Joint Report on Retail Swaps

As Required by Section 105(c) of the Commodity Futures Modernization Act of 2000

Board of Governors of the Federal Reserve System

Department of the Treasury

Commodity Futures Trading Commission

Securities and Exchange Commission

December 2001

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on Retail Swaps

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Commodity Futures Modernization Act of 2000

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Board of Governors of the Federal Reserve System
Department of the Treasury
Commodity Futures Trading Commission
Securities and Exchange Commission

December 26, 2001

The Honorable J. Dennis Hastert
Speaker of the House
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Speaker:

We are pleased to transmit our report on retail swaps as required by the Commodity Futures Modernization Act of 2000 ("CFMA").

The CFMA directed the Board of Governors of the Federal Reserve System, the Secretary of the Treasury, the Commodity Futures Trading Commission, and the Securities and Exchange Commission (the "agencies") to study issues regarding the offering of swap agreements to retail customers, principally small businesses and individuals.

Specifically, the study was to address the potential uses of swap agreements by retail customers; whether financial institutions are willing to offer such swap agreements; the appropriate regulatory structure, if any, to address customer protection issues with respect to the offering of such swap agreements; and other matters the agencies deemed necessary or appropriate to address. The agencies interviewed several potential market participants whose views are described in the report.

The CFMA also directed the agencies to submit a report to Congress on the findings and conclusions of the study, along with any recommendations for legislative action.

As indicated in the report, the agencies do not recommend legislative action at this time for swap agreements offered to retail customers.

Staff of the Federal Deposit Insurance Corporation, the Federal Reserve Bank of New York, and the Office of the Comptroller of the Currency worked with the agencies during the study and participated in the preparation of the enclosed report.

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We appreciate the opportunity to convey this report to you.

Sincerely,

Alan Greenspan
Chairman
Board of Governors of the Federal Reserve

Paul H. O'Neill
Secretary
Department of the Treasury

James E. Newsome
Chairman
Commodity Futures Trading Commission

Harvey L. Pitt
Chairman
Securities and Exchange Commission

Board of Governors of the Federal Reserve System
Department of the Treasury
Commodity Futures Trading Commission
Securities and Exchange Commission

December 26, 2001

The Honorable Richard B. Cheney
President of the Senate
United States Senate
Washington, D.C. 20510

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JOINT REPORT ON RETAIL SWAPS

As Required by Section 105(c) of the Commodity Futures Modernization Act of 2000

I. INTRODUCTION

The Commodity Futures Modernization Act of 2000 ("CFMA") requires the Board of Governors of the Federal Reserve System ("Board"), the Secretary of the Treasury ("Treasury"), the Commodity Futures Trading Commission ("CFTC"), and the Securities and Exchange Commission ("SEC") to conduct a study of issues involving the offering of swap agreements to persons other than eligible contract participants.[1] This Report responds to the CFMA's requirement that the agencies submit to Congress by December 21, 2001, the findings and conclusions of the study and their recommendations on whether any legislative action is necessary and appropriate.

A primary purpose of the CFMA was to create a clear legal foundation and regulatory framework for many types of over-the-counter ("OTC") derivatives transactions entered on a principal-to-principal basis between "eligible contract participants" ("ECPs") as defined in Section 1a(12) of the Commodity Exchange Act ("CEA").[2] Parties that do not qualify as ECPs include individuals who do not have total assets in excess of $10 million (or $5 million if they enter swap agreements for risk management) and non-financial entities that do not have total assets in excess of $10 million (or net worth in excess of $1 million if they enter swap agreements in the ordinary conduct of business or for risk management). For purposes of this study, non-ECPs are "retail customers," and swaps offered to them are "retail swaps."

Since its enactment, the CFMA has excluded OTC swap agreements and other specified derivatives transactions between domestic and foreign financial institutions, broker/dealers, insurance companies, commodities firms, and other ECPs from most of the CEA. The CFMA's limitation of this exclusion to ECPs was consistent with the recommendation of the President's Working Group on Financial Markets that OTC swap agreements between institutional counterparties generally should not be subject to the CEA.[3]

The CFMA did not address the legal or regulatory status of swap agreements with retail customers, with the exception of clarifications to a provision of the CEA known as the Treasury Amendment, which excluded certain transactions in foreign currency, government securities, and

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[1] Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554 – Appendix E, §105(c), 114 Stat. 2763A-365 (2000).

[2] 7 U.S.C. §1a(12).

[3] President's Working Group on Financial Markets, *Report on Over-the-Counter Derivatives Markets and the Commodity Exchange Act* (November 1999).

other specified financial instruments from the CEA.[4] Specifically, the CFMA explicitly excluded OTC foreign currency futures and options transactions offered to retail customers by certain federally and state-regulated entities from most provisions of the CEA.[5]

This Report does not cover retail swap agreements in foreign currency because Congress has addressed these transactions in the CFMA's revisions to the Treasury Amendment. However, in the CFMA, Congress did not address CEA issues involving retail swap agreements on underlying assets or instruments not covered in the clarifications to the Treasury Amendment.[6] Instead, Section 105(c) of the CFMA posed the following topics for the agencies to investigate in the study:

1. The potential uses of swap agreements by persons other than eligible contract participants.

2. The extent to which financial institutions are willing to offer swap agreements to persons other than eligible contract participants.

3. The appropriate regulatory structure to address customer protection issues that may arise in connection with the offer of swap agreements to persons other than eligible contract participants.

4. Such other relevant matters deemed necessary or appropriate to address.

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[4] 7 U.S.C. §2(c). Prior to the CFMA, there was disagreement concerning the scope of a provision of the CEA known as the "Treasury Amendment," which provided an exclusion from the CEA for foreign currency transactions. The CFMA provided clarity to this issue. With respect to government security transactions, futures on government securities which trade on an organized exchange are subject to the jurisdiction of the CFTC. 7 U.S.C. §2(c)(2)(A). Other transactions in government securities, regardless of the nature of the counterparties, are excluded from most provisions of the CEA. 7 U.S.C. §2(c)(1).

[5] OTC futures and options transactions in foreign currency offered to or entered into with retail customers are excluded from most provisions of the CEA if the counterparty is a regulated bank, a registered broker-dealer or futures commission merchant ("FCM") or affiliate thereof, or one of a number of other federally or state-regulated entities. 7 U.S.C. §2(c)(2)(B). However, such transactions remain subject to certain provisions of the CEA, including antifraud, if entered into by an FCM or affiliate of an FCM that is not also one of the other enumerated entities. 7 U.S.C. §2(c)(2)(C).

OTC foreign currency futures and options transactions offered to or entered into with retail customers by all other entities are subject to the CEA and the CFTC's jurisdiction, as provided in the amended CEA, as are foreign currency futures and options transactions executed or traded on an organized exchange (other than foreign currency options executed or traded on a national securities exchange, which are subject to SEC jurisdiction).

[6] Analysis of whether any particular types of retail swaps are subject to the CEA or any other federal laws falls outside the scope of the study required by Congress and this Report.

To investigate these topics, the agencies interviewed representatives of derivatives dealers (including commercial and investment banks and a non-financial firm), a derivatives trading system, and a trade association on August 1 and 2, 2001, in New York. Institutions were selected based on the nature and scope of their derivatives activities and their interest in expressing views on the questions posed. Appendices 1 and 2 of this Report contain a list of interviewed institutions and a copy of interview questions.

Part II of this Report consists of a summary of what the agencies learned from these interviews. Part III sets forth the agencies' conclusions and recommendations. Appendix 3 has been prepared by Treasury Department staff in order to address tax issues associated with retail swap agreements. Staff of the Federal Deposit Insurance Corporation, the Federal Reserve Bank of New York, and the Office of the Comptroller of the Currency worked with the agencies during the study and participated in the preparation of this Report.

II. SUMMARY OF INTERVIEWS

In general, the interviewees stated that they are satisfied with Congress's clarification of the applicability of the CEA to derivatives activity in the CFMA. Therefore, most interviewees are not currently advocating legislative action or a regulatory framework with respect to retail swaps, since they have no current interest in entering into this business. They indicated that there does not appear to be either any demand for retail swaps at present or any financial incentive for firms to offer retail swaps, in light of the array of alternative products currently available.

Two of the interviewees expressed an interest in retail swaps. One firm expressed an interest in providing energy derivatives as a hedging vehicle for small businesses and individuals that do not meet the requirements to be ECPs and indicated a belief that there is demand for such a product. Another firm indicated a philosophical belief that current law is too restrictive and that swaps should be available to non-ECPs.

A. Potential Uses of Retail Swaps

Among the potential uses for swap agreements by non-ECPs that the interviewees identified in the course of the study are the following.

1. Equities

The interviewees generally observed that equity derivatives may be used for two purposes: to hedge an existing position in an individual equity security or to create synthetic exposure to one or more individual securities or security indices.

Hedging. OTC equity derivatives are frequently used to hedge exposure to adverse price movements in a security, typically when the counterparty has a concentrated position in the security that it does not wish to liquidate, perhaps due to tax consequences, or when the counterparty is unable to liquidate a position in a security due to transfer restrictions under federal securities laws. Although such counterparties typically meet the statutory criteria for ECPs, one interviewee suggested that the growing number of "dot-com" millionaires in the late 1990s could potentially have generated interest in the development of equity derivatives products for holders of restricted securities that own net assets of between $1 million and $5 million.

Several of the interviewees noted, however, that firms generally do not recommend the use of swap agreements to hedge positions in individual equity securities because of tax considerations.[7] Under the Internal Revenue Code, they said, entering into a swap agreement to hedge an appreciated financial position, such as equity that has risen in value since being acquired, may be deemed a constructive sale. If substantially all the economic risk of the underlying financial position is eliminated, the holder is required to recognize any gains for tax purposes. Consequently, the commercial and investment banks interviewed indicated that they typically advise persons seeking to hedge partially or reduce exposure to an equity position to enter into OTC options contracts, based on their view that the use of such contracts may not always trigger a taxable event. They also indicated that this strategy does not raise CEA issues, since options on securities are considered "securities" under the federal securities laws and are not subject to the CEA.

Synthetic Exposure. The interviewees also noted that OTC equity derivatives could be used to gain exposure to a security in lieu of purchasing or selling the security directly. It might be advantageous to use an equity derivative for this purpose, in their view, if greater leverage could be obtained (as compared to a traditional margin account), or if the cost of executing, clearing or settling trades in the underlying security or securities were comparatively expensive, as in the case of the component stocks of a security index or securities in certain non-U.S. markets.

Several interviewees questioned, however, whether retail investors would be able to use retail swaps for these purposes. Some interviewees expressed the view that swap dealers were unlikely to permit retail investors to obtain significantly greater leverage using a swap agreement than by purchasing or selling the underlying security or a standardized derivative instrument in a traditional margin account, largely because of credit concerns. For example, some of the commercial and investment banks interviewed indicated that they typically require their customers to collateralize the derivative contract with the securities they are seeking to hedge.

Some interviewees opined that, in light of the relative cost of negotiating and entering into swap agreements,[8] individually-tailored swap agreements might not be cost effective for all

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[7] The discussion of tax issues in this section of the Report reflects the comments of interviewees, and no inference should be drawn concerning whether the Treasury Department agrees or disagrees with the opinions or analyses of tax issues expressed by the interviewees. A discussion written by Treasury Department staff of tax issues of relevance to retail swaps can be found in Appendix 3.

[8] See discussion in Part II.B below.

but the highest net worth individuals and institutional investors as a means of establishing a synthetic exposure. The commercial and investment banks interviewed also generally noted that retail investors currently have access to a wide variety of securities and derivatives products to gain exposure to equity securities, including equity-linked notes, warrants, exchange-traded funds, mutual funds, exchange-traded options and, likely in 2002, exchange-traded security futures.

2. Interest Rate Products

Several interviewees noted that there was very little demand for interest-rate swap agreements at present except among institutions and high net worth individuals that already qualify as ECPs. For example, one firm remarked that, to the best of its representatives' recollections, it had never entered into fixed income swaps with an entity that owned or had under management less than $100 million in assets.

Some interviewees said that non-ECPs could potentially use interest-rate swap agreements to obtain the benefit of more favorable interest rates on household or small business expenses, such as mortgage or consumer debt, separately from the underlying loan. These interviewees added, however, that at the present time, it is convenient for non-ECPs to refinance a mortgage or transfer consumer debt, and the ability to enter into an "unbundled" swap agreement would not appear to offer retail customers a cost-effective or convenient alternative.

3. Energy

Several interviewees stated that non-ECPs may have an interest in swap agreements on energy products, such as electricity, natural gas, and heating oil, as a tool to assist small businesses and households in controlling energy costs. One firm further indicated an interest in offering such contracts as a third party – *i.e.*, to provide risk management transactions for such commodities without also supplying the underlying commodity.

This firm noted that, as a result of the deregulation of the energy markets in certain states, households and businesses have entered into forward contracts for full or partial energy requirements with competing energy providers at fixed or capped prices. It was further noted that, in localities where physical delivery of energy products may be restricted because of regulatory or operational constraints, cash-settled swap agreements have in some cases been available for ECPs in order to provide them a means to hedge their exposure to price fluctuations. Accordingly, small businesses and, to some extent, households that are not ECPs may similarly desire to enter into swap agreements in order to control their energy costs when forward delivery contracts are not available; in this firm's view, current uncertainty about the status of such contracts under the CEA has hindered their development.

Some interviewees, however, opined that the current tax treatment of gains and losses on swap agreements entered into by individuals (and outside the context of conducting a trade or business) to hedge energy costs may make such agreements less attractive. They indicated that while gains on energy swap agreements would be fully taxable, losses on these swaps either would not be deductible or would qualify as a miscellaneous deduction, which are only deductible to the extent total miscellaneous deductions exceed two percent of adjusted gross income.[9]

In summary, all but two of the interviewees reported that there does not appear to be significant demand for retail swaps at present, with one firm specifically stating that there was retail interest in swap agreements with respect to energy products. The interviewees generally noted that retail customers currently have access to a wide range of derivative instruments and other alternatives to swap agreements to meet their financial needs, for example, for purposes of hedging or gaining exposure to particular securities or interest rates. To the extent that non-ECPs might seek to use swap agreements to protect against adverse price movements with respect to household or business expenses (*e.g.*, interest rates, energy prices), several interviewees suggested that in most circumstances it would be cheaper and more convenient for non-ECPs to purchase such protection together with the underlying loan or commodity, rather than in a separate transaction.

B. Extent to Which Institutions Are Willing to Offer Swap Agreements to Persons Other than ECPs

According to most of the interviewees, derivatives market participants are not generally planning to offer swap agreements to retail customers at present, apart from the interest there may be in offering retail swaps with respect to energy products. In general, the interviewees noted that firms currently have no commercial interest in offering swaps to retail customers because there is no demonstrable demand for them. Lack of demand is apparently sufficient to preclude any desire on the part of these institutions to explore issuance of these instruments, thus obviating the need to analyze legal issues.

In responding to any customer demand for such products that might arise in the future, some interviewees identified specific considerations derivatives firms would need to address generally in developing and marketing swap products to non-ECPs. In particular, to the extent that non-ECPs were to prefer retail swaps over existing alternatives because of specific perceived advantages – such as greater flexibility – firms would have to consider the costs associated with providing those features in a retail context. These include, for example, administrative issues associated with negotiating retail swaps, the potential credit risks of offering retail swaps to non-ECPs, and the need to implement sales practices for the offering of swap agreements to non-ECPs.

Administrative Issues. Four interviewees specifically indicated that administrative and technological issues related to the entering into and preparing the documentation of retail swaps would have to be considered in developing a profitable business model for such products. For example, to make offering of retail swaps feasible from an administrative and technological

[9] This issue is discussed in Appendix 3.

perspective, swap dealers may need to standardize retail swaps significantly. Standardization could facilitate the swap dealer's management of exposure and enable it to take advantage of economies of scale in marketing and distribution. On the other hand, one firm suggested that the principal advantage of swap agreements over existing standardized or exchange-traded instruments is their flexibility, in that they could be structured to meet specific customer objectives. Accordingly, it appears that one challenge for firms in determining the feasibility of offering retail swaps is the potential tension between the desire to mitigate infrastructure costs by standardizing terms of retail swaps and the need to offer products that would meet the financial objectives of specific retail customers.

Creditworthiness. Three interviewees specifically noted that swap dealers would have to consider the ability to monitor the creditworthiness of non-ECPs in developing a viable retail swap product for retail customers, particularly in light of the expected size and profitability of retail transactions. Several of the commercial and investment banks interviewed indicated that, in the context of their existing swap business with ECPs, they employ extensive risk management practices to control their credit exposure to counterparties. These practices usually include, among other things, extensive analysis and monitoring of the counterparty's financial status by a credit committee or similar body, in light of particular transactions being contemplated.

Sales Practices and Appropriateness. Two of the firms interviewed specifically noted that derivatives firms would need to develop adequate sales practice procedures to assess the appropriateness of swaps for retail customers to protect themselves against the risk of private litigation or, where applicable, regulatory enforcement proceedings. Many of the commercial and investment banks interviewed indicated that they currently have highly detailed procedures for ensuring the appropriateness of equity options offered to certain ECP clients, such as private banking clients. In evaluating the appropriateness of individual transactions for their existing ECP clients, the commercial and investment banks interviewed indicated that they often produce multiple drafts of term sheets, engage in frequent discussions with the client, and consult with various departments within the firm to ensure thorough analysis.

One firm expressed the view that it would be very difficult, in light of the extensive procedures it currently employs in transactions with ECPs to justify recommending a swap transaction to a retail customer.

Legal Uncertainty. Two interviewees remarked that legal uncertainty was an impediment for the development of retail swaps with respect to energy products. Given the lack of interest in offering other types of retail swaps, however, it does not appear that most institutions have felt the need to analyze comprehensively CEA issues as they might apply to retail swaps.

In this connection, most interviewees strongly advised against taking legislative action regarding the application of the CEA to retail swaps. As discussed in greater detail in Part II.C below, these interviewees believe that legislative action with respect to retail swap transactions, in the absence of evidence of demonstrable retail demand or institutional interest in offering most of these instruments, does not appear justified.

C. Appropriate Regulatory Structure to Address Customer Protection Issues that May Arise in Connection with the Offering of Swap Agreements to Persons Other than ECPs

The interviewees generally believed that it is premature to consider the appropriate regulatory structure to address customer protection issues that may arise in connection with the offering of retail swaps in the absence of demonstrable demand for a retail swaps product. There was a general reluctance among most of the interviewees to address CEA issues legislatively so soon after the enactment of the CFMA, which served to resolve many of the legal issues about which swap market participants had been concerned.

One interviewee noted that creating a regulatory regime for a product that does not as yet exist could have the effect of channeling business into artificial regulatory structures that are unnecessary and do not address the needs of the market place. Another interviewee cautioned that unnecessary legislative or regulatory activity to create such a product might stimulate artificial interest in a product that could, in turn, give rise to abusive marketing or sales practices by unregulated entities.

As noted above, one interviewee indicated that there is interest in offering retail swaps with respect to energy products, for example, to small businesses that do not meet the ECP criteria of the CFMA. With respect to the appropriate manner to address CEA issues for such products, the interviewee did not advocate a legislative solution, nor did it propose the development of a new regulatory regime for these products. Two other interviewees observed that firms interested in offering retail swaps would generally prefer to seek regulatory relief for such products on an case-by-case basis instead of reopening the CFMA for debate in light of the considerations discussed above.

Some firms suggested that there was no need for a specialized regulatory structure to address public policy issues. Likewise, several interviewees expressed concern that a specialized regulatory framework for retail swaps might affect traditional products -- such as contracts that offer price or interest-rate protection in connection with an agreement to provide the underlying commodity or loan -- that are offered subject to existing federal and state regulation. One firm identified the following issues for consideration by policymakers in determining the need for regulation and the appropriate regulatory structure for retail swap products:

- whether there exists, or is any need for, a special federal or state regulatory framework for the underlying instrument, and the extent to which unregulated swaps activity might affect regulated markets for the underlying instrument (*e.g.*, price discovery mechanisms in securities markets);
- whether federal law would preempt the application of state laws to retail swap products;
- whether the party offering a retail swap product is a regulated entity subject to adequate regulation; and

- how regulatory action might result in offshore migration of derivatives activity, and how offshore activity might affect a domestic retail swaps market.

III. CONCLUSIONS AND RECOMMENDATIONS FOR LEGISLATIVE ACTION

The agencies do not believe it is necessary at this time to recommend legislative action for swap agreements offered to persons other than ECPs.

According to the interviewees, persons who are not ECPs seem at this time to have sufficient instruments at their disposal to meet their risk management and investment needs, and there is currently a lack of interest among most major market participants in offering swaps to retail customers. As noted in this report, energy swaps are a possible exception to both findings.

With respect to retail energy swaps, it is possible, upon request by a market participant, that the CFTC could exercise administrative authority as appropriate, on a case-by-case basis, within the limitations of its current statutory jurisdiction under the CEA regarding such requests. In this connection, the CFTC would need to consider, among other issues, the extent of its authority to grant relief, whether the granting of such relief would be in the public interest, and any implication such relief might have on potential state regulation of such products.

If at some future date interest in retail energy swaps increases beyond the scope of the CFTC's authority to address regulatory issues related to these products in a satisfactory manner, Congress may wish at that time to consider the desirability of further legislative action with respect to the legal status of and federal regulation, if any, of retail energy swaps, as they did in the CFMA with respect to OTC transactions in foreign currency with retail customers. If further legislation is considered in the future, in addition to the specific regulatory issues identified by the interviewees, consideration should be given at that time to the economic functions served by retail energy swaps, the public interests to be protected, and the impact of any new regulatory regime on the development of retail products.

Appendix 1
List of Interviewees

Commercial Banks:

Bank of America

JP Morgan Chase & Co.

Investment Banks:

Goldman Sachs Inc.

Lehman Brothers Inc.

Morgan Stanley Dean Witter

Others:

Blackbird Holdings, Inc.

Enron Energy Services, Inc.

International Swaps and Derivatives Association

Appendix 2
List of Interview Questions

1. What do you see as the potential uses of retail swaps?

2. Are you willing to offer retail swaps (or currently doing so)? If not, why not?

    - What types of underlying assets?
    - What type of contracts?
    - In what notional amounts?
    - What types of retail customers? Individuals? Small businesses? Other?
    - What are the risks involved in offering these products? How would you (do you) manage those risks?

3. What is the appropriate regulatory structure to address customer protection issues that may arise in connection with the offering of retail swaps?

    - Is there a need for regulation to protect customers?
    - Should the regulatory structure differ depending on whether the entity offering/booking the swaps is otherwise regulated?
    - Should the regulatory structure differ depending on whether the market for the underlying asset is subject to regulation?

4. What other matters (for example, tax and other regulatory issues) are necessary or appropriate for a study of retail swaps to address?

Appendix 3
The Taxation of Over-the-Counter Derivatives in the Hands of Retail Customers[1]

The following discussion considers the tax issues that may arise if over-the-counter derivatives are made available to persons other than eligible contract participants. Throughout the discussion, the distinction between hedging activities undertaken by retail customers pursuing a trade or business and those undertaken in other contexts is a critical determinant of the applicable tax treatment.

Investment Versus Hedging Activities

Retail customers may enter over-the-counter ("OTC") derivatives contracts for purposes of either investment or hedging.[2] Where the motivation is the opportunity for gain, the transaction may be characterized as investment, and there are essentially no tax issues peculiar to OTC derivatives. Current law addresses the taxation of investment contracts of all kinds in the hands of natural persons, corporations, and pass-through entities such as partnerships. Although a realization-based system favors certain investment products over others, there is no reason to believe that the current system poses any differential obstacles to retail customers entering OTC derivatives contracts for purposes of investment.[3]

Tax Hedges

Current law recognizes the economic importance of business hedges by offering a regime under which taxpayers may reasonably match the timing of gain or loss from an existing exposure with the timing of loss or gain from the hedge. This ability to match timing for tax purposes is critical as, in the absence of special hedging rules, there will often be a mismatch between the timing of the tax consequences of the hedge and the timing of the tax consequences

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1 This appendix was prepared by Treasury Department staff and does not reflect the views of the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, or the Securities and Exchange Commission.

2 As used in this appendix, the term "retail customers" refers to individuals and business that are not eligible contract participants as defined in the Commodity Exchange Act, "investment" includes speculation, and "hedging" is used in its colloquial sense, regardless of whether there is a hedging transaction for tax purposes.

3 A realization-based system imposes tax on the gains from most investment contracts at the time of a "realization" event, typically a sale. For example, tax is assessed on the gains from a stock investment only after the shares have been sold. In contrast, a mark-to-market system imposes tax at regular intervals even if no realization event has occurred. Such systems involve measuring the fair market value of a position at the close of the tax period and calculating tax based on any gain or loss during that period. Only certain instruments and specific classes of taxpayers must mark to market under current law. In addition, if a taxpayer eliminates substantially all of the opportunity for gain and risk of loss from an appreciated financial position, tax on the appreciation may be triggered as if the position had been sold.

from the existing exposure. For example, an airline hedging the cost of jet fuel may do so with a mix of instruments that produces tax consequences for the airline that are taken into account at times that are different from the times when the airline takes its fuel expenses into account for tax purposes. Under the special hedging provisions, a taxpayer may reasonably match the timing of the tax results of the hedge to the timing of the deduction for the fuel expenses.

By also matching the tax character of gains or losses from business hedges with the tax character of the existing exposure, the tax system ensures that both are taxed not only at the same time but also at the same rate. Indeed, in the absence of a provision preventing hedges from producing capital gains and losses, some hedging losses would become temporarily or even permanently nondeductible.

To qualify for this treatment, however, a number of conditions must be satisfied: First, the existing exposure that is hedged must be in the context of a trade or business. Hedges reducing exposure related to personal consumption, including those for household energy usage, are therefore not accorded this treatment.

In addition, only certain types of exposures fall under these provisions. For the hedge to receive the special tax treatment, the existing exposure must be an ordinary item. For example, it may depend on the price of ordinary property, that is, property that does not produce capital gain or loss for tax purposes. Business inventory is perhaps the most obvious example of ordinary property. Capital assets, including stocks and other personal property, fall outside of this category. A tax hedge may also be used to protect against adverse movements in the cost of borrowing or the price underlying other ordinary business expenses. Excluded, however, from the category of permitted exposures are cash flows, whether dividends or business profits.

There is no reason, in principle, why retail customers could not rely on the tax hedge provisions to facilitate business hedging activities that employ OTC derivatives. The requirement that a tax hedge must be in the context of a trade or business, however, excludes significant classes of potential retail customers. For these customers, even if the hedged exposure results in taxable income or deduction, the inapplicability of the tax hedge regime makes possible a mismatch between the timing of the tax consequences of the hedge and the timing of the tax consequences of the hedged exposure.

Non-Deductibility of Payments Pursuant to OTC Derivatives

Hedging outside the context of a trade or business raises another fundamental difficulty. Under current law, non-business retail customers would find that gains with respect to the hedging instrument are generally taxable at the rates applicable to ordinary income,[4] but losses are, at best, only partly deductible. For example, the hedging losses may be subject to the limitations on the deductibility of capital losses or to the total ban on deductions for expenditures for personal consumption. This asymmetric treatment might discourage retail customers from using OTC derivatives to manage risk outside the context of a trade or business.

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[4] Many hedges would produce short-term capital gains and losses.

Under Federal tax law, most OTC derivatives contracts entered by retail customers are "notional principal contracts" ("NPCs"), which are defined as a "financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts."[5] This definition includes many common OTC derivatives designed to hedge exposure to energy prices. Under these derivatives, payments are calculated based on an index derived from energy prices.

Among the cash flows pursuant to NPCs are periodic payments. These payments could, under a typical NPC, flow either from the retail customer to the dealer or from the dealer to the retail customer. Again considering the example of a contract to hedge exposure to energy prices, payments might flow to the retail customer after any month in which actual prices rose above a threshold level specified in the contract. Should prices instead fall below a threshold level, the retail customer would have to make the monthly payment. For those entering such OTC derivatives contracts in the course of a trade or business, payments received would be included in income, and subject to tax at the ordinary rate. Payments made pursuant to the contract would be deductible as a normal business expense.

For those wishing to hedge outside of the context of a trade or business, however, the symmetry would break down.[6] Payments received from the dealer would be included in income and taxed at ordinary rates. On the other hand, payments made to the dealer might not be deductible.[7] The prospect of taxation of payments from the dealer, with no potential offset in the form of deductible payments to the dealer, would reduce the attractiveness of retail OTC derivatives products.

Also of concern from a tax policy perspective is the fact that the asymmetry, which effectively "whipsaws" taxpayers, is effectively eliminated if the hedge is imbedded into an energy sales contract. Once again considering the case of the household energy contract, the asymmetry disappears if an energy supplier contracts with a customer to provide electricity at a fixed rate during a specific period of time. Economically, this arrangement is not different from spot purchases combined with a hedge because the gains and losses on the imbedded hedge are reflected in the fixed price paid for the electricity. When the spot price is low and the fixed price exceeds the spot price, there is in effect a loss on this imbedded hedge. When the spot price is high, the situation is reversed and the imbedded hedge economically produces a gain. In this

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[5] Treas. Reg. § 1.446-3(c)(1)(i).

[6] In addition, hedging outside a trade or business context does not constitute a tax hedge; thus the retail customer is unable to reasonably match for tax purposes the timing of gain and loss from the existing exposure with gain and loss from the hedging instrument.

[7] Even if such payments were deductible, individual income taxpayers are subject to a 2 percent floor on miscellaneous deductions. Unless the amount of such payments, coupled with other miscellaneous deductions such as unreimbursed employee expenses, exceeds 2 percent of adjusted gross income, no deduction is permitted.

case, neither the gain nor the loss on the imbedded hedge is a tax event; so the treatment (or non-treatment) is entirely symmetric. One of the basic principles of good tax policy is neutrality, in the sense that tax concerns should not provide incentives to make a particular choice among economically equivalent transactions. In this case, however, there is a clear tax incentive to purchase both electricity and imbedded risk management from a single supplier, rather than purchasing electricity from one source and risk management from another.

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 loan scandal, 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 1992 Energy Policy Act, which opened the utility companies' wires 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 Scientists and environmental groups in calling for curbs 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 two-person 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.

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The exemption, tucked into broader legislation that established the legality of unregulated 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.

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.

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 subpoena 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."

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 to 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.

December 18, 2001

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.

TOWERGROUP

The Power of Knowledge

eSpeed: Building Scalable and Liquid Markets for the Online Trading Community

027:69S
June 2001
Charlotte L. Needham

Vision

Although gaining credibility has taken some time, the acceptance of online trading means a more efficient marketplace for all players. Demand for online trading of financial and nonfinancial products has grown significantly in recent years by both the buy side and sell side alike. For those who create online marketplaces, more challenges lie ahead, including maintaining liquidity, improving efficiency, straight-through processing, and creating electronic markets for new nonfinancial commodities and futures such as energy, weather, and bandwidth.

Through its relationship with Cantor Fitzgerald, eSpeed has achieved success in the interdealer broker market, leading all electronic interdealer brokers (IDBs) in the trading of US Treasuries. Treasury transaction volume, both electronic and voice-assisted, on the eSpeed system accounted for just over 50% of all trading in the first quarter of 2001, when average daily trading volume was an estimated $94 billion. However, eSpeed's domination of the IDB market ends where the Treasury market ends and other securities markets begin. Since market acceptance of eSpeed's other product lines has yet to develop critical mass, the opportunity for growth may be increasingly difficult. Furthermore, no e-trading system has successfully integrated a wide range of products on a single platform, casting doubt on the ability of any one platform to support in-depth multiproduct trading.

Highlights

- Electronic trading has radically changed the financial securities markets with groundbreaking technology that allows market participants to increase efficiency, improve profits, and reengineer traditional ways of doing business.
- Cantor Fitzgerald has invested over $250 million in electronic trading technology since 1996. In 1999, the firm spun off its technology solutions and the electronic brokering function derived from this investment into eSpeed, a subsidiary in which Cantor Fitzgerald now holds a 55% equity stake.
- By creating a scalable platform through an assortment of strategic alliances, acquisitions, and investments in technology, eSpeed has become a formidable player in the world of electronic trading, touching all sectors of the market: issuers, dealers, online brokers, and retail investors.
- eSpeed faces significant competition from a variety of market participants, ranging from interdealer brokers to broker/dealers to futures exchanges. As challenging as this sounds, the competition actually provides a glimpse of how eSpeed has spanned the breadth of the e-commerce market with its products and services.
- Several market risks jeopardize eSpeed's standing in the electronic trading community, including its heavy reliance on one market, US Treasuries; the limited success of one of its breakthrough products, the Cantor Exchange; its binding relationship with Cantor Fitzgerald; the possible rejection of eSpeed's system by financial and nonfinancial institutions; and potential strategic partners opting for solutions and products from other technology providers.

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TowerGroup believes that eSpeed is embarking on a very ambitious endeavor. Some factions in the market have sought electronic trading systems that support multiple products, capable of tying them into a related strategy, but no such system has emerged. To date, it is clear that the electronic trading models that best support US Treasuries are different from the best systems for corporate bonds, futures, and municipals. Whether any system can effectively integrate multiple products remains to be seen. If these systems are able to attract liquidity, eSpeed will be in a position to lead this effort and become the preeminent provider of electronic trading systems in the world. However, failure to attract liquidity may compromise eSpeed's credibility to further expand its business opportunities beyond the US Treasury market, which is shrinking in the wake of US debt reduction.

Taxonomy

Client | Process | Distribution Channel

Business Drivers

- Electronic trading of financial securities, such as equities, fixed income, and foreign exchange, is gaining ground and will only increase in the future as straight-through processing and other industry protocols are developed.
- Electronic trading perpetuates a more efficient, cost-effective, and liquid marketplace, which benefits all market participants including issuers, financial services institutions, and investors.

Implications

- Dealers' cost of doing business and pursuit of liquidity will drive them to embrace new ways of trading financial and nonfinancial products even if it means working with those they view as competition—i.e., circumstances will force them to engage in "coopetition."
- As global futures and equities exchanges begin consolidating and converging to electronic trading, proven technologies will help make these types of transitions less volatile.

Action Items

- Financial services institutions and venture capital firms need to be more selective regarding the e-commerce companies that they are funding, learning from past mistakes of the e-commerce debacle.

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- Online trading venues should consider the failures as well as the successes in the marketplace, noting that successful e-trading technology solutions have a sustainable revenue model and a scalable technology that is adaptable to a variety of asset classes.

Introduction

The advent of electronic trading of financial securities has radically changed not only the financial markets but also the technology applications that allow market participants to increase efficiency, improve profits, and reengineer the traditional ways of doing business. For institutional and retail brokers, firms of all sizes have their own strategy for participating in e-commerce, whether it is outsourcing technology needs, participating in consortiums of dealers, banks, or industry participants, or creating technology solutions internally. Simply put, in the new world of e-commerce, if a company is not investing in technology solutions for business-to-business (B2B) marketplaces, it will be left behind.

One company with a distinctive approach to this challenge is a traditional interdealer broker, Cantor Fitzgerald, which by making a sizable investment in its internal proprietary trading system, created what it believes is an end-to-end technology solution for B2B marketplaces. Through the establishment of its subsidiary, eSpeed, the firm has both penetrated new vertical markets and expanded on those markets in which it currently operates voice-brokerage businesses. eSpeed's expansion into these marketplaces has been accomplished by means of strategic alliances, technology and financial investments, and a scalable technology solution.

eSpeed's objective—to become the technology solution for the B2B marketplace—has run into several obstacles in its short history, specifically with its first offering, the Cantor Exchange (CX), a futures and options exchange for the dealer market. The CX, now in its third year of operation, generates modest liquidity, yet Cantor Fitzgerald and eSpeed continue to support this failed attempt to successfully attract liquidity in the electronic derivatives trading business. In addition, eSpeed's product suite has grown considerably since it began successfully offering US Treasuries to the interdealer broker (IDB) market. This product growth in non–US Treasury securities and nonfinancial markets may have been too fast to build sufficient liquidity and garner interest among the trading community, since it has not yet achieved a significant amount of liquidity.

This TowerGroup Research Note examines eSpeed's business model, its accomplishments, and its future challenges.

The Creation of eSpeed

Background

In 1996, Cantor Fitzgerald, a leading broker dealer since 1945, decided to make a substantial investment in technology to automate its interdealer financial instrument trading business. To date, that investment has grown to approximately $250 million. Through this investment in technology, an internal trading system was developed, which eventually led to the development of the Cantor Exchange, an electronic exchange for futures trading that began operating in September 1998. The technology in question eventually became a subsidiary called eSpeed.

eSpeed commenced operations as a division of Cantor Fitzgerald on March 10, 1999, and was incorporated in June of the same year. This led to the company's initial public offering on December 10, 1999, when the

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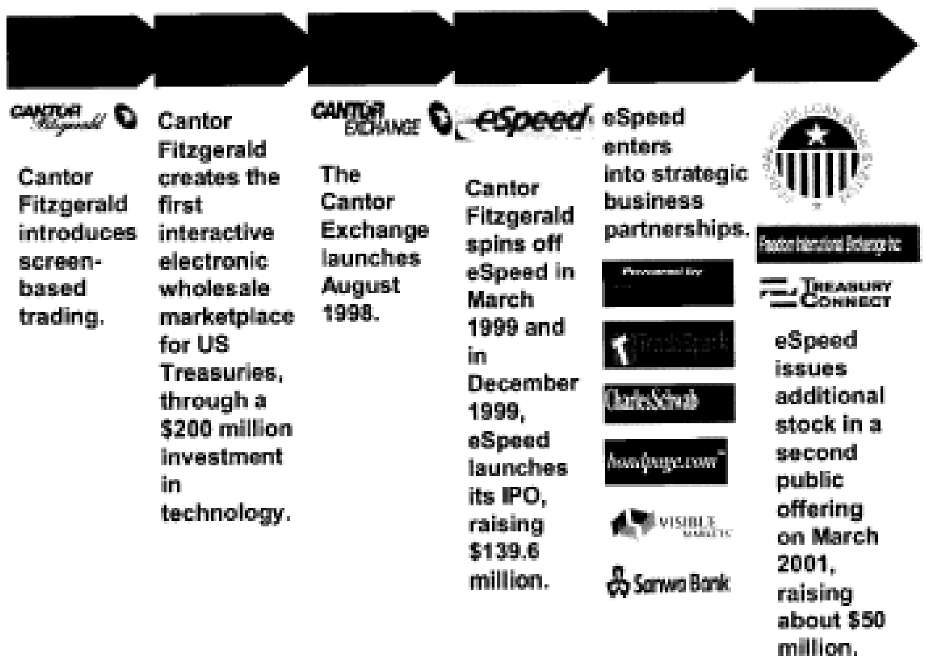
parent company bestowed its proprietary electronic transaction processing software, network distribution systems, and related contractual rights on eSpeed. In return, Cantor Fitzgerald received majority equity ownership of eSpeed as well as technology and electronic trading support. eSpeed received approximately $139.6 million in proceeds from the initial public offering (IPO), which helped expand its market coverage through strategic partnerships, acquisitions, and new investments in technology. Despite its independent status, eSpeed still depends heavily on its parent for voice-broker support, trade volume, and the closing of major investment deals such as the TradeSpark and Freedom International Brokerage transactions (see Exhibit 1).

Exhibit 1

The Evolution of Electronic Trading at Cantor Fitzgerald



Source: TowerGroup

eSpeed's Technology

The initial investment made by Cantor Fitzgerald in 1996 produced a scalable electronic trading engine for trading financial and nonfinancial products electronically in real time through a global distribution network. To protect its proprietary technology and intellectual property, the firm has applied for and received patents and now it licenses that technology to eSpeed for use in the eSpeed system. Some of the patents in question cover a data processing system, the method for electronically trading fixed-income instruments, and a system for shared remote access of multiple application programs by one or more computers.

A core component to eSpeed's auction and transaction engines is its Interactive Matching technology, which is a proprietary rules-based method that provides incentives to participants by allowing the last successful

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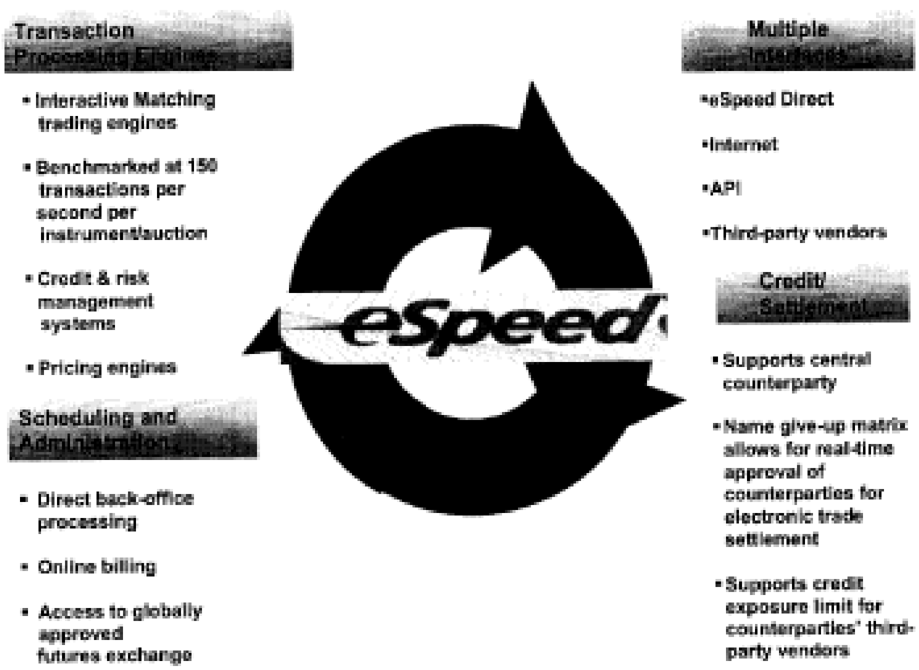
active buyer or seller a time-based right of first refusal on the next transaction, be it a buy or sell. The engines were developed to accommodate anonymous trading in a variety of global markets including the largest, US Treasuries, to one of the more splintered markets, corporate bonds. As a result, the technology created is flexible and thereby adaptable to a broad array of financial and nonfinancial products, including futures, energy, and global debt securities.

The eSpeed system is accessible to over 650 clients via multiple connection channels and in multiple languages. The delivery channels include the Internet, via a Java-based browser; by the eSpeed private network, via eSpeed Direct, an application programming interface (API); or third-party vendors. eSpeed connects its three triangulated data centers and 23 hub cities to multiple client access points with fully redundant leased-line providers (see Exhibit 2).

Exhibit 2
eSpeed Technology



Source: eSpeed

eSpeed's Business Model

eSpeed's transaction-based revenue model depends heavily on leveraging its technology solutions to initiate strategic partnerships and investments in technology. The firm relies on these strategic alliances and investments with a variety of market participants including technology providers, financial and nonfinancial services firms, and issuers. These relationships provide eSpeed with access to technological needs and/or new markets sectors, which in turn provide the firm access to revenue via transaction fees or licensing agreements (see Exhibit 3).

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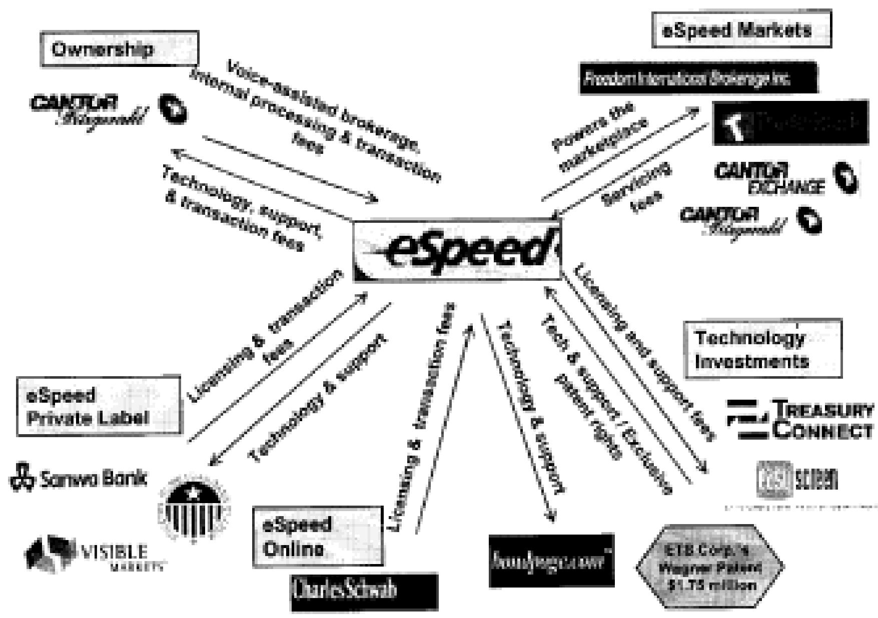
Exhibit 3

Strategic Partnerships Are Key to eSpeed's Business Model



Source: *TowerGroup*

The majority of eSpeed's strategic alliances are derived from its relationships with clients to whom it provides a technology solution for trading in a specific product or market via the eSpeed system. Some of its partnerships include online brokerages Charles Schwab and Scottrade. Others include e-commerce firms looking to build or enhance their systems like Federal Home Loan Bank (FHLB) and Visible Markets. eSpeed benefits from revenue derived from the transaction volume, licensing agreements fees, and the added liquidity to the eSpeed platform.

In addition, strategic technology investments entered into by eSpeed with TreasuryConnect, EasyScreen, and Electronic Trading Systems Corporation (ETS) provide eSpeed with the opportunity to enhance its market coverage as well as increase the chances of future licensing agreements. For instance, EasyScreen, a software designer for electronic trading, provides authorized eSpeed clients with access directly from the eSpeed platform to nine global derivatives exchanges, including London International Financial Futures and Options Exchange (LIFFE), the Chicago Board of Trade/Eurex trading system a/c/e, Chicago Mercantile Exchange (CME), and the Australian Derivatives Exchange. EasyScreen is also creating an interface between its front-end trading software and the CX. For these EasyScreen services and exchange connections, eSpeed pays licensing and support fees and in return receives added derivative users and traffic to its CX. Besides generating revenue, EasyScreen gains global market exposure to eSpeed's global client base.

The Cantor Fitzgerald/eSpeed Relationship. Through the Cantor Fitzgerald/eSpeed owner-subsidiary relationship, the companies entered into several services agreements under which fall provisions for the services and fees each party will provide the other. eSpeed supplies the electronic trading system and is responsible for providing electronic brokerage services and general technology support to its parent. In

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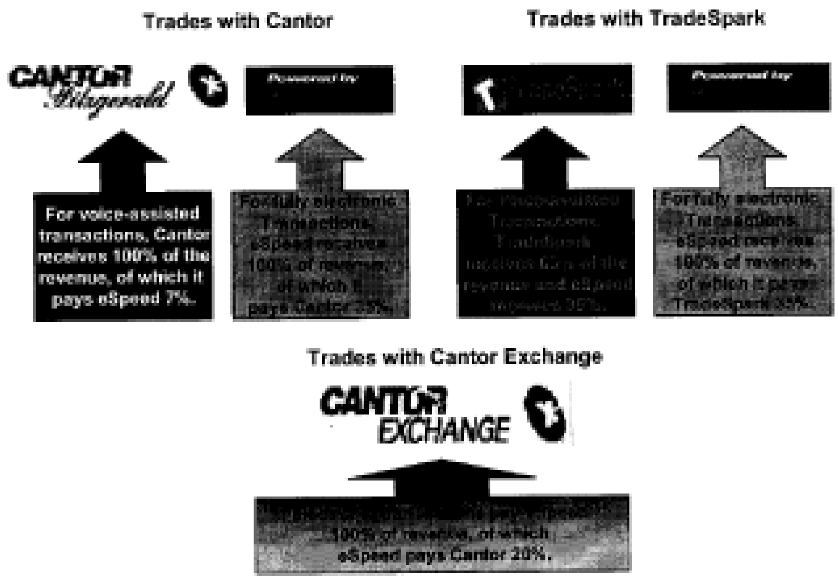
return, Cantor Fitzgerald provides voice-assisted brokerage services, fulfillment services such as clearance and settlement, credit risk management, compliance, and other related services. Per the arrangement, transaction revenues are divided as such: eSpeed takes 100% of the revenues on all electronic transactions and in turn pays Cantor Fitzgerald 35% of the revenue. Vice versa, if Cantor Fitzgerald executes a voice-brokered trade, the firm receives 100% of the revenue and pays eSpeed 7%. Other eSpeed Market relationships such as TradeSpark have similar transaction fee arrangements (see Exhibit 4).

Exhibit 4
eSpeed's Transaction Revenue Model



Source: TowerGroup

The ties between Cantor Fitzgerald and eSpeed run deep, each depending on the other for revenue and its future success. The company's capital infusion and influence have enabled eSpeed to build its system as well as provide liquidity through its voice-brokerage support, which accounts for less than half of eSpeed's order flow.

eSpeed Product Offerings

The eSpeed product offerings leverage the company's technology across a variety of markets, creating strategic alliances within the financial and technology communities. These partnerships result in revenues from the licensing of its technology, and transaction fees generated through trading volumes carry over its electronic trading engine. The eSpeed product offering reflects its attempt to bring liquidity to its trading system while providing technology to market participants that lack the time or capital to build trading systems that cover less profitable, complex, or more illiquid financial and nonfinancial products. These offerings to the e-commerce sector of the financial and nonfinancial industry include eSpeed Markets, eSpeed Software Solutions, and eSpeed Online.

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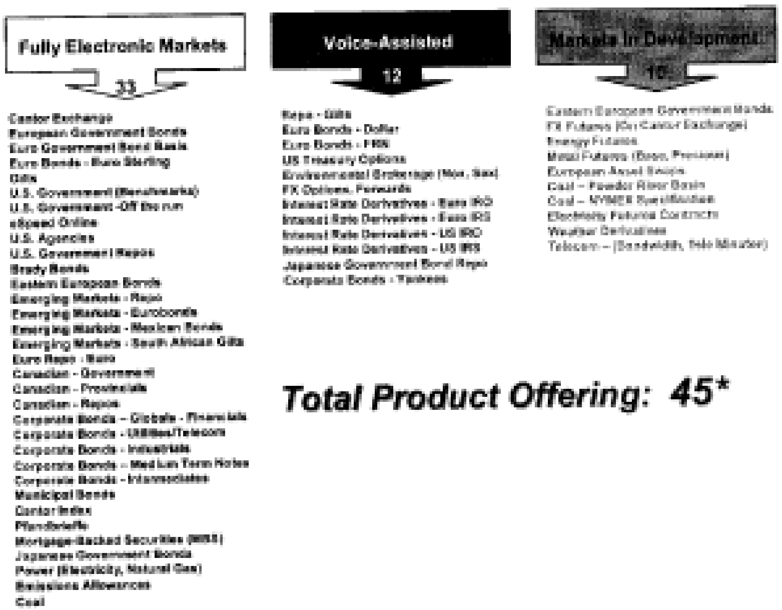
eSpeed Markets. eSpeed Markets provides major financial institutions access to a central wholesale marketplace for trading in a variety of financial and nonfinancial securities, including US Treasuries, futures, and energy (see Exhibit 5). eSpeed divides its eSpeed Markets coverage into verticals, including Financial, Energy, Telecom, Chemicals, and Other Industries, constantly evolving its platform to include the latest financial or nonfinancial products that are ready to be traded electronically. eSpeed powered electronic marketplaces for Cantor Fitzgerald (serving over 500 financial institutions) and its Cantor Exchange, TradeSpark (serving over 120 companies), and Freedom International Brokerage fall under this product category.

Exhibit 5

eSpeed Product Offerings



*Total products include fully electronic and voice-assisted products.

Source: TowerGroup

eSpeed Software Solutions. eSpeed Software Solutions, formerly eSpeed Private Label, provides financial services institutions and issuers the opportunity to license eSpeed technology in order to build a system catering to their specific needs. For instance, the Federal Home Loan Bank (FHLB), a government-sponsored enterprise that provides financing for housing and substantial issuer of short-term debt, signed a licensing agreement with eSpeed in February 2001 to create the eWindow auction platform. The eWindow platform will be operated by FHLB but will use eSpeed's trading technology solutions. FHLB intends to use the system as an origination platform for issuing its FHLB agency discount notes to participating dealers. eSpeed is currently in beta testing for the system, which the FHLB expects to launch late this summer (see Exhibit 6).

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Exhibit 6
eSpeed Software Solutions Agreements

Company/ System Name	Launch Date	System Type/ Target Market	Products	Technology Solutions Provided by eSpeed
FHLB/eWindow	September 2001	Origination/ Dealers	FHLB Agency Discount Notes	eSpeed is providing the auction platform.
Sanwa Securities Sanwa Bank	January 2001	Auction/ Institutional and Retail	Japan Government Bonds (JGBs)	eSpeed is providing online distribution of JBGs and other fixed-income securities.
Visible Markets VISIBLE MARKETS	October 2000	Auction/ Institutional	mortgage-backed securities (MBS), asset-backed securities (ABS), and corporates	eSpeed system supplements Visible Markets' existing online, auction marketplace, but will not disclose for which products.

Source: TowerGroup

eSpeed Online. eSpeed Online supplies retail-based online brokerages access to the eSpeed system for trading in securities other than equities. Through eSpeed Online, online retail brokers can offer a broader range of products to their clients via their own branded Web sites without actually having to hold those instruments in inventory. Retail clients of the online brokers gain access to the wholesale market prices provided by dealer participants using the eSpeed system. Offered are such products as governments, municipals, corporates, and more.

eSpeed has negotiated agreements with the following 13 online brokerage firms: AB Watley, Bondpage.com, Charles Schwab, Firstrade Securities, MostActives.com, Mr. Stock, Muriel Siebert, myTrack, Scottrade, Sutton Online, The Net Investor, Tradescape, and WebStreet Securities. The only eSpeed Online partnership to begin live trading is Charles Schwab, in January 2001, which is utilizing eSpeed's fixed-income trading services, branding the bond trading portion of its site, Schwab BondSource Services, where Schwab clients have access to trading in US Treasuries and agency securities.

Sizing up the Competition

eSpeed is in an unenviable position, one in which it competes with a variety of market participants, including interdealer brokers, dealers, futures exchanges, and fixed-income trading systems. (For more information see TowerGroup Research Note 025:23S, "Online Bond Trading: Only the Strong Will Survive.") Its efforts to expand its business beyond traditional financial products—to include trading in energy, bandwidth, and derivatives—places it in direct competition with firms that may have greater depth of experience in these markets. TowerGroup believes that eSpeed will encounter considerable resistance entering new markets because it has not established any past expertise in trading these products as it has in bond and futures markets.

Interdealer Brokers. IDB systems bring together the dealer community in a central location to trade a variety of fixed-income products directly with each other. eSpeed provides the electronic brokering component of Cantor Fitzgerald's IDB business, while Cantor Fitzgerald operates, the voice-brokering segment. eSpeed has achieved success in the IDB market with first-mover advantage leading all electronic IDBs in the trading of US Treasuries. In this sector, eSpeed competes with such international firms as BrokerTec Global, Garban-Intercapital, MTS S.p.A, and Instinet Fixed Income Markets. BrokerTec and Garban-Intercapital are the most formidable competitors in this space with their presence in the US Treasury market, a market eSpeed depends on heavily for the majority of its transaction volume. (For more information see TowerGroup Research Note 024:25S, "Online Bond Trading for Professionals: Building Electronic Pools of Liquidity.")

Futures Exchanges. In this space, eSpeed's futures platform, the Cantor Exchange (CX) competes primarily with well-established exchanges such as the Chicago Board of Trade (CBOT). However, BrokerTec Global, an electronic interdealer broker in the Treasury market, will go head-to-head with both since its announcement in June 2001 that it received regulatory approval by the Commodity Futures Trading Commission (CFTC) to become a Futures Exchange and a Clearing Corporation. BrokerTec's 14-member consortium of Wall Street firms includes J.P. Morgan Chase, Merrill Lynch, and Goldman Sachs to mention a few. The consortium members account for a substantial portion of the volume in the futures market, which means if they bring their liquidity to the new BrokerTec exchange, BrokerTec Futures Exchange (BTEX) , the other electronic futures exchanges will feel some pressure.

In addition to competitive threats, the Cantor Exchange, a joint venture with the New York Board of Trade (NYBOT), has other problems, namely that it has not developed the type of following that was anticipated. The failure of the exchange has taken eSpeed by surprise. The CX's volumes have dropped steadily since its launch. The number of contracts traded totaled just 188,031 in 2000, a 57.7% decline from the 444,155 contracts traded in 1999. Continuing the downward trend, in the first quarter 2001, contracts traded totaled just 26,031 on the CX, on pace for a lower transaction volume than 2000. The CX quarterly volume totals are only a fraction of the over 40 million financial futures and options contracts traded by the CBOT in the first quarter of this year.

eSpeed has addressed the steady decline in volume by entering into an agreement with EasyScreen to provide access to multiple global derivatives exchanges as well as its plans to move into new vertical markets such as energy futures. In addition, eSpeed has yet to determine how it will incorporate its April 2001 purchase of the Wagner patent into the CX. The patent applies to futures trading systems, in which transactions are completed automatically by a computer matching bids and offers on a first-come, first-serve basis. This is a different method of execution than that currently employed by the CX, which features eSpeed's Interactive Matching technology. TowerGroup believes it is too late for eSpeed to rebuild its reputation in the electronic futures market due to the prolonged demise of the CX.

Exhibit 7
eSpeed's Vertical Markets

System Name	Primary Geography	Products	Partnerships/ Liquidity Providers	Estimated Electronic Average Daily Volume as of March 31, 2001*
Cantor Exchange (CX)	Global	US Treasury and agency futures	Cantor Exchange clients and the New York Board of Trade (NYBOT)	420 contracts**
eSpeed	Global	US Treasuries, Euro and Japanese government debt, agencies, corporates, municipals, mbs, repos, interest rate swaps, emerging market debt, futures and options	Cantor Fitzgerald and its over 500 clients	$185.0 billion**
Freedom International Brokers	Canada	Canadian government bonds, corporates, agencies, provincials, repos, interest rate swaps, foreign exchange, futures and options	BMO Nesbitt Burns, CIBC World Markets, Merrill Lynch Canada, RBC Dominion Securities, Scotia Capital Markets, and TD Securities	Launched in June 2001
TradeSpark L.P.	US	Natural gas, electricity	Axia Energy, Coral Energy, Dominion, TXU Energy Trading, and Williams Energy Marketing and Trading	$290 million**

*TowerGroup estimates
**Includes both fully electronic and voice electronic volume
Source: eSpeed

Energy Trading Platforms. The energy trading market has become a major e-trading sector in the last year and a half with new participants entering and exiting the market regularly. eSpeed is no exception, with its launch of TradeSpark in October 2000, a multidealer online trading venue for natural gas and electricity. In Tradespark, eSpeed has ventured into the commodity vertical, trading nonfinancial products and partnering

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with participants outside the financial industry such as Axia Energy, Coral Energy, Dominion, TXU Energy Trading, and Williams Energy Marketing and Trading, which provide liquidity and voice-broker support. As for the technology used by TradeSpark, eSpeed provides its auction-based system, risk and credit management tools, and network connections.

During the first quarter of 2001, TradeSpark's trading volume, both electronic and voice-assisted, totaled $18 billion. This is a 56% increase over the $12 billion traded in the fourth quarter of 2000, which makes the total volume in the first six months of operation approximately $30 billion. Despite its impressive volumes and a plethora of liquidity providers, eSpeed faces some stiff competition in this market segment, including the New York Mercantile Exchange (NYMEX) and the IntercontinentalExchange, an electronic exchange for the trading of natural gas and metals. NYMEX currently has an extended-hours electronic trading system and relies on open outcry and voice brokerage for regular hours trading; however, it is in the process of developing its enymex trading system due out in late summer 2001. As for the IntercontinentalExchange, it recently acquired the International Petroleum Exchange (IPE) in London, making it a viable threat even to the NYMEX. TradeSpark will have difficulty trading on the same level as these exchanges but should be better equipped to compete against nonexchange market competitors such as EnronOnline and HoustonStreet Exchange (see Exhibit 7).

Strengths and Challenges

Company Strengths

The relationship with Cantor Fitzgerald has provided eSpeed the capital for initial technology investments and partnerships and furnished the contractual rights to its technology in addition to helping establish the eSpeed name among Wall Street dealers trading with the parent company. Cantor Fitzgerald's capital set eSpeed in motion, investing in its own proprietary trading technology without outside assistance from partners or venture capitalists, giving eSpeed a fair degree of autonomy. By bestowing its technology to eSpeed in exchange for equity ownership and technology support, the firm provided eSpeed a basis for its revenue model by paying both service and transaction fees to its subsidiary. The dealer community uses eSpeed every day when a transaction is completed with Cantor Fitzgerald, which has given eSpeed exposure to the street and made those dealers some of its largest clients. This relationship, although seemingly too close at times, has supplied eSpeed with capital and a connection to the dealer community that will sustain the platform in the future.

eSpeed, unlike many competing e-commerce firms or technology start-ups, had the backing of an established Wall Street broker/dealer with plenty of capital as well as access to capital via its stockholders through its IPO and subsequent stock offering (in March 2001, with net proceeds of approximately $50 million). This type of funding has made it possible for eSpeed to invest in venues such as TradeSpark and Freedom International Brokerage. In addition to these alliances, eSpeed's investments in technology continue. Facilitated by its second equity offering, it recently purchased the rights to the Wagner Patent for futures trading and TreasuryConnect, an electronic trade communication and execution platform for over-the-counter derivatives. Investments such as these help build the company's value by creating opportunities for new business and possible licensing and servicing agreements without the concern of venture capital or other private funding.

The ability to offer clients and partners access to scalable technology is certainly one of eSpeed's strengths. Within this model, eSpeed has provided for client access to both voice-brokerage and electronic trading, which has helped facilitate the deployment of its trading systems to clients and partners. eSpeed's scalable model suggests that its technology has a better chance of competing in e-trading markets, which are

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continually evolving to include new products and management tools. Through its suite of products, eSpeed has demonstrated that it can deliver across numerous verticals and horizontals, although its success in these markets remains unclear.

eSpeed is the leading IDB electronic trading platform for US Treasuries. Its top position not only provides a great deal of credibility but also enables a wider range of customers access to its platform, which enhances their familiarity with the systems. eSpeed uses this strategy to leverage additional platforms that trade other financial products by offering a single platform for integration of trading across product lines.

As e-commerce market participants continue to launch new trading platforms, eSpeed is positioned to leverage its success in bond trading to other markets. eSpeed's technology has proven that it works for the US Treasury market. A considerable number of electronic trading firms have been ineffective at providing their clients both with a successful technology and market liquidity. eSpeed must ensure it has the market liquidity and expertise to operate in each new market it enters to avoid failure.

Challenges Facing eSpeed

Although the Cantor Fitzgerald relationship with eSpeed has resulted in the founding of the company and brought the firm's liquidity to the eSpeed system as well as transaction revenue and capital for strategic investments and partnerships, the arrangement does put limitations on eSpeed's current and future business. The agreements between the two companies curtail eSpeed's ability to initiate strategic alliances and acquisitions, which could affect its ability to succeed, especially if market participants are not willing to work so closely with a company that has such strong ties to a large IDB such as Cantor Fitzgerald. If the firm begins to have financial problems or loses clients because of a better opportunity or technology, this would negatively impact eSpeed's revenue performance and the liquidity available to markets in which eSpeed participates.

By viewing the list of strategic alliances, investments, and product offerings, market observers may get the impression that eSpeed is spread a bit thin. Yet these are areas of much-needed growth and expansion, since a significant portion of eSpeed's revenue model involves building marketplaces for private label clients and generating service and licensing fees from those agreements. eSpeed needs to take advantage of its reputation in the Treasury market and expand its strategic alliances into sectors of current and anticipated product coverage.

The inability of eSpeed to generate activity on the Cantor Exchange, its first mover or flagship product launched in September 1998, has been a disappointment to the company. The lack of liquidity on this system has generated many questions about what happened to this eSpeed offspring. Currently, there is no indication that eSpeed plans to discontinue trading on the CX in spite of its negligible volumes. Instead eSpeed is putting its confidence in its recent technology investments and product expansion plans, which it expects will rejuvenate the exchange. Although it sounds attractive, if the exchange has consistently lost liquidity in its nearly three years of operation, there is nothing to make firms that have been avoiding the system begin using it now. The CX had a chance to make a difference in the futures market and it has proved unsuccessful—without liquidity it cannot survive the current influx of competition.

eSpeed's volumes, and ultimately its profits, depend heavily on transaction revenue derived from dealings in the US Treasury market. In the first quarter of 2001, eSpeed's US Treasury securities transactions accounted for just over 50% of all of eSpeed's trading volume. As the US government continues to pay down the outstanding Treasury debt through its Buyback program launched in March 2000, eSpeed continues to depend on a shrinking market. The firm's heavy reliance on this one product could signal future problems. Future market stability and a reduced need for the Fed to move interest rates will bring not only

Treasury trading volumes down but also eSpeed's volume and revenue. In addition, eSpeed's market competitors may begin to excel in this market and clients may opt for their services instead. This is precisely why eSpeed needs to continue to expand its product scope and strategic alliances to bring liquidity to the system for the financial products that will someday drive its markets.

Conclusion

The advent of electronic trading has given technology and financial services firms the opportunity to profit from their proprietary trading technology. eSpeed is no different, benefiting from a substantial investment in technology by its parent firm, which proceeded to create an e-trading technology solution that it now customizes for market participants.

As evidenced by the recent economic downturn, the need for potential e-trading participants to invest in proven trading technology solutions is even more important than ever, since capital for such investments is harder to come by. eSpeed's technology, scalable marketplace, and strategic investments are key components to the firm's success to date. eSpeed needs to seize this opportunity to generate business through its private label offering and through market alliances.

eSpeed's accomplishments in the fixed-income e-trading marketplace should not obscure the fact that it is faced with many challenges that may ultimately affect its future success. eSpeed will have to build liquidity in its horizontal markets as dealers and investors alike retreat from the diminishing US Treasury market in search of a new benchmark. Issues surrounding the lack of activity on the Cantor Exchange must be addressed, whether through expansion into vertical markets, strategic alliances with the dealer community, or its closing. The firm needs to continue to promote its eSpeed Software Solutions and benefit from its intellectual property rights by increasing licensing and servicing fee revenue. The binding Cantor Fitzgerald relationship should be reevaluated in order to make it easier for eSpeed to build relationships and alliances without its parent firm's consent or involvement. Cantor Fitzgerald's ability to maintain its end of the partnership agreement directly impacts whether or not eSpeed can and will achieve its goals for product expansion and financial growth.

December 13, 2001

Page One Feature

Enron Lobbied Hard to Limit Oversight of Trading Operations

By MICHAEL SCHROEDER and GREG IP
Staff Reporters of THE WALL STREET JOURNAL

WASHINGTON -- A year ago, when most of the political world was obsessed with the deadlocked presidential election, **Enron** Corp. was quietly but aggressively lobbying Congress. Its object: a little-noticed bill shaping federal policy toward the complex financial instruments known as over-the-counter derivatives.

In 1989, the Houston energy giant, originally a utility that produced and transported natural gas and electricity, had begun shifting its focus to energy trading. It soon came to view the burgeoning market for derivatives -- financial instruments that derive their value from an underlying commodity or wager on the future -- as the key to its ambitious expansion plans. And it wanted as little government interference with that market as possible.

The company's lobbying campaign was so aggressive that staff members of one congressional committee asked a lobbyist for an Enron-led industry group to negotiate major aspects of the bill with regulators. In the end, Enron had provisions inserted in the law that blocked federal oversight of some of its major corporate product lines, such as energy and metals derivatives, and its EnronOnline energy-trading network.

Now, once-mighty Enron is in bankruptcy court. Its market value has plunged since last year to about $500 million from more than $77 billion. But one of the most striking features of its rapid decline was that financial regulators had little clue what was going on inside Enron. That's at least partly because Enron -- as much as any company in America -- had invested a lot of time and money over the past decade in keeping government out of its business.

'Crisis of Confidence'

Wednesday, the House Financial Services Committee belatedly jumped in. Lawmakers heard from Joseph Berardino, chief executive of accounting firm Arthur Andersen LLP, who said that Enron's collapse had created a "crisis of confidence" in the accounting profession. And they heaped criticism on the company and on Andersen, its auditor, for issuing financial statements they said failed to reflect the shakiness of Enron's condition.

[1] See full coverage of the rise and fall of Enron.

[2] Listen to the Enron hearing in the House, by arrangement with

Rep. John LaFalce, a New York Democrat, echoed the sentiments of many committee members when he called Enron's collapse a wake-up call. "How many more Enrons are out there, and what are the systemic factors that made this collapse and other future collapses possible?" asked Mr. LaFalce.

Wednesday, the Securities and Exchange Commission said it is considering new regulations this year to require more precise disclosures about

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companies' accounting policies. And federal energy regulators said they are planning new rules for energy-derivatives accounting.

The Enron debacle spotlights an enormous void in the nation's system of financial regulation, and it is rekindling a difficult debate over just how that gap should be filled.

Innovations in technology and finance have helped obliterate clear distinctions between banks, brokerage firms and newer hybrids, such as Enron, which built a privately run online trading empire that handled huge volumes of electricity and natural gas.

Multiple Standards

These days, it's possible for exchanges, which once required centralized trading floors crowded with traders, to spring up overnight in cyberspace. Meanwhile, financial regulators, hewing to decades-old divisions of authority, continue to keep a close watch on banks, brokerage firms and conventional exchanges, while leaving new entrants such as Enron to police themselves.

There now is a widespread consensus among policy makers that, at the very least, the nation needs stricter accounting rules that would force companies such as Enron to do a better job of disclosing their financial conditions. Other industry watchers would go further. Enron, they say, was one of the country's leading commodities markets. It had amassed a $19 billion portfolio of derivatives.

In many ways, the Enron debacle raises the same questions that arose three years ago, after the near-failure of hedge fund Long-Term Capital Management -- a private investment fund for wealthy individuals that made leveraged bets on financial markets. Long-Term Capital's misplaced wagers, many based on derivatives, almost triggered a meltdown in global markets during 1998.

In the months following that near-calamity, many policy makers, such as then-Treasury Secretary Robert Rubin, vowed to change the regulatory system to avert similar risks in the future. While they opposed tighter regulation for derivatives trading, they argued there was at least a need for greater disclosure in the derivatives market.

Since then, however, a broad industry coalition including Enron has worked with sympathetic regulators and legislators to beat back pressure for more oversight of over-the-counter derivatives. And in some cases, they have rolled back powers that regulators had had.

Most regulators and financial-industry executives insist that the financial system remains sound. The fact that Enron's collapse doesn't as yet appear to have been caused by its derivatives trading, or to have triggered a broader crisis, seems to bolster their argument.

Advocates of derivatives say the instruments give companies, investors and lenders a way to reduce their exposure to many kinds of financial risks. Indeed, that's the main reason for their popularity.

New types of derivatives have emerged in recent years, allowing traders to bet on electricity prices, telecommunications bandwidth and the influence of the weather, all of which Enron dominated. Enron also was a big player in credit derivatives, which act as an insurance policy against corporate bankruptcy by promising to pay back a lender's money in exchange for a premium.

The market for credit derivatives, which barely existed five years ago, has grown to an estimated $360 billion, according to the Office of the Comptroller of the Currency. And it says the nominal value of derivatives on the books of commercial banks soared to $51.3 trillion at the end of September from $6.8 trillion in 1990, with nearly $20 trillion of that growth coming since 1998.

Behind the Times

Federal oversight hasn't kept up. The Commodity Futures Trading Commission regulates futures and, along with the Securities and Exchange Commission, options traded on exchanges, but not derivatives traded off-exchange, or "over the counter." The latter term describes trades that are privately negotiated between large financial institutions or corporations. How such derivatives are regulated depends on what kind of firm sells them. For example, bank regulators such as the Federal Reserve can scrutinize commercial banks' activity, while the SEC can examine that of brokers who conduct business in the U.S.

Enron -- which started trading natural gas, then expanded to electricity, metals and more-exotic derivatives -- fell through the cracks of this regulatory framework. As a publicly traded company, Enron routinely provided the SEC with general information about its finances. But it wasn't obliged to give the agency any detailed information about its OTC trading activities. In fact, the CFTC's only peek into Enron's vast trading operation was through a tiny registered futures affiliate, Enron Trading Services Inc.

EnronOnline, the electronic marketplace Enron launched in late 1999, also fell outside federal jurisdiction. The exchange came to control a quarter of all wholesale energy trades among U.S. utilities, independent power producers and other market players. In many ways, the Web-based trading system resembled its heavily regulated counterparts, such as the New York Mercantile Exchange.

But Enron and its imitators didn't fit regulations written for the likes of conventional markets such as the Nymex. Those exchanges bring many traders together and cater to a broad range of investors, both large and small. But Enron's marketplace was limited to big, sophisticated players.

Moreover, Enron jealously guarded its independence. While some companies voluntarily discuss their derivatives trading with the CFTC, Enron regularly failed to do so, say people familiar with the agency.

Enron spokesman Mark Palmer says the company's unregulated status was appropriate. "With a deep bilateral market of sophisticated buyers and sellers, that regulation was not needed," he said. Though Enron did some trading for its own account, Mr. Palmer disputes suggestions that his firm was similar to a hedge fund, adding that most of the $19 billion in derivatives contracts on its balance sheet were commitments to deliver, or take delivery of, natural gas or electricity.

In the roaring 1990s, with the deregulation movement at its zenith, few in Washington dared even to suggest more regulatory oversight of derivatives. One of the few who did was Brooksley Born, who President Clinton named to head the CFTC in 1996. Her comments in speeches and in a discussion paper about the need for more oversight and regulation of OTC derivatives triggered an uproar among derivatives dealers -- from J.P. Morgan & Co. to Enron. They quickly complained to Congress and other regulators that the uncertainty Ms. Born was creating could destabilize their markets.

The industry complaints got a sympathetic hearing from many politicians and regulators -- particularly at the Fed and the SEC -- who saw Ms. Born's campaign

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as a bid to expand her agency's authority.

At the industry's urging, then-House Banking Chairman Jim Leach, an Iowa Republican, called a private emergency meeting of the regulators in late June 1998, summoning Ms. Born from Georgetown University Hospital, where her daughter was undergoing knee surgery. The regulatory staff and lawmakers berated Ms. Born for more than two hours in a fruitless effort to persuade her to stop her campaign.

Three months later, the Long-Term Capital Management crisis erupted. "You are welcome to claim some vindication," Mr. Leach told Ms. Born at an October 1998 congressional hearing.

In the subsequent months, Ms. Born intensified her campaign for greater derivatives regulation. And she appeared to be gaining support. Several studies, task forces and panels were formed, recommending lenders perform better due-diligence when dealing with high-risk traders and that trading firms improve risk-management models.

A coalition of regulators, including the Fed, Treasury, CFTC and SEC, meanwhile, wanted to force hedge funds to make public more information about their holdings, a recommendation Rep. Richard Baker, a Louisiana Republican, incorporated into a proposed law. They also recommended extending the powers of both the SEC and the CFTC over unregulated affiliates used by regulated firms to conduct particularly risky trades. That could have brought Enron under the CFTC's jurisdiction, since Enron had a futures brokerage affiliate that was already registered with the agency.

An industry panel with Gerald Corrigan, a former president of the Federal Reserve Bank of New York and now a managing director at **Goldman Sachs Group** Inc., acting as co-chairman made several recommendations. One called on banks and Wall Street dealers to make a quarterly disclosure to their regulators of their 10 biggest exposures in each of several categories of risk. It also called for them to identity the parties on the opposite sides of those transactions.

No Consensus

Though some Wall Street firms, including Goldman, now meet informally with regulators to discuss their exposures, the panel's recommendations were never formally implemented. "There simply was not a consensus" among either regulators or dealers "that it was worth the time, energy and cost to do it," says Mr. Corrigan.

Meanwhile, the derivatives industry was fighting the push for more regulation. The effort was spearheaded by trade groups like the International Swaps and Derivatives Association and the Managed Funds Association, which represents hedge funds. Enron also joined the battle.

Over the years, the company had built a formidable lobbying machine, with a staff of 28 in Washington alone, most of whom have been laid off since the company's recent collapse. Enron also paid $2.1 million last year to about a dozen Washington lobbying firms to work on a range of energy and financial issues, more than double the fees it paid in 1997, according to the Center for Responsive Politics, a nonprofit group that studies the role of money in politics.

To date, the only significant changes in OTC derivatives laws have been those largely endorsed by the industry, such as removing legal obstacles to the creation of common clearing corporations for settling derivative trades among multiple parties. Another change, removing legal obstacles to two participants treating offsetting contracts with each other as a single position, is expected to be part of new bankruptcy legislation.

The reforms opposed by Enron and other derivatives traders were killed. Rep. Baker's proposed hedge-fund disclosure law died in the House Banking Committee. No one introduced any legislation to give the SEC or CFTC more authority over derivatives.

Some of Enron's political muscle comes from well-connected members of its team. In 1993, Enron named Wendy Lee Gramm, a former CFTC chairwoman and wife of Texas Sen. Phil Gramm, to its board. The collapse has put Ms. Gramm, who is chairwoman of the board's audit committee, in the hotseat. One of Enron's key outside lobbyists is Ken Raisler, a former CFTC general counsel and now a law partner at Sullivan & Cromwell in New York. Late last year, Enron hired Linda Robertson, a senior Clinton administration Treasury official, to head its Washington office.

During the last election, Enron made political contributions of $2.4 million, more than double the next-most-generous energy and natural-resource company. Republicans got 72% of Enron's contributions. For the same period, House and Senate agriculture-committee members, who oversee commodities trading, and other key lawmakers received $50,338, up from $38,256 in the previous election cycle.

All of this gave Enron unmistakable clout. In the fall of 1998, after the LTCM debacle, when Ms. Born was gaining support for her effort to press for derivatives regulation, Enron lawyer Mr. Raisler met with one of Ms. Born's supporters, CFTC Commissioner John Tull. Mr. Raisler asserted that Treasury wanted Mr. Tull to oppose Ms. Born's initiatives. Mr. Tull told Ms. Born about the meeting and that he was withdrawing his support at Treasury's request, according to people with knowledge of the meeting.

Mr. Raisler confirms he met with Mr. Tull. "I don't remember what we discussed other than that, I, on behalf of my clients, said we were dismayed at how Brooksley was handling herself during that period," he says. Mr. Tull, who has retired to his Arkansas rice farm, didn't return phone calls. Ms. Born said she couldn't confirm or deny the incident.

In late 2000, Enron won sweeping legislative guarantees against future regulation of its trading businesses. People involved in negotiating the Commodity Futures Modernization Act say that Enron representatives were fanatical about preventing any hint of derivatives regulation. Its refusal to budge put it at odds with some moderate members of its own lobbying coalition, including Goldman Sachs and Morgan Stanley. Mr. Raisler denied that there was any such split.

Enron was so forceful in pushing for energy and metals commodities to be exempted from oversight that the exemption provision was sometimes referred to by Capitol Hill staff as the "Enron Point." That and other Enron-friendly provisions made it into the bill.

Enron's Mr. Palmer says, "We were never shy about our views" on leaving OTC derivatives trading unregulated, but he added that many other market participants felt the same way. "Enron," he adds, "is a bit of a lightning rod."

Michael Greenberger, former director of the CFTC's trading and markets division, blames Congress for giving derivatives dealers a blank check to operate "opaque and nontransparent to the government as a whole."

So little is known about the operations of Enron and other derivatives players that its hard to predict the economic impact of their missteps. "You don't know the leverage of these things. They're playing with fire," adds Mr. Greenberger, now a professor at the University of Maryland law school. "One of these emergencies won't subside."

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(4) http://interactive.wsj.com/archive/retrieve.cgi?id=SB1008181357847808200.djm
(5) http://interactive.wsj.com/archive/retrieve.cgi?id=SB1008196294985520800.djm
(6) mailto:mike.schroeder@wsj.com
(7) mailto:greg.ip@wsj.com

Close Window

From:	Schultheiss, Heidilynne
Sent:	Monday, October 29, 2001 10:00 AM
To:	Carleton, Norman; Nickoloff, Peter
Subject:	Europe Energy Firms Are Wary of Enron

October 29, 2001

Europe Energy Firms Are Wary of Enron

By REUTERS

Filed at 9:08 a.m. ET

LONDON (Reuters) - Energy companies in Europe are shying away from trading with troubled U.S. energy group Enron amid concerns about the company's credit status, industry sources said on Monday.

Several large energy groups have frozen their dealings with Enron -- one of Europe's biggest gas and power traders -- as they hold urgent talks with the U.S. group about setting up new credit arrangements, the sources said.

``I think Enron's approach is to get the major counterparties back on board as quickly as possible and then hope the smaller ones will follow," said the head of risk management at one UK utility that halted its trade with Enron last week.

``They are talking with us about bank letters of credit," he said. ``The people that are still trading with them are doing so on a very restrictive basis."

A spokesman for Enron's European headquarters in London headquarters declined to comment.

Reluctance to trade with Enron in Europe comes as the company tries to rebuild investor confidence after its stock hit five-year lows.

Triggering the slide was news last week the U.S. Securities and Exchange Commission is investigating huge losses relating to a private equity operation run by its former chief financial officer.

Houston-based Enron trades a large amount of its volume in the U.S. and Europe through its Internet EnronOnline system.

Last Friday the company said trade on EnronOnline was above average levels with more than 8,400 transactions at a notional value of approximately $4 billion.

Traders said Enron's plight could hit liquidity in European gas and power markets, where liberalization has unleashed rapid growth in energy trading in the last couple of years.

One industry source cited a brokers list showing eight companies in the UK electricity market had put on hold their trading Enron, which is among the biggest five traders in the market.

In mainland Europe, where Enron has been a major driver of liquidity, potential counterparties are treading with care.

``We are avoiding them as counterparties -- either by not trading with them or by using a 'sleeve' (a third party trader)," said a senior trader at one of Germany's big utilities, who declined to be named.

French traders said wariness about dealing with Enron had dampened liquidity although Enron was still in the market on Monday morning.

``Enron is a major player so counter parties are looking to see if there is a problem," said one French trader.

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 10:01 AM
To: Carleton, Norman; Nickoloff, Peter
Subject: Enron Seeks Additional Financing

October 29, 2001

Enron Seeks Additional Financing

By RICHARD A. OPPEL Jr.

DALLAS, Oct. 28 - The Enron Corporation, still struggling to reassure investors it can weather a financial crisis over complicated transactions involving its former chief financial officer, is seeking $1 billion to $2 billion in additional financing from banks, an industry official said today.

Last week, Enron, the nation's largest energy-trading concern, used about $3 billion in available credit lines and spent about $2 billion to pay off commercial paper. Now, by obtaining even more financing, Enron is hoping to convince investors and other energy-trading firms that it will not face a cash squeeze that could lead trading partners to refuse to extend credit or do business with it.

Enron's board, which has been holding meetings by telephone over the last two weeks to monitor the company's financial situation, held another meeting this afternoon. "The board is meeting frequently and will announce any actions when appropriate," an Enron spokesman said.

Two weeks ago, Enron disclosed that its shareholder equity had been reduced by $1.2 billion because of deals with investment partnerships involving its former chief financial officer, Andrew S. Fastow, who was ousted last week. The company also disclosed about $1 billion in separate write- offs, and it said last week that the Securities and Exchange Commission had made an inquiry into its financial accounting.

Enron hopes to maintain its investment-grade credit rating, which is crucial to ensuring that other energy traders continue to do business with it. Lately, Enron's bonds have been trading at prices more like junk bonds, and two major credit-rating agencies are considering whether to downgrade the company's rating.

Nickoloff, Peter

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 10:03 AM
To: Carleton, Norman; Nickoloff, Peter
Subject: Plumbing Mystery of Deals by Enron

October 28, 2001

Plumbing Mystery of Deals by Enron

AT the heart of the sudden collapse in investor confidence in the Enron Corporation are unusual trades it entered into with partnerships led by its chief financial officer, Andrew S. Fastow, beginning in the summer of 1999. Because they were transactions among related parties, the company was required to disclose them, but the disclosures raised as many questions as they answered. Following are some questions that investors are asking, and the currently available answers.

Q. Why did Enron enter into the deals?

A. Enron's first disclosures, in 1999, gave no reason. In later reports, it said it was seeking to "hedge certain merchant investments and other assets," by which it apparently meant investments in technology and telecommunications companies.

Q. How did those investments do?

A. It looks as if they plunged in value, although there is no clear disclosure on that.

Q. Why can't that be discerned?

A. The company never said just what the investments were. And the transactions with the partnerships were complicated, involving a variety of derivative securities, Enron stock and various promissory notes. Enron's financial disclosures do not provide enough information to understand the arrangements completely.

Q. Why were they so complicated?

A. One reason may have been to use accounting rules to its advantage. One accounting rule dictates that companies may not record profits or losses on transactions in their own stock. If a company sells its shares at $10 each and then buys them back - whether for $1 or $50 - there is no gain or loss. But shareholder equity does go up or down on the balance sheet - in that case reflecting how much extra cash the company took in, or paid out, on the transactions. Enron's transactions appear to have been structured to fall under that rule.

Q. Who made money from these transactions?

A. Enron reported some profits along the way from the deals, although not all of the profits were spelled out in its quarterly filings. And it appears that the partnerships distributed money to investors.

Q. If the deals began in 1999, why all the uproar now?

A. Many investors and analysts were not curious about them when everything seemed to be going well. As long as Enron was exceeding its forecasted profits each quarter, they were willing to assume that what was not being disclosed was not really important.

Q. When were concerns raised with Enron?

A. The complaints grew as Enron's share price fell earlier this year. By this summer, Enron decided that Mr. Fastow would sell his stake in the partnerships. Then, because the partnerships would no longer be considered related to Enron, the company would no longer have to disclose anything about the transactions. But investors were still worried, and Enron later closed out its deals with the partnerships.

Q. How did Enron do?

A. Badly. It took a $35 million loss, which, given the size of the transactions involved and the previous profits taken, was not very much. But it also reduced shareholder equity by $1.2 billion.

Q. How did that happen?

A. That, like so much else, is not clear. But it looks as if the partnership owed Enron that much money, could not pay and was let off the hook by Enron. In return, Enron terminated "previously recorded contractual obligations to deliver Enron shares in future periods." Enron treated that like a share buyback, even though the shares in question had not been issued, and determined that there was no need to treat it as a loss that would reduce reported earnings.

Q. Is that legal under the accounting rules?

A. Presumably it is. But Enron's limited disclosures make it impossible to say for sure. Enron may have discovered ways to use the accounting rules to enable it to keep losses off income statements, while leaving profits on them. That may become clearer when the Securities and Exchange Commission, which has begun preliminary inquiries, completes its work. FLOYD NORRIS

From:	Schultheiss, Heidilynne
Sent:	Monday, October 29, 2001 10:06 AM
To:	Carleton, Norman; Nickoloff, Peter
Subject:	Once-Mighty Enron Strains Under Scrutiny

October 28, 2001

Once-Mighty Enron Strains Under Scrutiny

By ALEX BERENSON and RICHARD A. OPPEL Jr.

IS time running out for Enron?

At the beginning of this year, the Enron Corporation, the world's dominant energy trader, appeared unstoppable. The company's decade-long effort to persuade lawmakers to deregulate electricity markets had succeeded from California to New York. Its ties to the Bush administration assured that its views would be heard in Washington. Its sales, profits and stock were soaring.

And under the leadership of Jeffrey K. Skilling, its chief executive, Enron's arrogance had grown even more quickly.

The company, based in Houston, dripped contempt for the regulators and consumer groups that stood between it and fully deregulated markets - for electricity, water and everything else. Everyone would win under deregulation, Enron said - especially its shareholders, whose stock would soar as the company profited from creating new markets.

"We are on the side of angels," Mr. Skilling said in March, dismissing those who saw the company as a profiteer in California's energy crisis. "People want to have open, competitive markets. They want fair competition. It's the American way."

But less than a year later, everybody seems to have lost, especially Enron's investors. Enron's stock is plunging, and questions about its finances are mounting.

Some experts in the energy industry worry that if the crisis at the company worsens, trading in natural gas and electricity could be seriously disrupted and energy prices could grow more volatile. In a worst-case outlook, Enron could become the 2001 version of Long-Term Capital Management, the huge hedge fund whose collapse roiled financial markets during the fall of 1998. Enron's shares have fallen more than 80 percent this year, erasing $50 billion in shareholder value.

Enron closed on Friday at $15.40, down 95 cents, after hitting a 52-week low of $15.04 earlier in the day.

The future of electricity deregulation is in doubt, thanks to blackouts and soaring power prices in California earlier this year - a crisis that ended only when that state contradicted deregulation's basic tenets by intervening deeply in the power market. Enron's efforts to become a profit-making water supplier and to create a new market in broadband communications capacity have been expensive failures. In August, Mr. Skilling quit, forcing Kenneth L. Lay, his predecessor as chief executive and still Enron's chairman, to resume day-to-day control of the company.

The company declined to make senior executives, including Mr. Lay, available for comment, and asked that questions be submitted in writing. Mr. Skilling could not be reached.

Enron's problems boiled over earlier this month, when it disclosed that its shareholders' equity, a measure of the company's value, dropped by $1.2 billion in the last quarter because of a deal disclosed only very hazily in Enron's regular financial statements. The Securities and Exchange Commission is looking into the company's financial reporting, and some investors question whether Enron has overstated profits at its primary business of trading electricity and natural gas.

THE slump in the company's shares accelerated after Enron revealed the fall in its shareholders' equity. On Wednesday, the company forced out its chief financial officer, Andrew S. Fastow, who is at the center of the controversy over Enron's confusing finances. The company, which six months ago seemed to be reaping billions of dollars from California's energy crisis, today faces a potential cash crunch.

The surprise about shareholder equity inflamed investors' smoldering concern about Enron's opaque financial statements. Now, with Wall Street analysts and bond-rating agencies demanding more information about the complex transactions that have fueled the company's profits, Enron has been reduced to issuing news releases assuring investors that it has adequate access to cash.

Enron does not appear to be in immediate danger of running out of cash. On Thursday, the company drew down a $3.3 billion credit line it had previously arranged with a group of banks led by Citigroup and J. P. Morgan Chase, which have each extended at least $400 million. But because of Enron's importance in the natural gas and electricity markets, industry experts say that any problem at the company could disrupt energy trading nationwide.

The supply of natural gas and electricity would probably not be affected even if the company failed, because Enron is mainly a trader, rather than a producer, of energy. But a crisis at the company might increase the volatility of energy prices, which have swung wildly in the last year.

Philip K. Verleger Jr., an energy- markets economist, emphasized that he thought Enron would survive this crisis. But he said it was not clear what would happen if Enron ran out of cash or if traders that use the company's EnronOnline Internet trading marketplace defaulted on their obligations.

"You suddenly have all these positions they have taken on there - are they good? Are the firm's hedges good? What's the situation?" Mr. Verleger said. "It's got everyone scared."

In the short run, Enron's credit rating may be its biggest problem. If the company's rating falls below investment grade, Enron could be forced to issue tens of millions of shares of stock to cover loans that it has guaranteed. But creating new shares would make the shares that already exist less valuable, because those shares would no longer represent full ownership of the company.

A drop in the company's credit rating could also prompt other energy traders and producers to back away from doing business with Enron, hurting the company's sales and profits.

Enron's credit rating stands several notches above the critical point. But its bonds, which are publicly traded, have fallen so low that they are now offering interest rates of almost 10 percent, comparable with many junk bonds. Two of the three major credit-rating agencies, Moody's Investors Service and Fitch Investors Service, have put Enron's bonds on review for possible downgrades.

"The issue that's in the front of everybody's mind right now is credit," said Mark Gurley, senior vice president and general manager for trading at Aquila Inc., one of the nation's largest energy traders. Aquila is based in Kansas City, Mo.

For now, Aquila and other major energy traders and producers, including Reliant Energy, the El Paso Corporation, and Dynegy are continuing to do business with Enron. And Mr. Gurley said that Enron's own trading in the electricity and natural gas markets did not suggest the sort of frenzied selling reminiscent of the collapse of Long-Term Capital Management in 1998.

"They haven't done anything trading-wise that gives me any indication they are closing their books down," he said.

Still, some executives at other companies said they were looking more carefully at transactions with Enron, especially long-term contracts. They also said risk-management and credit officers were calling each other regularly to discuss the situation.

Mark Palmer, an Enron spokesman, said on Friday that no energy- trading company had stopped doing business with Enron. He declined to say whether any of the company's trading partners had suspended or altered credit terms. He said the company was continuing to see normal volumes of business.

But the crisis that Enron will face if its credit rating is downgraded is just a symptom of the bigger problem the company must confront. For years, the details of Enron's finances have been a mystery even to the Wall Street analysts whose job it is to follow the company, and to the investors who own its stock and bonds. When Enron's profits were soaring and it was creating lucrative new markets, shareholders did not seem to care about the impenetrability of its financial statements.

Now they do. Yet the company seems incapable of offering straight answers to the questions investors ask.

To others in the industry, the opaqueness of the company's financial statements parallels Enron's efforts to keep its energy-trading business lightly regulated and free of disclosure requirements. Though they do not expect Enron to crumble like Long-Term Capital Management, they say that, like the giant hedge fund, Enron uses a lot of debt, regulatory oversight is limited and outsiders have a difficult time figuring out its finances.

The most pressing concerns are a series of partnerships and trusts Enron created to move some of its assets and debt off its balance sheet. With names like Marlin and Osprey, the partnerships have at least $3.3 billion in bonds outstanding, backed by assets like a stake in Azurix, Enron's water company subsidiary. Enron has promised that if the partnerships' debts exceed the value of their assets, Enron will issue enough new shares to make up the difference.

DEALS with partnerships formed by Mr. Fastow, who was chief financial officer when they were organized, led to the $1.2 billion write-off in shareholders' equity that Enron announced last week. The company has offered only skimpy details of its transactions with those partnerships.

Enron ended its relationships with those partnerships in the last quarter, after being criticized by shareholders. In the process, it wrote off a promissory note that it had carried on its books, reducing its shareholders' equity by $1.2 billion. But, because of complex accounting rules, the transaction was not apparent in Enron's quarterly earnings report.

The transaction disturbs investors because it suggests that Enron may have found a way to hide losses, throwing the accuracy of its financial statements into question. When Enron released third-quarter earnings on Oct. 16, it reported a loss from $1 billion in write-offs on failed investments. The earnings statement did not mention the additional $1.2 billion equity write-down. But the company said its core business had been solidly profitable, and its shares rose.

In a conference call with analysts after the announcement, Mr. Lay, Enron's chairman, also disclosed the reduction in shareholder equity. The reference was a brief one, however, and some listeners did not catch it. Those analysts were angered when they found out the next day what Enron had done, and many were confused by the accounting procedure. Enron's stock began to slide, and investors clamored for more information about the write-off. But so far, the company's efforts to clear up the situation have further unnerved investors.

Mr. Lay has met with investors during the last two weeks to try to explain the deals, but some on Wall Street say they have come away with doubts about Mr. Lay's grasp of the situation. They say that the two people at Enron who appear to have been most knowledgeable about the deals - Mr. Skilling and Mr. Fastow - have both left the company.

In an interview in late August, Mr. Lay said he did not know some details about the deals involving Mr. Fastow. In response to one question about them, he said, "You're getting way over my head."

Mr. Palmer of Enron disputed any suggestion that Mr. Lay did not have a grasp of the investments at issue, saying Mr. Lay was handicapped in talking about them because of the S.E.C. investigation. "There is not a whole lot we can say, or should say, about them," Mr. Palmer said. He also said the company expected to generate about $3 billion in cash through asset sales by the end of next year.

In a conference call on Tuesday, analysts pressed Mr. Lay and other top Enron executives to reveal more information about the LJM write- down and its other partnerships. Instead, they offered only vague explanations of the deal, leaving Wall Street worried that more write-offs might be coming.

David Fleischer, a Goldman, Sachs analyst and a longtime supporter of the company, was among those who came away concerned. "If Enron is unable to clarify its off- balance-sheet transactions and restore confidence in the very near term by assuring investors that no more surprises are forthcoming that would affect the balance sheet or liquidity position, then the company will likely lose access to the capital markets," he wrote in a research note after the call.

To try to reassure investors, Enron said late Thursday that EnronOnline, its Internet-based trading exchange, executed more than 8,400 trades that day, a higher-than-normal volume.

"We know we have our work cut out for us if we are to rebuild our credibility with the investment community - and we're working on that," Mr. Lay said in a statement. "But in the meantime, the best evidence of our strength is the willingness of customers to bring their business to Enron."

But those reassurances apparently are no longer enough for Wall Street. Enron's stock tumbled almost 6 percent Friday, to its lowest levels in six years.

Now analysts are scrambling to figure out the extent of Enron's off- balance-sheet debt and to assess the risk that the company will have to issue new shares to make good on its partnership guarantees.

Carol Coale, an analyst at Prudential Securities in Houston, calculates that Enron may have close to $9 billion in off-balance-sheet debt. She said that Enron had for two years been trying to sell about $6 billion in foreign assets - including properties in Latin America and a power plant in India embroiled in a dispute with the state government - and she worries about those prospects for sale in light of Enron's problems and the souring economy.

"As Enron is forced to sell assets to keep the ratings agencies off their backs, they may have to write those assets down," Ms. Coale said. On Wednesday, she downgraded her rating on Enron to "sell" from "neutral."

"The bottom line is, it's really difficult to recommend an investment when management does not disclose the facts," Ms. Coale said.

Short-sellers, who attacked Enron's accounting even before the company disclosed the write-off, say the company's problems may run even deeper than analysts fear. Enron may have used the partnerships not just to finance money-losing investments but to hide losses in its core trading business, they say.

"The company still isn't disclosing enough to know whether the core business, the trading business, is profitable," said Mark Roberts, director of research at Off Wall Street, which recommended shorting Enron's stock on May 7, when it stood at $59.43. "The issue remains: why are they doing these transactions? Our theory has been that the core operations aren't that profitable."

James Chanos, a leading short- seller who has bet that Enron's stock will fall, said, "Is Enron booking gains when it has real profits, but hiding the losses when deals go against it?" Mr. Palmer of Enron said the company stood by its reported energy-trading profits.

Even traders at other energy companies say they do not have a clear picture of Enron's positions. Enron maintains that it is in no danger of being wiped out by a sharp move in electricity or gas prices because it keeps its trading book balanced - meaning the energy it has agreed to sell is offset, in roughly equivalent amounts, by energy it has agreed to buy.

"With these guys, they tell us - and all you've got is their word - that they're hedged," said Mr. Verleger, the economist.

IN fact, Enron has lobbied forcefully over the years to limit regulation and disclosure of its trading operations. Last year, the company successfully lobbied Congress to effectively ensure that its Internet- trading platform would be exempted from regulation by the Commodity Futures Trading Commission.

Enron and other power traders do file limited information in reports to the Federal Energy Regulatory Commission, the agency that oversees wholesale electricity and natural gas markets. But the commission does not keep track of specific transactions and prices.

Large-scale energy trading has existed for only about a half-dozen years. Enron pioneered the business, and now dominates it, accounting for about one-quarter of all trading in the United States.

Before Congress and federal regulators opened up the market for wholesale electricity, a process that began in earnest a decade ago, the power business was a simpler affair. Utilities were given areas of monopoly service, and their rates - and ability to deliver enough electricity - were overseen by state regulators. But with the move to deregulate the business, independent and unregulated generators and traders have flourished, providing an ever-growing portion of the nation's power.

Beginning in the 1980's, the sale and transportation of natural gas was also deregulated, spurring Enron, which used to be primarily a gas-pipeline company, to move into the trading business.

The company's shift to trading gas and electricity accelerated in the mid-1990's, with the ascension of Mr. Skilling, who became chief executive in February, just six months before his unexpected resignation. Underscoring the change in direction, in securities filings this year Enron described its principal business as "security brokers, dealers and flotation." Before, it had said it was in the business of "wholesale-petroleum and petroleum products."

For most of its ascent, Enron reported outstanding profit figures and Wall Street accepted them with pleasure. A year ago, when it disclosed the first transactions with partnerships led by Mr. Fastow, the company's former chief financial officer, analysts who asked questions were told that the deals were routine and were being disclosed only because of Mr. Fastow's involvement.

Enron does not appear to face an immediate cash crunch. But the bank credit lines that it drew on last week to pay off its short-term debt will have to be renegotiated next spring. The controversial partnerships do not have to pay their debts until the following year - unless Enron loses its investment-grade credit rating before that.

ENRON will also need to maintain its large trading positions, which could suffer if participants in those markets grow more nervous about Enron's credit. When Long-Term Capital was stumbling in 1998, some Wall Street rivals sold the securities they thought Long-Term owned, trying to force Long-Term to sell its positions quickly and at a loss. Something similar in energy markets might be possible. If so, Enron might find, as Long-Term did, that positions that should offset each other do not.

Enron's new chief financial officer may yet persuade investors that in fact the company's profits are real, and that its condition is better than the short-sellers believe. As questions are answered, confidence, and the share price, could rebound.

But for now, investors are skittish, and some competitors are eager to take advantage of Enron's plight.

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 3:52 PM
To: Carleton, Norman; Nickoloff, Peter
Subject: House "stimulus" package showering $254 million on Enron

Enron is mentioned in the third paragraph -- I highlighted the text in red ...

October 27, 2001

How to Lose a War

By FRANK RICH

Welcome back to Sept. 10.

The "America Strikes Back" optimism that surged after Sept. 11 has now been stricken by the multitude of ways we're losing the war at home. The F.B.I. has proved more effective in waging turf battles against Rudy Giuliani than waging war on terrorism. Of the more than 900 suspects arrested, exactly zero have been criminally charged in the World Trade Center attack (though one has died of natural causes, we're told, in a New Jersey jail cell). The Bush team didn't fully recognize that a second attack on America had begun until more than a week after the first casualty. The most highly trumpeted breakthrough in the hunt for anthrax terrorists - Tom Ridge's announcement that "the site where the letters were mailed" had been found in New Jersey - proved a dead end. And now the president is posing with elementary-school children again.

Given that this is the administration that was touted as being run with C.E.O. clockwork, perhaps it should be added to the growing list of Things That Have Changed Forever since Sept. 11. But let's not be so hasty. Not everything changes that fast - least of all Washington. The White House's home-front failures are not sudden, unpredictable products of wartime confusion but direct products of an ethos that has been in place since Jan. 20.

This is an administration that will let its special interests - particularly its high-rolling campaign contributors and its noisiest theocrats of the right - have veto power over public safety, public health and economic prudence in war, it turns out, no less than in peacetime. When anthrax struck, the administration's first impulse was not to secure as much Cipro as speedily as possible to protect Americans, but to protect the right of pharmaceutical companies to profiteer. The White House's faith in tax cuts as a panacea for all national ills has led to such absurdities as this week's House "stimulus" package showering $254 million on Enron, the reeling Houston energy company (now under S.E.C. investigation) that has served as a Bush campaign cash machine.

Airport security, which has been enhanced by at best cosmetic tweaks since Sept. 11, is also held hostage by campaign cash: As Salon has reported, ServiceMaster, a supplier of the low-wage employees who ineptly man the gates, is another G.O.P. donor. Not that Republicans stand alone in putting fat cats first. In a display of bipartisanship, Democrats - lobbied by Linda Hall Daschle, the Senate majority leader's wife - joined the administration in handing the airlines a $15 billion bailout that enforces no reduction in the salaries of the industry's C.E.O.'s even as they lay off tens of thousands of their employees.

To see how the religious right has exerted its own distortions on homeland security, you also have to consider an administration pattern that goes back to its creation - and one that explains the recent trials of poor Tom Ridge.

Mr. Ridge is by all accounts a capable leader - a successful governor of a large state (Pennsylvania) who won the Bronze Star for heroism in Vietnam. A close friend of George W. Bush, he should have been in the administration from the get-go, and was widely rumored to be a candidate for various jobs, including the vice presidency. But after being pilloried by the right because he supports abortion rights, he got zilch. Instead of Mr.

Ridge, the administration signed on the pro-life John Ashcroft and Tommy Thompson - who have brought us where we are today.

The farcical failures of these two cabinet secretaries are not merely those of public relations - though Mr. Thompson often comes across as a Chamber of Commerce glad- hander who doesn't know his pants are on fire, and Mr. Ashcroft often shakes as if he's not just seen great Caesar's ghost but perhaps John Mitchell's as well. Both have a history of letting politics override public policy that dates to the start of the administration. They've seen no reason to reverse their partisan priorities even at a time when the patriotic duty of effectively fighting terror should be their No. 1 concern.

Pre-Sept. 11, Mr. Thompson, in defiance of science, heartily lent his credibility to the Bush administration's stem cell "compromise" by going along with its overstatement of the viability and diversity of the stem cell lines it would deliver to researchers. Post-Sept. 11, he destroyed his credibility by understating the severity of the anthrax threat, also in defiance of science. Now he maintains that the $1.5 billion the administration is requesting to plug the many holes in our public health system - almost all of it earmarked for stockpiling pharmaceuticals, not shoring up local hospitals - is adequate for fighting bioterrorism. This, too, is in defiance of all expert estimates, including that of the one physician in the Senate, the Republican Bill Frist.

It should also be on Mr. Thompson's conscience that for the first two weeks of the anthrax crisis he kept the federal government's house physician - David Satcher, the surgeon general and a much-needed honest broker of public health - locked away, presumably because Dr. Satcher, a Clinton appointee, became persona non grata in the Bush administration for issuing a June report on teenage sexuality that angered the religious right. Only after Mr. Ridge arrived on the scene was the surgeon general liberated from the gulag.

As for Mr. Ashcroft, he has gone so far as to turn away firsthand information about domestic terrorism for political reasons. Planned Parenthood, which has been on the front lines of anthrax scares for years and has by grim necessity marshaled the medical and security expertise to combat them, has sought a meeting with the attorney general since he took office but has never been granted one. This was true not only before Sept. 11 but, says Ann Glazier, Planned Parenthood's director of security, remains true - even though her organization, long targeted by such home-grown Talibans as the Army of God, has a decade's worth of leads on "the convergence of international and domestic terrorism."

Ms. Glazier found the sight of Mr. Ashcroft and other federal Keystone Kops offering a $1 million reward for anthrax terrorists a laughable indication of how little grasp they have of the enemy. "Religious extremists don't respond to money," she points out. Such is the state of the F.B.I., she adds, that one agent told a clinic to hold onto a suspect letter for a couple of days "because we have so many here we're afraid we're going to lose it" (perhaps among the Timothy McVeigh documents).

If either the attorney general or the secretary of health and human services inspired anything like the confidence that, say, Mayor Giuliani does, there wouldn't have been a need to draft Mr. Ridge. Even so, he's mainly a P.R. gimmick - a man who should have been in the administration in the first place reduced to serving as a fig leaf for lightweights. As director of homeland security, he's allegedly charged with supervising nearly 50 government agencies - so far with roughly a dozen staff members. When asked to define Mr. Ridge's responsibilities, Ari Fleischer said on Wednesday that it was "a very busy coordination job," but so far Mr. Ridge is mainly sowing still more confusion.

The one specific duty that he has claimed - in an interview with Tom Brokaw - was that he'd be the one "making the phone call" to the president to shoot down any commercial airliner turned into a flying bomb by hijackers. That presumably comes as news to Donald Rumsfeld, who made no provision for any homeland security czar in the Air Force chain of command he publicly codified days after Mr. Ridge's appointment.

Since the administration tightly metes out the news from Afghanistan, we can only hope that the war there is being executed more effectively than the war here - even as Mr. Rumsfeld and his generals now tell us that the Taliban, once expected to implode in days, are proving Viet- Cong-like in their intractability. The Wall Street Journal also reported this week that "instead of a thankful Afghan population, popular support for the Taliban appears to be solidifying and anger with the U.S. growing."

Maybe we're losing that battle for Afghan hearts and minds in part because the Bush State Department appointee in charge of the propaganda effort is a C.E.O. (from Madison Avenue) chosen not for her expertise in policy or politics but for her salesmanship on behalf of domestic products like Head & Shoulders shampoo. If we can't effectively fight anthrax, I guess it's reassuring to know we can always win the war on dandruff.

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 3:57 PM
To: Carleton, Norman; Nickoloff, Peter
Subject: Enron Ousts Finance Chief as S.E.C. Looks at Dealings

October 25, 2001

Enron Ousts Finance Chief as S.E.C. Looks at Dealings

By FLOYD NORRIS

The Enron Corporation, its stock battered by a sudden loss of investor confidence, yesterday ousted its chief financial officer, Andrew S. Fastow, whose involvement in complicated transactions with Enron has drawn the scrutiny of the Securities and Exchange Commission.

"In my continued discussions with the financial community, it became clear to me that restoring investor confidence would require us to replace Andy as C.F.O.," Kenneth L. Lay, Enron's chairman and chief executive, said in a statement announcing the change. Only one day before, Mr. Lay had told investors in a conference call that he and the Enron board "continue to have the highest faith and confidence in Andy."

The company said that Mr. Fastow had taken a leave of absence, but it also named his successor, Jeffrey McMahon, the head of Enron's industrial markets group and a former corporate treasurer.

Enron said none of the officials were available for interviews last night.

The move came after the close of trading on the New York Stock Exchange, where Enron's shares fell $3.38, to $16.41. The price has been cut in half since Oct. 16, when Enron reported its third-quarter earnings. A $1.2 billion reduction in shareholder equity brought on by ending some relationships with partnerships that Mr. Fastow had headed was not disclosed in the earnings news release. Mr. Lay briefly mentioned it in the conference call that followed, but some analysts thought he was referring to a separate $1 billion write-off that was disclosed in the earnings document, and were angered when they later learned about it.

On Tuesday, when both Mr. Fastow and Mr. Lay discussed the company with analysts on the conference call, neither was willing to discuss details of the transactions between Enron and the partnerships formerly controlled by Mr. Fastow. Mr. Lay cited the S.E.C. inquiry in declining to discuss the details of the transactions.

The fact the transactions took place has been known for a year, but Enron's disclosures have been widely criticized for being impossible to understand.

By structuring the deals as involving forward commitments to deliver Enron stock, it appears that Enron was able to assure that losses on them would not lead to reported losses, but instead to reductions of shareholder equity that had no effect on the income statement. That is one of the issues the S.E.C., whose inquiries were disclosed Monday by the company, is expected to address.

Concerns have also grown this week over whether Enron will face losses from complicated financing strategies that kept billions of dollars of debts off its balance sheet but left the company responsible for paying - either in cash or with stock - if things went wrong. On Tuesday, Mr. Fastow assured investors that the company "expects to continue to have sufficient liquidity to meet normal obligations," and said it had bank credit lines that were more than adequate.

Mr. Fastow was viewed as one of the architects, with Jeffrey K. Skilling, the former Enron chief executive who resigned in August, of the change in business strategy that turned Enron from a gas-pipeline company into a an energy trading powerhouse that developed a large Wall Street following. Its stock price peaked in the summer of 2000 at $90.75.

According to a person close to the company, while Mr. McMahon, Mr. Fastow's successor, was Enron's treasurer, he told Mr. Skilling, who at the time was the chief operating officer, that he thought the partnerships involving Mr. Fastow presented a conflict of interest. After that discussion, Mr. McMahon moved to a different job at the company, this person said.

Shares of Enron traded as low as $15.51 yesterday afternoon, the lowest price for the stock since early 1995, before recovering. In after- hours trading, they fell to $16.14.

One of the factors that hurt the stock yesterday was a decision by M. Carol Coale, an analyst at Prudential Securities, to drop her rating to "sell" from "hold." She had lowered the rating to "hold" from "buy" on Monday.

"After the S.E.C. inquiry was announced," she said in an interview yesterday evening, "Enron should have addressed it by delivering a scapegoat, as a gesture to the Street. Now they are replacing him today. The timing is a little late, but I think it will be received positively by the Street."

But she said that investor sentiment might work the other way. "People could fear that if you remove Fastow from the management team, you'll never get any answers."

Nickoloff, Peter

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 3:59 PM
To: Carleton, Norman; Nickoloff, Peter
Subject: Enron Tries to Dismiss Finance Doubts

October 24, 2001

Enron Tries to Dismiss Finance Doubts

By FLOYD NORRIS

Enron has ample access to cash, the company's chief executive said yesterday as he assured investors that there was no need for additional write-offs stemming from unusual financing activities.

In a conference call with investors that was hastily scheduled after Enron's stock plunged on Monday, the chief executive, Kenneth W. Lay, strongly defended the company's chief financial officer and said there was no conflict of interest involved in transactions that the Securities and Exchange Commission was looking into.

But he refused to go into detail on the transaction that Enron made with partnerships run by Andrew S. Fastow, the chief financial officer. In addition, Mr. Fastow, while declaring that Enron "expects to continue to have sufficient liquidity to meet normal obligations," declined to answer any questions about it.

The conference call, which began just as trading opened on the New York Stock Exchange, at first seemed to be reassuring investors. Within minutes of the beginning of the call, the share price rallied to $23.25. But it soon began falling, and ended the day down 86 cents, at $19.79. The day's low of $19.62 was the lowest since Jan. 12, 1998, and was down 78 percent from the high set by the stock in the summer of 2000.

Until recently, most investors focused on the company's reported operating earnings, which showed good results as it became a leading player in energy markets. But the focus has shifted to a series of transactions, some involving off-balance- sheet financing. One, involving partnerships controlled by Mr. Fastow, led to a $1.2 billion reduction in shareholder equity that raised concern last week and led to S.E.C. inquiries that the company disclosed on Monday.

One of the company's strongest supporters has been David Fleischer, an analyst at Goldman, Sachs. But he told Mr. Lay on the call yesterday that Enron had to be more forthcoming with information. "There is an appearance that you are hiding something," he said.

After the call, Mr. Fleischer expressed disappointment. "They've engaged in a number of transactions that one wonders about, and that are hard to understand," he said in an interview. "They have not been as forthcoming in explaining them" as is needed, he said. But he said he was still recommending the stock. "I don't think accountants and auditors would have allowed total shenanigans," he said. "In the absence of total shenanigans going on at this company, there is tremendous value here."

Mr. Lay cited the S.E.C. inquiries as a reason for not discussing details on the transactions involving the partnerships that were controlled by Mr. Fastow. But he emphasized that both he and the company's board "continue to have the highest faith and confidence in Andy."

Mr. Lay said that auditors from Arthur Andersen had carefully reviewed Enron's reporting in conjunction with another off-balance-sheet vehicle, called Marlin. That company owns one-third of Azurix, an Enron subsidiary that owns Wessex, a British water utility. The auditors "have determined there is no write-down required," he said under questioning by Richard Grubman of Highfields Capital Management, a money management firm.

Mr. Grubman said that Marlin owed almost $1 billion on debt that was guaranteed by Enron but had no assets other than the Azurix stake. Noting that Enron had paid about $300 million to buy a third of Azurix from public shareholders and had since taken write-downs on its investment in Azurix, Mr. Grubman asked why the company was not setting up reserves to cover its exposure on that debt, which under a complicated arrangement could end up being satisfied through the issuance of Enron shares.

Mr. Lay said that no action was needed but declined to address details. Eventually he cut off Mr. Grubman. "I know you're trying to drive the stock price down, and you've done a pretty good job of it," Mr. Lay said. "But let's move on to the next question."

Mr. Fastow said the company was having no problem issuing commercial paper and had $1.85 billion in such debt outstanding. He said it was backed by $3.35 billion in bank lines of credit, of which $1.75 billion will expire next May if it is not renewed.

Mr. Lay said he was sorry about "the misunderstanding" that resulted when his brief mention of the $1.2 billion reduction in shareholder equity in a conference call last week was not noticed by some analysts. That reduction would have been apparent if the company had released its balance sheet with the earnings report, but it did not. He said the company would consider releasing balance sheets with earnings reports in the future, but made no promises.

The large reduction in shareholder equity did not affect reported earnings, and so was not in the earnings release. But it raised concerns that some of the sophisticated financing techniques used by the company might be effectively keeping losses off the earnings statement. The S.E.C. is expected to look into whether the accounting for that transaction was correct.

After one questioner on the call said it would be easier to understand Enron if it released financial statements for the special purpose vehicles that were set up to enter into such transactions as Marlin, Mr. Lay said the company "will look into providing" such statements.

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 4:02 PM
To: Carleton, Norman; Nickoloff, Peter
Subject: Where Did the Value Go at Enron?

October 23, 2001

Where Did the Value Go at Enron?

By FLOYD NORRIS

What really went on in some of the most opaque transactions with insiders ever seen?

Wall Street has been puzzling over that since Enron released its quarterly earnings a week ago. Yesterday shares in Enron plunged $5.40, to $20.65, after the company said that the Securities and Exchange Commission was looking into the transactions.

The reaction was in some ways puzzling. Given the questions that have been raised since the earnings announcement - some of them prominently featured in The Wall Street Journal - it was likely that the S.E.C. would begin a preliminary inquiry.

Whether it will go farther than that is not clear, but if nothing else the slide in Enron shares over the last week shows the hazards that can confront a company that allows word of a major reduction in its balance sheet value to dribble out. Enron's shares rose 67 cents, to $33.84, last Tuesday, as investors first reacted to the earnings announcement. But since then they have fallen $13.19, or 39 percent.

The $1.2 billion reduction in shareholders' equity was not mentioned in a news release Enron issued on its quarterly earnings last Tuesday. It was briefly mentioned in a conference call with analysts, but many of the listeners seem to have not noticed that, wrongly thinking Kenneth L. Lay, Enron's chairman and chief executive, was referring to a $1 billion write-off that was disclosed in the earnings release.

When questions were asked in the following days, the explanations were less than thorough. Enron explained that the reduction in shareholders' equity was related to the termination of "structured finance vehicles" involving partnerships that had been controlled by the company's chief financial officer.

"Both the debt and the equity people are looking for more clarity about how the company goes about its business," said Ralph Pellecchia, a credit analyst at Fitch Investors Service. He added that the issue of the company's "credibility related to this transaction really seems to have a life of its own."

Enron declined yesterday to allow any officials to be interviewed about its financial reports. But last night it said Mr. Lay would hold another conference call with investors at 9:30 a.m. today.

The company's earlier disclosures regarding the partnerships baffled many analysts. They referred to such things as "share settled costless collar arrangements" and "derivative instruments which eliminated the contingent nature of existing restricted forward contracts." The disclosures said the company entered into the transactions "to hedge certain merchant investments and other assets."

It appears that Enron was able to report profits from them, even though the underlying assets included investments that declined in value. The Wall Street Journal, citing reports the partnerships made to institutional investors, has reported the partnerships did well enough to make large cash distributions to their investors. Enron officials in recent days have refused to discuss the arrangements in any detail.

One of the questions that the S.E.C. may look into is whether the termination of those transactions should have been treated as a balance sheet item, or whether it should have been taken as a loss that affected reported earnings. An S.E.C. spokesman declined to comment.

Under accounting rules, a company's transactions in its own shares cannot produce profits or losses, whatever the effect on cash flow. So a company that sells its shares for $10 each, and buys them back at $50, or at $1, will report no earnings effect. Enron said that the reduction to shareholders equity, and a related reduction in notes receivable, "is the result of Enron's termination of previously recorded contractual obligations to deliver Enron shares in future periods."

Stephen Moore, an analyst with Moody's Investors Service who has put Enron's debt on review for a possible downgrade, said that while some of the details were not clear, "Essentially, Enron's promise was that a certain amount of Enron's shares would be worth $1 billion. The shares plummeted, and they were not" worth that much.

Enron emphasizes its own version of earnings, which leaves out some expenses, and directs attention away from its balance sheet, which is disclosed only in S.E.C. filings, not in the earnings news release. The reduction in shareholders' equity would be shown only on the third-quarter balance sheet, which has yet to be released.

Earlier this year, Jeffrey Skilling, then Enron's chief executive, reacted strongly when a questioner on a conference call challenged the failure to provide balance sheet numbers when earnings were released. He called the questioner a common vulgarity that surprised many listeners. Mr. Skilling later resigned for what he said were personal reasons and Mr. Lay, the chairman and former chief executive, took back the latter title.

While Enron was riding high, its often difficult-to-understand reports were generally seen as not being a problem. The company appeared to be the dominant force in the business of energy trading, and to be able to produce phenomenal profits. When Mr. Lay was reported as having played an important role in formulating the Bush administration's energy policies, the aura was only enhanced. In January, the shares traded for $84.

But now, with some of the company's ventures clearly having run into problems, it appears that investors are growing less willing to accept the company's reports. That the partnership transactions were disclosed at all was because of the involvement of the chief financial officer, and some have wondered if there might have been similar deals with others.

Mr. Lay has promised to make the company's financial reports easier to understand, and last week's report was at first praised by some analysts for doing just that.

In a news release yesterday, Mr. Lay said the company welcomed the S.E.C.'s request for information. "We will cooperate fully with the S.E.C. and look forward to the opportunity to put any concern about these transactions to rest," he said.

From: Schultheiss, Heidilynne
Sent: Monday, October 29, 2001 4:05 PM
To: Carleton, Norman; Nickoloff, Peter
Subject: NYT Abstract: Enron Reports $1 Billion In Charges And a Loss

FREE ABSTRACT	PREMIUM ARCHIVE

October 17, 2001, Wednesday **Enron Reports $1 Billion In Charges And a Loss** By KENNETH N. GILPIN Source: The New York Times Section: Business/Financial Desk 619 words **Abstract** Enron Corp posts third-quarter loss because of more than $1 billion in one-time charges for various businesses; net loss was $618 million in contrast to net income of $292 million year earlier; revenue rose 59 percent, to $47.6 billion, from $30 billion last year (M) **Lead Paragraph** The Enron Corporation, the nation's leading wholesale electricity marketer and natural gas trader, posted a third-quarter loss yesterday because of more than $1 billion in one-time charges for various businesses. The company reported a net loss of $6... Purchase Full Text of Article

From:	Schultheiss, Heidilynne
Sent:	Wednesday, October 31, 2001 9:37 AM
To:	Carleton, Norman; Nickoloff, Peter
Subject:	NY Times OpEd: Repeal of AMT and Benefit to Enron

October 31, 2001 **The One-Eyed Man** By PAUL KRUGMAN Somewhere I read that to really understand legislation you have to look for the clause giving special consideration to one-eyed bearded men with a limp - that is, you have to look for the provision that turns a bill ostensibly serving a public purpose into a giveaway for some special interest. Most of the commentary about the "stimulus" bill passed by the House last week focuses on the huge benefits it lavishes on giant corporations. But that doesn't tell us much about the specific interests being served. What's good for corporate America is good for General Motors; it would be hard to devise a bill that consists mainly of corporate giveaways without giving a lot of money to the biggest companies. To understand what the bill is really about, you have to look at the big payoffs to not-so-big companies. One piece of the bill is custom- designed to benefit a small group of multinational financial firms. Another is clearly there for the sake of certain health insurers. But the most remarkable thing is how much of the benefit from repeal of the alternative minimum tax - a measure that is also included in the Bush administration's supposed stimulus plan, and which seems to be one of the administration's key priorities - goes to companies that are not all that big. For example, it's not too surprising that calculations by Citizens for Tax Justice show General Motors, with its 380,000 workers, getting a check for $800 million. But it's quite amazing that TXU (formerly Dallas Power and Light), a company with only 16,000 employees, would get a check for $600 million. And there are a number of medium-sized companies that, like TXU, are in line for surprisingly big benefits. These companies include ChevronTexaco, Enron, Phillips Petroleum, IMC Global and CMS Energy. What do they have in common? Well, they tend to be in the energy or mining businesses; and they tend to be based in or near Texas. In other words, the one-eyed bearded man with a limp looks a lot like Dick Cheney. There is almost certainly a lot of overlap between the companies that would derive large benefits from alternative minimum tax repeal and those that would have received large subsidies under the energy plan devised by Mr. Cheney's task force. You may remember that the administration, in apparent defiance of the law, refused to make the records of that task force's meetings available to Congress; that's one of those issues that seems to have been dropped after Sept. 11. And I guess it's superfluous to point out that the big winners in all this seem to be companies that gave large, one-sided donations to the Republican Party in the last election. (This is not to suggest that Democrats are any less susceptible to the influence of money.) To me, the story of the Bush administration is starting to look like the plot of "Victor/Victoria." First we had a candidate who was supposed to be a moderate. Then we learned, or thought we learned, that this was a mask; he was really a hard-line conservative who pretended to be a moderate in order to gain office. But the latest economic proposals from the administration, like the Cheney energy plan, don't look as if they came from serious free-marketeers. They don't make sense in terms of either demand-side or supply-side economics, but they do give a lot of money to certain companies. So maybe ideology was just another mask for someone who was really the candidate of corporations - not corporations in general, but a small group of companies with a quite specific set of business interests - and who is only pretending to be a hard- line conservative who pretended to be a moderate in order to gain office. It's an interesting and all too plausible picture. But it's a picture that most people will never see on their TV, and that many people would refuse to accept no matter how strong the evidence. That, of course, is what makes the whole thing possible. In the land of the blind, the one- eyed bearded man with a limp is king. In last Wednesday's column I said the "original" war bonds were issued during World War II. In fact, war bonds were also issued during the Civil War and World War I. I don't think this affects the argument.

From: Carleton, Norman
Sent: Wednesday, November 07, 2001 3:07 PM
To: Schultheiss, Heidilynne; Nickoloff, Peter
Subject: WSJ: Dynegy In Talks To Put About $2B Into Enron Now

November 7, 2001

WSJ: Dynegy In Talks To Put About $2B Into Enron Now

Dow Jones Newswires

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By Robin Sidel
Of The Wall Street Journal
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NEW YORK -- Dynegy Inc. (DYN) is in advanced discussions to infuse about $2 billion into **Enron** Corp. (ENE) in a transaction that may lead to a full-blown merger between the two companies, sources familiar with the matter told The Wall Street Journal.

A formal transaction could be unveiled as early as Thursday, these people said. The situation is very fluid and is subject to change, these people noted.

(This report and related background will be available at the Journals' Web site, WSJ.com.)

Enron has been rocked by last month's disclosure of a $1.2 billion reduction in its equity base partly tied to financial dealings with company partnerships headed by Enron's former chief financial officer. Last month, it reported a third-quarter loss of $618 million. The Securities and Exchange Commission has launched a formal investigation into the matter. Last week, **Enron** secured $1 billion in new credit lines, using gas-pipeline assets as collateral.

Enron needs the infusion in part because its previously announced plans to raise cash through the sale of power assets is going more slowly than expected. Mostly, though, it needs to restore its credibility with Wall Street at a time when its access to the financing markets is drying up.

Enron shares recently traded down $1.57, or 16%, at $8.10.

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-Robin Sidel; The Wall Street Journal; 212-274-7991
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Enron, Houston, declined to comment. Dynegy could not be reached for comment.

Shares of **Enron** recently were down 87 cents, or 9%, to $8.80. Dynegy was down $2.18, or 6%, to $33.82.

News of the Dynegy discussions was first reported on CNBC.

-Robin Sidel, The Wall Street Journal; 212-274-7991

From: Carleton, Norman
Sent: Wednesday, November 07, 2001 3:09 PM
To: Schultheiss, Heidilynne; Nickoloff, Peter
Subject: DJ: Former Enron CEO Testifies Before SEC Tuesday - Exec

November 7, 2001

Former Enron CEO Testifies Before SEC Tuesday - Exec

By JASON LEOPOLD

Of DOW JONES NEWSWIRES

(This article was originally published Tuesday.)

LOS ANGELES -- Jeff Skilling, the former chief executive of embattled energy company **Enron** Corp. (ENE), canceled an appearance in Los Angeles Tuesday because he was testifying before the U.S. Securities and Exchange Commission in Washington D.C., according to Ross DeVol, executive of the office of the chairman of the Milken Institute, which was sponsoring a conference where Skilling was scheduled to speak.

DeVol said he spoke to Skilling on the telephone Monday, and Skilling said he was canceling his appearance in Los Angeles because he was subpoenaed by the SEC last week to testify Tuesday.

"I spoke with Jeff briefly, and he said he had to testify before the SEC in Washington, but he didn't say specifically what for," DeVol said.

Skilling was unavailable for comment. **Enron** spokesman Mark Palmer said he was under the impression Skilling was in Houston Tuesday and not testifying before the SEC, but that he received the information "third hand."

An SEC spokesman said the agency could not confirm or deny Skilling's appearance before the commission. As a matter of policy, the SEC does not comment on investigations.

Enron shares have declined more than 70% since mid-October, when the company disclosed a $1.2 billion reduction in shareholder equity that resulted from the unwinding of a partnership headed by its former chief financial officer, Andrew Fastow.

The SEC launched an inquiry two weeks ago into the partnership, according to **Enron**, and last week, **Enron** said the inquiry had become a formal investigation.

An **Enron** spokesman said the SEC investigation is focusing on "third party and related party transactions."

-By Jason Leopold, Dow Jones Newswires; 323-658-3874; jason.leopold@dowjones.com

From: Carleton, Norman
Sent: Wednesday, November 07, 2001 3:11 PM
To: Schultheiss, Heidilynne; Nickoloff, Peter
Subject: Dow Jones Newswires: Liquidity Concerns Continue To Dog Enron Bond Holders

November 7, 2001

Liquidity Concerns Continue To Dog Enron Bond Holders

Dow Jones Newswires

(This article was originally published Tuesday)

By Michael C. Barr
Of DOW JONES NEWSWIRES

NEW YORK -- Wary investors in bonds of embattled **Enron** Corp. (ENE) continue to have cause to worry.

The company's bonds are being quoted on a dollar basis in the 70s, according to Harold Rivkin, principal, H. Rivkin & Co., a distressed bond brokerage, Princeton, N.J.

"It's an investment grade name but the market is treating the bonds as if they were junk or a distressed credit," said Rivkin. Distressed investors focus on the debt of companies perceived as in or near default.

"Some of Enron's debt is trading as if the company were rated single-B," added Tom Haag, senior analyst in charge of distressed securities, Lutheran Brotherhood, Minneapolis, Minn.

The Houston-based energy company has suffered from a big loss of investor confidence following the company's recent announcement of a $618 million third quarter loss and the disclosure of a $1.2 billion erosion of investor equity related to partnership transactions undertaken with the company's former chief financial officer, Andrew Fastow.

While **Enron** was able last week to obtain $1 billion in new credit lines from JP Morgan and Salomon Smith Barney, it was necessary for the company to provide security support in assets of its Northern Natural Gas Co. and Transwestern Pipeline Co. In addition, the company has about $1 billion in cash on hand.

Debt Downgraded

Nevertheless, Fitch on Monday downgraded Enron's senior unsecured debt to triple-B-minus from triple-B-plus. It's now just a notch above junk bond status. Last week, Standard & Poor's Corp. lowered its credit rating on **Enron** to triple-B, while Moody's Investors Service lowered its rating to Baa2.

"Downgrades can deny them access to the capital markets," said Marty Whitman, chairman, Third Avenue Funds, New York City.

The company will have to increasingly rely upon secured bank lending. And with Enron's assets tied up in banks' hands, "investors will not want to take a look at the company's common" stock, Whitman said.

"Investor confidence is a credit issue for a trading company," said Bob Grossman, chief credit officer, Fitch. **Enron** bonds remain on Rating Watch Negative.

Crucial will be Enron's ability to maintain its trading relationships with its counterparties. It will also have to avoid further losses and maintain its liquidity and demonstrate credit raising capability, said Grossman.

The company has a liquidity plan that it's working on. "We are waiting to see how well they can execute it," Grossman said. There are factors that they have control over, and others that they don't, he added.

Search For Liquidity On

In an effort to support its capital position, the company was reported in Tuesday's Wall Street Journal to be seeking a cash infusion of $2 billion. The company was approaching buyout firms and power trading companies, according to the article.

And, in the current investment environment, liquidity is paramount, especially for a company that uses a lot of cash, said Lutheran Brotherhood's Haag.

"Anyway the company can improve its liquidity will help," Haag said.

But creditors might be putting the company on a tighter leash. Not only is liquidity crucial, but so are the terms on which it's offered, added Haag.

"There is a sense that the banks are grabbing up all the best security," said Harold Rivkin.

In a further move to allay investor concerns, it was reported by CNBC reporter David Faber on Tuesday that **Enron** would take steps to make it much easier to understand its complex partnerships.

This concession to investor fears can't have come too soon.

"I'm very alarmed about off-balance sheet debt," said Third Avenue Funds' Whitman.

The company did not respond to a telephone request for comment.

-By Michael C. Barr, Dow Jones Newswires; 201-938-2008;

michael.barr@dowjones.com

The Future of Financial Reporting After Enron – Restoring The Public Trust, Once Again

National SEC Reporting Conference

SEC Institute

New York, New York

December 18, 2001

Lynn E. Turner

Director of the Center For Quality Financial Reporting

Colorado State University

(formerly Securities and Exchange Commission Chief Accountant)

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I want to thank Andy, as usual, for the kind introduction. As you no doubt know by now, Andy and the SEC Institute put on absolutely the premier conferences for professionals who deal with the SEC and financial reporting of public companies. I am once again honored that he would invite me to the podium.

An Important Role for an Honored Profession

Our profession has the honor of serving the public as a result of a franchise Congress saw fit to convey to us sixty-eight years ago. The collective roles we play are critical to the success of the U.S. capital markets and ultimately to the U.S. economy.

Some of you prepare financial statements that provide investors and the capital markets with the financial information they require, in order to make informed decisions. Some of you are involved with independently ensuring the integrity of that data, an equally important role. Without the public service our profession performs, the capital markets could not function efficiently.

And just how important is that? Lets put it in context. Today, one out of two American adults have invested their money, including their savings for perhaps retirement or their children's education, in the markets. That is up approximately sixty percent in the last decade. It is likely your neighbor, a member of your family or the person sitting next to you have placed their trust and confidence in what you, what we all do in our profession.

During the past ten years our profession has experienced much financial success. We have all lived through the greatest economic boom our country has ever experienced. No American, in the 225 years since the Declaration of Independence, has seen such a phenomenal period of growth and wealth.

Changing Times – A Crisis In Confidence

But in the past, as with today, we have seen the good times also bring with them excesses. In the early 1800's everyone invested in canals after the success of the Erie Canal. But that excess eventually turned into an economic decline and losses by investors. Steamships, then railroads replaced the canals. Today's Union Pacific was brought out of bankruptcy during a period when investor's lost their shirts, so to speak from excessive investing in this new technology. Likewise, the new technologies of radios, cars and airplanes in the 1920's preceded the stock market crash of 1929. Having been burned too often and being skeptical, and with war bonds offering greater safety in investing, investors did not return to the markets until after World War II.

Some have said the rooster has come home to roost given the unbridled speculation and irrational exuberance of the 1990's. From the flower children generation of the 60's and 70's that was going to change the world, we turned into the "me" generation by the 90's. We bought into the dot.com phenomena which has turned into the dot.gone, as in investor's money is now gone. We bought into the greater fool theory and over time were fooled ourselves.

Let me give you some food for thought. Companies like Webvan and EToys have become as extinct as the dinosaur. Of the 547 IPO's from 1999, many trade for pennies or don't trade at all. The recent and final Fortune Dot.com Deathwatch highlighted that 519 dot.coms have passed in the last two years, 384 since the beginning of the year, with 98,522 people being laid off in 2001 by these once high flyers.

Investors were sold a "bill of goods" by the underwriters of the "new economy" and have been burned by their own lack of research. The underwriters lined their pockets while the pockets of investors got fleeced. In the December 11th edition of the Wall Street Journal, an article said of Credit Suisse First Boston's $100 million settlement, "many small investors ended up as losers when they rushed to buy those new stocks just as the favored customers were selling." As a result, investors today are unwilling to fund new technology companies and innovation in our economy suffers. No one should be surprised.

Analysts also lost the public's trust when they became cheerleaders who pushed for new business, rather than pushing the numbers and providing honest, intellectual research. In fact, research by four university of California professors show that stocks most highly recommended by analysts in 2000 under performed the market last year by 31.2% while those they least favorably recommended out performed the market by 49%. The only thing more amazing to me is why analysts think the investing public should read their reports. Perhaps Regulation Fair Disclosure will help save the analysts from themselves, as once again they are compelled to do what their name implies, analysis. Lets hope the whispers have been silenced for good.

The tale of our own profession is not a rosy one. There has been a constant parade of stories in the press about financial fraud, which are causing the investing public to question the credibility, the integrity and the validity of what we do. I remember attending a conference in March of 1998, before I joined the Commission, at which a respected member of the Bar held up an article for the audience. The title of the article was "Pick a Number, Any Number." Many similar articles including one where the title was CPA – Certified Public Accomplice, have followed that up. The President of the American Institute of Certified Public Accountants, or AICPA, said he believed the word "Accountant" in CPA was constraining on the profession. Personally, I like the ring to it a lot better than the word accomplice!!

But more recent articles in Harvard Business Review and Business Week have followed these articles. These stories have highlighted widespread abuses in earnings management and the use of pro forma numbers. Numbers that present a company as "management wishes it was" – not as it truly is. Numbers that make one wonder if Grimm's Fairy Tales haven't come to the world of accountants and become a part of our curriculum.

But then again, we are quickly snapped back to reality by such tales as:

- Cendant

- Rite Aid
- Livent
- Informix
- WR Grace
- Sunbeam
- Just For Feet
- Lernout and Hauspie
- Xerox
- Lucent
- Oxford Healthcare
- Superior Bank
- HBO McKesson
- Microstrategy
- Critical Path
- Waste Management.

The price tag to investors as a result of the restatements of financial statements arising from these cases and others during the past half dozen years or so total close to $100 billion dollars. The number of restatements have risen from 116 in 1997 to over 230 in 2000 according to a study by Andersen. In many of the restatements, the previously audited numbers were found to be in error for not just one, but rather two or more years. And so people are asking, "where were the auditors?" Can you recall any of the headlines associated with the above cases saying – "Investors Protected - Fraud Detected In Time by Auditors."

Let me read you from a footnote in the 1999 Rite Aid financial statements. It says:

> "*In connection with the review by the staff of the Securities and Exchange Commission* of a registration statement relating to debt securities previously sold by the company, the company is discussing with the staff certain accounting matters. *As a result of those discussions* and the company's

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review, the company has made adjustments to its financial statements for fiscal years 1997 and 1998. (emphasis supplied)"

The key point here is that a desk top review by a staff accountant in Washington D.C. turned up the initial restatements that eventually led to more changes in the Rite Aid financial statements and the financial fraud case the legal authorities and SEC are currently investigating. Changes that decreased inventory by more than half a billion dollars, decreased property, plant and equipment by more than $600 million dollars, and decreased shareholder's equity by approximately $1.6 billion dollars. I ask you, as many ask me, how is it this SEC staff person found what others in the field, including the auditors, did not?

And what must the public think of the recent headlines heralding the settlement of a Big Five accounting firm of fraud charges for its involvement in a medicare billing scam? This same firm's international operations are the subject of a recent case brought by the Justice Department and the SEC charging them with being an active participant in fraud. Let me read from the allegations:

> "The complaint alleges that in 1999, Harsono authorized KPMG-SSH personnel to bribe an Indonesian tax official on behalf of one of KPMG-SSH's clients....KPMG-SSH agreed to make the illicit payment to influence the Indonesian tax official... The Commission's Order finds that, in March 1999, Baker Hughes' CFO and its Controller authorized the above described illegal payment, through KPMG-SSH, its *agent* in Indonesia, to a local government official in Indonesia. (emphasis supplied)"

At an international conference of securities regulators in June of this year, the international CEO of this firm said the SEC had over stepped its bounds last year with its auditor independence rulemaking. He stated auditor independence rules should be based on an accounting firm assessing whether it had determined it was independent or not. In response to those comments, I ask you, does anyone here today think an "agent" making illegal bribes for a client, is capable of making a determination of whether they are an independent third party, capable of rendering an unbiased opinion on a set of financial statements?

Enron

And to top it all off, we now have Enron, who until recent months, was the seventh largest corporation in America. A company whose value affected every S&P 500 indexed fund in the country.

USA Today has put the losses to investors in Enron at $92 to $93 billion dollars. The loss to the common stock holders alone is approximately $63 billion dollars. I think it will be some time, months, maybe years before we know the full collateral effect and losses from the collapse of Enron. But for today, let me put these losses in perspective for you. They are:

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- Six times the losses suffered from Hurricane Andrew.

- Approximately twice the amount of funding Congress recently approved for the losses from 9/11.

- Approximately the amount of the economic stimulus package President Bush has requested for the entire country.

- The losses from failures of savings and loans institutions, such as Lincoln Savings and Loan and Silverado, which together aggregated approximately four to five billion dollars, pale by comparison.

As a result of the problems arising from the restatement of the Enron financial statements, statements audited by an accounting firm that was paid a $1 million per week, twenty-one thousand employees at Enron are wondering if they will keep their jobs, what they can afford for Christmas and in some cases, what will they do with their retirement nest egg wiped out.

<u>A Profession In Crisis</u>

As Paul Volcker, the former Chairman of the Federal Reserve said shortly before Thanksgiving in New York, we are a profession in crisis. We are like a ship without sails in a stormy sea. We are sorely lacking a captain who can bring us about, raise the sails once again and get us moving in the right direction. We need to be in search of solutions, not excuses. Instead of always responding as we have in the past that most audits are ok, or that we can't achieve zero defects, we need for once to embrace the notion that the public expects us to at least pursue a goal of zero defects as an end, albeit a goal that may prove elusive.

And as a college professor I ask you, how do you think investors perceive our profession? What grade do you think your neighbors, your family and friends, that have their money invested in the markets, are gong to grade the profession? Are we even deserving today of an average grade of "C"? Have we passed or failed the test of public opinion?

<u>More Than Words - A Call For Action</u>

I often tell my students, the purpose of learning about history and current events, is to gleam the lessons they teach us. Then I ask the students to take that knowledge and use it in a positive manner to change the future. So it is, that our profession also needs to study the financial disasters we have just discussed, just as the airline industry and regulators do when an air disaster occurs. We need to study what has gone wrong and use what we learn in a positive, yet focused and very determined effort. Most of all, we need to make the necessary changes that will ensure that, unlike the movie "Groundhog Day," we do avoid tomorrow, what has happened to us today.

At the same time, much of what we can learn from history is <u>already</u> catalogued in prior reports. Reports from committees or commissions that have studied in-depth the shortcomings of our profession. The 1978 report of the Cohen Commission, the 1985 Price Waterhouse report regarding challenges and opportunities for the accounting profession, the 1987 Treadway Committee report, the 1996 report of the GAO on the profession and the O'Malley Panel Report issued in August 2000. All of these reports include some excellent recommendations including many that our profession has yet to implement.

So what are the solutions?

<u>Renewed Commitment to the Public Interest</u>

First, we as a profession need to recommit ourselves to serving the public. And on this point, words alone won't do. Too many times in the past the Big Five accounting firms and the professional trade organization have failed to walk the talk. Actions are needed. The time for talking has long ago come to an end. Just ask those Enron employees who got layed off in the past couple of weeks, just before Christmas. Our words ring hallow with them, as well they should.

Recently, the CEO of Andersen and the CEO's of the other Big Five accounting firms called for changes as a result of the Enron debacle. I couldn't agree more. The CEO's said the FASB needs to fix the problem of SPE's. But these are the same firms that a dozen years ago fought the SEC's efforts to establish and strengthen these rules. [I would add that the "fix" should include not just SPE's, but also of the hundreds of billions of dollars of off-balance sheet debt structured as leases or other forms of structured financings.]

These CEO's also said we need to establish a more effective oversight system than currently exists among a group of organizations such as the AICPA, SECPS, PEEC, QCIC and POB. I couldn't agree more as this is a group that sounds and acts more like alphabet soup, than an effective regulator. But these are the same firms and CEO's that refused to sign on to a strong new charter for the POB during the past year, instead rejecting the recommendations of the O'Malley Panel and SEC and holding out for a weaker POB. A POB that has <u>*NO*</u> disciplinary powers or powers to set auditing standards that will protect the public. A POB that is <u>*MANY*</u> times weaker than a framework for self-regulation recently adopted in the UK by the profession and regulators. Weaker than the SEC supervised self-regulatory organization proposed some fifteen years ago by the then CEO of Pricewaterhouse.

The accounting firms also called for improvements in the effectiveness of audits. But a year and a half after the O'Malley Panel issued its recommendations, the Auditing Standards Board (ASB) has yet to adopt a single new statement on auditing standards, implementing the most critical recommendations. And when the ASB recently exposed an improved standard requiring auditors to document more of the work they perform, not all of these firms voted in support of the improvements.

The CEO's did call for, as SEC Chairman Pitt has previously done, enhanced financial disclosures such as greater disclosure of key financial performance measures and more timely disclosure of material information to investors. I commend the Chairman of the SEC and Big Five firms and wholeheartedly support their efforts in this regard. Of course companies can currently do this under existing SEC rules but in many instances have chosen not to.

But there is one ***MAJOR*** point these accounting firm CEO's are missing. It is the public interest issue. It is why we have a "*P*" in CPA. It is the fact that it does not matter what rules we have for SPE's, it doesn't matter what financial information is required to be disclosed, or when it is disclosed, if:

1. The CEO and CFO plays the numbers game and puts out inaccurate, incomplete or misleading information, and

2. The auditor fails to say time out, the numbers have to be changed and corrected.

A good first step toward demonstrating to the public we are more concerned about serving the public and less about how we can maximize consulting work by cross-selling services, would be to tell the public we are going to remain CPA's, not cognitor's, not XYZ'ers, or whatever name they think of next at the AICPA. I urge you to vote against the monstrosity of a proposal by the AICPA for a global business consulting credential, and the related for profit portal project that appears to line the pockets of some within the AICPA, but certainly not those we serve. As BDO Seidman said in a September 5, 2001 letter to the AICPA, "In our view, the proposed global credential is an ill-conceived initiative that could greatly damage the accounting profession and, indeed, may already have irreparably tarnished the self-image of the CPA." PricewaterhouseCoopers, BDO Seidman and the growing number of state societies that have come out vocally against this proposal are to be recognized and thanked for their opposition to this shipwreck in the making.

Immediate Adoption of O'Malley Recommendations

A second step towards a solution that will reassure the public, would be for the firms to commit to adopt all of the recommendations of the O'Malley Panel now. The O'Malley Panel recommendations include the call to rewrite most, if not all of the auditing standards to make them more detailed and put "teeth" in them. They also include the call for forensic type auditing procedures and greater documentation of the actual work performed. These recommendations should be expedited through the ASB on a "fast track" basis. Already the public has waited for over a year. The public should not have to wait for another year or two or three.

One issue the staff of the SEC and O'Malley Panel discussed was the issue of non-standard journal entries being made by companies, particularly at the end of a financial reporting period. Many of the financial frauds that have occurred over the past dozen or so years stem from these entries. And it is interesting to note that in a recent peer review, I observed that a major international accounting firm did not require its auditors to examine, even on a test basis, such entries. If the auditor is not going to look at what is unquestionably one of the major vehicles used to "cook the books," he is going to have a tough time figuring out what is in the soup!!! It is time that the ASB adopt a rule that requires all auditors, in all audits to examine non-standard journal entries.

On the issue of the O'Malley Panel, let me also make one additional comment. Recently a partner at a senior level in one of the firms said: "Lynn, how do you reconcile the fact the O'Malley Panel concluded audits were ok today, with your views that work remains to be done." My response is to note the O'Malley Panel set forth over 200 good recommendations to the profession, including a requirement for performance of forensic auditing procedures. I have strongly supported these. What is surprising is that we got such good recommendations in light of the fact the O'Malley Panel findings were based to a large degree on the Committee's review of quasi-peer reviews. These reviews were done under the supervision of team leaders from the accounting firms who also lead the teams for the regular peer reviews. I doubt these team leaders, some of which were also at the same time overseeing the regular peer review, were going to say the performance of audits were less than satisfactory during the quasi-peer reviews because of the shadow that would be cast on the reports they issued during the regular reviews.

Providing Needed Tools for SEC Enforcement

The O'Malley Panel did recommend the SEC allocate additional resources to combating financial fraud. With only twenty to twenty five accountants in its enforcement division in Washington D.C., where much of the heavy lifting is done, along with another twenty five or so spread around the country, the SEC has been significantly understaffed. And in the past, the SEC staff, who are some of the brightest and most dedicated professionals I have worked with, have been underpaid in comparison to their counterparts in the banking agencies or in private practice. I hope Congress will respond to the O'Malley report and provide the necessary funding for additional staff as well as reasonable compensation levels for existing staff.

I also hope that the SEC will use all of its powers to thoroughly investigate the Enron matter in its entirety and bring those who are found to have operated outside the established guidelines, to quick justice. I have every faith the agency will do just that. However, we must be mindful that the defense Bar has a very successful record of "waiting out" the SEC in its enforcement cases, waiting to see if the investigating staff leave for a job that pays. Unfortunately, this has resulted in too many cases reported in the press in the past dozen years, ultimately being dismissed without adequate compensation to investors.

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And the defense Bar should not be underestimated. Recent cases involving Baymark and California Micro Devices have raised serious questions as to whether the standard of recklessness the SEC applies to Rule 102(e) proceedings against accountants, is too high a standard by which to measure unprofessional conduct by an accountant or auditor. Rule 102(e) is the regulation by which the SEC may censure an accountant in a public company or an auditor and deny them the right to practice before the Commission. The rule is used to protect the integrity of the system and processes that are key to efficient markets. It requires that an accountant must be reckless in order to demonstrate they have engaged in unprofessional conduct. As a result, in cases involving negligence or other unprofessional behavior that is less than recklessness, a 102(e) sanction baring the practice of the accountant before the commission or in a public company cannot be pursued.

It should be noted that some professionals have challenged the SEC with respect to whether a Rule 102(e) proceeding may be initiated against an accountant within a public company, if they are not a currently licensed CPA. Today, many of the CFO's, Controllers and key financial reporting people do not have, or have not maintained a current CPA license. In essence, the lack of current SEC actions pursuant to Rule 102(e) against non-licensed accountants sends a strong message. I think it is the wrong message that CFO's and Controllers are better off without their licenses than they are with them.

Effective Oversight

A third piece of any solution will necessarily entail effective oversight of the profession. In the mid-80's, the CEO of Pricewaterhouse proposed an SEC supervised self-regulatory organization or SRO. I believe we need to seriously consider whether the time has come for an SEC supervised SRO in light of:

- The AICPA and profession having cut-off the funding for the POB in spring of 2000 when it attempted to fulfill its mandate to the public and carry out an investigation of the lack of compliance with independence rules.

- The AICPA having a weak, if not totally ineffective self-disciplinary group called the Professional Ethics Executive Committee or PEEC. A group that conducts its meetings behind closed doors, that often defers taking action on cases for years at a time, that has no subpoena powers, and that has failed to take action in a number of instances after the SEC has. The AICPA and firms had stated to the SEC and public in press releases towards the end of 2000 that they would work towards increasing the public membership of this organization from the current three out of 20 members. Andersen publicly said it would support an increase in public membership to half of the committee's total membership. Unfortunately, this has become a broken promise.

- The AICPA creating a for-profit portal and web of business relationships along with a business consulting credential. It is difficult to understand how a not-for-profit organization can enter into this web of for-profit relationships and not create conflicts with the notion of being a public interest self-regulatory organization.

- The POB itself has no disciplinary powers and has fought to avoid getting them

- The POB has limited capabilities to ensure auditing standards are written based on meeting the needs of the public for effective audits, as opposed to being written by, and for, the general legal counsels of the firms.

- The Quality Control Inquiry Committee or QCIC that is often trumpeted as investigating alleged audit failures in fact has no subpoena powers. It only has members from the profession, often retired partners from the Big Five "club", lacks members from the public and only looks at documents that are already publicly available. It has recommended cases to the PEEC for further action. Action that too often fails to materialize.

The new regulatory system being implemented in the U.K. provides a glimpse at the key components that must be in any effective self-regulatory system for the accounting profession. These include:

- A governing board comprised of representatives of the public who are not practicing accountants and that conduct their affairs in the "sunshine." As Senator Patrick Daniel Moynihan has said: "Secrecy is for losers."
- A disciplinary mechanism that has subpoena powers and the ability to keep its investigations confidential until completed.
- An ability to oversee or establish auditing standards that will protect the public and that are changed on a timely basis in response to shortcomings found in the system as a result of timely investigations of major financial reporting problems.
- The ability to carry out timely investigations of particular financial reporting cases, accounting firms or the profession.
- The ability to perform reviews of the profession and ensure appropriate quality controls are working effectively.

In light of the Enron matter, the unbroken flow of financial frauds and an alarming increase in the number of financial statements having to be restated, Congressman Dingell has called for the POB to undertake an investigate Andersen and the profession. We will soon see if the POB is really the representative of the investing public we hoped for; one that will speak out on behalf of and protect investors; or is in reality what is best referred to as a "Quiet, Lets Not Rock the Boat Board." Keep in mind that during the very public, very heated debate on the auditor independence rules last year, while investor's testified and commented time and time again, the POB was so silent you could hear the pin drop. Perhaps now we will finally see a reinvigorated POB go back to the drawing board and adopt *ALL* of the recommendations of the O'Malley Panel. The public deserves no less.

<u>Timely and Quality Accounting Standards</u>

Reestablishing the public's trust and confidence in the numbers must also include a renewed effort on the part of the standards setters to provide timely guidance in the form of high quality accounting standards. And by high quality accounting standards, I mean standards that will result in the financial statements reflecting the actual economics of the underlying business transactions.

We have what is acknowledged around the world as being the best accounting standard setter – the Financial Accounting Standards Board or FASB. But the Board today often comes under tremendous pressure from business, the accounting firms and Congress to compromise its conceptual framework and adopt standards that give management more ability to be less transparent about the actual results they have achieved. You only have to look to Statement No. 123 on stock options, No. 133 on derivatives and most recently Nos. 141 and 142 on business combinations for classic examples of such behavior.

And in light of the Enron matter, we have already seen some critics use this opportunity to attack the Board's efforts to move toward more fair value measures. Instead, they would rather have the balance sheet show a number the company paid for an asset, a value that provides investors absolutely no information as to what the real values of assets and liabilities are in today's world. These people have short-term memories and have conveniently "forgot" about the under-reported losses that occurred in the S&L debacle, or the losses on derivatives that "surprised" investors of companies such as Proctor & Gambles, Gibson Greetings, and Bankers Trust when their true value and exposures became known. Or how about the Fortune 500 companies where approximately ten percent of them had to report an impact of greater than $50 million in their financial statements, some even in the billions, when they were required to report their derivatives at their fair value this year. The question is not whether we should use fair value reporting, but rather a matter of adopting standards and guidance that ensure the values reported are reasonable. And last year the SEC staff made just such a request to the accounting profession.

Yet the Board has taken way to long to develop standards that are sorely needed to protect the public. For example, the Commission asked the FASB to address the issue of whether certain transactions result in a liability or equity in the mid-70's. Investors are still waiting for an answer. In 1982 the FASB undertook the project on consolidations, which includes the issue of SPE's. An issue the staff of the SEC has repeatedly urged the FASB to act on during the past three years. Today investors are still waiting for an answer. In 1970's the Cohen Commission recommended the FASB adopt a standard that would require a footnote describing and discussing items in financial statements that effect the comparability of the statements from one period to another, a standard that would have gone a long way towards fixing the current "pro forma earnings" problem. Yet investor's today, after almost twenty-five years, are still waiting for guidance. If the SEC and investors are to look first to the private sector to set standards, then they have the right to expect timely action on the part of the standard setters.

One of the reasons the Board is kept so busy, is the ability of those who design, structure and engineer financial transactions, to get around the rules. The advent of the SPE's in the early to mid 80's is a product of such efforts. Much of the off balance sheet lease financing can also be attributed to financial engineering. A design and engineering process the accounting firms play a key role in and which results in less, rather than more, transparency for their real client, the investing public. Each of the accounting firms work closely with investment bankers and clients to structure off-balance sheet transactions and products that can make Wall Street and the firms millions, but in the Enron debacle have cost investors billions. While I firmly believe an accounting firm should work closely with companies it audits to ensure they get the accounting answers right, working with them to remove things from the eyes of investors is just plain wrong. I urge audit committees and the Auditing Standards Board to take the necessary steps to stop this practice immediately.

And speaking of standard-setters, let me mention the Emerging Issues Task Force or EITF. This is a group of professionals from the accounting firms and industry who meet in Norwalk Connecticut about every other month to discuss and provide guidance on emerging accounting issues. The group does not include representatives of the public or users of financial statements, such as investors. While the new International Accounting Standards Board must approve all standards adopted by its equivalent of the EITF in a public process, the approval of the FASB is not required for any EITF standards. The Board can override an answer the EITF approves, but has formally done so only once since the formation of the EITF in 1983.

The EITF does not have a charter or mission to come up with an answer that provides the greatest transparency and highest quality financial reporting. And all too often, the group arrives at exceedingly complex answers that are difficult at best to implement in the field, driven by business interests of special interest groups, industry members and accounting firms that are often lobbied by their clients. That is what happened when the EITF dealt with the issue of SPE's in 1990 and the members initially voted not to do anything. An impassioned plea for help by the SEC staff resulted in a final watered down rule that quite frankly does not adequately address the issue.

Today some believe the EITF's most important role is to serve when needed as an amnesty program, by constantly giving a "bye" to those who in the past have failed to follow the spirit and intent of the rules, a view I also share. The EITF's most recent deliberations on the accounting for elimination of the effects of derivative transactions in consolidation is a glaring example of such standard setting.
Too bad the Enron investors and workers won't get a similar "bye" on their losses. It is time for the Board of Trustees of the FASB, to undertake to have an independent review performed of the EITF, and ensure it is adequately serving the public's interest.

Enhanced Disclosures

Both current SEC Chairman Pitt and former Chairman Levitt have rightly called for enhanced disclosures regarding financial measures that would provide investors greater information about the value of companies. The Garten Committee was established to study this issue. Its report this summer recommended the SEC develop a concept release soliciting public comment on the issue. In addition, the SEC staff called upon the AICPA to take steps to ensure the comparability and consistency of these types of disclosures.

Many have suggested that these types of disclosures be made optional or voluntary. That takes no effort as there is nothing that prevents a company from making these types of disclosures today. Nothing that is, but management itself.

I urge the SEC to move forward with a concept release or perhaps in light of Enron, go directly into rule making. I believe all companies should be required to disclose the ten or twelve most significant key performance indicators, or KPI's as they are commonly referred to. This should be a flexible disclosure system that at least initially permits each company to determine which KPI's are most relevant to measuring the performance of the company, and then disclose those on a consistent basis with disclosure of how those indicators are determined.

And I would be remiss if I did not also say I wholeheartedly support Chairman Pitt and Chief Accountant Herdman in their call for financial statements written in "Plain English." I tell you that all too often the legal community has nothing up on the accountants when it comes to disclosures that often read as if the attorneys had written them. And certainly GAAP does not require this so we cannot blame this on the FASB or other standard setters. Those who prepare financial statements as well as auditors need to step back, remember who our audience is, one out of two Americans, and write the disclosures in a fashion that is much more understandable and user friendly. We need to keep in mind that GAAP and the SEC rules are not "maximum levels of disclosures you must stop at, but rather are minimum levels that may very well need to be supplemented to give an investor a clear understanding of what is being discussed.

Former SEC Chairman Ray Garrett had it right when in 1975 he said:

> "In the final analysis, it seems to me that rules are a necessary part of financial disclosure and that it is only fair to allow people to predict accounting outcomes of transactions at the time they are entered into. On the other hand, it is not reasonable to expect that rules will serve as an immunization against the obligation to reflect reality in financial statements. *Rules, therefore, can only be regarded as a minimum. Good information for investors requires good will and good sense as well as good rules* (emphasis added)."

Thinking back to some of the financial statements I have prepared in the past, I know I could have done a better job on this point myself. And this is a recommendation all of us can implement immediately without a rule being forced upon us. I say "Lets go do it and do it this year!"

<u>Time To Reconsider For Mandatory Rotation</u>

One of the things that really caught my attention while I was at the Commission, as well as on other occasions, was the number of times I have seen auditors actually identify an issue, but then did not get it fixed. Instead of calling a strike, they were like an umpire who gives the batter a pass and calls "ball four" rather than strike three – you're out. Waste Management, WR Grace and JWP are three such examples mentioned in a recent Washington Post series of articles that should be required reading in each auditing class.

Ellen Seidman, then Director of the Office of Thrift Supervision or OTS, testified before the Senate Committee on Banking, Housing and Urban Affairs on September 11th, 2001 regarding the audit of the failed Superior Bank. In her opening statement the Director stated "Congress or the FBA's [Federal Banking Agencies] could also encourage the AICPA and SEC to establish an 'external auditor rotation requirement'…its adoption would result in a 'fresh look' at the institution from an audit perspective, to the benefit of investors and regulators."

Over the years I have wavered back and forth on whether we should institute periodic mandatory rotation of audit firms. On one hand the accounting firms rotate the audit partner every seven years. Yet I have seen the former partner rotated "off" to serve in a client relationship role, while a new younger partner is brought on. When I raised this as an issue with the AICPA SEC Practice Section a couple of years ago, they quickly dismissed it as a non-issue.

The accounting firms also cite that problems have been encountered in the first year of an audit. They state the first year is when an auditor is most at risk while learning about the business. However, I have never heard one of them say they did not learn enough about the business in the first year to complete the audit. And think about it, I am not aware that any of the financial fraud cases I cited above involved the first year audit of an company.

As a result, I think it is time we rethink the need to institute mandatory auditor rotation. I can't help but think that if the partners of Andersen, PWC or Ernst & Young on Waste Management, WR Grace or JWP had known someone would be looking at their work, they might have called the third strike in the numbers game.

Corporate Governance that Governs

And I would be remiss if I did not discuss the issue of corporate governance. The second most popular accounting question on Enron behind "where were the auditors" is the question of "where was the audit committee?" Unfortunately we won't know the answer for some time, as we do not know if they did ask the tough questions and if they did, who provided the answers.

But in the meantime we can move forward with changes to enhance the role of the audit committees. Consistent with the findings of the Blue Ribbon Panel on Audit Committees, we should request the stock exchanges to adopt measures that would require the audit committee, as opposed to management, to retain the services of the auditors.

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The stock exchanges should remove their rule that permits a board to "override" the independence requirements for board members on an audit committee. And the audit committees should be required to approve in advance all services, and disclose if they have, as the SEC once did in the late 1970's, before the rule was withdrawn in the early 1980's.

As was recommended by the O'Malley Panel, the audit committee should be required to obtain each year a report from the CEO and CFO that states whether the company's internal accounting controls are working effectively. Management should also have to include this report in the Annual Report to shareholders as has been recommended by the Financial Executives International. Perhaps the auditors should be required to rigorously examine the internal controls, a step they are not required to do today. It is worth noting that in the case of Rite-Aid, management had included a report on internal controls in their filings with the commission that failed to detail out the material weaknesses in internal controls. Investors heard nothing about those weaknesses, not from the company, not from the audit committee and not from the auditor's until the Form 8-K announcing a change in auditors was filed with the commission many months after the restatements began. Unfortunately the Form 8-K, announcing the change in auditors for Xerox, also highlighted material weaknesses in accounting controls. No doubt a number of people must be asking, why is it we find out about problems with the internal accounting controls that are necessary for accurate financial information and disclosures to investors *ONLY* when there is a falling out between the company and its auditors?

Let me switch briefly to the subject of the chief financial and principal accounting officers. Today, CFO's at the major American corporations turn over approximately four times faster than they did at the beginning of the 90's. And while the turnover ten years ago was often tied to one's retirement, it is much more likely today to be tied to a company missing an earnings estimate. Way too often today the CFO becomes the "fall guy" for such misses while the CEO's, COO's, vice presidents of manufacturing. Marketing and other key management positions stay on. And as surveys have shown, it is all too often the CFO who is pressured by these other members of management to stir the pot and cook the books. And when the CFO doesn't like the recipe that is handed to him or her, they are shown the door.

As a result, I also believe the SEC should make a change to its rules for Form 8-K. A Form 8-K should be required to be filed whenever a chief financial officer or chief accounting officer is terminated. The report should require disclosure of whether the audit committee approved the termination and whether there were any disagreements regarding financial accounting or disclosure matters. Perhaps a similar disclosure should be required for audit committee members.

Informed Investing

While I have been critical of the profession in relation to the events of the past few years, let me point out that there has been plenty of blame to share among all of the market participants. As I pointed out earlier, analyst's conflicts have essentially rendered their research worthless. Research that lacked depth and reality in the past.

At a hearing regarding the Enron matter in the House of Congress on December 12th, subcommittee Chairman Baker pointed out on that day, there were still 13 analysts following Enron. He aptly noted that of the 13, 2 had recommendations of strong buy, 1 had a recommendation of strong sell, and the other 10 were somewhere in between. With all of the uncertainty surrounding Enron, I wonder how anyone can come up with a strong buy recommendation? And we should all be aware of the fact, that when analysts say recommend or buy, they really don't mean that. Strong buys mean buy, buys mean hold, and holds mean get out of it. You don't have to worry about what a sale or strong sale mean because they are as rare today as a 57 Chevy. Accordingly, what we really need is new rules for analysts that replace this opaque system of misleading guidance with a system the average American investor can understand and decipher without a translator.

If analysts desire to become part of the solution, they will also have to find a way to restrict and disclose all conflicts in a very substantive fashion. Situations such as the one recently discussed in the New Yorker where a CSFB analyst downgraded an entire industry group and then was terminated does not provide investors with confidence this will happen.

The rating agencies also swung and missed on a timely downgrade of Enron's credit ratings. This was the second strike this year as the same thing happened earlier with Pacific Gas & Electric. The agencies say if they downgrade the debt the result will be a negative impact on the companies that will worsen their situation. Excuse me folks, but that is exactly what I thought we had the rating agencies for. The Enron debt was trading for something like 50 cents on the dollar by the time the downgrade from the ratings agencies materialized. If they are going to tell us the patient is dead only when they can no longer feel a pulse, I fail to see what value they bring to investors and the markets. Perhaps the SEC and Congress need to take a closer look at the practice of these organizations.

And investors also must learn that if they are going to invest, they must do their homework. Investing without studying and learning about the company or mutual fund you are going to invest in is like taking a test without going to class or reading the book. The results are never good and there is only one person to blame. And its not the teacher! Enron is a classic example of this as many investors, including some of the countries largest institutional investors such as Alliance Capital, Fidelity and Janus, invested in Enron despite the fact they made disclosures no one could understand, about complex business transactions that involved a seemingly endless web of potential conflicts.

Closing:

On September 2 of this year, the New York Times wrote:

> "But something else is weighing on stocks. That is the creeping realization among investors that the momentous earnings reported by many companies in recent years may have been digitally remastered to include a lot of hype, embroidery and fluff.
>
> This is significant. Investors coming around to this view will be less inclined to trust forecasts that company executives make. Having lost faith in a company's numbers, investors will be unable to place a fair value on its stock. In the dark on valuations, many investors will shun the shares.
>
> An extreme reaction? Not at all. It is precisely the payback that companies deserve for embellishing their earnings."

But our capital markets are too important to our country and the investing public to allow this damage to continue. When we see investors lose their confidence in the numbers, they lose confidence in the markets. Then they flee to safer havens as we have seen them do this year when for the first time in over a decade, cash has been drawn out of the equity markets. And as that occurred, the air has been taken out of our economy and the economic boom I spoke of at the beginning, has turned into an economic drought with millions of Americans having lost their jobs and livelihoods.

Our profession has an important role to play in fixing what is wrong. Events of the last few years and in particular the last few weeks have cast a long shadow over us. We must chose whether to step out from under it by taking quick and responsible actions or remain within the shadow for a long time.

Warren Bennis once said "Leaders are people who do the right things. Managers are people who do things right." Today, we need to find leaders who have that rare vision and foresight that will once again ensure serving the public interests is our number one priority. Leader's who are willing to take quick action, not just speak words.

And we need to deliver to our customer, the investing public, the product we have so proudly advertised in the past. Today the public has come to question the integrity of what we do, just as they have wondered about the tires on their cars. We can no longer afford to let this lack of trust and confidences erode our credibility. We must act immediately, before they seek another product, to restore their faith.

Overview of Audit Committee & Audit Issues

Stuart L. Gillan
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Big Issues

- Audit Committee
- External Auditors
- Board of Directors
- Disclosure
  - Conflicts of interest
  - Off-balance sheet items
- Stakeholders
  - Employees
  - Creditors

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SEC Audit Committee Rule (Jan. 2000)

- Require that companies' independent auditors review the financial information included in the companies' Quarterly Reports
- Require that companies include reports of their audit committees in their proxy statements;[13]
  - (i) reviewed and discussed the audited financial statements with management;
  - (ii) discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61,[14]

SEC Audit Committee Rule

- Statement by the AC whether the audited financial statements be included in the company's Annual Report on Form 10-K.
- Disclose whether their Board of Directors has adopted a written charter for the audit committee,
- Disclose whether the audit committee members are "independent" as defined in the applicable listing standards,[17] (disclose additional information about directors not considered independent).

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Other BRC Recommendations

Independence

- Tighter definition of independence for board members on the audit committee
- Committee comprised solely of independent directors.

Other BRC Recommendations

Effectiveness

- Minimum of three *financially literate* directors
- Outside auditor is accountable to the board of directors and the audit committee
- Audit committee is responsible for ensuring that the outside auditor is independent.
- Audit committee and outside auditor should discuss judgments about the *quality* of the company's accounting principles.

SEC Auditor Independence Requirements (Feb. 2001)

- Emphasis on independence
- Fee disclosure
  - Audit
  - Non-audit
  - Information systems

IRRC Analysis of Audit Fees

Companies' Revenue		Audit Fees Paid	Aggregate Fees Paid
< $50 million	Average	$154,734	$391,399
$50 mil < $100 mil	Average	$177,704	$468,466
$100 mil < $500 mil	Average	$307,307	$760,377
$500 mil <$1 bil	Average	$489,356	$1,355,489
$1 bil < $3 bil	Average	$798,137	$2,534,845
$3 bil < $5 bil	Average	$1,270,879	$4,425,821
$5 bil< $10 bil	Average	$2,297,512	$7,909,641
$10 bil < $50 bil	Average	$4,348,172	$16,868,011
$50 bil < $100 bil	Average	$15,066,357	$57,646,734
> $100 bil	Average	$15,990,840	$75,095,860

Source: IRRC analysis for 1,070 companies.

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Top 20 ranked by "Other Fees"

Rank Other Fees"	Company	Auditor	Since	$ Audit fee	$ Other Fee	$ Info Sys Fee	MktVal FY '00 $ Billion	Ratio Other/Audit	Ratio Other+Info)/Audit)
1	General Motors	D&T	1918	17,000,000	77,000,000	2,000,000	27.61	4.5	4.6
2	Morgan (J.P.)	PWC		21,300,000	73,100,000	11,100,000	74.92	3.4	4.0
3	Ford Motor	PWC	1946	18,000,000	68,500,000	1,000,000	32.97	3.8	3.9
4	General Electric	KPMG		23,900,000	68,200,000	11,500,000	382.20	2.9	3.3
5	Sprint	EY	1965	2,500,000	51,400,000	12,400,000	19.36	20.6	25.5
6	AT&T	PWC		7,860,000	46,840,000	1,525,000	61.88	6.0	6.2
7	Johnson & Johnson	PWC		9,300,000	43,100,000	-	178.68	4.6	4.6
8	Wells Fargo	KPMG	1931	4,154,510	36,672,025	852,966	72.55	8.8	9.0
9	Bank Of America	PWC		13,174,500	35,440,592	829,048	96.57	2.7	2.8
10	International Business Machines	PWC		12,200,000	34,600,000	16,400,000	199.12	2.8	4.2
11	Merrill Lynch	D&T		20,115,000	32,837,413	6,746,028	41.83	1.6	2.0
12	Waste Management	AA		48,000,000	31,000,000	-	18.39	0.6	0.6
13	International Paper	AA		4,670,000	30,600,000	-	19.25	6.6	6.6
14	Du Pont (E.I.) de Nemours	PWC	1954	7,000,000	30,000,000	-	46.10	4.3	4.3
15	Philip Morris	PWC	1933	14,300,000	29,300,000	-	102.20	2.0	2.0
16	Lilly (Eli)	EY		3,200,000	28,900,000	-	92.94	9.0	9.0
17	BellSouth	PWC	1984	2,970,976	28,638,000	-	72.26	9.6	9.6
18	Honeywell International	PWC		5,100,000	27,800,000	-	26.95	5.5	5.5
19	Enron	AA		25,000,000	27,000,000	-	0.19	1.1	1.1
20	Motorola	KPMG		3,900,000	26,800,000	35,500,000	36.81	6.9	16.0

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Top 20 Ranked by Ratio of (Other + Info) / (Audit)

Rank	Name	Auditor	Since	$ Audit fee	$ Other Fee	$ Info Sys Fee	MktVal FY '01 $ Billion	Ratio Other/Audit	Ratio (Other+Info)/Audit)
1	Arctic Cat	GThton		95,000	347,000	5,775,000	0.26	3.7	64.4
2	Focal Communications	AA	1996	158,000	198,000	7,000,000	0.09	1.3	45.6
3	Puget Energy	PWC		534,000	1,616,000	15,649,000	1.68	3.0	32.3
4	Marriott International	AA	1993	1,049,800	4,883,900	25,397,600	9.09	4.7	28.8
5	Sprint	EY	1965	2,500,000	51,400,000	12,400,000	19.36	20.6	25.5
6	Veritas Software	KPMG		800,000	3,400,000	14,300,000	15.59	4.3	22.1
7	MemberWorks	PWC		168,327	81,557	3,313,091	0.15	0.5	20.2
8	Adaptec	PWC	1995	463,000	8,409,000	-	1.45	18.2	18.2
9	Best Buy	EY	1994	410,000	6,094,000	577,000	15.05	14.9	16.3
10	Pitney Bowes	PWC	1934	2,200,000	26,200,000	9,100,000	10.11	11.9	16.0
11	Motorola	KPMG		3,900,000	26,800,000	35,500,000	36.81	6.9	16.0
12	Edgewater Technology	AA		185,000	2,854,000	-	0.04	15.4	15.4
13	Charter Communications	AA		750,000	9,387,300	1,715,900	4.53	12.5	14.8
14	Micron Technology	PWC	1985	1,400,000	2,100,000	18,000,000	16.28	1.5	14.4
15	Commercial Federal	D&T		308,000	4,336,000	-	1.18	14.1	14.1
16	Gaylord Entertainment	AA	1991	292,000	1,035,499	2,912,620	0.79	3.5	13.5
17	Gap	D&T	1972	569,000	7,676,000	-	11.41	13.5	13.5
18	Moody's	PWC		635,000	8,145,000	-	5.41	12.8	12.8
19	Apple Computer	KPMG		2,265,000	7,054,000	21,493,000	7.47	3.1	12.6
20	Entergy	PWC	1994	1,437,900	3,244,075	14,786,120	8.18	2.3	12.5

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SEC Fails to Grant No-Action Relief on "Auditor Conflict" Shareholder Proposal

- Shareholder proposal at Disney
- Requests board to ensure that the external audit firm provides only audit services
- Similar proposals at at least 20 other companies
- Calls for rotation of auditors

Audit Committee Activity & Independence

In year 2000

1,700 large US companies

	Audit Cttee.	Full Board
Avg. Size	3.5	9.5
Avg. Indp	85%	61%
Meetings	3.5	7.5

(source IRRC)

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Enron Board and Audit Committee

- 14 member Board
  - Chairman Lay
  - CEO/President Skilling
  - 3 non-employees with business links
  - 9 independent (few other board seats)
  - Met 9 times
- 6 member Audit Committee
  - 1 with business link
  - Met 5 times

The Audit Committee

- Recommends
  - The appointment of the independent auditors to the Board of Directors,
- Reviews
  - The scope of and fees related to the audit,
  - Accounting policies and reporting practices,
  - Internal auditing and internal controls,
  - Compliance with Enron's policies regarding business conduct
- The Audit Committee
  - Met and held discussions with management
  - Independent auditors.
  - Consolidated financial statements were prepared in accordance with GAAP
  - Reviewed and discussed the audited consolidated financial statements with management and the independent auditors.

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Some Textbook Red Flags (KPMG)

- Inappropriate "tone at the top"
- Unrealistic growth goals
- Overly complex organizational structure or transactions
- High turnover of senior management
- Unusually rapid growth
- Inexperienced management

Related Party Transactions 1999

- The effect of the transactions was
  - (i) Enron and the third-party amended certain forward contracts to purchase shares of Enron common stock, resulting in Enron having forward contracts to purchase Enron common shares at the market price on that day,
  - (ii) LJM received 6.8 million shares of Enron common stock,
  - (iii) Enron received a note receivable and certain financial instruments hedging an investment held by Enron.
  - Enron recorded the assets received and equity issued at estimated fair value.

Related Party Transactions 2000

- Enron and the Related Party entered into an agreement to terminate certain financial instruments
- Enron received approximately 3.1 million shares of Enron common stock held by the Related Party. A put option was terminated under this agreement.
- Enron paid approximately $26.8 million to the Related Party.

"Enronism"
Financial Times, Jan 10, 2002

- "You have two cows. You sell three of them to your publicly listed company, using letters of credit opened by your brother-in-law at the bank, then execute a debt/equity swap with an associated general offer so you get all four cows back, with a tax exemption for five cows.
- The milk rights of the six cows are transferred via an intermediary to a Cayman Island company secretly owned by the majority shareholder, who sells the rights to all seven cows back to your listed company.
- The annual report says the company owns eight cows, with an option on one more."

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Regulatory Reform?

- What's the goal?
  - Stamping out fraud / incompetence?
- What's the best mechanism?
  - Internal
  - External

Regulatory Reform?

- Audit Committees
  - Liability issues
  - Market for directors
- External Auditors
  - Conflicts of interest
  - Economies of effort
- Enhanced Disclosure
  - Time and effort
  - Improved transparency / improved valuations

- Increased focus on potential conflicts of interest
  - Internal and external
- Increased focus on "good governance"
  - Board / committee monitoring
  - Board / committee independence

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Virginia Tech

Financial Risk Management Center

1999 FISC/WISC Meetings
List of Attendees
(In Order by Organization)

Geoffrey Aronow
Senior Partner
Arnold & Porter

Susan Lee
Partner
Arnold & Porter

Daniel R. Waldman
Partner
Arnold & Porter

Bradley Ziff
Arthur Andersen & Co.

Myrna Parker
Manager
Arthur Andersen LLP

Patrick M. Donovan
Vice President
Bankers Trust Company

Mark R. Schittig
Supervisory Financial Analyst
Board of Governors of the Federal Reserve
System

Robert Davis
Associate
Cadwalader, Wickersham & Taft

Carlton E. Einsel
Associate
Cadwalader, Wickersham & Taft

Greg Jubin
Associate
Cadwalader, Wickersham & Taft

Ellen S. Levinson
Government Relations Advisor
Cadwalader, Wickersham & Taft

Jonathan Kahn
Partners
Castlebridge Advisors, Inc.

James W. Gosselin
Ex Managing Member
Castlebridge Partners, LLC

Bradley D. Belt
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Stephen Kane
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David M. Morris
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Eric Meier
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Dennis O'Callahan
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Laura Williams
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Enron Broadband Services Launches Online Bandwidth In Europe

FOR IMMEDIATE RELEASE: Tuesday, February 27, 2001

London: Enron Broadband Services, a wholly-owned subsidiary of Enron Corp. (NYSE: ENE), a today the launch of online bandwidth trading in Europe. Bandwidth transactions that used to take close can now be concluded in minutes, creating wholesale market efficiencies.

Bandwidth trading is carried out via the EnronOnline trading platform. Launched in November 19 the trading of Enron's natural gas, oil, electricity and other commodities, EnronOnline is the worl business-to-business e-commerce website, currently handling over 3,850 transactions with a no over $2.6 billion, each day.

The easy-to-use, customisable site enables registered customers to log on and buy and sell ban a few clicks. STM-1 capacity is available, with contract durations of between three and 12 month delivery ranging from two to 14 months. Once a transaction is closed, settlement and provisionin offline.

To provide the physical infrastructure to enable bandwidth trading, Enron has installed pooling p switching and interconnection facilities at selected locations throughout Europe, through which c between bandwidth buyers and sellers can be established and monitored. To further facilitate th commoditisation of bandwidth, Enron has also developed standard terms and conditions which p start dates and service level agreements backed by liquidated damages.

"Enron's online bandwidth trading service is not an exchange or bulletin board. Instead, it satisfie quoted price with Enron acting as the principal," said Marcello Romano, vice president, Bandwid Enron Broadband Services, Europe.

"The last three months have marked a turning point in the development of this market in Europe are waking up to the value of firm service level agreements and the flexibility offered through ban trading and risk management solutions. The best efforts service associated with this market is fin challenged."

Editors Notes

About Enron

Enron Broadband Services is a leading provider of high quality, high bandwidth delivery and app services. The company's business model combines the power of the Enron Intelligent Network, E Broadband Operating System, bandwidth trading and intermediation services, and high-bandwid applications to fundamentally improve the experience and functionality of the Internet. Enron's B Operating System allows application developers to dynamically provision bandwidth for the qual necessary to deliver broadband content. Enron is also creating a market for bandwidth that will a providers to scale to meet the demands required by increasingly complex applications. Enron Br Services can be found on the Web at www.enron.net.

EnronOnline (www.EnronOnline.com) offers customers a free Internet-based system for conduc transactions with Enron as principal. EnronOnline provides real-time prices for bandwidth, power coal, weather products, petrochemicals, pulp and paper and other commodities in the Americas, Asia. Since its launch in November 1999, EnronOnline has expanded to include approximately 1 and has completed over 685,000 transactions with a total notional value exceeding $420 billion.

Enron is one of the world's leading electricity, natural gas and communications companies. The revenues of $101 billion in 2000, markets electricity and natural gas, delivers physical commodit financial and risk management services to customers around the world, and has developed an in network platform to facilitate online business. *Fortune* magazine has named Enron "America's M Company" for six consecutive years. Enron's Internet address is www.enron.com. The stock is tr the ticker symbol "ENE."

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Enron Launches EnPipe Virtual Gas Transportation Serv

FOR IMMEDIATE RELEASE: Monday, March 05, 2001

London: Enron today announced the launch of EnPipe, its virtual gas transportation service.

"EnPipe is a location swap service linking the UK and Belgian gas markets, providing an alterna Bacton to Zeebrugge Interconnector gas pipeline," explained John Sherriff, President and CEO o Europe. "It's a virtual gas transportation service which we can provide through an innovative com contracts and assets."

"Compared with existing capacity subleases, EnPipe is easier to use, more transparent and mor With EnPipe, our customers can avoid the risks associated with reliance on a single physical fac

EnPipe products are available in both forward and reverse flow directions for any periods betwee to one gas-year out to 2005. Deliveries for all products are at the NBP and the Zeebrugge Hub, costs and potential for problems associated with particular facilities and beach delivery points.

The EnPipe service will start on 1st April 2001, with bids due by 17.00h (GMT) on 15th March 20

Further information for customers is available from the EnronOnline website (www.enrononline.c the Continental Gas Trading team at Enron (+44 20 7783 7081).

Editors Notes

Enron's European activities began in 1989 and are headquartered in London. Today the compan over 4,500 people across Europe with principal offices in Amsterdam, Brussels, Bucharest, Buda Frankfurt, London, Madrid, Milan, Oslo, Warsaw, Stockholm and Zurich. Enron is a leading parti liberalised UK and Nordic energy markets and is the leading new entrant in the rapidly liberalisin European energy markets. Natural gas and electricity marketing businesses are supported by po developed, owned and/or operated by Enron in Italy, Poland, Spain, Turkey and the UK, includin largest privately-owned CCGT combined heat and power plant, the 1875 MW Teesside station in

Enron is one of the world's leading electricity, natural gas and communications companies. The revenues of $101 billion in 2000, markets electricity and natural gas, delivers physical commodit financial and risk management services to customers around the world, and has developed an in network platform to facilitate online business. Fortune magazine has named Enron "America's M Company" for six consecutive years. Enron's Internet address is www.enron.com. The stock is tr the ticker symbol "ENE."

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Enron Completes One Million Transactions on EnronOnl

FOR IMMEDIATE RELEASE: May 23, 2001

Houston: Enron Corp. announced today that it has completed its one millionth transaction on En the world's largest web-based e-commerce platform for commodities.

"EnronOnline has become the benchmark for the way energy and other commodity industries do has brought transparent, real-time pricing to our customers and provides them with reliable deliv clicks of a mouse," said Jeff Skilling, president and CEO. "This is a great day for Enron employe worked hard to make EnronOnline a reality."

As an online extension of its successful wholesale energy business, EnronOnline began transac gas and electricity on Nov. 29, 1999. Since that time, the company has extended the platform to approximately 1,500 wholesale commodity products ranging from energy-related commodities to metals, forest products, plastics, petrochemicals, and weather and credit derivatives.

Approximately 60 percent of all Enron transactions are now conducted online, and the cost of pr transactions has been reduced by 75 percent. To date, the notional value of all transactions on E exceeds $590 billion.

"In just 18 months, EnronOnline has added tremendous scale to our wholesale business, integra strengths in credit and risk management and logistics," said Skilling. "With the power of the Inter believe the potential for extending our business model to new markets is limitless."

Enron is one of the world's leading electricity, natural gas and communications companies. The revenues of $101 billion in 2000, markets electricity and natural gas, delivers physical commodit financial risk management services to customers around the world. Fortune magazine has name "America's Most Innovative Company" for six consecutive years. Enron's Internet address is ww The stock is traded under the ticker symbol "ENE."

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Enron Launches EnronCredit.com™, the First Real Time Credit Department for Corporations

FOR IMMEDIATE RELEASE: Wednesday, February 23, 2000

LONDON: Enron today launched EnronCredit.com™, the first global online credit department to credit prices and enable business-to-business customers to hedge credit exposure instantly via t EnronCredit.com helps businesses evaluate the credit quality of their customers in real time and March 8, 2000, will allow them to transact in bankruptcy swaps via Enron's global internet-based system, EnronOnline™.

"As E-commerce increases the number of transactions, the range of counterparties and the vola markets, corporations need sophisticated credit risk management tools to evaluate and manage real time," said John Sherriff, President and COO of Enron Europe.

"EnronCredit.com™ allows companies to focus on their core business activities and leaves the e management of credit risk to us. Our strong position in the marketplace as a leader in both E-co risk management as well as our thorough understanding of a number of industries qualify Enron provide innovative B2B credit risk management solutions, " Sherriff added.

EnronCredit.com™ helps medium to large corporations across all industries mitigate credit risk d to their commercial contracts on a real time basis. In order to use the full scope of the services o website, users will first need to register for a user name and password.

Editors Notes

EnronCredit.com can be found www.enroncredit.com

EnronCredit.com™ is a trademark of Enron Europe Limited.

Enron is one of the world's leading electricity, natural gas and communications companies. The which owns approximately $34 billion in energy and communications assets, produces electricity gas, develops, constructs and operates energy facilities worldwide, delivers physical commoditie financial and risk management services to customers around the world, and is developing an int network platform to facilitate online business. Enron's Internet address is www.enron.com and th traded under the ticker symbol, "ENE".

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Enron Launches Australian Power on EnronOnline

FOR IMMEDIATE RELEASE: Thursday, March 23, 2000

SYDNEY: Enron announced today the launch of Australian power as the newest commodity ava EnronOnline. EnronOnline is an internet-based transaction system for wholesale electric power a commodities. EnronOnline users can transact business directly with Enron as principal.

EnronOnline provides real-time prices for power, natural gas, coal, weather products, petrochem and paper, emissions credits and other commodities in the Americas, Europe and Asia. Since N EnronOnline has completed over 50,000 transactions.

"This is a significant step for Enron Australia, which builds upon our existing trading operations," Quilkey, managing director of Enron Australia. "EnronOnline offers users a new level of price dis energy-related products around the world. We already have a strong interest in the service from based counterparties.

"Enron Australia has been operating in Australia since July 1998 and has developed a leading p delivering risk-management products to the Australian market. With this service, Australian elect be added to the extensive selection of traded products available through EnronOnline. Clearly, t depth and liquidity to the local market."

Registered users will be able to instantaneously conduct transactions with Enron and see real-tim worldwide commodities through the Internet. EnronOnline is free of charge to users and availabl www.EnronOnline.com. Users who are not pre-registered will need to complete the online passw application and registration forms in order to be able to view prices and transact online.

Enron is one of the world's leading electricity, natural gas and communications companies. The which owns approximately $34 billion in energy and communication assets, produces electricity gas, develops, constructs and operates energy facilities worldwide, delivers physical commoditie financial and risk management services to customers around the world, and is developing an int network platform to facilitate online business. Enron's internet address is www.enron.com and th traded under the ticker symbol "ENE".

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Enron Pipelines Launch Capacity Bidding Open Season EnronOnline

FOR IMMEDIATE RELEASE: Monday, June 12, 2000

HOUSTON: Enron announced today that its interstate natural gas pipelines will begin offering ca EnronOnline.

Transwestern Pipeline Company will be the first of the Enron pipelines to offer capacity for biddin open season conducted on EnronOnline, the global Internet-based commodities transaction sys Natural Gas Company, Northern Border Pipeline Company and Florida Gas Transmission Comp to offer services on the new e-commerce platform in the near future.

"The use of EnronOnline to market interstate transportation capacity represents a major step for pipelines look for new ways to use e-commerce to better serve our customers," stated Stan Hort and Chief Executive Officer of Enron Gas Pipeline Group. "This innovative approach to marketin capacity clearly benefits both interstate pipelines and customers. We now have expanded custo through the industry's leading e-commerce platform, EnronOnline, while customers receive more and greater flexibility in purchasing capacity."

Transwestern will initially offer 20,000 Dekatherms per day of firm capacity for the month of July open season will be conducted through a sealed bid process to begin June 22 at 8:00 a.m. Cent close June 26 at 2:00 p.m. Central Time. All bidders will be notified of acceptance or rejection of 4:00 p.m. Central Time the same day. Transwestern will observe all underlying procedures for a capacity as specified in its FERC Gas Tariff.

Since its debut last November, EnronOnline, an internet-based transaction system, has rapidly b commodity-trading platform of choice, offering real-time prices for natural gas, power, coal, weat petrochemicals, pulp and paper, emissions credits, bandwidth and other commodities in the Ame and Asia. The new e-commerce platform has completed more than 140,000 transactions with a transaction value exceeding $65 billion.

Enron is one of the world's leading electricity, natural gas and communications companies. The which owns approximately $37 billion in energy and communications assets, produces electricity gas, develops, constructs and operates energy facilities worldwide, delivers physical commoditie financial and risk management services to customers around the world, and is developing an int network platform to facilitate online business. Enron's Internet address is www.enron.com and th traded under the ticker symbol, "ENE."

Customers wanting information about Transwestern's upcoming open season on EnronOnline, s Steve Harris, Vice President, Transwestern Commercial Group at (713) 853-1796. Media inquirie directed to Gina Taylor at (713) 853-7681.

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EnronOnline Passes $50 Billion Milestone

FOR IMMEDIATE RELEASE: Thursday, June 01, 2000

HOUSTON: Enron announced today that transaction value on EnronOnline has passed the $50 billion milestone for calendar year 2000.

EnronOnline is a principal-based electronic transaction platform that offers real-time pricing for commodities including electricity, natural gas, coal, pulp and paper, clean air credits, bandwidth, weather and credit derivatives, petrochemicals and plastics, and oil and refined products. The site allows commodities consumers and producers from around the world to buy from or sell to Enron with the click of a mouse.

In less than 6 months, EnronOnline has grown into the world's largest e-commerce website," said Louise Kitchen, managing director of EnronOnline. For the past several days, transaction value has exceeded $1.5 billion per day.

Enron launched EnronOnline on Nov. 29, 1999, and currently more than half of Enron's wholesale transactions are conducted online. In its first ≥6 weeks, more than 130,000 transactions have been conducted on EnronOnline. The e-commerce site exceeded yearly projections for 2000 during the first quarter.

Enron is one of the world's leading electricity, natural gas and communications companies. The company, which owns approximately $37 billion in energy and communications assets, produces electricity and natural gas, develops, constructs and operates energy facilities worldwide, delivers physical commodities and financial and risk management services to customers around the world, and is developing an intelligent network platform to facilitate online business. Fortune magazine has named Enron "Most Innovative Company" for five consecutive years, the top company for "Quality of Management" and the second best company for "Employee Talent." In addition, Enron ranks in the top quarter of Fortune's "Best 100 Companies to Work For in America." Enron's Internet address is www.enron.com. The stock is traded under the ticker symbol "ENE."

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Enron Launches Global Web-based Commodity Trading Site

FOR IMMEDIATE RELEASE: Tuesday, October 26, 1999

HOUSTON: Enron announced today the launch of EnronOnline, a global Internet-based transaction system for wholesale energy and other commodities. EnronOnline will allow participants to not only view commodity prices in real-time but also to directly transact with Enron over the Internet free of commission. The transaction system will go live on Nov. 29, 1999, with the launch of North America natural gas to be followed by all other products over the next six weeks.

"EnronOnline offers customers the next level of wholesale energy transaction service by having easy and simple access to Enron's prices and products," said Jeffrey K. Skilling, president and COO of Enron. "This Internet system complements Enron's extensive marketing capabilities and gives our counterparties the choice of transacting over the telephone or instantly through our website."

Enron's customers across the world will be able to access several hundred traded products through EnronOnline. The company will leverage its wholesale market expertise to publish real-time prices for power, natural gas, coal, weather products, liquids, petrochemicals, pulp and paper, emission credits and other commodities in the Americas, Europe and Asia. It will continue expanding web-based commodity and product offerings globally.

"Unlike other Internet commodity service providers, EnronOnline doesn't match buyers with sellers," said Skilling. "Customers will be able to instantaneously conduct transactions directly with an Enron company as a principal."

Real-time capabilities in the United States will be delivered wherever possible through Enron Communication, Inc.'s intelligent fiber optic network. This system is designed to combat web latency and create a true real-time environment online for Enron's customers.

A preview of the system is currently available at www.EnronOnline.com.

Enron is one of the world's leading electricity, natural gas and communications companies. The company, which owns approximately $34 billion in energy and communications assets, produces electricity and natural gas, develops, constructs and operates energy facilities worldwide, delivers physical commodities and financial and risk management services to customers around the world, and is developing an intelligent

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network platform to facilitate online business. Enron's Internet address is www.enron.com and the stock is traded under the ticker symbol, "ENE."

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Enron Completes One Million Transactions on EnronOnline

FOR IMMEDIATE RELEASE: May 23, 2001

Houston: Enron Corp. announced today that it has completed its one millionth transaction on EnronOnline, the world's largest web-based e-commerce platform for commodities.

"EnronOnline has become the benchmark for the way energy and other commodity industries do business. It has brought transparent, real-time pricing to our customers and provides them with reliable delivery with a few clicks of a mouse," said Jeff Skilling, president and CEO. "This is a great day for Enron employees who have worked hard to make EnronOnline a reality."

As an online extension of its successful wholesale energy business, EnronOnline began transacting natural gas and electricity on Nov. 29, 1999. Since that time, the company has extended the platform to approximately 1,500 wholesale commodity products ranging from energy-related commodities to bandwidth, metals, forest products, plastics, petrochemicals, and weather and credit derivatives.

Approximately 60 percent of all Enron transactions are now conducted online, and the cost of processing the transactions has been reduced by 75 percent. To date, the notional value of all transactions on EnronOnline exceeds $590 billion.

"In just 18 months, EnronOnline has added tremendous scale to our wholesale business, integrating our core strengths in credit and risk management and logistics," said Skilling. "With the power of the Internet, we believe the potential for extending our business model to new markets is limitless."

Enron is one of the world's leading electricity, natural gas and communications companies. The company, with revenues of $101 billion in 2000, markets electricity and natural gas, delivers physical commodities and financial risk management services to customers around the world. Fortune magazine has named Enron "America's Most Innovative Company" for six consecutive years. Enron's Internet address is www.enron.com. The stock is traded under the ticker symbol "ENE."

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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

Corrections

Cendant Signs $1.4B Outsourcing Deal With IBM

Documentum Acquires Bulldog's Technology

Oracle, Dell Release Certified Configurations

Oracle Adds Web Services Functionality To App Server, Database

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Enron Files For Bankruptcy Protection

UPDATE: EnronOnline Still Trading

Economy Shrank Sharply in 3Q; Tech Bottoms Out

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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.

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Enron Launches Clickpaper.com in Europe

FOR IMMEDIATE RELEASE: Tuesday, January 30, 2001

London: Enron Industrial Markets announced today the European launch of Clickpaper.com, an based transaction system dedicated to the forest products industry to support its expansion plan sector.

Clickpaper.com provides a 'Trade' platform to buy and sell physical and financial (swaps) pulp, p wood products, which is principal-based, commission-free, and real-time. In addition, Clickpaper function provides open space to anonymously post bids and offers with other market members o commission-free basis for products that do not fit the terms, conditions or specifications for the c products that are posted on the 'Trade' portion of the site. The Web-site also provides news, res information directly related to the industry.

"Enron is the world's leading provider of financial risk management services to the pulp and pap By adding firm contracts for physical products with defined quality and performance specification range of pulp, paper and wood commodities, Clickpaper.com will become the preferred on-line s principal-based transactions in this rapidly commoditizing industry," said Jeffrey McMahon, presi of Enron Industrial Markets. "Utilizing the proven business model created with EnronOnline, Clic offers customers in the pulp and paper industry a unique set of benefits, including competitive pr price transparency, which we believe will provide liquidity to this market.

Since launching with dollar-denominated products in September 1999, Enron's Clickpaper.com h more than one million tonnes of product, equivalent to USD 650 million in notional value of phys financial products traded.

The European launch of Clickpaper.com coincides with the listing of a wide range of both physic financial pulp, paper and packaging products in GBP Sterling and German Marks on the system NBSK (Northern Bleached Softwood Kraft or 'pulp'), Newsprint, LWC (Light Weight Coated), A4 (Old Corrugated Containers), and Testliner. More than 300 producers and consumers have been the first wave of marketing activity designed to encourage them to trade on the Internet-based sy

Future plans for Clickpaper.com include expanding the product menu with additional financial ris management products, and additional physical pulp, paper, and wood products on a global basis and the commoditization of the products increases and an active, transparent spot and forward m pulp and paper products develops.

Editors Notes

The system is currently available at www.Clickpaper.com. Guest passwords and user IDs are av interested customers in the industry. Prices for pulp, paper and packaging products will continue on www.EnronOnline.com.

Enron has provided risk management products and financing for the pulp, paper and wood prod since 1997 and is the largest trader of financial risk management products in the pulp and paper date, Enron has completed financial transactions totaling more than 17 million tons of pulp and p with a notional value exceeding $9 billion. Producers and consumers have used these products price risk associated with their raw materials and finished products.

Enron's European activities began in 1989 and are headquartered in London. Today the compan more than 4000 people across Europe with principal offices in Frankfurt, London, Oslo, Moscow

Enron is a leading participant in the liberalized UK and Nordic energy markets and is the leading in the rapidly liberalizing continental European markets. Natural gas and electricity marketing bu supported by power stations developed, owned and/or operated by Enron in Italy, Poland, Spain the UK, including the world's largest privately-owned CCGT combined heat and power plant, the Teesside station in the UK.

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Enron Communications Announces First Commodity Ba Trade

FOR IMMEDIATE RELEASE: Thursday, December 02, 1999

HOUSTON: Enron Communications, Inc., a wholly-owned subsidiary of Enron Corp. and a leade delivery of high-bandwidth application services, announced today the first forward trade of bandw

"This is 'Day One' of a potentially enormous market," said Jeff Skilling, Enron president and chie officer. "Most companies that need bandwidth today are only able to secure inflexible multi-year set amounts of capacity - just like oil contracts in the 1970s, natural gas contracts prior to 1990 a power contracts prior to 1994. As was the case in those industries, the market structure for band currently inefficient and expensive. We are demonstrating that bandwidth can be traded under fl based contract structures with the assurance that quality standards are in place and monitored r the buyer and seller."

The trade will result in a monthly incremental contract for DS-3 bandwidth between New York an Angeles that can move data at about 45 megabits per second-a speed that allows the transmiss streaming video and other bandwidth-intensive applications.

The seller in the transaction will be Global Crossing, a worldwide leader in the construction and high capacity telecommunications networks.

"We are excited to be a part of this new concept. As a large-scale builder of network infrastructu always interested in developing new, creative ways to bring bandwidth to market. We congratula their leadership, and look forward to working with them," said Jon Tingley, president of Global C Services.

Also today, Enron Communications announced that the "North American (New York - Los Angel Benchmark Segment"--the commodity benchmark for bandwidth crossing the US--will soon be c the "Atlantic (New York - London) Benchmark Segment" for trading bandwidth internationally. Th segment links the US and European locations beginning with the UK pooling point, located in Gl Crossing's London facility.

"The North American Benchmark Segment is now open for business. The Atlantic Benchmark S expected by May 2000," said Tom Gros, Enron vice president for global bandwidth trading.

About Enron Communications

Enron Communications delivers the Enron Intelligent Network™, a Pure IP™ broadband overlay Internet. Enron Communications also provides rich, multimedia ePowered™ application services bandwidth management services that enhance online commerce and communications. In early 2 Enron Intelligent Network will extend its reach to Europe, Japan, Asia and South America with m POPs and local ePowered distribution partners. Enron Communications offers ISPs and network range of bandwidth transport solutions that enable businesses to handle high traffic and high bit wholly owned subsidiary of Enron Corp., Enron Communications can be found on the web at ww

Enron is one of the world's leading electricity, natural gas and communications companies. The which owns approximately $34 billion in energy and communications assets, produces electricity gas, develops, constructs and operates energy facilities worldwide, delivers physical commoditie financial and risk management services to customers around the world, and is developing an int

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network platform to facilitate online business. The stock is traded under the ticker symbol, "ENE.

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Enron's off-balance machine

Enron's failure is likely to provoke years of mud-slinging and legal suits. Do we need to wait for the gory details, asks Rob Jameson, or are the most important lessons are already apparent?

On December 2, 2001, Enron Corporation filed for bankruptcy protection from its creditors in the largest financial failure the US has ever seen. It was an ironic end for a company that had become one of the US equity markets' brightest stars in the past decade by pioneering new instruments and concepts in financial risk management across energy, telecom and credit markets.

Enron was the sixth-largest energy company by market capitalisation in the world, with revenues of $101 billion and assets of $47.3 billion in 2000. Its failure has marred the reputations of its top executives and hurt all its stakeholders.

Shareholders who stayed loyal saw the price of an Enron share slide from a high of around $90 a share in August 2000 to well under 50 cents a share in November 2001. Major creditors such as US banks and credit insurers were left exposed to potential losses of hundreds of millions of dollars, and losses rippled around the world to banks that had taken part in Enron's syndicated borrowings, and to funds that had bought Enron's debt and equity.

Enron's corporate customers were left trying to unwind long-term risk management agreements with a counterparty that might not be able to pay up. The energy markets that Enron had helped to create faced the credit risk, disruption and liquidity shock of losing their biggest and best-capitalised participant.

And many of Enron's 21,000 employees in the US and around the world found themselves not only without a job, but losing a portion of pension plans that had been invested in their employer.

History suggests that failures as precipitous as that of Enron are rarely the result of a single risk event or bad practice. So how did Enron become a company that could not afford to stall? And what mechanisms made the task of pulling the firm out of its death spiral so impossible for its feted corporate pilots?

A star is born

Enron became a business legend not only because it made money and grew fast, but because it evolved from being a company with a rather dull set of physical assets in a regulated market into a financially sophisticated risk management company that shaped its own trading environment. It was a trick that analysts later believed the company might carry off in many more markets around the world from power, to water, to metals and bandwidth.

The company was formed from the merger of Houston Natural Gas and InterNorth of Omaha, Nebraska, in July 1985, the year that the US Federal Energy Regulating Commission issued an order that required pipelines to provide open access to pipeline capacity. With other regulatory developments over the next several years, the order encouraged the growth of a market in short-term gas supply contracts, and eventually a true spot market for natural gas. It was a market that Enron came to dominate through the development of its own physical pipeline assets, and through its emerging expertise in the management of portfolios of contracts for natural gas, the most volatile major commodity market in the world.

The key moments in Enron's development can be seen in our accompanying timeline, as its self-proclaimed accomplishments grew ever bigger: "the premier natural gas pipeline" (1985); "the world's first natural gas major" (1990) and "the world's leading energy company" (1995). But it was the skills the company had gained in risk management that fed this vision. They allowed the company to build a trading operation, to transfer its intellectual skills to other markets, and to begin to offer high-margin risk management services.

Enron first began to market this skill with the launch of its GasBank service in 1989, which allowed producers and wholesalers to buy firm future gas supplies and to hedge their natural gas price risk. The choice of terminology was not accidental. Over the years, the company continued to see itself as an 'energy bank,' and to position its image and skills as similar to those of the investment banks on Wall Street that were applying rocket

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science to purely financial contracts to lucrative effect during the 1990s. Like the best of those banks, Enron would take money as an intermediary and provider of liquidity, rather than retaining energy price risk on its books.

Unlike banks, however, Enron remained unregulated after the emerging energy derivatives industry successfully fought off attempts by the Commodity Futures Trading Commission to extend its powers to the market in the early 1990s. The firm remained answerable only to its shareholders and debtholders for its capital structure and risk management, and to their proxies the Securities & Exchange Commission and the rating agencies for the accuracy of the limited information that it chose to disclose.

This was always disconcerting for analysts. After all, they were recommending the company to investors precisely because it was the preeminent financial wizard of its sector in terms of the interaction between physical assets and cashflow; the management of complex contract portfolios and asset volatility; and the shaping of risk and leverage to extract the maximum value from capital.

It was an open secret in the corporate world that accounting standards and company reporting across the risk management industries had not kept pace with new techniques in off-balance sheet financing, financial engineering and contract technology. In the energy trading sector, in particular, the values of unrealised gains and losses that might be included in a company's accounts were dependent upon many assumptions. The potential for a gap between financial reality and company reporting was growing in an industry-wide trend that leveraged the importance of a company's chief financial officer, and of corporate credibility in general.

Meanwhile, through the 1990s Enron repeatedly hit its earnings targets and then set itself tough new goals in a manner that made it the darling of Wall Street's equity analysts. Enron's special skills in commodity market development and price risk management seemed to offer the firm an embarrassment of riches in terms of investment opportunities in the US and around the world from the mid 1990s as power and other regulated utility markets in the UK, US and elsewhere followed the same path toward deregulation.

While Enron retained strategic ownership of some physical assets, such as power plants and pipelines in the US energy industry and abroad, the company believed its future lay in spearheading deregulation and trading in energy and other commodity markets around the world, while also developing high-margin risk management services.

Occasionally, Enron admitted to stumbling in its home territory of energy contract risk management, notably in the case of the J-Block episode. This deal left Enron dangerously exposed to falling gas prices in the UK after it signed a massive 'take-or-pay' gas contract in 1993 with companies operating the J-Block gas field in the UK North Sea. Enron finally had to reach a settlement with its suppliers in 1997. The episode cost the company some $537 million after tax in 1997, and led to serious questions being

Timeline

July 1985: Enron formed by merger of Houston Natural Gas and InterNorth, an Omaha, Nebraska-based natural gas pipeline company. Company works its way through the liberalisation of the natural gas market in the US to become an open-access transporter of gas.

1988: Enron begins construction of power plant in UK.

1989: Enron launches its GasBank to allow producers and wholesalers to buy firm future gas supplies and to hedge their natural gas price risk.

June 1994: Enron North America begins to trade electricity.

December 1996: Dabhol Power Project, of which Enron is a principal stakeholder, begins construction of a liquefied natural gas power plant.

June 1997: Enron records a charge of $450 million to bring to a close the problems underlying the J-Block contract, which had committed it to natural gas prices that were out of line with the market.

August 1997: Enron says it has sold its first weather derivative contract. It's the first of many attempts to build risk management markets outside the energy markets to exploit Enron's perceived commodity risk management intellectual capital and expertise. In the next three years Enron invests significant capital and management time in trying to develop traded risk management markets in bandwidth (first trade, December 1999), pulp and paper, plastics, coal, and in moving into existing metals risk management markets.

September 1997: Enron Energy Services is formed to provide energy outsourcing services to commercial and other consumers.

December 1998: Enron buys the UK's Wessex Water and creates a 'global water company' that it calls Azurix. Enron works to extend its electricity wholesale marketing influence from the UK's power market into Europe.

May 1999: Phase 1 of the troublesome Dabhol Power Project begins 'commercial operation'.

November 1999: EnronOnline is launched as a global commodity trading site and Enron is positioned as a 'new economy' company.

May 2000: Enron acquires MG plc, a London-based metals trader, to extend its commodity market capabilities.

August 2000: Enron's stock reaches high-water mark at around $90 per share.

January 2001: Enron's stock still at $80, and executives continue to talk up the shares to analysts, saying in late January that $126 a share might prove a reasonable target price. Through the early spring the price of shares in the company falls, but the share price to earnings ratio continues to indicate that investors think Enron will grow profits much faster than any of its energy market competitors.

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asked at board level about control over large transactions.[1]

But it was not energy price risk management that was to bring the company down. There were more fundamental problems developing in its business strategy, corporate-level financial engineering and strategic investments.

It was clear from the mid-1990s that not all of Enron's investments and new markets were going to pay off. The most notorious single investment was its 65 per cent stake in India's Dabhol Power Project, which began construction in December 1996 but led to a running battle with the project's only customer, a state utility, in the late 1990s. Other physical assets that were part of Enron's strategic vision turned out to offer little in the way of profit or cashflow – and not only in the power markets. Enron's foray into the world water and waste management industry, via purchases such as Wessex Water in the UK, offered pedestrian returns while sucking up valuable capital.

Indeed, by the late 1990s there was a danger that Enron would be seen as an awkward conglomeration of three businesses: a collection of physical assets that offered returns that varied from pedestrian to loss-making; a profitable energy trading and risk management business that made money and offered exciting, but not exponential, growth; and an investment portfolio of entirely speculative and capital-hungry bright ideas. Meanwhile, the core energy trading and risk management business that held the company together was critically dependent upon Enron's continuing management credibility and creditworthiness.

To make its dreams real, and meet its self-inflicted earnings and share price targets, the company knew that it had to recycle the capital tied up in mundane assets into more exciting investments in new commodity markets, electronic trading infrastructures, and expensive human skills.

So, like many other major corporations in the 1990s, Enron began to take many of its assets and liabilities off its reported balance sheet. It did so using a series of special purpose entities and limited partnerships that enabled Enron to gain financing in various novel ways. The company was open about the fact that it used off-balance sheet vehicles to access capital and to hedge risk. But it also knew that if it followed certain accounting rules it would not have to reveal many details about these 'structured financings', or the complicated transactions that they spawned.

Meanwhile, the growing market capitalisation of the energy giant was turning into a honey trap. With the Internet boom in full swing, Enron shares started to be described as an 'Internet play', as the company stressed its investments in the broadband industry that would support the 'New Economy', and its development of online trading. By 2000, Enron Online had become established as a leading web-based service that offered traders in energy and other markets information, transaction services and trading tools. The company was also trying to become a market-maker and price risk management provider in bandwidth trading in the same way that it had become dominant in natural gas as that industry deregulated. It

Timeline

February 2001: Jeff Skilling, one of the architects of the company's strategy, takes over as chief executive officer.

March 2001: *Fortune* runs a story, 'Is Enron Overpriced?' that brings some analysts' concerns to a wider audience and makes it clear how little credit analysts seem to understand about the financial engineering and true level of earnings success of the company. Story quotes one analyst as saying that if Enron does not meet its earnings expectations, its stock price "could implode". Most analysts still rate Enron strongly, but are disappointed when a deal under which Enron would have distributed Blockbuster movies over the Internet falls apart.

April 2001: Cracks begin to appear in confidence about Enron as it discloses that it is owed \$570 million by the bankrupt Californian power utility PG&E. Enron CEO Jeff Skilling becomes irate with a hedge fund analyst for asking critical questions about the value of assets that secure Enron's off-balance sheet financing vehicles. Some analysts are becoming concerned that Enron CFO Andy Fastow suffers a conflict of interest from his personal stake in some of the off-balance sheet vehicles that Enron has deployed.

August 14: Jeff Skilling resigns as Enron CEO after only six months in the job, citing personal reasons; chairman Kenneth Lay resumes the CEO job that he'd held before Skilling took over, for however long it might take to find a successor. Stock at \$42.93.

August 2001: Enron's stock falls below \$40, as analysts fear ever worse things about the degree of behind-the-scenes financial engineering and the 'quality' of reported earnings.

October 16, 2001: Enron admits in an earnings report that it will have to write off \$1.01 billion on investments, and some millions as a result of complex financing partnerships set up by Fastow and approved by the board. On October 22, Enron acknowledges the SEC is investigating its off-balance sheet activities.

October 23, 2001: Enron CEO Lay holds a conference call that undermines Enron's credibility still further. Analysts are dismayed by the offhand way in which the company mentions an additional \$1.2 billion equity writedown, in addition to the \$1.01 investment writedown, as a result of terminating investment partnerships that had been set up by Fastow.

October 23, 2001: Moody's puts the rating of Enron's debt on watch. By now, many of Enron's counterparties in its core energy and other markets are reassessing its creditworthiness. At exactly the time that it has become clear that Enron's value lies in its core energy markets and its trading relationships, those components of the company are being corroded by the growing credit and corporate governance scandal. The liquidity trap is closing fast.

October 24, 2001: Fastow takes "leave of absence".

October 25, 2001: Enron says that it is drawing on a billion-dollar credit line in an attempt to reassure the markets it will not run out of money.

October 31, 2001: SEC investigation becomes a formal enquiry as Enron's stock price hits a nine-year low of around \$11.

even planned to use its skills and assets to offer whole new distribution channels to lucrative entertainment industries.

Later on, in autumn 2001, as the company faced disaster, its top executives were forced to admit that they had used the debt capital raised on and off-balance sheet during the boom years to make some poor investments in non-core businesses.[2] To many, it seemed that Enron had bought its Internet and other new economy dreams by mortgaging its chances of survival as a more mundane company.

By then it had been revealed just how complicated some of the off-balance sheet transactions really were. On November 8, 2001, Enron, having broken accounting rules, was obliged to reveal a small fraction of its off-balance sheet transactions. It's not clear from Enron's restatement of its accounts what the economic motivation was for complicated transactions such as that described in Box A (see page 5). But one thing became clear as trouble brewed in the summer of 2001: complicated off-balance sheet transactions such as this made it difficult to convince analysts that the company was being straightforward in its attempt to meet earnings targets.

Analysts also began to realise they had no way to be certain whether or not cash booked upfront had come with a hidden price tag in the form of future credit risk or other liabilities.

Off-balance sheet transactions can be used to shape the risk and leverage profile of a company in more profound ways. For example, the Marlin special purpose entity that was created to raise money from Enron's water company assets, issued some $900 million in debt to investors, due in 2003, that is backed by its water company assets. But if the book value of the water company assets, such as Wessex Water, fell before the debt was repaid, then Enron was likely to have to make up the shortfall by means of a charge against its own earnings. Osprey, a vehicle for raising finance using Enron's energy and other assets, has a similar structure.

In addition, creditors that funded some of the special purpose vehicles were promised early repayments in cash or collateral if Enron's credit rating fell below a certain level. This kind of clause is increasingly common in corporate finance as investors in debt instruments hope it will reduce the risk that they will end up holding credit risky 'junk' bonds. But while agreeing to these clauses helped Enron gain the financing that it needed at a competitive rate, the contingent nature of the funding significantly reduced the chances of the company surviving any crisis that triggered flows of stock, cash or salable assets back to its financing partners.

In a report on the potential danger of ratings downgrade triggers, released after the Enron bankruptcy on December 7, Moody's Investors Service noted that as Enron's ratings were downgraded, it triggered a number of cash or collateral demands. These included, says Moody's, "a $690 million note payable to a limited partnership which, absent collateral, is a demand obligation. Moreover, Enron must repay, refinance, or cash collateralise additional facil-

Timeline

November 8, 2001: Enron formally restates its earnings for 1997 to 2001, to account for the $1.2 billion reduction to shareholders' equity that has already caused it so much trouble. It admits that "certain off-balance sheet entities should have been included in Enron's consolidated financial statements". Including them means that Enron's declared debt burden increased by hundreds of millions of dollars in the period, and its net income is likewise reduced.

November 9, 2001: Staring disaster in the face, Enron announces that it has agreed to a takeover by ChevronTexaco-backed Dynegy. The company would be led by Dynegy's Chuck Watson, who reassures investors that the new company would "keep a strong balance sheet and straightforward financial structure as key priorities". Under the deal, ChevronTexaco advances Dynegy $1.5 billion to buy a share in the Northern Natural Gas pipeline, giving Enron the cash infusion it needs to stay afloat and preserve its credit ratings. Dynegy gains the right to purchase the whole of the pipeline if the deal fell through. Rather hopefully, the press announcement describes the takeover as "unleashing the value of Enron's core energy businesses".

November 12, 2001: Enron downgraded, which it admits on November 19 will require it to pay off early $690 million of debt that would otherwise mature in 2003. Shares fall again, and though by November 21 the company has succeeded in renegotiating the debt, market commentators are starting to say that Dynegy might invoke material adverse change (MAC) clauses in the merger agreement, and breaches of representation, to free itself of the deal. Signs are growing that Enron's core energy trading business will soon be crippled by the uncertainty.

November 21, 2001: Between November 16-21, Enron arranges a $1 billion credit line from JPMorgan Chase and Citigroup, secured against its pipelines. The company continues desperate negotiations with its other creditors to preserve its funding and liquidity.

November 28, 2001: Dynegy Inc says it has terminated the merger agreement and will exercise its option to purchase Enron's interest in the Northern Natural Gas Company. The main rating agencies downgrade Enron's rating to below investment grade, which in turn triggers harmful clauses in Enron's debt obligations. Lay says there will be a temporary suspension of all payments except those necessary to protect the company's core energy franchise. Over the next few days, Enron's shares trade between 45 and 25 cents, down from their high of $90 in 2000.

December 2, 2001: Enron files for chapter 11 bankruptcy protection from the courts, saying it intends to sue Dynegy for $10 billion for breach of contract. Its executives continue to struggle to salvage some of the value of its core energy business, hoping to set it up as a new entity. But from this date, the lawyers and the US bankruptcy court hold the whip hand over a corporation that had rarely missed its earnings targets.

December 3, 2001: Thousands of employees in Houston are laid off as commentators speculate on the chance of Enron finding enough financing and market credibility to preserve its core natural gas and power trading businesses, for the benefit of its creditors.

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ties totaling $3.9 billion which primarily consist of $2.4 billion of debt in Osprey Trust and $915 million of debt in Marlin Water Trust".[3]

This kind of contingent funding was liable to be particularly damaging in the case of Enron, because ratings triggers were also present in many of Enron's wholesale energy trading contracts. Indeed, investors and creditors knew that the whole of the cash-flow from Enron's counterparty-based businesses were contingent upon confidence in both Enron's short-term liquidity and the continuance of its investment grade credit rating.

Structured financings aren't only a question of liquidity, but also of trust. Analysts know that if such deals are not structured appropriately, they can allow companies to retain economic risks that are not reported elsewhere. There is a danger, therefore, simply in the impenetrability of complicated off-balance sheet financing.

Enron's on-balance sheet levels of debt did not look especially unhealthy in spring 2001, and the ratios of debt-to-equity and so on of the company were considerably below the ratios that it had once endured as a heavily indebted pipeline company. But as the share price fell, and uncertainty about the level of off-balance sheet commitments increased, the credibility of Enron's top executives became increasingly vital.

A. Example off-balance sheet deal

"In June 2000, LJM2 [one of the private investment partnerships formed in 1999 to make off-balance sheet transactions with Enron] purchased dark fibre optic cable from Enron for a purchase price of $100 million. LJM2 paid Enron $30 million in cash and the balance in an interest-bearing note for $70 million. Enron recognised $67 million in pre-tax earnings in 2000 related to the asset sale. Pursuant to a marketing agreement with LJM2, Enron was compensated for marketing the fibre to others and providing operation and maintenance services to LJM2 with respect to the fibre. LJM2 sold a portion of the fibre to industry participants for $40 million, which resulted in Enron recognising agency fee revenue of $20.3 million. LJM2 sold the remaining dark fibre for $113 million in December 2000 to an SPE [special purpose entity] that was formed to acquire the fibre. In December 2000, LJM2 used a portion of the proceeds to pay in full the note and accrued interest owed to Enron. At the time of LJM2's sale of the fibre to the SPE, Enron entered into a derivative contract which served as credit support for the benefit of some of the debt holders of a third-party investor in the SPE. This credit support provided the lender with a specified rate of return. As a result, Enron's credit exposure under the $70million note was replaced with $61 million in remaining exposure under the derivative contract. LJM2 earned $2.4 million on its resale of the fibre."

Enron, restatement of accounts, see http://www.enron.com/corp/sec

The trap closes

Much of Enron's strategic vision began to fall apart with the bursting of the dotcom bubble and the travails of the global telecommunications industry, but there was a delayed reaction in the equity markets to the significance of all this. In April 2001, however, the company started to cut hundreds of jobs from its broadband unit, and as the cuts continued they underlined how long Enron might have to wait for payback on its expensive investments.

Through early 2001 the price of Enron's shares took a tumble but few of the hedge funds that had started to sell Enron's stock short thought that the energy giant was likely to go bust. Surely, most analysts thought, its profitable core energy and trading services business would support the shares at around $30 a share or some such?

The softening up of confidence in Enron was under way, however. It's clear with hindsight that an important moment was when analysts' uncertainty began to be voiced in mainstream publications such as *Fortune* in March 2001.

The questions began to be asked with renewed force when Jeff Skilling, appointed as CEO in February, resigned just six months later. Skilling's August departure raised questions about Enron's management structure. Much worse, it gave credibility to analysts who had been wondering out loud for some months about the propriety of how Enron had structured its off-balance sheet vehicles. Worst of all, the person at the centre of some of the most pointed questions was Enron's chief financial officer Andrew Fastow, who had overseen its off-balance sheet activities.

Oddly, Fastow and other executives had taken personal stakes in some of the investment partnerships that formed the counterparties to Enron's off-balance sheet deals.[4] That meant that, as Enron moved into a crucial stage of crisis management in late 2001, Fastow and other key executives could not credibly reassure the market about the size, structure and purpose of Enron's liabilities and particularly its off-balance sheet machine. Setting aside Enron's auditors, these executives were also the only real guarantors of Enron's reported earnings since the late 1990s.

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All the pieces were now in place for a crisis that could not be managed. The final countdown to disaster over the two months leading up to Enron's Chapter 11 bankruptcy filing on December 2 is charted in our timeline. By the time that Enron had adjusted its crisis management to cope with its corporate governance failures, its liquidity time-bomb was ticking much too fast.

The company formally restated its earnings on November 8 to account for a $1.2 billion reduction to shareholders' equity. It was obliged to admit "certain off-balance sheet entities should have been included in Enron's consolidated financial statements pursuant to generally accepted accounting principles".

Including them meant Enron's declared debt burden increased by hundreds of millions of dollars in the period, and its net income was likewise reduced. Enron's own summary of the restatement is given in Box 8, but the numbers weren't as important as its own terse admission that the original "financial statements for these periods and the audit reports relating to the year-end financial statements for 1997 through 2000 should not be relied upon".

Conclusion

Already, observers of the Enron bankruptcy have taken divergent views on its causes. Those who give the benefit of the doubt to Enron's top executives suspect that while the company might inevitably been heading for a fall in terms of its share price, it was catapulted into bankruptcy by panic-stricken investors. The argument says that investors failed to recognise that Enron's accounting and corporate governance problems had inflicted relatively trivial damage on an essentially healthy company.

Those of a more cynical bent have suggested that Enron was a star performer only in the sense of putting on a good act. For these commentators, Enron's ability to meet earnings targets, and report other figures and ratios that pleased the market, was the result of the over-clever – not necessarily illegal – shaping of cashflows. That's a charge that can only be finally settled by a minute examination of the company's books, and by the SEC investigation now under way.

The chief executive officer of Andersen, the accounting firm that audited Enron, has already sought to deflect criticism by pointing to a general failure of the accounting profession. He says that today's company accounts are too backwards-looking, that they offer only intermittent disclosure, that they fail to come to terms with off-balance sheet special purpose vehicles, and that they should support a wider range of key performance indicators.[5]

The various enquiries into the Enron failure are likely to probe deep and long. By that time, though, we will have far more information to hand than did investors as they dumped Enron's shares, or creditors as they enforced contingent clauses to pull their capital out from the company.

This suggests that we must look for a simpler explanation of Enron's $80-to-26-cent death spiral.

Perhaps Enron's shareholders sold out on the company because they believed that to finance its dreams and make its targets, the company had engineered away any chance of a more mundane existence. There was no floor to the share price because as the stock fell, investors and creditors came to suspect that mechanisms were already in place that would drain any $40-a-share core business of the liquidity and reputation that it depended upon. They already knew that the company's accounts would be of little use in such a situation. And they no longer believed the only people who could quickly fill in the gaps. ■

8. Enron's restatement of its 1997-2001 accounts

"The restatement will include a reduction to reported net income of approximately $96 million in 1997, $113 million in 1998, $250 million in 1999 and $132 million in 2000, increases of $17 million for the first quarter of 2001 and $5 million for the second quarter and a reduction of $17 million for the third quarter of 2001. These changes to net income are the result of the retroactive consolidation of JEDI and Chewco beginning in November 1997, the consolidation of the LJM1 subsidiary for 1999 and 2000 and prior year proposed audit adjustments. The consolidation of JEDI and Chewco also will increase Enron's debt by approximately $711 million in 1997, $561 million in 1998, $685 million in 1999 and $628 million in 2000."

Enron, summary of restatement of accounts, see http://www.enron.com/corp/sec

Notes

1 ERisk "CRO Profile: Rick Buy - Enron Corporation", February 2001

2 "Enron Plans Asset Sell-Off to Slash Debt", Houston Chronicle, November 15, 2001

3 Moody's Special Comment, "The Unintended Consequences of Rating Triggers", December 7, 2001.

4 Enron, preambles to restatement of accounts, see http://www.enron.com/corp/sec

5 Joe Beradino, "A Wake-Up Call", The Wall Street Journal, December 4, 2001

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Unwinding Enron's Tangled Web

Duncan Wood, ERisk

December 12, 2001

Enron's lenders, counterparties and investors have been quick to estimate their exposure to America's biggest corporate bankruptcy, but replacing those estimates with actual losses will take rather longer – and observers suggest two main sources of uncertainty.

First, the sheer scale of Enron's involvement in the derivatives market promises to be the first real test of the industry's preferred method for closing out transactions when one counterparty goes bankrupt – and there's no certainty that the industry will find an ally in the US bankruptcy code.

Despite the best efforts of the International Swaps and Derivatives Association (Isda) to promote legislation that would give industry practice legal certainty, lawyers are advising concerned counterparties that their ability to terminate transactions by calculating a net gain or loss is not guaranteed.

Second, the widespread use of Enron's debt as collateral in structured credit transactions means a long wait for holders of that paper, as Enron's trustees value the company's assets and determine the level of recoveries.

It doesn't end there. The two issues overlap to a considerable extent. Synthetic collateralised debt obligations (CDOs) – the structured credit instruments most badly affected by Enron's bankruptcy – rely on credit default swaps to pass on exposure to investors, and credit derivatives documentation is arguably the most legally unproven of all derivative products.

The most recent commentary issued by rating agency Standard & Poor's (S&P) on the Enron collapse reflects the difficulty in divining the extent of the exposure faced by the energy firm's lenders, counterparties and investors: "Credit exposure to Enron likely exceeds the $33 billion on Enron Corp's balance sheet." A more precise estimate is not offered.

For investors that have exposure to Enron through structured credit, the picture is perhaps the clearest – all of the rating agencies moved quickly to assess the impact of Enron's demise on the notes they cover. "We currently expect 20 cents on the dollar to be recovered," says Mitchell Lench, manager of Fitch's European CDO team in London, who confirms that synthetic CDOs have been hit hardest simply because they tended to incorporate exposure to Enron on a routine basis.

Synthetic CDOs are issued most often by European banks, keen to shift some credit risk to what is usually a small, sophisticated pool of investors, he explains – and in that context, Enron was a favourite name because the banks were expected to build the pool of debt by including representatives from a diverse range of industry sectors, and Enron continued to be seen as one of the strongest energy companies until very recently.

Although synthetic deals are generally composed of up to a hundred names, all of whom will generally be investment-grade, Lench says that Enron's bankruptcy could be enough to prompt a downgrade of the deal. "If Enron is 1 per cent of the deal, and you're losing 80 cents on the dollar, that's 80 basis points of credit enhancement you no longer have."

S&P has been reviewing the status of 44 CDO transactions it has rated, all containing some exposure to Enron and several have since been downgraded, all of them synthetics. Nik Khakee, a director in S&P's structured finance group in New York, says that the total notional value of the 44 deals exposed to Enron is $79 billion – but the total amount of Enron's exposure included in those deals adds up to a relatively small $600 million. Despite Enron's popularity as a component of CDOs, and despite the downgrades suffered as a result, it is clear that investors in synthetic CDOs generally won't be too worried.

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However, S&P also rated six transactions called credit-linked notes (CLNs) says Khakee, and the loss potential here is far greater – they represent $2.7 billion in direct exposure to Enron. CLNs use a similar structure to synthetic CDOs: a special-purpose vehicle (SPV) issues notes to investors, accepting their funds in return, and then transacts a credit default swap with the firm that is holding the debt. The big difference is that a single name backs the CLN, rather than a pool of different names. "With these CLNs, the invstor is buying exposure to a pool of one," says Khakee.

Enron also transacted three structured credit deals of its own that were rated by S&P, issuing a total of $3 billion in notional value, says Khakee. "In these deals, Enron is the counterparty – they were one counterparty in a credit default swap and the counterparties on the other side of the deal are facing risk from Enron not because the company is part of their portfolio, but because the deal will have to be terminated."

For investors in Enron's own structured credit, it is unclear what happens next. Khakee suggests that the counterparty will need to seek a replacement value for the terminated default swap, and will potentially have a claim against Enron equal to the net difference between the value of the swap when first transacted and the current market value of a replacement – they will mark the deal to market, and accept either a net gain or loss.

Fitch's Lench, however, says that's not necessarily the case. "It depends on the structure," he says. "My understanding is that, on day one of the transaction, in order to de-link the rating of the notes from Enron, investors' funds would be used to buy sovereign debt. In the event of Enron's bankruptcy, those bonds would be liquidated to repay the investors."

The uncertainty about close-out procedures for Enron's structured credit deals redoubles when attention switches to the company's derivatives activities, which covered the whole gamut of assets from commodities and currencies to interest rates, credit and equity. One area that could have been stickiest was Enron's role as a credit derivative dealer – traders admit that the energy company was a major player in the market, standing alongside some banks in terms of the volume of its deals and appetite for credit risk. Add to that the number of transactions in which other counterparties were buying or selling their own exposure to Enron – contracts now triggered by Enron's default – and you have the biggest event ever to hit the credit derivatives market.

"It's by far the largest default of any US corporate and it's been the largest trigger since Conseco triggered," says Greg Rosen, director and default swap trader with CSFB in New York. "Enron was also a very large seller of protection – definitely a net seller – and we estimate that between $3 and $4 billion was sold to the market."

Firms that have been trading Enron credit risk via the default swap market have been going back through their documentation to check the terms of their transactions and settle the deals – CSFB included. "It's certainly been time-consuming," says Rosen, noting that there could be anywhere up to $8 billion in swaps with Enron as the underlying credit. Nevertheless, he says: "It's been very positive in terms of reassuring people that the products work as advertised. We expect the trades to settle in a timely and orderly manner."

Those firm that had Enron as a counterparty, meanwhile, have had to find new protection – which Rosen expects to result in a large liability for Enron. "Everyone's lost the protection they thought they had, and gone out to find new protection. Spreads are likely to have widened since their original transaction, so they'll have a claim against Enron based on the difference between the original and the replacement," he says.

But what about firms that have a multitude of different derivatives transactions with Enron? The energy giant's presence in a range of derivative markets, and its well-documented appetite for risk means that many counterparties will need to replace not just a default swap, but a whole basket of different transactions, from electricity swaps to forwards to interest-rate swaps and default swaps.

Ideally, counterparties should be able to terminate all of their transactions with Enron, and work out a net sum, to be paid from one party to the other, representing a gain or loss across all of the defaulted deals. At least, that's how the industry would like it to work.

Kimberley Summe, general counsel with Isda in New York, says that industry documentation makes specific provision for cross-product netting, pointing out that all varieties of derivative are recognised and provided for under industry-standard documentation known as the master agreement. But getting the bankruptcy courts to keep up with changes in the derivatives industry hasn't been a simple matter, and some lawyers have been warning their clients for years that cross-product netting may not be enforceable, no matter how much the industry wants it to be.

One lawyer – who asked not to be named because she didn't want to "be seen giving ammunition to the bankruptcy court" – says there's no guarantee that bankruptcy lawyers in the Enron case will recognise the arguments of the derivatives industry.

"The US bankruptcy code imposes restrictions on all of the things that are essential to the derivatives market – like demanding payment, collateral and netting – but over the years provisions have been added for different derivatives instruments. People have been trading for the last 10 years on the assumption that those provisions will work. Everyone expects them to, but it hasn't been tested," she says.

Bankruptcy law is careful about the allowances made for preferential treatment – the general idea being, says the lawyer, that the goal is to preserve the value of the bankrupt company, and then to divide its assets among creditors. Derivatives market practice, including netting, could place some creditors ahead of others in the queue. The industry has argued that this is essential for the safe functioning of the financial system, and US lawmakers have tended to agree – but the latest legislation that would enshrine the rights of derivatives market participants to net across a range of products has not been passed in its entirety. As things stand, there's a danger that Enron's trustees will see attempts to net across derivative products as a dilution of Enron's value, argues the lawyer.

Most significantly, there's no definite provision for credit default swaps under the existing legislation. "Are they swaps at all?" she asks. "If not, they don't fit into any protected category. People could be sitting there with a useless default swap from Enron – at the same time, they could have other obligations which they have to pay in."

Isda isn't keen on the suggestion that cross-product netting might not work. "The master agreement is intended to cover all types of contracts," says Summe. "Counterparties should be able to net across product types." She concedes that Isda has been trying hard to get netting legislation passed "because we need an update of the definitions," but notes that although Isda produces the industry's legal documents, it does not offer legal opinions. Anyone wanting to know whether cross-product netting will work "would get a better idea from a law firm".

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Who watches the watchmen?

As Enron's experience testifies, killer risks can slip through even a sophisticated ERM programme. Tightening the net involves looking again at the roles of risk management and internal audit. Alan McNee investigates

The common factor in several of the worst risk management disasters of recent years has been that serious problems at institutions have slipped through the risk management safety net.

In some cases, this was because various people and groups within an organisation assumed the risk in question was someone else's responsibility. In others, it was because the fatal risk was taken by people higher up in the organisation than the risk managers that should have called a halt to them. (It's easy for a chief risk officer to stop a risky practice being carried out by a junior trader; less so when it's the chief executive officer who is doing it).

This highlights the issue of how risk management relates to other areas of management and to corporate governance. The chief risk officer (CRO), if such a role exists in the company, may have overall responsibility for identifying, measuring and managing risk, but it's increasingly apparent that this responsibility may be shared by other individuals and groups within banks and other institutions. Internal audit, compliance, the legal department, information technology and the board of directors are all responsible for risk, and in some areas, have the power to decide which risks will be held on to and which ones will be laid off.

So where should the boundaries of enterprise risk management (ERM) be drawn? What are the respective responsibilities and powers of the risk management group, on the one hand, and the internal audit group on the other – and how clearly delineated are these two areas in practice? What is the relationship of the risk manager to the firm's legal counsel, the IT group and the compliance department?

Perhaps most important, what is the relationship of the risk manager to the senior officers of the company: the chief financial officer, the chief executive, the chairman and the board? If the most senior people in the company decide to take unacceptable risks, either collectively or individually, how far can the risk management function be expected to go in advising them against it, or even trying to prevent them? That last question is given particular resonance by recent events at Enron.

> 'If the most senior people in the company decide to take unacceptable risks, how far can the risk management function be expected to go in advising them against it?'

Internal audit is perhaps the internal function whose operations most obviously impinge on risk management. But there is also a widely accepted dividing line between the two functions. Arnold Schilder, executive director of supervision at De Nederlandsche Bank (the central bank of the Netherlands), is chairman of the Basle Committee's accounting task force. He explains the committee's view of the distinction between risk management and internal audit as follows: "The risk management group has the day-to-day control of the main risks that the bank faces, such as credit, market, country, operational and liquidity risk. It ensures that there are policies for dealing with risk, and it communicates this to the board, usually through the chief financial officer (CFO).

"Internal audit is quite separate from that. Our preferred position would be that it reports to the CEO. Its role is to oversee the whole internal control structure, and so it has to review the risk management function, among other things."

The role of the internal audit function in monitoring the bank's internal capital is one area where these two distinct functions inevitably run up against each other. The accounting task force's report makes clear that internal audit needs to review independently the way the bank's risk management systems monitor the bank's capital levels. Schilder says the board of governors will set capital requirements for internal purposes based on, among other things, policies drafted by the risk management group and typically presented to the board by the CFO.

"They are also based on targets for realising shareholder value and return on equity," he notes.

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"internal audit takes note of the board's decisions, sees to it that they are adhered to in practice, and reports to the board any deviations from this."

In a report[1] published in August this year, the accounting task force looked at the issue of internal audit in banks, and the relationship of banking supervisors to auditors. Among other recommendations and findings, the report made several key points that are directly relevant to the relationship between internal audit and risk management:

- Every activity and every entity of the bank should fall within the scope of the internal audit;
- Internal audit should regularly carry out an independent review of the risk management system developed by the bank to relate risk to the bank's capital level and to the method established for monitoring compliance with internal capital policies; and
- A bank's risk recognition and capital assessment processes differ from the risk management process, which typically focuses more on the review of business strategies developed to maximise the risk/reward trade-off within the different areas of the bank.

Deborah Chesworth is a manager in the prudential standards division at UK financial regulator the Financial Services Authority and the FSA's representative on the Basle Committee's accounting task force. She echoes Schilder's comments on the clear distinction between risk management and audit, and the latter's role in overseeing the whole control structure.

However, she also notes that the different layers of control function can add up to a potentially confusing picture. "The Basle Committee paper on internal audit rightly says that internal audit has guardian responsibility, but there are also areas where other departments have similar guardian functions," she says. "So there are certainly issues about how many levels of

A. Case Study: the Wachovia experience

DON TRUSLOW is chief risk officer (CRO) at Charlotte, North Carolina-based bank Wachovia. The 'new' Wachovia was formed from the merger earlier this year of Wachovia and First Union, after First Union beat off a hostile bid from SunTrust. With $326 billion in assets, Wachovia is now the fourth-largest bank holding company in the US. Truslow became CRO of the pre-merger Wachovia last year, and took over the role in the newly merged entity this August, replacing First Union's Rob Nimmo.

Truslow says the bank's risk management structure has five chief risk officers in each main business line, such as the capital markets division, who report directly to the CRO, as well as having a 'dotted line' to the executive running that particular business line. There are also five institutional risk areas – portfolio management, operational risk, market risk, compliance and risk support services (which includes credit risk review) – whose directors partner closely with the risk managers of the business units.

The aim, says Truslow, is to get away from the idea that responsibility for risk resides only with risk managers, and to avoid risk managers being seen as the 'risk police', who are there to look for infringements of guidelines. "The risk managers set the boundaries, but we try to discourage the idea that they 'own' all the risk in each area," he says. "The business unit managers own the risks in their organisation and there is a strong partnership between the risk management group and the people running the business. As risk managers, we also want to be engaged with the running of the business."

The internal audit function at Wachovia reports through the CFO. It's part of the finance group and reports to the audit committee on the board. As for its relationship to the risk management function, Truslow says: "It's a question of checks and balances. They check whether our procedures and policies are adequate. There needs to be clear, independent oversight, but we also work very closely with internal audit. The risk management group will be proactive in crafting policies and putting procedures into place, while the audit group will then come in after the fact to check that they're working."

On the tricky issue of responsibility for operational risk, Truslow says the op risk entailed in day-to-day transactions is the remit of the people running each business unit. But when it comes to operational risk that could have a major impact on the stability of information technology platforms, for example, he notes: "These are major issues that are critical to the whole organisation. So oversight of that kind of operational risk falls to me as well as to the operations and IT groups."

As for the grey areas of risk, where it is not immediately clear who is responsible for a particular risk, Truslow says: "Judgement and standing back is important. I could write detailed policies on how each risk should be dealt with and by whom, but the reality is that we make judgement calls every day. Operational risk is something that's always been faced, but in the past it was dealt with in a somewhat dispersed manner. We now see it as a major component of our job and as something that needs to be addressed in a much more consistent and defined way. But the fact is that there are many more grey areas when it comes to operational risk than with, say, credit risk. There's much better data on credit, for a start, and better-defined models." ■

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checks and balances you should have in an organisation." The same is true of the relationship between risk managers and internal auditors: "There is a philosophical issue – what is the right role for internal audit in overseeing the risk management function so as to give the board and its audit committee the assurance they need?" she says.

Is ERM enough?

Away from the specific distinction between audit and risk management, the role of group-level risk management is an area of particular difficulty. Some of these statements may seem to contradict the notion of enterprise risk management (ERM), consigning the risk manager to a limited role. But as Barry Schachter, head of risk management at Caxton Corporation in New York, notes: "It's hard to say what should or does fall outside of the purview of ERM, either in theory or in practice, because there's no clear definition of what the phrase 'enterprise risk management' means."

The truth is that while a chief risk officer can bring together a company's understanding of a diverse set of risks, very few CROs are invited to comment on group-level company structure or financial engineering. For most of them, bottom-up risk analysis is in, top-down risk analysis is taboo.

Yet in many cases it is the combined effect of debt levels and risk concentrations at group level that make a company as a whole vulnerable to shocks from a particular risk event or stock market reappraisal. It's also the method of leverage and its on-or-off balance sheet status that affects whether the markets as a whole will be able to see what is going on. The more dangerous kind of financial wizardry, however, is often difficult to disentangle from the ambitions of the CFO and CEO who appoint and reward the chief risk officer. They are unlikely to appreciate a CRO asking whether they truly understand the tail risk building up in the corporate machine they have assembled.

This issue of 'who watches the watchmen' is a timely one, given some of the spectacular risk management failures of the past few years. The most recent example is Enron – a company with a CRO sitting on its executive committee; a risk assessment and controls group whose purpose was to measure and report risk throughout the company; and the stated intention of achieving true ERM across its diverse activities.

> 'In many cases it is the combined effect of debt levels and risk concentrations at group level that make a company vulnerable to shocks from a particular event'

Despite all this, Enron has just filed for Chapter 11 bankruptcy protection, and is the subject of an SEC investigation, after disclosing millions of dollars in losses related to investment partnerships that were run by its former chief financial officer. The Enron saga looks set to be studied by risk managers for years to come, and in particular, it provides a case study of how a risk management function counts for nothing if the senior executives of the company choose to ignore basic prudential standards.

But this kind of organisational conflict is not unique to Enron. Inevitably, risk managers in many companies run up against situations where they cannot stop activities they see as unacceptably high-risk, because these are sanctioned at the highest level. Tony Peccia, vice president in charge of operational risk at CIBC in Toronto, says that, for example, if a CEO decides to pursue a certain strategy "then the only thing the risk manager can do is point out the risks – which hopefully they will at least be aware of. The worst thing that can happen is for people to be caught off-guard, so that they think they are within their tolerance levels but then find out they've taken on more risk than they thought!".

The FSA's Chesworth says internal auditors can face similar dilemmas over high-level risks: "The classic issue is how far internal audit is genuinely empowered to do its job. The key is reporting lines, not just in principle but also the real command structure. For example, who decides the salaries of internal audit staff? Who signs off on the funds they need to do the work properly? If it's someone responsible for areas that the internal auditors have to audit, then that could lead to a conflict of interest."

She concedes that some such issues may be insoluble. "Internal audit comprises a set of employees, so of course they will always be accountable to someone. However, there are plenty of things that companies can and should do to minimise these problems – such as having clear and appropriate

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apportionment of responsibilities, and giving the head of internal audit direct access to the audit committee and the board."

Don Truslow is CRO at North Carolina-based bank Wachovia (see box A on page 2 for a case study). He says the issue of 'high-level' risk is generally more acute in companies where management is under unrealistic performance pressure. "I don't worry at all about the risks of senior management doing something I don't know about or have control over," he says. "Our board is clear about delegating the job of managing risk to me, and there's little opportunity for something to be going on that I don't know about. In several well-known cases where other companies have disclosed big surprises over the past few years, it's hard to classify them other than as the result of managers feeling very intense pressure over stock performance, and taking bad decisions accordingly."

Schachter of Caxton Corporation agrees: "It does seem as if some high profile risk management disasters have involved not a 'rogue trader', but 'rogue senior management'. ERM will always be challenged to control risks that are taking place right at the top of an organisation – and no matter how you organise it, if the risk manager doesn't either have a very senior role or report to someone in the organisation who is very senior, then you won't catch these things."

Having senior people in a firm taking unacceptable risks is, among other things, a fairly serious form of operational risk. And it's this risk class that poses perhaps the most problems when it comes to deciding who should monitor it. The classic risk categories of market, credit and liquidity risk are (fairly obviously) the preserve of risk managers, except when internal audit steps in to check that they are being handled correctly. But operational risk is an issue that could potentially involve everyone in the company, from CEO to security guard. So how far is it the responsibility of risk managers, and how far should other functions within the organisation be involved in it?

CIBC's Peccia predicts that operational risk management will eventually become as refined as market or credit risk, with tolerance levels set for operational risk exposure. "The role of the risk manager will be to measure these risks and to ensure that these tolerance limits are not being breached," he says. "When there is a danger that they are about to be breached, the risk manager will bring this to the attention of the risk committee. So risk managers won't take decisions about changing the risk tolerance of the firm, but they will help to establish the tolerance levels in the first place, making recommendations through the risk committee, and then monitor the trend of how much op risk is taken on."

> 'Operational risk is an issue that could potentially involve everyone in the company, from the chief executive officer to the security guard'

The FSA's Chesworth says the internal audit function will also have a role to play in checking on operational risk. "In many ways, operational risk is a brand name for a set of risks that have always existed, and if firms hadn't already been managing those things to some extent then they wouldn't still be here. In that sense, internal audit will already have been looking at op risk."

The auditor's role becomes more complicated in firms where quantitative methods are applied to model the level of op risk exposure, says Chesworth: "Will internal auditors be expected to look at these models and understand them? Is it cost-effective to employ people in the internal audit department who have the skills to understand and check the operational risk models used by the risk management group?"

But she notes that the qualitative side of operational risk management will continue to be important, and internal auditors will continue to double-check how it is being managed. "The quantitative side of op risk – or risk in general – is all about measuring experience and using it to make predictions. With that comes the ability to set limits and allocate capital. But that doesn't mean you can just sit back once you've done that.

"The maths helps you to measure and allocate capital to it but op risk is about processes and behaviours. So I wouldn't expect to see a big move away from the qualitative control aspects, even with extra focus on the quantitative side," she says. ■

[1] "Internal audit in banks and the supervisor's relationship with auditors", Bank for International Settlements, August 2001 (http://www.bis.org/publ/bcbs84.htm)

Hart, Susan

From: Michael Sondow [msondow@iciiu.org]
Sent: Tuesday, January 15, 2002 8:31 PM
To: Hague list
Subject: [Hague-jur-commercial-law] Self-regulation Part II: The Enron Coverup

Enron-GATS.txt

The investigations Of Enron initiated by the US Treasury Dept, Justice Dept., and various Congressional Committees are coverups. Here is part of the true story:

Enron: Washington's Number One Behind-the-Scenes GATS Negotiator

By Tony Clarke
Special to CorpWatch
October 25, 2001

So, what do Enron Corporation and the General Agreement on Trade in Services (GATS) have in common? After all, Enron is primarily a giant energy corporation specializing in everything from natural gas pipelines to electricity. And the GATS is a new body of rules at the World Trade Organization (WTO) which is designed to liberalize cross border trade-in-services. Why, then, is Enron such a big player in the GATS negotiations at the WTO?

Well, for one thing, Enron is not just another energy corporation. It has recently reorganized to become one of the largest, multi-sector, private service providers in the world. While specializing in energy services, Enron's product lines now include a broad range of services from transportation to electronic commerce. Since Enron markets its services on a global basis, the GATS rules being negotiated at the WTO provide the power tools that can be used to knock down any barriers that may exist to profitable cross border trade-in-services.

For these reasons, Enron has positioned itself to be a leading player in the major big business lobby machines driving the GATS negotiations. But, on top of this, Enron has enormous economic and political clout, even as it currently faces serious troubles. Enron is still a player despite a Securities and Exchange Commission investigation into transactions by its former Chief Financial Officer. The free fall in its stock prices and billion dollar losses Enron has incurred, are set against a backdrop of skyrocketing multi-billion dollar revenues in the last two years. More importantly, Enron's connections with the Bush Administration make it one of the most powerful corporate players in Washington today. And these connections make it an even more influential player in the WTO's service negotiations.

The GATS negotiations are designed to provide transnational corporations with the tools they need to take control of much of what remains of the 'commons' on this planet. Every service imaginable is on the table, including a wide range of public services in sectors that affect the environment, culture, energy and natural resources. By phasing out all governmental "barriers" to international trade and commercial competition in services, the GATS rules are meant to apply to virtually all government measures affecting trade in services, from labor laws to consumer protection, including regulations, guidelines, subsidies and grants, licensing standards and qualifications, and limitations on access to markets, economic needs tests and content provisions.

How Enron GATS What It Wants

While it was founded just over 16 years ago with its origins in the natural gas business, Enron has quickly become a high-powered, diversified, global services corporation. Originally formed out of a 1985 merger between Houston Natural Gas and InterNorth (a natural gas company in Omaha, Nebraska), Enron soon became the largest natural gas pipeline distributor in the U.S. By the mid-1990s, Enron had become the leading U.S. buyer and seller of natural gas and electricity, with extensive power generation ventures overseas. By the millennium, Enron, led by its CEO Kenneth Lay, had transformed itself into a multi-sector service corporation with five major divisions: Enron 'Online Services' commodity trading system provides the largest eCommerce site in the world, dwarfing all other energy marketing web sites combined. Enron 'Broadband Services' streamlines media applications, customizing bandwidth solutions on the Internet. Enron 'Transportation Services' specializes in the company's traditional natural gas pipeline operations. Enron 'Energy Services' is now the company's retail arm for the sale of natural gas and electricity to both commercial and industrial users. And, Enron 'Wholesale Services' currently delivers more than two times the natural gas and electrical power volumes as does its nearest energy marketing competitor.

Today, trade-in-services is the fastest growing sector of the global economy. In order to globally market its energy and related services, Enron needs favorable GATS rules to promote the deregulation of services in other countries and provide conditions for the privatization of public services (so it can buy up more subsidiaries). The existing GATS rules already contain mechanisms, such as the 'domestic regulation' provisions, which provide built-in instruments to compel governments to eliminate regulations governing services and set conditions for the privatization of publicly delivered services. The current GATS 2000 negotiations taking place at the WTO are designed to not only strengthen these tools but also to expand the scope of the rules to include all public services, ranging from healthcare and education to energy, water and transportation services. In short, if the proposed GATS rules are adopted, they will radically restructure the role of government regarding public access to essential social services worldwide, to the detriment of democracy itself.

Enron is now poised to become a prime example of how transnational corporations not only influence, but actually determine, global trade rules at through the WTO, especially the GATS. As a key member of the U.S. Coalition of Service Industries (UCSI), Enron has positioned itself to play a major role in the GATS 2000 negotiations. It is well known that the USCI, which is composed of most of the largest for-profit service corporations in the U.S., has played a powerful role in shaping the agenda for the GATS negotiations. In 1999, Enron was also a top sponsor of the World Services Congress in Atlanta, where the big business agenda for GATS 2000 was consolidated. In addition, Enron is an active member on the Board of the

National Trade Council which is internationally recognized as a strong backer of the WTO, as well as a prime mover behind granting the President fast track authority over all trade negotiations.

White House Power Broker

What makes Enron even more pivotal in the GATS negotiations is its extraordinary economic and political clout. Between 1999 and 2000 alone, Enron's total revenues increased by a whopping 151.3 percent, from $40.1 billion to 100.8 billion -- putting its current financial woes in context. During this period, the corporation's electricity sales doubled, mainly due to exploiting the California energy crisis, while its sales in natural gas rose by a third. As a result, Enron was ranked 16th on the Global Fortune 500 and 8th on the U.S, Fortune 500 in 2000. In the first quarter of 2001, the company posted a 281 percent increase in revenues and a 20 percent increase in net income.

At the same time, Enron's reach into the White House has become legendary in Washington circles. While the corporation's political ties were well established with the presidencies of George Bush Sr. and Bill Clinton, they are now much more entrenched in the administration of George W. Bush. Enron's CEO, Kenneth Lay, is especially well placed. During the 2000 presidential campaign, Lay was a leading member on Bush's Pioneer Group, composed of the 400 plus people who personally contributed one hundred thousand dollars or more to his election drive. Lay was the number one career donor to the Bush campaign, contributing $318,050 in 2000. Enron gave another $300,000 to Bush's inauguration party.

When it comes to energy policies, Enron's political clout in the Bush Administration is simply awesome. According to Mother Jones magazine, Enron's Kenneth Lay is Bush's top energy advisor. Not only is Lay a key player on Bush's 48 member Energy Advisory panel but he also works closely with Vice President Dick Cheney's new Energy Policy Development Council formed to find short term solutions to energy problems. During the 2000 election campaign, Enron's Political Action Committee contributed to the senatorial campaigns of: Spencer Abraham (R-Michigan), who became Bush's Secretary of Energy; Jeff Bingaman (D-New Mexico), who became the new chair of the Energy and Natural Resources Committee in the now Democrat controlled Senate; as well as the re-election of Tom Delay (R-Texas) who sponsored the bill that mandated the deregulation of electricity across the U.S. Moreover, three top White House advisors involved in drafting President Bush's national energy strategy are reported to have either held stock or earned fees from Enron: Karl Rove, Bush's chief political strategist; Lawrence Lindsay, Bush's chief economic advisor; and Lewis Libby, Cheney's chief of staff.

US Energy Deregulation, A Blueprint for the WTO?

The recent deregulation of energy services in the U.S. became a major demonstration case of Enron's political clout, as well as perhaps a major clue as to how the new GATS rule making could play out on the international scene. Known as the 'Enron Bill' in D.C. circles, Sen. Tom Delay's legislative package called for a national deregulation of energy, particularly electricity. To strengthen their position, a series of moves were made in regards to the Federal Energy Regulatory Commission. First, CEO Ken Lay and other Enron officials interviewed prospective candidates to fill vacancies on the Commission and President Bush chose two people recommended by Enron. Then, the New York Times revealed on May 26, 2001 that Lay himself wrote to the Commission Chair, Curtis Hebert, saying that if Mr. Hebert changed his views on electricity deregulation, Enron would continue to support him in his new job. Hebert was reportedly offended by Enron's move, refused the offer and feared for his job. Again, on May 26th, Ken Lay met with actor Arnold Schwartzenegger, LA Mayor Richard Riordan, and former junk bond dealer and fraud convict, Michael Milken, to drum up support for Enron's deregulation solution to what then appeared to be America's looming energy crisis.

Meanwhile, Enron was able to reap huge profits from the California energy crisis. When sudden energy shortages translated into massive cost increases, major suppliers of commercial and industrial energy like Enron were able to cash-in big time. In the last quarter of 2000, Enron raked in $377 million in profits, largely due to the California energy crisis. The market should be even more deregulated, argue Enron officials, to allow 'demand' and 'supply' forces to resolve the ongoing energy crisis. A cartel of corporations, including Enron, are now being investigated by California state officials for holding back the supply of power through plant shutdowns in order to spike prices and profits. In addition, the Los Angeles Times has reported that the CEOs of energy corporations took advantage of the California crisis to pocket unusually high options transactions themselves. Enron's Ken Lay, for example, is reported to have netted $123 million in 2000, which is three times higher than his 1999 take and ten times higher than what his 1998 figures.

In effect, Enron's strategy on the GATS negotiations is to develop new trade rules to consolidate internationally what it has accomplished on energy deregulation in the U.S. To pry open new markets for energy and related services in other countries, Enron's plan is to ensure that GATS rules are established through the WTO that can be used to accelerate the deregulation, and where necessary the privatization, of these services. Once again, Enron has equipped itself for this mission. The current U.S. Trade Representative, Robert Zoellick, who is responsible for U.S. input

into the GATS negotiations, has reportedly been the
recipient of a $50,000
'advisory fee' from Enron. James Baker, former U.S.
Secretary of State,
and Robert Mosbacher, former Secretary of Commerce, are both
on the
Enron payroll as advisors on overseas projects and
international
negotiations. Enron's Board includes Charles Walker, former
U.S. deputy
Treasury Secretary; John Wakwham, former British Secretary
of State for
Energy, who specializes in providing advice on European
businesses; and
Frank Wisner, former U.S. Ambassador to India. With CEO Ken
Lay
already serving as Bush's number one energy advisor, it
becomes
increasingly clear that the U.S. negotiating position in the
GATS round will
go a long way to reflect Enron's interests.

Who Pays the Price?

In all likelihood, the GATS will also strengthen Enron's
hand on the global
stage. While this may bode well for its shareholders, the
company's track
record already leaves something to be desired in terms of
human rights
and the environment in communities and countries where the
corporation
operates. If Enron gets its way in the GATS, these problems
may in fact
escalate.

For instance, Enron uses its political clout internationally
with U.S.
embassies and even the CIA to win lucrative contracts
overseas. In India,
Enron eventually won the $2.8 billion contract to build the
Dhabol Power
Plant in 1995 after then U.S. Ambassador, Frank Wisner,
exerted
enormous pressure on the Indian government and the CIA
provided Enron
with strategic intelligence on its competitors and the
bidding process.
Later, when local villagers protested against the
construction of the Dhabol
project which threatened the environment and their
livelihood, Enron paid
state forces for security which resulted in a crackdown on
proteaters.
According to Human Rights Watch, "Enron's local entity, the
Dabhol

Power Corporation, benefited directly from an official policy of suppressing dissent through misuse of law, harassment of anti-Enron protest leaders and environmental activists, and police practices ranging from arbitrary to brutal. The company did not speak out about human rights violations and , when questioned about them, chose to dismiss them altogether."

Enron's influence peddling has had far reaching consequences in other countries as well. In 1989, George W. Bush intervened, as governor of Texas, urging the Argentine government to grant Enron the contract to build a pipeline from Argentina to Chile. The Argentine Minister of Public Works told reporters Bush's intervention amounted to influence peddling. Nevertheless, Enron was awarded the contract shortly after Bush was publicly seen socializing with then president of Argentina. In 1995, the Clinton Administration threatened to cut off development aid to Mozambique if it did not sign a deal for Enron to construct a pipeline from Mozambique to South Africa. Declared Mozambique's natural resources minister, John Kachamila: "Their diplomats, especially Mike McKinley (deputy chief of the U.S. Embassy), pressured me to sign a deal that was not good for Mozambique. He was not a neutral diplomat. It was as if he was working for Enron."

It remains to be seen what further role Enron will play in the GATS 2000 negotiations which will likely go on into 2003. Given its track record to date in pressing for deregulation and privatization, Enron is certainly well placed to be Washington's number one behind-the-scenes negotiator. As an agent of GATS, Enron can hardly be counted on as a model employer when it comes to taking over service delivery in various parts of the world. As Jeffrey Skilling, until recently Enron's longtime president, put it at industry conference in 1997: "You must cut costs ruthlessly by 50 to 60 percent. Depopulate. Get rid of people. They gum up the works."

Tony Clarke is the Director of the Polaris Institute in Canada.

From: Michael Sondow [msondow@iciiu.org]
Sent: Saturday, December 01, 2001 7:36 PM
To: Hague Convention list
Subject: [Hague-jur-commercial-law] Where does the criminality stop?

http://www.corpwatch.org/trac/issues/wto/featured/2001/tclarke.html

Enron: Washington's Number One Behind-the-Scenes GATS Negotiator
By Tony Clarke
Special to CorpWatch
October 25, 2001

"Enron's connections with the Bush Administration make it one of the most powerful corporate players in Washington today."

==

http://www.guardian.co.uk/business/story/0,3604,609926,00.html

"A derivative need not be a complex financial instrument. It need not be a dangerous one. But in the hands of criminals and cretins it is often both. Whether Enron's management were one or the other - or both - will doubtless become clear over the years that it will take for litigation to work through its course."

==

http://www.guardian.co.uk/business/story/0,3604,609926,00.html

"The company, which has said it will file for bankruptcy next week, axed 1,100 jobs at its London energy trading centre on Friday, leaving just 250 staff.

Many left the building feeling robbed, not only of their salaries but also of the year-end bonuses they had expected to receive.

Making matters worse from their point of view were revelations that many Enron directors had enjoyed a wide range of lucrative company perks, including consultancy work or favourable purchasing agreements from affiliated companies.

"Directors who have side consulting arrangements are not considered, under governance guidelines, to have the necessary independence from management," said director of the Center for Corporate Governance at the University of Delaware, Charles Elson.

Detailed disclosures

In a statement published earlier this year, Enron gave details of extra earnings by its directors.

John Urquhart, director, received
$493,914 in 2000 for consulting services
to Enron.
Lord John Wakeham, director, received
$72,000 in 2000 for his advice on Enron's
European operations
Herbert Winokur, director, was affiliated
with the privately owned Enron supplier
National Tank which made $370,294 in
sales to Enron in 2000

"Best practice is no consulting fees to any directors," said editor at the research body The Corporate Library, Nell Minnow.

In addition, the Enron document revealed that Enron used a travel agency which is 50% owned by the sister of its chairman and chief executive, Ken Lay.

Sharon Lay's travel agency sold travel services worth $517,200 in 2000."

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http://www.enron.com/corp/pressroom/board.html

ENRON Board of Directors:

Norman P. Blake, Jr.
Former CEO and Secretary General, United States Olympic Committee

Wendy L. Gramm
Former Chairman, U.S. Commodity Futures Trading Commission

Robert K. Jaedicke
Professor (Emeritus) of Accounting and Former Dean,
Graduate School of Business, Stanford University

Paulo V. Ferraz Pereira
Former President and CEO,
State Bank of Rio de Janeiro, Brazil

William C. Powers, Jr.
Dean of the University of Texas School of Law

John Wakeham
Former U.K. Secretary of State for Energy

From: Michael Sondow [msondow@iciiu.org]
Sent: Saturday, December 01, 2001 8:00 PM
To: Hague Convention list
Subject: [Hague-jur-commercial-law] Enron & Int'l Trade (cont'd)

http://www.corpwatch.org/trac/issues/wto/featured/2001/tclarke.html

"Enron's strategy on the GATS negotiations is to develop new
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Enron payroll as advisors on overseas projects and
international
negotiations. Enron's Board includes Charles Walker,
former U.S. deputy
Treasury Secretary; John Wakwham, former British
Secretary of State for
Energy, who specializes in providing advice on
European businesses; and
Frank Wisner, former U.S. Ambassador to India."

From: Michael Sondow [msondow@iciiu.org]
Sent: Saturday, December 01, 2001 8:08 PM
To: Hague Convention list
Subject: [Hague-jur-commercial-law] Enron, Int'l Trade, & the US Government (cont'd)

http://www.corpwatch.org/trac/issues/wto/featured/2001/tclarke.html

"In 1989, George W. Bush intervened, as governor of Texas, urging the Argentine government to grant Enron the contract to build a pipeline from Argentina to Chile. The Argentine Minister of Public Works told reporters Bush's intervention amounted to influence peddling. Nevertheless, Enron was awarded the contract shortly after Bush was publicly seen socializing with then president of Argentina. In 1995, the Clinton Administration threatened to cut off development aid to Mozambique if it did not sign a deal for Enron to construct a pipeline from Mozambique to South Africa. Declared Mozambique's natural resources minister, John Kachamila: "Their diplomats, especially Mike McKinley (deputy chief of the U.S. Embassy), pressured me to sign a deal that was not good for Mozambique. He was not a neutral diplomat. It was as if he was working for Enron."

From: BestDay_News@ambest.com
Sent: Thursday, January 17, 2002 3:50 AM
To: MELISSA.PEDRI@do.treas.gov
Subject: BestDay for January 17, 2002

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To view the complete, latest on-line edition of this newsletter in your Web browser, please visit: http://www.bestdaynews.com

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NEWS FOR THURSDAY, JANUARY 17, 2002
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TOP OF THE NEWS

Lack of Competition
Hampers Texas Med-Mal Market
By David Pilla
Dwindling competition is sapping the medical liability insurance market in Texas, a situation that mirrors what is going on in other parts of the United States.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47227

Regulators May Decide on Exclusion
For Personal Property Lines Jan. 18
By Dennis Kelly
State insurance commissioners expect to decide Jan. 18 whether to allow terrorism exclusions for personal property lines, as most have for commercial lines, said John Morrison, Montana insurance commissioner.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47247

Health Plans: 2% Rate Increase
For Medicare+Choice in 2003 Is Not Enough
By Fran Matso Lysiak
Free Article: Officials with the American Association of Health Plans say it's up to Congress and the Bush Administration to

save the Medicare+Choice program, since the Centers for Medicare & Medicaid Services recently decided that health plans participating in the program will only receive a 2% pay increase in 2003.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47251

COMMERCIAL COVERAGE

Major commercial property/casualty premiums are uniformly on the upswing, some by as much as 200%, and confusion reigns in the market as carriers try to decide what they can and cannot cover and at what price, following the terrorism of Sept. 11.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47233

EARNINGS

The Allstate Corp. (NYSE: ALL) said it took a $107 million fourth-quarter charge related to restructuring expenses. The company also said that it will pay $59 million to settle a diminished-value lawsuit.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47243

FINANCIAL

Conseco Inc. (NYSE:CNC) said it has repurchased $34 million of public debt due to mature this year since its last debt reduction update.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47245

HEALTH

Several of the largest health maintenance organizations in California are joining together in what's being called a groundbreaking initiative that includes paying bonuses to their contracted physician groups based on the care they provide and patient satisfaction.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47241

LEGISLATION

New York lawmakers have passed a health-care reform bill that hinges on the conversion of Empire Blue Cross/Blue Shield to for-profit status.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47248

Protecting insurers' use of credit scoring, fighting a proposed federal charter and development of a federal reinsurance terrorism backstop are among the National Association of Independent Insurers' goals this year, said Jack Ramirez, president of the NAII.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47230

LITIGATION

The Pennsylvania Supreme Court has ruled that when an insurance company acts in bad faith by refusing to settle a claim, it breaches its contractual duty as well as its fiduciary duty toward its policyholder.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47232

RATING ACTION

Free Article: A.M. Best Co. has affirmed the financial strength rating of A (Excellent) for PMA Capital Insurance Group, Philadelphia, and removed it from under review.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47246

Free Article: A.M. Best Co. has downgraded the financial strength rating to A (Excellent) from A+ (Superior) of the Royal & Sun Alliance Insurance Group (RSA), United Kingdom.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47226

STATE REGULATION

Ohio Director of Insurance Lee Covington said he's suing nine former officers of Credit General Insurance Co. and Credit General Indemnity Co. for failing to protect the companies from becoming insolvent.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47229

TERRORISM

A committee of insurance commissioners is deciding whether to allow terrorism exclusions for personal property and personal umbrella polices, similar to the exclusions most states are approving for commercial insurance policies.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47237

The headquarters staff of global reinsurer St. Paul Re returned Jan. 14 to its offices at 195 Broadway, one block from the World Trade Center site, for the first time since the Sept. 11 collapse of the towers.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47234

EXECUTIVE

Citigroup (NYSE:C) said it has named Robert B. Willumstad president.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47249

The former head of defunct medical malpractice insurer PIE Mutual Insurance Co. has pleaded guilty to three felony counts in connection with misappropriating PIE funds and making illegal political contributions, the U.S. Department of Justice said.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47242

Regence Group, an affiliation of Blue Cross and/or Blue Shield companies in four states, has promoted Susan A. Hansen to vice president of membership and claims-systems consolidation.

http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47235

GE Employers Reinsurance Corp. has named Nicholas D. Gassman as vice president of sales for its specialty insurance group.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47250

SCPIE Holdings Inc. has named Edward G. Marley vice president/controller.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47236

Note: All articles marked "Free" are valid only for the day of the newsletter's release. Subsequent to that date, full text of previously published articles is available to BestWire subscribers or on an individually purchased basis.
Previously issued press releases are available at A.M. Best's worldwide Web site.
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-- A Closer Look: Online Aggregators Retool in Drive for Profitability

-- Review/Preview News Commentary: Extreme Reality...Managing the Unimaginable: A.M. Best's Life/Health Review/Preview Available on Web; P/C Trends Gain Momentum After September Terror

-- Special Report: Turmoil in the Texas Property Market: Financial Performance Deteriorates

-- Statistical Study: Top Fraternal Life Societies--2000

-- In the Spotlight: Ace's Evan Greenberg Surveys New Landscape

-- Full ratings update, plus selected rationales.

To access current issue:
http://www.bestweek.com

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RECENT RATING ACTIONS
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Downgraded: Royal & Sun Alliance
http://www4.ambest.com/press/rr.asp?Refstring=6554465777554650

Affirmed: PMA Capital Group
http://www4.ambest.com/press/rr.asp?Refstring=6554465777554651

Downgraded: SCOR
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544656

Affirmed: QBE International
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544653

Affirmed: QBE Re Europe
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544654

Affirmed: Iron Trades
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544655

Actions Taken: Folksam International
http://www4.ambest.com/press/rr.asp?Refstring=6554465777554649

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SITE OF THE DAY
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Odyssey Re said it would add additional provisions in its fourth-quarter results for $19.5 million in after-tax net losses related to the bankruptcy of energy-trading giant Enron Corp.
http://www.odysseyre.com/

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BEST'S REVIEW HIGHLIGHTS
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Finding Higher Ground: The insurance industry has plenty of employment opportunities, but companies need to rethink job descriptions and benefits packages to lure job seekers into an industry rarely considered exciting or lucrative.
http://www.bestreview.com/2002-01/is_ground.html

From Mountains To Molehills: Insight: Work backlogs can be cleared if agencies attack the inefficiencies and change their procedures.
http://www.bestreview.com/2002-01/pc_mountains.html

Anticipating the Benefits: About $80 billion is allocated to ordinary life insurance purchases each year, suggesting the paramount importance of understanding differences in policy yields between whole life and universal life.
http://www.bestreview.com/2002-01/lh_benefits.html

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AHEAD IN THE NEWS
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Mold claims, which have been plaguing homeowners insurers in Texas, are beginning to ripple into commercial liability lines in California, where insurers are beginning to put mold exclusions on lines such as general liability.

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REPORTS
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Top Fraternal Life Societies--2000
http://www4.ambest.com/bestweek/interim.asp?refnum=10503

Turmoil in the Texas Property Market: Financial Performance Deteriorates
http://www4.ambest.com/bestweek/interim.asp?refnum=10504

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Comments, feedback: mailto:bestday_editor@ambest.com

To search for an A.M. Best financial strength rating:
http://www3.ambest.com/ratings/search.html

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Pedri, Melissa

From: BestDay_News@ambest.com
Sent: Wednesday, January 16, 2002 3:49 AM
To: MELISSA.PEDRI@do.treas.gov
Subject: BestDay for January 16, 2002

BESTDAYNEWS E-MAIL EDITION

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NEWS FOR WEDNESDAY, JANUARY 16, 2002
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TOP OF THE NEWS

France's Scor Warns of 2001 Loss,
But Looks to Strong 2002
By Brendan Noonan
French reinsurer Scor (NYSE:SCO) forecast a loss of 250 million euro ($1 = 1.13 euro) for 2001, citing a sharp deterioration in fourth-quarter results, and said it would exit program business in the United States and health reinsurance in all markets except France.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47179

Odyssey Re Reports Enron Exposure
And Losses From Sept. 11 Terrorism
By John Hillman
Odyssey Re Holdings Corp. (NYSE:ORH) said it would add additional provisions in its fourth-quarter results for $19.5 million in after-tax net losses related to the bankruptcy of energy-trading giant Enron Corp. and a strengthening of provisions for losses arising from the terrorism of Sept. 11.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47175

Twelve Agencies in Mississippi Merge
By Fran Matso Lysiak

Free Article: Twelve independent insurance agencies in Mississippi have merged, creating one of the state's largest privately owned insurance agencies.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47168

COMMERCIAL COVERAGE

Mold claims, which have been plaguing homeowners insurers in Texas, are beginning to ripple into commercial liability lines in California.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47178

FRAUD

Liberty Mutual Insurance Co. is suing a New Jersey physical therapy services company and others, alleging automobile personal injury protection fraud.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47177

Hartford Insurance Group (NYSE:HIG) said it has filed suit in Morris County Superior Court against 27 New Jersey residents, alleging the defendants conspired to stage motor-vehicle accidents and fake injuries to generate hundreds of thousands of dollars in fraudulent claims.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47174

LIFE INSURANCE

The forecast for the life insurance industry is cautiously optimistic, with growth either flat or up anywhere from 3% to 8%, with increasing customer expectations and ongoing mergers a challenge for 2002, according to directors of LOMA, the financial-services research organization.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47170

LITIGATION

A San Francisco superior court judge has granted final approval of a $20 million settlement of a class-action suit against Blue Shield of California over how Blue Shield communicated the method it calculated copayments and deductibles, from Jan. 1, 1987, through June 30, 1992.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47181

MERGERS & ACQUISITIONS

BB&T Insurance Services said it would acquire a Greensboro, N.C.-based employee-benefits company, expanding BB&T's focus on that line.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47171

XL Capital Ltd. (NYSE:XL) said it has acquired a minority interest in Stanfield Capital Partners LLC, an investment-management company, and completed the acquisition of a 67% interest in Le Mans Re.

http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47172

RATING ACTION

Free Article: A.M. Best Co. has withdrawn the financial strength rating of A- (Excellent) for Folksam International, Sweden, and assigned it an NR-5 (not formally followed).
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47176

Free Article: A.M. Best Co. has affirmed the A- (Excellent) financial strength rating of Iron Trades Insurance Co. Ltd. (ITIC), London, and has removed the under review status applied on Sept. 21, 2001, to reflect A.M. Best's concerns on the QBE Group's potential loss exposure incurred following the World Trade Center disaster and its implications for the group's European subsidiaries.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47165

Free Article: A.M. Best Co. has affirmed the A- (Excellent) financial strength rating of QBE International Insurance Ltd.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47143

Free Article: A.M. Best Co. has affirmed the A- (Excellent) financial strength rating of QBE Reinsurance Europe.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47144

Free Article: A.M. Best Co. has downgraded the financial strength rating of Scor, Paris, to A (Excellent) from A+ (Superior) and has removed the rating from under review.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47142

STATE REGULATION

Information about a consumer's income, credit history and physical and mental health will now be protected under rules established by the Florida Department of Insurance.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47182

WASHINGTON

President Bush has signed a bill into law that gives lawsuit protection to small businesses and small contributors to Superfund sites, as well as money to help clean up "brownfields."
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47173

WORKERS' COMPENSATION

Small businesses have always made up the bulk of policyholders with the New York State Insurance Fund. But that's changing because large businesses are having trouble getting workers' compensation coverage that includes terrorism, said the fund's chief executive officer.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47169

EXECUTIVE

Protective Life Corp. (NYSE:PL) said it has named Richard J.
Bielen senior vice president, chief investment officer and
treasurer of the company and its principal subsidiaries.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47141

Mutual of America Capital Management Corp. has appointed Peter
J. Schmole as vice president of marketing.
http://www4.ambest.com/BestDayNews/LoadStory.asp?BSN=47180

Note: All articles marked "Free" are valid only for the day of the
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-- Special Report: Turmoil in the Texas Property Market:
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-- Statistical Study: Top Fraternal Life Societies--2000

-- In the Spotlight: Ace's Evan Greenberg Surveys New Landscape

-- Full ratings update, plus selected rationales.

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http://www4.ambest.com/press/rr.asp?Refstring=6554465777544656

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Actions Taken: Folksam International

http://www4.ambest.com/press/rr.asp?Refstring=6554465777554649

Assigned: Renaissance Re (debt)
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544648

Assigned: WellPoint (debt)
http://www4.ambest.com/press/rr.asp?Refstring=6554465777544651

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SITE OF THE DAY
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California's Department of Managed Health Care has dismissed some allegations against Kaiser Foundation Health Plans in a hearing over the health maintenance organization's appeal of a $1.1 million fine levied against it in May 2000.
http://www.kp.org/

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BEST'S REVIEW HIGHLIGHTS
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2001: Terror, Mold and More: Last year will be remembered for the terrorist attacks that destroyed the World Trade Center in New York, downed four commercial planes, killed thousands and created the biggest losses in insurance history.
http://www.bestreview.com/2002-01/is_terror.html

Navigating Rough Seas: Directors and officers writers find tough economic times give rise to litigation in this rapidly growing market.
http://www.bestreview.com/2002-01/pc_seas.html

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AHEAD IN THE NEWS
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The U.S. Supreme Court will begin hearing arguments today in a case that pits state law against the federal law governing how much influence health insurers have over a patient's right to get a second medical opinion.

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REPORTS
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Still, the new policy doesn't directly address the problems some money managers have encountered in trying to comply.

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"There are too many categories for us to meet your objective," he told trustees.

It appears Brinson will fall short again under the new policy, albeit not as far.

Michael J. Nehl, executive director of the Chicago teachers' fund, said the new policy calls for a compliance review every six months. As for enforcement, he said the new policy provides that any manager failing to comply will have to send a representative to explain to the board why it missed the target.

Mr. Nehl said trustees adopted no particular penalties.

"We will take each case individually," he said.

The policy as designed is one-size-fits-all, but enforcement seems to be anything but that.

Mr. McLaughlin worries about the policy interfering with Brinson's performance, he said at the roundtable. He said Brinson is willing to participate but believes directing any more than 30% of brokerage would affect its investing.

Brinson executives couldn't be reached for further comment.

Also at the roundtable, a number of managers expressed concern about best execution, but the board didn't provide any guidance.

Gene R. Saffold, a trustee who is a managing director in public finance at Salomon Smith Barney, Chicago, asked without getting any acceptable reply for a definition of best execution.

The board had adopted the brokerage policy without having a definition of best execution and without evaluating its managers' trading execution quality. Mr. Nehl said the board is leaving it up to managers to determine best execution. He said the board has no plans to hire an expert service to evaluate trading execution.

One has to wonder if the minority brokerage policy, with its ambiguity, is designed more for appearances, to assuage a group looking for a way to participate in institutional brokerage trading, rather than adopted as a genuine effort to promote a goal with public pension money, without sacrificing best execution however it is defined. ■

The collapse of Enron Corp. could forever lead to changes in how record keepers and other 401(k) providers are replaced, specifically involving the blackout period when participants aren't allowed to trade during such transitions. As a story on Page 1 of this issue notes, lawsuits by Enron 401(k) participants argue that because the company stock they owned through the plan was volatile, they should have been allowed to trade — just as other shareholders were selling their shares. Not being allowed to trade left their 401(k) plan's Enron stock holdings in jeopardy of big losses.

The 401(k) plan might call a timeout, but the capital markets never do. That is what the trading ban fails to consider. This kind of quiet period needs to stop.

There is little comfort that a sponsor, according to one attorney, has fiduciary responsibility during the no-trading period. Enron's fiduciaries could have sold the stock in the 401(k) as the price fell, but they didn't. As corporate executives, these same fiduciaries might have been reluctant to sell and see their company's stock cascade even more. There is an inherent conflict of interests in these dual roles, one supposed to serve the 401(k), the other the company and other shareholders. How can a corporate executive sell the 401(k) stock as a fiduciary on the one hand, but, on the other hand, as a corporate manager, try to rally other shareholders and Wall Street analysts to hold the stock and even buy more shares?

Participants likewise have little comfort in believing they can take recourse against the company in the event of trouble with a plan sponsor stock during a blackout period. If a company collapses, as in the case of Enron, 401(k) participants will have difficulty recovering any apparent losses because of shrinking corporate assets available to settle any dispute.

Enron participants have been left to wonder if any service provider was looking out for their interests during this no-trade period. Arthur Andersen LLP, the plan's consultant, auditor and accounting firm; Northern Trust Co., the plan's trustee; and Northern Trust Retirement Consulting LLC, the plan's record keeper, are being sued by the participants for their roles in recommending and imposing the blackout period while Enron was changing record keepers to Hewitt Associates from Northern Trust.

The Enron case should serve as an alert that there has to be a way for participants to trade during such transitions. The no-trading period doesn't just affect a sponsor's stock, but all assets. That no-trade period puts many 401(k) assets in jeopardy if there are problems at other companies or if there is a potential broader market decline.

ERISA doesn't apparently address this issue directly. But it does state that fiduciaries owe their allegiance to participants, not to the plan sponsor or service provider.

Of course, blackout periods don't affect all 401(k) participants, because many companies forbid participants from trading in company stock until employees reach a certain age or status, in effect, imposing a years-long no-trading period. That is another problem.

As a retirement vehicle, 401(k)s have grown in a short time into significant programs, upon which millions of workers depend. No one should welcome the intervention of Congress, which could overreact and impose unduly onerous and unnecessary restrictions. But if sponsors and service providers don't act soon, tough regulation could be the outcome. In any case, participants can't be left in the lurch anymore. ■

George Harrison, tax rebel

George Harrison might have not intended "Taxman," the song he wrote and sang with the Beatles, as precursor to the protest of the Thatcher and Reagan revolutions or an anthem to any particular economic philosophy. But it was a protest lyric that unfortunately is as telling as ever regarding disincentive to work and entrepreneurship and property rights. In tribute to his passing, the words to his song serve as an enduring cry for freedom.

"Let me tell you how it will be/There's one for you, 19 for me/'Cause I'm the taxman, yeah, I'm the taxman.

"Should 5% appear too small/Be thankful I don't take it all/'Cause I'm the taxman, yeah I'm the taxman.

"If you drive a car, I'll tax the street/If you try to sit, I'll tax your seat/If you get too cold I'll tax the heat/If you take a walk, I'll tax your feet.

"And you're working for no one but me/Taxman." ■

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Published every other week by Crain Communications Inc. **Atlanta** - 3340 Peachtree Road N.E., Suite 1450, 30326; **Boston** - 27 Franklin St., Suite 505, 02110-1540; **Chicago** - 360 N. Michigan Ave., 60601; **London** - New Garden House, 78 Hatton Garden, EC1N 8LD England; **Los Angeles** - 6500 Wilshire Blvd., Suite 2300, 90048-4947; **New York** - 711 Third Ave., 10017-4036; **San Francisco** - 5 Third St., Suite 811, 94103; **Washington D.C.** - National Press Bldg., 20045. Address all subscription correspondence to Pensions & Investments, 1155 Gratiot Avenue, Detroit, Mich. 48207-2912.

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EDITORIAL

An incomplete policy revision

By Barry B. Burr

If a pension fund has a policy, trustees and staff ought to evaluate and enforce it. Even if a money manager or trustee disagrees with the policy, once adopted by trustees, the policy ought to be enforced.

The $9.3 billion Chicago Public School Teachers' Pension and Retirement Fund has had a policy for years on the use of minority- and women-owned brokerage firms by the money managers the pension fund hires. But it has no specific enforcement procedure.

The policy was revised for domestic large-capitalization equity managers following an October roundtable, in which some of the fund's managers criticized some aspects. With the revision, trustees adopted an enforcement procedure, but still without any designated penalty for noncompliance.

The new policy, effective Jan. 1, calls for large-cap managers to direct at least 35% of their total brokerage commissions to minority- and women-owned brokerage firms that have a significant local presence. The old policy requires these managers to direct 40% of commissions to Illinois firms, with 40% of that to be directed to in-state minority- and women-owned brokers.

Still, the new policy doesn't directly address the problems some money managers have encountered in trying to comply.

John V. McLaughlin, executive director, Brinson Partners Inc., said at the roundtable his firm doesn't direct more than 30% of trades because to do more would jeopardize its investment goals, indicating the difficulty of trading some stocks.

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Timeout trouble

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The 401(k) plan might call a timeout, but the capital markets never do. That is what the trading ban fails to consider. This kind of quiet period needs to stop.

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Enron participants have been left to wonder if any service provider was looking out for their interests during this no-trade period. Arthur Andersen LLP, the plan's consultant, auditor and accounting firm; Northern Trust Co., the plan's trustee; and Northern Trust Retirement Consulting LLC, the plan's record keeper, are being sued by the participants for their roles in recommending and imposing the blackout period while Enron was changing record keepers to Hewitt Associates from Northern Trust.

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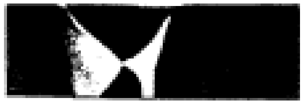
a summary of the legislation. Mr. Andrews, a member of the House Education and the Workforce Committee, first introduced the bill last year.

Sen. Jeff Bingaman, D-N.M., a member of the Senate Health, Education, Labor & Pension Committee, also is considering whether to introduce similar legislation, according to an aide. Mr. Bingaman already has decided to hold hearings on Enron's handling of its retirement plan, the aide confirmed.

Sen. Edward Kennedy, D-Mass., chairman of the Senate Health, Education, Labor and Pensions Committee, also plans to hold hearings on Enron's 401(k) plan early next year.

Meanwhile, if Enron's 401(k) participants are successful in their cases against the service providers, it will make switching providers



"THEY SHOULD HAVE DELAYED THE CHANGE UNTIL THE STOCK IS LESS VOLATILE. DON'T FREEZE PEOPLE IN THE MIDDLE."

Eli Gottesdiener, plaintiff's attorney

have delayed the change until the stock is less volatile," Mr. Gottesdiener said in an interview. "Don't freeze people in the middle."

Targeting the service providers as defendants is crucial to plan participants. When Enron filed for reorganization under Chapter 11 of the Bankruptcy Code, that action automatically stays or stops cases against Enron outside of the bankruptcy court. Enron and Enron executives are being sued for including company stock in the plan and forcing participants to hold Enron stock by putting the company match in Enron securities. Under Enron's plan, participants had to hold the company stock match until they reached age 50.

Northern Trust, the outgoing record keeper, only held the plan assets for the first three business days during the blackout period

service providers involved with qualified benefit plans.

"Presumably if there is additional risk, there would be increased cost to plans," Mr. Schmidt said.

Sponsor is fiduciary

During a blackout period, plan participants cannot switch in or out of investment options. Therefore, the plan sponsor, under the Employee Retirement Income Security Act, takes on the responsibility of being the participants' investment fiduciary, said C. Frederick Reish, an attorney with the Los Angeles-based law firm of Reish & Luftman. This means the employer takes on the full investment responsibility to select each participant's asset allocation, Mr. Reish said.

"The employer should have liquidated the employees' (company) stock," he said.

But plan participants assert Arthur Andersen and Northern Trust could be held liable for not stepping in to stop Enron's breaches of its fiduciary responsibility, Mr. Gottesdiener said.

The Nuremberg defense that they were only following orders will not fly, he said. ■

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cited then about investing in Enron's latest initiatives, including its now-failed effort to create a market for trading bandwidth capacity. "We believe... this is the future of the Internet," Mr. Hayes told the committee, according to a transcript of the Oct. 16, 2000, meeting.

CalPERS entered its first corporate partnering program with Enron in 1993, forming the first of two joint ventures that produced double-digit returns for the California pension fund.

The idea: CalPERS and Enron would ante up an equal of amount of assets into funds that invested in energy companies. This way, CalPERS benefited from Enron's expertise in the industry, while Enron was able to keep these more speculative ventures off its books.

In fact, of the $60 billion in direct investments Enron had as of a year ago, $27 billion represented ventures with other partners, Mr. Fastow told the CalPERS investment committee, according to a transcript of the October 2000 meeting.

"But, as a public company, we tend to have to worry about short-term financial reporting," he said. "So one thing we're concerned about is our credit rating." Credit quality was critical to Enron's running its market in energy.

Heavy criticism

Mr. Fastow's management of outside partnerships with Enron drew heavy criticism when revealed this fall and ultimately led to his ouster from the company.

In the first joint venture, known as the Joint Energy Development Investment program, or JEDI, CalPERS and Enron each poured up $250 million. The joint venture was closed in 1997, with CalPERS racking up a net annualized internal rate of return of 22.2%.

Following on the heels of that success, the two giants formed a successor joint venture, JEDI II. This time, CalPERS and Enron each committed $500 million. Of that amount, CalPERS still had invested $156.5 million as of last June, when pension officials pulled the plug on the fund because of the uneven outlook for energy projects in California.

In the meantime, however, CalPERS has chalked up a 62% annualized gain on realized investments since the joint venture's inception in January 1998.

The investments had been so successful that staff amended the structure of the JEDI II agreement, allowing CalPERS to participate in Enron's broadband and Net Works units, where Enron officials sought to take "old economy" companies and create commodity type markets for the products. ■

Stevens, senior managing director; Hal Reynolds, managing director; Dave Borger, managing director; and Stuart Matsuda, vice president.

SBC's Judith Brown retiring

Judith J. Brown, executive director of benefit plan investment administration for SBC Communications, will be retiring in early 2002. Dru Cessak, who had been responsible for shareholder services, will be taking over Ms. Brown's duties, including administration of SBC's $13.7 defined benefit and $12.6 billion defined contribution plans. She will be executive director of shareholder services and benefit plan administration.

N.Y. fund drops BGI strategy

The $112 billion New York State Common Retirement Fund terminated its $2.7 billion U.S. tactical asset allocation portfolio with BGI and will reallocate the money into two internally managed portfolios — $1.9 billion to an S&P 500 index fund and $857 million to a fixed- income portfolio.

The system also reallocated $2.8 billion it had in the BGI Low Cap Fund, moving $1.5 billion into a BGI Russell 2000 index fund and $1.3 billion into BGI's Russell 1000 Alpha Tilts Fund.

Separately, the fund made the following private equity commitments: $200 million to the J.P. Morgan Global 2001 Fund; $125 million to the OCM Opportunities Fund IV; $75 million to the Third Cinven Fund; $250 million to the KKR Millennium Fund; $100 million to the Morgan Stanley Real Estate IV International Fund; $50 million to the Morgan Stanley Real Estate IV Domestic Fund; and $300 million to the Hudson River Fund II.

County hires 11 managers

The $1.1 billion Wayne County Employees' Retirement System hired 11 equity

Verbund Pensionskasse, with €280 million ($250 million) in assets, will merge early next year with the €1 billion PAG Pensionskasse multiemployer pension plan. The Verbund plan covers employees of Verbundgesellschaft, Austria's largest power generator. Assets are managed externally by five European-based managers.

VRS alters rebalancing policy

The $36.4 billion Virginia Retirement System adopted a policy of rebalancing only when its exposure to any asset class is off from its strategic target allocation by two percentage points or more, said O. Nelms Everett. The fund previously rebalanced every month.

Gainesville taps Pzena

The $150 million Gainesville (Fla.) General Employees Pension Plan hired Pzena Investment to manage $16 million in active domestic small-cap value equities, said Tim Christiansen, pension management analyst.

401(k) hires MFS

Petroleum Helicopters hired MFS as bundled provider for its $100 million 401(k) plan, said Angie Quebedeaux, senior benefits adviser. MFS replaces J.P. Morgan/American Century.

Church shifts to stock

United Church of Canada hired Boston Partners to manage C$32 million (US$30 million) in active U.S. large-cap value equities. Duc Le, pensions and general fund manager at the C$900 million pension fund, said the money was shifted from fixed income.

Heitman names CEO

Maury Tognarelli was named CEO and president of Heitman Financial, effective Jan. 1. He now is president and COO. Jerry Claeys, CEO and chairman of Heitman since January 1999, will remain chairman.

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AT DEADLINE

Unilever, MLIM settle

Wilshire slates spinoff

SBC's Judith Brown retiring

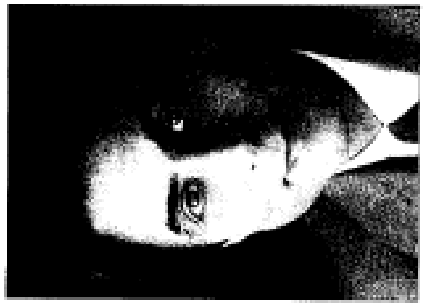
N.Y. fund drops BCI strategy

Hsu moves to Atlantic

Vermont plans to merge

VRS alters rebalancing policy

Gainesville taps Pzena



"THEY SHOULD HAVE DELAYED THE CHANGE UNTIL THE STOCK IS LESS VOLATILE. DON'T FREEZE PEOPLE IN THE MIDDLE."

Blackout period criticized

Sponsor is fiduciary

More legislation

profit reports, the department said in a written statement. The PWBA is reviewing the company's benefit plans, the rules that govern them, and steps taken by the company shortly before its collapse to temporarily freeze trading of 401(k) assets, the statement said. "Enron's employees have gotten the short end of the stick," Ms. Chao said in the statement.

• Last week, plaintiffs in the third lawsuit filed in connection with Enron's 401(k) plan sued Arthur Andersen LLP, the company's consultant, auditor and accountant; Northern Trust Co., the plan's trustee; and Northern Trust Retirement Consulting LLC, the plan's record keeper. Hewitt Associates LLC, the 401(k) plan's new record keeper, could be the next to be sued.

In short, the Enron debacle could lead to a fresh look at the extent to which employees' retirement nest eggs are tied to the well-being of their employer. Among other things, it could lead to new limits on how much of a 401(k) plan may be invested in employer stock and changes in rules governing stock that can be held in retirement plans.

Reps. Peter Deutsch, D-Fla., and Gene Green, D-Texas, both members of the House Energy & Commerce committee — which does not have jurisdiction over pension matters —are drafting a bill, called The Pension Protection Act, that would impose a 10% cap on employer stock that can be held in 401(k) retirement plans. Under the legislation being contemplated, retirement plans would have to examine their investments annually and sell out of employer stock if their holdings exceed 10% of assets, explained Eric Lynn, a legislative assistant to Mr. Deutsch. The bill will be introduced before Congress recesses later this month. Because neither congressman is on a committee that oversees pension matters, the two authors of the bill intend to seek co-sponsors from others that do have direct oversight, Mr. Lynn said. Federal pension law already prohibits employers from investing more than 10% of traditional defined benefit pension plans in company stock. Under the law, there is no require-

CalPERS

Continued from page 1

will debate its legal strategy toward Enron. All options are on the table, including filing a lawsuit, joining in a suit filed by others, or joining the bankruptcy committee, said Brad Pacheco, a CalPERS spokesman.

Others enter fight

Other investors already have jumped into the fray: Amalgamated Bank, New York, has charged that Enron executives and directors pocketed $1.1 billion from the sale of Enron stock over the past three years, and wants other institutional investors join its suit. And other pension funds, including the $112 billion New York Common Retirement Fund, Albany, reportedly are considering suing Enron.

Only a year ago, however, relations between the giant pension fund and the Houston energy power were rosy.

Andrew Fastow, Enron's then-chief financial officer, and Shirley Huddler, the Enron official dedicated to the CalPERS relationship, "have made CalPERS and the system hundreds of millions of dollars in profits over the last two years," Rick Hayes, now head of CalPERS' alternative investments program, told the CalPERS investment committee last fall.

Indeed, CalPERS' 1998 $80 million co-investment with Enron to purchase three New Jersey power plants likely was the single highest-returning investment made by the fund's alternative investment program, generating an internal rate of return of [illegible] after the plants were sold later to El Paso Power Co.

And CalPERS officials were ex-

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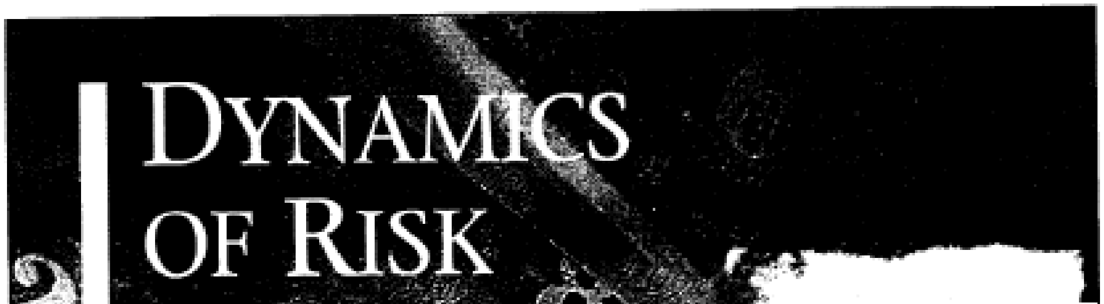

Enron

Continued from page 1

trade the volatile stock during the blackout period when Enron's plan was switching record keepers.

Not a pretty picture, pension-wise. Nor are the details:

• In an internal memorandum obtained by *Pensions & Investments*, Enron's benefits department announced the company no longer will match employees' 401(k) contributions, except in union plans. Until Nov. 30, the now-hobbled former energy giant had matched 50% of participant contributions up to a maximum of 6% of base pay. The match was invested in the Enron Corporate Stock Fund, according to documents filed by the company with the Securities and Exchange Commission. Neither Enron executives nor their attorneys returned numerous telephone calls by deadline.

• Labor Secretary Elaine Chao confirmed Dec. 5 that the Pension and Welfare Benefits Administration is investigating questions raised by Enron's handling of its workers' retirement benefit plans. Many employees lost up to 90% of their retirement assets after the company indicated it would restate profit reports, the department said in a written statement. The PWBA is reviewing the company's benefit plans, the rules that govern them, and steps taken by the company shortly before its collapse to temporally freeze trading of 401(k) assets, the statement said. "Enron's employees have gotten the short end of the stick," Ms. Chao said in the statement.

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ing blackout periods.

No tax deduction

Enron also might have to repay the tax deduction it received on its contribution of company stock to the retirement plan if the Labor Department and the Internal Revenue Service determine the company violated federal pension law, which places a lid of 10% on employer securities in employer-directed plans.

Sen. Barbara Boxer, D-Calif., has charged that Enron's defined contribution plan became employer-directed when, during the blackout period to change record keepers, it froze trading in 401(k) plan assets even as its stock was collapsing.

In a Dec. 4 letter to Ms. Chao and IRS Commissioner Charles O. Rossotti, Ms. Boxer maintained that a change in plan administrators is not listed in the law as an exception to the rule that employees cannot be forced to invest in company stock.

"If you agree that they are in violation, then under this section of the law, Enron loses its tax benefits and owes the federal government," Ms. Boxer wrote to the regulators.

And the fallout from Enron is prompting lawmakers to consider imposing limits on employer stock that can be held in retirement plans.

Reps. Peter Deutsch, D-Fla., and Gene Green, D-Texas, both members of the House Energy & Commerce committee — which does not have jurisdiction over pension matters —are drafting a bill, called The Pension Protection Act, that would impose a 10% cap on employer stock that can be held in 401(k) retirement plans. Under the legislation being contemplated, retirement plans would have to examine their investments annually and sell out of employer stock if their holdings exceed 10% of assets, explained Eric Lynn, a legislative assistant to Mr. Deutsch. The bill will be introduced before Congress recesses later this month. Because neither congressman is on

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AT DEADLINE

NYC axes Zurich Scudder

New York City Retirement Funds terminated Zurich Scudder Investments, which managed $840 million in international strategies for the funds, said Nicole Fise, spokeswoman. The money will be allocated to existing managers. Bank of Ireland will run $25 million and GE Asset Management, $10 million, for the Board of Education Retirement System. Sprucegrove will run $125 million, Delaware International, $136 million, and Bank of Ireland, $133 million, for the city employees' fund. Bank of Ireland will manage $25 million; Invista, $26 million; and GE, $27 million, for the fire department fund. Bank of Ireland and Capital Guardian each will manage $15 million for the police department fund. Delaware will run $123 million and Putnam, $122 million, for the Police & Fire Variable Funds. Bank of Ireland and Cap Guardian each will manage $32 million for the Police Special Officers Fund.

Kodak hires John Lane

John C. Lane was named director of pensions for the $13 billion Eastman Kodak pension fund. Mr. Lane, CIO for the $48 billion Pennsylvania Public School Employees' Retirement System, confirmed his appointment and said he is "very excited" about his new job. The Kodak post had been vacant since the retirement of Russell Olsen.

Continued on page 35

BAD NEWS

Enron: 401(k) and cash balance plans battered as company crashes

By Arleen Jacobius and Vineeta Anand

HOUSTON — As Enron Corp.'s energy empire collapses, employees are getting hammered by deep cuts to their defined benefit and defined contribution retirement plans.

Some 54% of their 401(k) balances are invested in Enron common stock that is next to worthless. It closed at 66 cents a share Dec. 6, down from more than $83 Dec. 31.

Another 7% of their assets are in Enron cumulative second preferred convertible stock.

To add insult to injury, the company halted the employer match, which was $21 million last year. The 401(k) plan had $2.1 billion in assets at its peak Dec. 31.

And, to make matters worse, Enron is considering discontinuing future accruals of 5% of pay to its cash balance plan, which will save the company $15 million, assuming Enron contributes the same amount this year that it did last year. The plan, set up in 1995 to replace a defined benefit plan offsetting an employee stock ownership plan, had assets of $241.8 million at the beginning of 1999 and liabilities of $230 million.

Meanwhile, the Department of Labor is investigating Enron's 401(k) plan, even as plan participants — many of whom just lost their jobs — [illegible]

CalPERS: Pension fund's alternative investment partnership with Enron headed for divorce court

By Joel Chernoff

SACRAMENTO, Calif. — You wouldn't know it now, but just over a year ago Enron Corp. was virtually a poster child for CalPERS' pioneering alternative investments program.

Indeed, Enron was the first corporation with which the alternative investments team at the $144 billion California Public Employees' Retirement System, Sacramento, chose to form a partnership.

In total, the pension fund invested more than [illegible] ventures with Enron, earning double-digit returns. In addition, the pension fund owns 3 million shares of Enron stock through various index strategies.

Now, the giant pension fund might be squaring up for a legal battle with Enron, which is fighting for survival after filing for reorganization under Chapter 11 of the Federal Bankruptcy Code.

The second joint venture has been frozen since last year, and the value of CalPERS' Enron shares has plunged 99% since their 52-week peak of $296 million.

On Dec. 12, CalPERS' investment committee

See CalPERS on page 33

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
January 17, 2002
PO-931

TREASURY SECRETARY PAUL O'NEILL REMARKS TO THE U.S. SAVINGS BONDS VOLUNTEER COMMITTEE

Thank you Richard, and thank you for hosting this year's luncheon and meeting of the U.S. Savings Bonds Volunteer Committee. Before I make the formal presentations we have for you, I'd like to thank you, your 2001 committee and Banco Popular for helping make last year a tremendous year for the savings bond program.

Richard, as private sector CEOs you and I always looked at the bottom line to let the numbers tell the story. So, let's take a quick look at the numbers you and your committee posted. Bond sales in fiscal year 2001, totaled $6.6 billion -- up an impressive 30 percent from a year earlier. Your efforts to encourage Americans to take a look at the value of our newest savings bond, the inflation-indexed I Bond also made their mark. For the first time, I Bonds accounted for more than half of all bond sales.

I know that this success was the result of your personal commitment, not only as chair, but also as a member of the committee over several years to encourage Americans to plan for and save for their future. Your efforts to reach out to the Hispanic community with this important message are particularly gratifying. This dovetails with your efforts to reach out to the under-served and un-banked to bring them into the financial mainstream.

So, it is with great pleasure that I present you with Treasury's Gold Medal of Merit as a token of our appreciation. I'd also like to present this special Citation that commemorates our thanks for your service.

As I ask Vance Coffman to join me at the podium, I'd like to remind you that his and Lockheed-Martin's support over the years are hard to beat. Vance is no stranger to the committee having headed up the savings bond effort among his colleagues in the Aerospace industry. And in doing so he demonstrated his and his company's leadership by consistently earning the program's highest honors for participation. So as I present you with this certificate appointing you Chair of the 2002 U.S. Savings Bonds Volunteer Committee, I want to thank you in advance for the energy and leadership you and your team will bring to our effort this year.

What you, the Savings Bond Volunteers, do is a crucial part of educating Americans of every age and background on the importance of retirement savings. In the broader context of saving, I'd like to make a few comments on the security of the nation's retirement system. The pension system has evolved in recent years into one that increasingly emphasizes two of the country's quintessential values, personal responsibility and freedom of choice. This evolution provides workers much greater opportunity than ever before to build wealth and save for their own retirement but also imposes a greater degree of individual responsibility in doing so.

Defined contribution plans, commonly known as 401(k) plans, give individual workers their own account in which they can build wealth and save for retirement. Participants are allowed, within limits set in the tax code, to choose the level of their plan contributions. The tax relief plan signed into law last summer increased the amount individuals can put into IRAs and 401(k)s, because the President is very committed to expanding every American's ownership and control of their retirement nest eggs.

Your 401(k) is a nest egg you own, and you decide how to invest your contributions, choosing among a set of investment options offered by their employer. In many plans, participants are also free to invest their employer's matching contributions as they see fit. This freedom to choose among investments allows employees to choose the tradeoff between risk and return with which they are most comfortable.

Working Americans value that sense of ownership and control - especially the knowledge that no one can take your nest egg away from you. That peace of mind depends on public confidence that retirement plans operate fairly and openly. The rapid collapse of the Enron Corporation and the effect of the decline in its stock price on its employees' retirement funds may have diminished that confidence. When the company's stock became virtually worthless, employee's life savings dissolved.

The experience of Enron employees is unsettling to the millions of Americans whose life savings are in their 401(k) plans. Working Americans save to buy a home, to pay for their children's education, and to retire in comfort. The President is very concerned that people lost much of their retirement savings through no fault of their own.

The Justice Department is pursuing a criminal investigation. The Department of Labor and the Securities and Exchange Commission are also conducting separate investigations for potential violations of their regulations.

If anyone at Enron broke the rules, they will be punished. At the same time, we need to look at the policy issues presented by the Enron case. We need to determine whether the rules that apply to 401(k) plans, pensions, and other types of retirement plans are adequate to ensure that individuals do not lose control over the life savings they own. We also need to review whether accurate information is available so that individuals can make wise saving and investment decisions.

Last week the President directed me, Secretary Chao of the Labor Department and Secretary Evans of the Commerce Department to convene a working group to analyze pension rules and to develop recommendations to strengthen retirement security. This review will focus on the issues of fair play in the market and the balance between consumer choice and firms' interests in offering defined contribution plans.

A working group of senior staff has already met twice and Secretaries Chao and Evans and I will hold our second meeting later today. The working group is looking at a broad range of issues, including the rules governing diversification, temporary lock out, and the availability of information to employees. We must ensure that the rules enhance opportunities for individuals to invest in our economy and ensure that their ownership of their life savings is protected. We want to enhance, not limit, choices individuals can make in planning for their retirement security. At the same time, we want to preserve and enhance employers' incentives to offer retirement options that will help their employees build an economically successful future. For individuals to make the best possible decisions, they must know that the rules prevent anyone from taking those decisions away from them. We are committed to delivering to the President recommendations that promote the retirement security of working Americans.

We are also pursuing new methods of making the full range of Treasury securities more widely available, because Treasury securities are a valuable tool for every American seeking financial security. We offer the safest, most liquid, securities in the world to fill investor needs across the whole spectrum of portfolios, from the individual investor who has $50 to invest, to the largest asset managers and other firms who invest billions of dollars in managing their portfolios.

The Internet now gives us the technological wherewithal to create the broadest possible primary market for Treasury securities that imagination and effort will allow.

The Bureau of Public Debt already has some of this in place. Their website offers investors the opportunity to get information on and buy both savings bonds and marketable bills and notes directly from the Treasury. Creating and continually enhancing this direct link to Treasury products will let our customers move seamlessly along the whole continuum of the securities we offer as their investment needs evolve.

Enhancing and protecting retirement security for all Americans is one of President Bush's priorities, and one of my top agenda items for this year. I'm eager to expand the availability of savings tools to all Americans, and to ensure that working American's ownership of their retirement nest eggs is protected.

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
January 15, 2002
PO-924

REMARKS OF TREASURY SECRETARY PAUL O'NEILL TO THE NATIONAL RETAIL FEDERATION

Good afternoon. It's wonderful to be with you today. I want to take a few moments to make some remarks about what we're up to in Washington, and then I'd like to hear from all of you. As retailers, you are the first to sense changes in consumer behavior, and therefore sense the direction our economy is taking. Hearing from you about what you are seeing in your stores is crucial in helping me do my job.

I saw the forecast you made and also the data released this morning on retail sales from December. They fit into my overall view of where we are today - we see signs that the economy is improving, but the signs don't give a clear indication that our rate of improvement will be as strong as we'd like it to be. When I talk to executives in different industries, I hear different outlooks. In some cases, I hear that inventories are at record low levels - a good sign for an imminent recovery. Others tell me, however, they see no prospects for new orders. The signs are mixed, and growth forecasts reflect that - suggesting that we'll have positive growth, but less than the 3-plus percent rate that we'd like to return to quickly. That's not good enough. It's especially not good enough for the people who've lost their jobs since this recession started last March.

We need to take action to strengthen our recovery and speed the process of putting Americans back to work. Last month, we were very close to getting an economic security package through the Congress, but we didn't get it done. The President has told the Congress and the nation that we will continue to push for tax changes that will increase business investment and job creation and put money in the hands of consumers.

Getting the economy growing again is good for working American families, good for retailers like all of you, and also good for the federal government's budget. As you know, the economic slowdown has virtually eliminated federal budget surpluses for the next two years. The tax cut enacted last summer accounts for about 15% of the reduction in this year's surplus, new spending in the wake of the September 11 attacks accounts for about 20%, and the rest - two-thirds of the reduction - is the result of the slower economy. For example, the CBO reports that when first quarter revenue is adjusted for the one time shift in timing that was legislated last year, corporate tax receipts would have been down 40% quarter over quarter. The President's tax relief package did not reduce corporate taxes at all in 2001 - the decline is entirely due to the slowdown in the economy.

The sooner we get the economy growing again, the sooner we will return to the era of budget surpluses.

Of course we should run a budget surplus when our economy is running well, but we should not raise taxes to achieve an accountant's surplus when our economy is limping or in the early stages of recovery.

Because it is so topical, I want to say a few words about the assignments the President gave me last week to convene two groups to see what action should be taken, if any, to modify laws, rules or regulations to better protect employees and investors from the circumstances of Enron employees and investors.

We who believe in free markets know that government plays a crucial role in establishing the rules of the game. Market economies work when the rules of the game provide investors with the information they need to make sound decisions and also provide them with certainty that the rules will be followed. The United States has the lowest cost of capital in the world because we have the best rules. Individuals - whether they are asset managers at large investment houses or simply managing their own personal savings -- are confident that they have the information they need to make sound decisions and the ability to act on that information as they see fit.

In the Enron case, something clearly went awry.

The Justice Department is pursuing a criminal investigation. If anyone at Enron broke the rules, they will be punished.

At the same time, the President has asked us to look at the rules that apply to 401(k)s, pensions and other types of retirement plans to make certain the rules are adequate to ensure that individuals do not lose control over the life savings they own. We also need to review whether accurate information is available so that individuals can make wise saving and investment decisions.

I met Friday with Labor Secretary Elaine Chao and Commerce Secretary Don Evans to begin an examination of the rules that apply to 401(k) plans and private pensions. Working Americans save through their 401(k)s to buy a home, to pay for their children's education, and to retire in comfort. These savings belong to individual workers, and no one should take control away from the individuals who own those nest eggs. We will look at a broad range of issues, including the rules governing diversification, temporary lock out, and the availability of information to employees. We must ensure that the rules enhance opportunities for individuals to invest in our economy and ensure that their ownership of their life savings is protected. For individuals to make the best possible decisions, they must know that the rules prevent anyone from taking those decisions away from them.

Finally, the President has asked me to lead a group looking into disclosure rules, so that all investors have the information they need to make sound decisions. I will be working with Chairman Greenspan, with Harvey Pitt at the SEC and Jim Newsome at the CFTC to ensure that rules for disclosure keep pace with the increasing complexity of financial instruments used in our economy. Our economy flourishes when each individual is able to make individual decisions based on complete and accurate information. Individual investors making the most informed decisions possible will allocate resources in our economy where they will have the greatest return. It is the foundation of a successful market economy and a necessity for the peace of mind of millions of employees whose life savings are the foundation for their dreams and aspirations.

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The White House
President George W. Bush

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For Immediate Release
Office of the Press Secretary
January 10, 2002

President Calls for Review of Pension Regulations and Corporate Disclosure Rules
REMARKS BY THE PRESIDENT IN MEETING WITH HIS ECONOMIC TEAM

The Oval Office

9:42 A.M. EST

THE PRESIDENT: Thank you all for coming. I met with my economic security team last week to talk about ways to create jobs. We're meeting again with the components of the team to talk about one part of economic security, and that's pension security.

One of the things we're deeply concerned about is that there have been a wave of bankruptcies that have caused many workers to lose their pensions, and that's deeply troubling to me. And so I've asked the Secretary of Treasury, Secretary of Labor and Secretary of Commerce to convene a working group to analyze pensions, rules and regulations, to look into the effects of the current law on hard-working Americans, and to come up with recommendations how to reform the system to make sure that people are not exposed to losing their life savings as a result of a bankruptcy, for example.

As well, Secretary of Treasury, along with the SEC, the Fed, and the CFTC, are going to convene a working group to analyze corporate disclosure rules and regulations. In light of the most recent bankruptcy, Enron, there needs to be a full review of disclosure rules, to make sure that the American stockholder, or any stockholder, is protected.

And so, I think this is an important part of, obviously, other investigations that are ongoing. The Justice Department announced and informed us late yesterday that they're in the process of investigating aspects of the Enron bankruptcy. The administration is deeply concerned about its effects on the economy. We're also deeply concerned about its effects on the lives of our citizenry.

I'll be glad to answer a few questions.

Q When was the last time you talked to either Mr. Lay or any other Enron official, about the -- about anything? And did discussions involve the financial problems of the company?

THE PRESIDENT: I have never discussed, with Mr. Lay, the financial problems of the company. The last time that I saw Mr. Lay was at my mother's fundraising event to -- for literacy, in Houston. That would have been last spring. I do know that Mr. Lay came to the White House in -- early in my administration, along with, I think 20 other business leaders, to discuss the state of the economy. It was just kind of a general discussion. I have not met with him personally.

Q -- to inoculate and your administration politically from the fallout?

THE PRESIDENT: Well, first of all, Ken Lay is a supporter. And I got to know Ken Lay when he was the head of the -- what they call the Governor's Business Council in Texas. He was a supporter of Ann Richards in my run in 1994. And she had named him the head of the Governor's Business Council. And I decided to leave him in place, just for the sake of continuity. And that's when I first got to know Ken, and worked with Ken, and he supported my candidacy.

This is -- what anybody's going to find, if -- 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 that workers are protected.

Q Mr. President, does it appear that Iran is flexing its muscles in Western Afghanistan, and does that threaten the U.S. war on terrorism in that region?

THE PRESIDENT: Well, first of all, Iran must be a contributor in the war against terror; that our nation and our fight against terror will uphold the doctrine, either you're with us or against us; and any nation that thwarts our ability to rout terror out where it exists will be held to account, one way or the other.

I hope -- we had some positive signals early -- early in this war from the Iranians. 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 Qaeda murderers to hide in their country. We would hope that if that be the case, if someone tries to flee into Iran, that they would hand them over to us, that they're a part of -- if they're a part of the coalition, then they need to be an active part of the coalition.

In terms of Afghanistan, we are -- we would like to work with the Iranians, as well as other neighboring countries, to bring a stable interim government to stabilize the interim government. And to the extent that they're involved, we would hope that they would participate, if they are trying -- if they in any way, shape, or form try to destabilize the government, the coalition will be -- we'll deal with them, in diplomatic ways, initially. And we would like very much for them to be active participants in a stable Afghanistan. It's to their advantage, by the way, that Afghanistan be stable.

Q Mr. President, based on the evidence the Israeli delegation presented at the State Department yesterday, about this arms shipment, do you believe that it's time for the United States to either break or suspend relations with Mr. Arafat and the Palestinian Authority?

THE PRESIDENT: John, I think it's very important for our administration to remain engaged with both parties. Obviously, I want to make sure that the evidence is definitive. But I'm, like many, beginning to suspect that those arms were headed in the wrong -- to promote terror. And terror will never enable us to achieve peace in the Middle East. So long as there's terrorists trying to disrupt the peace process, there won't be peace.

I do believe that, once the evidence is in, that those responsible need to be held to account. On the other hand, I also believe that our country must stay engaged in the process. I intend to ask Zinni to go back to the region at the appropriate time, to keep pushing for a dialogue, to keep pushing for the process to go forward.

Mr. Arafat must renounce terror, must reject those who would disrupt the peace process through terror, and must work hard to get to the peace table. It seems like it's up to him to make these decisions.

Q But has he been less that truthful in speaking to Secretary Powell, General Zinni and others, in saying he had nothing to do with this and no knowledge of it?

THE PRESIDENT: We will find out the facts, John. But he is -- you asked a question, should we basically disengage? And the answer is no, we won't disengage from the Middle East. We will stay involved in the Middle East peace process -- or trying to get to the peace process. And it starts with making the region more secure.

Mr. Arafat must renounce terror, and must reject those in the region that would disrupt the peace process by the use of terrorist means.

Q What can you do about pensioners -- what can you do about pensioners now? Isn't that horse already out of the barn at Enron?

THE PRESIDENT: Our group is meeting, and they will bring recommendations here. They'll look at -- fully investigate what went on. My concern, of course, is for the shareholders of Enron. But my -- I have great concern for the stories -- for those I read about in the stories who put their life savings aside, and for whatever reason, based upon some rule or regulation, got trapped in this awful bankruptcy and have lost life savings.

And one of the things this group is going to do is take a good hard look at it.

Thank you all.

END 9:50 A.M. EST

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TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
January 11, 2002
PO-917

TASK FORCE STATEMENT ON REVIEW OF RETIREMENT BENEFIT RULES AND PROTECTION

Today, Treasury Secretary Paul O'Neill, Labor Secretary Elaine Chao, and Commerce Secretary Don Evans met to respond to the President's directive that they explore the rules, regulations and laws that govern pension plans and investment programs, such as 401(k)s, and determine whether changes should be made to further protect employees' retirement savings. They directed staff to immediately begin analyzing the effectiveness of retirement security protections

"We will take the necessary steps to ensure appropriate protection for the retirement nest eggs of millions of Americans," stated Treasury Secretary Paul O'Neill.

"We need to fully protect workers who depend on pensions and 401(k) plans for their retirement," stated Labor Secretary Elaine Chao.

"Our number one priority is the security of the retirement savings of America's workers," stated Commerce Secretary Don Evans.

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Fair Shares?

Why Company Stock Is a Burden for Many— And Less So for a Few

Workers Often Must Hold On To Stakes Held in 401(k)s; Top Brass Have Options

Hedging for the 'Upper Tier'

By ELLEN E. SCHULTZ
And THEO FRANCIS
Staff Reporters of THE WALL STREET JOURNAL

In the 1990s, as the stock market climbed year after year, many corporations and their employees entered into a marriage of convenience: The company would dole out its own shares as compensation and benefits. Employees would have a steadily appreciating asset that encouraged loyalty and created an incentive to work hard for the company's success.

They're still doing it. Gillette Co., for example, "believes it is important that employee interests be aligned with company interests," says spokesman Stephen K. Brayton, echoing the explanations of dozens of other companies that use their own stock for executive pay, incentive bonuses, or contributions to 401(k) retirement-savings accounts.

Shackled to Stock

But as share prices have fallen over the past year and a half, it has become clear that not all stock handouts are created equal. Millions of rank-and-file workers at hundreds of companies have found themselves shackled to big chunks of company stock, while executives are able to exercise wide latitude in what they do with theirs. Because of the law capping tax-deductible executive compensation at $1 million a year, many companies top off their executive pay packages with stock options, as well as bonuses and other incentives that are typically paid in stock, much of it unencumbered.

Based on filings with the Securities and Exchange Commission, hundreds of companies use their own stock in lieu of cash as their matching contributions to employees' retirement-savings accounts. And the majority of those restrict the ability of employees to sell the shares and move the proceeds into mutual funds and other alternatives offered through their 401(k)s. Benefits consultants Hewitt Associates found in a recent study that nearly half of 215 firms offering company stock in their 401(k) plans only contribute their own shares to employee accounts, and that 85% of those companies restrict sales of the stock.

Gillette doesn't let employees switch out of its stock contributions to their 401(k)s until age 50, according to government filings. At Coca-Cola Co., it's age 53. Procter & Gamble Co., Qwest Communications International Inc. and troubled Enron Corp.—now facing lawsuits over employees' 401(k) losses—are among the many others that impose similar restrictions. So far this year, Gillette employees have had to watch the company-contribution portion of their retirement savings shrink by millions of dollars as the share price has fallen 11%. Employees at Coca-Cola have endured a share-price decline this year of 18%. Procter & Gamble shares have been flat.

The companies point out that executives participate in the same 401(k) plans as other employees, subject to the same restrictions. Still, the bulk of company stock that executives own is usually held outside such restricted accounts.

At Qwest, with a share price down 69% so far this year, top executives and directors have sold a combined $172 million of Qwest shares so far this year, according to SEC data collected by Thomson Financial/Lancer Analytics. Qwest Chief Executive Joseph P. Nacchio alone has sold Qwest shares valued at $89 million.

Likewise, many companies offer supplemental savings plans for executives that don't force them to hold company stock. Some top executives at Coca-Cola can participate in a supplemental retirement-savings plan with a guaranteed annual return of 14%. Executives at Qwest are able to contribute as much as 100% of their salaries and bonuses to a supplemental plan in which they can allocate their own and company contributions as they like.

Spotty Disclosure

Executives also can protect themselves—without selling their shares and triggering taxes—by using hedging techniques offered for just that purpose by firms such as Goldman Sachs Group Inc., Eaton Vance Corp. and Bessemer Trust Co. Disclosure of these deals to the SEC is generally required but spotty.

"It clearly has been a growing business, and very busy in the last 12 months," says Michael Dweck, head of the Single Stock Risk Management division at Goldman Sachs. (The firms marketing these hedging strategies typically hedge their own side of the transactions to protect themselves, as well.) "People recognize the inherent risk of holding all your wealth in a single stock." His operation generally won't arrange transactions for blocks of stock worth less than $5 million. "It's for the upper tier of management," Mr. Dweck says.

For the rest, companies point out, employees have ample opportunity to diversify their retirement-savings portfolios by investing their own contributions in other options offered. Indeed, many workers have ill-advisedly put a lot of their own 401(k) money into their employers' stock.

Wyn Triska, a 42-year-old power-plant technician for an Enron unit in Estacada, Ore., says he warned many of his co-workers of the dangers of wagering all their retirement savings on Enron. "Even when Enron was going up," he says, "I never put a cent into it—it just doesn't make sense to load up on one stock." Nonetheless, even he has been unable to sell the stock that Enron has contributed to his 401(k) as the share price has plummeted from $86 a little more than a year ago to around $4 now. Under the company's 401(k) rules, he can't sell until age 50.

For many rank-and-file workers, risk-averse or not, their 401(k)s are their largest assets, apart from their homes. So holding company stock they can't sell has become a source of resentment and frustration. Federal pension law leaves 401(k) plans largely outside the realm of regulation. But lately, some employees have taken their frustration to the courts.

Just this month, in three separate lawsuits—the latest filed yesterday—participants in Enron's 401(k) plan allege that Enron misled them about the risks of investing in the company's shares. The suits, all filed in Federal District Court in Houston, note that the company "locked down" the retirement plan from Oct. 17 to Nov. 19 to make administrative changes. That prevented all employees, regardless of age, from selling any Enron shares in their 401(k)s as the stock price collapsed amid financial turmoil at the company and an SEC investigation into its accounting practices. Enron says it doesn't comment on pending litigation.

Those lawsuits, along with a handful filed against other companies recently, don't take on directly the practice of forcing employees to accept and hold company stock in their 401(k)s. That's perfectly legal. So whatever the outcome, a company would still be able to restrict employee sales of company-stock contributions to 401(k) *before* the price declines. "Even when they've had gains, they can't really lock them in because they can't diversify," says Randall Shoker, an Oxford, Ohio, financial adviser.

Michael Green knows that. The 35-year-old investment specialist joined Dell Computer Corp. in 1995 as a product manager.

'I tried so hard to sell' Dell shares, says one employee. 'We went around and around.'

He and his wife, Lisa, an assistant controller at the company, were thrilled as the stock rose to about $51 a share in late 1999 from $1 in mid-1995, adjusted for splits.

But by the late '90s, the couple felt overexposed to Dell. In addition to the Dell stock that the company had contributed to their 401(k) plans, they had received stock options as bonuses. And they had bought a home in Austin, Texas, where the real-estate market is tied in part to the fortunes of Dell, one of the area's biggest employers.

The Greens sold some of the stock they received as bonuses. But Dell wouldn't let employees sell shares the company contributed to their retirement accounts until they had been at the company for five years. "I tried so hard to sell," Mr. Green says. "We went around and around."

The company changed its policy last year to allow all Dell employees to sell the shares in their 401(k) plan and shift the proceeds into alternatives available through the plan. By then, though, Dell shares had plummeted, erasing $200,000 from the Greens' 401(k) accounts. "That's as much as we paid for our house," Mr. Green says. Both left Dell earlier this year for other jobs.

SEC filings show that Dell executives, though subject to the same restrictions on their regular 401(k) accounts, can participate in a supplementary retirement-savings plan that allows them immediately to reinvest the company's contribution in a variety of options. Executives have seized that opportunity: Just 9% of the supplementary retirement plan was invested in Dell stock at the end of last year, according to the company's latest 11K filing, compared with about 50% of Dell's 401(k) plan.

Dell spokesman T.R. Reid declines to comment on the Greens' circumstances. He says that any employees who lose so much money on company contributions could do so only because they had made a bundle until that point. And providing Dell shares to the employee retirement-savings plan, he says, "certainly provides incentive to not only think but act like a shareholder."

The company ended the five-year lockdown rule, Mr. Reid says, because it was no longer necessary to keep employees focused on improving Dell's shareholder value. And he says Dell executives don't have to hold company stock in their supplementary plan because they "receive a significant portion of their compensation in Dell stock," and thus they already "have the broader interests of the company and shareholders squarely in their sights."

SEC filings show that Dell executives nonetheless have means to protect themselves from exposure to the company's stock. Michael Dell, chairman and chief executive of the computer company he founded, transferred a total of 4.1 million shares, worth $190.7 million, into so-called exchange funds in several transactions between September 1999 and May 2000. (The shares accounted for about 1.3% of Mr. Dell's total company holdings at the time).

Offered by financial firms to the wealthy, exchange funds are, in essence, mutual funds that allow holders of large chunks of a single stock to pool their assets, giving them a stake in a diversified, less-risky basket of securities and, in some cases, postponing tax liabilities. Altogether, the value of Mr. Dell's hedged shares would have fallen in market value by 38%, or $73 million, by earlier this month had he taken no precautions. (The return on the diversified exchange fund isn't disclosed).

Until the five-year rule was lifted, employees like Mr. Green could get out of their Dell 401(k) holdings only by withdrawing money from their accounts, paying income tax and a 10% penalty on the withdrawal, and then reinvesting the difference.

Or, says Dell spokesman Mike Maher, they could have elected "to take their compensation and not put it in their 401(k), and invest it in some other stock." By doing so, however, they would have forgone the company's matching contribution altogether. Mr. Maher declines to comment on Mr. Dell's transactions. He notes that like executives, regular employees who receive options are free to sell their shares. "We're all playing by the same rules," he says.

Off the Radar Screen

The hedging maneuvers executives can employ to protect their company holdings fall largely off the radar screens of regulators and shareholders. While the SEC generally requires that key executives report these transactions, experts say the rules are largely ignored. "We really are only able to uncover several a month at most, which leads me to believe that the insiders are not filing these as often as they should," says Lon Gerber, director of research at Thomson Financial/Lancer Analytics, which combs SEC filings to track insider trading trends.

Mr. Dweck, head of the Goldman Sachs division that manages single-stock investments for wealthy investors, says his group's clients disclose their transactions when required. And Qwest Chairman Philip Anschutz recently disclosed that last May, he entered into a "forward-sale agreement" with a brokerage firm, locking in as many as 10 million Qwest shares at close to their then-current price. Qwest's share price has since fallen 68%; the value of Mr. Anschutz's shares covered in the agreement would have plunged to $127 million from $394 million. (Those shares amounted to about 3.3% of Mr. Anschutz's total holding of 300 million shares, or 18% of Qwest's shares outstanding, both directly and through a company he controls.)

A forward-sale agreement wasn't available to Joseph Daugherty. He has been stringing and repairing telephone cable for 23 years, first for Bell South Corp. and then in the Salt Lake City area for U S West, which was acquired by Qwest last year.

A few months ago, he was looking forward to early retirement next summer. But now, he says, he'll have to keep working. The $200,000 in assets he had in his 401(k) in early May has shrunk to roughly $50,000. Part of that loss is attributable to the retirement plan's rules, which don't allow most workers to shift out of company-contributed Qwest shares until age 55. Mr. Daugherty, who concedes he's a risk-taker, blames himself for the rest: He voluntarily sank the remainder of his 401(k) savings into Qwest stock.

Qwest won't comment on the finances of either Mr. Daugherty or Mr. Anschutz. But Steve Hammack, a Qwest spokesman, says U S West established the policy of contributing company stock. He notes that starting Jan. 1, 2001, the company began allowing managers to diversify company stock contributions they receive this year into other investments available through the plan. The restrictions on union members, he says, are covered by the company's collective bargaining agreement.

"The fact is," Mr. Hammack responds in an email, "the majority of companies in the U.S. that match employee contributions do so in their own company stock. A good number also restrict employees from diversifying out of the company match."

Erisa, the federal law governing pension plans, provides employees with little legal traction to complain about their forced 401(k) holdings. Employer contributions to retirement-savings plans aren't generally subject to fiduciary rules. (As for employee contributions, employers are supposed to choose "prudent" investment options.)

Successful Lobbying

Retirement-savings plans are exempt from Erisa diversification rules, too. These rules make it illegal for a company's pension plan to invest more than 10% of its assets in the company's own securities. But savings plans such as 401(k)s can generally invest as much as 100% of the assets in company stock with impunity. Currently, roughly one-third to one-half of retirement-plan assets at large companies are invested in company stock. That suits employers, which would just as soon contribute stock as draw down precious cash, and in the past, they have lobbied successfully to defeat efforts to impose diversification rules on 401(k)s.

That confounds people such as Mr. Triska, the technician at Enron's Portland General Electric unit. "Anyone will tell you that you need to diversify to reduce risk," he says.

Diversification has spared Mr. Triska some of the pain experienced by co-workers who bet big on Enron in their retirement savings. Since Sept. 10, while the Enron shares in his 401(k) have plunged 86%, his shares in Weitz Partners Value Fund have declined only 4.52%, and his shares in Fidelity Growth Company and Janus Global Life Sciences funds have risen 7.3% and 2.2%, respectively.

Enron executives are subject to the same restrictions on Enron's stock contributions to their 401(k)s as other employees: no sales of company-contributed stock until age 50. But company filings with the SEC show that "key management and highly compensated employees" also participate in separate retirement-savings plans that don't require them to hold Enron stock at all. Executives can pile as much as 25% of their salaries and 100% of their bonuses annually into these accounts, allocating the money among a variety of investments.

Further, SEC filings show that so far this year, many Enron executives were steady sellers of company stock they had accumulated beyond the ambit of their 401(k)s. Former Enron Broadband Services Chief Executive Kenneth Rice, for example, sold Enron shares valued at $23.7 million during the period, and former CEO Jeffrey Skilling sold $27.5 million of Enron stock.

"We believe it's important for employees to have a stake in the company," says Karen Denne, a spokeswoman for Enron. "It's also important that we align employee and company performance."

—Cassell Bryan-Low contributed to this article.

Employees' Retirement Plan Is a Victim as Enron Tumbles

By RICHARD A. OPPEL Jr.

The rapid decline of the Enron Corporation has devastated its employees' retirement plan, which was heavy with company stock, and has infuriated workers, who were prohibited from changing their investments as the stock plunged.

Through the 401(k) retirement plan, employees chose to put much of their savings in Enron shares, and the company made contributions in company stock as well. But around the time Enron disclosed serious financial problems last month, the company froze the assets in the plan because of an administrative change. For several weeks, as the stock lost much of its value, workers stood by helplessly as their retirement savings evaporated. They were not allowed to switch investments at all — even though the plan had far less risky choices.

The unfortunate timing caps a year of pain for Enron's workers. At the end of last year, the 401(k) plan had \$2.1 billion in assets. More than half was invested in Enron, an energy conglomerate. Since then, the stock has lost 94 percent of its value.

DYNEGY AND ENRON WEIGH OPTIONS

Dynegy considered whether to seek to renegotiate its deal to buy Enron, while Enron sought to shore up its finances. Business Day, Page C1.

At Portland General Electric, the Oregon utility acquired by Enron four years ago, some workers nearing retirement have lost hundreds of thousands of dollars. The utility has lined up grief counselors to help them work through their problems.

"We had some married couples who both worked who lost as much as \$800,000 or \$900,000," said Steve Lacey, an emergency-repair dispatcher for Portland General. "It pretty much wiped out every employee's savings plan."

Shortly after it was frozen, the articles started coming out about some of the questionable activities of Enron," Mr. Lacey added. "The stock took a tremendous drop, and we were pretty much helpless."

The loss serves as a grim reminder of the danger of relying too heavily on one investment. Stock plunges similar to Enron's have also wiped out the retirement savings of many employees of the Nortel Networks Corporation, Lucent Technologies Inc. and Global Crossing Ltd.

The loss by Enron's workers also stands in stark contrast to the profits made by some senior Enron executives, who sold stock during the last few years. Enron's chairman, Kenneth L. Lay, made \$20.7 million during the first seven months of 2001 by exercising stock options — and more than \$180 million by exercising options during the three prior years. Last week, Mr. Lay agreed to forgo a \$60 million severance package after Enron traders and employees made clear how upset they were that he would profit from the proposed acquisition of the company by Dynegy Inc. while they were suffering.

Enron — which is already the subject of a Securities and Exchange Commission investigation of transactions among Enron and partnerships headed by the company's former chief financial officer, Andrew S. Fastow, and a number of shareholders' suits — now has an additional legal problem.

On Tuesday, Steve W. Berman, a lawyer from Seattle who represented states against the tobacco industry, filed a lawsuit in Federal District Court in Houston seeking class-action status on behalf of Enron employees who lost money on the stock through their retirement plan. The lawsuit says that Enron schemed to pump up the price of the stock artificially and violated its fiduciary duty to its employees by failing to act in their best interests.

"They were promoting Enron as a retirement investment vehicle and matching employees' contributions with Enron stock, when they knew the stock was overvalued, and that's a breach of their fiduciary duties," Mr. Berman said in an interview yesterday.

What's more, he said, the assets were frozen on Oct. 17, with the stock at \$32.20, even though Enron executives knew there would be imminent disclosures about the company's accounting practices. "They knew the worst news was about to come out, but they froze the stock," he said.

Enron closed yesterday at \$5.01.

The company declined to comment on much of the allegations because of pending litigation. A spokeswoman, Karen Denne, said that the change in plan administrators had been in the works for a number of months and that she did not know the exact date the change was put into effect.

Like many other big companies, Enron made its contributions to the plan in company shares. But employees also chose to put much of their own contributions into the stock, lured by its stellar past performance. The company says that 89 percent of the Enron stock in the plan wound up there because employees chose it, and 11 percent was the company's contribution.

"A lot of people believed in the stock, so it wasn't just the company match," said an employee at Enron's headquarters in downtown Houston. "It was their own money, too. People are just shell-shocked."

The stock's past performance had lured many workers. Last year, as the stock soared, total assets in the 401(k) plan rose more than 35 percent.

About 57 percent of Enron's 21,000 employees participate in the 401(k) plan. The company generally matches employee contributions at 50 cents on the dollar, up to 6 percent of their salary, with Enron stock, which cannot be sold and put into another investment until the employee reaches age 50. But Ms. Denne said workers otherwise "have a range of options" in which to invest their money.

Employees' Retirement Plan Becomes a Victim of Enron's Stumble

Helpless workers stand by as their savings evaporate.

Gerry O'Connor, a senior consultant with the Spectrem Group, a consulting firm based in Chicago, said it was not uncommon for companies to freeze assets when administrators were switched. "If you don't, you can wind up with misallocated money, wrong statements, and all kinds of complicating factors," he said.

But a heavy dose of assets in one company stock has been a concern to many specialists in retirement planning. Employees are taking "a lot of risk, but they don't think of it as such," Mr. O'Connor said.

"They say, 'You know, I work for this company, and we're doing great.'"

In addition to the swoon in their 401(k) plans, Enron employees have watched the value of their stock options wither. Enron gave a far larger percentage of employees options than most companies do, but now, with the fall in Enron shares, nearly all of those options are worthless.

Enron's tumbling fortunes have come as a particular shock to some of its workers in Oregon. About 95 percent of the 2,700 employees of Portland General, which Enron recently agreed to sell to help it raise badly needed cash, are invested in the 401(k) plan, said Scott Simms, a spokesman.

The losses, he added, have hit everyone "including officers all the way through to other staff."

"It's certainly not something in which certain employees have lost out and others haven't," he said. "It was the same plan for everyone."

In an interview with The Oregonian in Portland, Peggy Y. Fowler, Portland General's chief executive, said the asset freeze was an unfortunate coincidence. "The timing couldn't have been worse," she said.

"We refer to our retirement program as a three-legged stool — Social Security, the company pension and the 401(k)," Ms. Fowler said. "One of the legs has been cut off."

Bitsberger, Timothy

From: Lori.Santamorena@bpd.treas.gov
Sent: Thursday, January 03, 2002 8:24 AM
To: Brian.Roseboro@do.treas.gov; Timothy.Bitsberger@do.treas.gov
Subject: fyi- Cantor Fitzgerald

fyi- you may have already read this.

Lori

The New York Times

January 3, 2002, Thursday, Late Edition - Final

SECTION: Section C; Page 1; Column 4; Business/Financial Desk

LENGTH: 1424 words

HEADLINE: Horrible Year Ends on Up Note At Cantor;
Financial Health for the Firm And More Smiles for the Staff

BYLINE: By DIANA B. HENRIQUES

BODY:
As Howard W. Lutnick, the chairman of Cantor Fitzgerald, headed to Florida last weekend to see out the worst year of his life, he found himself, beyond all expectations, with good news to share.

"I have told my families" -- as Mr. Lutnick affectionately calls the survivors of the colleagues he lost on Sept. 11 -- "that Cantor will be profitable in the fourth quarter," he said. With a faint trace of his old swagger, he added: "We will be highly profitable -- not barely profitable, but highly profitable." The achievement would have been merely satisfying for the Wall Street bond-trading firm in a normal year. But "normal" and "Cantor" parted company on the day the terrorist attacks destroyed the firm's headquarters at the top of the World Trade Center and killed 658 of the 960 people working there, including Mr. Lutnick's brother, Gary. Since then, simply surviving might have been news enough for Cantor, which has promised 25 percent of any future profits to the families of those who were lost. Instead, Mr. Lutnick said in an interview, Cantor ended 2001 profitable enough to pay for the first of 10 years of promised he! al! th insurance for the families, with cash left over to distribute in mid-February as the first installment on a $100,000 minimum gift pledged to each family.

The company bank accounts have been easier to repair than the people. Mr. Lutnick says he thinks of each surviving employee as "a miracle." Nevertheless, there have been layoffs as the company has

In addition, some employees have been unable to go to work at all since Sept. 11 because of the emotional trauma they experienced, one executive said. "We know that the greater impact of this will come three to six months down the road," this executive said. "You have to wonder where some of these people will be then."

But although all the Cantor employees still wrestle with the grief of having lost hundreds of close friends and colleagues -- one who was critically injured died not long ago, bringing fresh pain -- some say their days now include a little more laughter, a bit of optimism, a sense of having weathered the very worst of a continuing storm.

"We smile," one executive said. "We laugh. We're here together. We have a purpose."

The people who have joined the firm since Sept. 11, almost exclusively in the stock-trading operations, "have gotten a chance to get acclimated," said Philip Marber, the senior managing director who used to lose sleep worrying over how to recreate the well-oiled trading desk he lost. "A little more chemistry is starting to occur. It's kind of jelling a little bit -- which is what we were hoping would happen."

The surviving families seem more content with Mr. Lutnick, whose tearful televised promises to help were met with angry suspicion by early October. The company's new charity fund has distributed nearly $9 million in gifts -- Mr. Lutnick and other partners recently offered a $5 million matching grant to help the fund raise $10 million more -- and Cantor has paid roughly $45 million in promised bonuses and other benefits to the families since November.

Mr. Lutnick is not bitter about the reaction, he said.

"It was a moment in time," he said. "They're sad it happened; I'm sad it happened. But it's past, it's over."

In recent months, as he pulled out of a media spotlight that had blistered him in the weeks immediately after the attacks, he mailed 1,300 to 1,400 handwritten notes to the families of his lost employees.

A private partnership, Cantor is not required to disclose profits. But it is also the majority owner of eSpeed, a publicly traded electronic trading network, which must keep investors informed about important trends. Here, too, Mr. Lutnick, as the chairman and chief executive, has room to boast.

"A few weeks ago, I had the incredible pleasure of announcing that eSpeed would be profitable for the first time, in the fourth quarter of 2001," he said. Forecasting profit of a penny to a nickel a share, Mr. Lutnick added: "We're not going to just make 'earnings per share,' which you can do with some accounting games, but we are going to make actual money."

The eSpeed stock, suspended from Nasdaq trading for 18 days after Sept. 11, rallied after Mr. Lutnick's announcement. It closed yesterday at $8.35 a share, not far from its Sept. 10 closing price of $8.69, but nowhere near its peak of almost $83 a share in March 2000, or even its initial offering price two years ago of $22.

"There are not many e-commerce companies left standing, let alone ones that have met their forecasts," Mr. Lutnick said.

It is not possible to say how these gains will affect Mr. Lutnick's own compensation. At Cantor, he is the general managing partner of a private limited partnership, which does not disclose compensation for any of its partners, including Mr. Lutnick. At eSpeed, where his 2000 salary was $350,000 and his bonus was $650,000, his 2001 compensation has not yet been made public.

The rebounding stock market was one important ingredient in the fourth-quarter recovery at Cantor, of course. Fortunately for Cantor, some 75 percent of the firm's top revenue producers in its stock-trading business worked outside the doomed New York office.

Yesterday, Cantor opened an office in Shrewsbury, N.J., easing the crowding in the makeshift trading room Mr. Marber set up in Midtown Manhattan after the attacks. The new suburban office will start with 10 people, but Mr. Marber hopes it will grow to about 25 if the firm's stock-trading business continues to thrive.

Cantor and eSpeed each carried $40 million in property insurance and $25 million in business-interruption coverage, according to Mr. Lutnick. That is expected to largely cover the property and business damage, including an estimated $32.4 million in total losses at eSpeed and additional undisclosed partnership losses at Cantor.

But Cantor's recovering profits also benefited, perversely, from some terrible luck -- its own and that of the Enron Corporation.

Well before the attacks, Cantor had begun to shift its core business, trading government and corporate bonds for big institutional clients, from expensive human traders to the less-expensive electronic trading system operated by eSpeed. With the sudden loss of so many of its traders, Cantor was forced overnight to shift more of its lower-margin business to eSpeed. Though eSpeed itself lost about 180 of its 477 worldwide employees, it was nevertheless able to resume operations within 48 hours of the attacks.

"We always knew that eSpeed would be our future," said Joseph C. Noviello, now that company's chief information officer. "But that future arrived instantly on Sept. 11."

With that future, Cantor has stepped out of about a dozen markets where its traders were once active. "There was too much of a human loss to go back and try to rebuild it the old way," Mr. Lutnick said. "We have to be different; we have to play the hands that have been dealt to us."

To be sure, eSpeed still faces stiff competition in the rapidly consolidating electronic bond-trading arena, which has shrunk by almost a third of its players over the last year, according to a tally by the Bond Market Association. But Mr. Lutnick says eSpeed is still "the dominant system for trading U.S. **Treasury securities** around the country," and Wall Street analysts generally agree.

In addition, eSpeed got a boost from the trouble at Enron, the giant energy company that filed for bankruptcy a month ago. Before its collapse, Enron was doing a bustling business through Enron Online, its energy trading service. After Enron failed, that trading shifted to more diverse trading networks, including TradeSpark, which is jointly owned by Cantor, eSpeed and five large energy companies including a subsidiary of the Williams Companies.

Indeed, TradeSpark is powered by eSpeed's technology and pays eSpeed a commission on each transaction, Mr. Noviello explained. "So that business has seen enormous growth since the fall of Enron," he said.

But despite a more upbeat mood and a strong sense of having delivered on an important pledge to their lost friends' families, everyone at Cantor is ready to leave 2001 behind, employees said.

"Last week, to top it all off, I got hit by a cab," Mr. Marber said. "Right on 39th Street. A lot of bumps and bruises, nothing worse. But I remember thinking, as I picked myself up: 'Please, I just want this year to end.' "
http://www.nytimes.com

GRAPHIC: Photos: Howard W. Lutnick, left, the chairman of Cantor Fitzgerald, had good news to share last week: a profitable fourth quarter. At right, Philip Marber, left, and Joseph C. Noviello, executives who have been instrumental in the firm's recovery. (Justin Lane for The New York Times left Librado Romero/The New York Times above)

Chart: "Back To Before"
The stock of eSpeed, an electronic trading firm almost wholly owned by Cantor Fitzgerald, has risen close to its pre-Sept. 11 level in recent months on reports that it would be profitable in the fourth quarter. But the stock is still far short of its March 2000 peak of almost $83 a share.

Graph tracks the daily closing price of eSpeed shares from Sept. 10 through January.
(Source: Bloomberg Financial Markets)

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(202) 828-3360
Fax (202) 828-3372

1999 OCT 26 1:36

Derivatives

October 25, 1999

The Honorable Lee Sachs
Assistant Secretary
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Sachs:

I wanted to thank you again for taking the time on October 6 to meet with myself and other Enron representatives to discuss the President's Working Group on Financial Markets' upcoming report on over-the-counter (OTC) derivatives and other policy issues related to Enron's commodity businesses.

We appreciated your thoughts on the anticipated release of the President's Working Group report. While you indicated that the report's recommendations would not likely impact our existing OTC contracts and commodities business, Enron remains concerned that the report may contain suggestions that over-the-counter participants be subject to some form of regulatory requirements in the future.

Enron's position on the matter is simple and straightforward -- there is no need for additional regulation of OTC derivatives dealers. Current CFTC oversight is appropriate and sufficient. OTC derivatives markets (particularly energy derivatives markets) function very efficiently and safely today, allowing us to provide our customers with essential, custom-tailored risk management tools. We hope that Treasury and the other financial regulators will agree with our position, and that this view is reflected in the Working Group report.

We look forward to working with you in the future on these important issues. If we can provide you with additional information or assistance concerning Enron's businesses, regulatory and legislative positions, or energy commodity markets in general, please contact Jeff Keeler in Enron's Washington, D.C. office at 202-466-9157.

Sincerely,

Kevin Hannon

Kevin P. Hannon

Denis

Kenneth L. Lay
Chairman and
Chief Executive Officer

Enron Corp.
P. O. Box 1188
Houston, TX 77251-1188
(713) 853-6773
Fax (713) 853-5313
klay@enron.com

September 14, 2000

The Honorable J. Dennis Hastert
Speaker
United States House of Representatives
H-232, Capitol
Washington, DC 20515

Dear Mr. Speaker:

I am writing to urge enactment of H.R. 4541, the Commodity Futures Modernization Act of 2000. This important legislation provides critical legal certainty for a range of transactions that are a central part of Enron's risk management and commodity trading businesses. Enron is the largest trader of natural gas and electricity in the US and we actively trade other commodities. To facilitate our commodity trading business, we have developed EnronOnline, the world's largest business-to-business marketplace with over $140 billion in trades since November 1999.

We appreciate the fine work of the House Agriculture, Commerce, and Banking Committees and applaud the leadership of their Chairmen and Ranking Members. With respect to the language most critical to Enron, we urge adoption of the Commerce Committee version of H.R. 4541. Specifically, Section 9 of H.R. 4541 enhances legal certainty for transactions in certain commodities by providing that:

- Except for the application of the Commodity Exchange Act's antifraud and antimanipulation provisions, bilateral transactions in commodities (except agricultural commodities) between sophisticated market participants would not otherwise be subject to the Commodity Exchange Act.

- Except with respect to the Commodity Exchange Act's antifraud and antimanipulation provisions and in certain circumstances the requirement to disseminate trading data, the CEA would not otherwise apply to transactions in commodities (other than agricultural commodities) on Electronic Trading Facilities that are limited to sophisticated market participants.

These two important provisions eliminate legal uncertainty over certain transactions and reduce the regulatory burden placed on sophisticated market participants. The provisions recognize that sophisticated parties do not require the protections of the CEA and, more importantly, eliminate the risk that transactions between eligible contract participants could subsequently be determined by a court of law to be unenforceable for failure to comply with the CEA. Also, the relief with respect to electronic trading facilities recognizes the natural evolution in the marketplace from the telephone to the Internet. Providing legal certainty for use of electronic trading facilities eliminates the risk that these electronic platforms would be determined to be operating illegally as "exchanges" unregulated by the CFTC.

Prompt adoption of H.R. 4541 with the language included above will assure that Enron can continue to grow our businesses and provide innovative service to our customers without the risk and cost of legal uncertainty that now exists.

I appreciate your attention to this important matter and would be pleased to respond to any questions that you might have.

Sincerely,

Kenneth L

Natural gas. Electricity. Endless possibilities.

Denis

Kenneth L. Lay
Chairman and
Chief Executive Officer

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P. O. Box 1188
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24 October 2000

The Honorable Phil Gramm
Chairman
Senate Banking Committee
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Phil:

As you are aware, the House overwhelmingly passed H.R. 4541, the Commodity Futures Modernization Act of 2000, by a vote of 377-4, demonstrating broad consensus for the very difficult compromise underlying the bill. This important legislation now requires your leadership in order to pass the Senate, allowing the hard work and compromise to be rewarded during this Congress.

The legislation provides critical legal certainty for a range of transactions that are a central part of Enron's global risk management and commodity trading businesses. To facilitate our commodity trading business we have developed EnronOnline, which is the world's largest business-to-business marketplace with over $200 billion in transactional volumes since November 1999. Prompt adoption of H.R. 4541 will assure that Enron can continue to grow our businesses and provide innovative service to our customers without the risk and cost of legal uncertainty that now exists.

Based on our recent telephone conversation, I know that you have concerns with respect to bank product and securities law issues raised by the bill. We do not have views on these provisions except for our concern that prompt passage of the legislation will not be possible unless the issues are adequately resolved. However, we are confident in the ability of you and your staff and we hope that these issues will be resolved in this Congress.

I appreciate your attention to this important matter and would be pleased to respond to any questions that you might have.

Sincerely,

Ken

Natural gas. Electricity. Endless possibilities.

Fisher, Peter

From: David Gilmore [fxa@fxa.com]
Sent: Thursday, November 29, 2001 8:19 AM
To: fxa@fxa.com
Subject: FXA Alert: Bank exposure to Enron.

>From FXA On-line found on www.fxa.com, Reuters FXAFX1, Telerate 57001.

[13.00/08.00] BANK EXPOSURE TO ENRON. DEUTSCHE BANK PUT ITS ENRON EXPOSURE
AT $100MLN. JP MORGAN CHASE HAS STATED $500MLN IN UNSECURED AND $400MLN IN SECURED EXPOSURE. CITIGROUP PUT AT $700-800MLN WITH ABOUT HALF SECURED. ABN
AMRO HAS UNSPECIFIED EXPOSURE BUT CLAIMS ALL ITS LOANS ARE SECURED, AND PART OF
$3BLN SYNDICATED LOAN FOR INDIA POWER PROJECT (DABHOL POWER CO). INTERESTING
THAT US TSY SAID WEDS IT IS FOLLOWING THE ENRON DEVELOPMENTS BUT NOTED NO UNUSUAL ACTIVITY IN THE FINANCIAL MKTS (I.E. NO SYSTEMIC RISK). NOTHING FROM
FED SO FAR IN TERMS OF STATEMENTS (ON ENRON).

From: David Gilmore [fxa@fxa.com]
Sent: Thursday, November 29, 2001 10:55 AM
To: fxa@fxa.com
Subject: FXA Alert. Rumor 2 large Jpn banks with large Enron exposure

From FXA On-line found on www.fxa.com, Reuters FXAFX1, Telerate 57001.

[15.45/10.45] DLR/YEN FIRM ON RUMORS TWO LARGE JPN BANKS HAVE DECENT EXPOSURE TO ENRON. KEEP IN MIND THAT JPN BANKS ARE REPORTING RECORD LOSSES AND LOAN WRITE OFFS...NOT POSITION OF STRENGTH. BUT FOR THE RECORD THEY HAVE ALSO REPORTED CAP/ASSET RATIOS AROUND 11% ON AVG, WELL ABOVE 8% BIS REQUIREMENT. THAT SAID EVEN HAYAMI NOTED RECENTLY THAT IF JPN BANKS USED SAME STANDARDS AS US BANKS IN DEFINING CAPITAL THEY WOULD BE BELOW 8%.

Fisher, Peter

From: David Gilmore [fxa@fxa.com]
Sent: Thursday, November 29, 2001 11:36 AM
To: fxa@fxa.com
Subject: FXA Alert. Jpn investment trusts, not city banks with main Enron exposure

Seems mkt rumor mill turned the very real Jpn investment trust exposure to Enron corporate paper into Jpn banks with not very real Enron exposure. Hearing that investment trusts have bought dlr/yen to unwind hedges put in place when the Enron bonds were purchased. Involves about two to three institutions.

Fisher, Peter

From: Bridgewater Daily Observations [Bridgewater_Daily_Observations@bwater.com]
Sent: Friday, November 30, 2001 8:30 AM
Subject: Bridgewater Daily Observations, "Rationality Returning To Credit Markets"

bwam113001.pdf

Rationality returning to credit markets:

As we have discussed, the recent selloff in bonds and eurodollars seemed unjustly magnified in light of the sketchy evidence that the economy is accelerating and the strong evidence that inflation is falling. But this market action makes more sense in light of the news that Enron has apparently been liquidating substantial long positions in two-year notes and deferred euros (i.e., longer than one year forward). Given the apparent size of their positions, they were most likely hedging fixed rate debts back to floating rates, reducing their effective interest rate by synthetically shifting the maturity of their debt to the lower yields on the short end of the yield curve. They probably had big gains in the positions, which would have provided a source of badly needed cash. But that is just our guess.

Complete report at www.bwater.com then click on client access, or if you have already downloaded an order ID from the Bridgewater website you will be able to read the enclosed file. If you need help accessing the website and downloading an order ID please call Joe Quinn at (203) 291-7397 or reply to this email.

<<bwam113001.pdf>>

Fisher, Peter

From: Nancy Lazar [nlazar@isigrp.com]
Sent: Monday, December 03, 2001 10:36 AM
To: ISI Reader
Subject: ISI Morning Political Report with Audio

Importance: High

12-03mpr.pdf

In today's POLITICAL REPORT:

* Terrorism Insurance Bills Introduced in Senate
* Enron Likely to Engage Washington on Many Fronts
* Pivotal House Trade Vote Set for Thursday
* Central Bank Watch
* This Week in Congress
* Senate Confirms Fed Governors

Please let us know if you have any questions.

All the best,

Nancy Lazar
212/446-5633

Fisher, Peter

From: Roseboro, Brian
Sent: Wednesday, January 16, 2002 9:41 AM
To: Fisher, Peter
Subject: FYI: SEC, Accounting Firms Redrafting Audit Rules

FYI

SEC, Accounting Firms Redrafting Audit Rules

Agency Chairman Draws Fire for Role in Effort

By Kathleen Day and Albert B. Crenshaw
Washington Post Staff Writers
Wednesday, January 16, 2002;

Securities and Exchange Commission Chairman Harvey L. Pitt and the accounting industry are scrambling to craft a new system for policing auditors in an effort to shore up confidence in the financial reports of publicly traded companies.

The new plan, which could be unveiled within days, is designed to head off criticism in the wake of the Enron Corp. fiasco that the current system of self-regulation does not work. The effort is being driven by Pitt, who faces complaints from some lawmakers that he should distance himself from the SEC's investigation.

Pitt represented the five major accounting firms as a private lawyer before he was appointed by President Bush to take over the SEC on Aug. 4.

Sens. Jon S. Corzine (D-N.J.) and Byron L. Dorgan (D-N.D.) have said Pitt's previous ties to the industry should require him to declare a hands-off policy. "I think Harvey Pitt has a high degree of integrity," said Corzine, a former partner with Goldman Sachs Group Inc. "But I do believe for appearance' sake . . . Pitt ought to do what Attorney General John Ashcroft has done and clearly step aside from the process."

But Pitt disagreed. "To talk about recusals at this point misperceives how this agency operates," he said in an interview.

Pitt said he has done and will continue to do his job in accordance with ethics rules, which forbid -- but with some exceptions -- the SEC chairman from taking any action concerning a former client for a year after taking office.

The SEC, which regulates financial markets, is also responsible for the oversight of accounting firms, which are supposed to certify that financial records give a fair portrait of a company's finances.

With the Enron collapse focusing criticism on accounting firms, the SEC is facing conflict-of-interest questions, not only because of Pitt's former ties to the industry, but also because Bush's two nominations for vacant seats on the five-member SEC come from big accounting firms.

Pitt yesterday would not comment on how he voted last fall, when the commission agreed to launch an investigation into the Enron affair. That investigation is examining the role played by Enron officials and the company's outside auditor, Arthur Andersen.

Pitt also would not specify what he would do if the SEC staff were to come before the commission again, at the conclusion of its investigation, with recommendations that actions be taken against companies or accounting firms.

"Enforcement inquiries are conducted by our staff and the SEC commissioners do not have any involvement in the myriad decisions that our enforcement staff will be called upon to make," Pitt said.

"It is not the function of the chairman of the SEC or any commissioner to manage any investigations. If and when I am asked to do anything on this matter, I will follow both the letter and the spirit of the ethical requirements of this office. Any suggestion that I would do otherwise is an attempt to politicize the workings of an independent agency."

Pitt also would not comment on the negotiations he is having with the top five accounting firms and the industry trade group, the American Institute of Certified Public Accountants -- all of them former clients -- on how to revamp oversight of the profession. An SEC spokesman said those discussions are permitted by ethics rules and are appropriate.

Industry sources said that talk about a regulatory overhaul, a topic that has been kicked around for years, was given new impetus after Enron's failure. Enron filed for bankruptcy Dec. 2 after being forced to restate earnings. The industry wants to unveil its proposal before Congress reconvenes next Wednesday and begins hearings into what caused the energy company's problems, sources said.

The new framework would create a private-sector regulatory organization, similar to those that the SEC now permits the securities markets to use to discipline members and establish guidelines for what is accepted and unacceptable behavior, industry sources said.

But the organization would not be controlled by accounting firms, the sources said, because it would be governed by boards whose members would come largely from outside the accounting industry. Accounting industry officials acknowledge that the reforms may not go far enough to quell criticism from consumer groups and some lawmakers, who say self-regulation is at the root of the accounting profession's problems.

The five major accounting firms declined to comment on the proposal.

The major accounting firms, in the past, have fought such a proposal, insisting that the current system, which includes industry self-regulating groups and state licensing boards, are sufficient. But in missing seemingly egregious misstatements and incorrect reports at Enron, the Arthur Andersen team raised anew questions about how well the nation's system of private accountants, paid by their audit clients, serves the nation's investors.

The federal government gave the accounting industry the valuable franchise to audit companies that sell shares to the public after the stock market crash of 1929. In return, auditors are supposed to serve the public interest, and maintain independence from their clients.

"The true client is society in an audit -- yet the client that is paying your fee is the corporation," said Stephen Loeb, professor of accounting and business ethics at the University of Maryland. With this system, "you have a conflict of interest. It's always going to be there," he said.

In addition, many accounting firms earn large sums by selling consulting services to their clients. For instance, Andersen was paid $52 million last year by Enron -- $25 million for auditing and $27 million for consulting services.

Accountants argue that they are professionals who can and do stand up to their clients when that is necessary. And, they add, ultimately their livelihood depends on retaining the public's trust. Otherwise, they say, audits would lose their value.

That, though, is exactly what is happening, some critics charge.

Arthur Levitt Jr., chairman of the SEC during the Clinton administration, proposed prohibiting accounting firms from selling certain consulting services to corporations whose books they audit in 2000. But that proposal was beaten back by the accounting industry and was opposed by several members of Congress.

In addition, generally accepted accounting principles, the rules that accountants must follow in auditing public companies, allow considerable flexibility in evaluating what a business has done. Some lawmakers question whether those rules give accounting firms too much latitude.

"Does the Enron debacle (and cases like it) rest on activity that is allowable under generally accepted accounting principles and standards, or that constitutes clear violations of those principles and standards, or some combination thereof?" Rep. John D. Dingell (D-Mich.), ranking minority member of the House Commerce Committee, asked the SEC last month.

Auditing problems are not new. The late 1990s saw a wave of "restatements," in which many major companies, including Rite-Aid Corp., Sunbeam Corp., Waste Management Inc. and Cendant Corp., were forced to admit that profits reported earlier had been vastly overstated.

Some cases involved fraud, which auditors said they are ill-prepared to detect. Critics have said that auditors should do more extensive checks of contracts, deliveries and other aspects of a company's operation. But accountants warn that would make routine audits far more expensive. They say that in fierce competition for clients, the lowest cost auditor often wins.

From: Roseboro, Brian
Sent: Wednesday, January 16, 2002 10:17 AM
To: Fisher, Peter
Subject: BLOOMBERG headlines on your speech

BLOOMBERG headlines on your speech:

Treasury's Fisher says accounting rules must be improved
Fisher says standards haven't kept pace with evolving markets
Fisher says companies must improve disclosure standards
Fisher predicts more "financial catastrophes" without changes
Fisher says private companies must lead efforts to make changes
Fisher says any wrong doing will be punished in Enron case

end

Gross, Jared

From: Gross, Jared
Sent: Thursday, January 10, 2002 11:53 AM
To: Fisher, Peter
Subject: POTUS Remarks (less Middle East Q&A)

REMARKS BY THE PRESIDENT IN MEETING WITH HIS ECONOMIC TEAM

The Oval Office

9:42 A.M. EST

THE PRESIDENT: Thank you all for coming. I met with my economic security team last week to talk about ways to create jobs. We're meeting again with the components of the team to talk about one part of economic security, and that's pension security.

One of the things we're deeply concerned about is that there have been a wave of bankruptcies that have caused many workers to lose their pensions, and that's deeply troubling to me. And so I've asked the Secretary of Treasury, Secretary of Labor and Secretary of Commerce to convene a working group to analyze pensions, rules and regulations, to look into the effects of the current law on hard-working Americans, and to come up with recommendations how to reform the system to make sure that people are not exposed to losing their life savings as a result of a bankruptcy, for example.

As well, Secretary of Treasury, along with the SEC, the Fed, and the CFTC, are going to convene a working group to analyze corporate disclosure rules and regulations. In light of the most recent bankruptcy, Enron, there needs to be a full review of disclosure rules, to make sure that the American stockholder, or any stockholder, is protected.

And so, I think this is an important part of, obviously, other investigations that are ongoing. The Justice Department announced and informed us late yesterday that they're in the process of investigating aspects of the Enron bankruptcy. The administration is deeply concerned about its effects on the economy. We're also deeply concerned about its effects on the lives of our citizenry.

I'll be glad to answer a few questions.

Q When was the last time you talked to either Mr. Lay or any other Enron official, about the -- about anything? And did discussions involve the financial problems of the company?

THE PRESIDENT: I have never discussed, with Mr. Lay, the financial problems of the company. The last time that I saw Mr. Lay was at my mother's fundraising event to -- for literacy, in Houston. That would have been last spring. I do know that Mr. Lay came to the White House in -- early in my administration, along with, I think 20 other business leaders, to discuss the state of the economy. It was just kind of a general discussion. I have not met with him personally.

Q -- to inoculate and your administration politically from the fallout?

THE PRESIDENT: Well, first of all, Ken Lay is a supporter. And I got to know Ken Lay when he was the head of the -- what they call the Governor's Business Council in Texas. He was a supporter of Ann Richards in my run in 1994. And she had named him the head of the Governor's Business Council. And I decided to leave him in place, just for the sake of continuity. And that's when I first got to know Ken, and worked with Ken, and he supported my candidacy.

This is -- what anybody's going to find, if -- 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 that workers are protected.

Q What can you do about pensioners -- what can you do about pensioners now? Isn't that horse already out of the barn at Enron?

THE PRESIDENT: Our group is meeting, and they will bring recommendations here. They'll look at -- fully investigate what went on. My concern, of course, is for the shareholders of Enron. But my -- I have great concern for the stories -- for those I read about in the stories who put their life savings aside, and for whatever reason, based upon some rule or regulation, got trapped in this awful bankruptcy and have lost life savings.

And one of the things this group is going to do is take a good hard look at it.

Thank you all.

Ellis, Dina

From: Hart, Susan
Sent: Tuesday, June 12, 2001 4:54 PM
To: Ellis, Dina; DeMarco, Edward

Moran Urges Support For Opt-Out Privacy Plan, Commission

by Bara Vaida <mailto:bvaida@nationaljournal.com>

The privacy position of the new chairmen of the Senate Commerce and Judiciary committees poses a concern to the high-tech community, Rep. **James Moran**, D-Va., co-chairman of the New Democrat Coalition <http://www.ndol.org/ndol_ka.cfm?kaid=103>, told high-tech lobbyists Tuesday.

"As elated as I am at the change in the leadership of the Senate, the chairs of the Judiciary and Commerce committees have sponsored opt-in bills ... that will mean a difficult situation on the [Senate] playing field," Moran told the lobbyists who had gathered to hear a preview of the New Democrat Coalition's "e-genda 2001," scheduled for release Wednesday afternoon.

The opt-in approach to privacy would put the burden on online businesses to obtain consent from consumers before using their personal information for marketing purposes or selling it to third parties. Moran instead urged the lobbyists -- from Microsoft, Cisco Systems, AT&T, Hewlett-Packard, VeriSign, Enron and other high-tech companies -- to consider supporting the opt-out approach that would put the burden on consumers.

Sens. **John McCain**, R-Ariz. and **John Kerry**, D-Mass., introduced the leading opt-out privacy bill, S. 2928 <http://rs9.loc.gov/cgi-bin/bdquery/z?d106:SN02928:@@@L&summ2=m&>, in the 106th Congress. Moran also urged the lobbyists to support a bill, H.R. 583 <http://rs9.loc.gov/cgi-bin/bdquery/z?d107:HR00583:@@@L&summ2=m&>, that he co-sponsored. It would create a 17-member commission to study existing privacy laws, conduct field hearings and make legislative recommendations to Congress within 18 months.

Moran said the House Government Reform Committee could consider his bill soon -- before its leading Republican co-sponsor, **Asa Hutchinson** of Arkansas, leaves the House to head the Drug Enforcement Administration for President **Bush**.

Sources close to the Senate Commerce Committee have said new Chairman **Ernest (Fritz) Hollings**, D-S.C., plans to hold several hearings on privacy policy in July. The hearings likely will focus on various aspects of the opt-in privacy bill, S. 2606, that Hollings sponsored in the 106th Congress, but Hollings does not plan to reintroduce his bill until after the hearings, industry sources said.

On other high-tech related issues, Californian **Calvin Dooley**, co-chairman of the House New Democrat Coalition, told the lobbyists that new legislation to renew presidential trade-negotiating expected to be introduced in the House this week is "dead on arrival" with Democrats if it does not include language related to labor and environmental standards.

Dooley has been trying to craft a compromise bill that would include enforcement of labor and environmental provisions. Many Republicans want to leave those issues out of trade deals.

New Democrats, however, are optimistic about House passage of legislation to renew normal trade relations with China. Although Congress voted last year to approve permanent normal trade relations with China, the country has yet to join the World Trade Organization, hence forcing another annual vote on the issue.

On other issues, the New Democrats are developing a comprehensive energy policy because they said the West Coast's energy problems are threatening the ability for future high-tech growth in the region.

Oster, Karen

From: Farrell, Paula
Sent: Monday, January 14, 2002 5:58 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Monday, January 14, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Monday, January 14, 2002 3:44 PM
To: Ellis, Dina; Farrell, Paula; Hart, Susan; O'Brien, Michael
Subject: FW: National Journal's CongressDaily - Monday, January 14, 2002

-----Original Message-----
From: cp-del@nationaljournal.com [mailto:cp-del@nationaljournal.com]
Sent: Monday, January 14, 2002 6:31 PM
Subject: National Journal's CongressDaily - Monday, January 14, 2002

National Journal's CongressDaily
Issue date: January 14, 2002
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TRADE
U.S. Loses In WTO Ruling On Foreign Sales Corporations

A World Trade Organization appellate panel today affirmed an earlier ruling against U.S. laws granting tax breaks for business income earned from overseas operations. The ruling in the foreign sales corporations case, reported to be the largest the United States has ever lost before the WTO, delighted European officials, who called for the United States to quickly bring itself into compliance with WTO rules while the European Union holds off on imposing penalties, which could reach $4 billion a year. But U.S. trade officials signaled their disappointment and congressional panels now must decide what course of action to take in response. "We are disappointed with the outcome," said Trade Representative Zoellick. "The United States respects its WTO obligations, which serve America's interests, and we intend to continue to seek to cooperate with the European Union in order to manage and resolve this dispute." Zoellick continued: "This is an especially sensitive dispute that, at its core, raises questions of a level playing field with regard to tax policy. We will be consulting closely with Congress and affected U.S. interests regarding next steps." Senate Finance ranking member Charles Grassley, R-Iowa, in a statement today, said: "The [trade negotiating authority] bill passed by the Finance Committee includes a provision that calls for the next round of the World Trade Organization to comprehensively address these international tax issues. So today's ruling is yet another reason why the Senate should vote by the end of February on the bipartisan trade legislation that's pending."

Business advocates today were assessing the ruling, looking for room in the legal implications of the decision, but implicitly acknowledging a loss on all counts. "The decision leaves in place the underlying problem," said Homer Moyer, a partner in the Washington law firm of Miller and Chevalier, who works with an industry coalition that is working the FSC issue. "We continue to have an underlying tax disparity, which must be

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rectified one way or the other, even if it requires changes in WTO rules." The Associated Press reported that EU Trade Commissioner Pascal Lamy said he was pleased and called for "rapid proposals" from Washington to rectify the tax laws. "Now it is up to the United States to comply with the WTO's findings to settle this matter once and for all," Lamy said.

The FSC case goes back several years. In February 2000, the WTO Appellate Body upheld a ruling that the FSC provisions of tax law violated WTO subsidy rules. In response, Congress approved the Extraterritorial Income Exclusion Act of 2000, but the European Union won a WTO ruling last August that the revised law still conferred a "prohibited export subsidy" and failed to withdraw the FSC "subsidy," as the earlier ruling directed. It was that ruling that was affirmed in today's WTO appeals ruling. Under an EU-U.S. agreement reached in September 2000, the dispute now will go back to a WTO arbitrator to decide on the exact amount of possible countermeasures. The arbitrator's report is expected by the end of March, according to an EU statement. - by Bruce Stokes and Geoff Earle

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EMPLOYMENT

Hill's Labor Agenda For 2002 Tinted By Enron Debacle

When Congress returns to work next week, legislators, staffers and lobbyists will find the Washington labor agenda transformed by investigations into employee 401(k) and pension investment programs brought on by the Enron scandal. But they also face questions about reviving an economic stimulus package, ergonomics, and a renewed call to increase the minimum wage. Enron "will dominate the conversation for the coming months," predicted Ann Combs, assistant secretary for the Pension and Welfare Benefits Administration, which handles employee benefit issues for the Labor Department, in a telephone interview with CongressDaily. The pension administration launched an investigation in November into how Enron employees lost most of their savings intended for retirement when Enron stock plummeted last year, and whether the companies' investment trustees fulfilled their duties to employees.

Also, Labor Secretary Chao recently was chosen to work with Treasury Secretary O'Neill and Commerce Secretary Evans to look at needed modifications in retirement laws in the wake of the Enron debacle. The group met for the first time Friday, and, while there is no deadline for sending recommendations to Congress, Combs said, "Everyone appreciates the urgency of the situation." Senate Health, Education, Labor and Pensions Chairman Kennedy will hold a hearing on the Enron retirement investment issue next month, and House Education and the Workforce Chairman Boehner also will investigate. Separately, the Senate Banking Committee has scheduled a Feb. 12 oversight hearing into the accounting and investor protection aspects of Enron Corp.'s collapse. Several former SEC chairmen are scheduled to testify, including Arthur Levitt, who served from 1993-2000.

Meanwhile, labor issues are expected to tint the debate as Congress revives efforts to pass an economic stimulus proposal, with a political battle expected over balancing unemployment and healthcare benefits with tax cuts. "I don't know how they can go home and continually face these laidoff workers," said Bill Samuel, AFL-CIO legislative director, who said labor groups would continue to push for benefits, ergonomics regulation, and an increase in the minimum wage. The Labor Department has yet to announce a position on ergonomics, but several sources said it will not issue a new regulation, as labor supporters had hoped. Labor supporters are also outraged by President Bush's recess appointment of Eugene Scalia to be Labor Department solicitor, citing his views against ergonomics, but business groups praised him as a well-qualified candidate. - by April Fulton

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JUDICIARY
Bipartisan Immigration Bill To See Early Senate Action

Congressional efforts to liberalize U.S. immigration policy, which were off to a promising start early in 2001, appeared effectively doomed immediately following the Sept. 11 attacks at the hands of foreign terrorists - some of whom had been living illegally in the United States for years. However, by the end of last year, it had become clear that the event also had presented an opening for lawmakers of various ideological stripes to reframe their arguments in a way that was mutually beneficial. The result was legislation sponsored in the Senate by Judiciary Immigration Subcommittee Chairman Edward Kennedy, D-Mass., and Immigration Subcommittee ranking member Sam Brownback, R-Kan., as well as Sens. Dianne Feinstein, D-Calif., and Jon Kyl, R-Ariz., which married enhanced border security with family friendly immigration reform, and earned the support of advocacy groups working both issues. That bill stalled in the Senate late last year, but is expected to be the Senate's first order of business this session in the category of immigration, a Kennedy spokeswoman said today.

Both chambers were poised in December to unanimously approve a legislative preconference agreement hammered out among House and Senate lawmakers. The House border security measure, introduced by Judiciary Chairman Sensenbrenner and Judiciary Immigration Subcommittee Chairman George Gekas, R-Pa., was approved by unanimous consent at the end of the session. But its companion measure was blocked in the Senate by Appropriations Chairman Byrd, who was perturbed by the White House's rejection of his request for border control funding earlier in the year. But while that left border security as unfinished business in the Senate, House GOP leadership took a short cut it likely will have to answer for this year: Bowing to pressure from a band of socially conservative Republicans, House GOP leaders agreed to omit from the immigration package compromise 245(i) extension language which would enable immigrants already residing in the country to pay $1,000 to stay in the United States while they await legalization.

The action alienated congressional Democrats - as well as the Bush administration, which is a proponent of a temporary 245(i) extension - and set the stage for an intra-party fight that pits the president against a faction of the GOP which favors greater restrictions. The Senate early in 2001 already had approved a yearlong extension of the 245(i) program. A spokesman today said Sensenbrenner is prepared to try and move the compromise 245(i) bill on the House floor this year. - by Pamela Barnett

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JUDICIARY
Bush Said To Remain Vague On Immigration Needs

Advocates for and against a more open border policy appear to agree on at least one thing: President Bush has done an admirable job in remaining politically amorphous on immigration matters, in a way that allows him to appeal to factions on both sides. A recent statement by Bush in which he said he intends to make immigration a "priority" this year - while failing to elaborate - marked a familiar pattern. It is clear that Bush still is wooing Hispanic voters - which insiders said Bush believes is important to his re-election bid in 2004. That is evidenced perhaps most clearly in his advocacy of a U.S.-Mexico agreement, which would facilitate border crossing for migrant workers. But the White House also surprised immigration advocates on both sides last week, with its announcement that Bush's budget this year would seek to reverse a controversial federal law that barred legal immigrants who arrived after 1996 from collecting food stamps.

"What [Bush] did is not insignificant," said a spokesman for Rep. Luis Gutierrez, D-Ill., who chairs the Congressional

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Hispanic Caucus' immigration task force. "The president really took an important step . one that he deserves to be congratulated for." The question, he added, is whether Bush will be a vocal advocate for such things as 245(i) reinstatement and an immigrant food stamp program, or whether he will settle for the political mileage he expects to earn with immigrants rights groups simply by proposing the programs. The prominence the subject of immigration reform is given in Bush's upcoming State of the Union address this month could provide a clue to his intentions, remarked one observer.

"The administration is key," agreed Dan Stein, executive direction of the U.S. Federation for American Immigration Reform, a group that essentially wants a moratorium on U.S. immigration. But he added: "It's hard to get a sense of the administration's position. President Bush is starting to sound like a Democrat." That strategy "won't work, he said, because Democrats will always seek to "play Santa Claus" and one-up the president. But at the very least, Bush's pledge on food stamps allows him to distinguish himself from advocates of greater restrictions, such as Rep. Tom Tancredo, R-Colo., who chairs the congressional Immigration Reform Caucus. Tancredo, who was among those who helped pressure Republican leaders to remove 245(i) provisions from the House version of the border security bill last year, last week accused Bush of "steal[ing] a page from the Democratic playbook," with his food stamp proposal. "His attempt to expand our political base through surrendering to the Hispanic vote is usually the Democrats' job. Votes can't be bought with welfare," Tancredo said. - by Pamela Barnett

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JUDICIARY

High Court Ends Six-Year Fight Over Prozac Drug Patent

A six-year court fight over rights to the lucrative anti-depression drug Prozac ended today when the Supreme Court refused to consider reinstating drug maker Eli Lilly Co.'s patent, the Associated Press reported. Generic versions of Prozac went on the market shortly after a federal appeals court invalidated a Lilly patent last year. That patent would have protected Lilly's monopoly until December 2003 and brought in an estimated $4 billion in sales for the company. Lilly sued generic drug manufacturers for patent infringement in 1996, when the rivals first sought FDA approval to make a generic form of Prozac. Barr Laboratories Inc. and other generic drug makers claimed Lilly had improperly double-patented Prozac to extend its exclusive control over the drug, and the appeals court agreed. The Supreme Court did not comment in rejecting Lilly's appeal of that ruling. Prozac had worldwide sales of $2.6 billion in 2000, the last full year that Lilly had exclusive rights to it. It was one of the company's best-selling drugs, accounting for about one-quarter of the company's sales.

The high court today also turned down a chance to set limits on how far the government can go to protect endangered species. The case the court refused to review involves shrimp found mainly in California, but it would have affected government efforts to protect all dying wildlife. An association of California builders challenged the constitutionality of the Endangered Species Act and the way the government handled the classification of shrimp. The builders group questioned the need for protection for the shrimp, which are not sold commercially. Paul Clement, acting solicitor general, defended the shrimp classification. "Individual species are part of an interdependent web," Clement wrote. "The significance of a particular species cannot always be easily determined at a given point in time."

Finally, a man fired after secretly helping the FBI investigate an anthrax threat lost his case today. The court turned down a chance to decide if First Amendment free speech rights cover a public employee's cooperation with law

enforcement, even when that assistance is against the wishes of their bosses. Since Sept. 11, justices have not agreed to review a case that directly implicates terrorism. They declined to take this one without comment. A judge had dismissed the man's case, and the 10th U.S Circuit Court of Appeals also said the firing was proper. The appeals court noted that he was not fired for reporting the alleged threats. His continued involvement with the investigation, after telling his boss he would no longer help the FBI, was not free speech, the appeals court said.
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POLITICS
Republicans To Defend More Open Seats In 2002 Races

The retirement announcements last week of GOP Reps. James Hansen of Utah and Joe Skeen of New Mexico bring to 26 - eight Democrats and 18 Republicans - the number of House members announcing they will not seek to return to the 108th Congress, leaving Republicans more than twice as many open seats to defend during November's midterm elections. The tally includes Rep. Steve Largent, R-Okla., who will officially resign his seat Feb. 15 to concentrate on his run for governor. Republican state Rep. John Sullivan was elected Jan. 8 to replace Largent, but cannot be sworn in until Largent resigns.

Three Democrats and nine Republicans have already announced they will retire, including Democratic Reps. Eva Clayton of North Carolina, William Coyne of Pennsylvania and Tim Roemer of Indiana. In addition to Skeen and Hansen, Republicans planning retirement are House Majority Leader Armey, Reps. Porter Goss and Dan Miller of Florida, Steve Horn of California, Marge Roukema of New Jersey, Bob Schaffer of Colorado and Wes Watkins of Oklahoma. House Republicans have urged Goss, whose profile as House Intelligence Committee chairman has risen since the Sept. 11 attacks, to reconsider his retirement, in part to help Republicans in Florida redistricting.

Five Democrats and nine Republicans have declared they will give up their seats to pursue bids for statewide office. Democratic Reps. John Baldacci of Maine, Tom Barrett of Wisconsin, Rod Blagojevich of Illinois and David Bonior of Michigan are all running for governor in their home states, while Texas Rep. Ken Bentsen is seeking the Democratic nod for Senate. Republican Reps. Saxby Chambliss of Georgia, John Cooksey of Louisiana, Greg Ganske of Iowa, Lindsey Graham of South Carolina, John Sununu of New Hampshire and John Thune of South Dakota are running for Senate. GOP Reps. Van Hilleary of Tennessee and Bob Riley of Alabama, as well as Largent, are vacating their seats to run for governor.

Redistricting played an important role in more than one retirement decision. Coyne, Horn and Bonior all announced their retirements after redistricting plans made clear their seats would be eliminated or merged, although only Horn listed it as a specific factor. Chambliss and Ganske faced radically different districts if they chose to run for re-election. Oklahoma redistricting could drastically alter districts now held by Largent and Watkins, while Wisconsin, which loses a seat, is likely to carve up Barrett's district. - by Mark Wegner
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POLITICS
Bush Calls For Broader Powers To Negotiate Trade Pacts

Apparently recovered from a fainting incident that left him with a scraped cheek and bruised lip, President Bush renewed his push today for expanded trade as a cure for recession and vowed anew to oppose any repeal or delay of tax cuts enacted last year. Bush opened a two-day, three-state push by reiterating his request for broader powers to negotiate trade pacts, saying, "I'm confident we need to open up markets, not close them down." Bush pledged to fight any effort to roll back tax cuts approved last

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year, the Associated Press reported. "I've made up my mind - the tax relief plan we passed, which you're now beginning to feel the effects of, is going to be permanent," he said. He is traveling this afternoon to a feed mill in Aurora, Mo., and Tuesday to New Orleans. Senate Agriculture Chairman Harkin, who appeared with Bush in Moline, had urged the president to make time "to meet with farmers, rural leaders and others" who are interested in the new farm bill. Harkin's letter appeared to be part of a Democratic campaign to point out that Bush officials meet with agribusiness rather than farmers. Harkin later said that Bush has agreed to meet with him later this month to discuss the farm bill.
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POLITICS
Clinton Seeking Changes To Proposed Federal Compensation Plan
Survivors of the Sept. 11 terrorist attacks and relatives of those who died are joining Sen. Hillary Rodham Clinton, D-N.Y., in seeking changes to the proposed federal compensation plan, the Associated Press reported. The Sept. 11 Victims Compensation Fund was created as part of a $15 billion airline relief package established by Congress. It allows families to apply for federal money to cover lost wages, pain and suffering, as long as they agree not to sue airlines and other entities. Clinton Sunday met with families and announced several proposed changes to eligibility guidelines, including eliminating a requirement that the injured seeking compensation must have received medical treatment by noon on Sept. 12. Families of those killed in the attacks receive an immediate payment of $50,000, and those injured get $25,000 when their applications are processed. The minimum award for the families of deceased is $250,000, before deductions. The average award is expected to be about $1.65 million. Clinton said the 24-hour rule should be removed because many victims could not get to a hospital until later. The Justice Department's deadline for written comments on the legislation is Jan. 22.
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POLITICS
Most State Election Officials Oppose Reform Under Consideration
A majority of state election officials oppose election reform standards under consideration in Congress but do support improvements in voting technology and machinery, according to a survey released today by the nonpartisan Election Reform Information Project. "They are enthusiastic at the prospect of federal funding for elections, but nervous about what 'strings' might be attached," Project director Doug Chapin said. More than 70 percent of top state election officials said they opposed federal standards for recruitment and training, Election Day operations and procedures, recount procedures and ballot designs, while 58 percent also said they opposed federal standards for how votes are counted. But 69 percent said they did support technology improvements, and said funding was the biggest obstacle to improving elections. However, slim majorities of local officials voiced support for better training and for procedures for counting votes and contested elections. The House passed an election reform bill in December. The Senate has yet to approve a bill although a bipartisan group of key senators did unveil a bill late last year. The survey, conducted by Princeton Survey Research Associates, interviewed the chief election official in 36 states and in 208 counties between Oct. 16-Nov. 9.
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TRANSPORTATION
America West Airlines Meets Conditions For Loan Backing
Cash-strapped America West Airlines said today it has met the government's conditions to receive federal backing for a $429

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million loan, the Associated Press reported. The deal is expected to be signed and the money made available by the end of the week, the airline said. America West is one of only two airlines to apply for part of the $10 billion in loan guarantees approved by Congress to help airlines following the Sept. 11 terrorist attacks. The loan guarantees essentially make the government a co-signer on the company's loan. In America West's case, the government would agree to pay back up to $380 million if the airline defaults. The Air Transportation Stabilization Board approved the federal aid Dec. 28, with the condition America West provide assurances it would keep down labor costs and give the government the option of buying a third of the airline's stock at a fixed price. Under terms of the America West deal, the government has until 2012 to purchase nearly 18.7 million shares at $3 apiece. So, for example, if the price rose to $8 a share, the government could sell it and make a profit of about $94 million.

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POLITICAL ROUNDUP

California. In his first major campaign appearance of the 2002 election cycle, Rep. Gary Condit, D-Calif., reminded voters during a Friday candidate forum of his bipartisan style of legislating and of his seven terms representing the Central Valley's 18th District. "I have been effective on your behalf. And I'm going to ask you something. I've helped you. I'm asking you to help me in March," Condit said, according to the Los Angeles Times. Condit, politically damaged by his relationship with missing federal intern Chandra Levy, faces opposition in the March 5 open primary from five Democrats and four Republicans. Reconfigured after redistricting, the 18th District is reliably Democratic, but a Condit victory in the primary could boost GOP state Sen. Dick Monteith in the general election. Assemblyman Dennis Cardoza, Condit's strongest Democratic opponent, did not attend the forum, choosing to keep a previously scheduled campaign event. According to the Times, no one raised the issue of Condit's relationship with Levy until the end of the 90-minute forum, when Republican Modesto City Councilman Bill Conrad raised the issue, drawing boos from an audience of about 150.

Michigan. Michigan Democratic Party officials are launching another effort to alter the first-in-the-nation status given by party rules to New Hampshire and Iowa in the presidential nominating process. State party leaders aborted an earlier effort, led by Sen. Carl Levin, to avoid a national convention floor fight in 2000. But in a Jan. 9 letter to Democratic National Committee members, state Democratic Chairman Mark Brewer, National Committeewoman Debbie Dingell and Levin said they will propose an amendment to change rules for the 2004 cycle, the Detroit News reported. Brewer, a member of the DNC's Rules and Bylaws Committee, will ask the panel to adopt the Michigan amendment Saturday. He is likely to fail, but Brewer and Dingell have pledged to carry the fight to the full DNC. "It's worth noting that the Republican Party's rules confer no special status to the New Hampshire and Iowa contests," their letter said. "We would find it both ironic and embarrassing that on this question, it is our party that enshrines anti-democratic privilege in its rules."

Ohio. Ohio Republicans are considering the elimination of Democratic Rep. James Traficant's Youngstown-based 17th District, a source told the Associated Press. The state loses one of its 19 seats through reapportionment and Democrats are expected to lose at least one seat. Republicans control redistricting and have considered proposals affecting Democratic Reps. Sherrod Brown, Dennis Kucinich and Tom Sawyer. Traficant, who has pleaded innocent to racketeering, bribery and conspiracy charges, is out of favor with House Democrats for supporting House Speaker Hastert, but enjoys a loyal following within his district. Ohio

state Rep. Gary Cates, a Republican who chairs the Elections and Ethics Subcommittee, today told CongressDaily he did not know whether Traficant's district would be eliminated, but said GOP Gov. Bob Taft and party leaders could unveil a plan Wednesday. While Republicans control the process, some Democratic votes will be needed to enact a law in time for the state's Feb. 21 filing deadline and May 7 primary. Traficant goes on trial Feb. 4. A spokesman said Traficant plans to seek re-election, but would study redistricting maps before deciding where to run.
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THE FINAL WORD

"I asked the president, 'What was so exciting?' I didn't think it was that big of a game."

- Sen. Tom Harkin, D-Iowa, quoted by the Quad-City Times of Davenport, Iowa, at the John Deere & Co. Harvester Works plant in East Moline, Ill., where President Bush spoke the morning after he fainted while eating pretzels and watching football. Bush was watching the NFL playoff game between the Baltimore Ravens and the Miami Dolphins. Baltimore won the game, 20-3.
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Special Correspondents--Jerry Hagstrom, Julie Rovner

Subscription price: $2,649 a year. Subscription and e-mail transmission information: 202-266-7230 (cngdaily@njdc.com).
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CDENDIT

From: Farrell, Paula
Sent: Monday, January 14, 2002 6:02 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Friday, January 11, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Friday, January 11, 2002 3:28 PM
To: Cummings, Leslie; Ellis, Dina; Farrell, Paula; Hart, Susan
Subject: FW: National Journal's CongressDaily - Friday, January 11, 2002

> ----------
> From: cp-del@nationaljournal.com[SMTP:CP-DEL@NATIONALJOURNAL.COM]
> Sent: Friday, January 11, 2002 6:24:22 PM
> Subject: National Journal's CongressDaily - Friday, January 11, 2002
> Auto forwarded by a Rule
>

National Journal's CongressDaily
Issue date: January 11, 2002
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FINANCE
Enron Spectacle Widens, Fuels Concern Over Retirees

As the Enron bankruptcy scandal raises questions over the Bush administration's prior knowledge of the company's problems, parallel inquiries are delving into the company's actions on retirees and may prompt action this year on how firms handle employee retirement plans, business leaders acknowledged today. "These are tough issues that the Congress and the private sector are going to have to work out," said National Association of Manufacturers Employment Policy Director Neil Trautwein at a briefing on the group's labor agenda for the coming year. But anticipating an Enron-generated backlash, Trautwein cautioned against legislation to restrict employee ownership of company stock. "I think this points out that people could use some additional help, but limits are the wrong way to go," Trautwein said. "Getting the federal government to come in say what you can invest in is a bad idea."

The torrent of revelations concerning the failed energy giant and its connections to the Bush administration and Capitol Hill continued today, with confirmation that top Enron officials sought help from the federal government in obtaining relief from the firm's bankers. The Associated Press reported that a Treasury Department spokeswoman confirmed that Peter Fisher, undersecretary for domestic finance, spoke with Enron President Lawrence (Greg) Whalley six or eight times in late October and early November. Also today, CNN reported that the Senate Governmental Affairs Permanent Subcommittee on Investigations will send out 51 subpoenas today for information on the company's collapse.

On employee ownership of company stock, many federal officials and advocates are increasingly concerned over the effect of company failures on employees, who have fewer resources and options to recover their life's savings. "We are concerned about the vulnerability workers have with their investments," AFL-CIO Legislative Director Bill Samuel said today, adding it was a key

priority for labor groups this year. A spokesman for Senate Health, Education, Labor and Pensions Chairman Kennedy said the committee would hold a hearing in early February to address the 401(k) issues raised by Enron. "We realize that there's a larger problem out there that needs to be addressed," the spokesman said. House Education and the Workforce Chairman Boehner has also said he will explore the issue. A spokesman for Boehner said a bill Boehner passed in the House last year that would make it easier for companies to give retirement investment advice to employees would address some of the concerns being raised about Enron. Sens. Jon Corzine, D-N.J., and Barbara Boxer, D-Calif., introduced a bill recently to prevent employees from owning more that 20 percent of their company's stock, an approach opposed by NAM. - by April Fulton
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FINANCE
Gaps Shown In Company's Political Contributions

Although Enron Corp. and its top brass pumped millions of dollars to the Republican Party and President Bush over the years, the embattled energy concern gave few contributions to the members of Congress who may investigate the fate of the firm and its executives, according to a CongressDaily analysis of fundraising documents. In the 1999-2000 election cycle, for example, Enron did not contribute a single dollar directly to the Republican and Democratic leaders of the House and Senate panels that plan to lead the investigation into Enron's high-profile collapse. The company gave $1,000 to the personal re-election efforts of Senate Minority Leader Lott - but no money to Minority Whip Nickles, Republican Policy Committee Chairman Larry Craig of Idaho, Majority Leader Daschle or Majority Whip Reid. Likewise, House Speaker Hastert received just $3,500 from Enron for his personal re-election effort and House Minority Leader Gephardt took in $1,000.

At the same time, Enron earned a spot in the top 50 political contributors in 1999 and 2000 for the first time by giving $1.1 million to national Republican Party accounts. In addition, Houston-based Enron was the 12th largest contributor to Bush's presidential campaign, with $114,000. The discrepancy is the result of a fundraising strategy that called for Enron to focus on writing large checks to national and state party accounts - while giving far less money directly to the re-election efforts of individual members of Congress. In 1999-2000, Enron and its executives gave $1.7 million in soft money donations to the political parties and just $300,000 directly to candidates.

As a result, Enron's contributions to key members of Congress have been relatively sparse. In the last election cycle, Enron contributed just $137,500 in regulated, hard dollars to the hundreds of lawmakers who sit on a range of congressional committees that plan to investigate the company, including the House Government Reform, House Energy and Commerce, House Financial Services, Senate Governmental Affairs, Senate Energy and Natural Resources, Senate Commerce and Senate Banking committees. That is far less money than scores of other organizations contributed. The $27,000 that Enron gave to the Republican members of the House Energy and Commerce Committee, for example, fell behind 114 other organizations. Rep. W.J. (Billy) Tauzin, R-La., who last year took over the Energy and Commerce chairmanship, alone gave more money to committee Republicans than Enron in 1999 and 2000.

In the first half of 2001, Enron's contributions to influential members of Congress slumped further. According to Enron's most recent financial disclosure for the period from January to June 2001, the company did not contribute to the personal re-election efforts of Hastert, Gephardt, Lott or Daschle. At the same time, the company contributed just $12,000 to the members of the seven congressional panels that plan to

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look into its financial dealings. Republicans on the House Energy and Commerce Committee received just $3,500 from the company in the first six months of 2001. That is less, for example, than the Western Peanut Growers Association and 314 other political organizations handed out.

Enron's contributions to congressional leadership PACs and so-called nonfederal 527 accounts also slowed in 2001. In November 2001, Enron contributed $5,000 to Lott's leadership PAC and $2,500 to House Rules Chairman Dreier's leadership PAC. Earlier in the year, Enron contributed $2,500 each to the leadership PACs of Hastert, Armey, Tauzin and Chief Deputy Majority Whip Roy Blunt, R-Mo. The company also made a $5,000 contribution in September to the moderate New Democrat Network and a $10,000 contribution mid-year to the conservative GOPAC, which assists nonfederal GOP candidates. - by Brody Mullins and Charlie Mitchell

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WHITE HOUSE

Bush Returns To Domestic Issues, Signs Brownfields Bill

Calling it the most important environmental legislation produced by Congress last year, President Bush today signed the Small Business Liability Relief and Brownfields Revitalization Act at an appearance in Conshohocken, Pa. The legislation provides funding for brownfields cleanup while protecting small businesses from certain types of liability related to the sites. Because cleaning up brownfields can provide new areas for development, Bush touted the legislation as a type of jobs bill that could also help provide a solution for urban sprawl. Bush said this bill - and the education legislation he signed earlier this week - marks an increase in his focus on domestic issues, even as he continues to wage the fight against terrorism.

The president noted his FY03 budget will call for Congress to more than double EPA spending on brownfields revitalization, from $98 million to $200 million. The budget also includes $25 million for urban development and brownfields cleanup by HUD, the White House said today. The president was introduced with lavish praise by EPA Administrator Whitman, who called Bush "one of America's greatest environmentalists." Bush returned the compliment, saying Whitman is "going to go down as one of the best selections" he made for his Cabinet. Earlier this year, Whitman's future with the administration appeared somewhat clouded when Bush reversed a campaign position and said he would not seek mandatory limits on carbon dioxide emissions, even though Whitman had assured European officials he would. Meanwhile, Bush Thursday signed the two remaining FY02 appropriations bill, the Labor-HHS spending bill and the Foreign Operations appropriations bill, OMB officials said. - by Keith Koffler

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AGRICULTURE

Rejection Of Farm Group's Cuba Trip Spurs Travel Debate

Washington's Cuba watchers were busy this week assessing the Treasury Department's rejection of an application by a high-profile group organized by the Farm Foundation, an Illinois think tank, to travel to the island. At issue were questions about whether the agency's rejection of the application last week was a bureaucratic snafu or an indication the Bush administration is tightening up on farm groups going to Cuba. The move resulted in adverse publicity for the Bush administration in rural areas, where the issue of expanding Cuba trade is hot. The rejection of the Farm Foundation's application puzzled farm leaders because Agriculture Secretary Veneman, Agriculture Deputy Secretary James Moseley and Undersecretary for Farm and Foreign Agricultural Services J.B. Penn all served on the Farm Foundation board before resigning to take their USDA positions. Veneman told reporters last year that her contacts with the Farm Foundation were her greatest source of appointees at USDA. American Farm Bureau Federation President Bob Stallman, who sits on the Farm Foundation board, said this week he was "disappointed a group like the Farm Foundation can't go to Cuba" and was particularly disturbed that the rejection came on Jan. 3, only five days before the group was scheduled to leave.

Former Agriculture Secretary Glickman, a member of the Farm Foundation board who was supposed to be a part of the delegation, initially joked to CongressDaily that Treasury rejected the application because "they think we're a bunch of revolutionaries." But Glickman quickly added that the rejection "was a little more complex" than the Bush administration rejecting the application to appease Cuban American voters. Glickman said the Farm Foundation may not have engaged in "enough advance planning in the licensing process." But Glickman also added, "The government didn't show the flexibility it needed to work through the issue" and "could have helped the group" improve its application.

John Kavulich, president of the New York-based U.S. Cuba Trade and Economic Council, a pro-trade group, said, "I don't think anyone should say this is the Bush administration sending a signal." But Farm Foundation President Walt Armbruster said in a telephone interview from Florida, where the group that was headed for Cuba was holding a meeting, that he "can't tell" whether the rejection was the result of an application problem or a political statement. Armbruster said Treasury officials told him they rejected the application because there were too many spouses, the agenda was too "unfocused" and had no strategy for making a direct sale. But Armbruster said including spouses in trips is normal Farm Foundation procedure and that "the criteria are not real clear" for the applications. Armbruster said some USDA officials and senators and House members tried to intervene with Treasury, but that he never sought Veneman's help and that he discussed the matter only with Treasury civil servants, not political appointees. A USDA spokeswoman said while the agency called to check the status of the Farm Foundation's request, no USDA official acted on the group's behalf. Sen. Byron Dorgan, D-N.D., said the Farm Foundation rejection is proof "the administration is tightening restrictions on travel to Cuba" and "demonstrates how absurd the policy is." Treasury Secretary O'Neill, Dorgan said, told him Treasury is "not actually doing anything different, but the evidence suggests they are." - by Jerry Hagstrom

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ENVIRONMENT

Yucca Mountain Decision Heading For Capitol Hill Battle

As Nevada officials this week began considering their options for staving off a nuclear waste repository at arid Yucca Mountain, Congress emerged as the likely key pressure point in the battle. "We're checking into all parliamentary options," Sen. John Ensign, R-Nev., an opponent of the waste site, told the Las Vegas Sun. Energy Secretary Abraham Thursday designated the Nevada site as the government's choice for permanent storage of high-level radioactive waste from weapons plants and nuclear power stations. But Abraham's designation is not the final word, triggering a sequence of regulatory and political steps that waste foes said could derail the plan. After notifying GOP Nevada Gov. Kenny Guinn of his decision on Thursday, Abraham must wait 30 days to notify President Bush of his decision. Bush then has an indefinite period to ratify Abraham's decision. If he does, Guinn is given 60 days under law to veto the designation. If Guinn exercises his veto, the issue goes to Congress. The Sun reported today that Guinn Thursday told Abraham that "I was damned disappointed in his decision and he was to expect my veto."

If Guinn sends the issue to Congress, as expected, the two chambers must act in 90 days to allow the waste plan to move forward, or else it would be dead. Ensign would join a Democratic leadership opposed to the dump. Guinn said lawyers hired by the state are researching whether Senate Majority Leader Daschle, an avowed opponent of storing nuclear waste at Yucca, has the authority to pigeonhole the issue - an issue that could end up in court, the Sun reported. However, if it comes to a vote, Senate Majority Whip Reid fears senators would back Bush. "Right now, the odds are we can't get 51 votes," Reid said at a Las Vegas news conference, the Las Vegas Review-Journal reported. Even if the program won congressional approval, it then must receive adequate funding. Reid now is chairman of the Senate Energy and Water Appropriations Subcommittee, where money for the waste program would need to win approval.

Meanwhile, both Democratic and Republican politicians in Nevada said the fallout from the issue could hurt the GOP in the state, the Review-Journal reported today. "Overall, this is bad news for the Republican Party," said Clark County Commissioner Myrna Williams, a Democrat. Independent sources expected some adverse impact on the GOP. "This might have happened if Al Gore had been elected president, but the fact of the matter is, it is happening on George W.'s watch," Ted Jelen, University of Nevada political science chairman, told the newspaper.

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ECONOMY

Ford Cuts 35,000 Jobs, Closes 5 Plants, Drops 4 Vehicles

Ford Motor Co. plans to cut 35,000 jobs worldwide, close five plants and eliminate four vehicles in a massive restructuring that its chief executive called a "painful, but necessary" effort to return the world's second biggest automaker to profitability, the Associated Press reported. "We strayed from what got us to the top of the mountain, and it cost us greatly," chief executive William Clay Ford Jr. said today from company headquarters in announcing the plan. The job cuts amount to about 10 percent of its overall work force and include 22,000 in North America. The plants to be closed are in Edison, N.J., and Oakville, Ontario, by 2004; Brook Park, Ohio, near Cleveland in either 2003 or 2004; Hazelwood, Mo., near St. Louis by an undetermined date; and Vulcan Forge in Dearborn, Mich., as soon as possible. Vehicles to be dropped are the Ford Escort, Mercury Cougar, Mercury Villager and Lincoln Continental. Ford said it was taking a $4.1 billion, one-time charge against earnings to pay for its plan. The plan also includes the suspension of bonuses for company managers and the elimination of 401(k) matching contributions for employees. Ford employs approximately 345,000 people worldwide, including 170,000 in North America. On Wall Street today, at 2 p.m., the NASDAQ had fallen 23 points to 2,023.32 and the Dow Jones Industrial Average slid 51 points to 10,016.59. In morning trading on the New York Stock Exchange, Ford shares were up 9 cents at $15.38.

Meanwhile, wholesale prices, led by a sharp drop in energy costs, fell by 0.7 percent in December, helping to make 2001 the tamest year for inflation at the producer level since 1986. The Labor Department's producer price index, which measures price pressures before they reach consumers, fell by 1.8 percent for all of last year, the biggest annual decline since 1986, when wholesale prices dropped by 2.3 percent, the government reported today. That marked a big improvement from the 3.6 percent increase in wholesale prices registered in 2000.

Federal Reserve Chairman Greenspan said today that there were scattered hopeful signs that the recession could be ending, but he warned that the American economy still faces "significant risks." Greenspan, making his first public comments on the economy since the Fed last cut interest rates on Dec. 11, said there are "tentative indications" that the economic slump could be drawing to a close, but he said those signals at present are

far from conclusive.
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HOUSE RACES
Sessions' Old District Site Of A Spirited Texas Showdown

Texas redistricting put more Republicans into GOP Rep. Pete Sessions' 5th District, but his decision to abandon the previously marginal district for a safer seat has Democrats closely watching a competitive GOP primary. "You're going to have either a no-name Republican or a guy with a lot of money," said Texas Democratic consultant Ed Martin. Republicans enjoy a 61-39 percent advantage in the new 5th District, which had picked up GOP-leaning voters in Dallas County but still has Democratic voters in 10 mostly rural counties between Dallas and Houston. Instead of running in the reconfigured 5th District, Sessions has filed for the more Republican and compact Dallas-based 32nd District - one of two new seats Republicans will pick up through redistricting. Five Republicans have filed to run in the March 12 primary, but the race appears to be between millionaire attorney Phil Sudan, who unsuccessfully challenged Democratic Rep. Ken Bentsen in 2000, and businessman Jeb Hensarling, a top political aide to GOP Sen. Phil Gramm who has never run for political office.

Hensarling, a businessman who once served as National Republican Senatorial Committee executive director, claims strong ties to the district, solid GOP credentials and support from Gramm and other party leaders. Neither candidate begins the race with high visibility and Hensarling acknowledges that Sudan's personal wealth could be an advantage in the short primary season. Sudan spent a cumulative $3 million in the 2000 race against Bentsen, who represents a Houston-based district. Sudan filed to run for the Dallas-based 5th District in time for the Jan. 2 deadline after a potential GOP primary rival opted to run elsewhere. Hensarling - campaigning on domestic security, the economy, education and rural development - quipped he would be happy to introduce Sudan to the district. "Once he gets here, I'm certainly happy to give him a roadmap to Houston," he said.

But Sudan said voters are concerned about philosophy and record, not geography. "I won a contested Republican primary. I defeated a so-called Republican moderate," Sudan said of his 2000 primary. Sudan is campaigning on tax reform and security issues, opposes abortion and supports gun ownership rights. He said would "put up a substantial amount of my own money," but declined to say how much. The GOP nominee will likely face Democrat Ron Chapman, a former Dallas County appellate judge who has been on the Dallas County ballot since 1978 and shares the name of a popular Dallas radio personality. Democrats unsuccessfully sought to recruit state Sen. David Cain, but describe Chapman as a promising candidate who could benefit from a strong Democratic turnout in Senate and gubernatorial races. Chapman, who hopes to raise at least $1 million and is backed by Rep. Martin Frost, D-Texas, describes himself as a loyal Democrat who can work with Republicans to address the war and economic issues. "The general feeling I get is that there is a lot of dissatisfaction with the partisan bickering," he said. - by Mark Wegner
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POLITICS
Bush Signs Recess Appointments For Reich, Scalia

Circumventing Senate opposition, President Bush signed recess appointments today for conservatives Otto Reich and Eugene Scalia. The White House gave Congress formal notification of the long-threatened appointments early today. By exercising his executive authority while Congress is in recess, Reich and Scalia will be allowed to serve until Congress recesses again at the end of the year. Bush named Reich assistant secretary of State for Latin America, the top diplomatic post for the region that Bush

made his primary foreign relations priority before the war on terrorism consumed his first year in office. Scalia, the son of Supreme Court Justice Antonin Scalia, now assumes the post of Labor Department solicitor, for which Bush nominated him several months ago.
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POLITICS
Reform Council Reaffirms Support For Stripping Amtrak Of Tracks, Stations

Holding what may be their last meeting, members of the advisory Amtrak Reform Council today reaffirmed their support for stripping the financially troubled railroad of the tracks and stations it owns, but still must decide whether and how to open train operations to competition. The Council, which will deliver its recommendations to Congress Feb. 7, was holding a daylong meeting today. Two of the three reform options would abolish Amtrak's monopoly on intercity rail travel by introducing competition for some or all routes. The other option would keep rail operation under a federal carrier, which could be Amtrak, or a series of regional carriers. The National Association of Railroad Passengers said Thursday that recommendations to separate Amtrak from its nonrail assets "bear a disturbing similarity to the early steps in the process that led to Britain's current railway crisis."
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ENVIRONMENT
Allard Urges Whitman To Delay Transfer, Restructuring Of EPA's Ombudsman

Sen. Wayne Allard, R-Colo., is asking EPA Administrator Whitman to delay a transfer and restructuring of EPA's ombudsman until Congress reviews the decision. In March, Allard and Idaho GOP Sens. Larry Craig and Mike Crapo introduced legislation to make the Office of the Ombudsman independent. However, Whitman plans to officially move the ombudsman, Robert Martin, into the EPA Inspector General's office next week. The change had been recommended in a GAO report. Allard is concerned the change will cost the ombudsman his independence, which is key to his job. On Tuesday, Allard wrote Whitman to reiterate the request. In addition to the letter, Allard also talked with Whitman over the phone last week seeking the delay. Meanwhile, Martin Thursday filed a lawsuit to prevent the reshuffling of his office, saying it would weaken his independence within the agency, the Associated Press reported. The watchdog group Government Accountability Project joined Martin in the lawsuit.
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POLITICS
Lieberman To Deliver Foreign Policy Address Monday

Sen. Joseph Lieberman, D-Conn., plans to deliver a foreign policy address Monday at Georgetown University. Lieberman is returning from a congressional delegation to Central Asia, which included stops in Afghanistan and Pakistan. Lieberman's speech comes on the heels of a speech last Friday by Majority Leader Daschle criticizing the administration's economic policy. According to Lieberman's office, his speech will be a major address outlining Lieberman's vision for winning the war on terrorism.
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POLITICS
Poll Finds Support For Reforming The Postal Service

The Direct Marketing Association - the leading trade group for the direct-mail industry - released a national poll Wednesday that indicates support for reforming the U.S. Postal Service. When asked, "Do you believe that solving the problems of the U.S.

Postal Service should be a high priority of Congress?" 55 percent agreed and 42 percent disagreed. When asked whether respondents favored "legislation that will give the U.S. Postal Service the flexibility and tools it needs to reform and improve its operations," 73 percent agreed and only 19 percent disagreed. The poll of 1,005 adults was conducted from last Thursday through Sunday by Opinion Research Corp. The DMA and other groups have been working with the Postal Service for several years to pass compromise legislation that changes the way the USPS is structured and operates.
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POLITICS
NRCC Hires Three New Campaign Strategists
Gearing up for this November's midterm elections, the National Republican Congressional Committee announced today it has hired three new campaign strategists, including a deputy political director. The committee hired Scott Douglas, formerly a regional field director for the Bush presidential campaign and a deputy chief of staff at FEMA. Douglas worked at the NRCC from 1994-99, serving as deputy executive director. The committee also hired Ted Christian and Andrea Horton as two new field representatives to track regional House races. Christian formerly served as executive director of the New Jersey Republican Party. Horton, a consultant with the Texas firm Olsen, Delisi & Shuvalov, has served in the press shop of Texas Attorney General John Cornyn.
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THE FINAL WORD
" [T]hat piece of garbage ."
- Las Vegas Mayor Oscar Goodman, quoted in the Las Vegas Review-Journal today, characterizing Energy Secretary Abraham following Abraham's official designation of a site at Yucca Mountain, Nev., 90 miles from Las Vegas, as the nation's nuclear waste repository. Goodman said he would marshal mayors from cities at nuclear waste shipping points across the nation to help fight the waste plan.
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CongressDaily is published daily, Monday through Friday, by National Journal Group Inc.

To read CongressDaily on the Web, contact 1-800-207-8001 or njcirc@njdc.com for your username and password.

President--John Fox Sullivan, 202-739-8468 (jsullivan@njdc.com)
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Special Correspondents--Jerry Hagstrom, Julie Rovner

Subscription price: $2,649 a year. Subscription and e-mail

transmission information: 202-266-7230 (cngdaily@njdc.com).
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CDENDIT

Oster, Karen

From: Farrell, Paula
Sent: Monday, January 14, 2002 6:02 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Thursday, January 10, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Thursday, January 10, 2002 3:35 PM
To: Ellis, Dina; Farrell, Paula; Hart, Susan; O'Brien, Michael
Subject: FW: National Journal's CongressDaily - Thursday, January 10, 2002

-----Original Message-----
From: cp-del@nationaljournal.com [mailto:cp-del@nationaljournal.com]
Sent: Thursday, January 10, 2002 6:21 PM
Subject: National Journal's CongressDaily - Thursday, January 10, 2002

National Journal's CongressDaily
Issue date: January 10, 2002
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WHITE HOUSE
White House Urges Nonpartisan Investigation Of Enron

The White House today had tough words for congressional investigators readying probes into the bankruptcy of former energy giant Enron, warning lawmakers to steer clear of "partisan" activities targeting Republicans and urging them to focus instead on the circumstances surrounding the company's failure. "I think people need to remember that the American people are sick and tired of partisan witch hunts and endless investigations," White House Press Secretary Ari Fleischer said today. "Enron gave hundreds of thousands of dollars to Democrats," he noted. "If Congress instead focuses on partisanship and focuses on blame of one party, then Congress will not serve the country well," Fleischer said, calling Enron's fall an opportunity for legislators to devise new policies to avoid repeat acts by other companies. Fleischer refused to say specifically whether it would be proper for Congress to look into direct contacts between Enron and administration officials. Enron Chairman and CEO Kenneth Lay and his company together have been among President Bush's most generous benefactors, but Lay and Enron have also donated significant sums to other Republicans and to Democrats.

Fleischer revealed that Lay contacted both Treasury Secretary O'Neill and Commerce Secretary Evans last fall about Enron's financial situation. Neither O'Neill nor Evans told the president of Lay's contacts with them. Bush, in fact, only found out today, Fleischer said. Bush first heard about Enron's collapse last fall, when it become evident to the general public, Fleischer indicated. The president said today at the White House that he had never discussed Enron's finances with Lay, adding that he had last seen Lay last spring. Lay last fall told O'Neill of concerns that Enron would not be able to meet its obligations and that the company's declining fortunes could adversely impact the energy sector. O'Neill asked a deputy to look into the matter and

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concluded the problem was isolated to Enron, according to Fleischer. Lay told Evans that he was "having problems with his bond rating and was worried about its impact on the energy sector," Fleischer said. Evans spoke with O'Neill and the two agreed no action should be taken "to intervene" with Enron's bondholders, according to Fleischer. At presstime, CNN reported that Attorney General Aschroft had recused himself from playing any role in the Justice Department's investigation.

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Reporters--Pamela Barnett, Lisa Caruso, Geoff Earle, Keith Koffler, Brody Mullins, Stephen J. Norton, Mark Wegner
Special Correspondents--Jerry Hagstrom, Julie Rovner

Subscription price: $2,649 a year. Subscription and e-mail transmission information: 202-266-7230 (cngdaily@njdc.com).
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Revesz, Paul

From: Farrell, Paula
Sent: Monday, January 14, 2002 6:02 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Thursday, January 10, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Thursday, January 10, 2002 3:35 PM
To: Ellis, Dina; Farrell, Paula; Hart, Susan; O'Brien, Michael
Subject: FW: National Journal's CongressDaily - Thursday, January 10, 2002

-----Original Message-----
From: cp-del@nationaljournal.com [mailto:cp-del@nationaljournal.com]
Sent: Thursday, January 10, 2002 6:21 PM
Subject: National Journal's CongressDaily - Thursday, January 10, 2002

National Journal's CongressDaily
Issue date: January 10, 2002
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WHITE HOUSE
White House Urges Nonpartisan Investigation Of Enron

The White House today had tough words for congressional investigators readying probes into the bankruptcy of former energy giant Enron, warning lawmakers to steer clear of "partisan" activities targeting Republicans and urging them to focus instead on the circumstances surrounding the company's failure. "I think people need to remember that the American people are sick and tired of partisan witch hunts and endless investigations," White House Press Secretary Ari Fleischer said today. "Enron gave hundreds of thousands of dollars to Democrats," he noted. "If Congress instead focuses on partisanship and focuses on blame of one party, then Congress will not serve the country well," Fleischer said, calling Enron's fall an opportunity for legislators to devise new policies to avoid repeat acts by other companies. Fleischer refused to say specifically whether it would be proper for Congress to look into direct contacts between Enron and administration officials. Enron Chairman and CEO Kenneth Lay and his company together have been among President Bush's most generous benefactors, but Lay and Enron have also donated significant sums to other Republicans and to Democrats.

Fleischer revealed that Lay contacted both Treasury Secretary O'Neill and Commerce Secretary Evans last fall about Enron's financial situation. Neither O'Neill nor Evans told the president

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of Lay's contacts with them. Bush, in fact, only found out today, Fleischer said. Bush first heard about Enron's collapse last fall, when it become evident to the general public, Fleischer indicated. The president said today at the White House that he had never discussed Enron's finances with Lay, adding that he had last seen Lay last spring. Lay last fall told O'Neill of concerns that Enron would not be able to meet its obligations and that the company's declining fortunes could adversely impact the energy sector. O'Neill asked a deputy to look into the matter and concluded the problem was isolated to Enron, according to Fleischer. Lay told Evans that he was "having problems with his bond rating and was worried about its impact on the energy sector," Fleischer said. Evans spoke with O'Neill and the two agreed no action should be taken "to intervene" with Enron's bondholders, according to Fleischer. At presstime, CNN reported that Attorney General Aschroft had recused himself from playing any role in the Justice Department's investigation.

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Publisher--Steve Hull, 202-739-8475 (shull@njdc.com)
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CDENDIT

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From: Farrell, Paula
Sent: Monday, January 14, 2002 6:02 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Friday, January 11, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Friday, January 11, 2002 3:28 PM
To: Cummings, Leslie; Ellis, Dina; Farrell, Paula; Hart, Susan
Subject: FW: National Journal's CongressDaily - Friday, January 11, 2002

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> From: cp-del@nationaljournal.com[SMTP:CP-DEL@NATIONALJOURNAL.COM]
> Sent: Friday, January 11, 2002 6:24:22 PM
> Subject: National Journal's CongressDaily - Friday, January 11, 2002
> Auto forwarded by a Rule
>
National Journal's CongressDaily
Issue date: January 11, 2002
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FINANCE
Enron Spectacle Widens, Fuels Concern Over Retirees
As the Enron bankruptcy scandal raises questions over the Bush administration's prior knowledge of the company's problems, parallel inquiries are delving into the company's actions on retirees and may prompt action this year on how firms handle employee retirement plans, business leaders acknowledged today. "These are tough issues that the Congress and the private sector

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are going to have to work out," said National Association of Manufacturers Employment Policy Director Neil Trautwein at a briefing on the group's labor agenda for the coming year. But anticipating an Enron-generated backlash, Trautwein cautioned against legislation to restrict employee ownership of company stock. "I think this points out that people could use some additional help, but limits are the wrong way to go," Trautwein said. "Getting the federal government to come in say what you can invest in is a bad idea."

The torrent of revelations concerning the failed energy giant and its connections to the Bush administration and Capitol Hill continued today, with confirmation that top Enron officials sought help from the federal government in obtaining relief from the firm's bankers. The Associated Press reported that a Treasury Department spokeswoman confirmed that Peter Fisher, undersecretary for domestic finance, spoke with Enron President Lawrence (Greg) Whalley six or eight times in late October and early November. Also today, CNN reported that the Senate Governmental Affairs Permanent Subcommittee on Investigations will send out 51 subpoenas today for information on the company's collapse.

On employee ownership of company stock, many federal officials and advocates are increasingly concerned over the effect of company failures on employees, who have fewer resources and options to recover their life's savings. "We are concerned about the vulnerability workers have with their investments," AFL-CIO Legislative Director Bill Samuel said today, adding it was a key priority for labor groups this year. A spokesman for Senate Health, Education, Labor and Pensions Chairman Kennedy said the committee would hold a hearing in early February to address the 401(k) issues raised by Enron. "We realize that there's a larger problem out there that needs to be addressed," the spokesman said. House Education and the Workforce Chairman Boehner has also said he will explore the issue. A spokesman for Boehner said a bill Boehner passed in the House last year that would make it easier for companies to give retirement investment advice to employees would address some of the concerns being raised about Enron. Sens. Jon Corzine, D-N.J., and Barbara Boxer, D-Calif., introduced a bill recently to prevent employees from owning more that 20 percent of their company's stock, an approach opposed by NAM. - by April Fulton

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FINANCE

Gaps Shown In Company's Political Contributions

Although Enron Corp. and its top brass pumped millions of dollars to the Republican Party and President Bush over the years, the embattled energy concern gave few contributions to the members of Congress who may investigate the fate of the firm and its executives, according to a CongressDaily analysis of fundraising documents. In the 1999-2000 election cycle, for example, Enron did not contribute a single dollar directly to the Republican and Democratic leaders of the House and Senate panels that plan to lead the investigation into Enron's high-profile collapse. The company gave $1,000 to the personal re-election efforts of Senate Minority Leader Lott - but no money to Minority

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Whip Nickles, Republican Policy Committee Chairman Larry Craig of Idaho, Majority Leader Daschle or Majority Whip Reid. Likewise, House Speaker Hastert received just $3,500 from Enron for his personal re-election effort and House Minority Leader Gephardt took in $1,000.

At the same time, Enron earned a spot in the top 50 political contributors in 1999 and 2000 for the first time by giving $1.1 million to national Republican Party accounts. In addition, Houston-based Enron was the 12th largest contributor to Bush's presidential campaign, with $114,000. The discrepancy is the result of a fundraising strategy that called for Enron to focus on writing large checks to national and state party accounts - while giving far less money directly to the re-election efforts of individual members of Congress. In 1999-2000, Enron and its executives gave $1.7 million in soft money donations to the political parties and just $300,000 directly to candidates.

As a result, Enron's contributions to key members of Congress have been relatively sparse. In the last election cycle, Enron contributed just $137,500 in regulated, hard dollars to the hundreds of lawmakers who sit on a range of congressional committees that plan to investigate the company, including the House Government Reform, House Energy and Commerce, House Financial Services, Senate Governmental Affairs, Senate Energy and Natural Resources, Senate Commerce and Senate Banking committees. That is far less money than scores of other organizations contributed. The $27,000 that Enron gave to the Republican members of the House Energy and Commerce Committee, for example, fell behind 114 other organizations. Rep. W.J. (Billy) Tauzin, R-La., who last year took over the Energy and Commerce chairmanship, alone gave more money to committee Republicans than Enron in 1999 and 2000.

In the first half of 2001, Enron's contributions to influential members of Congress slumped further. According to Enron's most recent financial disclosure for the period from January to June 2001, the company did not contribute to the personal re-election efforts of Hastert, Gephardt, Lott or Daschle. At the same time, the company contributed just $12,000 to the members of the seven congressional panels that plan to look into its financial dealings. Republicans on the House Energy and Commerce Committee received just $3,500 from the company in the first six months of 2001. That is less, for example, than the Western Peanut Growers Association and 314 other political organizations handed out.

Enron's contributions to congressional leadership PACs and so-called nonfederal 527 accounts also slowed in 2001. In November 2001, Enron contributed $5,000 to Lott's leadership PAC and $2,500 to House Rules Chairman Dreier's leadership PAC. Earlier in the year, Enron contributed $2,500 each to the leadership PACs of Hastert, Armey, Tauzin and Chief Deputy Majority Whip Roy Blunt, R-Mo. The company also made a $5,000 contribution in September to the moderate New Democrat Network and a $10,000 contribution mid-year to the conservative GOPAC, which assists nonfederal GOP candidates. - by Brody Mullins and Charlie Mitchell

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WHITE HOUSE

Bush Returns To Domestic Issues, Signs Brownfields Bill

Calling it the most important environmental legislation produced by Congress last year, President Bush today signed the Small Business Liability Relief and Brownfields Revitalization Act at an appearance in Conshohocken, Pa. The legislation provides funding for brownfields cleanup while protecting small businesses from certain types of liability related to the sites. Because cleaning up brownfields can provide new areas for development, Bush touted the legislation as a type of jobs bill that could also help provide a solution for urban sprawl. Bush said this bill - and the education legislation he signed earlier this week - marks an increase in his focus on domestic issues, even as he continues to wage the fight against terrorism.

The president noted his FY03 budget will call for Congress to more than double EPA spending on brownfields revitalization, from $98 million to $200 million. The budget also includes $25 million for urban development and brownfields cleanup by HUD, the White House said today. The president was introduced with lavish praise by EPA Administrator Whitman, who called Bush "one of America's greatest environmentalists." Bush returned the compliment, saying Whitman is "going to go down as one of the best selections" he made for his Cabinet. Earlier this year, Whitman's future with the administration appeared somewhat clouded when Bush reversed a campaign position and said he would not seek mandatory limits on carbon dioxide emissions, even though Whitman had assured European officials he would. Meanwhile, Bush Thursday signed the two remaining FY02 appropriations bill, the Labor-HHS spending bill and the Foreign Operations appropriations bill, OMB officials said. - by Keith Koffler

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AGRICULTURE

Rejection Of Farm Group's Cuba Trip Spurs Travel Debate

Washington's Cuba watchers were busy this week assessing the Treasury Department's rejection of an application by a high-profile group organized by the Farm Foundation, an Illinois think tank, to travel to the island. At issue were questions about whether the agency's rejection of the application last week was a bureaucratic snafu or an indication the Bush administration is tightening up on farm groups going to Cuba. The move resulted in adverse publicity for the Bush administration in rural areas, where the issue of expanding Cuba trade is hot. The rejection of the Farm Foundation's application puzzled farm leaders because Agriculture Secretary Veneman, Agriculture Deputy Secretary James Moseley and Undersecretary for Farm and Foreign Agricultural Services J.B. Penn all served on the Farm Foundation board before resigning to take their USDA positions. Veneman told reporters last year that her contacts with the Farm Foundation were her greatest source of appointees at USDA. American Farm Bureau Federation President Bob Stallman, who sits on the Farm Foundation board, said this week he was "disappointed a group like the Farm Foundation can't go to Cuba" and was particularly disturbed that the rejection came on Jan. 3, only five days before the group was scheduled to leave.

Former Agriculture Secretary Glickman, a member of the Farm

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Foundation board who was supposed to be a part of the delegation, initially joked to CongressDaily that Treasury rejected the application because "they think we're a bunch of revolutionaries." But Glickman quickly added that the rejection "was a little more complex" than the Bush administration rejecting the application to appease Cuban American voters. Glickman said the Farm Foundation may not have engaged in "enough advance planning in the licensing process." But Glickman also added, "The government didn't show the flexibility it needed to work through the issue" and "could have helped the group" improve its application.

John Kavulich, president of the New York-based U.S. Cuba Trade and Economic Council, a pro-trade group, said, "I don't think anyone should say this is the Bush administration sending a signal." But Farm Foundation President Walt Armbruster said in a telephone interview from Florida, where the group that was headed for Cuba was holding a meeting, that he "can't tell" whether the rejection was the result of an application problem or a political statement. Armbruster said Treasury officials told him they rejected the application because there were too many spouses, the agenda was too "unfocused" and had no strategy for making a direct sale. But Armbruster said including spouses in trips is normal Farm Foundation procedure and that "the criteria are not real clear" for the applications. Armbruster said some USDA officials and senators and House members tried to intervene with Treasury, but that he never sought Veneman's help and that he discussed the matter only with Treasury civil servants, not political appointees. A USDA spokeswoman said while the agency called to check the status of the Farm Foundation's request, no USDA official acted on the group's behalf. Sen. Byron Dorgan, D-N.D., said the Farm Foundation rejection is proof "the administration is tightening restrictions on travel to Cuba" and "demonstrates how absurd the policy is." Treasury Secretary O'Neill, Dorgan said, told him Treasury is "not actually doing anything different, but the evidence suggests they are." - by Jerry Hagstrom

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ENVIRONMENT

Yucca Mountain Decision Heading For Capitol Hill Battle

As Nevada officials this week began considering their options for staving off a nuclear waste repository at arid Yucca Mountain, Congress emerged as the likely key pressure point in the battle. "We're checking into all parliamentary options," Sen. John Ensign, R-Nev., an opponent of the waste site, told the Las Vegas Sun. Energy Secretary Abraham Thursday designated the Nevada site as the government's choice for permanent storage of high-level radioactive waste from weapons plants and nuclear power stations. But Abraham's designation is not the final word, triggering a sequence of regulatory and political steps that waste foes said could derail the plan. After notifying GOP Nevada Gov. Kenny Guinn of his decision on Thursday, Abraham must wait 30 days to notify President Bush of his decision. Bush then has an indefinite period to ratify Abraham's decision. If he does, Guinn is given 60 days under law to veto the designation. If Guinn exercises his veto, the issue goes to Congress. The Sun

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reported today that Guinn Thursday told Abraham that "I was damned disappointed in his decision and he was to expect my veto."

If Guinn sends the issue to Congress, as expected, the two chambers must act in 90 days to allow the waste plan to move forward, or else it would be dead. Ensign would join a Democratic leadership opposed to the dump. Guinn said lawyers hired by the state are researching whether Senate Majority Leader Daschle, an avowed opponent of storing nuclear waste at Yucca, has the authority to pigeonhole the issue - an issue that could end up in court, the Sun reported. However, if it comes to a vote, Senate Majority Whip Reid fears senators would back Bush. "Right now, the odds are we can't get 51 votes," Reid said at a Las Vegas news conference, the Las Vegas Review-Journal reported. Even if the program won congressional approval, it then must receive adequate funding. Reid now is chairman of the Senate Energy and Water Appropriations Subcommittee, where money for the waste program would need to win approval.

Meanwhile, both Democratic and Republican politicians in Nevada said the fallout from the issue could hurt the GOP in the state, the Review-Journal reported today. "Overall, this is bad news for the Republican Party," said Clark County Commissioner Myrna Williams, a Democrat. Independent sources expected some adverse impact on the GOP. "This might have happened if Al Gore had been elected president, but the fact of the matter is, it is happening on George W.'s watch," Ted Jelen, University of Nevada political science chairman, told the newspaper.

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ECONOMY

Ford Cuts 35,000 Jobs, Closes 5 Plants, Drops 4 Vehicles

Ford Motor Co. plans to cut 35,000 jobs worldwide, close five plants and eliminate four vehicles in a massive restructuring that its chief executive called a "painful, but necessary" effort to return the world's second biggest automaker to profitability, the Associated Press reported. "We strayed from what got us to the top of the mountain, and it cost us greatly," chief executive William Clay Ford Jr. said today from company headquarters in announcing the plan. The job cuts amount to about 10 percent of its overall work force and include 22,000 in North America. The plants to be closed are in Edison, N.J., and Oakville, Ontario, by 2004; Brook Park, Ohio, near Cleveland in either 2003 or 2004; Hazelwood, Mo., near St. Louis by an undetermined date; and Vulcan Forge in Dearborn, Mich., as soon as possible. Vehicles to be dropped are the Ford Escort, Mercury Cougar, Mercury Villager and Lincoln Continental. Ford said it was taking a $4.1 billion, one-time charge against earnings to pay for its plan. The plan also includes the suspension of bonuses for company managers and the elimination of 401(k) matching contributions for employees. Ford employs approximately 345,000 people worldwide, including 170,000 in North America. On Wall Street today, at 2 p.m., the NASDAQ had fallen 23 points to 2,023.32 and the Dow Jones Industrial Average slid 51 points to 10,016.59. In morning trading on the New York Stock Exchange, Ford shares were up 9 cents at $15.38.

Meanwhile, wholesale prices, led by a sharp drop in energy

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costs, fell by 0.7 percent in December, helping to make 2001 the tamest year for inflation at the producer level since 1986. The Labor Department's producer price index, which measures price pressures before they reach consumers, fell by 1.8 percent for all of last year, the biggest annual decline since 1986, when wholesale prices dropped by 2.3 percent, the government reported today. That marked a big improvement from the 3.6 percent increase in wholesale prices registered in 2000.

Federal Reserve Chairman Greenspan said today that there were scattered hopeful signs that the recession could be ending, but he warned that the American economy still faces "significant risks." Greenspan, making his first public comments on the economy since the Fed last cut interest rates on Dec. 11, said there are "tentative indications" that the economic slump could be drawing to a close, but he said those signals at present are far from conclusive.

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HOUSE RACES

Sessions' Old District Site Of A Spirited Texas Showdown

Texas redistricting put more Republicans into GOP Rep. Pete Sessions' 5th District, but his decision to abandon the previously marginal district for a safer seat has Democrats closely watching a competitive GOP primary. "You're going to have either a no-name Republican or a guy with a lot of money," said Texas Democratic consultant Ed Martin. Republicans enjoy a 61-39 percent advantage in the new 5th District, which had picked up GOP-leaning voters in Dallas County but still has Democratic voters in 10 mostly rural counties between Dallas and Houston. Instead of running in the reconfigured 5th District, Sessions has filed for the more Republican and compact Dallas-based 32nd District - one of two new seats Republicans will pick up through redistricting. Five Republicans have filed to run in the March 12 primary, but the race appears to be between millionaire attorney Phil Sudan, who unsuccessfully challenged Democratic Rep. Ken Bentsen in 2000, and businessman Jeb Hensarling, a top political aide to GOP Sen. Phil Gramm who has never run for political office.

Hensarling, a businessman who once served as National Republican Senatorial Committee executive director, claims strong ties to the district, solid GOP credentials and support from Gramm and other party leaders. Neither candidate begins the race with high visibility and Hensarling acknowledges that Sudan's personal wealth could be an advantage in the short primary season. Sudan spent a cumulative $3 million in the 2000 race against Bentsen, who represents a Houston-based district. Sudan filed to run for the Dallas-based 5th District in time for the Jan. 2 deadline after a potential GOP primary rival opted to run elsewhere. Hensarling - campaigning on domestic security, the economy, education and rural development - quipped he would be happy to introduce Sudan to the district. "Once he gets here, I'm certainly happy to give him a roadmap to Houston," he said.

But Sudan said voters are concerned about philosophy and record, not geography. "I won a contested Republican primary. I defeated a so-called Republican moderate," Sudan said of his 2000 primary. Sudan is campaigning on tax reform and security issues,

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opposes abortion and supports gun ownership rights. He said would "put up a substantial amount of my own money," but declined to say how much. The GOP nominee will likely face Democrat Ron Chapman, a former Dallas County appellate judge who has been on the Dallas County ballot since 1978 and shares the name of a popular Dallas radio personality. Democrats unsuccessfully sought to recruit state Sen. David Cain, but describe Chapman as a promising candidate who could benefit from a strong Democratic turnout in Senate and gubernatorial races. Chapman, who hopes to raise at least $1 million and is backed by Rep. Martin Frost, D-Texas, describes himself as a loyal Democrat who can work with Republicans to address the war and economic issues. "The general feeling I get is that there is a lot of dissatisfaction with the partisan bickering," he said. - by Mark Wegner

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POLITICS

Bush Signs Recess Appointments For Reich, Scalia

Circumventing Senate opposition, President Bush signed recess appointments today for conservatives Otto Reich and Eugene Scalia. The White House gave Congress formal notification of the long-threatened appointments early today. By exercising his executive authority while Congress is in recess, Reich and Scalia will be allowed to serve until Congress recesses again at the end of the year. Bush named Reich assistant secretary of State for Latin America, the top diplomatic post for the region that Bush made his primary foreign relations priority before the war on terrorism consumed his first year in office. Scalia, the son of Supreme Court Justice Antonin Scalia, now assumes the post of Labor Department solicitor, for which Bush nominated him several months ago.

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POLITICS

Reform Council Reaffirms Support For Stripping Amtrak Of Tracks, Stations

Holding what may be their last meeting, members of the advisory Amtrak Reform Council today reaffirmed their support for stripping the financially troubled railroad of the tracks and stations it owns, but still must decide whether and how to open train operations to competition. The Council, which will deliver its recommendations to Congress Feb. 7, was holding a daylong meeting today. Two of the three reform options would abolish Amtrak's monopoly on intercity rail travel by introducing competition for some or all routes. The other option would keep rail operation under a federal carrier, which could be Amtrak, or a series of regional carriers. The National Association of Railroad Passengers said Thursday that recommendations to separate Amtrak from its nonrail assets "bear a disturbing similarity to the early steps in the process that led to Britain's current railway crisis."

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ENVIRONMENT

Allard Urges Whitman To Delay Transfer, Restructuring Of EPA's Ombudsman

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Sen. Wayne Allard, R-Colo., is asking EPA Administrator Whitman to delay a transfer and restructuring of EPA's ombudsman until Congress reviews the decision. In March, Allard and Idaho GOP Sens. Larry Craig and Mike Crapo introduced legislation to make the Office of the Ombudsman independent. However, Whitman plans to officially move the ombudsman, Robert Martin, into the EPA Inspector General's office next week. The change had been recommended in a GAO report. Allard is concerned the change will cost the ombudsman his independence, which is key to his job. On Tuesday, Allard wrote Whitman to reiterate the request. In addition to the letter, Allard also talked with Whitman over the phone last week seeking the delay. Meanwhile, Martin Thursday filed a lawsuit to prevent the reshuffling of his office, saying it would weaken his independence within the agency, the Associated Press reported. The watchdog group Government Accountability Project joined Martin in the lawsuit.

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POLITICS

Lieberman To Deliver Foreign Policy Address Monday

Sen. Joseph Lieberman, D-Conn., plans to deliver a foreign policy address Monday at Georgetown University. Lieberman is returning from a congressional delegation to Central Asia, which included stops in Afghanistan and Pakistan. Lieberman's speech comes on the heels of a speech last Friday by Majority Leader Daschle criticizing the administration's economic policy. According to Lieberman's office, his speech will be a major address outlining Lieberman's vision for winning the war on terrorism.

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POLITICS

Poll Finds Support For Reforming The Postal Service

The Direct Marketing Association - the leading trade group for the direct-mail industry - released a national poll Wednesday that indicates support for reforming the U.S. Postal Service. When asked, "Do you believe that solving the problems of the U.S. Postal Service should be a high priority of Congress?" 55 percent agreed and 42 percent disagreed. When asked whether respondents favored "legislation that will give the U.S. Postal Service the flexibility and tools it needs to reform and improve its operations," 73 percent agreed and only 19 percent disagreed. The poll of 1,005 adults was conducted from last Thursday through Sunday by Opinion Research Corp. The DMA and other groups have been working with the Postal Service for several years to pass compromise legislation that changes the way the USPS is structured and operates.

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POLITICS

NRCC Hires Three New Campaign Strategists

Gearing up for this November's midterm elections, the National Republican Congressional Committee announced today it has hired three new campaign strategists, including a deputy political director. The committee hired Scott Douglas, formerly a regional field director for the Bush presidential campaign and a deputy

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chief of staff at FEMA. Douglas worked at the NRCC from 1994-99, serving as deputy executive director. The committee also hired Ted Christian and Andrea Horton as two new field representatives to track regional House races. Christian formerly served as executive director of the New Jersey Republican Party. Horton, a consultant with the Texas firm Olsen, Delisi & Shuvalov, has served in the press shop of Texas Attorney General John Cornyn.
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THE FINAL WORD
" [T]hat piece of garbage ."
- Las Vegas Mayor Oscar Goodman, quoted in the Las Vegas Review-Journal today, characterizing Energy Secretary Abraham following Abraham's official designation of a site at Yucca Mountain, Nev., 90 miles from Las Vegas, as the nation's nuclear waste repository. Goodman said he would marshal mayors from cities at nuclear waste shipping points across the nation to help fight the waste plan.
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Special Correspondents--Jerry Hagstrom, Julie Rovner

Subscription price: $2,649 a year. Subscription and e-mail transmission information: 202-266-7230 (cngdaily@njdc.com).
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CDENDIT

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Revesz, Paul

From: Farrell, Paula
Sent: Monday, January 14, 2002 5:58 PM
To: Atkins, Preston Jr
Cc: Revesz, Paul; Oster, Karen
Subject: FW: National Journal's CongressDaily - Monday, January 14, 2002

-----Original Message-----
From: Knack, Elizabeth
Sent: Monday, January 14, 2002 3:44 PM
To: Ellis, Dina; Farrell, Paula; Hart, Susan; O'Brien, Michael
Subject: FW: National Journal's CongressDaily - Monday, January 14, 2002

-----Original Message-----
From: cp-del@nationaljournal.com [mailto:cp-del@nationaljournal.com]
Sent: Monday, January 14, 2002 6:31 PM
Subject: National Journal's CongressDaily - Monday, January 14, 2002

National Journal's CongressDaily
Issue date: January 14, 2002
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TRADE
U.S. Loses In WTO Ruling On Foreign Sales Corporations
A World Trade Organization appellate panel today affirmed an earlier ruling against U.S. laws granting tax breaks for business income earned from overseas operations. The ruling in the foreign sales corporations case, reported to be the largest the United States has ever lost before the WTO, delighted European officials, who called for the United States to quickly bring itself into compliance with WTO rules while the European Union holds off on imposing penalties, which could reach $4 billion a year. But U.S. trade officials signaled their disappointment and congressional panels now must decide what course of action to take in response. "We are disappointed with the outcome," said Trade Representative Zoellick. "The United States respects its WTO obligations, which serve America's interests, and we intend to continue to seek to cooperate with the European Union in order to manage and resolve this dispute." Zoellick continued: "This is an especially sensitive dispute that, at its core, raises questions of a level playing field with regard to tax policy. We will be consulting closely with Congress and affected U.S. interests regarding next steps." Senate Finance ranking member Charles Grassley, R-Iowa, in a statement today, said: "The [trade negotiating authority] bill passed by the Finance Committee includes a provision that calls for the next round of the World Trade Organization to comprehensively address these international tax issues. So today's ruling is yet another reason why the

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Senate should vote by the end of February on the bipartisan trade legislation that's pending."

Business advocates today were assessing the ruling, looking for room in the legal implications of the decision, but implicitly acknowledging a loss on all counts. "The decision leaves in place the underlying problem," said Homer Moyer, a partner in the Washington law firm of Miller and Chevalier, who works with an industry coalition that is working the FSC issue. "We continue to have an underlying tax disparity, which must be rectified one way or the other, even if it requires changes in WTO rules." The Associated Press reported that EU Trade Commissioner Pascal Lamy said he was pleased and called for "rapid proposals" from Washington to rectify the tax laws. "Now it is up to the United States to comply with the WTO's findings to settle this matter once and for all," Lamy said.

The FSC case goes back several years. In February 2000, the WTO Appellate Body upheld a ruling that the FSC provisions of tax law violated WTO subsidy rules. In response, Congress approved the Extraterritorial Income Exclusion Act of 2000, but the European Union won a WTO ruling last August that the revised law still conferred a "prohibited export subsidy" and failed to withdraw the FSC "subsidy," as the earlier ruling directed. It was that ruling that was affirmed in today's WTO appeals ruling. Under an EU-U.S. agreement reached in September 2000, the dispute now will go back to a WTO arbitrator to decide on the exact amount of possible countermeasures. The arbitrator's report is expected by the end of March, according to an EU statement. - by Bruce Stokes and Geoff Earle

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EMPLOYMENT

Hill's Labor Agenda For 2002 Tinted By Enron Debacle

When Congress returns to work next week, legislators, staffers and lobbyists will find the Washington labor agenda transformed by investigations into employee 401(k) and pension investment programs brought on by the Enron scandal. But they also face questions about reviving an economic stimulus package, ergonomics, and a renewed call to increase the minimum wage. Enron "will dominate the conversation for the coming months," predicted Ann Combs, assistant secretary for the Pension and Welfare Benefits Administration, which handles employee benefit issues for the Labor Department, in a telephone interview with CongressDaily. The pension administration launched an investigation in November into how Enron employees lost most of their savings intended for retirement when Enron stock plummeted last year, and whether the companies' investment trustees fulfilled their duties to employees.

Also, Labor Secretary Chao recently was chosen to work with Treasury Secretary O'Neill and Commerce Secretary Evans to look at needed modifications in retirement laws in the wake of the Enron debacle. The group met for the first time Friday, and, while there is no deadline for sending recommendations to Congress, Combs said, "Everyone appreciates the urgency of the situation." Senate Health, Education, Labor and Pensions Chairman Kennedy will hold a hearing on the Enron retirement investment issue next month, and House Education and the Workforce Chairman

Boehner also will investigate. Separately, the Senate Banking Committee has scheduled a Feb. 12 oversight hearing into the accounting and investor protection aspects of Enron Corp.'s collapse. Several former SEC chairmen are scheduled to testify, including Arthur Levitt, who served from 1993-2000.

Meanwhile, labor issues are expected to tint the debate as Congress revives efforts to pass an economic stimulus proposal, with a political battle expected over balancing unemployment and healthcare benefits with tax cuts. "I don't know how they can go home and continually face these laidoff workers," said Bill Samuel, AFL-CIO legislative director, who said labor groups would continue to push for benefits, ergonomics regulation, and an increase in the minimum wage. The Labor Department has yet to announce a position on ergonomics, but several sources said it will not issue a new regulation, as labor supporters had hoped. Labor supporters are also outraged by President Bush's recess appointment of Eugene Scalia to be Labor Department solicitor, citing his views against ergonomics, but business groups praised him as a well-qualified candidate. - by April Fulton

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JUDICIARY

Bipartisan Immigration Bill To See Early Senate Action

Congressional efforts to liberalize U.S. immigration policy, which were off to a promising start early in 2001, appeared effectively doomed immediately following the Sept. 11 attacks at the hands of foreign terrorists - some of whom had been living illegally in the United States for years. However, by the end of last year, it had become clear that the event also had presented an opening for lawmakers of various ideological stripes to reframe their arguments in a way that was mutually beneficial. The result was legislation sponsored in the Senate by Judiciary Immigration Subcommittee Chairman Edward Kennedy, D-Mass., and Immigration Subcommittee ranking member Sam Brownback, R-Kan., as well as Sens. Dianne Feinstein, D-Calif., and Jon Kyl, R-Ariz., which married enhanced border security with family friendly immigration reform, and earned the support of advocacy groups working both issues. That bill stalled in the Senate late last year, but is expected to be the Senate's first order of business this session in the category of immigration, a Kennedy spokeswoman said today.

Both chambers were poised in December to unanimously approve a legislative preconference agreement hammered out among House and Senate lawmakers. The House border security measure, introduced by Judiciary Chairman Sensenbrenner and Judiciary Immigration Subcommittee Chairman George Gekas, R-Pa., was approved by unanimous consent at the end of the session. But its companion measure was blocked in the Senate by Appropriations Chairman Byrd, who was perturbed by the White House's rejection of his request for border control funding earlier in the year. But while that left border security as unfinished business in the Senate, House GOP leadership took a short cut it likely will have to answer for this year: Bowing to pressure from a band of socially conservative Republicans, House GOP leaders agreed to omit from the immigration package compromise 245(i) extension language which would enable immigrants already residing in the country to

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pay $1,000 to stay in the United States while they await legalization.

The action alienated congressional Democrats - as well as the Bush administration, which is a proponent of a temporary 245(i) extension - and set the stage for an intra-party fight that pits the president against a faction of the GOP which favors greater restrictions. The Senate early in 2001 already had approved a yearlong extension of the 245(i) program. A spokesman today said Sensenbrenner is prepared to try and move the compromise 245(i) bill on the House floor this year. - by Pamela Barnett

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JUDICIARY

Bush Said To Remain Vague On Immigration Needs

Advocates for and against a more open border policy appear to agree on at least one thing: President Bush has done an admirable job in remaining politically amorphous on immigration matters, in a way that allows him to appeal to factions on both sides. A recent statement by Bush in which he said he intends to make immigration a "priority" this year - while failing to elaborate - marked a familiar pattern. It is clear that Bush still is wooing Hispanic voters - which insiders said Bush believes is important to his re-election bid in 2004. That is evidenced perhaps most clearly in his advocacy of a U.S.-Mexico agreement, which would facilitate border crossing for migrant workers. But the White House also surprised immigration advocates on both sides last week, with its announcement that Bush's budget this year would seek to reverse a controversial federal law that barred legal immigrants who arrived after 1996 from collecting food stamps.

"What [Bush] did is not insignificant," said a spokesman for Rep. Luis Gutierrez, D-Ill., who chairs the Congressional Hispanic Caucus' immigration task force. "The president really took an important step . one that he deserves to be congratulated for." The question, he added, is whether Bush will be a vocal advocate for such things as 245(i) reinstatement and an immigrant food stamp program, or whether he will settle for the political mileage he expects to earn with immigrants rights groups simply by proposing the programs. The prominence the subject of immigration reform is given in Bush's upcoming State of the Union address this month could provide a clue to his intentions, remarked one observer.

"The administration is key," agreed Dan Stein, executive direction of the U.S. Federation for American Immigration Reform, a group that essentially wants a moratorium on U.S. immigration. But he added: "It's hard to get a sense of the administration's position. President Bush is starting to sound like a Democrat." That strategy "won't work, he said, because Democrats will always seek to "play Santa Claus" and one-up the president. But at the very least, Bush's pledge on food stamps allows him to distinguish himself from advocates of greater restrictions, such as Rep. Tom Tancredo, R-Colo., who chairs the congressional Immigration Reform Caucus. Tancredo, who was among those who helped pressure Republican leaders to remove 245(i) provisions from the House version of the border security bill last year, last week accused Bush of "steal[ing] a page from the Democratic playbook," with his food stamp proposal. "His attempt to expand

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our political base through surrendering to the Hispanic vote is usually the Democrats' job. Votes can't be bought with welfare," Tancredo said. - by Pamela Barnett
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JUDICIARY

High Court Ends Six-Year Fight Over Prozac Drug Patent

A six-year court fight over rights to the lucrative anti-depression drug Prozac ended today when the Supreme Court refused to consider reinstating drug maker Eli Lilly Co.'s patent, the Associated Press reported. Generic versions of Prozac went on the market shortly after a federal appeals court invalidated a Lilly patent last year. That patent would have protected Lilly's monopoly until December 2003 and brought in an estimated $4 billion in sales for the company. Lilly sued generic drug manufacturers for patent infringement in 1996, when the rivals first sought FDA approval to make a generic form of Prozac. Barr Laboratories Inc. and other generic drug makers claimed Lilly had improperly double-patented Prozac to extend its exclusive control over the drug, and the appeals court agreed. The Supreme Court did not comment in rejecting Lilly's appeal of that ruling. Prozac had worldwide sales of $2.6 billion in 2000, the last full year that Lilly had exclusive rights to it. It was one of the company's best-selling drugs, accounting for about one-quarter of the company's sales.

The high court today also turned down a chance to set limits on how far the government can go to protect endangered species. The case the court refused to review involves shrimp found mainly in California, but it would have affected government efforts to protect all dying wildlife. An association of California builders challenged the constitutionality of the Endangered Species Act and the way the government handled the classification of shrimp. The builders group questioned the need for protection for the shrimp, which are not sold commercially. Paul Clement, acting solicitor general, defended the shrimp classification. "Individual species are part of an interdependent web," Clement wrote. "The significance of a particular species cannot always be easily determined at a given point in time."

Finally, a man fired after secretly helping the FBI investigate an anthrax threat lost his case today. The court turned down a chance to decide if First Amendment free speech rights cover a public employee's cooperation with law enforcement, even when that assistance is against the wishes of their bosses. Since Sept. 11, justices have not agreed to review a case that directly implicates terrorism. They declined to take this one without comment. A judge had dismissed the man's case, and the 10th U.S Circuit Court of Appeals also said the firing was proper. The appeals court noted that he was not fired for reporting the alleged threats. His continued involvement with the investigation, after telling his boss he would no longer help the FBI, was not free speech, the appeals court said.
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POLITICS

Republicans To Defend More Open Seats In 2002 Races

The retirement announcements last week of GOP Reps. James

Hansen of Utah and Joe Skeen of New Mexico bring to 26 - eight Democrats and 18 Republicans - the number of House members announcing they will not seek to return to the 108th Congress, leaving Republicans more than twice as many open seats to defend during November's midterm elections. The tally includes Rep. Steve Largent, R-Okla., who will officially resign his seat Feb. 15 to concentrate on his run for governor. Republican state Rep. John Sullivan was elected Jan. 8 to replace Largent, but cannot be sworn in until Largent resigns.

Three Democrats and nine Republicans have already announced they will retire, including Democratic Reps. Eva Clayton of North Carolina, William Coyne of Pennsylvania and Tim Roemer of Indiana. In addition to Skeen and Hansen, Republicans planning retirement are House Majority Leader Armey, Reps. Porter Goss and Dan Miller of Florida, Steve Horn of California, Marge Roukema of New Jersey, Bob Schaffer of Colorado and Wes Watkins of Oklahoma. House Republicans have urged Goss, whose profile as House Intelligence Committee chairman has risen since the Sept. 11 attacks, to reconsider his retirement, in part to help Republicans in Florida redistricting.

Five Democrats and nine Republicans have declared they will give up their seats to pursue bids for statewide office. Democratic Reps. John Baldacci of Maine, Tom Barrett of Wisconsin, Rod Blagojevich of Illinois and David Bonior of Michigan are all running for governor in their home states, while Texas Rep. Ken Bentsen is seeking the Democratic nod for Senate. Republican Reps. Saxby Chambliss of Georgia, John Cooksey of Louisiana, Greg Ganske of Iowa, Lindsey Graham of South Carolina, John Sununu of New Hampshire and John Thune of South Dakota are running for Senate. GOP Reps. Van Hilleary of Tennessee and Bob Riley of Alabama, as well as Largent, are vacating their seats to run for governor.

Redistricting played an important role in more than one retirement decision. Coyne, Horn and Bonior all announced their retirements after redistricting plans made clear their seats would be eliminated or merged, although only Horn listed it as a specific factor. Chambliss and Ganske faced radically different districts if they chose to run for re-election. Oklahoma redistricting could drastically alter districts now held by Largent and Watkins, while Wisconsin, which loses a seat, is likely to carve up Barrett's district. - by Mark Wegner

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POLITICS

Bush Calls For Broader Powers To Negotiate Trade Pacts

Apparently recovered from a fainting incident that left him with a scraped cheek and bruised lip, President Bush renewed his push today for expanded trade as a cure for recession and vowed anew to oppose any repeal or delay of tax cuts enacted last year. Bush opened a two-day, three-state push by reiterating his request for broader powers to negotiate trade pacts, saying, "I'm confident we need to open up markets, not close them down." Bush pledged to fight any effort to roll back tax cuts approved last year, the Associated Press reported. "I've made up my mind - the tax relief plan we passed, which you're now beginning to feel the effects of, is going to be permanent," he said. He is traveling

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this afternoon to a feed mill in Aurora, Mo., and Tuesday to New Orleans. Senate Agriculture Chairman Harkin, who appeared with Bush in Moline, had urged the president to make time "to meet with farmers, rural leaders and others" who are interested in the new farm bill. Harkin's letter appeared to be part of a Democratic campaign to point out that Bush officials meet with agribusiness rather than farmers. Harkin later said that Bush has agreed to meet with him later this month to discuss the farm bill.
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POLITICS
Clinton Seeking Changes To Proposed Federal Compensation Plan
Survivors of the Sept. 11 terrorist attacks and relatives of those who died are joining Sen. Hillary Rodham Clinton, D-N.Y., in seeking changes to the proposed federal compensation plan, the Associated Press reported. The Sept. 11 Victims Compensation Fund was created as part of a $15 billion airline relief package established by Congress. It allows families to apply for federal money to cover lost wages, pain and suffering, as long as they agree not to sue airlines and other entities. Clinton Sunday met with families and announced several proposed changes to eligibility guidelines, including eliminating a requirement that the injured seeking compensation must have received medical treatment by noon on Sept. 12. Families of those killed in the attacks receive an immediate payment of $50,000, and those injured get $25,000 when their applications are processed. The minimum award for the families of deceased is $250,000, before deductions. The average award is expected to be about $1.65 million. Clinton said the 24-hour rule should be removed because many victims could not get to a hospital until later. The Justice Department's deadline for written comments on the legislation is Jan. 22.
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POLITICS
Most State Election Officials Oppose Reform Under Consideration
A majority of state election officials oppose election reform standards under consideration in Congress but do support improvements in voting technology and machinery, according to a survey released today by the nonpartisan Election Reform Information Project. "They are enthusiastic at the prospect of federal funding for elections, but nervous about what 'strings' might be attached," Project director Doug Chapin said. More than 70 percent of top state election officials said they opposed federal standards for recruitment and training, Election Day operations and procedures, recount procedures and ballot designs, while 58 percent also said they opposed federal standards for how votes are counted. But 69 percent said they did support technology improvements, and said funding was the biggest obstacle to improving elections. However, slim majorities of local officials voiced support for better training and for procedures for counting votes and contested elections. The House passed an election reform bill in December. The Senate has yet to approve a bill although a bipartisan group of key senators did unveil a bill late last year. The survey, conducted by Princeton

Survey Research Associates, interviewed the chief election official in 36 states and in 208 counties between Oct. 16-Nov. 9.
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TRANSPORTATION
America West Airlines Meets Conditions For Loan Backing
Cash-strapped America West Airlines said today it has met the government's conditions to receive federal backing for a $429 million loan, the Associated Press reported. The deal is expected to be signed and the money made available by the end of the week, the airline said. America West is one of only two airlines to apply for part of the $10 billion in loan guarantees approved by Congress to help airlines following the Sept. 11 terrorist attacks. The loan guarantees essentially make the government a co-signer on the company's loan. In America West's case, the government would agree to pay back up to $380 million if the airline defaults. The Air Transportation Stabilization Board approved the federal aid Dec. 28, with the condition America West provide assurances it would keep down labor costs and give the government the option of buying a third of the airline's stock at a fixed price. Under terms of the America West deal, the government has until 2012 to purchase nearly 18.7 million shares at $3 apiece. So, for example, if the price rose to $8 a share, the government could sell it and make a profit of about $94 million.
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POLITICAL ROUNDUP
California. In his first major campaign appearance of the 2002 election cycle, Rep. Gary Condit, D-Calif., reminded voters during a Friday candidate forum of his bipartisan style of legislating and of his seven terms representing the Central Valley's 18th District. "I have been effective on your behalf. And I'm going to ask you something. I've helped you. I'm asking you to help me in March," Condit said, according to the Los Angeles Times. Condit, politically damaged by his relationship with missing federal intern Chandra Levy, faces opposition in the March 5 open primary from five Democrats and four Republicans. Reconfigured after redistricting, the 18th District is reliably Democratic, but a Condit victory in the primary could boost GOP state Sen. Dick Monteith in the general election. Assemblyman Dennis Cardoza, Condit's strongest Democratic opponent, did not attend the forum, choosing to keep a previously scheduled campaign event. According to the Times, no one raised the issue of Condit's relationship with Levy until the end of the 90-minute forum, when Republican Modesto City Councilman Bill Conrad raised the issue, drawing boos from an audience of about 150.
Michigan. Michigan Democratic Party officials are launching another effort to alter the first-in-the-nation status given by party rules to New Hampshire and Iowa in the presidential nominating process. State party leaders aborted an earlier effort, led by Sen. Carl Levin, to avoid a national convention floor fight in 2000. But in a Jan. 9 letter to Democratic National Committee members, state Democratic Chairman Mark Brewer, National Committeewoman Debbie Dingell and Levin said they will propose an amendment to change rules for the 2004

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cycle, the Detroit News reported. Brewer, a member of the DNC's Rules and Bylaws Committee, will ask the panel to adopt the Michigan amendment Saturday. He is likely to fail, but Brewer and Dingell have pledged to carry the fight to the full DNC. "It's worth noting that the Republican Party's rules confer no special status to the New Hampshire and Iowa contests," their letter said. "We would find it both ironic and embarrassing that on this question, it is our party that enshrines anti-democratic privilege in its rules."

Ohio. Ohio Republicans are considering the elimination of Democratic Rep. James Traficant's Youngstown-based 17th District, a source told the Associated Press. The state loses one of its 19 seats through reapportionment and Democrats are expected to lose at least one seat. Republicans control redistricting and have considered proposals affecting Democratic Reps. Sherrod Brown, Dennis Kucinich and Tom Sawyer. Traficant, who has pleaded innocent to racketeering, bribery and conspiracy charges, is out of favor with House Democrats for supporting House Speaker Hastert, but enjoys a loyal following within his district. Ohio state Rep. Gary Cates, a Republican who chairs the Elections and Ethics Subcommittee, today told CongressDaily he did not know whether Traficant's district would be eliminated, but said GOP Gov. Bob Taft and party leaders could unveil a plan Wednesday. While Republicans control the process, some Democratic votes will be needed to enact a law in time for the state's Feb. 21 filing deadline and May 7 primary. Traficant goes on trial Feb. 4. A spokesman said Traficant plans to seek re-election, but would study redistricting maps before deciding where to run.

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THE FINAL WORD

"I asked the president, 'What was so exciting?' I didn't think it was that big of a game."

- Sen. Tom Harkin, D-Iowa, quoted by the Quad-City Times of Davenport, Iowa, at the John Deere & Co. Harvester Works plant in East Moline, Ill., where President Bush spoke the morning after he fainted while eating pretzels and watching football. Bush was watching the NFL playoff game between the Baltimore Ravens and the Miami Dolphins. Baltimore won the game, 20-3.

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Subscription price: $2,649 a year. Subscription and e-mail transmission information: 202-266-7230 (cngdaily@njdc.com).
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CDENDIT

Revesz, Paul

From: Russell Bernstein (b)(6)
Sent: Monday, January 14, 2002 4:06 PM
To: Paul.Revesz@do.treas.gov
Subject: Fwd:2001 Darwin Awards

Part.001

>From: "Ricardo Nuila"
>To: (b)(6)
>Subject: Fwd:2001 Darwin Awards
>Date: 14 Jan 2002 20:33:47 -0000
>
>On Fri, 11 Jan 2002 16:11:07 -0600 "Renaud, Lindsay" wrote:
> >THis is too good not to pass on...
> >
> >> -----Original Message-----
> >> From: Bhatia, Randy
> >> Sent: Friday, January 11, 2002 10:11 AM
> >> To: Renaud, Lindsay
> >> Subject: FW: Fw: 2001 Darwin Awards
> >>
> >> you've probably seen this, but still humorous...
> >>
> >> 2001 THE DARWIN AWARDS
> >> It's that time again! The awards this year are classic. These
> >> awards are given each year to bestow upon (the remains of) that individual, who through single-minded self-sacrifice, has done the most to remove undesirable elements from the human gene pool.
> >>

> >> 5th RUNNER-UP
> >> Goes to a San Anselmo, California man who died when he hit a lift tower at the Mammoth Mountain ski area while riding down the slope on a foam pad.
> >>
> >> The 22-year old David Hubal was pronounced dead at Central Mammoth Hospital. The accident occurred about 3a.m.,the Mono County Sheriff's department said. Hubal and his friends apparently had hiked up a ski run called Stump Alley and undid some yellow foam protectors from lift towers, said Lt. Mike
> >> Donnelly of the Mammoth Lakes Police Department. The pads are used to protect skiers who might hit towers.
> >>
> >> The group apparently used the pads to slide down the ski slope and Hubal crashed into a tower. It has since been investigated and determined the tower he hit was the one with its pad removed.
> >>
> >>
> >> 4th RUNNER-UP
> >> Goes to Robert Puelo, 32, was apparently being disorderly in a St. Louis market. When the clerk threatened to call the police, Puelo grabbed a hot dog, shoved it into his mouth and walked out without paying.
> >>
> >> Police found him unconscious in front of the store. Paramedics removed the six-inch wiener from his throat where it had choked him to death.
> >>
> >>
> >> 3rd RUNNER-UP
> >> Goes to poacher Marino Malerba of Spain, who shot a stag standing above him on an overhanging rock and was killed instantly when it fell on him.
> >>
> >>
> >> 2nd RUNNER-UP
> >> "Man loses face at party." A man at a West Virginia party (probably related to the winner last year, a man in Arkansas who used the .22 bullet to replace the fuse in his pickup truck), popped a blasting cap into his mouth and bit down, triggering an explosion that blew off his lips, teeth, and tongue. Jerry Stromyer, 24, of Kincaid, bit the blasting cap as a prank
> >> during the party late Tuesday night, said Cpl. M.D. Payne.
> >> "Another man had it in an aquarium hooked to a battery and was
> >> trying to explode it." "It wouldn't go off and this guy said I'll show you how to set it off." He put it into his mouth, bit down and it blew all his teeth out and his lips and tongue off, Payne said.
> >>
> >> Stromyer was listed in guarded condition Wednesday with extensive facial injuries, according to a spokesperson at Charleston Area Medical Division.
> >>
> >> "I just can't imagine anyone doing something like that," Payne
> >> said.
> >>
> >>
> >> 1st RUNNER-UP
> >> Doctors at Portland University Hospital said an Oregon man shot
> >> through the skull by a hunting arrow is lucky to be alive and will be released soon from the hospital. Tony Roberts, 25, lost his right eye last weekend during an initiation into a men's rafting club, Mountain Men Anonymous (probably known now as Stupid Mountain Men Anonymous) in Grant's Pass, Oregon. A friend tried to shoot a beer can off his head, but the arrow entered

> >> Robert's right eye. Doctors said that had the arrow gone 1 millimetre to the left, a major blood vessel would have been cut and Roberts would have died instantly.
> >>
> >> Neurosurgeon Doctor Johnny Delashaw at the university Hospital in Portland said the arrow went through 8 to 10 inches of brain with the tip protruding at the rear of his skull, yet somehow managed to miss all major blood vessels. Delashaw also said that had Roberts tried to pull the arrow out on his own he surely would have killed himself. Roberts admitted afterwards that
> >> he and his friends had been drinking that afternoon. Said Roberts, "I feel so dumb about this." No charges have been>
> >> filed, but the Josephine County district attorney's office said the initiation stunt is under investigation.
> >>
> >>
> >> Now THIS YEAR'S WINNER
> >> (The late) John Pernicky and his friend, (the late) Sal Hawkins, of the great state of Washington, decided to attend a local Metallica concert at the George Washington amphitheatre. Having no tickets (but having had 18 beers between them), they thought it would be easy to "hop" over the nine foot fence and sneak into the show.
> >>
> >> They pulled their pickup truck over to the fence and the plan was
> >> for Mr. Pernicky, who was 100-pounds heavier than Mr. Hawkins) to hop the fence and then assist his friend over. Unfortunately for (the late) Mr. Pernicky, there was a 30-foot drop on the other side of the fence. Having heaved himself over, he found himself crashing through a tree. His fall was abruptly halted (and broken, along with his arm) by a large
> >> branch that snagged him by his shorts. Dangling from the tree with a broken arm, he looked down and saw some bushes below him. Possibly figuring the bushes would break his fall, he removed his pocket knife and proceeded to cut away his shorts to free himself from the tree.
> >>
> >> Finally free, Mr. Pernicky crashed into holly bushes. The sharp
> >> leaves scratched his ENTIRE body and now, without the protection of his shorts, a holly branch penetrated his rectum. To make matters worse, on landing, his pocket knife penetrated his thigh.
> >>
> >> Mr. Hawkins, seeing his friend in considerable pain and agony,
> >> threw him a rope and pull him to safety by tying the rope to the pickup truck and slowly driving away. However, in his drunken haste/state, he put the truck into reverse and crashed through the fence landing on his friend and killing him.
> >>
> >> Police arrived to find the crashed pickup with its driver thrown
> >> 100 feet from the truck and dead at the scene from massive internal injuries. Upon moving the truck, they found John under it half-naked, scratches on his body, a holly stick in his rectum, a knife in his thigh, and his shorts dangling from a tree branch 25-feet in the air.
> >>
> >> Congratulations gentlemen, you win...
> >>
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United States General Accounting Office
Washington, DC 20548

August 16, 2001

The Honorable Joseph I. Lieberman
Chairman
Committee on Governmental Affairs
United States Senate

Subject: No Evidence That Communications Between the FERC Chairman and the Chairman of Enron Corporation Violated Criminal Statutes or Ethics Regulations

Dear Mr. Chairman:

This letter responds to your May 30, 2001, request that we review the communications between Curt Hébert, Jr., Chairman of the Federal Energy Regulatory Commission (FERC),[1] and Kenneth Lay, Chairman of Enron Corporation, who were the subjects of an article published in *The New York Times* on May 25, 2001. You were concerned that communications between the Chairman of FERC, an independent federal agency, and the Chairman of Enron, an entity regulated by that agency, may violate applicable federal criminal statutes or ethics regulations.

We conducted our work in June 2001. We interviewed witnesses who have first-hand knowledge of the conversation referred to in the *Times* article–Mr. Hébert, his Chief of Staff, FERC's General Counsel, and Mr. Lay.

In summary, based on our review of the information we gathered and consultation with our General Counsel, we found no evidence that either Mr. Hébert or Mr. Lay violated criminal statutes or ethics regulations.

Communications Between Mr. Hébert and Mr. Lay

Messrs. Hébert and Lay confirmed that they had a telephone conversation in February 2001, that Mr. Hébert asked Mr. Lay to endorse him continuing as FERC's Chairman,[2] and that Mr. Lay asked Mr. Hébert about his views on what FERC's policy

[1] President George Bush named Mr. Hébert as FERC Chairman on January 22, 2001. The President, with the advice and consent of the Senate, appoints all FERC commissioners to 5-year terms. The President designates one of the commissioners to serve as Chairman; the designated Chairman need not be approved by the Senate. Thus, Mr. Hébert serves as Chairman at the President's sufferance and could be replaced, without Senate approval, if the President desired. On August 7, 2001, it was reported that Mr. Hébert announced his resignation, to be effective at the end of August 2001.
[2] According to Mr. Lay, Enron had written to the White House supporting Mr. Hébert when he was first appointed FERC Chairman.

should be on access to the electricity grid. Further, they both agree that they did not discuss any matters Enron Corporation had before FERC. However, they disagree on how the conversation about FERC's policy on access should be interpreted. Mr. Hébert believes that Mr. Lay was attempting to tie his support for Mr. Hébert continuing as Chairman to a change in Mr. Hébert's position on this policy issue. Mr. Lay said that because Mr. Hébert was pressing him for an endorsement,[3] he took the opportunity to ask him about his position on access, an issue that he and Mr. Hébert did not agree on. However, Mr. Lay said he never told Mr. Hébert that Mr. Hébert's position on this issue was tied to his endorsement, nor did he imply any such connection. Mr. Lay told us that during the conversation, Mr. Hébert said that FERC was addressing some issues and that Mr. Lay would probably be happy with the direction in which FERC was moving. This statement conflicts with Mr. Hébert's recollection. Mr. Hébert told us that he refused to waiver on his policy.

Mr. Hébert's Chief of Staff and General Counsel were present during all or part[4] of the telephone conversation between Messrs. Hébert and Lay but heard only Mr. Hébert's conversation. They based their characterization of the substance of the conversation on what they heard and their subsequent conversation with Mr. Hébert. They both agree that Mr. Hébert asked Mr. Lay to endorse him continuing as Chairman. They further agree that they heard Mr. Hébert justify his position concerning the access issue to Mr. Lay. In addition, they both said that after the telephone conversation, Mr. Hébert said that he would not get Mr. Lay's support unless he changed his position and that he could not compromise his position.

GAO Legal Analysis

Three criminal statutes have some relevance to these circumstances. The first, 18 U.S.C. section 201, a bribery statute, makes it a crime to give, offer, or promise anything of value to a public official with the intent to influence any official act; the statute also makes it a crime for any public official to demand, seek, receive, accept, or agree to receive or accept anything of value in return for being influenced in performing any official act. The second, 18 U.S.C. section 210, makes it a crime to offer or promise money or a thing of value to any person in consideration of the use or promise to use any influence to procure any appointive office in the U.S. government. The third, 18 U.S.C. section 211, makes it a crime to solicit or receive any money or thing of value in consideration of the promise of support or use of influence in obtaining public office.

Additionally, there are ethics regulations to which all executive branch employees must adhere. Executive Order 12674 specifically states that an employee shall not solicit or accept any gift or item of monetary value from a person or entity seeking official action from, or conducting activities regulated by, the employee's agency. The executive order further specifies that employees shall not use public office for

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[3] According to Mr. Lay, Mr. Hébert expressed concern about the possibility that Pat Wood would be appointed to replace him as Chairman. Mr. Lay told us that in February, rumors were circulating that President Bush might appoint Mr. Wood to serve as a FERC commissioner and that the President might designate Mr. Wood to replace Mr. Hébert as Chairman. Mr. Wood was nominated as a commissioner by the President on April 30 and confirmed by the Senate on May 25.
[4] FERC's General Counsel said that sometime after February 9, 2001, he was summoned to Mr. Hébert's office where Mr. Hébert was already engaged in a telephone conversation with Mr. Lay.

private gain, and that employees shall act impartially and not give preferential treatment to any private organization or individual. The Office of Government Ethics has promulgated Standards of Ethical Conduct to which all executive branch employees are required to adhere.[5] These standards repeat that employees shall not use public office for private gain, shall act impartially, and shall not give preferential treatment to any private organization or individual.[6] Moreover, FERC has issued regulations that supplement the Office of Government Ethics' standards. In general, FERC employees with decisionmaking responsibilities are prohibited from having off-the-record (i.e., ex parte) communications relevant to the merits (i.e., capable of affecting the outcome of or influencing a decision) of a contested on-the-record proceeding. However, FERC's regulations specifically exclude from their definition of prohibited off-the-record communications, any relevant communications with respect to general background or broad policy discussions involving an industry FERC regulates, where the discussion occurs outside the context of any particular proceeding and does not affect the specific merits of the proceeding. Significantly, the regulations state that it is FERC's policy to encourage the public, including those subject to regulation by FERC, to submit suggestions, comments, or proposals concerning substantial prospective regulatory policy issues. This policy is intended to serve as a means of advising FERC of potential significant issues and problems that may come before it during its activities.

Regardless of who initiated the discussion concerning open access, it does not appear that any of the criminal statutes summarized above were violated. All three statutes require that money or a "thing of value" be offered or solicited in return for something else. The only thing that may have been sought or offered here was Mr. Lay's political support for Mr. Hébert continuing as Chairman. Although the courts interpret the term thing of value broadly to include both tangibles and intangibles, our review of case law found no support for the proposition that mere political support may be considered a thing of value for purposes of the relevant criminal statutes.

Moreover, under the plain language of each of the above-referenced criminal statutes, the offer of a thing of value must be tied to an expectation of a corresponding action by the other party. That is, there must be an expected quid pro quo, a specific intent to give or receive something of value in exchange for an official act. Here, there is no evidence that such an exchange was contemplated, and Mr. Lay specifically said that he did not tie his support to Mr. Hébert changing his position on access. When Mr. Hébert asked for Mr. Lay's endorsement, it was not unreasonable for Mr. Lay to ascertain whether the Chairman would take a position that would be to Enron's advantage. Mr. Lay wanted the Chairman to take a position in favor of making open access mandatory. According to Mr. Hébert, when he said that he would not support mandatory open access, Mr. Lay said that he would not support Mr. Hébert continuing as Chairman. In fact, after Messrs. Lay and Hébert discussed open access, neither party was willing to budge from his own position, and neither party offered to use his influence for the benefit of the other. Thus, there was no exchange or offer to exchange something of value for some action or influence by the recipient.

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[5] 5 C.F.R. § 2635.101 et seq.

[6] 5 C.F.R. §§ 2635.101(b)(7), (8), and 2635.702.

The essence of the above-referenced regulations is that government employees may not use their public offices for private gain, and government employees must act impartially and not give preferential treatment to any private organization or individual. Even though Mr. Hébert asked Mr. Lay for his support, there is simply no evidence that he used his public office to obtain that support or that he offered to give preferential treatment to Enron. To the contrary, Mr. Hébert refused to change his position on access even though that refusal might have cost him Mr. Lay's support.

In addition, as stated previously, FERC's regulations explicitly encourage parties regulated by FERC to submit suggestions, comments, or proposals concerning substantial prospective regulatory policy issues as a means of advising FERC of potential significant issues and problems. Thus, discussion of important policy issues such as access to the electrical transmission grid by representatives of companies like Enron is specifically encouraged as a matter of policy under FERC's regulations. The only restraint imposed by FERC's regulations is that FERC decisionmakers may not have ex parte discussions relevant to the merits of contested on-the-record proceedings pending before FERC with parties to those proceedings. Here, both Mr. Lay and Mr. Hébert specifically said that while Enron had some matters before the FERC, they did not talk about those matters. This was confirmed by our interviews with the other individuals who were present when the conversation took place. Thus, the FERC rules on ex parte communications were not violated.

Conclusion

On the basis of information obtained in the interviews and a review of the statutes and regulations previously discussed, we found no evidence that applicable federal criminal statutes or ethics regulations were violated. There is no evidence that the Chairman attempted to use his public office for private gain, acted other than impartially, or offered preferential treatment to Mr. Lay and Enron. Likewise, there is no evidence that Mr. Lay offered a thing of value to Mr. Hébert, the FERC Chairman, as that term has been interpreted by the courts on similar issues.

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As arranged with your office, unless you announce its contents earlier, we plan no further distribution of this letter until 30 days after the date of the letter. At that time, we will send copies of the letter to interested congressional committees and the Chairman of FERC. We will also make copies available to others on request.

The letter will also be available at www.gao.gov. If you have any questions, please call me at (202) 512-7455 or Director Ronald Malfi at (202) 512-6722. Senior Analyst Shelia James, Senior Attorney Peter Iannicelli, and Assistant General Counsel Robert Cramer made key contributions to this letter.

Sincerely yours,

Robert H. Hast
Managing Director
Office of Special Investigations

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