne; Novey, Michael; Hammer, Viva; Eichner, Matthew; Bitsberger, Timothy

Subject: Bloomberg: Enron Gets Extension on \$690 Min Note Due Next Week (Update1)

11/21 12:38

Enron Gets Extension on \$690 Mln Note Due Next Week (Update1)

By Mark Johnson

Houston, Nov. 21 (Bloomberg) — Enron Corp., whose shares had dropped 92 percent this year amid a financial crisis, said lenders extended to mid-December the payment date on a \$690 million note due next week,

Erron, which agreed to be bought out by rival energy trader Dynegy Inc. in a transaction now valued at more than \$23 billion, said earlier this week a drop in its credit rating may force it to repay the \$690 million note. The repayment would strain cash reserves Erron needs to back its trading operations, investors and analysts said.

The Houston-based company didn't say in its release who holds the note, which is owed by an affiliated partnership that owns Brazilian natural-gas assets and was backed by Enron.

The note is held by a group of banks led by the Citibank unit of Citigroup Inc., Standard & Poor's said in a press release yesterday.

Enron also is in discussions with other lenders on a restructuring of its debt, the company said in a statement distributed by PR Newswire.

"We believe the interests of Chase and Enron's other primary lenders are aligned in this restructuring effort," James Lee, vice president of JP Morgan Chase & Co., said in the Enron statement. "We will work with Enron and its other primary lenders to develop a plan to strengthen Enron's financial position up to and through its merger with Dynegy." Morgan has been advising Enron on its merger with Dynegy.

Enron said yesterday it may have to pay \$9.15 billion in debt due by 2003, suggesting the company may run out of cash before the merger closes. Dynegy has said the merger should close before the end of the third quarter of 2002.

Enror said in a regulatory filing that it has less than \$2 billion in cash or credit lines.

Shares of Enron, the most active stock in U.S. trading, fell \$1.79, or 23 percent, to \$5.20 in midday trading. Before the announcement that it had renegotiated the \$690 million note, its shares had fallen as much as 42.78 percent, the lowest level in more than a decade.

Dynegy fell \$2.50, or 6 percent, to \$39.20. Shares of ChevronTexaco Corp., which owns 26 percent of Dynegy, rose 49 cents to \$87.02

From:

Carleton, Norman

Sent:

Tuesday, November 20, 2001 4:51 PM

To:

Lori Sanatamorena (E-mail)

Subject:

FW: Bloomberg: Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

-----Original Message-----

From:

Carleton, Norman

Sent:

Tuesday, November 20, 2001 4:41 PM

To:

Roseboro, Brian; Bair, Sheila; Bitsberger, Timothy

Subject: E

Bloomberg: Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

11/20 16:05

Enron Falls Amid Concern Debt Threatens Dynegy Bid (Update5)

By Stacie Babula

Houston, Nov. 20 (Bloomberg) -- Enron Corp. shares and bonds dropped after the energy trader disclosed it may have to pay \$9.15 billion in debt due by 2003, suggesting the company may run out of cash before its takeover by Dynegy Inc. can be completed.

Shares of Enron fell \$2.05, or 23 percent, to \$7.01. Earlier they touched \$6.55, the lowest price in more than a decade. Enron's 6.4 percent notes due in July 2006 were bid as low as 69 cents on \$1 of face value and offered at 73 cents, down more than 13 percent in light trading, traders said.

Enron, whose dealings with affiliated partnerships led to earnings restatements, credit-rating cuts, a federal investigation and a management shakeup, said in a regulatory filing that it has less than \$2 billion in cash or credit lines. Dynegy plans to complete its buyout by October, and Enron may have to ask lenders to restructure payment schedules to survive.

"This filing shows that Enron is in a precarious financial situation," said Commerzbank Securities analyst Andre Meade, who rates Enron shares "hold" and doesn't own them. "They have to stay affoat for the Dynegy deal to go through, and that now looks difficult."

Enron and Dynegy wouldn't comment on the stock drop today. Standard & Poor's Investors Service said that Enron's credit rating remained on negative watch, indicating it would not immediately downgrade the company's debt.

\$690 Million Surprise

"Enron's near-term liquidity position is. . . expected to be sufficient to carry the company through the completion of its proposed merger with Dynegy," S&P said in a report.

Investors were concerned the debt, including a \$690 million note that Enron disclosed it may have to pay off next week, would lead to a cut in Enron's credit rating, analysts said.

The filing was a "distraction" that will not threaten the merger, said Todd Shipman, a director at S&P who follows Enron.

"Our approach to this has been on the basis that the Dynegy deal is a good thing for credit quality," Shipman said.

Moody's Investors Service, which didn't issue a statement on Enron's debt today, kept the company's credit rating at investment grade on Nov. 9, the day Dynegy announced it would buy Enron in a deal now valued at \$25 billion.

The ruling came after executives from Lehman Brothers Holding Inc., J.P. Morgan Chase & Co. and Citigroup Inc.'s Salomon Smith Barney lobbied the credit-rating company, people familiar with the situation said.

Avoiding Junk

A junk rating would have led Dynegy to abandon the acquisition, Dynegy Chief Executive Officer Charles Watson said. It would also have triggered debt repayment of at least \$3.9 billion, Enron said in a Securities & Exchange Commission filing vesterday.

Enron shares are selling for almost 32 percent less than the value of Dynegy's offer, showing investors have doubts the deal will be completed. Dynegy shares fell \$1.90 to \$41.70 today.

"It's become more clear that the chances of this deal going through aren't 90 percent, but much closer to fifty-fifty," said Edward Paik, who helps manage the Liberty Utilities Fund, with 1.6 million Enron shares. "There's just so much information that is unknowable" about Enron's financial position, he said.

Most of the \$9.15 billion in debt is due before the end of the third quarter, when the Dynegy buyout is scheduled to close, Enron said yesterday in a third-quarter filing with the SEC.

Asset Sales Planned

Last week, Enron Chief Operating Officer Greg Whalley said the company will sell assets of "non-core businesses" to raise money. It has \$8 billion invested in the businesses, including broadband telecommunications and the Dabhol power plant in India. Enron expects to get "billions" from the sales, Whalley said, without being more specific.

Enron reported yesterday that its U.S. operations had \$1.2 billion in cash left. It has added at least \$5 billion since Sept. 30 from credit lines, loans and a \$1.5 billion investment from ChevronTexaco, part owner of Dynegy.

Enron used \$1.9 billion of the money it raised to retire commercial paper, which is short-term debt. It gave no details on how it spent the remaining \$3.1 billion.

Enron Chief Financial Officer Jeffrey McMahon said last week that the company also was looking to get another \$500 million to \$1 billion from private investors.

Asset sales valued at about \$800 million are expected to close by the end of this year, according to the SEC filing. Enron spokeswoman Karen Denne wouldn't comment on whether it could sell assets fast enough to keep current on its debts.

Dynegy will have to help Enron sell assets, said Mitchell Stapley, who manages \$3.5 billion in fixed-income assets including Enron bonds for Fifth Third Investment Advisors Inc.

Dynegy and ChevronTexaco Corp., which owns 26 percent of Dynegy, also will have to help Enron negotiate with its lenders, said Kathleen Vuchetich, who helps manage the \$1.4 billion Strong American Utilities Fund, which is 5 percent Dynegy shares.

Debt Questioned

"I never dreamt (the \$9.15 billion) would be that large, coming due all at once," Vuchetich said. "It calls into question their decision to schedule it that way in the first place."

ChevronTexaco, the second-largest U.S. oil company, is providing \$2.5 billion in cash as part of the Enron buyout. It provided the first \$1.5 billion a week ago.

Shares of ChevronTexaco, based in San Francisco, rose \$3.62 to \$86.53.

Enron yesterday reduced third-quarter results by 3 cents a share, bringing the period's loss to 87 cents, or \$664 million. On Nov. 8, Enron lowered earnings back to 1997 by \$586 million to reflect losses by affiliated partnerships that were wrongly kept off the books. That included a third-quarter reduction of \$17 million.

A drop in Enron's senior unsecured debt rating to "BBB-" by Standard & Poor's on Nov. 12 may force Enron to pay off a \$690 million note by Nov. 27 if it doesn't find collateral to guarantee the debt taken on by an affiliated partnership that owns Brazilian natural-gas assets, the filing said.

Without repayment or collateral, investors can begin to liquidate the partnership's assets, Enron said. The company said it's working with lenders to come up with an acceptable agreement on the debt.

Making good on debt owed by its Whitewing affiliated partnership may cut Enron's fourth-quarter earnings, Enron said. Enron is obligated to back Whitewing by issuing junior convertible preferred stock. Because Enron's stock has plunged, it may have to write down its assets by \$700 million, the filing said.

2

©2001 Bloomberg L.P. All rights reserved. <u>Terms of Service http://www.bloomberg.com/tos.html, <u>Privacy Policy http://www.bloomberg.com/trademarks.html.</u></u>

From:

Carleton, Norman

Sent: To:

Thursday, November 29, 2001 9:31 AM Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Interesting piece in today's NY Times that pins recent spike in vol in Eurodollars & UST market on

Tracking: Recipient

Delivery

Read

Nickoloff, Peter

Delivered: 11/29/01 9:31 AM Read: 11/30/01 9:29 AM Schultheiss, Heidilynne Delivered: 11/29/01 9:31 AM Read: 12/10/01 12:33 PM

-----Original Message-----

From: Cetina, Jill

Sent: Thursday, November 29, 2001 8:36 AM

To: Gross, Jared; Malvey, Paul; Carleton, Norman; Bitsberger, Timothy; Roseboro, Brian; Sobel, Mark; Byrne,

Kathleen; Sharer, James; Quinn, Lois; Dulaney, Tim

Subject: Interesting piece in today's NY Times that pins recent spike in vol in Eurodollars & UST market on

Enron

Had heard participants speculate that something might up with Enron's Eurodollar portfolio but no one I talked to had seen the flow.

Enron's Woes Exacerbate Turmoil

03035

By GRETCHEN MORGENSON

| he swift downfall of Enron (news/quote) has contributed to extreme turbulence in the United States Treasury market in recent weeks, causing violent swings in interest rates not seen since Russia defaulted on its debt and the Long-Term Capital Management hedge fund nearly collapsed in late 1998.

Even though the exact makeup of Enron's large trading portfolio remains a mystery, traders said that the energy company had bet that interest rates would continue to decline because of continuing weakness in the economy.

Then two weeks ago, the economy began to show signs of revival. As investors decided that the days of Federal Reserve rate cuts were over, rates began to rise and prices on Treasury securities fell. The move out of Treasuries crushed traders who still expected the weak economy to push interest rates lower. Scrambling to cut their losses, those traders sold even more, depressing prices and pushing up rates further.

The sense among many market participants is that Enron's woes made a bad market excruciating. "I think the Street in general lost half of its year or more in the last week or two," said Stan Jonas, managing director at Fimat USA, a broker dealer. "Everyone was long the bond market, thinking the economy was going to be bad. Then everything shifted, and Enron drove it to extremes."

How extreme? In the two weeks beginning Nov. 12, two-year Treasury notes plummeted in price, pushing their yields up to 3.18 percent, from 2.41 percent. In the same period, yields on Treasuries with five-year maturities went to 4.4 percent, from 3.62 percent.

The trade that appears to have gone awry for Enron, market

ΕŢ.

Enron Collapses as Suitor Cancels Plans for Merger (November 29, 2001)

Market Place: A Big Fall Evoking Nasty Old Memories participants say, involved the sale of hundreds of thousands of Eurodollar futures, some of which matured in two or three years. Such contracts are frequently used to bet on the direction of interest rates. Enron could also have used the Eurodollar contracts to hedge against fluctuations in oil prices. In a weak economy, oil prices usually fall. But so do interest rates, so a bet on lower rates would produce gains to help offset the decline in oil prices. When data showed signs of life in the economy, traders surmised that Enron began to sell its Eurodollars and started an avalanche of selling among other traders.

There were huge Eurodollar positions being liquidated, said Gemma Wright, director of market strategy at Barclays Capital. "We don't know for certain who it was, but the amount of the loss was high."

One reason that traders suspect Enron may have been forced out of such a position was that the company had neither the cash flow nor the bank credit to meet calls for additional cash from traders at other firms. Typically, companies have cash reserves to meet such calls or have access to temporary lines of credit to cover shortfalls. Enron appears to have neither. Yesterday, the company said it was suspending all payments except for those "necessary to maintain core operations."

In addition to the recent interest rate spike, Enron has had to contend with falling oil prices. The price of crude oil has dropped 28 percent since the end of October.

Caught in a vise, Enron has almost certainly been selling securities to raise cash. Treasury securities and Eurodollar contracts, because their markets are large, are among the easiest to sell. In both cases, Enron was probably selling into a falling market.

Adding to the turmoil in the bond market, traders said, was less participation by Wall Street firms, which were unwilling to take on big new trading positions near the end of their fiscal year. Several firms end their years on Nov. 30.

Some traders say Enron's problems started with comments on Tuesday by Laurence H. Meyer, a governor of the Federal Reserve. Mr. Meyer suggested that additional rate cuts might be coming, and that remark helped stabilize prices of Treasury securities. "It's my view that there are no coincidences," Mr. Jonas said. "Laurence Meyer is a big hawk on interest rates, and he basically talked a 180. That was their big gun. The only bigger gun would have been Greenspan."

of a Run on a Bank (November 29, 2001)

The Chief Executive: Foundation Gives Way on Chief's Big Dream (November 29, 2001)

The Last Resort: A Bankruptcy Filing Might Be the Best Remaining Choice (November 29, 2001)

-The Lenders: Citigroup and J. P. Morgan Are Left With Exposure to Loans (November 29, 2001)

The Rating Agencies: Debt Rankings Finally Fizzle, but the Deal Fizzled First (November 29, 2001)

The Derivatives: Market That Deals in Risks Faces a Novel One (November 29, 2001)

(a)		
×		
×		

Newsletters
Subscribe to
DealBook
Get your free daily

Get your free daily briefing with the latest and most

comprehensive news about the deal-making industry, delivered by e-mail before the market's opening bell

×

Get Stock Quotes Look Up Symbols	
	-
Portfolio Company Researc U.S. Markets Int. Markets Mutual Funds Bank Rates	h

03036

Click here to order Reprints or Permissions of this Article

From: Sent: Carleton, Norman

Wednesday, November 07, 2001 3:05 PM Nickoloff, Peter; Schultheiss, Heidilynne

To: Subject:

DJ: Calpers Board To Meet On Enron Investments Next Week

November 7, 2001

Calpers Board To Meet On Enron Investments Next Week

By Jason Leopold

of DOW JONES NEWSWIRES

LOS ANGELES -- The board of California's Public Employees' Retirement System plans to meet next week to discuss how best to protect its investments in **Enron** Corp. (ENE), a Calpers spokesman said Wednesday.

Calpers, which holds 3 million shares in the Houston energy company and a \$500 million stake in an Enron partnership called Joint Energy Development Investments II, has a history of shareholder activism, but it's too early to speculate on what steps the board may take, spokesman Brad Pacheco said.

Theoretically, the board could decide to take a more activist approach, because the energy company's stock is "underperforming," Pacheco said.

"If a company is underperforming, we focus on the board structure and sit down with the directors of the company and say these are the issues," Pacheco said. "If the company does not cooperate, we increase our shareholder propriety and we could move forward with several actions, including litigation, to say the board has breached its fiduciary responsibility."

Enron's shares fell to a low of \$7 Wednesday before rebounding on a Wall Street Journal report the company was in talks with Dynegy Inc. (DYN) for a cash infusion and potentially a full merger.

Concerns about the company's dealings with off-balance sheet partnerships like JEDI II have driven the decline, which has erased three-quarters of the company's share price since mid-October. Enron's credit ratings have also been downgraded.

Calpers hasn't yet approached **Enron** executives to discuss the plunge in the company's stock and the quality of its investment, Pacheco said.

Last week, California state Sen. Steve Peace, D-El Cajon, wrote Calpers Chief Executive James Burton urging the pension fund to take steps to defend its investment in **Enron**.

"Calpers may play a significantly larger and more active role in the governance of **Enron** to ensure that **Enron** directors do not have conflicting interests, that **Enron** adheres to a policy of full financial disclosure and transparency and that Enron's board is comprised of a substantial majority of truly independent directors who understand their accountability to shareholders," Peace wrote in the Oct. 30 letter.

Calpers' board will discuss the letter in a closed-session meeting scheduled for Tuesday in Pasadena, Calif., but isn't bound to act on it because Peace isn't a boardmember, Pacheco said.

Calpers is the nation's largest public pension fund, with assets totaling approximately \$151 billion. -By Jason Leopold, Dow Jones Newswires; 323-658-3874;

Tracking:

Recipient

Nickoloff, Peter Schultheiss, Heidilynne

Delivered: 11/7/01 3:05 PM Read: 11/7/01 3:12 PM Delivered: 11/7/01 3:05 PM Read: 11/7/01 3:05 PM

From:

Carleton, Norman

Sent:

Wednesday, August 22, 2001 10:13 AM

To:

Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Enron article (2)

Tracking: Recipient

Delivery

Nickolaff, Peter

Delivered: 8/22/01 10:13 AM Read: 8/22/01 10:15 AM Schultheiss, Heidilynne Delivered: 8/22/01 10:13 AM Read: 8/28/01 8:50 AM

-----Original Message-----

From: Norman Carleton [mailto:Norman.Carleton@worldnet.att.net]

Sent: Thursday, August 16, 2001 11:43 PM

To: Norman Carleton; norman.carleton@do.treas.gov

Subject: Enron article (2)



AUG 16, 2001

Enron Head Seeks to Reassure Staff

By REUTERS

Filed at 4:48 p.m. ET

HOUSTON (Reuters) - The chairman of Enron Corp. (news/quote) (ENE.N) on Thursday sought to reassure employees that the energy giant's business was on firm footing as its stock faced a second day of brutal pressure on Wall Street, following a top executive's shock resignation.

Kenneth Lay told employees at a companywide meeting that Enron's business was strong, despite the extended pressure on its stock and heir apparent Jeff Skilling's unexpected resignation as president and chief executive officer.

Lay, who was met with a standing ovation when he took the podium, touched on a wide variety of topics during the 90-minute meeting during which he took questions and presented financial data he said proves the company is strong.

"We've got a lot of great stuff going on and we're not getting much credit for it in the marketplace, but we will," Lay said. "I do think the next several months and few years are going to be great for Enron."

His comments came as Enron's stock saw its worst day in 19 months, closing down \$3.40 or 8.5 percent at \$36.85 on the New York Stock Exchange. That brings its losses to roughly 13 percent since Skilling announced his resignation after the market's close Tuesday.

Lay said he believed the energy giant's stock can sustain a price-to-earnings (P-E) multiple of 25-30 going forward. It is about 20 right now, based on Wednesday's close.

"I think the current business model can easily justify a 25-30 P-E, with the current business model and in the current market," Lay said. "We can't get that 40-50 P-E back until we get our return on capital investment up."

1/16/02

Enron enjoyed the higher multiples as recently as March, but then the stock began an extended slump that saw it lose about half its value.

WHO REPLACES SKILLING?

Though Lay took Skilling's duties over, he told employees that he expected to fill the void Skilling left in the office of the chairman in the next few days. Skilling, 47, was chief operating officer before Lay handed him the CEO reins in February, and the COO position has remained unfilled since then.

The executive or executives who assume the operational role Skilling had will largely be seen as the new heir or heirs apparent to Lay, 59. Enron earlier said it would increase the office of the chairman, which previously was occupied by Lay and Skilling, to include Lay and two understudies.

"Certainly, there is a hole in the office of the chairman, and we will be addressing that very soon. I think I told some people yesterday that we were looking to do something probably in the next couple of days," Lay said.

Lay reiterated that the succession will be internal, but did not elaborate on which executives he would choose.

MANY GLOBAL ASSETS TO GO

The best way to return Enron's stock to its headier levels will be to get a higher return on capital investment, he said. Enron hopes to glean billions from a sale of low-yield global assets, which it will then pour into highreturn businesses, Lay said.

"The quickest way to do that is to monetize some of these assets," Lay said. "That doesn't mean we're going to monetize all of them."

He said Enron will still be very active in Europe, Japan, Australia and other countries, and may start working in developing countries at some point in the future.

Lay took more than a dozen questions from the audience, with topics ranging from work-a-day issues like how close cubicles will be spaced in Enron's new office building to the issue of what recourse there is for employees who have stock options that are priced in the \$80 range.

While he rebuffed a re-pricing of those options because "stockholders hate that," he did say all employees would be issued a new round of options that are priced at current levels.

Touching on another recent issue, Lay said Enron was in advanced talks to sell Oregon utility subsidiary Portland General, which was to be sold to utility Sierra Pacificfor \$3.1 billion until regulatory issues scuttled the deal.

"We have another transaction that is pretty far advanced and it might be a transaction where we would even maintain some ownership interest in that business for some time. But it's not far enough advanced to talk about right now," Lay said, not revealing the name of the potential buyer.

Asked if Enron's broadband arm would suffer more layoffs if was not successful by year's end, Lay said he thought ``the odds of that are very, very small." Lay said 500 people were taken out of Enron's broadband operation, with about half being laid off and the rest being redeployed within the company.

The underperformance of the broadband business, which coincided with the broad collapse of the telecommunications market, is among several problems that have dogged Enron lately.

They include a costly payment fight with the Indian government over the \$3 billion Dabhol power plant, the vilification of Enron by California politicians who blame Texas companies for their power crisis, and the breakup of a marquee video on-demand broadband Internet deal with Blockbuster Inc. (news/quote) (BBI.N).

Answering an employee question, Lay said there was no truth to a rumor that Royal Dutch/Shell RD.AS (SHEL.L) was planning a hostile takeover of Enron because of the stock's recent weakness.

From:

Carleton, Norman

Sent:

Wednesday, August 22, 2001 10:12 AM

To:

Nickoloff, Peter; Schultheiss, Heidilynne

Subject: FW: Enron article

Tracking: Recipient

Delivery Read

Nickolaff, Peter

Delivered: 8/22/01 10:12 AM Read: 8/22/01 10:13 AM

Schultheiss, Heidilynne Delivered: 8/22/01 10:12 AM Read: 8/28/01 8:54 AM

----Original Message----

From: Norman Carleton [mailto:Norman.Carleton@worldnet.att.net]

Sent: Thursday, August 16, 2001 11:39 PM

To: Norman Carleton; norman.carleton@do.treas.gov

Subject: Enron article



AUG 15, 2001

Enron's Chief Executive Quits After Only 6 Months in Job

By RICHARD A. OPPEL Jr. with ALEX BERENSON

ALLAS, Aug. 14 — Jeffrey Skilling, the chief executive of the Enron Corporation (news/quote), stunned Wall Street today by announcing that he would quit after just six months in the job, calling the move a "purely personal decision."

But the abruptness of the departure left many analysts questioning whether a series of setbacks the company has suffered played a part in the decision.

Kenneth Lay, Enron's 59-year-old chairman, will step back into the position he left early this year after 15 years as chief executive.

Mr. Lay, who originally recruited Mr. Skilling to Enron, said tonight that he had agreed to stay on through the end of 2005 to "make sure we've got plenty of time to work out an orderly succession."

Mr. Skilling, 47, had been at the heart of the transformation of Enron from an old-line natural gas pipeline company to the biggest and most aggressive of the new breed of unregulated energy traders that buy and sell billions of dollars of electricity and other commodities daily.

That strategy helped Enron's stock price soar during the last decade. But this year the company's shares have fallen sharply, as Enron has suffered from problems with its new broadband telecommunications trading unit, its investment in a large power plant in India, and criticism from officials in California, who blame Enron and other energy companies fo the collapse of the state's electricity market.

A former energy consultant at McKinsey & Company who joined Enron in 1990, Mr. Skilling built its energy-trading operations into the company's most profitable unit, accounting for nearly \$1.7 billion - or 85 percent - of operating income last year. He became president and chief operating officer in 1997, and in February of this year became chief executive.

03045

1/16/02

On a conference call, Mr. Skilling said he could not "stress enough that this has nothing to do with Enron." He added that "the reasons for leaving the business are personal, but I'd just as soon keep that private."

Mr. Skilling, who is divorced, has joint custody of three teenage children — a daughter, 17, and two sons, 14 and 11 — with his ex-wife. Mr. Skilling, who will leave the board but will serve as a consultant to the company, will not receive any severance package because his departure is voluntary, Mr. Lay said.

Since May 2000, Mr. Skilling has sold at least 450,000 Enron shares worth at least \$33 million, according to Securities and Exchange Commission filings. He still owns about 1.1 million shares, the filings show.

"Absolutely no accounting issue," Mr. Lay told analysts, "no trading issue, no reserve issue, no previously unknown problem issues" are behind the departure. There will be "no change in the performance or outlook of the company going forward," he added.

He also said the company was on track to meet analysts' earnings expectations, which are about \$1.80 a share this year and \$2.15 next year.

On the call, Mr. Skilling said that "in general there have been a lot of issues" that have buffeted the company this year, but he said that he believed Enron had already surmounted most of them. "Now is the time" to step down, he said, "because I think we've got a lot of these things behind us."

Nonetheless, the move jolted analysts, who, despite the stock's recent slide and the company's other problems, saw Mr. Skilling as the unquestioned leader to follow Mr. Lay.

In after-hours trading, shares of Enron fell about 8 percent, to \$39.55. That fall follows a plunge of almost 50 percent since January in the stock, which had closed in regular trading at \$42.93, up 78 cents. The news of the executive changes came after the market closed.

"I'm surprised and I'm stunned," said Philip K. Verleger, an energy economist with the Brattle Group, a consulting firm in Cambridge, Mass. "Skilling was the guy who executed the growth in the trading business."

Investors have become increasingly concerned that a surge in new power plant construction will lead to a glut of electricity within a few years and lower the value of Enron's role as a middleman between plant owners and electricity users. In addition, the company's efforts to enter the water business have fared poorly, and its broadband trading operation has become a cash drain.

Mr. Skilling's promotion early this year came after several crucial Enron executives resigned. These included Rebecca Mark, who at one time was considered a rival for the top job.

Ms. Mark became chief executive of the Azurix Corporation (news/quote) in 1999 after Enron spun off the company, its global water business. But its financial performance was disappointing, and Ms. Mark left the company last year. Enron later agreed to buy back Azurix stock for less than half what public shareholders had paid.

From: Sent:

Carleton, Norman

To:

Thursday, December 06, 2001 4:37 PM Nickoloff, Peter; Schultheiss, Heidilynne; Bitsberger, Timothy; Gross, Jared; Wiedman, Mark;

Cetina, Jill; Novey, Michael; Eichner, Matthew; Hammer, Viva

Subject:

DJ: Europe's 1st Exchange-Traded Weather Futures Launch Mon

Decemb	er 6,	2001
--------	-------	------

Europe's 1st Exchange-Traded Weather Futures Launch Mon

By MARK LONG

Of DOW JONES NEWSWIRES

LONDON -- The first exchange-traded weather futures in Europe start trading Monday, adding to the host of products that are springing up around deregulating energy and agricultural markets in the region.

The London International Financial Futures and Options Exchange, or Liffe, said Thursday that it acknowledged activity will be modest on the first day, but it remains confident that energy and insurance companies will boost liquidity and encourage interest from other sectors down the line.

Liffe said last month that it was to launch the first exchange-based weather futures market on Dec. 10 in order to provide a means for the many industries affected by weather to manage risk.

The U.K. Meteorological Office suggested last month that U.K. firms could save more than GPB7.6 billion a year if they were able to fully mitigate the effects of weather on their business, according to Liffe's Thursday briefing for reporters.

The initial listing of six Liffe weather futures contracts will be settled against the monthly and winter season indexes which Liffe introduced earlier this year.

The Liffe monthly weather indices are based on the mean of the daily average temperature for every calendar day of the month for each of three locations: London Heathrow, Paris Orly and Berlin Tempelhof. The index is expressed from a basis of 100 to ensure positive figures.

For the monthly weather futures contracts, twelve delivery months will be available at any one time and the first delivery months available to trade will be January to December 2002, inclusive.

For winter season contracts, two delivery months will be available starting with winter 2002, stretching from November-March.

The Liffe weather futures contracts are valued at GPB3,000, or EUR3,000, per one degree change. The tick size is 0.01, or one hundredth of a degree Celsius, giving each tick a value of GPB30 or EUR30.

So, a U.K. company could buy 50 lots of the January contract at 105 to hedge against warmer weather. If the January temperature is two degrees warmer than average - making the index 107 - the company would make GPB300,000. (50 lots times 200 index points times GPB30.) This could help offset, for example, a lower price received for the electricity it wanted to sell in the same timeframe.

The contracts will be cleared through the London Clearing House, "which gives a great deal of comfort to those market participants," said Ian Dudden, director of non-financial products for Liffe.

Exchanges all over the energy and commodities sectors have been quick to point out the higher credit quality they offer relative to over-the-counter participants like Enron Corp. (ENE), which spectacularly collapsed last week leaving many of its counterparties badly exposed.

While energy and insurance companies are expected to dominate early weather trading activity, the retail, travel and tourism, agricultural and leisure sectors are expected to follow suit.

In addition, products more tailored to specific market sectors, based on the Liffe trading system, may be designed by others in the future, Dudden said.

There is no intention to have larger participants acting as market makers in weather futures initially, Dudden said, adding the exchange will be constantly evaluating the response to the trading system and adjusting methods accordingly.

Also, Liffe will seek to add additional weather trading markets in the U.S. and Asia. These markets would likely have summer season contracts in addition to winter season contracts.

"This is really about building the market," Dudden said. "As we do that it'll become more and more apparent where we need to channel our energies. This is not the sort of market where you can dip one toe in and then jump right out again."

-Mark Long; Dow Jones Newswires; +44 (0)20 7842 9356; mark.long@dowjones.com

Troop	io ii	-	-84	
Trac	ŊΙ	п	u	

Delivery	Read
Delivered: 12/6/01 4:37 PM	Read: 12/6/01 4:37 PM
Delivered: 12/6/01 4:37 PM	Read: 12/10/01 2:00 PM
Delivered: 12/6/01 4:37 PM	Read: 12/11/01 6:11 PM
Delivered: 12/6/01 4:37 PM	Read: 12/6/01 5:07 PM
Delivered: 12/6/01 4:37 PM	
Delivered: 12/6/01 4:37 PM	Deleted: 1/3/02 10:55 AM
Delivered: 12/6/01 4:37 PM	Read: 12/6/01 4:37 PM
Delivered: 12/6/01 4:37 PM	Read: 12/6/01 6:15 PM
Delivered: 12/6/01 4:37 PM	
	Delivered: 12/6/01 4:37 PM Delivered: 12/6/01 4:37 PM

From: Sent:

Carleton, Norman

To:

Tuesday, November 13, 2001 12:51 PM Nickoloff, Peter; Schultheiss, Heidilynne; Cetina, Jill; Sharer, James; Adams, Fred; Pietrangeli,

Fred; Berardi, Steve; Anderson, Helen; Ludwick, CM; Whaley, Jean

Subject:

Nice work if you can get it

Enron CEO May Get at Least \$60.6 Million After Buyout (Update2)

By Margot Habiby

Houston, Nov. 13 (Bloomberg) -- Enron Corp. Chairman and Chief Executive Officer Kenneth Lay may get \$60.6 million or more in severance if he leaves after Enron's sale to Dynegy is completed, according to a regulatory filing.

Lay is entitled to receive a lump sum payment equal to \$20.2 million, multiplied by the number of full calendar years remaining on his contract, if he terminates his employment under certain circumstances, such as the acquisition by Dynegy, Enron said in a filing with the U.S. Securities and Exchange Commission.

Dynegy says its buyout of Enron, the biggest energy trader, is expected to close in 2002's third quarter. Lay's contract expires at the end of 2005. His contract provides that he also receive an amount to cover tax penalties if the payment he gets is considered an "excess parachute payment," the SEC filing said.

Enron agreed on Friday to be acquired by rival Dynegy for at least \$23 billion in stock and assumed debt, ending a financial crisis that threatened to bankrupt Enron and disrupt U.S. power and natural-gas markets. Lay has said he won't be an active manager in the new company, which will be led by Dynegy Chairman and CEO Chuck Watson.

Lay's contract was extended by two years, to the end of 2005, when he resumed the CEO's job following the departure of Jeffrey Skilling in August. If Enron's buyout by Dynegy were to close this year, or if there were another form of "change of control" at Enron, Lay may receive \$80.8 million, the Enron filing indicates.

Pay Package

Enron more than tripled Lay's pay package last year to \$18.3 million following the company's best share-price performance in 20 years, according to a proxy filed in March with the SEC. Enron shares have plunged 90 percent this year. Lay made \$5.97 million in 1999, according to Enron's proxy statement filed with the SEC.

Lay also received options to buy 782,830 shares over seven years, most at \$47,31 each, the March filing said. Those options are now worthless because Enron's stock price is below the price at which they could be exercised. Lay had gains of \$123.4 million from the exercise of options in 2000.

Enron's has been battling a cash crunch and a loss of investor confidence this year because of questions about partnerships it started and put under the control of its senior executives.

After the Enron acquisition, top managers at Dynegy will include Dynegy's Steve Bergstrom as president and chief operating officer, Dynegy's Robert Doty as chief financial officer and Enron's Greg Whalley as executive vice president. Whalley is Enron's president and chief operating officer.

Shares of Enron rose 21 cents to \$9.45 in midday trading. Dynegy rose 91 cents to \$45.22. Both companies are based in Houston.

-	in

e ipient	eli ery	ead
Nickoloff, Peter	Delivered 11 13 01 12 51 PM	Read 11 13 01 12 55 PM
Schultheiss, Heidilynne	Delivered 11 13 01 12 51 PM	Read 11 13 01 1 31 PM
Cetina, Jill	Delivered 11 13 01 12 51 PM	Read 11 13 01 1 09 PM
Sharer, James	Delivered 11 13 01 12 51 PM	Read 11 13 01 1 19 PM
Adams, Fred	Delivered 11 13 01 12 51 PM	Read 11 13 01 12 52 PM
Pietrangeli, Fred	Delivered 11 13 01 12 51 PM	Read 11 13 01 12 51 PM
Berardi, Steve	Delivered 11 13 01 12 51 PM	Read 11 13 01 12 52 PM

1

e ipient	eli ery	ead
Anderson, Helen	Delivered 11 13 01 12 51 PM	Read 11 13 01 2 25 PM
Ludwick, CM	Delivered 11 13 01 12 51 PM	Read 11 13 01 1 12 PM
Whaley, Jean	Delivered 11 13 01 12 51 PM	Read 11 13 01 12 52 PM